

### Peso Bull Run Is Over

We have been receiving a lot of questions about the peso lately. Why is it depreciating? What is the cause of the sudden and sharp decline? When will it stabilize?

How swiftly things change. Early this year, many were concerned that the peso was appreciating too much. Major foreign investment banks were calling for the USD/PHP rate to break below 40 and appreciate towards the 37.50 to 38 range. This prompted us to write *Peso Win-win* (April 8, 2013) when we first noticed the US dollar displaying broad-based strength. We followed it up with *Peso Tops Out* (May 27, 2013) when it became clear that the peso's long-term uptrend was over.

But people have gotten so accustomed to a rising peso the past eight years that the thought of it reversing seems so farfetched. This is why many were surprised and continue to be puzzled by the sudden depreciation of the peso, falling 7.3 percent since the May 22 "Fed taper" speech by Bernanke.

### Changing old mindsets

It is very difficult to change old mindsets. Just like in 2005, when the era of depreciating peso ended and the peso reversed, many were caught by surprise. People were so used to the peso depreciating against the greenback that a reversal was difficult to comprehend.

As you can see from the historical chart above, the peso continuously lost its value from Php 2 per dollar when it was still pegged in 1961 to Php 56.50 per dollar by 2004.

USD/PHP Monthly Chart (1960 – Present)



Source: [www.fxtop.com](http://www.fxtop.com), Wealth Securities Research

Since time immemorial, Filipinos have long considered the US dollar as a safe haven. Throughout the years, many would buy the greenback as part of their long-term savings.

So when we wrote that timely report in 2005, calling for the peso's bottom and urging investors to buy peso and peso assets for the long-term (see *Peso, the Strongest Currency in Asia*, Oct. 27, 2005), many were sceptical. In fact, some of our readers thought it was just a joke and were looking for the punch line.

Similarly, today, an appreciating peso has been ingrained in most people's mindset that the peso declining seems difficult to understand.

### Fundamentals aligning with technicals

In the foreign exchange market, trends have a tendency to last for several years. The previous chart shows that it took eight years (from the 1997 Asian Financial Crisis to 2005) before the long-term downtrend of the peso reversed. Note that the trend line break in 2005 coincided with major fiscal reforms at that time, particularly the implementation of EVAT, in addition to other fundamental catalysts (see *Peso Heading to 54*, Oct. 31, 2005).

### USD/PHP Monthly Chart (1960 – Present)

hav



Source: [www.fxtop.com](http://www.fxtop.com), Wealth Securities Research

Today, fundamentals are also aligning with technicals with regard to the peso. As you can see from the chart above, it also took eight years before the long-term uptrend of the peso was broken. This was in May when we called peso's top (see *Peso Tops Out*, May 27, 2013).

Coinciding with the technical break, the following fundamental factors argue for a weaker peso:

- 1) End of QE tapering
- 2) Rising interest rates
- 3) Fund deleveraging which trigger selling of emerging market assets

- 4) Broad based US dollar strength (vs. yen, commodity currencies and emerging market currencies)
- 5) Contagion from ASEAN/INR weakness (see *The Best House in a Bad Neighborhood*, Sept 1, 2013)

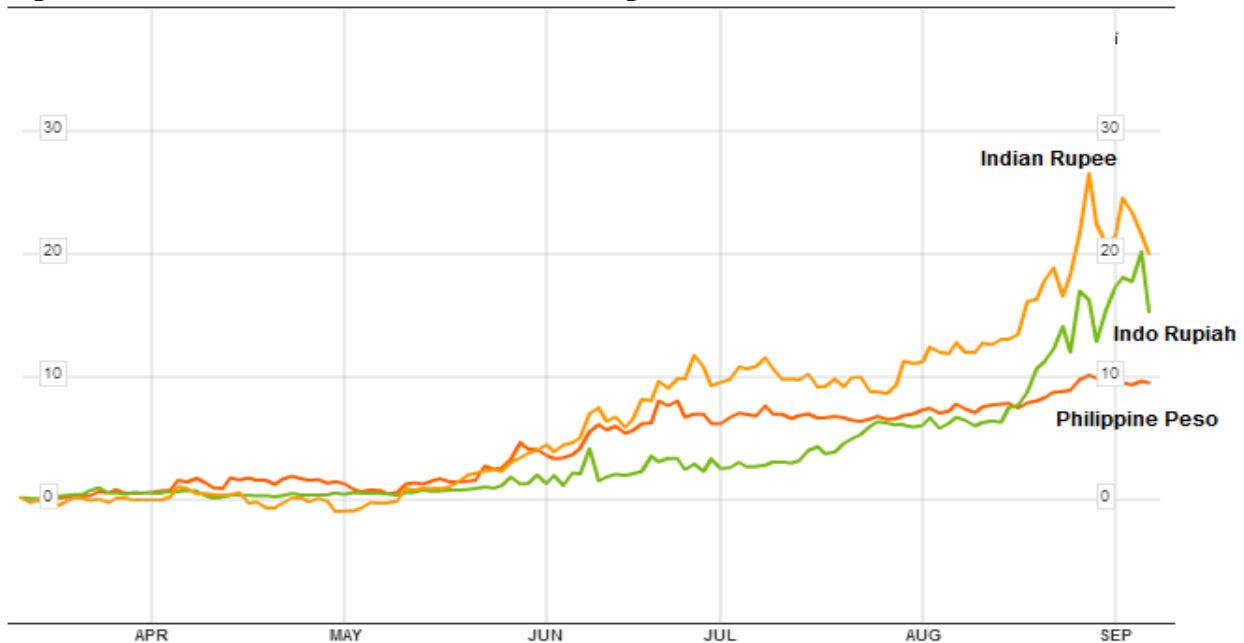
In fact, in a previous article we discussed in detail the reasons why the peso is already depreciating (see *It's the Strong Dollar, Stupid*, June 24, 2013).

### **Peso will move in tandem with regional currencies**

To answer the questions at the start of the article:

- 1) *Why is the peso depreciating?* We believe that the long-term uptrend in the peso which lasted for eight years has ended. Fundamental factors as mentioned in previous articles and technical analysis all point towards the peso reversal. This means that it may be a long time before we see the peso near 40 again.
- 2) *What is the cause of the sudden and sharp decline?* The reasons for the sudden and sharp decline are external in nature. While domestic fundamentals remain positive (strong GDP growth, low inflation, high GIR, current account surplus, etc.), global and regional dynamics (rising interest rates, broad-based US dollar strength, weakness of the ASEAN currencies & rupee, etc.) are dictating the movement of the peso.
- 3) *When will the peso stabilize?* There are initial indications that EM equities are turning. If the strength in EM equities continues, we see the peso stabilizing and even improving towards the 43 level.

### **Regional currencies dictate Peso movement (%Chg since March 2013)**



Source: Bloomberg

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