Philippines: BSP slashes rates as economy weakens

Growth in the Philippines slowed to 5.5% in 2Q, prompting the central bank to cut the policy rate by 25 bps

Stalling momentum prompts BSP to cut rates

Consumption in the Philippines failed to offset downbeat capital formation and anaemic government spending as growth in the second quarter stumbled to 5.5 percent, lower even than the 5.6 percent growth in 1Q. With growth below 6 percent for a second quarter and inflation well-behaved, the Bankgo Sentral ng Pilipinas (BSP) decided to give the economy another shot in the arm as the economy hit a big speed bump in the first half of the year.

4.25%

BSP overnight borrowing rate

25 bps rate cut

As expected

Durable equipment and construction drag on investment

Reflected in stalling capital goods imports and durable goods in consumer imports, durable equipment contracted from Q2 2018 (-8.5 percent) as the budget delay and high borrowing costs hit hard. Construction was also negative (-4.8 percent), weighed down by public construction as private construction was unable to lift the sector into growth. A drawdown in unsold inventories also hurt overall capital formation.

BSP hits the accelerator to help chase growth target

With growth reeling from the budget delay and elevated borrowing costs, the BSP decided to hit the accelerator and cut rates by 25 bps to hopefully close the year on a high note. BSP continued to walk back last year's ultra-aggressive rate hike to give the economy another shot in the arm to help chase the government's 6-7 percent growth target.

Door open for BSP to cut policy rates again in September, RRR reduction in 4Q

The BSP lowered its inflation forecast for 2019 to 2.6 percent (from 2.7 percent) and 2.9 percent (from 3.0 percent) for 2020 while also revealing its forecast for 2021 inflation of 2.9 percent. We expect the BSP to cut policy rates again by 25 bps at the September meeting given previous comments from Governor Diokno pointing to a total of 50 bps worth of rate cuts before the end of the year.

Furthermore, we expect the BSP to reduce reserve requirements (RRR) further in the 4Q after it completes its 2019 rate cut cycle to help infuse fresh liquidity into the market. RRR reductions will be put on hold as central bank gauges whether additional funds should be diverted to productive activities and not simply parked at its overnight facilities. With the BSP's recent string of easing and government spending back online in 2H, the Philippines will look to finish the year strongly, with growth fueled by all sectors of the economy to get it above 6% by the end of the year.

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