Metrobank Bulletin

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Business & Economy

US dodges default, the Fed pauses rate hikes

Will the BSP take cues from the Fed's decision, or will it take a different direction?

With the US debt default crisis behind us, investors are now looking at the next major risk event that could impact financial markets, namely the decisions of the US and Philippine central banks on policy interest rates. Today, the US Federal Reserve paused its 10-consecutive policy hikes since March 2022, leaving its key rates at 5.00-5.25%, while the Bangko Sentral ng Pilipinas (BSP) kept its rate unchanged at 6.25% during the last Monetary Board policy meeting last month.

Now everyone's asking "will the central bank follow the Fed's move?" The BSP's Monetary Board rate policy-setting meeting will be on June 22. Metrobank believes that the BSP, seeing some positive trends in the economy, may have the same move as the Fed on its next rate decision.

Below are the key reasons behind Metrobank's thinking:

1. **The US appears to be dealing with stickier inflation, while the BSP is anticipating a downward trend in Philippine inflation towards its target range of 2 to 4%.**

After narrowly skirting the debt ceiling crisis in early June, US authorities can focus back on the inflation problem. On its policy meeting today, however, it made a pause on hiking its rates, but surprised with a forecast of two more quarter-point hikes in its economic projections this year. Federal Reserve Chair Jerome Powell also noted that inflation remains elevated and this month's decision is only a pause that will allow the body to further analyze incoming data. He also signaled that a large majority of the FOMC expects additional tightening in its next meetings.

Here at home, headline CPI slowed for the fourth straight month in May to 6.1% from April's 6.6% on the back of lower transport costs and normalizing oil and food supply prices. This steady decline in inflation has led the BSP to lower its average inflation forecast in 2023 from 6% to 5.5%.

Given this, Metrobank expects the BSP to keep its policy rates steady at 6.25%. This is in line with the BSP's guidance that its policy rate will remain unchanged in the next two to three meetings as it expects inflation to fall within its target band of 2% to 4% by the third quarter of 2023.

