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By Wilson Sy

Philippines – unintentional beneficiary of the US-China trade war

Conventional wisdom would have us believe that the US-China trade war is negative for all countries, including the Philippines. However, a closer look at recent developments would show that our country is an unintentional beneficiary of the trade war. It may sound counterintuitive for some, but the trade war has spurred a chain reaction of events which have benefitted the Philippine stock market and the peso.

1. **Fears of global slowdown trigger central bank easing.** The International Monetary Fund (IMF) warned that the trade war could cut $455b or 0.5% from global growth next year. Morgan Stanley said that the trade war has caused a sharp drop in its business conditions index, signifying notable declines in hiring and capex plans. Fears of a global slowdown have prompted central banks in Europe, China, and Japan to come up with another round of monetary stimulus.
2. **Fed halts rate hikes, mulls rate cuts.** The Fed has stopped hiking interest rates in light of a sluggish global economy and expectations of slower growth in the US. The market now expects the Fed to cut interest rates this year to shore up growth. Fed Chair Jerome Powell said that the Fed is closely monitoring the trade war and is prepared to act appropriately to sustain US economic growth.
3. **Dovish Fed tempers US dollar strength.** Powell's dramatic U-turn from hawkish to dovish has tempered the move of the US dollar. With no rate hike and potential rate cuts in sight, the US dollar index has traded at a range of 95 to 98 in the past six months, providing a welcome respite to many emerging currencies including the Philippine peso.
4. **Lower borrowing costs for the Philippine government.** Expectations of slower global growth because of the trade war and more central bank easing have caused global interest rates and bond yields to drop. This is a favorable development for the Philippines as the government continues to raise debt funding for its massive infrastructure program.
5. **Oil plummets on weakening demand, global slowdown.** Oil has plunged 17% from its recent high due to weaker demand amid a slower global economy. This favors oil-importing countries such as the Philippines which stands to benefit from lower inflation and a more stable current account.
6. **Dovish Fed, lower inflation give room for BSP easing.** Powell's recent dovishness, the pause in rate hikes, and potential rate cuts from the Fed have provided the Bangko Sentral ng Pilipinas (BSP) enough leeway to cut interest rates without causing the peso to weaken. Meanwhile, the sharp slowdown in inflation has given the central bank ample room to implement cuts in reserve requirements and its policy rate. These policy actions should stimulate the Philippine economy and support its rebound from below-forecast growth in 1Q19.
7. **Peso stabilizes in light of dollar consolidation.** The consolidation of the US dollar has allowed the peso to remain stable, notwithstanding the BSP's monetary easing. Our domestic interest rates remain much higher compared to falling bond yields in developed markets, thus making the peso and Philippine bonds more attractive for carry trades. Last Friday, Bloomberg presented a table which showed that the Philippine peso has the lowest implied volatility and is the most stable among emerging currencies.

8. **Funds view the Philippine stock market more positively.** The Philippine economy is somehow insulated from trade tensions as domestic consumption accounts for ~75% of GDP. Growth is expected to come in at 6% while other countries are severely hobbled by the trade war. The BSP is also able to lower interest rates, providing another boost to economic growth, without negatively affecting the peso. These developments have prompted fund managers to see the Philippines in a more favorable light.

Goldman Sachs is bullish on Philippine peso

Goldman Sachs came out with a report last week where it recommended buying the Indian rupee and the Philippine peso, as both currencies can be resilient in a full-blown trade war. Both India and the Philippines are among the fastest growing economies in Asia and are driven primarily by strong domestic demand. Both are oil importers and will benefit from the precipitous drop in oil. The Philippines is favored due to slowing inflation and a stable currency despite ongoing monetary easing by the BSP. Conversely, Goldman advised its clients to short the Chinese yuan and the Korean won as both China and Korea are export-driven economies which will be hampered by trade war escalations. Goldman recommended a pair trade by shorting the Korean won and going long the Philippine peso. Many other houses forecast the peso to go to 54 due to our country's current account deficit. In contrast, Goldman is bullish on the peso as the unintended benefits of lower oil prices and lower interest rates have been supportive of the Philippine economy. **Goldman has a 6-month target of 51.50 and 12-month target of 51 for the Philippine peso.**

Recent developments support the peso and PSEi's resilience

The IMF stated that everybody loses in an all-out trade war. While no country will be completely immune from it, some countries may lose less because their economies are more insulated from a sharp deterioration in global trade. Still, the escalation of the trade war inevitably spells more volatility ahead for the stock market. Notwithstanding, the Philippines should be less vulnerable compared to other Asian and emerging countries because it has become an unintentional beneficiary of the US-China trade war. In this light, we expect the PSEi and the Philippine peso to remain relatively stable and outperform their peers, especially those directly hit by the trade war.