BUSINESS RECORDER
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## Foreign exchange earnings

Pakistan's foreign exchange reserves on 30 April 2020 as per the State Bank of Pakistan (SBP) website were 12.329 billion dollars, a respectable amount given the ongoing global pandemic that has severely negatively impacted on our exports and is likely to hit remittance inflows while 2 billion dollars of the 3 billion dollar 'hot' money inflows have left the country – inflows attributed to the high discount rate of 13.25 percent effective 20 July to 17 March.

Covid-19 has not only massively curtailed aggregate demand globally but also crippled supply due to the subsequent lockdown with economists maintaining that for the two to rise to pre-Covid-19 levels would require six months at best to beyond one year at worst. Pakistan as a case in point has fared much worse because the country was already engaged in curtailing aggregate demand and inadvertently reducing supply through agreeing to contractionary monetary and fiscal policies on 12 May 2019 with the International Monetary Fund (IMF) staff under the 6 billion dollar 39-month Extended Fund Facility (EFF) programme.

A high discount rate raised input costs to unsustainable levels and an undervalued rupee made imports of raw materials and semi-finished products very expensive for the productive sectors – policies designed by the IMF with concurrence from the SBP. A historically high reliance on external borrowing, estimated at 38.6 billion dollars during the duration of the Fund programme, with almost a billion dollar injection per month, was agreed to by the Ministry of Finance – a dependency predicated on irresponsibly raising current expenditure for the current year by 30 percent and development expenditure by 40 percent while at the same time, giving a tax revenue target that was ludicrously unrealistic given the 2.4 percent growth rate projected by the IMF supported in the budget documents. So with aggregate demand and production already severely curtailed the onslaught of Covid-19 has just added the finishing touches to our critically ailing economy for the remaining two and a half months of the current fiscal year.

The IMF's projections are noted in its April 2020 document titled Request for Purchase under the Raid Financing Instrument (RFI) – Staff Report: "the Covid-19 shock will have a severe impact on the Balance of Payment. In particular, (i) export growth is likely to come to a halt due to the fall in external demand; (ii) remittances are expected to drop by over US$5 billion during FY 2020 and FY 2021 as activity in GCC countries declines; and (iii) outflows from non-resident holdings of domestic treasuries could continue, despite having experienced $2.0 billion in outflows so far. This scenario will result in new external financing needs of about US$2.0 billion (0.8 percent of GDP; SDR 1,400 million) in Q4 FY 2020. It is envisaged that these urgent external financing needs will be met through the use of Fund credit under the RFI and fresh resources of around US$250 million committed by multilateral partners. These disbursements would maintain central bank reserves at US$12.0 billion (2.7 months of imports) by end-FY 2020, a level similar to that prior the shock. Moreover, a potential financing gap of around $1.6 billion could emerge in FY 2021, which would be filled through the use of reserve assets, additional support from multilateral partners, and, if needed, additional policy adjustments."

In other words, Pakistan's foreign exchange requirements have risen by at least 2 billion dollars to 40.6 billion dollars due to the Covid-19 for the programme duration. The question is whether the 1.2 trillion rupee Covid-19 package announced by the Prime Minister will reactivate the wheels of industry and create employment opportunities? The SBP has churned out the usual export/industry incentives meted out by many previous administrations – concessional funding but these are unlikely to be effective as according to its second quarterly report for the year private forms borrowed from

Libor based foreign currency loans and relied less on expensive rupee denominated loans as well as concessional facility of SBP. However in spite of this the Fund in its April 2020 staff report on Pakistan's request for rapid financing instrument (RPI) "emphasized that regulatory measures and expanded refinancing schemes must be targeted and temporary and their design should not create moral hazard nor foster poor credit risk management practices."

Pakistan's exports have yet to recover from the then finance minister Ishaq Dar's flawed policy of an overvalued rupee that focused on understating the government's debt with complete disregard of its impact on exports. However, other impeding factors are no less corrosive including large pending refunds (which create serious liquidity issues), the 8 percent discount rate effective 15 May 2020 is still too high compared to the Libor-based foreign currency loans and high utility charges designed to make consumers pay for sector inefficiencies and corruption. Refunds remain pending today in spite of repeated pledges to clear them.

Remittances rose during the first ten months of the current year (July-April) to 18.78 billion dollars against 17.8 billion dollars in the comparable period of the year before (5.5 percent rise) however with lower projected remittance inflows during the remaining three months of the current fiscal year with the ongoing lockdown in the Gulf countries as well as in Europe and the US (in spite of the usual expected spike associated with Eid holidays) the IMF estimate of a decline of 5 billion dollars for the year is credible.

Net foreign direct investment (FDI) rose in July-March 2020 compared to the comparable period the year before – to 2.69 billion dollars from 2.14 billion dollars. However, last year outflows were 1.2 billion rupees giving net FDI of 905 million dollars while in 2020 the outflows were lower at 548.5 million dollars giving net FDI of 2.1 billion dollars. The reasons for higher inflows in 2020 were: (i) China increased investment from 282.6 million last year to 532 million dollars this year and (ii) Norway doubled investment in the communications sector – from 110 million dollars to 282.6 million dollars mainly for payment of license renewal fees of two mobile companies.

Loans acquired during the PML-N tenure were due for payment as and when the PTI took over and this is reflected by the fact that foreign exchange reserves did not witness a spike after Prime Minister Imran Khan secured 3 billion dollar loan (and another 3.2 billion dollars as deferred oil facility) from Saudi Arabia, 2 billion dollars from China and one billion dollars from UAE. The Khan administration has improved the maturity of the debt however what one can conclude is that the foreign exchange reserves today are not from desired foreign exchange earnings - exports, remittances and foreign direct investment - but from undesired foreign exchange inflows, particularly borrowing which is reminiscent of Ishaq Dar's flawed policy.

To conclude, stabilisation efforts have yet to see a significant rising trend in inflow of desirable sources of foreign exchange and the fact that reforms in both the utility sector and Federal Board of Revenue remain pending, critical to making the economy resilient, reliance on borrowing continues to be the economy's mainstay.