MNI Bangko Sentral ng Pilipinas – June 2022

Announcement Date: Thursday, 23 June 2022

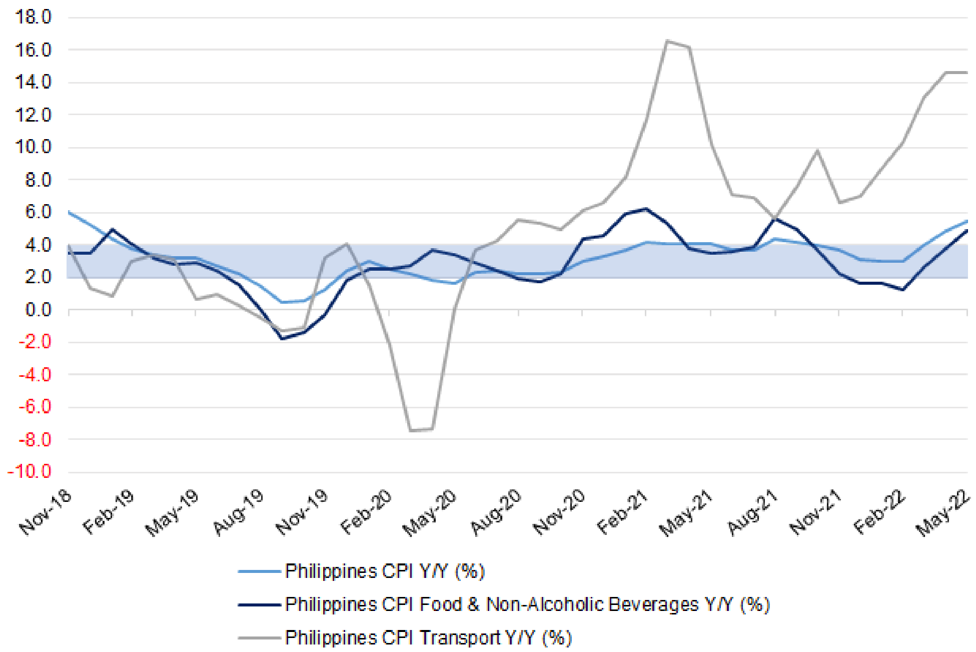
Announcement Time: 08:00 BST/15:00 PHST

Link To Statement: https://www.bsp.gov.ph/SitePages/PriceStability/MonetaryPolicyDecision.aspx

MNI Point of View: Smaller Doses To Make Pills Less Bitter To Swallow

Bangko Sentral is virtually certain to lift interest rates further come the end of this week's Monetary Board meeting, the question is by how much. While inflationary pressure continues to build testing the central bank's price-stabilisation credibility, official rhetoric suggests that gradual tightening is the path of least resistance.

The needles of inflation gauges are pointing in one direction, with the Philippines subject to imported inflation of food and energy costs. Headline CPI growth reached the fastest pace since 2018 in May, primarily on the back of lifts in the prices of food and transport. With price growth still accelerating, policymakers have started to express concern over second-round effects, such as the higher-than-expected adjustment in minimum wages across a number of regions and rising inflation expectations.



The shaded region represents the BSP's target range for headline CPI inflation.

Peso weakness, fuelled by policy tightening initiated by the Fed, is exacerbating these dynamics. For a nation that imports many of its key commodities (crucially crude oil and wheat), a weaker exchange rate makes imported inflation even more acute. BSP Managing Director Abenoja recently called peso movements "reasonable," noting that it has generally fluctuated in line with regional trend. But the Monetary Board will certainly be aware of the consequences of continued depreciation of the domestic currency.

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Ramped-up media presence of top BSP officials (perhaps linked to the transition of power at the central bank's helm, with outgoing and incoming Governors serving as the central bank's de facto most important spokesmen over the past few weeks) has served the purpose of setting the stage for future rate increases, after the inauguration of this tightening cycle in May. Messrs Diokno and Medalla have spoken in unison, vowing to work towards ensuring price stability and try to head off further second-round effects.

But Medalla played down potential for outsized rate hikes earlier this week, noting that the Bank prefers to move in more measured steps, referring specifically to 25bp increments. He told ABS-CBN News Channel that Bangko Sentral has "a philosophy of gradualism – that is, realising that monetary policy cannot turn back this kind of global pressures on prices." Policymakers don't want to "overuse that medicine [i.e. rate hikes] because that medicine is not very effective on supply shocks."

Measures taken by the government to address the rising costs of living should help the BSP move in more gradual steps. President-elect Marcos has recently announced plans to double as Agriculture Minister and launch negotiations with oil-producing nations to temper the rise in food and energy prices. We will judge the effectiveness of the new government's initiatives in due time, but for now take Marcos' declarations as a sign that containing inflation will be an important item on the agenda of his incoming administration.

