Navigating rates, FX and election dynamics in the Philippines

Despite the surprising hold on policy rates last month, we expect the BSP to cut rates by 75bp to 5% in 2025. Weaker external balances and REER overvaluation suggest that the Phillippine peso should weaken against the US dollar. Markets will be keenly watching the upcoming mid-term elections, especially given the dramatic turn of events as of late

Makati, Philippines

1 How aggressively will the BSP cut rates given the recent hold?

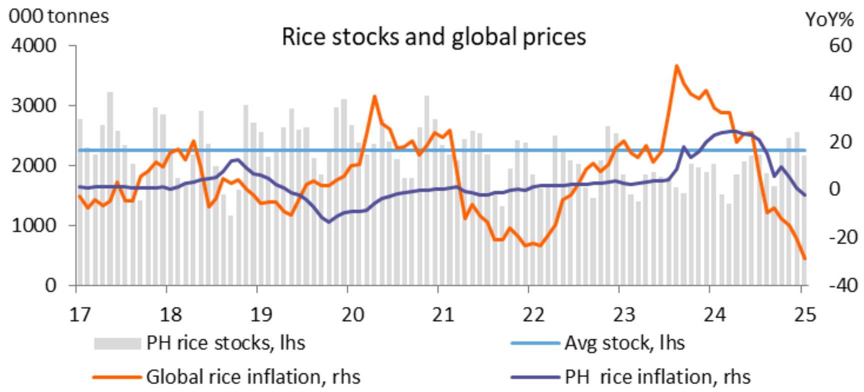
The Bangko Sentral ng Pilipinas' (BSP) decision to pause its rate-cutting cycle during the February policy meeting was unexpected. We believe this was primarily due to "unusual" global uncertainties rather than domestic fundamentals. Despite this surprising hold, we still anticipate that the BSP will reduce policy rates by 75bp to 5% in 2025.

Firstly, inflation remains a significant factor in the BSP's monetary policy decisions. We anticipate that CPI inflation will largely and sustainably stay within the central bank's target range. The substantial decline in global rice prices has not yet been fully reflected in local rice prices in the

Philippines, suggesting further potential for food price corrections. Additionally, the stability of the USD/PHP exchange rate should help mitigate the risks of imported inflation. Secondly, the current real policy rates continue to remain close to an all-time high and are some of the highest in the region. Thirdly, considering the sluggish trends in private consumption, investment, and export growth, it is even more likely that the BSP's rate cutting cycle is far from over.

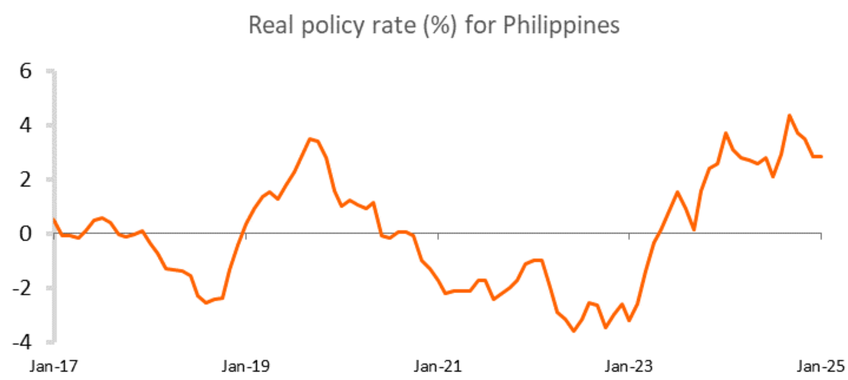
The timing of the rate cuts is expected to be more gradual and measured than previously anticipated, influenced in part by the Federal Reserve's actions. We foresee three additional rate cuts of 25bp each: one in April, driven by an unexpected drop in February's CPI inflation, and two more in September and December, contingent on clearer signals from the Fed.

Sharp fall in global rice prices, domestic prices are catching up



Source: CEIC

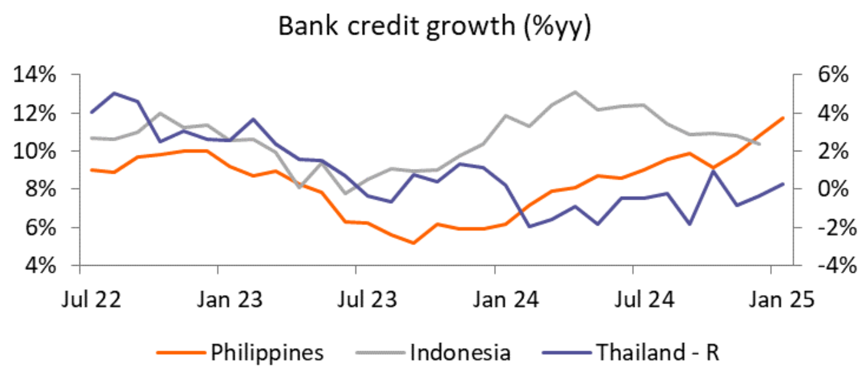
Real policy rate close to all-time highs



Source: CEIC

The BSP's substantial easing measures – including 75bp of policy rate cuts since August and 450bp in reserve requirement ratio (RRR) cuts since September 2024 – have significantly relaxed monetary policy conditions. Consequently, bank credit growth has surged from 6% year-on-year in December 2023 to 12% in January 2025. Enhanced monetary policy transmission and increased credit growth provide the BSP with the flexibility to delay rate cuts until later in the year when there is more clarity on tariffs and Fed rate cuts. We anticipate a strong likelihood of rate cuts by the Fed in September and December, which should offer the BSP reassurance in reducing local rates.

