IMF-Package:

A Ray of Hope for the Financial Markets?

The current financial year has been an unprecedented one with local and global financial crises overshadowing the financial markets. The severity of the global financial crisis even led to a debate regarding the validity of “capitalism”. Pakistan’s economy faced challenges with the deteriorating fundamentals and rise in geo-political risk. This led to a flight of capital to safety forcing the foreign reserves to deplete. The same phenomenon led to the devaluation of Pak-rupee against dollar and other foreign currencies. The liquidity crunch led to the imposition of down-side floor at the Karachi Stock Exchange by its BoD adding to the declining investor sentiment already prevalent in the country. The international rating agencies downgraded Pakistan’s overall rating leading to the widening of spread on the Pakistani sovereign bonds issued internationally.

The government approached International Monetary Fund, IMF, for assistance and was able to negotiate a $7.6 Billion package to address the current economic imbalance. The question on the mind of all investors naturally is regarding the impact of this package and its implication on the sustainability of the growth of the economy amid the current wave of geo-political risk. The investors need to address this question in a pre-IMF and post-IMF package scenario. The pros and cons of the IMF package can be debated but it is undoubtedly clear that the current global financial crisis had a severe negative impact on the ability of strong economies to assist Pakistan in its hour of need. This fact is evident from the current liquidity crunch in the U.S. and the declining trend of the equity markets in the European and Asian countries, particularly in the months of October and November. The decline in the international Oil prices from a high of $144 per barrel to almost $50 per barrel, a 67% decline added to the woes of the commodity-dependent middle-eastern economies. The middle-eastern countries facing high degree of inflationary pressure with a negative pricing pressure on their real-estate sector indicated their inability to support Pakistan, a country of choice for investment in the past. These factors led to the choice of the Pakistani government to tap the available resources through the IMF-package under these circumstances.

The IMF agreed to lend money to address the immediate risk of further currency devaluation and debt default in the country already battling with the pressure of over 25 percent inflation and deteriorating economic growth. The State Bank of Pakistan sustained its monetary policy tightening stance by an increase in the discount rate of another 200 bps. The IMF has declared in its statement that the Pakistani government has agreed to phase out energy subsidies, boost taxes and implement other money saving reforms including less government borrowing. The question of addressing inflation remains intact since the removal of subsidies can result in an increased inflationary pressure in the Price-Index data. This can lead to the continuation of the tightening trend of monetary policy in the near future further decelerating industrial and economic growth in the country.

Optimistic analysis signifies the fact that the IMF package will improve the foreign reserves of the country thus leading to the enhanced business activities with trading partners. The World Bank will put in a comprehensive social security net to shield the poor from any subsidy cuts. The State Bank is expected to implement a flexible exchange rate policy to curtail any sharp exchange rate volatility. The government of Pakistan is expected to reduce its fiscal deficit, stop the borrowing from the central bank and address the current account deficit. The methodology of utilization of this IMF-package, which is short-term in nature & adding to the liabilities of the country, will determine the future economic scenario.