

Philequity Corner (March 1, 2010)
By Valentino Sy

The Stable Philippine Peso

Despite problems in the Eurozone, the weakness of the Euro and the general recovery in the US dollar, the Philippine peso remains one of the most stable currencies in the world. Year-to-date the peso barely moved at 46.13 against the US dollar, slightly weaker by -0.07 percent.

Other Asian currencies, likewise, performed relatively well against the US dollar (see table). In fact, the currencies of our ASEAN neighbors such as Thailand, Indonesia and Malaysia have appreciated this year against the greenback.

	Current Price	YTD Chg (%)
Philippine Peso	46.1300	-0.07
Major Currencies		
Japanese Yen	88.9670	4.51
Australian Dollar	0.8954	-0.23
Canadian Dollar	1.0518	-0.27
Swiss Franc	1.0735	-3.51
Euro	1.3632	-4.85
British Pound	1.5238	-5.77
European Currencies		
Russian Ruble	29.9480	-0.19
Czech Koruna	19.0710	-4.09
Slovakia Koruna	22.1060	-5.69
Danish Krone	5.4608	-5.70
Hungarian Forint	197.9500	-6.16
Turkish Lira	1.5445	-35.07
Latin American Currencies		
Mexican Peso	12.7720	2.07
Chilean Peso	524.5500	-5.28
Brazil Real	1.8076	-5.33
Venezuelan Bolivar	4.2946	-50.00
Asian Currencies		
Thai Baht	33.0600	4.22
Indonesian Rupiah	9,342.5000	1.47
Malaysian Ringgit	3.4028	1.14
Indian Rupee	46.0850	0.96
Chinese Yuan	6.8260	0.02
Philippine Peso	46.1300	-0.07
Singapore Dollar	1.4064	-0.10
South Korean Won	1,159.8500	-0.15
Taiwan Dollar	32.0720	-0.25

Source: Bloomberg

In contrast, the Euro has depreciated by -4.85 percent against the US dollar year-to-date. Meanwhile, the British pound and the Swiss Franc are weaker by -5.77 percent and -3.51 percent,

respectively. The worst performers are the Venezuelan Bolivar which devalued by -50 percent and the Turkish Lira which weakened by -35 percent.

Peso is holding despite Euro weakness

In our article last week (see *The "IPIS" Theory*), we mentioned that we are looking closely at the Euro which is weakening because of the debt problems in the Eurozone. We said the US dollar generally looks bullish. Therefore the peso would probably weaken to 48 in the middle part of the year before rebounding back towards the 45 to 46 levels by year-end when the bulk of the remittance money comes in.

Note, however, that despite the weakness of the Euro, the peso and other Asian currencies appear to be holding. If the Euro finds support at 1.28 and turns, then Asian currencies may actually appreciate and the peso may go back to the 45 levels much earlier than we expect.

Reasons for the peso strength

We believe that the peso will remain relatively strong despite the volatility emanating from the Eurozone because of the following reasons:

1) Record OFW remittances – Remittances in December 2009 surged 11.4 percent to a new monthly high of \$1.567 billion. This surpassed the previous record of \$1.531 billion registered in October 2009 (during the aftermath of Typhoon Ondoy). For the whole 2009, remittances increased 5.4 percent to a record high of \$17.348 billion. This exceeded the 4 percent target set by the BSP for the year.

2) Increased portfolio inflows to the stock market – There has also been a substantial increase in portfolio inflows to the stock market in recent weeks. Net foreign buying registered by the PSE in February amounted to Php3 billion. This figure is significantly larger than the Php1.28 billion net inflow registered in January and the monthly average of Php1.24 billion in 2009.

3) Creation of a Philippine Exchange Traded Fund (ETF) – Another reason for the increased foreign buying in Philippine stocks is the possible creation of a Philippine ETF. ETF.com reported that iShares recently filed with the SEC an iShares MSCI Philippines Investable Market Index Fund.

This may be the reason why big caps have staged a strong rebound despite the concerns on Greece's debt and China's monetary tightening. It now appears that the 2,800 support for the PSE index which we mentioned in a previous article has held (see *Bulaga!* in the January 25, 2010 issue of **The Philippine Star**).

4) Resumption of export growth – Last December, Philippine exports rose the fastest in four years. Exports of electronics, which make up more than half of our exports, expanded 40.9 percent. Overall, exports grew almost 25 percent as the global economy recovered.

Possible risks to our forecast

At the same time, we have to watch out for certain risks that may affect our "stable" peso forecast. We are concerned about the following:

1) Widening of fiscal deficit – Officially, the government has set a budget deficit of Php293 billion for 2010. We just have to watch out for our fiscal deficit or suffer the same fate as those in the Eurozone. Selling assets are just stop-gap measures.

2) Steep rise in commodity prices – The peso will also be negatively affected if the price of oil goes above \$100 per barrel again or rough rice goes back to record price levels.

3) Failure of elections – Lastly, we cannot discount a failure of elections in May or an election result without a clear-cut winner.

In defense of the BSP

Last week, members of the Philippine Exporters Confederation, Inc. (Philexport) passed a resolution formally asking the BSP “to start re-thinking its exchange rate policy that has equated to a strong peso.” They said that it is “hurting domestic industries, overseas Filipino workers and exports.”

We just like to point out that, contrary to their allegation, the BSP has in fact defended the dollar against a strong peso several times when it broke the 46 level in the past. If the BSP did not intervene back then, the peso would have broken even the 45 level.

Currently, the BSP adheres to a market-oriented foreign exchange policy, but at the same time, it ensures orderly conditions in the market. We believe the BSP will intervene if the peso aggressively strengthens to 45, just like they did back in the past. And they will also be there to defend the peso if it depreciates to 48 to 49.

Peso may reach 43

Despite the risks mentioned above, there is a good chance that the peso may breach the BSP’s target range of 45 to 49. The possible catalysts for the peso to go beyond the BSP band are the following:

- 1) The election results in a widely accepted new government.
- 2) A new government that will take the bull by its horns by addressing the fiscal deficit directly (e.g. the standardization of sin taxes, scrapping of superfluous tax incentives, curtailment of smuggling, a rise in tax collections and an increase in VAT from 12 percent to 15 percent).
- 3) A resumption of the bull trend in emerging markets, particularly Asia, which will be positive for Asian currencies.
- 4) A breakout in the PSE Index above the previous high of 3,133.53 and the resumption of the bullish trend in the Philippine stock market.
- 5) A sustainable recovery in exports, a remarkable increase in tourism, and a dramatic rise in remittances.

If these catalysts materialize, we may have to change our forecast for the peso. If the PSE index goes to 3,300 and the S&P 500 goes to 1,250, that may mean that the peso will move towards the 43 level.

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