



## Inflation Update - February 2014

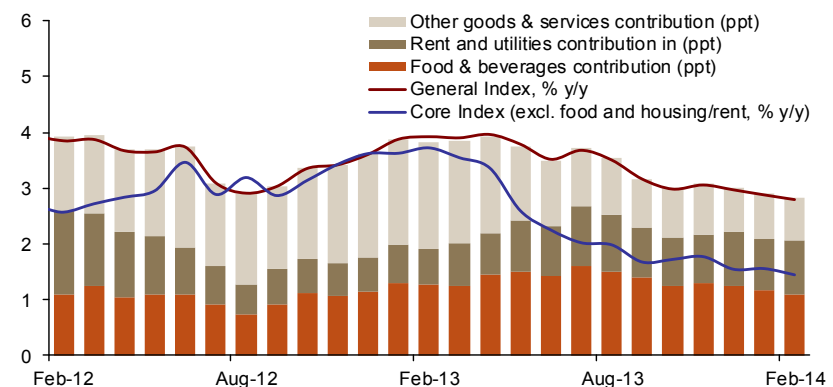
### Headline CPI inflation at 4-year low

- Saudi CPI inflation fell to a four year low of 2.8 percent year-on-year in February compared with 2.9 percent in January. The core inflation also fell to below 1.5 percent for the first time since April 2011.
- As expected, food inflation remained under downward pressure, hitting a 15-month low in February. Housing inflation continues to hover in a closed range as the market anticipate the impact of government housing initiatives.
- International conditions provide a benign backdrop to inflation in the Kingdom though any downward pressure is likely to be limited given strong domestic inflationary factors.

The Central Department of Statistics and Information (CDSI) released Consumer Price Index (CPI) inflation data for February, showing annual headline inflation hitting a four year low of 2.8 percent compared with 2.9 percent in the previous month. On a monthly basis, inflation also eased to 0.1 percent in February compared with 0.2 percent in January. Our estimate of Saudi core inflation, which excludes food and rental and housing-related services, slipped to 1.4 percent year-on-year compared with 1.6 percent in January (Figures 1 and 2). Core inflation was pushed down by falling prices of the other good and services group. The prices of the latter contracted by 0.4 percent year-on-year in February owing mainly to falling jewelry prices, which contracted by 16 percent year-on-year, following a similar fell in international gold prices in February compared to its level a year earlier.

As expected, food inflation slowed to 4.6 percent year-on-year in February compared with 5 percent in January putting the food inflation at its lowest level since November 2012 (Figure 5). Looking

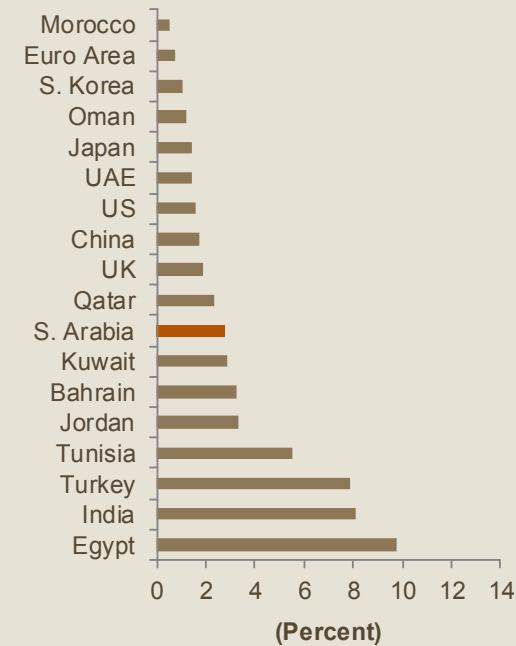
**Figure 1: Food prices pull headline CPI inflation downward**



#### Saudi CPI inflation (percent)

|          | Monthly change | Annual change |
|----------|----------------|---------------|
| February | 0.1            | 2.8           |
| January  | 0.2            | 2.9           |

