International Journal of Economics and Business Administration
Vol. 6, No. 4, 2020, pp. 127-134
http://www.aiscience.org/journal/ijeba
ISSN: 2381-7356 (Print); ISSN: 2381-7364 (Online)

Currency Devaluation Impact on the Economy and Industries of Pakistan

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Abstract

The Current account deficit was the highest in the FY 18 compared to FY 17. In the FY 18, the CAD was around 6.3% whereas the CAD in FY 17 was around 4.3%. The exchange rate within Pakistan was declining continuously and the cumulative exchange rate decline was having growth of around 13.6% between July 2018 and March 2019. The value of Rupee against dollar was around 3.2% and the amount was close to Rs.146.52 a dollar in March 2019 and Rs.159 a dollar in July 2019 which made the situation worse. 1% further devaluation means the national debt climbs by Rs. 125 billion. In Pakistan, industries are heavily dependent on imported raw materials for industrial goods, capital goods and components, however, quotas and tariffs block their access to advanced countries. A rise in the price of any component through currency devaluation increases the cost of imports. The exports have not increased to the required level due to decline in industrial base and conversion of economy to a consumer based import economy. Pakistan is occupied by 70% of deserts and this is acting as another factor behind the lack of growth within the economy.

Keywords

Foreign Direct Investment (FDI), Current Account Deficit (CAD), Exchange Rate, Devaluation, Fiscal Policy, Balance of Payment (BOP), Dollar Reserve

Received: July 9, 2020 / Accepted: August 26, 2020 / Published online: October 28, 2020

1. Introduction

Currently the impact of devaluation of currency is falling on the world economy. Due to a mismatch in the global terms of trade, the currency price is not going to the desired directions. In order to indulge the development of high grade of currency price, the economy of Pakistan is already falling because of decreasing level of international trade and falling GDP growth rate. Through this study, it will be easy for the economy of Pakistan to bring in new changes within the policy by understanding the existing gaps in policy implication depending on the crucial economic factors like inflation, rate of interest and taxation policies for the export and import of the economy. Current situation of Pakistan is more prone towards reduction of government expenditure, increase in tax that will create problems in the end as the growth in domestic credit will fall, and the real interest rate will increase. More or less the country is not aiming to increase the GDP. Through the development of industries and increasing employment opportunities within the country, Pakistan will improve its position in the global market. Some of the industries like woollen textile industry, cement industry and sugar cane industry had popped up previously [19]. This paper will discuss the impact on the export and import of the country and the industries that are involved in this. This will also discuss the influence of the devaluation in currency on the exports and imports of the industries.

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2. Research Methodology

Since the nature of the investigation is theoretical, henceforth the information has been gathered through secondary sources. For example, reference books, web, journals and so forth. These sources have been utilized to create and structure the arrangement of the paper.

3. Economic Condition of Pakistan Weaker Currency

The devaluation of currency is nothing but the downward adjustment of the currency of a country with respect to the other country's currency. The devaluation is the tool of monetary policies and this is used majorly to improve the trade balance of the country. Currency devaluation helps those countries which have a large industrial base or have a substantial export based economy, where the high valuation of local currency makes them less competitive. Devaluation in such cases makes their products and prices more competitive in the international market [11].

In the below diagram, devaluation of Pakistani currency is shown from Dec, 2017 to Nov, 2018. The line diagram shows that the value of Pakistani rupee was 105 Pakistani rupees per U.S. dollar in the month of December in 2017 which became around 140 Pakistani rupees per U.S. dollar in the month of Nov, 2018.

