Pakistan Economy

Rupee devalues for the third time in FY18

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Rupee devalues to Rs119-120 in interbank market

- As per our channel checks, Pak Rupee devalued by 3%-4% in early hours of the interbank market today to Rs119-120. It reportedly went as high as Rs122 (4.6%) and then came back down to Rs119-120 as per sources. To recall, Friday's close was Rs115.62.
- This would be the third time that Pak Rupee has devalued during current fiscal year. Govt. had devalued Pak Rupee by around 5% on Dec 8, 2017 to Rs110 and then again by around 4.5% to 115 on Mar 20, 2018. During the last 10 years, Pak Rupee has devalued annually by around 5%.
- We believe this is much needed as Pakistan's external account continues to deteriorate as the external Current Account Deficit (CAD) remained higher than our expectations. For the period Jul-Apr 2018, CAD increased to a whopping US$14.0bn (4.4% of GDP) compared to US$9.3bn (3.0% of GDP) last year.
- For FY18, we now expect CAD to be in the range of US$17-18bn (5.4%-5.8% of GDP) compared to earlier estimates of around US$16bn (5.1% of GDP).
- As a result, Pakistan foreign exchange reserves (reserves with SBP) also declined from US$16.1bn in Jul 2017 to US$10.0bn as of Jun 1, 2018, which is equivalent to 2 months of import cover.
- Other than higher than expected deterioration in external account, recent currency movement of Pakistan's trading partners have been contrary to expectations. Major currencies of our trading partners have weakened against the USD by higher than expectations.

Rupee devaluation assumption increased to Rs131 by Jun 2019

- As per our estimates, the Real Effective Exchange Rate (REER) index is now estimated to be in the range of 113-114 (before this round of devaluation) as compared to earlier estimate of 110. This has not fallen below 90 during the last 10 years. Prior to the Dec 8, 2017 devaluation, the REER index was 125.
- Based on upward estimation of REER index, we are revising our exchange rate assumption for FY19. We now expect the Pak Rupee to devalue to Rs131 by Jun 2019 as against earlier expectation of Rs127.
- Given that devaluation would result in inflation, we expect State Bank of Pakistan (SBP) to increase its Policy Rate from current 6.5% to 8.25% (up by 175 basis points) by Jun 2019. This would be positive for local banking sector. Every 1ppt increase in interest rates leads to 6% rise in banks' earnings.
- A weaker Pak Rupee will be largely positive for listed sectors including Oil & Gas Exploration, Power (IPP's) and Textiles due to dollar denominated revenues. On the other hand, Auto Assemblers and Cements could be negatively affected as it could lead to lower margins for Autos and higher coal prices, which could affect Cement company margins. Furthermore, we do not expect any major impact on Insurance, Fertilizer and Steel Sectors.
- We believe that this devaluation is a positive signal on the economic front to investors that the much required steps are being taken to address the external account.

Impact on Key Sectors

Sector Implications of depreciating PKR/USD parity

Sectors	Outlook	Comments
Oil & Gas Exp.	Positive	Selling Prices are indexed to International crude prices
Power (IPP's)	Positive	ROE component is indexed to PKR/USD parity
Textile	Positive	Devaluation to support exports
Banking	Neutral - Positive	Devaluation to increase inflationary pressures, which could lead to earlier than expected rise in interest rates
Insurance	Neutral	No material impact
Fertilizer	Neutral	Local prices are function of local gas prices and govt. subsidies
Steel	Neutral	Devaluation to result in high import costs, which will likely be passed on
Oil Marketing	Neutral - Negative	Devaluation could result in exchange losses for OMC's
Auto Assemblers	Negative	Devaluation to result in high import costs, which will likely be passed on and could result in lower demand
Cements	Negative	Higher imported coal cost

Source: Topline Research

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Market Weight	= Weight in KSE-100 Index
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