

# Day Break

Thursday, 28 March 2019

## ECONOMY

Exhibit: Monthly Inflation trend

	CPI YoY	CPI MoM
Mar-19	8.7%	0.7%
Feb-19	8.2%	0.6%
9MFY19	6.7%	0.6%
9MFY18	3.8%	0.2%

Exhibit: Inflation Break-up

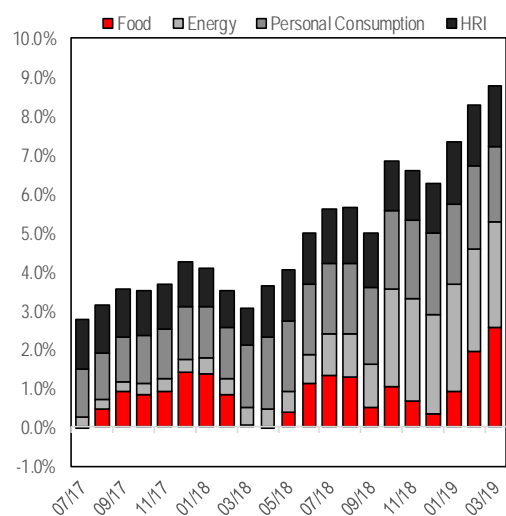
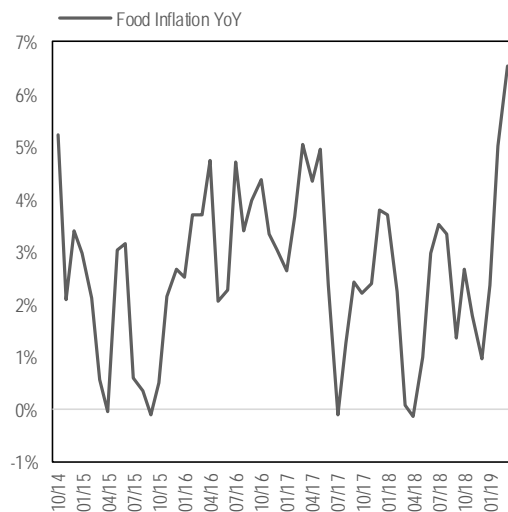


Exhibit: Food prices on a loose



Source: SBP, PBS & IGI Research

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## Economy

### Expecting a 25bps policy rate hike; Monthly inflation to record a +8.7%YoY growth

- For the month of Mar-19, we expect headline CPI inflation to print a +8.7%YoY (+8.2% last month) which close to a 5-yr high, Key assumptions that feed into our estimates are +1.2%MoM increase in food prices and ~2% rise in domestic petroleum prices
- We expect a **25bps** further rate hike taking policy rate to 10.75% and discount rate to 11.0%, leaving forward real rates close to ~3.5%.
- Recent improvements in country's C/a balance and foreign funding will eventually ease up external balance, however fiscal management still pose a challenge.

#### Monthly inflation to record a new 5-yr high of +8.7%YoY

For the month of Mar-19, we expect headline CPI inflation to print a +8.7%YoY (+8.2% last month) which is close to a 5-yr high. On monthly basis, the increase roughly translates to +0.7% compared to +0.6% in Feb-19. Nevertheless, this will push average period inflation for 9MFY19 close to +>6.0% compared to ~4.0% last year.

#### Rise in domestic food and petroleum prices to dictate monthly inflation

Key assumptions that feed into our estimates are +1.2%MoM increase in food prices as depicted by rising trend of SPI (up by ~1.35% on MoM basis) and ~2% rise in domestic petroleum prices (PKR 2.51/ltr MS and PKR 4.75/ltr HSD). Apart from non-food/energy seasonal demand with approaching end of winter is likely to stay strong.

#### Headline inflation to average 7.5% in FY19

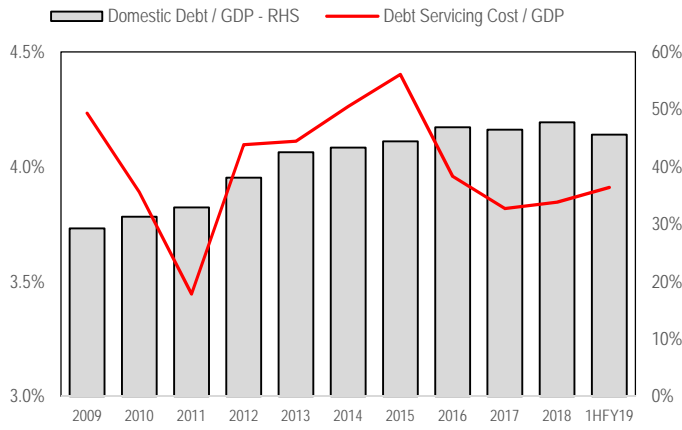
Although 3qF19 inflation is relatively high averaging ~+8.0% compared to +6.5% and +5.6% in 2q and 1q supported by high base effect, full year FY19 average inflation is likely to stay well under ~8% - we estimate 7.5%, which is in-line with SBP target.

#### Implication for Monetary policy; expecting a cautious +25bps hike in policy rate to 10.5%

Recent policy rate hikes of cumulatively 450bps has largely been dictated by country's widening current account deficit and subsequent weakening of PKR against USD, we expect upcoming monetary policy statement (MPS) is likely to show a cautious stance on the back of downward sticky core inflation (+8.8% in Feb-19, 9MFY19 average 8.2% versus 5.4% last year). We expect a 25bps further rate hike taking policy rate to 10.75% and discount rate to 11.0%, leaving forward real rates close to ~3.5%.

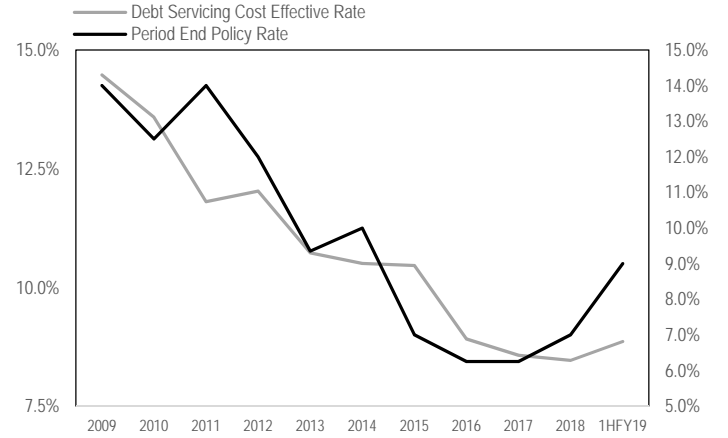
Key consideration for a cautious stance in our view includes marked improvement seen on external accounts, whereby C/a deficit contracted to USD 0.35bn compared to USD ~2.0bn average monthly (USD 18.98bn C/a deficit recorded in FY18) and improvement in country's FX position post external funding. However, fiscal slippages particularly on revenue remain yet to be addressed and cost of servicing domestic debt at rising interest rate environment would further complicate fiscal management for policy makers.

**Exhibit: With slowing economic growth rising interest rates, debt servicing burden is likely to increase**



Source: IGI Research, SBP

**Exhibit: Effective cost of domestic debt servicing mirrors existing policy rate**



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