Philequity Corner (04/10/06)
By Ignacio B. Gimenez

BSP firmly at the helm

Philequity Fund, Inc. and its fund manager Philequity Mangement, Inc. (where I sit as President and board member) jointly held their second board meeting for the year last week. During the presentation we recalled how our major market calls turned out well, especially with regard to the strengthening of the peso.

We noted in that meeting that as early as the time Philequity came out with its first article for Philippine Star, we were already anticipating a peso appreciation. We said that "*assuming fiscal reform measures are passed, we expect the P/$ rate to continue to appreciate to P50/$1 on the back of increasing investor confidence* ***(Fiscal Reforms Urgent – Philequity Corner, Jan. 31, 2005)***."

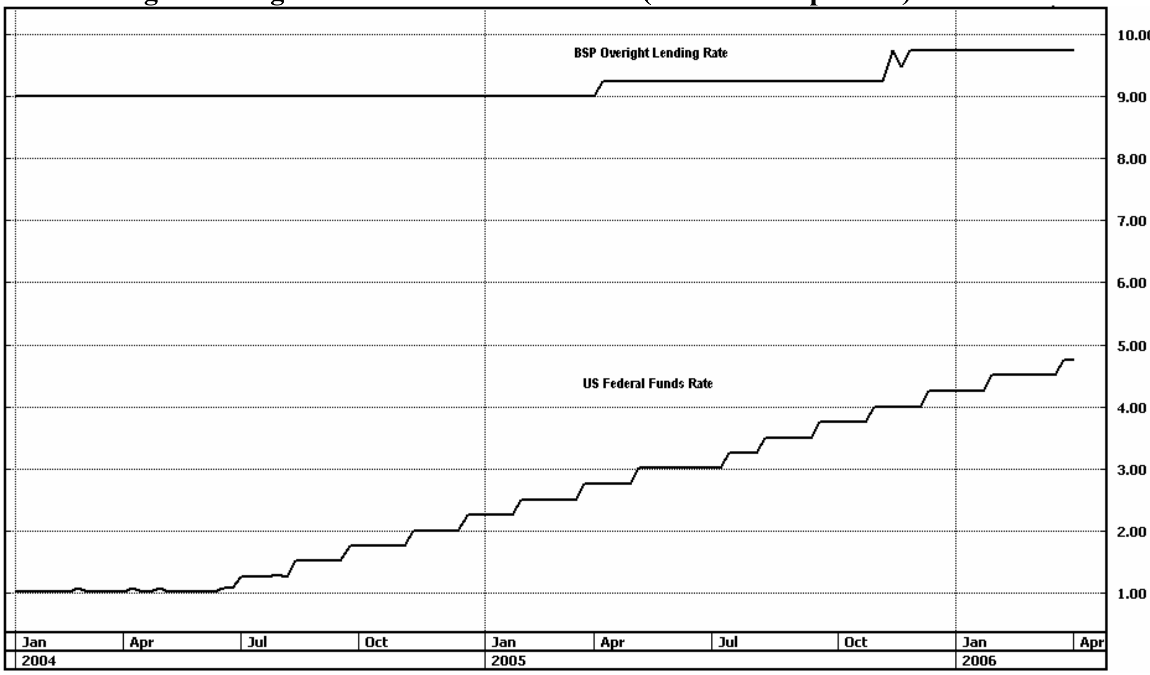
We were the first and perhaps the only one back then with a positive view on the peso when most banks and major houses were calling for peso depreciation towards P57:$1 to P57.50:$1. It took the other houses more than a year before they reversed their call on the peso. And now with the P/$ rate hovering at the 51 level, foreign houses like Goldman Sachs and HSBC have come out with even bolder predictions of P48:$1 and P47.50:$1.

Since we made the call, which also guided us in our investment decisions for our mutual funds, the peso has since appreciated by more than 9 percent against the greenback. We, however, are maintaining our peso target at P50:$1. This is a level that is justified by the country's improving economic fundamentals, compression of Philippine sovereign risk and ample supply of dollars by way of OFW remittance and portfolio investment flows. At the same time, this is also a level that Bangko Sentral ng Pilipinas (BSP) seems comfortable with. With the peso steady, consumer prices stable and interest rates remaining low, the BSP is firmly at the helm.

