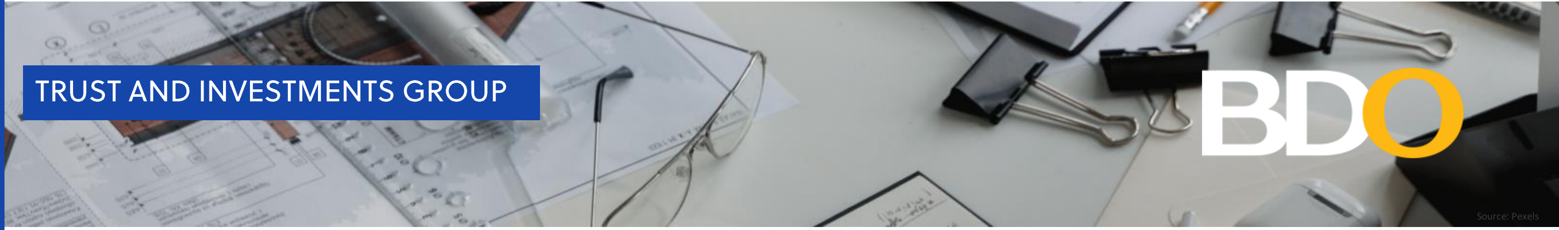

2025 BDO Trust Outlook & Strategy

Keep your seatbelts on

February 21, 2025
BDO Trust Research

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WITH CONTRIBUTIONS FROM TRUST RESEARCH, FIXED INCOME AND EQUITIES TEAMS

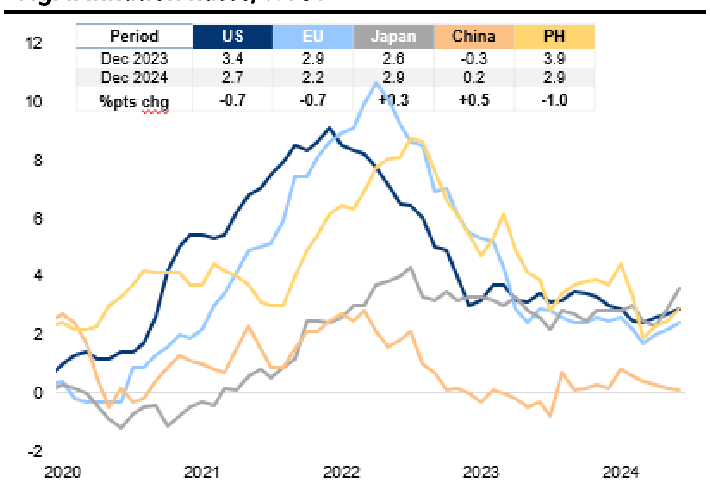
Trump returns to power. Republican control of both White House and Congress will provide President-elect Trump with multiple avenues to deliver on his campaign promises. Among these, we highlight his pro-growth policies that heighten concerns on US inflation & deficit, and remain wary of potential impact of protectionist policies which could broadly affect emerging market countries, including the Philippines.

Tariffs as a blunt tool. Trump's tariff policy implementation could prove to be the biggest contributor to volatility in global trade and markets, as the US President has made that a key piece of his administration. The uncertainty over each country's potential response and inflationary impact on the US economy introduces additional pressure on global markets, and strain relationships with other nations.

Shallower rate cuts. We see moderate Fed rate cuts of 1-2x this year (25-50bps) as pro-growth policies and tariffs could lead to inflationary pressures, narrowing the Fed's room to lower rates. We also expect the BSP to follow suit on moderate rate cuts, with one rate cut in 1H25 and another in 2H25, in line with Fed rate cuts, maintaining the policy rate differential, and protecting the PHP.

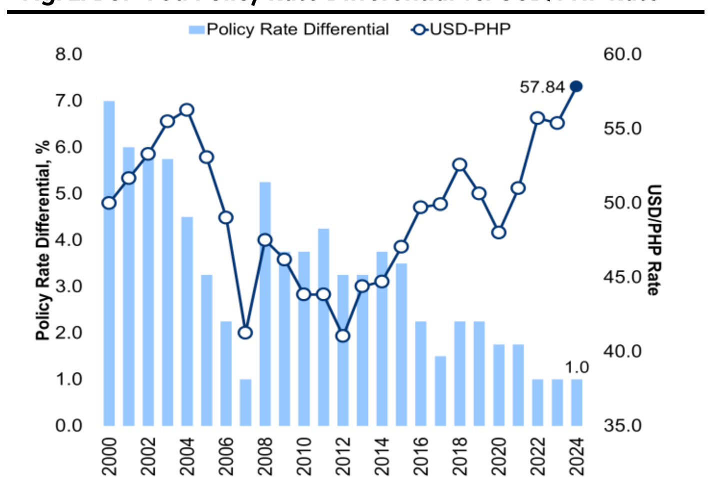
Expect a bumpy ride. While we expect a better Philippine economy in 2025 (GDP FY25F: 5.9%), as inflation turns more benign and consumption improves in an election year, headwinds from across the pond add an extra layer of volatility into the market. Investor sentiment on the Philippines remain frail, despite being less exposed on global trade risks. Other risks to our view include sustained geopolitical conflicts, secondary impact of a weak currency on inflation, and the lagged effects of tight monetary policy.

Fig. 1. Inflation Rates, %YoY



Source: PSA, CEIC

Fig. 2. BSP-Fed Policy Rate Differential vs. USD/PHP Rate



Source: BAP, Bloomberg, BDO Trust Research

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Trump 2.0 to have wide-ranging effects

Red sweep provides Trump with carte blanche control over policies
Pro-growth Trump 2.0 policies will have far-reaching consequences over corporate earnings growth, mergers & acquisitions (M&A), global supply chains, and relationships with the rest of the world.

We identify four key agenda by the new U.S. administration that have a direct impact on investments, namely: (1) extension of Tax Cuts & Jobs Act, as well as new tax cut proposals, estimated at $8 trillion; (2) tougher trade policies, particularly tariffs on imports by as much as 40-60% for Chinese imports, 25% for Canada & Mexico, and 10-20% broadly for other importers; (3) deregulation or looser rules on antitrust and capital requirements for financial institutions; and (4) reshoring of outsourced manufacturing jobs & deportation of illegal immigrants.

The early result of these policies has been a sell-down of longer tenor bond yields on fear of higher U.S. government deficit, coupled with a potential of a trade war, which could lead to higher inflation, if higher tariffs are passed on to end consumers in the U.S.

THE EARLY RESULT OF THESE POLICIES HAS BEEN A SELL-DOWN OF LONGER TENOR BOND YIELDS ON FEAR OF HIGHER U.S. GOVERNMENT DEFICIT, COUPLED WITH A POTENTIAL OF A TRADE WAR, WHICH COULD LEAD TO HIGHER INFLATION, IF HIGHER TARIFFS ARE PASSED ON TO

We saw the opposite happen in the U.S. equity markets, with sustained rallies in the S&P 500, post-elections, as investors anticipate higher future earnings growth due to corporate tax cuts and deregulation.

