Faysal Asset Management

Research Note – Positive real interest rates on the verge of electrocution

November 01, 2013

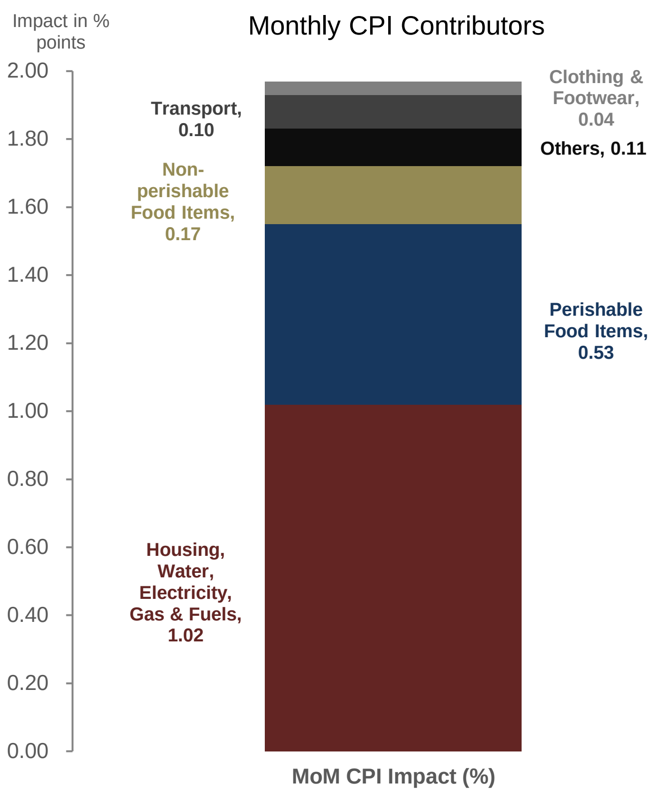
Faysal Asset Management

Inflation for October clocks in at 9.08% against expectation of 9.14%

As anticipated in our research note 'CPI Electrocuted' dated Oct 30, 2013, combination of several heavy weights (consumer electricity tariff, house rent, food items and petroleum products) in the inflation basket has resulted Consumer Price Index (CPI) to register 15 month high of 9.08% on year-on-year basis in October 2013 as compared to 7.39% in the previous month. The year-on-year surge in headline inflation came in line with our estimate of 9.14%.

Group	Weight (%)	MoM (%)	YoY (%)
General CPI for October 2013	**100.00**	**1.97**	**9.08**
Food & Non-alcoholic Beverages	34.83	1.78	9.52
Non-perishable Food Items	*29.84*	*0.51*	*7.93*
Perishable Food Items	*4.99*	*8.82*	*18.55*
Housing, Water, Electricity, Gas & Fuels	29.41	4.07	9.48
Clothing & Footwear	7.57	0.48	14.16
Transport	7.20	1.30	3.05
Furnishing & Household Equipment Maintenance	4.21	0.73	8.79
Education	3.94	0.85	8.70
Communication	3.22	0.02	4.85
Miscellaneous	2.76	0.73	4.74
Health	2.19	0.56	6.46
Recreation & Culture	2.03	0.18	9.79
Alcoholic Beverage & Tobacco	1.41	0.18	14.61
Restaurants & Hotels	1.23	0.94	11.72

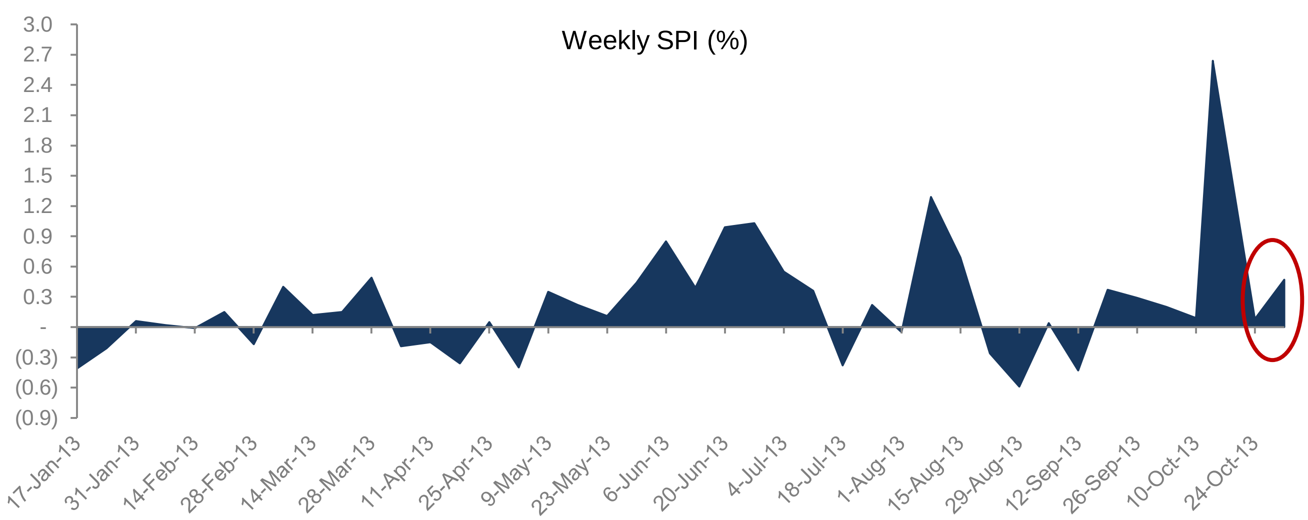
On month-on-month basis, headline inflation increased by 1.97% as compared to a decrease of 0.29% in the previous month. Consequently, average CPI for the 4MFY14 rests at 8.32% which is 0.32% higher than government's projection of 8.0% as announced in 'Medium-Term Budgetary Statement'. However, the State Bank of Pakistan in its latest 'Monetary Policy Statement' has already revised upward the inflation target to 11% to 12% for FY14.