This leads us to believe that, barring any last-minute twists, the Philippines' central bank will deliver a 25bp rate hike this week, mirroring that move in August. The shape of the interest rate path further down the road is more uncertain and, in the words of Medalla, will be data-dependent. For now, we expect the BSP to be biased towards using 25bp rate increases. The impending reshuffle in the composition of the Monetary Board should not affect the overall trajectory of monetary policy. Outgoing Governor Diokno will become the new Finance Secretary, keeping is seat on the Board, while incoming Governor Medalla is a central bank insider who already sits on the rate-setting panel. We expect a great deal of continuity in Bangko Sentral's strategic thinking following this rejig.

Bangko Sentral ng Pilipinas May Monetary Policy Statement:

At its meeting on monetary policy today, the Monetary Board decided to raise the interest rate on the BSP's overnight reverse repurchase facility by 25 basis points to 2.25 percent, effective Friday, 20 May 2022. Accordingly, the interest rates on the overnight deposit and lending facilities were raised to 1.75 percent and 2.75 percent, respectively.

At the same time, the Monetary Board noted that the strong rebound in domestic economic activity and labor market conditions during the first quarter of 2022 provides scope for the BSP to continue rolling back its pandemic-induced interventions, consistent with its exit strategy from monetary accommodation. With the provisional advances to the National Government reduced from P540 billion in 2020 and 2021 to only P300 billion in January 2022, the National Government will fully settle these loans tomorrow, 20 May 2022, ahead of the maturity schedule of 11 June 2022.

Moreover, given ample liquidity, a gradual recovery in credit activity, and stable financial market conditions, the Monetary Board has decided to reconfigure the BSP's government securities (GS) purchasing window from a crisis intervention measure into a regular liquidity facility under our interest rate corridor framework. As part of the BSP's standard monetary operations toolkit for injecting liquidity into the financial market, the recalibrated GS purchasing window shall enhance the BSP's ability to manage domestic liquidity conditions and ensure the sustainability of its balance sheet.

In deciding to raise the policy interest rate, the Monetary Board noted that the latest baseline forecasts have further shifted higher since the previous monetary policy meeting in March, indicating that elevated inflation pressures could persist over the policy horizon. Average inflation is likely to breach the upper end of the 2-4 percent target range in 2022 at 4.6 percent, while the forecast for 2023 has edged closer to the upper end of the target band at 3.9 percent.

The balance of risks to the inflation outlook now leans toward the upside for both 2022 and 2023, with upside pressures emanating from the potential impact of higher oil prices, including on transport fares, as well as the continued shortage in domestic pork and fish supply. Meanwhile, downside risks are linked mainly to the potential impact of a weaker-than-expected global economic recovery amid the lingering threat of COVID-19 infections, heightened geopolitical tensions, and a tightening of global financial conditions.

The Monetary Board also observed the emergence of second-round effects, including the higher-than-expected adjustment in minimum wages in some regions. Inflation expectations have likewise risen, highlighting the risk posed by sustained pressures on future wage and price outcomes.

Given these considerations, the Monetary Board believes that a timely increase in the BSP's policy interest rate will help arrest further second-round effects and temper the buildup in inflation expectations. The Monetary Board likewise reiterates its support for the sustained implementation of non-monetary interventions to mitigate the impact of persistent supply-side factors on inflation, particularly food supply and prices.

On balance, persistent inflationary pressures point to the need for prompt monetary action to anchor inflation expectations. As the economic recovery continues to gain traction, the BSP shall proceed with its plans for the continued gradual withdrawal of its extraordinary liquidity interventions and the start of the normalization of its monetary policy settings. Looking ahead, the pace and timing of further monetary policy actions by the BSP shall be guided by data outcomes, in keeping with the BSP's price and financial stability objectives.

Sell-side comments:

ANZ: Inflationary concerns will dominate the Bangko Sentral ng Pilipinas' (BSP) upcoming policy meeting as the CPI inflation hit 5.4% y/yin May. There are signs of broader price pressures as producers are now increasingly comfortable in passing on higher costs to consumers. Besides, consumers' one-year's inflation expectations have also climbed from 3.2% in Q4 2021 to 5.5% in Q1 2022. Retail pump prices continue to follow global oil price movements and food supply problems are yet to be resolved. The month of June, in fact, will likely witness more forces acting on consumer prices due to public utility vehicle fare hikes, higher electricity charges and partial recovery of past payments by Meralco as well as an increase in minimum wages by 14 regional wage boards. Against this backdrop, we expect the BSP to deliver another 25bp policy rate hike at their upcoming meeting.

Barclays: We expect the BSP to hike the policy rate by 25bp after it started raising rates at its May meeting. Despite larger hikes by other central banks, we expect the Philippines to continue on a gradual hiking cycle in order to avoid stunting the nascent recovery. We expect another hike in August, followed by a 25bp hike in Q4 and another in Q1 23.

