

Philippines: Central bank delivers aggressive response

The Philippine central bank (BSP) raised its policy rate by 50 basis points to 4% in a bid to bring inflation back to the target range of 2% to 4% by 2019. The hike and continued hawkish stance should support the peso



4%

BSP reverse repurchase rate

50bps hike brings the total increase now to 100bps

As expected

Tightening is likely to continue with inflation remaining elevated

BSP is not done with raising rates. Inflation has still yet to peak, as implied by BSP's upward revision of this year's and next year's inflation forecasts to 4.9% (from 4.5%) and to 3.7% (from 3.3%), respectively. The seven-month inflation average is only 4.5%. BSP's inflation forecast for 2018 implies that inflation will still peak in the coming months and that inflation could average 5.5% in the next five months. With the peak of inflation still ahead, inflation expectations are unlikely to stabilise anytime soon. Further monetary tightening would be needed to ensure that such expectations become well-anchored.

BSP's hawkish actions and bias also address weakness in the peso, which has contributed to inflationary pressures. PHP is the third-worst performer among Asian currencies so far this year. We expect the hawkish stance to deliver needed support for the currency, which could still come under pressure not only from a widening trade and current account deficit but also from the tightening of other major central banks. A trade dispute between the US and China could intensify and could open another period of weak emerging market currencies. [We are not worried about economic activity](#). Domestic demand remains robust, posting 10% growth in the second quarter. The disappointing GDP growth rate of 6% is a result of a weak trade sector. Tightening will also eventually moderate imports and improve the contribution of trade in GDP. We expect another 25 basis point rate hike in 4Q and another 50 basis points in 2019.

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