

Asia FI & FX Strategy Watch

Philippines – Changing liquidity toolkit

BSP's RRR cut – no impact on PHP

Over the last few months, PHP has shown higher sensitivity to dovish comments by BSP as it marked an end to the hiking cycle. However, BSP's announcement of cut in banks' RRR to 9.5% from 12%, effective from 30th June, had little impact on PHP. The cut was well-flagged by the governor during the last policy meeting, with marginal net liquidity injection as it was planned to offset upcoming expiry of other pandemic-era exemptions for banks. BSP further committed to offset the injection via other instruments, concurrently announcing issuance of 8-weeks bills.

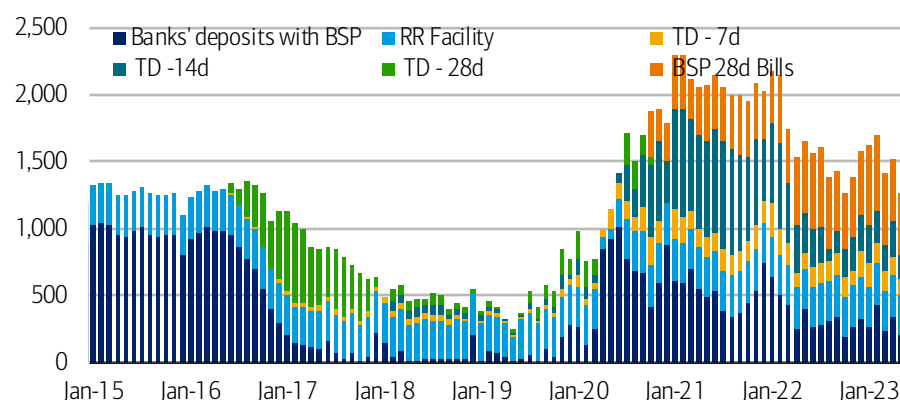
While PHP has benefitted from recent improvement in its terms of trade, PHP is not out of the woods yet. Narrow nominal rates spread, low real rates against persistent twin deficits, elevated real-valuation and thin reserves buffer leave little room for complacency against any adverse shock. Previously, BSP's hawkish guidance about maintaining 100bps policy rate spread over Fed rates has helped in reducing risk of further dovish. To this end, BSP's re-emphasis on delinking RRR cut from a shift in policy stance would help in reducing depreciation pressure on PHP.

Changing liquidity toolkit

Since the shift to interest-rate corridor in Jun'2016, BSP has relied on term deposit facilities, and later added bills issuance to its toolkit for liquidity absorption. The reduction in RRR, thus, a reflection of changing structure of BSP's liquidity management operations and move to auction based measures from blanket tools like RRR. Overall system liquidity hasn't yet reverted to pre-pandemic levels, but less than half of the excess liquidity is now being left in overnight facilities. *(Continued)*

Exhibit 1: Excess liquidity is still large but less than half is left in overnight facilities

Liquidity absorbed by various BSP facilities including reverse repo, term deposits and bills (PHP Bn)



Source: BofA Global Research, Bloomberg

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Abhay Gupta
Emerging Asia FI/FX Strategist
Merrill Lynch (Singapore)
+65 6678 0427
abhay.gupta2@bofa.com

Glossary

BSP: Bangko Sentral Ng Pilipinas

PHP: Philippines Peso

RR: Reverse repo

RRR: Reserve requirement ratio

TD: Term deposit

YoY: Year on year

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Overall liquidity is still flush

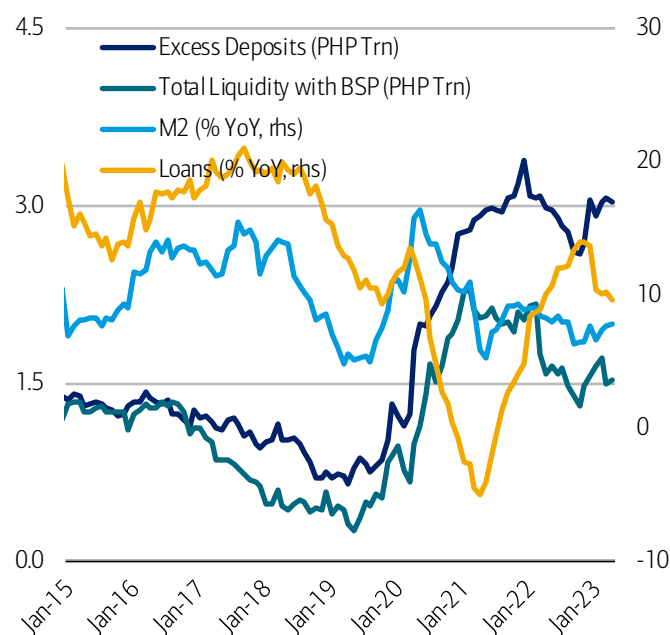
Despite the net neutral impact of RRR cut, this does indicate BSP's desire to maintain flush liquidity levels, well above the 2019 levels. One reason may be that loan growth has slowed further to below 10% as of Apr'23. This is lowest loan growth in the last-decade apart from during 2020-21, particularly so in real-terms and well below the nominal GDP growth rate of 13% as of 1Q23. Part of this has to do with the fact that a larger proportion of banks' balance sheet is now tied-up with government securities. Loan to deposit ratio has fallen to 69% from peak around 77% in 3Q'19.

