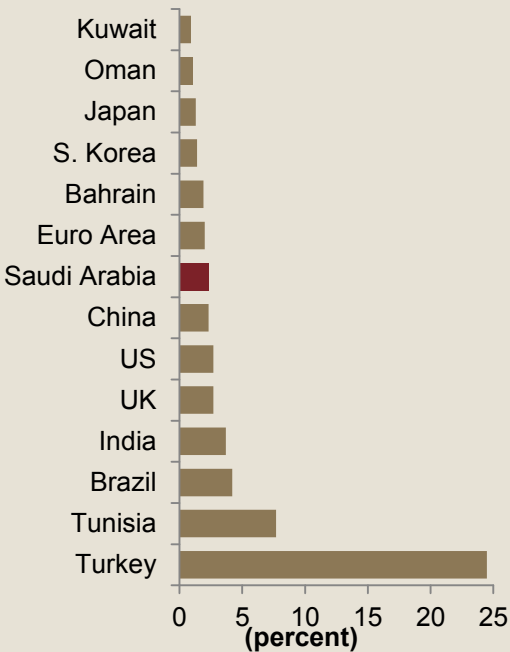




Saudi CPI inflation
(percent)

	Monthly change	Annual change
August 2018	-0.2	2.3
July 2018	0.1	2.3
Year-to-August average	0.4	2.5

Inflation rates in trade partners (latest)



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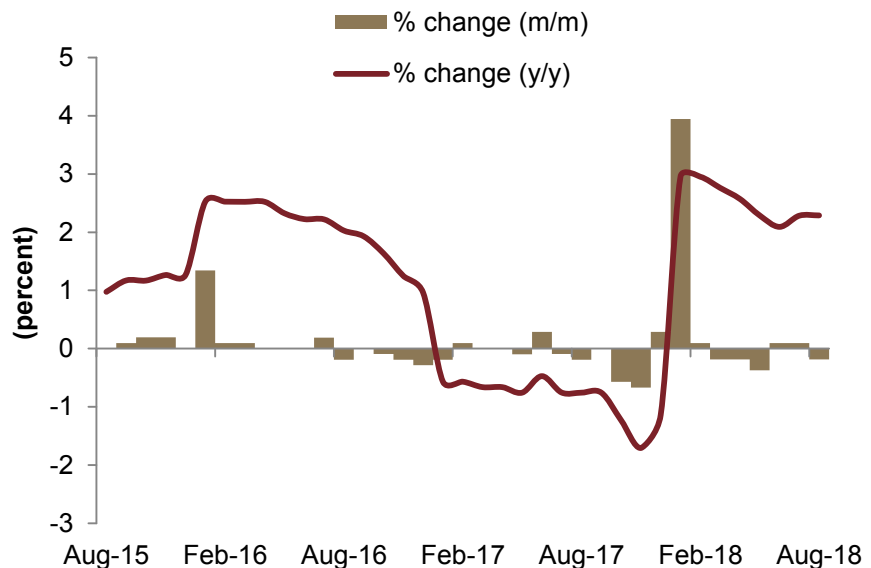
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Inflation rates continue to show mild rises

- We have revised our inflation rate forecast for the full year of 2018 to average around 2.6 percent, down from 3.1 percent previously, mainly due to the decline in rentals for housing prices.
- The latest General Authority for Statistics (GaStat) inflation release for August shows that prices rose by 2.3 percent year-on-year, and declined by 0.2 percent month-on-month.
- Since the start of the year, prices have risen by an average of 2.5 percent year-to-August, despite the introduction of the value-added tax (VAT) and utility and fuel price reform at the turn of the year.
- 'Food and beverages' prices rose by 6.1 percent year-to-August, and by 0.7 percent month-on-month following a marginal decline by 0.3 percent month-on-month in July.
- 'Housing and utilities' prices were flat year-to-August, despite the spike in the sub-item 'electricity and fuels' by 24.3 percent year-to-August, due to the fuel and utility price reform in January.
- Since the beginning of the year, annual growth in POS transactions was up for all sectors except for transportation, with average year-to-August rise at 11.4 percent, compared to 7 percent in the same period last year.
- Despite the fact that this year saw the implementation of VAT, we see that the impact of the slowdown in the housing sector, affected by the declining 'rentals for housing' has weighed on the overall inflation rate.

