# Being "Afraid of Float" to "Benign Neglect", A Jolting Ride of SBP on the Roller Coaster of Exchange Rate Regime

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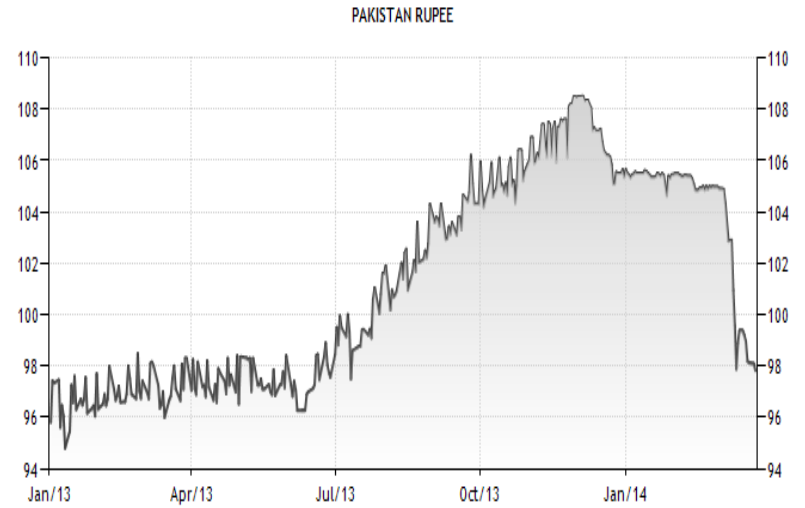Associate Professor, Lahore School of Economics (LSE)
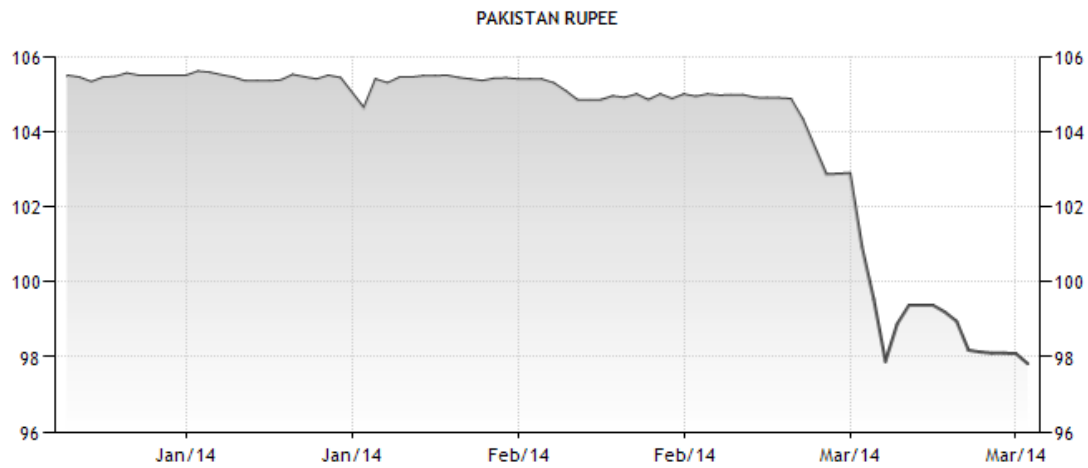
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Associate Professor, Lahore School of Economics (LSE)