Market expectations on the Fed rate cuts have also become shallower for 2025, coming from three cuts (~75bps) to just two (~50bps), mostly because of still-elevated inflation.

Fig. 3. Key Trump 2.0 Agenda under a Red Sweep

Key agenda
1. **Tax cuts**: extension of Tax Cuts and Jobs Act + new tax cut proposals (est. ~$8tn)
2. **Tougher trade policy**: tariffs on imports (60% China, 10-20% broadly) to offset tax cuts
3. **Deregulation**: rollback of antitrust (tech) and capital rules (banks)
4. **Reshoring/Immigration**: take back manufacturing jobs/deportation of illegal immigrants (hit on labor market)

Source: Bloomberg, BDO Trust Research estimates

Fig. 4. Potential Impact to Investments

Impact to investments
• **Bond yields rise** on fear of higher deficit & trade war, leading to higher inflation
• **Equity market rallies** on tax cuts and deregulation, which will boost corporate earnings
• **Stronger USD** on lower rate cut expectations, in a pro-growth, inflationary environment
• **For Philippines, limited foreign inflows on weak PHP, less interest rate cuts**

Source: Bloomberg, BDO Trust Research estimates

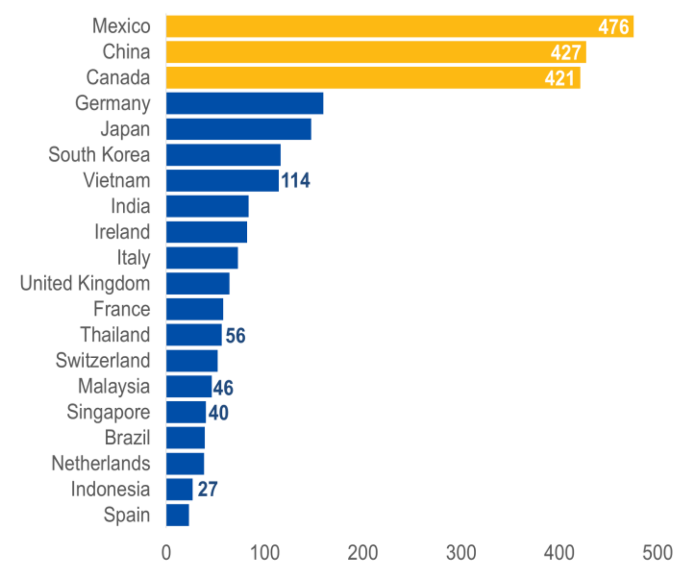
Trade and tariffs are on top of Trump's mind

Tariffs as a Negotiation Tool

President Trump has begun to impose tariffs as leverage to dictate policy vs. other countries, focused mainly on China, Mexico, and Canada. These countries are also the largest source of imports into the US economy (Fig. 4). While this tactic aims to protect U.S. industries, and potentially offset the shortfall from tax cuts, it can also escalate tensions with other nations, which can lead to retaliatory measures, and disrupt supply chains.

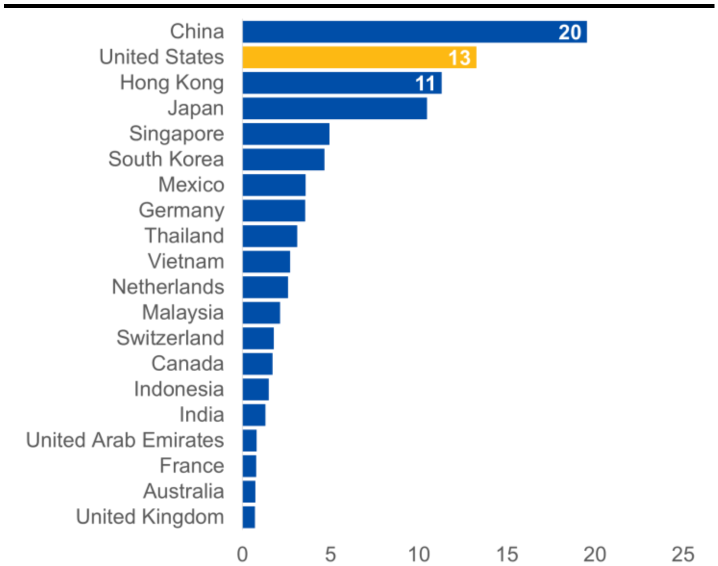
Compared to its ASEAN peers, the Philippines is less exposed to trade war risks as it has fewer exports (Fig. 5) into the US compared to our regional peers. Countries like Vietnam, Thailand, Malaysia, Singapore, Indonesia, rely significantly on U.S. demand, making them more vulnerable to tariff shocks. The Philippines' economy benefits from strong domestic consumption and trade ties with other neighbouring countries, helping it withstand global trade uncertainties.

Fig. 5. US Top 20 Origin of Imports ($ bn) 2003



Source: Bloomberg

Fig. 6. PH Top 20 Export Destinations ($ bn)



Source: Bloomberg

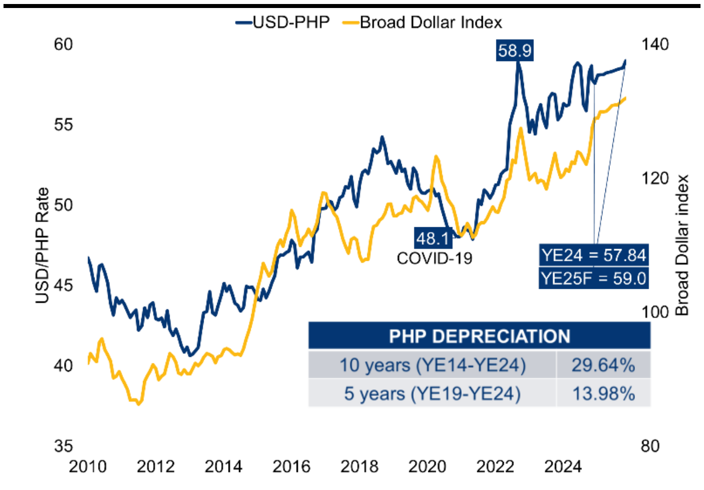
Stronger USD amid fewer rate cuts

The Philippine Peso (PHP) remains under pressure as the U.S. Dollar (USD) strengthens (Fig. 7), driven by expectations of moderate rate cuts from the Federal Reserve, especially given concerns of higher inflation which could be exacerbated by trade war. With the Fed expected to maintain higher interest rates for longer, demand for the dollar stays strong, making emerging market currencies like the PHP more vulnerable.

Over a 5-year and 10-year basis, we note that the PHP has depreciated by nearly 14% and 30%, respectively.

