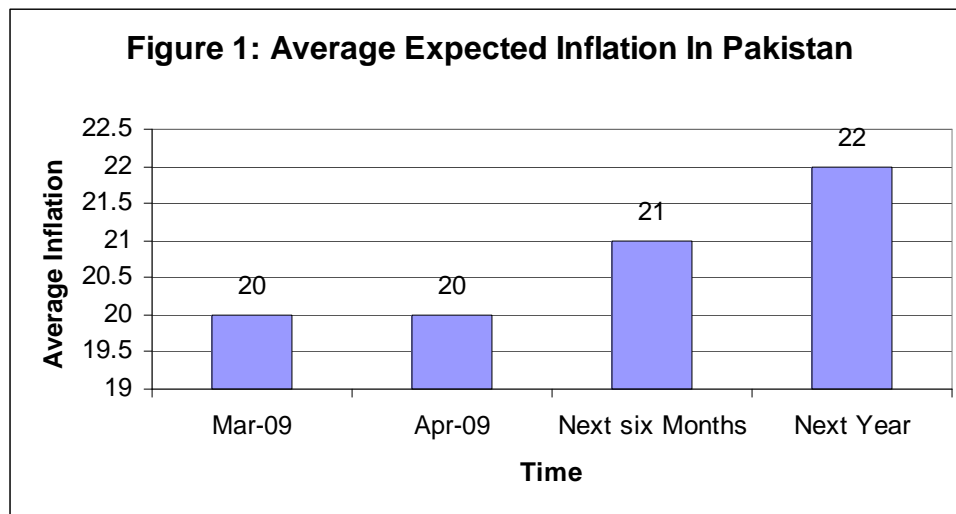


Despite Monetary Squeeze High Inflationary Expectations Persist

A recently conducted survey by the PIDE on inflation expectations reveals that people are expecting high inflation together with high unemployment, a decline in growth rate and decreasing currency value. The survey also shows that both demand pull and cost push factors are responsible for current inflation in Pakistan, the most prominent being global economic conditions and high food and fuel prices. High cost of living induced by inflation is now the most important problem in Pakistan. The most hurt are the lower income segments of the society followed by the middle income group. The survey reveals that the current monetary policy has not been effective in curbing inflation, highlighting the need for coordinated monetary and fiscal policies to control inflation.

The respondents indicated a 20% expected rate of inflation for the months of March and April 2009. Also, the respondents expect that for the coming six months inflation will remain on average at 21% and the expectation for the next year is even higher. In particular, more than half of the respondents expect higher inflation in the next year as compared with the current year (Figure 1).



An overwhelming majority of the respondents (71%) expect that the rate of unemployment will increase in the next six months and this situation is likely to persist in the next year. Nearly two-third of the respondents expect that the rate of growth will drop in the next six months.

Some 44% of the respondents expect the exchange rate to depreciate during the next six months whereas 35 percent of the respondents say that there will be no change in the exchange rate. Interestingly, a majority of the respondents (81%) believe that the political scenario affects inflation expectations. In addition, international inflation, foreign aid and financial development are also believed to affect inflationary expectations. The current inflationary pressure in Pakistan, in their opinion, is due to global financial crisis (39%), followed by food prices (34.9%) and oil prices (31.0%).

About two-thirds of the respondents view that monetary policy is ineffective in controlling the rate of inflation in Pakistan. A large majority of the respondents (86%) believe that coordinated move by the authorities implementing monetary and the fiscal policies will help to control the current spell of inflation in Pakistan.

PIDE - Inflation Expectations Survey

The Pakistan Institute of Development Economics (PIDE), a premier research institute of Pakistan, has led the field in developing quality research in social sciences and informing public policy. PIDE is an academic institution that coordinates its work plan with the Planning Division, Government of Pakistan. Granted the degree-awarding status by the Government of Pakistan since 2006, PIDE functions as a research body with an educational mission. Through recent restructuring, PIDE has developed several new initiatives such as the *PIDE Working Papers*, *PIDE Policy Viewpoint*, and a weekly PIDE Seminars series. It has been very active in the area of opinion evolution, breaking new ground in such areas as urban issues, governance and institutions, and civil service reform.

Inflation expectations have a central role in macroeconomic theory, by providing direction to consumption, saving and investment decisions of economic agents. Internationally, there is growing trend to adopt inflation targeting as the primary focus for the conduct of monetary policy. Inflation targeting framework requires the use of inflation expectations in monetary policy decisions. Expectations on future price movements not only help to derive inflation projections but also enable the policymakers to design effective policies to maintain price stability.

In monetary policy deliberations policymakers require a reliable measure to inflation expectation to assess the outlook for future inflation and gauge the stance of current monetary policy. The literature suggests that a survey forecasts are accurate and useful in predicting future inflation. Moreover, inflation expectations are important in identifying expected real interest rates that determine the level of real spending in the economy.

To provide estimates of inflation expectations in Pakistan PIDE has decided to start a quarterly survey on inflation expectations. For this purpose we used data base of the Pakistan Society Development Economists (PSDE) along with Economics Departments of the Universities, financial sector employees, government and non government organizations. The questionnaire was sent to 300 persons all over Pakistan and got 168 responses. These include doctors (PhD), professors, bankers, bureaucrats, businessmen and young economists. These results are therefore based on the response of those who understand details of inflation and its causes.

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