Philequity Corner by Valentino Sy
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It's the strong dollar, stupid

Back in 2005, when we said that the Philippine peso has bottomed against the US dollar (see *Peso, The Strongest Currency in Asia,* Oct. 24, 2005), many of our readers and investors doubted our call. People then were so accustomed of seeing the peso lose value against the dollar that the thought of the peso strengthening was so far-fetched and unbelievable.

But now the table has turned. Everyone is so used to seeing the peso appreciate against the dollar that just a couple of months ago many were expecting it to fall below 40. So when the peso started to move in the opposite direction, just when the Philippines received an "investment grade" rating (from Fitch and S&P) for its sovereign debt, many were puzzled.

Investors are now shocked and worried to see the peso decline 8 percent in just a short period of time. From a low of 40.55 last March, the peso-dollar rate hit an intra-day high 44.17 before closing at 43.72 last Friday.

Dollar strength, not peso weakness

While others are dumbfounded by the recent weakness of the peso, we in Philequity saw it coming. In an article we wrote last April, we noted that despite favourable macro fundamentals arguing for continued peso appreciation, the inherent strength of the US dollar is giving the peso a respite (see *Win-win for the Peso*, April 8, 2013).

In another article, we discussed the fundamental reasons behind the resurgence of the US dollar (see *The Peso Tops Out*, May 27, 2013). We said that it is not because the fundamental underpinnings of the peso have turned negative, but because the fundamentals of the dollar have considerably improved which caused the peso to depreciate along with most other currencies.

Abenomics = Weak Yen

Among major currencies, the Japanese yen declined the most against the US dollar after the Bank of Japan (BOJ) introduced bold measures of quantitative and qualitative monetary easing or the so-called "Abenomics" which effectively weakens the yen.

		% Change
Major Currencies vs. US Dollar	**Wk-on-Wk**	**Year-to-date**
Japanese Yen	(3.4)	(11.3)
Australian Dollar	(3.4)	(11.1)
New Zealand Dollar	(4.0)	(6.1)
British Pound	(1.4)	(4.8)
Canadian Dollar	(2.0)	(4.4)
Swiss Franc	(0.8)	(1.4)
Euro	(1.0)	0.2

S*ource: Bloomberg, Wealth Securities Research*

Weak yen = Weak Asian currencies

The yen's sharp decline warranted a corresponding fall in the currencies of manufacturing-heavy Asian economies like South Korea, Singapore and Taiwan in order for them to stay competitive with Japan.

Asian Currencies vs. US Dollar	Wk-on-Wk	% Change Year-to-date
South Korean Won	(2.4)	(7.8)
Indian Rupee	(3.0)	(7.4)
Philippine Peso	(2.1)	(6.2)
Malaysian Ringgit	(2.7)	(4.4)
Singapore Dollar	(1.6)	(4.1)
Taiwanese Dollar	(0.9)	(3.7)
Indonesian Rupiah	(1.4)	(2.2)
Thai Baht	(1.6)	(1.5)
Chinese Yuan	(0.0)	1.6

***S**ource: Bloomberg, Wealth Securities Research*

Europe's recession, China's soft-patch & decelerating global growth

Recent data also show that global economic growth is decelerating which is bad news for emerging economies. Decelerating global growth is bad for emerging economies since falling export prices often necessitate currency depreciation to mitigate profitability squeeze among exporters.

Lower commodity prices = Weak commodity currencies

Falling commodity prices also weighed heavily on commodity currencies such as the Australian dollar, New Zealand dollar, South African rand, Brazilian real and Chilean peso. Commodity price weakness is reflective of weaker global growth and slumping demand for commodities.

Other EM Currencies vs. US Dollar	Wk-on-Wk	% Change Year-to-date
South African Rand	(2.6)	(17.2)
Brazilian Real	(4.7)	(9.1)
Colombian Peso	(2.9)	(8.9)
Turkish Lira	(3.6)	(7.7)
Chilean Peso	(4.2)	(6.8)
Mexican Peso	(4.4)	(3.9)
Hungrian Forint	(3.6)	(2.3)

Source: Bloomberg, Wealth Securities Research

Deleveraging and unwinding of carry trades

The recent spike in the yields of JGBs and US treasuries, in addition to the Fed's plan to taper QE have caused a de-leveraging of funds from emerging markets back to the US. The unwinding of carry trades also caused the sudden appreciation of the US dollar vis-a-vis emerging market currencies (see *The Big Unwind*, June 17, 2013).

