



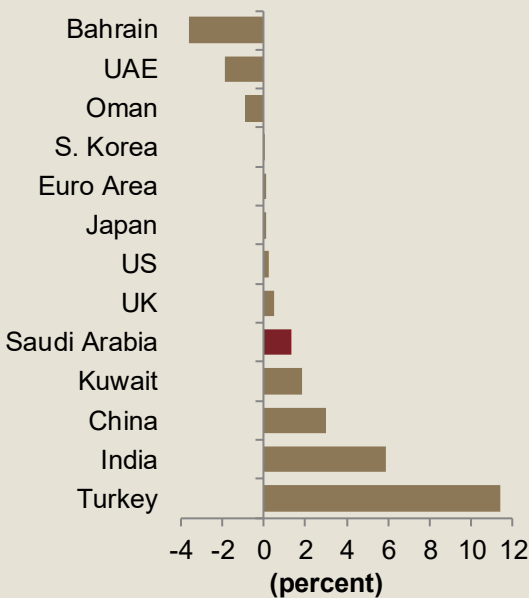
Saudi CPI inflation
(percent)

	Monthly change	Annual change
April 2020	-0.1	1.3
May 2020	-0.2	1.1

VAT Hike Resulting in Higher Inflation

- The latest General Authority for Statistics (GaStat) May inflation release shows that prices rose by 1.1 percent year-on-year, and declined by 0.2 percent month-on-month, compared to 1.3 percent year-on-year (and a decline by 0.1 percent month-on-month) in April.
- In the year-to-May, prices were almost flat (marginal change by -0.02 percent), despite lower consumption as a result of lockdown measures related to COVID-19 throughout most of Q2.
- ‘Food and beverages’ prices rose by 4.9 percent in the year-to-May, driven by higher local household consumption of food products during the lockdown, and higher consumption usually associated with the holy month of Ramadan.
- Meanwhile, ‘transportation’ prices declined in the year-to-May by 5.8 percent, mainly affected by the drop in gasoline prices.
- Looking ahead, in the near term we expect a rebound in consumer spending prior to VAT rising from 5 to 15 percent from 1st July, with weekly POS data showing a significant pick-up in activity during most of June.
- Despite a progressive easing of the lockdown, some sectors are still not expected to hit full capacity in Q3, particularly sectors such as travel, hotels and restaurants, tourism and entertainment, thereby capping any major rises in spending.
- Overall, we revised up our inflation forecast from 1.3 percent to 3 percent in 2020, reflecting the rise in VAT in mid 2020. The upward revision is based on the expectation of a single jump in inflation in July, at around 5.7 percent year-on-year, with monthly declines expected thereafter until the end of the year.

Inflation Rates in Trade Partners (latest)



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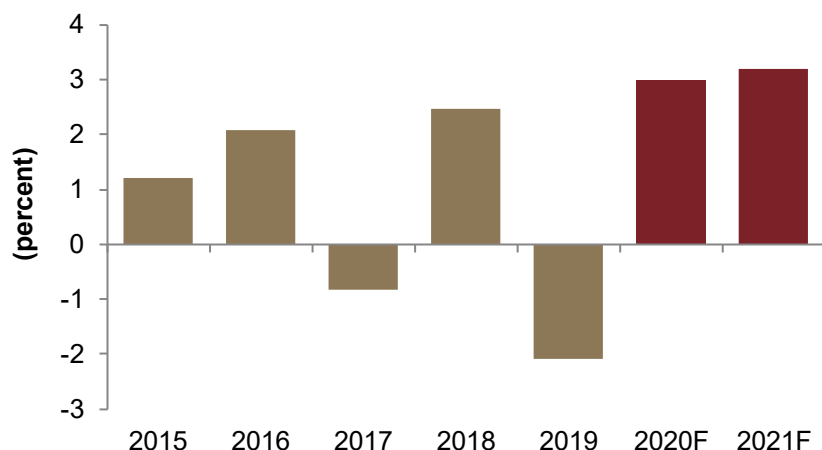
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Figure 1: Inflation forecasts





Recent Developments

The latest General Authority for Statistics (GaStat) May inflation release shows that prices rose by 1.1 percent year-on-year.

