

Inflation

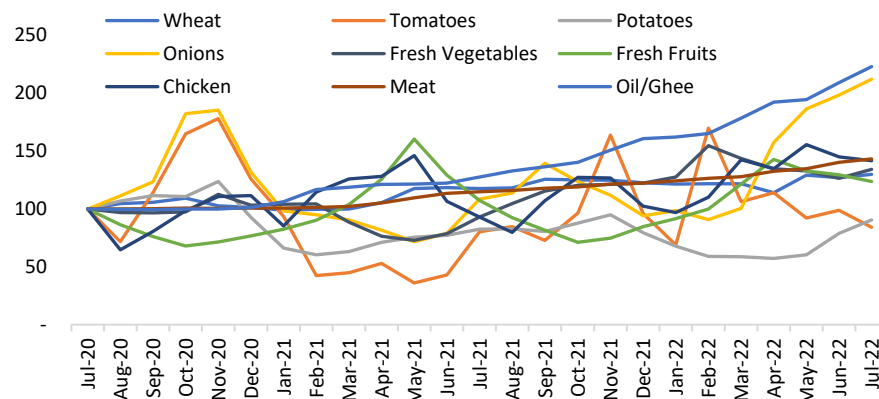
Persistent food and energy inflation to take headline inflation to 24.1% in Jul'22

Eid-festivity based seasonal rise in food inflation along with high energy inflation is expected to put Pakistan's broad CPI at 24.1% in Jul'22. Impact of the softening of international palm oil prices on food inflation remains to be seen. While another round of energy inflation stands contingent to gas price hike approval by the Cabinet, besides high electricity tariff adjustments.

No transmission of global price softening yet

Persistent food inflation is expected during Jul'22 owing to rise in wheat, edible oil, potatoes, onions, and other fresh vegetable prices. We inextricably link rising food inflation with seasonal demand spike of barbeque related vegetables during Eid-festivity in Pakistan. Some of it is also underpinned by higher retail fuel prices which have rocketed supply costs.

Edible oil and chicken prices continue to surge



Source: PBS, IMS Research

As per PBS, most wheat imports had halt after Mar'22 as international wheat prices rocketed; Mar'22 import cost of unmilled wheat was c.PKR1,370/20kg. The softening of wheat prices by c.40% since its year high is likely to pave way for relatively cheaper imports, however, import cost over-runs from PKR devaluation can continue to seep into headline inflation.

The transmission of softer international palm oil prices remains to be seen in headline inflation. We have estimated that domestic edible oil prices normally track international palm oil prices, however, the impact carries a lag (please refer to the sidebar). Simultaneously, the free fall in Pak Rupee continues to escalate costs while most domestic suppliers continue to hold high price inventory, rendering it infeasible to push an instant respite to broad inflation.

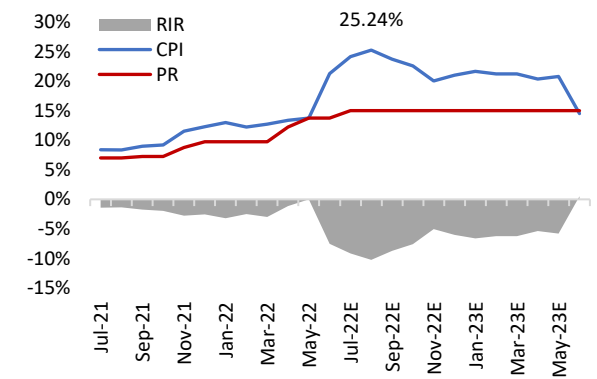
Energy inflation continues to remain high

During Jul'22 energy inflation is likely to stand its ground as retail fuel prices were revised upward while charging petroleum levy. The mid-Jul'22 reduction in retail fuel prices becomes a part of next month's inflation. Consequently, some of the respite in Transport index will erode as the government attempts to increase levy of gasoil and gasoline.

Wajid Rizvi

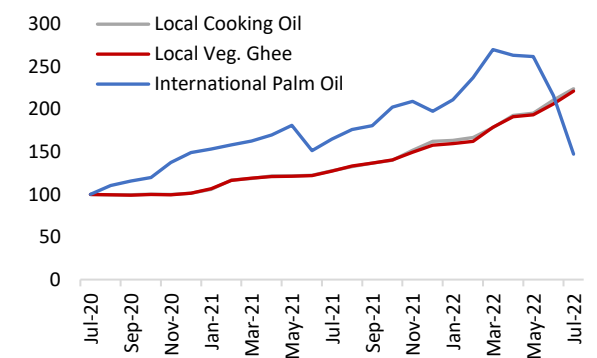
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Negative Real Interest Rate to persist during FY23



Source: IMS Research

Domestic edible oil prices display a lagged impact



Source: PBS, IMS Research

There is an element of quarterly house rent adjustment in the Housing index, which is likely to be overshadowed by Fuel Cost Adjustment (FCA) of PKR7.96/unit against PKR3.99/unit in the previous month. We believe, higher FCA outturns will be seen in coming months, primarily due to increased reliance on FO-based power generation.

Free fall of PKR to restrict any respite in inflation

Another round of inflation is in the offing, taking leads from fresh SPI prints, as most of which will continue to hinge on supply side factors. Needless to mention, nearly 20% of the headline inflation reading is directly impacted by PKR devaluation, which will continue to erode any solace from the softening of international prices.

The ratification of gas price hike will be a constructive move by the Cabinet in overcoming gaps in effective implementation of Weighted Average Cost of Gas (WACOG) Bill, thereby curtailing circular debt generation. However, it will be inflationary in nature. We estimate that the removal of cross-subsidy in gas and electricity tariffs by the government are a key upside risk to our annual CPI estimate of 20% for FY23E, however, some respite may come as lower domestic edible oil prices soothe food inflation.

Headline inflation to cross 24% in Jul'22

	Weight	Jul-22	Jul-21	YoY	Jun-22	MoM
CPI	100.0%	182.19	146.76	24.14%	175.71	3.69%
Food	34.6%	193.75	151.65	27.76%	187.67	3.24%
Tobacco	1.0%	182.58	144.69	26.19%	170.27	7.23%
Clothing	8.6%	169.72	149.60	13.45%	169.61	0.07%
Housing	23.6%	168.47	142.08	18.57%	159.01	5.95%
Furniture	4.1%	169.17	143.21	18.13%	168.60	0.34%
Health	2.8%	173.06	154.33	12.13%	171.32	1.01%
Transport	5.9%	250.30	148.88	68.12%	232.12	7.83%
Communication	2.2%	111.63	109.94	1.54%	110.78	0.77%
Recreation	1.6%	149.99	128.17	17.02%	145.62	3.00%
Education	3.8%	159.12	145.30	9.51%	158.67	0.28%
Restaurant	6.9%	183.71	143.85	27.71%	174.69	5.16%
Miscellaneous	4.9%	180.18	154.26	16.80%	177.79	1.34%

Source: PBS, IMS Research

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Buy	Total return expectation of $\geq 15\%$ or expected to outperform the KSE-100 index
Neutral	Total return expectation of $> -5\%$ or expected to match the return of KSE-100 index
Sell	Expected downside of more than 5% or expected to underperform the KSE-100 index

*Based on 12 month horizon unless stated otherwise in the report.

Valuation Methodology: We use multiple valuation methodologies in arriving at a Target Price including, but not limited to, Discounted Cash Flow (DCF), Dividend Discount Model (DDM) and relative multiples based valuations.

Risks: (i) Global commodity prices remain up-trending and (ii) second-round effects on food prices and wages demand

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