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CONFIDENTIAL

November 19, 1986

To: Members of the Executive Board
From: The Secretary
Subject: Pakistan - Real Effective Exchange Rate - Information Notice

Attached for the information of the Executive Directors is an information notice on the real effective exchange rate of the Pakistan rupee.

Mr. Belanger (ext. 8671) is available to answer technical or factual questions relating to this paper.

Att: (1)

INTERNATIONAL MONETARY FUND

PAKISTAN

Real Effective Exchange Rate--Information Notice

Prepared by the Middle Eastern Department and the
Exchange and Trade Relations Department

(In consultation with the Legal Department and
the Research Department)

Approved by S.H. Hitti and J.T. Boorman

November 18, 1986

The recent evolution of Pakistan's real effective exchange rate, as measured by the standard index developed in connection with the information notice system, is set out in the attached table and chart. Based on this index, as of August 1986 the Pakistan rupee depreciated in real effective terms by 10 percent since the last occasion on which the Executive Board had an opportunity to discuss Pakistan's exchange rate policy--the 1985 Article IV consultation in March 1986. ^{1/} In nominal effective terms, the currency depreciated by 9.9 percent from March to August 1986.

Since January 1982 the exchange rate for the Pakistan rupee has been determined through a managed floating system generally guided by currency baskets. Over the course of 1982 and early 1983, the rupee depreciated considerably in real effective terms. Subsequently through early 1985, partly reflecting the relatively large weight of the U.S. dollar in the baskets used to guide the rate at various times and the strength of the U.S. dollar against other major currencies, the rupee appreciated significantly in some periods in real effective terms. However, since February 1985, the weakening of the U.S. dollar against other major currencies along with some limited discretionary increase in the rupee-U.S. dollar exchange rate have been reflected in a real depreciation of the rupee of 28 percent.

^{1/} Chairman's Summing Up circulated as SUR/86/29 (4/4/86).

Pakistan's external payments position has come under strain in recent years. In 1984/85, ^{1/} an exceptionally large balance of payments deficit and loss of gross reserves occurred. However, in 1985/86 there was a stemming of the erosion in both the current account and the overall positions. Reflecting essentially higher export volumes for raw cotton, rice, and cotton textiles, savings on import costs for petroleum and edible oils, and an unexpected increase in workers' remittances, the current account deficit was reduced to the equivalent of 3 percent of GNP from more than 5 percent in 1984/85. Reflecting in part sales of foreign exchange bearer certificates, net capital inflows were also higher than in 1984/85, and the overall external position was in approximate balance. With this result, the increase in gross official reserves which occurred over the year (to 8 weeks of projected 1986/87 imports) reflected in large part short-term deposits by nonresident commercial banks. If these deposits are excluded, end-1985/86 reserves would have been equivalent to three weeks of the projected 1986/87 imports.

In concluding the most recent Article IV consultation in March 1986, Executive Directors encouraged the authorities to move toward greater flexibility in exchange rate policy in view of the continuing weak performance of manufactured exports generally and the low level of reserves. They also expressed concern over the expanded reliance on external short-term foreign borrowing to enhance external reserves and urged the authorities to continue to adhere to their traditionally cautious external borrowing policy.

For 1986/87, the staff's most recent assessment is that the overall external accounts would again be roughly in balance, reflecting further savings on the import bill due to lower world prices for crude oil and other major import items and some improvement in export earnings as a result of the real effective depreciation of the rupee and a continued good performance by the agricultural sector. The gross official reserves position, however, is expected to weaken because of some scheduled repayments of certain external obligations of the domestic banking system.

Staff Appraisal

The depreciation of the rupee since March 1986 reflects primarily the continuing weakening of the U.S. dollar against other major world currencies and reductions in the exchange value of the rupee against the U.S. dollar. In view of Pakistan's low level of own foreign exchange reserves and the need to diversify the export base and restrain the demand for imports, the staff considers that the real effective depreciation of the rupee was appropriate. The current level of

^{1/} Fiscal year beginning July 1.

competitiveness and Pakistan's exchange rate policy will be discussed more thoroughly in the context of the next Article IV consultation discussions scheduled for January-February 1987.

Table 1. Pakistan: Real Effective Exchange Rate and Related Series

(Indices: 1980 = 100)

	Real Effective Exchange Rate <u>1/</u> <u>2/</u>	Nominal Effective Exchange Rate <u>1/</u>	Relative Consumer Prices (Local Currencies)	Exchange Rate in Terms of U.S. Dollars <u>1/</u>	Consumer Price Index (Seasonally Adjusted)	Consumer Price Index (Not Seasonally Adjusted)
Quarterly						
1982						
I	110.6	111.4	99.3	92.9	117.8	116.8
II	102.1	104.4	97.8	84.3	118.4	117.1
III	99.9	104.7	95.4	80.7	117.9	119.3
IV	98.3	103.2	95.3	77.6	119.9	120.7
1983						
I	96.7	101.2	95.5	76.9	122.0	121.2
II	99.1	103.8	95.5	76.3	124.4	123.2
III	99.6	105.3	94.6	74.2	125.9	127.1
IV	102.8	107.1	96.0	74.3	130.8	131.6
1984						
I	101.3	107.1	94.6	73.4	131.6	130.8
II	100.1	106.4	94.1	72.0	133.2	132.1
III	102.9	109.8	93.7	70.1	135.1	136.3
IV	100.9	108.7	92.9	66.9	136.6	137.3
1985						
I	100.5	108.1	93.0	62.9	139.5	138.7
II	96.7	104.2	92.8	62.0	142.0	140.9
III	91.8	100.1	91.7	61.8	142.4	143.5
IV	86.5	94.8	91.2	61.9	143.8	144.6
1986						
I	82.9	91.0	91.1	62.0	145.6	144.8
II	77.9	85.4	91.2	59.9	146.6	145.4
Monthly						
1986						
March <u>3/</u>	81.2	89.2	91.1	62.0	145.7	144.6
April	79.9	87.8	91.0	61.1	145.8	145.1
May	77.6	84.9	91.4	60.0	146.8	145.3
June	76.2	83.6	91.2	58.6	147.1	145.7
July	74.9	82.4	91.0	59.1	146.7	147.4
Aug.	73.1	80.4	90.9	58.6	147.0	148.1
Percentage change						
March- Aug. 1986	-10.0	-9.9	-0.2	-5.5	0.9	

