AKD Daily

Wednesday, Mar 21, 2018

Today's Daily

Pak Economy: Rupee depreciation is a blessing in disguise

The Rupee depreciated another 4.4% against the greenback yesterday with interbank rate ending at PkR115.5/US$ reflecting existing pressures on the external front and central bank's reserves declining to US$12.13bn (down US$1.98bn CYTD; import cover: 2.69x). With regards to the external sector, as per latest data 8MFY18 CAD surged to its highest level ever at US$10.83bn (up 50.3%YoY) vs US$7.22bn in 8MFY17. While devaluation is likely to ease off pressures on external account in the long run (weaker rupee shall restore export competitiveness apart from impeding import growth), CAD at such high levels (FY18F: US$15.9bn) along with declining FX reserves (SBP reserves at US$10.9bn by Jun'18) can result in additional depreciation in CY18F. Expecting currency depreciation to be a key theme, we have conducted an event based study analysis of exchange rate movements (37 devaluation events) of 21 countries, where a complete devaluation (2.5% additional depreciation from current levels, in our view) has the potential to lift KSE100 Index by an average 30% within 120 trading days (ignoring other noise – such as political).

KSE100 - Index

Current	44,309.74
Previous	43,539.60
Chg.	1.77%

Mkt Cap. (PkRbn/US$bn)

Current	9,161 / 82.85
Previous	9,063 / 81.97
Chg.	1.08%

Daily Turnover (mn)

Current	219.91
Previous	115.97
Chg.	89.6%

Value Traded (PkRmn/US$mn)

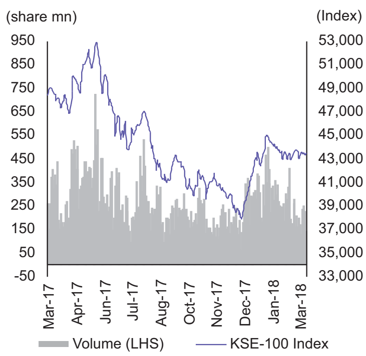
Current	10,978 / 99.28
Previous	5,259 / 47.56
Chg.	108.7%

News and Views

- he Pakistani rupee weakened sharply against the dollar to PkR115.5 on Tuesday in what appeared to be currency devaluation by the State Bank of Pakistan SBP. SBP spokesman Abid Qamar told Reuters the rupee plunge was a "market-driven" event.

- The country's current account deficit jumped by 50% in 8MFY18 to $10.826bn compared to $7.216bn in the same period. The import of goods surged to US$35.661bn as compared to US$30.401bn in the corresponding period in FY17 while the export of goods stood at US$15.970bn against US$14.231bn in 8MFY17.

- As GoP struggles to overcome legal challenges that can undermine an upcoming amnesty scheme, PM's advisor on Revenue, Senator Haroon Akhtar states on Tuesday that Pakistanis could repatriate up to US$5bn under the proposed scheme. Understanding that Pakistanis would not be bringing back their entire wealth, he stated that even if they manage to bring in US$4-5bn, the amnesty scheme could be considered successful.



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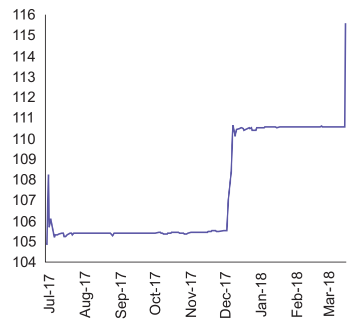
8.7% Devaluation in FY18 so far



Source: Bloomberg & AKD Research

Recent currency move signifies BoP weaknees: In an abrupt move yesterday, the Rupee has further depreciated 4.4% against the greenback with interbank rate closing at PkR115.5/US$. This is the second round of depreciation during FY18 - the currency earlier lost 4.4% in Dec'17. The current move reflects pressures on the BoP front (8MFY18 CAD: US$10.83bn) where central bank's reserves have declined to US$12.13bn (down US$1.98bn CYTD; import cover: 2.69x). While devaluation is likely to ease off pressures on external account in the long run (weaker rupee shall restore export competitiveness apart from impeding import growth), CAD at such high levels (FY18F: US$15.9bn) along with declining FX reserves (SBP reserves at US$10.9bn by Jun'18) can result in an additional depreciation of 2.5% in CY18F. Although much of this depends upon timely materialization of anticipated inflows (FY18F: US$11.8bn), where any significant inflows (news flows suggesting US$2bn grant from friendly countries and anticipated amnesty scheme) can help FX reserves to stabilize limiting further volatility.

