AKD Daily

Thursday, Jul 06, 2017

Today's Daily

Pakistan rupee: Tipping over!

The PkR/US$ parity depreciated in a sharp movement yesterday - the largest daily move since CY08 - with the rate closing at PkR108/US$ (~3.2% depreciation), primarily reflecting ongoing deterioration in fx reserve position due to rising trade imbalances (11MFY17 CAD 1.3xYoY higher) and slower foreign loan inflows (70% disbursement of the budgeted amount from multilateral donors in 11MFY17). While currency is expected to remain volatile, a pullback in the PkR remains likely (PkR/US$ trading at PkR106.3 intraday as per channel checks) taking cue from MoF and SBP's statements. However, over CY17 PkR is likely to consolidate around PkR106-107 with fx reserves remaining above US$19bn, in our view. Thereon, depreciative pressures are expected to build as CA dynamics worsen (FY18F: 4.5% of GDP) with import cover coming under 4m, to trigger further PkR/US$ depreciation (4.9% in FY18F). Implications on the macro front linger in the form of inflationary pressures (FY18F CPI inflation projection up by +30bps) and higher debt servicing. From the market's vantage, PkR weakness remains beneficial for Textile, E&P and IPPs while holding negative implication for Cements, Steel and Automobiles.

KSE100 - Index	
Current	45,413.42
Previous	45,394.06
Chg.	0.04%

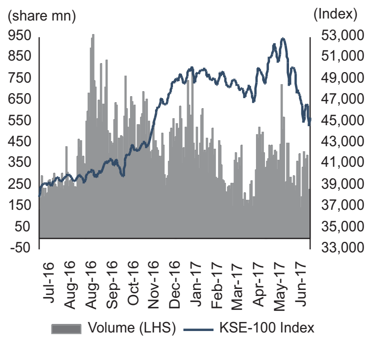
Mkt Cap. (PkRbn/US$bn)	
Current	9,304 / 88.69
Previous	9,308 / 88.73
Chg.	-0.05%

Daily Turnover (mn)	
Current	204.26
Previous	190.11
Chg.	7.4%

Value Traded (PkRmn/US$mn)	
Current	12,504 / 119.20
Previous	9,710 / 92.56
Chg.	28.8%

News and Views

- In a political development, Maryam Nawaz Sharif appeared before the JIT yesterday and spoke to the media about the alleged conspiracies being hatched against the PML-N and civilian supremacy.
- Pakistan has missed the cotton sowing target by a wide margin of 12 percent in the current crop season, which would compromise the production target of 14.04 million bales set for 2017-18.
- SBP has acquired the banknote and prize bond-printing functions of Pakistan Security Printing Corporation (PSPC) from the federal government. To note, PSPC holds a 40% stake in Security Papers Limited.



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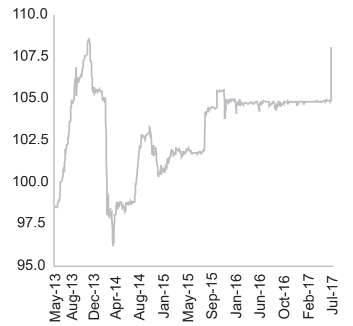
PkR/US$

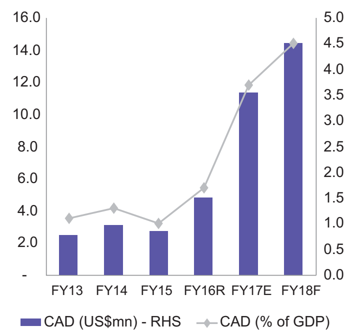


Source: Bloomberg & AKD Research

Rupee devalues - as reserves exhaust: In a sudden move, the Rupee depreciated sharply by 3.18% yesterday to close at PkR108.2/US$. As per channel checks, the devaluation is a function of decline in fx reserves limiting SBP's capacity to adequately support the currency amid a growing trade imbalance. In this regard, fx reserves have fallen by US$2.7bn from their peak in Oct'16 owing to slower project-loan inflows (70% disbursement of the budgeted amount from multilateral donors in 11MFY17). Moreover, pressures on interbank have risen considerably on account of a rapidly rising import bill with SBP's FE-25 facility to manage Rupee volatility also reaching its peak at US$1.3bn in May'17. While the SBP has resorted to short-term commercial borrowing, increase in CAD has outpaced efforts for fx reserve accretion with the deficit now standing at its highest since FY08.

