BUSINESS RECORDER
Founded by M.A. Zuberi

28th May, 2019

Auction for T-bills

The auction of treasury bills by the State Bank of Pakistan on 22nd May, 2019 indicated very clearly huge borrowing requirements by the government to finance its budget deficit and the commercial banks' expectations of a further rise in the policy rate in the coming months. According to the SBP, the government on 22nd May borrowed a record amount of Rs 3.1 trillion from commercial banks to meet the budgetary gap through the auction for T-bills as against the target of Rs 600 billion. The money borrowed was only for a duration of 3 months as the commercial banks were interested only in this tenor and avoided to invest in 6-month and 12-month maturity period. The cut-off yield (rate of profit) in the auction was 12.25 percent, up 1.5 percentage points from the last auction. While banks bought 3-month treasury bills very aggressively (worth Rs 3.1 trillion), they invested only Rs 4 billion in six-month T-bills while no bid was received for 12-month T-bills.

The behaviour of both the government and the commercial banks shows that they have acted in conformity with the current trends prevailing on the fiscal side and in the monetary sector in the country. High budget deficit has always been a problem for the country but this year it has been particularly agonising as the gap in revenues and expenditures or budget deficit has already hit an 11-year high of 5 percent of the GDP during July-March, 2019 and was estimated to be nearly 8 percent of GDP during 2018-19. Such a large deficit was mainly attributable to very high expenditures on defence and debt servicing of the government while total revenues seem to have shown only a small increase. Another aspect which needs to be highlighted is that other sources of financing the budget like external borrowings and domestic non-banking sources are too inadequate to fill the fiscal deficit with the result that the government has to rely, almost exclusively, on the domestic financial system to meet its budgetary requirements. However, what the government could do was to shift its dependence from the commercial banks to the central bank and vice versa. Coming to the record sale of Rs 3.1 billion of T-bills to the commercial banks in the latest auction as against the target of Rs 600 billion, it shows that the IMF has given a strong message to the authorities to shift existing government borrowings from the SBP to the commercial banks and prescribed such a conditionality for the EFF programme. Such a condition is usually included in the programme because borrowings from a central bank are highly inflationary compared to other sources of financing.

As for the behaviour of the commercial banks to invest only in 3-month T-bills and avoid long-term maturities, such a policy is perfectly rational from their point of view. Following a hefty increase of 150 bps to 12.25 percent, they expect a further rise in the policy rate and overall interest rate structure in the coming months. It is no secret that the IMF is insisting on tightening the monetary policy further and the SBP has also come up with the same conclusion. In its Monetary Policy Statement (MPS) on 20th May, 2019, the SBP stated that the CPI rose by 9.4 percent in March and 8.8 percent in April, 2019 on a y-o-y basis while average inflation reached 7.0 percent in July-April, FY19 compared to 3.8 percent in the same period of last year. The State Bank has also concluded that "inflationary pressures are likely to continue for some time" and the "inflation outlook suggests a fall in real interest rates on a forward looking basis." There is no doubt that the SBP is expecting a further rise in inflation and has said so. Since the primary responsibility of a central bank is to maintain price stability, the SBP is telling indirectly that lowering the policy rate is out of question in the near future while the banks and other stakeholders could expect a further rise in the policy rate to tame inflation in the coming months. In a scenario like this, banks would naturally wait for the interest rates to reach a peak for making longer-term investments to maximise their profits like any other enterprise. However, it may be stressed that such a strategy is not in the long-term interest of the country because a large part of the commercial banks' deposit resources would be invested in government securities while the private sector will be deprived of its genuine credit requirements. Seen from every angle, it is clear that such a problem could continue to exist till the government is able to reduce its dependence on the banking system by reducing its fiscal deficit. Of course, the road ahead is difficult to tread but the right kind of leadership in the country could motivate the citizens to tighten their belts and take this route.

RECORDER REPORT