Foundation Research |

Economy

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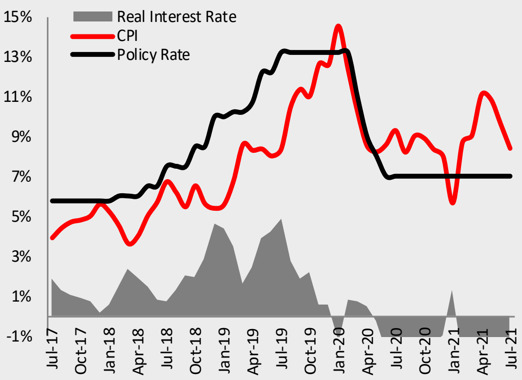
REP-095

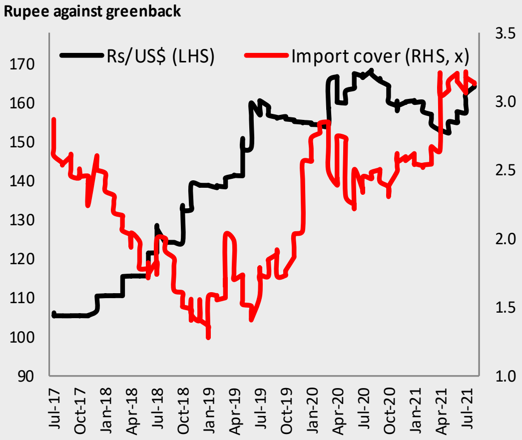
PAKISTAN

CPI vs policy rate



Source: SBP, Foundation Research, Aug 2021

Rupee against greenback



Source: SBP, Foundation Research, Aug 2021

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Pakistan Economy

August CPI to be 8.6% YoY

MoM inflation to be 0.8%

National CPI is expected to clock in at 8.6% YoY in August'21 (vs 8.4% YoY last month). In MoM comparison, inflation is estimated to be 0.8% attributed to uptick in food 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 August'21 CPI YoY reading to be around 8.6% vs 8.4%/8.2% in July'21/August'20. CPI on MoM basis is expected to be 0.8% during August 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 and chicken were higher during August'21. Petrol and diesel prices increased by ~4.2% MoM and ~1.2% MoM respectively during the month. LPG prices were also up in Aug'21 compared to July'21.

Food inflation (3M moving average of 11.9/10.0% YoY in Urban/Rural – see Fig 1) has declined from previous 3M-MA level (12.5/11.4% YoY in Urban/Rural) whereas core inflation (non-food, non-energy) has remained stable at 7.0% YoY (3M-MA) compared to 7.0% YoY in previous 3M-MA level.

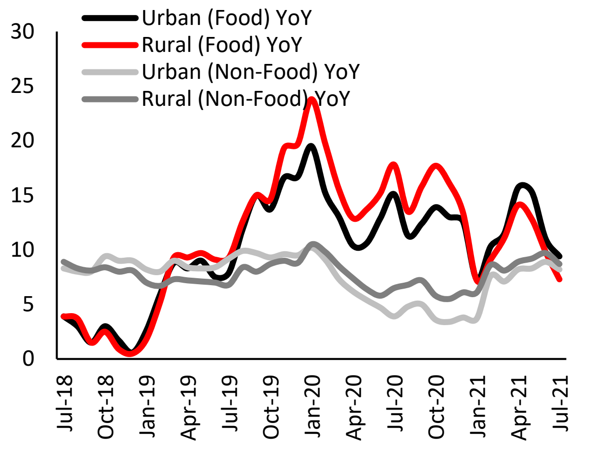
Stability foreseen in balance of payments

The Finance Minister has recently stated that Pakistan intends to remain in the US$6.0bn IMF EFF program which started 2 years ago but has been suspended since June'21 pending completion of the 6th review. 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. We flag that resumption of IMF program presents an upside risk to inflation outlook given expected energy price hike.

