



Inflation Update - June 2014

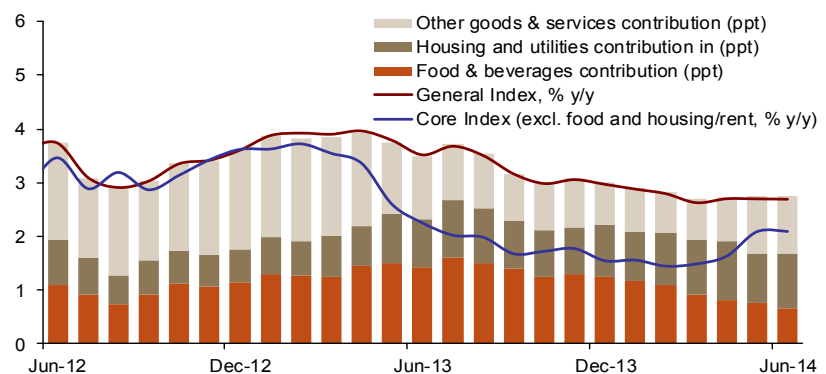
Surprise decline in food inflation

- Saudi annual CPI inflation remained unchanged at 2.7 percent for the third consecutive month in June.
- Food prices surprised with a decline of 0.2 percent month-on-month, but still remain the second largest contributor to annual inflation, after rental and housing related services.

According to the Central Department of Statistics and Information (CDSI), Saudi Arabia's inflation rate remained unchanged at 2.7 percent, year-on-year, for the third consecutive month in June. Foodstuffs and housing and related services remain the main sources of inflation despite a surprising month-on-month decline in food prices, as core inflation stabilized in June for the second consecutive month (Figures 1 and 2). Our estimate of core inflation, which excludes food and rent and other housing services, remained flat at 2.1 percent year-on-year for the second consecutive month in June. Core inflation was mainly driven by a seasonal increase in the home furniture segment during the summer months (4.9 percent year-on-year), which carries a 9.1 percent weight in the CPI basket.

Foodstuffs, which account for 21.7 percent of the CPI basket, saw prices rise by 2.8 percent year-on-year in June, adding 0.67 percentage point (ppt) to the headline figure. At this level, food index recorded the lowest annual increase since April 2010. This was mainly due to a drop in the monthly food inflation which broke last month's flat trend and declined, surprisingly, by 0.2 percent compared with May's print. The monthly print is thus on the low side of the 5-year average (Figure 3). We note that this monthly drop in food prices is not in line with seasonal factors that usually push food prices upward ahead of Ramadan (Figure 4). The decline in food prices also came against our expectation of higher prices in June on

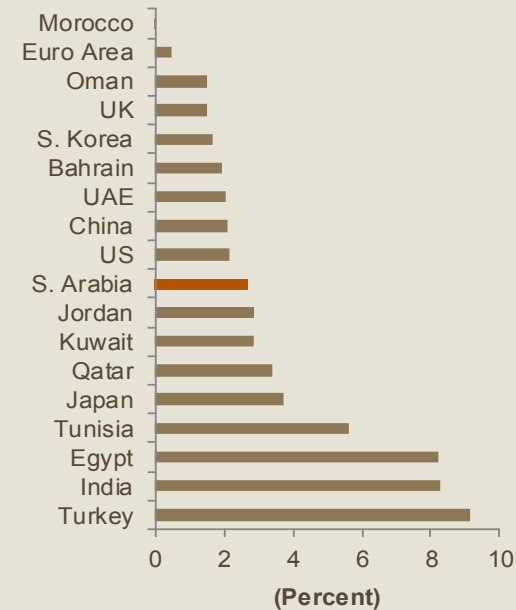
Figure 1: Headline inflation maintains a flat trend for the third consecutive month



Saudi CPI inflation (percent)

	Monthly change	Annual change
June	0.2	2.7
May	0.1	2.7

Trading partner inflation rate (latest, year-on-year change)



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Both headline and core inflation rate remained unchanged in June.

Food prices declined despite expected increases due to Ramadan.

Annual housing inflation rebounded to above 4 percent ...

...and remains the main force behind annual inflation.

Robust domestic demand does not appear to be fuelling strong inflationary pressures...

...but we do expect inflation to slightly pick up in the second half of the year...

...owing to a gradual increase in rental inflation.

the back of accelerating wholesale food prices in the previous two months. The drop in food prices may however reflect the government's attempts to supervise unjustifiable increase in prices during Ramadan as well as the downward trend in international food prices (Figure 5). According to the UN Food and Agriculture Organization, year-on-year global food price inflation remained in a deflationary mood for the last twelve months.

