FX Insight

PHP - Weakness May Not Last

Key Thoughts

The PHP remains a laggard in ASEAN and is still on a broad downtrend that began at the start of the year. BSP failure to move on its benchmark policy rate so far and ongoing concerns over the deteriorating current account deficit have allowed PHP bears to reassert and reinitiate short-PHP positions against the USD, putting downside pressure on the PHP. There has also been a renewed sell-off in Philippine assets and concomitant weakness in the PHP that could last until the BSP signals a more hawkish stance. We see low risk of a PHP move above the 53-handle and that the current bout of weaknesses could prove to be temporary. There are several factors for our optimism, including tax reforms, potential inflows into the stock market in 2018 based on our analysis using the Cyclical Adjusted P/E (CAPE) ratio model and expectations of BSP rate hikes in 2018to adjust its benchmark policy rate in 2018. Given these developments, we now expect the USDPHP to end-2Q and -3Q at 52.00 before ending 2018 around the 51.50-levels.

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PHP Weakness Could Be Temporary

The PHP remains a laggard in ASEAN and is still on a broad downtrend that began at the start of the year. Initial enthusiasm for the PHP on speculation that BSP could hike rate at its Mar meeting was doused by jawboning by both BSP and government officials. This has led to the PHP slipping around 4.5% against the USD since the beginning of the year (Chart 1).

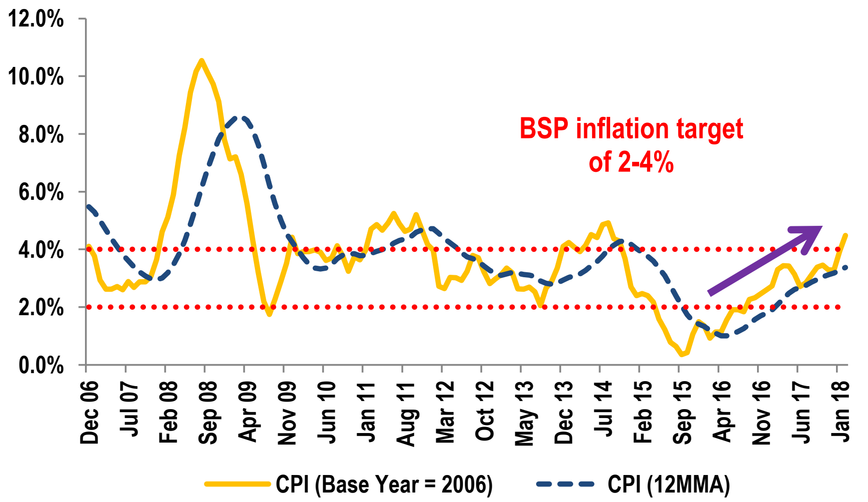
Chart 1: USDPHP has been on a Broad Uptrend since Jan 2018

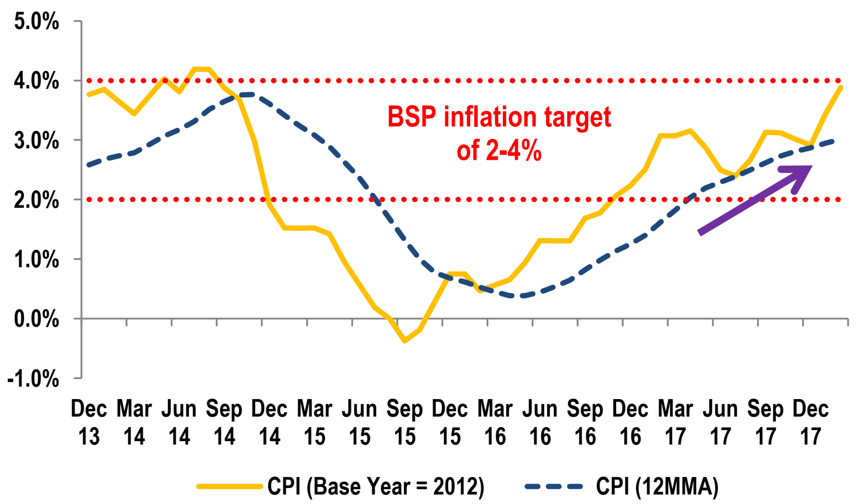
Source: Bloomberg, Maybank FX Research & Strategy

As we had cautioned in our various reports, BSP failure to move on its benchmark policy rate so far has allowed PHP bears to reassert and reinitiate short-PHP positions against the USD, putting downside pressure on the PHP. There has also been a renewed sell-off in Philippine assets and concomitant weakness in the PHP that could last until the BSP signals a more hawkish stance.

Market concerns that the BSP is behind-the-curve in curbing inflationary pressures have intensified. Recent CPI data showed headline inflation (using both the 2006 and 2012 base years) accelerating. Based on the 2006 series, headline inflation rose by 4.5% y/y in Feb from 4.0% in Jan, while that for the 2012 series, showed a 3.9% y/y increase vs. Jan's 3.4%. Based on the 2006 series, inflation is already above the upper bound of the 2-4% inflation target set by BSP, while inflation using the 2012 series is fast approaching the upper bound of the target. Based on either series, inflation is on an upward trend (Chart 2). Not surprisingly, the lack of action by the BSP has spurred investors to re-adjust their PHP positions, keeping the USDPHP on an uptrend.