# Irrelevant Title!





PAKISTAN RUPEE

SOURCE: WWW.TRADINGECONOMICS.COM | OTC INTERBANK



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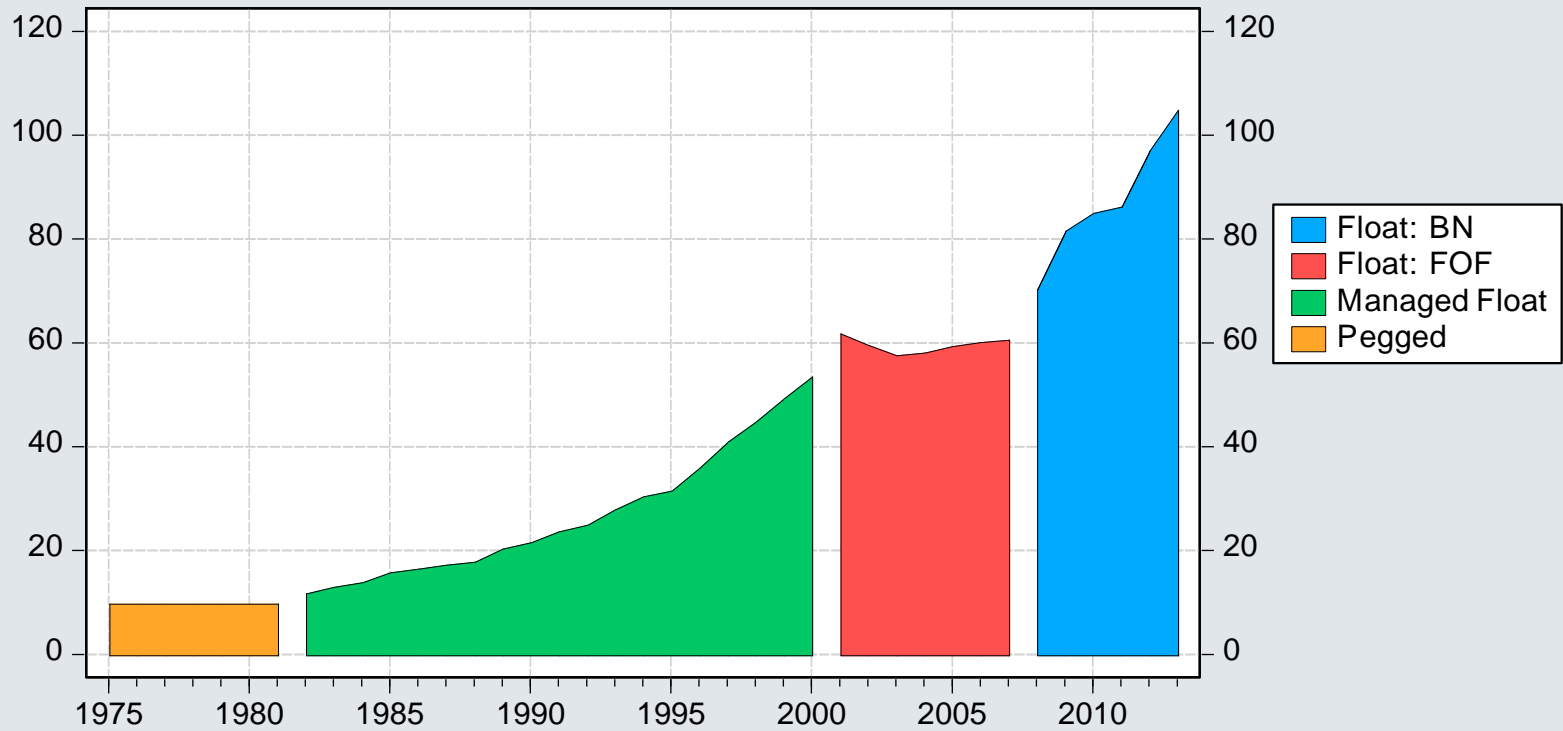
# What this paper is all about?

- No Sophisticated Models!
- No Prediction on Ex Ante Basis!
- No Explanation/justification of good or bad happenings on Ex Post Basis!
- A simple Comparative Analysis of Different ER Regimes
  - Based on Few Important Variables

