BUSINESS RECORDER
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BR Research

MPS: easing can wait!

No change; as expected. The direction is wait and see, as the SBP did not revise down its inflation target of 11-12 percent (based on old methodology). There are inflationary pressures from fiscal slippage and other adverse development (such as disruption in global oil supply). However, there are more chances of inflation to tame if slowdown in aggregate demand is faster than expected and currency may appreciate.

The external front has shown improvement with SBP reserves build up by $1.18 billion to $8.46 billion since Jun-19. This has allowed SBP to reduce its forward short term liability position and resulting in increase in net international reserves – Saudi oil facility is in action, programme related flows are coming in.

The key to determine the time of easing depends on the speed of buildup in reserves. Sooner the money flows in; there would be a nod of the IMF on reducing rates. The US Fed has reduced the policy rate by 25 bps and many central banks followed the suit and that will release the pressure on emerging economies' currencies and financial flows can come in – so keeping rates high is making carry trade (hot money) more lucrative.

Apart from that, Euro bond and Sukkuk are to be issued in international debt market. The NFA buildup is healthy for bringing rates down as there would be more domestic liquidity to be deployed in the private sector. The demand in the private sector is not at higher rates – there is contraction of private sector credit in Jul-Aug. As soon as government starts gathering higher foreign fiscal financing –domestic rates may start coming down.

Market is expecting rate cuts in six months' time – as 6M paper is trading at 13.74 percent – almost at discount rate, and the yield curve is inverted with one-year paper at 13.63 percent and 10-year paper at 12.39 percent.

The SBP has mentioned more than expected contraction in LSM in FY19 – mainly in domestic oriented industries like automobile and steel. At the same time, it was noted that LSM does not have right representation of high valued added textile sector. The growth is in volume, but due to depressed prices, the increase is not reflected in exports value. The contraction in imports is encouraging, and that builds the case of early easing time as aggregate demand may fall quicker than expected.

The challenge is in order. The first objective is to build reserves and that is to determine the value of exchange rate and interest rates.

Faster it is, sooner will the easing cycle start. The second in order is the fiscal slippage – FBR revenue growth is encouraging and is depicting that economic slowdown is not as perceived. If the fiscal slippage remains high, this would be inflationary and could delay easing. The good news is that there is slight improvement in SBP-IBA Consumer and Business confidence survey conducted during Aug-Sep19.