Abstract

Objective: This research is about inflation in Saudi Arabia over the period from 1970 to 2021. The aim of this paper is to analyze the inflation in Saudi Arabia, to determine the effect of financial structure of Saudi Arabia on the future changes in overall inflation.

Methodology: The way used to study inflation in this research is to search and get information from different available data, such as government websites and previous studies. Financial structure of Saudi Arabia was analyzed to understand inflation in the country.

Results: Economy of the kingdom of Saudi Arabia mainly relies on petro-chemical and oil export as inflation rate has been very low during past decades.

Limitations: This study caters with the future changes in overall inflation. Dramatic price changes in different sectors like food, household, and house rent were also studied. Fluctuations in the general price level which occur on a successive basis were then related to specific causes.

Practical Implications: Different causes of raising prices are discussed, along with the steps taken by the government to minimize inflation effects on the public of the Kingdom of Saudi Arabia. This study also provides valuable information for future researchers interested in analyzing the effects of inflation on different contexts.

Keywords: Saudi Arabia; Inflation; Economy; Oil; Prices

JEL Codes: G13; G17; G28; H25

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Inflación en Arabia Saudí

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Resumen

Objetivo: Esta investigación trata sobre la inflación en Arabia Saudita durante el período de 1970 a 2021. El objetivo de este documento es analizar la inflación en Arabia Saudita, para determinar el efecto de la estructura financiera de Arabia Saudita en los cambios futuros en la inflación general.

Metodología: Búsqueda y obtención de información proveniente de diferentes datos disponibles, como sitios web gubernamentales e informes. Análisis de la estructura financiera de Arabia Saudita para comprender la inflación en el país.

Resultados: La economía del Reino de Arabia Saudita depende principalmente de la petroquímica y la exportación de petróleo allí, ya que la tasa de inflación ha sido muy baja durante las últimas décadas.

Limitaciones: Este estudio contempla los cambios futuros en la inflación general. También se estudiaron los cambios drásticos de precios en diferentes sectores como los de los alimentos, el hogar y el alquiler de viviendas. Las fluctuaciones en el nivel general de precios que se producen de forma sucesiva se relacionan con causas específicas”.

Implicaciones prácticas: Este trabajo ayuda a comprender las diferentes causas del aumento de los precios, junto con las medidas adoptadas por el gobierno para minimizar los efectos de la inflación en el país. También proporciona información valiosa para que futuros investigadores puedan analizar los efectos de la inflación en otros contextos.

Palabras clave: Arabia Saudita; Inflación; Economía; Petróleo; Precios

Códigos JEL: G13; G17; G28; H25

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沙特阿拉伯的通货膨胀

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文章摘要

研究目标：此项研究是关于沙特阿拉伯1970年至2021年期间的通货膨胀。本文的目的是分析沙特阿拉伯的通货膨胀，以确定沙特阿拉伯的金融结构对整体未来通货膨胀变化的影响。

分析方法：在这项研究中，研究通货膨胀的方法是从不同的可用数据库中搜索和获取信息，如政府网站和该领域的前期研究。对沙特阿拉伯的财务结构进行了分析，以了解该国的通货膨胀。

研究成果：沙特阿拉伯王国的经济主要依赖于石化产品和石油出口，所以近几十年来通货膨胀率一直很低。

研究局限：这项研究迎合了未来整体通货膨胀的变化。还研究了不同方面的价格变化，如食品、家庭和房屋租金。总体价格水平的连续波动与特定原因有关。

实际应用：此研究调查了提高价格的不同原因，以最大程度地减少对沙特阿拉伯王国公众的通货膨胀影响。此项研究还为未来的研究人员提供了有价值的信息，该研究人员有兴趣分析通货膨胀对不同情况的影响。

关键词：沙特阿拉伯; 通货膨胀; 经济; 石油; 价格

JEL 代码：G13; G17; G28; H25

1. Introduction

The kingdom of Saudi Arabia was established in 1932, it covers an area of 2.23 million square kilometers with a population estimated about 24 million. Saudi Arabia’s single most important resource is oil, its reserves are estimated to be the largest in the world.

The oil sector on average accounts for nearly 64 per cent of gross domestic product (GDP), 90 per cent of the government’s budget revenue, and more than 90 per cent of its foreign exchange receipts. (Hitt & Abed)

Saudi Arabia has been the world leading oil producer and exporter, and its 262bn barrels of proven reserves constitute 25% of the world reserves. The economy is dominated by the oil sector. It makes up for 75% of government revenue and 95% of exports. The petrochemicals sector relies for its feedstock on gas, most of which is still associated with crude oil output. Oil revenue has been used to develop agriculture and other industries, “including iron and steel, construction materials, food processing and metal fabrication” (Oxford Economy).

