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Global

FX Insight

ASEAN FX - Not The End Of The Tightening Cycle For BI And BSP

BI & BSP Tighten Policy Again

BI hiked its 7-day reverse repurchase rate again by 25bp to 5.75% at its 26-27 Sep meeting amid ongoing volatility in the IDR. The IDR has been the worst performing currency against the USD since the start of the year. In its most aggressive move since 2000, the BSP lifted its benchmark policy rate by 150bp year-to-date with its most recent moves. The BSP hiked its overnight borrowing rate 50bp to 4.50bp on 27 Sep. The pressure to be more aggressive on rates was because of “persistent signs of sustained and broadening price pressures” as inflation has outpaced the upper bound of the central bank’s target range of 2-4% for this year and next.

We expect BI to pause and observe the impact of its previous rate hikes on the domestic economy and the IDR. The central bank is likely to make its next move at its Dec policy meeting with another 25bp rate hike to 6.00%. The commitment of BI to remain preemptive and front-loaded in terms of monetary policy should amplify the credibility of the central bank, helping to provide support to the IDR. The prospects of further rate hikes should help flush out speculators and bring some semblance of calm back to the IDR. Weekly technical chart suggests a retracement risk to the USDIDR with a pullback finding support around the 14500-levels.

The current move by the BSP does not signal the end of the tightening cycle. Market is already suggesting the need for another 50bp hike towards the end of the year to keep inflationary pressures in check. With the BSP committing to use all the tools in its toolkit to rein in inflation, further rate hikes by the BSP cannot be ruled out this year. Our economic team is looking for another 100bp rate hike within the next six months with 50bp likely to come by the end of 2018. Technical chart suggests risk is tilting to the downside with support for the USDPHP around 53.920-levels before 53.590, 53.340-levels.

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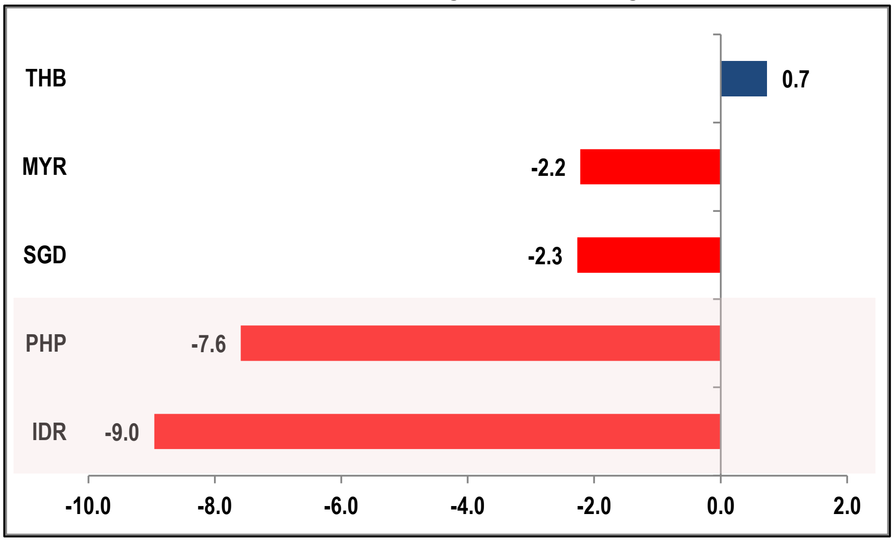
BI To Remain "Pre-Emptive, Front-Loading & Ahead Of The Curve"

As expected, BI hiked its 7-day reverse repurchase rate again by 25bp to 5.75% at its 26-27 Sep meeting amid ongoing volatility in the IDR. The IDR has been on the worse performing currency against the USD since the start of the year (Chart 1). This marks the fifth rate hike by the central bank this year and brings the cumulative moves to 150bps so far this year. The deposit and lending facility rates were lifted by 25bp as well to 5.00% and 6.05% respectively, keeping the interest rate corridor at 75bp on either side of the policy rate. This move by the BI remains consistent with the governor's strategy of keeping policy "pre-emptive, front loading, and ahead of the curve" in order to maintain macroeconomic and financial system stability.

Chart 1: IDR & PHP Worst Performing Currencies Against USD YTD



Source: Bloomberg, GM FX Research & Strategy

With 150bp rate hike in its pocket, this could be an opportunity for the BI to pause and observe the impact of its previous rate hikes on the domestic economy and the IDR. In its policy statement, the BI noted that the depreciation in the IDR "is in line with the currencies of peer countries, spurred by broad US dollar appreciation". This suggests that the BI could be less pressured to move again on its policy rate for now. The central bank is likely to sit tight and make its next move at its Dec policy meeting with another 25bp rate hike to 6.00%.