Secondly, cutting RRR helps in supporting banks' loan margins as RRR is unremunerated and an increase in posted reserves would have marginally reduced banks' margins. Given the large excess funding in the system, BSP would have bear the cost of sterilizing these reserves, while reducing the burden on banks.

Lastly, slow fiscal consolidation pace and high dependence on retail and bank demand to fund the deficit would also warrant continuation of flush liquidity conditions. At current levels, banks may be better-off parking the funds in short-term BSP facilities and bills, However, retail time deposit rates remain at low levels at around 4.7% for 1y to 5.1% for 5y, well below comparable bond yields. Thus, keeping liquidity flush would avoid deposit competition amongst banks and maintain retail demand for government bonds.

Exhibit 2: Loan growth is slowing despite large liquidity surplus

Loan and deposit growth (% YoY, rhs) and measures of liquidity (PHP Tn, lhs)

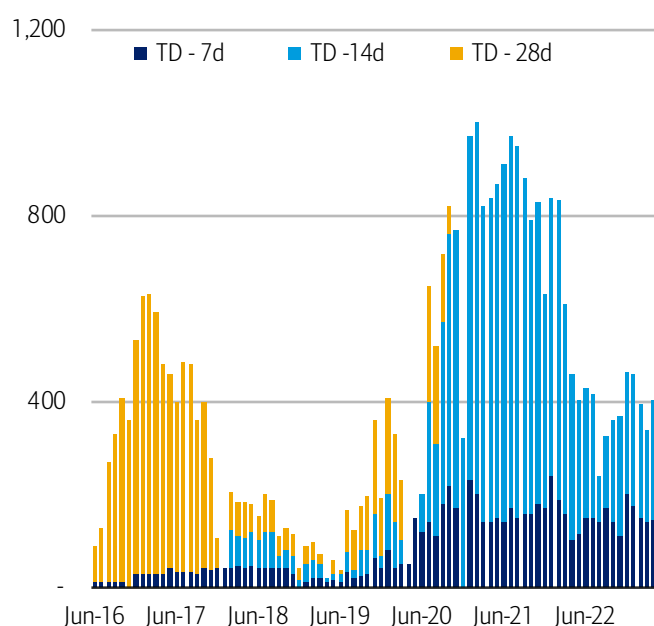


Source: BofA Global Research, Bloomberg

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Exhibit 3: Most of liquidity in longer tenor term deposits

Breakdown of term-deposit auctions to 1, 2 and 4 weeks (PHP Bn)



Source: BofA Global Research, Bloomberg

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But being locked in longer-tenors

Despite some normalization, overall system excess liquidity parked across various deposit or reverse repo facilities remains large at over PHP 0.9Tn as of end-May. BSP kept the reverse repo amount constant at PHP 0.3 Tn while overall amount being absorbed via term deposits and deposit facility has declined substantially (See Exhibit 1). As the excess liquidity normalized, BSP has kept the bills outstanding constant while reducing the short-tenor liquidity in term deposits. Currently, at PHP 470Bn, around 1/3rd of total liquidity is locked in 4-weeks bills. BSP has announced issuance of 8-week bills which might further increase the amount locked in longer-tenor operations. Given the already large surplus, marginal impact of the net injection is unlikely to be significant, either on FX or rates.

BSP's liquidity framework

Lastly, we briefly describe BSP's few liquidity management framework and toolkits. The purpose of the liquidity operations is to keep money market rates close to BSP's policy rate. Since the move to interest-rate corridor in Jun'2016, BSP began using term-deposit operations to lock liquidity in long tenors up to 4-weeks and raise term-structure of money market rates. With amendment of BSP charter in early'2019, BSP was also allowed to freely issue bills for managing liquidity, as against earlier provision of bills issuance only during emergency.

Structural surplus is managed through issuance of BSP bills/bonds and term deposits, which are offered as fixed amount but variable rate auctions, usually on weekly basis. Prior to the amendment of BSP's charter, BSP issued 4-weeks term deposits, however, lately BSP has limited term-deposits to 1-week and 2-weeks tenors only. Bills are being issued for 4-weeks tenor, with plans to initiate 8-weeks issuance on 30th June and extend to longer tenors, including bonds, over time.

The remaining surplus is absorbed through fixed-rate facilities on overnight basis. In the morning, reverse repo auctions for a fixed amount, currently at PHP 305Bn, absorbs part of the surplus. Towards end of the day, any remaining surplus or deficit is mopped-up by standing facilities at +/-50bps corridor around the policy rate.

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