

**Philequity Corner (October 12, 2009)**  
**By Valentino Sy**

**Peso the strongest currency since Ondoy, a paradox**

Amidst the floods, landslides and the calamities that have befallen the country, the peso has strengthened. People thought that the peso would go down because of the calamity, but it has actually gotten stronger. In fact, the peso was one of the strongest currencies after Ondoy, gaining 4.2 percent in two weeks (refer to table).

<b>Major Currencies vs. US Dollar</b>	<b>Current Price</b>	<b>%Chg YTD</b>	<b>%Chg since Ondoy</b>
Australian Dollar	0.9038	30.9%	3.8%
Canadian Dollar	1.0422	14.8%	3.4%
British Pound	1.5844	9.4%	-2.4%
Euro	1.4732	4.5%	0.0%
Swiss Franc	1.0314	2.3%	-0.5%
Japanese Yen	89.785	0.7%	1.4%
<b>Average</b>		<b>10.4%</b>	<b>1.0%</b>
<b>Asian Currencies vs US Dollar</b>			
Indonesian Rupiah	9457.5	15.0%	2.1%
Korean Won	1164.375	8.0%	2.7%
Indian Rupee	46.417	6.6%	4.0%
Thai Baht	33.325	5.6%	1.1%
Singapore Dollar	1.3959	3.2%	1.4%
Malaysian Ringgit	3.3982	2.6%	2.1%
Philippine Peso	46.46	2.2%	4.2%
Taiwan Dollar	32.233	1.8%	0.5%
Chinese Yuan	6.8255	0.4%	0.2%
<b>Average</b>		<b>5.1%</b>	<b>2.0%</b>

*Source: Bloomberg*

The recent surge in the peso is probably a result of the underperformance of the Philippine peso against other currencies before the calamities, the sale of \$261 million worth of Metro Pacific Investment Co. (MPIC) shares and OFW remittances surging sharply after Ondoy. The latter can be credited to the overwhelming support from Filipinos all over the world – the “bayanihan spirit” that we have been talking about in our two previous articles. Filipinos living abroad have been sending record amounts of dollars to relatives hit by the flood. Donations from Filipinos abroad have also increased for typhoon relief.

**Strength of the Peso**

The strength of the peso is due to the positive domestic factors enumerated below:

- 1) Record dollar reserves.** The country’s gross international reserves (GIR) reached a record \$42.3 billion as of end-September 2009. This amount is equivalent to 7.8 times import cover, the highest level ever recorded.
- 2) Revaluation of gold reserves.** Contributing to higher GIR is the revaluation gains from BSP’s gold holdings given the increase in the price of gold. Gold holdings as of end-September 2009 amount to \$5 billion, up 16.3 percent from \$4.3 billion as of end-December 2008.

- 3) **Remittances beat estimates.** At the start of the year, most economists were expecting remittances to be negative to flat. Latest figures, however, show remittances grew 9 percent in July, while January to July remittances are up 3.8 percent. This defies earlier projections that the global economic crisis would dampen the ability of overseas Filipinos to send money back to the Philippines. We even expect remittances to improve in the following months (especially after typhoon Ondoy and Pepeng) as support from relatives and donations from Filipinos come in.
- 4) **Upgrades on the Philippines.** Positive economic news is bullish for the peso. Recently, the Philippines received upgrades from IMF which adjusted GDP growth forecast to 1 percent from an earlier projection of 1 percent contraction. Its forecast on OFW remittances was revised to 4 percent growth from an earlier estimate of 4 percent contraction. Meanwhile, the current account surplus was revised higher to 3.2 percent of GDP.
- 5) **Positive portfolio inflows.** In 2008, the Philippines lost a net of \$1.8 billion in outflows as funds pulled out of Philippine equities, bonds and bank deposits. Portfolio inflows have started to pick up in recent months which included the \$261 million share offer of Metro Pacific Investment Corp. (MPIC) a couple of weeks ago. Positive portfolio inflows means a fresh supply of dollars.
- 6) **Maturing of the peso corporate bond market.** According to the BSP, P198.3 billion worth of corporate bonds were issued from January to July 2009. This equivalent to a 165 percent increase from the P74.8 billion worth of corporate bonds registered in the same period last year. The widening and maturing of the peso corporate bond market means that investors are now more willing to invest thru the capital market. This also means that more dollars are being converted to peso as people are finding peso-denominated corporate bonds as an alternative to the usual dollar savings deposits.
- 7) **Peso enjoys a hefty yield differential.** The relatively higher interest rates on peso deposits vis-à-vis dollar deposits is another reason why more people are converting their dollars to pesos.
- 8) **Current account surplus.** Lastly, our current account is in surplus and is expected to improve to 4.6 percent of GDP this year.

