



## Inflation Update - March 2014

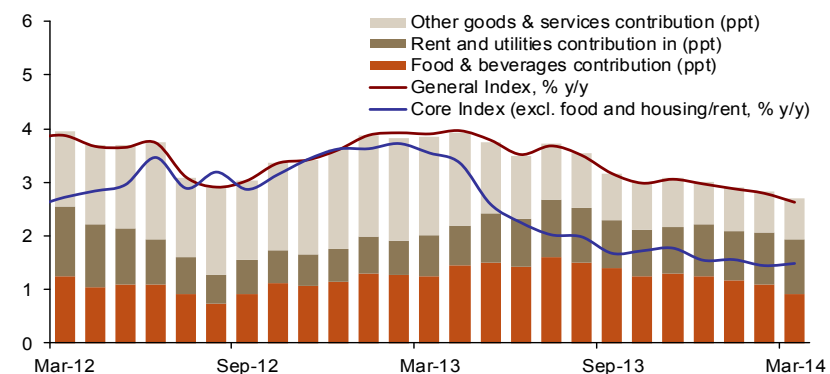
### Headline CPI inflation continues to fall

- Saudi CPI inflation fell the fourth consecutive month in March, reaching 2.6 percent year-on-year (y-o-y) in March compared with 2.8 percent in February. Core inflation slightly increased on the back of higher prices of “other expenses and services”.
- Lower food price inflation was the main reason for the CPI decline while rental inflation picked up slightly to become the largest single contributor to headline inflation in March.
- Negligible external price pressures, due to lower commodity prices, a strong dollar and subdued inflation amongst trading partners should offset any local inflationary pressures.

According to the Central Department of Statistics and Information (CDSI), Saudi Arabia’s inflation rate fell for the fourth consecutive month in March (Figure 1), reaching 2.6 percent year-on-year compared with 2.8 percent in the previous month. Lower food price inflation was the main reason for the decline while rental inflation picked up slightly. On a monthly basis, inflation increased slightly to 0.2 percent in March up from a two-year low of 0.1 percent in February.

Our estimate of the core index, which excludes food, rental and housing-related services, rose by 1.5 percent year-on-year (0.1 percent month-on-month) up from 1.4 percent in February (Figure 1 and 2). This was almost entirely due to a pick up in the prices of “other expenses and services”, the largest component of the core index. The latter was, in turn, driven mainly by gold prices (Figure 3), which got off to a good start this year, after a 28 percent drop in 2013. However, the recent fall in gold prices at the end of March means a stable outlook for the inflation of “other expenses and services” component of the core index.

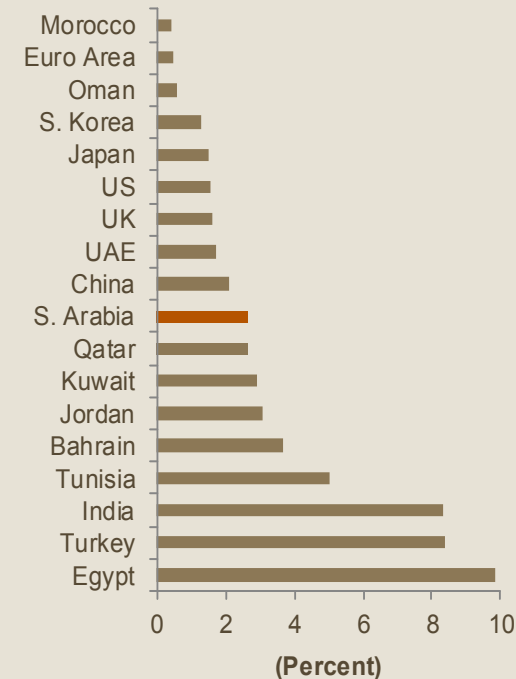
**Figure 1: Headline inflation trends downwards owing to lower food prices**



#### Saudi CPI inflation (percent)

	Monthly change	Annual change
March	0.2	2.6
February	0.1	2.8

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



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*Headline inflation fell for the fourth consecutive month in March...*

*...owing to falling food inflation...*

*... in line with the trend of international food prices.*

*Housing inflation rebounded to where it was seven months ago...*

*...and became the major source of inflation growth for the first time since April 2012.*

*There is little reason to expect any external inflationary pressure...*

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

*...driven by domestic inflationary sources.*

In March, food price inflation was at its lowest level since August 2012, at 3.8 percent y-o-y. In monthly terms, food prices actually contracted by 0.3 percent. As highlighted in our previous inflation update, this was expected as both global food inflation and domestic wholesale food inflation remained subdued. According to the UN Food and Agriculture Organization, year-on-year global food price inflation remained in a deflationary mood for the ninth consecutive month in March (Figure 4). With food accounting for the largest proportion of the cost of living index (21.7 percent), this slowdown was sufficient to lower headline inflation despite the increase in rental inflation.

