

# Surprised PKR devaluation

## Good for the market

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## Pak Rupee devalues by 3% in Interbank Market

- The Pak Rupee witnessed pressure in the interbank earlier today and closed at Rs114.0 against USD as compared to yesterday's closing rate of Rs110.6. Pak Rupee lost its value earlier than expectations as market was expecting that this weakening may take place in caretaker government setup in Jun 2018.
- To recall, the govt. had devalued the Pak Rupee by around 5% on December 8, 2017. In 4 months PKR is down 9% against USD after remaining stable for almost 28 months. During the last 10 years, Pak Rupee has devalued annually by 5% against USD.
- We believe this was much needed as Pakistan's external account has deteriorated as of late. During FY17, Pakistan posted current account deficit (CAD) of US\$12.2bn (4% of GDP) as compared to US\$2.6bn (0.9% of GDP) in FY16. For the period Jul-Feb'18, CAD increased to US\$10.8bn (3.5% of GDP) compared to US\$7.2bn (2.4% of GDP) last year.
- As a result Pakistan foreign exchange reserves (reserves with SBP) also declined from US\$17.4bn in Jan 2017 to US\$12.1bn, which is equivalent to 2.5 months of import cover.
- The International Monetary Fund (IMF) in its recently published detailed report has also stated that Pak Rupee is still overvalued by 10% and expects the full year CAD for FY18 at US\$15.7bn (5% of GDP).
- We expect further PKR devaluation of at least 10-15% during FY19 and FY20, on top of devaluation of 9% in FY18 so far, taking the US\$/PKR parity to around Rs140 by Jun'20. This would also be in line with the Real Effective Exchange Rate (REER) Index, which we currently estimate at around 110. This has not fallen below 90 during the last 10 years. Prior to the December 8, 2017 devaluation, the REER index was 125.

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- Given that such sharp devaluation would result in inflation, we expect State Bank of Pakistan (SBP) to increase interest rates by 200 basis points in FY19, over the expected 75 basis point hike in FY18 (25bps have already been increased by govt.) and expect the SBP Policy Rate to be at least 8.5% by Jun'20. This would be positive for local banking sector. Every 1ppt increase in interest rates leads to 6% rise in banks' earnings.
- We think this devaluation will partially help arrest current account woes of the country and 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 from the same as it could lead to lower margins for autos and higher coal prices which could affect cement company margins. Furthermore, Insurance, Fertilizer and Steel Sector are likely not to have any major impact.
- We believe that this devaluation will give a positive signal to investors that steps are being taken to arrest foreign exchange reserves. For foreign investors, it will provide an opportunity to revisit Pakistan that trades at 2019 PE of 8.4x which is 36% discount to MSCI EM Asia.

# Impact on key listed 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

# Impact on key stocks

## Earnings impact of 3% Devaluation

<b>E&amp;Ps</b>	
PPL	4.0%
POL	5.2%
OGDC	5.0%
MARI	5.0%
<b>Power</b>	
HUBC	2.4%
<b>Textile</b>	
NML	6.0%
<b>Autos</b>	
PSMC	-16.0%
INDU	-5.0%
HCAR	-5.4%
<b>Cements</b>	
DGKC	-0.8%
FCCL	-0.8%
KOHC	-0.9%
LUCK	-0.8%
MLCF	-0.9%

Source: Topline Research, Company Accounts

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Neutral	Stock will perform in line with the average total return of stocks in universe
Sell	Stock will underperform the average total return of stocks in universe

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Market Weight	= Weight in KSE-100 Index
Under Weight	< Weight in KSE-100 Index

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