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



For comments and queries please contact:  
Fahad Alturki  
Head of research  
falturki@jadwa.com

Head office:  
Phone +966 11 279-1111  
Fax +966 11 279-1571  
P.O. Box 60677, Riyadh 11555  
Kingdom of Saudi Arabia  
www.jadwa.com



*Headline inflation hit a four-year low in February...*

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

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

*Housing inflation lacked direction in the last eight months...*

*...as uncertainty over government housing initiatives clouds the market.*

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

*...while domestic inflationary pressure remains.*

forward, there is little reason to expect a major rise in domestic food inflation over the coming few month for two main reasons. First, wholesale food price inflation eased to 1 percent year-on-year in February, down from over 2 percent few months earlier. Second, prices of many agricultural staples have risen since the end of January, but benchmark agricultural commodity price indices are still lower than they were a year ago. The IMF food price index slipped by 3.4 percent year-on-year and the FAO index by 2.1 percent in February (Figure 6).

At 4 percent year-on-year in February, housing inflation continues to hover in a closed range between 3.5 percent and 4.2 percent since July last year (Figure 4). We think this lack of direction in housing inflation is mostly due the uncertainty in the market as both developers and consumers await the impact of different government initiatives that aim to revive the sector with more favorable policies including a proposed tax on unused land. As highlighted in previous inflation updates, we anticipate housing inflation to gradually trend downward as new supply of housing units balances the market, though further delays in the government housing initiatives is likely to keep rental inflation high.

This gradual downward trend in domestic inflation since end of November last year is inline with inflation rate in major trading partners. In fact, inflation is currently below target in nearly all the major economies. In the US, headline inflation rose slightly to 1.6 percent year-on-year in January, after dipping below 1 percent a few months earlier. In addition, market expectations of inflation remained low and stable in many advanced economies where there is ample surplus capacity. Inflation in most emerging economies is set to remain relatively low despite recent significant currency depreciations which affected only a small number of countries. In China too, inflation fell to just 2 percent in February owing mostly to lower food inflation, but the core index also fell.

While the external factors contribution to inflation in the Kingdom will remain subdued, we expect domestic inflationary pressure to remain relatively strong. High consumer spending, exceptionally low interest rates, rising demand deposits and bank lending and recent labor market reform will keep an upward pressure on domestic prices. Latest monetary data show the growth of demand deposits hitting a 10-month high of 4.3 percent month-on-month in January (Figure 8).

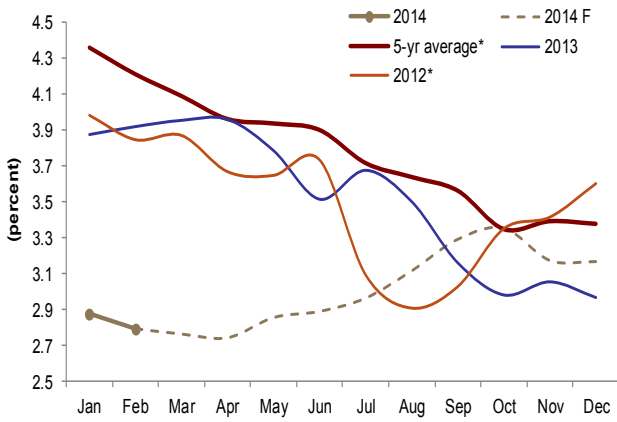
**Figure 2: Main highlights of Saudi CPI inflation**  
(percent)