Partially offsetting the impact of lower food price inflation was a rebound in housing and related items inflation, which climbed back over 4 percent, similar to levels in August last year (Figure 5). As a result, housing and related items inflation surpassed food inflation as the largest contributor to headline inflation in March, the first time since April 2012 (Figure 2). We maintain our view that the uncertainty associated with the unclear domestic housing policy, and its implications on property valuations, will increase the unpredictability of rental and housing inflation. Outside of housing and other expenses and services inflation, there remains very little domestic price pressure in the economy. The small and mainly downward movement in other components of the inflation basket suggests that inflation will maintain the current level over the next few months, but upside risks likely to emerge in the second half of this year.

At present, we expect average inflation to fall to 3 percent this year, compared with 3.5 percent in 2013. External inflationary pressure will remain muted due to declining inflation amongst trading partners, lower commodity prices and a strengthening of the dollar. The domestic environment will therefore dictate the CPI trend for the rest of the year (Figure 6). We expect inflation to remain at its current level for the next few months, but it will start to increase towards the second half of the year on the back of seasonal domestic consumption demand, elevated government spending and lower base effects. The ample liquidity in the banking system could feed into an acceleration of private sector credit growth (Figures 7 and 8). This would, in turn, create an upward pressure on prices. However, with growth in money supply, currency outside banks and credit extended to the private sector in line with activity in the non-oil sector, we do not expect any change in monetary policy over the coming 18 months, especially given the current inflation trend.

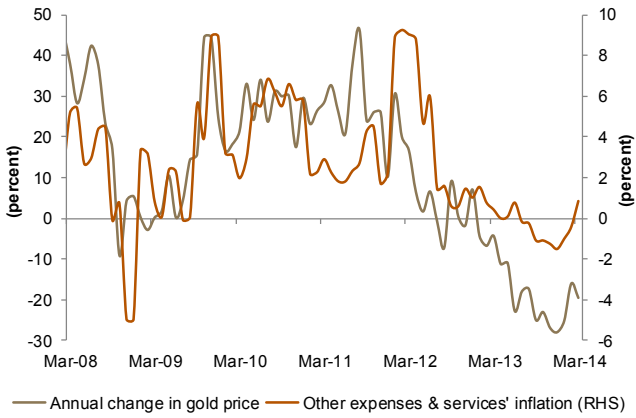
**Figure 2: Main highlights of Saudi CPI inflation**  
(percent)

	Weights	Month-on-month			Year-on-year			YTD
		Feb-14	Mar-14	Contribution, ppt.	Feb-14	Mar-14	Contribution, ppt.	
Food & beverages	21.7	0.0	-0.3	-0.1	4.6	3.8	0.9	-0.3
Housing & related items	20.5	0.3	0.8	0.2	4.0	4.1	1.0	1.5
Tobacco	0.5	0.4	0.0	0.0	6.4	6.4	0.0	0.6
Clothing & footwear	8.4	-0.4	0.6	0.0	-0.4	0.6	0.0	0.1
Home furniture	9.1	0.2	-0.3	0.0	6.2	5.2	0.5	0.3
Medical care	2.6	0.1	0.0	0.0	3.1	3.0	0.1	1.1
Transport	10.4	-0.4	0.0	0.0	-2.7	-3.0	-0.3	-0.2
Communication	8.1	0.2	-1.0	-0.1	0.6	-0.3	0.0	-1.0
Recreation & culture	3.5	0.2	0.2	0.0	3.9	4.1	0.1	0.5
Education	2.7	0.0	0.0	0.0	3.7	3.7	0.1	0.0
Restaurants & hotels	5.7	0.3	0.6	0.0	2.8	3.5	0.2	1.2
Other expenses & services	6.8	0.2	1.3	0.1	-0.4	0.8	0.1	1.7
<b>Core inflation*</b>	<b>57.8</b>	<b>0.0</b>	<b>0.1</b>	<b>0.1</b>	<b>1.4</b>	<b>1.5</b>	<b>0.8</b>	<b>0.3</b>
<b>General index</b>	<b>100</b>	<b>0.1</b>	<b>0.2</b>	<b>...</b>	<b>2.8</b>	<b>2.6</b>	<b>...</b>	<b>0.5</b>

