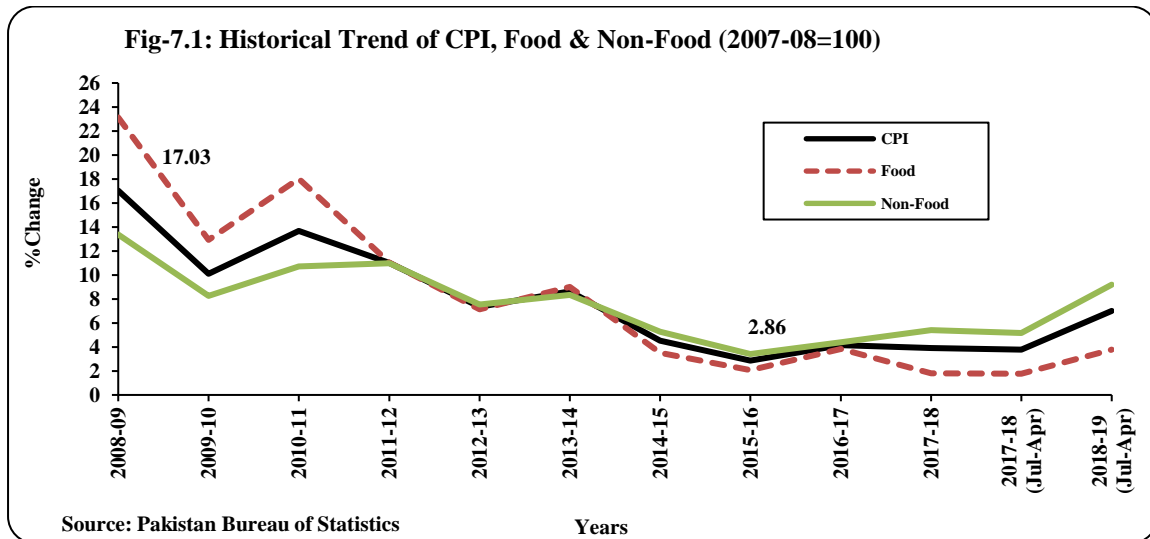


Inflation

Inflation is a persistent change in the prices of goods and services in an economy over a period of time. It is generally believed that persistently high inflation hurts economic growth and erodes the value of local currency. It has a diverse effect on perceptions and expectation of different segments of society and therefore has a differential impact on decision-making of different economic agents. Historically, Pakistan economy has seen ups and down in inflationary trends.



A persistent increase in the fiscal deficit during the last two years has been an important factor adding to demand pressures in the economy. During FY18, development expenditures declined, while growth in current expenditures accelerated. Thus, the composition of expenditure shifted from investment to more consumption. In this backdrop of higher economic activity and domestic demand, the growth in imports remained strong. Though all the major commodity groups except for food recorded strong growth, the major contribution to higher imports came from petroleum, machinery, metals, and chemicals.

The pass-through of exchange rate depreciation and higher international commodity prices, in addition to strong underlying demand pressures, started to reflect in higher year-on-year inflation from May 2018. The core inflation – excluding volatile food and energy prices – after remaining sticky around 5.5 percent, picked up pace from March 2018 onwards. Yet, the average inflation was slightly lower during the year, primarily due to low food inflation on the back of more than sufficient food stocks available in the country. Closely watching these developments and the likely impact of an expansionary fiscal policy and worsening external accounts on the macroeconomic stability, especially the future inflation path, the Monetary Policy Committee (MPC) raised the policy rate, reversing the multi-year easy monetary policy.

The headline inflation measured by Consumer Price Index (CPI) during the last five years remained on average at 4.8 percent. The preceding fiscal year (FY 2018), CPI inflation was contained to 3.9

percent, with an end-period inflation of 5.2 percent, compared to 4.2 percent during FY 2017. The main reason for increase in inflation was the increase in prices of non-food items, which increased by 5.4 percent. The increase in non-food inflation was due to higher energy prices and strong overall domestic demand. Food inflation was only 1.8 percent, due to only a moderate increase in international prices of food items. Low food inflation helped in keeping overall inflation relatively low. The core inflation was recorded at 5.9 percent.