Saudi Arabia’s riyal is pegged to the US$ (1$ is equal to 3.73 riyals). The banking system in Saudi Arabia consists of the Saudi Arabian Monetary Agency (SAMA, the central Bank) and 13 commercial banks. However, there has been a considerable increase in the number of branches.

The legislation promulgated in the 1960s provided SAMA with major control banking functions: issuance of the currency, management of the foreign reserves, and control of the commercial banks. Some important restrictions on SAMA remain. It may not extend credit to the government or to private entities, and because it may not contravene Islamic laws, it may not use the discount rate as an instrument of monetary policy. These restrictions obviously place limitations on SAMA in implementing its monetary policy and they are reflected in the structure of its assets and liabilities. (Hitt & Abed, 1974)

The country is vast, with widely dispersed settled areas. The Saudi Arabian authorities have sought to faster agricultural development through the construction of infrastructure facilities, land distribution, and the provision of technical assistance. (Hitt & Abed, 1974).

The Saudi government owns most of the public services (electricity, drinking water, communication, transportation, etc.) and owns the lion’s share of the large production companies, primarily Petro - chemical processing and manufacturing. This government is the dominant employer of local labor. It imposes almost no taxes on either sales or income. The monetary authority is not an independent agency and operates essentially under a pegged exchanged rate to US$. (Aljenrin, 2006).

The Saudi Arabia economic characteristics:

1) The structures of the economy are dominated by the oil sector.
2) The government owns all the natural resources, including oil.
3) Oil is the main source of income for the government.
4) There are no taxes imposed on either sales or income.
5) The government uses the oil revenue to finance its domestic expenditures to build the economy.
6) The Saudis import most of their needs for consumption and production from abroad. (Aljebrin, 2006).

The objective of this study is to analyze and study inflation in Saudi Arabia.

2. Inflation in Saudi Arabia (from 1970 to 2020)

I am starting this section with the 1970s and I will conclude with the year 2020. Aljebrin (2006) wrote a dissertation about the analysis of inflation in Saudi Arabia. The purpose of his study is to investigate the main determinants of inflation in developing oil-export based economies and to see if the main determinants of inflation are similar to other developing and developed economies. He found that the main determinants of inflation in developing oil-export based economies in the long run are growth of money, growth of non-oil GDP, and growth of oil price.

Moreover, in the short run, the main determinants of inflation are money growth and non-oil GDP growth. When inflation proceeds at an expected rate, various means to avoid its cost may exist, such as adjusting interest to increase or decrease the spending behaviors of consumers. Even if inflation is seen as an enhancing tool for the process of economic development, there are still long-term welfare costs in the form of distribution effects that only the rich see. Higher prices for goods and services imported from abroad and other external circumstances can result in transmitted effects to the domestic economy in the form of inflation as well. (Aljebrin). As we see in table 1 and chart 1, the inflation rate was varied; the highest rate was in 1975. The rate was stable from the year 1978 until 2006; it ranged between -2 to 2.3 respectively. However, from 2007 the inflation rate raised.

In Saudi Arabia, the rapid economic growth during the 1970s and early 80s was associated with high inflation. According to Al-Abodi (1997), in the early 1970s, the underdeveloped financial market and the structural rigidities such as bottlenecks in the form of skilled labor shortage, limited industrial capacity, and limited agricultural resources; prevent an equivalent increase in production and were responsible for inflationary pressure. On the other hand, in the late 1970s and 1980s, factors such as import price, money supply, and growth of government expenditure, were the most important reasons of inflation. (Aljebrin, 2006; Al-Aboudi, 1997).

According to Aljebrin, the consumer price index reveals the highest jump in 1975 and the associated inflation rate was 35. However, in the eighties and nineties the rate of inflation has decreased, and some years show deflation rates. (Aljebrin, 2006). Economic structures in developing oil export - based economies are particularly unique and different in several ways. Oil is the main source of income for governments which are the owners of all the natural resources. An increase in oil revenue
Table 1. Inflation Rate & CPI For Saudi Arabia (1970 to 2021)

<table>
<thead>
<tr>
<th>Year</th>
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<td>1995</td>
<td>5</td>
<td>2021*</td>
<td>3.23</td>
</tr>
</tbody>
</table>

that occurs from governmental sale of oil potentially increases the level of governmental domestic spending, which is the way the oil revenue is transferred through the governmental expenditures to the domestic economies. (Aljebrin, 2006).

