

PAKISTAN ECONOMY

PKR stability to depend upon foreign inflows

PKR volatility is once again on the rise after settling briefly as the IMF board approved the release of the USD 1.16Bn tranche to Pakistan. Fears regarding higher imports on the back of flash floods across major agricultural hubs have overtaken as the government estimates a loss in excess of USD 10Bn. That said, on a global level, USD has strengthened against all major currencies primarily triggered by the energy crisis in central Europe, initial signs of an economic slowdown in China amid resurgence of COVID cases and lastly Fed’s stance to maintain a tight monetary policy. Putting it into numbers, the PKR has shed 10.0% FYTD against the USD while the international US Dollar index has strengthened by 5% over the same period. Taking that into account and basing our calculation on REER which stood at 93.2 in July-22 (FY22 average REER: 96.7) when PKR/USD parity peaked at ~240, we estimate the economic value of PKR to be 217.3 against the USD. However, we flag that monetary/fiscal policy stance, run away inflation and upwelling CAD will likely dictate performance of the PKR given the local currency serves as first line of defense to combat external account pressures.

REER indicates PKR appreciation but international USD gains to likely negate the impact: REER in Jul-22 stood at 93.2 when average PKR/USD stood at 219.9. Taking cue from this, PKR should theoretically appreciate by around 7% however, what is interesting to note is that USD global index has gained ~5% FYTD thus largely negating the benefit of REER being below 100. Furthermore, assuming FY22 average REER of 96.7 to sustain for the current fiscal year, we expect PKR to settle at 217.3 against the USD.

Flash floods across major agricultural hubs have increased inflationary concerns: Recent floods caused by above expected monsoon rains have raised major concerns about food inflation and the fact that the country will have to resort to import of essential food items/crops that can escalate the Current Account deficit and put further pressure on the PKR. Though we have seen some contraction in domestic demand following a tight monetary policy stance and fiscal prudence plus the control mechanism put forth by the SBP to contain pilferage of precious foreign currency, high global commodity prices, weak forex reserves position and the government’s precarious fiscal position, containment of PKR will continue to remain a challenging task for the govt. particularly as we go into the election year and will put a lid on growth prospects given economic growth in Pakistan primarily emanates from domestic consumption.

Timing of foreign currency inflows holds fundamental importance: With the release of the IMF’s tranche and commitments from other multilateral/bilateral sources and friendly countries to support Pakistan amidst a balance of payments crisis, we opine the pressure on the local currency will slowly subside as inflows begin. However, timings and quantum of flows will be of fundamental importance and will likely shape PKR’s trajectory moving forward, in our view.

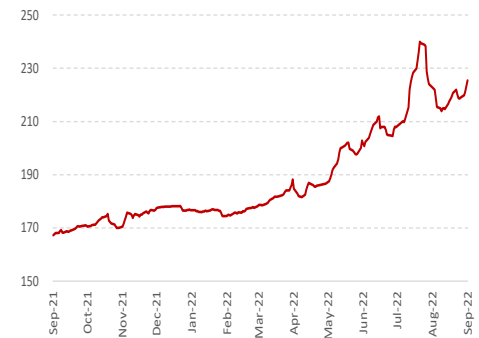
USD Global Index: Strengthening consistently over the past 12 months



Source: Investing.com, BMA Research

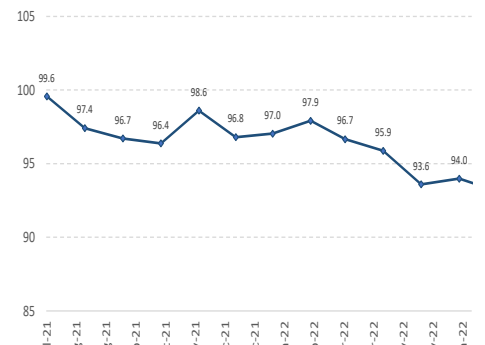
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Chart 1: PKR performance against the USD



Source: SBP, BMA Research

Chart 2: Real Effective Exchange Rate (REER)



Source: SBP, BMA Research

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Buy	>15% expected total return
Hold	10%-15% expected total return
Underperform	<10% expected total return
*Total stock return = capital gain + dividend yield	

Old rating system

Overweight	Total sector return > expected market return
Marketweight	Expected market return
Underweight	Total stock return < expected market return

Valuation Methodology

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- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)