Economics

DBS Flash

Philippines: BSP to cut rates soon

DBS Group Research | May 9, 2019

Masyita
Economist

Duncan Tan
Strategist

Please direct distribution queries to
Violet Lee +65 68785281 violetleeyh@dbs.com

- *Philippines growth fell short to 5.6% from 6.3% in 4Q18, the lowest since 1Q15 which was mainly due to budget delay, cut in infrastructure spending and weak exports.*
- *Inflation has eased significantly and is likely to remain benign.*
- *PHP is likely to continue to outperform EM Asia as interest rates might still be competitive even with 50bps of cuts.*
- ***Implication to forecast**: Given lacklustre growth and soft inflation, BSP is likely to cut policy rate by 50bps this year.*
- ***Implication to investors**: Markets seem to be reacting positively to impending monetary easing. We remain constructive on peso and local currency government bonds.*

Philippines growth fell short to 5.6% from 6.3% in 4Q18, the lowest since 1Q15. The low growth was mainly due to 2019 budget approval delay which also include P95.3bn cut in infrastructure spending as well as weak exports. The budget was approved on April 15th, two months after operating under re-enacted budget in which new project could not be started. Budget delay and infrastructure spending cut could impact negatively on growth as the economy has relied on public investment as the main driver of growth. In addition, this year's El Niño and power outage has also affected growth especially on agriculture and manufacturing sectors.

Although budget delay was mainly to blame for the lacklustre growth, the impact of weakening trade balance to growth could not be ignored. Mar19 trade balance had widened further to -USD3.1bn with exports growth remain in negative territory. Overall balance has improved from 4Q18, but further deterioration is likely given climbing oil price and trade tension between US and China. Yet, despite higher external headwinds from trade sides, Peso has been supported by capital inflows..

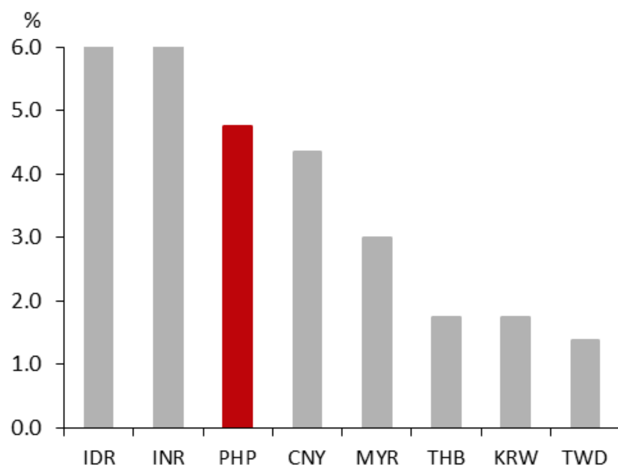
On the other side, inflation has eased significantly so far this year and is likely to continue. Inflation eased to 3% in April, the slowest in 16 months despite El Niño and higher oil price. Domestic demand might be more subdued than most expected as the impact of delayed budget and lower exports has outweighed the impact of lower inflation rate. We think inflation would ease further this year as domestic demand remain soft and food price are stable. These two factors combined might outweigh the impact of higher oil price.

Easing of consumer price, which has returned to BSP's target of 2-4% this year, combine with slower growth momentum has provided room for the central bank to unwind last year's monetary tightening with a combination of both RRR cut and policy rate cut. **We think a cumulative of 50bps this year is likely and could start as early as today's policy meeting with 25bps cut, especially if growth, which will be announced later today, disappoints.**

PHP doesn't have to weaken on rate cuts

Since the start of 2019, we have been constructive on both Philippine local government bonds (RPGB) and the peso (PHP). One comment we have been getting from our last report "Philippine Bonds: Soaring returns" (see here) is the following: BSP has turned dovish and is expected to cut rates much more than peer central banks, therefore PHP should depreciate. Our response to that argument is that PHP doesn't have to and in fact, we expect PHP to continue to outperform EM Asia currencies. Our basis is that interest rate support could stay strong because the BSP would be cutting rates from a rather high level. If BSP cuts 50bps by end-2019 (DBS forecast), the ending policy rate of 4.25% is still likely to be higher than many peers. Fundamentally, PHP's drivers are also more idiosyncratic/domestic-driven. If inflation continues to moderate and stabilize within BSP's 2-4% target range, we don't see a strong case for significant PHP depreciation.

