**[Our sluggish disinflation](https://www.dawn.com/news/1832153/our-sluggish-disinflation)**

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WHAT goes up must come down. This truth also applies to economic trends, which exhibit cycles of ups and downs. However, the pace of going up and coming down depends not on gravity, but economic policies. We are now seeing the effects of higher interest rates, which are slowly taking the steam out of inflation in the consumer price index (CPI). Year-on-year inflation has come down from its peak of 38 per cent in May 2023 to 17.3pc in April 2024.

How long does it take to contain high inflation and to lower it? If we take high inflation to mean anything higher than 15pc, then the current spell has been persisting for the last 22 months. The bad news is that in our inflation history, we have witnessed CPI inflation persist above 15pc, peaking at 29.3pc, for 28 months straight — from July 1973 to November 1975. Let us hope that this inflation history does not repeat itself in terms of the length of that spell. If we take high inflation to mean anything in the double digits (10pc or higher), then we have experienced a spell of high inflation that lasted for almost 46 consecutive months during 1972-1976.

Another episode of inflation pertained to the global financial crisis of 2008. CPI inflation in Pakistan shot up above 10pc in January 2008. After touching a peak of 26.1pc, it started to decline, but stayed over 10pc for 18 consecutive months till June 2009. However, just after five months, inflation again crossed single digits and stayed at higher levels for almost 30 consecutive months till June 2012.

These episodes of high inflation show that once inflation starts spiralling, it is not only difficult to bring it down, it also takes a long time to do so. This is one of many reasons that central banks around the world aim at maintaining price stability around a low, single-digit inflation figure. The current pace of sluggish disinflation could have been speeded up had the government shown fiscal prudence or the State Bank increased the policy rate beyond 22pc. However, the bank’s Monetary Policy Committee made the right move in not stifling the economy by killing growth altogether in FY24.

Will fiscal prudence continue in the fourth quarter of FY24?

Inflation is not the only malaise hurting us. With the onslaught of high inflation, our real GDP declined by 0.2pc in FY23, and is expected to grow around 2pc in FY24. This is a combination of low growth and high inflation known as stagflation. The inflation history cited here was accompanied by high growth of 6.8pc and 7.5pc in FY73 and FY74, respectively. The economic situation is much worse now, perhaps the worst in our history in terms of low growth and high inflation. This combination is playing havoc with the poverty situation. While Pakistan had commendably reduced its poverty rate between 2001 and 2018, this progress has slowed down due to macroeconomic instability, the effects of the Covid-19 pandemic, the devastating flood of 2022, and unending political polarisation. The World Bank recently estimated the lower-middle-income poverty rate to be 40.1pc ($3.65 per day at 2017 purchasing power parity) for FY24, which is about the same as the poverty rate in 2018. This means there will be seven million more poor individuals in 2024 compared to 2018.

What should be done to bring down inflation further, increase growth, and reduce poverty? Reducing inflation requires both tight monetary and fiscal policies. While the State Bank had been maintaining a tight monetary policy with historic high interest rates, fiscal policy remained lax in terms of high fiscal deficits and government borrowing from commercial banks. Unless the government achieves a surplus in its primary balance, fiscal policy will remain lax. The good news is that under the IMF’s Stand-by Arrangement, the fiscal authorities have shown some prudence, and the first three quarters of FY24 showed a GDP surplus of 1.5pc in the primary balance, while maintaining a fiscal deficit of 2.3pc of GDP.

Will fiscal prudence continue in the fourth quarter of FY24? The April to June quarter traditionally shows very high government expenditures and fiscal deficits. In FY23, the fourth quarter alone added 4.1 percentage points to the fiscal deficit, which took the FY23 deficit to 7.7pc of GDP. Similar pressures are likely in the current quarter, which will cause the fiscal deficit to mount further. Will the fiscal excesses of the fourth quarter convert the cumulative primary surplus of the first three quarters to a deficit? There is still some hope that primary accounts will show a surplus, otherwise the likelihood of getting a medium-term IMF facility will be diminished. Any policy missteps will also increase the risk of the resurgence of inflation.

Growth promotion requires an increase in investment, both domestic and foreign, as well as an increase in productivity. While there is a lot of talk about attracting foreign investment, there is a dearth of focus on attracting domestic investment. Promoting domestic investment requires, among other factors, lower interest rates, which can only emerge if the inflation trajectory continues to show a downward trend. Therefore, continuing with prudent macroeconomic policies will lead to lower inflation and lower interest rates, which is conducive to higher investment. Both fiscal and monetary prudence will promote domestic savings, necessary for domestic investment. The government has already engaged with the IMF to secure a new medium-term programme that will increase the likelihood of policy prudence, at least for that period.

What happens in the current quarter will be crucial for the government and our economy. While we are not in an IMF programme now, the tendency has been to go on a borrowing binge. Repeating this behaviour may cost the government dearly. It must show the foreign investors it has been wooing that it is now fiscally prudent and very serious. It must also show that our policy talk will soon translate into policy walk in the coming days. This will not be easy, as the government will be under a lot of pressure to dole out money to the usual suspects (power-brokers and resource-devouring groups) in our economy this quarter.

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