

Philippines: BSP Governor turns hawkish

The Philippine central bank (BSP) Governor has turned hawkish; our dovish policy rate outlook is now at risk



3%

BSP overnight reverse repurchase rate

Rate hike chance rises

BSP Governor Espenilla says it is “just a matter of time”.

Governor Nestor Espenilla Jr, pictured, is referring to a policy rate hike. Months of bringing other short-term rates higher may have been ignored. BSP has not been idle in the past month. It has been on a stealth tightening path for some time, with its weekly term deposit auctions that have

kept M3 at a pace that limits demand-pull price pressures. BSP term deposit rates and government T-Bill rates and bond yields have increased. In addition, BSP's sale of USD in the spot market also cut liquidity while reducing PHP volatility.

However, the market remains unsatisfied. The Governor recognised the need for an additional signal – a rate hike. Justification is that rising inflation expectations could lead to second round effects such as demands for higher minimum wages and transport fares. A few tripartite regional wage boards have been conducting public hearings. Petitions for higher minimum fares are under consideration by the regulator.

We are more pessimistic than the consensus

We believe that modest second-round effects are already incorporated in BSP's inflation forecast. BSP forecasts a return to the target range over the policy horizon of by early 2019 with its 3% 2019 inflation outlook from 2018 forecast of 3.9%. We are more pessimistic than the consensus forecast with our 4.3% forecast (against consensus of 4%) this year and 3.7% next year (against consensus of 3.5%). A Monetary Board member could support a rate hike with a prolonged elevated inflation prognosis or with a fourth hike of the US FOMC this year. Chances of our dovish policy rate view have dropped even as expectations in 2019 show a return to the inflation target range. The market expects a policy rate hike at the May or June meeting.