

## Philippines: Central bank governor maps out policy sequence

Banko Sentral ng Pilipinas (BSP) Governor Benjamin Diokno laid out the possible sequence for his next moves, hinting that policy rate cuts would be followed by RRR reductions



### BSP credibility key to efficacy

BSP Governor Diokno stressed the importance of credibility in crafting monetary policy, indicating that “without credibility, central banks resort to traditional aggressive tools to achieve the same result”. Oftentimes, the ability of the BSP to communicate its policy stance and direction effectively to the market is enough to manage not just inflation but inflation expectations as well. Managing expectations in many instances may be just as integral to inflation targeting if the BSP has an

effective “hold” on the markets through its credibility.

## Diokno signals policy rate cut

With inflation down again in June, the BSP governor hinted at potential policy rate (RRP) cuts in the near term, even indicating that a rate cut will likely come before further reductions in reserve requirements (RRR). With the last instalment of the RRR reduction scheduled for the end of July, we expect the BSP to gauge the effect of this additional liquidity on the financial system before making more adjustments on this front. Previously, Diokno had said he was open to reducing reserve requirements further should the funds be put to “good use”. Today's term deposit facility (TDF) auction showed that the already doubled PHP 60 billion worth of offering was fully awarded and oversubscribed, which could indicate that the influx of liquidity has yet to find its way to the real sector.

As such, we can expect the BSP to slash borrowing costs further as inflation grinds lower. We have pencilled in a 25bp RRP cut as early as the August meeting with 2Q GDP likely to have fallen below potential. Meanwhile, we can expect reductions to the RRR to be carried out at a non-monetary policy meeting, perhaps after the 26 September policy meeting via a phased 50bp reduction at the end of October and another 50bp by year-end.

## Timing is everything

Diokno's predecessors Amando Tetangco and Néstor Espenilla helped to lay the groundwork for a successful and almost seamless exit from an era of high RRR. Governor Tetangco's constant clamour for amendments to the BSP charter, such as the ability to issue BSP bonds, was fulfilled during his successor Espenilla's term with implementation of the interest rate corridor laying the foundation for the eventual first RRR reduction.

Diokno espouses the belief that central bank credibility is integral to monetary management, and his version of RRR cuts are viewed to be gradual and well-telegraphed. Although seemingly unorthodox, the pre-announced schedule of phased reductions for RRR (100bp in May, 50bp in June and 50bp in July) was welcomed by the market. Timing his resumption of RRR cuts when inflation was decelerating was well-received by the market and consistent messaging helped keep market panic to a minimum.

For the rest of the year, we expect BSP to continue to normalise policy rates after its aggressive rate hike in 2018 while at the same time signal effectively to market players that reductions in the RRR will follow in a scheduled and phased manner.