Philippines: Keeping an eye on inflation

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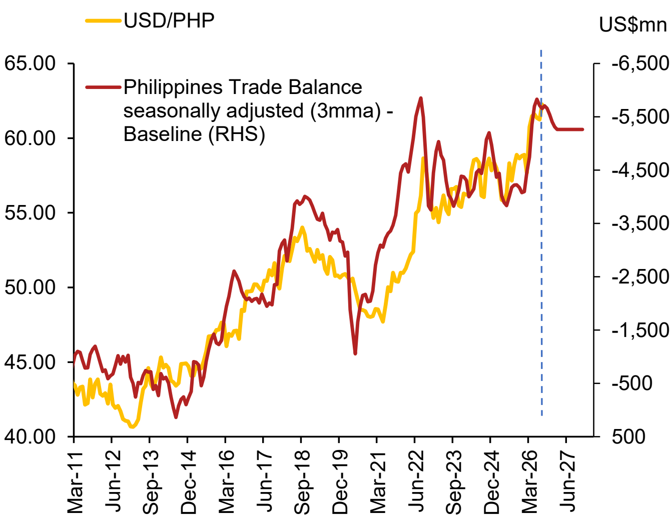
Key Points

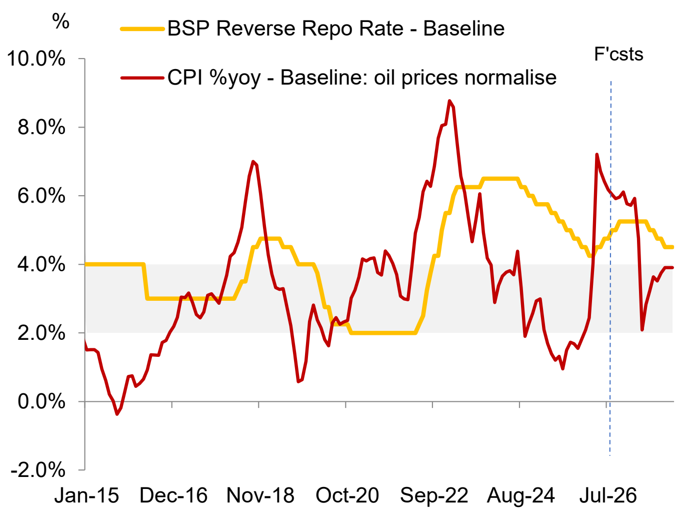
- **We have shifted our USD/PHP profile slightly higher, and now forecast USD/PHP trading around the 62.00 levels in 2H2026 before moving lower towards 61.00 in 1H2027.**
- Part of our forecast change reflects USD/PHP recently breaking above 62.00 levels, and also driven by global factors salient to PHP such as spikes in oil prices coupled with the rise and stickiness in US yields so far.
- **Nonetheless, our key message to clients is that PHP should still strengthen gradually over time in our base case for several reasons.**
- **First, we are forecasting the Philippines' trade deficit to narrow and short-end rates in the Philippines to widen against the US moving forward.** We expect oil prices to move gradually lower, the Philippines' non-oil trade deficit to stop widening with some support for exports, coupled with our expectation for BSP to remain hawkish relative to the Fed moving forward.
- **Second, while headline GDP growth has been relatively soft, what's important is that we expect some improvement as the worst of fiscal contraction fades, while we think domestic policy uncertainty is unlikely to worsen.** Some of this reflects our expectation for a gradual pickup in government spending, coupled with plans to introduce tax relief in expanding personal income tax exemptions and exempting small businesses from the minimum corporate income tax. The details of the final tax package will matter for the overall impact to the economy, but our current assessment is that it should be net-positive to growth over time.

