Day Break

Thursday, 25 January 2018

IGI Securities
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Economy

Exhibit: Inflation and Interest Rate

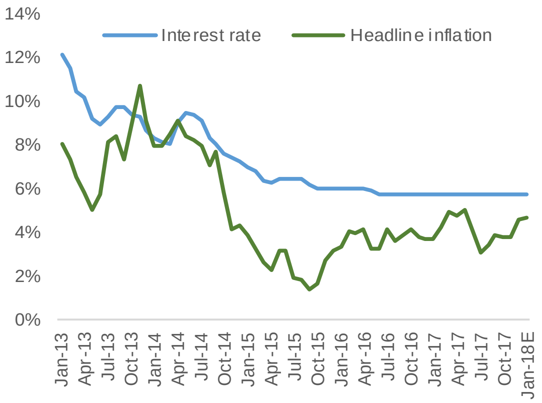


Exhibit: Expected percentage point impact on CPI inflation in Jan-18

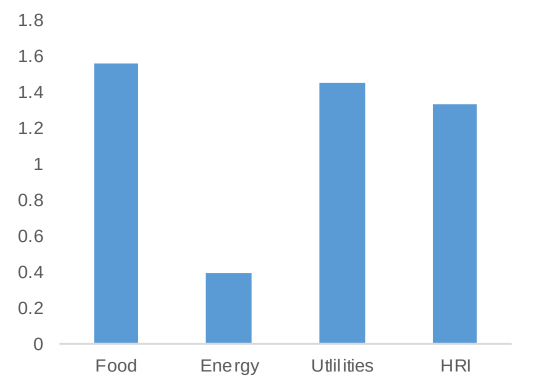
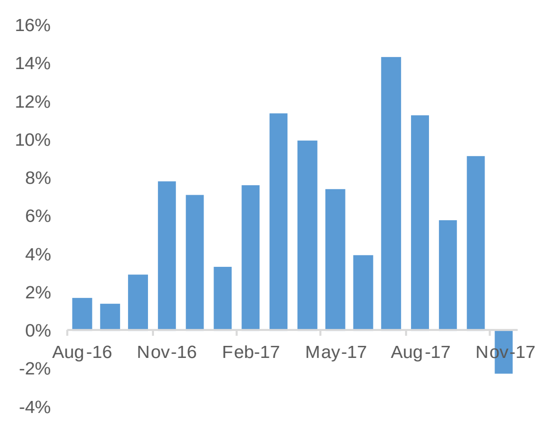


Exhibit: Strong LSM growth rate (YoY)



Source: SBP, PBS & IGI Research

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Monetary Policy & Inflation

Modest inflationary pressure to build up post PKR depreciation; Interest rate to remain unchanged

- The State Bank of Pakistan (SBP) is slated to announce its monetary policy on 26th Jan-18. We expect the regulator to maintain status quo, with target rate at 5.75%
- Next week, we expect PBS to publish data on inflation for the month of Jan-18, wherein, we expect headline inflation to clock in at +4.7%YoY (+0.3%MoM)
- Despite PKR depreciation, we still expect FY18 inflation to remain within the bounds of SBP target
- Given modest inflationary pressure, emphasis on GDP growth and expected positive outcome of recent policy measures on the external front, we foresee the monetary policy status quo to be maintained at least until end of 2HFY18

Policy rate to remain at 5.75%; Inflation to clock in at +4.7%YoY in Jan-18

The State Bank of Pakistan (SBP) is slated to announce its monetary policy on 26th Jan-18. We expect the regulator to maintain status quo, with target rate at 5.75%, given low inflation and emphasis on economic growth, despite mounting but still manageable external sector pressures. Similarly, next week, we expect PBS to publish data on inflation for the month of Jan-18, wherein, we expect headline inflation to clock in at +4.7%YoY (+0.3%MoM) due to expected uptick in food index (+3.9%YoY), quarterly revision of HRI (expected: +6.8%YoY) and expected rise in education index (+12.4%YoY).

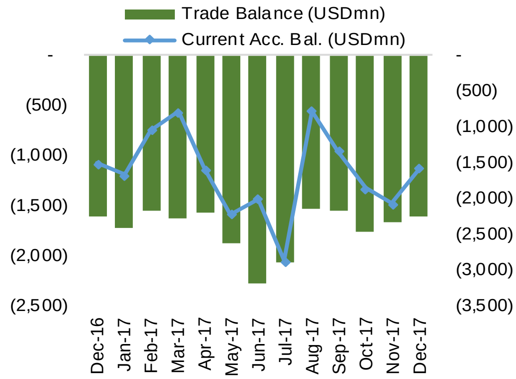
Real sector growth and price level, despite external vulnerabilities, point to status quo in monetary policy…

Delving into the last three monetary policy statements published in 1HFY18, we see that SBP has highlighted strong trend in real sector growth, subdued inflation and manageable external sector pressures in support for keeping a loose monetary policy in place. Observing the same variables, we see that the growth trend is intact with 5MFY18 LSM growth recorded at +7.2%YoY and private sector credit up by +13.9%YoY in the month of Dec-17. At the same time, latest inflation figure for the month of Dec-17 has jumped up to +4.6%YoY compared to 5MFY18 average of +3.6%YoY. While we expect headline inflation to be on a rising trend for the rest of FY18 due to recent PKR depreciation, yet the price level is well below SBP target of +6.0%YoY and does not warrant a rate hike. On the other hand, recent policy measures to restrict consumption based imports and inflows into financial account may help keep ballooning external balances within manageable levels and strengthen case for a stable interest rate.

…but market participants paint a different picture

However, auction data for treasury securities depicts a contrasting view, wherein, PIB auctions of last 6 months have been scrapped, while as per the latest MTB auction bid report, interest of market participants in T-bills is also skewed towards 3-month bills (no bids for 6 and 12 month tenors) indicating a market anticipation of a rate hike sooner rather than later.

Exhibit: Mounting pressure on external sector



Inflation expected to rise after a subdued period in 1HFY18

On the prices front, we expect headline inflation to clock in at +4.7%YoY (+0.3%MoM) for the month of Jan-18 compared to +3.7%YoY (+0.2%MoM) in same period last year. The rise in price level is expected to emanate from uptick in both food index and non-food index. Food index is expected to grow by +3.9%YoY as depicted by SPI data – a proxy for food prices growth. We expect food prices to rise by +5.3%YoY primarily led by perishables food items, while drag on food index is expected to emanate from cigarette prices (down 23%YoY). Simultaneously, non-food index is expected to rise by +5.3%YoY primarily on the back of +6.8%YoY hike in HRI (revised quarterly), as well as +12.4%YoY increase in education index and +4.5% rise in transport index (motor fuel prices up by +5.2%MoM in Jan-18).

Imported inflation to push CPI up, but monetary policy status quo expected for remainder of FY18

Recent PKR depreciation has started to seep into local prices (for instance, local fuel prices are up ~5%MoM, Automobile prices are up ~3%MoM). However, we still expect FY18 inflation to remain within the bounds of SBP target. Rising core inflation, on the other hand, points to a resurgence in demand pull inflation which could worsen CPI in case of any commodity price shock. However, given modest inflationary pressure, emphasis on GDP growth and expected positive outcome of recent policy measures on the external front, we foresee the monetary policy status quo to be maintained at least until end of 2HFY18.

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