The start of the current fiscal year FY 2019, CPI started rising. It increased to 5.8 percent in July 2018 and following three months after remaining sticky at 5 percent increased to 6.8 percent in October 2018. The spike witnessed in October 2018 was due to increase in gas prices. The Oil and Gas Regulatory Authority revised the retail prices of natural gas for various consumers after keeping them unchanged for about two years. The phenomenal increase of 9.4 percent witnessed in March 2019, while in April 2019 it slows down to 8.8 percent. The pressures on headline inflation are explained by adjustment in prices of electricity and gas, a significant increase in the perishable food prices, exchange rate depreciation along with reversal of global fuel prices.

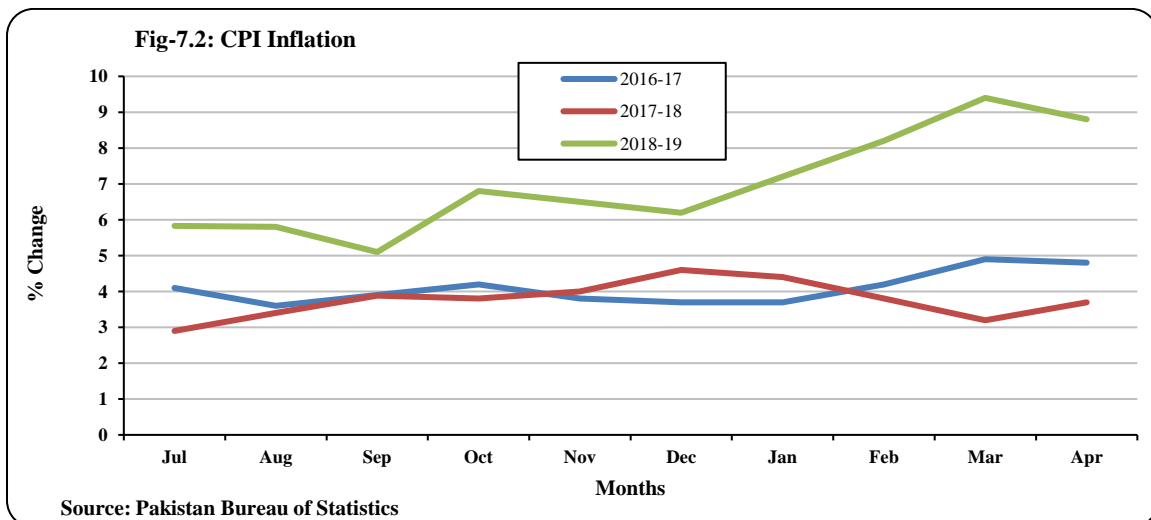
The most dominating push to inflation came from core inflation which has been on a rising trend since March 2018.¹ The gradual buildup of domestic demand fanned by the past expansionary monetary and fiscal policies, was the main factor behind rising core inflation, which increased to 8.5 percent in March 2019. The core inflation has dropped to 7.0 percent in April 2019 (after remaining above 8 percent during last seven months) as monetary tightening by the present government started to take effect. Although deceleration in core inflation is a welcome development, this may be a short-term relief as some measures (significant depreciation in the value of local currency, unfreezing of energy prices, etc.) taken by the present government to stabilize the economy will have an adverse short-term effect on inflation.

Table 7.1: CPI Inflation

	2016-17	2017-18	2018-19
Jul	4.1	2.9	5.8
Aug	3.6	3.4	5.8
Sep	3.9	3.9	5.1
Oct	4.2	3.8	6.8
Nov	3.8	4.0	6.5
Dec	3.7	4.6	6.2
Jan	3.7	4.4	7.2
Feb	4.2	3.8	8.2
Mar	4.9	3.2	9.4
Apr	4.8	3.7	8.8
Average (Jul-Apr)	4.1	3.8	7.0

Source: Pakistan Bureau of Statistics

A trend of previous years and current year month wise inflation is given in the table.



Source: Pakistan Bureau of Statistics

¹ In formulating its monetary policy, SBP uses the trend in core inflation as a good predictor for future inflation.

During July-April FY2019 headline inflation measured by CPI averaged at 7.00 percent against 3.77 percent on the back of the prevalence of some underlying demand in the economy as well as continued pass through of exchange rate depreciation and higher fuel prices. The international oil prices continued on their upward trajectory that government has partially passed on the impact.

