

3 Prices

The retention of a tight monetary stance since April 2005, supplemented by administrative measures to improve supply of key commodities, contributed to a significant decline in the volatility of inflation during July-May FY06¹ (relative to FY05); it also helped to keep the average inflation within the stipulated target of 8 percent during the period.

Inflationary pressures generally weakened throughout the current fiscal year, but this decline is a little unstable, as seen in the up tick in inflation measured by the Consumer Price Index (CPI) in May 2006 (see **Figure 3.1**). This uptick is primarily due to a sharp rise in food inflation due to increases in the prices of key food staples, particularly the unseasonal increase in the prices of pulses and a reversal of the downtrend in wheat prices. This said, SBP assessment indicates that food inflation would resume its downtrend June 2006 onwards as a result of the recent budgetary measures. In contrast to food inflation, CPI non-food inflation remained

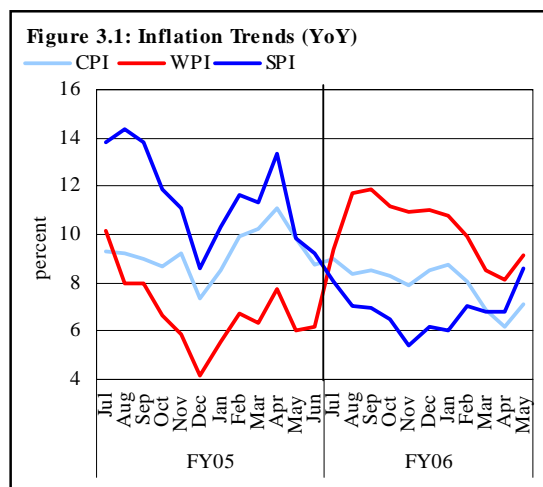


Table 3.1: Inflation Trends - (end May)

percent	Year-on-year (YoY) ¹		12-month moving average ²	
	FY05	FY06	FY05	FY06
CPI	9.8	7.1	9.3	8.0
<i>Food</i>	12.5	5.6	12.8	7.0
<i>Non-food</i>	8.0	8.2	6.9	8.7
<i>H. Rent</i>	12.0	8.3	11.0	10.3
WPI	6.0	9.1	7.3	9.9
<i>Food</i>	10.1	5.7	11.1	7.1
<i>Non-food</i>	3.2	11.6	4.7	11.9
SPI	9.9	8.6	11.8	7.0
Core inflation				
<i>NFNE</i> ³	7.5	6.6	6.8	7.2
<i>Trimmed mean</i> ⁴	8.0	6.0	8.8	6.8

¹ Change in May 2006 over May 2005.

² Change in average of Jun 2005-May 2006 over the average of Jun 2004-May 2005.

³ Non-food, Non-energy inflation

⁴ By trimming 20 percent of CPI items showing extreme changes

Source: Federal Bureau of Statistics

¹ This was true for all three price indices, the CPI, WPI and the SPI.

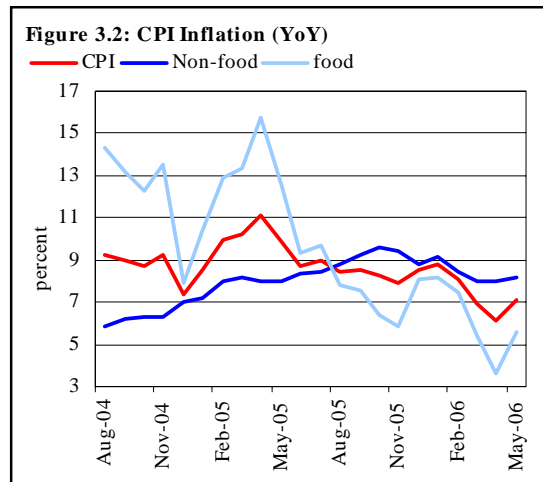
stable around 8.0 percent as the increases under energy, education and medicare sub-groups were partially offset by declines witnessed by house *rent index* (HRI) and *apparel, textiles & footwear* sub-groups.

In this backdrop, therefore, overall CPI inflation is also likely to continue declining in months ahead. Given CPI inflation is at 8.0 percent year-to-date (YTD) in May 2006, and an expected ease in June 2006, overall average CPI inflation for FY06 is likely to be marginally lower than the 8.0 percent target.

3.1 Consumer Price Inflation

Consumer price inflation fell from 9.8 percent YoY in May 2005 to 7.1 percent YoY during May 2006, but was nonetheless higher than 6.2 percent in April 2006.

However, it is still below the average of the first eleven months of the current fiscal year as well as the average annual target for FY06.² The deceleration in CPI inflation stemmed essentially from decelerating food inflation; while CPI non-food inflation has dropped from a FY06 peak of 9.6 percent YoY in October 2005, it did not fall below the 8 percent levels since February 2005 (see **Figure 3.2**).



The CPI food group witnessed an inflation of 5.6 percent during May 2006 that is significantly lower than the 12.5 percent YoY during May 2005. The deceleration in CPI food inflation has mainly been driven by a decline in the prices of poultry, ghee & cooking oil, and some vegetables & fruits, as well as relatively smaller increases in the prices of wheat, milk, beef and rice.

Unlike food inflation, volatility in non-food inflation remained low during the year. During May 2006, non-food inflation increased slightly to 8.2 percent from 8.0 percent. Increase in non-food inflation during the month under review was contributed by higher inflation in *fuel & lighting, household furniture &*

² See Inflation Monitor, May 2006, for more on different dimensions of inflation.

