

### **Dollar-rupee parity**

On Thursday, the rupee-dollar parity reached the historically high rate of 164 rupees to the dollar. The reason behind the deterioration of the parity is attributable to large payments for imports (particularly for oil) as well as on foreign loans (including payment of interest and/or principal on Eurobonds/sukuk reaching maturity). However on Friday, the rupee regained some ground that must have assuaged the rattled prime minister for the time being at least.

The parity has reached a historical high because never before was the exchange rate market-based, a prior condition accepted by the Pakistan authorities as part of the International Monetary Fund (IMF) staff-level agreement reached on 12 May 2019. The rupee has not yet reached equilibrium and further erosion of its international value is expected. Given that the prices of petroleum and products are quoted in dollars and are a major input for transport and energy sectors, any further deterioration of the parity would continue to have negative implications on the value of each rupee earned on the poor with limited budgets relative to the rich. Thus the 'painful' economic reforms that Prime Minister Imran Khan repeatedly emphasises are of a short duration, no more than six months, would continue to impact on the public for as long as the rupee continues to lose its value vis-a-vis dollar.

Previous to 12 May 2019, Pakistan was on a managed float system which was repeatedly abused to artificially keep the rupee-dollar parity down (more so during Nawaz Sharif's administrations as both he and his two-time Finance Minister Ishaq Dar erroneously considered a strong rupee synonymous with a strong economy) - a policy that led to Pakistan's exports becoming steadily more uncompetitive in the international market and imports more attractive. During the previous administration rupee overvaluation reached a historical high as Dar began to borrow heavily from the international marketplace - from multilateral and bilateral sources as well as from the capital market at rates well above the international average, and foreign commercial banks. By keeping the rupee overvalued he understated the budgeted allocation for repayment of interest and loans as and when due and kept electricity and gas tariffs lower than what was required for full cost recovery, a standard normal condition of the IMF.

So what is the situation today? The government is embarked on acquiring a bailout package from the IMF which requires the exchange rate be market-based. This would imply that the raise in gas prices of a little over 190 percent and of electricity prices by 1.49 rupees per unit effective July 1 would be applicable only for as long as the rupee-dollar parity remains at the current level. Any further rupee erosion would compel the government to increase tariffs further with implications on the purchasing power of households and the productive sectors. In this context, while the Ministry of Finance may be tempted to blame the SBP for the exchange rate, yet it must be borne in mind that electricity and gas are taxed heavily and responsibility for that rests with the Finance Ministry.

Imran Khan has reportedly been informed by his new economic team that the bitter pill has been swallowed by the people and that things would only get better with time. This assessment is erroneous not only because the rupee-dollar parity continues to erode but also because his Advisor on Finance has made projections in the budget for next fiscal year based on 150 rupee per dollar parity (including with respect to allocations for debt repayments as well as revenue from customs) which are obviously way off only two weeks after the budget was announced and the next fiscal year

is yet to commence on 1 July. Thus the exchange rate used is unlikely to convince the IMF that the country has complied with the prior condition of 0.6 percent primary deficit in the staff-level agreement.

The economic team has been at pains to inform the Prime Minister that the poor and vulnerable will be protected through: (i) no change in tariffs for those who consume 300 units of electricity per month or less; however they failed to point out that the poor would be affected by higher transport costs and the consequent impact on all food items; and (ii) the budget has doubled the allocation for the poor and the vulnerable (180 billion rupees for Ehsaas programme), however given that the Benazir Income Support Programme which was subsumed in the Ehsaas programme had an allocation of 118 billion rupees in 2018-19 actual increase is considerably less.

There is also talk of the unrealistic revenue target given to the Federal Board of Revenue and here too there are concerns that the government may have to either raise sales tax by one percent across the board, an easy to collect indirect tax, and/or withdraw exemptions special treatment to the productive sectors with implications on export revenue.

To conclude, the times ahead would be fraught with socio-economic unrest which no political government would be able to withstand. The Prime Minister would be well advised to compel his economic team to formulate Plan B that would meet the IMF conditions as much as is possible but also be doable in the context of the people of this country.

## RECORDER REPORT