

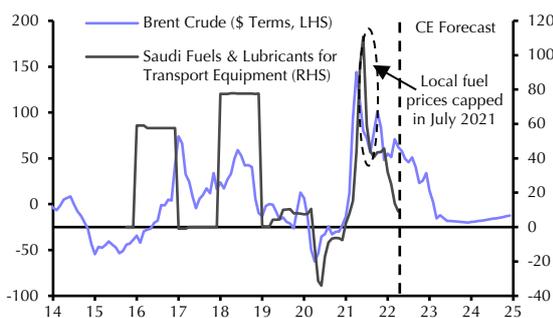


# MENA ECONOMICS UPDATE

## Saudi inflation to stay in check, risks lie to downside

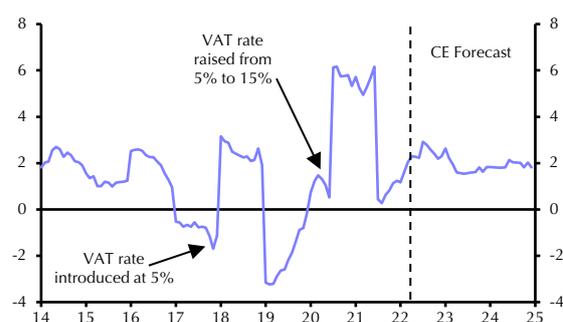
- **Headline inflation in Saudi Arabia rose to 2.3% y/y in April and we think that it will continue to accelerate over the coming months. Unlike in other parts of the emerging world, however, inflation will not surge to multi-year highs and, if anything, the risks to our inflation forecast lie to the downside.**
- Data released on Sunday showed that Saudi Arabia's headline inflation increased from 2.0% y/y in March to 2.3% y/y in April. The breakdown of the data showed that the increase was once again driven by stronger food inflation, which rose from 3.0% y/y in March to 4.3% y/y last month. Our measure of non-food inflation was unchanged at 1.8% y/y in April, with inflation easing in most major price categories.
- **Over the rest of this year, we think that inflation will continue to drift upwards, although it is likely to remain much lower compared to other parts of the emerging world.** The war in Ukraine has pushed global food prices to record highs in recent months and, given Saudi Arabia's dependence on imported foodstuffs – its food self-sufficiency ratio (that is consumption relative to production less net exports) is one of the lowest among major EMs – this will continue to push food inflation higher over the coming months.
- **The path of inflation in non-food price categories is likely to be mixed.** As the economy has re-opened, inflation within service sectors (recreation and culture and hotels and restaurants) has accelerated and is likely to pick up further. But the capping of local fuel prices at their July level meant that fuel inflation stood at just 9.3% y/y in April, compared with the near 40% y/y implied by global fuel prices. (See Chart 1.) So long as the cap remains in place, fuel inflation will ease a bit further.
- More generally, despite non-oil sector GDP being above its pre-virus trend at the end of last year, there are still signs of slack in the economy. The unemployment rate stood at 6.9% in Q4 2021, well above the nadir of 5.5% in mid-2019. All told, we expect non-food inflation will rise but only very gradually.
- **All told, we think that Saudi headline inflation will peak at around 3.0% y/y in Q3 and ease back over the rest of this year, averaging 2.3% for 2022 as a whole.** (See Chart 2.) Inflation will continue to slow over 2023-24 as the spillovers from the war in Ukraine fade and re-opening inflation dissipates – we expect inflation of 1.8% and 2.0% in 2023 and 2024 respectively.
- **That being said, there are risks to our forecasts on both the upside and the downside depending on how, as we expect, policymakers loosen fiscal policy on the back of high oil prices.** If the authorities opt to increase expenditure (the 2022 budget outlined a 6% cut to central government spending) that is likely to stoke demand and push up inflation further than we currently expect.
- **In contrast, if the government cuts the VAT rate, as previously indicated by Crown Prince Mohammed bin Salman, this would shave nearly 2.5%-pts off headline inflation in the very near-term** (assuming a cut from 15% to 10%). As consumers spend the windfall, we would expect inflation to pick up again over the following months albeit from a lower base. Given that officials have suggested that a VAT cut would be the first step to loosening policy, the risks to our inflation forecast seem to lie more to downside.

**Chart 1: Brent Crude & Saudi Fuels & Lubricants for Transport Equipment Inflation (% y/y)**



Sources: General Authority for Statistics, CEIC, Capital Economics

**Chart 2: Consumer Prices (% y/y)**



Sources: General Authority for Statistics, CEIC, Capital Economics



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