Core Inflation

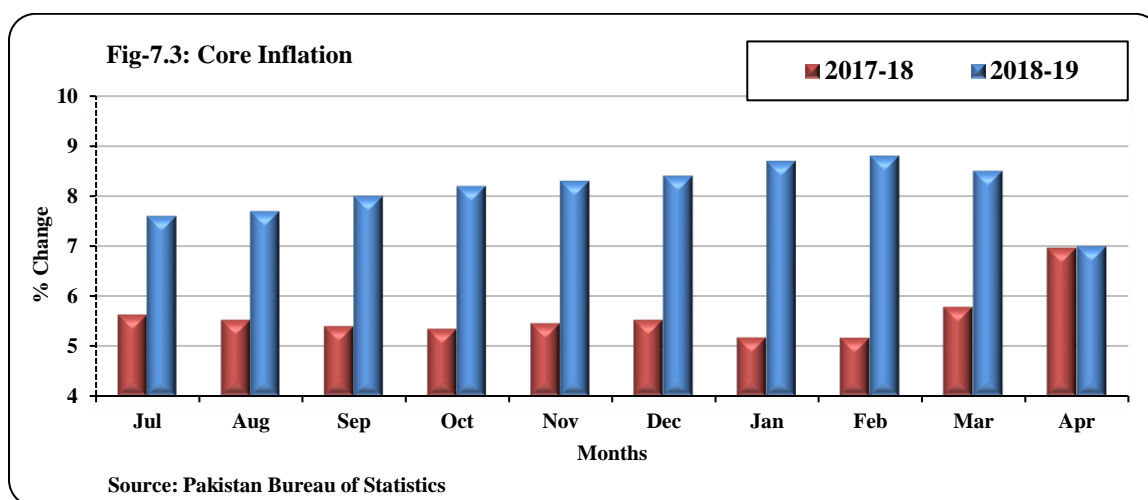
Core inflation is measured through the indices of 43 non-food non energy items. Non-food non-energy (NFNE) inflation is calculated by excluding food group and energy items (Kerosene oil, petrol, diesel, CNG, electricity and natural gas) from the CPI basket.

Core inflation remained sticky since the start of current fiscal year and reached to 8.8 percent in February 2019 the highest in last seven months of current fiscal year. The downward trend started in March 2019 and in April 2019 it slow down to 7.0 percent, while on average during July-April FY 2019, it is recorded at 8.11 percent compared to 5.60 percent of FY 2018. Considering these developments, the SBP is following a contractionary monetary policy and revised the policy rate to 12.25 percent as on 21st May 2019. The continuous increase in education and healthcare costs kept core inflation higher on average compared to the same period last year. The Table 7.2 shows the core inflation trend year-on-year basis.

Table 7.2 : Core Inflation

	2017-18	2018-19
July	5.6	7.6
August	5.5	7.7
September	5.4	8.0
October	5.3	8.2
November	5.5	8.3
December	5.5	8.4
January	5.2	8.7
February	5.2	8.8
March	5.8	8.5
April	7.0	7.0
Average (Jul-Apr)	5.6	8.1

Source: Pakistan Bureau of Statistics



Inflation by Income Group

The Consumer Price Index is constructed for five income groups (a) Upto Rs.8000 (b) Upto Rs.8001-12000 (c) Upto Rs.12001-18000 (d) Upto Rs.18001-35000 (e) Above Rs.35000.

During July- April 2018-19, the variation in the indices for these various income groups shows a mix pattern of movement from lower to higher income groups. Its comparative position is given in the following Table 7.3.

