

PHILEQUITY CORNER (10/31/05)

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PHILIPPINE PESO ... HEADING TOWARDS 54 ?

Our article last week titled “*Philippine Peso ... The strongest currency in Asia (Oct 24, 2005)*” may have been prophetic. While we clarified that the peso was the strongest except for the yuan - which was revalued after a decade-long peg with the US dollar – the peso is now indeed the strongest in Asia as you will see in the table below.

A lot of people were surprised and skeptical on our data since we only showed the current exchange rates and their percentage changes. In addition, we may have been the first to point this out to the public.

To make it clearer this time, we are presenting a table of the various currencies and their exchange rates relative to the US dollar as of end-2004 (for reference) and the rates as of last Friday (Oct. 28, 2005). For those asking what “%Chg YTD” means, it stands for “percentage change year-to-date.” For example, the Philippine peso which closed at 54.94 last Friday against the US dollar, has appreciated by 2.4 percent from its end-2004 price of 56.28. Using the same computation, the Euro has fallen by 12.3 percent and the Yen has declined by 11.3 percent against the US dollar since the start of the year.

Currency Rankings	Price End-2004	28-Oct	%Chg YTD
Major Currencies vs. US Dollar			
Australian Dollar	0.7803	0.7492	-4.2%
British Pound	1.9181	1.7735	-8.2%
Swiss Franc	1.1403	1.2803	-10.9%
Japanese Yen	102.63	115.67	-11.3%
Euro	1.3551	1.2069	-12.3%
Asian Currencies vs. US Dollar			
Philippine Peso	56.28	54.94	+2.4%
Chinese Yuan	8.2676	8.084	+2.3%
Malaysian Ringgit	3.795	3.7747	+0.5%
Korean Won	1035.1	1043.3	-0.8%
Singapore Dollar	1.6317	1.6902	-3.5%
Indian Rupee	43.46	45.0825	-3.6%
Thai Baht	38.92	40.8	-4.6%
Taiwan Dollar	31.74	33.603	-5.5%
Indonesian Rupiah	9270	10040	-7.7%

Source: Bloomberg, BSP

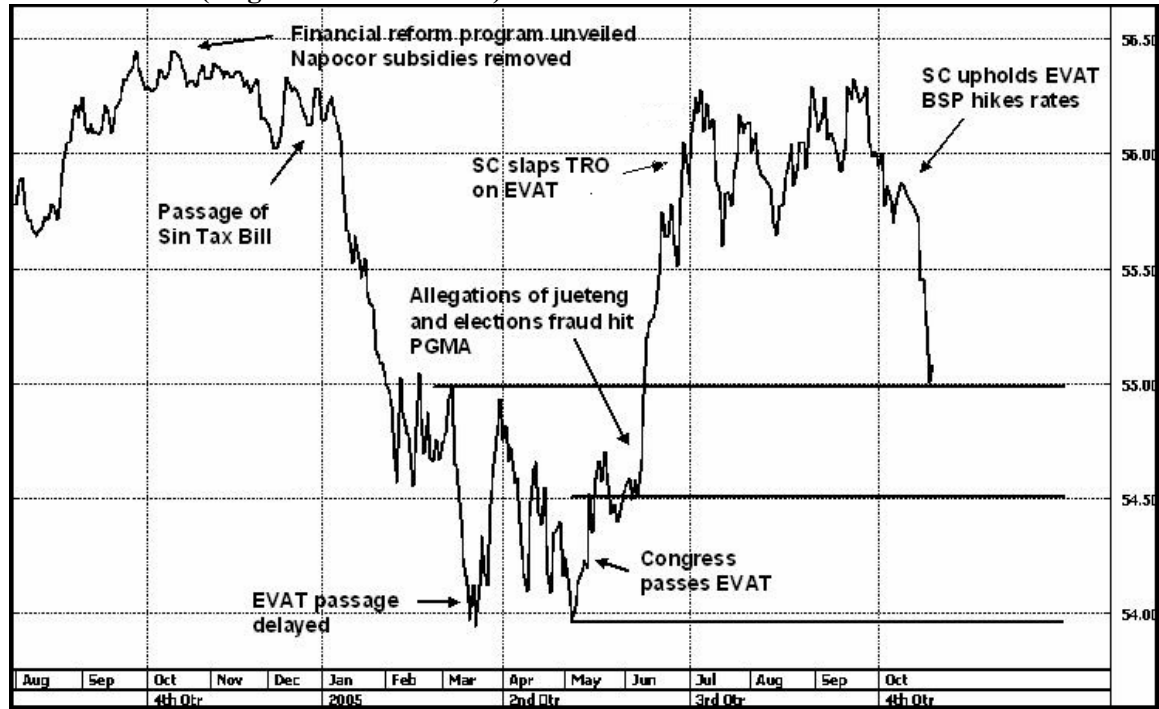
For those who missed our article last week, we reiterate the major reasons why the peso is strengthening:

- 1) The Supreme Court’s final decision to uphold the EVAT

- 2) Strong capital accounts driven by \$2.02bn in net foreign portfolio investments for the period Jan-Sept 2005
- 3) Record OFW remittances which could reach \$10.7bn by year end, plus an additional 30% to 40% for those not captured by the banking system
- 4) The announcement by the DOF of a balanced budget by 2008
- 5) The recent rate hike by the BSP which is in tandem with the US Fed moves

Below, we show how the US\$/Peso rate moved during the past year and the accompanying events that have transpired to affect it.

US\$/Peso Rate (Aug. 2004 to Oct. 2005)



Source: Technistock

As you can see from the chart, the peso flirted several times to break its all-time low of 56.50 against the US dollar during heights of political crisis. However, economic factors and the implementation of fiscal reforms have outweighed the political negatives. *Even with the record OFW remittances, the peso would not have appreciated if the fiscal reform program was not implemented.* At this point, investors have filtered out the political noise and have focused on the fiscal numbers.

We see the peso improving further. The catalysts are the following:

- 1) Additional interest rate increases by the BSP
- 2) Record OFW remittances this December
- 3) Increase in VAT rate from 10% to 12% by January
- 4) Possible upgrade in the country's credit rating by Moody's, Fitch and S&P
- 5) Reversal of the current US dollar strength against major currencies
- 6) Another mini-revaluation of the Chinese yuan

- 7) Successful privatization of government assets such as the NPC power plants and transmission assets, PNOC-EDC, San Miguel Corp & Meralco shares, etc.
- 8) Big ticket IPOs, i.e. First Gen, GMA 7

Barring unforeseen events like the resumption of exemptions on fuel products or a deferral of the 10% to 12% increase in VAT – which would be negative and seen as lack of political will for the government – the peso should continue to strengthen.

There should be initial resistance for the US\$/Peso at the 55 level. If broken, the next resistance is pegged at 54.50. Ultimately, we see the peso testing its highs at the 53.80 to 54 range which was reached in March and May 2005.

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