CA outlook - dismal at best: Colliding with currency depreciation, SBP has revised BoP statistics from FY15 onwards to include transactions done through off-shore accounts in efforts to increase transparency. Consequently, CAD for 11MFY17 has been revised up to 3.4% of GDP from 2.9% reported earlier (FY16 deficit revised to 1.7% of GDP from 1.2%). The change has primarily come from an increase in Machinery imports particularly in the Power/Energy sector (likely CPEC related) with imports revised up by US$1.03bn for 11MFY17. In tandem, adjustments have been made to the financial account. On a positive note, PkR weakness is likely to help exports recovery in the coming year which incorporated along with data revision, takes FY18F CAD projection to 4.5% of GDP (from 3.8%) compared to

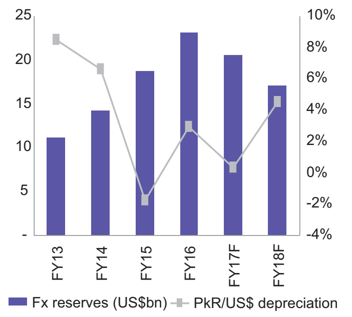
Current account trend



Source: SBP & AKD Research

FY17E deficit expected at 3.7%. While, this implies sharp increase in CAD, the adjustments are unlikely to have additional impact on the fx reserve position due to corresponding changes to the financial account.

Reserves vs. Rupee



Source: SBP, Bloomberg & AKD Research

Outlook - consolidation followed by weakness: With our projections indicating fx reserves to stabilize above US$19bn in CY17, we expect the currency to largely consolidate around PkR106-107 in remainder CY17 - though reliant on materialization of planned foreign inflows on a timely basis. In this regard, GoP's stance on currency devaluation being triggered by political uncertainty and SBP's claims to counter volatility further affirms our outlook. That said, depreciative pressures are expected to continue to steadily build up where our current account projections imply fx reserves deterioration in FY18 with the same expected to end the year around US$17-17.5bn (import cover projected at 3.9mths). This is expected to open room for further slippage in the PkR/US$ where we maintain our forecast of 4.9% depreciation for the ongoing fiscal year. That said, delay in foreign loans or a sharper recovery in international oil prices (Arablight assumed to stay below US$55/bbl) can trigger further devaluation during the year.

Negative implications for economic stability: Spillover effects of a weaker Rupee are likely to emanate in the form of direct pressures on the fiscal account with external debt servicing budgeted at ~8% of the year's revenue. Moreover, increasing reliance on imports for fuel and investment machinery also implies inflationary pressures, particularly in the form of higher domestic fuel prices. However, support is expected from persistent weakness in global crude prices, where the recent depreciation increases our CY17F/FY18F inflation projection by +10bps/+30bps to 4.4%YoY/5.1%YoY. While real interest rates remaining in the positive zone should allow SBP to hold interest rates at current levels till May'18 - higher than expected depreciation can open room for a nominal hike early-CY18.

Investment perspective: Export oriented sectors, particularly Textile, will be the key beneficiary of PkR weakness, where a stagnant Rupee has hurt competitiveness. In this regard, assuming 5% depreciation from our base case implies a positive 2.8% earnings impact on NML. E&P and IPPs with dollar-linked revenues also stand to benefit with 5% devaluation prompting 4.6%/5.7% avg. rise in FY18 earnings in our E&P and Power Universe. On the other hand, import-dependent sectors, including Automobiles, Cements and Steel face negative implications (see table on next page). In addition, select scrips (ENGRO, FFBL, EFERT within AKD Universe) with high share of foreign borrowing also face currency risks in the form of higher repayments.

Sector implications: Earnings impact on 5% depreciation

Sector	EPS Impact	Comments
Power		
HUBCO	4.71%	ROE (and hence Tariff) is linked to PkR/US$ exchange rates indexed on end of quarter rates
KAPCO	6.81%	
E&Ps		
OGDC	4.48%	With sales prices benchmarked to Intl. Crude Oil prices in US$, Rupee depreciation shall lead to higher revenue.
PPL	4.27%	
POL	5.11%	
Cements		
LUCK	-1.9%	We expect GMs for our AKD universe to deteriorate by 1% due to higher cost of coal (makes 40% of COGS) , declining our FY18F earnings by 2.3% from our base case.
DGKC	-2.6%	
MLCF	-2.5%	
FCCL	-2.1%	
CHCC	-2.2%	
PIOC	-2.5%	
GWLC	-3.0%	
Autos		
INDU	0%	Ability of OEMs to maintain margins, i.e. pass-on cost escalations to customers is at play, where brand power and currency hedging could mitigate downsides
PSMC	-2.10%	
OMC		
PSO	-8.5%	Availability of concessionary financing schemes (FE-25) import agreements for fuel and ultimately GoP's response in terms of POL price setting could sway profitability.
APL	-9.5%	
HASCOL	-10.2%	
Fertilizers		
FFBL	-25%	Increased cost of phosphoric acid (that makes 55% of COGS) will negatively impact GMs for FFBL by 1.9%, declining our CY18F earnings by 24% from our base case.
Textiles		
NML	2.80%	Company expected to have a net postive impact on their bottomline on the back of increament in revenue front due to higher export proceed, while higher cost of imported inputs (i.e. cotton) will negatively impact GMs, restricting bottomline impact.
Steel		
ASTL	-15.20%	Scrap prices jumps with US$ moves where the ability to pass on costs is high as imported billet and rebar prices rise as well and healthy demand sustains.

Source: AKD Research

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Sell	≤ -20% downside potential

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