



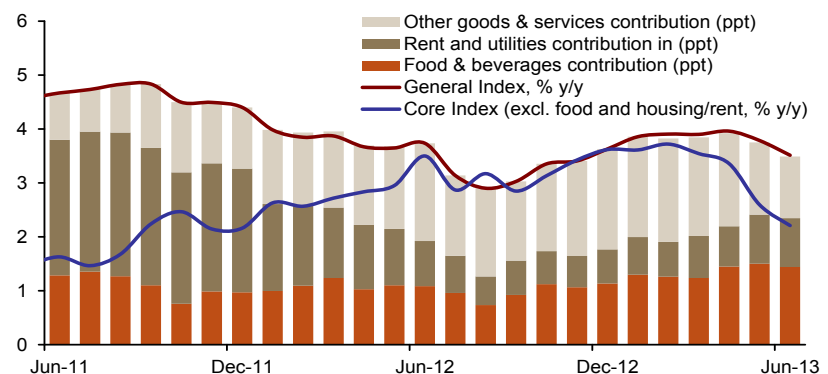
June Inflation Update CPI at 3.5 percent and no signs of cost-push

- Saudi annual CPI inflation eased to 3.5 percent in June compared with 3.8 percent in May, pushed down by falling core inflation and food prices while rent and housing-related services component remained flat.
- Food inflation is expected to increase further in July owing to a seasonal trend while strong housing demand will keep the upside risk to rental 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 reforms.

The Central Department of Statistics and Information (CDSI) released Consumer Price Index (CPI) inflation data for June, showing prices rising by 3.5 percent year-on-year compared with 3.8 percent in the previous month. On a monthly basis, prices slightly increased by 0.2 percent compared with 0.1 percent in May. Our estimate of Saudi core inflation, which excludes food and rental and housing-related services, maintained its downward trend for the fourth consecutive month. It fell to 2.2 percent year-on-year in June compared with 2.6 percent in May. Core inflation was mainly driven by the restaurant and hotel group (4.4 percent year-on-year) followed by furnishings, household equipment and maintenance (2.8 percent year-on-year).

With core inflation falling, the contribution of food and rent and housing-related services groups to the overall inflation increased to 66 percent compared with 64 percent in the previous month. Food

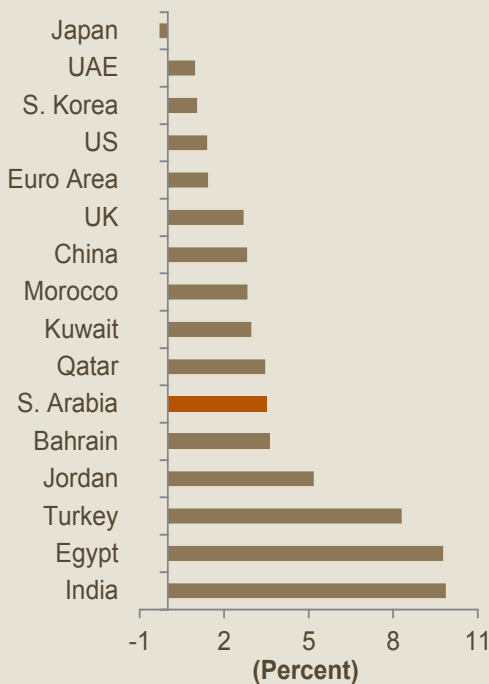
Figure 1: Lower core inflation pulls headline downward



Saudi CPI inflation (percent)

	Monthly change	Annual change
June	0.2	3.5
May	0.1	3.8

Trading partner headline inflation rates



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Headline inflation slows...

...as food and core inflation decelerates.

We expect food prices to rise again in July.

Rental inflation was flat in June...

...but we expect strong housing demand to keep the upside risk to housing inflation this year.

International conditions provide a benign backdrop to inflation...

...while domestic inflationary pressure remains...

