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Dollar shoots to Rs142, settles at 138

KARACHI: The rupee on Friday slumped by Rs8 to hit an all-time low of 142/dollar in an apparent central bank-backed devaluation, during intra-day trade aimed at moving closer towards the International Monetary Fund (IMF) recommended free floating exchange rate, a critical pre-condition for entering a loan deal.

In the inter-bank market, the rupee closed at Rs138, while on Thursday it closed at Rs134. The currency has dropped 10 percent since the Pakistan Tehreek-e-Insaf (PTI)-led government has come into power.

According to the Bloomberg's currencies basket, the rupee has erased more than a fifth of its value to become the worst performer in Asia this year. The devaluation comes after talks with the IMF for a bailout to bridge a $12 billion financing gap stalled without an agreement after the government said it wasn't ready to accept some of the lender's conditions attached to the rescue package. The IMF has long advocated Pakistan to loosen its grip on the rupee.

Analysts said rupee is one of the reasons negotiations hit an impasse with the IMF. Ashfaque H Khan, Dean at the NUST School of Social Sciences, said the currency devaluation would have negative implications for the public debt.

"Around Rs300 billion will be added to the foreign debt in response to today's whopping exchange rate adjustment." Ashfaque said. It's believed that the government has been using currency devaluation to ease pressure on the balance of payments stimulated by widening current account deficit and falling foreign exchange reserves and take advantage to increase exports.

The country's latest economic crisis emerged after the current account and budget deficits widened and the foreign reserves dropped to a four-and-a-half year low. Traders said the SBP's lack of intervention in the foreign exchange market caused a sharp drop in the value of rupee.

"The SBP initially didn't intervene to try to manage the free fall of the rupee in the morning. However, the currency recouped some losses in the afternoon after the central bank pumped dollars into the market and asked banks to sell the foreign currency only to genuine buyers," a market participant said.

The rupee was down near 2 percent at Rs138.10 in the open market, according to rates quoted by Exchange Companies Association of Pakistan. Earlier, Yaqoob Abubakar from Tresmark, an application that tracks financial markets, said rupee hit a new intra-day low of 144/$ but closed at 139.05/$.

"The reason behind recent depreciation is the demand and supply gap and panic in the market due to monetary policy," Abubakar said. "Thus we still expect some more movement till the IMF programme announcement," he said.

The government and the Fund failed to reach an agreement on a bailout package during a visit by IMF staff mission from November 7-12. The IMF had indicated there was a need for further devaluation in the rupee as well as hike in interest rates.

Pakistan is likely to restart negotiations with the Fund for financial assistance, which will end in agreement by the mid of January. "This action (devaluation), however, does not offer clarity regarding the timeline of our talks with the IMF. On the one hand, the monetary policy is moving in the direction consistent with the IMF's expectations, and could expedite the negotiations," said an analyst at the Taurus Research.

The analyst said on the other hand the SBP's ability to take a leading role, and contradict the government's apparent stance, implied that they were preparing for a future with or without the IMF to rein in the expectations of our elected officials.

Topline Securities in an economy update said the rupee had lost around 10 percent since the inauguration of the new government. "We believe this (devaluation) was much-needed as Pakistan's external current account deficit (CAD) remained higher than our expectations. For the period Jul-Oct 2018, CAD was reported at $4.8b (1.6 percent of GDP) compared to $5.0b (1.6 percent of GDP) last year," Topline report said.

Pakistan's foreign exchange reserves (SBP-held) also declined from $9.8 billion in July 2018 to $8.0 billion as of November 23, 2018, which is less than two months' of import cover. Market commentators expect the rupee will depreciate to 145/150 after signing off the new IMF programme.

Meanwhile, gold rates also witnessed an increase with the increase in dollar rates. The per tola price of gold on Friday crossed Rs65,000. Meanwhile, going beyond market expectations, the State Bank increased the benchmark interest rate by 150 basis points from 8.5 percent to 10 percent -- a six-year high level.

