Faysal Asset Management

Research Note – Calm before the storm

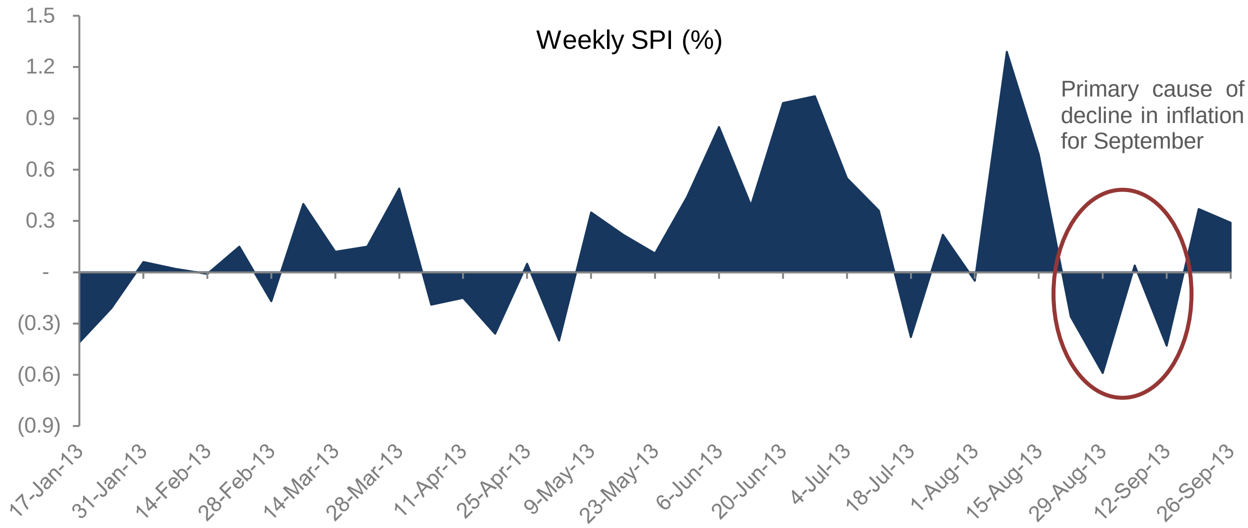
October 01, 2013

Inflation: Not a concern anymore?

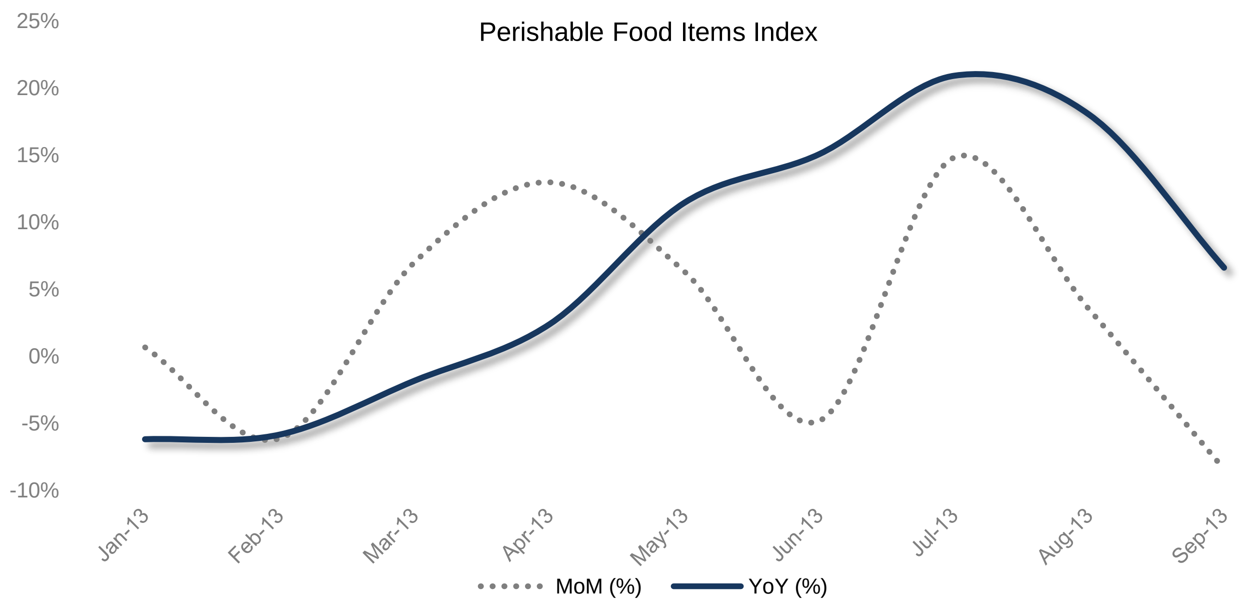
Latest Consumer Price Index (CPI) has got all the reasons to make you believe that it is not the right time to worry about inflation in the economy. The headline inflation number for the month of September 2013 has fallen by 0.29% month-on-month owing to sharp decline in prices of 'Perishable Food Items'. This marks the first decline in the monthly inflation number for the past six months which has led to a year-on-year CPI to clock in at 7.39%, much below the previous month's number of 8.55%.

