Day Break

Tuesday, 25 April 2017

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Economy

Exhibit: Headline inflation

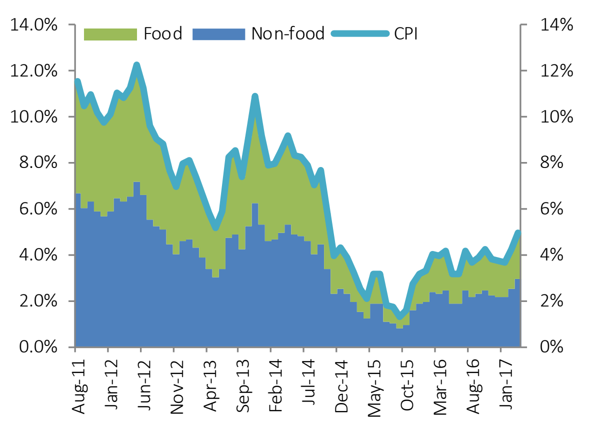


Exhibit: 9MFY17, Percentage point contribution to CPI

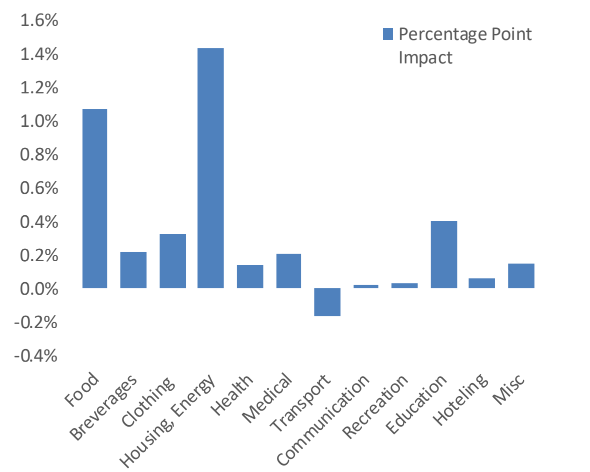
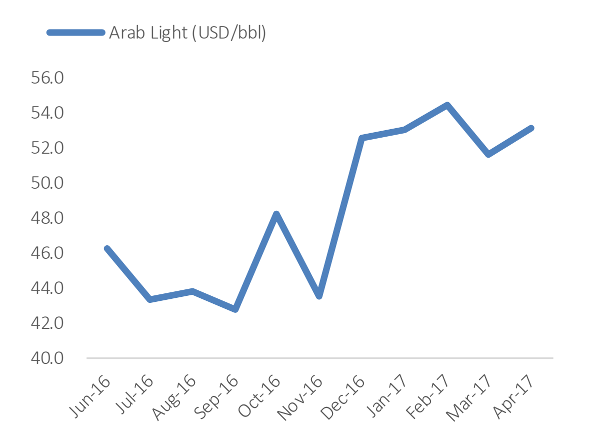


Exhibit: Upward trending intl. oil Prices



Source: Bloomberg, SBP & IGI Research

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Inflation

Inflation to pick up in 4QFY17 but to remain within the lower bound of SBP target

- During the 9MFY17, headline inflation posted a +4.0%YoY increase, considerably higher than the average of +2.6%YoY recorded in 9MFY16. Disregarding the base effect, the growth in headline inflation was led by Food basket and housing and rental index
- On the outlook, compared to inflation recorded in FY16 +2.85%, we expect the average FY17 inflation to be 4.3%YoY as a result of cost-push inflation from the recent surge in domestic POL prices as well as the anticipation of demand-pull inflation from the increase in food prices in the upcoming month of Ramadan.

Although headline inflation has remained relatively subdued in 9MFY17, we expect this could change in the months leading to FY17 year end. We base our estimate on account of higher POL prices and seasonal demand emanating from month of Ramadan. However, despite this FY17 average inflation is expected to clock in of 4.2%YoY, which is on the lower side of SBP target of 4.0-5.0%.

9MFY17 CPI clocks in at 4.03%

During the 9MFY17, headline inflation posted a +4.0%YoY increase, considerably higher than the average of +2.6%YoY recorded in 9MFY16. Disregarding the base effect, the growth in headline inflation was led by Food basket, as reflected by +3.8% increase in food index during the period. In the non-food basket, growth in house rental index uplifted overall CPI index. The aforementioned sectors contributed the most to the headline, adding +1.4 percentage points each, to the total 9MFY17 average inflation of +4.0%YoY.

Food prices remain key inflation driver during 9MFY17…

In the food basket, largest impact was brought on by perishable food items which, during the period, experienced a negative supply side shock, as a result of unfavorable weather conditions. Hence, the perishables food prices showed an increase of +5.7%YoY compared to a deflationary trend witnessed in the same period last year (down by 2.6%YoY).

Upcoming seasonal demand (Ramadan) to drive food prices further

In our view food prices are slated to increase in the remainder of FY17. Our opinion is partially substantiated by the rising trend witnessed in international food index, as monitored by FAO (UN Food and Agricultural Organization), which during the 9MFY17 showed a growth of 4.0%YoY compared to deflation of 9.0%YoY recorded last year in the same period. More importantly, in anticipation of seasonal demand (month of Ramadan), food price index is expected to further rise. As seen historically, food price index has increased by an average +0.9%MoM pre-Ramadan month (compared to average monthly increase of +0.2% witnessed during the

9MFY17). Thus, we see a potential uplift from the food prices feeding into headline inflation for the remainder of FY17.

Non-Food prices continue to edge up on back of Housing and rental prices

In the non-food basket, housing and rental index (HRI) took the lead and increased by +6.4%YoY in 9MFY17 compared to 5.9%YoY in 9MFY16, highlighting the effects of inflating construction costs. Similarly, Medical and Education prices also surged, striking averages of +9.4%YoY and +10.3%YoY respectively, over the 9MFY17 compared to 3.2%YoY and 9.0%YoY respectively, in 9MFY16.

POL prices to fuel inflation into 4QFY17

POL prices have remained relatively low during 1HFY17 as indicated by the deflation of 3.7%YoY in the transport sector. Yet, given the +0.6%YoY inflation in transport sector for 3QFY17 and the potential pass through of the international oil price, we see a rising trend in the POL prices for 4QFY17. Still, given the relatively low international oil prices, we do not see a large hike.

Consequently, the headline inflation is expected to post a modest figure of +4.2%YoY in FY17

Compared to inflation in FY16 +2.85%, we expect the average FY17 inflation to be 4.2%YoY as a result of cost-push inflation from the recent surge in domestic POL prices as well as the anticipation of demand-pull inflation from the increase in food prices in the upcoming month of Ramadan. This is in line with the State Bank of Pakistan (SBP) forecast of 4.0-5.0% in FY17. Monthly inflation increase during FY17 is estimated at ~0.4% compared to ~0.26% recorded in FY16. However, key risks to our call stems from rising current account deficit (9MFY17 C/a deficit of USD 6.13bn versus USD 2.35bn recorded last year same period). This could lead to potential drawdown on country's FX reserves, leading to weakening PKR parity, culminating into higher than expected inflation.

Source: Bloomberg, SBP & IGI Research

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