DAWN

2nd September, 2019

Jawaid Bokhari

Renewing business confidence

Notwithstanding the overall macroeconomic conditions remaining in a state of flux and official policies and business expectations converging less and diverging more, a few initial positive indicators have the potential to slightly rekindle the sagging business confidence in the economy.

First, the commercial banks have started investing in long-term Pakistan Investment Bonds (PIB) as the central bank's policy rate has peaked. For example, in one recent PIB auction, banks showed interest in acquiring PIBs worth Rs1 trillion while the government picked up offers of just Rs495 billion. Earlier, the banks were focused on investing in government papers with short tenure because of the market expectation of a further interest rate hike.

Another positive development is the steep fall in the current account deficit (CAD). In July this year, the CAD fell sharply by 73 per cent to just \$579 million from \$2.1bn in the same month last year. The figure is close to the International Monetary Fund's projection of \$557m. The trade gap has declined by nearly half over comparative months.

The country is in dire need of strategic domestic and foreign investment in prioritised sectors to help pull the economy out of crisis and on the path to robust economic recovery

Quoting the latest trade figures, advisor on commerce Abdul Razzak Dawood says "if a similar trend continues in the months ahead, by the end of the current fiscal year the pressure will ease on (forex) reserves and the rupee."

Similar views are also held by some independent analysts. With massive devaluation and a big improvement in the CAD, they point out that the current rupee-dollar parity is now viewed by the IMF as being close to equilibrium. And a noted financial expert does not consider the high inflation rate (at 10.3pc in July) a risk to rupee value. He argues that inflation was not a runaway story.

The rupee is stated to be undervalued when compared to the current real effective exchange rate (REER). However, REER is being updated as the country's trade and economic cooperation gradually acquires a regional bias, particularly with the significant presence of China in the domestic market.

In Pakistan, there is yet another critical issue for the State Bank of Pakistan to ponder upon while formulating monetary policy. The government's struggle to avoid a serious debt trap is being frustrated by the continuing rupee depreciation.

The country's total debt and liabilities shot up by 35pc to Rs40.2tr or 104pc of GDP during 2018-2019. Around Rs2.8tr was added to the total amount by currency devaluation. High central bank policy rate also has serious implications for domestic debt servicing. The fiscal deficit has hit a record of 9.1pc. It is not a sign of the government's finances moving towards stability.

A bank's senior treasury official does not rule out the possibility of the rupee gaining some value during this year. The demand for dollars will pick up significantly when the economic recovery starts. The government sees recovery in calendar year 2020 and some corporate executives say it may take one and a half to two years from now if investment-friendly policies are put in place.

It is also time for the SBP to loosen its tight monetary policy, analysts say, keeping in view the response of other central banks to the feared global economic slowdown/recession.

Finally, business sentiments are likely to improve with the National Accountability Bureau restrained from investigating suspected tax evasion cases or other unethical practices by some errant businessmen.

On August 23, NAB chairman retired Justice Javed Iqbal Khan announced that the watchdog would not pursue cases pertaining to income-tax and sales tax against the business community. Such on-going cases will be transferred to the Federal Board of Revenue. Notices issued to flour mills by the Bureau’s Multan Office were suspended with immediate effect.

The watchdog’s decision follows the federal cabinet’s observation that “businessmen are afraid of NAB. They are neither investing their money nor depositing it in the banks. In fact, they are hiding their cash under their mattresses. Business activities have stopped and the economy is crippled.”

While there is no doubt that NAB has contributed significantly to the loss of business confidence, the stabilisation policies designed to ease the external sector crisis have also played a major role in crippling production and destabilising the domestic market. The steep decline in imports is having a major impact on domestic output and investment.

The net inflows of foreign direct investment (FDI) plummeted to the paltry amount of $73.4m in July, a 59pc drop from July last year - a trend witnessed over the whole of 2018-19. An analyst considers these declining FDI inflows as ‘fading pipeline investments’. In the same month, the inflows from China have dropped by $94m and the United Kingdomc by $42m.

To quote from a media report, a top executive of a foreign firm says the current foreign exchange regime is discouraging FDI. He thinks that “foreign investors would wait for the rupee’s exchange rate to bottom out investing as there is an erosion of value.” He pointed out that foreign investors are not used to extensive procedural oversight in the flow of funds as being exercised by the central bank. “They want assurance that they have access to a dividend stream they can rely on flowing through unhindered.”

Incidentally, the FBR has also started analysing cases of transfer pricing where companies are suspected to be directly involved in shifting their profits abroad without payment of taxes.

The government is also pinning hopes on the forthcoming visit of a 64-member Chinese business delegation due to visit Pakistan in October. The Chinese are stated to be interested in relocating their industries in Pakistan. But the special economic zones where the Chinese investments are to be located are yet to become operational.

In its latest move, the government plans to set up 12 special economic zones (SEZs) including nine that received the go-ahead under China-Pakistan Economic Corridor. While work on SEZ at Rashakai is in progress, Prime Minister Imran Khan will now himself monitor on a weekly basis the progress on other long-delayed zones. As provinces are also involved in this major venture, he may not have smooth sailing.

Restoring business confidence is a challenging job in a complex situation marked by low savings, paltry investment, falling production, rising unemployment, declining wages, increasing poverty, low economic growth and high inflation. While suppressed domestic demand is stifling growth, the export outlook is not so predictable in a global economy that is slowing down.

The government’s actual development spending which could stimulate private investment is constrained by rising fiscal deficit with tax revenue not expected to increase fast enough. The prime minister has asked his economic team to prepare an economic revival plan completely aligned with the IMF programme so that the currently sluggish economic activity could receive a kick-start.

The country is in dire need of strategic domestic and foreign investment in prioritised sectors to help pull the economy out of the multiple crises and to put it on the path to robust economic recovery.