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PHILEQUITY CORNER

By Wilson Sy

Peso in a comfortable place

In our previous article, we discussed the statements and policy stance of the Bangko Sentral ng Pilipinas (BSP) which we believe would result in a more stable peso (see *Structurally hawkish*, July 24, 2023). This was reinforced by Finance secretary Ben Diokno when he said that “the peso is in a comfortable place” against the US dollar. Last week, the peso traded at the range of 54.48-54.95.

Steady peso

Year-to-date, the peso has been steady and less volatile compared to other currencies in the region. The peso is up 1.4% year-to-date, and it has gained 7.3% since bottoming at an all-time low of 59.20 in September last year. Recall that this was the time when the BSP and the government actively defended the peso to prevent it from further weakening (see *Defending the peso*, October 24, 2022).

Prudent pause

In recent interviews, BSP deputy governor Francisco Dakila said that the BSP has implemented a “prudent pause.” This is supported by the BSP’s view that inflation would return to the 2-4% target range by the fourth quarter. In addition, Dakila noted that there are “indications of our previous monetary tightening exerting its impact on the economy.” A pause from tightening would thus give the BSP time to analyze economic data in order to gauge the effect of lumpy rate hikes last year.

Meeting by meeting

Last Thursday, the US Federal Reserve (Fed) hiked its policy rate by 25 basis points. This brought the Fed policy rate to its highest level since 2001. Fed chair Jerome Powell reiterated the Fed’s commitment to its 2% inflation target. He also maintained that future actions would be decided on a meeting by meeting basis based on incoming data. The Fed revised its assessment of economic growth, changing its description from “modest” to “moderate.” Below are some quotes from Powell’s latest policy statement.

- “Inflation remains well above our longer-run goal of 2%.”
- “Inflation has moderated somewhat since the middle of last year. Nonetheless, the process of getting inflation back down to 2% has a long way to go.”
- “We will continue to make our decisions meeting by meeting, based on the totality of incoming data and their implications for the outlook for economic activity and inflation as well as the balance of risks.”
- “Recent indicators suggest that economic activity has been expanding at a moderate pace.”

Data dependent

Following the Fed's move, the European Central Bank (ECB) raised its benchmark rate by 25 basis points. In its statement, the ECB said that "inflation continues to decline but it is still expected to remain too high for too long." The ECB stated that it "will continue to follow a data-dependent approach to determining the appropriate level and duration of restriction."

Dow posts best win streak in 36 years

Though the Fed's policy rate rose to the highest level in two decades, market sentiment has been positive and equities have sustained their rally. While central banks remain vigilant against inflation, some Wall Street economists believe that we have witnessed the last Fed rate hike for this cycle. The Dow Jones Industrial Average closed higher for thirteen straight sessions. The 13-day streak which ended last Thursday was Dow's longest winning streak in 36 years. The Dow's strong performance may be signifying that the tech-led market rally is now broadening into other sectors.

Soft landing

In the Q&A portion of his policy statement, Powell stated that the Fed staff is no longer forecasting a recession. Powell believes that inflation would move back down to 2% without triggering a severe downturn that results in painful job losses. It would be a major achievement for the Fed if it can engineer a soft landing despite the unprecedented pace of monetary tightening starting last year.

The Fed, ECB, BSP, and other central banks have kept the door open for further rate hikes as they maintain their vigilance against inflation. They have adopted a data dependent approach to policy-making, thereby giving them better flexibility in reacting to changing economic conditions. With the current data on inflation and economic growth, central banks have some leeway to assess the impact of their actions on the economy on a meeting by meeting basis. This would also support the BSP's decision to implement a prudent pause in tightening. Indeed, the peso currently is in a comfortable place against the US dollar.