During July'21, current account deficit was recorded at US$773mn driven by 17% YoY increase in exports whereas (1) imports inclined by a whopping 41% YoY despite decline in international travel (part of services imports) and (2) remittances declined by 2% YoY but still remain elevated above the US$2.7bn per month level. The increase in imports is concerning given that goods imports have exceeded 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. We also note that resumption of international travel would exert pressure on CAD.

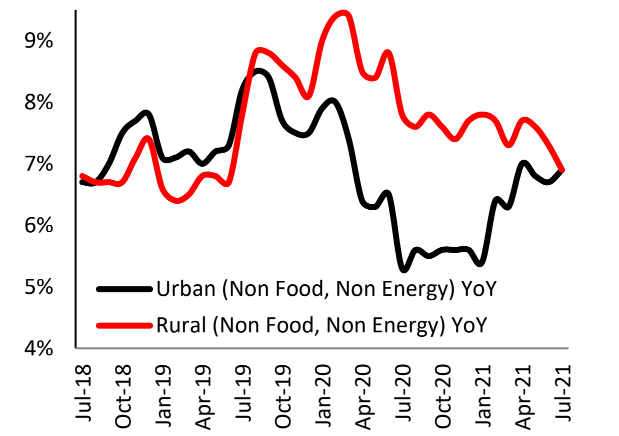
However, we believe that flexible exchange rate would be government's first line of defense against ballooning imports. To highlight, currency has depreciated against the greenback by 2.6/5.3/7.8% during last 1/2/3 months but FX reserves have remained stable with support expected to continue from remittances and 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: Food inflation on downward trajectory…



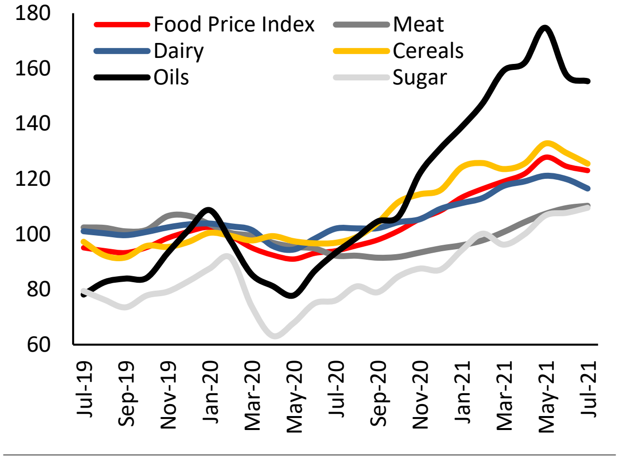
Source: PBS, FSL Research, Aug 2021

Fig 2: Urban and rural core inflation converge…



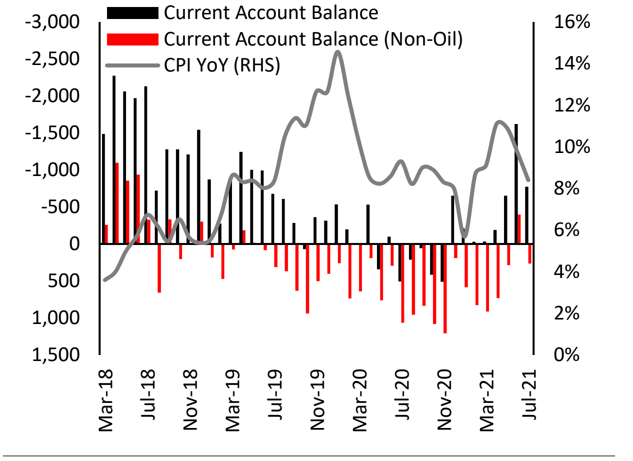
Source: PBS, FSL Research, Aug 2021

Fig 3: Int'l food prices moderating…



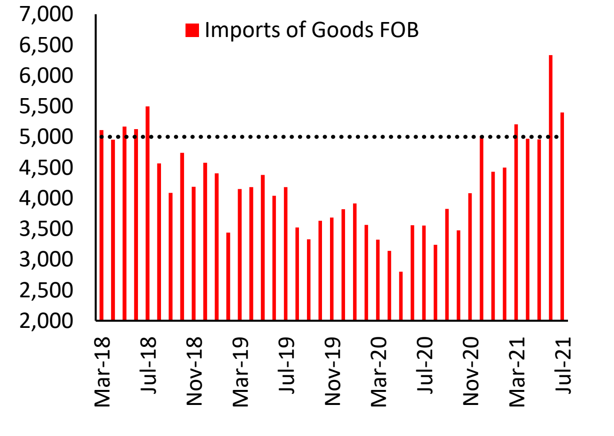
Source: FAO, SBP, FSL Research, Aug 2021

