HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 17 AUGUST 2023 [1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Maintain the 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 keeping the policy interest rate unchanged was appropriate. The BSP's latest baseline projections continue to show a return to inflation target in the fourth quarter of 2023 despite a generally higher path for inflation relative to the previous forecast from the monetary policy meeting in June. Average inflation for 2023 is seen to reach 5.6 percent, while the average inflation forecasts for 2024 and 2025 now stand at 3.3 percent and 3.4 percent, respectively. Meanwhile, inflation expectations for 2023 have remained steady, while those for 2024 and 2025 have declined slightly.

- Nonetheless, the balance of risks to the inflation forecast continues to lean towards the upside. Potential price pressures are linked to the impact of possible higher transport charges; higher minimum wage adjustments; persistent supply constraints on key food items; and the effects of El Niño weather conditions on food prices and power rates. Meanwhile, a weaker-than-expected global economic recovery remains the primary downside risk to the inflation outlook.

- The Monetary Board also recognized the challenging outlook for economic growth, as the weaker GDP outturn for the second quarter of 2023 reflected a broad-based slowdown in domestic demand. Household consumption slowed due to elevated commodity prices, while government spending contracted relative to the previous year. Authorities noted that the strength of economic activity going forward is likely to moderate as pent-up demand wanes and the full impact of prior monetary policy tightening continues to manifest. At the same time, fiscal impulse through programmed spending could support the growth momentum.

[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 21 September 2023.

The fiscal authorities are now pushing agencies to ramp up spending to fulfill the 2023 public expenditure program. Sustained non-monetary measures remain crucial in addressing lingering supply-side pressures on prices.

- Given these considerations, the Monetary Board deemed it appropriate to maintain monetary policy settings to allow a moderation of inflation even as authorities continue to assess the emerging risks to the inflation outlook.

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 dropped further to 4.7 percent year-on-year (y-o-y) in July 2023 from 5.4 percent in June 2023 due mainly to slower price increases of food and transport-related items. Official core inflation also declined to 6.7 percent in July 2023 from 7.4 percent in the previous month. All alternative measures of core inflation likewise declined. On a month-on-month seasonally adjusted basis, inflation in July 2023 was steady at zero percent from a 0.1-percent increase in the previous month.

B. Inflation expectations

- Inflation expectations have declined and remain within the target range for 2024 and 2025. The results of the BSP's August 2023 round of survey on private sector economists' inflation expectations showed a steady mean inflation forecast for 2023 at 5.5 percent relative to the July 2023 survey round. Meanwhile, the mean inflation forecast for 2024 and 2025 eased to 3.5 percent (from 3.6 percent) and 3.4 percent (from 3.6 percent), respectively. Analysts expect inflation to continue easing in the near-term due largely to base effects but viewed that upward risks to the inflation outlook could persist from supply disruptions arising from the potential adverse impact of El Niño.

C. Inflation outlook

- The latest baseline forecasts were higher compared to the previous round. Inflation is projected to average at 5.6 percent for 2023, 3.3 percent for percent for 2024, and 3.4 percent for 2025.

  The upward adjustments in the inflation forecast path over the policy horizon were driven mainly by the significant rise in Dubai crude oil prices in recent weeks. The higher inflation nowcast over the near term, a higher-than-expected minimum wage adjustment, and the depreciation of the peso likewise contributed to the upward revision. These were partly offset by the slower GDP growth outlook and lower assumption for global non-oil prices for 2023 to 2024.

Baseline inflation forecasts		
	22 June 2023 MB Meeting	**17 August 2023 MB Meeting**
2023	5.4	5.6
2024	2.9	3.3
2025	3.2	3.4

- The risks to the inflation outlook are skewed significantly to the upside for 2023 to 2025. The potential impact of higher transport charges, higher domestic prices of key food items facing ongoing supply constraints, higher-than-expected minimum wage adjustment in areas outside NCR, impact of El Niño weather conditions on food prices and utility rates, and higher electricity rates are the major upside risks to the inflation outlook. Meanwhile, the impact of a weaker-than-expected global recovery is the primary downside risk to the outlook.

