



First Capital
First Capital Research

INFLATION OUTLOOK:

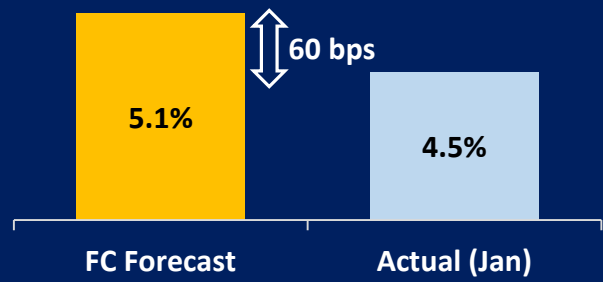
9TH MARCH 2018

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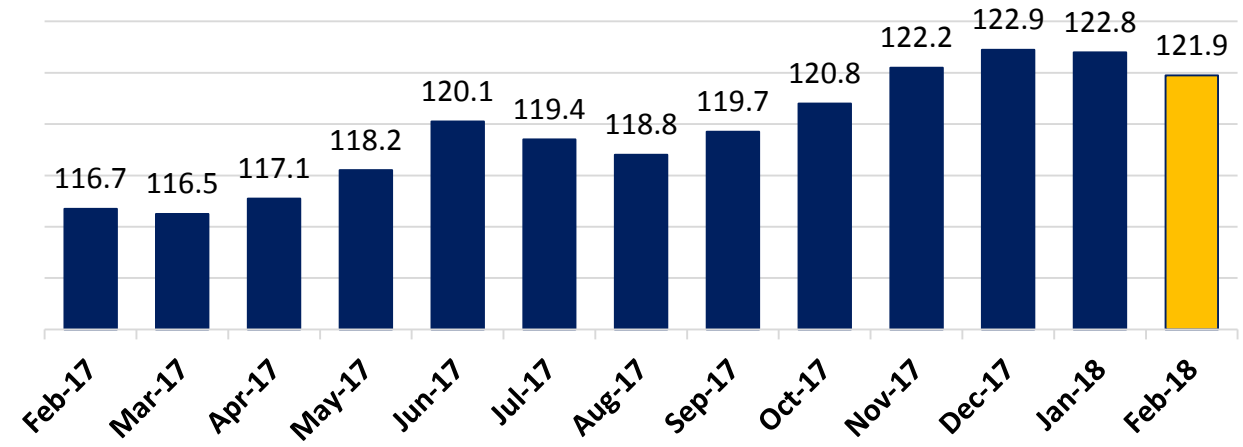
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February 2018 Inflation [CCPI] further dives to 4.5%YoY as supply recovers from shocks

