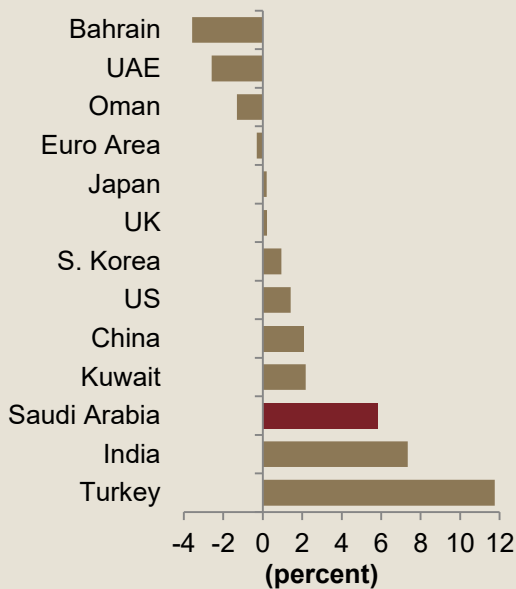




Saudi CPI inflation
(percent)

	Average Inflation	Year-to-date
Q3 2020	6.0	2.7
Q2 2020	0.9	1.1

Inflation Rates in Trade Partners (latest)



Inflationary pressure in Q3, as anticipated

- The latest General Authority for Statistics (GaStat) September inflation release shows that prices rose by 5.7 percent year-on-year, and declined by 0.2 percent month-on-month.
- Overall, prices rose by an average of 6 percent during Q3 (compared to 0.9 percent in Q2), reflecting the impact of higher VAT since July 2020.
- Meanwhile, within the 'food and beverages' segment, prices rose by a sizable 13.5 percent year-on-year in Q3, spurred not only by VAT hikes, but also by higher local household consumption of food products during the summer season and Eid Al-Adha break.
- At the same time, 'transportation' prices rose by an average of 7.7 percent year-on-year during the quarter, boosted by the notable rise in the sub-group item 'purchases of vehicles'.
- Also during the third quarter, although POS transactions slowed immediately after the implementation of VAT in July, some recovery in POS transactions was observed in and around Eid Al-Adha break.
- Looking ahead into Q4, some sectors are still not expected to hit full capacity until at least year end, especially sectors such as travel, hotels and restaurants, tourism and entertainment, thereby capping any major rises in spending.
- Taking into account the recent trends, we have maintained our inflation forecast for full year 2020 at 3 percent and 3.2 percent for full year 2021. That said, the main risk to our forecast relates to a second wave of COVID-19 in the Kingdom, which, if it were to transpire, would likely affect consumption and prices negatively in Q4, or Q1 2021.

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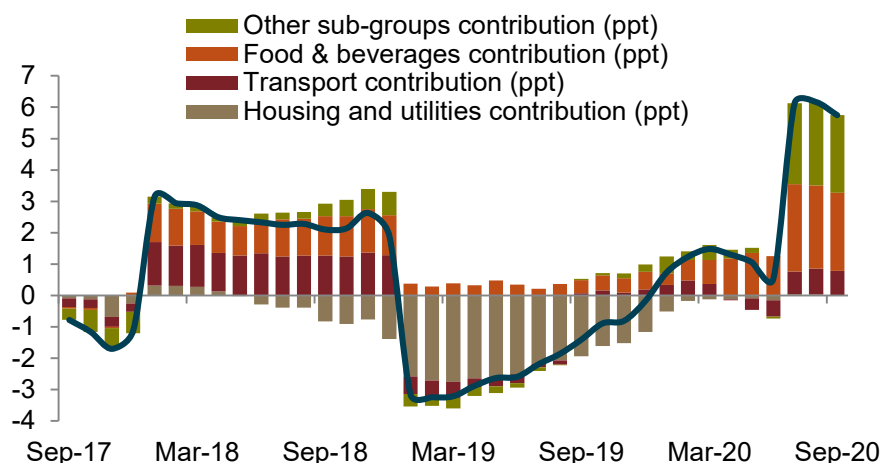
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Figure 1: Inflation rates





Recent Developments

Prices rose by an average of 6 percent during Q3 compared to 0.9 percent in Q2.

We have maintained our inflation forecast for full year 2020 at 3 percent and 3.2 percent for full year 2021.

'Food & beverages' prices rose by an average of 13.5 percent year-on-year in Q3.

'Housing & utilities' prices rose by an average of 0.1 percent year-on-year in Q3.