We revised up our inflation forecast to 3 percent, up from 1.3 percent previously.

Food prices in the Kingdom trended upwards, contrary to international food prices.

'Housing and utilities' prices declined by 0.7 percent in the year-to-May, as 'rentals for housing' continued to decline.

The latest General Authority for Statistics (GaStat) May inflation release shows that prices rose by 1.1 percent year-on-year, and declined by 0.2 percent month-on-month, compared to a rise by 1.3 percent year-on-year (and a decline by 0.1 percent month-on-month) in April. In the year-to-May, prices were almost flat (marginal change by -0.02 percent), despite lower consumption as a result of lockdown measures related to COVID-19 throughout most of Q2.

For full year 2020, we have revised up our inflation forecast to 3 percent, up from 1.3 percent previously, to reflect the impact of the planned rise in VAT from July 2020 onwards. We have also revised our inflation forecast to 3.2 percent, up from 2.7 percent previously, for 2021, for the same reason.

CPI Basket Groups

'Food and beverages' prices rose by 4.9 percent in the year-to-May, driven by higher local household consumption of food products during the lockdown, and higher consumption usually associated with the holy month of Ramadan (which began on the 24th of April). As a result, food and beverages prices in the Kingdom trended upwards, contrary to international food prices (Figure 2), with the Food and Agriculture Organization (FAO) index declining in recent months due to mounting inventories and weak import demand around the world.

'Housing and utilities' prices declined by 0.7 percent in the year-to-May, as 'rentals for housing' continued to decline (Figure 3). We see this trend as a result of two developments i) higher supply of affordable housing under the Ministry of Housing (MOH)'s Sakani program, which has encouraged citizens to move away from rental properties, and ii) the decline in the number of expats and dependents, with private health insurance data suggesting just over half a million such departures since the start of the year. Looking ahead, rentals for housing is expected to show more declines affected by the continuation of the above two factors. The Sakani program still has around 44 percent of its targeted 100 thousand units yet to deliver for 2020, and, as recently highlighted, we expect a total of 1.2 million expat departures in 2020 as a whole (not including expat dependents) which will weigh on rental prices during the year. (for more on this, please refer to our latest [labor market report](#)).

'Transportation' prices declined in the year-to-May by 5.8 percent, mainly affected by the drop in gasoline prices, which reflects the

Figure 2: Inflation rates in 'food & beverages' and the FAO (year-on-year change)

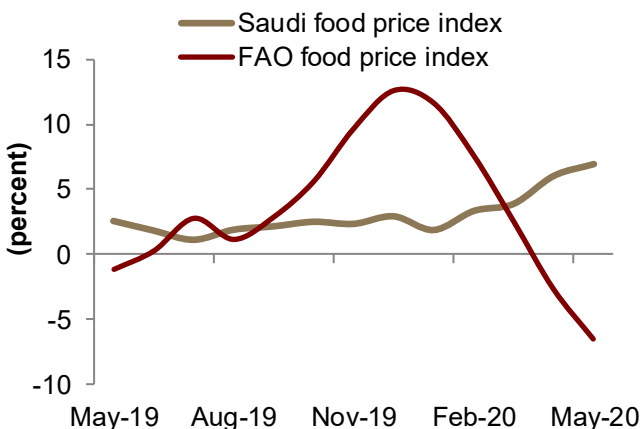
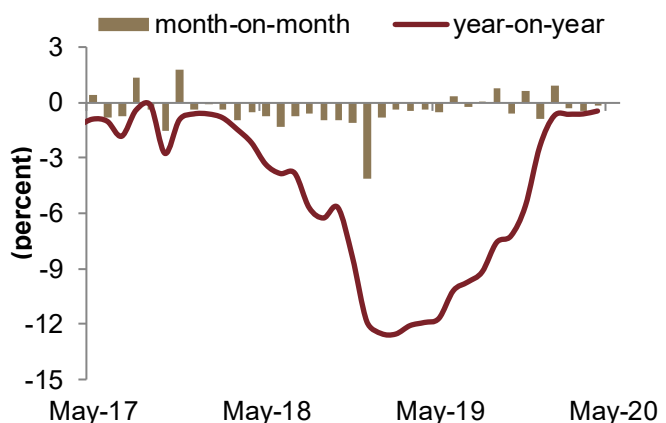


Figure 3: Rentals for housing





'Transportation' prices declined in the year-to-May by 5.8 percent, mainly affected by the drop in gasoline prices.

