Research and Market Strategy Department

Notes from the PEB: Not as dovish?

HIGHLIGHTS

- In its Philippine Economic Briefing (PEB) on May 27, the Bangko Sentral ng Pilipinas (BSP) seemed to signal a less dovish stance compared to statements in last week's Monetary Board (MB) meeting which opened the possibility of a rate cut as early as August.
- The BSP sees inflation peaking in the May to July period, but it expects full year inflation to remain at the upper end of its 2%-4% target range, consistent with the forecast of 3.8% average inflation in 2024.
- Meanwhile, Finance Secretary Ralph Recto, a member of the MB, reiterated his own expectations of 150 bps total cumulative cuts over the next two years, implying a much more gradual easing cycle relative to the 450-bp cumulative policy rate hikes over a 17-month span (May 2022 to October 2023).
- On USD/PHP, the BSP reaffirmed that open market operations remain focused on the presence of stress in the market which may affect inflation expectations.

INFLATION, POLICY RATE PATH, AND USD/PHP

- BSP Senior Assistant Governor (SAG) Iluminada Sicat explained that the BSP decided to maintain a restrictive policy stance by keeping RRP rates unchanged at 6.5% to "ensure that we anchor inflation expectations so that it will not result in further second round effects."
- With the BSP's full year risk-adjusted inflation outlook forecast expected to hover at the upper end of its target range, Sicat stressed that the BSP must be careful not to bring down interest rates too early as this will exacerbate existing upside risks.
- International Monetary Fund (IMF) Resident Representative to the Philippines Ragnar Gudmundsson added that both monetary and non-monetary measures to address inflation were needed to contain these upside risks, given that domestic inflation is driven mostly by supply shocks.
- Secretary Recto said that rice prices are expected to fall by 20% this September, driven by an increase in local production, which then supports the downtrend in inflation, and possible rate cuts, later in the year.
- On USD/PHP, Sicat reiterated that the BSP allows the market to determine the foreign exchange rate and does not target a certain level, but added that market stress is also actively assessed, which includes factoring in price action of peer currencies in the region.
- On growth, Secretary Recto expressed optimism that the economy will double by 2028, achieve a 9% poverty incidence by 2028, and become the 13th biggest consumer market by 2030.
- In addition, given both internal and external headwinds, Finance Secretary Recto noted that the recent revision in growth targets and fiscal path provides a more realistic framework for the government to allow for more gradual and sustainable fiscal consolidation that still supports growth but with less government borrowing.

OUTLOOK

- The Metrobank Research and Market Strategy Department believes that the BSP will maintain "sufficiently restrictive" policy as upside risks to inflation remain due to still-elevated food prices and heightened geopolitical risks that could lead to renewed supply shocks.
- In line with the BSP's guidance, we forecast domestic headline inflation to peak in July, which in turn would only be observable in early August. This supports our view that the BSP will start its easing cycle in Q4, rather than Q3, when inflation expectations have settled well within the BSP's 2-4% range.
- We also continue to see the BSP lagging the US Federal Reserve's own easing cycle, where we expect the first policy rate cut in the September FOMC meeting, which should then support the peso.
- We expect the peso to be further supported by a narrowing current account balance (USD 6.1 billion in 2024 vs. USD 11.2 billion in 2023) driven in turn by improving trade deficit levels and recovering travel exports, accompanied by an expected uptick in BPO revenues and OFW remittances in the fourth quarter. We forecast USD/PHP at 56.10 by year end 2024.