Day Break

Friday, 28 December 2018

ECONOMY

Exhibit: Monthly Inflation trend

	General (M/M)	Food (M/M)	SPI (M/M)
Dec-11	-0.7%	-2.2%	-2.0%
Dec-12	0.2%	0.0%	0.0%
Dec-13	-1.3%	-3.3%	-2.5%
Dec-14	-1.0%	-2.1%	-1.5%
Dec-15	-0.6%	-1.6%	-0.7%
Dec-16	-0.7%	-1.9%	-0.8%
Dec-17	-0.1%	-0.6%	-0.7%
Nov-18	0.1%	-0.5%	0.3%

Exhibit: Yield Curve

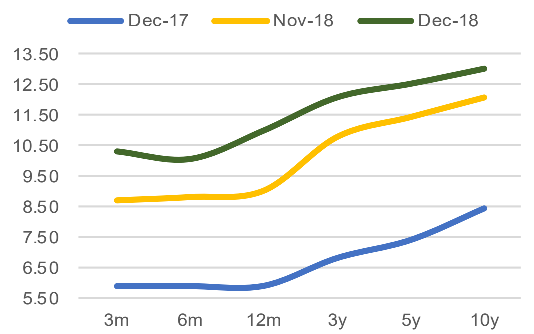
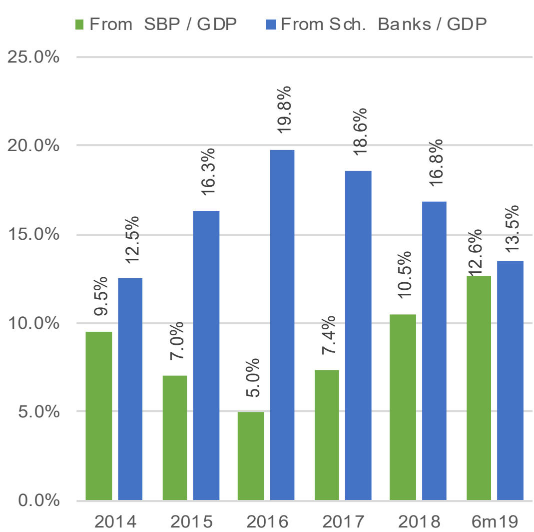


Exhibit: Government borrowing as percent of GDP



Source:SBP, PBS & IGI Research

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Inflation

Dec-18, monthly inflation to show muted growth; +6.6%YoY

- We expect Consumer Price Index (CPI) based inflation to record a flattish monthly growth, taking Dec-18 inflation to +6.6%. This brings 6MFY19 average period inflation to +6.1% compared to +3.8% last year.
- We had earlier projected that the ongoing price pressure will rest upon non-food prices, while food prices may slide going forward.
- In recent bond auction yield spread widened reflecting government borrowing requirements. As far as the public borrowing remains on the higher side and funding remains at schedule banks there is always a tendency for yields to trend upwards on account of liquidity constraints

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We expect Consumer Price Index (CPI) based inflation to record a flattish monthly growth, taking Dec-18 inflation to +6.6%. This brings 6MFY19 average period inflation to +6.1% compared to +3.8% last year. We had earlier projected that the ongoing price pressure will rest upon non-food prices, while food prices may slide going forward. The decelerating Sensitive Price Index (SPI) inflation depicts the easing food price pressure. Whereas the rising trend witnessed in non-food and rigid growth in core (NFNE) prices averaging 0.8% and 0.94% on a monthly basis during 5MFY19 validates our contention.

Food Prices: Dec to keep food prices growth soft

Historically food prices have shown a decelerating trend as winter period approaches. In past 7yrs, food prices have declined by an average of ~1.7% and SPI, a proxy index for food prices have dropped by ~1.2% on average in the same period. For the outgoing month of Dec-18, SPI index depicts a similar trend, a decline of 0.2% on a monthly basis.

Non-food Prices: Growth partially incorporated

Wholesale Price Index (WPI) a proxy index to imported inflation with oil prices having the highest weightage along with energy index, has so far shown strongest growth comeback in 2018, mainly due to rising oil prices, followed by sharp PKR and recent gas price hike. This rising trend in WPI to an extent has been replicated by non-food price index. For Dec-18, we expect WPI growth to ease up, primarily as international crude oil prices have dropped by ~10%MoM during the month, more than the PKR devaluation witnessed.

Bond Auction: Yield spread widened reflecting government borrowing requirements

In the recent Pakistan Investment Bond (PIB) auction held, government raised PKR ~20bn just managing to cover its maturing amount of PKR ~15bn. The 3yr bond fetched a yield of <+12% causing yield spread between 3yr and SBP discount rate to witness a sharp rise of ~1.6%. The steepening yield curve in our view does not come as a surprise, given market anticipation of further rate hikes, as the country progresses towards an IMF bail-out program in the coming month. However, we think prices are likely to soften up in coming months, as oil prices have receded sharply in recent months and PKR is less likely to show harsher depreciation episodes in months leading to FY19. We think the current rising pattern in yields are in fact based on the higher public sector borrowing requirement.

Outlook

As far as the public borrowing remains on the higher side and funding remains at schedule banks there is always a tendency for yields to trend upwards on account of liquidity constraints. So far government borrowing requirement has reached PKR 10.7trn by mid Dec-

18, and has been largely met through domestic sources largely fed by schedule banks. Although the SBP raised policy rate in the latest monetary policy statement announced in Dec-18, pushing forward real interest rate in positive territory +~3% (based on 7.5% SBP Inflation target), but excessive government borrowing requirements combined with 50-100bps rate hike market biasness as country approaches IMF program, yield curve is likely to stay steep in our view. Looking ahead we expect inflation to average ~8% in FY19 and see no further rate hike.

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