PIDE-Inflation Expectations Survey

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PIDE conducts a quarterly inflation expectations survey to provide information on inflation expectations and the state of the economy. Results of current survey indicate that governments' decision about VAT is among one of the major contributing factors of inflation expectations followed by persistent high inflation and policy credibility. According to 43.2 percent of respondents, growth rate will not change as compared to the current growth rate and 30.9 percent expect that growth rate will increase in the coming months. Majority of the respondents (61.4 %) believe that consumer price index will increase more rapidly in the coming year. Respondents believe that tightening the monetary policy is not an effective tool to control the inflation. Most of the respondents suggest that both monetary and fiscal policy should be used to control inflation rather than relying only on monetary policy.

Note: Survey is based on the opinions of experts in the field of Economics and Business.

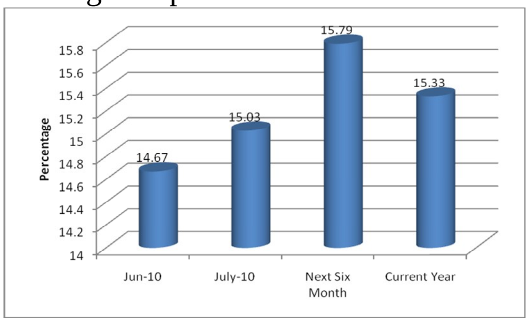
1. Introduction

High and persistent inflation undermines public confidence in the management of economic policy. It adversely affects the investment and other economic activities that are sensitive to the publics' assessments of the prospects for future economic stability. Higher inflation feeds into higher expectations which in turn influence the actual inflation and economic activities through a number of channels. There exists a strong relationship between monetary policy actions and the formulation of inflation expectations because the monetary policy is a key determinant of inflation expectations. Monetary policy is likely to be the most effective if inflation expectations remain close to actual inflation target.

2. Inflation Expectations

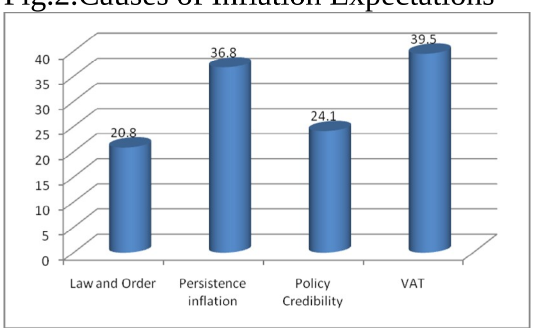
In general, respondents expect inflation to remain high in the coming months. Majority of the respondents' perception about level of inflation is 14.7 percent for month of June, 15.8 for next six months and 15.3 percent for the current year. Level of inflation will be higher than the target rate i.e. (9.5 percent) according to 90 percent respondents. (Figure 1)

Fig.1.Expected Rate of Inflation



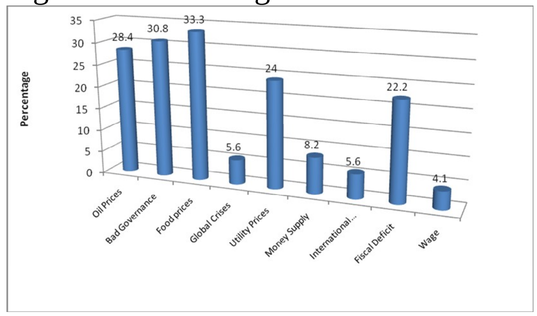
There are numbers of factors that drive the publics' expectations about future inflation. Among the most important factors are monetary policy credibility, governments' announcement of imposition of VAT, persistent high inflation over long period and the prevailing law and order situation in the country. When monetary policy does not remain credible and expectations remain elevated for a prolonged period that could pose upside risks to inflation.
According to 39.5 percent respondents, imposition of VAT is the main driving force which shapes inflation expectations, while others believe that persistent high inflation (36.8), policy credibility (24 percent), law and order situation (20 percent) are main factors which play key role in formulation of expectations. (Figure 2)