As we see in Table 2, the GDP has increased dramatically, and these increases have led to increased government expenditures, money supply demand of goods and services, and other variables. The increases in the GDP have often been accompanied by increases in inflation rates.

The population is growing approximately 1mn every two years. In 2005 the population was 23.10mn, in 2007 24.30mn, and was estimated at 24.90 in 2008.
The oil production b/d in 2005 was 11,114.4, which was more than 10,858.7 and 10,750.0 in 2006 and 2007. This growing in those sectors will affect the inflation in food and in houses in the short term. A continued upward rise in the general price level as measured by the consumer price index is a typical definition of inflation. However, dramatic fluctuations in the general price level which occur on a successive basis when related to specific causes (such as demand, cost, or war, etc.) can also be a definition of inflation. (Ajebrin, 2006).

There are various causes of inflation related to expansive monetary or fiscal policy which can be referred to as demand-pull in nature. Inflation can also be derived from profit inflation and wage inflation and is classified as either aggregate, or cost-push inflation. (Ajebrin, 2006). Inflation is a hot issue in Saudi Arabia these days. It accelerated to 16.5%, which is the highest rate in 30 years. Rent and food prices are still the main upward forces on prices.

There are several reasons for inflation:

First, the government spends most of the oil for the employment program and for creating jobs for citizens, which encourage them to move out of their parents’ house and to live in private apartments with their wives. This situation makes the housing prices very high.

A second reason for inflation is that companies are growing very fast and are hiring new workers from outside the country (Jordon, India, and other countries), which makes the rental problem even worse. And people start to move to the cities, looking for good jobs. That also creates a shortage in apartments and drives the prices higher.

Sources: Inflation rate in Saudi Arabia from 1986 to 2020

Chart 1. Inflation rate path for Saudi Arabia from 1986 to 2020

Another reason for inflation is that Saudi Arabia imports most of the needed food from outside and foreign companies, mostly from western countries, which are affected by the oil price and the political situation and conflict between Russia and Ukraine. Also, the reason for the inflation in food is the lack of legitimate rules to control prices. Companies and stores raise their product prices without any control by the government.

The poll by SABB, HSBC Saudi affiliate, found that 61% of respondents were concerned about inflation and 68% of them thought that increasing property costs would negatively affect their operation. But there are now hopes that the more stable US$ will help to moderate these pressures, because one major reason for the inflation is that Saudi Arabia pegs the peoples’ money to the U.S. dollar. Also, the Saudi Arabian Monetary authority (SAMA) recently said that it expected rent prices to continue to push higher over 2008 as a result of the shortages in housing, limited expansion in construction, and higher cost for housing. Also, the ongoing rally on the global food market is making food and beverages more expensive.

3. The causes of inflation

The major reason for inflation in Saudi Arabia is that surging rental and food costs over the past years have given rise to high inflation rates, as these two components make up nearly 40% of the consumer price index basket. Saudi Arabia has been affected by the recent spikes in the global food price. In addition, the agricultural sector has little scope for development and the rapidly growing population will place additional demands on food supplies.

There are various causes of inflation related to an expansive monetary or fiscal policy, and this can be referred to as demand-pull in nature. Inflation can also be derived from profit inflation and/or wage inflation and is classified as either aggregate or cost-push inflation. Inflations resulting from temporary causes are easily identified, such as those initiated by war and natural disaster. (Aljebrin, 2006)

The cause of inflation in rent is driven by a chronic lack of housing demanded for new housing in Saudi Arabia. The demand is very high due to the rapidly increasing population (70% of Saudi people are below the age of 30) and increased internal migration to the cities. Abdullatif Al-Shelash of Saudi Home Loans has estimated a need for 4.5 mn new housing units within the next five years.

