Day Break

Monday, 04 December 2017

Economy

Exhibit: Inflation and Policy Rate

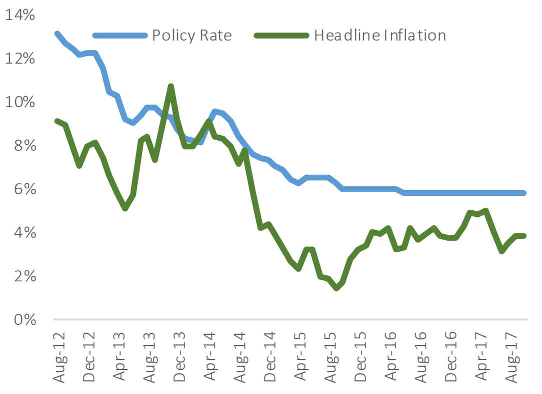


Exhibit: Expected percentage point impact

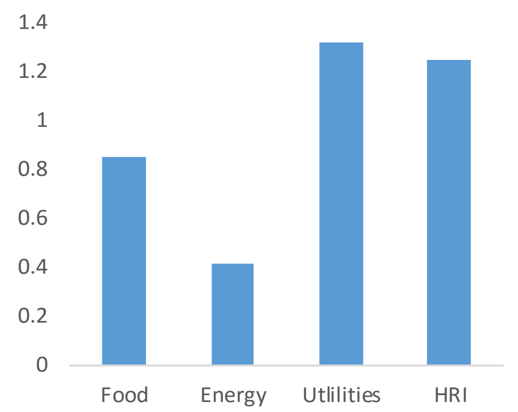
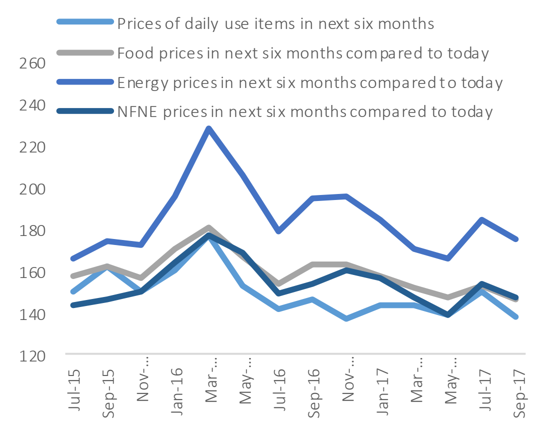


Exhibit: Inflation expectation



Source: SBP, PBS & IGI Research

Syed Daniyal Adil
Research Analyst
daniyal.adil@igi.com.pk
Tel: (+92-21) 111-234-234 Ext.: 973

Inflation

Nov-17 CPI inflation to post +3.8%YoY

- For the month of Nov-17, we expect headline CPI inflation to post +3.8%YoY compared to +3.8%YoY in the same period last year
- We expect food basket to grow by +2.1% and non-food basket to grow by +5.0%YoY
- According to SBP/IBA survey (conducted after every 2 months), public expectations about inflation for the next 6 months showed a decline in Sep-17 compared to Jul-17
- The government has raised USD 2.5bn from the issuance of 5yr Sukuk and 10yr Eurobond, which should help recreate the much needed FX buffer
- With stable food prices at the international level and range-bound oil prices, we continue to expect headline inflation being range-bound between 4.5%-5.0% in FY18

Inflation to remain modest in Nov-17

For the month of Nov-17, we expect headline CPI inflation to post +3.8%YoY compared to +3.8%YoY in the same period last year. Resultantly, 5MFY18 average inflation is expected to come in at +3.6%YoY, lower than +3.9%YoY average of same period last year. On a monthly basis, inflation is estimated to go up by +0.2%MoM compared to +0.2%MoM in Nov-16 and +0.5%MoM, on average, during the 4MFY18 period. Key contributors to expected number include a) quarterly revision in house rental index (HRI) (revised in Oct-17), b) increase in energy prices and c) higher food index.

MPS status quo maintained; interest rate kept at 5.75%

State Bank of Pakistan announced its monetary policy last week, maintaining policy rate at 5.75%. In the statement, the regulator affirmed that the economy is on track to achieve the target GDP growth rate of +6% while expecting inflation to remain well below the target of +6%. However, the statement pointed out external sector vulnerability in short-term while simultaneously outlining the improvements in the form of rising exports, FDI inflow and external borrowing.

Food basket to continue upward trend witnessed in last 2 months; non-food basket still key to inflation uptick…

The food basket has rebounded in the past couple of months, averaging +2.3%YoY compared to +0.6%YoY in 2MFY18, with Nov-17 expected to follow suit. We expect food basket to grow by +2.1%, dampened by 16.5% fall in prices of cigarettes. On the other hand, non-food basket is expected to grow by +5.0%YoY on the back of higher house rent index (up by +6.5%YoY), rising transport index (up by +5.2%YoY) and growing education index (up by +11%YoY).

… while the public expects low inflation to persist

According to SBP/IBA survey (conducted after every 2 months), public expectations about inflation for the next 6 months showed a decline in Sep-17 compared to Jul-17. Since inflation is influenced by what people expect, this survey acts as a potential indicator to gauge future expected movement in inflation. The survey concludes that in the month of Sep-17, people expected inflation in all the baskets, namely food, energy and non-food and non-energy, to remain relatively low in the next 6 months.

