



Philequity Corner (October 21, 2019)
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The strong Philippine peso

Many are asking us why the Philippine peso has been so strong despite most houses forecasting a weaker peso. In fact, the Philippine peso has been remarkably strong in the past 12 months. Even as the US dollar index (DXY) strengthened to the highest level in 28 months amidst the prolonged US-China trade war, the Philippine peso performed better.

Peso vs. Asian currencies

The Philippine peso's outperformance is broad-based, as shown in the table below. It is among the best-performing currencies in Asia over the past year. Relatively insulated from the US-China trade war, the Philippine peso strengthened the most against the South Korean won (+9.5% YoY) and the Chinese yuan (+7.7% YoY) over the past 12 months.

Peso vs. Major currencies

The peso has also shown significant strength against major currencies. It has appreciated the most against the Aussie dollar (+10% YoY), the Euro (+8.9% YoY), and the British pound (+7.1% YoY). Trade concerns have weighed on the Aussie dollar due to the close ties of Australia's economy to China. Brexit uncertainty has caused weakness on the pound, while negative interest rates have affected the euro.

Performance of Philippine peso vs. select major and Asian Currencies (%)

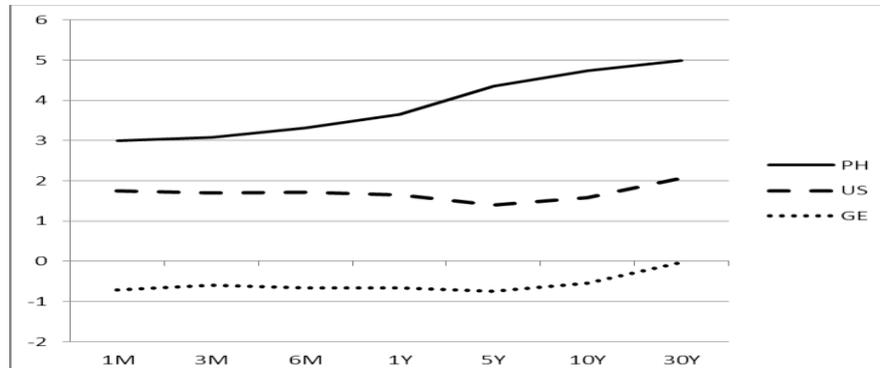
vs Major Currencies	1M	3M	6M	12M
Australian dollar	1.8%	2.6%	5.5%	10.0%
Euro	1.0%	0.5%	1.9%	8.9%
British pound	-1.6%	-3.4%	1.9%	7.1%
Canadian dollar	1.0%	0.4%	-1.0%	6.2%
US dollar	1.8%	-0.2%	0.9%	5.5%
Swiss franc	1.0%	-0.2%	-1.6%	4.6%
Japanese yen	2.2%	0.5%	-2.1%	1.8%
Average	1.0%	0.0%	0.8%	6.3%
vs Asian Currencies				
South Korean won	0.9%	-0.1%	4.7%	9.5%
Chinese yuan	1.8%	2.8%	6.6%	7.7%
Malaysian ringgit	1.9%	1.6%	2.0%	6.2%
Singapore dollar	1.2%	0.1%	1.6%	4.4%
Taiwanese dollar	0.4%	-1.9%	0.0%	4.1%
Indian rupee	1.7%	3.0%	3.5%	1.9%
Indonesian rupiah	2.5%	1.1%	1.7%	-1.8%
Thai baht	1.0%	-2.1%	-3.9%	-2.0%
Average	1.4%	0.6%	2.0%	3.8%

Source: Bloomberg, Wealth Securities Research

Search for yield

With \$17 trillion worth of global bonds carrying a negative return today, the absence of yields in traditional safe havens have made Philippine bonds and the Philippine peso attractive and a place for investors to park their funds. The graph below shows the spread of Philippine bonds vis-a-vis US and German bonds.

Philippine gov't bond yields vs. US & German gov't bond yields



Source: Bloomberg, Wealth Securities Research

Why is the peso strong?

- 1) **Carry trade.** The widening interest rate differential and significant positive carry have boosted the demand for Philippine bonds and the peso. For example, the spread between a 10-year Philippine government bond vs. 10-year US government bond is 317.2 basis points. Compared with a 10-year German bond yielding -0.54%, the spread is 528.6 basis points.
- 2) **Record high GIR.** The country's gross international reserves (GIR) rose to a record high in September, reaching USD 86.2 billion. The record-high GIR is a positive development, according to Finance Secretary Carlos Dominguez III. *"This will go along to make people confident that the currency is stable,"* he said in one of his recent interviews.
- 3) **Tax reform and credit rating upgrade.** The government's tax reform program has created the fiscal room for economic growth. This supports the infrastructure modernization project (Build, Build, Build) and other developmental programs of the government. This has also helped improve the country's credit rating and confidence in the government.
- 4) **Stable OFW remittances & BPO revenues.** Our country's two traditional sources of dollars are steady. OFW remittances grew 4.2% in August, bringing the January to August figures up by a respectable 3.6%.
- 5) **Tourist arrivals are increasing.** Tourist arrivals hit 5.55 million from January to August, up 14.1% year-on-year. Chinese tourists are the fastest growing inbound market, reaching 1.21 million in the first eight months, up 39.2% from the same period in 2018. For August alone, arrivals from China jumped 60% to 170,903.
- 6) **POGOs.** Another factor that contributes to the strong peso that was not there before is the Philippine offshore gaming operators (POGOs). POGO's are estimated to contribute USD155 million in licensing fees and royalties, USD219 million in office rent, and USD680 million in annual housing rental. Leechiu Property Consultants CEO David Leechiu estimates that including the salaries of 470,000 POGO workers, the annual impact on the economy is around USD9 billion.
- 7) **Low oil prices & inflation, narrower trade & CA deficits, and BOP surplus.** Low oil prices, benign inflation, and tempered current account and trade deficits have contributed to the strength of the peso (see *Lower oil prices – bullish for the Philippines*, Sept. 30, 2019). The country's balance of payments (BOP) registered a surplus of USD5.5 billion for the January - August 2019 period, reversing the deficit posted in the same period last year.

Where is the peso headed?

The Philippine peso closed at 51.27 vs. the US dollar last Friday and is now back at levels where it was trading before the Chinese yuan breached 7.00. With the break below 51.50 last week, technical analysis now points to the next target range of 50.50 to 51.00.

Philequity Management is the fund manager of the leading mutual funds in the Philippines. Visit www.philequity.net to learn more about Philequity's managed funds or to view previous articles. For inquiries or to send feedback, please call (02) 689-8080 or email ask@philequity.net.