Philequity Corner (June 15, 2015)
By Valentino Sy

Renewed EM currency volatility

Three weeks ago we wrote that the US dollar appears to be consolidating after staging one its longest dollar bull-runs since the 1990s (see *Is the US dollar bull run over?*, May 25. 2015). But while the US dollar index steadied as the Euro rallied the past three weeks, EM currencies continued their decline against the greenback.

The strong US jobs data in May and the increased likelihood of higher US interest rates later this year have rekindled concerns over EM countries with high fiscal account and current-account deficits.

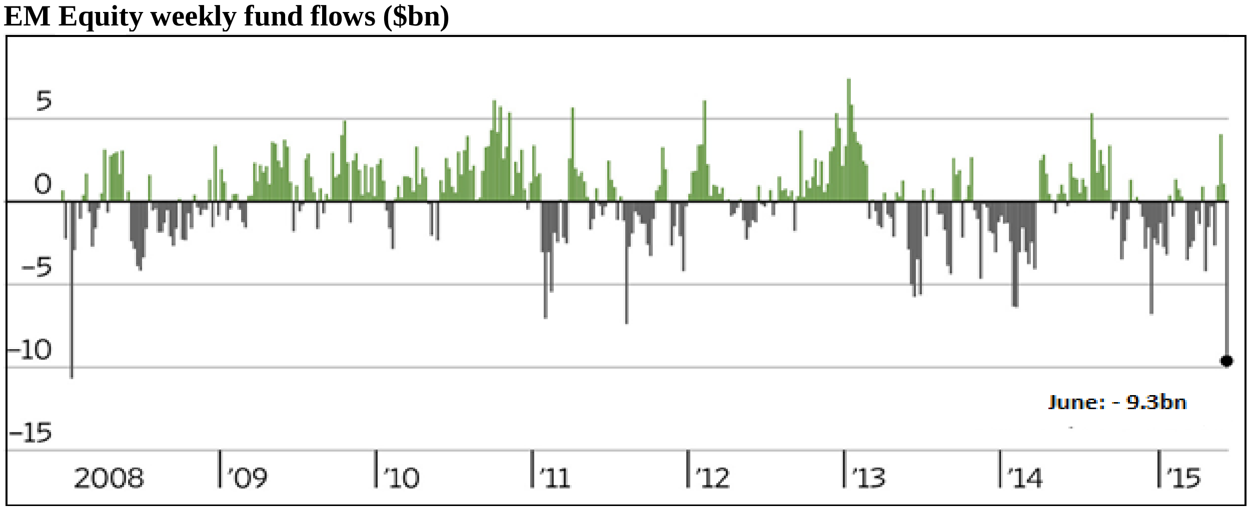
US monetary policy normalization

In last week's article (see *Bond yields rising,* June 8, 2015), we mentioned that we are now seeing the initial stages of interest rate normalization. This may result in increasing volatility across markets over the short-term. As bond yields rise due to the prospect of the Fed rate hike later this year, global investors have slowly been deleveraging and moving money out of riskier EM assets this year.

EM equity markets suffers worst outflows

According to funds tracker EPFR Global, emerging market stock funds registered a total of $9.3 billion outflow last week, the most since 2008. Investors have pulled out $26 billion from emerging market stock funds this year, already surpassing the $24 billion total for 2014. This record outflow in emerging market stock funds coupled with the sell-off in global bonds the past few weeks further exacerbates the volatility in EM currencies.

EM Equity weekly fund flows ($bn)



Source: EPFR Global, WSJ

Fragile 5 back under pressure

Morgan Stanley coined the phrase "Fragile 5" in August 2013 to represent vulnerable emerging market economies that have become too depended on unreliable foreign investment to finance their growth and cover current account deficits.

This year, the Fragile 5 currencies are back under pressure (with the exception of the Indian rupee) similar to what happened during the 2013 taper tantrum. Among the members of the Fragile 5, only India has made significant improvements in its current account, hence the rupee's outperformance.

	Current		%Chg	
Fragile Five vs. USD	**Price**	**2013**	**2014**	**2015Ytd**
Brazilian Real	3.12	-16.4%	-11.6%	-17.2%
Turkish Lira	2.71	-21.5%	-7.4%	-16.4%
South African Rand	12.38	-24.3%	-8.3%	-7.1%
Indonesian Rupiah	13,310.00	-25.7%	-2.8%	-7.0%
Indian Rupee	64.10	-14.0%	-1.7%	-1.6%
	Average	-20.4%	-6.3%	-9.9%

Source: Yahoo Finance, Wealth Securities Research

Asian currencies weaker amid interest rates cuts

Asian currencies (with the exception of the Taiwanese dollar) are weaker against the US dollar this year as Asian central banks continue to combat weak economic demand by cutting rates. China and South Korea have cut rates twice this year while Japan has maintained rates at zero. Other Asian central banks have also maintained their easing stance amid the growing likelihood of a US policy rate increase.

