Maybank

FX Note

PHP View Intact

Expecting Two BSP Cuts, USDPHP Forecast Unchanged

Jun headline CPI data that was released last Friday had come out weaker than the prior reading at 3.7% YoY (est. 3.9% YoY, May. 3.9% YoY). The core number was in fact pretty much stagnant at 0.0% MoM (est. 0.2% MoM, May. 0.1% MoM). The reading had come out just after the BSP had already been tilting dovish and expressed the possibility of an Aug cut happening. The softer inflation number had been due to lower price pressures for housing, water, electricity, gas and other fuel categories. However, the food and non-alcoholic beverages (FNAB) category did see a pick-up. This category in the coming months can actually see a reduction in price pressures as the government introduced EO 62 to cut the rice import tariff from 35% to 15%, effective 6 Jul 2024 until 31 Dec 2028 and also extended the lower rates on pork, mechanically deboned meat (MDM) of poultry and corn. At the same time, Administrative Order 20 (AO 20) removes the non-tariff barriers on importation of agricultural products. Given this and the nature of inflation softening in Jun 2024, our economist no longer sees inflation breaching the BSP's 4.0% upper end target in the coming months and therefore revise downward both 2024 & 2025 headline inflation forecasts to +3.2% (vs +3.5% previously) and +2.8% (vs 3.0% previously). Consequently, our economist is also now expecting two 25bps rate cuts by the BSP, with the first starting in Aug 2024 and another to come in 4Q 2024. This would bring down the rate from 6.50% to 6.00% by year-end.

The change in the BSP policy view does not affect our existing FX forecast. We expect the USDPHP to end 3Q 2024 higher than from current levels although the pair would see a downward trajectory after that. Our own forecast had already factored in sentiment concerns related to the BSP beginning to ease in Aug and potentially ahead of the Fed given that the central bank had already given hints of this happening. We would also like to reiterate our reasoning behind our forecasts. The first reason behind why we do see a risk of the USDPHP heading lower into 3Q 2024 would be related to concerns associated with the US elections. At this point, markets look to be seeing the increasing possibility of a Trump win and although we do recognize that the election season has still quite a way to go, the former President's campaign is showing quite strong momentum. The risk of a higher inflationary environment associated with a Trump win can possibly keep rates elevated and USD supported and make a downward USDPHP move more challenging. A Fed cut in Sep may not be enough to offset these concerns. Given the PHP's rate sensitive nature, elevated UST yields can weigh quite a bit on the currency.

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However, that aside, we stay wary of the possibility of the nature of any Fed cut in Sep being one where the Fed may still choose to sound fairly hawkish. With the US economy not exactly falling off the cliff at this point, the Fed may be cutting more as a pre-cautionary measure rather than after the fact matter, where the economy has slipped into a high level of weakness. Therefore, the Fed may in itself also not want to let financial conditions become too loose as they gradually guide the economy towards its neutral level. Under such circumstances, UST yields would be hard pressed to drop substantially, weighing on the PHP.

Seasonally, the third quarter in the last three years has also represented a period of stronger DXY. There is little reason now to expect that this would shift this year given how conditions look to be evolving as discussed. This in turn would give support to the USDPHP pair.

A combined less favourable external environment combined with this dovish leaning BSP amid softening Philippines inflation is therefore likely to guide the USDPHP to trade at elevated levels in 3Q 2024. Regardless, we see a downward trajectory remains intact post 3Q 2024. The pace of the Fed easing cycle is likely to become clearer at year end and this in turn should give most USD – Asian pairs relief including the USDPHP. UST yields can see more decline under these circumstances. Election uncertainty that can cause UST yields to become stretched on the upside in 3Q 2024 may also start to dissipate after the Nov election. We would also like to note that this downward trend would be gradual as the Fed is likely to ease slowly. US economic data cooling in itself is likely to be gradual and possibly even more so under a plausible Trump administration.

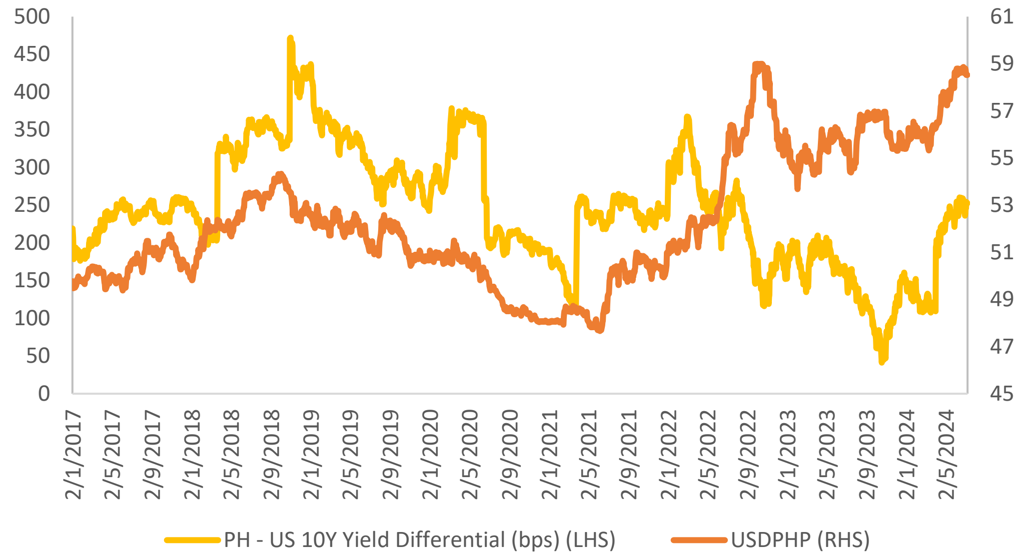
The USDPHP forecast for 3Q 2024 does also point that the upside in some sense is limited. This is due to firstly, a Fed move in Sep is still an easing. The second reason is that we have noticed in the past few years that OFWR tends to be higher in 3Q (see chart 2). We suspect that stronger USD in 3Q last few years may tend to elicit more repatriation by Filipinos overseas to take advantage of the strong currency rate. This in turn can help limit PHP weakness.

