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## Egypt, Pakistan and the IMF

The central bank governor coming right from the IMF - managing Egypt, is fueling skepticism that the Fund has brought him to emulate Egyptian model in Pakistan. The fear that IMF is perusing Egyptian type of reforms in Pakistan has been there for a year or so (read: 'Learning from Egypt', published on 7th February, 2018).

The question is whether Raza Baqir came on the IMF's behest. Nothing can be said with certainty, but a few facts must be narrated to filter brewing conspiracy theories. Reza was reportedly in touch with Asad while he was the FM, and sources say that he was touted as advisor to FM in finance ministry. Another point reported is that Baqir visited Bani Gala and met PM and his team a few times before his appointment as Governor SBP.

The next question is whether the Egyptian model would be implemented in Pakistan and what could be the role of new governor in it. Well, if we assume that the SBP Governor was recommended to be part of the economic team by Asad, then the chances are that he is to be positioned to negotiate with the IMF in Fund's lingo on what and where the IMF went wrong in Egypt.

A couple of years back, Egypt went into an IMF programme after a gap of 15 years, and just based on that fact the adjustments in Egypt were supposed to be higher relative to Pakistan, as we are habitual borrowers. The fiscal mess in Egypt was of higher proportion as the deficit was well in double digits for years, while at home, the toll in worse conditions remained below 9 percent of GDP. Excluding grants, Egypt's fiscal deficit went up to as high as 16.5 percent in FY14.

Another stark difference was in petroleum product prices - in Egypt these were subsidized, whereas at home, these are considered as top revenue generating items. Even after, on average, 35 percent increase in gasoline and diesel prices in 2016, the tax price to cost ratios was 56 percent in Egypt. At peak, the PSO of Egypt owed $6 billion to international oil companies which was reduced to $3.5 billion, due to fall in oil prices, at the time of entering Fund programme - tale of circular debt in Egypt

The adjustments took place which fueled inflation and poverty in the past 2-3 years. The price to cost ratio is now hovering around 85-90%. Pakistan does not need any similar adjustment. However, in case of electricity prices, 40 percent increase took place in Egypt in 2016 and here probably 25 percent adjustment would happen soon.

The position of the fiscal and energy mess in Egypt was worse than Pakistan and since there were no reforms, in the absence of IMF, higher adjustment was warranted. The debt problem in Egypt was similar. The higher concentration of domestic debt while in the Fund programme, the mix has improved as more foreign debt was raised from IMF and others due to IMF's letter of comfort.

The other element which could be more concerning to Pakistanis is the abrupt and too much currency adjustment in Egypt couple of years ago. The fear is that it may replicate in Pakistan. Egypt's Real Effective Exchange Rate (REER) prior to the IMF programme went up to 130 and came down a bit due to nominal currency depreciation before moving up again. Later, the infamous depreciation of the currency to half, took the REER down to 65-70 level and it was around 85 by the end of 2018.

In Pakistan, the REER responded much better to nominal currency adjustment - moved down from 124 in Nov17 to 103 in Feb19, due to 25 percent currency depreciation. Hence, based on REER, not many adjustments are warranted - for details read 'Currency equilibrium -almost there', published on 4th February, 2019. But what if the flexible exchange rate takes it to around 70-80? That thought is sending jitters to the market.

The implementation of flexible exchange rate is dicey in a thinly traded market. Just like Pakistan, there is (at least was) a parallel exchange rate market in Egypt. The premium in that market was around 30 percent at the time of entering the Fund programme - the peak of premium was around 50 percent. Such anomaly in exchange rate market does not exist in Pakistan. Hence, there might be a case of less currency adjustment, if free float/flexible exchange rate regime is introduced. But there is a case of keeping artificial cap on kerb market premium at home.

The current account deficit in Egypt peaked at 6 percent in FY16 and is down to 2.5-3 percent of GDP, but not much changed in goods' trade balance, rather home remittances, tourism, and Suez Canal due related flows improved the balance. The flurry of foreign portfolio investment - manly in treasury bills, is deemed a big success. The T-Bill yields peaked at 23 percent. However, lately with lowering rates and change in direction in flows to emerging markets, the hot money started evaporating.

The biggest problem Egypt faced after going into an IMF programme was high inflation. The headline inflation peaked at around 30 percent with food prices as high as 40 percent at a point. But, there could be a case of hyper inflation in the absence of IMF - as it happened in Venezuela or Zimbabwe. In 2008, Pakistan's food inflation peaked at 25 percent and this time around the inflationary impact of currency depreciation is much less to date. For details read 'Inflation to remain in single digit', and 'Impact of currency depreciation'

There were buffers created by the IMF in Egypt for supporting poor as subsidies were slashed, but those did not prove to be enough as poverty problem exacerbated in the country. According to the World Bank, around 60 percent of population in some cities is living below the poverty line. Prior to the programme, 27.8 percent of population was living below poverty line.

PM Imran should take a stern notice of these facts and figures, and should not let an Egypt type of reforms package to be implemented at home, if he is committed to reduce the poverty in Pakistan.

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