Partially offsetting the impact of lower food price inflation was a rebound in rental inflation. It climbed back over 4 percent in June, contributing 1pp, the largest of any component, to headline inflation (Figure 2). The increase in this group is being driven by the rent component, which increased 4.6 percent year-on-year in June, compared with 4.2 percent in May. We think that higher demand during the summer months is putting upward pressure on rents at a time when government initiatives to reform the housing market are still to affect the rental market.

Annual inflation for transport remained in the negative territory, though its monthly increase was one of the highest among all other subgroups of the CPI basket. In contrast, inflation for other components of the cost of living index, that are generally driven by consumer demand (clothing and footwear, recreation and culture, education and restaurants and hotels), has stabilized or fallen slightly in the past few months.

Looking ahead, we expect inflation in the second half of the year to gradually increase compared with the first half (Figure 6). While food inflation is likely to be more affected by international prices and USD exchange rate vis-à-vis other Saudi trading partners' currencies, we expect the rent and housing services price index to stay the course at around the current level with only a slight increase, as witnessed through the previous year. Such steady but slow increase in the housing inflation rate is likely to be driven partially by a base effect and partially by strong domestic demand on housing units. In addition, while healthy growth of money supply and bank credit to the private sector (13.4 percent and 12 percent year-on-year in May, respectively) will fuel domestic liquidity market (Figures 7 and 8), we do not expect the monetary authorities to take any policy rate action, especially given the evident stabilization in core inflation. We expect the average 2014 inflation to register 3 percent year-on-year.

Figure 2: Main highlights of Saudi CPI inflation
(percent)

	Weights	Month-on-month			Year-on-year			YTD
		May-14	June-14	Contribution, ppt.	May-14	June-14	Contribution, ppt.	
Food & beverages	21.7	0.0	-0.2	-0.1	3.2	2.8	0.7	-0.1
Housing & related items	20.5	0.1	0.6	0.2	3.7	4.1	1.0	2.4
Tobacco	0.5	0.0	0.3	0.0	6.4	6.7	0.0	0.9
Clothing & footwear	8.4	-0.1	-0.4	0.0	0.6	0.2	0.0	-0.6
Home furniture	9.1	0.2	0.2	0.0	4.7	4.9	0.4	0.9
Medical care	2.6	0.1	-0.1	0.0	2.7	2.7	0.1	1.8
Transport	10.4	0.7	0.5	0.0	-0.9	-0.2	0.0	1.3
Communication	8.1	-0.4	0.3	0.0	-0.9	0.0	0.0	-0.4
Recreation & culture	3.5	0.7	0.0	0.0	6.2	5.8	0.2	2.1
Education	2.7	0.0	0.0	0.0	3.7	3.7	0.1	0.0
Restaurants & hotels	5.7	0.5	0.5	0.0	3.1	2.8	0.2	1.8
Other expenses & services	6.8	-0.3	0.6	0.0	3.3	1.9	0.1	2.6
Core inflation*	57.8	0.2	0.2	0.1	2.1	2.1	1.1	1.0
General index	100	0.08	0.23	...	2.7	2.7	...	1.1

Note: *Core inflation excludes food and housing inflation and is Jadwa Investment's estimate.