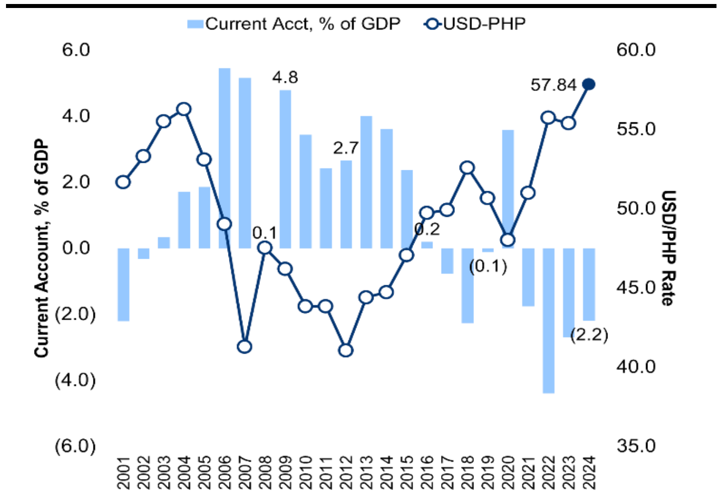
On the local front, a dovish pause by the Bangko Sentral ng Pilipinas (BSP) and a still wide current account deficit (Fig. 8) add to the peso's weakness. The BSP's cautious approach to monetary policy, combined with persistent trade imbalances, reduces support for the currency. These factors, along with external headwinds, contribute to sustained depreciation risks for the PHP. Over a 5-year and 10-year basis, we note that the PHP has depreciated by nearly 14% and 30%, respectively.

Fig. 7. USD/PHP Rate vs. Broad Dollar Index (2006 – 2024)



Source: BAP, Bloomberg

Fig. 8. PH Current Account (% of GDP) vs USD/PHP Rate 2001 – 2024F



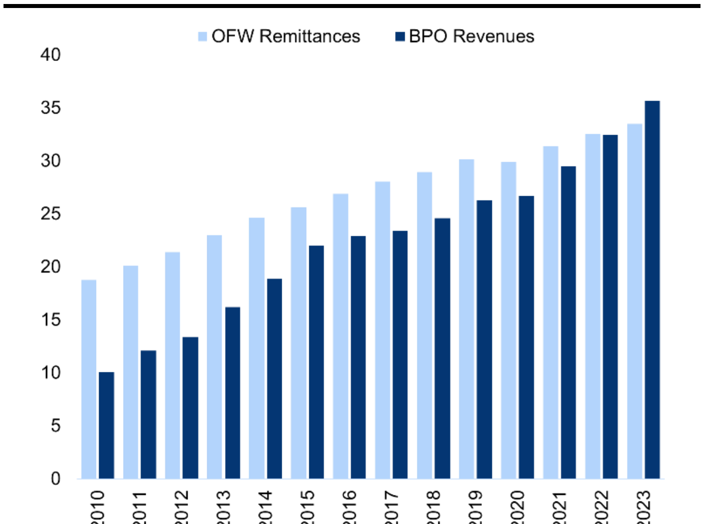
Source: Bloomberg

Stable Support from OFW Remittances and BPO Revenues

On the flipside, a strong USD should prove beneficial to Overseas Filipino worker (OFW) remittances and business process outsourcing (BPO) revenues, as they remain key pillars of the Philippine economy, contributing around 15% of GDP or approximately $69.2 billion. These inflows provide steady foreign exchange support, helping offset trade deficits and stabilizing domestic consumption.

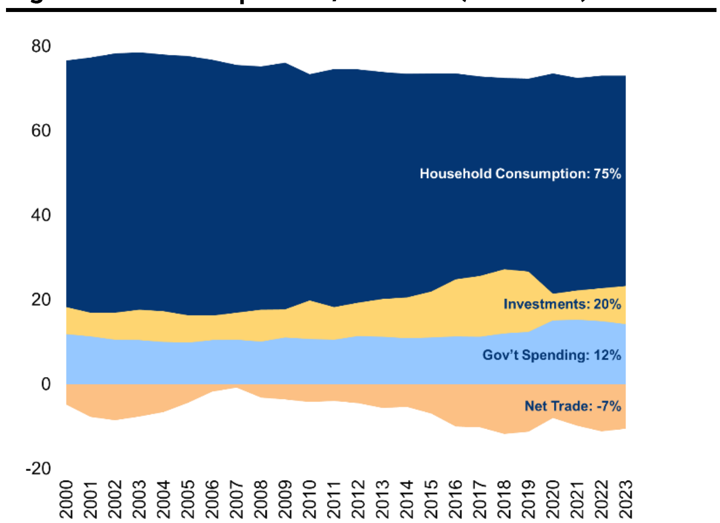
While concerns exist over U.S. companies' reshoring jobs, the Philippine BPO sector has so far remained resilient. During Trump's first term, fears of outsourcing restrictions did not lead to a significant decline in BPO revenues. The industry continues to adapt, benefiting from cost advantages, skilled talent, and strong client relationships.

Fig. 9. OFW Remittances vs. BPO Revenues, USDbn 2010-2023



Source: CEIC

Fig. 10. PH GDP Components, % of GDP (2000-2023)



Source: CEIC

PH GDP slows down in 2024, shaped by mix of local & global forces

Inflation, currency fluctuations, fiscal policies, and government spending priorities all play a role in defining the economic trajectory. With these factors in mind, the big questions remain: (1) Will the Philippines finally meet or slip below target in 2025? (2) Will the BSP continue easing this year?

The FY24 GDP figure stood at only 5.6% (Fig. 11), missing the government's target of 6-7%. On the demand side, household consumption slowed to 4.8% vs. the 5.6% growth in 2023. This is contrary to expectation that household consumption will likely rebound due to lower inflation and steady remittance inflows. Capital spending picked up due to lower interest rates, recording a 7.5% growth in 2024 vs. the 5.9% the previous year. Government spending picked up to 7.1% from the sluggish 7.6% in 2023 as infrastructure spending ramped up in 2Q24 to 4Q24. As for the trade performance, imports of goods and services increased to 4.3% from the 1.0% growth in 2023. Exports also grew at a modest pace at 3.6% vs. 1.0% in 2023. Despite the higher numbers vs. 2023, FY24 growth was still below pre-pandemic levels (6.4% on average).

For FY25, we revise our GDP growth estimates from 6.2% to 5.9% on expectations that consumer spending will continue to disappoint even as inflation cooled further in the latter part of last year.

