Day Break

Friday, 29 September 2017

IGI Securities
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Economy

Exhibit: YoY inflation (%)

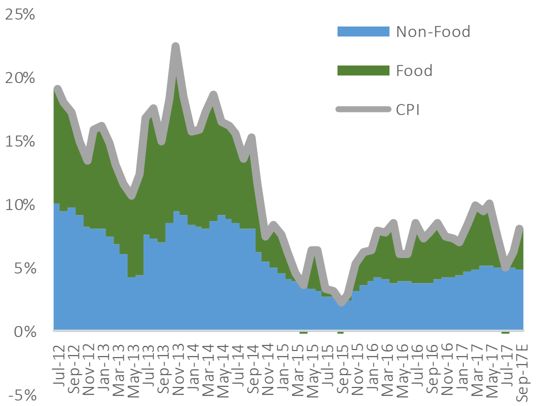


Exhibit: 3 month moving average real interest rate

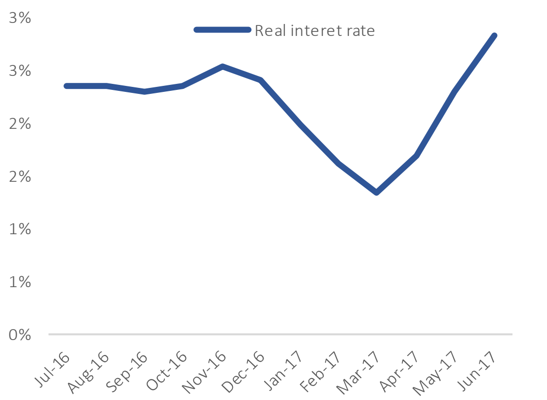
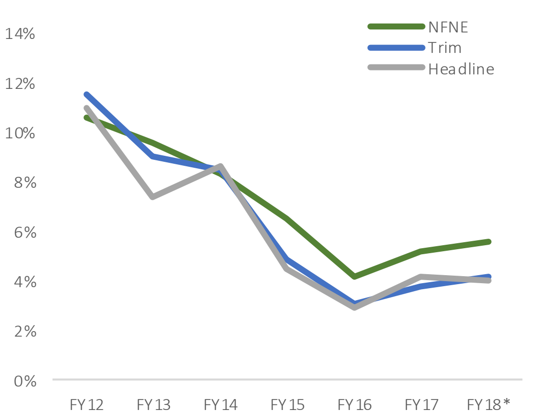


Exhibit: Core and headline inflation trend



Source: PBS & IGI Research

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Inflation & Monetary Policy

Monetary policy to remain unchanged while inflation to post a modest growth

- We expect SBP to keep the policy/discount rate steady at 5.75%/6.25% while Sep-17 headline inflation is expected to print +4.2%YoY growth.
- Inclusive of Sep-17 estimates, 1QFY18 inflation will average +3.5%YoY, 40bps lower than same period preceding year's average of +3.9%YoY.
- Two key macroeconomic factors will keep the upcoming monetary policy unchanged, namely a) the low inflation reading in 1QFY18E and b) the low level of current account (C/a) deficit in Aug-17.
- In addition to macroeconomic factors, there is political consideration in keeping interest rate low, wherein, as election nears, government's key priority remains highlighting pro-growth policies. Henceforth, we expect monetary policy decision as Status Quo.

Policy rate expected to remain unchanged despite Sep-17 inflation pointing to an upward trend

The State Bank of Pakistan (SBP) is scheduled to announce its monetary policy on Friday (29-Sep-17) while the Pakistan Bureau of Statistics is expected to release its monthly data on inflation next week. We expect SBP to keep the policy/discount rate steady at 5.75%/6.25%, while Sep-17 headline inflation is expected to print +4.2%YoY (+0.93%MoM) growth compared to +3.9%YoY (+0.20%MoM) in the same month last year.

Inflation to grow modestly on the back of HRI and rebounding food prices

After a subdued start in FY18, wherein CPI inflation recorded 2MFY18 average of +3.2%YoY (+3.91% last year), we expect headline inflation to pick up pace in Sep-17 and register a growth of +4.2%YoY (+3.4% and +2.9% YoY in Aug-17 and Jul-17 respectively). Inclusive of Sep-17 estimates, 1QFY18 inflation will average +3.5%YoY, 40bps lower than same period preceding year's average of +3.9%YoY. Key reason for monthly uptick in inflation is expected to be non-food basket, wherein, the prices are expected to rise by +4.9%YoY on the back of +7.2%YoY uptick in House rent index (HRI; last revised in Jul-17). Simultaneously, food basket is expected to pick up pace as depicted by +2.12%MoM growth recorded in Sensitivity Price Index (SPI) – a proxy index for food prices. We estimate food basket to grow by +3.2%YoY leading to a ppt impact of 1.2 despite 20.9%YoY decline in prices of cigarettes acting as a drag.

Exhibit:

Inflation Break-up; Non-food (utilities & HRI pulling up inflation)

(ppt)	Sep-17E	Aug-17	Jul-17	1Q'FY18E	Sep-16	Aug-16	Jul-16	1Q'FY17
Food	1.3	0.5	-0.0	0.6	1.7	1.4	2.0	1.7
Non-Food	2.9	2.9	3.0	2.9	2.2	2.2	2.2	2.2
- Energy	0.3	0.3	0.3	0.3	- 0.1	- 0.0	0.0	- 0.0
-Utilities	1.2	1.3	1.4	1.3	1.3	1.2	1.1	1.2
-HRI	1.4	1.4	1.4	1.4	1.1	1.1	1.1	1.1
Total	4.2	3.4	3.0	3.5	3.9	3.6	4.2	3.9

Source: IGI Research, SBP, PBS

Muted headline inflation and upcoming elections to encourage 'Status Quo' in monetary policy

Two key macroeconomic factors will keep the upcoming monetary policy unchanged, in our view. First is the low inflation reading in 1QFY18E (avg. +3.5%YoY) and second is the low level of current account (C/a) deficit in Aug-17; dissenting views on sharp PKR depreciation.

Based on Sep-17E inflation, real interest rates would stand at 2.75%, unlikely to pose a meaningful risk. However, rising core inflation pattern (+5.6%YoY in 1QFY18E compared to +5.2%YoY in FY17) indicates a brewing demand pull inflation, going forward. Consequently, given the rising core inflation, headline inflation could see a jump in coming months leading to downward pressure on real interest rates (1.75% by 2QFY18 end).

To recall, Aug-17 C/a deficit clocked in at USD 550mn compared to Jul-17 number of USD 2.1bn, owing to narrower trade deficit and higher remittances received. As a result, market expectations of sharp PKR depreciation dissented, albeit on a temporary basis, as Aug-17 C/a deficit number was low due to one-off factors, namely a) strong growth in remittances (USD 1.95bn vs. USD 1.5bn in Jul-17 was noted due to Eid (seasonal factor) and, b) lower import of food and transport products. We highlight that foreign inflows are still the primary factor to keep C/a deficit at a sustainable level, as opposed to government introducing tax to curb imports.

In addition to macroeconomic factors, there is political consideration in keeping interest rate low, wherein, as election nears, government's key priority remains highlighting pro-growth policies. Henceforth, we expect monetary policy decision as Status Quo.

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