The only concern we have is the budget deficit which is expected to reach Php 250 billion in this year or 3.2 percent of GDP. Most other countries have the same problem because of the pump-priming efforts to combat the global recession. Nonetheless, this problem should be addressed.

#### **Weakness of the US dollar**

The peso has likewise benefited from the general weakness of the US dollar, the reasons for which are cited below:

- 1) **Short US dollar carry trade.** Due to the quantitative easing policy of the Fed, US interest rates are near zero. This becomes a huge incentive for investors to borrow against the US dollar and buy into equities, commodities, and other currencies to profit from the higher yield. This is in stark contrast with what happened in 2008 (during the aftermath of the US sub-prime and credit crises) when there was a flight to the US dollar after a massive sell-off on most other assets.

- 2) **Unfeasibly large budget deficit and huge trade deficit.** The huge US budget deficit has fuelled concerns that the US may not meet its obligations in the future. The deficit is expected to hit \$1.4 trillion in 2009 or \$950 billion higher than the shortfall registered last year. And while the trade deficit has significantly improved, it is still huge and is expected to reach \$357 billion in 2009.
- 3) **Quantitative easing increases supply of US dollars.** The Fed's policy of quantitative easing has pumped a record amount of liquidity in the financial system to combat deflation. However, the consequence is to devalue the US dollar as we see today when the supply of US dollars is now far greater than the demand.
- 4) **Secret plot to replace the US dollar?** Because of the massive printing of US dollars by the Fed, there are now rumors circulating that several countries are plotting to end the decades-old practice of buying and selling oil in dollars. According to UK paper, the Independent, finance ministers and central bank governors of China, Russia, Brazil, Japan and Arab oil producers like Saudi Arabia, Abu Dhabi, Kuwait and Qatar met secretly to find ways to replace the US dollar with a basket of currencies.
- 5) **Buying of gold, oil and other commodities as hedge against the falling dollar.** As interest rates fall to near zero in the US, the liquidity created is driving up commodity prices. Investors are turning to commodities like gold and oil as a hedge against the depreciating US dollar and future inflation. So far, gold has risen 18.7 percent this year, while oil has gained 62 percent. Meanwhile, the basket of commodities represented by the Reuters/Jeffries CRB index is up 14.4 percent year-to-date.
- 6) **ETF markets make it easy for investors to buy physical gold or crude oil.** The weak dollar and the high prices of gold and oil have increased the demand for gold and oil ETFs which can be self-reinforcing. The higher demand for these ETFs may push the price of their commodities further, which in turn increases the attractiveness of the ETFs. At the same time, this dampens the demand for the US dollar. The SPDR Gold Shares (symbol: GLD) is now the second biggest ETF (next to SPY) with \$35.43 billion in assets. GLD has more gold than the central banks of Japan (\$28 billion), Russia (\$20.8 billion), and the ECB (\$18.4 billion), Taiwan (\$15.5 billion), and India (\$13.2 billion).

#### **Peso at 46 or better by year end**

Most houses made the wrong call on the peso at the start of the year, projecting it to depreciate 52 to 53 by year-end. They cited the huge budget deficit and a flat growth in remittances as the major hindrances for the peso. In contrast, we in Philequity said that we agree with Bangko Sentral ng Pilipinas' (BSP) more credible target of 46 to 49 (see our article, *Peso to Regain Strength* in the June 1, 2009 issue of **The Philippine Star**).

In fact, we even said that "*we would not be surprised if the peso overshoots the BSP's low-end exchange rate target of 46 and improves further.*" We continue to maintain that position. And given the factors mentioned above, and the fact that the peso has lagged the appreciation of other currencies year-to-date, there is a strong chance that the peso will end the year at the low-end of the BSP's forecast, if not better.