Fig. 11 PH GDP Growth (%)

	2010-2019 Ave.	FY23	1Q24	2Q24	3Q24	4Q24	FY24
GDP	6.4	5.5	5.8	6.4	5.2	5.2	5.6
Household Consumption	5.9	5.6	4.6	4.7	5.2	4.7	4.8
Essentials	5.7	2.6	3.3	3.7	4.9	3.8	3.9
Discretionary	6.2	10.7	7.2	7.5	5.9	6.7	6.9
Government Consumption	7.6	0.6	1.7	11.9	5.0	9.7	7.1
Gross Capital Formation	12.0	5.9	0.5	11.6	13.7	4.1	7.5
Fixed Capital Formation	11.0	8.2	2.1	9.7	7.6	4.8	6.0
Construction	11.1	9.1	6.9	16.2	8.8	7.8	9.9
Public Construction	8.9	9.7	12.1	21.7	3.7	4.9	10.6
Private Construction	12.7	8.8	5.3	10.3	11.9	9.5	9.3
Durable Equipment	14.0	8.9	-5.5	-4.5	7.9	0.1	-0.5
Exports	8.9	1.4	8.4	4.2	-1.4	3.2	3.6
Imports	10.9	1.0	2.2	5.3	6.4	3.2	4.3

Source: CEIC, BDO Trust Research estimates

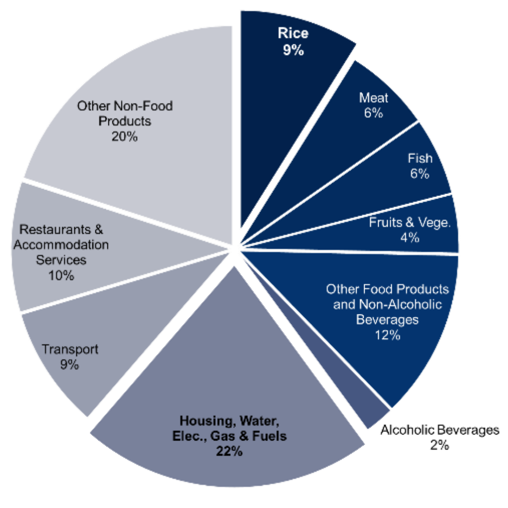
For FY25, we revise our GDP growth estimates from 6.2% to 5.9% on expectations that consumer spending will continue to disappoint even as inflation cooled further in the latter part of last year. On the other hand, the labor market is still holding up with unemployment rate recording the lowest at 4.3%, and increasing minimum wage. With a resilient labor market and the gradual decline of food prices, we still expect a gradual recovery of household consumption, especially starting from 2Q25. Capital spending will also likely pick up albeit at a much slower pace due to lesser expected rate cuts. Aggressive government spending may also pan out in the first quarter if project launches materialize before the March 2025 deadline. Even with the factors mentioned above and the 10% higher budget this year vs. the previous year, we expect that the government may still possibly miss the target this year.

On the inflation front, inflation eased and is expected to slow further. However, fluctuations in energy and food prices continue to pose risks, which could drive inflation back upward. The Philippines, in particular, is highly sensitive to these food and energy costs (Fig. 12), making inflation a key concern. The country's average inflation significantly dropped from the 6.0% in 2023 to 3.2% in 2024 (Fig. 13), falling within the government's target band of 2-4% for the first time in three years. One of the main factors helping to keep inflation in check is the lower global rice prices (Fig. 14 & 15), coupled with adequate rice stock inventory levels. In addition, the declining cost of crude oil (Fig. 16), largely due to weak fuel demand in China (Fig. 17), could continue ease local pump prices in 2025, further stabilizing inflation.

In 2025, we expect inflation to remain within the target range at 2.8%, supported by lower tariffs on rice imports and barring unexpected commodity shocks. The general downtrend of inflation supports our expectation that the BSP will continue easing this year. However, the BSP will do so prudently, due to other global developments, such as the impact of a Trump 2.0 on global inflation and growth, that could induce inflation and could weaken the peso.

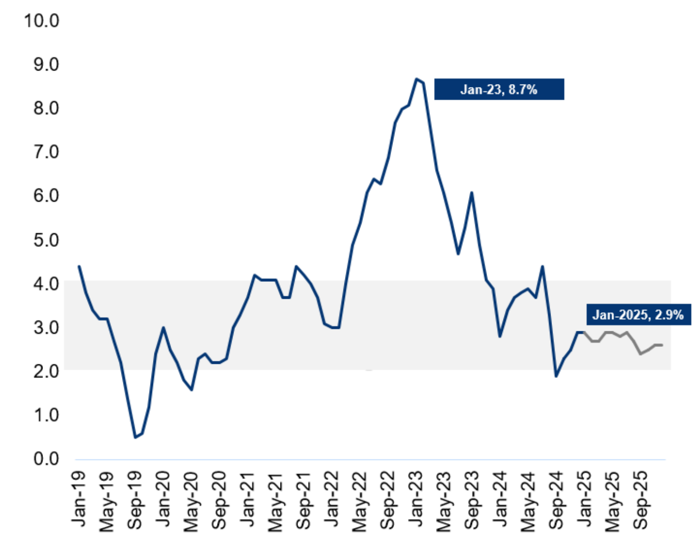
In 2025, we expect inflation to remain within the target range at 2.8%, supported by lower tariffs on rice imports and barring unexpected commodity shocks.

Fig. 12. CPI Basket, 2018-based



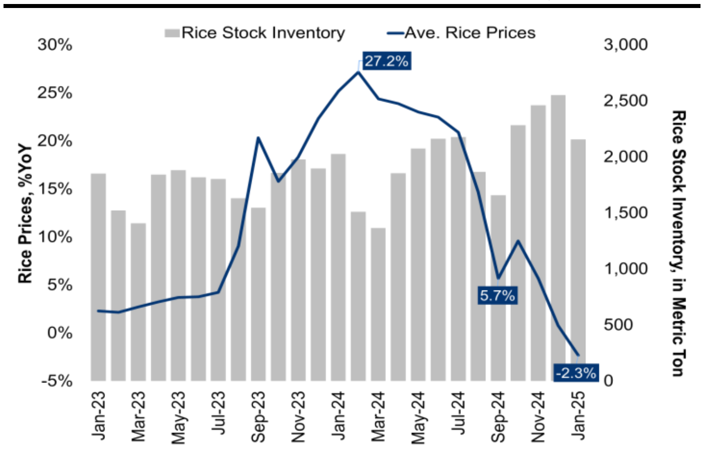
Source: PSA, BDO Trust Research

Fig. 13. Inflation Rate, 2019-2025F



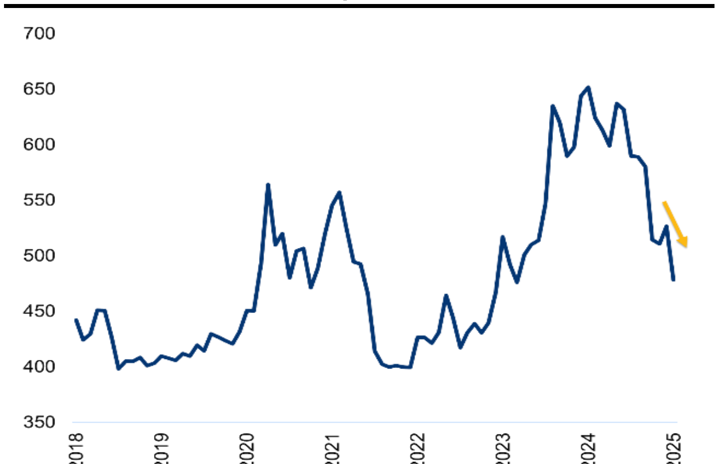
Source: PSA, BDO Trust Research estimates