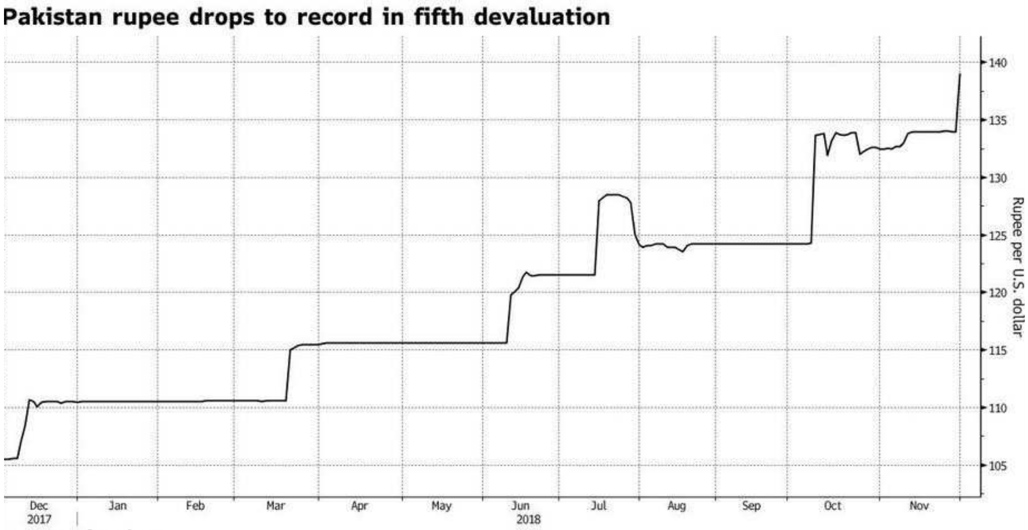

Figure 1. Fall in Pakistani Rupee in the fifth devaluation. [16].

4. Dollar Reserve of Pakistan and Asian Countries

The comparison of devaluation is also important. The below graph present the change in dollar reserves of the Asian countries from September 2017 to August 2018. These countries also have trade relation with Pakistan

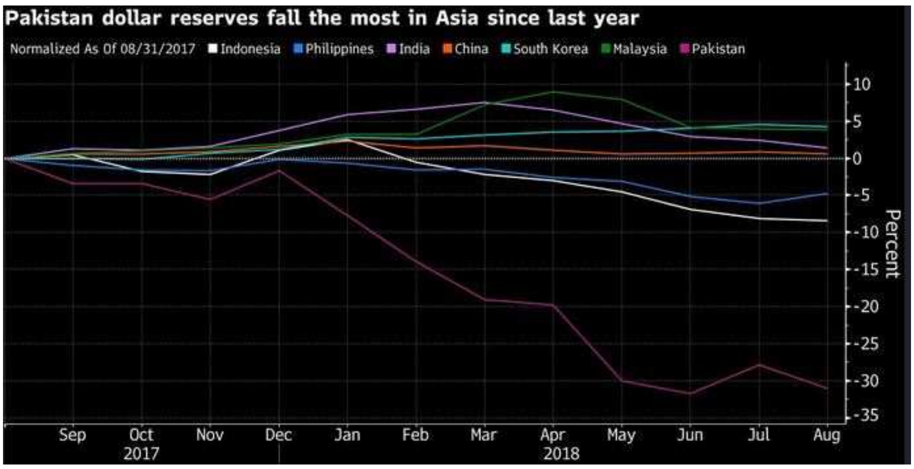

Figure 2. Dollar reserve of Asian Countries from Sep, 2017 to Aug, 2018. [17].

The above figure shows that the fall in dollar reserve is found highest in case of Pakistan followed by Indonesia. The fall in dollar reserve is only found in case of Philippines, Indonesia and Pakistan. One of the major trade partners of Pakistan is China. The figure shows that China has maintained its dollar reserve as the line for China is constantly moving forward.

Theoretically, it can be concluded that Pakistan has advantage in exporting to China as the Pakistan's exported good is cheaper to China. The above figure of dollar reserve for Asian countries shows that there is more opportunity and advantages to the Pakistan to export and to improve the trade balance. Improved BOP and trade balance can lead a country to a huge economic growth.

5. Wide Trade Deficit of Pakistan

The following figure is prepared from the data published by Pakistan Bureau of Statistics. This figure shows the trends of export and import of Pakistan from 2013 to 2017.