EM Asia - Policy Rates



Source: Bloomberg

Looking at price trajectory. Since end-March, the PHP has rallied against most EM Asia currencies despite more dovish comments by BSP Governor Diokno (he recently described policy rate and RRR cuts as "inevitable" and "just a matter of timing"). Markets seem to be reacting quite positively to the impending easing as BSP is not expected to fully unwind 2018 rate hikes. Additionally, easing could help to offset the drag that has come from the budget. At last week's Asian Development Bank meeting, Governor Diokno maintained that the PHP "still reflects true value" and "there is no need to build up FX reserves."

For Philippine rates, there are no market instruments from which we can precisely infer the amount and timing of rate cuts that is priced in. However, judging by the shape of some of the curves (e.g. RPGB, PHPUSD NDS), we suspect markets have not priced in much of the expected easing (yet). Therefore, there is scope for RPGB curve to bull-steepen ahead. S&P's recent upgrade of Philippine's credit rating to BBB+ from BBB should also be supportive of bond prices. Ultimately, we think RPGB's strong year-to-date performance still has legs.

Group Research

Economics & Strategy

Taimur Baig, Ph.D.
Chief Economist - G3 & Asia
+65 6878-9548 taimurbaig@dbs.com

Nathan Chow
Strategist - China & Hong Kong
+852 3668-5693 nathanchow@dbs.com

Masyita Crystallin, Ph.D.
Economist – Indonesia & Philippines
+62 21 2988-4003 masyita@dbs.com

Joanne Goh
Regional equity strategist
+65 6878-5233 joannegohsc@dbs.com

Eugene Leow
Rates Strategist - G3 & Asia
+65 6878-2842 eugeneleow@dbs.com

Chris Leung
Economist - China & Hong Kong
+852 3668-5694 chrisleung@dbs.com

Philip Wee
FX Strategist - G3 & Asia
+65 6878-4033 philipwee@dbs.com

Ma Tieying
Economist - Japan, South Korea, & Taiwan
+65 6878-2408 matieying@dbs.com

Radhika Rao
Economist – Eurozone, India & Thailand
+65 6878-5282 radhikarao@dbs.com

Irvin Seah
Economist - Singapore, Malaysia, & Vietnam
+65 6878-6727 irvinseah@dbs.com

Duncan Tan
FX & Rates Strategist - ASEAN
+65 6878-2140 duncantan@dbs.com

Samuel Tse
Economist - China & Hong Kong
+852 3668-5694 samueltse@dbs.com

Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).

Disclaimer:

The information herein is published by DBS Bank Ltd and PT Bank DBS Indonesia (collectively, the "DBS Group"). It is based on information obtained from sources believed to be reliable, but the Group does not make any representation or warranty, express or implied, as to its accuracy, completeness, timeliness or correctness for any particular purpose. Opinions expressed are subject to change without notice. Any recommendation contained herein does not have regard to the specific investment objectives, financial situation & the particular needs of any specific addressee. The information herein is published for the information of addressees only & is not to be taken in substitution for the exercise of judgement by addressees, who should obtain separate legal or financial advice. The Group, or any of its related companies or any individuals connected with the group accepts no liability for any direct, special, indirect, consequential, incidental damages or any other loss or damages of any kind arising from any use of the information herein (including any error, omission or misstatement herein, negligent or otherwise) or further communication thereof, even if the Group or any other person has been advised of the possibility thereof. The information herein is not to be construed as an offer or a solicitation of an offer to buy or sell any securities, futures, options or other financial instruments or to provide any investment advice or services. The Group & its associates, their directors, officers and/or employees may have positions or other interests in, & may effect transactions in securities mentioned herein & may also perform or seek to perform broking, investment banking & other banking or finan¬cial services for these companies. The information herein is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation. Sources for all charts & tables are CEIC & Bloomberg unless otherwise specified.
DBS Bank Ltd., 12 Marina Blvd, Marina Bay Financial Center Tower 3, Singapore 018982. Tel: 65-6878-8888. Company Registration No. 196800306E.PT Bank DBS Indonesia, DBS Bank Tower, 33rd floor, Ciputra World 1, Jalan Prof. Dr. Satrio Kav 3-5, Jakarta, 12940, Indonesia. Tel: 62-21-2988-4000. Company Registration No. 09.03.1.64.96422.