

■ RATE HIKE INEVITABLE

Double-digit inflation likely to persist till 1HFY23

By Mehtab Haider

ISLAMABAD: Inflation may hover around 10-10.5 percent for FY2022 and 11-11.5 percent for the first half of FY2023 and this uptrend calls for a prompt adjustment in policy rate by at least 75 basis points (bps).

It was suggested by Pakistan Institute of Development Economics (PIDE) in its latest publication.

It said year-on-year (YoY), inflation was expected to remain in the range of 11.5 to 12.0 percent for end-June 2022 and 8.5 to 9.0 percent for December 2022.

PIDE's inflation forecasting models anticipate a one percent increase in electricity prices, translating into 8 percent increase in fuel prices, and upward policy adjustment of 75 basis points in policy rate within the next two months.

PIDE forecasts inflation to remain substantially higher compared to forecasts by State Bank of Pakistan (SBP) (7.9 percent), International Monetary Fund (IMF) (8.5 percent), and Asian Development Bank (ADB) (7.5 percent).

On top of econometric models for aggregated CPI (Consumer Price Index) inflation, PIDE's Inflation Analytics also include forecast at a disaggregated level. By relying on univariate models, Inflation Analytics forecast 94 composite commodities to calculate the direct impact of

shocks in different commodities – electricity is one of those, though the most important one.

Disaggregated forecasting model captured one percent inertia in electricity prices. However, as part of the IMF extended fund facility, Pakistan and the fund are discussing at least a 14 percent increase in electricity prices to overcome the crushing burden of ever-increasing circular debt.

"In this backdrop, we introduced an additional shock of 13 percent in the next five months and found that with the full adjustment of electricity shock, inflation could go up by 0.43 percent for FY2022 and 0.66 percent for the first half of FY2023," PIDE report said.

To calculate the second-round impact of electricity prices on the rest of the CPI basket, "we developed a model between the electricity price index and CPI-Excluding Electricity".

The impulse response of the newly constructed CPI to a 10 percent shock in electricity reveals there could be an additional 0.16 percent inflation in the first four months of the electricity price increase. Similarly, the additional shock of 10 percent in fuel prices could further push the inflation by 0.32 percent for FY2022 and 0.46 percent for the first half

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of FY2023. PIDE also expects inflation to persist in double digits till December 2022 with an upward momentum through the remaining part of FY2022 and the first half of FY2023.

PIDE said it strongly believed there would be a significant upward revision in SBP's forecasts (expected range of 9-11 percent from previous forecast of 7-9 percent). Despite being significantly higher than forecasts from other institutions, PIDE's forecast is perfectly in line with the results of the survey of industry experts.

More than 80 percent of the respondents expected inflation for FY2022 would remain between 9.5-11.0 percent. Respondents also believed that inflation would remain in double digits for the next two fiscal years and would only be back in the single-digit in FY2024.

Survey participants also saw GDP growth to remain between 4.0-4.7 percent for the next several years. PIDE

analysis also indicates persistence in inflation has risen and will further rise in the next five quarters.

Out of 94 composite commodities, around 70 are projected to continue with double digit inflation. Of these 70, more than 25 commodities are projecting more than 14 percent inflation.

PIDE also anticipates inflation to remain broad-based – both food and non-food contributing to high inflation.

Measures of uncertainty, fan charts, also indicate that inflation is expected to remain within the range predicted by PIDE's models.

"Given the prior information that Pakistan requires at least a 14 percent increase in power prices to overcome ever-increasing circular debt, we introduced an additional shock of 13 percent in the next five months and found that with the full adjustment of electricity shock, inflation could go up 0.43 percent for FY2022 and 0.66 percent for the first half of FY2023," the PIDE economists said.