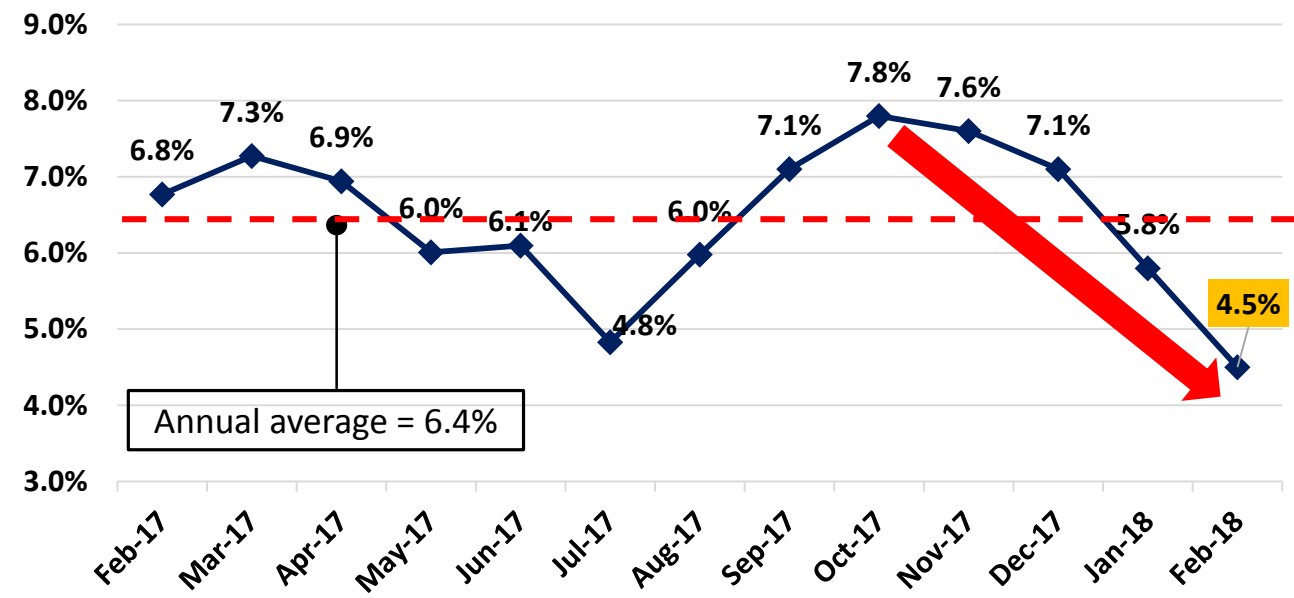


- ❑ Inflation saw a further dip to 4.5%YoY in Feb 2018 (Jan 2018 = 5.8%YoY) for the fourth consecutive month
- ❑ The dip in inflation can be attributed to the food prices recovering from supply shocks experienced in Aug-Dec 2017
- ❑ The CCPI index stood at 121.9 in Feb 2018, down by -0.7% from 122.8 in Jan 2018 (2013=100)
- ❑ The downtrend is in line with FC Research’s forecasted direction of the movement of CCPI while Feb 2018 actual inflation was lower than FC Research forecast of 5.1% by 60bps.

