Philequity Corner (October 10, 2011)
By Valentino Sy

Why the US Dollar is strong & why the Peso softened?

We have been asked by our investors why the US dollar is strong lately and why the peso softened. Just when almost everyone has given up on the US dollar, it recorded its strongest one-month rally since 2008 (up 5.6 percent in September alone). We believe that a variety of fundamental reasons are supportive of the US dollar over the short term:

1) **EU debt crisis** – The euro which makes up 60 percent of the US dollar index collapsed last month on the weight of the escalating EU sovereign debt crisis. Despite the German vote for a stronger EFSF bailout fund two weeks ago, the Euro plunged lower, closing at 133.91 last Friday. The troika of the European Commission, the ECB and the IMF has so far failed to alleviate concerns of an inevitable Greek default and its subsequent fallout to its periphery.

Source: www.stockcharts.com

2) **Risk-off trades** – The US dollar is also benefiting from the flight to cash as global assets are sold en masse on "risk off" trades. According to EPFR Global, a leading supplier of fund flows and asset allocation data, at least US$ 20 billion were pulled of every asset considered as a risky asset in September alone. Specifically, the high-yield bond funds and emerging market equities have seen huge pull outs of funds. Even commodity funds were not spared and have experienced negative flows, including gold funds and silver funds. The massive redemptions in the month of September caused huge declines in commodity prices not seen since 2008.

Commodity Futures	Price 30-Sep	Price 31-Aug	Chg (%) MoM
Precious Metals			
Silver	30.83	41.56	-25.8%
Palladium	611.00	790.45	-22.7%
Platinum	1,523.00	1,860.00	-18.1%
Gold	1,622.30	1,825.72	-11.1%
		Average	**-19.4%**
Industrial Metals			
Copper	315.20	419.40	-24.8%
Lead	2,005.00	2,585.00	-22.4%
Zinc	1,870.00	2,280.75	-18.0%
Nickel	18,450.00	22,182.00	-16.8%
Tin	20,600.00	24,364.00	-15.4%
		Average	**-19.5%**
Agricultural Commodities			
Wheat	609.25	791.50	-23.0%
Corn	592.50	767.50	-22.8%
Soybean	1,179.00	1,457.50	-19.1%
Sugar #11	25.29	28.88	-12.4%
Rough Rice	15.95	17.95	-11.1%
		Average	**-17.7%**
Energy			
WTI Crude Oil	79.20	88.81	-10.8%

Source: Bloomberg, Wealth Research

3) **Safe haven currency –** If the US dollar is strong, it is not because the US economy is strong itself, but because other traditional safe havens like the Swiss franc and the Japanese yen has been taken out of the game. Last month, the Swiss and Japanese authorities decided to take aggressive action to cap further currency gains in order to protect their domestic and export industries. The US dollar was left as the only safe haven currency option.

   The Swiss franc, which throughout of the year was the recipient of funds flowing out of the euro, fell 12.7 percent against the US dollar last month after the Swiss National Bank decided to cap its currency at 1.20 Swiss francs per euro. The commodity currencies such as the Aussie dollar and the Canadian loonie fell 9.8 percent and 7.4 percent for the month, respectively, as commodity prices pulled back sharply in September.

   Asian currencies declined 5.6 percent led by the Korean won and Singapore dollar which were down 10.4 percent and 8.5 percent, respectively, in September. Exporting economies such as South Korea and Singapore are seen to be among the worst hit as Europe and US fail to address their slowing economies.

   Meanwhile, the Philippine peso which we touted as among the more stable currencies in the world (see *PIGS vs. TIP*, August 22, 2011) finally succumbed to stronger US dollar pressure, but nonetheless remained relatively strong versus other currencies. The peso fell only 3.6 percent in September, which is way better than the 6.9 percent average decline of major currencies and the 5.6 percent average loss of Asian currencies vis-à-vis the US dollar.

	Price 30-Sep	Price 31-Aug	Chg (%) MoM
Dollar Index	78.241	74.117	5.6%
Major Currencies			
Swiss Franc	0.9082	0.806	-12.7%
Australian Dollar	0.9662	1.0707	-9.8%
Canadian Dollar	1.0503	0.9777	-7.4%
Euro	1.3388	1.4369	-6.8%
British Pound	1.5584	1.625	-4.1%
Japanese Yen	77.0625	76.66	-0.5%
		Average	**-6.9%**
Asian Currencies			
South Korean Won	1178.1	1066.77	-10.4%
Singapore Dollar	1.3073	1.2044	-8.5%
Malaysian Ringgit	3.189	2.9718	-7.3%
Indian Rupee	48.9737	46.095	-6.2%
Taiwan Dollar	30.4855	29.01	-5.1%
Indonesian Rupiah	8950	8534	-4.9%
Thai Baht	31.195	29.93	-4.2%
Philippine Peso	43.7745	42.25	-3.6%
Chinese Yuan	6.3813	6.3781	-0.1%
		Average	**-5.6%**

   Source: Bloomberg, Wealth Research

4) **Slowing global economy –** Slowing global economic growth implies weakening demand for goods and services affecting countries which rely primarily on export growth. This has caused currencies (of export-oriented economies) such as the Australian dollar, Canadian dollar, Singapore dollar, Korean won and Taiwanese Dollar to depreciate against the US dollar.

Because of all of these, the peso and the Philippine stock market finally had to give way. But as you can see, the peso's and the Philippine stock market's decline is minimal compared to the substantial drops in US, Europe, the BRICs and other developing countries.

Why the US dollar rally is good for the Philippines?

While our own stock market (down 4.8 percent year-to-date) was not spared from the sell-off in global assets and the flight to the greenback, we note some good things coming out of this situation. These positives are the following:

1) **Peso appreciation arrested** – Philippine policymakers are more concerned about a peso appreciation. In fact, the BSP have sold the peso aggressively in previous months in order to prevent the peso-dollar rate from breaching beyond Php42:US$1 level.

2) **OFWs, BPOs and Exporters spared** – The dollar rally has spared the BPO industry and exporters from losing competitiveness brought about by the previous trend of appreciating peso. Moreover, the remittances of millions of OFWs will now be protected from further deterioration in value.

3) **Prices of oil and other imported commodities declined** – The recent strength of the US dollar has been more than offset by the decline in commodity prices. This is good for the Philippines, particularly since we import most of our oil and fuel products, as well as agricultural commodities such as rice, wheat, corn and sugar. On the downside, Philippine mining companies will take a hit because of lower metal prices.

Dollar rally: an opportunity to buy the peso

Over the long-run term we do not find any fundamental reasons why the peso should continue to decline against the US dollar. Our country's fundamentals remain very sound. We do not have the structural problems of the EU and the US. We have much healthier fiscal and current account balances. We have a steady supply of US dollars coming from OFW remittances and BPO revenues.

Philippine banks' exposure to the eurozone is also minimal. Moreover, with our international reserves at record highs of $75 billion (as of August 2011), we now have more flexibility to withstand external shocks.

We therefore see the decline in the peso as only temporary. We belive that 44 to 44.50 should be good levels to buy the peso. Historically, the peso tends to strengthen towards the end of the year as more remittances flow in time for the Christmas season.

We also expect the BSP to provide stability measures if the peso depreciates sharply over the next few weeks. Having bought dollars when the peso dollar rate was flirting at the 42 level, the BSP now has a lot of ammunition to stabilize the peso if it goes beyond 44.

For further stock market research and to view our previous articles, please visit our online trading platform at www.wealthsec.com *or call 634-5038. Our archived articles can also be viewed at* www.philequity.net.