



Philequity Corner (October 31, 2016)
By Wilson Sy

Strong Dollar or Weak Peso?

Investors have been asking us to write about the peso because of its recent weakness. They have one nagging and persistent question - Is the peso's recent weakness caused by a strong US dollar or is it inherently weak?

7-year low for the peso

We have written many articles about the stable peso and its Goldilocks range in the past years. It is also in the book, *Opportunity of the Lifetime*, specifically Chapter 7: *Peso Tops Out*. After reaching a high of 40.50 early in 2013, the peso has been ranging in the sweet spot of 43 to 48 for 3 years (see *Philippine Peso: A Haven of Stability*, 2 February 2015). Unfortunately, after consolidating below 48 for many years, the peso finally broke the critical level of 48/\$ and reached a 7-year low.

Worst in Asia for the month of September

As we said in the previous article, the peso is the worst performing currency in Asia vs. the US dollar in the month of September. On a YTD basis, it is the 2nd worst, behind only the Chinese yuan. See below a table showing the YTD and September performance of the different Asian currencies against the US dollar. The underperformance in September is painfully obvious as nearly all of the currencies in the table strengthened against the US dollar during that month.

Performance of Asian currencies vs. US dollar

Performance vs. US dollar	YTD return %	September return %
Philippine Peso	-3.4%	-4.1%
Malaysian Ringgit	2.2%	-1.7%
Singaporean Dollar	1.7%	-0.1%
Hong Kong Dollar	0.0%	0.0%
Vietnamese Dong	0.7%	0.0%
Thai Baht	2.5%	0.1%
Chinese Yuan	-4.4%	0.1%
Pakistani Rupee	0.0%	0.3%
Indian Rupee	-1.1%	0.5%
Korean Won	2.5%	1.2%
Taiwanese Dollar	3.7%	1.3%
Indonesian Rupiah	5.4%	1.7%
Australian Dollar	4.0%	1.9%
Japanese Yen	12.5%	2.0%

Weakest monthly performance in 16 years

The peso is not just weak in relative terms, but also on a historical basis. **The peso's September depreciation of 4.1% is the weakest monthly performance since October 2000 – the height of the political crisis during President Joseph Estrada's term.** Not only did the peso hit a 7-year low, but its September 2016 performance was also its weakest in 16 years.

Major currencies and Asian currencies in peso terms

In order to determine whether the peso is weak on its own or a victim of dollar strength, we decided to value other currencies in peso terms. Using the peso as a reference point, we checked how it fared against a basket of major and Asian currencies.

Our investigation shows that, contrary to popular notion, the peso's drop in September was not due to a strong dollar. In fact, the table below shows that the peso was a victim of its own weakness. In September, the peso depreciated against all major and Asian currencies. On a YTD basis, the peso is weaker against all currencies except the Chinese yuan and the British pound.

Performance of peso vs. major and Asian currencies

Peso vs. Major currencies		YTD return %	September return %
JPY	Japanese Yen	-18.3%	-5.9%
EUR	Euro	-3.2%	-4.3%
USD	USD Dollar	-3.4%	-4.1%
CAD	Canadian Dollar	-7.3%	-3.5%
GBP	British Pound	15.2%	-2.6%
Peso vs. Asian Currencies			
IDR	Indonesian Rupiah	-9.2%	-5.9%
TWD	Taiwanese Dollar	-7.4%	-5.4%
KRW	Korean Won	-6.3%	-5.4%
AUD	Australian Dollar	-7.2%	-5.3%
INR	Indian Rupee	-2.3%	-4.6%
CNY	Chinese Yuan	1.1%	-4.3%
THB	Thai Baht	-6.0%	-4.2%
HKD	Hong Kong Dollar	-3.3%	-4.1%
PKR	Pakistani Rupee	-3.4%	-4.0%
SGD	Singaporean Dollar	-4.7%	-3.9%
VND	Vietnamese Dong	-4.2%	-3.8%
MYR	Malaysian Ringgit	-5.7%	-2.3%

A temporary blip or an aberration?

