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Difficult Start for the New Pakistan Administration

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On July 25, a general election was held in Pakistan in which the opposition party, Pakistan Tehreek-e-Insaf (PTI), or Pakistan Movements for Justice, won 115 seats to become the largest party in the National Assembly (Lower House). The ruling party Pakistan Muslim League (Nawas) (PML-N) gained only 64 seats, failing to take control of the government for the second consecutive term.

Although the Pakistan rupee was temporarily bought back on the 26th to a level of 126.79 rupees per U.S. dollar (an appreciation of 1.2% from the previous day), the rupee returned back to around 128 rupees next day as the defeat of the ruling party itself had been anticipated in advance. Also the KARACHI SE 100, Pakistan's representative stock index, rose 1.7% on the 27th over the previous day to finish 42786 rupees.

Figure 1: Exchange Rates of the Pakistan Rupee against the US Dollar (daily ending)

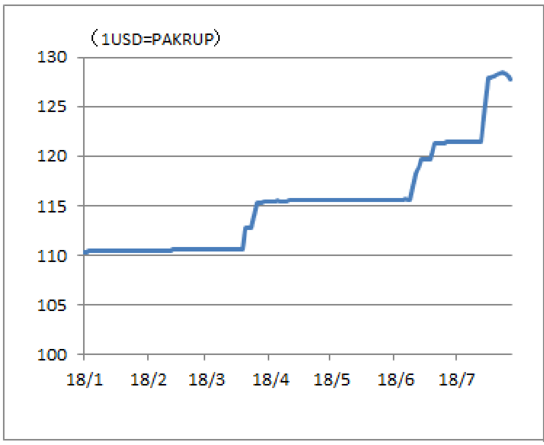
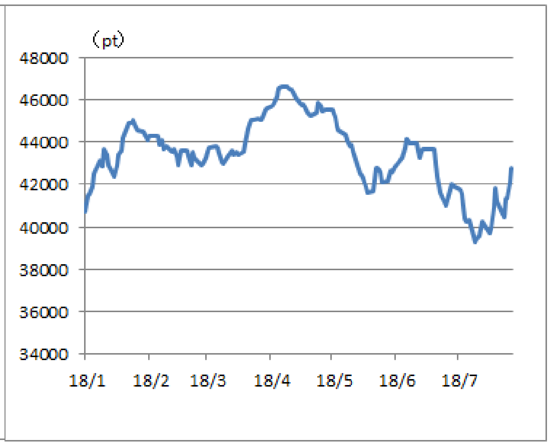


Figure 2: Stock Prices in Pakistan



The first difficulty the new administration is going to face is a balance of payments crisis. The foreign exchange reserves of Pakistan declined to $13.7 billion at the end of June 2018, less than two month equivalent of imports.

Three ways of measures may be available for the government to deal with it. The first is to take the risk to devaluate the FX rate of the rupee.[1] In this case, however, the government will have to accept the risk of a rapid rise in inflation rate. Consumer price index rose already by 5.2% year on year in June.

The second one is a large raise of interest rates to attract foreign investment. But it would be a heavy burden on the domestic economic activities.

The third possible measure is to ask the International Monetary Fund (IMF) for support of financing, or to make a loan in foreign currency. In that case, however, the IMF would require Pakistan a fiscal tightening and structural reforms as conditionality for a new loan, and at the same time it will closely investigate the investment related to the China-Pakistan Economic Corridor (CPEC) project. There is some who is concerned about Pakistan's capacity to bear the repayment burden as the ex-government led by PML-N did not reveal a precise repayment schedule of the CPEC. Depending on the outcome of the investigation, the IMF may come to demand Pakistan for a scale-down of the CPEC project.

In reality, we will see a combination of these measures and whatever the combination will be, the growth rate of the Pakistan economy will greatly slow down.

What is drawing an external attention other than the negotiations with the IMF is its future relationship of Pakistan with China. Currently, construction of the CPEC is under way in Pakistan in cooperation with China. Although the PTI signified its approval of the CPEC during the election campaign, it had expressed its dissatisfaction at the monopoly of the contracts by the Chinese companies. It is noteworthy with what kind of stance the new government will face China.

Domestically, it is feared that the political division will worsen. In the latest election, there was a trace that the military had substantially intervened in the election campaign to support the PTI, and it seems that there was a strong dissatisfaction left on the PML-N side. It is highly likely that the political situation in Pakistan will undergo an unstable phase for some time to come.

Problems of Pakistan are piling up both at home and abroad and the new government will be faced with a severe start.

[1] The foreign exchange system in Pakistan is so-called a dirty floating system in which National Bank of Pakistan manages the movement of foreign exchange rates.