Monthly CCPI Index



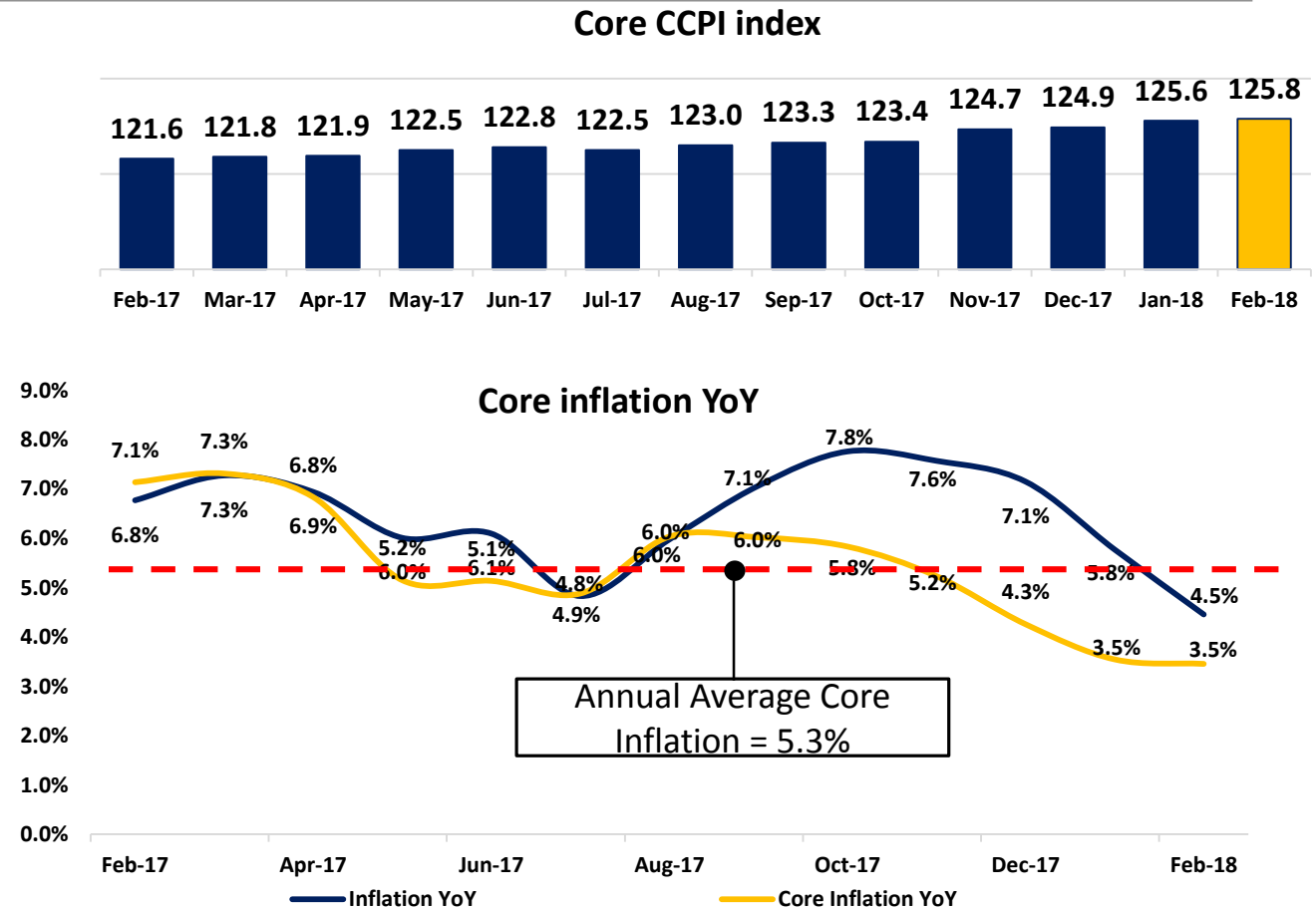
Inflation [CCPI] YoY



Source: Dept. Census and Statistics

Core inflation flat at 3.5%YoY; fallen back to Jan 2016 levels as food prices subside

- ❑ Core inflation remained 3.5% in Feb 2018 unchanged from last month
- ❑ The gap between Core inflation and Headline inflation has continued to decline in February too, as the food prices have subsided due to recovered output
- ❑ Annual average core inflation also marginally dipped to 5.3% in Feb 2018 (Jan 2018 = 5.6%)



Source: Dept. Census and Statistics