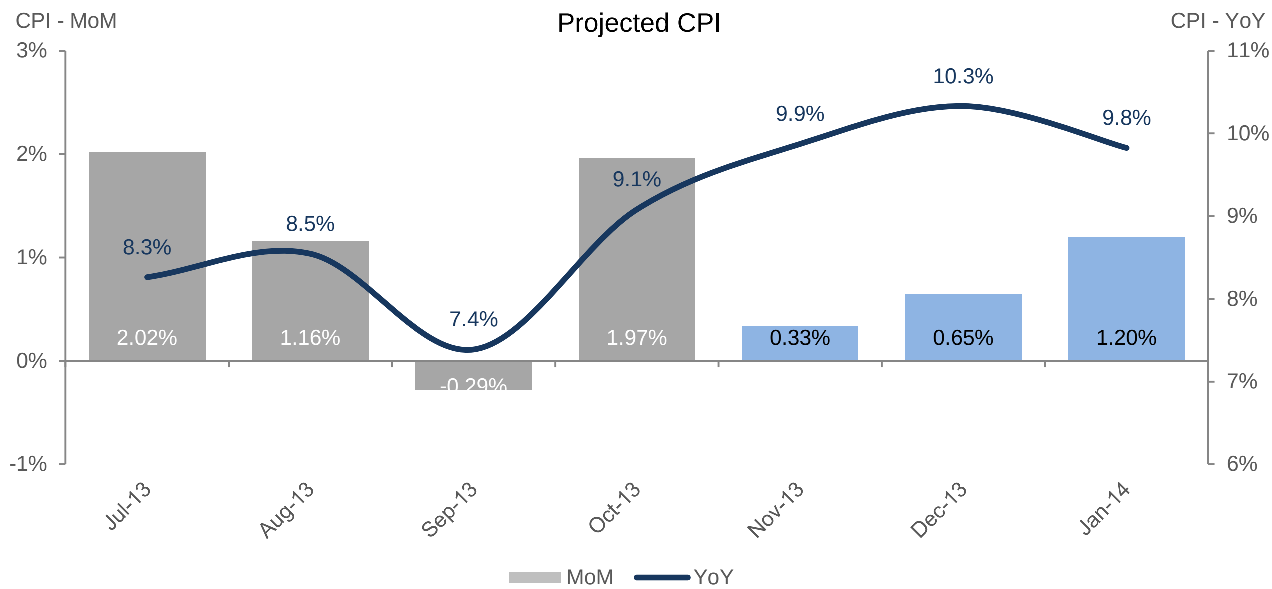
The upsurge in CPI index for the month of October 2013 is primarily attributed to consumer electricity tariff, house rent, perishable food items, non-perishable items and motor fuel having weightages of 4.4%, 21.8%, 5%, 29.8% and 3% respectively. All these items led the monthly inflation to register hike of 1.97% as compared to decline of 0.29% in the previous month.

As depicted in the graph, the major constituents of the monthly surge are the heads of 'Housing, Water, Electricity, Gas and Fuels' and 'Perishable Food Items' which contributed 1.02% and 0.53% points respectively. As anticipated, average 16% hike in NEPRA approved consumer power tariff was incorporated in the monthly CPI which has primarily resulted in year-on-year CPI to register 15 month high of 9.08%.

According to the Pakistan Bureau of Statistics (PBS), Sensitive Price Index (SPI) for the weeks ended October 24 and October 31, 2013 shows subdued price acceleration of 0.08% and 0.47% respectively. For the later week, price of tomato contributes 0.40% in the SPI reading out of total 0.47%. Latest SPI figures suggest almost constant prices across the entire CPI basket except perishable food items.



Our preliminary calculations incorporating recent SPI readings suggest year-on-year CPI to clock in at ~9.9% for the next month before heading into double digits by the calendar year end.



Anticipating a proactive approach by State Bank of Pakistan, we maintain our stance of a 50bps to 100bps hike in the key benchmark interest rate in the forthcoming monetary policy statement scheduled in November. We expect bond prices to reverse to pre-auction levels with 10, 5 and 3 Year Bonds yields rising back to 12.90%, 12.50-55% and 11.90-95% respectively as depicted below, while shorter tenor Treasury Bills maintaining their current levels driven by the ample liquidity in the system.