Philequity Corner (07/25/11)
Yuan revalues after a decade-long peg to the US dollar

By Ignacio B. Gimenez

Yuan revalues

Last week, China let the yuan strengthen by 2.1% to 8.11/US dollar from its decade-long rate of 8.28/US dollar. The new exchange rate system calls for daily adjustments based on a basket of currencies. This is viewed as a way of establishing a framework for gradual appreciation.

Malaysia, likewise, removed its peg on the US dollar in favor of a managed float, allowing its currency to appreciate for the first time in seven years.

With the yuan's peg removed, we expect other Asian currencies including the Philippine peso to gradually strengthen against the US dollar. Initial reactions have in fact been so strong that some central banks had to intervene to cushion the rise. The South Korean won, for example, gained 1.4 per cent to 1,021/US dollar while the Taiwanese dollar rose 1 percent to 31.648/US dollar. Meanwhile, the Thai baht appreciated 1.2 percent to 41.35/US dollar and Singapore dollar rose 1 percent to 1.6611/US dollar – their biggest one-day rise in two years.

Many currency analysts are looking for the Yuan to appreciate to 7.7 to 7.8/US dollar in a year's time.

Effect on the peso

Despite the strong performance of Asian currencies last Friday, the Philippine peso closed weaker by 14 centavos at 55.89/US dollar after reaching an intraday high of 55.25/US dollar. Strong dollar demand from corporations and political concerns ahead of the three-day long weekend and the State of the Nation Address (SONA) were cited as the reasons for the weaker peso trade late afternoon on Friday. In the long run, however, we view the yuan revaluation as positive for the peso.

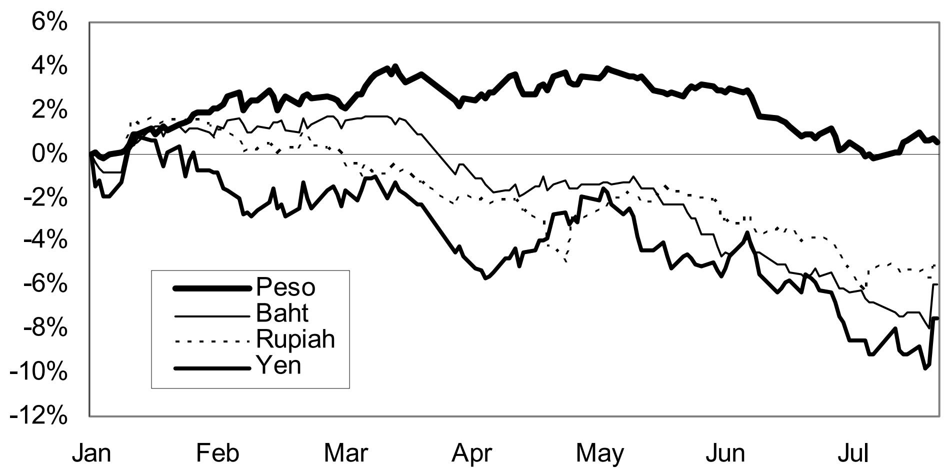
The Philippines tends to benefit from the yuan revaluation since the country enjoys a positive trade surplus with China. A stronger yuan will make our products relatively cheaper and thus boost further exports to China which currently make up 8.9% of total exports. China is the fastest growing market for Philippine exports and is now our 4th largest trading partner. Trade between the two countries has been growing 55% since 2002.

Another possible boost to the Philippines following the yuan revaluation is in tourism. For the first four months of the year, the growth of Chinese tourists coming into the Philippines was the most significant compared to the traditional market which includes U.S., Korean, and Japanese tourists. The Department of Tourism (DOT) has just finished a successful marketing blitz during the 2nd Beijing International Tourism Expo and it expects Chinese tourist arrivals to double to 70,000 this year. With the rising spending power of the Chinese combined with the more vigorous marketing by the DOT, we expect the Philippines to attract more Chinese tourists in the coming years.

Thus, the expected increase in export sales and tourism revenues due to the yuan revaluation both have a long-term positive impact to the Philippine currency.

