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BSP surprise pause bolsters peso

The Philippine peso strengthened against the US dollar after the Bangko Sentral ng Pilipinas (BSP) surprised markets last Thursday by pausing its interest rate easing cycle. BSP kept its benchmark policy rate unchanged at 5.75%, and its overnight deposit and lending rates steady at 5.25% and 6.25%, respectively. This decision came after three consecutive cuts in 2024, totaling 75 basis points.

USDPHP breaks below 58 support level

The USDPHP rate broke below the crucial 58 support level following BSP's policy decision to maintain rates. The peso closed at 57.83 last Friday, marking its strongest level year-to-date. This move also pushed the currency below the 200-day moving average for the first time in four months, signaling a potential shift in trend. A sustained break below this key indicator suggests an expansion of the peso's trading range, compared to its previous consolidation within the narrow 58-59 band. This move comes as a welcome relief for market participants after the BSP's successful defense of the 59 level in recent months.

Interest rate differential key to peso stability

BSP's decision follows the Federal Reserve's recent pause in its easing cycle and the release of higher than-expected US inflation data last week. The Fed maintained rates at its January 29 meeting, following three consecutive cuts in late 2024. While BSP Governor Eli Remolona, Jr. maintains his dovish outlook, still guiding for 50 basis points of rate cuts in 2025, the surprise pause has helped maintain the critical interest rate differential with the US. A narrower rate gap could have intensified pressure on the peso, potentially stoking inflation through higher import costs.

Markets shrug off US reciprocal tariffs

Markets largely brushed aside President Donald Trump's February 13 announcement of reciprocal tariffs targeting both ally countries and adversaries with higher duties on US goods. The "Fair and Reciprocal Plan" would match tariff rates imposed by other nations on American products, particularly affecting countries like India, Brazil and Turkey, which currently levy higher duties than the US.

Despite these potentially significant trade implications, global currencies strengthened against the dollar, while the US stock markets pushed to all-time highs. This suggests that investors view the plan as less disruptive and not as bad as previously feared.

No need to hurry

During his testimony before Congress on February 11, Powell said the Federal Reserve is not in a hurry to cut interest rates further, citing a strong economy and inflation that is still above the Fed's 2% target. Regarding Trump's tariffs policies, Powell maintained a neutral stance, reiterating that it is not the Fed's role to engage in trade policy. However, Powell acknowledged that tariffs could influence inflation and economic conditions, which the Fed would monitor closely as part of its mandate to manage monetary policy.

Dollar weakness adds to peso's momentum

US Dollar Index (DXY) slid 1.09% over two days following Trump's reciprocal tariffs announcement to close at 106.79 last Friday. The decline pushed the DXY back into the established 100-107 trading range, with Bloomberg reporting that speculators are unwinding long dollar positions. A Bank of America survey of fund managers indicates that bullish dollar bets represent the most crowded trade among rates and currency traders, suggesting potential for further unwinding. This broader dollar weakness adds momentum to the peso's recent rally.

Markets learn to live with Trump

China's stock market resurgence – with MSCI China up 14% year-to-date and tech giants Alibaba and Pinduoduo surging 47% and 28% respectively – shows how markets have grown immune to Trump's rhetoric. Currency traders, exhausted by Trump's shifting daily narratives, are no longer rushing to the dollar's safety on every headline. This Trump fatigue, combined with the increasingly crowded US dollar positioning and BSP's surprise rate pause has pushed the USDPHP rate below key technical levels at 58 and its 200-day moving average. If China's stock market continues to improve, other Asian markets may follow, potentially boosting Philippine stocks and supporting further gains in the peso.