BSP NOT AS DOVISH?

Financial Markets Sector
Philippine Rates Outlook
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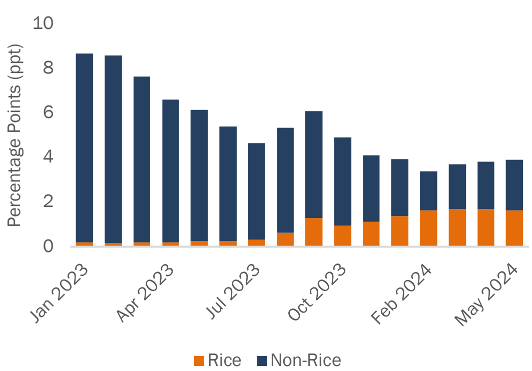
- Metrobank Research forecasts domestic headline inflation to peak in July, supporting its view that the Bangko Sentral ng Pilipinas (BSP) will start their easing cycle in Q4 when inflation expectations have settled well within the government's target.
- Metrobank Research adds a downward bias to its 4.0% inflation forecast for 2024, on the back of a projected softening of upward pressures from rice and oil prices.
- Despite BSP Governor Eli Remolona reiterating the independence of the Monetary Board's decision on policy rate adjustments from the Fed, Metrobank Research anticipates that the BSP will neither pre-empt nor cut bigger than the Fed.
- Finance Chief Ralph Recto also expressed during the PEB that policy rate cuts totaling 150 basis points (bps) is likely within the next two years. However, BSP Governor Remolona said in a recent statement that such strategy is "too aggressive".
- On USD/PHP, BSP Senior Assistant Governor (SAG) Iluminada Sicat reiterated during the PEB that the BSP allows the market to determine the foreign exchange rate and does not target a certain level. This view was also supported by BSP Governor Eli Remolona's recent statements expressing the BSP's readiness to intervene under stress situation.
- Metrobank Research forecasts the yearend exchange rate at PHP 56.1/USD 1, with the peso anticipated to be supported by wider policy rate differentials and an improved current account balance by year-end.

Inflation to peak in July

The Philippines' headline inflation rose to 3.9% year-on-year in May, a slight acceleration from the 3.8% recorded in April. This is driven by the increase in the index of the housing, water, electricity, gas and other fuels. This brings the year-to-date average inflation from January to May 2024 to 3.5%.

During the PEB last May 27, 2024, BSP SAG Iluminada Sicat said that inflation is projected to breach the upper end of the Development Budget Coordination Committee's 2%-4% target until July and will revert back within target range thereafter. With this, the BSP's risk-adjusted full year inflation forecast for 2024 has been lowered to 3.8% from the previous 4.0%, although still settling near the upper end of the target. Moreover, upside risks to inflation remain, mainly arising from higher transport charges, electricity rates, global oil prices, and food prices including the declining yet still elevated global rice prices.

Chart 1. PH Inflation



The Philippine Statistics Authority (PSA) earlier stated that although global rice prices have peaked in January, rice inflation, which is the main contributor to headline inflation in the past months, is expected to remain elevated until July due to low base effects, considering rice prices began to soar in August 2023.

To address rice inflation, the government is looking into reducing the duty rates on rice to 15% from the current 35%. The PSA estimates that once implemented through an Executive Order (EO), this will cut rice prices by approximately PHP 5 to PHP 7 per kilo.

National Economic and Development Authority (NEDA) Chief Arsenio Balisacan also mentioned during the economic briefing that the government, through the Inter-Agency Committee on Inflation and Market Outlook (IAC-IMO), is taking various steps to address existing and anticipated inflationary measures. These include, among others, monitoring prices and supply and demand levels of key commodities; facilitating timely and adequate imports; and addressing longer-term issues on agricultural productivity.

Foreign exchange intervention less likely

The USD/PHP exchange rate encountered fluctuations throughout the month of May this year as the peso weakened approximately 5.36 percent against the US dollar, breaching the crucial 58-per-dollar threshold. This plunge marked the weakest level since October 2022. The peso's depreciation against the US dollar over the month put peso as the 4th worst performing currency in Asia behind the Korean won, Thai baht and, Japanese yen.

We also expect the 59 figure to hold as the BSP may intervene heavily at this level, similar to October 2022. Recent statement from BSP Governor Remolona that "BSP may intervene when necessary to smoothen excess volatility and restore order during period of stress" also indicate likely central bank intervention.

Moving forward, Metrobank Research still expects USD/PHP to remain elevated throughout Q2 and Q3 at 57-58 considering the broad dollar strength in global FX and the usual import season for the Philippines. However, cooling inflation in the US combined with sluggish imports growth in the Philippines and increasing sources of dollar inflows should allow the peso to appreciate to our yearend forecast of 56.10.