We expect to see a rise in consumption prior to the rise in VAT during May and June 2020.

We expect to see a hike in consumption, especially in education, public utilities, jewelry, furniture and electronics.

However, we do not expect to see a huge rise in imports prior to the VAT rise in July 2020.

steep decline in global oil prices during the same period with the sub-group item 'fuels and lubricants for transport equipment', down by 34 percent in the year-to-May.

The Rise in VAT in July 2020

Back in early May, as part of a number of austerity measures, the Ministry of Finance announced a rise in the level of VAT from 5 to 15 percent from July 2020 onwards. As a result, and similar to the trend seen when VAT was first introduced back in January 2018, we expect to see a rise in consumption during May and June 2020, prior to a second hike in July.

2018 VAT and 2020 VAT

The implementation of the 5 percent VAT in January 2018 saw a hike in consumption in Q4 2017, especially in December 2017 (Figure 4). Similarly, as we mentioned in our latest [chartbook June 2020](#), we expect to see another hike in consumption, especially in certain sectors such as education, public utilities, jewelry, furniture and electronics. In fact, latest weekly data from SAMA shows a hike in POS transactions in many sector during the first three weeks of June, which was also exacerbated by easing of lockdowns.

To meet the rise in demand on goods and services back in 2017, a number of items saw higher imports during Q2 2017, such as vehicles, food and textile products (Figure 5), and also apparent in the rise in the number of letters of credit (LCs). For example, new LCs from motor vehicles rose by 105 percent year-on-year in July 2017, five months before the VAT implementation in January 2018. With the current VAT rise, however, we do not expect to see a similar rise in imports, for two main reasons. Firstly, COVID-19 and the accompanying lockdowns around the world have disrupted global supply chains, with significantly lower levels of global trade seen in the last few months. Secondly, the short period of time between the announcement of the second rise (May 10th) and the implementation (July 1st) does not afford enough time for the an adequate importation of goods prior to the rise. We note that the first round of VAT rises was announced more than a year ahead of implementation. As such, we expect retailers to sell most of their stock (supplemented by some imports) especially since April saw a significant decline in sales and consumer spending.

Figure 4: POS transactions in 2017
(average Jan-Nov 2017 vs. December 2017)

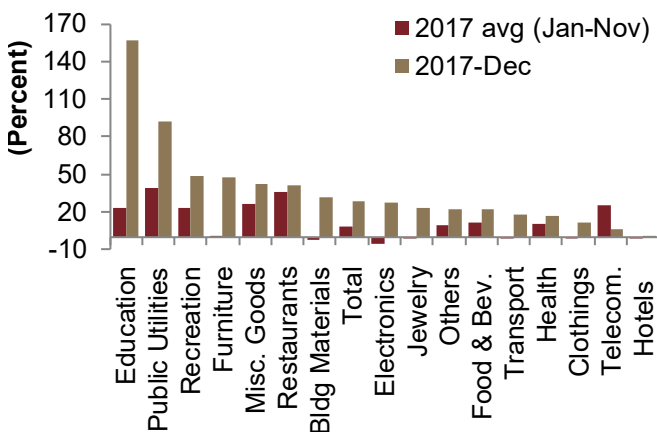
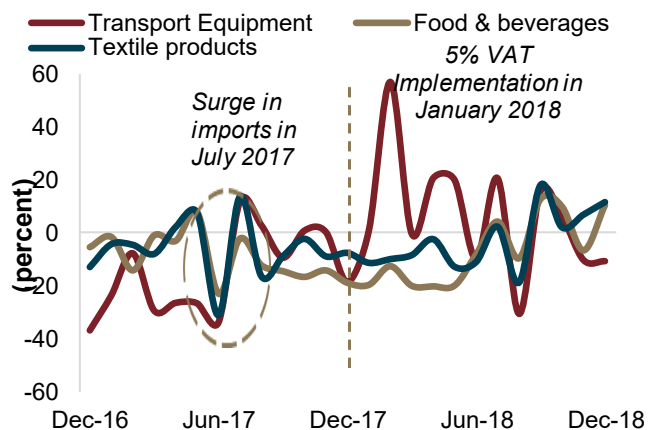


Figure 5: Imports in 2017 and 2018





Consumer Spending

Annual growth in POS transactions in the year-to-June (3rd week of June), was 9 percent higher compared with the same period last year.

