Much Ado About Something
Thoughts on Devaluation Mania

October 3, 2016

Devaluation this week?
Media has gone haywire about devaluation within the next few hours, with analysts and reporters asking the same questions over and over again. Is it really this morning or through Tuesday’s FX auction or Wednesday before the long weekend?

What we know and what we don’t know
Let us put things into perspective before answering these questions that mostly focus on the timing, which in our view comes secondary to how devaluation would happen and how effective it will be.

USD funding pledges were made, but have the funds been transferred?
The government has agreed on several funding packages with Saudi Arabia (USD2-3 billion) and China (USD2 billion), but as far as we know, those funds have not been transferred yet, and had not reflected on NIR. If the funds have been transferred, then no announcements have been made ‘in an attempt’ to surprise the market with devaluation timing.

Does it have to be ‘before’ the IMF annual meetings or ‘around’ that time?
The IMF annual meetings are scheduled for October 7-9, but it is not a must that we devalue ahead of the meetings to prove to the IMF good faith. If devaluation is part of the deal with the IMF, which we know it is, there must have been an agreement between the government and the IMF on the devaluation rate and timing. There has to be a plan. We do not see the IMF request a devaluation ahead of their approvals over concerns the CBE would not devalue post-package approvals. Devaluation would be around the IMF annual meetings and not necessarily before.

The foreign exchange rate is closely tied to the timing
If devaluation did happen this week, or as far as we know, pre-transfer of the pledged financing packages, the rate has to be high enough to blow the parallel market and attract supply of USD into the banking system (EGP12.50+). If the government has an ‘edge-closer’ plan for devaluation, with a rate of EGP11.00-11.50 in mind, a solid buffer of USD liquidity within the banking system is needed to convince market participants that this is a fair market clearance rate. We do know that the IMF agreement entails NIR build-up, which means that the funding packages have to be well-rationed and not utilized in currency defense. We reiterate that our theoretical FV for the EGP/USD rate is around 11.75, and even if overshooting in rate did happen, eventually the rate should come down to these levels.

Reiterate: ‘When’ is not the focus; ‘How’ is our key concern
We reiterate our view. It is not about devaluation or its timing. It is already too late. It is about availability and rate or how devaluation will be executed to blow the black market and attract the FX supply into the banking system, since it is currently circulating through parallel market channels.

EGX to rebound in anticipation of currency movement; Financial institutions and real estate sectors in focus
EGX should start the week on a positive note in anticipation of the currency movement this week. Farther trend will be dictated by the actual devaluation rate versus rate expectations and signs of foreign investor confidence in the system. The market will trade within the 7,900-8,500 range and foreign participation will be a key catalyst to drive another EGX spike. Banks’ margins will continue to benefit from the hike in rates, given the high allocation to treasury investments. If FX shortage is resolved, balance sheet growth will revive. We like CIEB and HDBK. EFG-Hermes and EK Holding are well positioned in their respective space and offer good value/growth dynamics. Real estate developers (TMGH, PHDC, OCDI) will continue to deliver strong results, driven by higher inflation/devaluation concerns. Do not forget land bank owners (MNHD). High infrastructure spending beneficiaries including Orascom Construction and El Sewedy Electric are amongst our picks. ORWE is another industrial player, shielded from FX shortage and a direct beneficiary of export incentivizing programs. SKPC and AMOC revenues are USD-based and driven by tight PE and refining markets, respectively, which creates a decent upside, in addition to potential attractive dividend yield.
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