Fig. 14. Rice Price Index and Rice Stock Inventory



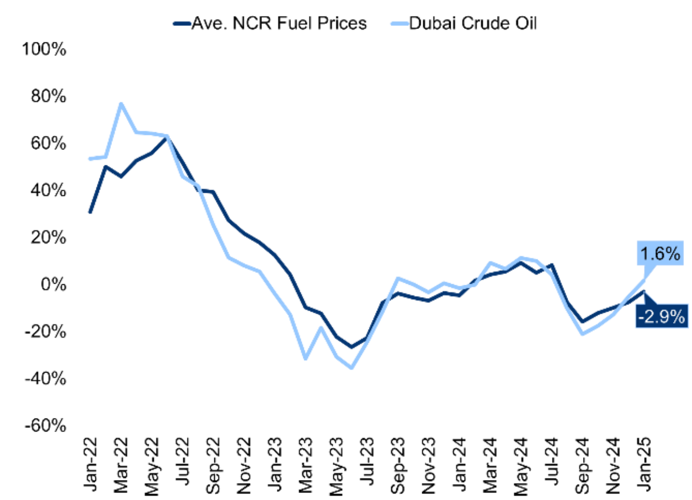
Source: CEIC, BDO Trust Research estimates

Fig. 15. Thai White Rice, 5% Export Price



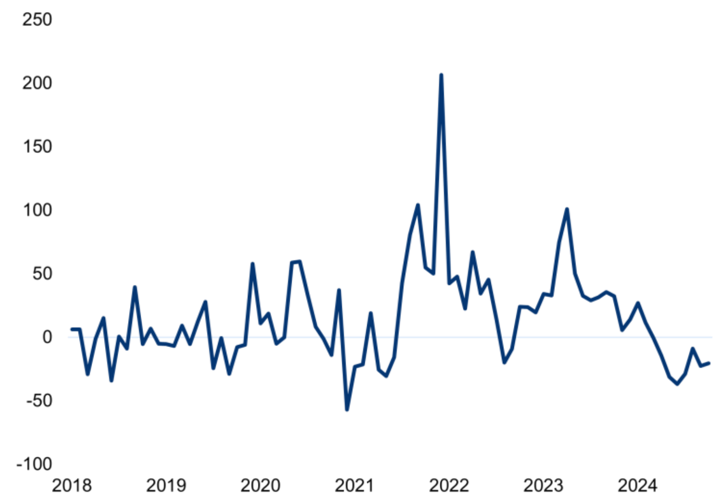
Source: CEIC, BDO Trust Research estimates

Fig. 16. NCR Fuel and Dubai Crude Prices, % YoY, Jan 2022-Jan 2025



Source: CEIC, BDO Trust Research estimates

Fig. 17. China Fuel Demand, % YoY, 2018-Oct 2024



Source: CEIC, BDO Trust Research estimates

CREATE MORE Act to set stage for investment-led growth PH

The proposed CREATE MORE Act (Fig. 18) aims to enhance the Philippines' investment climate by building on the reforms introduced by the CREATE law. By offering more targeted incentives and reducing regulatory barriers, it seeks to attract foreign direct investment (FDI) and support long-term economic growth.

Despite ongoing reforms, the country still lags behind regional peers in FDI inflows. Business-friendly policies like CREATE MORE could help bridge this gap by making the Philippines a more competitive destination for investors. Strengthening investment incentives and improving ease of doing business are key steps toward sustaining growth and driving job creation.

Fig. 18. Summary of CREATE MORE Act

Reduction in Corporate Income Rates	• Reduced 20% Corporate Income Tax (CIT) rate for Registered Business Enterprises (RBEs)	↑ support for small businesses
Enhanced Deductions	• Allowable deduction for power costs from 50% to 100% • Expenses related to trade fairs are now deductible	↑ encourage FDIs
Streamlined VAT incentives	• VAT exemption applicable to goods imported by exporters with at least 70% export sales	↑ stimulus for export activities
Flexible Work Arrangements	• Allows RBEs to adopt flexible work models while retaining tax incentives	↓ could hurt property market

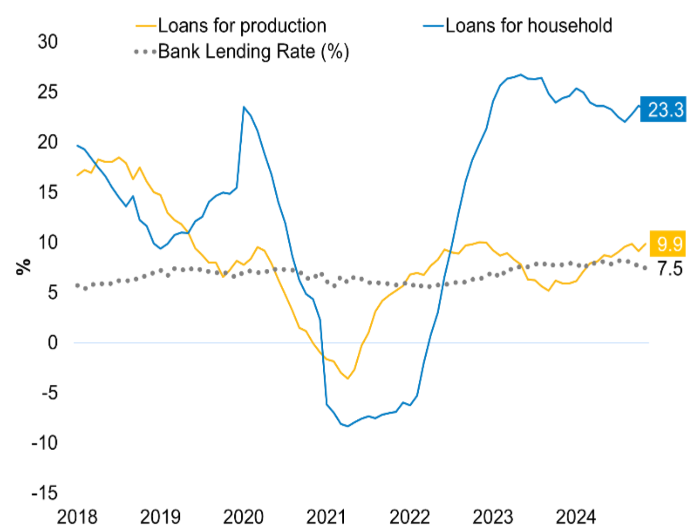
Source: BDO Trust Research

Broad-based loan growth across segments

Loan growth remained strong (Fig. 19 & 20) across all segments in 3Q24, with consumer, middle market, and corporate lending showing sustained expansion. Consumer loans grew steadily at 16%, while middle market lending rose to 12%, reflecting increased borrowing appetite. Corporate loans saw a notable increase, reaching 12%, following a sharp rise in 2Q24.

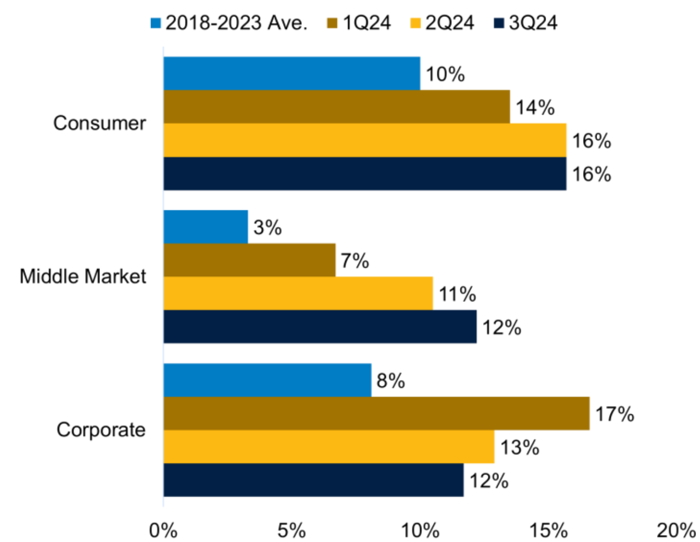
With the BSP expected to cut policy rates further in 2025, loan growth is likely to accelerate. Lower borrowing costs could drive higher demand across sectors, particularly in corporate and middle market segments. As credit conditions improve, lending activity is set to support broader economic expansion.

