

Alarming Bell "Inflation Pump-Up":

With October 2013 drawing to a close and a sharp sequential spike witnessed in the latest weekly Sensitive Price Index (SPI) inflation numbers (+2.64% WoW on the back of an estimated 19.5% hike in average domestic electricity tariff) published by Pakistan Bureau of Statistics (PBS). Major contribution to the higher October CPI is likely to come from 4 per cent MoM hike in fuel prices. The considerable increase is expected to push transportation head (7.2 per cent weight in CPI) by 2.2-2.4%. Going forward, inflation numbers are likely to remain elevated in the next two months (Nov'13-Dec'13). Driven by the increase in electricity tariffs and with the reflection of the Eid-ul-Azha factor on food prices, it is expected that the Oct'13 CPI (Consumer Price Index) will likely clock in the range of 8.3-8.9% vs 7.4% reported in the previous month.

Electricity and Fuel: Major Contributors:

The caveat here is timing, where the CPI methodology published by PBS suggests that data for electricity prices is collected over the first three day of the month whereas the SPI spike has occurred in the week ended October 14, 2013. If the electricity tariff hike is going to show up in CPI numbers (a likely scenario in our view), then the timing will largely be a technicality as November 2013 and onwards inflation reading will spike up. Major contribution to the higher October CPI is likely to come from 4% MoM hike in fuel prices. The considerable increase is expected to push transportation head (7.2% weight in CPI) by 2.2-2.4%. Further, we believe that housing (29.4% weight in CPI) may spike by 1.2-1.9% MoM on the back of quarterly adjustment of house rent. Due to increase in fuel prices, revision of housing index and surge in perishable food prices on the back of Eid-ul-Azha.

Impact on Up-Coming MPS Nov-13:

All of which brings us back to the million dollar question on interest rates. SBP's stance on Monetary Policy would largely depend on Oct 13's inflation number as it will be the last reading before Nov-13 monetary policy. The risk of sharper and faster than eyed Discount Rate hikes is intact if CPI numbers come in on the higher end of the Spectrum. Now central bank stance to strife for keeping investment and growth supportive stance no longer be enough to spur SBP to retain discount rate at 9.5% where it faces other pressing challenges such as a record low rupee against USD and the risk of potentially destabilizing capital outflows and pressures on current account existing deficit can make the decision extremely challenging for policy makers.

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| Inflation Trends | | (Base 2007-2008) |
|------------------|--|------------------|
| Period | | YOY % |
| 12-Sep | | 8.8 |
| 12-Oct | | 7.7 |
| 12-Nov | | 6.9 |
| 12-Dec | | 7.9 |
| 13-Jan | | 8.1 |
| 13-Feb | | 7.4 |
| 13-Mar | | 6.6 |
| 13-Apr | | 5.8 |
| 13-May | | 5.13 |
| 13-Jun | | 5.9 |
| 13-Jul | | 8.3 |
| 13-Aug | | 8.55 |
| 13-Sep | | 7.40 |

Source: SBP & CNM Research

| Annual CPI | 13-Aug | 13-Sep | Oct-13E |
|---------------------------------|--------|--------|---------|
| General | 8.55% | 7.39% | 9.00% |
| Food & Non alcoholic beverages | 10.12% | 7.48% | 8.44% |
| Housing, water, fuel & lighting | 6.52% | 6.60% | 10.82% |
| Clothing & footwear | 15.04% | 14.88% | 13.95% |
| Transport | 2.15% | 0.15% | 3.22% |
| Furnishing & household | 8.58% | 8.89% | 8.87% |

Source: PBS & CNM Research