Table 7.3 : Inflation by Consumer Income Groups (Base Year 2007-08=100)

	Combined	Upto Rs.8000	Upto Rs. 8001-12000	Upto Rs. 12001-18000	Upto Rs. 18001-35000	Above Rs.35000
2008-09	17.0	18.0	17.8	18.1	17.6	16.8
2009-10	10.1	10.5	10.5	10.6	10.3	9.8
2010-11	13.7	14.5	14.3	13.0	14.7	13.3
2011-12	11.0	10.0	10.6	10.5	10.8	11.5
2012-13	7.4	7.9	8.6	8.4	6.8	6.4
2013-14	8.6	8.8	8.5	9.1	9.1	8.3
2014-15	4.5	3.7	3.8	4.3	4.4	4.8
2015-16	2.9	2.4	2.8	2.4	3.0	3.0
2016-17	4.2	3.8	3.9	3.9	4.1	4.3
2017-18	3.9	2.8	3.1	3.2	3.5	4.6
Jul-Apr						
2017-18	3.8	2.7	3.0	3.1	3.3	4.4
2018-19	7.0	4.9	5.3	5.5	6.9	8.4

Source: Pakistan Bureau of Statistics

The higher income group experienced higher inflation as it recorded at 8.4 percent and lower income recorded at 4.9 percent compared to 4.4 and 2.7 percent respectively, of last year. The combined income group experienced 7.0 percent against 3.8 percent last year.

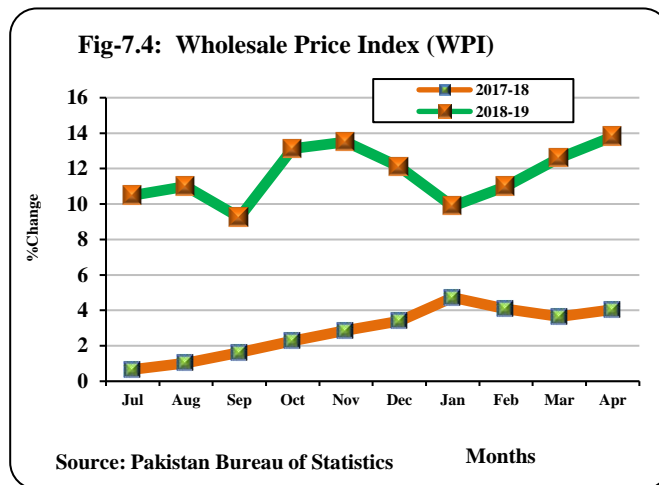
Wholesale Price Index (WPI)

The Wholesale Price Index (WPI) is influenced by the landed imports prices and local production. During current fiscal year, there has been a constant increase in WPI. The persistent jump in Wholesale prices is largely the result of the rise in landed prices of imported goods due to exchange rate adjustments along with upward movement of fuel and commodity prices.

Table 7.4 : Wholesale Price Index (WPI)

	2017-18	2018-19
July	0.7	10.5
August	1.0	11.0
September	1.6	9.2
October	2.3	13.1
November	2.9	13.5
December	3.4	12.1
January	4.7	9.9
February	4.1	11.0
March	3.6	12.6
April	4.0	13.8
Average (Jul-Apr)	2.8	11.7

Source: Pakistan Bureau of Statistics



The following Table 7.5 shows the trend of various wholesale price groups.

Table 7.5 : Wholesale Price Index

Commodity	Weights	Jul-Apr (%)		Point Contribution	
		2017-18	2018-19	2017-18	2018-19
General(WPI)	100.00	2.83	11.69	2.83	11.69
Agriculture Forestry & and Fishery	25.77	3.02	7.41	0.78	1.91
Non-Food	68.89	3.61	12.36	2.49	8.51

