

Philequity Corner (May 5, 2014)
By Valentino Sy

Scenarios for the Peso

Since we started this column in Feb. 2005, Philequity has made three major calls on the peso. First was our call of the peso's bottom in 2005 (see *Peso, the Strongest Currency in Asia*, Oct. 24, 2005). Second was our call of the peso's top last year (see *The Peso Tops Out*, May 27, 2013).

Third and most recent was our call that the peso's support level at 45.50 – 46 will hold (see *EM Currency Contagion*, January 27, 2014). The peso indeed found support at 45.485 on Feb. 4, 2014, a week after we published our call. Since then, the peso has strengthened by 2.3% against the US dollar to close at 44.50 last Friday.



Monetary conditions to tighten

Following the US Fed's latest move to step up the gradual removal of its bond-buying program, the Bangko Sentral ng Pilipinas is closely monitoring domestic credit/liquidity conditions.

"If liquidity growth continues to be strong even as the inflation outlook stays manageable, we will not hesitate to again consider further pre-emptive macroprudential measures," according to BSP Governor Amando Tetangco.

Not by raising rates but by other tools

With inflation expectations broadly aligned with their target of 3-5% in 2014 and 2-4% in 2015, the BSP has kept its overnight borrowing rate at 3.5 percent. It, however, raised bank reserve requirements to 19 percent from 18 percent last month. While it avoided tweaking policy rates, the hike in reserve requirements was intended to guard against potential price pressures that could arise from continued strong liquidity growth and rapid credit expansion.

Verbal intervention

Another tool that central banks, like the BSP, have successfully used to influence the market is giving forward guidance thru verbal intervention (see *Don't Fight the Bangko Sentral*, Feb.17, 2014). This means telegraphing

or hinting future actions by using words to show what it intends to do.

The peso rose last week after market participants heeded BSP's hints that further adjustments in monetary policy tools are being considered. By giving forward guidance, the BSP intends to influence and put to maximum effect its policy tool adjustments.

BSP at the helm

While the BSP remains market-oriented, it was successful in smoothing out excessive volatility when fears of another emerging market currency crisis were high following the Argentine bolivar's devaluation early this year (see *EM Currency Contagion*, January 27, 2014). With all the tools available in its arsenal in adjusting to challenging global conditions, the BSP remains clearly at the helm.

EM currencies recover

As the peso rallied against the US dollar the last three months, other emerging market currencies recovered as well. In fact, the "Fragile Five" currencies (Brazilian real, South African rand, Turkish lira, Indonesian rupiah and the Indian rupee), which were last year's worst performers, led the rally this year.

As mentioned in a previous article, troubled emerging market economies which suffered last year when the US Fed started tapering its bond buying program have started fixing their problems (see *Best House in an Improving Neighborhood*, Feb. 24, 2014). India and Indonesia have reduced their current account deficits while South Africa and Brazil have raised rates.

CURRENCIES VS. US DOLLAR	Current Price	Recent low	Date of low	% Chg from low	% Chg ytd
"Fragile 5" Currencies					
Indian Rupee	60.1625	68.845	8/28/2013	12.6%	2.6%
Turkish Lira	2.1055	2.39	1/27/2014	11.9%	2.0%
Brazilian Real	2.2214	2.4505	1/29/2014	9.3%	6.0%
South African Rand	10.4796	11.3909	1/29/2014	8.0%	0.1%
Indonesian Rupiah	11525	12281	12/27/2013	6.2%	5.3%
			Average	9.6%	3.2%
Asian Currencies					
South Korean Won	1,030.3300	1,089.7100	2/4/2014	5.4%	-1.9%
Malaysian Ringgit	3.2657	3.3511	2/4/2014	2.5%	-0.3%
Singapore Dollar	1.2531	1.2830	1/23/2014	2.3%	-0.8%
Thai Baht	32.4020	33.1480	1/6/2014	2.3%	-0.9%
Philippine Peso	44.5000	45.4850	2/4/2014	2.2%	-0.2%
Taiwan Dollar	30.18	30.636	3/21/2014	1.5%	1.3%
Chinese Yuan	6.2594	6.2674	4/30/2014	0.1%	3.4%
			Average	2.3%	0.1%

Source: Bloomberg, Wealth Securities Research

The table above shows that Fragile Five currencies gained an average of 9.6 percent from their recent lows. Meanwhile, the peso has rebounded 2.2 percent from its low which is at par with the region's 2.3 percent move against the greenback.

Possible scenarios for the Peso

Given the tightening monetary conditions and strengthening regional EM currencies, we believe that the peso can further strengthen towards 44 or even lower. From a technical standpoint, we also believe that we have seen the intermediate lows of the peso at 45.50 vs. the US dollar.

We now see two likely scenarios unfolding for the peso.

Scenario 1: The first scenario calls for the peso going as high as 44 to the dollar. It would then trade in the 44 – 45.50 range.



Scenario 2: The second scenario calls for the peso breaking below 44 and heading towards 43. The rally of the PSE index, EM stocks and EM currencies will be the catalysts for this move. In case the PSE index rallies to new highs, we may even see a sharper appreciation towards 42. In this scenario, we may see the peso ranging between 42 and 45.50 longer term.



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