Chart 2: Headline CPI is Trending Higher (for Base Year= 2006 & 2012)

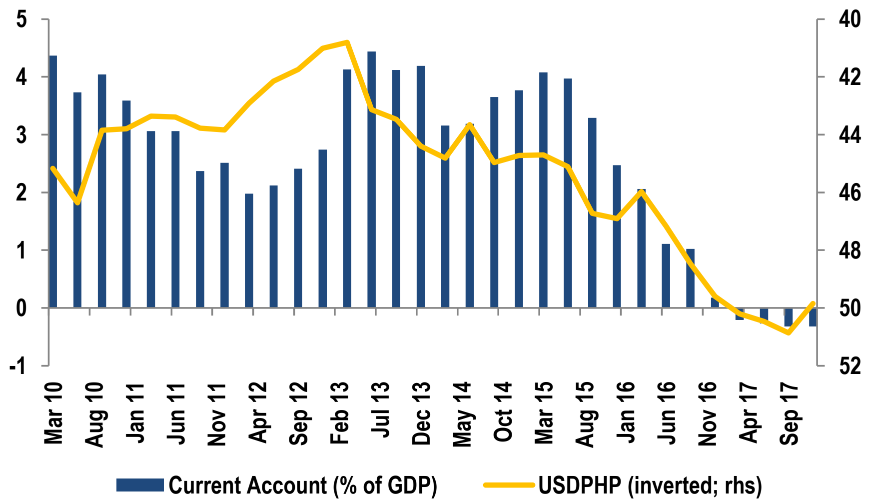




Source: Bloomberg, Maybank FX Research & Strategy

Another ongoing concern that has kept the PHP elevated above the 52-handle is its deteriorating current account deficit as the USDPHP tend to track the current account positions (Chart 3). While the trade deficit has eased from its record of USD4.0bn in Dec, and overseas remittances rebounded, the broad trend of the current account deficit remains to the downside. The government's ambitious infrastructure building programme should keep the current account in deficit for at least in 2018. In addition, risks are to the downside for overseas remittances growth due to the repatriation of Filipino workers from Kuwait and government policy on tightening immigration and foreign workers. This has increased expectations that remittances are unlikely to improve the current account deficit significantly.

Chart 3: Deteriorating Current Account Balance Weighs on PHP



Source: Bloomberg, Maybank FX Research & Strategy

More importantly, the positive effects from remittances should fade in 1Q 2018 as seasonality factors appear to weigh on remittances in the first quarter. The current account deficit is likely to deteriorate further on rising oil prices (in value terms) given that Philippines is an oil-importing economy. The deficit in the current account is unlikely to narrow anytime soon on account of the increased public spending and investments by the government in its pursuit of higher growth. These concerns weigh on the PHP and should keep the USDPHP elevated above the 52-levels in 2018.

Deteriorating risk appetite due to perception that BSP could be behind the curve in battling inflation and external balances concerns is fueling asset reallocation away from Philippines equities. Month-to-date in Mar, foreign investors have sold USD370.8mn in equities compared to USD295.6mn in Feb, while so far in Apr a total of US16.5mn has been sold. Cumulatively, foreign investors have sold USD637.7mn in equities so far this year compared to the USD1.10bn purchased for the whole of 2017. Expectations of further risk aversion could fuel further sell-off in Philippines equities which should weigh on the PHP in the nearer term. Consequently, this has kept the USDPHP supported above the 52-levels.

Nevertheless, we see low risk of a PHP move above the 53-handle and that the current bout of weaknesses could prove to be temporary. There are several factors for our optimism, including tax reforms. The tax reforms, effective 1 Jan 2018, could be the catalyst that kicks off the next phase of investment-led growth. Already, the tax reform has led to a budget surplus in Jan – the first since Aug 2017. With partial funding secured and the commitment of the government to infrastructure building intact, this should inspire investor confidence and spur both portfolio and FDI inflows that should be supportive of the PHP.

Positive surprises could also come from inflows into the stock market in 2018 based on our analysis using the Cyclical Adjusted P/E (CAPE) ratio model. Our estimates suggest that domestic equities are relatively cheap (as reflected by the estimated P/E ratios minus their 10-year average P/E ratios) compared to its regional peers. Greater inflows should lift the PHP higher. So far, risks aversion and rising UST yields have made Philippines assets less attractive with foreign investors selling USD197.6mn in equities so far in 2018.

We continue to expect the BSP to adjust its benchmark policy rate in 2018. Headline inflation by either the 2006 measure or 2012 one shows an uptrend. We believe that it is a matter of when and not if the BSP will move to hike rates. BSP is currently watching for any signs of second-round effects and inflation becoming broader-based. Pending petitions for adjustments in minimum wages and transportation fares as well as the effects of a weaker PHP could be the trigger points for the BSP to take action. Our house view remains for the BSP to hike its benchmark interest rate twice by 25bp each time, once at end-2Q 2018 and the other at end-4Q 2018. These moves should be positive for the PHP.

Given the market developments to date including investor perception that the central bank is behind the curve and the still deteriorating current account deficit as well as rate hikes, we now expect the USDPHP to end-2Q and -3Q at 52.00 before ending 2018 around the 51.50-levels.

Maybank USDPHP Forecasts

Forecast	2Q 2018	3Q 2018	4Q 2018	1Q 2019
USDPHP	52.00 (50.50)	52.00 (50.50)	51.50 (50.00)	51.00 (--)

Previous Forecasts in Parenthesis

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