Inflation Update

Saudi CPI inflation
(percent)

	Monthly change	Annual change
October 2018	-0.3	2.4
September 2018	-0.2	2.1
Year-to-October average	0.3	2.5

Inflation rates in trade partners (latest)

Mild pick-up in inflation rates

- The latest General Authority for Statistics (GaStat) inflation release for October shows that prices rose by 2.4 percent year-on-year, and declined by 0.3 percent month-on-month.

- Since the start of the year, prices have risen by an average of 2.5 percent year-to-October, 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 6.3 percent year-to-October, with main price rises coming from fish, bread and cereals.

- 'Housing and utilities' prices were marginally down by 0.7 percent year-to-October, likely to be due to the impact of 'rentals for housing' which declined by an average of 2.9 percent year-to-October.

- 'Transportation' prices saw the highest growth rate among the CPI basket groups in the year-to-October, by 10.5 percent, after 'Tobacco'.

- 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.

Figure 1: Inflation rates

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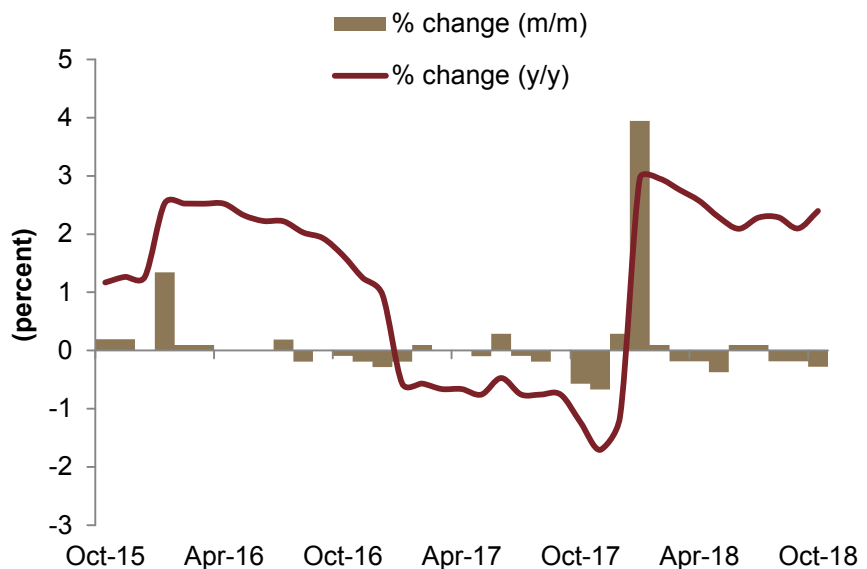
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Recent Developments

The latest General Authority for Statistics (GaStat) inflation released for October shows that prices rose by 2.4 percent year-on-year, and declined by 0.3 percent month-on-month. In the year-to-October, prices have risen by a yearly average of 2.5 percent, despite the introduction of the 5 percent value-added tax (VAT) and utility and fuel price reform at the turn of the year.

In the year-to-October, prices rose by a yearly average of 2.5 percent.

The inflation rate in October, at 2.4 percent, is the highest in seven months, compared to a rise in September by 2.1 percent, year-on-year. However, on a month-on-month basis, prices continued to slow, by 0.3 percent in October and 0.2 percent in September, indicating a gradual slowdown in prices as the local economy is adjusting to VAT, utility price reform, and other structural changes in the labor market.

CPI basket groups

'Food & beverages' prices rose by 6.3 percent year-to-October.

'Food and beverages' prices rose by 6.3 percent year-to-October. Looking at sub-group data, we find that the main rises in food prices, year-to-October, came from fish, followed by bread and cereals, which were affected by the rise in international cereal prices, measured by the FAO (Food and Agriculture Organization of the United Nations). In the year-to-October 2018, the FAO cereals price index was up by an average of 9.2 percent. Meanwhile, the FAO food price index declined by an average of 2.8 percent, compared to an increase by 9.9 percent during the same period last year. Looking ahead, we expect food prices to slow following this international trend, as the 'food and beverages' group contain several imported items.

'Rentals for housing' declined by an average of 2.9 percent year-to-October.

'Housing and utilities' prices were marginally down by 0.7 percent year-to-October, despite the spike in the sub-item 'electricity and fuels' by 24.3 percent in the year-to-October, due to the fuel and utility price reform enacted at the start of the year. This slowdown in prices is likely to be due to the impact of 'rentals for housing', a sub-item with a large weight in the segment, which declined by an average of 2.9 percent year-to-October (Figure 2).

