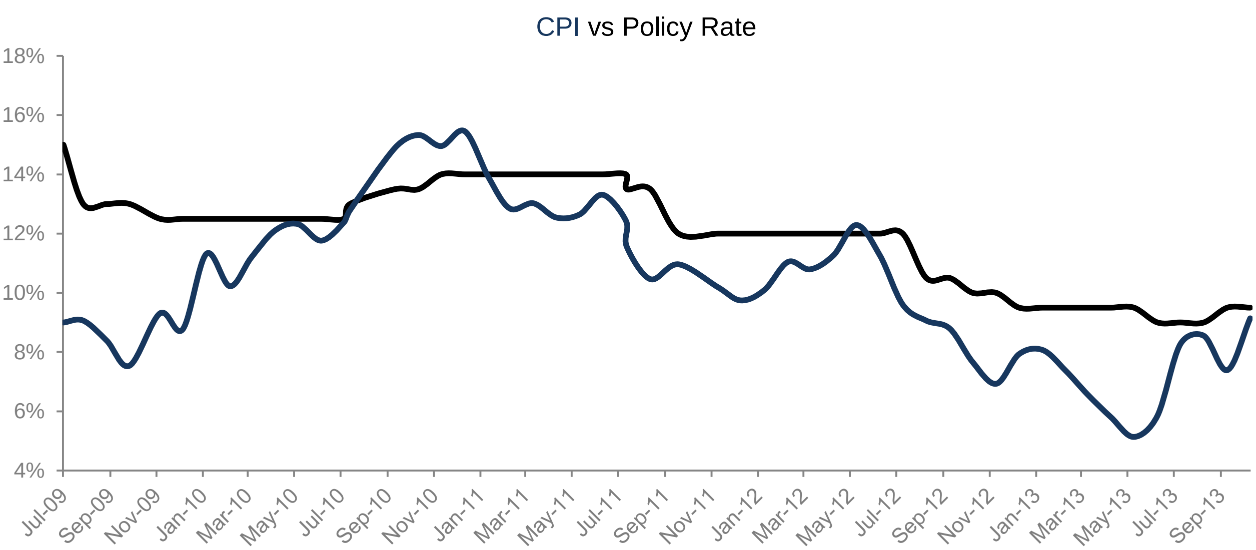
Faysal AssetManagement

Research Note – CPI electrocuted

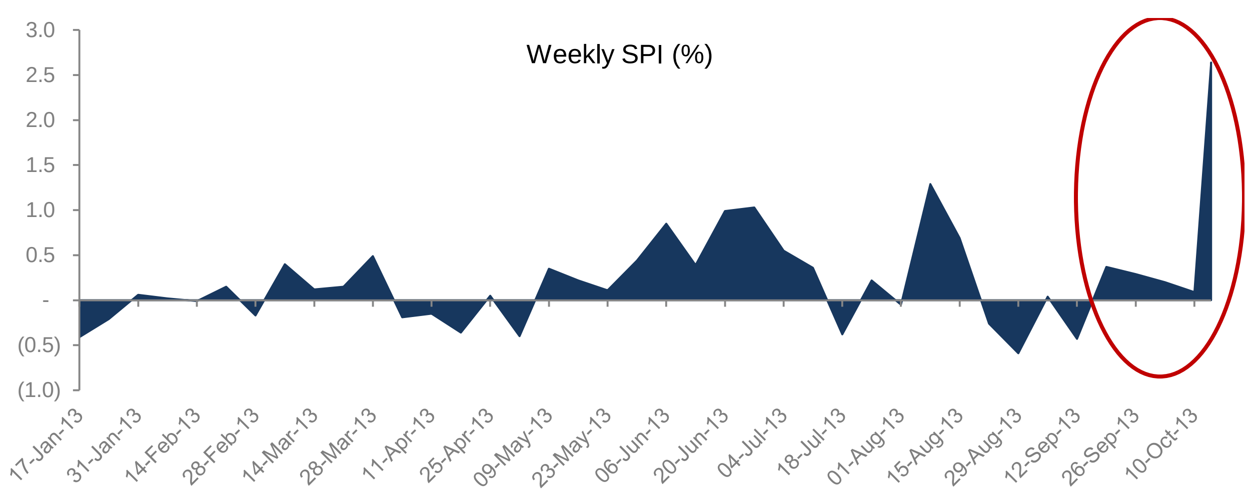
October 30, 2013

Inflation set to rebound by clocking in at 9.14%

Over the recent past, inflation in Pakistan has resembled a roller coaster with sharp declines and abrupt spikes mainly attributed to excessive volatility in food prices. In this regard, the month of October will present no exception where combination of several heavy weights (house rent, petroleum products, food items and consumer electricity tariff) in the inflation basket will result in another sharp upsurge. However, this time around, headline inflation will not revert back and is projected to exceed double digits by the end of calendar year and will likely remain on high side given the devaluation of Pak Rupee, energy tariff rationalization and fiscal consolidation measures introduced following the IMF program.



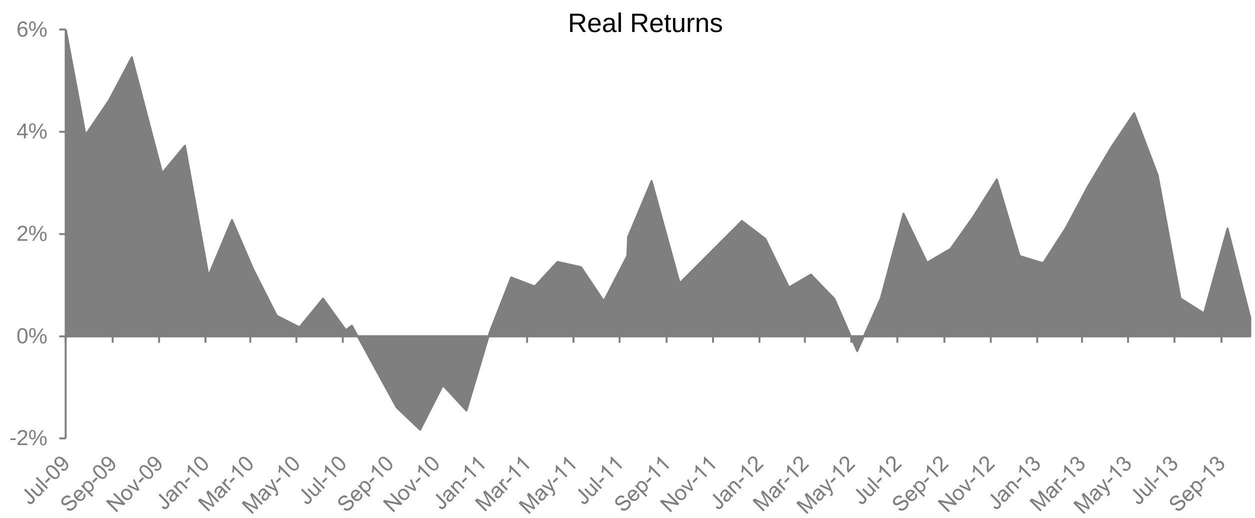
For the month of October 2013, we expect year-on-year headline inflation to clock in at 9.14% versus 7.39% last month. As anticipated earlier, the upsurge will stem from scheduled quarterly adjustment in house rent index, rise in petroleum product prices (petrol +3.7%, diesel +4.1%), Eid led spike in perishable food item prices along with adjustment made in consumer electricity tariff as depicted by the Sensitive Price Index (SPI). All these factors will contribute towards month-on-month inflation of 2.02% against 0.29% decline witnessed last month. For the current month, rise in consumer power tariff alone will contribute 0.84% in month-on-month CPI index.



As depicted in the figure above, the SPI for the week ended October 14, 2013 registered an unprecedented hike of 2.64% out of which 2.22% was attributed to the hike in electricity charges. The remaining hike largely attributed to Eid led spike in prices of tomatoes, potatoes, onions and chicken.