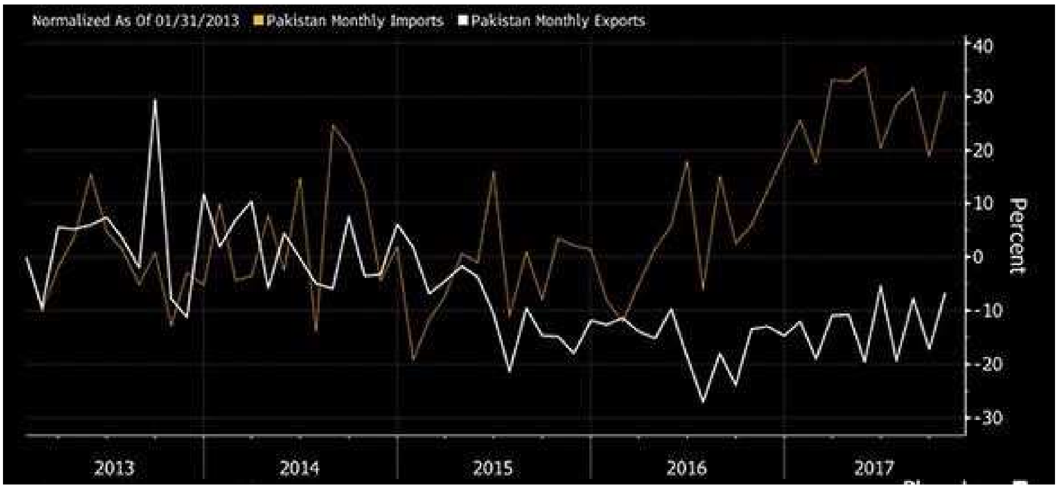

Figure 3. Pakistan Trade deficit widens. [6].

From the figure it is found that after 2015 the monthly import has increased and the export of the country is falling down continuously. The trend for both the import and export is fluctuating. However, the gap between export and import has widened over the time.

It can be said that the above figure shows a great imbalance in trade and the policies are not made to improve the BOP as the gap between export and import is widened over last 3 years.

6. Critical Evaluation of Economic Condition of Pakistan

Looking at the FY18, it is found that Pakistan economy performed better and the growth of the economy reached the margin of 5.8%. The economic growth was mainly driven by the increase in the consumer demand [22]. The government of Pakistan has taken the accommodative monetary policy that has widened the macro-economic imbalances. The Current account deficit was the highest in the FY 18 compared to FY 17. In the FY 18, the CAD was around 6.3% whereas the CAD in FY 17 was around 4.3% [22].

6.1. Devaluation of Currency

The devaluation of the currency has an influence on the export and import of the country. The industries that are engaged in the exports and imports are mostly affected. Now, the comparison of devaluation on its business partner countries also has some sort of influence. For example, if the devaluation in country A is more than the devaluation in country B, then country A will tend to export more and import less as export will be cheaper and import will be expensive [14].

The reason behind the recent fall in the value of currency was the failure of Central Bank of Pakistan to grip on the currency due to rising economic pressure and a CAD of $19billion in the fiscal year 2018. The speculation of expecting the support of monetary fund from the International Monetary Fund was also the reason behind the failure of Central Bank of Pakistan. The current economic situation of Pakistan is bit faltering in nature and the status of the Pakistan Rupee has witnessed record fall against the Dollar after the bailout of the country with the IMF deal. The country has agreed a deal of around $6 billion loan from IMF with one major condition of the currency devaluation against dollars that will increase the price of electricity and gas.

In this situation Pakistan should monitor its policies to improve the economic conditions by improving the trade pattern. The devalued currency has drawbacks but it provides the opportunity to improve the trade pattern by raising its export. The focus should be on raising the exports as it is cheaper to the importing country and export can potentially raise the foreign reserve [18]. Pakistan can give subsidies and tax relaxation on exports to the domestic producers to encourage the export. General idea about relation between currency devaluation and inflation can be considered from following demonstration.