Despite the large decline in April, annual growth in POS transactions in the year-to-June (3rd week of June), were 9 percent higher compared with the same period last year. A hike in POS transactions in both gas stations (540 percent) and food and beverages (68 percent), compared with the same period last year, has supported growth in the current year, despite the lockdown in most parts of Q2 (Figure 6).

More specifically, POS transactions in food and beverages saw a significant rise during March and April, as demand on food retailers rose during the lockdown, in addition to the higher food consumption usually associated with the holy month of Ramadan, which began on the 24th of April. Meanwhile, the rise in POS transactions at gas stations was visible during the first week of June, as lockdown measures were significantly eased in most parts of the Kingdom, added to the fact that gasoline prices reflected low global prices.

However, it is worth noting that 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 precautions measures. As such, the rise in POS transactions in many sectors might reflect this trend in recent months, especially in sectors that were usually associated with cash payments such as gas stations.

Outlook

We expect consumer spending to trend downwards in July and be pressured until the end of the year.

Looking forward, whilst consumer spending rose in May and most likely in June too (as per partial data for June), we expect this to trend downwards in July and be pressured until the end of the year (Figure 7). Despite a progressive easing of the lockdown, some sectors are still not expected to hit full capacity in Q3, particularly sectors such as travel, hotels and restaurants, tourism and entertainment, thereby capping any major rises in spending. Moreover, as recently highlighted, we expect a total of 1.2 million expat departures in 2020 as a whole (not including expat dependents), to weigh on consumption during the year.

Business owners might lower their prices to meet lower demand.

In terms of prices, we expect business owners to lower their prices in order to meet the lower levels of demand. In addition, we also expect the rise in tariffs imposed recently on a number of imported

Figure 6: Point of sales transactions by sector
(year-to-20 June) - (year-on-year %change)

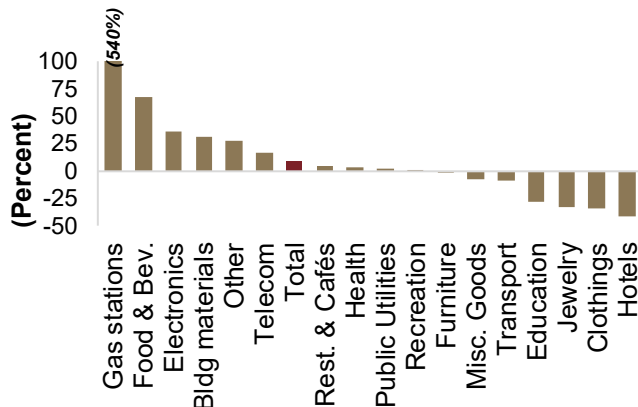
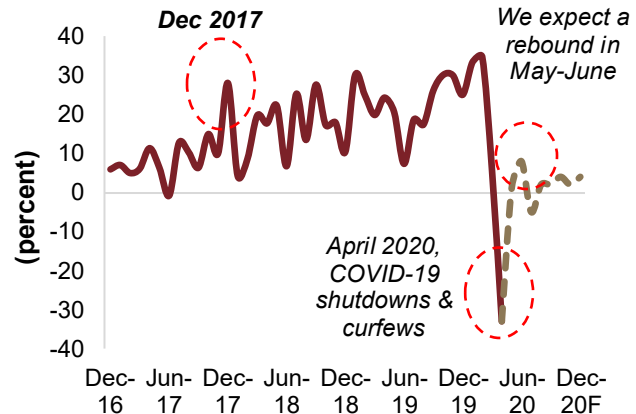


Figure 7: Point of sales transactions forecast
(year-on-year change)





We expect 'housing and utilities' to continue seeing deflationary pressure due to 'rentals for housing' being affected by continued expat departures.

Overall, we revised up our inflation forecast from 1.3 percent to 3 percent in 2020.

items to have only a marginal impact on prices, with most affected items being within building materials.