We see the 'rentals for housing' segment continuing to show further declines.

The latest General Authority for Statistics (GaStat) September inflation release shows that prices rose by 5.7 percent year-on-year, and declined by 0.2 percent month-on-month. Overall, prices rose by an average of 6 percent during Q3 (compared to 0.9 percent in Q2), reflecting the impact of higher VAT since July 2020.

Taking into account the recent trends, we have maintained our inflation forecast for full year 2020 at 3 percent and 3.2 percent for full year 2021. That said, the main risk to our forecast relates to a second wave of COVID-19 in the Kingdom, which, if it were to transpire, would likely affect consumption and prices negatively in Q4, or Q1 2021.

CPI Basket Groups

'Food and beverages' prices rose by an average of 13.5 percent year-on-year in Q3, spurred, in part, by a hike in VAT from July onwards, but also by higher local household consumption of food products during the summer season. In addition, higher food consumption was observed during Eid, with Eid Al-Adha this year taking place between the last week of July and the first week of August (Figure 2).

'Housing and utilities' prices rose by an average of 0.1 percent year-on-year in Q3 (compared to -0.5 percent in Q2), as the 'rentals for housing' segment continued to decline. Meanwhile, the 'maintenance of the dwelling' segment rose by 8.6 percent in Q3 (compared to a decline of 1 percent in Q2), which, in addition to the rise in VAT, likely reflects lower supply of such services and pent-up demand after lifting of the containment measures related to COVID-19 (Figure 3).

Looking ahead, we see the 'rentals for housing' segment continuing to show further declines due to a number of developments. Firstly, a recent royal decree exempted all real estate transactions from VAT, whilst at the same time introducing a real estate transaction tax of 5 percent. The royal decree also stated that the government will bear the 5 percent transaction tax for first time buyers purchasing a property up to the value of SR1 million (compared to the previous VAT exempted threshold of SR850 thousand). We see both these changes raising the level of home ownership amongst citizens, in turn, pushing rental rates downwards. At the same time, higher supply of affordable housing under the Ministry of Housing (MOH)'s Sakanj program, has also continued to encourage citizens to move

Figure 2: Inflation rates in 'food & beverages' and selected sub-group items (year-on-year change)

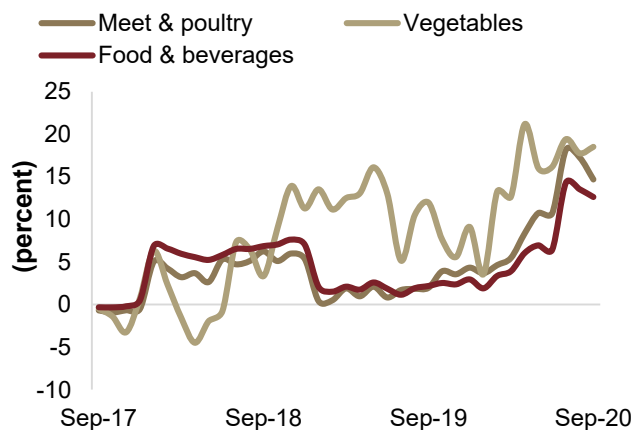
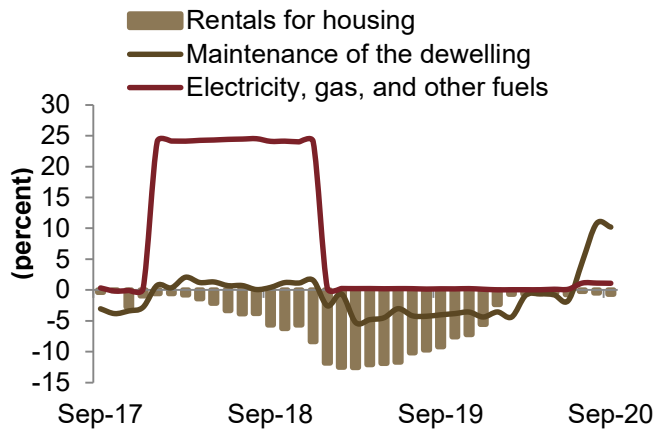


Figure 3: Inflation rates in 'Housing & Utilities' and selected sub-group items (year-on-year change)





The Sakani program still has around 24 thousand units to deliver during the remainder of 2020.

'Transportation' prices rose by an average of 7.7 percent year-on-year in Q3, versus - 3.1 percent in Q2.