Figure 3: Monthly food inflation

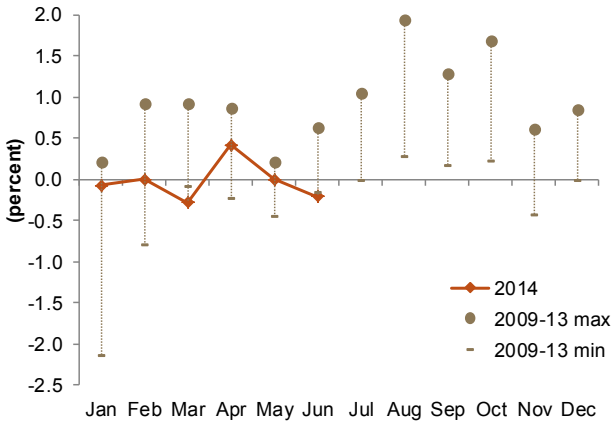


Figure 4: Monthly food inflation and Ramadan

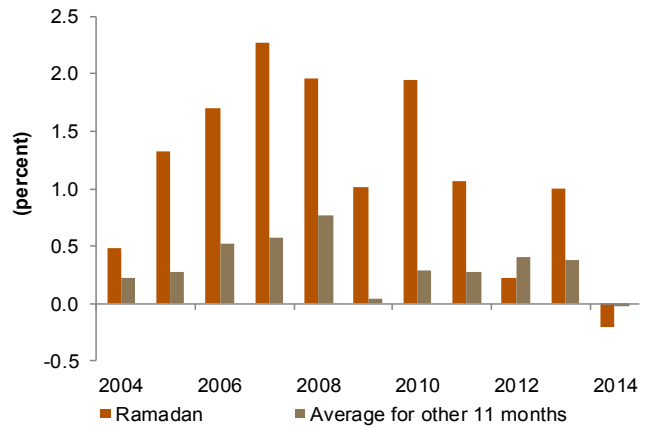


Figure 5: International annual food inflation

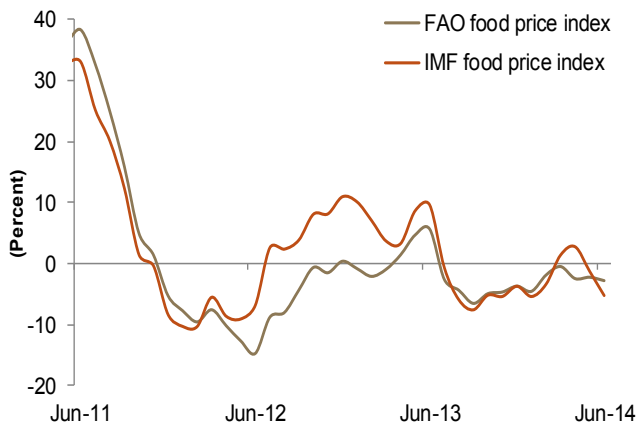


Figure 6: Inflation forecasts (year-on-year change)

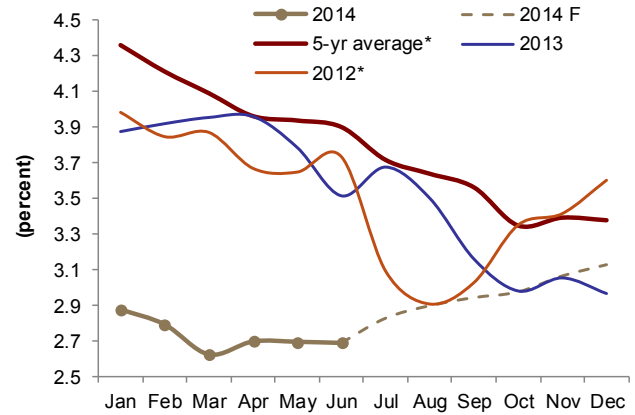


Figure 7: Monetary indicators (year-on-year change)

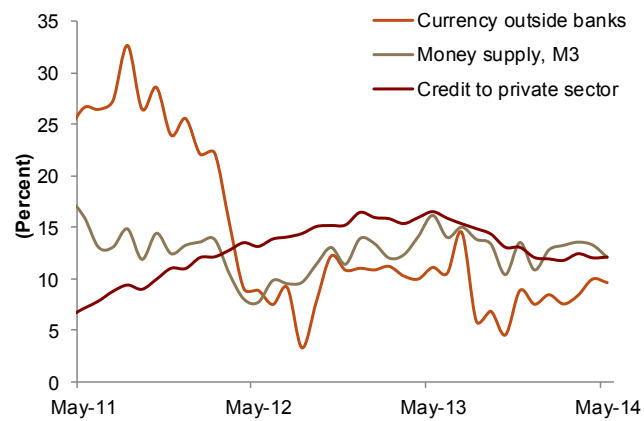
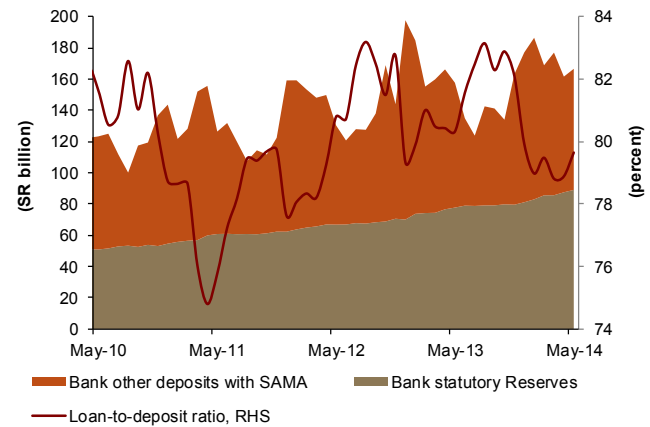


Figure 8: Liquidity indicators



Note: *includes Jadwa Investment estimate for the earlier years. Sources: Central Department Of Statistics & Information, IMF, FAO, Reuters, Haver Analytics, Jadwa investment



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