Food category drives MoM inflation down as it recovers from supply shocks

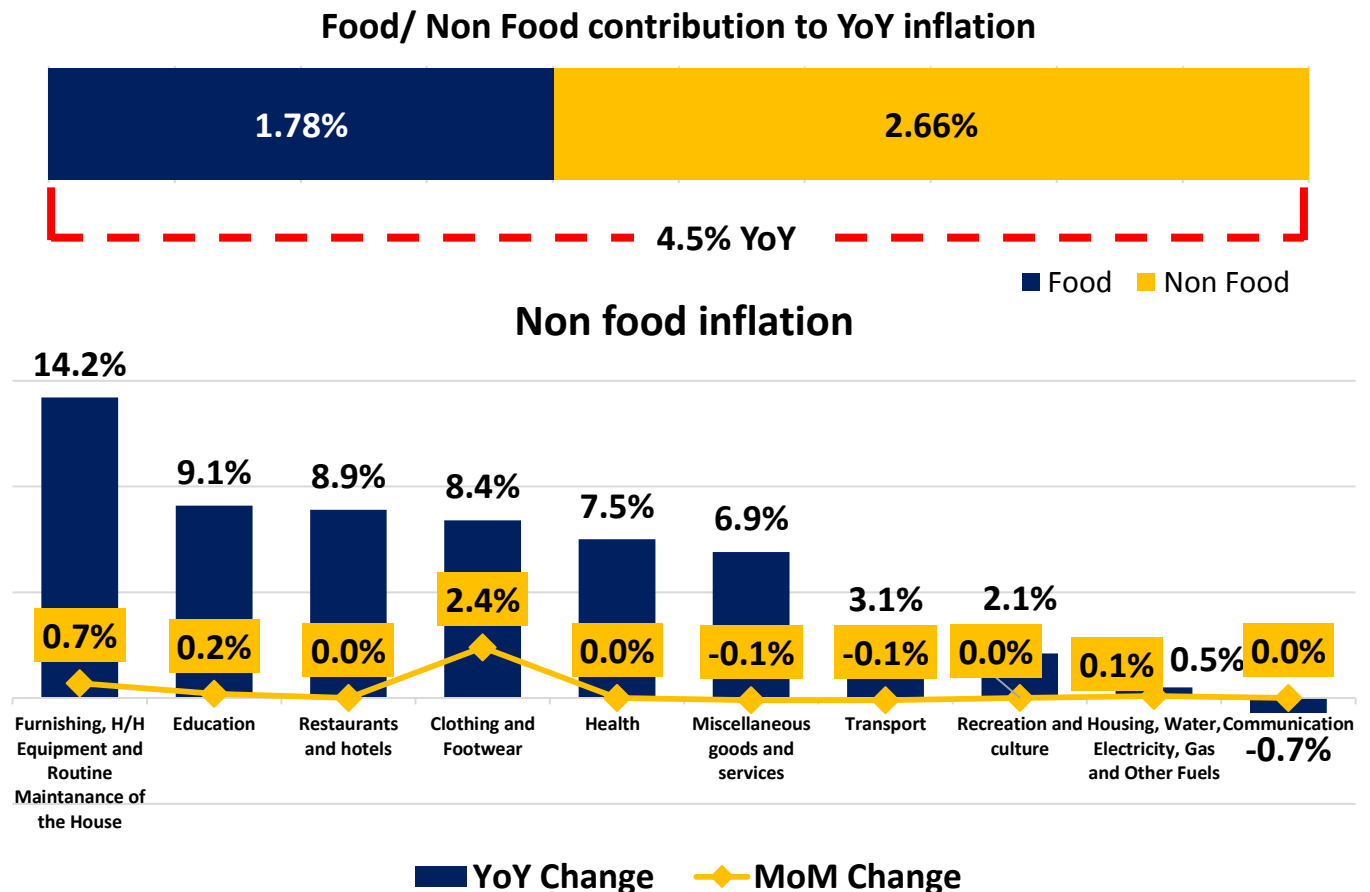
- ❑ The CCPI declined -0.7%MoM which can be dominantly attributable to the decline in the food prices
- ❑ Food price index dipped -2.9%MoM. The decline in vegetable and rice prices due to healthy harvest weighted heavily on the index.
- ❑ Non Food category however increased 0.8%MoM driven by clothing and footwear. Housing, water and electricity prices also increased due to increased firewood prices which affected the non food category.

