AVOIDING THE CRISIS

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Economists are notorious for invariably making wrong or inaccurate forecasts. I would, therefore, not indulge in predicting what is to happen in 2018. Rather, I would look at the past trends, present situation, global economic environment and the likely domestic political and economic developments in the coming year and make some conditional informed guesses.

There are four possible scenarios arising from a reading of the probable sources of uncertainty in the coming year. Three of them relate to domestic and one to external sources.

On the domestic front, the big question is whether the general elections would be held on time, in a fair and transparent manner, and without resulting in a hung parliament.

If the transition from the present government to a newly elected government takes place smoothly, there would be a positive impact on the economy. However, in case of dispute or non-acceptance of results, or the elections not taking place as envisaged, there would be serious economic dislocation.

Another possibility would be our opposition political or religious parties going ahead with their pronouncements of protests, dharnas and strikes. If they do, the pace of economic activity would slow down and there would be a setback to the momentum of economic growth. In case dharnas do not occur at all, or are of shorter duration, the damage would be limited.

Thirdly, whether the provincial governments, flush with 60 percent of transfers from the federal government, would use these resources liberally for populist and vote-centered spending. Of course, the federal government's capacity to indulge is restricted due to the enormous burden of inflexible expenditures on debt servicing, defence, subsidies and transfers.

If the provincial governments are not restrained in their spending, the overall fiscal deficit is likely to swell beyond manageable limits necessitating extended borrowing. The increase in wages and salaries and public spending would also fan inflationary tendencies.

Fourthly, if the US government does translate its threats and notices into action, the repercussions on the economy are likely to be quite humungous. We hope and wish our nation is spared this calamity.

If we consider the probability of any of the above four scenarios actually materialising as low, then we are left with the most likely scenario of muddling through.

If we assume extension of the current conditions until the new government comes into office, followed by some uptick thereafter, then the quality of economic management and the response capacity to avert possible crises become critical.

Let us begin with a survey of the current economic situation:

On the positive side, growth is visible and may reach six percent after a long hiatus, provided the movement forward is not disturbed by any foreseen exogenous or internal shocks.

Foreign investors have shown confidence by oversubscribing Pakistani Euro bonds and sukuk at a highly competitive price and the rating agencies are maintaining a positive, stable outlook.

The addition of regasified liquid natural gas (RLNG) – a cheaper and cleaner fuel than furnace oil – to the system, and an expansion of generation capacity by almost 10,000 mw (by 2018) have eased the energy shortages that were hampering production and exports.

Depreciation of the rupee, along with an incentive package for exporters, has sparked a gradual upsurge in the volume of exports. Private sector credit, for both working capital and fixed investment, has been on an upward moving path.

CPEC-related investments have boosted the FDI flows that are projected to accelerate in 2008.

The pressure points and vulnerabilities are equally daunting. Both current account and fiscal account would remain under severe pressure. The FY 2017 fiscal account shows that the provinces, instead of generating surplus, contributed 1.5 percent of GDP towards the overall deficit. There is no mechanism at present to bring about fiscal coordination and, therefore, this risk would remain quite elevated and the imbalance would be difficult to tackle.

The circular debt in the power sector is approaching about Rs. 800 billion and no satisfactory mechanism has been put in place to avert it in future.

Tariff differential subsidies, transmission and distribution losses and shortfall in recovery of dues would continue to widen the gap between purchase price and sales price. The additional generation would only accentuate the situation.

Unless power sector reforms are put in place on a priority footing, the fiscal deficit – including the off-budget clearance of circular debt – would remain a major headache.

On the external account, there is a highly difficult balancing act to be performed.

Avoiding the IMF: A difficult task

Stabilisation measures, such as curtailing current account deficit by raising the price of imported goods, can choke off the incipient growth momentum; while increased external borrowing to finance 5 to 6 percent of projected current account deficit would affect debt sustainability.

The past three years were highly beneficial for the external account as the international prices of petroleum and petroleum products (POL) had come down substantially giving some relief. If the oil prices continue their present upward trend, it would turn into a strain on the balance of payments. The combination of higher international prices and exchange rate depreciation would result in a higher value of imports as the demand for POL products is inelastic.

