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Snap

Philippine central bank surprises as policy rate is slashed

The central bank of The Philippines unexpectedly surprised with a hefty policy rate cut to provide another round of stimulus as the economy braces itself for a recession

2.25% BSP policy rate

Lower than expected

Impending recession and benign inflation gave BSP impetus for rate cut

The Philippines has emerged from a two and half month lockdown in June with economic activity all but grounded from 16 March to 31 May as the government implemented strict quarantine measures to combat Covid-19. The quarantine measures may have helped slow the spread of the virus but it battered GDP output with roughly 72% of the economy shut during the lockdown period. With the economy struggling, the government was forced to relax several mobility restrictions to get the economy back on its feet, hoping to salvage some economic growth before the end of the year.

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As a result, the central bank opted to provide additional monetary stimulus as the Philippines braces itself for a recession while inflation remains benign. The central bank's own inflation forecast points to limited price pressures with 2020 headline inflation expected to average 2.3% for the year.

The policy rate was cut by 50 basis points to 2.25% today, bringing year-to-date easing to 175bp. The central bank has been quite active in terms of stimulus measures in 2020, unveiling a PHP300bn repurchase agreement with the national government and reducing reserve requirements by 200bp, on top of the rate cuts.

Official projections for growth point to a worst-case scenario of -3.4% for 2020 while several multilateral agencies recently downgraded forecasts too with the International Monetary Fund and Asian Development Bank expecting growth to contract by 3.6% and 3.8%, respectively.

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Diokno likely to hang up the shears for now

After the flurry of rate cuts and infusion of liquidity, today's move may be the last from the central bank in 2020 with Governor Diokno likely to favour approximating positive real policy rates. Meanwhile, the Governor is also likely to hold back on reducing reserve requirements in the near term given that the financial system is flooded with liquidity with excess funds parked at central bank's deposit facilities hitting roughly PHP1.3 trillion in June.

The surprise rate cut by the central bank is likely to sap some appreciation pressure for the peso in the near term, which has enjoyed relative strength in recent weeks buoyed by financial account inflows tied to the government's foreign borrowings. Meanwhile, the local bond market may benefit from the easing, offsetting some concerns about additional bond supply in the near term after the government posted another substantial budget deficit for the month of May.

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