



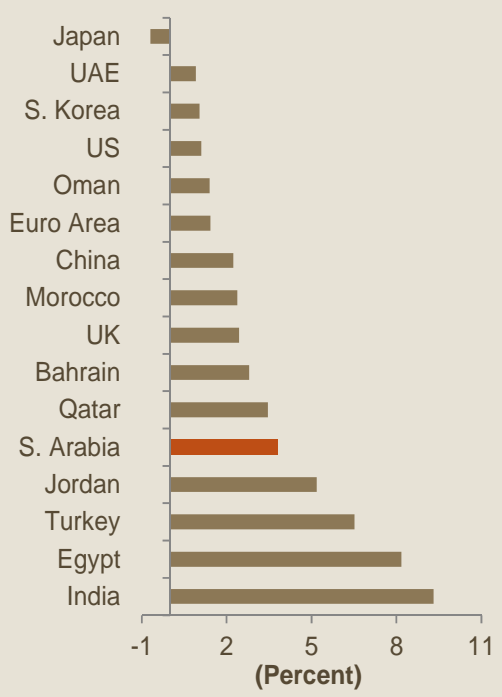
May Inflation Update

Core inflation pulls the headline lower

Saudi CPI inflation (percent)

	Monthly change	Annual change
May	0.1	3.8
April	0.2	4.0

Trading partner headline inflation rates (latest, year-on-year change)

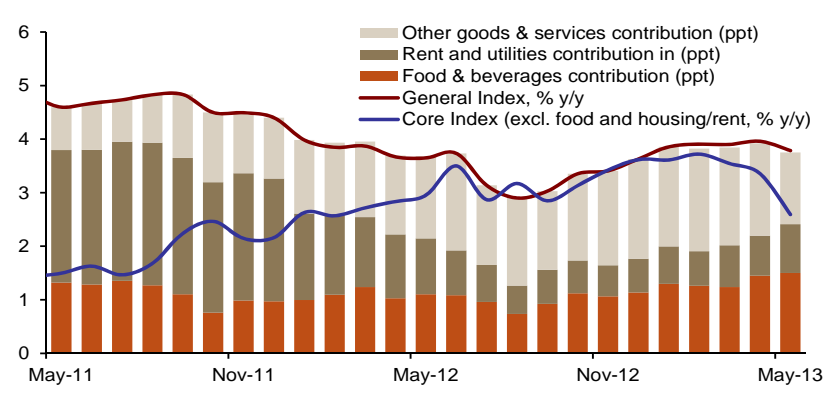


- Saudi annual CPI inflation eased to 3.8 percent in May compared with 4 percent in April, brought down by a significant fall in the core index to 2.6 percent from 3.4 percent in April.
- Despite slowing core inflation, the food and rent/housing components accelerated in May and remained the main contributors to headline inflation.
- While domestic inflationary pressure is likely to persist as we approach the holiday seasons, we see the current inflationary trend as more of a demand-pull inflation rather than a cost-push inflation caused by recent labor market reform initiatives.

According to the Central Department for Statistics and Information (CDSI), Saudi Arabia's inflation rate for May slowed to 3.8 percent year-on-year compared with 4 percent in the previous month. Despite being the lowest so far this year, inflation in the Kingdom remains high relative to main trading partners. On a monthly basis, prices slightly eased to 0.1 percent in May compared with 0.2 percent in April.

Our estimate of Saudi core inflation, which excludes food and housing-related services, also eased to 2.6 percent year-on-year in May compared with 3.4 percent in April. In fact the fall in core inflation was the main cause of lower overall inflation while the contribution of rental and food inflation increased. The lower core rate was driven by falling prices across its main components, namely clothing and footwear, transport, furnishings, household equipment and maintenance, recreation and culture, and restaurants and hotels segments, all of which represent 64 percent of the core index.

Figure 1: Lower core inflation pulls headline downward



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Headline inflation slows...

...as core inflation decelerates...

...but food inflation remains high by historical standards.

Rental inflation also accelerates...

...pushing the contribution of the housing price index to overall inflation to a 12-month high.

International conditions provide a benign backdrop to inflation...

...while domestic inflationary pressure remains...

... but no evidence of cost-push inflation, yet.