While the prices of foreign machinery and equipment and raw materials would suppress their imports, essential food and other goods would continue to flow in. The composition of the imports would radically shift from investment-oriented ones to subsistence and sustenance items.

Foreign investors would also shy away as their returns in dollar terms would be eroded to the extent of the depreciation of the rupee. Hence, this major financing venue for meeting the current account deficit would also shrink or become evasive.

Export data for the past five months is encouraging, but the rate of increase has to be higher than the current trend to narrow the trade imbalance.

Similarly, additional efforts would have to be made to divert workers' remittances through banking channels. The CSF flows from the services account have to be totally discounted.

As the current account is simply a reflection of the savings and investment situation prevailing in a country during a given period, it would have consequences for the domestic economy too.

The spillover from imported inflation – petroleum, food, etc. – to domestic inflation would thus become inevitable. Monetary policy would have to be tightened in response to surging inflation and interest rates would have to be raised thus increasing the cost of capital and investment goods.

The demand for private sector credit would thus be lower than what it is today as it faces a double whammy – higher cost of imported machinery and raw materials, and higher interest rates.

Some investors may choose to slow down their pace, while others in the beeline may decide to wait for a more opportune time.

The public sector development program would also have to be cut down to offset the increased outlays on debt servicing in the budget.

As the quantum of increased debt servicing is likely to be higher than the rise in collection from custom duties and sales tax on imports, the budgetary deficit would exceed the envisaged level.

The provincial governments may not cooperate with the federal government in bringing the deficit down as they have divergent electoral interests in an election year.

Since the budget deficit would be high (increased dissaving), the cumulative investment ratio would come down with the growth rate experiencing a likely slide.

To avoid this scenario from actualising, the economic managers will have to walk a difficult tightrope, as a tradeoff with job creation, through higher growth and inflation, would be staring them in the face every time they have to make a decision in respect of trade, fiscal, monetary or exchange rate policy.

Our economic managers would also be constrained by the fact that their political party colleagues would not like them to take tough and unpopular decisions that might alienate their voters, diluting or diminishing their chances of winning the elections.

But the populist measures, if taken, would only add to the misery and we would once again be derailed from the track of high growth path, as witnessed in 2008 and 2013.

My humble plea to all the political parties would be that they should show a sense of collective responsibility and adopt a ‘DO NO HARM’ stance as far as economic management is concerned and allow the economic managers a free hand to avoid any crisis that may force us to approach the IMF once again.

The PML-N is in power at the Centre (with JUI-F) and Punjab, with an alliance in Balochistan with PkMAP, PML-Q and NP; PPP in Sindh with a past alliance with MQM; PTI with JI in KP. Thus all the political parties of Pakistan have an equal stake to ensure that the economic situation does not go out of hand.

Any of these parties, coming to power after the 2018 elections, would be confronted with an intractable situation if no remedial action is taken before hand. The winners would no doubt like to inherit a much stable and calm economy to manage.

Vote for change

A close reading of the manifestos of the major parties does not show much divergence in their economic policy stance. So why should they incur a self-inflicting wound upon themselves by being contentious on the economy?

The economic managers, on their part, would have to consult all the major political parties, keep the parliament and provinces in the picture and take their views and concerns seriously.

I am sure the cynics among us, and they are plentiful, would laugh at this “naive” proposal and say how in this highly polarised, factionalised, divisive and charged atmosphere, anyone in his right mind could expect the antagonistic and hostile leaders of these parties to bless such an idea.

But I am confident in my belief that whatever views they may be holding about each other, their love for the country – and the welfare of its people – is their prime consideration.

In their resolve to pull out Pakistan from continuing to fall behind its neighbours, and to avoid the loss of economic sovereignty once again, our political leaders would come together and embrace this proposal. In my eternal optimism I wish and hope that they would prove the cynics among us wrong.

In any case, the policy makers have to make tough choices in a politically difficult environment, either to go along with the growth momentum or opt for containing inflation. The course they choose would finally determine the prospects for 2018. Not an enviable task by any means!

About the Author

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is the former governor of the State Bank of Pakistan and one of the country's best-known economists. He recently completed his eight-year term as the dean and director of the prestigious Institute of Business Administration, Karach