Following Clarification/Rebuttal was issued to Business Recorder in response to an Editorial published on February 6, 2020 entitled: 'IMF programme needs tweaking'

This is with reference to your editorial titled 'IMF programme needs tweaking' published on 6th February, 2020. We would like to draw your attention to the three points raised in your editorial that are either factually or conceptually incorrect. These points are:

1. *"…however, what was ignored at the time and continues to be ignored to this day is data uploaded on State Bank of Pakistan's (SBP's) website which notes that the rupee had been undervalued since December 2018 and that in March 2019 it was undervalued to the tune of just under 3 percent."*

2. *"…a decision that would reduce SBP profits thereby putting pressure on the fiscal deficit given that during the first quarter, an unprecedented rise in SBP profits went half way in lowering the budget deficit."*

3. *Additionally, the high discount rate has attracted foreign portfolio investment in government securities which are even worse than the then finance minister Ishaq Dar's policy to incur debt equity (sukuk/eurobonds) as the return is more than 6 percent higher while the amortization period is a lot less than the five- and 10-year maturity set by Dar."*

SBPs views on these points are as follows

1. The first statement appears to be referring to data on the nominal / real effective exchange rate (NEER/REER) indices of the Pakistani Rupee available on SBP's website. However, it is factually incorrect and an inaccurate reading of what the data represent. We would like to clarify that this data do not suggest in any way an undervaluation of the exchange rate and that SBP has not expressed any such view in its statements. Therefore, the statement made in your editorial is incorrect and misleading.

It is worth noting that while the concept of REER is simple, users often face difficulties in understanding its construction and interpretation. Often, appreciation or depreciation of REER is confused with the concept of currency overvaluation or undervaluation although these are two separate concepts. Neither can overvaluation or undervaluation be deduced from comparing the numbers to 100 as your editorial writers seem to have done.The REER number merely shows a comparison relative to the 'chosen' base year. .

The extent of exchange rate under/over valuation is computed through a medium-term analysis using sustainable norms for the current account balance, fiscal balance, demographic condition, debt, etc.

2. Regarding point 2 raised in your editorial and mentioned above, the idea that State Bank profits will fall due to the expansion of refinance limits by Rs200 billion for export- oriented sectors is also false. In fact, profits will actually increase by the amount of interest-earned on the principal amount of funds

availed by firms under the EFS and LTFF facilities, at a rate of 3 and 6 percent respectively. Also, it should be noted that the banks and not SBP carries the risk for these facilities.

3. With respect to point 3 mentioned above, a simple comparison between interest rates on Eurobonds and local currency bonds is an incorrect measure of their relative cost and risk. An important point to note in this context is that, in the former case, the Government of Pakistan bears the exchange rate risk, while in the latter the lender/investor bears that risk. Furthermore it is incorrect to imply that the discount rate is the primary factor that has attracted foreign portfolio inflows as Pakistan had a higher discount rate in 2011 but attracted negligible foreign portfolio inflows in our debt markets.

You will agree that the exchange rate is a very delicate topic to comment on due to its sensitivities for the economy and particularly the financial sector. Therefore, any casual remark could have deep negative repercussions, which an economy like ours going through a stabilization phase cannot afford. Robust fact checking could help in avoiding any misleading information and thus any potential damage to an institution and the country.

You are therefore requested to clarify SBP's position by publishing the above mentioned views, in an equally prominent space as your original article. SBP respects Business Recorder for its dedicated reporting on the state of the economy and financial sector. SBP has always offered its support to the newspaper for the provision of information, verification of facts and SBP views. We wish to continue with this practice and would like to once again offer our support for fact checking and conceptual clarifications ahead of your article publications.

Following Editorial published in Business Recorder, Karachi on February 6, 2020:

'IMF programme needs tweaking'

The 6 billion dollar 39-month front-loaded International Monetary Fund (IMF) programme has achieved stabilisation defined narrowly as reducing the current account deficit and strengthening of foreign exchange reserves though it has failed to achieve other associated components of stabilisation notably a healthy growth rate (projected at an extremely unhealthy 2.4 percent in the current year) and minimal price changes (the rate for January 2020 as high as 14.6 percent with food inflation well above 20 percent).

And within the context of achieving stabilisation as defined narrowly by the economic team leaders – Dr Hafeez Sheikh and Dr Reza Baqir – there are three extremely disturbing elements that have surfaced since 12 May 2019 when IMF "prior" conditionalities to the loan approved in July 2019 came into effect. Firstly, market-based exchange rate was implemented with SBP's decision not to provide an indicative level to banks' treasuries within which the dollar-rupee parity would be free to fluctuate; however, what was ignored at the time and continues to be ignored to this day is data uploaded on State Bank of Pakistan's (SBP's) website which notes that the rupee had been undervalued since December 2018 and that in March 2019 it was undervalued to the tune of just under 3 percent. The resulting depreciation accounts for a massive rise in debt servicing as each rupee loss in terms of the dollar adds 100 billion rupees to the government debt (which given that the IMF's structural benchmark is 0.6 percent primary deficit conveniently excludes interest payments), a massive decline in imports thereby contracting customs collections as well as reducing imports of raw materials and semi-finished products though exports rose marginally in dollar terms.

Secondly, the 13.25 percent discount rate continues to stifle economic activity (since July 2019) though the Governor SBP recently announced a further 200 billion rupee credit injection into exporters at 5 to 6 percent as long-term finance facility and export refinance scheme – a decision that would reduce SBP profits thereby putting pressure on the fiscal deficit given that during the first quarter, an unprecedented rise in SBP profits went half way in lowering the budget deficit. Additionally, the high discount rate has attracted foreign portfolio investment in government securities which are even worse than the then finance minister Ishaq Dar's policy to incur debt equity (sukuk/eurobonds) as the return is more than 6 percent higher while the amortization period is a lot less than the five- and 10-year maturity set by Dar.

And finally, the IMF agreed to raising total budgeted current expenditure by 33 percent under current expenditure with Ehsaas programme parked under current expenditure (more specifically under grants to others) envisaging a 190 billion rupees allocation. It is relevant to note that this is 70 billion rupees more than what was realised last year for Benazir Income Support Programme which has been subsumed in Ehsaas programme). If this additional amount is taken away from the current expenditure, the actual rise is 31 percent. Development expenditure was budgeted to rise by 40 percent. And the first quarter review's projection of a budget deficit as per IMF was 7.6 percent. In effect, this deficit needs to be contained on an emergent basis as this is also exacerbating to inflationary pressures.

The IMF's insistence on upfront conditions was based on our history of not implementing structural reforms, including governance reforms particularly in the poorly performing power/gas and tax sectors, which are, without doubt, imperative. However, a look at the achievements of the incumbent government reveals that these reforms remain pending and that the poorly performing sectors are engaged in meeting IMF conditionalities through following the examples set by their predecessors notably passing on the buck to hapless consumers – households seriously compromising their capacity to withstand the price hike as well as the industrial sector which accounts for contracting output with a consequent impact on unemployment levels.

The conclusion is something has to give or else the present government would either have to abandon the IMF programme in the face of mounting public resistance/opposition or else fall as the carefully crafted majority in parliament may unravel due to this pressure. In other words, it is critical for the visiting Fund staff and the Pakistani team leaders to revisit/tweak some of the policies currently in place or else the major objective of the Fund programme would be lost yet again.