



# PIDE-Inflation Expectations Survey

Vol. 3, No. 1/2011

PIDE inflation Expectations survey reveals that public is expecting high inflation and high unemployment and remains skeptical about the growth rate in future. According to respondents, persistent high inflation, policy credibility, political crises in some of the oil producing countries, implementation of RGST and prevailing law and order situation in the country are the major sources of public expectations about future high inflation. Respondents think that inflation in Pakistan is largely driven by food prices, bad governance and oil prices. According to survey results, tight monetary policy is hardly the panacea to meet the inflation target (i.e. 9.5 percent).

## 1. Introduction

The prime objective of SBP's monetary policy is to deliver price stability to support the Government's economic objectives of growth. Price stability is defined by the Government's inflation target, which is announced each year in the annual budget statement. The current year inflation target is 9.5 percent set by the government which is expressed in terms of an annual rate of inflation based on the Consumer Price Index (CPI).

Pakistan's economy is facing double digit inflation for last several years and this high inflation has an economic cost. It undermines the economy's ability to generate long-lasting gains in output, incomes, and employment. It creates uncertainty for consumers, businesses, and investors, and erodes the value of incomes and savings. High inflation and expectations of high inflation also encourage speculative activities rather than investments that increase production capacity. A credible commitment by the monetary authorities to keep inflation low and stable provides a climate conducive to sound economic decisions. It also leads to lower interest rates, supporting productive investments that allow the economy to grow at

a sustainable, non-inflationary pace over time and to generate higher incomes and new jobs.

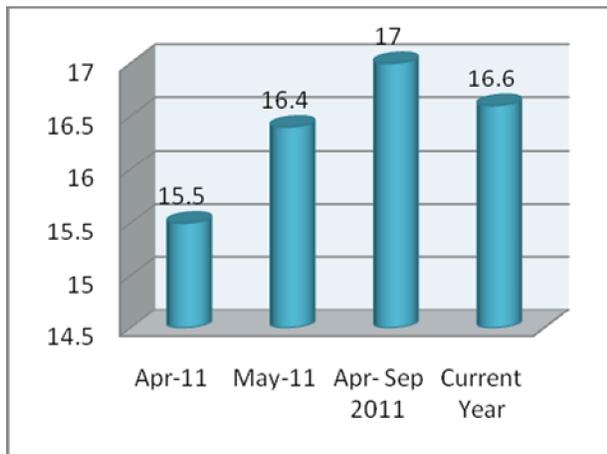
In Pakistan, combinations of factors have contributed to push up inflation for last several months. These include government borrowing from SBP to finance deficit, continuously rising energy and food prices and low policy credibility. These factors are also contributing about high inflation expectations in the future. According to survey results, tight monetary policy is hardly successful to meet the inflation target.

## 2. Inflation Expectations

In the first half of fiscal year 2011, there has been strong upward pressure on inflation in Pakistan because of high food prices and unrestrained borrowing of government from SBP. CPI inflation was at 12.3 percent in July 2010, was 15.7 percent in September 2010 and 15.5 percent in December 2010. Similarly food inflation rose from 12.8 percent in July 2010 to 20.4 percent in December 2010. General CPI inflation and food inflation fell down to 12.9 percent and 17.7 percent respectively in February 2011 which is good

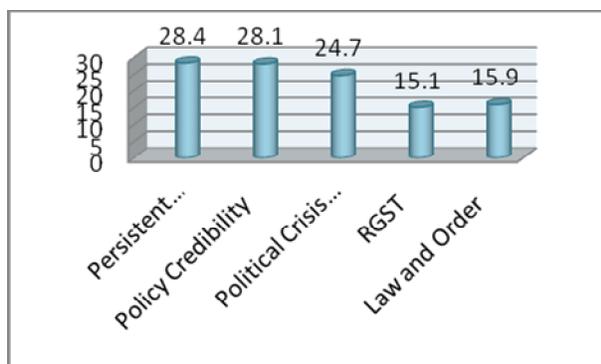
news. Despite this improvement in inflation, publicis still expecting higher inflation.