Outlook: External sector vulnerability could build-up inflationary pressure

In the 4MFY18, Pakistan has recorded USD 5.0bn C/a deficit, while during the same period, FX reserves have fallen by USD 2.7bn to USD 13.5bn underlining the mismatch between inflows and outflows and challenging PKR stability. Any potential PKR devaluation could lead to significant imported inflationary pressure, in our view.

Although the government has raised USD 2.5bn from the issuance of 5yr Sukuk (USD 1bn at 5.625% yield) and 10yr Euro-bond (USD 1.5bn at 6.875% yield), which should help recreate the much needed FX buffer, yet the impact might be minimal given the rapidly rising imports and upcoming debt repayments, outlining a key risk to external account stability and consequently to current low inflation. However, with stable food prices at the international level (as indicated by FAO Food Price index) and range-bound oil prices (with the government's capacity to absorb price increase through tax reduction), we continue to expect headline inflation being range-bound between 4.5%-5.0% in FY18.

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IGI Finex Securities Limited
Research Analyst(s)
Research Identity Number: BRP009

Contact Details

Research Team

Saad Khan	Head of Research	Tel: (+92-21) 111-234-234 Ext: 810	saad.khan@igi.com.pk
Abdullah Farhan	Senior Analyst	Tel: (+92-21) 111-234-234 Ext: 912	abdullah.farhan@igi.com.pk
Syed Daniyal Adil	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 973	daniyal.adil@igi.com.pk
Suleman Ashraf	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 957	suleman.ashraf@igi.com.pk
Muhammad Saad	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 973	muhammad.saad@igi.com.pk
Tanweer Kabeer	Research/Fund Select	Tel: (+92-21) 111-234-234 Ext: 966	tanweer.kabeer@igi.com.pk
Umesh Solanki	Database Manager	Tel: (+92-21) 111-234-234 Ext: 974	umesh.solanki@igi.com.pk

Equity Sales

Faisal Jawed Khan	Head of Equities	Tel: (+92-21) 35301779	faisal.jawed@igi.com.pk
Zaeem Haider Khan	Regional Head (North)	Tel: (+92-42) 35777863-70	zaeem.haider@igi.com.pk
Muhammad Naveed	Regional Manager (Islamabad & Upper North)	Tel: (+92-51) 2604861-62	muhammad.naveed@igi.com.pk
Ejaz Rana	Regional Manager (Faisalabad)	Tel: (+92-41) 2540843-45	ejaz.rana@igi.com.pk
Asif Saleem	Branch Manager (RY Khan)	Tel: (+92-68) 5871652-56	asif.saleem@igi.com.pk
Mehtab Ali	Branch Manager (Multan)	Tel: (+92-61) 4512003	mahtab.ali@igi.com.pk
Zeeshan Kayani	Branch Manager (Abbottabad)	Tel: (+92-992) 408243-44	zeeshan.kayani@igi.com.pk
Ihsan Mohammad	Branch Manager (Peshawar)	Tel: (92-91) 5253035	ihsan.mohammad@igi.com.pk

IGI Finex Securities Limited
Trading Rights Entitlement Certificate (TREC) Holder of
Pakistan Stock Exchange Limited |
Corporate member of Pakistan Mercantile Exchange Limited

Head Office
Suite No 701-713, 7th Floor, The Forum, G-20,
Khayaban-e-Jami Block-09, Clifton, Karachi-75600
UAN: (+92-21) 111-444-001 | (+92-21) 111-234-234
Fax: (+92-21) 35309169, 35301780
Website: www.igisecurities.com.pk

Stock Exchange Office
Room # 719, 7th Floor, PSX Building, Stock Exchange Road, Karachi.
Tel: (+92-21) 32429613-4, 32462651-2 , Fax: (+92-21) 32429607

Lahore Office
5-F.C.C. Ground Floor, Syed Maratib Ali Road,
Gulberg II, Lahore
Tel: (+92-42) 35777863-70, 35876075-76
Fax: (+92-42) 35763542

Islamabad Office
Mezzanine Floor, Office 5, 6 & 7, Kashmir Plaza,
Block- B, Jinnah Avenue, Blue Area, Islamabad
Tel: (+92-51) 2604861-2, 2604864, 2273439
Fax: (+92-51) 2273861

Faisalabad Office
Room #: 515-516, 5th Floor, State Life
Building, 2- Liaqat Road, Faisalabad
Tel: (+92-41) 2540843-45
Fax: (+92-41) 2540815

Rahim Yar Khan Office
Plot # 12, Basement of Khalid Market,
Model Town, Town Hall Road, Rahim Yar Khan
Tel: (+92-68) 5871653-6, 5871652
Fax: (+92-68) 5871651

Multan Office
Mezzanine Floor, Abdali Tower,
Abdali Road, Multan
Tel: (92-992) 408243 - 44

Abbottabad Office
Ground Floor, Al Fatah Shoppinig Center , Opp. Rad
Station, Mansehra Road, Abbottabad
Tel: (+92-99) 2408243 - 44

Peshawar Office
2nd Floor, The Mall Tower,
35 The Mall Peshawar Cantt.
Tel: (92-91) 5253035, 5278448

Sialkot Office
Suite No. 10 & 11, 1st Floor, Soni Square,
Mubarik Pura, Sialkot.
Tel: (+92-52) 3258437, 3258762