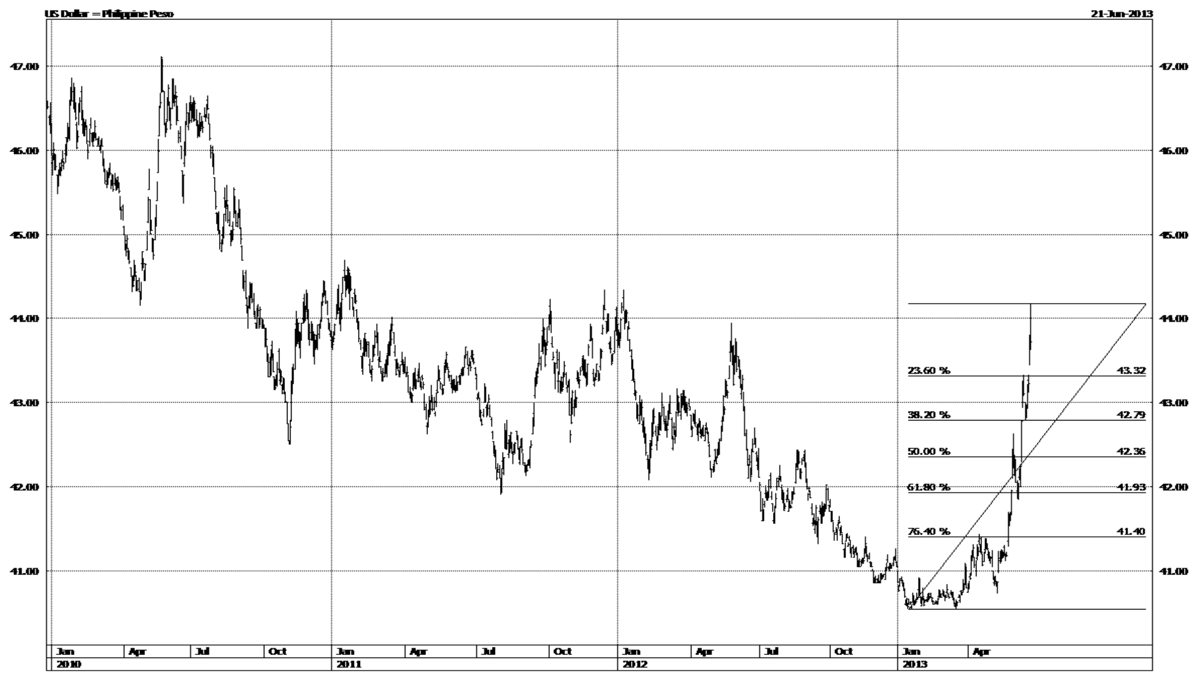
Since most global investors target currency exposures to countries with strong fundamentals such as the Philippines, Indonesia, Malaysia, Thailand, Mexico and Turkey, these countries succumbed the most to liquidation pressure. The tables above show the sharp week-on-week drops in their respective currencies following Ben Bernanke statement last Thursday that the Fed indeed plans to start tapering QE this year.

Peso to stabilize from here

In an article we wrote three weeks ago, we said that after 8 years of peso appreciation which brought the peso-dollar rate to a low of 40.55, we expect the peso to trade back towards the 42 to 44 range. This we said is the sweet spot for the peso (see *Back to the Sweet Spot*, June 3, 2013). In less than a month, the peso-dollar rate hit the upper end of our target range.

We now believe that the peso's decline is overdone. The peso is back at the level where it was trading at when QE2 started in Nov. 2010. At pre-QE2 peso levels, not only is the QE taper fully priced in, but the whole improvement in domestic macro fundamentals is being discounted.

Based on technical analysis, the 44 -44.20 should provide a strong level of resistance. After the recent sharp move, we expect the peso to consolidate from here on. A pullback towards 42.80 (equivalent to 38.2% retracement) or even 41.90 (equivalent to 61.8% retracement) is highly likely.



Source: Wealth Securities Research

Peso at current levels is a blessing

While the peso is now considerably weaker against the US dollar compared to the levels three months ago, it is not something to worry about. In fact, we believe that the peso trading at these levels is a blessing. While people fret to see the peso at current levels, we in Philequity are actually more concerned with the peso going to 40 which we believe is counterproductive and generally bad for the economy.

Peso fundamentals have not changed. And since it is the strengthening of the US dollar against most currencies which caused the peso to depreciate, we are not concerned. Given the choice, we actually prefer the peso at current levels than the peso going back to 40. Even if inflation creeps up, overall we believe this is good for the whole economy.

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