Figure 1: Inflation rates





Recent Developments

Since the beginning of the year, prices rose by a yearly average of 2.5 percent year-to-August.

The latest General Authority for Statistics (GaStat) inflation release for August shows that prices rose by 2.3 percent year-on-year, and declined by 0.2 percent month-on-month. Since the beginning of the year, prices rose by a yearly average of 2.5 percent in the year-to-August, despite the introduction of the 5 percent value-added tax (VAT) and utility and fuel price reform at the turn of the year.

During the summer months, between June and August, a number of seasonal events took place: Ramadan, Eid Al-Fitr, summer school break, and Eid Al-Adha. During these three months, we cannot find any significant rises in food prices and clothing, although prices for restaurants and hotels were marginally higher.

CPI basket groups

'Food & beverages' prices rose by 6.1 percent year-to-August.

'Food and beverages' prices rose by 6.1 percent year-to-August. Looking at sub-group data, we find that the main rises in food prices, year-to-August, came from fish, meat and poultry, followed by bread and cereals. Looking ahead, we expect prices to slow following international trends, as both sub-groups contain a number of imported items. In the year-to-August 2018, the FAO (Food and Agriculture Organization of the United Nations) food price index declined by an average of 1.7 percent, and the meat price index was flat, compared to an increase by 11.5 and 10 percent respectively, during the same period last year.

Historical data shows that prices, especially for food items, usually increase prior to and during the month of Ramadan, due to higher demand. Despite the fact that this year saw the implementation of VAT, food prices did not exhibit any unusual price hikes during Ramadan, and remained within the year-to-August average inflation rate (Figure 2).

'Housing and utilities' prices were flat year-to-August, despite the spike in the sub-item 'electricity and fuels' by 24.3 percent year-to-August, due to the fuel and utility price reform enacted at the start of the year. This flat performance is likely to be due to the impact of 'rentals for housing', a sub-item with a large weight in the segment,

Table 1: Main highlights of Saudi CPI inflation
(percent)

	Weights	Month-on-month			Year-on-year		
		Jul-18	Aug-18	Contribution, ppt	Jul-18	Aug-18	Contribution, ppt
Food & beverages	18.8	-0.3	0.7	0.0	6.7	6.5	1.2
Housing & utilities	25.3	-0.4	0.1	-0.2	-1.3	-1.3	-0.3
Tobacco	0.7	0.0	0.0	0.0	9.8	9.8	0.1
Clothing & footwear	6.2	-1.8	-1.8	0.0	-8.3	-8.6	-0.5
Furnishing & maintenance	8.5	-1.2	-0.9	0.0	0.5	0.5	0.0
Health	2.3	-0.8	-1.1	0.0	4.0	4.0	0.1
Transport	9.9	-0.5	-1.3	0.0	10.4	10.5	1.1
Communication	8.5	-1.2	-1.2	0.0	1.4	1.5	0.1
Recreation & culture	3.4	0.2	-0.8	0.0	1.1	0.9	0.0
Education	4.2	0.0	1.0	0.0	0.5	0.5	0.0
Restaurants & hotels	6.5	-1.0	-0.9	0.0	7.6	8.4	0.5
Misc. goods & services	5.7	-1.3	-0.7	0.0	0.5	0.3	0.0
Core inflation*	55.9	0.1	0.0	0.0	2.3	2.3	1.3
General index	100.0	0.1	-0.2	-0.2	2.28	2.29	2.3

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



Sakani program has offered almost 500 thousand units to citizens since launching in February 2017...

...and is expected to introduce around 134 thousand additional units.

'Restaurants & hotels' prices saw the highest growth year-to-August, by 7.1 percent, after 'Transport' and 'Tobacco'...