Event based study indicating towards a rally in the making: From a quants perspective, we have conducted an event based study analysis of exchange rate movements (37 devaluation events) of 21 countries and corresponding impacts on respective equity markets 260 days prior and post the devaluation event. Looking at market movements prior to the devaluation event(s), we find that markets on average tend to come off by 33% (from peak during the review period) compounding up to the event (where KSE100 retreated 28% in CY17 from its peak till currency devaluation in Dec'17).

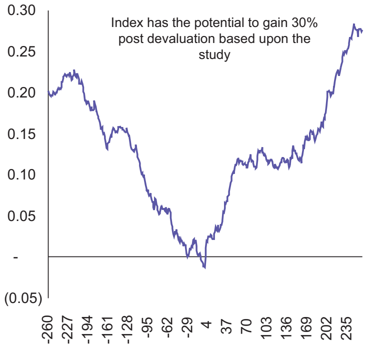
Devaluation Events

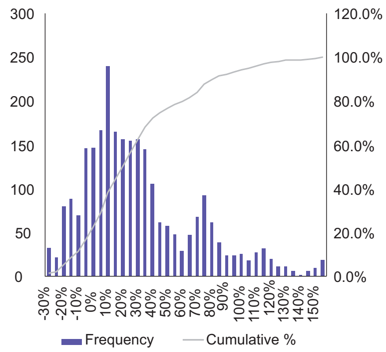
Country	Date	Deval.
Brazil	18-Jan-99	9%
Brazil	24-Sep-02	5%
Czech	8-Feb-99	2%
Egypt	3-Nov-16	36%
Finland	8-Sep-92	13%
Hungary	4-Jun-03	6%
Hungary	5-Jan-15	3%
Pakistan	22-Jul-93	6%
Pakistan	23-Oct-96	8%
India	27-Aug-13	4%

Source: Bloomberg & AKD Research

Note: Due to presence of extreme outliers in the dataset, market movements have shown significant dispersion on account of idiosyncratic factors (multiple factors at play such as commodity prices shocks).

Mkts perform pre & post deval | **Post devaluation: YoY returns**



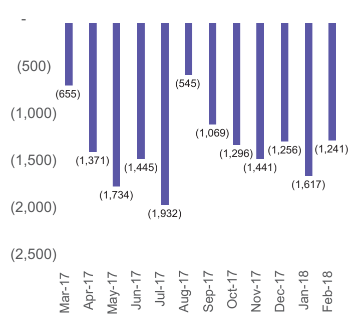


Source: PSX, Bloomberg, AKD Research

While ignoring political turbulences and other black swan events in the aftermath of the devaluation event, fractional algorithm based polynomial-panel regression has been run to gauge market movements post devaluation. In this backdrop, based on the current estimates of GDP growth rate of 5.5%, a complete devaluation (in our view, 2.5% additional depreciation from current levels) has the potential to lift the KSE100 Index by an average 30% within 120 trading days (while ignoring other noise – such as political). Under a different framework, analyzing daily YoY movements, positive returns of around 10% have highest cluster based probability in our distribution at 10% accompanied by positive skewness (where 77% of returns remained positive). In this regard, KSE-100 index has already gained 17% since mid-Dec'17 with the recent round of devaluation likely to maintain the positive momentum. Beneficiaries include export oriented sectors like Textiles while IPPS, E&P & IT companies benefit from their dollar linked revenues. Banking sector can also gain traction on the back of higher inflationary pressure and its consequent impact on monetary policy.

Feb'18 CAD review: CAD for Feb'18 slows down to US$1.24bn (down 25.5%MoM) after peaking out in Jan’18 (since FY09) primarily due to ease off in trade deficit at US$2.26bn (down 19.3%MoM) vs US$2.79bn in Jan'18. In this regard, imports have fallen to US$4.32bn (-12.0%MoM) on account of decreasing machinery imports (down 20.2%MoM) - partially offset by increase in petroleum products (up 5.2%MoM). However, exports remained largely stagnant at US$2.06bn (slightly down 2.4%MoM) gaining support from increase in Food and other manufacturing exports (up 2.3%MoM) despite textile sector exports falling by 10.6%MoM. Remittances provided no relief however, recording at US$1.45bn (-11.5%MoM) vs US$1.64bn in the previous month. Subsequently, 8MFY18 CAD has reached to US$10.83bn (up 50.3%YoY) – the highest ever.

CAD weakness persists for now (US$mn)



Source: SBP & AKD Research

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