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Snap

Philippines: Central bank move will hurt the peso

The central bank, BSP, has cut banks' reserve requirement ratio (RRR) for a second time in three months by another percentage point, effective 1 June. This is negative for the peso

1ppt

Bank reserve requirement ratio cut to 18%
Second cut in three months

Liquidity in the near-term would be high and would be a negative for the peso

We attribute the very recent underperformance of the Philippine peso to expectations of higher liquidity in the system. The increased liquidity is not only because of the large P130bn maturity of local government currency bonds and the reduction of the weekly BSP term deposit auction by P10bn but also the cut in the bank reserve requirement ratio (RRR) by one percentage point. The RRR cut is equivalent to P90bn of liquidity. The cut in RRR is the second this year (after one in March). Liquidity in the next few days will be high and work against the peso unless BSP directly intervenes in the spot market or external developments turn more friendly to emerging markets. The market now expects the government to announce a retail treasury bond (RTB) offering that would in effect refinance the P130bn FXTN maturity. BSP targets to bring the RRR to below 10% in five years. The move is part of BSP's operational adjustment that would bring the RRR near Asian norms. Unfortunately, the short-term liquidity would be negative for the peso. There is also a longer-term impact on the currency. Banks will likely use part of the liquidity to finance corporate and government activity resulting in enhanced growth prospects for the economy. Higher growth also means higher imports and wider trade deficits.

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