Where are we heading?

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The PTI government enjoys a fairly strong popular support. Undoubtedly, the economy it has inherited was beset by a host of macroeconomic challenges. The Caretakers showed their inability to intervene, and where they did, they made it worse, like the steep depreciation of rupee from Rs 115 to Rs 128 in two tranches.

One had thought that a popular government with a fresh mandate would hold the proverbial bull by the horns and treat the ailment like an expert physician. Unfortunately, we find few runs on the board, and frankly, not much to cheer about. What is more worrying is that barring the gas price adjustment (not yet notified), there is a discernable unease in taking unpleasant decisions.

In our articles published on 18-9-2018 and 26-9-2018, we had evaluated the mini-budget and the evolving dangers on the horizon. The former was found inadequate while in the latter we pointed out a host of dangers arraying against the economy. Under the circumstances, markets and investors are anxiously looking toward an economic vision that would reinvigorate their sagging spirits.

So far, PTI government has made two petroleum price adjustments. On both occasions, economics was not the paramount consideration. In September, we lost sales tax revenue of Rs 4 billion by reducing prices rather than increasing them, to recoup the lost revenue in July-August which was missed by the Caretakers in view of the court proceedings, or at least left unchanged. This policy has been repeated for the month of October with a much larger revenue loss. The required action was to increase the petroleum prices as per the adjustment mechanism. But the government decided to maintain the previous prices at a significant cost to the exchequer.

In the two main products – high-speed diesel and petrol – sales tax was reduced by Rs 4.50/liter and Rs 4.26/liter, respectively, with a combined revenue loss of Rs 6.5 billion for one month. On both these products, the applicable sales tax is below the statutory rate of 17%. It is difficult to fathom how so much of precious Government revenue can be sacrificed for reasons not consistent with prudent economic management. This loss of revenue is difficult to recoup during the fiscal year for two reasons. First, if international prices remain constant, to make up the loss higher increases in prices would be required both to bring the prices to required level and to recoup the lost revenue for this month. Second, international prices are rising and every month one would be needing fresh increases to keep pace with those prices. Under such circumstances, no one would be thinking of recouping the lost revenue but of possibility of passing on the fresh increases.

On the other hand, the first quarter performance of FBR fell short from its target by Rs 56 billion, despite having the head-start from nearly Rs 40 billion from extended period of amnesty scheme. This clearly means an increase in fiscal deficit, which we have previously argued it was not meaningfully reduced through the mini-budget.

These two actions are not in line with the main messages PTI leaders have been conveying in their political campaign. For instance, consider the emphasis on debt burden, notwithstanding the inaccuracies routinely found in those claims. Even a rupee’s worth of increase in deficit is an addition to public debt. The budget of the Abbasi administration had a purported deficit of 4.9%. Amusingly, the mini-budget has ended up raising the deficit to 5.1%, though none would come even close to the actual deficit as the necessary measures are absent. Another disappointing feature is the absence of measures that would have translated austerity into some monetary value. Contrary to a marked effort to reduce deficit – and consequently debt – it seems the government is indifferent to such consideration.

While these issues confront the Government, additional developments point to continuing difficulties lying ahead. First, a rate increase of 100 bps (cumulatively 250 bps since January) announced by monetary policy committee of SBP on 29-9-2018 reflected the unabated demand pressures. This would also have an adverse effect on budget deficit through increased debt servicing cost. Second, inflation in the first quarter slowed a bit – from 5.8% in July-Aug to 5.2% – primarily because the petroleum prices were not adjusted and the gas price adjustment has yet to be approved by the Cabinet. Electricity price adjustment, also delayed for more than two years, has yet to be approved at the ECC level. Hence more inflation is in store. Third, the current account deficit remained elevated in the first two months, though a significant slow-down was noted in the month of August, with deficit dropping to $ 600 million compared to an average of $ 2 billion in the preceding months. Fourth, while modest increase in remittances was recorded, FDI has nearly halved. Fifth, the initial spurt in the exchange rate observed on the eve of elections has finally subsided and pressures are building to cross the level of Rs 128.50 clocked on 16 July 2018. Finally, on the back of these changes, SBP has revised its growth projection from government's target of 6% to 5%.

These developments are indicative of an economy in continuing distress, badly in need of a manager who would set a predictable policy course that removes uncertainties and gives markets and investors the confidence they need badly. Yet this is not visible on the scene though six weeks have passed. One wonders, where are we heading?

The ostensible reason behind the delay in laying out a clear road map is evaluation of options of going to the IMF versus seeking friendly help to tide over the current difficulties. These are not options; they complement each other. The bottom line is that we have a job in hand, a painful one; we may agonize, as much as we want, but we have to face it and do it. The dismal science tells us there are no easy choices in economic management. Unpleasant decisions are inescapable; earlier these are taken, less pain would be endured.

The window of opportunity provided by the goodwill that a new government enjoys is like a fleeting moment. Unless seized and acted upon, the government would soon be mired in new problems, which would sap its energies and erode its ability to take difficult decisions.

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