



Effect of Rupee Appreciation on the Economy

ABOUT IPR

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4- Shami Road,
Lahore Cantt,
Pakistan. UAN: 111-123-586
www.ipr.org.pk

Recently, government has announced creation of the Pakistan Development Fund. PDF has so far received US Dollars 1.5 billion. Immediately the Rupee appreciated by 7%. The Institute for Policy Reforms has analyzed the effect of this appreciation on the country's economy.

Government has shared limited information. Details about the source of funds and their use are scarce as are the terms on which they have been acquired. There is no information, yet, about the law under which the PDF has been set up.

IPR has studied the effect of Rupee appreciation against four economic indicators, as follows:

- The Government claims that it has helped decrease its stock of foreign debt by Rs.800 billion. This is not a serious indicator to study, as foreign debt stock changes in value with changes in exchange rates on a daily basis. That is why foreign debt is dollar denominated. Further, this Rs. 800 billion is inflated. With an outstanding stock of about \$54 billion and a saving per dollar of seven Rupees, the figure comes to 370 billion rupees. Add to that the fresh liability of about 150 billion rupees and the decrease in stock comes to a maximum of Rupees two hundred and twenty billion. The government estimates are almost four times larger than our calculations suggest.
- Rupee appreciation will clearly have a salutary effect in reducing inflation. IPR expects inflation to go down by 1.5 to 2 percentage points. Consequently, the rate of inflation could fall to 7.5%. For direct benefits to the people, administered prices, in particular must fall significantly. Our estimates are that power tariffs (above lifeline consumption) should decrease by 8% and diesel and petrol prices by about Rs.7 per liter. We hope that this will be announced shortly.

- Rupee appreciation, however, will affect public finances negatively. The fiscal deficit could increase with a fall in tax revenues, because these are partly linked to the rupee value of goods imported. A fall in the rupee value of imports will mean a corresponding loss in collection of import duty, sales tax, and withholding tax on importers. This will reduce total tax collection by sixty five billion Rupees on an annualized basis. Likewise, government's non-tax revenue will decrease by about thirty five billion Rupees, primarily because of exchange losses to the SBP. There will be a gain of eleven billion Rupees from reduction in interest payments on external debt and in other costs. This means a total loss of revenue of eighty nine billion Rupees. Consequently, the fiscal deficit could rise by 0.3% of the GDP on an annualized basis.

- More worrying is the effect of Rupee appreciation on the already precarious balance of payments situation. We estimate the loss in exports of US \$ 900 million due to a less attractive exchange rate to exporters. At the same time, lower landed prices will mean an increase of US \$ 750 million in imports. The combined adverse effect is US \$ 1.65 billion on the current account of the balance of payments on an annualized basis. This could more than wash out the inflow of 1.5 billion dollars over time.