But more than the yuan revaluation, we think that the progress made with regard to fiscal reforms remains the single most significant factor in the peso's performance. This was the reason why at beginning of the year, we placed our peso target at 52/US dollar following the passage of the Sin Tax bill and the Lateral Attrition bill. The peso even tested the 54/US dollar level several times back in March and April. However, the delays in passing the EVAT bill compounded by the political noise which started in May with the jueteng and tape scandals led the peso to follow the regional downward trend.

Peso performance vs. other regional currencies (Jan 1 to July 22)

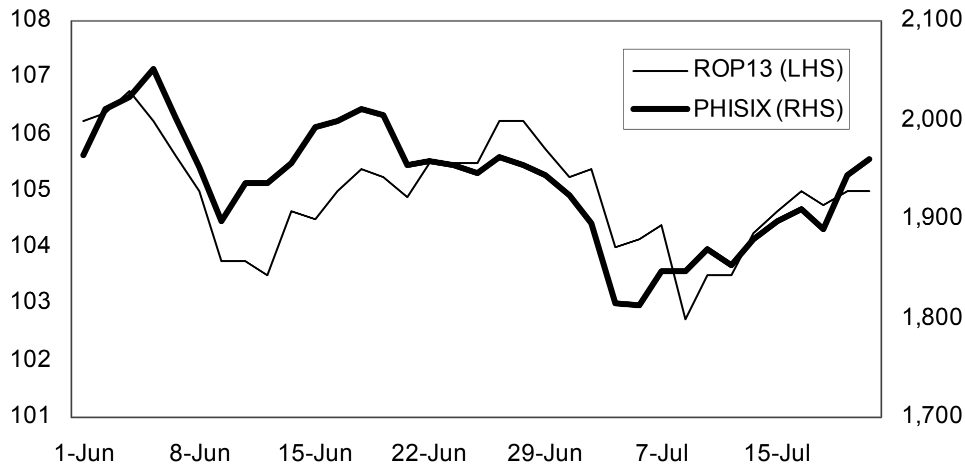


Nonetheless, the peso continues to outperform other currencies this year and despite the seeming peso volatility it is still up 0.5% year-to-date against the US dollar. What this means is that despite the TRO on the EVAT, the progress made on the fiscal front since the 2nd half of 2004 has effectively caused the peso to trade at a premium vs. other currencies since the start of the year.

Restoring credence to fiscal reforms

The market responded positively to the swift replacement of key economic managers. After falling to as low as 1,805.49 (a day after the TRO on EVAT was announced), the Philippine Composite Index (PHISIX) has since rebounded by 8.3% to close at 1,954.40 last Friday. Likewise, ROPs rallied by at least 200 basis points during the same period.

PHISIX & ROP '13 (June 1 to July 21)



The replacement of competent and principled economic managers (who resigned a few weeks back) with equally competent and principled new economic team reinstates confidence and credibility to the government-initiated fiscal road map.

As previously mentioned, I personally know Finance Secretary Gary Teves who was a director of Philequity Fund for six years. I also had a chance to work with Trade Secretary Peter Favila as part of the Philippine Stock Exchange's Market Integrity Board. Both men are truly fine additions to the government's economic team.

Incidentally, the government is already making great strides with regard to controlling the fiscal deficit. For the 1st half of 2005, deficit amounted to P67.5bn or 32% lower than P98.65bn target. Revenue collection for the same period is already up 12% to P384.4bn. This should further be improved once the EVAT bill is implemented.

In the long-run, whether President Arroyo stays on in office or Vice President Noli de Castro takes over after an impeachment or resignation, what fund managers look at are the macro numbers. As long as fiscal numbers keep on improving, the country will be alright as shown by the recovery of stock prices and the improvement of ROPs and the peso. And as long as the constitutional process is followed and there's no extra-constitutional methods used - that will make the Philippines the pariah of the political world - we believe that fund managers like us in Philequity will always go back to macroeconomic fundamentals.

The government should concentrate on continuing the fiscal reforms that they have started. This will help the government reduce the budget deficit which in turn will strengthen the ROPs and the peso. The end result of fiscal reforms will be an improvement of the economy and the stabilization of the political situation.

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