DBS: A policy rate hike by the BSP during this week's meeting is for certain, and we expect a 25bps increase to 2.50%. Outgoing Governor Diokno and incoming Governor Medalla has been communicating a June increase, following the central bank's policy rate hike in May (the first since 2018). On June 17, Bloomberg reported that the BSP will likely proceed with a plan to increase its interest rate by 25bps on June 23, as mentioned by Medalla. When asked about a larger-than-signalled rate increase following the US Fed's 75bps hike last week, Medalla said that the Philippines did not create as much demand as the US. The BSP is now geared towards combating inflation, and would be keen to temper upside price pressures, beyond global commodity cost push pressures, and rising inflation expectations. The BSP is uncomfortable with accelerating inflation (headline: 5.4% YoY in May), which exceeded the central bank's 2-4% inflation target band for the second straight month in May. An economic recovery supported by looser pandemic restrictions and opening dynamics means that extreme pandemic-era monetary accommodation can be further withdrawn and normalised. The BSP continues to see upside inflation risks. First, there has been further evidence of second round inflation effects via increased public utility jeepney fares. Second, a depreciating peso would fan further imported inflation at a time of elevated global commodity prices. This could in turn stoke higher inflation expectations and second-round effects, which the BSP wants to contain.

Goldman Sachs: We expect BSP to deliver a 25bp rate hike to its policy rate to 2.50%, from 2.25% currently. At the previous meeting, the BSP Governor has signaled that the 25bp hike was a start to a gradual tightening cycle given there are signs of second round impact on inflation starting to build. Despite higher headline inflation in May, we note that inflation excluding food, utilities and transportation remains within BSP target band of 2-4% giving BSP some room to deliver a gradual tightening in policy amid the ongoing economic recovery. Given that most of the inflation pressure stems from supply side shocks and still limited second-round impact, we expect the BSP to deliver a gradual monetary policy tightening of 25bp at its next meeting. Going forward, we continue to expect BSP to deliver back-to-back 25bp hikes until it reaches 4.0% in Q1 2023. In this meeting, we also expect the BSP to revise up its inflation forecast again following the minimum wage hike, jeepney fare hike, as well as fuel price adjustment from domestic petrol companies. Given this adjustment, we see risks that the BSP may signal a faster tightening from 'gradual tightening' currently.

ING: Bangko Sentral ng Pilipinas will meet this week with pressure mounting on the BSP to hike rates aggressively. Inflation moved well past its target to 5.4% and a weakening currency will only translate to more inflation down the line. BSP Governor Benjamin Diokno signalled a 25bp increase next week but we think the beleaguered currency and accelerating inflation will be enough to force a more punchy 50bp rate hike from BSP next week.

Morgan Stanley: We expect Bangko Sentral ng Pilipinas to deliver another 25bp increase to bring its benchmark overnight reverse repurchase facility rate to 2.5% in the June meeting, following the lift-off in May. The central bank has emphasized previously that policy decisions would be "guided by data outcomes". With inflation rising to 5.4%Y in May on higher food and transport prices and broad resilience across various high frequency consumption and investment activity indicators at the start of 2Q, incoming Governor Medalla has also more recently signaled a further rate hike this month. Looking further out, we expect BSP to undertake another 2x25bps hike in 3Q22, which would take the policy rate to 3.0% in 3Q22. We expect the policy rate to stay at 3.0% in 2023 and 2023 real policy rate to still be below neutral. The gradual path of normalization reflects our view of BSP's relatively dovish stance and that a negative (albeit narrowing) output gap is still likely to present in the Philippines. Hence, it faces a less acute inflation challenge relative to the US.

Pantheon: We expect the Monetary Board to approve a further 25bp increase in the overnight reverse repo rate, taking it to 2.50%. This should be the last increase this year, as we expect the Q2 GDP print due in August to disappoint and force members to pause the normalisation of policy later that month. Moreover, fuel disinflation will soon take hold, and we see signs that June should mark the peak in food inflation.

Scotiabank: A similar calculus applies to the Philippines' central bank with a nearly evenly divided consensus between a hike of 25bps and 50bps. The peso has been weakening of late for the same reason cited above for the rupiah and multiple other EM crosses (outward pull effect of Fed policy tightening on capital flows).

TD: We expect the BSP to deliver an outsized 50bp hike given a poorer inflation outlook. Inflation jumped to 5.4% in May while a bigger minimum wage hike will keep inflation elevated.

UOB: The BSP is expected to raise policy interest rates in this meeting, the question is by how much. The latest Bloomberg poll (as of 17 Jun) showed three analysts (including UOB senior economist Julia Goh) expecting a 25.