CHART 1: WE ARE FORECASTING USD/PHP TO MOVE LOWER TOWARDS THE 61.00 LEVELS AS THE TRADE DEFICIT NARROWS



Source: CEIC, Bloomberg, MUFG GMR

CHART 2: WE FORECAST BSP HIKING RATES ONCE MORE IN 2026, AND BRINGING THE POLICY RATE TO 5.25% FROM 5.00% CURRENTLY



Source: CEIC, Bloomberg, MUFG GMR

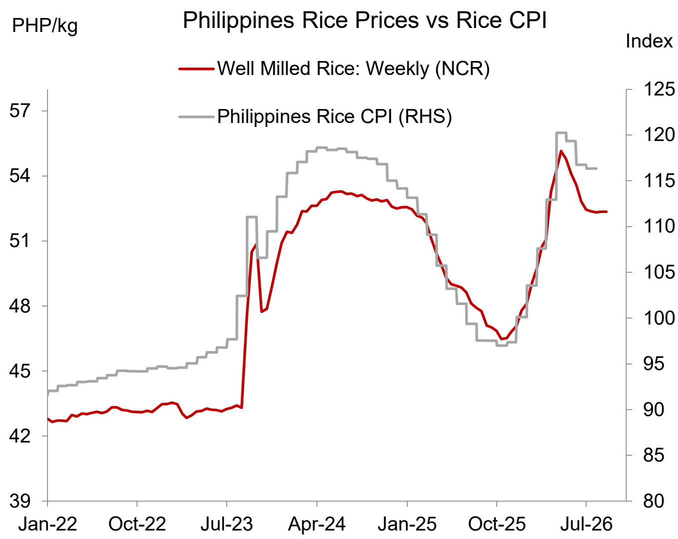
TABLE 1: PHILIPPINES KEY FORECASTS - BASELINE

	Spot	3Q2026 F	4Q2026 F	1Q2027 F	2Q2027 F
USD/PHP	62.359	**62.20**	**62.00**	**61.50**	**61.00**
BSP Policy Rate (RRP)	5.00%	**5.00%**	**5.25%**	**5.25%**	**5.00%**
10-year Bond Yield (%, EOP)	7.26%	**7.30%**	**7.20%**	**7.10%**	**7.00%**
Reserve Ratio Requirement (%)	5.00%	**5.00%**	**5.00%**	**5.00%**	**5.00%**

Source: CEIC, Bloomberg, MUFG GMR Estimates.

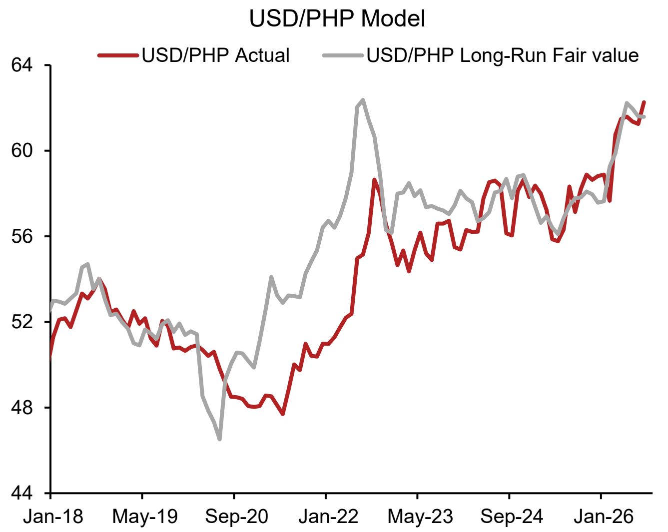
- **Third, while there are significant risks from a severe El Nino event, the good news is that we have seen domestic rice prices move into better balance between supply and demand at least over the past 2 months.** This could very well change of course depending on weather patterns and food import policies, and is one important risk to our view.
- **Lastly, our model suggests PHP is now slightly undervalued against the Dollar.** Of course in FX, using valuation alone to trade is a fool's errand, and we never just base our directional FX view solely on that. The broader point remains that we see the fundamental drivers combined with undervaluation giving us some confidence on our modal forecasts for USD/PHP to move lower over time towards the 61.00 handle over the next 12 months.

CHART 3: DOMESTIC RICE PRICES HAVE STABILISED, BUT A SEVERE EL-NINO IS A KEY RISK



Source: CEIC, Bloomberg, MUFG GMR

CHART 4: OUR MODEL OF USD/PHP SHOWS THAT PHP IS SLIGHTLY UNDERVALUED AGAINST THE DOLLAR



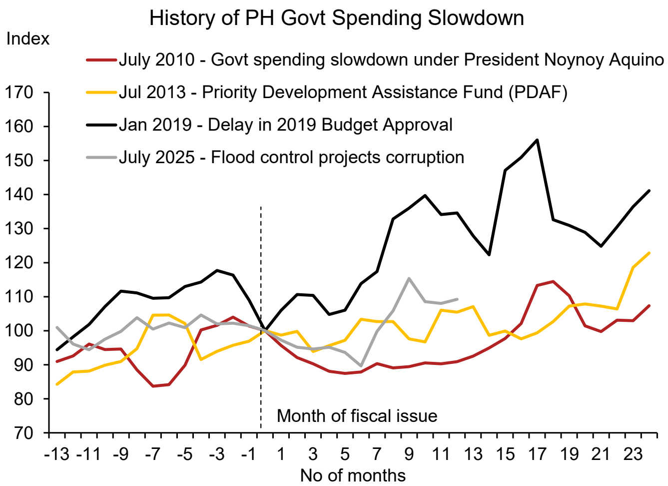
Source: CEIC, Bloomberg, MUFG GMR. Note: Based on Autoregressive Distributed Lag (Error Correction) Model of USD/PHP. See Appendix for more details

- **We see four key risks to our view.** First, global events such as Fed rate hikes, which we stress is not our global team's base case, coupled with a significant re-escalation in the US-Iran conflict driving up oil prices. Second, a severe El Nino event pushing up domestic food and power prices and hence raising inflation pressures and further lowering growth prospects. Third, a rise in domestic policy uncertainty. Fourth, a meaningfully dovish turn by the BSP.
- **Putting it all together from a strategy perspective, we have relatively low conviction on any USD/PHP directional view right now, but ultimately see risk-reward at current spot levels favouring USD/PHP moving lower rather than higher.** As such, we think some structures such as 1-3m put spreads on

USD/PHP can be one way to express that view. For clients with RHS FX needs, we would prefer to wait for better levels.