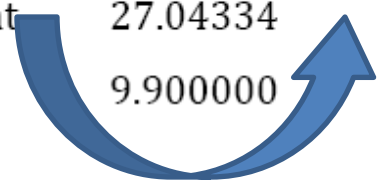# Research Design



Exchange Rate (PKR/USD)
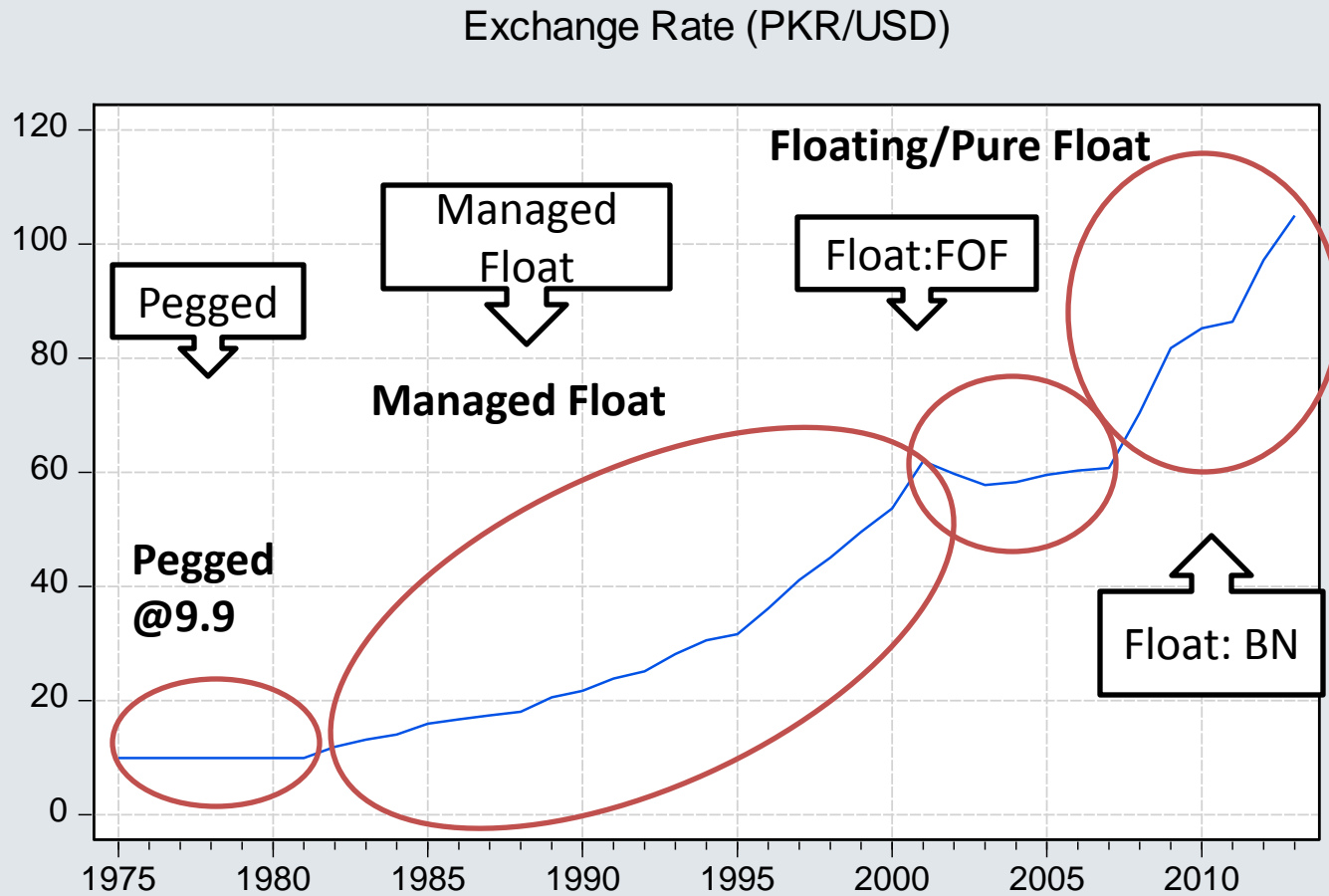
# Exchange Rate By Regime