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

inflation, however, slowed to 6.1 percent year-on-year (0.1 percent month-on-month) in June compared with 6.4 percent (0.2 percent month-on-month) in May. Despite the decrease in food inflation in June, it remained high by historical standards (Figure 5) and the largest single contributor to overall inflation, adding 1.4 percentage point (pp). We expect food prices to reverse the trend and rise in July in line with the trend ahead of Ramadan. According to the CDSI's statement, all subcomponents of the food and beverage group increased last month compared with a year earlier, with a noticeable increase in bread and cereals (9.6 percent year-on-year) and meat and poultry (8.8 percent year-on-year). The food price inflation is in line with the trend of the FAO food price index which increased by 5.4 percent year-on-year in June compared with 5.1 percent in May (Figure 6).

The rent and housing-related services inflation was unchanged at 3.6 percent year-on-year last month. On monthly basis, however, the rent and housing-related services inflation decelerated to 0.3 percent compared with 0.7 percent. As the rental sub-component remained unchanged at 4.2 percent year-on-year in June, the deceleration in the housing-related services was mostly due to a fall in housing maintenance inflation to 1.8 percent year-on-year compared with 3 percent in May. Despite the slower inflation in the rental and housing-related services group in June, rental inflation will remain under pressure with an upside potential owing to strong housing demand.

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 during Ramadan and into the Eid holidays. High consumer spending (Figure 7), rising bank lending, 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 will lead a higher labor cost part of which is expected to be passed to consumers, 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
		May-13	June-13	Contribution, ppt.	May-13	June-13	Contribution, ppt.	
Food & beverages	21.7	0.2	0.1	0.03	6.4	6.1	1.4	2.3
Housing & related items	20.5	0.7	0.3	0.07	3.6	3.6	0.9	2.2
Tobacco	0.5	0.0	0.0	0.00	12.8	12.6	0.1	0.0
Clothing & footwear	8.4	-0.2	0.0	0.00	2.0	1.3	0.1	-0.9
Home furniture	9.1	0.0	0.0	0.00	3.3	2.8	0.2	2.3
Medical care	2.6	0.5	-0.1	0.00	4.7	4.4	0.1	2.0
Transport	10.4	-0.6	-0.3	-0.02	2.5	1.7	0.2	-0.1
Communication	8.1	0.5	-0.5	-0.03	2.4	1.8	0.1	0.5
Recreation & culture	3.5	-0.5	0.4	0.01	1.4	1.4	0.0	-0.3
Education	2.7	0.0	0.0	0.00	1.7	1.7	0.0	0.0
Restaurants & hotels	5.7	0.1	0.8	0.05	4.7	4.4	0.3	1.7
Other expenses & services	6.8	-1.6	1.9	0.12	0.1	0.8	0.1	-0.8
Core inflation*	57.8	-0.3	0.2	0.12	2.6	2.2	1.2	0.4
General index	100	0.1	0.2	...	3.8	3.5	...	1.3

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



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

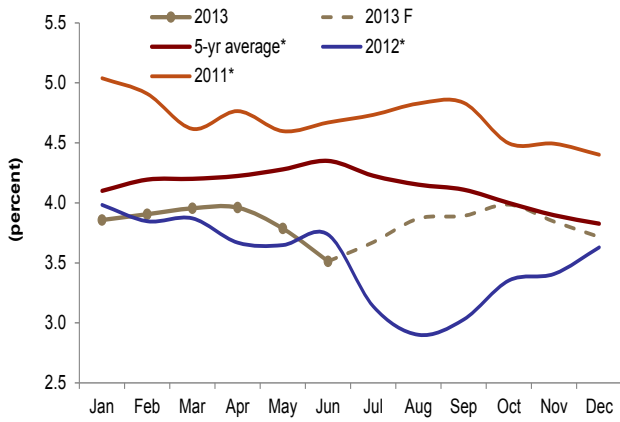


Figure 4: GCC headline inflation
(year-on-year change)

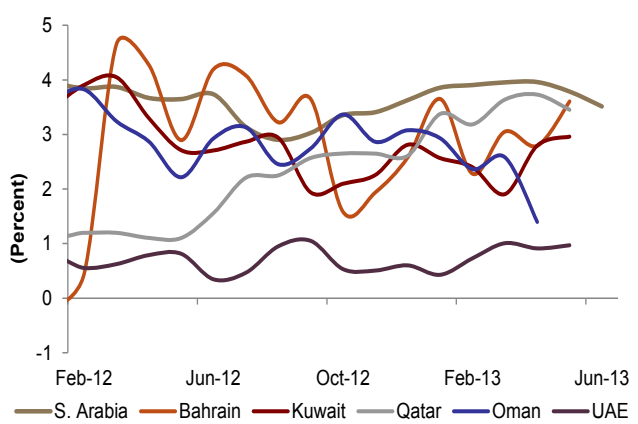


Figure 5: Annual food inflation
(year-on-year change)