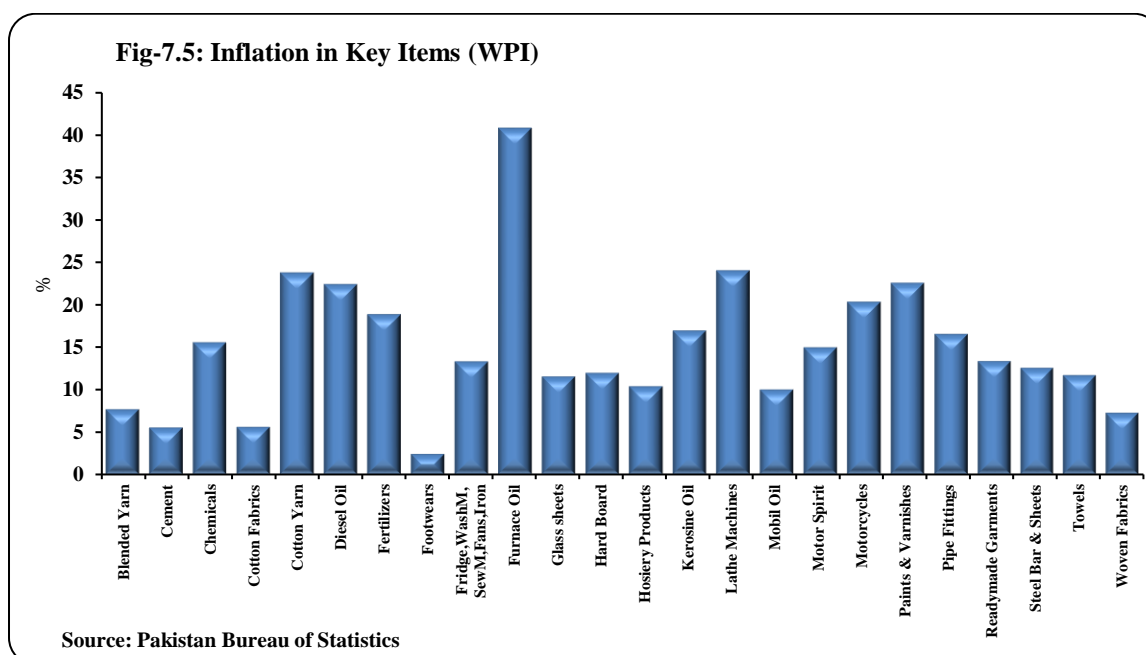
Table 7.5 : Wholesale Price Index

Commodity	Weights	Jul-Apr (%)		Point Contribution	
		2017-18	2018-19	2017-18	2018-19
Ores & Minerals, electricity gas & water	12.04	0.34	14.31	0.04	1.72
Food Products, Beverages and Tobacco, Textiles Apparel and Leather Products	31.11	1.23	10.27	0.38	3.19
i) Food Products and Bev.& Tobacco	20.07	-0.11	7.62	-0.02	1.53
ii) Textiles & Apparel	10.33	4.42	13.79	0.46	1.42
iii) Leather Products	0.71	-1.18	33.07	-0.01	0.23
Other Transportable Goods Except Metal Products, Machinery and Equipment	22.37	7.67	21.15	1.72	4.73
Metal Products Machinery & Equipment	8.71	2.37	6.70	0.21	0.58

Source: Pakistan Bureau of Statistics (PBS)

During July-April FY 2019 the WPI inflation was at 11.69 percent, compared 2.83 percent of the corresponding period last year. Movement of various groups of WPI such as Agriculture forestry & Fishery increased by 7.41 percent, ores & minerals 14.31 percent, textiles & apparel 13.79 percent, leather 33.07 percent, other transportable 21.15 percent, metal machinery 6.70 percent as compared to 3.02 percent, 0.34 percent, 4.42 percent, -1.18 percent, 7.67 percent and 2.37 percent, respectively of the same period last year.

In July 2018, the rupee depreciated by 4.4 percent. With a lag of one month, i.e. in August 2018, WPI recorded a double digit growth (of 11.0 percent). Likewise, the adjustments of 16.3 percent made in the value of rupee (vis-à-vis US dollar) between July-April period of FY2019, resulted an increase in WPI of 11.7 percent during the same period, with highest spike of 13.8 percent observed in April 2019. The foregoing analysis shows that there is a definite positive (and perhaps a lagged) impact of depreciation of rupee on WPI-inflation. Nonetheless, depreciation is not the only factor influencing WPI. Increase in domestic energy prices, continued impact of excessive monetization of government debt and some supply-side bottlenecks all contributed to WPI inflation.



Sensitive Price Indicator (SPI)

SPI monitors the prices of 53 most essential items taken from 17 different urban centres and is reported every week. The trend of this index is monitored regularly and immediate measures are taken to control fluctuation in prices. The year-on-year change in SPI during FY 2019 remained quite volatile.

The annualized increase in SPI during July-April 2018-19 was recorded at 4.0 percent against 0.8 percent in the same period last year. Thirty three (33) major food items such as; wheat, wheat flour, tomatoes, onions, masoor pulse, moong pulse, mash pulse chicken, sugar, red chilies etc. having a weight of 68.19 percent influenced SPI by (+) 7.28 percent.