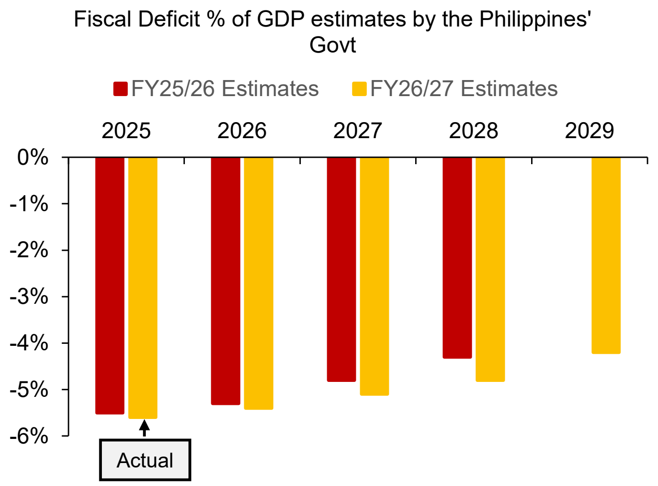
- **From a policy rate perspective, we continue to forecast BSP hiking rates once more, likely in the October 2026 meeting, and bringing the policy rate to 5.25% from 5.00% currently.** Looking further ahead, we are currently forecasting BSP to start cutting rates next year starting June 2027 as year-on-year inflation moderates. Nonetheless, we see some risk that the timing of these cuts could be pushed out to a later date, especially if upside risks from a severe El Nino and food prices materialise.
- **From a rates perspective, we are neutral on Philippines local currency bonds at these levels. While there has already been quite a bit of sell-off on local bonds far, a hawkish BSP, a slower pace of fiscal consolidation, coupled with uncertain inflation trajectory makes us hesitant to take a strong view on PH bond yields at current levels. We see 10-year PH yields remaining sticky at around 7% through our forecast horizon.**

CHART 5: WE CONTINUE TO EXPECT SOME GRADUAL IMPROVEMENT IN GOVERNMENT SPENDING BASED ON HISTORY OF PAST FISCAL SPENDING SLOWDOWNS



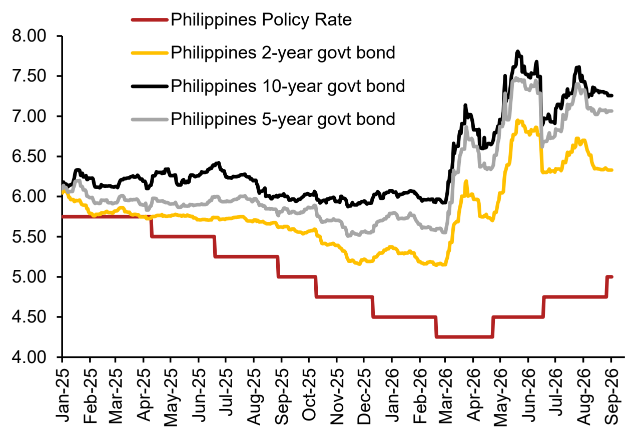
Source: CEIC, Bloomberg, MUFG GMR

CHART 6: THE GOVERNMENT IS PENCILLING A SLOWER PACE OF FISCAL CONSOLIDATION MOVING FORWARD, WHICH SHOULD PROVIDE SOME SUPPORT TO GROWTH



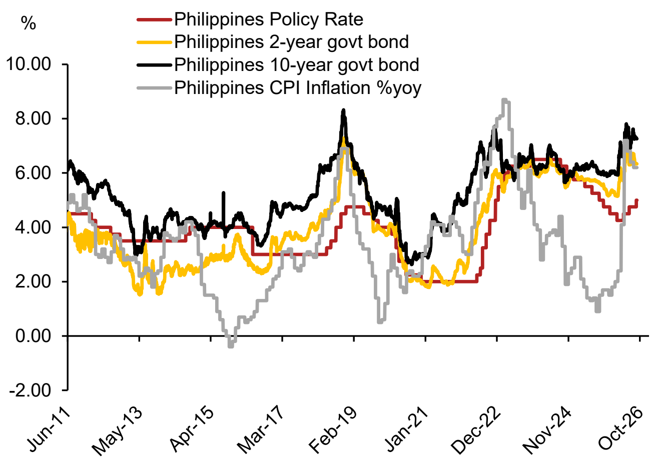
Source: CEIC, Bloomberg, MUFG GMR.

