Day Break

Wednesday, 28 February 2018

Economy

Exhibit: Expected inflation in Feb-18

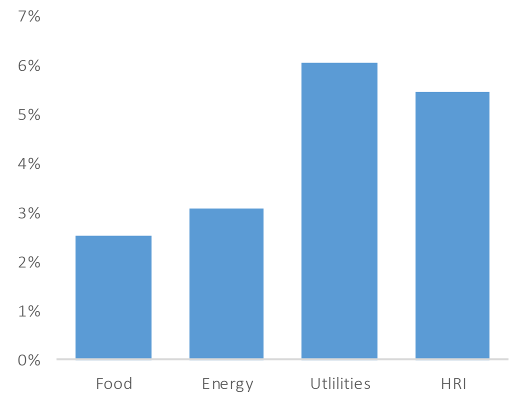


Exhibit: Trend in food inflation

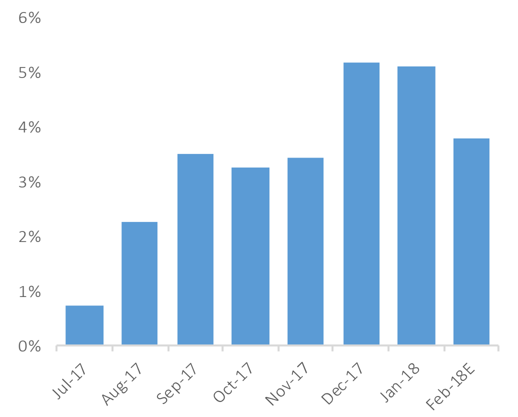
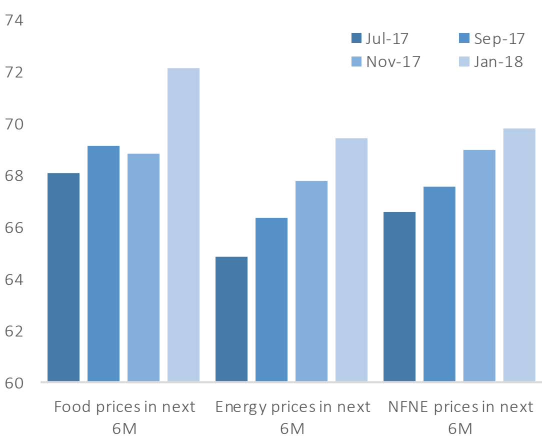


Exhibit: Trend in public inflation expectation



Source: SBP, IBA, PBS & IGI Research

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Inflation

Feb-18 headline inflation to post +4.01%YoY growth

- For the month of Feb-18, we expect headline CPI inflation to post +4.01%YoY compared to +4.22%YoY in the same period last year.
- Food prices are expected to post a slower growth, +3.76%YoY in Feb-18, as indicated by the SPI figures during the month.
- Non-food index is expected to grow by +5.04%YoY taking 8MFY18 average to +5.00%YoY.
- As per the latest (Jan-18) SBP/IBA survey (conducted after every 2 months), public expectations about inflation for the next 6 months showed a rise in jan-18 compared to Nov-17.
- We continue to expect headline inflation to be in the range of 4.5%-5.0% in FY18.

Inflation to remain modest in Feb-18

For the month of Feb-18, we expect headline CPI inflation to post +4.01%YoY compared to +4.22%YoY in the same period last year. Resultantly, 8MFY18 average inflation is expected to come in at +3.87%YoY, lower than +3.91%YoY average of same period last year. On a monthly basis, inflation is estimated to go down by 0.11%MoM compared to +0.29%MoM rise in Feb-16. Key contributors to expected inflation include a) house rental index (HRI) (revised in Jan-18), b) increase in motor fuel prices, c) education index and d) higher food index.

Growth in food prices to slow down relative to last couple of months

In the past couple of months, food prices have grown by +5.13%YoY, on average. However, the food prices are expected to post a slower growth, +3.76%YoY in Feb-18, as indicated by the SPI figures. Overall food basket is expected to rise by +2.51%YoY, with tobacco prices (down ~18%YoY) expected to drag aforesaid basket lower.

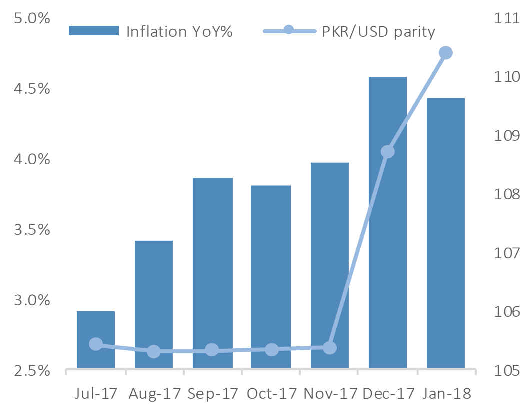
Rise in non-food prices to stay robust

Non-food basket has depicted strong growth in prices this year, with HRI, motor fuel and education index leading the chart. We expect this month to follow suit, with rise in HRI, motor fuel and education index to be +5.43%YoY, +3.70%YoY and +12.40%YoY, respectively. Consequently, non-food index is expected to grow by +5.04%YoY taking 8MFY18 average to +5.00%YoY.

Public expects inflation to rise in months to follow

As per the latest (Jan-18) SBP/IBA survey (conducted after every 2 months), public expectations about inflation for the next 6 months showed a rise in Jan-18 compared to Nov-17. Since inflation is influenced by what people expect, this survey acts as a potential indicator to gauge future expected movement in general price level. The survey concludes that in the month of Jan-18, people expected inflation in all the baskets, namely food, energy and non-food and non-energy, to grow higher in the next 6 months.

Exhibit: Inflation and PKR devaluatin in 7MFY18



Outlook: External sector vulnerability still the biggest concern

Outlook on inflation continues to be dictated by external sector woes. Recent PKR depreciation led to an immediate spike in general price levels as is evident from monthly inflation figures post devaluation. Although USD depreciation against other major currencies has provided PKR some breathing room, however, with worsening external accounts, further PKR depreciation cannot be ruled out which may lead to higher inflationary pressures. Accordingly, the State Bank of Pakistan has, in its most recent Monetary Policy Statement, increased the target rate by +25bps to 6.0%, citing growing inflation and current account imbalance as two of the key reasons amongst other variables.

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 to be in the range of 4.5%-5.0% in FY18.

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