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**Food and energy inflation**

There are many ways to measure inflation. It can be measured as ‘core inflation’ that looks at change in prices of goods and services excluding energy and food (because their prices keep changing over time); as ‘headline inflation’ that measures change in the prices of everything including energy and food; ‘cost push inflation’ that results from increase in the cost of production; and ‘demand pull inflation’ which is caused by aggregate demand outpacing aggregate supply (mainly due to surplus money supply).

No matter which of these ways is employed to gauge inflation in 2020, the result is the same: the last year was an outlier in more respects than one. It witnessed abnormally low prices for energy, reduced economic activities and restricted availability of food in its first half. These were accompanied by higher food prices and declining growth of the GDP. In the second half, the rolling out of the Covid-19 vaccine and the hope for both medical and economic recoveries among major economies of the world resulted in an increased demand both for energy and other commodities. This has resulted in the rise of their prices globally: between October 2020 and January 2021, the global petroleum prices went up by 32 percent; the price of soybean oil rose by 70 percent and that of palm oil by 20 percent. Similarly, the prices of refined sugar, pulses and tea increased by 56 percent, 32 percent and 6.6 percent respectively.

How have these trends impacted inflation in Pakistan? Since we are dependent on imports to meet our demands for edible oil, pulses and tea (add for wheat and sugar, too, since 2020-21), an increase in their import prices results in an increase in sale prices in Pakistan. In other words, these cause cost push inflation.

Several other factors also contribute to food inflation in Pakistan. The prices of perishable commodities such as tomatoes, onions and other vegetables and fruits fluctuate with their supply. Due to a lack of storage facilities, they are sometimes sold below their cost of production when their supply is abundant. But then their prices rise exorbitantly when their supply dries up.

Besides imported and perishable foods, poultry meat is another item the price of which has increased recently. This is mainly because of the rise in soybean-oil prices because the meal made from this oil is a major poultry feed in Pakistan. Since the corona-induced restrictions on large feasts and gatherings were lifted in Pakistan in August 2020, there has been a surge in the demand of poultry meat. The rise in the prices of poultry meat is, thus, both demand-driven and due to increase in the cost of production.

On the other hand, the prices of wheat and wheat flour have risen largely because of administrative failure. In order to avoid flour shortages, the federal government did import wheat and then provided wheat flour on subsidized rates but many other factors led to wheat price inflation last year. These factors seem to persist this year too.

Like the previous years, for instance, the wheat crop has been hit by a heavy spell of rains/hailstorm quite close to its harvesting. The recent rains are expected to reduce wheat output by 4-10 percent in southern Punjab which could lead to Pakistan missing its wheat production target – albeit by a narrower margin than last year.

On the other hand, an increase in the officially set minimum price of wheat from last year’s Rs1400/40 kilo to Rs1800/40 kilo in Punjab and Rs2000/40 kilo in Sindh means that the price of wheat flour is set to rise at least by Rs12-15 per kilo. Even if by a stroke of luck Pakistan manages to meet its wheat production target this year, the provincial price disparity between Sindh and Punjab and smuggling of wheat flour to Afghanistan may lead to another big rise in wheat prices.

As far as energy prices are concerned, these have been rising from a low base since the summer of 2020. This suggests that inflation in them will remain higher in 2021 that that in 2020. Since global prices of petroleum have already gone back to pre-Covid levels after touching a historic low in 2020, Pakistan will witness a rise in energy prices because of being dependent on imported petroleum for its energy needs.

Even if that were not the case, energy prices are still bound to increase in Pakistan in the near future. Here is why: in the absence of a plan-B, it is in the interest of Pakistan to remain engaged with the IMF. Not only has our Covid-19 response been dependent on the IMF, unsustainable economies like ours are always in the need of a seal of confidence from the IMF to prove their credit worthiness in front of their creditors.

Pakistan’s ongoing extended fund facility (EFF) program with the IMF has resumed after a hiatus of one year. The IMF Board has approved the release of a tranche of $500 million. However, it has asked for tackling the energy sector’s circular debt, among many other things. This debt has increased 250 percent between 2016 and the end of 2020 – from Rs689 billion to an estimated Rs2,400 billion.

The IMF wants Pakistan to make the power sector financially viable by recovering from consumers the complete cost of energy production and transmission. It has, therefore, told the government to give autonomy to energy sector regulators – Ogra and Nepra – so that they can pass on the impact of any increase in global energy prices to domestic consumers without seeking approval from the cabinet. The two regulators will also have to recover the backlog in energy prices from consumers through tariff adjustment.

If one looks at these steps from the perspective of achieving macroeconomic stability, they all appear quite sane except the fact that an increase in energy prices will trigger rise in prices of other goods and services by increasing the cost of their production and transportation. This, in turn, will make the transition to macroeconomic stabilization quite costly.

To ensure that this cost is not all borne by the people, the government will require a parallel strategy for social protection to alleviate the effects of stabilization on vulnerable and poor groups. To Pakistan’s advantage, the IMF program recognizes the need for finance social protection measures. The existing social protection programs, therefore, should be beefed up by shifting financial resources from a wholesale subsidy regime to targeted subsidies.

To sum it all up, every single factor – from core inflation to headline inflation and from cost push inflation to demand pull inflation – is there to suggest the erosion of our purchasing power in 2021. Let us see how well the government can make use of the Ehsaas program to act as a shock absorber for lower and lower-middle income earners.

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