D. Demand conditions

- Consistent with the expected impact of prior monetary policy tightening, the Philippine economy expanded at a slower pace in Q2 2023. Real GDP grew by 4.3 percent year-on-year in Q2 2023, much slower than the 6.4-percent and 7.5-percent expansion posted in Q1 2023 and Q2 2022, respectively. This brought real output growth to an average of 5.3 percent for the first half of 2023, well below the DBCC-approved real GDP growth target of 6 to 7 percent for the year.

- Domestic demand continued to support output growth, although the slowdown appears to be broad-based. In Q2 2023, growth was driven in part by tourism-related spending, commercial investments, and household spending. However, slower growth was observed in consumer spending while growth in investments was nil. Meanwhile, government spending contracted during the quarter.

- Demand indicators also pointed to waning revenge spending and moderating domestic growth impulses. Household spending for food and non-alcoholic beverages, recreation and culture, restaurants and hotels, and miscellaneous goods and services posted slower growth in Q2 2023, while a steeper contraction was seen for household spending on alcoholic beverages and tobacco. Recent volume, value, and purchasing managers' indices indicate a slowdown in manufacturing sector activity, while the latest Weekly Economic Activity Tracker suggests a continued moderation in economic momentum.

E. Supply-side indicators

Developments in Agriculture

- Nationwide average retail rice prices increased from month-ago levels in July 2023. The upward movement in rice prices reflected the uptrend in farmgate prices due to cost pressures from inputs, as well as the rise in international rice prices, particularly in the quotes from the country's major import sources.

- The Agriculture, Forestry, and Fishing (AFF) sector posted a growth of 0.2 percent in Q2 2023, slower than the 2.2-percent growth in Q1 2023. The marginal growth in AFF output in Q2 2023 is attributed mainly to the positive contribution of *palay*, livestock, poultry, corn, mango, and support activities to AFF, which more than compensated for the lower sugarcane and fisheries production.

- Domestic food security is continuously threatened by the country's vulnerability to natural calamities and volatility in input prices. The whole-of-government approach is expected to address food inflation and mitigate risks to food security through urgent implementation of measures to fill short-term supply gap and boost local production. Moreover, the Department of Agriculture has undertaken and coordinated measures to address the effect of El Niño on the agricultural supply in anticipation of a prolonged dry season.

- Based on the assessment of weather conditions as of 13 July 2023, El Niño conditions are present and will likely persist until northern Hemisphere winter season (December-January-February). The Philippine Atmospheric, Geophysical and Astronomical Services Administration (PAGASA) cited the presence of a weak El Niño in the Philippines and noted a higher chance for the development of moderate to strong El Niño in the country towards November-December 2023. In addition, most climate models predict El Niño conditions[2] to likely persist until at least Q1 2024.

Oil Price Developments

- Dubai crude oil prices rose in the first week of August 2023 compared to the full-month average price in July 2023 due mainly to the additional oil supply cuts by Saudi Arabia, Russia, and Algeria as well as oil supply disruptions in several oil producing countries in July 2023, subdued Russian oil exports in June, and lower US crude oil inventories. On the demand side, China's pledge to provide economic stimulus measures and higher crude oil imports in June 2023 as well as the IMF's upgrade of its

[2] Adopted from the US Climate Prediction Center/NOAA, PAGASA defines El Niño conditions as the one-month observed sea surface temperature anomaly of 0.5°C or greater in the Niño-3.4 region, and an expectation that the 3-month Oceanic Niño Index threshold of 0.5°C or greater will be met (i.e., three overlapping 3-months for example January-February-March, February-March-April, and March-April-May).

global growth outlook for 2023 raised expectations of stronger oil demand and partially pushed up international crude oil prices.