	Current		%Chg	
Asian EM Currencies vs. USD	**Price**	**2013**	**2014**	**2015Ytd**
Malaysian Ringgit	3.75	-8.2%	-6.3%	-7.2%
Indonesian Rupiah	13,310.00	-25.7%	-2.8%	-7.0%
Thai Baht	33.66	-8.4%	0.1%	-2.3%
Korean Won	1,113.19	1.1%	-4.1%	-1.8%
Indian Rupee	64.10	-14.0%	-1.7%	-1.6%
Singapore Dollar	1.34	-3.2%	-4.5%	-1.5%
Philippine Peso	45.30	-9.2%	-0.7%	-1.4%
Chinese Yuan	6.21	3.1%	-2.6%	-0.2%
Taiwan Dollar	30.92	-1.0%	-8.0%	2.2%
	Average	-7.3%	-3.4%	-2.3%

Source: Yahoo Finance, Wealth Securities Research

Among Asian EM currencies, the Malaysian ringgit has fared worse this year, down 7.2 percent. The ringgit has dropped to 3.748 last Friday, a level last seen during the financial crisis in 2009.

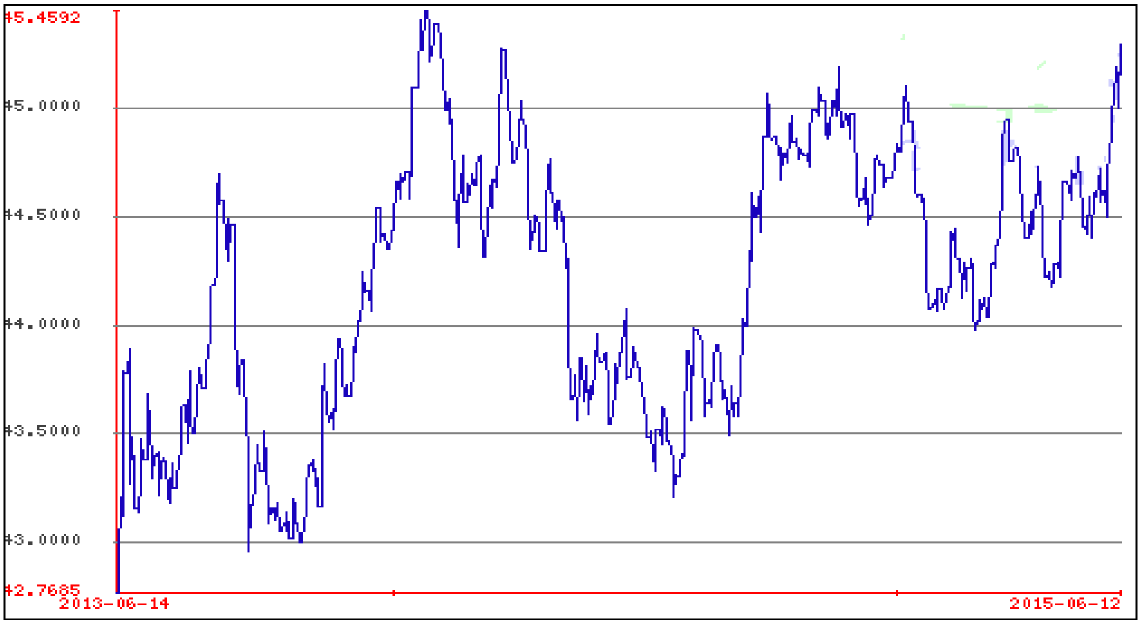
Meanwhile, the Indonesian rupiah which is down 7 percent year-to-date, hit a 17-year low of 13,310 last Friday.

Peso tracks EM currencies lower

The peso has weakened 1.4 percent year-to-date against the US dollar, tracking the decline of EM currencies. Short-term, the peso may retest its post-2013 tantrum low of 45.405 where it previously found support.

While the peso may not be spared from the volatility arising from heightened risk aversion and EM currency pressure, we believe that it will continue to be one of the more stable currencies in Asia. Our stable OFW remittances, robust BPO revenues and high foreign reserves should help cushion peso volatility.

Philippine Peso (June 2013 – June 2015)



Source: Fxtop.com

Verbal intervention from Kuroda

In past articles, we argued that the Fed and other central banks may start to intervene if the strong dollar becomes counter-productive to the stability of the global economy (see *It's the Strong Dollar, Stupid! – Part 2,* October 6, 2014 and *Philippine Peso: A Haven of Stability*, Feb. 2, 2015).

Last March, Fed Chair Janet Yellen implicitly hinted that too much US dollar strength may not be good for US corporates causing the dollar to pull back.

Recently, BOJ Governor Haruhiko Kuroda said that Japan's real effective exchange rate was "very weak" and unlikely to fall further, prompting the yen to strengthen to 123.42 from a low of 125.86.

Yellen and Kuroda's "verbal interventions" has slowed the rate of US dollar appreciation against major currencies. It can also possibly arrest further spikes in EM currency volatility.

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