Philequity Corner (May 25, 2015)
By Valentino Sy

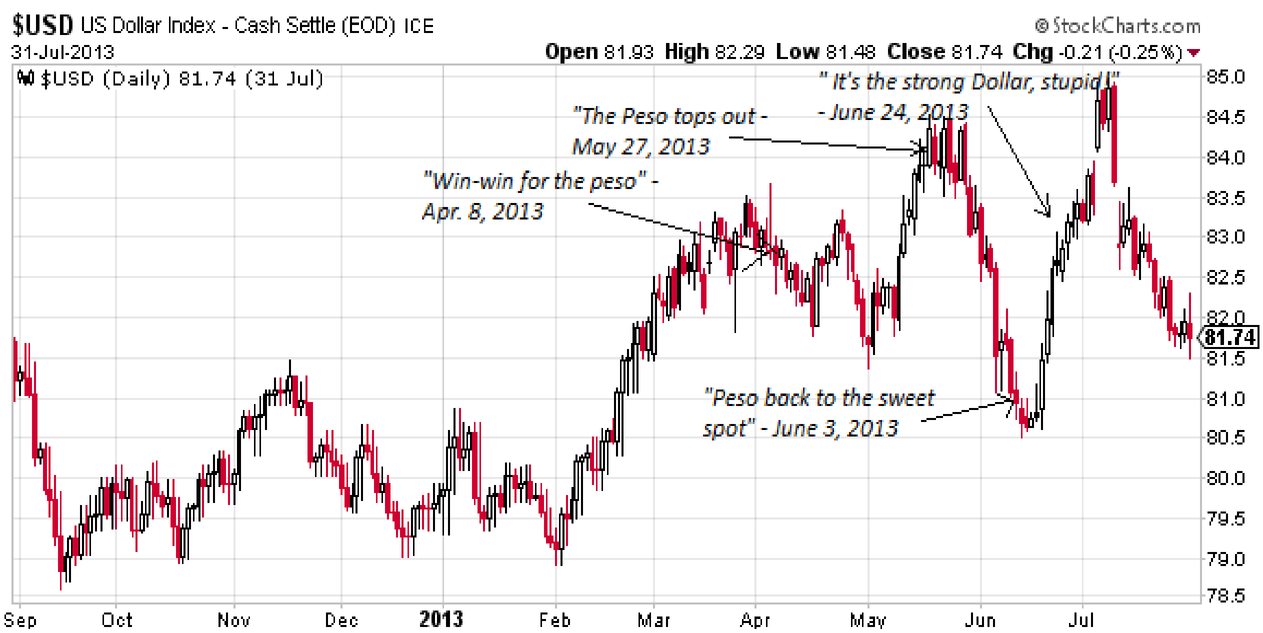
Is the US dollar bull-run over?

We first alerted our readers about a potential major move in the dollar two years ago (see *Win-win for the Peso*, April 8, 2013). At that time, many were concerned of the peso strengthening below 40 vs. the dollar. In fact, a lot of foreign banks and investment houses were predicting the peso to hit 37.50 by end-2013. However, we said that it was more likely for the peso to get a respite and trade back towards 41 – 42 because we saw the US dollar starting to gain strength across the board during that time.

In fact, in the next article, we became convinced that the peso has indeed topped out against the dollar (see *The Peso Tops Out*, May 27, 2013) after eight long years of being bullish on the peso. In that column we enumerated the fundamental factors why the US dollar is appreciating across the board.

We followed this up with two more pieces (see *Peso back to the Sweet Spot*, June 3, 2013 and *It's the Strong Dollar, Stupid!*, June 24, 2013). We pointed out that peso fundamentals have not changed and that the relatively weaker peso which is caused by the inherent US dollar strength is actually good for the economy.

Below is the chart of the US dollar index where we show the dates when the articles mentioned above were written.



