HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 16 FEBRUARY 2023 [1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Raise the BSP's current policy interest rate by 50 basis points to 6.0 percent for the overnight RRP rate; and

b) Increase the current interest rates on the overnight deposit facility (ODF) to 5.50 percent and overnight lending facility (OLF) to 6.50 percent.

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

- Inflation is projected to remain elevated in the coming months due to a combination of persistent supply constraints and emerging demand-side pressures. Projected inflation could remain above 4.0 percent until Q3 2023, equivalent to 19 consecutive months of above-target inflation outturns. Meanwhile, inflation is projected to revert close to the lower end of the target range by January 2024 due mainly to negative base effects and the likely deceleration in global oil and non-oil prices.

- Since November 2008, the Monetary Board noted that headline inflation accelerated to its fastest pace in January. Meanwhile, various measures of core inflation also rose sharply, indicating a further broadening of price pressures. The risks to the inflation outlook now lean toward the upside for both 2023 and 2024.

- The Monetary Board deemed it necessary for a strong follow-through monetary response to help further anchor inflation expectations and demonstrate the BSP's commitment to its price stability objective. The main priority is to guide and prevent unfavorable shifts in the public's inflation expectations, which will also temper the emergence of further second-round effects.

- The Monetary Board was of the view that the higher near-term gross domestic product (GDP) growth path suggests that the economy will be able to retain its momentum despite a restrictive monetary policy stance. In a high-inflation environment with robust pent-up demand, inflation expectations remain at risk of de-anchoring until a deceleration in headline inflation becomes evident.

---

[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 23 March 2023.

- At the same time, the Monetary Board noted that continued monetary tightening will also provide a buffer against external spillovers that could emanate from tightening global financial conditions as major central banks, particularly the US Federal Reserve, raise interest rates further.

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

- Inflation increased further in January 2023, implying stronger inflation persistence than initially expected. Headline inflation accelerated to 8.7 percent year-on-year (y-o-y) in January 2023 due primarily to the faster price increases in rent and utility rates, food as well as restaurant services.

- Likewise, core inflation measures continued to increase, which suggests second-round effects on a broader part of the Consumer Price Index (CPI) basket. The official core inflation rose further to 7.4 percent in January 2023. Alternative core inflation measures likewise increased.

B. Inflation expectations

- Inflation expectations have also increased for 2023-2025. The February 2023 survey of economists showed a higher mean inflation forecast for 2023 at 6.0 percent (from 4.9 percent based on the January 2023 survey round). Similarly, the mean inflation forecasts for 2024 and 2025 rose to 4.0 percent and 4.1 percent (from 3.7 percent and 3.6 percent, respectively). Analysts expect inflation to remain above the upper end of the government’s target range in 2023 given higher-than-expected January 2023 inflation print, as well as due to demand-side price pressures and supply shocks.

C. Inflation outlook

- The latest baseline forecasts indicate that inflation will remain elevated in the coming months with inflation averaging at 6.1 percent for 2023 and 3.1 percent for 2024. The forecasts for 2023 and 2024 were adjusted upwards by 1.6 percentage points (ppt) and 0.3 ppt, respectively, due to more elevated near-term inflation compared to initially expected. The upward revisions for 2023 and 2024 were driven mainly by the higher-than-expected inflation outturn in January 2023, following the sharp uptick in the prices of housing rentals, electricity, and water rates as well as key food items. The upward adjustment in the forecast path also reflects the higher inflation nowcast for February 2023, higher global crude oil prices, and faster GDP growth. These upside factors were offset partly by the peso appreciation and the impact of the cumulative policy rate adjustments of the BSP.

Baseline Inflation Forecasts		
	15 December 2022 MB Meeting	**16 February 2023 MB Meeting**
2023	4.5	6.1
2024	2.8	3.1

- The risks to the inflation outlook now lean toward the upside for both 2023 and 2024. The potential impact of uncertainties in the global food market, increased domestic prices of key food items facing supply constraints, additional transport fare hikes due to elevated oil prices, and higher-than-expected wage adjustments in 2023 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

- The outlook for domestic economic activity remains strong for 2023 and 2024 despite global headwinds and the BSP's policy adjustments. An improved global growth outlook for 2023 together with the higher-than-anticipated domestic growth in Q4 2022 resulted in an upward revision in the domestic growth forecast for 2023 which is now expected to settle near the high end of DBCC's target.[2].

- Domestic labor market conditions continued to show overall improvement. While the 4.3-percent unemployment rate in December 2022 was marginally higher than the 4.2 percent unemployment rate in November 2022, unemployment rate during the month was considerably lower than the 6.6 percent and 5.3 percent rates recorded a year ago and during the pre-pandemic period, respectively.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- Nationwide average retail rice prices increased in December 2022. The uptick in average rice prices in December 2022 could be attributed to the lingering impact of agricultural damages and losses left by strong typhoons that hit the country during the main harvest season.

- Prices of key food items rose mainly due to lingering supply-side issues and spillover effects of the Russia-Ukraine conflict leading to persistent global supply chain bottlenecks and soaring prices of fuel, feeds, and fertilizers. Likewise, increasing food inflation highlights the country's vulnerability to natural calamities, animal diseases, and volatility in global commodity prices. It also exposes gaps in the agricultural value chain as well as indicate non-competitive practices. To cushion the impact of these challenges on the country's food security, the Government implemented

[2] Government growth targets based on the 183rd Development Budget Coordination Committee (DBCC) Meeting on 5 December 2022.

crucial non-monetary measures to fill short-term supply gap (e.g., temporary reduction of tariff rates and time-bound increase in import volumes and expansion of import sources) and boost local production (e.g., longer-term productivity-enhancing programs).

