



Philequity Corner (November 28, 2022)
By Wilson Sy

Why did the peso strengthen?

After hovering at the 59 level, the peso continued its strong rebound last week. The peso posted a weekly return of 1% and gained 3.3% in the past month. In this article, we explain the reasons behind the recent appreciation of the peso.

Fall of the US dollar

The strength of the peso is primarily driven by the pullback of the US dollar. In our past articles, we explained the factors that caused the weakness of the US dollar (see *Peak Dollar?*, October 31, 2022, and *Mighty dollar stumbles*, November 21, 2022). From its two-decade high of 114.78 on September 28, the US dollar index (DXY) has fallen 7.6% and closed at 106.06 last week. The retreat of the US dollar paved the way for the pronounced recovery of major currencies. The British pound is up 16.7% from its recent low. Meanwhile, the euro bounced 8.7% and the yen rebounded 8.4%. In terms of performance, the peso is actually in the middle of the pack (up 4.2% from its low) compared to other Asian currencies, with the Korean won (up 7.7% from its low) and the Thai baht (up 7.1% from its low) leading the charge.

The decline of the dollar was triggered by pronouncements made by monetary officials that the Fed will be “stepping down” its rate hikes after its 75-basis-point rate increase in November. Investor hopes that inflation has peaked were bolstered by lower-than-expected inflation in October (see *Rally resumes on easing inflation*, November 14, 2022).

Fed minutes signal slower rate increases

The further fall of the US dollar was precipitated by the release of the minutes of the Fed’s November meeting. The minutes showed that there were some Fed officials that were contemplating a slowdown in rate hikes. Below, we summarize some notable quotes from the minutes of the Fed’s last meeting.

1. “A few participants commented that **slowing the pace of increase** could reduce the risk of instability in the financial system.”
2. “Participants further noted that the overall tightening of global financial conditions, along with energy prices and other headwinds, was contributing to a slowdown in the growth rate of global real GDP.”
3. “Participants remarked that the foreign economic slowdown, in combination with a strong US dollar, was likely to weigh on the US export sector, and several participants commented that there could be wider spillovers to the US economy.”
4. “Several participants commented that continued rapid policy tightening increased the risk of instability or dislocations in the financial system.”
5. “Members agreed that, in determining the pace of future increases in the target range, they would take into account the cumulative tightening of monetary policy, the lags with which monetary policy affected economic activity and inflation, and economic and financial developments.”

Medalla: Fed, BSP done with jumbo hikes

Last week, Bangko Sentral ng Pilipinas (BSP) Governor Felipe Medalla responded to pronouncements made by Fed officials regarding a potential slowdown in their pace of tightening. The BSP chief said, “My own reading is that the US will keep on raising, but no more than 75 basis points. So that will be a lot less

painful for economic growth in the Philippines.” Medalla clarified that the BSP has to respond and continue hiking rates even if the Fed rate hikes indeed slow down. Medalla explained, “My view is the interest rate differential is still quite narrow. So not responding to 50 (basis points) brings the interest rate differential to an extremely low number, below 100 basis points, which may result in undesirably volatile peso.” Medalla believes that the Fed and also the BSP are done with jumbo rate hikes.

Rising global equity markets and the BSP Governor’s comments supported the strong performance of the local stock market. The PSEi gained 2.6% last week and closed at 6,607. After piercing through the resistance level of 6,500, the PSEi is now up 15.9% from its low of 5,699 on October 3. The stock market benefited from six straight days of net foreign buying amounting to P3b and total month-to-date net inflows of P7b. Strong foreign buying in the stock market is one of the reasons behind the rebound of the peso.

Peso trajectory driven by US dollar, Fed policy

The peso’s surprising strength was driven by the retreat of the US dollar amid expectations of a slowdown in Fed rate hikes. We said in our previous articles that it is crucial for investors to watch for a potential peak in inflation because this would also mean a peak in financial tightness which would usher a peak in the US dollar. Ultimately, the trajectory of the peso would be determined by the overall direction of the US dollar and what the Fed does.

Based on the minutes of their last meeting, some Fed officials believe that slowing down the pace of rate increases would reduce the risk of inducing financial instability. Moreover, it would allow policymakers to assess the cumulative impact of their tightening because monetary actions typically work with long and variable transmission lags. As we saw in the recent recovery of global currencies, the rally in equity markets, and the rebound in bond prices, a less aggressive Fed is positive for financial markets.

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