	All items	Food	Non food
Index value - Feb 2018	121.90	129.30	118.90
Index value - Jan 2018	122.80	133.10	118.80
MoM Change - Feb 2018	-0.70%	-2.90%	0.10%
MoM Change - Jan 2018	-0.10%	-1.90%	0.80%
Contribution to MoM		-0.87%	0.11%
YoY Change - Feb 2018	4.50%	6.00%	3.80%
YoY Change - Jan 2018	5.80%	10.50%	3.80%
Annual average	6.40%	9.60%	5.00%

Source: Dept. Census and Statistics

YoY inflation driven by non food category

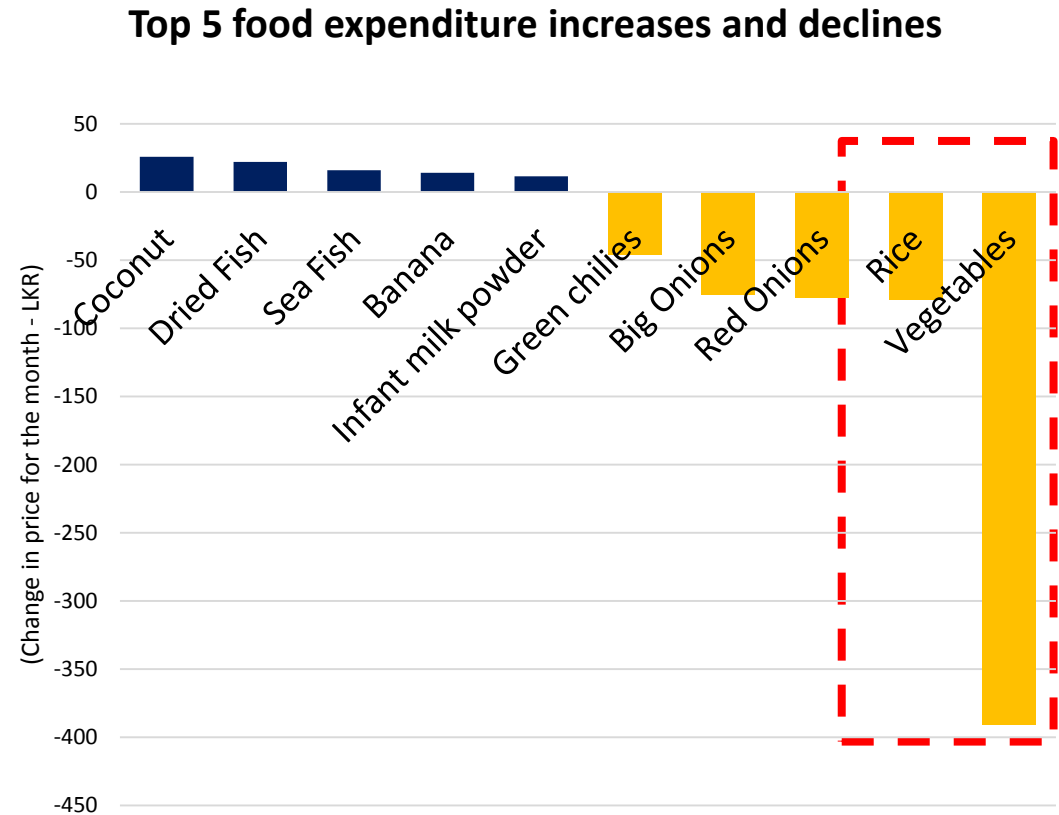
- ❑ Food category (+6.0% YoY) explained only 40% of YoY inflation in Feb 2018, losing its dominance in YoY inflation
- ❑ Non food category's inflation continued at 3.8%YoY in Feb 2018 explaining the balance 60% of the annual inflation
- ❑ The non-food category was driven by continued effect of tuition fees for higher educational courses in Jan 2018.



