

Global Inflationary Pressure & Economic Outlook

Oil futures surged to a new record \$122 a barrel as of May FY08, impacting the economy negatively through increased inflationary pressure. The impact of high oil prices is deeply felt throughout the economy as it impacts not only the price for gasoline but also other goods and services. The supply threats that emerged overseas and a weaker dollar sent light, sweet crude for June delivery to a new trading record of on the New York Mercantile Exchange.

The oil price's sharp rise this year has driven consumer sentiments lower, threatening a slow-down in the growth of large Asian economies including China and India. The impact of tight credit conditions in the United States along with a sluggish job market can also negatively impact the global investment allocations. This increase in the oil price has impacted the prices of goods and services in Pakistan as well.

The mix of factors that drove oil to its latest record were a microcosm of the forces that have almost doubled oil prices from their levels of \$64.40 a barrel in May FY07. The possibility of \$150-\$200 per barrel seems increasingly inevitable over the next 6-24 months according to the financial oil gurus. The weakness in dollar against Euro attracted investors to commodities such as oil, which they see as a hedge against inflation. A series of Federal Reserve rate cuts starting last year weakened the dollar considerably against foreign currencies; analysts blame the dollar's protracted decline for oil's sharp rise this spring.

Beyond the occasional threats to crude supplies, global demand for oil continues to grow. While demand for oil and gasoline has been soft in the U.S., the Chinese and Indian economies are growing by double digits, boosting global demand for oil. The expected growth in the Pakistani economy of around 6% also warrants higher demand for oil and other sources of energy. This leads us to forecast upward pressure on the prices of commodities, goods and services amid higher demand.

We have already witnessed the impact of higher cost on large-scale manufacturing and some parts of the service sectors. This impact is also witnessed in the agriculture sector. The growth in the Pakistani economy is based on the agriculture, industrial and service segments. The increasing inflationary pressure has thus impacted all three segments of the economy. Various industrial sectors have shown a negative YoY growth in FY08 due to the higher cost of doing business. This higher cost can trickle down into the slow down of the country's overall economic growth.

Although it is quite difficult to predict the future oil prices due to the unstable international geo-political conditions, one must keep a close watch as it has a deepening impact on the global economic village. The interdependency relationship might vary between mature and growing economies but the inflationary setback due to high oil prices impacts all.

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