In previous articles, we explained how the strong dollar is the main reason behind the peso's depreciation. So far, it is a 3-part saga as can be seen below:

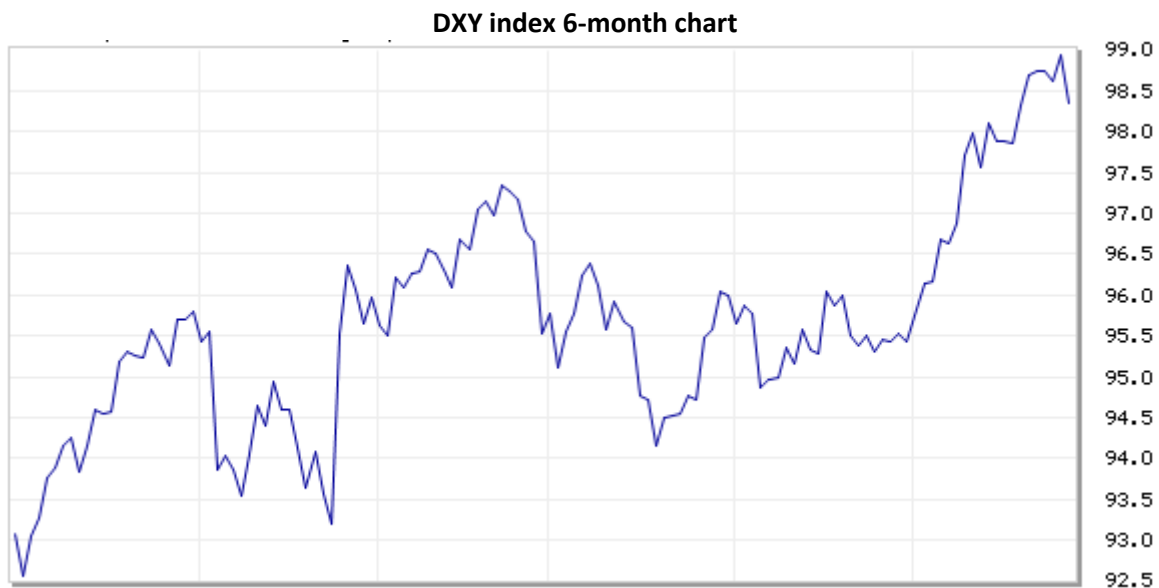
1. *It's the Strong Dollar, Stupid!*, 24 June 2013
2. *It's the Strong Dollar, Stupid!, Part 2*, 6 October 2014
3. *It's the Strong Dollar, Stupid! – Episode 3*, 18 January 2016

In Episode 3, we also mentioned how other currencies fared much worse than the peso, with some currencies falling as much as 8% at the start of 2016. However, as far as September is concerned, it seems that the strong dollar is not the culprit.

On a brighter note, we noted in last week's article that we may just be seeing a reversion to the mean because the peso outperformed its peers in the past 5 years. We also noticed that this October, other Asian currencies are catching up with the peso's weakness. We hope that the extreme weakness of the peso in September is a temporary blip or aberration.

Dollar strength returns

After weakening on its own, the peso had a chance to rebound after it retested support of 48 two weeks ago. Unluckily for the peso, it would barely get a breather from its slide lower as negative political headlines continued and US dollar strength returned. With US economic data showing that expansion is on track, the possibility of a rate hike in December rose to 70%. See below a 6-month chart of DXY, the benchmark US dollar currency index. Note the sharp upmove recently.



Cause and effect

This double whammy of inherent peso weakness and US dollar strength has caused the peso to depreciate at a record pace. Foreign outflows from Philippine stocks have further exacerbated this as foreign funds became jittery due to negative headlines. Unfortunately, the peso weakness caused stock prices to fall, bond yields to go up and credit default swaps to rise. As foreign funds see Philippine asset prices plunging across the board, they are prompted to reduce their exposure to the Philippines even

more, causing the currency to depreciate further. Left unchecked, these moves in Philippine financial assets can cause a vicious cycle.

The answer is... BOTH!

So what is causing the peso to depreciate? Is it the strong US dollar or is the peso weakening on its own?

The answer is... BOTH!

In September to early October, the peso succumbed to its own weakness. In the past few weeks though, dollar strength has plagued all currencies, including the peso. Hit by this double whammy, the peso remains at lows not seen since the 2008 US Financial Crisis.

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