Philippines central bank still hinting at August rate cut

Despite the Philippine peso being one of the worst-performing currencies in Asia in recent months, the latest Bangko Sentral ng Pilipinas (BSP) rate decision was accompanied by some extremely dovish commentary

Rates left unchanged, but commentary very dovish

Most central banks nursing a weak currency wouldn't go out of their way to provide markets with new reasons to sell, but the BSP doesn't seem that bothered.

While the latest decision to leave policy rates unchanged at their current rate of 6.5% was unanimously expected by the forecasting community, the commentary that accompanied the decision was unexpectedly dovish.

The PHP is the second weakest Asia-Pacific currency after the yen in the quarter to date, and the third weakest month-to-date, behind the Japanese yen and Indonesian rupiah. So you might have expected the tone from the BSP governor to be a bit more defensive.

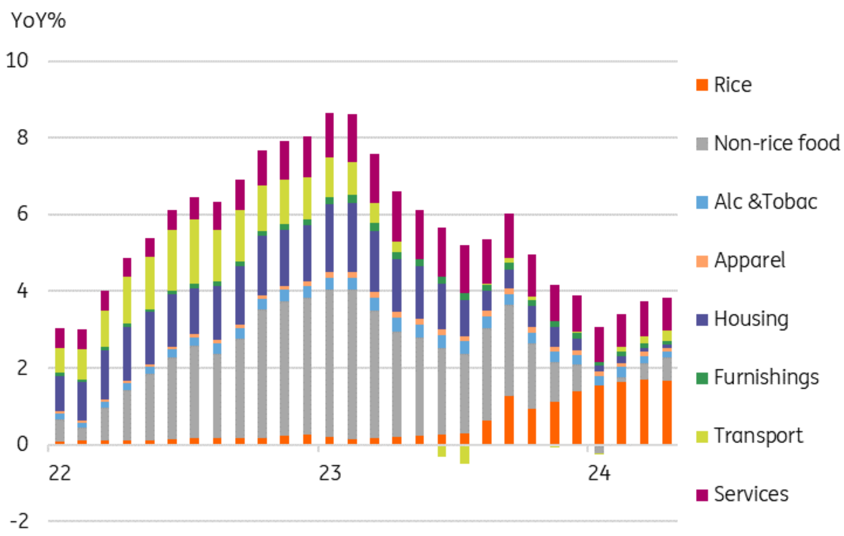
Instead, Governor Eli Remolona remarked that he felt an August cut was still a possibility - which puts them cutting ahead of where most people see the US Federal Reserve beginning to ease (markets are leaning towards a September Fed cut, but even that isn't in the bag).

Rice tariff reductions providing most of the cause for inflation optimism

With inflation lingering at the upper end of the BSP's target range (2-4%), the central bank cut its inflation forecasts for 2024 and 2025 to 3.1%. Most of the justification for this seems to be due to cuts to rice tariffs, which will fall from 35% to 15% effective on 5 July. Rice accounts for about half of all of Philippine headline inflation currently, so the downward revisions to inflation look feasible.

However, such an administered price adjustment (rather than a monetary policy response) seems to be a curious way to address the fundamental inflation problem, namely low rice stocks relative to demand, and it remains to be seen whether this is an effective and credible solution or just a quick fix that unravels later on.

About half of all Philippine inflation is rice alone



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Market response so far has been muted

The peso weakened slightly in the immediate aftermath of the BSP decision and accompanying comments. But not as much as might have been expected, and it recovered fairly quickly. BSP has been intervening to support the currency in recent weeks, though the governor seems to accept that the direction of travel for the currency is skewed, saying that "...we don't want the peso to depreciate too sharply". This makes sense because if that were to happen, it would import inflation and undo any benefits of the tariff reduction.

We still feel that it is going to be difficult for BSP to front-run rate policy with the Fed unless it is prepared to let the peso weaken significantly, and we prefer a 4Q rate cut to what was proposed today. That said, it is clear which direction the BSP's intentions are pointing so we are prepared to be disappointed.

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