

Devaluation of PKR

A stable economy is the biggest pillar of a successful nation. It cannot be stable if a country's currency is devalued, as it poses a significant hurdle to economic growth. Unfortunately, rupee devaluation is a prominent obstacle to our country's growth. This issue needs to be addressed properly by exploring its causes, impacts and most importantly its solutions.

• Pakistan's rupee has abnormally devalued against dollar. It is dropped by over 20% in 2023.

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Rupee devaluation over recent years:

year	Value
2008	82 PKR against 1 \$
2013	84 PKR against 1 \$
2018	125 PKR " "
2021	178 PKR " "
2023	280 PKR " "

Reasons of rupee devaluation:-

Reasons

- The decline in dollar reserves
- Shifting of policy from artificial control to free floating currency
- Conditions of IMF
- Quantitative Easing
 - (a) Abnormal increase in inflation
 - (b) Purchasing power parity declined
 - (c) Many industries got shutdown
 - (d) Increase in the volume of foreign loan

The decline in dollar reserves:-

The value of the Pakistani rupee (PKR) is highly dependent on the country's foreign exchange reserves. According to the **State Bank of Pakistan**, the total reserves stood at \$23 billion in June 2021, with \$15 billion held by the central bank and \$8 billion by commercial banks. However, by June 2023, the reserves had decreased to less than \$7 billion (**Trading Economics, 2023**). This significant decline is attributed to various factors, including a trade deficit of \$44 billion in

the fiscal year 2022-23, debt payments of \$13 billion, and an increase in illegal dollar smuggling to neighboring countries (State Bank of Pakistan).

Shifting of policy from artificial control to the free floating:-

These are three main ways that a country can control the price of its currency. The first is state control, where the govt directly sets the price, commonly seen in communist or closed economies like North Korea and Russia (Trading Economics, 2023). The second is market control, where the price is determined by supply and demand in a free market, typical in capitalist or open economies (IMF, 2022). The third is artificial control where the govt indirectly influences the price through banks and money exchangers, without directly setting it (State Bank of Pakistan, 2022).

In November 2022, Pakistan's finance minister and central bank governor used artificial control to fix the price of US dollar at 225 Pakistani rupee, however, the market price

was higher, at over 265 PKR
(Pakistan Bureau of Statistics, 2022)

Conditions of IMF

The IMF conditioned its loan to Pakistan on making the Pakistani rupee a free floating currency, which means its price should be determined by the private market (IMF, 2023). However, this led to a significant devaluation of the rupee.

Quantitative Easing

There is an international monetary rule that states a country's currency is dependent on the US Dollar when its central bank prints more notes than its reserves. This is because the US dollar is the global reserve currency, and most international transactions are denominated in US dollars.

- 521 billion PKR in 2010-11 fiscal year.
- 648 billion PKR in 2013-14 fiscal year.

Source: State Bank of Pakistan

- Between 2018 and 2022, Pakistan's foreign exchange reserves fluctuated drastically, from \$18.1 billion to \$10.3 billion, which indicates a high dependence on US dollar.

Implications:

Source:- World Bank, 2022.

(a) Abnormal Increase in Inflation:

Pakistan's inflation rate rose significantly to 39.18% in 2023, causing concern for the country's economy.

(Source: Dawn, January 6th, 2024)

The drastic devaluation of PKR has sharply increased in the prices of essential imported goods including oil, gas and coal which had a prominent effect on transportation costs, electricity prices, industrial products and everyday consumer items.

- The cost of importing \$1 billion was 178 PKR in June, 2021, but now it costs over 280 billion PKR. (Source: Pakistan Bureau of Statistics, 2021).

- Pakistan spent a substantial \$23 billion on hydrocarbon imports in 2022-23 (Source: Pakistan Ministry of Energy, 2023).

- The prices of everyday items including fuel increased by around 48% compared to the previous year. (Source: PBS, 2022)

(b) Purchasing Power Parity declined

PKR devalued and people purchased fewer products. All the salary class has almost the same salary or the maximum increase occurred by 10-15%. On the other hand, the price of the product has more than doubled in last two years. Multiple reasons are there, but the major one is devaluation of PKR.

(c) Numerous Industries faced shutdown

The increase in production costs has led to higher prices of products, resulting in the shutdown of over 250 industrial sectors in Pakistan. The primary reason for this increase in production costs is the rise in expenses related to raw materials, semi-finished goods, electricity and transportation, making it difficult for Pakistani products to compete with those from other countries. The costs of importing raw

materials and semi-finished goods has increased upto 25% in 2023-24 due to the devaluation of PKR.

(Source: PBS, 2023-24)

- Electricity costs have risen by 40% in 2023-24 with a further increase of 15% anticipated in the next quarter. (Source: NEPRA, 2023-24)

- Transportation costs have rose by 30% in 2023-24 due to higher fuel prices, with diesel prices rising by 35% and petrol prices by 28%.

- Over 250 industrial units including prominent companies like Indus, Honda, Suzuki and textile industries like Koh-e-Noor, Nishat and Lawrencepur have shutdown due to the increase in production costs.

(Source: Pakistan Industrial and Traders Association, 2023-24)

- The Pakistan Industrial and Traders Associations have reported a 20% decline in industrial production in 2023-24 with a further decline of 15% anticipated in the next quarter.

(Source: PITTA)

(d) Increase in the volume of Foreign loan:

The devaluation of PKR has increased the volume of foreign loans without any additional borrowing. The primary reason for this increase is that foreign loans are denominated in US dollars must be repaid in the same currency, which requires more rupees to purchase the same amount of US dollars.

- In January 2022, 178 billion PKR were required to purchase 1 billion US dollars, while in April 2023, 285 billion PKR were needed to buy the same amount of US dollars.

(Source: PBS, 2022-23)

- The total loan volume on Pakistan (both external and internal) increased from 38 trillion PKR in June, 2021 to 54.3 trillion PKR in June 2023, with approximately 4.7 trillion PKR of this increase attributed to the devaluation of PKR.

(Source: Economic Division 2023)

- The rupee decline has resulted in a substantial decrease in the cost of repaying foreign

loans, without any additional borrowing.

(Source: Ministry of Finance, 2023)

Solutions

Decrease pressure on dollar reserves

Bring dollars to the country

Solutions

Political stability

Control the dollar smuggling

Decrease Pressure on dollar reserves

- Shift trade to alternative currencies like yuan, ruble and Iranian rial to reduce dependence on dollar.
- Pak Iran trade in PKR
- Pakistan Afghanistan trade in PKR

Bring dollars to the country

- There should be increase in remittances, tourism and foreign investments. The long-term solution is that increased exports would result in more dollar earnings.

Political Stability

Political stability results in economic stability. Investors invest in the local market due to political stability and peace, and sustainable economic goals. The economy would grow, increase exports and more dollars enter the country.

Control the dollar Smuggling

Controlling dollar smuggling would help to stop illegal money flow, boosting Pakistan's foreign exchange reserves and stabilizing the rupee.

Conclusion

Despite Pakistan is facing significant economic challenges like rupee devaluation, the UN's projection of a 2% GDP growth for the upcoming year provides a ray of hope. Underlying economic strengths and opportunities such as diversification and effective policies can lead to gradual improvement.

You did it really well

The content and presentation is fine

However, you must practice attempting question in 35 minutes, so writing 8-9 sides are sufficient for each question