2. The Peso FX rate is not just about the difference in overnight policy rates.

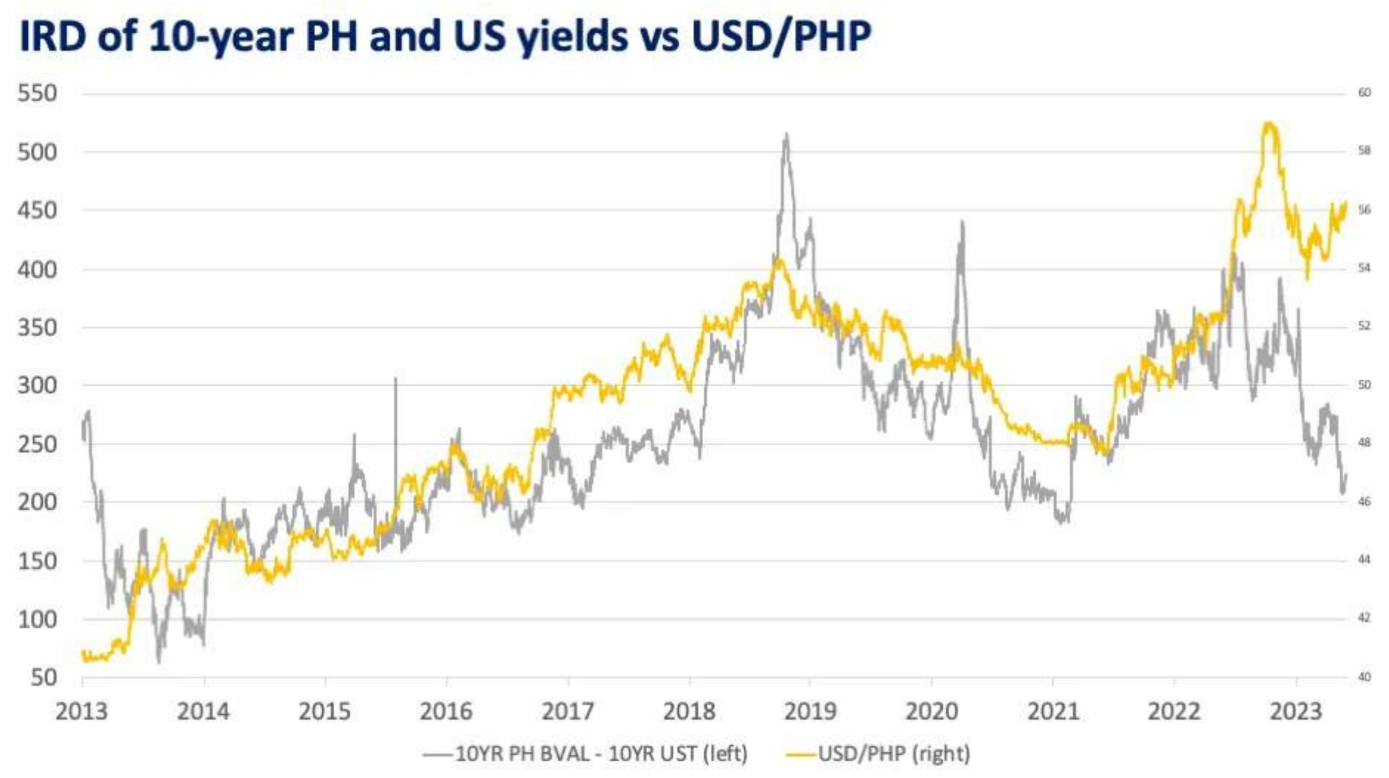
The risk with diverging policy rate paths between the BSP and the Fed is that the Philippine Peso's exchange rate against the US Dollar may become more volatile. The BSP therefore also looks at how its policy rate decisions affect the Peso's foreign exchange rate trends.

When the interest rate differential (IRD) between the Philippine Peso and the US Dollar is wide relative to historical averages, foreign portfolio investors are more incentivized to purchase Pesos so that they can invest in the higher-yielding Peso instruments. When the IRD is narrow relative to history, the opposite has happened, that is, foreign investors sell their Pesos and go back to US Dollars.

Over the last 10 years, the IRD in policy rates between the two currencies averaged 200bps, but this has now tightened to 100bps. Markets are therefore concerned that tighter interest rate differential at the policy rate level could result in portfolio outflows, leading to a weaker Peso.

Metrobank's analysis, however, suggests that the USD/PHP rate is not solely influenced by central bank's policy rates, which are overnight rates. Metrobank found that historically, the USD/PHP exchange rate also depends on two other factors, one, the IRD between the 10-year Peso government securities and US Treasury Bonds and two, the level of the Philippines' Gross International Reserves (GIR).

When comparing 10-year Philippine and US bond yields, the IRD between the two currencies has remained well-above 200bps and much closer to its 10-year historical average of around 250bps. The yield premium helps attract foreign portfolio investors to long-term peso government securities, which tempers selling pressures on the Peso, especially now that both the BSP and Fed are at or near the end of their rate hiking cycles.



The interest rate differential in PHP/USD has recently tightened to 100bps.

Metrobank also determined that the country's GIR level, which represents all of the Philippines' foreign currency reserves generated from the government's overseas investments, export proceeds, and remittances from Overseas Filipino Workers (OFWs), affects USD/PHP movement. Today, the GIR level remains strong at USD101.76 billion as of April 2023, a robust level that can support the Peso and manage volatilities.

The Philippine GIR is strong enough to manage volatilities.

This means that even if the IRD between the overnight policy rates of the BSP and Fed were to tighten to 75bps, Metrobank believes that the USD/PHP exchange rate will not approach the record highs of Php59/USD seen last November 2022, which was driven by the aggressive Fed rate hikes.