Group	Weight (%)	MoM (%)	YoY (%)
General CPI for September 2013	**100.00**	**(0.29)**	**7.39**
Food & Non-alcoholic Beverages	34.83	**(1.71)**	7.48
Non-perishable Food Items	*29.84*	*(0.40)*	*7.64*
Perishable Food Items	*4.99*	***(8.41)***	*6.61*
Alcoholic Beverage & Tobacco	1.41	0.16	14.45
Clothing & Footwear	7.57	0.63	14.88
Housing, Water, Electricity, Gas & Fuels	29.41	0.10	6.60
Furnishing & Household Equipment Maintenance	4.21	1.06	8.89
Health	2.19	**1.18**	6.68
Transport	7.20	**2.05**	0.15
Communication	3.22	0.01	4.94
Recreation & Culture	2.03	0.33	10.06
Education	3.94	0.28	8.20
Restaurants & Hotels	1.23	**2.48**	12.04
Miscellaneous	2.76	**1.37**	5.73

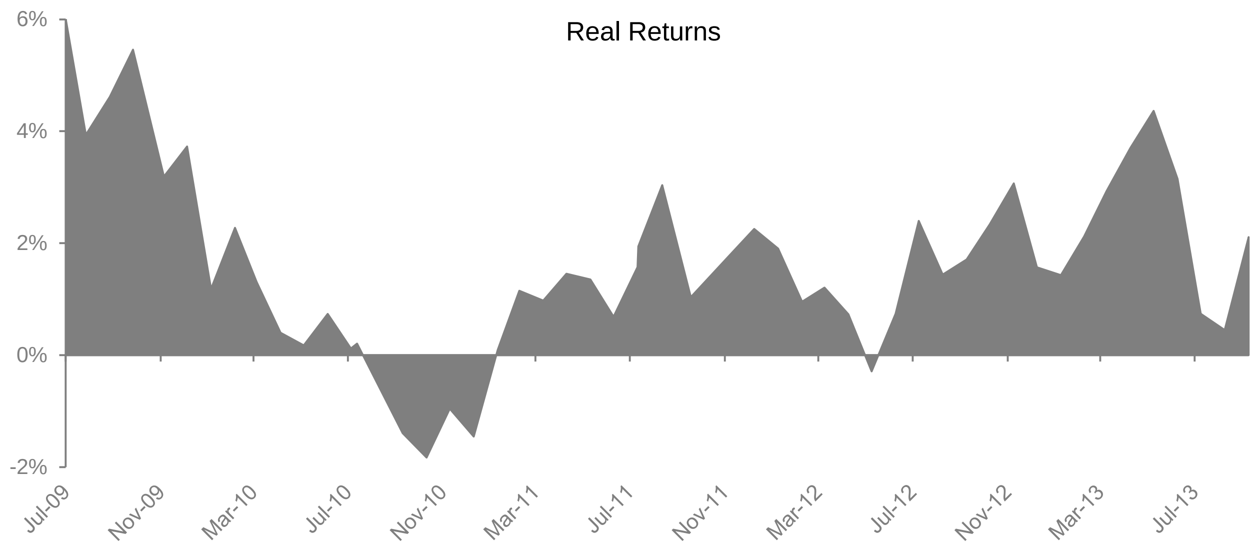
Even though the reduction in CPI is higher than market expectation an overall reduction to the broader price index was anticipated as the weekly Sensitive Price Indicator (SPI) had been falling owing to moderation in food prices (more specifically perishable food items) post Ramadan / Eid season and the seasonal monsoon floods.