**Fig.1. Expected Rate of Inflation**



In current PIDE Inflation Expectations Survey for March 2011, respondents are expecting 15.5 percent inflation for April 2011 and 16.4 percent for May 2011. Results also indicate that expected inflation will remain about 17.0 percent for the next six months and 16.6 percent for the current year.

**Figure2: Factors Responsible for Inflationary Expectations**

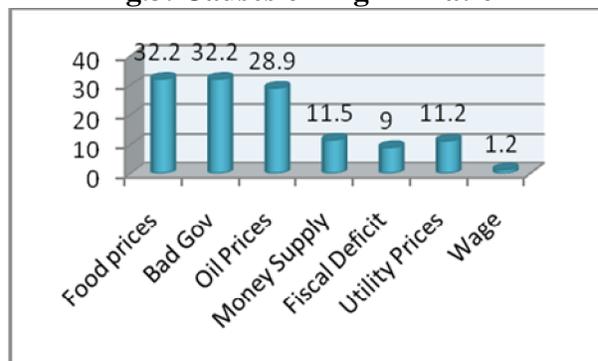


According to respondents, persistent high inflation, policy credibility, political crises in some of the oil exporting countries, implementation of RGST and prevailing law and order situation in the country are fueling the public expectations about future high inflation. As shown in Figure 2, persistent high inflation and creditability of the policies

are the major sources of inflationary expectations followed by political crises in oil exporting countries (24.7percent), law and order situation (15.9 percent) and implementation of RGST (15.1 percent).

Respondents think that inflation in Pakistan is largely being driven by food prices, bad governance and oil prices. As shown in Figure 3, according to 32.2 percent of respondents, food prices and bad governance are the main driving forces of current high inflation followed by oil prices (28.9 percent). In addition to these, money supply, utility prices, fiscal deficit and wages are also considered as important determinants of inflation in Pakistan (Figure 3).

**Fig.3. Causes of High Inflation**

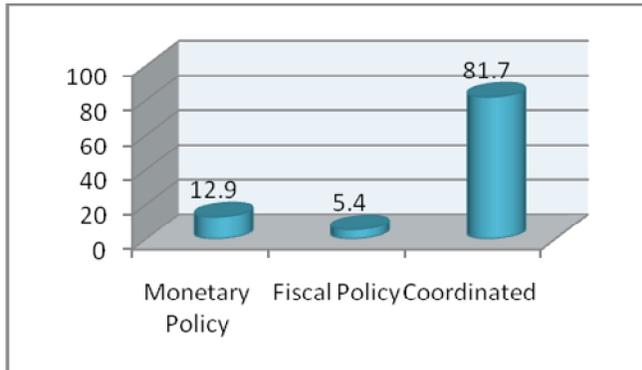


### 3. Monetary & Fiscal Policies and Interest Rate

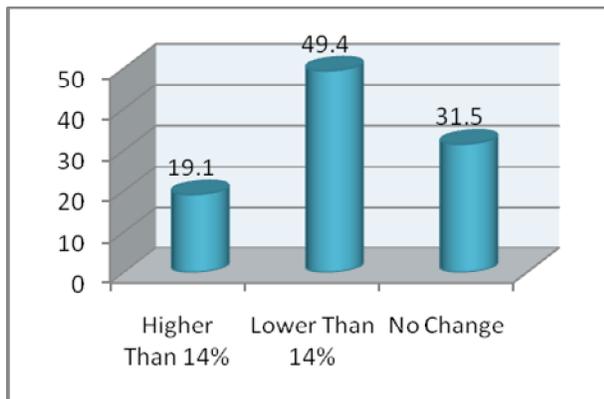
Results of PIDE Inflation Expectation Survey reveal that supply shock is the major source of inflation in Pakistan, so the only tight monetary policy is not the solution of the problem. Monetization of fiscal deficit is also contributing factor in inflation. In response to the question regarding the effectiveness of the policy to curb inflation, vast majority of the respondents (81.7 percent) suggest that both monetary and fiscal policy should be used to curb the inflation. Experts believe that government should avoid the monetization of

fiscal deficit to control inflationary pressure. About 50 percent respondents are in favor of easy monetary policy and 30 percent prefer tight monetary policy for revival of the economy (Figure 4).