...boosted by higher demand during the summer months.

which declined by an average of 2.1 percent year-to-August (Figure 3).

As 'rentals for housing' is exempted from VAT, we see this declining trend as largely correlated with the Ministry of Housing (MOH) reforms in the real estate sector, which aims to make housing prices more affordable for citizens. For example, Sakani program has offered almost 500 thousand units to citizens since launching in February 2017, with housing units accounting for 42 percent of total units, which also include land and mortgages (Figure 4). During Q4 2018, the MOH is expected to introduce around 134 thousand additional units, in order to reach the planned target of providing 350 thousand units during 2018.

Moreover, latest data show that the total number of foreigners in the Saudi labor market has declined by around 796 thousand since the start of 2017 up to the end of Q1 2018, which possibly indicates a significant rise in final exits, and likely reduction in demand for housing rentals.

'Restaurants and hotels' prices saw the highest growth year-to-August, by 7.1 percent, after 'Transport' and 'Tobacco'. The rise in 'restaurants and hotels' prices were boosted during the summer months; June, July and August, when a number of seasonal events took place, including Ramadan, Eid Al-Fitr, the summer school break, and Eid Al-Adha. As such, prices rose by an average of 7.7 percent, year-on-year, over this period (Figure 5).

Latest data from the Saudi Commission for Tourism and Heritage (SCTH), shows that Saudi cities received 16.7 million domestic trips during the summer season of 2018, up 6 percent than the summer of 2017, with total domestic tourism spending exceeding SR20.4 billion, growing by almost 14 percent year-on-year. In total, higher demand on tourism within the Kingdom has likely resulted in higher prices on restaurants and hotels. More hotel and accommodation projects in the pipeline would likely result in lower prices in the future, as we discussed in our [Tourism and Entertainment Report](#) - published in May 2018.

Figure 2: Food prices in Ramadan
(month-on-month change)

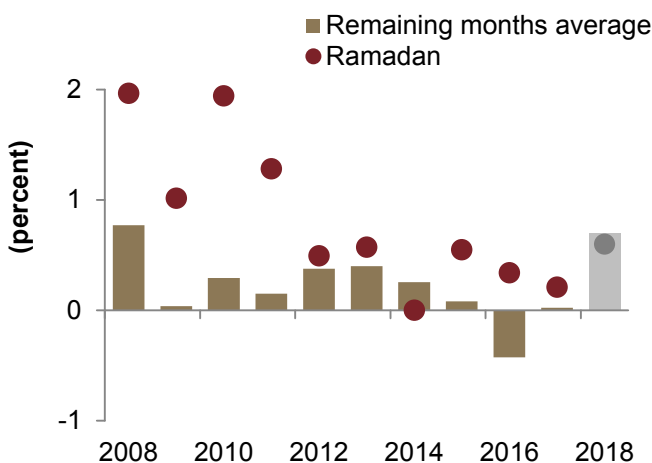
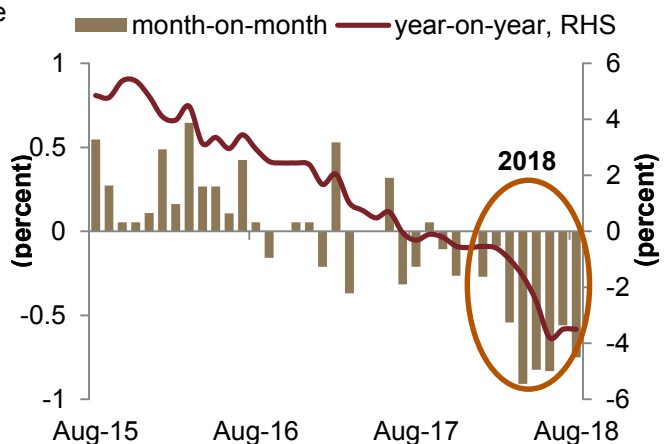


Figure 3: Rentals for housing





Since the beginning of the year, annual growth in POS sales was up for all sectors except for transportation.

