BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 18 MAY 2023[1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Maintain the BSP's current policy interest rate at 6.25 percent for the overnight RRP rate; and

b) Maintain the current interest rates on the overnight deposit facility at 5.75 percent and overnight lending facility at 6.75 percent.

II. Key Considerations in the Formulation of the Monetary Policy Stance

- Based on the sum of new information and its assessment of the impact of previous monetary policy actions, the Monetary Board decided that a pause in monetary policy tightening was appropriate. The BSP's latest baseline projections continue to reflect a gradual return of inflation to the target band of 2 to 4 percent over the policy horizon. Average inflation for 2023 is now projected to settle at 5.5 percent, lower than 6.0 percent previously, while the average inflation forecast for 2024 fell slightly to 2.8 percent. Meanwhile, inflation expectations for 2024 and 2025 are steady and within the target range.

- The Monetary Board also noted that while GDP growth has remained robust in the first quarter of 2023, demand indicators have also pointed to a potential moderation in recent months, suggesting that previous policy rate increases by the BSP continue to work their way through the economy. Moreover, the Monetary Board is encouraged by recent whole-of-government actions to ease constraints on food supply.

- Nevertheless, even as headline inflation has continued to decelerate with slower increases in the prices of food and energy-related items, core inflation has only eased marginally. In addition, the balance of risks to the inflation outlook remains largely tilted towards the upside owing to persistent constraints in the supply of key food items, the potential impact of El Niño on food prices and utility rates, as well as the effects of possible additional adjustments in transportation fares and wages. Meanwhile, the impact of a weaker-than-expected global economic recovery continues to be the primary downside risk to the outlook.

[1] The discussions herein reflect the assessment made by the Monetary Board based on macroeconomic and financial information available at the time of the monetary policy meeting. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 22 June 2023.

- Given these considerations, the Monetary Board deems it prudent for the BSP to take a pause in monetary policy tightening while remaining ready to respond to emerging threats to inflation. The Monetary Board also deems it necessary to keep the policy interest rate at its current level in the near term, as ongoing price pressures continue to warrant close monitoring. A prudent pause also allows monetary authorities to further assess how macroeconomic and financial conditions will evolve in view of tighter global financial conditions.

III. Recent Developments and Inflation Outlook

The Monetary Board considered the recent macroeconomic and financial developments discussed below in assessing the monetary policy stance:

A. Domestic price conditions

- Headline inflation slowed down further to 6.6 percent year-on-year (y-o-y) in April 2023 from 7.6 percent in March due mainly to easing inflation of food and energy-related items. Likewise, official core inflation declined to 7.9 percent in April 2023. Alternative core inflation measures, except for the weighted median which was steady, also declined.

- Meanwhile, on a month-on-month seasonally-adjusted basis, inflation remained nil in April.

B. Inflation expectations

- Inflation expectations for 2023 ease while those for 2024 and 2025 are steady and remain within the target range. The results of the BSP's May 2023 round of survey on private sector economists' inflation expectations showed a lower mean inflation forecast for 2023 at 5.8 percent from 6.0 percent in April 2023. Meanwhile, the mean inflation forecasts for 2024 and 2025 were unchanged at 3.6 percent and 3.5 percent, respectively. Analysts expect average inflation in 2023 to settle above the upper end of the government's target range for the year owing mainly to supply shocks.

C. Inflation outlook

- The latest baseline forecasts have been revised further downward to 5.5 percent for 2023 and 2.8 percent for 2024. The forecast for 2023 is lower by 0.5 ppt from the previous forecast of 6.0 percent while the forecast for 2024 is broadly unchanged.

  The downward revision for 2023 mainly reflects the lower-than-expected inflation outturns in March and April, the slower domestic and global growth outlook, as well as the impact of the additional 25-bp policy rate increase of the BSP in March 2023. Lower crude oil prices and the peso appreciation also contributed to the declining inflation path for 2024 but were partly offset by positive base effects following the successive negative month-on-month inflation prints in 2023.

Baseline inflation forecasts, in percent		
	23 March 2023 MB Meeting	**18 May 2023 MB Meeting**
2023	6.0	5.5
2024	2.9	2.8

- **The risks to the inflation outlook continue to be skewed toward the upside for both 2023 and 2024.** The potential impact of additional transport fare hikes, higher domestic prices of key food items facing supply constraints, a higher-than-expected minimum wage adjustment in 2023, and the impact of El Niño weather conditions on food and electricity prices are the major upside risks to the inflation outlook. Meanwhile, the impact of a weaker-than-expected global recovery remains the primary downside risk to the outlook.

D. Demand conditions

- Real GDP growth eased to 6.4 percent in Q1 2023, slower than the 7.1-percent and 8.0-percent growth posted in Q4 2022 and Q1 2022, respectively. Consumer sentiment, meanwhile, remained pessimistic for Q1 2023 and declined for Q2 2023 due to lower incomes alongside other factors, suggesting a potential moderation in spending on goods and services. The volume and value indices of factory output indicated slower expansion, while businesses reported reduced hiring intentions and fewer expansion plans for Q2 2023.

- At the same time, domestic labor market conditions continued to show overall improvement. The unemployment rate for March 2023 was 4.7 percent. This was lower than 4.8 percent and 5.8 percent in February 2023 and March 2022, respectively.