Also, we expect 'housing and utilities' to continue seeing deflationary pressure due to 'rentals for housing' being affected by continued expat (and dependent) departures, in addition to the rising rate of home ownership provided by Sakani (Figure 8). With 'housing and utilities' weights being even higher in Gastat's recent revision (Table 1, Box 1), overall inflation is likely to be sensitive to changes in this segment.

Finally, prices in the 'transport' segment are expected to trend lower than last year, affected by lower international gasoline prices (Figure 9), which will also have a larger impact on the inflation rate with this segment's weight rising in the latest revision.

Overall, we have revised up our inflation forecast from 1.3 percent to 3 percent in 2020, and from 2.7 percent to 3.2 percent in 2021, reflecting the rise in VAT in mid 2020. The upward revision is based on the expectation of a single jump in inflation in July, at around 5.7 percent year-on-year, with monthly declines expected thereafter until the end of the year, as a result of subdued consumption during the second half of the year, with businesses and retailers potentially lowering end prices and, in some instances, absorbing some part of the VAT rises in the short term.

Table 1: CPI basket segments weights, revised and old series

Items	Old weight	New weight
Housing & Utilities	25.3	25.5 ↑
Food & Beverages	18.8	18.8 =
Transport	9.9	13.1 ↑
Furnishings & household Equipment	8.5	6.7 ↓
Communication	8.5	5.6 ↓
Restaurants & Hotels	6.5	5.6 ↓
Clothing & Footwear	6.2	4.2 ↓
Misc. Goods & Services	5.7	12.6 ↑
Education	4.2	2.9 ↓
Recreation & Culture	3.4	3.1 ↓
Health	2.3	1.4 ↓
Tobacco	0.7	0.6 ↓

Figure 8: Number of Sakani monthly housing units delivered to citizens

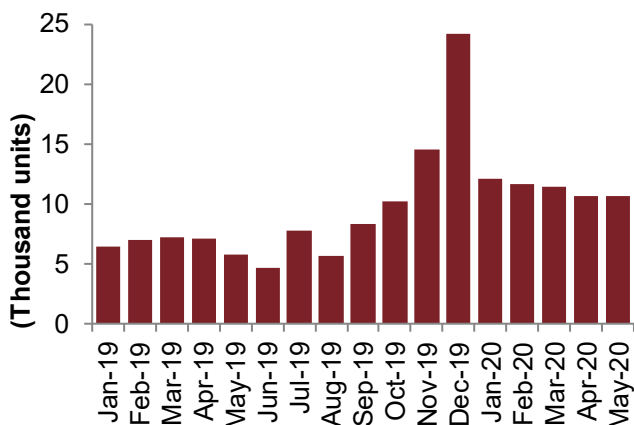
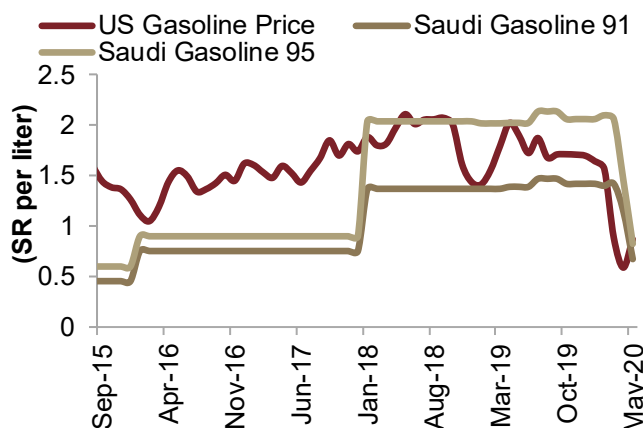


Figure 9: International and local gasoline prices





Box 1: Revision to CPI data

GaStat recently revised consumer price data, updating the base year from 2013 to 2018.

The main change in the revised CPI basket weights is shown in the 'transport' and 'miscellaneous goods & services' segments.

The weight of 'housing and utilities' segment is now revised upward for the third time between 2007 and 2020.

GaStat recently revised consumer price data, updating the base year from 2013 to 2018, and consequently has revised the weights on the subcomponent series. The main change in the revised CPI basket weights is shown in the 'transport' segment, increasing from 9.9 to 13.1 percent, and in the weight of 'miscellaneous goods & services' increasing from 5.7 to 12.6 percent (Figure 10 and Table 1).

