

Philippines: What the peso plunge means for policy

The central bank will probably keep its policy rate steady at next Thursday's meeting and through the rest of the year, as inflation trends to within the target range. The risk is the currency



3%

BSP overnight repo rate

Steady policy rate likely in 2018

Forget breaching the inflation target

Philippines' central bank is likely to keep its policy rate steady at next Thursday's meeting and through the rest of the year, as inflation trends lower. At the meeting, the bank is expected to release inflation forecasts for CPI indices of 2006 and 2012. They will probably show inflation peaking around mid-year before trending lower in late 2018 and returning to the target range of 2% to 4% by 1H 2019.

With these inflation expectations over the policy horizon, and with a monetary policy lag of 12 to

18 months, we find no compelling reason to tighten anytime soon. The risk to this steady policy rate path is a significantly weaker Philippine peso. A decline of 4% to 5% generates not only momentum but also fears of the exchange rate's impact on inflation. Constant and significant direct intervention in the currency market could establish a downward trend of the FX reserves, which may stoke fears of further weakness. The central bank may eventually turn to monetary policy and/or macro-prudential measures to support the currency.