



Update on Pakistan's Economy

June 16th, 2008

Subject: Inflation during July-May 2007-08

The overall CPI based inflation registered a sharp pick up in May 2008 to 19.2 percent on year-on-year basis – the highest increase in the last three decades. Rising food prices continue to be the largest contributor to headline inflation, with year-on-year price increases in this sector hitting 28.4 percent in May compared with 25.4 percent in April and 11.3 percent in May 2007. The headline inflation was 19.2 percent in May 2008 as against 17.2 percent in April 2008 and 7.4 percent in the corresponding month of last year (May 2007). Inflation for the current fiscal year was targeted at 6.5 percent. However, global food and fuel crises have impacted Pakistan heavily, resulting in massive surge in inflation in general and food inflation in particular. The oversized spike in inflation owes to an unprecedented rise in the prices of food, fuel and other commodities at the international level. Inflationary pressure is not likely to ease, at least, in the next two / three years owing to the continuing increase in global food and fuel prices, the second round effects of previous food / energy price shocks, a gradual removal of fuel and power subsidies, a weaker rupee, higher import prices and monetary overhang from the unprecedented government borrowing from the SBP for budgetary financing.

It is a well-known fact that food inflation has emerged as a major source of concern for policy makers around the world, including Pakistan. Food inflation in Pakistan has been fueled by a combination of domestic demand driven factors (rising per capita income), local supply shortage and global trends in the prices of essential commodities. Higher prices of edible oil (palm oil and soybean) and dependency on their imports transmitted higher international prices to domestic prices. Similarly, the domestic prices of wheat and rice also followed the global trend and witnessed sharp increases. To encourage farmers to grow more wheat and check cross-border smuggling the government has increased the procurement price of wheat from Rs. 425 /40kg to Rs. 625 /40kg – an increase of 47 percent. Livestock and dairy products (meat and milk) also registered sharp increases because of their rising domestic demand on the one hand and increase in the prices of feedstock on the other. It may be noted that there are only seven essential food items (wheat & wheat flour, rice, pulses, meat, milk, ghee/cooking oil and vegetable & fruits) contributing significantly to the sharp pick up in food inflation in Pakistan.

Non-food inflation also surged in the month of May 2008 to 12.4 percent as against 11.1 percent in April 2008 and 4.7 percent in May 2007. The sharp pick up in non-food inflation owes heavily to transport (19.1%), cleaning/laundry (16.6%), medicines (14.0%), and house rent (12.0%) etc. Fuel & lighting and transport sub-indices have surged mainly on account of the pass through of higher international oil prices to domestic consumers and are likely to increase even more with the gradual removal of subsidies on these items.

During the first eleven months (July- May) of the FY08, the average CPI-based inflation stood at 11.1 percent as against 7.8 percent in the same period last year. Food inflation moved to 16.2 percent in the first eleven months of the current fiscal year as against 10.3 percent in the same period last year. Non-food inflation is also trending upward as second round of food inflation is building pressure on non-food inflation. For July-May 2008, non-food inflation increased to 7.3 percent as against 6.1 percent of last year.

	2006-07	2007-08 Target	May		July-May	
			2006-07	2007-08	2006-07	2007-08
Overall Inflation	7.8	6.5	7.4	19.2	7.8	11.1
Food Inflation	10.3	-	11.3	28.4	10.3	16.2
Non-Food Inflation	6.0	-	4.7	12.4	6.1	7.3
Non-Food Non-Energy	5.6	-	4.5	12.9	5.6	7.6