- Based on the latest assessment of weather conditions as of 12 January 2023, prevailing La Niña conditions will likely transition to El Niño–Southern Oscillation (ENSO)-neutral during the February-March-April 2023 season**.** Nonetheless, persisting La Niña conditions may continue to bring above normal rainfall conditions that could lead to potential adverse impacts such as heavy rainfall, floods, flashfloods and landslides, which were observed in some parts of the country over the past weeks.

Oil Price Developments

- Dubai crude oil prices rose in January 2023 compared to the previous month but has since eased to below US$80 per barrel in early February. On average, Dubai crude oil prices rose in January 2023 due to expectations of improved oil demand prospects amid easing of COVID-19 restrictions in China. This was further supported by expectations of more mobility and travel activity in observance of the Lunar New Year. Prices started to ease around late January and early February following the decision of the US Federal Reserve to raise its key policy interest rate by to combat inflation, concerns that higher interest rates could weigh down on global growth prospects, and expectations of sustained oil exports from Russia.

- Meanwhile, global oil supply-demand balance remained highly uncertain albeit industry projections show some inventory buildup in 2023 and 2024.[3] The US Energy Information Administration's (EIA's) latest projection, as of February 2023, already considers higher oil demand from China with the rebound in activity, higher oil production from Russia—two of the main sources of uncertainty. At the same time, projections of Organization of the Petroleum Exporting Countries+ (OPEC+) output were also revised downward given the rise in global inventory.

Developments in the Utilities Sector

- The overall electricity rate slightly decreased in February 2023 due mainly to lower generation charge. According to Meralco, the generation charge decreased due to the lower costs from the Wholesale Electricity Spot Market (WESM) and Independent Power Producers (IPPs), which effectively offset the increase in charges from Meralco's Power Supply Agreements (PSAs). At the same time, the remaining distribution-related refund continue to temper the monthly Meralco bills.

F. Financial market developments

[3] Based on the US Energy Information Administration (US EIA) Short-Term Energy Outlook report (February 2023).

- The peso appreciated against the US dollar, on a year-to-date basis, by 2.36 percent on 27 January 2023 from the end-December 2022 closing rate. The appreciation is due partly to market expectations of a slower pace of monetary policy tightening by the US Federal Reserve, following reports of weaker-than-expected US wages and services activity, and lower US CPI inflation in December. The increase in the gross international reserves (GIR) as of end-December 2022 and optimism over the country's economic growth prospect, as the Philippines is expected to be one of the fasting-growing economies in the region in 2023, likewise added support to the peso.

- The Philippine Stock Exchange Index (PSEi) averaged 6,909.5 index points in January, higher by 5.4 percent compared to its average in December. The rise in the benchmark index could be attributed to: (1) improved local manufacturing activity in December; (2) expectation of less aggressive monetary policy tightening by the US Federal Reserve amid improvement in US labor data and moderation in US inflation in December ; and (3) the strengthening of the peso.

G. Domestic liquidity and credit conditions

- Domestic liquidity (M3) and credit remain ample to sustain a broad-based economic recovery. Preliminary data show that M3 grew by 6.4 percent y-o-y to about ₱16.3 trillion in December from the 5.5-percent (revised) growth in November. Meanwhile, preliminary data on outstanding loans of universal and commercial banks (U/KBs) for production and consumption activities rose by 12.1 percent in December (from 12.6 percent in November) and 24.8 percent (from 24.2 (revised)), respectively.

- Secondary market GS yields generally declined on 6 February 2023 particularly in the middle and long-end of the yield curve. Yields fell following the widely anticipated policy rate hike of the US Fed and the announcement of the retail Treasury bond (RTB) offering by the Bureau of the Treasury (BTr). The decline in yields was also supported by market players' buying interest on expectation that the BSP is nearing the end of its monetary tightening cycle.

H. Fiscal developments

- Fiscal consolidation continued as the National Government (NG) recorded a deficit of ₱1,1111.8 billion for January - October 2022, 7.6 percent lower than recorded in the same period in 2021. Netting out the interest payments, the primary deficit amounted to ₱678.7 billion, 18.5 percent lower than the amount recorded in 2021.

I. External developments

- Persistent inflation and restrictive financial conditions are weighing down on global output growth but global interest rates are likely to remain higher given sticky CPI. The World Bank (WB) downgraded both its 2023 and 2024 growth outlook as tightening global financial conditions and protracted geopolitical tensions in Eastern Europe weigh on global economic output. Meanwhile, in its January 2023 World Economic Outlook (WEO) Update, the IMF upgraded its full-year economic growth projection for 2023 but revised downwards its forecast for 2024. Although adverse risks have moderated since October 2022, risks to the outlook remain firmly tilted toward the downside

- Global economic activity contracted slower in January 2023 as output, new business, new export orders, and outstanding business declined at a more moderate pace amid improving economies conditions in parts of Europe and Asia. However, major economies such as the United States, United Kingdom, Russia, Australia, Germany, France, Australia, and Kazakhstan posted lower economic output, which weighed on overall global growth.

- Global economic output contracts for the sixth consecutive month. The JP Morgan All-Industry Output Index contracted at a slower pace at 49.8 in January 2023 from 48.2 in December 2022 as new business moved closer to a stable level, driven by a rebound in the services sector. Despite the continued decline in output and new business, more respondents expect future output to increase in the next 12 months as low unemployment, rising nominal wages, and China's continued reopening prop up global demand. However, prolonged geopolitical risks, elevated inflation, and rising interest rates are expected to weigh on private demand in the succeeding quarters.

- Several central banks have raised their respective key policy rates in February to address price pressures and anchor inflation expectations.