Philequity Corner (October 11, 2010)
By Valentino Sy

Currency Wars

Recent weeks have seen much talk about the potential "currency war" among nations such as the US, UK, Japan, China, Brazil, and Australia to name a few. Also known as "competitive devaluation," this means that these countries are seeking the devaluation of their currencies in order to promote exports and help their domestic economies. This in turn forces other countries to respond with similar efforts.

Beggar Thy Neighbor

In economics, a currency war or competitive devaluation is regarded as a "beggar thy neighbor" approach which seeks to benefit one country at the expense of others. Translated into Tagalog, literally the phrase means "gawing pulubi ang iyong kapitbahay."

Lowering the value of the home currency will raise the price of imports while reducing the price of exports. Therefore, it spurs export production and reduces imports at the expense of the neighbor (or trading partner). As a result, more production will occur domestically, thereby raising employment and GDP.

FED's QE2

The US Fed fired the opening salvo after it hinted last month that it is planning Quantitative Easing Part II (QE2). In their FOMC statement in September, the Fed noted that it is willing "to provide additional accommodation if needed to support the economic recovery." This opens the door for another round of quantitative easing, possibly by November.

US Dollar Falls

One of the consequences of the planned QE2 by the Fed has been the sharp weakening of the US dollar. Starting September 1st, the US dollar trade-weighted index has already lost 7.2%. Year-to-date, the Japanese yen is up 13.1 percent against the US dollar, while the Aussie dollar is up 12.7 percent against the greenback over the same period.

Among Asian currencies, the ASEAN currencies have appreciated the most against the US dollar year-to-date with the ringgit, baht and rupiah appreciating by more than 10 percent each. The Philippine peso, meanwhile, has gained 9.2 percent against the US dollar over the same period.

Major Currencies vs. US dollar	YTD Chg(%)
Japanese Yen	13.12
Australian Dollar	12.74
Swiss Franc	7.38
New Zealand Dollar	5.95
Canadian Dollar	4.12
British Pound	-1.35
Euro	-2.34

Asian Currencies vs. US dollar	YTD Chg(%)
Malaysian Ringgit	12.3
Thai Baht	11.33
Indonesian Rupiah	10.86
Philippine Peso	9.23
Indian Rupee	9.16
Singapore Dollar	7.66
South Korean Won	5.11
Taiwanese Dollar	3.85
Chinese Yuan	1.12
Hong Kong Dollar	0.11

Source: Bloomberg (as of October 8, 2010 5:00pm)

Other Central Banks Retaliate

As the Fed prepares to launch its QE2 offensive, other central banks retaliate with similar measures.

- The Bank of Japan (BOJ) announced last week that it would further cut overnight call rates to a range of zero to 0.1 percent (from 0.1 percent). The BOJ also announced to buy US$60 billion worth of financial assets which includes government and corporate bonds, commercial papers, asset-backed securities and even ETFs and J-REITs. The BOJ also stepped in last month to weaken the yen with its biggest daily intervention on record, buying more than US$23 billion in the open market.

- Brazil's economy which relies heavily on exports is suffering as its currency, the real, has gained 25 percent over the US dollar since the beginning of last year. Central bank intervention has already reached US$1 billion per day as the real hit a 9-month high of R1.70:$1. Brazil also increased the tax on foreigners investing in the country. In addition to intervening in the currency markets, Brazil has implemented a tax on foreigners investing in the country. It had already implemented this policy since October 2009 but now the tax on investment in fixed income securities and stocks has been doubled from 2 percent to 4 percent of the nominal value.

- Despite the strong Australian labor market, the Reserve Bank of Australia (RBA) maintained interest rates especially after the Aussie dollar appreciated by more than 10 percent in just over a month. By deferring the rate increase, RBA is hoping it can stem a potentially more aggressive appreciation of the Aussie dollar.

- The Fed's statement also raised the expectations of more QE in the UK. This was given a boost by the recent minutes from BOE's Monetary Policy Committee (MPC) meeting in September which indicated that the probability of further QE might become necessary.

- China, of course, has been increasingly accused by the West of artificially depressing their currency, the yuan. This has resulted in a massive trade imbalance in favor of China over the West.

- Other countries such as South Korea, Thailand and Singapore have been consistently intervening to stem the tide of strength of their currencies.

Peso end-2010 target upgraded to 43

Even the Bangko Sentral ng Pilipinas (BSP) has been trying to hold back the strength of the peso. In fact, we have mentioned in a previous article that the BSP heavily defended that Php44:$1 area by buying dollars at that level (see *Peso Going to 40*, August 23, 2010). If not for their intervention, the peso would have breached that level earlier.

When we came out with our forecast for the peso several months ago (see *Philippine Peso: Gaining Strength Against Major Currencies*, April 12, 2010), many found it too optimistic for the peso. Given the recent developments, particularly the massive money printing that will be undertaken by the major central banks, it now looks conservative. We are upgrading our peso target from 44 to 43 by end-2010. Meanwhile, we maintain our peso target of 42 by end-2011 and 40 by end-2012.

Lessons from History

During the 1997 Asian Financial Crisis, currencies in the ASEAN region also dropped due to the loss of confidence throughout the region. The peso, for example, fell from 26 pesos per dollar at the start of the crisis to 38 pesos as of mid-1999, and to 56 pesos in 2001. Other ASEAN currencies also lost a lot, some depreciating by 100% in order to correct their huge trade and balance of payments imbalances. Right now, the US is trying to avert a recession. Is the reverse happening to the US dollar versus the ASEAN currencies?

Similarly, in 1985, the US was in the midst of a recession. Known as the Plaza Accord, there was an agreement that year between the governments of France, West Germany, Japan, the US and the UK to depreciate the US dollar in relation to the Japanese yen and the German deutsche mark by intervening in the currency markets. From 1985 to 1987, the value of the US dollar depreciated by 51 percent versus the yen and lost about 30 percent against the mark. Is there something similar happening now to get the US out of recession?

Cebu Pacific IPO priced at Php125 per share

The final offer price for the Cebu Pacific IPO is Php125 per share. The offering period will run from October 12 to 19. Those interested to avail can contact Wealth Securities, Inc. at 689-8000/634-5038 or email at office@wealthsec.com / sales@wealthsec.com. Look for Kit, Marlex or Edwin.

For comments and inquiries, you can email us at info@philequity.net. You can also view our archived articles at www.philequity.net or www.wealthsec.com.