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MACRO FLASH Inflation

Inflation accelerates on the back of food and tobacco prices in January

Consumer prices rose by 1.65% mom in January, exceeding both our forecast of 1.35% and consensus of 1.12%. Thus, annual inflation jumped to 7.3% in January, from 6.2% by YE12.

- **The acceleration in inflation stemmed from price adjustments to tobacco, along with a surge in food prices.** Tobacco prices increased by 15% mom, following the tax hike as of January, contributing 0.7pp to the headline inflation. Food prices, particularly unprocessed food, soared by 4% mom in January, well beyond even our above-consensus forecast of 2.1%. Hence, the favourable trend in food inflation, which backed the disinflation trend throughout the year 2012, has shifted course as of January. Annual food inflation accelerated to 6.9% in Jan'13 from 3.9% in Dec'12.
- On the other hand, **the downward trend in core inflation seems intact.** Core inflation I (excluding food, energy, alcohol, tobacco and gold) decelerated slightly to 5.7% from 5.8% in December. The deceleration has actually proved short of our expectations, mostly due to a somewhat milder-than-forecast seasonal drop in clothing prices. Despite the CBT's guidance of below 5% core inflation for YE13, we remain cautious on the back of an expected revival in domestic demand in 2013.

Regarding monetary policy, the **CBT had already cautioned** about a possible jump in unprocessed food prices and in headline inflation in January, in the latest MPC meeting minutes last week. Hence, we do **not expect any changes to the monetary stance** following today's inflation print. Monetary policy is currently being shaped by the real performance of the TRL and the course of loan growth. Real effective exchange rate (REER) for January will be announced tomorrow at 2:30 pm. local time. According to our calculations, **REER will have been around 120.5 in January**, moving beyond the 120 threshold into overvalued territory. The CBT has already acted in January, by cutting the lower band by 25bp to 4.75%. The thing is the TRL is currently trading at 2.0640 against the currency basket, and our calculations suggest the **REER may remain above the 120 mark in February as well,** which **might trigger another 25bp cut in the lower band** in February, if sustained until the MPC meeting. Note that a cut at the lower band is aimed solely at deterring capital inflows, and is not expected to provide any additional stimulus to economic activity. Otherwise, we expect the CBT to maintain the policy rate and the upper band of the corridor, as well as the RRRs unchanged at the February meeting at this stage.

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