# Descriptive Stats on Exchange Rate in Different Regimes

**Table 1: PKR-USD Exchange Rate and Its Volatility in Different Regimes**

| Time Frame | REGIME | Exchange Rate ( Mean) | Exchange Rate (Std. Dev.) | Obs. |
|---|---|---|---|---|
| 2008-2013 | Float: BN | 87.63969 | 12.10056 | 6 |
| 2001-2007 | Float: FOF | 59.74073 | 1.429629 | 7 |
| 1982-2000 | Managed Float | 27.04334 | 12.77098 | 19 |
| 1975-1981 | Pegged | 9.900000 | 0.000000 | 7 |
| | | | | 39 |

# Growth Rate By Regime

**Table 3: GDP Growth Rate in different Exchange Rate Regimes**

| REGIME | Mean | Std. Dev. |
|---|---|---|
| Float: BN | 2.923502 | 0.931532 |
| Float: FOF | 5.278538 | 2.094297 |
| Managed Float | 4.975131 | 1.907178 |
| Pegged | 6.179820 | 2.535719 |
| All | 5.038649 | 2.111224 |

# Current Account Balance

**Table 4: Current Account Balance**

| REGIME | Nominal Values (USD) | | % of GDP | |
|---|---|---|---|---|
| | Mean | Std. Dev. | Mean | Std. Dev. |
| Float: BN | -5.81E+09 | 6.65E+09 | -3.462383 | 4.126803 |
| Float: FOF | -1.45E+09 | 4.91E+09 | -0.428004 | 4.572595 |
| Managed Float | -1.54E+09 | 1.11E+09 | -3.196601 | 1.770231 |
| Pegged | -8.47E+08 | 1.52E+08 | -4.500759 | 1.018332 |
| All | -1.88E+09 | 3.26E+09 | -2.905154 | 2.923895 |

# Average Market Cap of Listed Co.s (% of GDP)



Average Market Capitalization of Listed Companies (% of GDP)
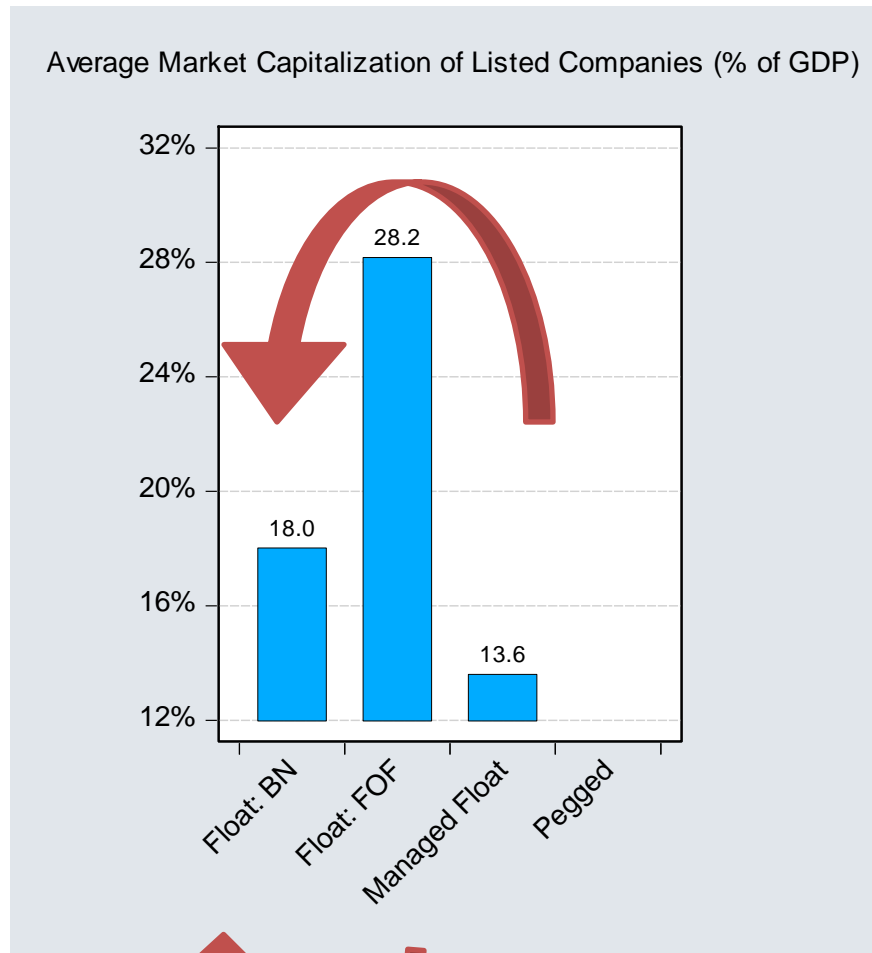
# Average Annual Inflation Rate



