Foreign Exchange December 2017 Review

Icon Management Private Limited

Due Depreciation Implemented

The month of December 2017, witnessed devaluation of PKR against USD by jumping from the levels of 105.50 to 110.5. In a volatile trading session, the rupee slumped to 109.50 per dollar at one point after opening at 105.55. It closed at 107 per dollar, according to the State Bank of Pakistan (SBP), after having mostly traded in a tight range of 104-105 per dollar since December 2015. The SBP had previously attempted to devalue in July but the move was reversed by then-Finance Minister Ishaq Dar, who claimed he was unaware of the central bank's plan and ordered an investigation. A growing number of economists had been urging the SBP to devalue what they said was an artificially strong rupee, arguing that its strength was hurting the manufacturing sector. The authorities believed the currency adjustment would help shift foreign currency holdings from commercial banks currently standing at a higher level of around $6 billion back to official reserves and help divert remittances to official channels with declining gap among the official, banking and open market rates. As result of spike in the dollar rate, the volume of loans on Pakistan augmented by whooping Rs 400 billion whereas price of petrol and diesel were likely to go up by at least Rs3 per liter. In the long run, the recent imposition or increase in the import duties and regulatory duties would make unnecessary imports expensive. Imposition of import duties in order to curtail the growing balance of payment is also somehow helping as the imports of cell phones and cars is on a decline but this will also contribute to inflation. Pakistan would continue to remain under the IMF's post-program monitoring (PPM) until about 2023 for borrowing significantly higher than its quota, because of which, it might be perceived that the Central Bank might consider further devaluating the PKR. In order to stabilize the current account deficit, Pakistan raised $2.5 billion from the government issued five-year Sukkuk (Islamic bond) and the 10-year Eurobond at relatively lowered rates. Last year, the government raised $1 billion through a five-year Sukkuk at 410 basis points above the five-year US Treasury bill, whereas that spread was 365 bps this time around. The yield on the 10-year bond was down by 1.6 per cent from the last 10-year bond floated by Pakistan in foreign capital markets. According to the Word Bank, Pakistan's external financing needs for the year 2018 will be around 17$ billion for which Pakistan might have to look up to the Donor agencies. The balance of payments pressure is largely due to imports of machinery and other Chinese goods connected with a $57 billion infrastructure investment by China, part of its planned Belt and Road trade route stretching to Asia, Europe and beyond. The FX reserves stood at 20.189$ Billion as of 22nd December 2017. Pakistan will need to develop its manufacturing sector and revive its fallen exports in order to curtail the tribulations of growing current account deficit. Depreciation of the currency will also help improve the exports and the SBP reserves.