INTERNATIONAL THE NEWS

Imprudent devaluation to have multiplier effect on inflation

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LAHORE: Decisions to increase petroleum products rates and let the rupee decline by 3.8 percent took the public and the businesses by surprise. These decisions would have multiplier effect on inflation that is already on the rise due to high food prices.

The Pakistan Muslims League-Nawaz (PML-N) government that had been adjusting the petroleum products rates monthly for the last six months; left the adjustment of petroleum prices to the caretaker government. The caretaker government after assuming power announced that the petroleum rates would remain unchanged.

Then as soon as the rupee declined against US dollar on June 11 the government abruptly increased the petroleum products rates. Was it the massive devaluation of rupee that prompted the government to change its decision? But the devaluation seems to be pre-planned at the central bank.

Most economists believe that the rupee is overvalued and needed to be adjusted downward against the US dollar. But the adjustment should have been done in a prudent way. Devaluation benefits exporters.

A year back they were getting around Rs100 against one dollar of export. Now they will be getting Rs120 against one dollar.

In other words, in one year the exporters' profits in rupee terms have increased by 20 percent. They are now in a position to somewhat lower their prices in dollar to fetch more orders.

They did make adjustments in the past six months by passing on some benefit in prices to the buyers and retained most of its. Most of the previous devaluations were made gradually meant that the exporters absorbed the devaluations in their profits instead of passing it on to the foreign buyers.

However, a devaluation of 3.8 percent in rupee value in one day would prompt the foreign buyers to ask for their share in the pie. Our exports were moving up as the competitiveness of the exports was restored by earlier devaluation.

If the exporters could pocket the entire devaluation they would be accumulating wealth. But it has been observed in the past that higher devaluation in one go cannot be absorbed by exporters alone.

When the Shaukat Aziz government announced 6 percent R&D on textile exports, the buyers of our products got away with 50 percent of this rebate. The massive devaluations done in 1993 and 1996 did not result in higher exports as the benefit was mostly passed on to the buyers.

This is the reason that experts call for a planned systemic devaluation in a way that benefits the local exporters only. For instance, the rupee should have been allowed to shed 1.5 percent of its value on June 11 and then central bank should have intervened for next two days to reduce the devaluation to 1 percent.

The rupee should have been allowed to shed another two percent against the dollar after two to three days. Another central bank intervention should have restored 1 percent of rupee value.

A week later, 1.5 percent devaluation should have been permitted with a recovery of 0.5 percent in the next few days. The whole process would have taken a month but the up and down movement of the currency would have given the exporter an excuse not to succumb to the demands of the foreign buyers to lower their rates in dollar terms. One time large devaluation hurts the interests of the exporters.

The cost of imports would definitely increase but the volume of imports is unlikely to decrease appreciably. Logically, the devaluation should check exports but the import regime in Pakistan is so skewed that most of the consumer and finished products are being imported at absurdly under-invoiced values.

Devaluation increases the impact of government levies on imports, but if products are being imported at 10-25 percent of their actual values, the impact would not be so sharp and imports would remain viable.

The government would have to revamp its customs valuation department that charges duties on input according to their prices available on net on the day of release but adopts no such mechanism for finished goods that sometimes are imported at lesser rates than their inputs.

Inflation would now be on the move, as for the first time in five years the consumer price index would face the multiple pressure of devalued rupee, as well as high petroleum and food prices.