Macro Economics

2023 in review: The rage of inflation

Philippines

Growth hampered as spending slows down

In the first half of the year, the country posted its slowest growth since the pandemic as high prices and the absence of government spending took its toll on consumption. While GDP rebounded in 3Q, surging 5.9% following a massive catch-up spending by the government, it remains apparent that consumer spending is on the decline.

Moving forward, the government's tight fiscal space could hamper future efforts to boost the economy as the country's economic managers are keen on reducing the current debt-to-GDP ratio of 60.2%. Additionally, the deficit-to-GDP ratio is being eyed to improve to 3.0% from the current 5.7%.

Nevertheless, the economy remains quite steady, with tourism touted to provide the additional lift next to OFW remittances and BPO revenues. An average GDP growth of 6% in 2024 is no small feat, yet it undermines the real potential of the country.

Inflation expected to bottom in 1Q24

Inflation was the single biggest setback for all countries in the planet, with the exception of countries like Brunei and Panama. For the Philippines, inflation peaked at 8.7% in January as prices of food and oil surged, compounded by the Israel-Hamas war in early October. Recent data suggests inflation could be easing amid moderating food and oil prices.

Monetary authorities remain vigilant as upside risks persist due to weather and geopolitics, among others, as it steers inflation back to its sweet spot, likely reaching the BSP's 2-4% target in 2024.

Interest rates soar on inflation, domestic and imported

The BSP's policy rate of 6.50% is the highest since August 2007, thanks to the rise in inflation and the U.S. Fed's 100-bp hike this year. With interest rates this high, business expansion was put on hold, adding to the drag to GDP. Post-off-cycle rate hike, markets are expecting the BSP is done raising rates and will start cutting by 2H24. The BSP continues to keep its cards close to its chest.

Peso and the markets on the defensive

The peso sank versus the USD, retesting the PHP57 level due to the U.S. Fed's string of rate hikes before regaining some lost ground to hover above Php55. This dampened local stocks which fell below 6,000 in October before recovering to 6,200 in a base-building move. Local bond yields mirrored the defensiveness of investors, which saw the 10Y touching 7% amid fears of further tightening as well as increased government borrowing to fund its projects.

Table 1: Metrobank PH Economic Forecasts

Metric	2023F	2024F	2025F
GDP (YoY)	5.5%*	6.0%	6-7%
Inflation (YoY)	6.0%	4.3%	4.3%
Target RRP Rate	6.50%	5.50%	4.25%
USDPHP	55.1	54.0	52.7

** with upside bias*

U.S.

The most awaited recession in U.S. history

Markets have been calling for the U.S. to fall into recession for the last 20 months but the economy continues to defy the odds, growing steadily on the back of the strong jobs condition even as spending shows signs of slowing down. 3Q GDP surprised on the upside, growing 5.2% from the previous reading of 4.9%.

However, tighter financial and credit conditions are expected to take a toll on consumption and investment. Hence, the soft landing narrative remains the common outlook for the U.S.

Inflation cooling down but still above Fed's 2% target

The Personal Consumption Expenditures (PCE) price index rose 3.0% YoY in October, while core increased to 3.5% YoY. This was partly due to a drop in energy costs, while food prices continued to climb.

Inflation is expected to continue moderating through 2024, though the Fed's sweet spot of 2% may take some time to happen. Nevertheless, as inflation continues to cool, markets now expect the Fed to start easing early next year.

The Fed is done

The year 2023 saw the most aggressive rate hiking binge by the Fed since March 2022. At 5.50%, the Fed believes it has achieved its goal of taming inflation but not after leaving in its wake patches of softness in the economy, especially spending. All eyes now on the reversal of this "quantum leap."

The Fed is signaling a 75-bp cut in 2024, providing markets a runway for a yearend rally even as the U.S. indices trade at demanding valuations. Some are more aggressive, looking at as much as 150-bp cut for next year. Enjoy the ride in the meantime but be ready to bail out when the music stops.

