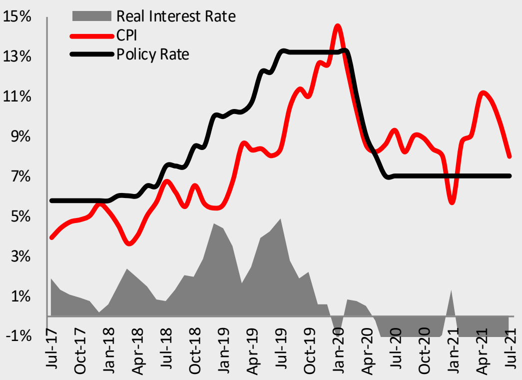
Foundation Research |

Economy

Foundation Securities
A Fauji Foundation Group Company
REP-095

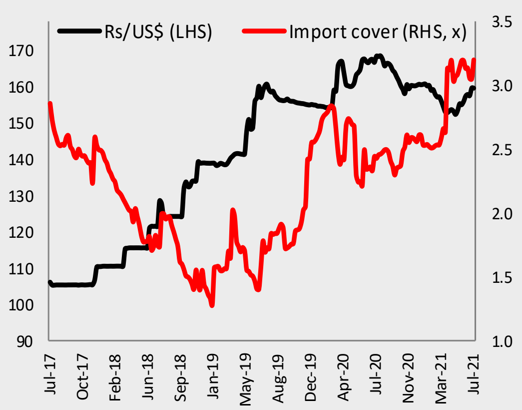
PAKISTAN

CPI vs policy rate



Source: SBP, Foundation Research, July 2021

Rupee against greenback



Source: SBP, Foundation Research, July 2021

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Pakistan Economy

July CPI to be 8.0% YoY

MoM inflation to be 0.9%

National CPI is expected to clock in at 8.0% YoY in July'21 (vs 9.7% YoY last month). In MoM comparison, inflation is estimated to be 0.9% attributed to uptick in food prices and petroleum products prices.

We foresee average inflation of 8.1% in FY22 given higher forecasted YoY International oil prices in our base case of no increase in electricity tariff. In case electricity tariff is increased as per IMF requirements, it would take up average inflation to ~9.3% YoY in FY22.

Food and Petroleum inflation to push up CPI

We expect July'21 CPI YoY reading to be around 8.0% vs 9.7%/9.3% in June'21/July'20. CPI on MoM basis is expected to be 0.9% during July given increases in food prices (~34.6% weight in CPI) and petroleum prices (3.4% weight in CPI). In the food head, prices of tomato, onion and garlic were higher during July'21. Petrol and diesel prices increased by ~4.7% MoM and ~3.1% MoM respectively during the month. LPG prices were also up in July'21 compare to June'21.

Inflation was 8.9% YoY in FY21 (vs 10.7% YoY in FY20) mostly due to high food inflation (12.5/13.2% YoY in Urban/Rural in FY21 – see Fig 1) as core inflation (non-food, non-energy) was lower in FY21 (6.0/7.6% YoY in Urban/Rural) compared to 7.5/8.7% in FY20, in line with moderate underlying demand in the economy. High food inflation stems from supply disruptions caused by non-availability of quality seeds, weak commodity management, tighter border control, untimely/torrential rains and higher international food prices.

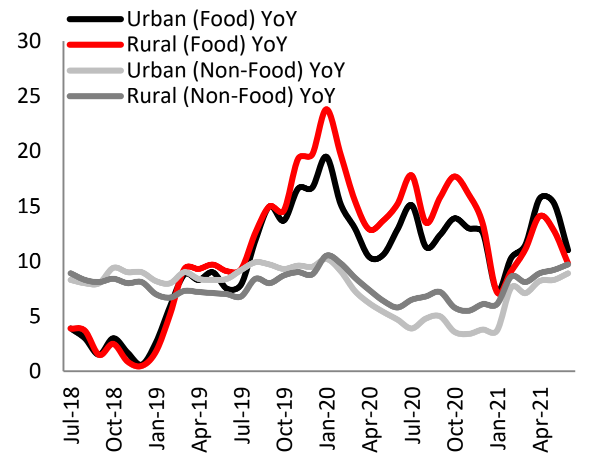
Stability foreseen in balance of payments

Pakistan expects inflow of US$2.8bn in August 2021 from IMF under their increased allocation for member countries which would compensate for the delay in disbursement of US$1.1bn under the postponed 6th review of the IMF EFF program. Major stumbling blocks between IMF and Gov't for the 6th review have been (1) energy tariff hike and (2) budgetary tax measures. We feel that Gov't plan (1) to resolve circular debt and (2) implement structural reforms would result in resolution of deadlock with IMF within 3-6 months.