Fig.2.Causes of Inflation Expectations



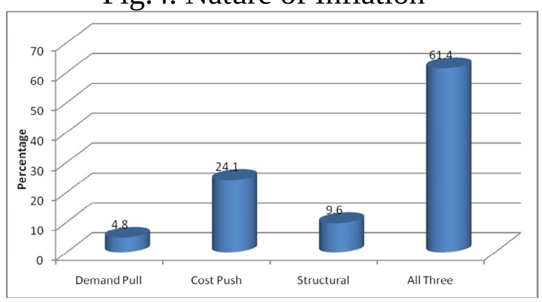
According to survey response, food prices, bad governance, utility prices, oil prices and fiscal deficit are the main contributing factors for high inflation. In the view of 33 percent, food prices are the important factor for high inflation, followed by bad governance (30.8 percent). (Figure 3)

Fig.3. Causes of High Inflation



In response to question regarding nature of current inflation, 24 percent believe that it is cost push inflation and 4.8 percent say it is demand pull inflation. Whereas 61.4 percent believe that demand pull, cost push and structural factors are the main source of current price hike. (Figure4)

Fig.4. Nature of Inflation



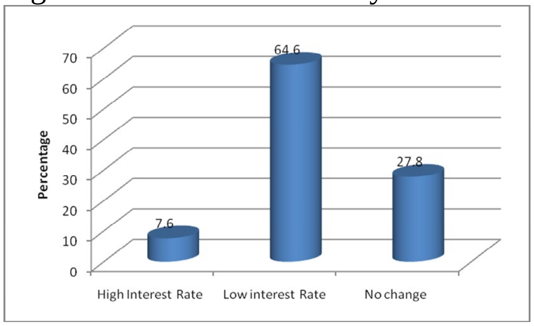
Replying to the question regarding the consumer prices in the next years, 61.4 percent think that consumer prices will rise more rapidly, 19.3 percent are of the view that it will increase at the same rate, while 15.5 percent of the respondents think that consumer prices will increase at slower rate in the next year (2010-2011).

3. Monetary, Fiscal Policy and Interest Rate

To control inflation, SBP increased the policy rate by 50 basis point to 13 percent with effect from 2nd August, 2010; At the same time SBP pointed out that government borrowing from SBP has increased. These two are contradictory to each other. Government borrowing from the SBP increases the liquidity in the system which causes the price hike. In the view of 86.3 percent respondents both monetary and fiscal policy should be used to control inflation rather than solely relaying on monetary policy.

According to survey response, 64.6 percent respondents view that low interest rate is better for the economy, whereas only 7.6 percent respondents say that in the current inflationary situation high interest rate is better for the economy.(Figure 5)

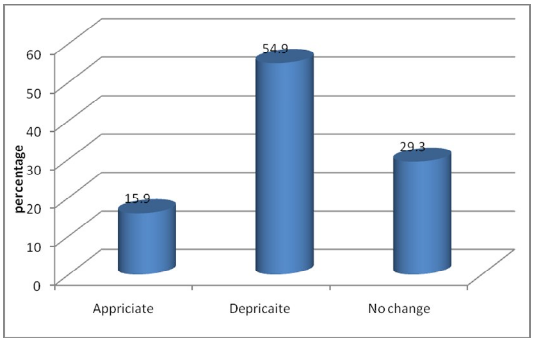
Fig.5. Best Rate for Economy



4. Exchange Rate and Unemployment

In response to question regarding the peoples' perception about exchange rate for the next month and next six months, a majority of respondents (54.9 percent) expect that domestic currency will depreciate in the coming month, while 15.9 percent of the respondents think that domestic currency will appreciate in the coming month. The opinion is depicted in figure 6.