Food inflation continued to trend upward though at slower pace than in last month. Food prices rose by 0.2 percent month-on-month in May compared to 0.9 percent in April. On annual basis, however, the rise in food prices remained high by historical standards (Figure 5). Such significant increase in annual food prices also put the food segment as the largest single contributor to overall inflation, adding 1.5 percentage point (pp). According to the CDSI's statement, all subcomponents of the food and beverage group increased last month compared with a year earlier. The food price increases are in line with the trend of the IMF's food price index which increased by 7.6 percent year-on-year in May. The FAO food price index also maintained a positive trend for the second consecutive month, rising by 5.1 percent in May (Figure 6).

The rent and housing-related services price index accelerated to 3.6 percent year-on-year in May, up from 3 percent in April, adding 0.9pp to the headline inflation, the highest contribution since May last year. Such acceleration in the rate of inflation for the housing segment is most likely due to higher rental inflation which registered 4.2 percent year-on-year in May compared with 3.4 percent the previous month. On monthly basis, rental prices increased by 0.7 percent in May compared to their level in April. As highlighted in previous updates, this acceleration in rental inflation is in line with our view that housing inflation is expected to remain elevated this year before gradually easing next year, though further delays in the government housing inductivities is likely to keep rental inflation high.

While the external factors contribution to inflation in the Kingdom will remain subdued owing to a stronger USD and low trading partner inflation rates, we expect domestic inflationary pressure to remain relatively strong particularly ahead of Ramadan and into the Eid holidays. High consumer spending (Figure 7), rising bank lending and exceptionally low interest rates and rising demand deposits (Figure 8) will maintain the current demand pull inflation. While it is expected that the recent labor market reform initiatives will lead to a cost-push inflationary pressure, the current trend shows this is not the case, at least for now. The fall in our core index supports the view that food (demand driven) and housing (shortage of supply) are the main drivers of headline inflation. Furthermore the staff cost segment of the recent HSBC's Purchasing Managers' Index points to unchanged staff costs in the last few months.

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

	Weights	Month-on-month			Year-on-year			YTD
		Apr-13	May-13	Contribution, ppt.	Apr-13	May-13	Contribution, ppt.	
Food & beverages	21.7	0.9	0.2	0.1	6.2	6.4	1.5	2.1
Housing & related items	20.5	0.0	0.7	0.2	3.0	3.6	0.9	1.9
Tobacco	0.5	0.0	0.0	0.0	12.8	12.8	0.1	0.0
Clothing & footwear	8.4	-0.1	-0.2	0.0	3.3	2.0	0.1	-0.9
Home furniture	9.1	0.8	0.0	0.0	3.6	3.3	0.3	2.3
Medical care	2.6	0.6	0.5	0.0	4.1	4.7	0.1	2.1
Transport	10.4	-0.5	-0.6	-0.1	5.6	2.5	0.2	0.2
Communication	8.1	0.2	0.5	0.0	2.0	2.4	0.1	1.1
Recreation & culture	3.5	0.1	-0.5	0.0	1.4	1.4	0.0	-0.7
Education	2.7	0.0	0.0	0.0	1.7	1.7	0.0	0.0
Restaurants & hotels	5.7	0.5	0.1	0.0	5.5	4.7	0.3	0.9
Other expenses & services	6.8	-0.4	-1.6	-0.1	0.0	0.1	0.0	-2.7
Core inflation*	57.8	0.1	-0.3	-0.1	3.4	2.6	1.3	0.2
General index	100	0.2	0.1	...	4.0	3.8	...	1.1

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



Figure 3: Inflation forecasts
(year-on-year change)

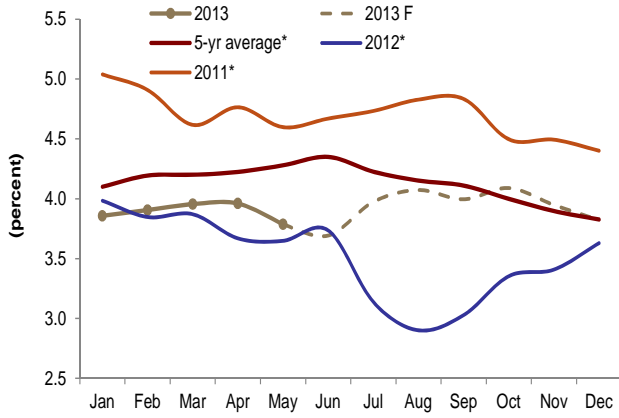


Figure 4: GCC headline inflation
(year-on-year change)