|                           | Weights     | Month-on-month |            |                    | Year-on-year |            |                    | YTD        |
|---------------------------|-------------|----------------|------------|--------------------|--------------|------------|--------------------|------------|
|                           |             | Jan-14         | Feb-14     | Contribution, ppt. | Jan-14       | Feb-14     | Contribution, ppt. |            |
| Food & beverages          | 21.7        | -0.1           | 0.0        | 0.0                | 5.0          | 4.6        | 1.1                | -0.1       |
| Housing & related items   | 20.5        | 0.4            | 0.3        | 0.1                | 3.7          | 4.0        | 1.0                | 0.7        |
| Tobacco                   | 0.5         | 0.2            | 0.4        | 0.0                | 6.0          | 6.4        | 0.0                | 0.6        |
| Clothing & footwear       | 8.4         | -0.1           | -0.4       | 0.0                | -0.5         | -0.4       | 0.0                | -0.5       |
| Home furniture            | 9.1         | 0.4            | 0.2        | 0.0                | 6.7          | 6.2        | 0.5                | 0.6        |
| Medical care              | 2.6         | 1.0            | 0.1        | 0.0                | 3.5          | 3.1        | 0.1                | 1.1        |
| Transport                 | 10.4        | 0.2            | -0.4       | 0.0                | -1.9         | -2.7       | -0.2               | -0.2       |
| Communication             | 8.1         | -0.2           | 0.2        | 0.0                | 0.5          | 0.6        | 0.0                | 0.0        |
| Recreation & culture      | 3.5         | 0.1            | 0.2        | 0.0                | 3.4          | 3.9        | 0.1                | 0.3        |
| Education                 | 2.7         | 0.0            | 0.0        | 0.0                | 3.7          | 3.7        | 0.1                | 0.0        |
| Restaurants & hotels      | 5.7         | 0.2            | 0.3        | 0.0                | 2.7          | 2.8        | 0.2                | 0.5        |
| Other expenses & services | 6.8         | 0.3            | 0.2        | 0.0                | -1.0         | -0.4       | 0.0                | 0.4        |
| <b>Core inflation*</b>    | <b>57.8</b> | <b>0.2</b>     | <b>0.0</b> | <b>0.0</b>         | <b>1.6</b>   | <b>1.4</b> | <b>0.7</b>         | <b>0.2</b> |
| <b>General index</b>      | <b>100</b>  | <b>0.2</b>     | <b>0.1</b> | <b>...</b>         | <b>2.9</b>   | <b>2.8</b> | <b>...</b>         | <b>0.3</b> |

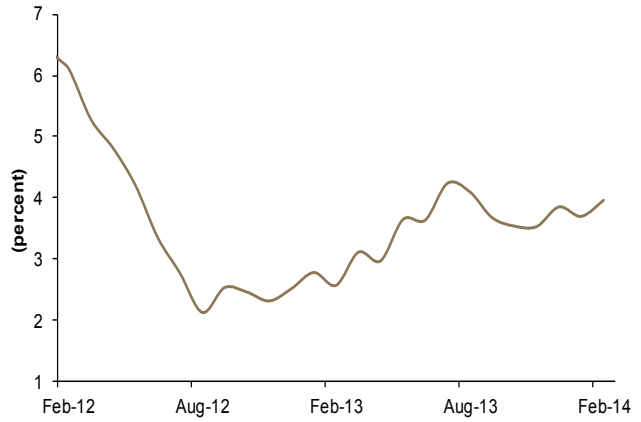
Note: \*Core inflation excludes food and housing inflation and is Jadwa Investment's estimate.



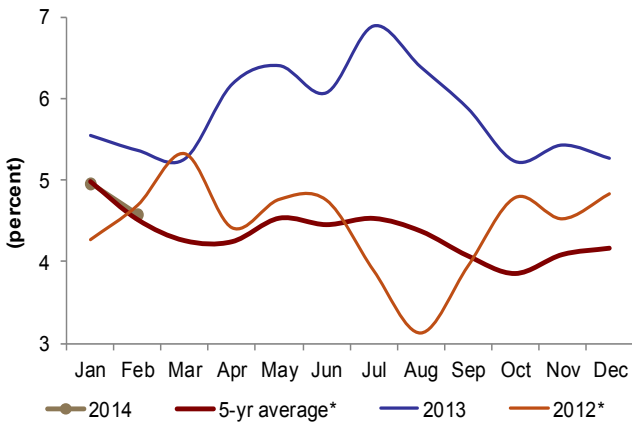
**Figure 3: Inflation forecasts**  
(year-on-year change)