Another reason that drives inflation is that the Saudi riyal pegs to US$. The Saudi Arabian Monetary Agency (SAMA) continues to face a dilemma over the monetary policy. SAMA has consistently argued that the US$ peg is not the main cause of rising inflation, pointing instead to domestic factors such as rapid money supply growth, high government spending, and large rises in housing costs. And there are also wage pressures as workers try to compensate for the higher inflation. But one factor that may help the authorities is that the fall in US interest rates appears to have come to an end. Given the US$ peg, Saudi rates should move broadly in line
with those in the US, but they have not matched the pace decline although SAMA’s reverse repo rate is at 2%, the same as the fed funds rate. Its benchmark repo rate is 5.5%. Even so, real interest rates are still well into negative territory, encouraging further borrowing and spending on property in particular, which could exacerbate inflation pressures. (Oxford Economic country, Jul 2008)

4. How the government responds

The government has cut duties on wheat imports and lowered tariffs from 20% to 5% on frozen poultry, eggs, dairy products, vegetable oil, and canned food in order to counteract the rising cost of food. It could afford to expand food subsidies that currently cover rice and baby milk, among other products. The government has introduced a new mortgage law which it hopes will liberate the housing market, stimulating investment and growth in the real estate sector (Al-Eqtisadiah, 2008).

Another thing that the government could do to reduce inflation is to release the riyal from its US dollar peg. This view was reflected in a report by the Shura Council that advises king Abdullah. The council recommended that the riyal be allowed to appreciate by 20%. Another option would be for the government to issue long term bonds. Since Fitch ratings recently upgraded Saudi Arabia’s credit rating one notch from A+ to AA-, government bonds would represent a very low risk investment and thus could prove attractive in the current volatile global economic climate. (Middle East Economic, 2008).

Also, the government has raised salaries and wages by 15% which may help people to pay the higher prices. The recent inflation problems have not passed by the government, and over the last few months it has increased its efforts to address the issue through a number of measures. The authorities raised bank reserve requirements to curb liquidity, and in the following month, king Abdullah ordered new subsidies on imported rice and baby milk to ease the impact of price rises on Saudi residents. The government has also raised welfare payments and public sector wages. Finally, the government has started to give subsidies for charity agencies which give people money to build houses, and give loans without interest.

5. The authors Friedman, Musgrave, and Galbraith

Friedman: States inflation is always a monetary phenomenon. Also, he argues against the concept of cost-push inflation. He believes that the increase in money supplies by the government and its central bank is directly linked to inflation, and that increases in the cost of goods and services would not occur otherwise. (Source: Economic SYNOPSISES short essays and reports on the economic issues of the day 2007. Number 1, https://files.stlouisfed.org/files/htdocs/publications/es/07/ES0701.pdf)
Musgrave: Argues that the government should step in and intervene in the economy and solve its problems, such as inflation, which is one of its roles to deal with. The Saudi government responded to the inflation phenomena in different ways, as we saw.

Galbraith: Claims that the government should not raise salaries in order to reduce the inflation rate. And that is what actually happened in Saudi Arabia’s situation. The Saudi government responded to the inflation by 15% increase in the salary, and a month later, the inflation more than doubled. (Source:The Case for Strategic Price Policies, https://www.project-syndicate.org/commentary/strategic-price-controls-warranted-to-fight-inflation-by-james-k-galbraith-2022-01?barrier=accesspaylog)

6. Findings

1) The inflation rate in Saudi Arabia reached 8 percent in 2008, which is the highest rate in the last 20 years. However, in 1975 the inflation rate in Saudi Arabia reached 35 percent, which is more than what it was in 2008, therefore I think it is not as big an issue as many people complain about.

2) The inflation rate decreased since 2008 till 2020 because of several reasons, such as the government’s responses and the global financial crises.

3) There are several reasons for the inflation in the short run in Saudi Arabia, such as:

- Surging rental and food costs over the past years have given rise to high inflation rates, as these two components make up nearly 40% of the consumer price index basket.
- Saudi Arabia has been affected by the recent spikes in global food price. In addition, the agricultural sector has little scope for development and the rapidly growing population will place additional demands on food supplies.
- The cause of inflation in rent is driven by a chronic lack of housing demanded for new housing in Saudi Arabia. The demand is very high due to the rapidly increasing population (70% of Saudi are below the age of 30) and increased internal migration to the cities.
- Another reason that drives inflation is that the Saudi riyal pegs to US$. The Saudi Arabian Monetary Agency (SAMA) continues to face a dilemma over its monetary policy.

7. In the Future

This is a study of the status quo rather than a prediction for future fluctuations in inflation in Saudi Arabia. Saudi Arabia will continue to invest in expanding its spare oil capacity, which will increase its ability to influence prices in the medium and longer term – a valuable foreign policy asset.
Researchers in future can work on establishing a correlation between the inflation in the Kingdom of Saudi Arabia and oil prices. This research will be helpful in having an idea of fluctuations in prices and factors affecting those fluctuations.

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