Table 1: USDPHP Forecast

Forecast	3Q 2024	4Q 2024	1Q 2025	2Q 2025
USDPHP	**60.00** **(57.00)**	**58.50** **(56.25)**	**58.00** **(55.50)**	**57.00** **(--)**

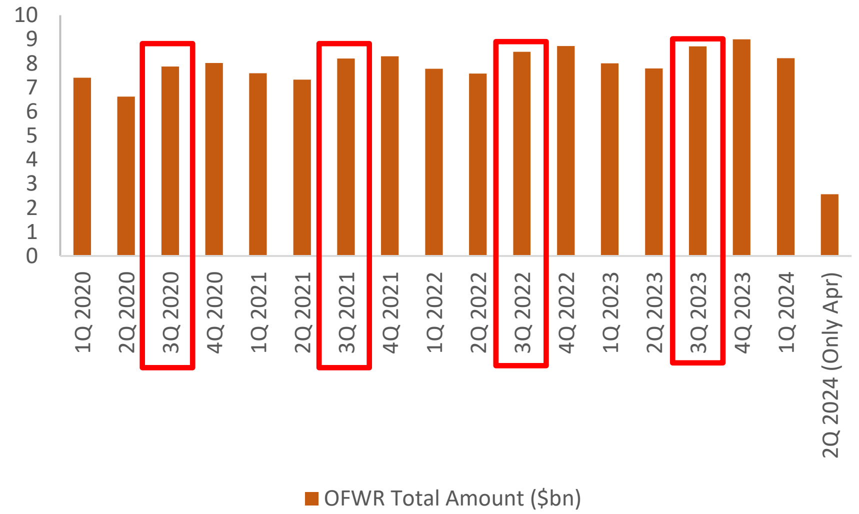
Source: Maybank FX Research & Strategy
Previous Forecasts in Parentheses

Chart 1: Narrowing PH - US 10Y Yield Differential Overtime Has Been Weighing on the PHP and a BSP Easing Can Risk Further Hurting on the PHP



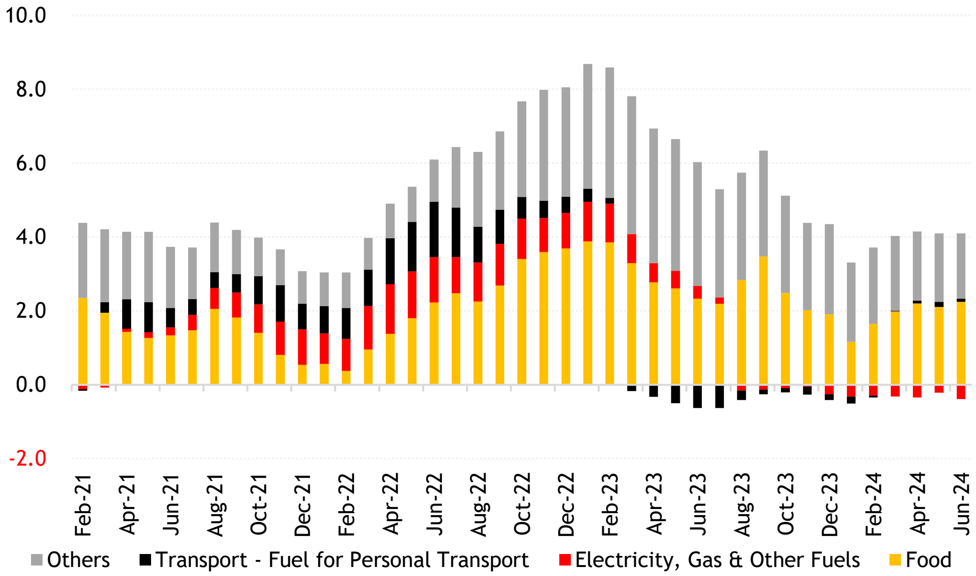
Source: Bloomberg, Maybank FX Research & Strategy

Chart 2: Stronger OFWR in 3Q Can Help Limit PHP Weakness



Source: Macrobond, Maybank FX Research & Strategy

Chart 3: Softening CPI Backs BSP Cut Starting from Aug 2024



Source: CEIC, Maybank FX Research & Strategy

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