Just as importantly, is that the ongoing monetary policy tightening cycle still has legs. To date, the BI has hiked its policy rate by 150bp since May to anchor the IDR. The commitment of BI to remain preemptive and front-loaded in terms of monetary policy should amplify the credibility of the central bank, helping to provide support to the IDR. The prospects of further rate hikes should help flush out speculators and bring some semblance of calm back to the IDR.

The introduction of a domestic non-deliverable IDR forwards (DNDF) by BI at its Sep policy meeting should provide another avenue for market participants to hedge their foreign currency exposure. Though the BI governor had said that the DNDF would be effective on 28 Sep, it is still not operational as BI and Indonesia Foreign Exchange Market Committee (IFEMC) are still in discussion regarding the infrastructure. Currently, onshore players are not allowed to quote offshore NDFs though offshore NDFs are used quite blatantly still. The aim of the DNDF is to shift demand for hedging onshore and to further deepen the domestic financial system. Some features of the proposed are (1) banks are prohibited to carry out domestic NDF transactions against the MYR and THB given existing swap agreements between the three economies; (2) there must be underlying transactions such as trade in goods and services, investments or bank loans among others; (3) the amount and period of a DNDF transactions must not exceed the amount and period of the underlying transaction; and (4) contract settlement is in IDR based on the BI's spot USD rate – the JISDOR. For now, there is little is little details as to the framework or how it will DNDF will be operationalize. But for the DNDF to be effective alternative hedging instrument, the authorities may have to enforce a complete ban on domestic financial institutions quoting the offshore NDF for clients.

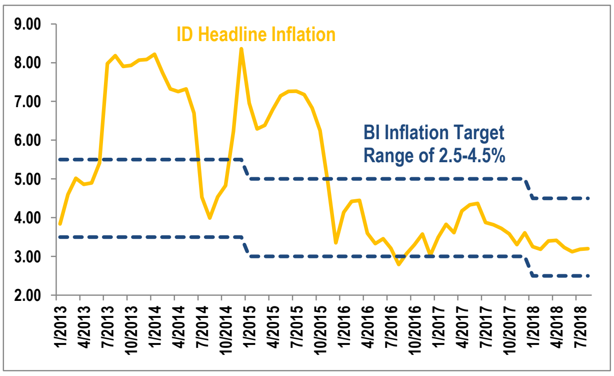
BSP's "Strong Monetary Action To Continue

In its most aggressive move since 2000, the BSP lifted its benchmark policy rate by 150bp year-to-date with its most recent moves. The BSP followed up its 50bp move in Aug with another similar 50bp hike to its overnight borrowing rate on 27 Sep. That brought the benchmark rate to 4.50bp. The BSP left the interest rate corridor intact with the overnight lending rate and overnight deposit rate both raised by 50bp accordingly to 5.00% and 4.00% respectively. The interest rate corridor remained symmetrical on either side of the policy rate by 50bp. The pressure to be more aggressive on rates was because of "persistent signs of sustained and broadening price pressures" as inflation has outpaced the upper bound of the central bank's target range of 2-4% for this year and next.

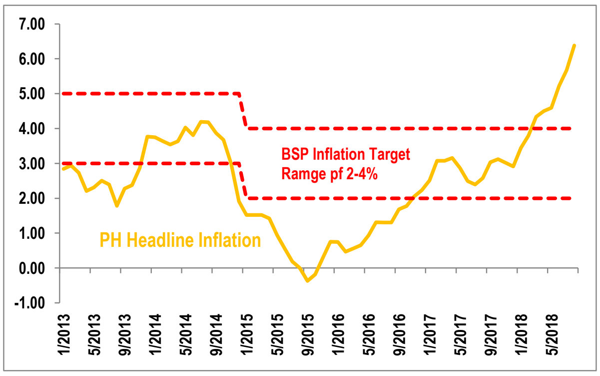
Like the previous 50bp rate hike, the current move does not signal the end of the tightening cycle. The upgrade in inflation forecast for 2018 and 2019 to 5.2% and 4.3% respectively from 4.9% and 3.7% previously suggests the BSP is open to further policy tightening to anchor inflationary expectations (Chart 2). Market is already suggesting the need for another 50bp hike towards the end of the year to keep inflationary pressures in check. With the BSP suggesting that the growth momentum is sustainable despite the rate hikes, and its commitment to use all the tools in its toolkit to rein in inflation, further rate hikes by the BSP cannot be ruled out this year. Our economic team is looking for another 100bp rate hike within the next six months with 50bp likely to come by the end of 2018.