**Fig.4. Effectiveness of Monetary and Fiscal Policies**



**Fig.5. Best Policy Rate for the Economy**

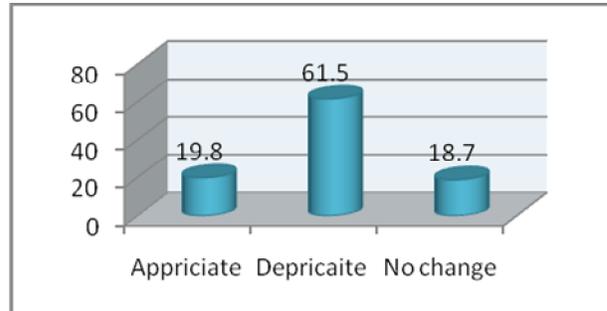


#### 4. Exchange Rate

Exchange rate is an important channel through which monetary policy affects output and prices. Higher interest rates make domestic financial assets attractive and this induces the appreciation of the domestic currency. But due to the lack of competitiveness of the external sector of the economy, domestic currency is continuously in pressure and 61.5 percent respondents are expecting that domestic currency will depreciate in the next six months. About 20 percent of the respondents

expect that exchange rate will appreciate in the coming months, while remaining are of the view that there will be no change in it (Figure 6).

**Fig.6. Expectations about Exchange Rate for the Next 6 Months**

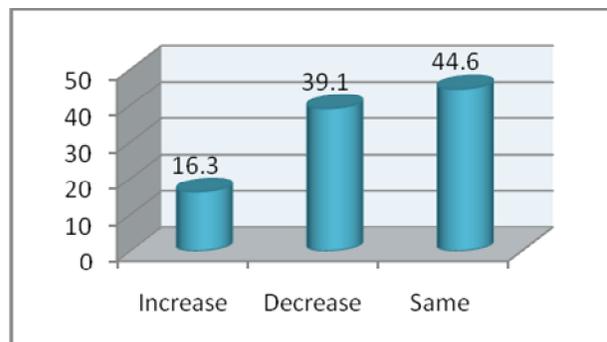


#### 4. Growth Rate and Unemployment

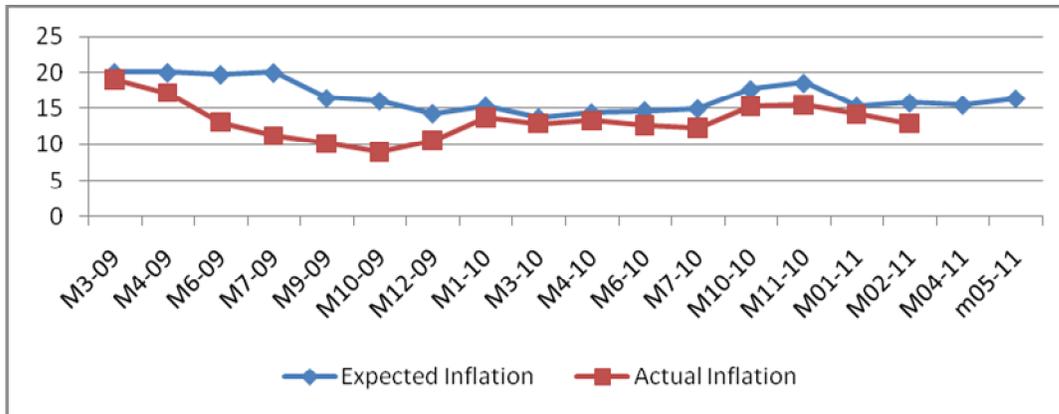
Survey results indicate that experts are skeptical about growth rate and expecting high unemployment in the next six months. About 47 percent are of the view that growth rate will remain the same in coming months whereas 39.1 percent are expecting low growth in the coming months (Figure 7). Majority of the respondents considered that government policies are ineffective to boost growth and reduce the unemployment in the country.

Vast majority (68.8 percent) of the respondents are expecting high unemployment in the next six months.

**Fig.7. Expectations about Growth Rate for the Next 6 Months**



**Figure 8. Trends in Actual and Expected Inflation**



**Note:**

This report is the outcome of survey conducted by PIDE. Participants of the survey are economists and business men from all over the Pakistan.

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