During FY21, current account deficit was recorded at US$1.9bn which has been underpinned by record exports (up by US$3.6bn or 13% in FY21) and remittances (up by US$6.2bn or 27% YoY in FY21). However, we note with consternation that goods imports have touched levels last seen during FY18 balance of payments crisis (see Fig 5). This presents a risk to CAD outlook if (1) import volumes increase (given higher Gov't economic growth target) or (2) commodity prices rise further or (3) remittances normalize to pre COVID level.

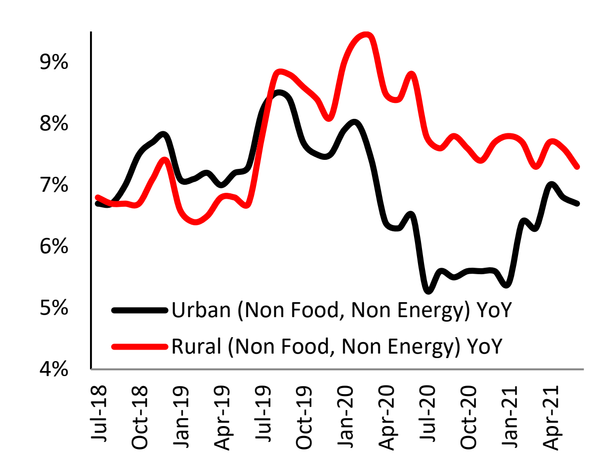
However, we believe that flexible exchange rate would be government's first line of defense against ballooning imports. To highlight, currency has depreciated against the greenback by 2.6/4.2/5.3% during last 1/2/3 months but FX reserves have remained stable with support expected to continue from Roshan Digital Account inflows. Monetary policy would come into play only if demand side inflationary pressures emerge. FSL estimates that in FY22 current account deficit would be ~2.1% of GDP (US$6.6bn) versus SBP forecast of 2-3% of GDP (US$6.2-9.5bn).