Chart 2. PHP/USD

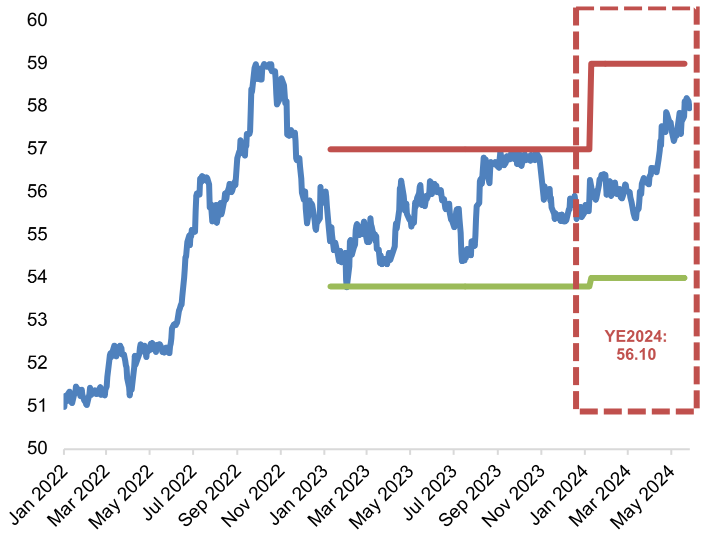
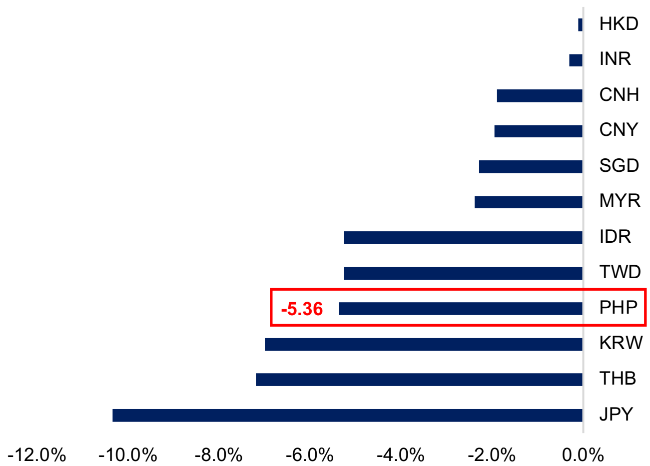


Chart 3. Year-to-Date Dollar Spot Returns



US Federal Reserve may cut rates by July or September

During the last Federal Open Market Committee meeting in May, the US Federal Reserve (Fed) maintained the Federal Funds Target Rate (FFR) at 5.25% to 5.50%. This was the sixth consecutive meeting that the FOMC decided to hold policy rates steady, following a string of 11 rate hikes, including four hikes in 2023.

US data indicated a weakening in economic growth as GDP growth in the first quarter of the year came out at 1.3%. This matched consensus estimates and lower-than-last quarter of 2023's GDP growth of 1.6% could indicate a lagged effect of the restrictive interest rate environment in the US following the last hike in July 2023. As Fed's mandate include targeting maximum employment and price stability, Fed officials are monitoring closely the labor market and inflation data. Prior to beginning cuts in the FFR, they need to gain more confidence that the inflation is moving towards the 2.0% target.

Recent April inflation prints, which include the Consumer Price Index (CPI) and the Personal Consumption Expenditure (PCE) indicate a slow taming down of prices from last month. The Fed's preferred inflation gauge, the core PCE which excludes food and energy, shows a downward trajectory towards the 2.0% long-term target. Their median projection as of March 2024 for the monthly headline PCE and Core PCE for 2024 is 2.4% and 2.6%, respectively. Federal Open Market Committee (FOMC) is expected to revisit their economic projections in their June meeting.

Chart 4. US CPI, PCE, Core PCE

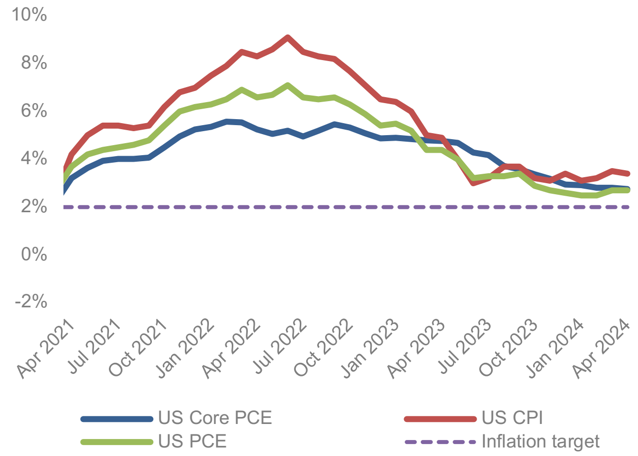
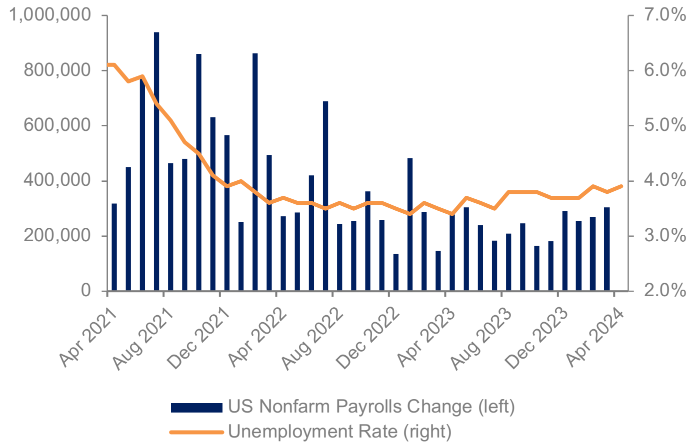