The rate hike was very much in line with the IMF demand that Pakistan push the interest rate into double digits. "The new rate will come into effect on December 3, 2018," the central bank announced.

With the fresh revision, the central bank has raised the interest rate by a cumulative 4.25 percentage points in five rounds since January 2018. The prime objective is to make borrowing expensive in a bid to apply brakes on the accelerating inflation in the country.

"Near-term challenges to Pakistan's economy continue to persist with rising inflation, an elevated fiscal deficit and low foreign exchange reserves," the SBP said in the Monetary Policy Statement released on Friday.

On the other hand, while justifying sharp nosedive of rupee against dollar, Minister for Finance Asad Umar said exchange rate was artificially kept stable during the PML-N-led regime for providing benefit to foreign sellers and now supply-demand gap has forced adjustments keeping in view the whopping current account deficit that touched $19 billion mark.

The minister said the previous wrong policies had resulted into surpassing of Bangladesh from Pakistan on economic front and now only Afghanistan was lagging behind Pakistan. In the name of keeping exchange rate stable, the minister said, exports remained at disadvantaged position while foreign sellers were providing windfall benefits through flawed policy, resulting into depletion of reserves of billions of dollars in the last two years.

"The devaluation of rupee against dollar has nothing to do with the IMF arrangement, but it is the outcome in the wake of the massive gap on current account side and depletion of foreign currency reserves simultaneously," Asad Umar said in a news briefing along with Minister for Planning Khusro Bakhtiar and Minister of State for Revenue Hammad Azhar here at Information Service Academy.

The minister also hinted at major changes in the top bureaucracy of the Federal Board of Revenue (FBR) and many relevant sources said that major changes might be brought in the Board keeping in view the dismal performance of the tax machinery.

The minister said if the government could not slash down its budget deficit then economic revival would become difficult. He said the capital movement was allowed as free for all and Foreign Exchange Regulation Act (FERA) and Protection of Economic Reform Act (PERA) were introduced in 1992 and then many influentials purchased assets abroad.

To a query regarding financial assistance package from friendly countries, Asad Umar said technical talks with China and UAE were at advanced stage and he could predict that it would be finalised within December 2018. Keeping in view the proposed package, he said, he had claimed filing the financing gap on external account.

However, he said, they did not make any request to Malaysia for any assistance package, but substantial investment was expected to pour from potential investors.

The minister said the rupee was artificially kept stable by purchasing dollars during the last PML-N government and this flawed policy was going to burst by witnessing adjustment keeping in view gap in demand and supply. He said rupee against dollar witnessed slide by Rs23 in last six months of the PML-N regime from December 2017 to May 2018 as it was the result of keeping exchange so long in the same range through unsustainable and artificial means.

When the minister was asked about any major structural reforms undertaken by the PTI-led government in first 100 days on which U-turn was not taken, Asad Umar replied that four major reforms were undertaken by the government including separation of policy from tax administration in the FBR, establishment of Policy Board in the Securities and Exchange Commission of Pakistan (SECP), establishment of Pakistan Investment Company and moving towards governance reforms.

Talking about medium to long term solutions, Asad Umar said Pakistan will have to reduce cost of doing business for increasing exports, boosting up remittances and investments to overcome its economic woes. He said the FBR would accelerate release of stuck up refunds for exporters.

Khusro Bakhtiar said the government would introduce governance reforms by placing merit-based policy and performance contract and has so far identified 11 ministries for moving ahead. He said investment and savings in percentage of GDP reduced in last five years indicating that the growth could not be achieved on sustained basis. He said the savings to GDP ratio stood at 10 percent in Pakistan, while it was ranging 30 percent in India. He said that India got IMF package one time in last 30 years and undertook reforms, while Pakistan obtained package from the IMF 13 times.

The minister conceded that the inflationary pressures could go up but the government intended to undertake desired structural reforms to fix the economy. Under the CPEC, he said the agriculture, socio economic development and poverty alleviation would be the major focused areas.

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