

Economic fundamentals belie govt's 'comfort zone' approach

ISLAMABAD: The PTI-led government is claiming for achieving 'comfort zone' but prevailing economic fundamentals do not support this complacent approach mainly because of yawning budget deficit with every passing day that is considered mother of all 'economic ills'.

One top official of government disclosed to The News on Saturday that the reason beyond the government's overjoy was based on bridging the financing gap on external front as Islamabad was expecting that the day to day pressure on account of oil payment would start diminishing from mid-January 2019 when Saudi Oil Facility (SOF) would become operational.

"Some procedural requirements will be accomplished within January 2019 and SOF will be kick-started within couple of weeks," said the official.

The Islamic Development Bank (IDB) facility of \$4.5 billion oil and commodity financing requirement of three years period has already been operational from July 1, 2018 but it could not be utilized at optimal level so far.

This is a positive development but there are some worrying developments occurring on the economic front as well which should be highlighted for bringing them into radar screen of the government.

On budget deficit front, the demand of IMF for achieving primary balance after excluding interest repayment into surplus cannot be fulfilled without raising FBR revenues at federal level and achieving revenue surplus of one percent of GDP from the provinces in the presence of existing NFC Award which cannot be altered under the existing constitutional arrangements.

The FBR tax collection target in the context of curtailing budget deficit, further hike in discount, raising electricity tariff by 22 percent and erasing monster of circular debt as well as allowing exchange rate depreciation of rupee in the range of Rs150 and even beyond for striking staff level agreement with the IMF.

The IMF is asking for raising the FBR tax collection target to the tune of Rs200 billion more in order to jack up tax collection up to Rs4700 billion with the demand of further devaluation of rupee against dollar from possible under consideration new target of Rs4450 to Rs4500 billion through additional measures in the upcoming mini budget which the government is expected to unveil mid of next month.

The FBR is collecting taxes at growth of 5 percent and far facing shortfall of more than Rs110 billion in first five months and after witnessing collection of this ongoing month this revenue shortfall is expected to cross at least Rs150 billion in first half of the current financial year. With possible revenue measures in the mini budget the FBR collection could be envisaged at Rs4500 billion against existing target of Rs4398 billion. But the IMF is projecting FBR target on the basis of macroeconomic model with exchange rate of Rs150 after which the collection at import stage must go up to the tune of Rs4700 billion.

When the government shows its inability to jack up FBR target and materializing revenue surplus from the provinces then the IMF asks for resetting of priorities in expenditures either to cut down development or defense in order to keep budget deficit in the vicinity of 4 percent of GDP.

The discount rate is another problematic area for finalizing the government-IMF deal. The reliance on short term borrowings has phenomenally increased and recent auctions of PIBs shows that bankers are expecting more hikes in discount rates in coming months.

The government borrowing from the SBP had ballooned close to Rs5 trillion and the government would have to make major adjustments for reducing its reliance under the IMF program. So bankers are going to exploit this situation with the expectation that they will make shift from long term investment into five to ten years PIBs into Treasury Bills (TBs) with three month maturity only.

One market player told The News that the government refused to lift Rs95 billion PIBs at floating rate last month but now they picked up Rs16 billion at fixed rate indicating that the discount rate would be dictated by the banks in the near future. Between 1 July and 7 December, the banks have divested Rs683 billion from their holdings of government securities.

Former secretary finance Dr Waqar Masood in one of recent article had stated “This situation is reflective of a monetary policy that is falling significantly short of the market expectation. Despite an effort of 475 bps in the policy rate, investors’ expectations remain of further adjustment and hence nobody is ready to invest in the long term paper”.

When contacted to Ministry of Finance Advisor and Spokesman Dr Khaqan Najeem on Saturday, he said that the successful auction and acceptance of PIBs bids at a competitive interest rate of 12.74% per annum for amount of Rs16.7bn [realized value] (Rs6.2bn for 3 years, Rs1.5bn for 5 years and Rs9 bn for 10 years PIB) is expected to stabilize market interest in the longer-tenor papers of the GOP in subsequent auctions.

This is a move by the government to diversify its borrowing towards longer tenor of PIBs. It will reduce the burden of GOP borrowing from SBP and will reduce rollover and re-pricing risk of shorter-term marketable government debt.

It is expected that participation of banks in primary auctions of government securities particularly in the longer tenor of PIBs will improve in the future, he concluded.

Mehtab Haider