Average Inflation in Different ER Regimes
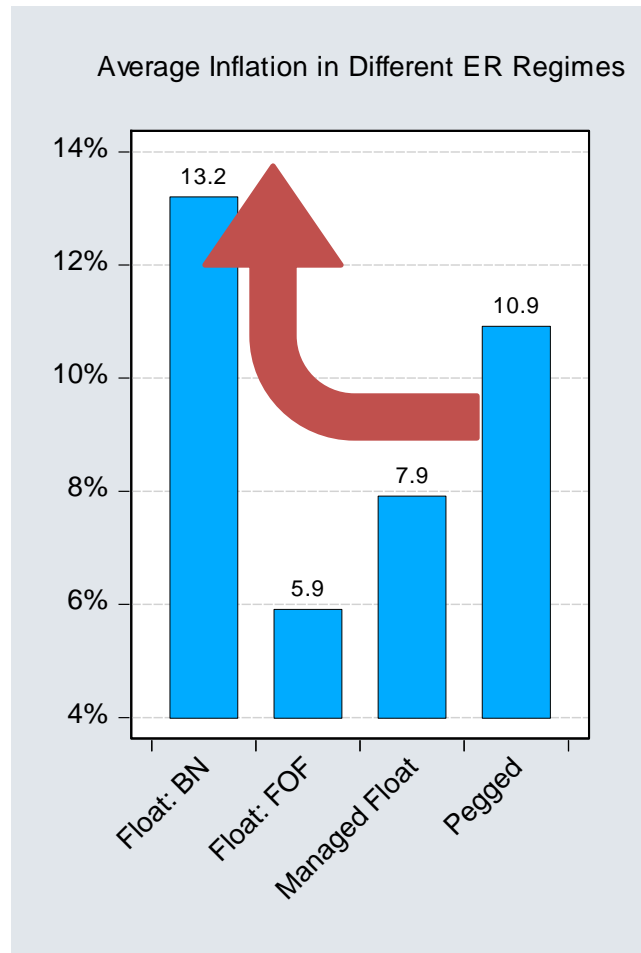
# Savings (Fuel for Any Economic Engine)

**Table 5: Savings as Percentage of GDP**

| REGIME | Mean | Std. Dev. |
|---|---|---|
| Float: BN | 9.846151 | 1.350556 |
| Float: FOF | 16.02370 | 1.228923 |
| Managed Float | 12.39053 | 3.891199 |
| Pegged | 7.455923 | 1.734753 |
| All | 11.86925 | 4.027091 |