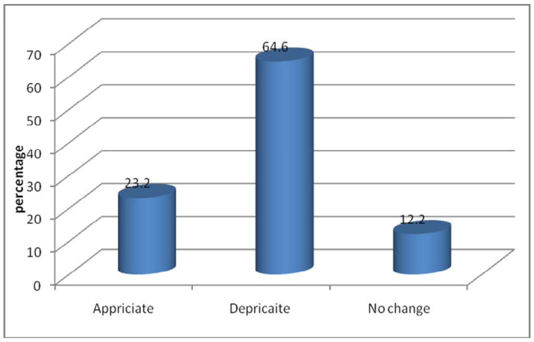
Fig.6. Expectation about Exchange Rate for the Next Month



For the next six months, 23.2 percent of the respondents expect the exchange rate will appreciate, whereas 64.6 percent predict that it will depreciate and the remaining are of the view that there will be no change.

As far as unemployment is concerned 70.7 percent respondents think that unemployment will increase in the next six months. According to 67.9 percent of the respondents, unemployment will increase in the next 12 months.(Figure 7)

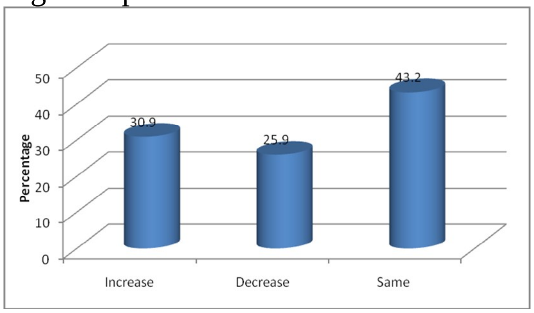
Fig.7. Expectation about Exchange Rate for the Next Month



5. Growth Rate

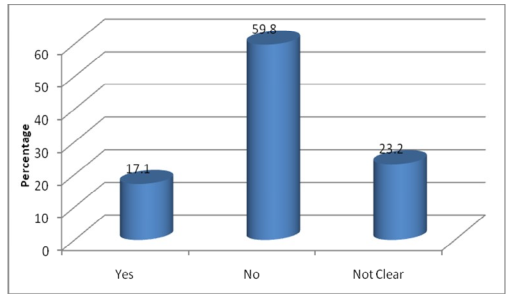
Majority of the respondents (43.2 percent) are of the view that growth rate will not change as compared to the current growth rate, 30.9 percent say that it will increase, while 25 percent are of the view that growth rate will decrease as compared to current rate. (Figure 8)

Fig.8. Expectation about Growth Rate



About 60 percent of the respondents are of the view that government's current policies are not sufficient to enhance growth, 17 say that these policies are useful, while the remaining are not clear about the government policies.(Figure 9)

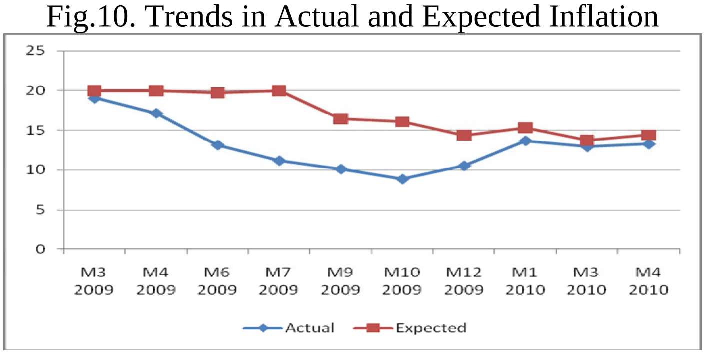
Fig.9.Effectiness of Government Policy for Growth



Trends in Actual and Expected Inflation

Respondent's perception about future inflation is likely to move with official measure of inflation with a reasonable lag and the gap between actual and expected inflation become closer from January 2010 onward. (Figure 10)

Fig.10. Trends in Actual and Expected Inflation



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