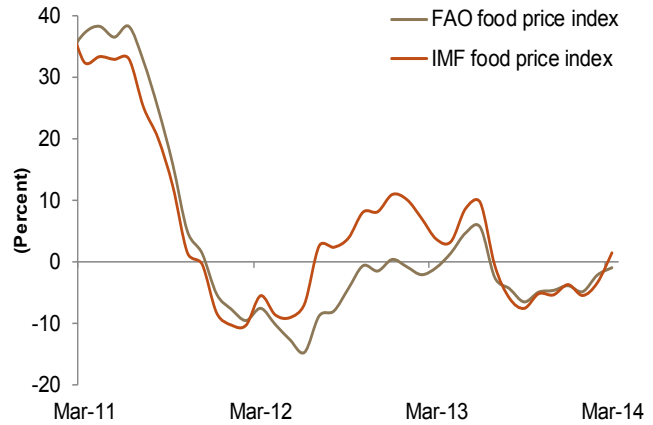
Note: \*Core inflation excludes food and housing inflation and is Jadwa Investment's estimate.



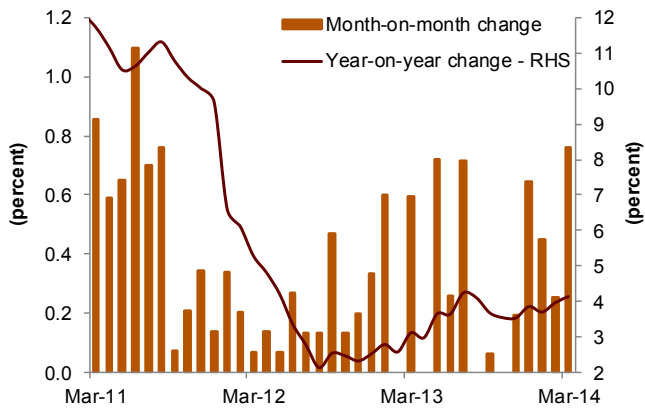
**Figure 3: Gold price and inflation for “other expenses & services”**



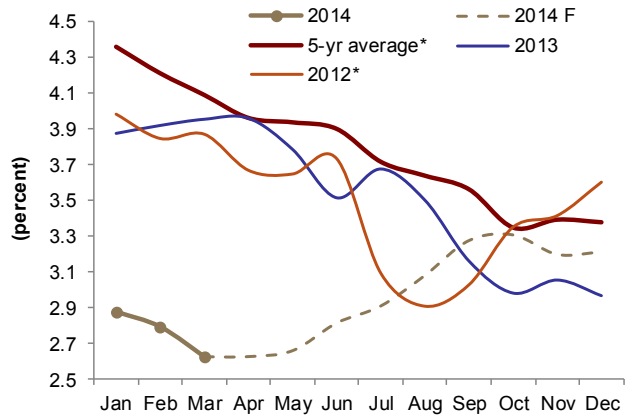
**Figure 4: International food prices (year-on-year change)**



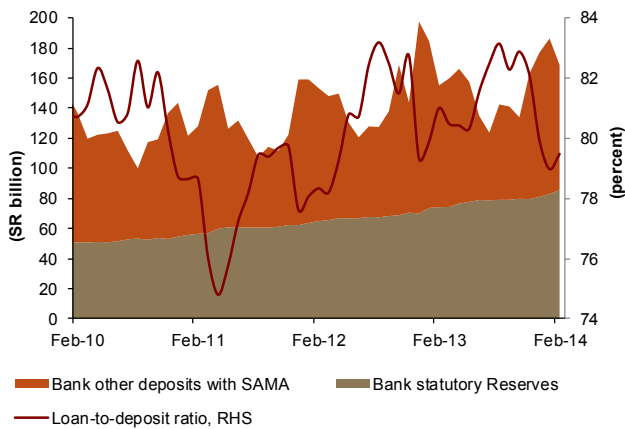
**Figure 5: Housing and related items inflation**



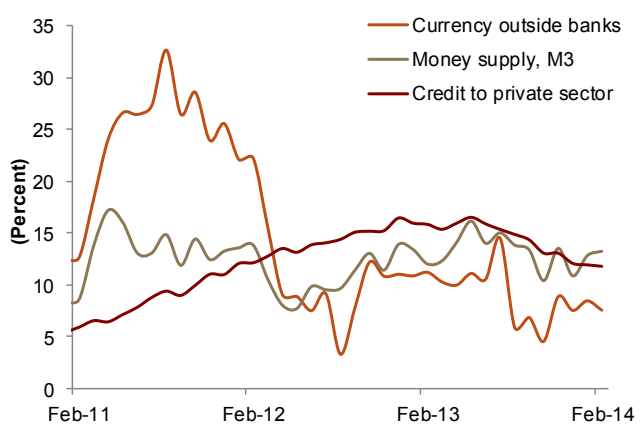
**Figure 6: Inflation forecasts (year-on-year change)**



**Figure 7: Liquidity indicators**



**Figure 8: Monetary indicators (year-on-year change)**



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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