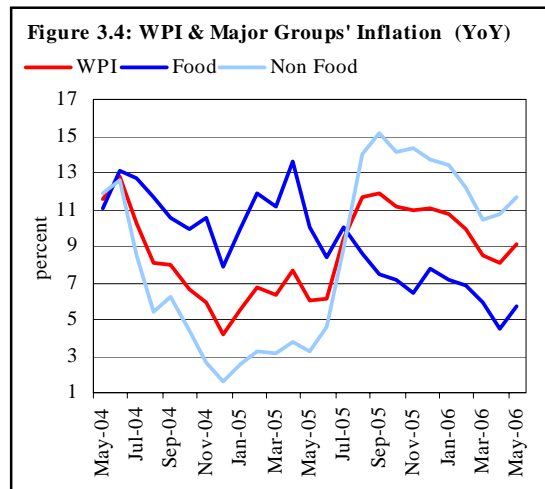
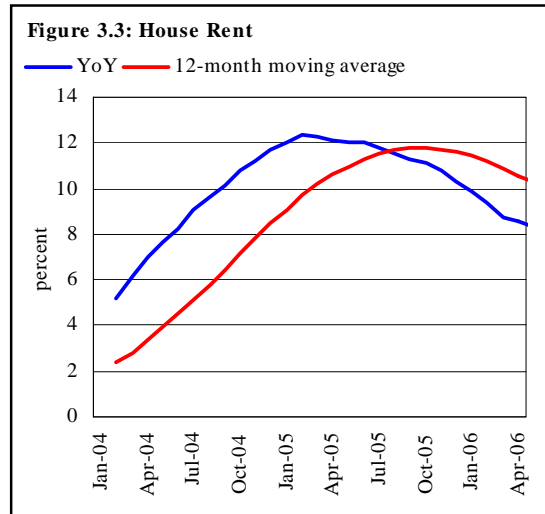
equipments, cleaning, laundry & personal appearance and education. Inflation in other two groups including HRI and apparel, textiles & footwear declined during the month; however, their impact has been overshadowed by sub-groups showing accelerated inflation.

Interestingly, more than one-fourth of the deceleration in CPI inflation is explained by a declining trend of HRI inflation (see **Figure 3.3**).

3.2 Wholesale Price Inflation (WPI)

After declining steadily through most of Jul-Apr FY06, WPI inflation jumped back to 9.1 percent YoY in May 2006 up from 8.1 percent in the preceding month, and significantly higher than the 6.0 percent recorded in May 2005. This increase has been contributed both by *food* and *non-food* groups of WPI (see **Figure 3.4**).

The annual rate of growth in *food* sub-index increased from 4.5 percent in April 2006 to 5.7 percent in May 2006, which is mainly attributable to the sharp increase in the wholesale prices of pulses, particularly gram split and *besan* along with sugar, milk and meat. In particular, the prices of almost all pulses showed YoY increase in the range of 30 to 87 percent during the month, and further rise was contained only through improved supply



through imports.³ Moreover, the prices of wheat and vegetables, which have seen a declining trend during the last few months, also witnessed an increase in May 2006 over the previous month.

Within the *non-food* group all sub-groups except *fuel, lighting & lubricants*, showed higher inflation in May 2006 as compared with that in April 2006 (see **Table 3.2**). In particular, the index of *building material*, which had been witnessing a deflation during Dec-Mar FY06, has finally recorded an inflation of 2.2 percent and 2.9 percent YoY in April and May 2006 respectively. This probably reflects that impact of a sharp rise of more than 25 percent (YoY) in cement prices during each of these months, as well as that of a significant increase in the prices of *wires & cables*, and *other building materials*. It nonetheless is still below 5 to 6 percent rise in *building material* index seen in the corresponding period of FY05. The relatively low increases witnessed in *building material* is a reflection of a continued decline in the prices of *iron and steel* on the back of lower international prices as the global steel production increased significantly to meet the strong demand from China and other Asian economies.

In contrast, *raw material* index saw a rise of 11.3 percent YoY in May 2006, substantially higher than the deflation of 19.4 percent in the corresponding month last year. The rise in *raw material* index during May 2006 is mainly attributed to noteworthy increases in the sub-indices of *tobacco, wool, sugarcane* and cotton.

Table 3.2: WPI Group-wise Inflation (YoY)

	Food	Raw materials	Fuel, lighting & lubricants	Manufacture	Building materials
May-05	10.1	-19.4	18.6	-1.5	6.1
Jun-05	8.4	-20.0	23.9	-1.5	3.7
Jul-05	10.0	-3.1	26.7	0.1	2.0
Aug-05	8.6	3.8	34.4	3.1	3.2
Sep-05	7.5	0.1	40.1	1.5	2.7
Oct-05	7.2	15.2	29.8	3.0	0.8
Nov-05	6.4	15.1	29.6	3.7	0.3
Dec-05	7.8	19.1	26.1	4.1	-3.1
Jan-06	7.2	17.4	27.4	3.4	-4.2
Feb-06	6.9	14.2	25.2	3.1	-3.7
Mar-06	5.9	8.9	22.7	2.1	-2.7
Apr-06	4.5	9.0	21.4	2.9	2.2
May-06	5.7	11.3	21.4	4.1	2.9

Source: Federal Bureau of Statistics

³ Import of pulses increased by 19.7 percent during Jul-Apr FY06 compared to the corresponding period last year.

Sensitive Price Indicator (SPI)

Like CPI, the impact of weak base of corresponding month last year was also reflected in SPI inflation during May 2006. Average inflation in weekly SPI was 7.7 percent in May 2006 which is significantly higher than the inflation of 6.4 percent seen in the preceding month (see **Figure 3.5**). The contributing factors are increased prices of fuel, sugar, milk, potatoes, and pulses.