- Meanwhile, high prices in the near term also indicate a tight global oil market, as reflected in the expected deficit in the International Energy Agency, Organization of Petroleum Exporting Countries, and the US Energy Information Administration (EIA) outlook for 2023-2024. The expected deficit in the near term is influenced mainly by the production cuts of the OPEC+[3] as well as the projected increase in fuel demand in non-OECD Asia, particularly in China and India.

Developments in the Utilities Sector

- Retail electricity rates decreased in August 2023, reflecting lower costs from the Wholesale Electricity Spot Market (WESM) and Power Supply Agreements (PSAs). Charges from the WESM declined on lower demand for the Luzon power grid due to the onset of rainy season. Charges from PSAs also decreased because of lower fuel prices and partly due to the appreciation of the peso against the US dollar.

F. Financial market developments

- The peso appreciated against the US dollar, on a year-to-date basis, by 1.6 percent on 31 July 2023 from the end-December 2022 closing rate. The peso strengthened due partly to positive sentiment over the IMF's upward revision of growth outlook for the Philippines in 2023 and the Asian Development Bank's optimistic forecast that the Philippines is expected to post the fastest GDP growth in Southeast Asia in 2023; higher personal remittances in May; lower balance of payments (BOP) deficit in June; and higher inbound tourism receipts in the first half of 2023. In addition, broad US dollar softness amid slower-than-expected US inflation in June also contributed to the appreciation of the peso. However, the peso depreciated in the second week of August due to broad US dollar strength amid a hawkish signal from the US Fed following the release of higher-than-expected US producer price index data for July 2023, and partly because of dampened market sentiment following the release of weaker-than-expected Q2 2023 GDP data for the Philippines.

G. Liquidity and credit conditions

- Liquidity growth remain steady while credit expansion marginally slowed down. Preliminary data show that liquidity or M3 grew by 6.6 percent year-on-year in May 2023, the same rate of expansion recorded in April 2023. Meanwhile, preliminary data on outstanding loans of universal and commercial banks for production and consumption activities rose by 9.4 percent year-on-year in May 2023 from 9.7 percent in the previous month.

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

- Short-term secondary market GS yields decreased on 3 August 2023 relative to end-June 2023. Yields declined on buying interest following the increase in the Fed funds rate target range during the US Fed's monetary policy meeting on 25-26 July 2023, with US Fed Chairman Jerome Powell's post policy statement seen as dovish by the market.

H. Fiscal developments

- Fiscal consolidation continued as the National Government (NG) recorded a deficit of ₱551.7 billion for January – June 2023, 18.2 percent lower than the amount recorded in the same period in 2022. Netting out the interest payments, the primary deficit amounted to ₱269.3 billion, lower by 35.0 percent than the 2022 level.

I. External developments

- Prospects for global economic growth improved but remains below the historical average. In the July 2023 World Economic Outlook (WEO) update, the International Monetary Fund (IMF) revised its 2023 global economic growth projection to 3.0 percent, slightly higher than the 2.8-percent forecast in the April 2023 WEO. The upward revision in the outlook is primarily driven by the stronger-than-expected recovery in the service sector amid resilient consumer demand. In addition, the resolution of the US debt ceiling standoff and reduced risk of global financial instability have tempered the adverse risks initially highlighted in the April 2023 WEO. Nonetheless, global economic expansion is expected to remain well below the annual average of 3.8 percent[4] until at least 2024 owing in part to declining international trade and deteriorating global manufacturing activity.

- Several central banks have raised their respective key policy interest rates in July 2023 up to early August 2023 to address persistence of above-target inflation and anchor inflation expectations in their respective jurisdictions. By contrast, some central banks maintained their policy interest rates, highlighting easing price pressures which allow them to assess the impact of previous monetary policy adjustments on the outlook for inflation and economic growth.

[4] Historical average global growth from 2000 – 2019