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

	Weights	Month-on-month			Year-on-year		
		Sep-18	Oct-18	Contribution, ppt	Sep-18	Oct-18	Contribution, ppt
Food & beverages	18.8	1.7	2.7	0.04	6.8	7.3	1.31
Housing & utilities	25.3	-0.1	-0.4	-0.21	-3.2	-3.6	-0.97
Tobacco	0.7	0.0	0.0	0.00	10.0	10.1	0.12
Clothing & footwear	6.2	-1.8	-1.8	-0.02	-6.4	-4.9	-0.29
Furnishing & maintenance	8.5	-3.0	-2.9	-0.03	2.2	2.8	0.23
Health	2.3	-2.9	-2.6	0.00	4.1	4.0	0.09
Transport	9.9	-3.2	-3.2	-0.04	11.1	11.5	1.17
Communication	8.5	-3.0	-3.1	0.00	1.4	1.4	0.11
Recreation & culture	3.4	-3.7	-3.8	0.00	2.2	3.2	0.10
Education	4.2	2.0	3.0	0.00	0.2	0.2	0.01
Restaurants & hotels	6.5	-3.3	-2.8	-0.01	8.4	8.6	0.55
Misc. goods & services	5.7	-3.3	-2.8	-0.01	0.4	0.1	0.01
Core inflation*	**55.9**	**-0.1**	**-0.2**	**-0.12**	**3.1**	**3.5**	**1.92**
General index	**100.0**	**-0.2**	**-0.3**	**-0.28**	**2.1**	**2.4**	**2.40**

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

As 'rentals for housing' is exempted from VAT, we see this declining trend as largely correlated with latest data showing that the total number of foreigners in the Saudi labor market has declined by around 1.1 million since the start of 2017 up to the end of Q2 2018, possibly indicating a significant rise in final exit visas, and therefore resulting in a reduction in demand for housing rentals.

Sakani program is expected to introduce around 51 thousand additional units in December 2018.

Additionally, the slowdown is likely to be affected by 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 more than 560 thousand units to citizens since launching in February 2017, with housing units accounting for 42 percent of total units. (Figure 3). In December 2018, the MOH is expected to introduce around 51 thousand units in order to reach the planned target of providing 350 thousand units during 2018. In fact, November saw a significant rise in the number of delivered housing units by the Sakani program, with units increasing by 41 percent year-on-year, and by 55 percent month-on-month.

'Transportation' prices saw one of the highest growth year-to-October, by 10.5 percent, after 'Tobacco'.

'Transportation' prices saw one of the highest growth rates among the CPI basket groups in the year-to-October, by 10.5 percent, coming second after 'Tobacco'. Apart from the impact of the fuel price reform at the start of the year, 'transport' inflation rates were marginally up during September and October, boosting the year-to-October average. In fact, there was a decline in prices month-on-month during this period, however, prices were higher year-on-year affected by lower prices during the same time last year (September and October 2017) in the sub-groups 'purchase of vehicles' and 'transport services' inflating the year-on-year inflation rates during the same months in 2018 (Figure 4).

Consumer Spending

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

Since the beginning of the year, annual growth in POS sales has been higher for all sectors, except for transportation, education and telecommunication (Figure 5). The average year-to-October rise in 2018 was 11 percent, compared to 8 percent in the same period last year. Compared with last year, we find significant rises in spending on 'restaurants and hotels' and 'food and beverages' segments.
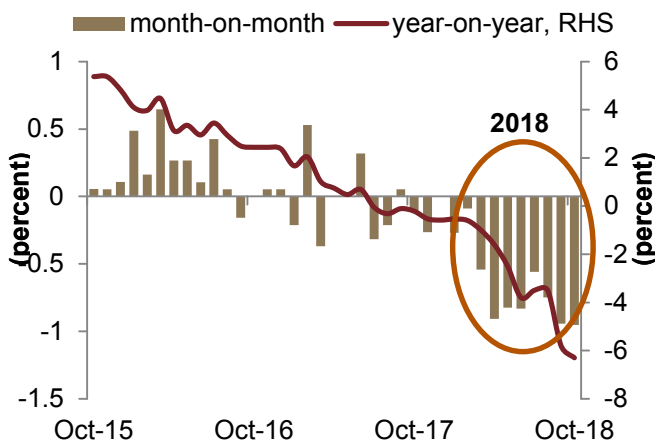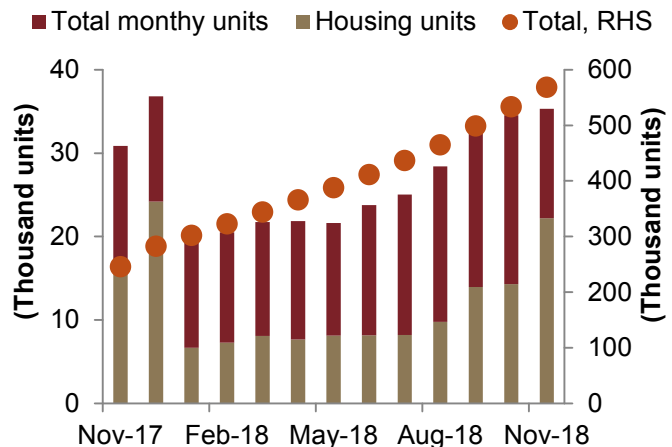
Figure 2: Rentals for Housing

Figure 3: Ministry of Housing "Sakani" units

Meanwhile, lower spending averages on 'transportation' during the course of the year could reflect a slowdown in fuel consumption, in response to the utility and fuel price reform that took place at the start of the year.

