BUSINESS RECORDER
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Analyses&Comments by BR Research

Finding stability under the IMF

The inevitable has happened. Soon after, the currency dipped by 8 percent in a day, as the Finance Minster flew to attend the IMF and WB annual board meeting. The sharp currency dip has brought real effective exchange rate close to equilibrium.

There is no surprise element as this was bound to happen. However, the sequence of events was ill managed by the policymakers. They kept the plans too close to heart and apparently did not have any assertive plans. What followed was unnecessary uncertainty that fueled pessimism in economy already facing a slowdown.

Asad may well have the best intentions and right plans for the medium to long term sustainability; but he seemingly lost the first battle. The inevitability demanded that the plan should have been announced earlier to allow the currency to adjust slowly to its equilibrium value.

The indecision does not bode well for market sentiments. The government came with a mantra of change and transparency; but in the process they missed the core function i.e. managing day to day affair.

Dar was not the best of the finance minister. But he had the power and trust of the then PM and he had used it to full strength. He had a plan and implemented it without delving too much into the repercussions. Asad enjoys similar strength; but he comes across as a weak and indecisive manager.

The government in general, and finance minister in particular, are reacting to the public and market sentiments. This is not a right strategy in days of crisis where the government needs to anchor the decisions and give directions to bring much needed stability in policymaking. In a quest to make everyone happy, they are making a fool out of themselves.

Enough of criticism. The steps of going to the IMF programme and currency depreciation are right decisions. The question is what comes next. The government needs to learn lessons from its own mistakes and should be forward looking and proactive in approach.

The tough part is done. With 8 percent dip in currency, the REER, which was at 112 in August when the rupee dollar parity was 124, should have come down to 104-105 by October. This implies there is further 4-5 percent room in currency depreciation, and seeing high inflation in coming months, the equilibrium may touch the 140 -142 mark.

The need is to negotiate with the IMF. The currency is down by 29 percent in the past nine months, this along with interest rates adjustment will take time to reflect in numbers.

The chances are that currency will remain stable at this rate for a couple of months, and it depends on other measures. Sooner the fiscal adjustments happen; the better it is for stability. The issue is to manage imported demand and to bring twin deficit down to permissible levels.

The IMF programme negotiation will take place in 4-6 weeks time and by that time; the government should try to fetch some foreign inflows from KSA and China. The immediate panic is gone as the Fund driven stability will be soon in action.

The good thing is that many of the Fund's expected conditions are already met, and soon others will come in play. Expect electricity tariffs to go up to bring down the energy related subsidies and lower the circular debt. The SBP might increase the policy rate further by 100 bps in upcoming two policies and the government borrowing from central bank would not be an option.

The fear is that the mini budget and revision in energy prices might not be enough to curtail the fiscal deficit to the liking of IMF. The government might have to come up with some fresh measures both for enhancing revenues and curtailing expenditure.

All these steps would surely further slowdown the economy and the prospects of generating two million additional jobs per year may remain a pipedream in the first two years of government. The focus should be entirely on stability for next couple of months and once the efforts start translating into numbers, the government should accelerate the reform process.

During the next couple of months, the need is to fill in the vacant positions in key institutions. The work on reforming PSEs should start - let's see how can the government convince the IMF to agree on the policy of turning around PSEs as the Fund may like privatization.

In the meanwhile, the government should offer some investment opportunity for expats by offering bonds and look for investments. The need is to work on enhancing savings within the country by issuing retirement and insurance schemes.

The growth can be triggered from the announced housing scheme if it is played right. The bottom-line is that the government should move away from short fixes. One cannot blame the PTI for getting into yet another IMF programme as the onus of this programme falls on PMLN.

The PTI performance will be gauged on the promised reforms in the next couple of years; and if by 2023, we don't need another Fund programme, the PTI government would have done its job. Else it would be business as usual.