The Philippines cuts rates, with future moves hinging on oil prices

Bangko Sentral ng Pilipinas (BSP) has lowered the overnight borrowing rate by 25bp to 5.25%, in line with our expectations. We anticipate two more 25bp rate cuts in 2025, but they are likely to be delayed until the fourth quarter of the year. Risks to our view are skewed towards fewer rate cuts if oil prices spiral further

Bangko Sentral ng Pilipinas (the central bank of the Philippines)

The BSP lowered the overnight borrowing rate by 25bp to 5.25%, in line with both our expectations and the consensus forecast. The BSP also lowered its 2025 inflation forecast to 1.6%, below its 2-4% target band and also below our forecast of 2.1%. The tone was unsurprisingly hawkish given the recent turn of geopolitical events, which have resulted in higher oil prices and thus a weaker local currency.

We continue to expect two more rate cuts of 25bp each in 2025, driven by a lower-than-expected inflation trajectory and downside risks to domestic growth. However, risks are currently skewed towards fewer rate cuts given the Philippines' vulnerability to higher oil prices. The ongoing tariff issues and geopolitical tensions will continue to play out throughout 3Q, resulting in a more calibrated and measured path to future rate cuts. Greater clarity on geopolitical escalations and the Fed's rate cut path suggests that these rate cuts are likely to be delayed until the fourth quarter.

The impact of higher oil prices

The Philippines remains a significant net importer of oil, making it highly sensitive to fluctuations in global oil prices. While elevated oil prices typically exert upward pressure on both consumer price inflation and the current account deficit, the inflationary impact may be more manageable this time. Current inflation is not only at a six-year low but also well below the BSP's target range of 2-4%.

Our estimates indicate that the recent 20% increase in oil prices could add approximately 0.7-0.9 percentage points to CPI inflation. Assuming oil prices stabilise around US$76.5 per barrel, our forecast places 2025 CPI inflation at roughly 2.5% – comfortably below the midpoint of the BSP's target range.

However, in a more extreme scenario where oil prices surge another 20% to exceed US$90 per barrel, CPI inflation could rise above 3%, given there are no fuel subsidies in place. This would likely constrain the BSP's ability to ease monetary policy and may prompt a shift toward a more neutral stance. Additionally, a weaker Philippine peso could further amplify the inflationary effects of higher oil prices, underscoring the importance of exchange rate dynamics in the overall inflation outlook.

The surge in oil prices to US$128/bb in 2022 indeed had a significant impact on CPI inflation, particularly through increased transportation and food costs. The indirect effects on food prices, especially non-rice food inflation, were quite pronounced.

Given the potential for another rapid increase in oil prices, the government's proactive measures, such as monitoring supply and implementing fuel subsidies for affected sectors like transport and agriculture, are crucial. These steps aim to mitigate the ripple effects on the cost of basic goods and services, helping to stabilise the economy and protect consumers from severe inflationary pressures.

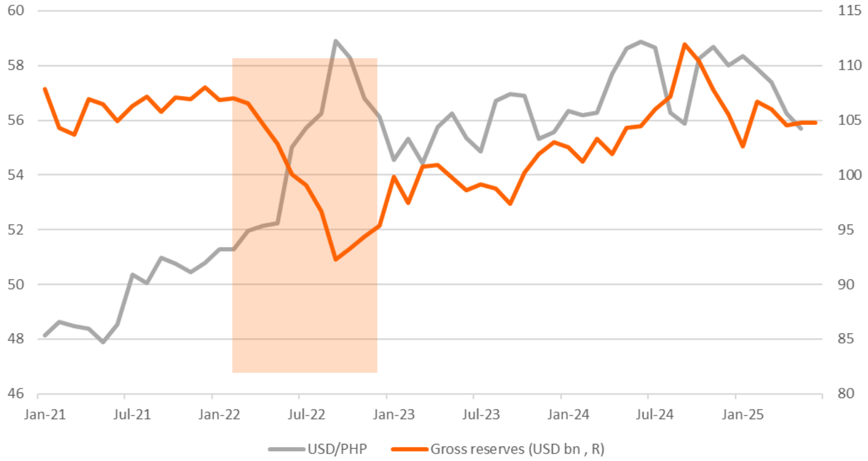
A weaker PHP could amplify the inflationary effects of higher oil prices

PHP underperformed the region last month, particularly over the past week when it swiftly dropped by 2.2% against the USD. The recent surge above 56.0 has been fueled by rising oil prices, significantly affecting the Philippines due to its status as a major oil importer.

From a valuation perspective, PHP remains overvalued on a real effective exchange rate basis. The country has the largest current account deficit in the region, driven by rising imports and softer remittance growth, making it highly vulnerable to oil price shocks. A 10% rise in oil prices could widen its deficit by roughly 0.25% of GDP, which stood at an elevated 3.7% of GDP in the first quarter of 2025, pressuring the PHP in the near term.]

We agree with the BSP governor that it might be futile to go for aggressive FX intervention to contain depreciation pressures arising from global risk aversion. It's worth remembering that the central bank allowed the currency pair to rise to 59 in 2022 before intervening to limit the damage.

BSP drew a line in the sand at 59.0 on USD/PHP in 2022 by actively intervening



Source: CEIC

What about minimum wage hikes?

Many market participants have been worried about the impact of higher minimum wages on CPI inflation. After the House passed its version of the bill, President Marcos' economic team released a paper opposing a blanket wage increase.

They argued that a daily wage hike of P100 could increase unemployment by 0.2%, and a P200 hike could push it up by 0.6%. At the same time, the impact on CPI inflation was estimated in the range of 0.7- 2%. The team argued that higher wages would lead to increased production costs, higher prices for goods and services and a widening income gap. Although both chambers were in favour of an increase, they couldn't agree on the amount in time, and thus the bill was ultimately abandoned. The resurgence of wage hike discussions and any subsequent increases will be crucial for the inflation outlook, particularly against the backdrop of rising oil prices.

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