Improved monetary policy transmission and higher credit growth



Source: CEIC

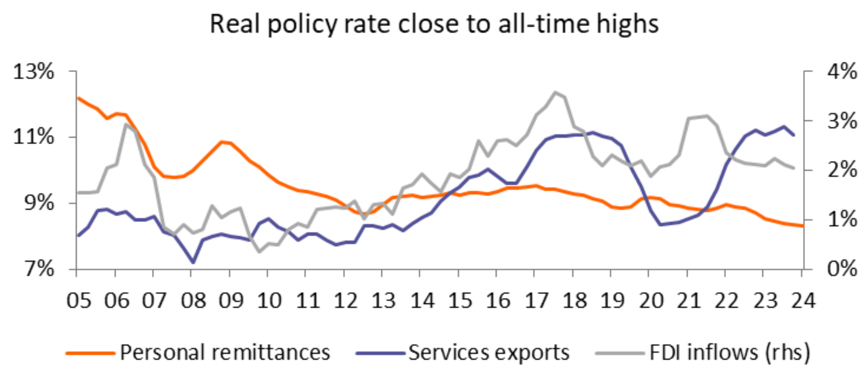
2 Has USD/PHP peaked?

We believe the US dollar is currently factoring in numerous negative elements, and the balance of risks for the coming weeks has shifted to the upside. As we move into the second quarter and tariffs are implemented, we maintain a bullish outlook on the USD, anticipating a setback for global activity. Concurrently, weaker external balances and REER overvaluation indicate that the Philippine peso is likely to depreciate against the USD in 2025.

Since October 2024, the Philippines' overall balance of payments has been deteriorating, marked by a widening current account deficit, weak foreign direct investment (FDI), and stagnant personal remittance inflows. The current account deficit surged to 4.5% of GDP in the fourth quarter. Unlike some of its Asian peers, the Philippines has not significantly benefited from supply chain diversification and the China+1 strategy, particularly in the electronics sector, where countries like Vietnam, India, and Malaysia have gained global export market share.

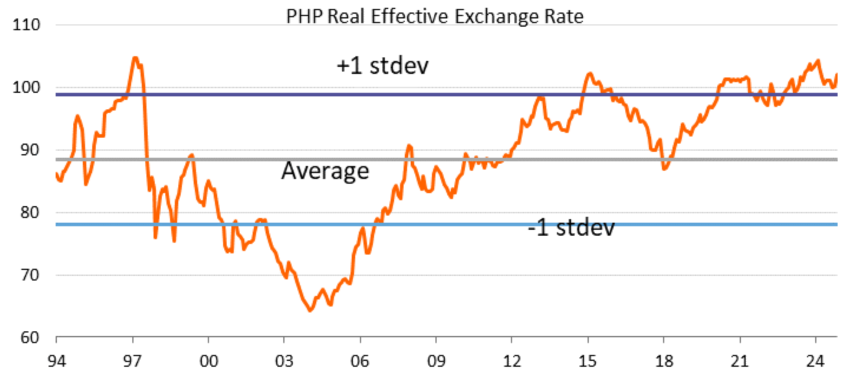
Additionally, the BSP has room to address PHP overvaluation, as the PHP REER has been trading at +1 standard deviation above the 20-year mean despite the worsening external balances. We forecast USD/PHP to weaken to 58.0 in the second quarter of 2025.

Weaker trend for FDI, remittances, and Balance of Payments



Source: CEIC

PHP overvalued on real effective exchange rate basis



Source: CEIC

3 What are the implications of the upcoming mid-term elections for markets?

The recent arrest of former president Rodrigo Duterte for alleged crimes against humanity has sparked concerns about its potential impact on the upcoming mid-term elections in the Philippines. While mid-term elections typically do not signify major policy shifts, this development could heighten political uncertainty.

The upcoming mid-term elections are crucial as Rodrigo Duterte's daughter, Sara Duterte, is set to face an impeachment trial shortly after the vote. To avoid her removal as Vice President and maintain her eligibility to run for president in 2028, the Duterte family needs their allies to secure seats in the Senate. This suggests that political unrest might continue, as the outcome of Sara Duterte's impeachment trial and the potential shifts in Senate power will keep both the public and the media intensely focused on the unfolding drama.

From a policy perspective, there’s a possibility that the implementation of certain reforms that were recently passed gets delayed. The Senate recently passed bills that will 1) cut the tax on stock transactions to 0.1% from 0.6%, and 2) overhaul the mining tax system. These bills were seen to be financial market-friendly but could be delayed with the renewed focus on politics. Moreover, the proposed daily minimum wage hike of PHP200 – which sparked significant debate around how the wage hikes could work to the detriment of businesses and consumers – could be pushed to the back burner as well.

From the markets’ perspective, we do not expect the political climate to impact the macro stability narrative, given that our forecasts suggest contained inflation and moderating fiscal deficits.

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