POS transactions in the year-to-mid-October were 22 percent higher compared with the same period last year.

During Eid Al-Adha break, the rise in POS transactions was more visible in 'food & beverages', 'clothing', and 'recreation & culture'.

Overall, general growth in POS transactions is likely to have been boosted by the encouragement of using cashless payment methods.

away from rental properties. In fact, the Sakani program still has around 24 thousand units to deliver during the remainder of 2020 (Figure 4). Lastly, the decline in the number of expats and dependents will result in lower demand for rental properties, with private health insurance data suggesting almost 800 thousand such departures since the start of the year.

'Transportation' prices rose by an average of 7.7 percent year-on-year in Q3, (versus -3.1 percent in Q2). Within this, the 'purchases of vehicles' segment (which makes up 63 percent of 'transport' weight) saw a notable rise by 7.7 percent year-on-year in Q3 (compared with 2.2 percent in Q2). Conversely, the sub-group item 'fuels and lubricants for transport equipment' (which makes up 15 percent of 'transport'), was down by 11 percent in Q3 (Figure 5), as gasoline prices trended lower than the same period last year.

Consumer Spending

POS transactions in the year-to-mid-October were 22 percent higher year-on-year, primarily as result of huge rises at 'gas stations' (up 300 percent), 'food and beverages' (up 69 percent), and 'construction materials' (up 40 percent), versus the same period last year. Year-to-date rises came about despite lower POS transactions being observed immediately after a hike in VAT in July and severe lockdown measures during most of Q2.

In Q3, POS transactions slowed at the beginning of the quarter, before witnessing a rise during Eid Al-Adha break (over the last week of July and the first week of August). The rise was more visible in sectors such as 'food and beverages', 'clothing', 'recreation and culture', and 'jewelry'. Later in Q3, another rise in spending was seen in the 'education' segment around the last week of August and the first week of September, in-line with the virtual commencement of schools (Figure 6).

Overall, it is worth noting that a general growth in POS transactions is likely to have been boosted by the encouragement of using cashless payment methods during the pandemic, as part of the COVID-19 precautionary measures. This partially explains why ATM cash withdrawals (as proportion of both ATM cash withdrawals and POS transactions) have been declining in 2020 so far, at around 61 percent in August 2020, versus 72 percent over the same period last year (Figure 7).

Figure 4: Number of Sakani monthly housing units delivered to citizens

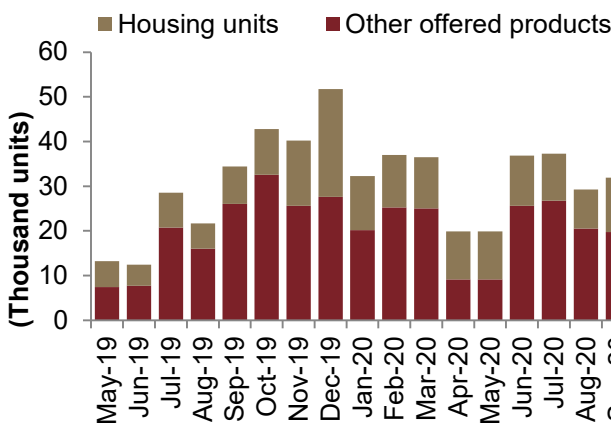
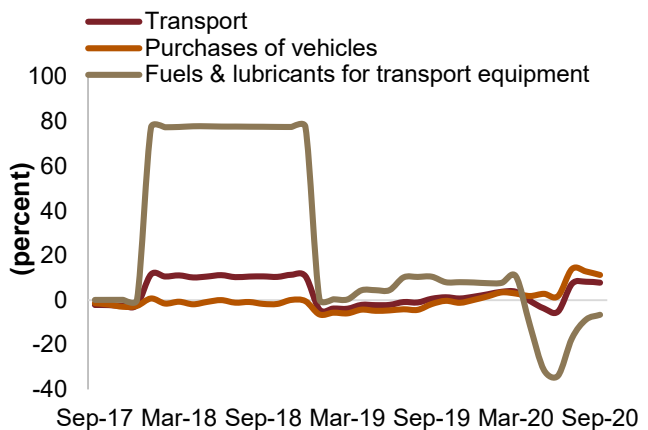


Figure 5: Inflation rates in 'Transport' and selected sub-group items (year-on-year change)





Despite a progressive easing of lockdown measures, our expectation is that some sectors will not hit full capacity until Q4, or even after.