E. Supply-side indicators

Developments in Agriculture

- Agriculture, Forestry, and Fishing (AFF) posted an expansion of 2.2 percent in Q1 2023, a turnaround from the 0.3-percent contraction in Q4 2022, and faster than the 0.2-percent growth in the same quarter last year. Higher AFF output is attributed mainly to the positive contribution of rice, livestock, poultry, corn, and coconut industries, which more than compensated for lower sugarcane and pineapple production. Rice output alone accounted for 0.9 percentage point of the 2.2-percent growth of AFF.

- Meanwhile, based on the latest assessment of weather conditions as of 13 April 2023, ENSO neutral conditions will likely continue through the northern hemisphere spring season and is expected to transition to El Niño by May-June-July 2023. Consequently, the Philippine Atmospheric, Geophysical and Astronomical Services Administration upgraded the ENSO Alert System status to El Niño Alert from El Niño Watch on 2 May 2023. El Niño Alert is issued when the Oceanic Niño Index of +0.5°C or greater is forecasted to persist in the next 2 months or more and the probability for EI Niño occurrence is at 70 percent or more.

Oil Price Developments

- Dubai crude oil prices declined in the first week of May 2023 from the full-month average in April following a weak US GDP outturn in Q1 2023, fragility in the US banking system, and contraction in China's factory activity in April 2023. Tighter global financial conditions due to persistent high inflation also contributed to the decline.

- Global oil supply-demand outlook is mixed for 2023 and 2024. The US Energy Information Administration's (EIA's) latest projection, as of April 2023, shows a slight surplus in oil supply for both 2023 and 2024. Meanwhile, the International Energy Agency (IEA) and OPEC expect excess demand in the second half of 2023.

  Nonetheless, according to the US EIA, oil production growth in non-OPEC countries, specifically in North and South America, will offset the proposed cuts by OPEC+.[2] On the demand side, oil consumption is deemed to be on an increasing trend, partly driven by the expected recovery on China's economy due to the lifting of its strict zero-COVID policy. However, downside risks remain from the potential effects of rising vulnerabilities on US and global banking sectors due to tight credit conditions and a high-interest rate environment.

Developments in the Utilities Sector

- The overall electricity rate increased in May 2023 due mainly to higher generation charge. According to Meralco, the generation charge rose due to the higher costs from the Wholesale Electricity Spot Market (WESM) and Meralco's Power Supply Agreements, which offset the lower charges from the Independent Power Producers.

  The increase in charges from the WESM reflected tighter supply conditions alongside higher peak demand. Likewise, charges from PSAs went up due to the depreciation of the peso against the US dollar which affected more than 26 percent of PSA costs that were dollar-denominated.

[2] The Organization of the Petroleum Exporting Countries + (OPEC +) countries include: Russia, Mexico, Kazakhstan, Oman, Azerbaijian, Malaysia, Bahrain, South Sudan, Brunei, and Sudan.

F. Financial market developments

- The peso depreciated against the US dollar by 1.1 percent in April 2023 from the ₱54.76/US$ average in the previous month. The depreciation was partly on account of market reaction to hawkish statements of US Fed officials as well as the release of data showing lower remittance inflows from overseas Filipinos in February 2023. Renewed concerns about US banking sector stability likewise added pressure on the peso. These factors were partly pared, however, as the country recorded a wider balance of payments surplus and higher gross international reserves in March.

G. Liquidity and credit conditions

- Credit and liquidity growth are steady. Preliminary data show that liquidity or M3 grew by 6.0 percent y-o-y in March 2023, the same rate of expansion recorded in the previous month. Meanwhile, preliminary data on outstanding loans of universal and commercial banks for production and consumption activities rose by 8.9 percent in March 2023 (from 8.7 percent in February 2023) and 21.3 percent, (the same rate as in February 2023), respectively.

- With respect to the transmission of policy rate increases to bank interest rate and government securities (GS) rates, there has been a full pass-through to the interbank call loan rate; high pass-through for the short-term effective lending rate, short-term time deposit rate and short-term GS rates; and partial pass-through for short-term effective lending rates and long-term time deposit rate.

  Secondary market GS yields increased particularly in the short end and middle of the yield curve in end-April 2023 relative to end-January 2023. Yields rose as the market stayed on the sidelines ahead of the release of the consumer price index data for April 2023 and the policy meeting of the US Fed on 2-3 May 2023.

H. Fiscal developments

- Fiscal consolidation continued as the National Government (NG) recorded a deficit of ₱270.9 billion for the first three months of 2023, 14.5 percent lower than the amount recorded in the same period in 2022. Netting out the interest payments, the primary surplus amounted to ₱128.9 billion, lower by 23.1 percent than the 2022 level.

I. External developments

- Global growth has moderated as downside risks continued to dominate the outlook. In the April 2023 World Economic Outlook, the IMF downgraded its full-year global economic growth projection for 2023 and 2024 to 2.8 percent and 3.0 percent, respectively. The cumulative effects of prolonged supply disruptions, tightening financial conditions, and elevated debt levels are expected to weigh on global economic activity. Manufacturing activity continued to contract in the US, Japan, and China amid weak global conditions.

- Meanwhile, several central banks have raised their respective key policy interest rates in May 2023 to address persistence of above-target inflation and anchor inflation expectations in their respective jurisdictions.