Source: Stockcharts.com

Dollar resumes 2nd leg of its bull-run

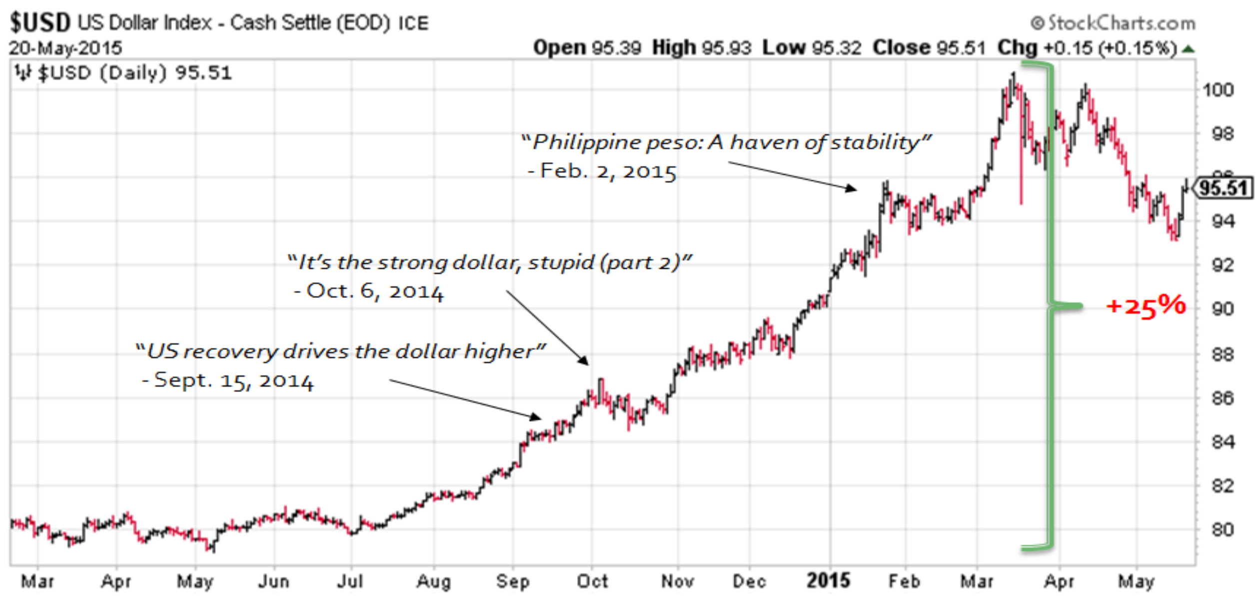
After that strong dollar run, the US dollar traded back in a range for the rest of 2013 up to the 1st half of 2014. But eight months ago, when the greenback started moving up again, we promptly notified our readers that the 2nd leg of this bull-run had already begun (see *US recovery drives the dollar higher*, Sept. 15, 2014). We argued that an improving US economy and a hawkish Fed combined with aggressively easing ECB and BOJ will drive the dollar much higher.

We followed this up with two more articles (see *It's the Strong Dollar, Stupid! – Part 2*, October 6, 2014 and *Philippine Peso: A Haven of Stability*, Feb. 2, 2015). We reiterated that divergent central bank policies which started in the 2nd half of 2014 has fueled the strong appreciation of the US dollar. But despite this, the peso has been relatively stable even as major currencies suffered their steepest declines against the greenback. However, we added that the Fed and other CBs may intervene if the strong US dollar becomes counter-productive to the stability of the global economy.

The dollar's 25% rise

The dollar eventually ran up for 9 straight months with the US dollar index rising 25 percent to 100.39 by mid-March 2015. At that point, the bull-run already was one of the largest compared to historical bull-runs dating back to the 1990s. In fact, sentiment on the dollar became overly bullish that a number of analysts and economists have started calling for parity with the euro.

Below is the chart of the US dollar index (showing the 2nd leg of the dollar bull run) wherein we indicated the dates that the articles mentioned above were written.



Source: stockcharts.com

Verbal intervention from Yellen

Amid widespread optimism towards further dollar advance, the Fed surprised investors last March by indicating they were in no rush to raise interest rates in the face of slowing growth. During interviews with Fed Chair Janet Yellen, she had implicitly hinted that too much US dollar strength may not be good for US corporates. She also stated that interest rates will rise only when it is warranted.

Normally, the Fed "intervenes verbally" before they even act and investors pay great attention to these subtle suggestions. As a result, the dollar halted its ascent and pulled back as much as 8 percent from its March 2015 high.

US dollar consolidation is much preferred

The market may have underestimated the impact of the dollar's move on the Fed's thinking. But just as we had warned in our article last February, the Fed would not want the dollar to become overly strong because of its negative effects on US corporates. Note that many US multinationals which derive their income from exports will surely be affected. Moreover, excessive US dollar strength also creates volatility and ultimately instability to global trade.

While it is not yet clear if indeed the one-way trade that drove the US dollar to its longest sustained appreciation in two decades has ended, we know that at least in the short term, it had started to pause and consolidate. Whether it continues or not, a pause is certainly positive because it gives companies and countries time to adjust. A US dollar appreciating too fast too soon is bad for businesses in general.

Too much of a good thing is bad

The pause in further US dollar strength is also good for the peso which has surged significantly the past year against the euro and the yen.

Short-term, it appears that the euro has made a double bottom against the Philippine peso at around the 46.85 level (refer to chart below). This comes after the peso has **gained more than 20 percent against the euro** from June 2014 to March 2015.

Against the yen, the peso has been stable at around 0.37 the past six months **after appreciating 15 percent in the 2nd half of 2014** (refer to chart below).

EUR/PHP Rate (June 2014 to May 2015)

Source: fxtop.com

JPY/PHP Rate (June 2014 to present)

Source: fxtop.com

There are many advantages of the peso going strong against the euro and the yen especially for Filipinos wanting to travel abroad and those buying and importing products from Europe and Japan. However, we at Philequity prefer the steadier "goldilocks scenario" for the peso. We do not want it to be too strong, just as we do not want it to be too weak. Too much of a good thing is bad.

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