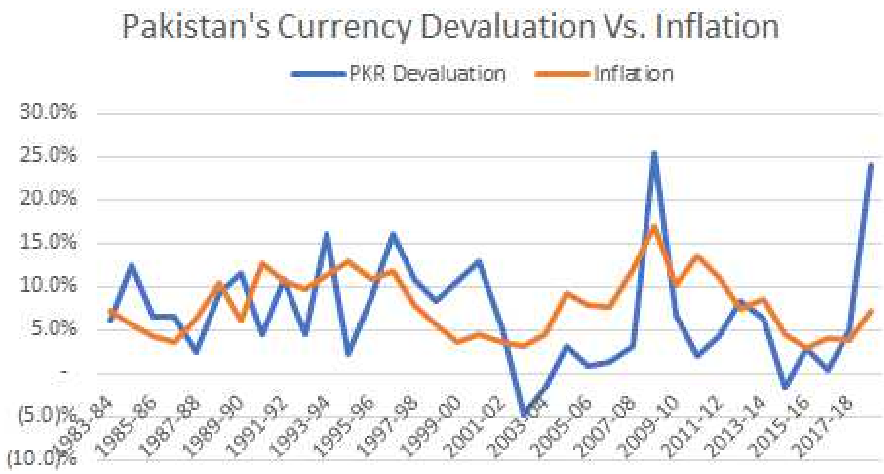

Figure 4. Pakistan's Currency Devaluation Vs. Inflation [26].

6.2. Economic Outlook of the Country

Due to an increase in the macroeconomic imbalances, the exports were not happening and were sluggish in nature while there was an increase in imports due to significant rise in the domestic demand [22]. One of the major reasons for the lack of growth in exports was the decline in the industrial base and conversion of the economy to the consumer based import economy [11]. Another major reason behind the slip in the export of the country was having increased level of recurrent spending compared to decrease in revenue due to non-taxable revenues. Even the agriculture department was not having the required level of growth and due to the shortage of water, the Year to year productivity declined. The exchange rate within Pakistan was declining continuously and the cumulative exchange rate decline was having growth of around 13.6% between July 2018 and March 2019. This has caused an increase in foreign debt and its servicing cost which has put more pressure on the economy and government's budget decision making. This is an important factor behind the lack of growth in Pakistan [22]. The government also faced difficulties in borrowing loans from IMF and World Bank which also affected economy. The below given outlook clearly demonstrate the true picture.

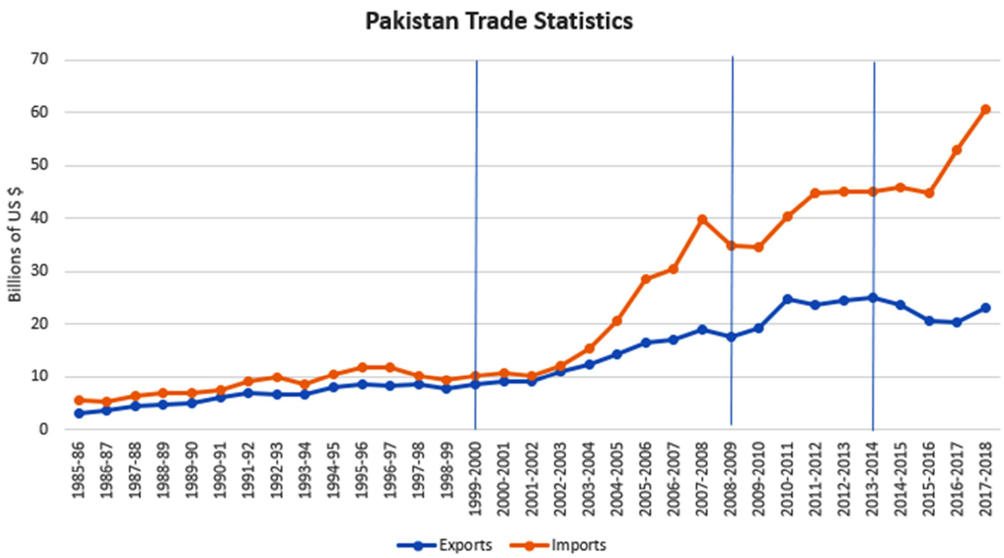

Figure 5. Pakistan Trade Statistics [25].

