PRESS RELEASE

Worsening economic outlook underlines the need for cooperation

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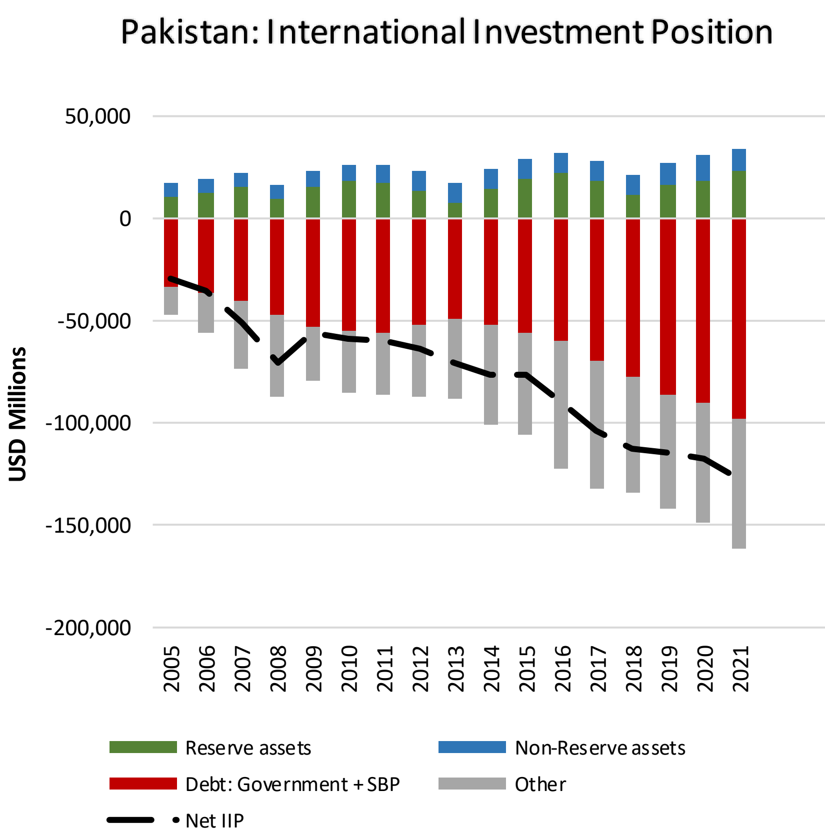
The Economic Advisory Group appreciates the government for taking the necessary decisions to remove subsidies and pass on the increase in the fuel prices to the consumer, and for announcing a gradual increase in (base) electricity tariffs in the coming months. The budget document has also been revised to meet IMF conditions on fiscal targets. The staff level agreement reached with the IMF is an important development at a time when Pakistan's credit risk continues to increase, and its external debt is being traded at a steep discount.

However, despite the painful adjustment, the SBP's decision to use precious foreign reserves to finance current account deficits in recent months has put Pakistan in a vulnerable position. Fiscal slippages and rising international commodity prices increased pressure on the current account. With limited foreign reserves and impending debt repayments, it would have been prudent to allow the exchange rate to absorb these emerging pressures.

The fast depletion in foreign currency reserves as a result of the SBP's decision to finance the current account deficit and support the exchange rate, combined with the heightened political uncertainty has worsened the nation's credit risk to an extent that Pakistan is one of the several countries that face a high probability of default. This has resulted in additional pressure on the exchange rate that could have been avoided had the policymakers adopted a more prudent approach.

The EAG also questions the wisdom behind the IMF's prior condition that Pakistan secures $4bn of commitments from other countries before the IMF loan is dispersed. In its role as a global lender of last resort, the IMF needs to revisit this condition. It is unrealistic to expect that a country facing extreme financial distress can secure such commitments prior to the IMF loan dispersal. Instead, to address the moral hazard that results from entering into an IMF program, the IMF must maintain greater regulatory oversight in the contracting of new external loans to ensure external debt sustainability. The figure shows that, despite being in IMF programs, the continuous increase in government borrowing from external sources has worsened Pakistan's net international investment position vis-à-vis the rest of the world and led it into a debt trap.



The EAG urges the political leadership of the country to keep in mind market realities in their discourse on the economy. While it may unrealistic and possibly undemocratic to expect complete consensus on economic issues, avoiding country default would be in the interest all stakeholders. This becomes especially pertinent when it comes to the issue of securing the necessary commitments from bilateral partners to decrease the risk of default. The uncertainty around who will lead the government in the near to medium-term future can make foreign governments less willing to extend support. In the absence of the IMF revisiting its prior condition of Pakistan bridging the $4bn gap, the failure to secure such commitments from bilateral partners can trigger a speculative attack on the currency in an unpredictable fashion, and risks taking the country towards default.

The EAG has always maintained that the solution to Pakistan's economic problems lies in well thought out economic reforms. The country's leadership has continued to avoid this and instead relied on borrowing from all possible sources to deliver a false sense of prosperity to a rapidly growing population. It must not be forgotten that, in absence of reforms, this false sense of prosperity only comes at the expense of future prosperity. The sharp increase in the cost of both external and domestic debt servicing in recent years indicates that this damaged future may have arrived.

EAG is an independent policy group, comprising individuals from economics, policy and the private sector, which deliberates regularly on economic developments and shares its views with the government and public. It is supported by PRIME, an independent think tank.

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