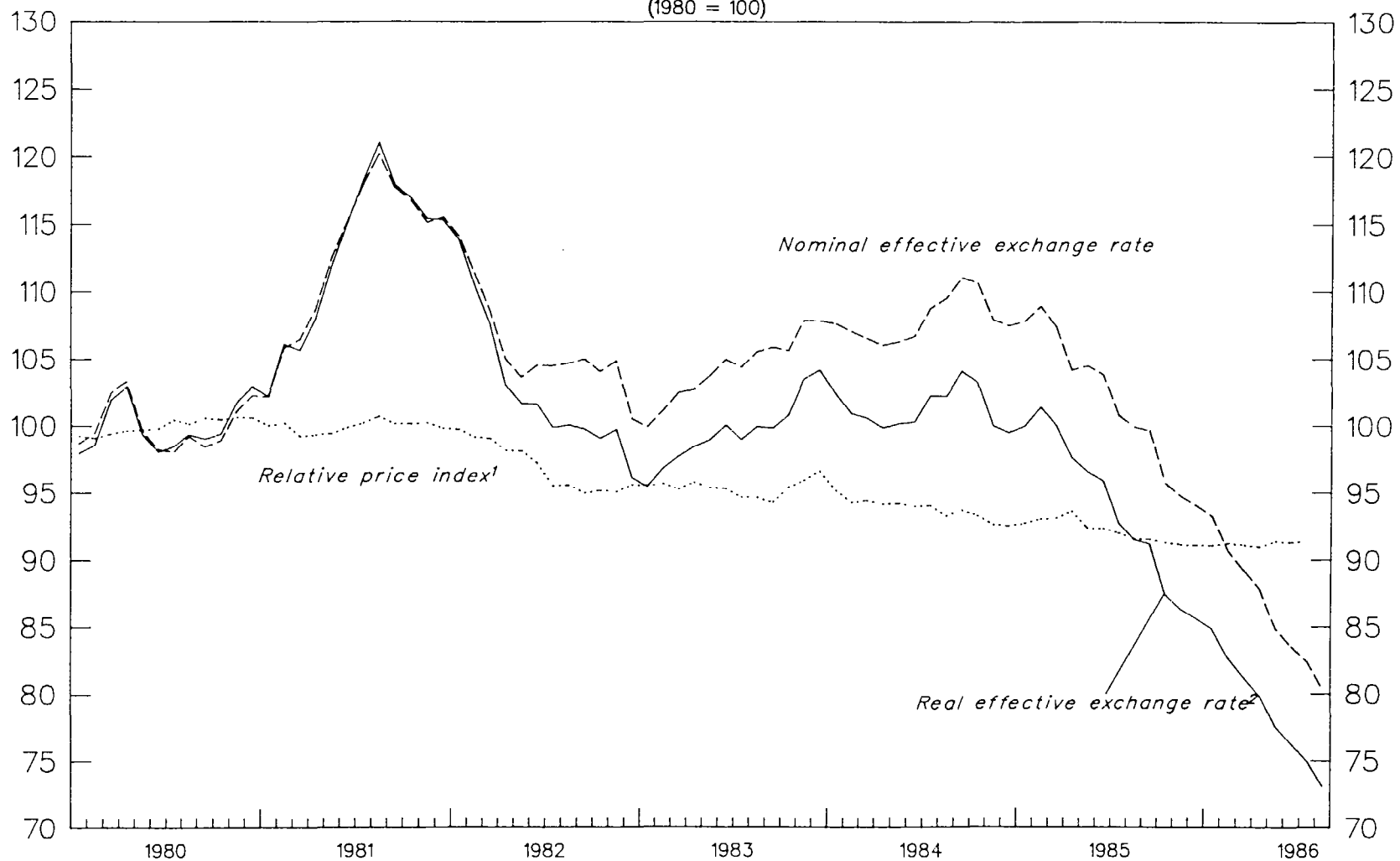
Source: Information Notice System.

1/ Increases mean appreciation.

2/ Using seasonally adjusted price indices.

3/ Date of latest consideration by Executive Board.

PAKISTAN
INFORMATION NOTICE SYSTEM INDEX OF REAL EFFECTIVE EXCHANGE RATE
(1980 = 100)



Source: Information Notice System.

¹In terms of local currencies.

²Trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices, increases mean appreciation.