Source: Dept. Census and Statistics

Vegetables and rice prices drags down food category's inflation in Feb 2018

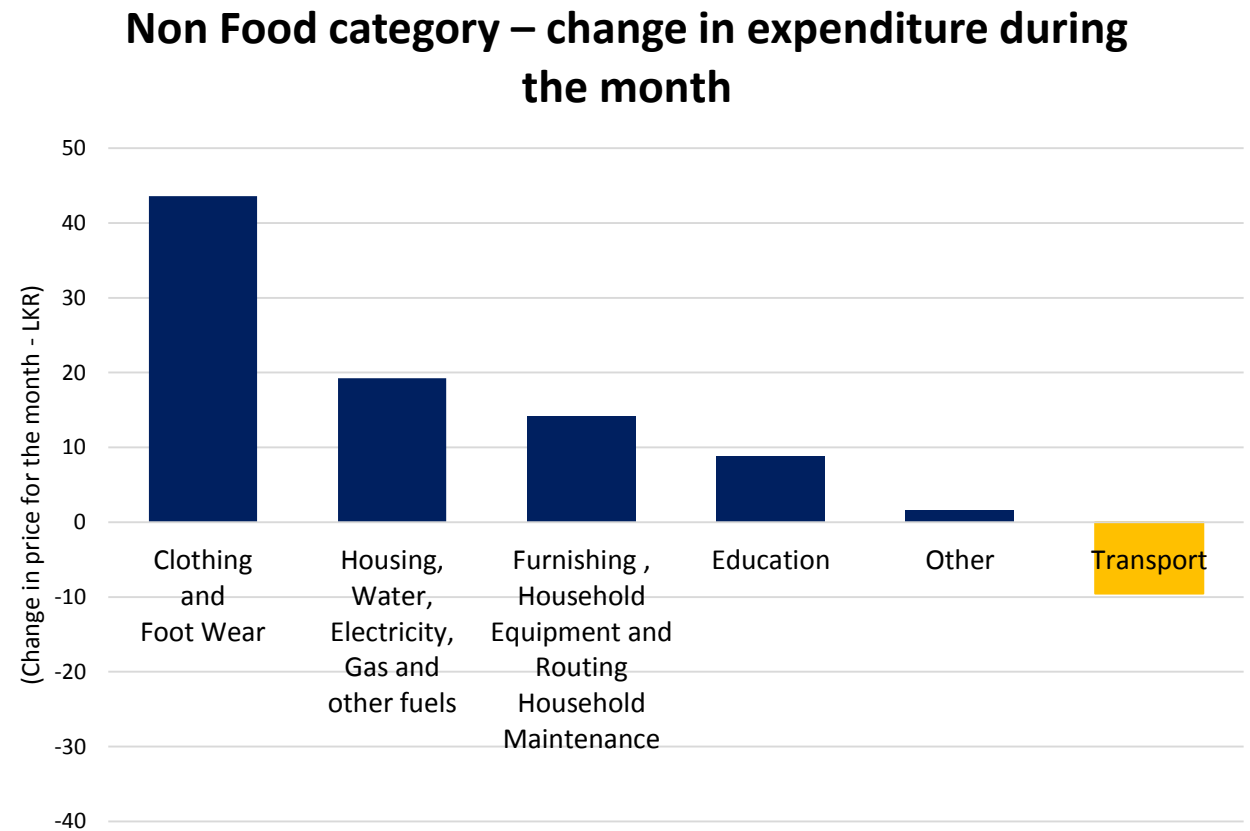
- ❑ Expenditure on Food and non alcoholic beverages increased by only 6.0%YoY in Feb 2018 (Jan 2018 = 10.5%YoY)
- ❑ On an MoM basis, decrease in value on vegetables (-0.53%), rice (-0.11%) and red onions (+0.10%) contributed largely to the decline in the index despite an increase in expenditure on dried fish (+0.03%).
- ❑ The main drivers of vegetable prices to relax is the higher output as rains returned in Jan 2018. Prices of rice were driven down by the increased availability due to imports as well as the higher output in the Maha season.



