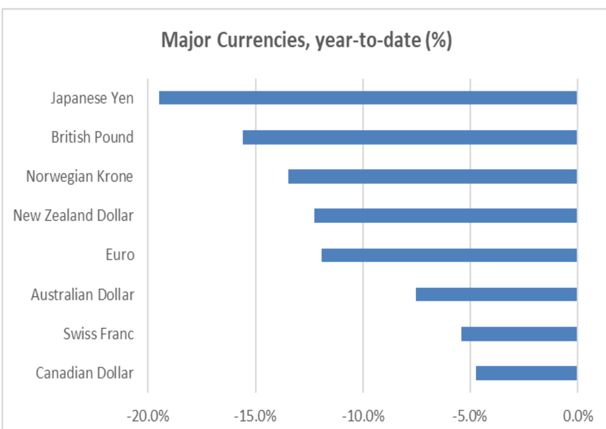
Philequity Corner (September 19, 2022)
By Wilson Sy

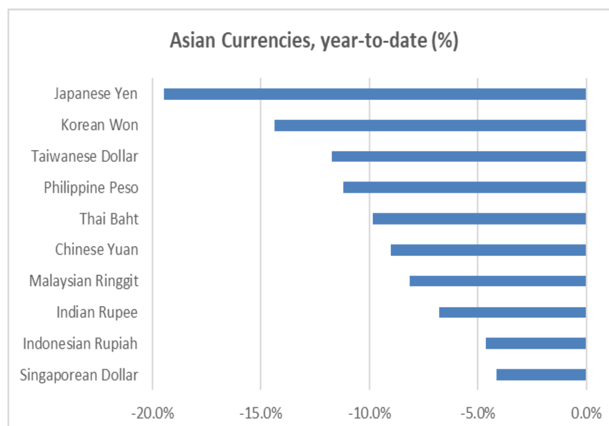
Weak yuan may affect peso

The peso hit record lows again last week. Most currencies likewise continued their descent against the US dollar. The Chinese yuan has dropped below the closely watched critical level, breaching 7 for the first time in two years. The yuan weakened to an intraday low of 7.025 before closing at 6.98 last Friday.

Broad US dollar strength

The Chinese currency has fallen 9% this year as the US dollar continues its relentless rally. The trade-weighted US dollar index (DXY) has strengthened 19% after the US Fed began an aggressive interest rate hiking campaign this year. Major currencies like the Japanese yen, the British pound, and the euro are at multi-decade lows. Emerging Asian currencies like the Indian rupee and the Philippine peso have hit new all-time lows.





Deteriorating exports

Worse-than-expected exports in August amid weakening external demand have also contributed to the weaker Chinese yuan. Chinese exports fell considerably short of expectations and grew by just 7.1% in August, compared with 18% in July. Exports have long anchored Chinese economic growth and accounted for 19% of China’s GDP in 2021. A prolonged export deterioration will likely exacerbate China’s economic slowdown.

Growth slowdown

China is currently on track for one of its slowest-growth periods in modern history as it struggles to cope with its zero-covid policy and rolling city-wide lockdowns. After China's GDP shrank 2.6% in the 2Q22, analysts have lowered China's GDP growth forecast to 3.5% this year, according to a recent Bloomberg survey. This figure is way off the government’s target of 5.5% announced in March.

Property market slump

According to the National Bureau of Statistics of China, the crisis in the Chinese property market continues to worsen as new home prices in 70 cities fell for the 12th straight month. Residential sales are down 30% compared to last year, and property investment fell more than 7%. A nationwide mortgage boycott has also dampened confidence in the sector after developers halted housing projects due to liquidity issues and strict covid restrictions.

Capital outflows

Capital outflows have increased given the Fed's aggressively hawkish stance and the increasingly less attractive Chinese bond yields. The unexpected PBOC rate cut last month was exacerbated by a hawkish US Fed, further widening the monetary gap between US and China. Note that US 2-year yields are now nearly 3.9%, while Chinese 2-year yields are at 2.029%. As a result, global investors have withdrawn $7.7 billion from China's debt markets in August, its seventh straight month of portfolio outflows, according to the Institute of International Finance (IIF).

Opposing monetary policies

Given the opposing monetary policies between the US and China, the widening yield differentials, and the slowdown in the Chinese economy, the yuan is poised to weaken further. The chart below shows a bullish pennant breakout in the USD/CNY, showing a price objective of 7.18. Such a move will bring USD/CNY to the price highs of 2019 and 2020. An acceleration in the Chinese yuan depreciation can be one of the risk factors for Asian currencies, including the Philippine peso.

Source: Tradingview.com, Wealth Securities Research

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