Fig 1: Core inflation has on upward trajectory



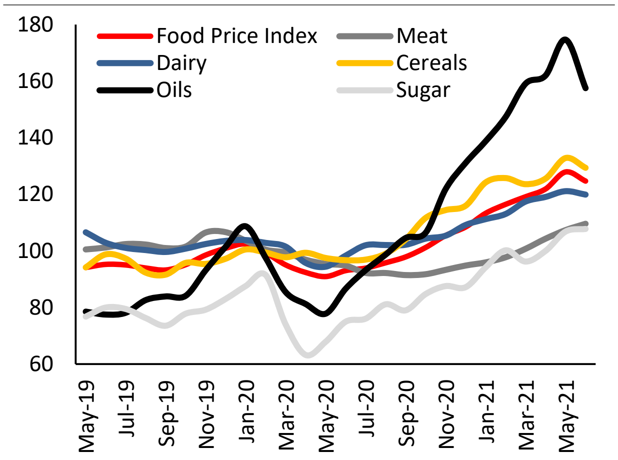
Source: PBS, FSL Research, July 2021

Fig 2: Urban core inflation nearing rural core inflation



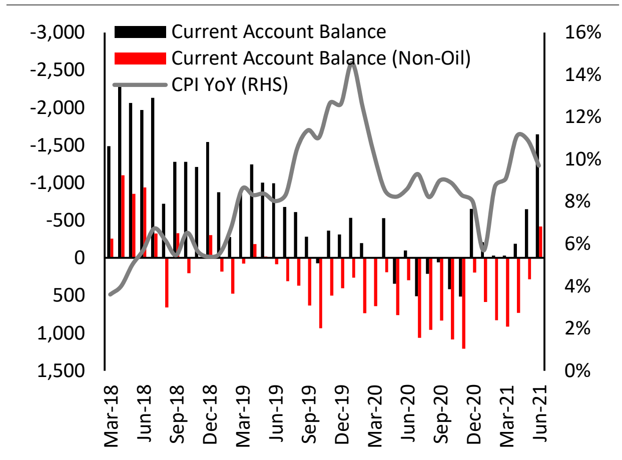
Source: PBS, FSL Research, July 2021

Fig 3: Int'l food prices declined recently…



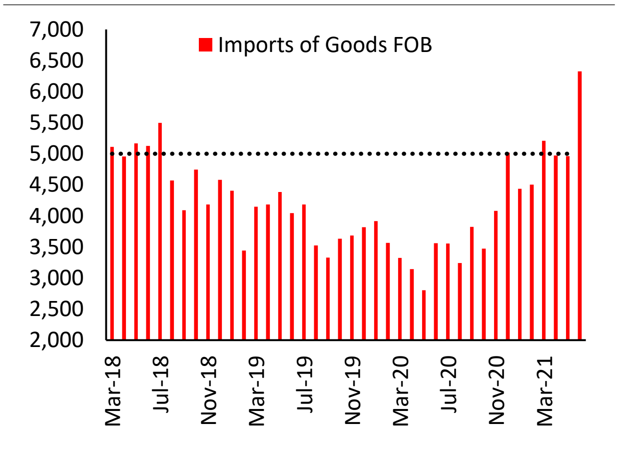
Source: FAO, SBP, FSL Research, July 2021

Fig 4: Current account and CPI…



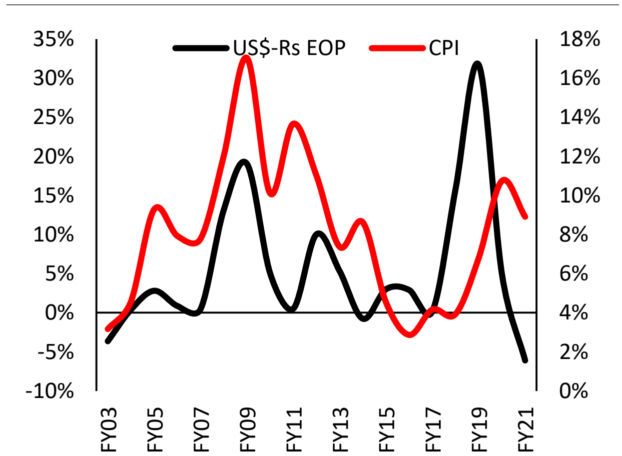
Source: SBP, PBS, FSL Research, July 2021

Fig 5: Goods import rise above FY18 levels (US$ bn)



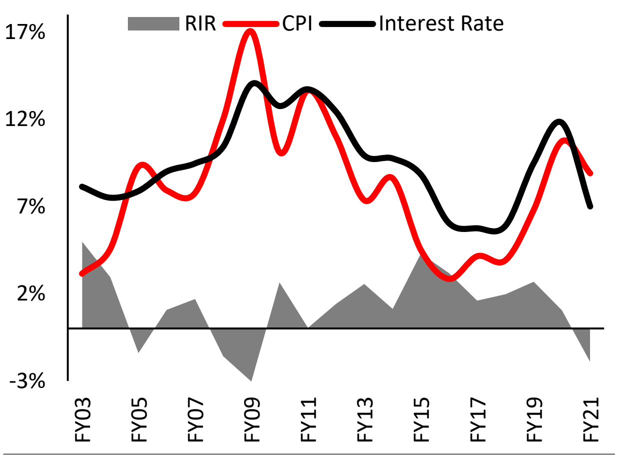
Source: SBP, FSL Research, July 2021

Fig 6: Exchange rate and inflation move in tandem



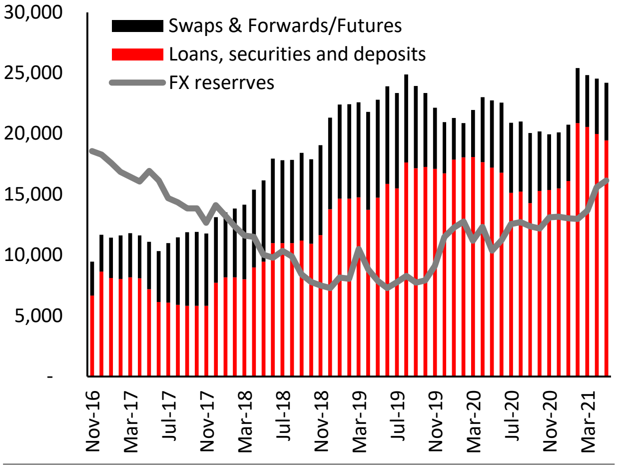
Source: Bloomberg, SBP, FSL Research, July 2021

Fig 7: Inflation and interest rate over the long run



Source: PBS, SBP, FSL Research, July 2021

Fig 8: SBP FX reserves lower than o/s 1yr liabilities



Source: SBP, FSL Research, July 2021

Abbreviations

FX	Foreign Exchange
MoM	Month on Month
YoY	Year on Year

Important disclosures:

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Recommendations definitions

If

Expected return >+10%	Outperform.
Expected return from -10% to +10%	Neutral.
Expected return <-10%	Underperform.