Fig 4: Current account and CPI…



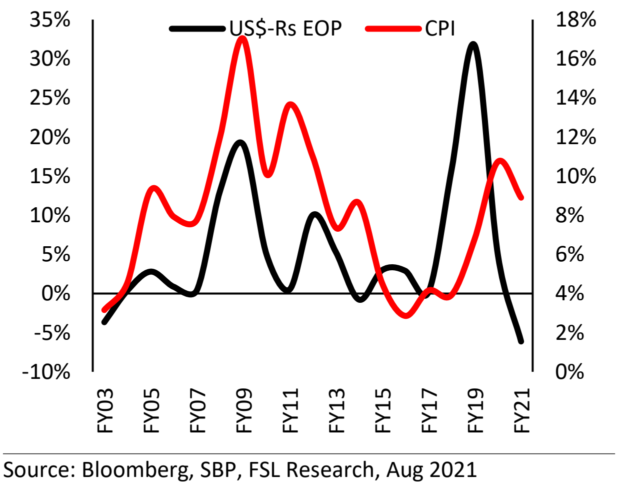
Source: SBP, PBS, FSL Research, Aug 2021

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



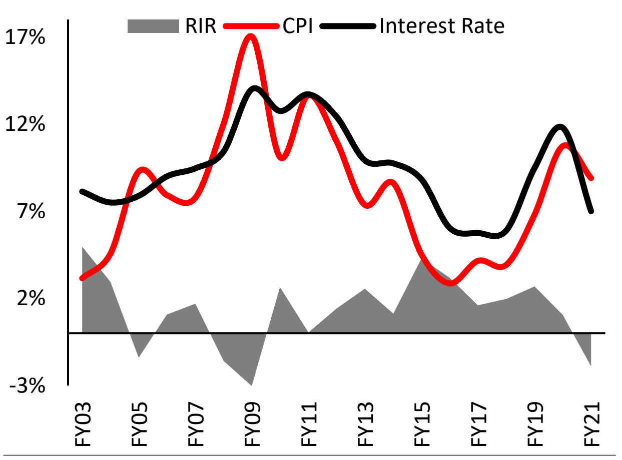
Source: SBP, FSL Research, Aug 2021

Fig 6: Exchange rate and inflation move in tandem



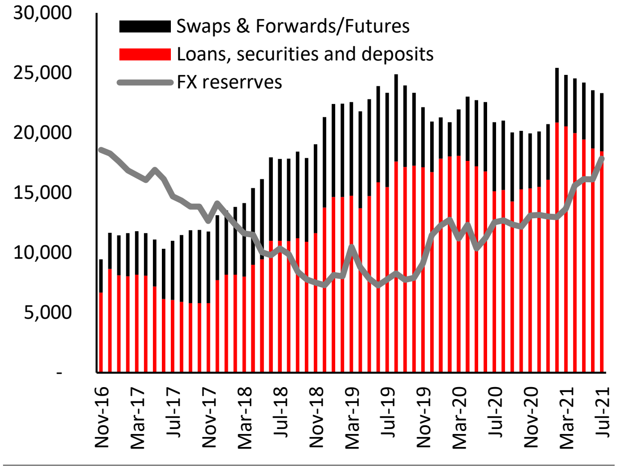
Source: Bloomberg, SBP, FSL Research, Aug 2021

Fig 7: Inflation and interest rate over the long run



Source: PBS, SBP, FSL Research, Aug 2021

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



Source: SBP, FSL Research, Aug 2021

Abbreviations

FX	Foreign Exchange
MoM	Month on Month
YoY	Year on Year

Important disclosures:

Recommendations definitions

If

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