Chart 2: BSP Moved To Anchor Inflationary Expectations But Not BI

ID - Inflation Has Been Well-Behaved

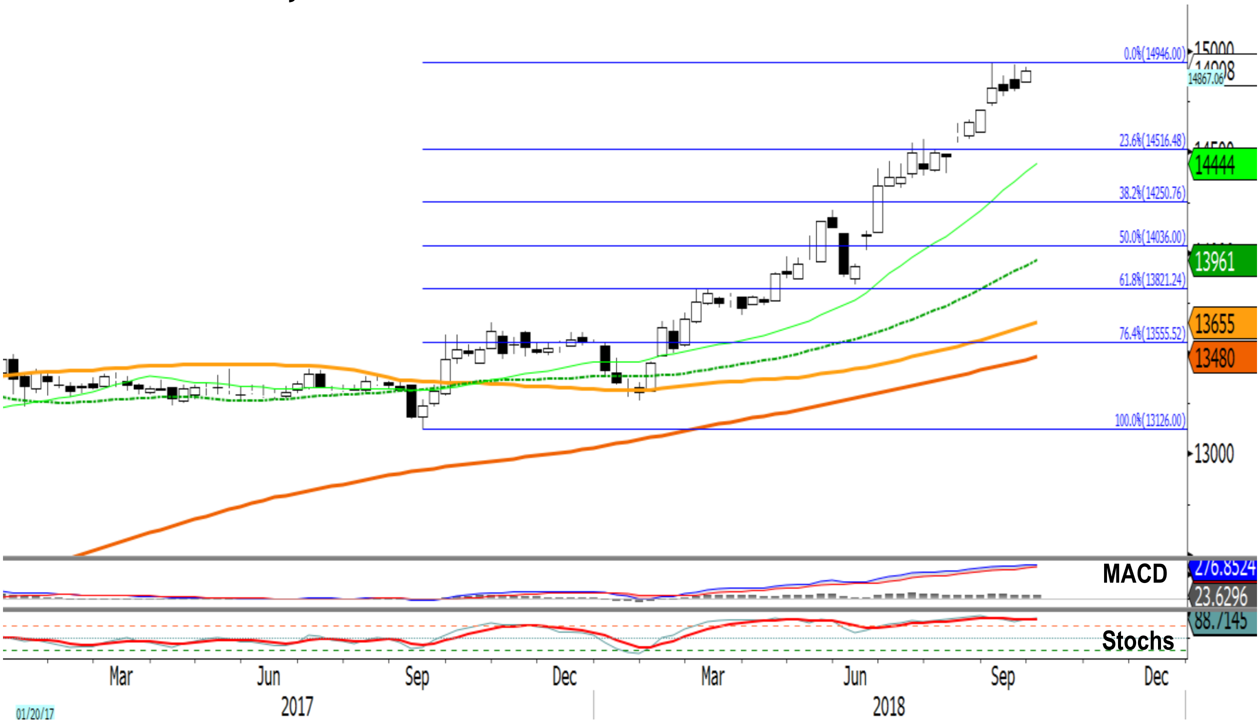


PH - Inflation Has Busted The BSP Target Range



Source: CEIC, GM FX Research & Strategy

Chart 3: USDIDR Weekly Chart - Retracement Risks



Source: Bloomberg, GM FX Research & Strategy

USDIDR was last seen around 14909-levels. Bullish bias on the weekly chart remains intact but waning, while stochastics remains at overbought conditions. This suggests room for retracement risks. Pullback should find support around the 14500-levels (23.6% fibo retracement of the 2018-low to high). Immediate resistance around 14946-levels (2018 high) ahead of 15100-levels.

Chart 4: USDPHP (Daily Chart) - Risk Tilted Lower

Source: Bloomberg, CEIC, GM FX Research & Strategy

USDPHP was last seen around 54.140-levels. Pair has lost most of its bullish bias on the daily chart, while stochastics is falling from overbought conditions. This suggests risk is tilting to the downside. Support is around 53.920-levels before 53.590 (50DMA), 53.340-levels (23.6% fibo retracement of the 2018 low to high). Resistance around 54.460-levels (2018 high).

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