This paper seeks to explain how inflation exceeded 14% in January 2020, despite subdued demand in the economy. The explanation is simple: YoY food inflation almost touched 24% last month, and this category is the heaviest in Pakistan's consumer price index (CPI). With the government scrambling to control food inflation, we expect inflation to begin falling in the months ahead, and just as the January number surprised the market, the fall in inflation could be just as sudden.

While this development contradicts the neoclassical view that inflation is driven by demand pressures, it again questions the need for SBP's stated objective to target 200-300 bps *real* interest rates. In our view, it will be hard for SBP to resist pressure to cut rates in March, and a token cut will not suffice – we suggest that SBP could cut rates by 75-100 bps. As we have hinted at before, if the FBR revenue target become challenging in FY20 (as is likely), GoP may encourage imports as the bulk of FBR's revenue collection is done at Karachi ports. We summarize by noting that GoP may use the external sector gains to increase revenue collection, but the price it will pay is the growing burden of carry trades.