6.3. Relationship with Trade Partners

In order to improve the economic and commercial relationship with the global countries the economy of Pakistan will be aiming to indulge the overall development of exports compared to imports within the country [5]. Recently, the Prime Minister of Pakistan decided to suspend the trade relationship with India. Previously Pakistan was importing agricultural products like tomatoes and potatoes from India which was negatively impacting its own agriculture industry, so, suspension of trade with India might help to promote agriculture sector and reduce trade deficit which in turn might help to improve the trade balance. However, the China Pakistan Economic Corridor (CPEC) which is considered as a backbone of Pakistan economy and a lifeline for country's industry in the future is facing continuous delays due to which the economy and industries of the country are suffering [20]. The development of special economic zones under CPEC would attract investment from foreign countries which could develop industrial sector which in turn could help to reduce imports and increase exports.

Previous section discussed that the dollar reserve is falling from 2017 to 2018 and it has beaten all major Asian countries in terms of losing dollar reserve. In this situation, it is recommended to Pakistan to raise the dollar reserve by improving the BOP. The BOP can be improved by raising the export and reducing the import. The export can be raised by subsidies and tax relaxation on exports to the domestic producers which is already discussed in the previous section. Now, import can be reduced by raising the tax on imported goods, raising the production within the country that are imported from the foreign countries and encouraging people of Pakistan to use domestic products. Overall trade trens can be analysed though following Figures.

Figure 6. Pakistan Trade Trend from 2013 to 2017 [23]

7. Key Industries Within the Pakistan

Major industries of Pakistan are agriculture, live-stocks, growth of spices, cotton textile industry, woollen textile industry, cement industry, sugar cane industry, auto-mobile industry and to some extent tourism. The live-stocks, textile products, agriculture products and spices are the main components of exports to other countries by Pakistan. To some extent, the energy and mining industry is being popped up within the economy of Pakistan. Pakistan has also started to promote its tourism industry in order to increase the income. Recently, the country has developed the tourism industry in the Northern areas of the country. Many people of Pakistan are living on the income that is being received from the tourist's visits but this industry is facing many ups and downs in recent times due to tensions on its borders. Moreover, Pakistan is occupied by 70% of deserts and this is acting as another factor behind the lack of growth within the economy [12]. Most of the industries are facing problems due to devaluation in Pakistan rupee. Following graph shows share of industry in the GDP.

Now in order to involve the development of high class of resource moving and more human resources, absorbing industries that will bring more foreign reserves to the country should be brought in so the currency instability can be minimised [5].

8. Performances of Industries Within Pakistan

Despite an increase in the level of demand within the country, the performances of industries is not being up to the mark as the development of these industries is not occurring to the required level due to devaluation of Pakistan rupee against major foreign currencies. Now in order to bring in high quality of resources, administrative monitoring on the industries is important and required. This is missing in the economy of Pakistan. If undertook, it will definitely allow the country to bring in high rate of economic activities that will increase the overall incorporation of business incoming [8]. On the other hand, using the overall resource distribution of economy, Pakistan has to bring up the trade concern and try to increase the quality of trade with the global world. However, minimisation of effects of currency devaluation can be done only by implementing good fiscal policies and investing extensively on growth of industries. China has said that it would continue to provide loans to Pakistan so to remove dependencies on foreign loans [8].

