

Mizuho Flash: BI & BSP

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BI & BSP: A Tale of Diverging Inflation Fortunes

***In a nutshell:** BI kept its policy rate unchanged at 5.75% while BSP raised its policy rate by 50bp to 6.00%, in a tale of diverging inflation fortunes. The Philippines is dealing with much stickier inflation than the rest of the EM Asia region whereas in Indonesia inflationary pressures have eased significantly, ahead of even BI's expectations. This leaves room for BI to stay on a prolonged pause while BSP will need to keep at rate hikes until inflationary pressures have eased visibly. We remain comfortable with our expectation for another 25bp hike in Q1, with the risks that BSP may be inclined to hike further.*

In line with expectations, **BI kept its policy rate unchanged at 5.75% while BSP raised its policy rate by 50bp to 6.00%, in a tale of diverging fortunes.** The divergence was on account of the inflation trajectory: **The Philippines is experiencing stickier inflation than its regional peers while inflationary pressures in Indonesia have eased perceptibly.**

Underscoring this, **BSP raised its 2023 and 2024 headline inflation forecasts to 6.1% and 3.1% from 4.5% and 2.8%.** Even then, **BSP stated that risks to CPI were “strongly skewed” to the upside.** Higher inflation expectations and still robust domestic demand underscore the persistence of inflation keeping BSP on a clearly hawkish trajectory. PHP depreciation and pick up in imported inflationary pressures have done little to help the situation. Going forward, **BSP Governor Medalla stated that incremental hikes will be data dependent.** Our base case is for a final 25bp hike at the 23 March meeting but the risk is that BSP is pushed into more rate hikes into Q2 based on inflation outcomes.

BI's outcome was less sticky. With inflationary pressures easing faster than its own expectations, BI was comfortable to maintain its policy rate at 5.75%. **This was complemented by IDR stability** (rather, regional outperformance relative to peers) - a key input into BI's policy framework¹.

For BI, **the mix of data is pointing to a prolonged pause, which is also our baseline.** BI now expects 2023 GDP growth to be at 5.1% from 4.9% (i.e. to the upper end from the midpoint of the 4.5-5.3% range) as China's re-opening boosts exports along with strong household consumption. BI expects resilient growth, low inflation and attractive rates are expected to boost IDR prospects; IDR volatility from Fed policy is expected to be handled by non-rate measures such as 'operation twist', i.e. buying longer term tenors bonds while selling shorter tenors bonds.

While BI is in a more comfortable position than BSP, for example, its situation is not without risks. Easing commodity prices weigh on exports, growth and fiscal revenues and risks pushing Indonesia into “twin deficit” (current account and fiscal balance deficits) territory. This raises capital outflow and IDR depreciation risks, which may be exacerbated by a continued re-pricing of US Fed rate hike expectations in H1 and rising political risks in H2 ahead of the February 2024 elections. **As such, BI may have to be more data and situation dependent than it is so inclined.**

¹ BI is in discussions around a policy to increase the repatriation of export proceeds onshore to raise FX supply onshore and reduce IDR volatility.

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