Philequity Corner (September 17, 2018)
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Weathering the Storm in the Philippine Peso

EM currencies, including the Philippine peso, have been facing stormy weather for quite some time now. Several factors have combined to create turbulence in EM currencies. Among them are: high inflation, rising current account & fiscal deficits, the normalization of US interest rates, a strong dollar, the US-China trade war, rising crude oil prices and fears of contagion from Turkey and Argentina.

Most EM currencies have declined sharply since the start of the year with some currencies like the Turkish lira, Argentine peso and the Indian rupee hitting record lows against the US dollar. The Philippine peso tumbled to a 13-year low of 54.13 against the US dollar last Wednesday before closing the week at 53.97.

Turkey and Argentina spark contagion concerns

Contagion fears coming from Turkey and Argentina have exacerbated the slide in EM currencies. The Turkish lira hit a new all-time low against the US dollar this year as high inflation, large trade deficit, ballooning public debts and US imposed economic sanctions and tariffs have led to massive capital outflows making the lira unattractive. Year-to-date, the lira has depreciated by 63.6%.

Argentina likewise finds itself marred in another financial crisis. Like Turkey, Argentina has high debt levels, a huge trade deficit and high inflation rate. Despite bringing its policy rates to a world-high 60%, the Argentine peso still fell to a record low of 39.9 against the US dollar last Thursday and is currently down 106.7% year-to-date.

Other EM currencies vs. US dollar

Other currencies which dropped sharply year-to-date are the Brazilian real (-25.3%), South African rand (-19.6%), Russian ruble (-18.1%), Indian rupee (-12.8%) and the Pakistani rupee (-12%). The Philippine peso has weakened as well (-8.4%) following the sharp declines in regional and global EM currencies.

Performance of Select EM currencies vs. US dollar

Asian currencies vs USD	Ytd return (%)	1yr return	2yr return	3yr return	5yr return	10yr return
Argentine peso	-106.7%	-128.5%	-161.9%	-316.6%	-581.9%	-1165.6%
Turkish lira	-63.6%	-80.2%	-108.1%	-103.9%	-206.3%	-395.5%
Brazilian real	-25.3%	-32.5%	-26.8%	-8.1%	-82.0%	-130.1%
South African rand	-19.6%	-12.6%	-3.3%	-8.8%	-48.2%	-80.7%
Russian ruble	-18.1%	-18.5%	-5.6%	-0.6%	-109.7%	-166.3%
Indian rupee	-12.8%	-12.6%	-7.7%	-8.4%	-13.3%	-57.2%
Pakistani rupee	-12.0%	-17.6%	-18.8%	-18.7%	-18.1%	-62.7%
Chilean peso	-11.7%	-9.7%	-2.4%	-0.9%	-36.5%	-29.5%
Indonesian rupiah	-9.3%	-12.1%	-12.3%	-3.5%	-31.9%	-57.0%
Philippine peso	*-8.4%*	*-6.1%*	*-13.3%*	*-15.5%*	*-23.3%*	*-15.4%*
Chinese yuan	-5.2%	-4.8%	-2.5%	-7.4%	-11.9%	0.0%
South Korean won	-5.1%	0.5%	0.2%	5.2%	-3.2%	-0.8%
Taiwanese dollar	-4.3%	-2.9%	2.5%	4.8%	-4.2%	3.5%
Vietnamese dong	-3.1%	-3.0%	-5.0%	-4.2%	-11.2%	-42.0%
Singapore dollar	-2.7%	-1.9%	-0.7%	3.1%	-8.1%	4.5%
Malaysian ringgit	-2.4%	1.1%	-0.5%	4.0%	-25.9%	-20.0%
Thai baht	0.0%	1.4%	6.6%	9.8%	-2.4%	6.0%
Mexican peso	3.9%	-6.8%	0.3%	-13.2%	-44.7%	-78.6%

Sources: Bloomberg, Wealth Securities Research

Peso dragged down by inflation and the twin deficits

Concerns over high inflation and the re-emergence of twin deficits in both the fiscal and current accounts have also weighed the peso down. August inflation came in at 6.4% vs. 5.7% the previous month, hitting a 9-year high. The country also posted a wider current account deficit for 1H2018 amounting to USD 3.1 billion from a mere USD 133 million in 1H2017.

Super Typhoon aggravates inflationary pressures

Super Typhoon Mangkhut (a.k.a. Ompong), carrying maximum sustained winds of 269 KPH, hit the farmlands of Northern and Central Luzon last Saturday causing widespread harm to Philippine agriculture. Agriculture Secretary Manny Pinol estimated damages to amount to as much as Php11 billion worth of rice and corn. These losses are expected to hurt the country's food supply and further aggravate inflationary pressures.

Turkey's rate hike lifts the lira

To thwart the attack on their currency, Turkey's central bank hiked interest rates by 625 basis points to 24%. This move boosted Turkish sovereign dollar bonds which rose across the curve to their highest level since the end of August. The Turkish lira which jumped to as high as 6.00 against the US dollar after the announcement closed at 6.16 as of Friday. The lira has now rebounded by 14.5% from its record low of 7.20 to the dollar recorded last August 13.

Russia raises rates for the first time since 2014

Likewise, Russia unexpectedly raised interest rates for the first time since 2014. Russia's central bank raised key rates by 25 basis points to 7.5%. The central bank said it will take into account inflation rate and external factors when considering further rate hikes.

EM currencies rebound

EM currencies were boosted by Turkey's rate hike and the lira's sharp rally. The South African rand has now risen by 4.8% since registering a 2-year low last Sept. 5, while Russian ruble has now gained 3.6% from its 2-year low recorded last Sept. 10.

Central banks taking aggressive steps

For now, it appears that contagion risks from a fallout from Turkey and Argentina have subsided. Central banks are now taking aggressive steps as shown by the actions of Turkey and Russia. Central banks are now aware of possible contagion and are vigilant.

Navigating safely in this stormy phase

In the case of the Philippines, the BSP promised it will "take strong immediate action" to douse inflation expectations, as well as excessive swings in the peso-dollar rate. The BSP has already raised policy rates by a total of 100 basis points since May. The market is expecting another aggressive action from the BSP to check rising inflation during its next rate-setting meeting scheduled later this month.

The government also has plans to bring inflation down by addressing food supply issues. The difficulties facing the government are many but they should immediately tackle issues that they have control on. With the tools in hand and proper vigilance, we believe that the government and the BSP will be able to navigate this country safely in this stormy phase.