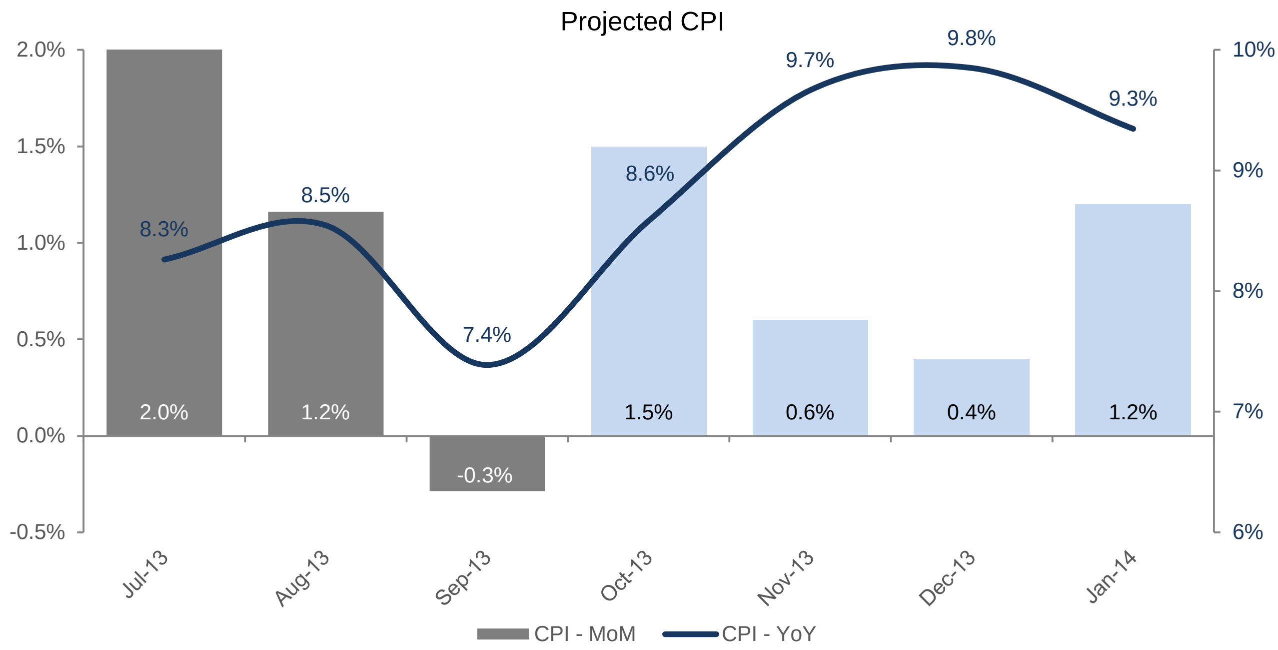
The sub index of 'Perishable Food Items' has declined by 8.4% month-on-month, the prime cause of muted CPI for September. According to the Pakistan Bureau of Statistics (PBS), the prices of chicken (-24.5%), tomatoes (-23.6%), onions (-15.6%) and fresh fruits (-15.5%) have decreased during the month. On the flip side, increase in prices of wheat and wheat related products (+3.0%), petroleum products (+3.0), eggs (+13.2%), fresh vegetable (+4.8%) and potatoes (+4.5%) have offset the odds of broader decline in inflation.



With sharp decline in inflation for the month of September, real return stands at quite comprehensive level of 211bps, a respite from the previous month's real return of 45bps.



Nonetheless, the benign headline CPI number for September is just a temporary relief as YoY CPI growth is anticipated to turn the real interest rate negative by year end. The stage is set for a strong rebound in inflationary pressures on the back of recent power tariff hikes on the consumer and commercial sector, scheduled quarterly revisions in house rent index, escalating petroleum product prices, currency devaluation and upcoming seasonal impact of Eid. In this regard, it is pertinent to mention that government has recently completed second phase of energy tariff rationalization under the IMF program to reduce power subsidies. Alongside, prices of petroleum products have once again been raised (Petrol up 3.8% and Diesel up 4.2% already on the first working day of October) amid global concerns and sharp depreciation in Pak Rupee (Pak Rupee down 6.3% FYTD against the Dollar).



Our projections point towards a sharp rise in the CPI over the course of next three months with a peak towards approximately 9.8%. These estimates are at an early stage and might be conservative in our view given the magnitude of power tariff hike pass on towards the consumer and commercial sector.

Rising inflationary concerns in the economy mainly underpinned by energy tariff rationalization and deteriorating exchange rate parity are placing drag on consumer purchasing power and production potential of the economy. To combat this, the State Bank of Pakistan (SBP) has already embarked on a tightening monetary policy by increasing the policy rate by 50bps to 9.50%.

The Government will be extremely lucky if it manages to hit its official target of 8% inflation for fiscal year 2014, a far cry from the likely double-digit inflationary era the country is heading towards.

The current decline in inflation will provide only a temporary respite to the Central Bank amidst dwindling economic indicators. We expect currency deprecation, rationalization of power tariff, positive real interest rates and achievability of tax revenue targets as key indicators which will dictate the future course of Monetary Policy actions. On the basis of the aforementioned, we do not rule out a further monetary contraction of 50bps in the upcoming Monetary Policy Statement in November.