# You Name Any Variable!

**Table 6: Net Foreign Direct Investment as percentage of GDP**
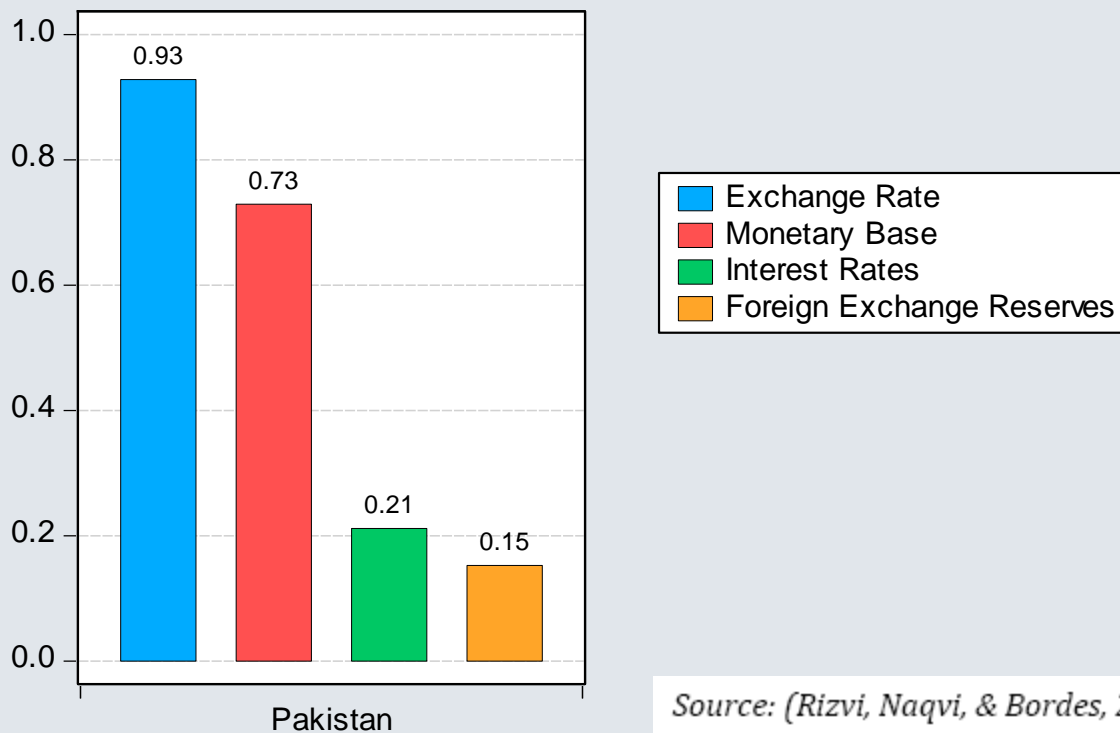
| REGIME | (%) Mean | Std. Dev. |
|---|---|---|
| Float: BN | 1.599760 | 1.174274 |
| Float: FOF | 1.765538 | 1.318932 |
| Managed Float | 0.612804 | 0.362096 |
| Pegged | 0.215368 | 0.123201 |
| All | 0.880369 | 0.903620 |