CHART 7: PHILIPPINES LOCAL CURRENCY BONDS HAVE SOLD OFF QUITE A BIT THIS YEAR



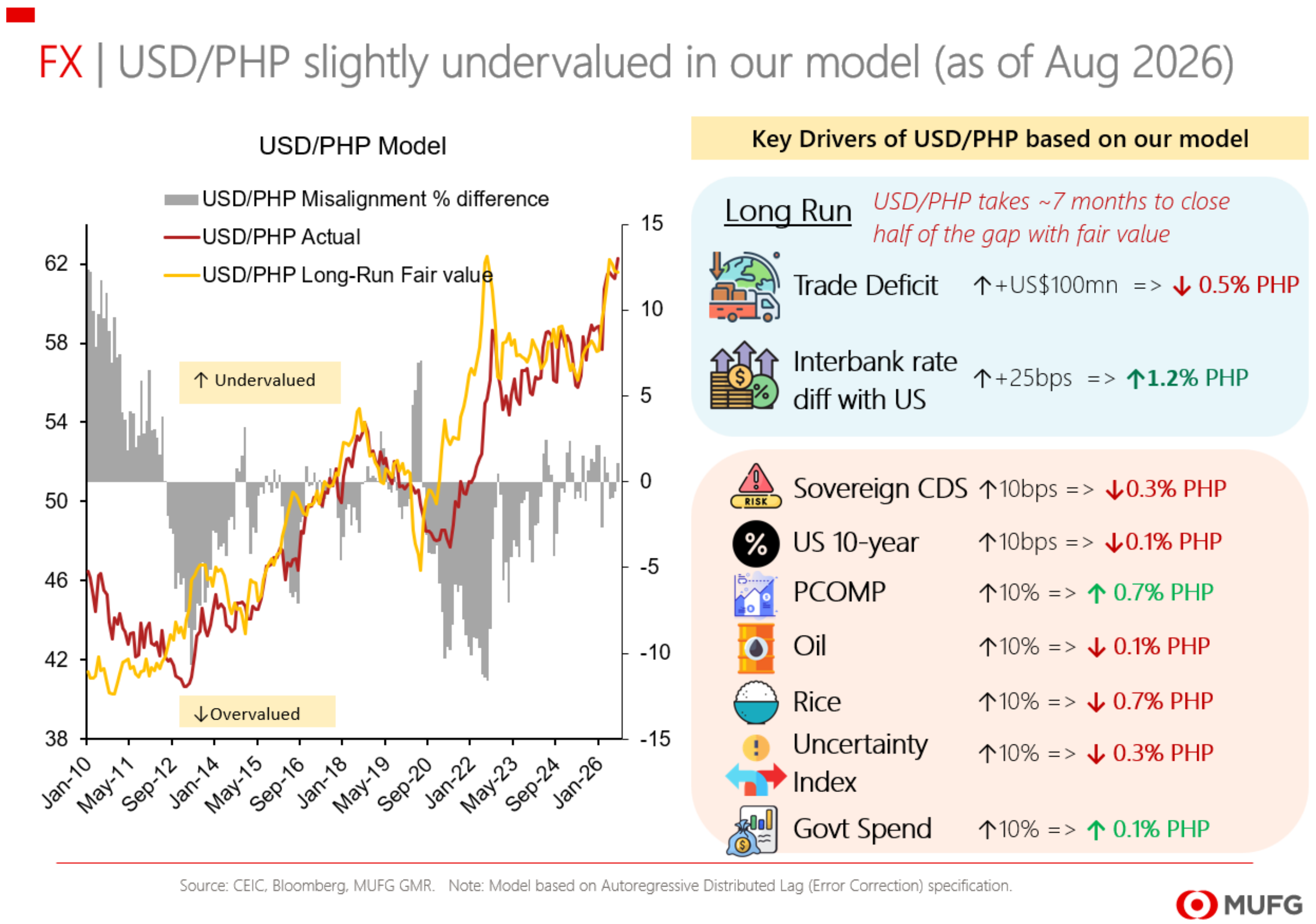
Source: CEIC, Bloomberg, MUFG GMR

CHART 8: A MOVE LOWER IN LOCAL PH YIELDS WOULD LIKELY REQUIRE CPI INFLATION TO MODERATE MORE



Source: CEIC, Bloomberg, MUFG GMR.

CHART 9: PHP IS SLIGHTLY UNDERVALUED BASED ON OUR FX MODEL AS OF THE END OF AUGUST 2026



Source: CEIC, Bloomberg, MUFG GMR. Note: Model based on Autoregressive Distributed Lag (Error Correction) specification

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