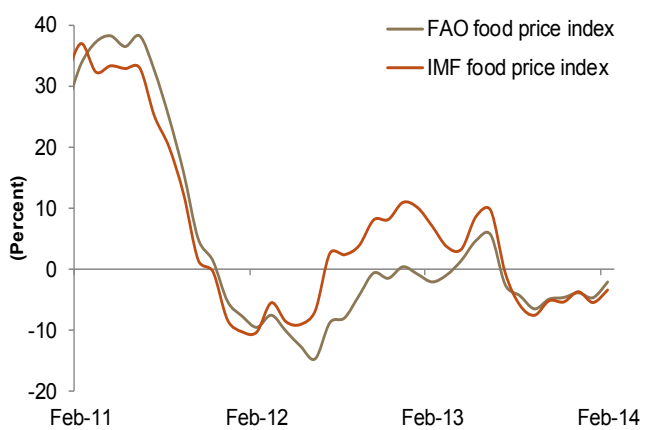
**Figure 4: Housing inflation**  
(year-on-year change)



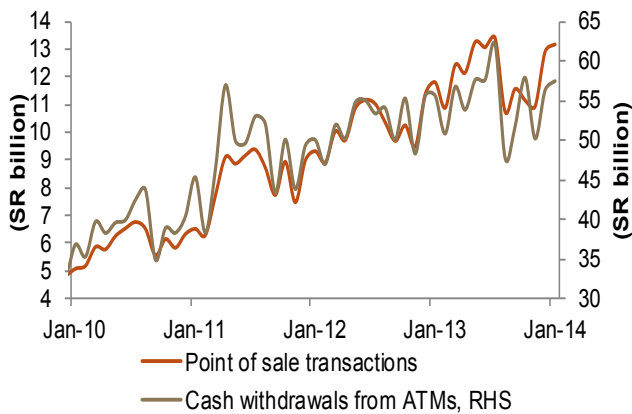
**Figure 5: Annual food inflation**  
(year-on-year change)



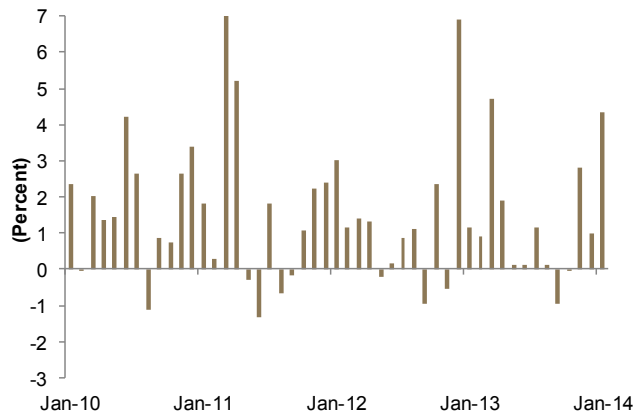
**Figure 6: International food prices**  
(year-on-year change)



**Figure 7: Indicators of domestic demand**



**Figure 8: Demand deposits**  
(month-on-month change)



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



## Disclaimer of Liability

Unless otherwise stated, all information contained in this document (the "Publication") shall not be reproduced, in whole or in part, without the specific written permission of Jadwa Investment.

The data contained in this Research is sourced from Reuters, Bloomberg, Tadawul and national statistical sources unless otherwise stated.

Jadwa Investment makes its best effort to ensure that the content in the Publication is accurate and up to date at all times. Jadwa Investment makes no warranty, representation or undertaking whether expressed or implied, nor does it assume any legal liability, whether direct or indirect, or responsibility for the accuracy, completeness, or usefulness of any information that contain in the Publication. It is not the intention of the Publication to be used or deemed as recommendation, option or advice for any action (s) that may take place in future.