# What was Wrong during Float:BN

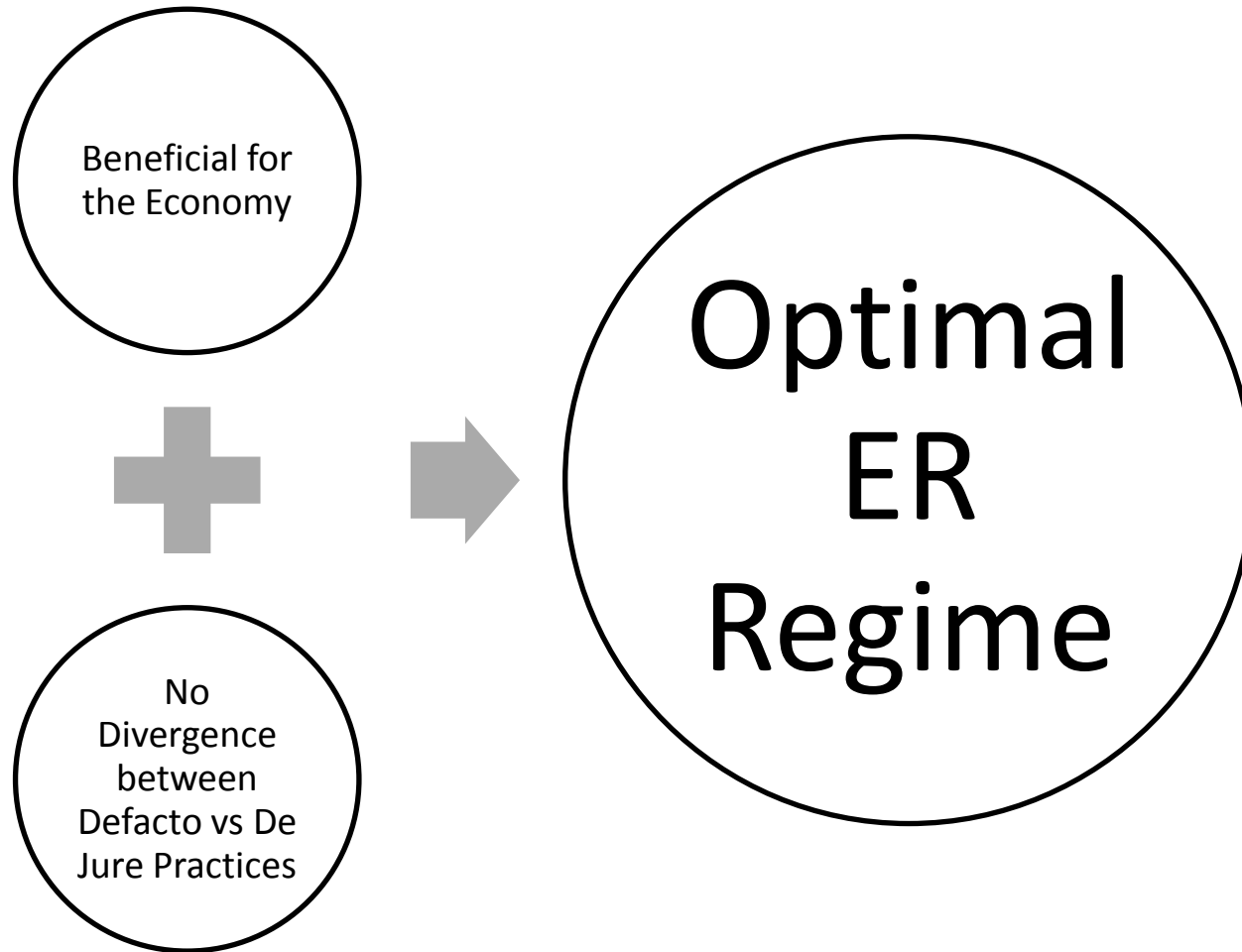$$IM = \frac{R_t - R_{t-1}}{MB_{t-1}/e_{t-1}}$$

# Stability in ER and Intervention Measures



Stability in Selected Variables
(Probability of being within +-2.5 Percentage Change Band)

Source: (Rizvi, Naqvi, & Bordes, 2012)

# Policy Choice

Beneficial for the Economy

**+**

No Divergence between Defacto vs De Jure Practices

**→**

Optimal ER Regime

# Pegging

**Pros**
- Stabilized inflation
- Stabilized Interest rates
- Discipline in Policy making

**Cons**
- Loss of independent Monetary policy
- Transmission of External Shocks
- Inherently prone to Financial Crisis
- Speculative Attacks

# Pure Float

**Pros**
- Free Market Mechanism
- No intervention
- Natural coupling with Financial openness policies
- Fluid Capital flows

**Cons**
- Threat of huge currency depreciation
- Huge volume of external debt
- Presence of ERPT
- Trade deficit due to import orientation

# Simple Scoring (1-4: Worst-Best)

| Time Frame | REGIME | Exchange Rate (Mean) | GDP Growth | Current Account Balance | Avg. Market Cap | Inflation | Savings | FDI | PEI | GCF | Total Score |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 2008-2013 | Float: BN | 2 | 1 | 2 | 3 | 1 | 2 | 3 | 2 | 1 | 17 |
| 2001-2007 | Float: FOF | 3 | 3 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 34 |
| 1982-2000 | Managed Float | 1 | 2 | 3 | 2 | 3 | 3 | 2 | 3 | 3 | 22 |
| 1975-1981 | Pegged | 4 | 4 | 1 | 1 | 2 | 1 | 1 | 1 | 2 | 17 |

# Optimal Policy!

- We suggest policy makers to go for **<u>Managed Float</u>**
- *Balanced Economic Performance*
- *No intervention in principal*
- *Right of intervention in case of abrupt or unjustified movements in ER*
- *Increased credibility due to Absence of Fear of Floating*
- *Increased Confidence of market participants*

# Thanks for your Patience

## Q & A