Metrobank

Research and Market Strategy Department

POLICY RATE VIEWS

BACK-TO-BACK CUTS: BSP FOLLOWS FED ACTION

Current Target Federal Funds Rate (FFR) 4.25% - 4.50%	Current Reverse Repurchase Rate (RRP) 5.75%
Interest Rate Differential (IRD): **125 bps**	

Fed cuts by 25 bps

The US Federal Reserve (Fed) reduced the Federal Funds Target Rate (FFR) by 25 basis points (bps) to 4.25% - 4.50% at the last Federal Open Market Committee (FOMC) meeting this year on December 17-18.

Reverting back to inflation

In its December statement, the FOMC continues to acknowledge the progress toward the Fed's objectives and maintains its confidence on the overall strength of the economy.

Since the Fed's 50-bp cut in September, the committee has recognized that inflation is already moving sustainably toward the 2.0% target. It has also shifted its focus to the cooling labor market given lower non-farm payroll numbers.

However, latest guidance from the FOMC signals that the Fed's focus has reverted to inflation given prevailing risks such as geopolitical tensions and policy uncertainties in the US. The latest Summary of Economic Projections points to expectations of higher inflation and lower unemployment rate in the near-to-medium term, a reversal from the Fed's guidance in the preceding months, and only 50 bps worth of cuts in 2025 and a higher terminal rate of 3.00%.

Additionally, in the post-FOMC meeting press conference, Chair Jerome Powell indicated that as the policy rate has already been reduced significantly by 100 bps from its peak of 5.50%, the Fed "can therefore be more cautious" in considering further adjustments.

BSP follows with a 25-bp cut

The Bangko Sentral ng Pilipinas (BSP) reduced the Reverse Repurchase (RRP) rate by 25 bps to 5.75% at the last Monetary Board (MB) meeting this year on December 19.

Remolona's signal

According to BSP Governor Eli Remolona, while inflation this year is expected to remain within target, the balance of risks to inflation have shifted to the upside due to potential upward adjustments to transport and electricity costs. Apart from this, BSP continues to monitor other risks coming from geopolitical factors. Meanwhile, lower rice tariffs remain the biggest downside risk to inflation.

Given "target-consistent inflation" and current economic conditions, Governor Remolona signaled that the BSP will continue easing in the absence of a big surprise in economic data. However, he indicated that "100 bps may be a bit much." Lastly, he also reiterated previous statements that the BSP will take "baby steps" in reducing policy rates.

In assessing the impact of easing inflation and a less restrictive policy rate environment, BSP expects domestic demand in 2025 to "remain firm but subdued." BSP Assistant Governor Zeno Abenoja stated that the GDP outlook may reach the government target, but at the lower bound.

On USDPHP, Governor Remolona reiterated previous statements that the current passthrough of the depreciation of peso to inflation is currently modest and that the BSP does not target a specific level.

ECONOMIC DATA

US Inflation and Labor Market

US inflation has been on a slight upward trend in recent months amid faster year-on-year (YoY) increases in food costs and as energy and core goods prices drop YoY on a slower pace. However, shelter prices, the main contributor to inflation, continue to slow down YoY.

The Fed's preferred inflation measure, the US Core Personal Consumption Expenditures (Core PCE) price index, rose by 2.8% YoY in October, an acceleration from the 2.7% in September. Similarly, the headline US Consumer Price Index (CPI) was at 2.7% in November, faster than the 2.6% price rise in October.

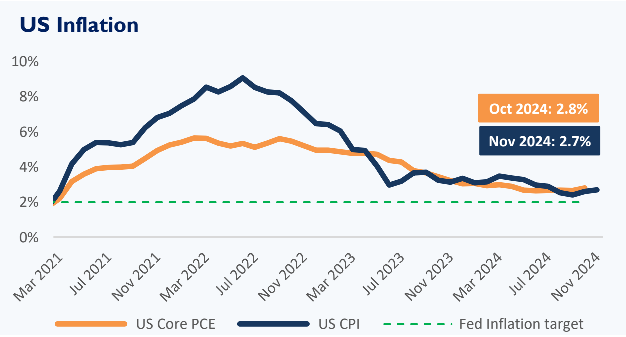
US non-farm payrolls increased by 227,000 in November, exceeding the 220,000 market expectation for the month and the 36,000 recorded in October. While the latest jobs print suggests a possible pickup, the US unemployment rate stood at 4.2% as of November, slightly higher than the 4.1% in the preceding month.

Philippine Inflation

The BSP slightly nudged its baseline inflation forecasts to 3.2% for 2024 and 3.3% for 2025, while risk-adjusted forecasts were also revised upward to 3.2% for 2024 and 3.4% for 2025. The BSP's latest estimates take into account upside risks from geopolitical factors, as well as transport and electricity prices. For 2026, the BSP's baseline forecast is at 3.5% while the risk-adjusted inflation is retained at 3.7%.

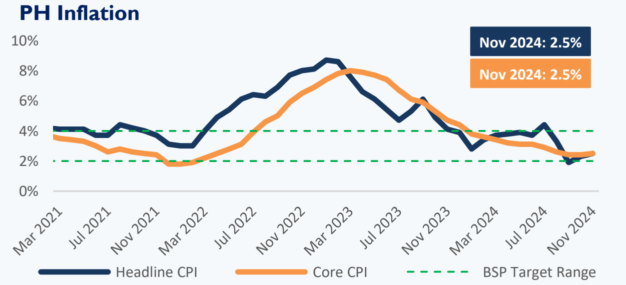
In November, the Philippines' headline CPI accelerated by 2.5% YoY, mainly driven by higher food prices after bad weather disrupted supply chains. The latest inflation print is faster than the 2.3% YoY recorded in October, but in line with market expectations for the month. This brings year-to-date inflation to 3.2%, well within the BSP's 2%-4% full year target.

