**How to know if inflation is getting better?**

**The next quarter for the country is going to be very critical in terms of tackling inflation.**

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Although inflation is still running uncomfortably high and many Pakistanis are struggling to keep up with rising prices, new data showed that price gains may be easing go­ing forward. The vision is that if Pakistanis can somehow ex­pect prices to drop in the com­ing days, not only can they make better financial plans for themselves, but in turn also help the government in taming inflation, which as we know has been painfully clocking at around 30% over the last few months. So how do pol­icymakers determine whether inflation is getting better or worse?

Although much attention is focused on the CPI (Consumer Price Index) re­port, however, in one’s opinion our cen­tral bank’s preferred measure should instead be the price index for Personal Consumption Expenditures since it cov­ers a much broader range of spending and something that one feels in the cur­rent circumstances needs to be tabulat­ed and released monthly by Pakistan’s Bureau of Statistics. The CPI index cap­tures what consumers pay out-of-pock­et for goods and services, while the PCE index covers spending by and on behalf of households, which includes non-prof­it institutions that provide services to households. For example, that means that health care costs in the PCE index reflect consumers’ out-of-pocket ex­penses as well as costs covered by em­ployer-provided insurance, social secu­rity, medical covers, even philanthropic and non-government organisations, and government programs, while the CPI in­dex only covers the direct costs to con­sumers. So, in effect, the PCE index, and health care have a much greater weight. Further, our central bank should also consider releasing average inflation fig­ures that are tabulated over longer peri­ods — ranging from perhaps, 6 months, one year, and up to two years — because month-to-month data can invariably bounce around or wobbly. Finally, one feels it would be beneficial for every­one’s understanding if beyond the head­line inflation number, the State Bank of Pakistan also looks at providing subcat­egories in the data for the markets to de­termine whether the price changes, if any, are temporary or longer-lasting.

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One important measure is “core” in­flation, which excludes volatile food and energy prices and almost all markets closely watch this benchmark. Food and energy prices can dramatically move up or down each month and might not re­flect longer-term price trends, since those changes could be a result of tem­porary factors and could also reverse rel­atively quickly. If we only look at overall inflation, we may think that general pric­es are rising or falling more rapidly than they are. At the same time, it is also im­portant to monitor inflation for services like rents, which make up a large portion of core inflation and a significant chunk of household budgets. Private-sector data in Pakistan suggests that rent prices are already starting to cool, but report­ing lags mean that it will take time for that to be reflected in the official data. However, it is good news. While easing rent prices would be welcome news for the government, however, ideally it will be good to see inflation lower particular­ly in essential food items.

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So, in essence, while the central bank and the government should pay close at­tention to core inflation, they still have to primarily focus on food and energy, since this very category tends to primarily im­pact people’s expectations about future inflation - a relief in food and fuel pric­es inflation affect many consumers’ dai­ly lives. Interestingly, categories such as new & used cars have seen price declines in recent months, which again is a good sign in the current battle against infla­tion. Personally, even though one thinks some of that momentum is starting to cool off, especially on the goods side, still there are too many components that are showing too much strength right now.

Finally, very importantly, your expec­tations about inflation matter. In mod­ern-day strategies to fight inflation, governments also track inflation expec­tations, which is the rate at which peo­ple expect prices to rise in the future or if they even expect them to rise at all. This ends up affecting actual inflation because consumers, businesses, and in­vestors could change their spending be­haviour today based on what they think will happen to prices in the near term. This is where the Pakistani government needs to be very careful in not indulging in populist steps or any policy announce­ment that could spike inflation, because these in turn could actually spike infla­tion artificially, thereby wasting all ear­lier efforts in taming it. For example, a populist or an artificially jacked-up min­imum wage rate would not just render domestic manufacturing uncompetitive vis-à-vis its regional neighbours, but also could become a problem for policy­makers because it could lead to a “wage-price spiral”- a prolonged loop in which price increases lead to higher wages – in-turn putting even more pressure on inflation. We recently saw the Bangla­deshi policymakers resist this to avoid the risk of losing Bangladesh’s export markets. If consumers are paying more for goods and services, they could de­mand higher wages from their employ­ers. If businesses respond by increasing wages, they might continue to increase the prices that consumers pay to cover steeper labour costs. Once this vicious phenomenon gains ground, even the government at that stage could be too late to counteract it, thereafter making it a painful cycle for the economy. The next quarter for the country is going to be very critical in terms of tackling infla­tion and this government needs to tread very carefully in maintaining the hope and understanding that in Pakistan wage growth is slowing partly because the labour market is cooling off and partly because firms cannot afford sig­nificant wage growth in anticipation of the continuation of the high inflation at least for one more year – Any unreason­able measures would simply compound the current economic predicament!

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