Table 7.6 : Sensitive Price Indicator (SPI)

	2017-18	2018-19
July	-0.6	3.6
August	-0.1	3.3
September	1.9	1.0
October	2.1	1.3
November	2.1	1.3
December	2.2	2.0
January	2.0	3.7
February	0.5	6.5
March	-1.8	8.8
April	-0.5	9.3
Average (Jul-Apr)	0.8	4.0

Source: Pakistan Bureau of Statistics (PBS)

Table 7.7: (%) Change in prices of major items of SPI

Description	Unit	Weights	Apr19/ Apr18	Contribution (%)
Wheat	10 Kg	0.6246	4.0	0.02
Wheat Flour, Bag	10 Kg	11.908	3.2	0.39
Rice Basmati Broken, (AQ)	1 Kg	1.2987	5.8	0.07
Rice Irri-6 (Punjab/Sindh)	1 Kg	0.2222	11.5	0.03
Bread Plain, Medium Size	Each	1.2783	2.9	0.04
Beef With Bone, (AQ)	1 Kg	3.985	12.8	0.51
Mutton, Average Quality	1 Kg	2.8074	9.4	0.27
Chicken Farm, Broiler, Live	1 Kg	2.3882	9.1	0.22
Milk, Fresh, Unboiled	1 Ltr	15.7250	5.7	0.90
Curd (Dahi)	1 Kg	1.1850	2.9	0.03
Powdered Milk, Nido, Polybag	400 gm	0.0903	6.6	0.01
Eggs Hen, Farm	Dozen	1.0400	-5.1	-0.05
Mustard Oil, Average Quality	1 Kg	0.1183	5.5	0.01
Cooking Oil, Tin, (SN)	2.5 Ltr	1.9032	9.8	0.19
Vegetable Ghee, Tin, (SN)	2.5 Kg	2.9039	6.3	0.18
Vegetable Ghee (Loose)	1 Kg	3.1109	9.0	0.28
Bananas	Dozen	0.7771	11.8	0.09
Pulse Masoor, Washed	1 Kg	0.5377	8.6	0.05
Pulse Moong, Washed	1 Kg	0.5174	25.8	0.13
Pulse Mash, Washed	1 Kg	0.4912	3.1	0.02
Pulse Gram, Washed	1 Kg	1.0302	8.9	0.09
Potatoes	1 Kg	1.2907	-4.9	-0.06
Onions	1 Kg	1.3825	57.8	0.80
Tomatoes	1 Kg	1.0554	106.5	1.12
Sugar, Refined	1 Kg	4.4561	24.2	1.08
Gur, Average Quality	1 Kg	0.1134	23.5	0.03
Salt Powder, Loose, Lahori	1 Kg	0.1913	9.5	0.02
Red Chilly Powder, Loose	1 Kg	0.7964	29.6	0.24
Garlic	1 Kg	0.3451	33.4	0.12
Tea, Lipton Yellow Label, Packet	200 gm	2.1985	12.5	0.28
Cooked Beef, Average Hotel	Plate	0.5724	9.2	0.05
Cooked Daal, Average Hotel	Plate	0.5771	5.0	0.03
Tea Prepared, Average Hotel	Cup	1.2719	10.8	0.14
		68.19		7.28

Source: Pakistan Bureau of Statistics (PBS)

Impact of global commodity prices

During the start of current fiscal year, global commodity prices have been driven by a number of factors such as rising US interest rates, an appreciation of the US dollar, growing trade tensions between major economies and financial market pressures in some emerging market and developing economies. There has been an upward trend observed in international commodity prices like sugar increased by 7.7 percent, Palm oil 7.9 percent and soya bean oil 10.3 percent in April 2019 over July 2018.

Prices of Crude oil follow boom bust phenomena. During current fiscal year, it reached to \$ 80.5 per barrel in October 2018 then lowered down to \$ 56.5 per barrel in December 2018 then again increased to \$ 71.2 per barrel in April 2019.