Source: Dept. Census and Statistics

Non food expenditure for Feb 2018 driven by clothing and footwear

- ❑ Expenditure on Non Food category increased only 0.8%MoM in Jan 2018, up from 0.2%MoM in Dec 2017
- ❑ On an MoM basis, increase in value changes clothing and footwear (+0.06%) and housing, water, electricity, gas and other fuels (+0.03%) contributed to the increase
- ❑ No specific reason could be identified for the increase in clothing and footwear expenditure while the increase in utilities was caused by the increased prices of firewood.

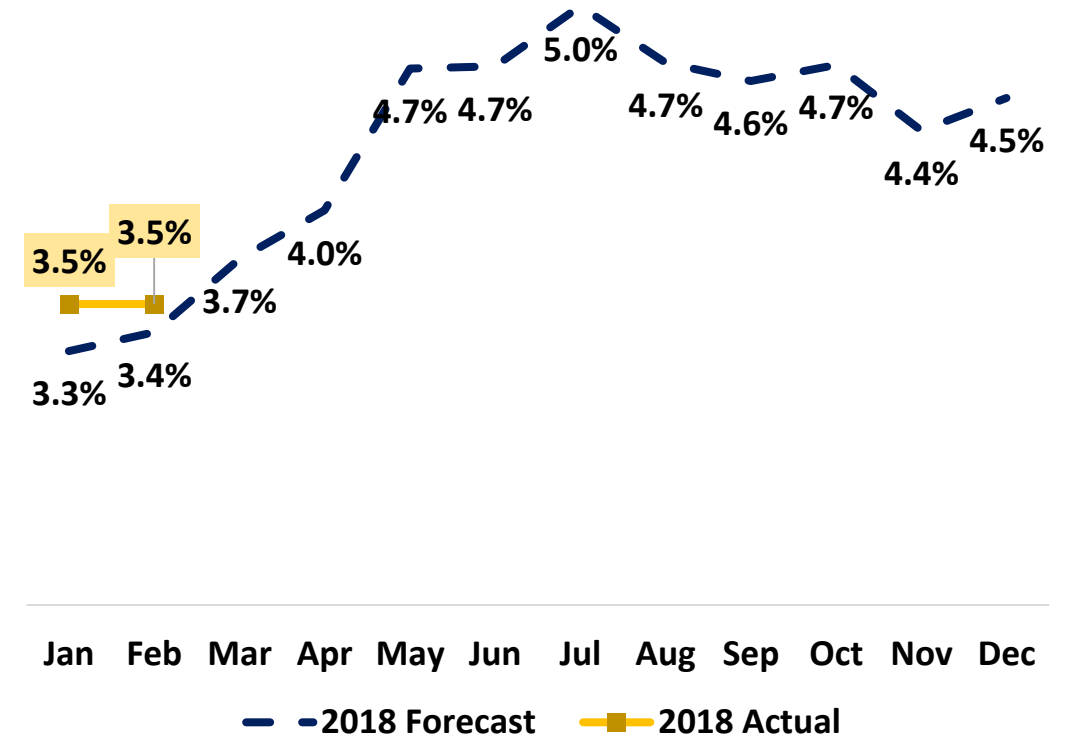


Source: Dept. Census and Statistics

Core Inflation Forecast

Core inflation forecast (YoY) for 2018

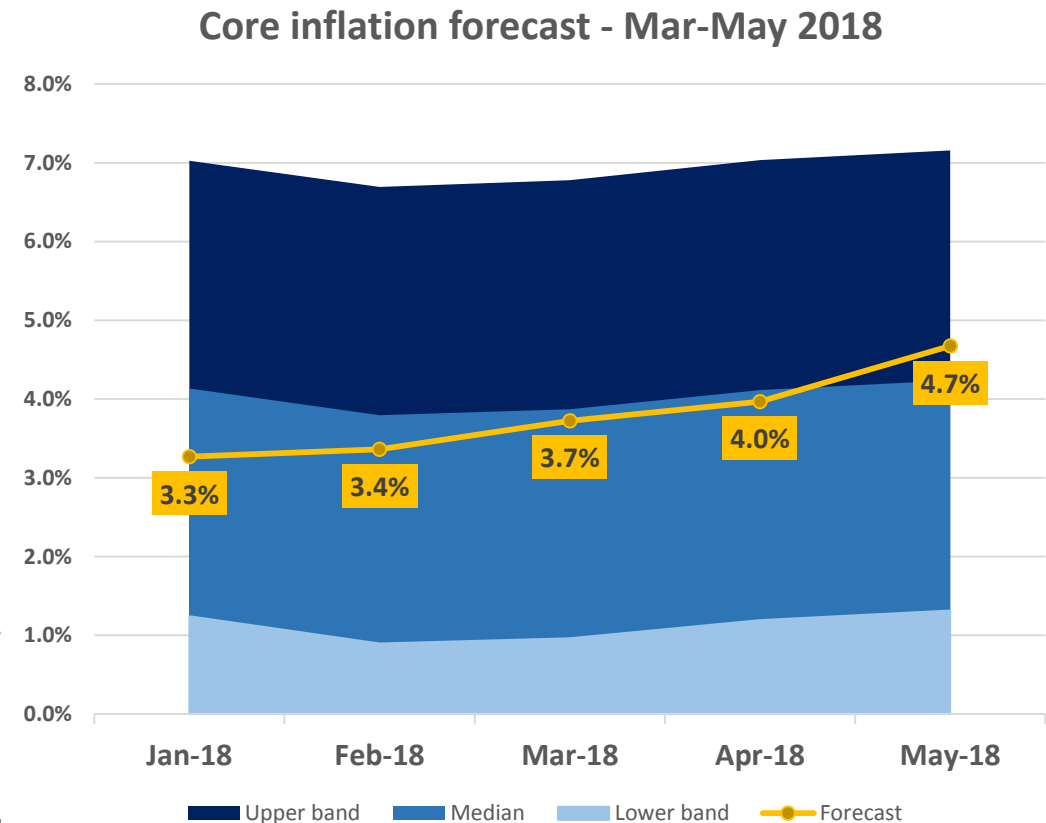
- ❑ Annual average Core inflation for 2018 is estimated to be 4.3% ruling out any external shocks on the economy
- ❑ The effects of supply shocks which drove inflation higher in Jul-Nov 2017 have been adjusted downwards for the 2018 forecast.
- ❑ Also, the private sector credit growth is expected to remain moderate compared to 2017, therefore we estimate the core inflation to be moderately lower than 2017 levels
- ❑ From May 2018 onwards we expect the effects of fuel pricing formula to reflect in the non food categories.
- ❑ The core inflation forecast for Jan 2018 was 3.3% (actual = 3.5%) while for Feb 2018 the forecast was 3.4% (actual = 3.5%)



Source: First Capital Research

Core inflation drivers for the next 3 months: Mar-May 2018

- ❑ Based on a regression analysis, First Capital Research estimates Core inflation to slightly pick up to 3.7% (Actual in Feb 2018 = 3.5%). This reflects the hike in cement prices by LKR 30 affecting the non food categories
- ❑ In April we estimate the core inflation to further increase to 4.0% given the increased demand in the festive season for processed food as well as non-food items
- ❑ In May we expect the core inflation to significantly increase to 4.7% given the pricing formula for fuel expected to be implemented by March/ April which will start reflecting in the processed food and non food categories with a 1-2 months lag
- ❑ A possible implementation of the gas pricing formula will further push the inflation upwards as the price increase spills over to processed food and non food categories



Source: First Capital Research

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