Meanwhile, core CPI, which excludes volatile food and energy items, slightly accelerated to 2.5% YoY in November from the preceding month's 2.4% YoY.



BSP RISK-ADJUSTED INFLATION FORECAST

As of Aug 2024	As of Oct 2024	As of Dec 2024
2024: 3.3%	2024: 3.1%	2024: 3.2%
2025: 2.9%	2025: 3.3%	2025: 3.4%
2026: 3.3%	2026: 3.7%	2026: 3.7%



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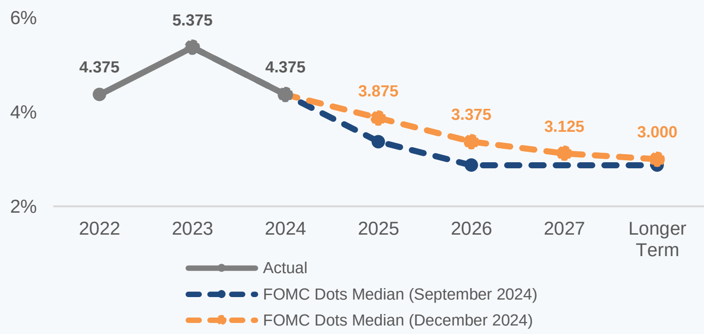
Federal Reserve's Summary of Economic Projections

Fed's Economic Projections (in %)	as of September 2024					as of December 2024				
	2024	2025	2026	2027	Longer run	2024	2025	2026	2027	Longer run
Real GDP	2.0	2.0	2.0	2.0	1.8	2.5	2.1	2.0	1.9	1.8
Unemployment Rate	4.4	4.4	4.3	4.2	4.2	4.2	4.3	4.3	4.3	4.2
PCE Inflation	2.3	2.1	2.0	2.0	2.0	2.4	2.5	2.1	2.0	2.0
Core PCE Inflation	2.6	2.2	2.0	2.0		2.8	2.5	2.2	2.0	

Source: US Federal Reserve

Fed Dot Plot



Fed pivots back to inflation

PCE Inflation takes center stage in the Fed's latest projections as the Trump administration could prompt a more cautious approach from the Fed. The latest Summary of Economic Projections (SEP) shows upward revisions in its inflation projections, a pivot from the direction of the previous SEP in September. Both Personal Consumption Expenditure (PCE) and Core PCE are projected to settle higher this year at 2.4% and 2.8%, respectively. Meanwhile, the projections for 2025 indicate that both will settle at 2.5%.

On the labor market, unemployment is projected to settle lower this year and in 2025 at 4.2% and 4.3%, respectively, compared to previous projections, signaling expectations of cooling inflation. Meanwhile, the long run unemployment rate remains unchanged.

Although Chair Powell stated that he thinks the US economy is "in a good place," the Fed has begun to anticipate how the upcoming administration's promises could affect inflation. Despite policy uncertainties, the Fed anticipates faster economic growth this year and the next compared to its previous projections.

Dot plot ticks higher

The Fed's December dot plot, a tool used as forward guidance by the US central bank, took a few steps upward after dipping in September. The latest SEP showed that the median target FFR in 2025 is now at 3.875%, higher than the 3.375% in September. This translates to a cumulative 50-bp cut next year instead of the previously expected 100 bps. The dot plot also revealed that the Fed expects the terminal rate to settle higher at 3.00%.

METRO RESEARCH'S TAKE

Stepping into an uncertain 2025

The recent policy movement by the Fed was aligned with Metrobank Research's expectation. Despite changes in the Fed's outlook on the US economy, we maintain our forecast that the Fed will continue with its easing cycle in the next two years to support the labor market and economic growth in the US. We expect the Fed to still deliver a total of 75 bps worth of cuts in 2025 and another 75 bps in the succeeding year, bringing the target FFR to its terminal rate of 3.00% by end-2026. This forecast has been revised after the US elections to account for policy uncertainties following Trump's win as president and the red sweep in Congress.

BSP to continue easing, keeping our call for three cuts in 2025

On the local front, Metrobank Research expects the BSP to continue with its easing cycle in the next two years given the projected target-consistent inflation outlook. With this, BSP is expected to match its pace of three rate cuts next year while monitoring the potential impact from Trump-related policies on the exchange rate. BSP will remain watchful for possible episodes of extreme pressure on PHP, given its implications on inflation and price expectations. Should BSP carry out 75 bps worth of easing in each of the next two years, RRP should settle at 4.25% by end-2026.

Spot still in the spotlight

Recent less dovish sentiments from the Fed has led to sustained dollar strength with the US dollar index rising to as high as 108.125 today, December 19, the highest level since November 2022. This adds pressure on other currencies including the peso.

With the BSP matching the Fed's 25-bp cut, the interest rate differential of the Fed and the BSP is maintained at 125 bps. Metrobank Research maintains its end-2024 USDPHP forecast of 58.8. Likewise, we are expecting USDPHP to end at 57.9 by end-2025 and 56.5 by end-2026.

Related Articles:
1) One for the road: BSP and Fed to cap 2024 with a rate cut
2) Fed Update: Rate cuts to support jobs market | Metrobank Wealth Insights
3) Policy Rate Updates: Philippine central bank takes baby steps in rate cut cycle | Metrobank Wealth Insights