Philequity Corner (July 11, 2022)
By Wilson Sy

Taking a cue

The peso continued to depreciate and touched 56 last week. In light of our currency's swift decline in a short span of time, we received many inquiries from investors and readers asking about the direction of the peso. Aside from studying macroeconomic numbers, global currency movements, and technical analysis, we should also monitor the statements and pronouncements of key policy-makers. We believe that taking a cue from our country's economic managers may help us determine where the peso is heading.

Central policy

In the first Cabinet meeting, President Ferdinand Marcos, Jr. cited the importance of economic management in his new administration. The President said, "We can all understand that the most important area that we will have to deal with will have to be the economy. The central policy that everybody else would be following will be that set out by our economic managers." The major role that was assigned to the economic managers reinforces our view that their statements should be closely monitored.

Not something to worry much about

As investors grow concerned over the move of our currency, Socioeconomic Planning Secretary Arsenio Balisacan said that the depreciation of the peso is "not something that we need to worry much (about) because we still have to see how that depreciation relates with our neighbors, with our competitors, and with our economic fundamentals."

Market forces drive peso move

While the Bangko Sentral ng Pilipinas (BSP) is mindful that a weaker peso may stoke inflation, BSP Governor Felipe Medalla said that market forces will ultimately determine the direction of the peso. He attributed the peso depreciation to a wider current account deficit. Medalla explained that very high economic growth this year caused imports to grow much faster than exports because our trading partners are not growing as fast.

BSP signals faster tightening

Initially, the new BSP Governor provided a relatively dovish guidance. He telegraphed a 25 bps rate hike in August. Reports of faster inflation in June and the dramatic decline of the peso may have prompted a change in guidance. Last week, Medalla said, "The BSP is prepared to be more aggressive in raising its policy rate, compared to its initial gradualist stance. In particular, BSP is prepared to raise its policy rate by 50 bps by August." Medalla reiterated that the BSP will not match the Federal Reserve's (Fed) rate increases although these cannot be totally ignored either. He stated that the central bank is prepared to hike interest rates by another 100 bps in 2H22. He stressed that rate decisions would be data dependent.

Impact of peso depreciation on inflation

The BSP Governor said that the central bank is paying close attention to heavy depreciation pressures on the peso brought about by a strong US dollar and a hawkish Fed. Medalla explained, "We are a lot more concerned about the inflation effects of a more depreciated peso given that we already have a very high inflation." According to Medalla, every 1% adjustment in exchange rate translates to a 0.05-0.10% change in inflation. As of last Friday, the peso is down 9.7% year-to-date.

Competitive peso benefits key sectors

Diokno said that peso depreciation benefits key sectors such as exporters and OFWs. Total exports amounted to $19.4b in 1Q22, up 9.8% YoY. OFW remittances reached $11.3b from January to April, 2.6% higher. Meanwhile, BPO revenues came in at $29.5b last year, up 10.6%. Aside from these, Diokno identified mining as an important sector for the government. Tourism would also strongly benefit from a weaker peso. A depreciating currency would make these sectors more competitive by increasing the peso value of their dollar-based revenues. Balisacan highlighted manufacturing as a priority for job creation and poverty alleviation. A weaker but more competitive peso would also make imports more expensive and can result in import substitution which can benefit our domestic industries.

Stabilization of the peso

After the Cabinet meeting where the economic team presented its agenda, the Finance Secretary provided a preview of the administration's medium-term fiscal framework. This featured a revised GDP growth target of 6.5-7.5% for this year (slightly lower than 7-8% previously) and 6.5-8% for next year. The economic team aims to trim the budget deficit to 3% starting 2026 to 2028 (from 8.6% in 2021) and bring down debt-to-GDP ratio to 60% by 2025 (from 63.5% in 1Q22). If the government is successful in implementing its economic agenda, it would be able to improve tax revenue generation, strengthen its fiscal position, bring down the budget deficit, trim debt levels, and manage the current account position. Achieving these would strengthen our economy and ultimately support the stabilization of the peso.

UP School of Economics

The peso, like most other currencies, has continued to depreciate against a very strong US dollar. This was driven by steep Fed rate hikes in response to elevated inflation. In the case of the peso, the narrowing interest rate differential, the government's bigger debt load, and a widening current account deficit contributed to its weakness. Elevated energy and food prices which were exacerbated by the Russia-Ukraine war worsened the fall of the peso this year.

Aside from monitoring macroeconomic developments, we should take our cue from the statements, pronouncements, interviews, and off-the-cuff remarks of the country's economic managers. It is crucial to understand their thinking, preferences, and monetary policy perspective. Since they are all from UP (see *Winning Streak*, June 6, 2022), it is also important to grasp the logic, theories, and doctrines espoused by the esteemed UP School of Economics. Comprehending the mindset of the economic managers would help us determine the course of our economy and the direction of the peso in the short-term and over the long-term.

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