The main risk to our forecast is related to a second wave of COVID-19 in the Kingdom, which would affect consumption and prices negatively in Q4, or indeed in early 2021, if it were to transpire.

Outlook

Looking forward, we expect consumer spending to be pressured until at least the end of the year. Despite a progressive easing of lockdown measures, our expectation is that some sectors will not hit full capacity until Q4 of this year, or possibly even after. In particular, sectors such as travel, hotels and restaurants, tourism and entertainment are likely to remain affected (with commercial air travel still prohibited), thereby capping any major rises in spending.

Taking into account the recent trends, we have maintained our inflation forecast for full year 2020 at 3 percent and 3.2 percent for full year 2021. In the remainder of 2020, we still expect monthly decline in prices until the end of the year as a result of subdued consumption, with businesses and retailers lowering end prices and, in some instances, absorbing some part of the VAT rises in the short term. That said, the main risk to our forecast is related to a second wave of COVID-19 in the Kingdom, which would affect consumption and prices negatively in Q4, or indeed in early 2021, if it were to transpire.

Figure 6: Point of sales transactions in selected sectors

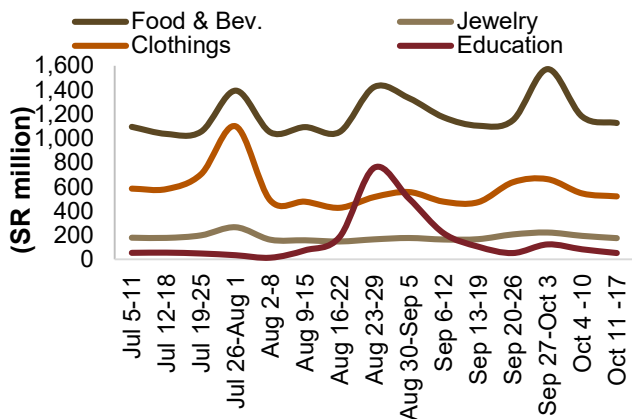


Figure 7: POS transactions vs. cash withdrawals (percent of total)

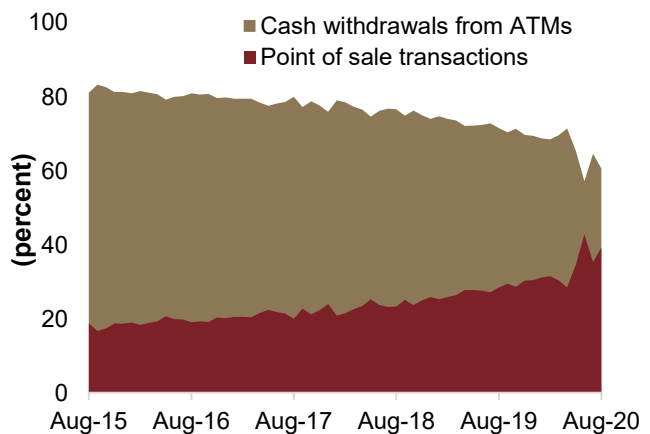




Table 1: Main highlights of Saudi CPI inflation
(percent)

	Weights	Year-on-year			Quarter-on-quarter		
		Q3-20	Q2-20	Contribution, ppt	Q3-20	Q2-20	Contribution, ppt
Food & beverages	18.8	13.48	6.47	2.64	7.62	3.53	0.52
Housing & utilities	25.5	0.10	-0.51	0.02	0.40	-0.56	0.06
Tobacco	0.6	12.95	1.18	0.09	11.48	0.11	0.03
Clothing & footwear	4.2	5.64	-0.57	0.35	6.53	0.17	0.14
Furnishing & maintenance	6.7	8.39	1.36	0.72	7.43	0.32	0.22
Health	1.4	2.09	-0.06	0.05	2.52	-0.02	0.02
Transport	12.6	7.74	-3.10	0.78	12.73	-5.11	0.49
Communication	5.6	9.59	-0.70	0.82	10.09	-0.06	0.28
Recreation & culture	3.1	2.68	-0.25	0.09	4.89	-0.92	0.06
Education	2.9	-1.95	1.20	-0.09	-2.75	-0.14	-0.11
Restaurants & hotels	5.6	7.38	0.48	0.50	7.75	-0.58	0.17
Misc. goods & services	12.6	5.37	1.95	0.32	4.94	0.50	0.10
General index	100.0	6.01	0.96		5.68	-0.16	

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