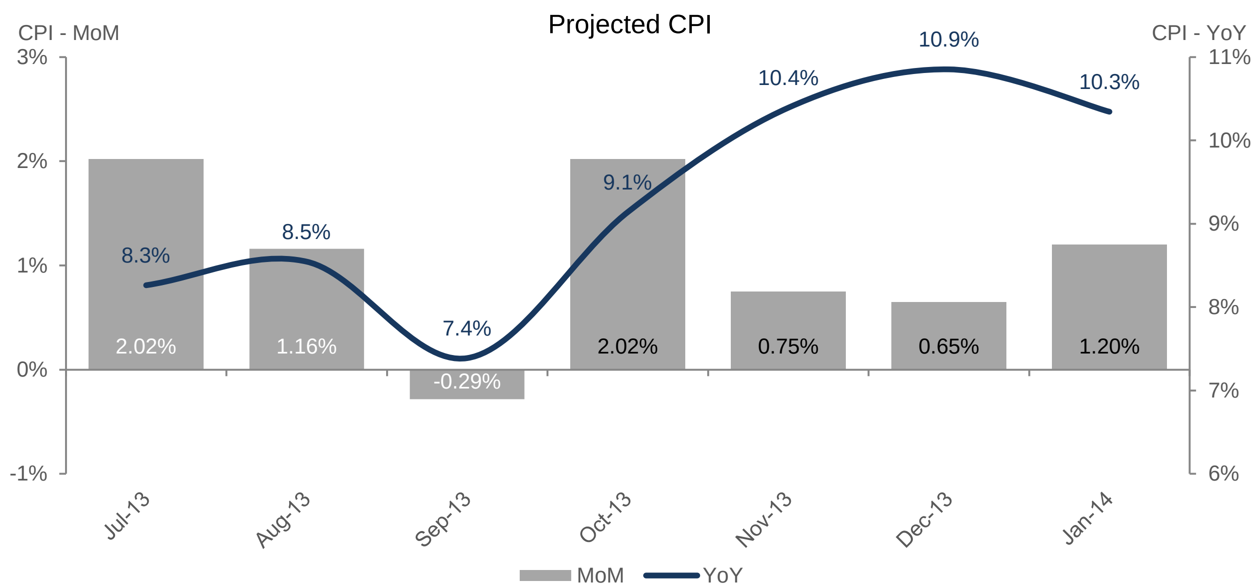
Power Tariff Category	Old Tariff	New Tariff	% increase
Up to 50 units	2.00	2.00	0.0%
1-100 units	5.79	5.79	0.0%
101-200 units	8.11	8.11	0.0%
201-300 units	8.11	12.09	49.1%
301-700 units	12.33	16.00	29.8%
Above 700 units	15.07	18.00	19.4%

The aforementioned table depicts newly approved consumer power tariff by NEPRA which is in line with the IMF's proposal to gradually phase out power subsidies. Unlike the previous tariff regime of incremental unit charges, domestic consumers would only be allowed one-slab benefit when power consumption moves towards the higher slab above 200 units per month. The Pakistan Bureau of Statistics (PBS) has already included the new power tariff in its SPI report for the week ended October 14, 2013 and our estimations suggest that ~19% average hike in power tariff would be incorporated in the monthly CPI index, contributing a 0.84% rise in the month-on-month headline inflation.



With a sharp rebound in inflationary pressure for the current month, real returns would fall to as low as 36bps. Last time, when the real return number fell below 50bps, the Central Bank hiked the benchmark interest rate by 50bps to 9.5%.

Our inflationary projection points towards double digit inflationary era to commence by next month on the back of low base effect in November along with energy tariff rationalization, devaluation of Pak Rupee and fiscal consolidation taking its toll on the consumer basket.



The State Bank of Pakistan is scheduled to announce the Monetary Policy next month which due to the sharp escalation in prices amidst weakening external position would dictate the Central Bank to hike the policy rate by at least a further 50bps.

Keeping the IMF program in perspective, our estimates suggest that 50-100bps increase in the policy rate is on the cards in the upcoming monetary policy to maintain positive real interest rates in the months ahead.