Philequity Corner
January 8, 2007
By Ignacio B. Gimenez

New highs for the Peso, PSEi

In our October 30 issue entitled "*Newton's Law as Applied to the Stock Market,*" we discussed how physical laws seem to be applicable to economic and financial markets as well. We mentioned that once certain catalysts put economies or markets into a trend, this will hold until a different force would upset or change the trend. And more often, these trends will last for years and even decades as can be seen on what has been happening to China, India, Brazil and most of the ASEAN countries.

While we have lagged these countries, the implementation of crucial reforms in the past two years has become *a tipping point* that put our own economy and financial markets into the same uptrend. Of course, there will be pauses and corrections in between but the general trend has been set.

Projecting ahead of the pack

Against this backdrop, we argue that the economy now enjoys good fundamentals and only drastic changes to these fundamentals could distract the positive momentum we are in. It was on this assumption that we made our forecast on the peso and stock market, and it is also on the basis of current fundamentals that we are keeping our forecast.

In January 2005, we were the first to come up with a call that the peso would hit P50 based on fundamentals when it was then doing P56 to the dollar. This elicited negative reaction from doomsayers but this skepticism has since died down as the peso continued its rise.

Peso at P46

Last November, we came out anew with a projection that the peso will reach P46 to the US dollar by end-2007. This seemed quite a brave call when the peso was hovering around the P50 level and most analysts limited their targets to around P48-49. Back then, our target seemed aggressive and drew negative reactions. But a few weeks later, we noticed that not a few foreign analysts came up with similar targets.

With the peso entering the P48 territory, even government critics would agree that our P46 target is within striking distance. We have repeatedly expounded on the factors that has contributed to the peso's continued strength: the stable and strong OFW remittances, growing dollar earnings from BPOs, strong dollar reserves, strong portfolio investment inflows, and the improved fiscal state of the government. The peso is also riding on the current strength in regional currencies. Our growing trade ties with the booming Chinese economy would also help cushion the impact of any slowdown in the US, a major export market for the Philippines. Potential contribution from mineral exports is still another factor. Our mining sector remains largely untapped despite its huge potential.

$3 billion from Transco sale

But what could propel the peso to the P46 level or beyond are the expected proceeds from government's privatization program. This, we believe, is something that most economists have yet to consider in their projections. For this year, the government should be receiving the $509 million proceeds from its recent sale of its stake in Philippine Telecommunications Investments Corp. Beyond this, the government is expecting at least $3 billion from the winning bidder of the concession to operate the transmission assets of the National Transmission Corporation. To put this in proper perspective, $3 billion (from just one deal) is about 25% of the annual OFW remittances and about 10% of our annual export receipts! The resurgence in the stock market also offers a good opportunity for government to divest from its holdings in listed companies whose market values have appreciated significantly.

The PSEi at 3400.

We also made our brave call in January 2005 for the index to hit 2,600 and this was surpassed by early 4Q06. Again, last November, we also made another brave call (which also raised eyebrows) for the index to hit 3,400 by end-2007. With the PSEi hitting 3,000 last week, our target (which is just 13% away) may not be as farfetched anymore as when we made the call.

Our index is really just catching up with other regional indices which have since hit their record highs. Again, we are just describing the general trend. There will be corrections and dips along the way especially following the so-called Santa Claus rally and window-dressing that took place last month.

Source: Technistock

What could go wrong?

There are perceived risks to our projections though. These are what we consider at the beginning of this article as the forces that could upset or distract the trend we are into.

1. A political scenario where the opposition wins at least one-third of Congress that will trigger the resumption of impeachment proceedings against the president. This scenario would be obtrusive to further reforms. It will also project a destabilized political situation that could turn away investors.

2. Populist tendencies of the new leaders. This is what scares us the most, given that many in the reported opposition slate are the same politicians who have opposed the fiscal reforms that we have implemented. They are the same people who tried to block the implementation of the EVAT which has served as the centerpiece of government's reform program that got us out of a debilitating fiscal crisis. Any pronouncements to revert back to the old VAT rate would be economically devastating.
3. A more pronounced slowdown or an overheating of the US economy. Global markets still take their cue from the US market. Investors are now looking at the US as a Goldilocks economy where they expect a not-too-hot, not-too-cold scenario in terms of macroeconomic fundamentals. Any surprises in either direction could prompt changes in their investment plans and this has repercussions in the global markets as well.

For inquiries and comments, you can email us at gime10000@yahoo.com or research@philequity.net or call Jerome Gonzalez or Ricardo Puig at 634-5038.