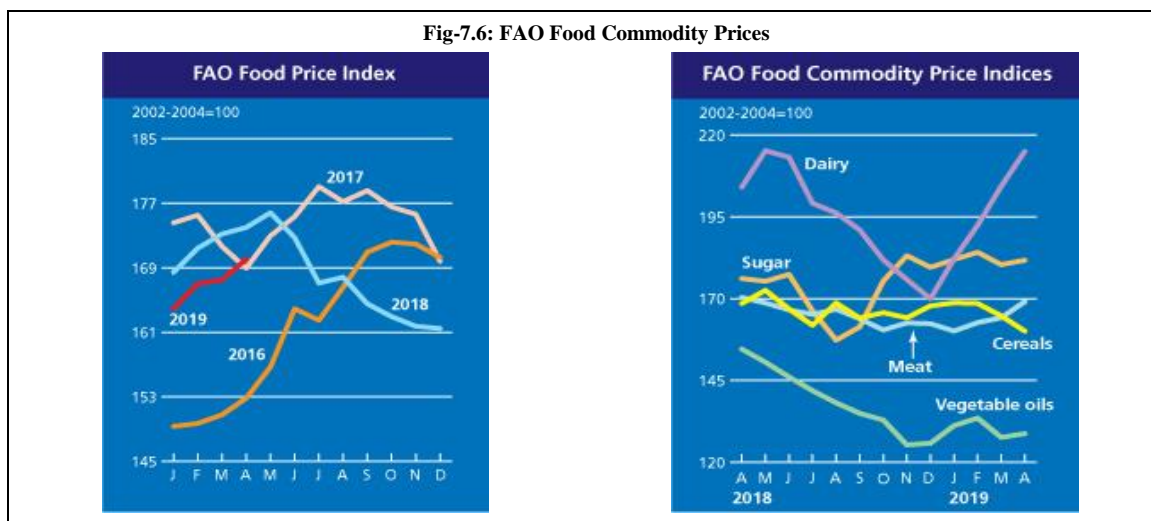
Table 7.8: International Prices of Major Commodities

	Sugar \$/Ton	Palm Oil (\$/Ton)	Soybean Oil (\$/Ton)	Crude Oil (\$/Brl)	Wheat (\$/Ton)	Tea \$/Ton	DAP \$/MT
Jul-18	260.0	545.0	665.4	74.4	218.3	2890.0	400.8
Aug-18	240.0	534.0	654.0	73.1	236.6	2770.0	409.0
Sep-18	250.0	605.0	754.0	78.9	212.4	2670.0	421.6
Oct-18	290.0	590.0	752.0	80.5	213.5	2740.0	420.8
Nov-18	280.0	539.0	729.0	65.2	203.6	2700.0	410.2
Dec-18	280.0	535.0	728.0	56.5	211.3	2620.0	389.7
Jan-19	280.0	585.0	748.0	59.3	209.8	2540.0	382.1
Feb-19	290.0	603.0	773.0	64.1	219.0	2380.0	357.4
Mar-19	280.0	573.0	750.0	66.4	205.8	2380.0	335.0
Apr-19	280.0	588.0	734.0	71.2	199.5	2650.0	323.8
% Change							
Apr-19/Jul-18	7.7	7.9	10.3	-4.3	-8.6	-8.3	-19.2

Source: Commodities Price Pink Sheet

The FAO Food Price Index (FFPI) rose in April 2019 to around 170 points, 1.5 percent (2.5 points) higher than in March and marking its highest value since June 2018. At this level, the FFPI would still remain 2.3 percent below its level in the corresponding month last year. Except for the sub-index for cereals, all the other sub-indices firmed in April, led by dairy and meat, and to a lesser extent vegetable oils and sugar.

Among the cereals, wheat prices fell the most in April, influenced by prospects for a strong rebound in the 2019 production, amid large exportable supplies. Maize prices were also lower, mostly because of expectations of larger South American crops. By contrast, FAO's rice price index was generally stable in April, amid diverging trends across the various market segments and origin.



Conclusion

The rising input costs on the back of high utility prices and the lagged impact of exchange rate depreciation likely to maintain upward pressure on inflation in the following month of current fiscal year. The impact will be more visible in non food prices while the food prices likely to remain stable due to effective monitoring of prices and smooth supply of essential items by the federal and provincial governments. The headline CPI inflation is projected to fall in the range of 7.0 to 8.0 percent in FY2019, and it is anticipated to be considerably higher in FY 2020 due to any further adjustment of energy prices, volatility in international oil prices along with rationalization of taxes.