DXY poised to weaken in 2H24

The U.S. dollar enjoyed relative strength throughout 2023, but recently lost momentum following dovish comments from some Fed officials.

Given the likelihood of rate cuts, the U.S. dollar index (DXY) is expected to weaken, further diminishing the "strong dollar" theme.

Table 2: Bloomberg U.S. Economic Forecasts

Metric	2023F	2024F	2025F
GDP (YoY)	2.4%	1.2%	1.7%
PCE (YoY)	3.8%	2.5%	2.2%
Fed Funds Rate	5.25-5.50%	4.25-4.50%	3.25-3.50%
DXY	103.0	99.7	96.3

Sources: Metrobank Institutional Investors Coverage Division, Bloomberg, CME Group Inc., official government websites

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Sector Review

FY Consensus (PHP Bn) ◆ 9M23

Banks

- Net interest margin continued to expand through 9M23, driven by a surge in higher-margin consumer loans, which were supported by elevated policy rates.
- However, loan growth has moderated as corporates await more favorable rates, potentially in 2024, and remain wary due to demand uncertainty brought by inflation.
- Muted loan growth is expected to persist through 2024, but potential rate cuts in the latter part of next year warrant monitoring as it could accelerate loan demand.

Food, Beverage & Tobacco

- A decline in household consumption, primarily due to inflation, has dragged the sector. 4Q holiday spending and slight optimism are seen as near-term lifts.
- 9M23 results varied; many firms faced challenges. Declining demand led to lower topline figures, but cost management and fall in commodity prices offered some relief.
- Looking ahead, high inflation should continue to weigh on household spending. Despite a decline in select commodity prices, the risk from El Niño lingers.

Real Estate

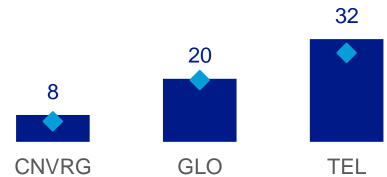
- Not much has changed for the three main segments – offices remained a drag, malls have lifted, while the residential segment appears to have slightly deteriorated.
- Office struggles with high vacancies due to remote work and new supplies. Malls are up due to revenge spending, while residential sales are down amid elevated cancellations.
- Rate cuts are expected to buoy the sector, particularly the residential segment. However, view on offices remains negative, largely due to lower rental rates.

Retail

- Weak demand, influenced by macroeconomic factors, and increased competition led to the sector's underperformance. Furthermore, higher operating expenses squeezed margins.
- High inflation has constrained consumer budgets, leading to a preference for less expensive products. Additionally, households appear to have delayed home renovations.
- Improvements in consumer sentiment, coupled with minimum wage increases, are expected to drive demand. Additionally, rate cuts should bolster expansion initiatives.

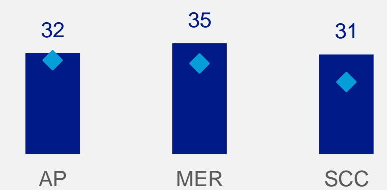
Telecommunications

- Core businesses, mobile and broadband, have experienced sluggish growth since 2H22 which continued through 2023. As a result, markets expressed concerns regarding the sector's performance.
- Mynt, GLO's non-telco arm, has been steadily growing its contribution to the company's core profits. Voyager's Maya, on the other hand, is still burning cash and dragging TEL.
- With a tepid outlook for both mobile and broadband, telcos are likely to find their next growth phase in enterprise, e-wallets, and other non-telco businesses.



Utilities

- Earnings remained positive, with the generation companies (gencos) leading in 1H23 given elevated spot prices. The distribution side took driver seat in 3Q23 as fuel cost receded.
- Spot prices dropped in 3Q23, following a peak in the summer, as the demand-supply margin normalized with the onset of cooler weather.
- The threat of El Niño, which is expected to be more pronounced in 1H24, poses an upside risk to an already-elevated spot price amid improving-but-still-tight energy supply.



Sources: Company data, Bloomberg

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