

**SBP chief in PAC**

THE governor of the State Bank of Pakistan made an appearance in front of the Public Accounts Committee on Tuesday to field questions from the members and to reassure them that whatever risks the inflows of short-term foreign investors to the government's local currency debt auctions may pose, they are manageable. He has a bit of a task ahead of him when it comes to convincing the public on this point for a variety of reasons. One is that this phenomenon is relatively new in Pakistan, at least on this scale. Close to \$3bn have flowed into local currency government debt instruments from foreign investors, most of whom are 'carry traders'. The latter is a class of investors that borrows from one country where interest rates are low and invests in another where the same rates are high, earning a nice and easy margin in between. The biggest risk these 'carry traders' run when investing in a country like Pakistan is the exchange rate, since their investment is in local currency. If the currency is devalued before they decide to pull out, then whatever profit they would have made through the interest rate would be wiped out because of devaluation. State Bank governor Reza Baqir is right to play down the risks that this money may pose to the external stability of the economy. But the market is betting, whether right or wrong, that the inflows have tied his hands regarding the interest rates, and, keeping this mind, all eyes are on the forthcoming monetary policy decision due this month.

This has been a big challenge for Mr Baqir. The market has made up its mind that with inflation on the downswing, which it now seems to be, the conditions for a rate reduction do exist. The State Bank governor also told the PAC that the monthly average inflation is expected to stay between 11pc and 12pc by the close of this fiscal, whereas it stands midway in that range at the moment. If one month's inflation release shows that the spiral has peaked, it may still not be sufficient grounds for a rate cut since the yearly outlook remains the same. At that point the governor is sure to face a fresh round of questioning, and the pressure that would be put on him to start unwinding the high interest rates would definitely become more intense. The question is whether he is ready for that moment.