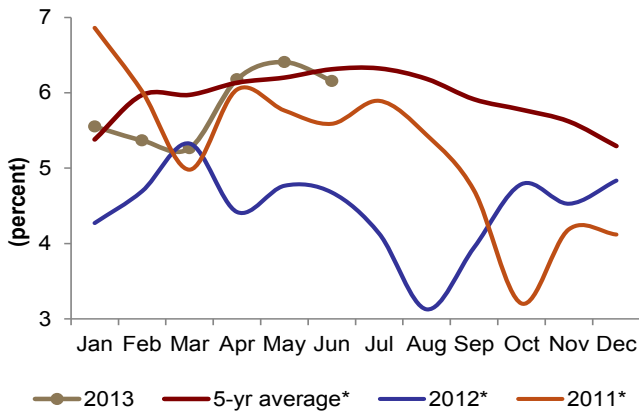


Figure 6: International food prices
(year-on-year change)

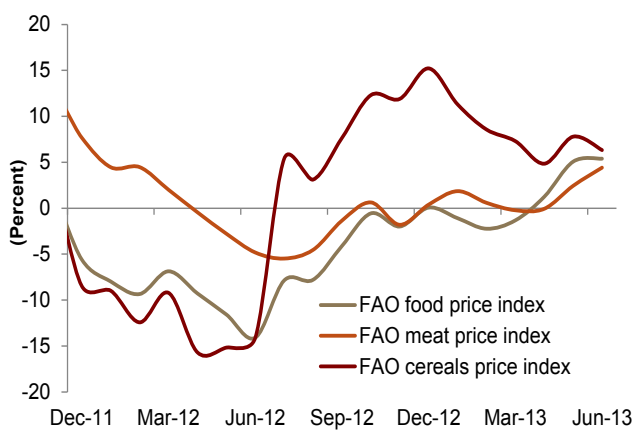


Figure 7: Indicators of domestic demand

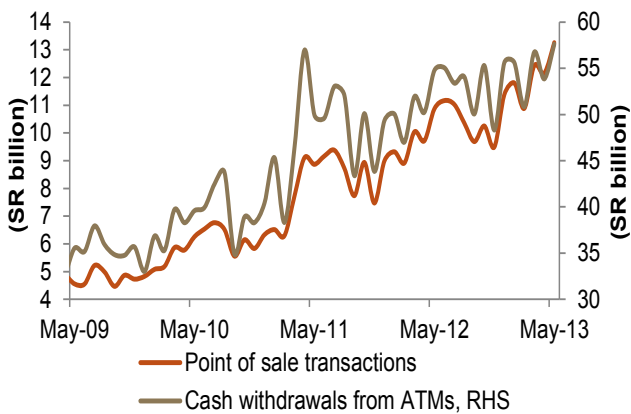
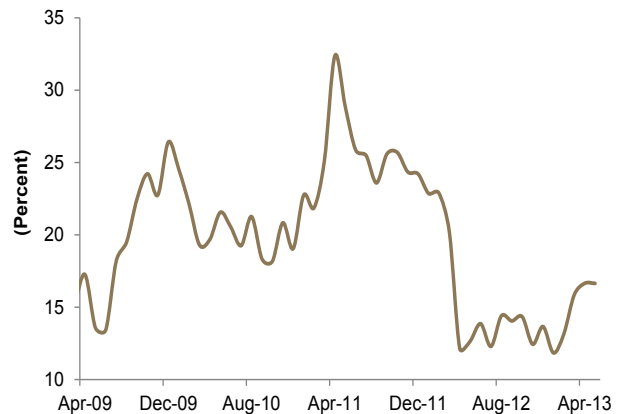


Figure 8: Business and individual demand deposits
(year-on-year change)



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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