OCBC Bank

BSP leaves rates unchanged for a "prudent pause"

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Highlights

- **BSP leaves rates unchanged at 4.50%, defying market expectations.**
- **A "prudent pause" was cited to allow the central bank time to assess impacts from May's policies.**
- **May's uptick in inflation may have been a key consideration for BSP to delay its rate cut until August at least.**
- **The BSP downgrades its inflation outlook from 2.9% to 2.7%.**
- **BSP forecasts peso strength of 52.01 and 51.50 in 2019 and 2020 respectively, but says they are not "targets".**
- **We continue to expect three more rates cuts by BSP for the remaining of this year.**

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The BSP has surprisingly left rates unchanged at 4.50%, against our expectations of a 25bp rate cut. This came against expectations of a 25bp rate cut, with 16 of 24 polled economists on Bloomberg forecasting a rate reduction prior to the meeting.

A "prudent pause"

Governor Benjamin Diokno cited the case for a "prudent pause" that will allow the central bank to observe the impacts of May's rate cut and RRR reductions on the real economy. As much as the decision to keep rates on hold surprised the markets, **we note that the use of the word "pause" leaves the door wide open for further monetary easing**. It suggests that the BSP has likely just began its rate cut cycle, having only conducted one rate cut of 25bp in May since the 175bp rate hike last year.

Inflation continues to be a bugbear for BSP

The uptick in Philippines' inflation in May, in our opinion, was probably the key reason for the BSP to keep rates on hold this month. Despite higher oil prices in May, a closer look at the data shows that food prices were the main attribute in May's stronger than expected CPI, increasing from 3.0% to 3.4%. Conversely, price gains in the transport sector actually eased from 3.8% to 3.5%. T**he increase in food prices** – a basket that has a seemingly lower correlation to energy prices – may have weighed on the considerations of BSP and eventually resulting in a "prudent pause".

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BSP downgrades inflation forecast to 2.7% from 2.9%

The BSP continues to maintain an optimistic outlook on inflation, downgrading its 2019 forecast from 2.9% to 2.7%. It cited expectations of a stronger peso on keeping import-led inflation subdued. We have previously noted that the uptick in

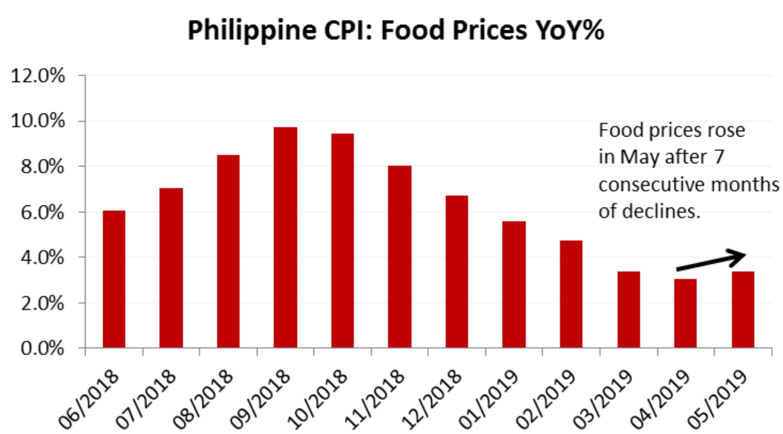
May's inflation was likely to be transient as the base becomes structurally higher beginning June. The central bank, however, notes that a prolonged El Nino is likely to impact crop prices and add upward pressure on inflation.

Peso forecast an unexpected addition

The BSP mentioned its assumption of the peso at 52.01 and 51.50 against the USD in 2019 and 2020 respectively – an unexpected addition. To that extent, Deputy Governor Guingundo clarifies that these assumptions are not targets. Given that they are building a hypothesis of lower import-led inflation from a stronger peso, however, it may appear to suggest that the probability of a rate cut may increase should the peso strengthen past the assumptions. Spot peso has averaged 52.25 YTD at time of writing and will have to trade at about current levels of 51.65 (at time of writing) to match BSP's peso 2019 assumption.

Final thoughts: global dovishness amid data dependency

With the US Federal Reserve sending an unambiguously dovish message overnight, **we now see lesser challenges for regional central banks to ease their respective monetary conditions.** A repeat of the EM outflows observed in 2018 is unlikely as UST yields have collapsed, increasing room for global central bankers to slash rates in a slowing growth environment. Amid this backdrop, what has been undoubtedly clear from the press conference is **BSP's emphasis on data dependency despite ripening global conditions for looser monetary policy**. The uptick in May's inflation was likely to have led to its "prudent pause", with both Diokno and Guinigundo repeatedly mentioning the need for data firmness. Nonetheless, the choice of the word "pause" as well as its downgrade of inflation outlook suggests that the BSP remains one of the most dovish regionally. **We continue to expect three more rate cuts of 25bp from the BSP this year, assuming inflationary pressures continue to abate from current levels.**



Source: CEIC, OCBC Bank