

**Philequity Corner (February 17, 2014)**  
**By Valentino Sy**

### **Don't Fight the Bangko Sentral**

Last week, we wrote about the emerging markets turmoil (see *Darlings No More*, 10 February 2014). The weakness in the Argentine peso, Turkish lira, Brazilian real, Russian ruble and other emerging market currencies drove down the peso to 45.48 against the dollar. In the gray market, the exchange rate reached 45.80.

#### **Smelling Blood**

During that time, several foreign banks forecasted that the peso would reach 48. In fact, some analysts of foreign houses started comparing this EM currency turmoil to the 1997 Asian Financial Crisis, saying that the same contagion will unfold. Consequently, many fund managers started unwinding their long positions. Smelling blood, speculators and hedge funds started shorting EM currencies, including the peso. Fortunately for the country, the BSP acted judiciously and promptly to thwart these unnecessary, speculative and opportunistic attacks on the peso.

#### **Myriad of tools**

We believe that the BSP bought pesos when the peso breached the 45 level as they found that the attacks were excessive and purely speculative in nature. Aside from buying pesos, the BSP, through Governor Amando Tetangco, Jr. and Department of Finance, made statements to allay fears brought about by the EM turmoil. In reality, the BSP has a myriad of tools to combat excessive speculations, such as:

1. Verbal intervention
2. "Friendly" persuasion on the banks and major players
3. Direct intervention in the foreign exchange market
4. Increase/decrease in the benchmark interest rate
5. Limitation of access to the special deposit account (SDA)
6. Adjustment of banks' reserve requirement
7. Other unconventional methods

#### **Verbal intervention**

If we look at the chart of the peso, one cannot help but notice the BSP's prescient words at peaks and troughs.

##### **Verbal intervention at the peak:**

*"The central bank has intervened in the foreign exchange market and is focused on containing inflows from speculators."* – BSP Governor Amando Tetangco, Jr., January 2013

##### **Verbal intervention at the bottom:**

*"... we would be prepared to participate in foreign exchange trading if there is excessive volatility. So we want to minimize volatility."* - BSP Governor Amando Tetangco, Jr., February 2014

These statements are an example of how effective verbal intervention can be in calming markets. A classic example of this would be European Central Bank President Mario Draghi's pledge to do whatever it takes to save the euro (see *Whatever It Takes*, 27 August 2012). Without spending a single euro, he effectively caused bond prices to rise and staved off a possible breakup of the Eurozone simply by saying "whatever it takes."

### **Peso tops out at 40.55**

In previous articles (see *The Peso Tops Out*, 27 May 2013 and *The Peso Bull Run is Over*, 9 September 2013), we said that the peso topped out after 5 years of appreciating. We also said that we expect it to weaken from there. On the other hand, some foreign houses were predicting that the peso would break 40 and even go to 37.50. With the BSP stating emphatically that the appreciation of the peso was "overdone", it effectively marked the top of our currency.

### **Don't fight Cesar**

Since then, the peso moved as we predicted. Two weeks ago, the peso hit a low of 45.48 against the dollar, its weakest level since August 2010. At this point, some foreign houses reversed their call and said that the peso will depreciate further and go as far as 48 to the dollar. They also put an underweight on the Philippine peso, saying that it is overvalued. This is where Department of Finance Secretary Cesar Purisima comes in. In a February 7 speech he gave in Singapore, Secretary Purisima said "**the peso is undervalued.**" His speech sent the peso higher.

Another lesson learned – Don't fight Cesar Purisima.

### **Peso bottoms at 45.50**

*"We still have room to keep rates steady, but given how these factors play out, that room may be narrowing."* - BSP Governor Amando Tetangco, Jr., February 2014

In past articles, we said that "the sweet spot of the peso lies in the 42-45 range" (see *The Goldilocks Peso*, 4 November 2013). We also said that "a look at the longer term chart shows that the peso is nearing strong support at the 45.50 to 46 level" (see *EM Currency Contagion*, 27 January 2014), which means that the peso is near the bottom. Our statement coincides exactly with the actions of the BSP, both its verbal and direct intervention.

With both Governor Tetangco and Secretary Purisima thwarting excessive speculation on the peso and hinting at future interest rate hikes, our currency rose sharply, closing at 44.73 last Friday. This dose of verbal intervention may cause the peso to go back to immediate resistance of 44, with a chance that it may overshoot. In the interim, we expect the peso to trade in the 43.50 to 45.50 range, with a bias towards strengthening.

### **Betting against the house**

Betting against the BSP is similar to betting against the house in a casino – you are bound to lose. Many of the analysts and economists who were betting against the BSP are not even in the Philippines. Thus, they are unable to pick up the signals sent by the BSP and Department of Finance. If we had to bet, we would bet on the side of Governor Tetangco and Secretary Purisima.

### **Another mantra**

One of our favorite mantras is “Don’t fight the Fed.” We wrote about this concept during the last bear market (see *Don’t Fight the Fed*, 24 September 2007). On the local front, we now have another mantra – Don’t Fight the BSP.

### **Investors’ briefing on currencies and stocks**

Aside from stocks, we will be discussing our forecast for the peso and other currencies in detail on March 8, 2:30 PM at the Meralco Theatre. We will be talking about fundamental and technical analysis, as well as how we were able to forecast the top of the peso. We will also explain why we think the 45.50 to 46 level may be the bottom for our currency.

### **Listen to the music**

In the meantime, take a cue from the words of Governor Tetangco and Secretary Purisima. Let their statements be music to our ears. As we have done before, we will end this article with a song. We leave you with a song from the ‘70s, **Listen to the Music** by Grammy award winner, the Doobie Brothers:

Don’t you feel it growin’, day by day  
People gettin’ ready for the news  
Some are happy, some are sad  
Oh, we got to let the music play

What the people need  
Is a way to make ‘em smile  
It ain’t so hard to do if you know how  
Gotta get a message  
Get it on through  
Oh, now mama’s go’n’ to after ‘while

Oh, oh, oh, listen to the music  
Oh, oh, oh, listen to the music  
Oh, oh, oh, listen to the music  
All the time!

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