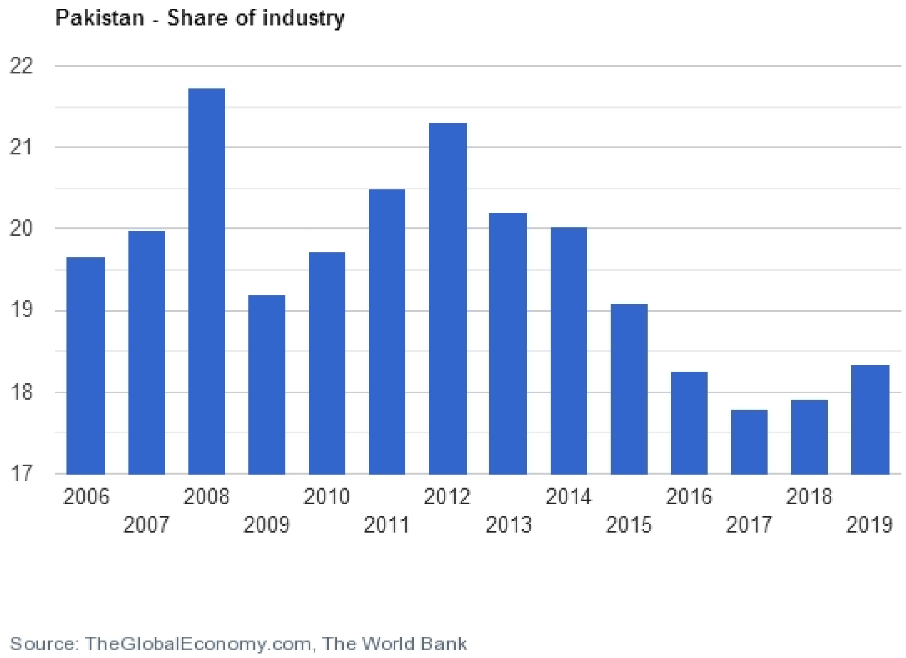

Figure 7. Share of Industry in the Economy of Pakistan [24].

9. Impact of Devaluation of Currencies on Industrial Performances of Pakistan

The current impact of the devaluation of currency of Pakistan is causing deep downfall in many sectors but has actually helped in the development of tourism industry. The devaluation has caused the prices of imported materials to increase significantly which has severely affected the business of various industries [15]. For instance, devaluation has caused cars prices to rise sharply as most of the parts of automobile sector are imported which in turn has caused a significant decrease in demand. As a result, leading companies like Indus Motors Cars, the maker of Toyota vehicles, are forced to shut down all production for longer duration then before [4]. Importers have also reported losses due to continuous devaluation. Lucky Commodities, the largest coal importers have reported losses throughout 2018 due to continuous devaluation as the change in rupee value from ordering to receiving consignment is significant which causes port handling charges to increase sharply [1]. Textile industry, one of the leading export sectors of Pakistan, witnessed an increase of 9% to $13.53billion in exports in fiscal year 2018. However, the rupee lost around 20% from December 2017 to the fiscal year end which nullified the impact of increase in trade value [21]. Devaluation has also caused the energy prices to increase drastically which has made operations of industries much costly and has made them less competitive.

In order to promote economic development within Pakistan, the government have to promote industries and endeavour better level of industrialisation. For this, the government must target to reduce the inflation and tax rate and control currency devaluation and provide business friendly environment in order to bring more business and trade. To achieve the high growth rates, the government is now aiming to increase the rate of FDI and bring down the effect of the devaluation of rupee that will help to reduce reliance on tourism industry activities and will bring in better business and employment opportunity. The government should also try to promote its agricultural sector exports by exporting its main commodities which are surplus like wheat, rice, fruits etc. to China which imports billions of dollars' worth of food items. This can, in turn help to increase its exports exponentially [11].

10. Conclusion

The above discussion has highlighted the issues of the weaker currency, poor dollar reserve and wider trade deficit and has also indicated that there is a lack of proper monetary and fiscal policy to control the economic indicators. Devalued currency can improve the export but there is lack of fiscal policy to do so. Moreover, the export can reduce the wider gap between export and import. In spite of lower dollar reserve there is inefficient amount of effective policies to reduce the import. An urgent plan is needed to increase the industrial production in the coming years to give a boost to export. Once exports level increase, IMF and other monetary bodies will become more flexible for rupee valuation. If Pakistan is able to improve exports significantly then it could reduce trade deficit which in turn would make it easier to utilize remittances for repayment of foreign loans. To improve the economic condition of Pakistan, the government has planned to improve four areas of industries namely Energy, Economy, Extremism and Education. This can potentially bring the stability in the economic growth and proper utilisation of resources. CPEC can also prove to be a game changer and can help to increase the exports and reduce imports by setting up special economic zones and promoting local industries. The continuous support of the government towards the growth of private sector will flourish the flow of currency within the country. The utilisation of resource and productivity of Pakistan can be improved by proper policy implication that will help to achieve economic goals of a successful economy.

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