Chart 5. US Nonfarm Payrolls, Unemployment Rate



The downward trend in inflation, together with recent GDP print for 1st Quarter of 2024, show weakened consumer spending given the high interest rate environment. This reinforces the view of a Q3 2024 start of the easing cycle in the US.

BSP may cut rates by 4Q 2024

Metrobank Research continues to expect the BSP to likely delay its first cut until the Fed begins its monetary easing, especially with the current high level of the USD/PHP exchange rate. Despite Governor Eli Remolona reiterating the independence of BSP's decision on policy rate adjustment from the Fed's, Research thinks the BSP will not pre-empt or cut bigger than the Fed.

With the BSP's risk-adjusted full year forecast settling near the upper end of the government's target range, BSP SAG Sicat said that the BSP is maintaining a restrictive policy stance in order to ensure that inflation remains anchored and to avoid further second round effects. Given this, the BSP official also highlighted that the BSP must be very careful not to bring down interest rates too soon, as doing so could possibly bring full year inflation above target.

The monthly year-on-year inflation is expected to peak in July and anticipated to begin its downward trend in August. With the August and September inflation figures expected to have been released prior to the Monetary Board's scheduled meetings in the fourth quarter of the year, Metrobank Research maintains its view that the BSP will likely begin its monetary easing cycle in Q4 2024.

Trade Ideas for Investors

Invest in 1- to 3-year Peso Government Securities and Corporate Bonds to be opportunistic before extending duration

The recent rally in the Philippine fixed income markets was partly caused by rally in US treasuries amid increased expectation of a September rate cut after a slower month-on-month growth of US Core PCE. This has resulted in peso bond yields moving 5-30 basis points lower from the 2023 highs. Although, this might signal investors to long duration, there might be a room for potential sell-off given the concentration of Bureau of Treasury's (BTr) borrowing schedule around long-term bonds.

For investors who remain cautious to long duration, we recommend to invest in shorter 1 to 3-year bonds while waiting for better entry levels for the longer-dated bonds in BTr's primary auction

Indicative pricing as of June 4, 2024. Subject to available volume.

Security	Maturity Date	Remaining Tenor (years)	Coupon Rate (gross)	Offer Yield to Maturity	Offer Price
RTB 5-13	Aug 12, 2025	1.19	2.6250%	6.2000%	96.725
FXTN 25-1	Nov 29, 2025	1.48	18.2500%	5.9800%	113.893
CNVRG 27 R25	Apr 8, 2027	2.80	5.5942%	6.5100%	98.075
RLC 27 R25	Aug 26, 2027	3.20	5.9362%	6.5900%	98.457

RTB 5-13 provides a 15-basis point (bp) premium against the 1-year peso treasury bill for a 2-month extension. There is also ample liquidity in the market, which makes it easy for clients to exit or shift to other securities when the right opportunity arises. FXTN 25-1 is a play on accruals as this bond provides the highest coupon across the curve.

We like Converge's credit as it continues to exhibit steady growth in the Philippines' telecommunications industry. Consolidated revenues increased to PHP 35.359 billion or +4.94% year-on-year in 2023 and the company has been expanding its operations beyond Metro Manila. Converge's bonds are a way to still gain exposure to the company's credit while earning regular cashflows.

Robinsons Land Corporation is one of the leading real estate and property developers in the Philippines. The company is looking to ramp up business expansion, with a reported planned domestic capital expenditure of PHP 22 billion for fiscal year 2024. We prefer property companies with strong exposure to the retail sector since consumer spending is expected to remain stable.

Both CNVRG and RLC bonds provide a 20-bp yield pickup over the 3-year RTB 5-15.

Invest in 5- to 20-year Peso Government Securities to lock in returns

On the other hand, clients who are already satisfied with current levels may already buy 5- to 20-year peso government securities, particularly higher coupon bonds whose prices are already close to par or even at a discount.