Fig. 19. Consumer vs. Production Loans Growth, % YoY



Source: CEIC, BDO Trust Research

Fig. 20. BDO: Loans per Segment 2018 – 3Q24



Source: Company reports, BDO Trust Research

Local banks to benefit from RRR cuts and stable NIMs

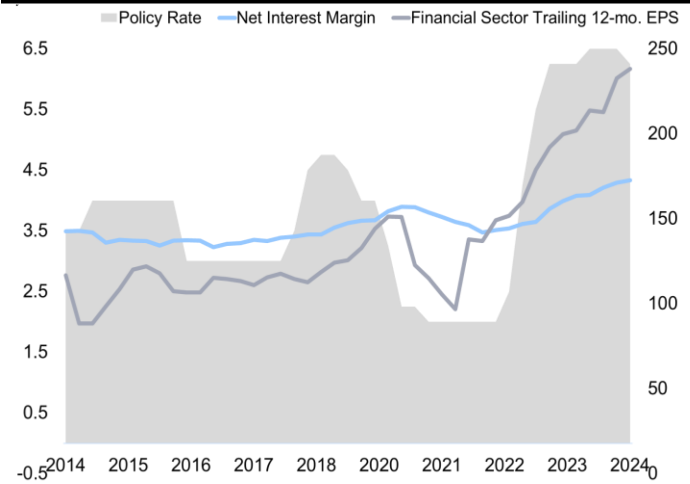
Local banks stand to benefit from reductions in the reserve requirement ratio (RRR), which could structurally improve liquidity and profitability. Unlike other ASEAN markets, the Philippines is uniquely positioned for RRR cuts as a long-term policy shift. If implemented, this could lead to a re-rating of bank valuations.

BSP Governor Remolona has hinted for a 200bps RRR cut, and a more modest 50bps policy rate cut, in 2025. Every 100bps of RRR cut releases an estimated PHP190-200bn of additional liquidity into the banking system, which should support loan growth and lower costs for banks.

A 100-basis-point cut in RRR improves net interest margins (NIMs) by 4-5 basis points, supporting profitability. However, a 25-basis-point policy rate cut has a slightly negative effect, reducing NIMs by 3-4 basis points (Fig. 21). With stable NIMs and the potential for further RRR reductions, Philippine banks could see improved earnings resilience (Fig. 22) and stronger investor confidence.

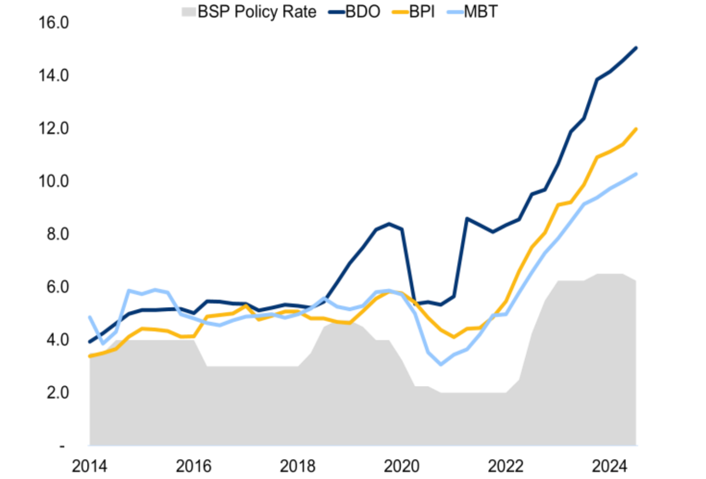
A 100-BASIS-POINT CUT IN RRR IMPROVES NET INTEREST MARGINS (NIMS) BY 4-5 BASIS POINTS, SUPPORTING PROFITABILITY. HOWEVER, A 25-BASIS-POINT POLICY RATE CUT HAS A SLIGHTLY NEGATIVE EFFECT, REDUCING NIMS BY 3-4 BASIS POINTS.

Fig. 21. Impact of BSP Policy Rate Changes to Financial Sector's Net Interest Margin & Earnings per Share



Source: CEIC, BDO Trust Research

Fig. 22. Impact of BSP Policy Rate to Earnings per Share of Top 3 Banks



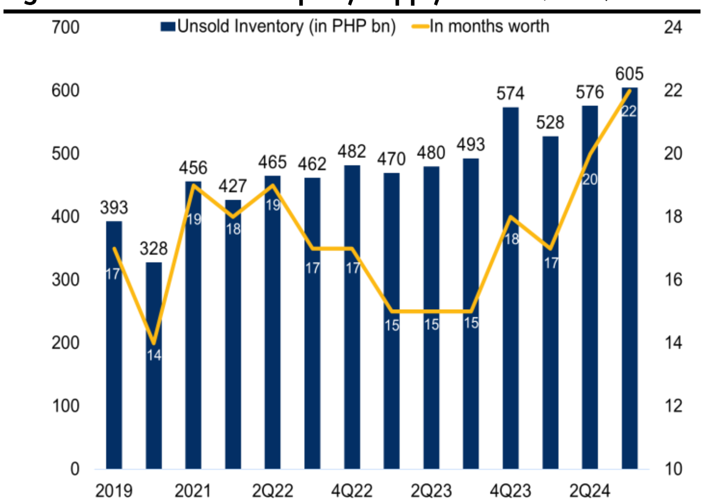
Source: Company reports, BDO Trust Research

'Higher for a bit longer' will be a drag on property market

This more moderate view on policy rates weighs on the real estate sector as interest rates are expected to remain elevated for longer. Initial projections of six rate cuts in 2025 have been significantly reduced to just one or two, dampening hopes for significantly lower borrowing costs. Still high financing costs could slow property demand, prolonging the current supply glut (Fig. 23) in residential real estate and keeping vacancy rates elevated in commercial spaces (Fig. 24).

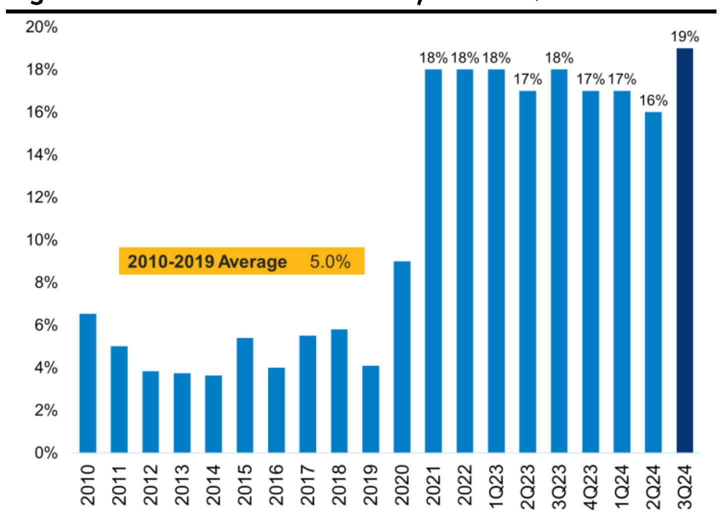
With the PHP yield curve remaining flat, market sentiment reflects uncertainty over future rate adjustments. A slower pace of easing limits affordability for both developers and buyers, potentially delaying recovery in the property market. Until there is greater clarity on monetary policy direction, real estate activity may remain subdued.