Consumer Spending

Since the beginning of the year, annual growth in POS sales have been higher for all sectors, except for transportation (Figure 6), with average year-to-August rise at 11.4 percent, compared to 7 percent in the same period last year. We find a notable rebound in spending on 'restaurants and hotels' and 'food and beverages' segments. The higher spending on 'restaurants and hotels' seen in the year-to-August is also reflected in higher inflation rates in this segment, as discussed above, which would likely indicate that demand was higher for touristic activities during the summer months in the Kingdom.

Looking at the average sales per transaction, the year-to-date average have not seen a significant change compared to the same period last year. Year-to-date average showed a decline by 19.7 percent in 2018 compared with -20 percent in 2017 (Figure 7).

We have revised our inflation rate forecast for the full year of 2018 to average around 2.6 percent, down from our previous forecast of 3.1 percent.

Outlook

We have revised our inflation forecast for the full year of 2018 to average around 2.6 percent, down from our previous forecast of 3.1 percent, accounting for the slowdown in the 'housing' sector, which weighs 25.3 percent in the updated CPI basket. The slowdown comes mainly from the decline in housing rental prices, which has remained in the negative territory since July 2017. In addition, on average, prices in most segments within the CPI basket have been marginally declining since February 2018, with an average decrease of 0.1 percent month-on-month.

In 2019, we expect inflation rates to average around 1.1 percent, as prices are expected to continue the downward trend in the short term, to adjust with VAT and the structural reforms in the labor market. At the same time, prices are expected to be affected by the reduction in VAT threshold starting Q1 2019. In 2018, VAT was firstly imposed on enterprises with annual revenues of at least SR1 million. For the second round starting January 2019, the threshold will get lowered to SR375 thousand. This step needs registering additional 300 thousand small and medium enterprises, with many of them in the retail sector. However, this inclusion is expected to be less inflationary compared to the first VAT round in January 2018, as the size of enterprises are smaller in this inclusion.

In 2019, we expect inflation rates to average around 1.1 percent.

In addition, according to the Fiscal Balance Program (FBP) and the recently released Preliminary Budget Report, the government plans another round of energy price reform in 2019. Although it is not quite clear if this round will include further electricity price hikes, LPG and Kerosene price rises are scheduled next year. Therefore, we expect this to have an impact on inflation in 2019 and the years ahead.

Despite the challenges that were expected to arise with the inflation rates, we believe that the Citizen's Account (Figure 8), and the inflation allowance to public sector employees during 2018, have helped citizens cope with inflationary pressures over the course of year. For 2019, the government has reassured, in the Preliminary Budget Report, that any additional reforms will continue to be compensated through the Citizen's Account.



Figure 4: Ministry of Housing “Sakani” units

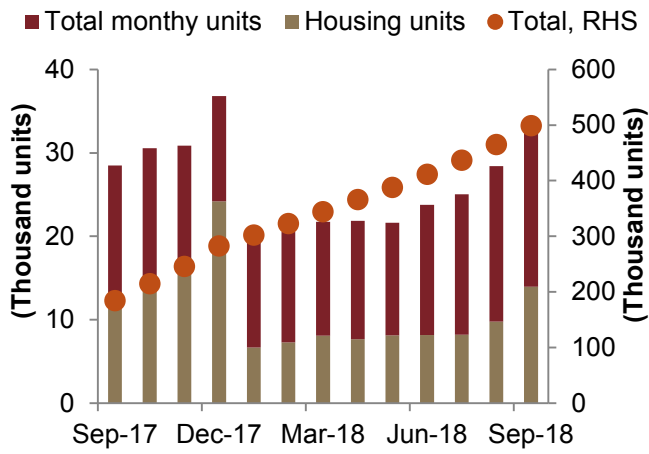


Figure 5: Prices in ‘Restaurants and hotels’ (year-on-year change)