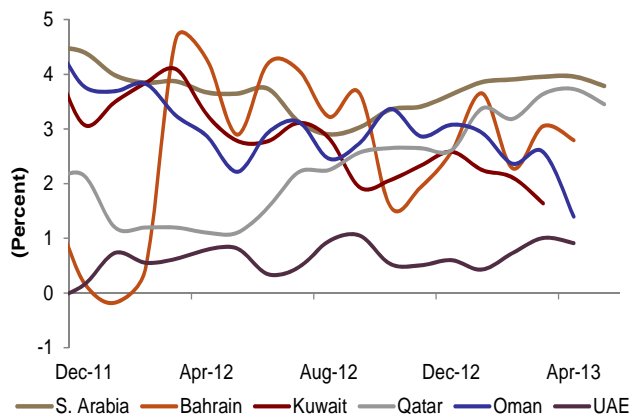


Figure 5: Annual food inflation
(year-on-year change)

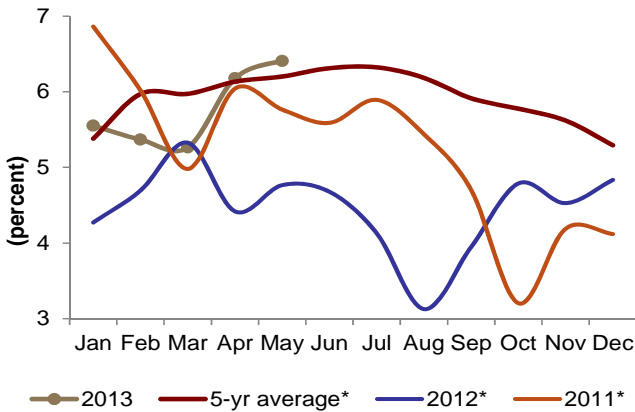


Figure 6: International food prices
(year-on-year change)

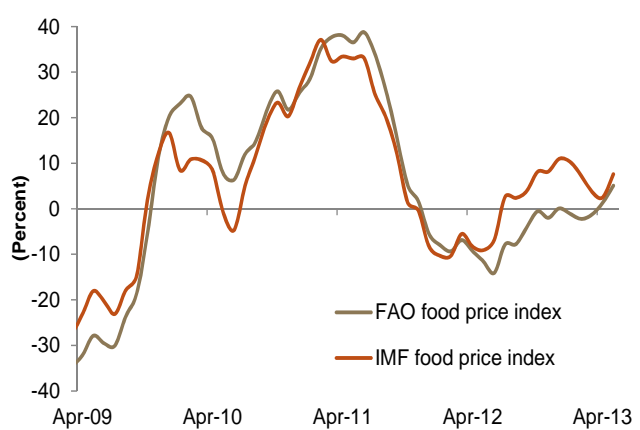


Figure 7: Indicators of domestic demand

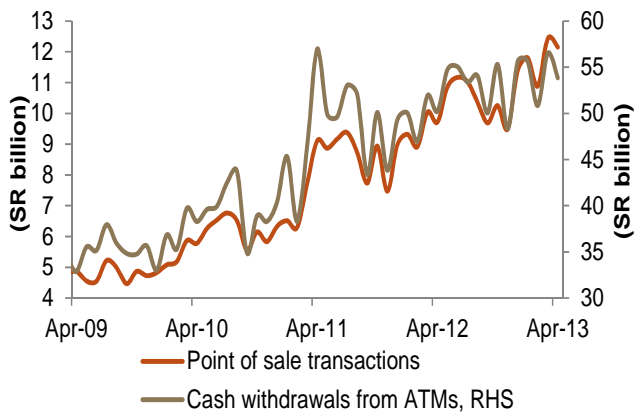
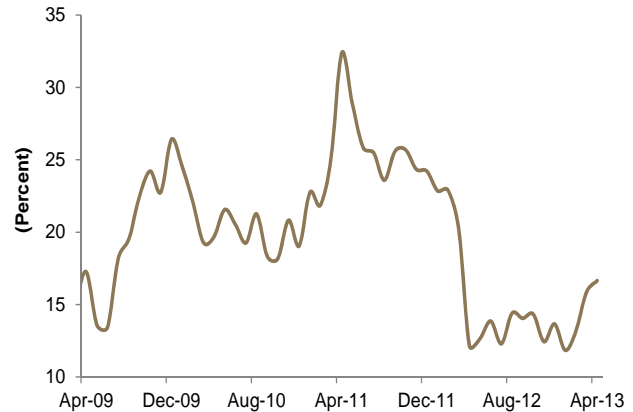


Figure 8: Business and individual demand deposits
(year-on-year change)



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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