Fig. 23. PH Residential Property Supply Glut 2019 - 3Q24



Source: Company reports, BDO Trust Research

Fig. 24. Metro Manila Office Vacancy 2010 – 3Q24



Source: Regis Partners

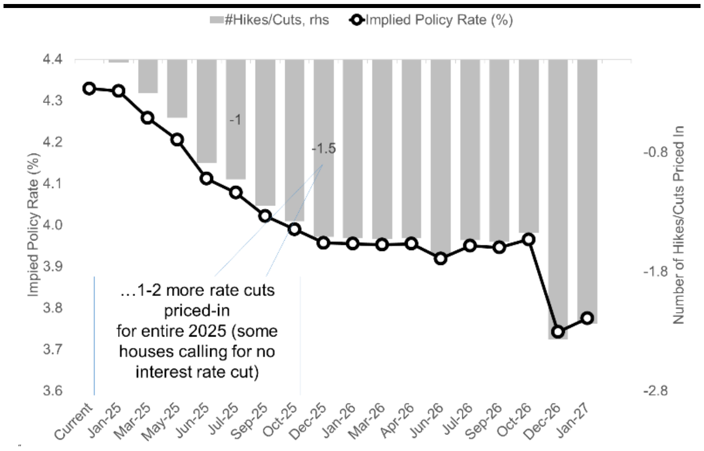
Moderate Fed rate cuts expected in 2025

Market expectations for U.S. interest rate cuts in 2025 have been sharply reduced, with projections falling from six cuts to just one or two (Fig. 25), this year. Some economists anticipate no rate cuts at all, given persistent inflation risks and a resilient U.S. economy. A slower pace of easing suggests that borrowing costs may remain elevated, which could impact global liquidity conditions and capital flows. We expect the BSP to be more or less in-step with Fed rate cuts to maintain the policy rate differential, and protect the PHP.

We expect the BSP to be more or less in-step with Fed rate cuts to maintain the policy rate differential, and protect the PHP.

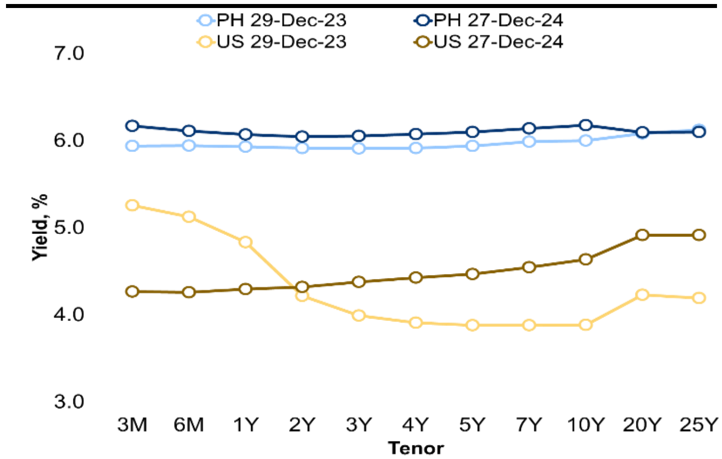
With limited rate cuts ahead, the PHP yield curve still remains flat but slightly elevated, reflecting cautious market sentiment. A lack of steepening indicates that investors are adjusting to the possibility of prolonged higher interest rates. This environment may lead to muted credit demand and sustained pressure on financial conditions in the near term. US Treasuries on the other hand have started to revert to a normal yield curve slope (Fig. 26), as longer tenors were sold down on concerns of a US deficit under the Trump 2.0 administration.

Fig. 25. Implied Overnight Fed Funds Rate & Number of Hikes/Cuts Current



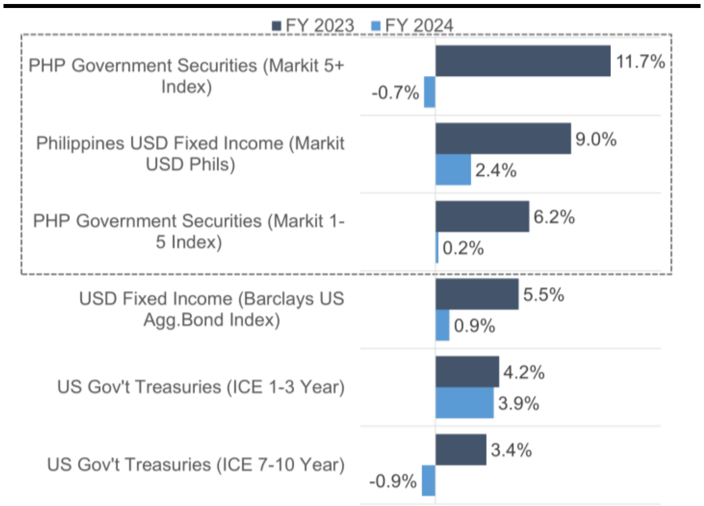
Source: Bloomberg Fed Funds Futures, World Interest Rate Probabilities, as of 08 Jan 2025

Fig. 26. PHP Gov't Bond and US Treasury Yield Curves Dec 2023 vs Dec 2024



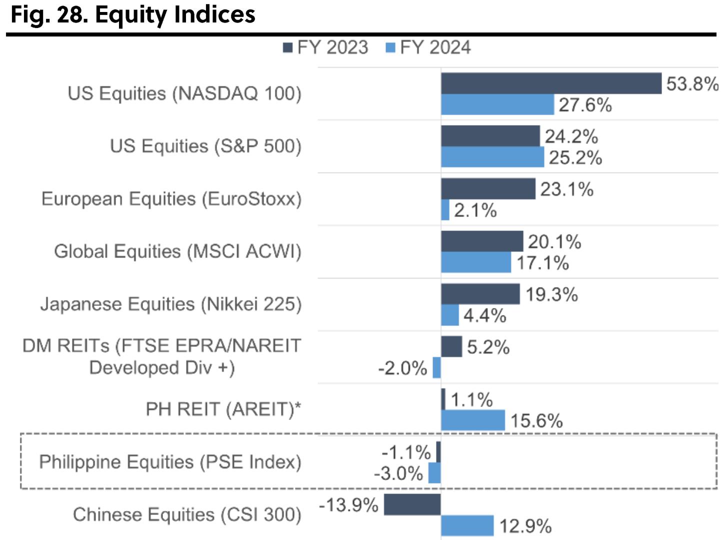
Source: Bloomberg, BDO Trust Research as of 08 Jan 2025

Fig. 27. Fixed Income Indices



Source: Bloomberg as of 27 Dec 2024, BDO Trust and Investments Group (TIG), *returns on a USD basis

Fig. 28. Equity Indices



Source: Bloomberg as of 27 Dec 2024, BDO Trust and Investments Group (TIG), *returns on a USD basis

