

## PHILEQUITY CORNER (10/15/2007)

By VALENTINO SY

### Peso at 38 by 2008

Despite the political babble increasing once more, the peso remains one of the strongest currencies in Asia and the rest of the world. The peso closed at 44.05 against the US dollar last Friday, its highest level in seven years. This is evidence of growing investor confidence in the Philippines and the increasing insulation of the economy from political noise.

Year-to-date, the peso has appreciated 10.2 percent against the greenback and we expect further strengthening due to the following reasons:

- 1) Continued general weakness of the US dollar
- 2) Current account and balance of payments surplus
- 3) Growing BPO revenues
- 4) Record OFW remittances this Christmas season
- 5) Privatization of government assets

	End-2006	Oct. 12	%Chg year-to-date
<b>Major Currencies vs. US Dollar</b>			
Canadian Dollar	1.1664	0.9723	16.6%
Australian Dollar	0.7897	0.9046	14.5%
Euro	1.3203	1.4178	7.4%
British Pound	1.9637	2.0360	3.7%
Swiss Franc	1.2197	1.1846	2.9%
Japanese Yen	118.9300	117.6100	1.1%
<b>Average</b>			<b>7.7%</b>
<b>Asian Currencies vs. US Dollar</b>			
Indian Rupee	44.2800	39.3250	11.2%
Thai Baht	35.2890	31.4400	10.9%
Philippine Peso	49.0300	44.0500	10.2%
Malaysian Ringgit	3.5310	3.3690	4.6%
Singapore Dollar	1.5320	1.4634	4.5%
Chinese Yuan	7.8175	7.5560	3.3%
Korean Won	917.3700	917.7000	0.0%
Taiwan Dollar	32.5250	32.5880	-0.2%
Indonesian Rupiah	8,966.4000	9,068.0000	-1.1%
<b>Average</b>			<b>4.8%</b>

Source: Bloomberg

Ever since the US Fed shifted its policy from a tightening to an easing stance last August, the pace of US dollar weakening increased. Resource-based currencies like the Canadian Dollar and the Australian Dollar have strongly appreciated and are up 16.6 percent and 14.5 percent year-to-date against the greenback, respectively. Meanwhile, the Euro is already up 7.4 percent this year. In Asia, the Indian Rupee, followed by the Thai Baht and the Philippine peso, led the gainers against the US dollar.

The strong balance of payments, current accounts and capital accounts is another major reason for the peso appreciation. The country's balance of payments position amounted to \$3.2 billion in the 1<sup>st</sup> half of 2007, up by 56.8 percent from \$2 billion in 1<sup>st</sup> half of 2006.

The current accounts surplus stood at \$3.7 billion in the 1st half of 2007, up by 42 percent year-on-year. Net transfers with strong remittances from our OFWs rose 13.4 percent to \$6.6 billion over the same period.

Meanwhile, the flow of investments into the Philippines has continued to improve. Net foreign direct investments (FDI) posted a substantial net inflow of \$419 million in July, bringing the net FDI to \$1.6 billion for the first 7 months of 2007, up 70 percent from year ago levels.

Besides FDI, portfolio inflows in equities and bonds have also supported the growth of the capital accounts. For January to September 2007 net inflows amounted to \$3.4 billion or 2.4 times the \$1.4 billion net inflow generated in a comparable period last year.

Another source of dollar revenues is the burgeoning business process outsourcing (BPO) industry which is expected to grow three-fold to \$12.1 billion by 2010 from end-2006 level of \$3.45 billion. In addition, the resurgent mining industry is expected to contribute \$15 billion by 2010 from end-2006 level of \$1.3 billion.

#### **The peso will remain strong**

Going forward, we expect the strong peso drivers in the first half to continue through the year's end and towards 2008. Other catalysts include the successful privatization of other government assets (remaining PNOC-EDC stake, NPC power plants, transmission assets, San Miguel Corp. and Meralco shares, etc.) and the long-awaited credit upgrade.

Already, the BSP is at the losing end trying to slow the peso's rise while foreign reserves have risen to almost \$31 billion as a result of the intervention. While this strategy may work in the short-run, this is very costly to the BSP which has reported losses of over \$713 million for the 1<sup>st</sup> half of 2007.

In the long-term, however, we believe that the virtuous cycle of debt reduction, accelerating economic growth, plus strong OFW remittances, FDI and portfolio inflows will maintain upward pressure on the peso. **Thus, we are now looking at an end-2007 exchange rate target of P43/US\$1 and end-2008 target of P38/US\$1.**

### Peso-US Dollar Rate (1997 to present)



Source: Technistock

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