Indicative pricing as of June 4, 2024. Subject to available volume.

Security	Maturity Date	Remaining Tenor (years)	Coupon Rate (gross)	Offer Yield to Maturity	Offer Price
RTB 5-18	Feb 28, 2029	4.74	6.2500%	6.4100%	99.465
FXTN 7-68	Oct 13, 2029	5.36	7.0000%	6.4300%	102.104
FXTN 20-17	Jul 29, 2031	7.12	8.0000%	6.5500%	106.814
FXTN 10-71	Aug 17, 2033	9.21	6.6500%	6.9300%	99.848
FXTN 10-72	Jan 25, 2034	9.65	6.6300%	6.9000%	97.722
FXTN 20-23	Jan 24, 2039	14.65	6.7500%	6.7300%	100.154
FXTN 20-26	Feb 28, 2044	19.75	6.2500%	6.7300%	95.360

These longer tenor bonds are more sensitive to interest rate risk and are more appropriate for clients who will hold the bonds to maturity. It may also be possible to earn capital gains as bond prices are expected to appreciate in value once policy rate cuts actually happen. Bondholders can continue to accrue interest income while waiting for that opportunity.

However, note that all bonds are subject to market and liquidity risk. When selling bonds back to the secondary market, it is possible that the bonds may be sold at a price lower than where they were originally bought, potentially incurring a trading loss. It may also not be possible to immediately sell certain bonds if there are no buyers present in the market.

Take profit in longer tenor Peso Government Securities before reinvesting in BTr's primary auction

On the other hand, clients who already hold 10- to 20-year peso government securities and have a view potential sell-off in the longer tenor securities may take profit in these positions and park their cash in short term securities before reinvesting in the upcoming auction.

Tenor	Auction Date	Market Level	Indicative level to invest in
10 years	11 Jun 2024	6.736%	6.700-6.950%
15 years	18 Jun 2024	6.790%	6.750-7.000%
20 years	25 Jun 2024	6.844%	6.800-7.050%

However, note that this strategy is subject to reinvestment risk given that yields might have moved lower by the time investors would reinvest in the primary auction.

Invest in 3-12M Brokered Third Party Bearish and Range Binary Structured Notes

Given our views that the BSP will most likely protect USD/PHP at 59.00 and the local pair will close lower by the end of the year, clients may also consider investing in Brokered Third Party Binary Structured Notes linked to the USD/PHP as an alternative to short-term securities.

The **bearish binary note** may be an appropriate investment for clients who share the same view of USD/PHP going lower in the near future. The note pays a maximum coupon when the USD/PHP 11:30 AM Weighted Average Rate (“fixing rate”) two (2) business day before maturity date falls below the specific strike rate. However, if the fixing rate rises above the strike rate, then the note pays a minimum coupon instead.

Indicative pricing as of June 4, 2024 at spot reference 58.73. Subject to client suitability and derivative credit facilities.

Issuer	Tenor (months)	Currency	View	Strike Rate	Minimum Coupon	Maximum Coupon
Goldman Sachs International	3	PHP	Bearish	58.73	1.3500%	6.3900%
	6	PHP	Bearish	58.73	1.3500%	6.2500%
	9	PHP	Bearish	58.73	1.3500%	6.0300%
	12	PHP	Bearish	58.73	1.3500%	5.9000%

On the other hand, the **range binary note** is more suitable for clients who believe that USD/PHP will just trade within a range of two rates over the investment horizon. The note pays a maximum coupon when the fixing rate two (2) business day before maturity date is within the chosen range. However, if the fixing rate falls outside the range, then the note pays a minimum coupon instead.

Indicative pricing as of June 4, 2024 at spot reference 58.73. Subject to client suitability and derivative credit facilities.

Issuer	Tenor (months)	Currency	View	Range	Minimum Coupon	Maximum Coupon
Goldman Sachs International	3	PHP	Inside Range	57.26175 - 60.19825	1.3500%	5.1400%
	6	PHP	Inside Range	57.26175 - 60.19825	1.3500%	6.0700%
	9	PHP	Inside Range	57.26175 - 60.19825	1.3500%	6.5200%
	12	PHP	Inside Range	57.26175 - 60.19825	1.3500%	6.9700%

These are just illustrations of how binary notes can be priced. The actual product is flexible enough that the bank is able to adjust the binary note components, depending on a client’s preferences. For example, it is possible to set a higher minimum coupon but the corresponding maximum coupon will also adjust lower. Conversely, a lower the minimum coupon will result in a potentially higher maximum coupon.

Terminating structured notes prior to maturity may result in potential mark-to-market (MTM) losses depending on the prevailing foreign exchange rate at the time of the unwind. Clients are encouraged to hold their structured notes until the maturity date to avoid potential losses.

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