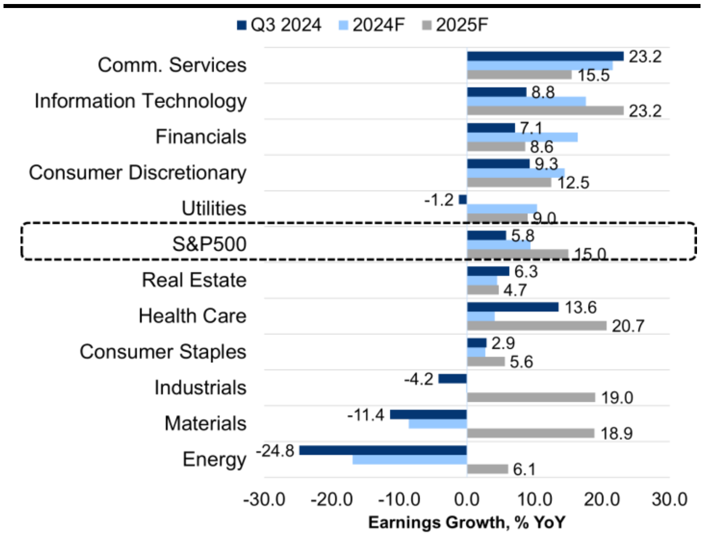
US equities rally post-elections

US equities have surged post-elections (Fig. 28), supported by expectations of corporate tax cuts and deregulation under a potential second Trump administration. However, concerns over rising fiscal deficits and higher government borrowings have pushed up longer-term bond yields (Fig. 27). Despite these headwinds, investor sentiment remains strong, with policy-driven earnings growth supporting US equity markets.

Tech and A.I. theme will continue to drive global equities

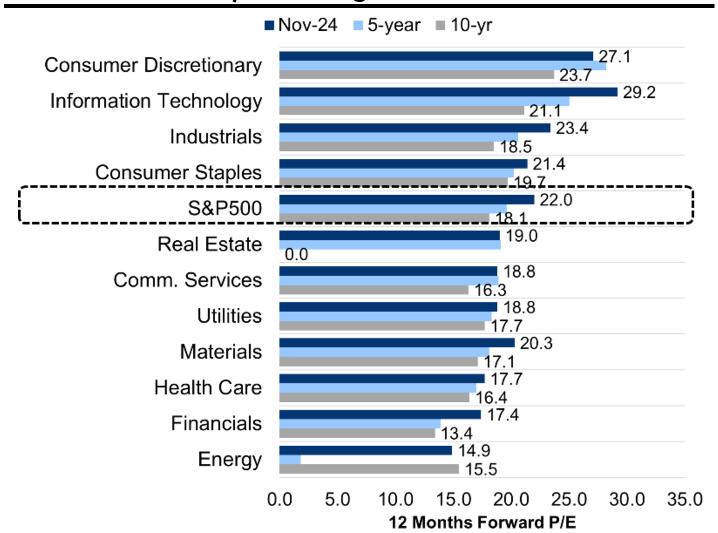
The technology and AI sectors continue to be key drivers of global equities, benefiting from strong earnings momentum (Fig. 29 & 30) and resilient macroeconomic conditions. US stocks are on track to meet or exceed year-end targets, bolstered by sustained corporate profitability and optimism over innovation-led growth.

Fig. 29. S&P 500 Index – Earnings Growth, % YoY
Q3 2024 Actual vs 2024 and 2025 Forecasts



Source: FactSet as of 22 November 2024

Fig. 30. S&P 500 Index – By Sector, Forward P/E
Actual vs 5- and 10-year Average



Source: FactSet as of 22 November 2024

Prefer US equities for offshore diversification

US equities remain a preferred option for offshore diversification, offering exposure to developed markets with strong performance (Fig. 32). The BDO Global and US Equity Index Feeder Funds provide investors access to US and global equity markets, ensuring broad coverage of high-growth sectors, including technology and healthcare. The bulk of these funds is allocated to US equities (Fig. 31), which have delivered steady returns over time.

Fig. 31. BDO US Equity Index Feeder Fund Top Holdings

Source: Bloomberg, BDO TIG as of 22 November 2024

Fig. 32. S&P 500 Index – By Sector, Forward P/E
Actual vs 5- and 10-year Average

	Year-To-Date	3-year	5-year	
	% Return USD Terms		% Return USD Terms	Variance
MSCI ACWI Index	17.49%	13.80%	57.20%	
ETFs and Mutual Fund				
iShares MSCI ACWI	18.56%	18.95%	70.42%	13.22%
SPDR S&P 500	24.70%	25.95%	91.58%	34.38%
Invesco QQQ	22.45%	24.50%	150.42%	93.22%
BlackRock World Technology	32.45%	7.62%	147.78%	90.58%
BDO Feeder Funds				
Global Equity Index	18.47%	18.81%	71.68%	14.47%
US Equity Index*	24.83%			
PSE Index				
Php Terms	5.12%	-6.90%	-13.35%	
USD Terms	-0.85%	-20.88%	-27.06%	

Converted into a S&P500 index tracker on 05 September 2023

Summary of Forecasts

Bumpy road up ahead

The Philippine economy is expected to grow by 5.9% in 2025, supported by stronger consumer demand and a recovery in investment spending. Inflation is forecasted to ease to 2.8% due to the lagged impact of previous rate hikes and base effects, though supply shocks remain a risk. The BSP is projected to cut rates by 1-2 times to maintain an attractive interest rate differential versus the U.S. Federal Reserve and stimulate growth. Meanwhile, the end of the rate hike cycle should drive the 10-year peso government bond yield lower to 5.6%, though inflationary pressures may limit further declines.

The PHP is expected to weaken further to 59.00 against the USD, with potential depreciation to PHP60.80 during the peak import season in April or May, as the strong dollar weighs on emerging market currencies. Foreign investment flows could remain subdued under this environment. However, the Philippine Stock Exchange Index (PSEi) is projected to reach 7,400, supported by expected earnings growth of 10-11% and a price-to-earnings (P/E) ratio of around 9-10x. Despite external risks, domestic fundamentals and easing inflation should provide some tailwinds for equities.

Fig. 33 Summary of Forecasts

	2022 Actual	2023 Actual	2024 Actual	Direction	2025 Forecast	View
GDP	7.6	5.6	5.6	↗	5.9	Pick up on consumer demand due to decelerating inflation and expected catch-up on investment spending
Inflation	5.8	6.0	3.2	↘	2.8	Lower on lagged impact of rate hikes and high base effects but commodity supply shocks still pose an upside risk
BSP Policy Rate	5.50	6.50	5.75	↘	5.25	Inflation trends support 1-2 rate cuts in FY25 to maintain the differential vs. the Fed Funds Rate, and encourage expansion
10yr Peso GS Yield	7.0	6.0	6.20	↘	5.60	End to hiking cycle to drive yields lower but downside limited by inflationary pressures
USD-PHP Rate	55.73	55.36	57.84	↗	59.00**	Stronger USD on lower Fed rate cut expectations for 2025, to drive weakness in EM currencies, including the PHP; during import season, peso could depreciate to PHP 60.80
PSE Index	6,566	6,450	6,528	↗	7,400	Foreign flows could remain tepid under strong USD regime; Index target implies ~ 9-10x P/E and 10-11% EPS growth,

Source: BDO Trust and Investments Group as of February 2025
** aligned with BDO Treasury forecast

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