The BSP, likewise, is addressing the concerns of our exporters. According to a press release by BSP last Friday, the country's gross international reserves (GIR) reached an all-high of $20.844 billion partly due to BSP's foreign exchange operations – which means that the BSP is now beginning to buy US dollars to stem further peso strength. At the current levels, the country's GIR is now able to cover 4.3 months worth of imports and 3.3 times the country's short-term debt based on original maturity. More importantly, this now gives the BSP the flexibility to manage the exchange rates during times of external shocks such as further spikes in oil prices, a collapse in emerging market liquidity, etc.

Indirectly, the BSP is also supporting the US dollar by maintaining its key policy rates despite the continued Fed rate hikes (see chart below). Since 2005, the US Fed has had 10 successive quarter point increases in its Fed Funds rate totaling to 2.5 percent, while the BSP had increased its rates by just .75 percent over the same period. At its meeting last week, the Monetary Board kept overnight borrowing and lending rates at 7.5 percent and 9.75 percent, respectively. They noted that the continued stability of the peso has mitigated the inflationary effects of high oil prices and the one-time increase of prices due to the implementation of RVAT in February.

BSP overnight lending rate vs. US Fed Funds Rate (Jan. 2004 to present)



Source: Technistock

Peso moving in tandem with the region

Currently, the peso is just drifting along with other Asian currencies which are all strengthening against the US dollar. As you can see from the table below, the Indonesian Rupiah has already gained 8.5 percent against the US dollar. The Thai baht has appreciated by 6.8 percent and the Korean won by 5.7 percent. The peso, meanwhile, is up by 3.8 percent against the US dollar which is just the average gain by the Asian currencies represented in the table.

Asian Currencies vs. US Dollar	**%Chg 2004 to 2005**	**Rate as of End-2005**	**Rate as of Apr. 7, 2006**	**% Chg Year-to-date**
Indonesian Rupiah	-6.0%	9822	8983	8.5%
Thai Baht	-5.4%	41.01	38.22	6.8%
Korean Won	2.3%	1011	953.3	5.7%
Philippine Peso	5.7%	53.09	51.08	3.8%
Singapore Dollar	-1.9%	1.6629	1.6072	3.3%
Malaysian Ringgit	0.4%	3.778	3.668	2.9%
Taiwan Dollar	-3.4%	32.835	32.326	1.6%
Indian Rupee	-3.6%	45.025	44.6875	0.7%
Chinese Yuan	2.4%	8.0685	8.0111	0.7%
Average	**-1.0%**			**3.8%**
		Rate as of		**% Chg**
Major Currencies vs. US Dollar		**End-2005**	**Apr. 7, 2006**	**Year-to-date**
Euro	-12.6%	1.1837	1.2093	2.2%
British Pound	-10.2%	1.7228	1.7419	1.1%
Swiss Franc	-15.4%	1.3157	1.3015	1.1%
Japanese Yen	-14.7%	117.68	118.3	-0.5%
Australian Dollar	-6.1%	0.7327	0.7262	-0.9%
Average	**-10.0%**			**1.1%**

Source: Bloomberg

Clearly, the current peso strength is not only influenced by factors internal to the Philippines but by external factors as well. As we've said before, a reversal of the US dollar strength against most currencies last year (which is already happening) is also a catalyst for further peso strength, and so is another mini-revaluation of the Chinese yuan (which is expected to happen anytime soon).

All things being equal or as economists often say *ceteris paribus*, we are maintaining our peso target at P50/$1. However, if the US dollar continues to weaken against regional currencies or if the Chinese Central Bank decides to loosen its grip on the yuan further, we will not be surprised if the peso indeed overshoots our target as some foreign houses have predicted.

For comments and inquiries, you can email us at info@philequity.net or gime10000@yahoo.com.