The current CPI revision comes two years after the previous revision back in 2018, when the base year was updated from 2007 to 2013, and the CPI basket weights were also revised. The weight of 'housing and utilities' segment is now revised upward for the third time between 2007 and 2020, indicating how local consumers are increasingly spending on this segment during the past 20 years, to account for a quarter of their expenditure (the segment includes rentals for housing, electricity and fuels, water supply and maintenance services, Figure 11).

However, we believe that consumer preferences might have further developed since 2018, as a number of economic reforms and structural changes took place in the past few years, such as the VAT implementation in the beginning of 2018, higher consumption on entertainment during 2019, and the changes in consumption affected by the increasing number of expat departures.

Figure 10: Revised inflation rates
(year-on-year change)

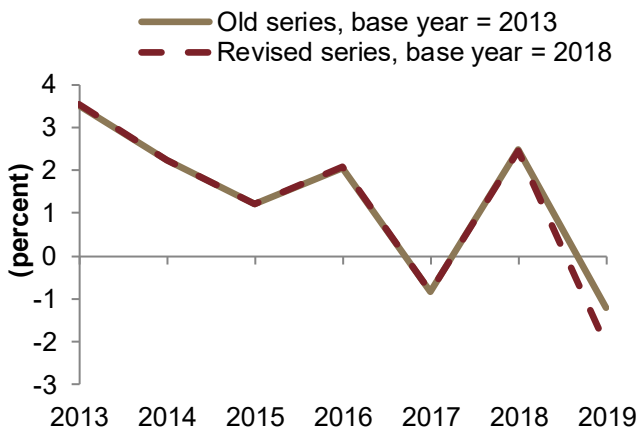


Figure 11: Segments weights in the CPI basket

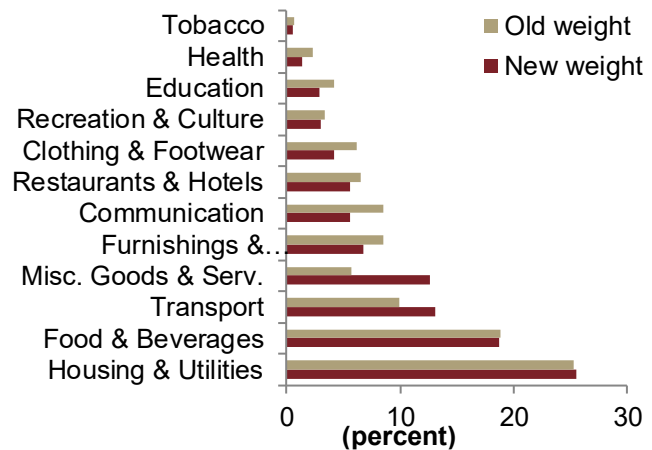




Table 2: Main highlights of Saudi CPI inflation
(percent)

	Weights	Month-on-month			Year-on-year		
		May-20	April-20	Contribution, ppt	May-20	April-20	Contribution, ppt
Food & beverages	18.8	1.2	2.0	0.2	7.0	6.1	1.4
Housing & utilities	25.5	-0.1	-0.3	0	-0.4	-0.5	-0.1
Tobacco	0.6	0.1	0.2	0	1.0	1.0	0.0
Clothing & footwear	4.2	0.2	0.0	0	-0.9	0.2	-0.1
Furnishing & maintenance	6.7	-0.2	0.2	0	1.4	1.3	0.1
Health	1.4	0	0.1	0	-0.4	-0.3	0
Transport	12.6	-3.2	-3.1	-0.3	-3.8	-0.4	-0.4
Communication	5.6	0	-0.2	0	-0.8	-0.6	-0.1
Recreation & culture	3.1	0	-0.1	0	0.8	0.7	0
Education	2.9	0	0.0	0	1.2	1.2	0.1
Restaurants & hotels	5.6	0.1	-0.3	0	0.6	0.7	0
Misc. goods & services	12.6	0.4	0.1	0	2.4	1.7	0.1
General index	100.0	-0.2	-0.1	-0.2	1.1	1.3	1.1

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