Looking at the average sales per transaction, the year-to-date average have not seen any change compared to the same period last year. Year-to-date average showed a decline by 19.8 percent in both 2017 and 2018 (Figure 6).

Outlook

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. Despite the challenges that were expected to arise with the inflation rates, we believe that the payments of the Citizen's Account (Figure 7), which have reached a total of SR27.5 billion over the past year, 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.

In 2019, we expect inflation rates to average around 1.1 percent.
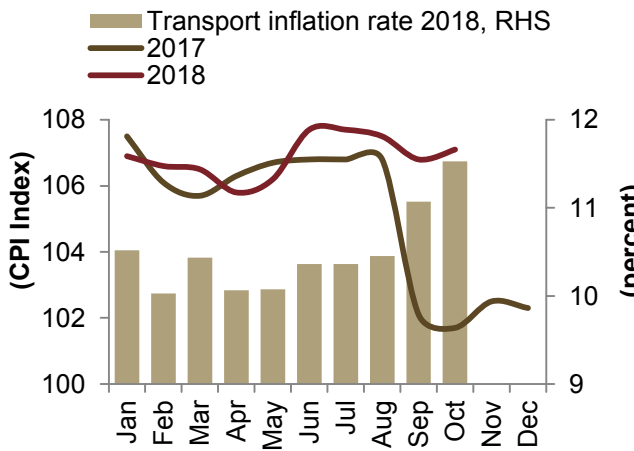
Figure 4: Prices in the Sub-group 'Transport Services

Figure 5: POS Sales Growth, by Sector
(year-to-October)

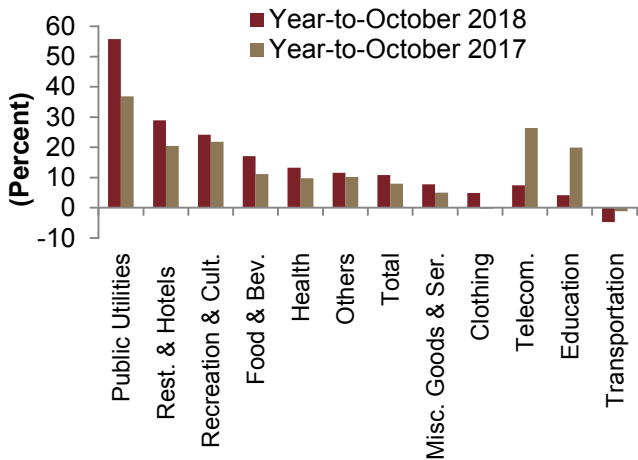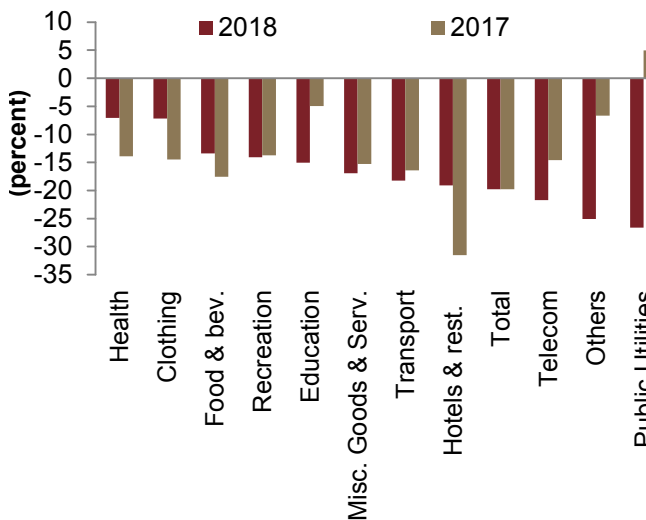**Figure 6: POS Sales per Transaction, by Sector**
(year-to-October)

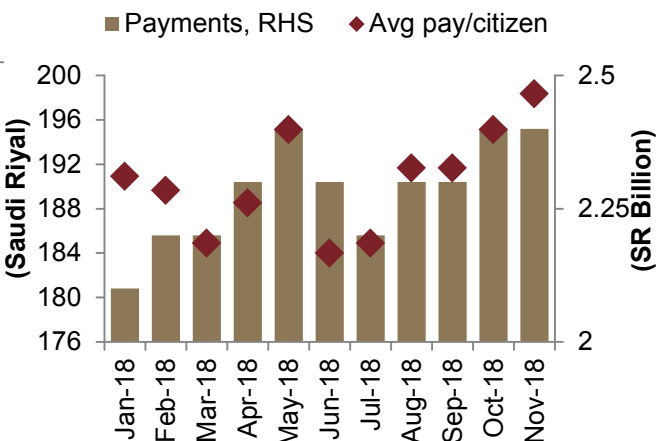**Figure 7: Payments of the Citizen's Account**

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