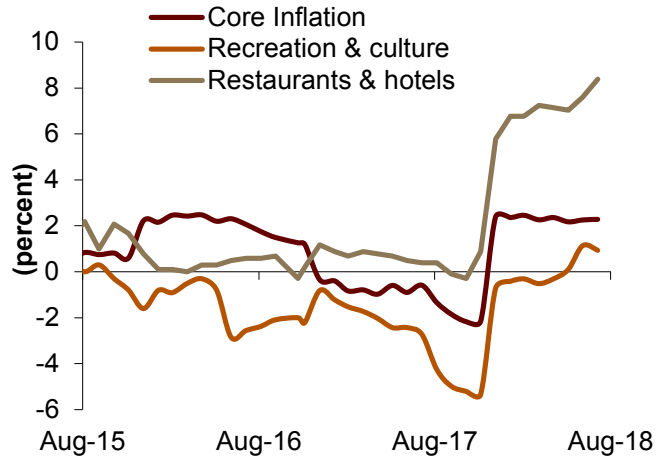


Figure 6: POS sales growth, by sector (year-to-August)

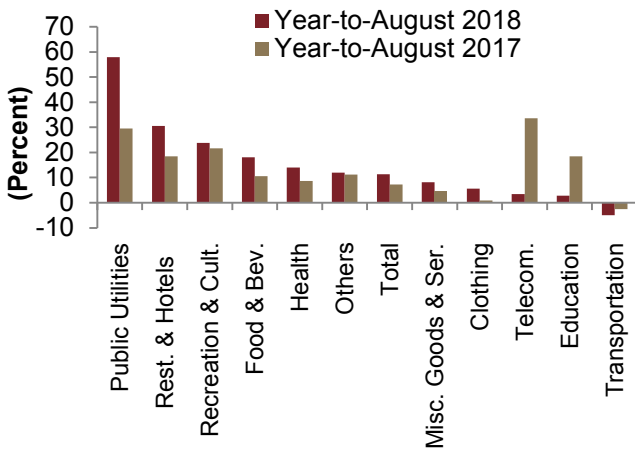


Figure 7: POS sales per transaction, by sector (year-to-August annual averages)

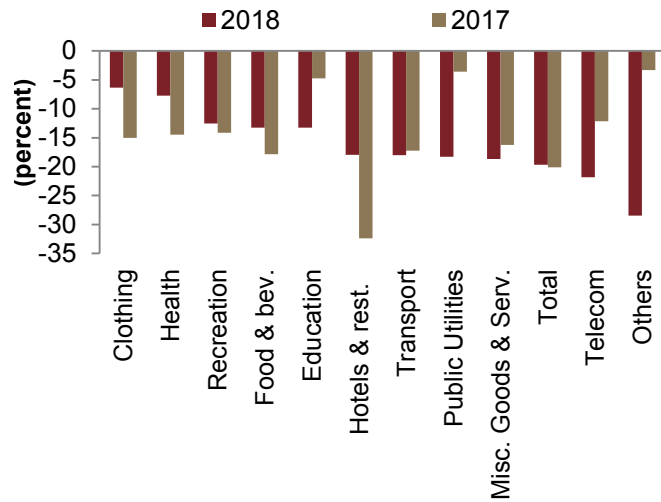
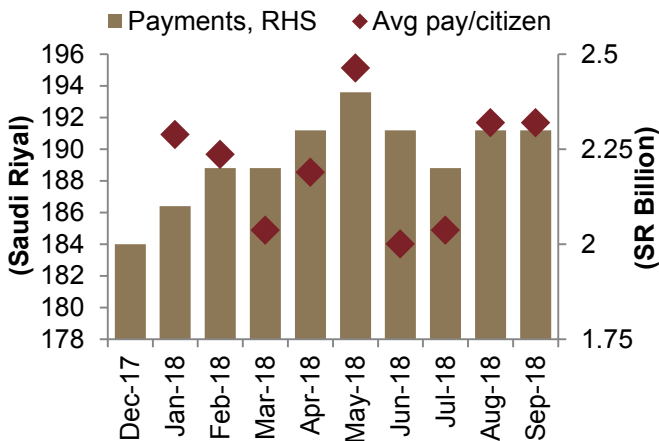


Figure 8: Payments of the Citizen’s Account





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