Due to concerns of a deeper economic slowdown and regional banking issues in the US, the Fed has signaled that it's near the end of its hiking cycle, and with the still-wide IRD in long-term Peso and Dollar government bonds, the pressure on the Peso exchange rate has eased. The market is currently forecasting USD/PHP to possibly trade beyond the 56-level over the next few months as importations pick up in line with seasonality, before moving back lower towards year-end when OFW remittances traditionally flow into the country.

Given these, Metrobank therefore believes the BSP may no longer need to match every policy move of the US Federal Reserve, as it did in the latter part of 2022.

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Money Basics

Is this a good time to take up a loan?

Three things to consider before borrowing money, according to Metrobank

So how does a potential pause on the central bank's rate hikes affect you, as a consumer? Rising interest rates make borrowing money more expensive. This has a direct impact on things like your credit card bills, new loans, and mortgages. So should the BSP decide on pausing policy rates on June 22, this means that you don't have to worry about rising interest rates if you're planning to borrow money for a new car, home, or even to expand your business.

While this may be encouraging, there are still many factors to consider before taking up a loan for a big purchase. Before you start heading to a bank, here are some things to keep in mind, whether as a first-timer or as a repeat borrower:

Review your financial health

You need to look at your financial health first. Do you have existing debts, which you need to prioritize and pay off soon? Can your emergency fund cover unexpected expenses? Can you use your savings or extra cash to pay for a big purchase?

Make sure your loan purpose is clear

Loans should help improve the quality of your life or generate economic value for you, such as learning new skills which can help you get promoted in your job. In the case of thinking of purchasing a new condo— think of its actual benefits: will it be better for you and your wallet to buy a condo vs. to just rent? Remember, banks will also evaluate your application and the interest rate they will give you based on your loan purpose.

Determine your capacity to pay a loan back

Is your current income enough to pay for the money you will borrow? Do you have other assets that you can submit as collateral? After you have checked your sources of income and your monthly budget, see if you have enough to take in a loan. If you are diligently budgeting, adjust it to fulfill your loan payments.

Lending institutions, especially banks, use the debt burden ratio (DBR) to compute the loan amount you can repay, including the amount you can borrow. This is shown as a ratio of the needed loan payments to your monthly income. Lenders often use this to gauge if you are a capable borrower who can qualify for a loan.

The debt burden ratio or DBR is your total monthly loan payments divided by your monthly income. It is expressed in percentage. The higher the DBR, the less your financial capacity to pay for additional loans. So a higher DBR will likely mean that your bank will give you a lower loan amount or might not approve your application at all.

Personal finance experts vary in their recommendations on the acceptable total monthly loan payments. As a guideline, your total loan payments should be in the 30%-35% range of your monthly income. If you can keep your total monthly repayments at that range, this will give you enough elbow room to pay for your essential expenses, while also having some savings or even investments.

If you're planning to take up a home or a car loan, you might want to consider Metrobank's new offers with their 'Your Dream is on Us' promo - which runs until June 30, 2023.

Metrobank offers a low interest rate of 9.11% p.a. for a 5-year car loan on a one-month advance payment scheme. The bank also waives up to PHP 50,000 off your bank fees, so you'll have extra funds to drive to your next adventure. On top of this, you will be pre-qualified for a Metrobank Toyota Mastercard, which offers a 3% fuel rebate at participating Petron stations, 10% discount on genuine parts and accessories, labor at Toyota dealers, and more.

Metrobank also offers a low interest rate of 6.50% p.a. fixed for one year on Home loans plus up to PHP 50,000 waived fees. As an additional perk, you will be eligible to get a Metrobank Credit Card so you can enjoy deals and discounts when you furnish your new home.

Applying for a Car or Home Loan is easy. Just head to any Metrobank branch near you or register via the Metrobank website (https://www.metrobank.com.ph/upgrade/home-loan or https://www.metrobank.com.ph/upgrade/car-loan). To know more about these offers, check out https://www.metrobank.com.ph/articles/car-home-loan-promo-2023. Terms and conditions apply.