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Rate hike ignites govt debt market

KARACHI: Government debt markets leapt into action on Wednesday — one day after the State Bank raised the key policy discount rate by one percentage point.

In a Treasury bill auction that sought to raise Rs600 billion, the government ended up getting 426 bids that offered Rs2.326 trillion, not counting non-competitive bids. But the bidding behaviour of banks remained cautious because 368 of the total bids were cast in three-month papers while 34 bids each were cast for six- and 12-month tenors.

Out of the 368 bids in three-month papers, the government accepted all but 10, betraying its voracious appetite for liquidity at the start of the fiscal year.

The bid amount told an even starker story. Out of the total amount, Rs2.054tr was in three-month tenor, representing 88 per cent of the total amount bid.

Banks bid Rs2.3tr, but huddle near three-month tenor

Clearly, banks are holding out for further hikes in the discount rate after three months, despite attractive yields offered in the latest auction in three- and 12-month tenors.

This reluctance to go beyond three months on government paper comes despite clear assurances given by the State Bank in its Monetary Policy Statement (MPS) announced the day before the auction that interest rates and the exchange rate are now fully adjusted to from “previously accumulated imbalances”.

The language is central bank lingo for “no more rate hikes or devaluations”.

The cut-off yields followed the rate hike. In three-month papers, the government set the weighted average cut-off yield at 13.66pc, almost one percentage point above where it was in the last auction held on July 3. In six- and 12-month papers, the same yield was 13.85pc and 14.02pc respectively.

Both six- and 12-month tenors have seen virtually no participation since December 2017, shortly before the cycle of monetary tightening began that has more than doubled interest rates over a year and a half.

Over the course of this tightening cycle, banks have shied away from government debt auctions, preferring to leap in only immediately after a rate hike when they have opted in large numbers for three-month papers only.

The last time the debt markets saw such large participation was in the 540th auction held on May 22 this year, only two days after the SBP announced a 1.5 percentage point hike in the discount rate.

That auction saw the government lift Rs3.14tr, mostly in three-month tenors, with a limited amount in six-month papers too. There were no bids cast for 12-month paper in that auction.

Prior to that, another spike in participation occurred in the 533rd auction held on Feb 13 this year, in which the government lifted Rs2.127tr, again mostly in three-month papers with limited participation in six-month tenors and no bids cast for 12-month maturities.

That was the first auction after the MPS of Jan 31 in which the discount rate was raised by 0.25 percentage points. Since then, yields on three- and six-month papers have risen by nearly 3.13 and 3.26 percentage respectively in each tenor.

In the longer 12-month tenors, yields have risen very sharply.

The last auction where 12-month paper was lifted was on June 3, but prior to that the last action these tenors saw was in Sept 2017.

Back then, the cut-off yield for 12-month paper was 6.03pc, where in the latest auction this has risen to 14.17pc, more than double.

Given the small number of bids cast in both six- and 12-month tenors in the latest auction, banks are clearly holding out for further rate hikes beyond October.

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