

Market Puzzle Over "Discount Rate":

There is no doubt about the big news coming up in few hours; the market is waiting to see the State Bank of Pakistan (SBP) stance for the next 2-month in this newly elected government. Markets in Pakistan are still confused about the SBP expected discount rate. Much of the prevailing uncertainty is due to low inflation but there is no clarity on foreign inflows coupled with high budgetary borrowings target set by the new government in FY 2013-14. SBP has adopted relatively an expansionary policy stance for the past two years as the policy rate has been reduced by cumulative 400 basis points from 13.5% in August 2011 to 9.5% in December 2012 (until date). Looking at this status quo on the discount rate, most of the financial market expects a strong possibility that the (SBP) monetary policy statement will either maintain a status quo on the discount rate or decrease it by 50 basis points to 9.0 percent, while there is no indication of an increase in it.

Grounds for rate-cut:

Pakistan monthly CPI has dipped to 5.13% YoY in May 2013 which is a 9-year low. In last 3 months, average inflation is 5.8% while cumulative CPI has eased to 7.5% in 11MFY13. In FY14, we will see slight increase in inflation due to recent taxation measures in federal budget, expected hike in energy prices and excessive government borrowings but it may not be a restraining factor in monetary easing as we expect CPI to range between 8-9% against government target of 8%.

Eye on pragmatic:

Softening inflation alone will no longer be enough to spur SBP to cut discount rates at a time when it faces other pressing challenges such as a record low rupee against USD and the risk of potentially destabilizing capital outflows and pressures on current account existing deficit up to 8.8% can make the decision extremely challenging for monetary policy making.

Bankers/investors buying gesture:

With an arbitrage like opportunity being provided by the SBP, bankers/investors have participated heavily in longer maturity in last T-bill auction. This coupled with declining secondary market yields are highlighting the expectation of reduced interest rates by the market participants.

Monetary Policy Rates	
W.E.F	Policy Rate
10-Nov	14.0
11-Aug	13.5
11-Oct	12.0
11-Nov	12.0
12-Feb	12.0
12-Apr	12.0
12-Jun	12.0
12-Aug	10.5
12-Oct	10.0
Dec-12 until date	9.50
Source: State Bank of Pakistan	

Inflation Trends	(Base 2007-2008 =100)	
	YOY %	MoM %
CPI Inflation		
Period	YOY %	MoM %
Apr-12	11.3	1.8
May-12	12.3	1.1
Jun-12	11.3	0
Jul-12	9.6	-0.2
Aug-12	9.1	0.9
Sep-12	8.8	0.8
Oct-12	7.7	0.4
Nov-12	6.9	-0.4
Dec-12	7.9	0.2
Jan-13	8.1	1.7
Feb-13	7.4	-0.3
Mar-13	6.6	0.4
Apr-13	5.8	1.1
May-13	5.13	0.51

Source: State Bank of Pakistan & CNM Research