HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 24 MARCH 2022 [1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Keep the overnight RRP (borrowing) rate unchanged at 2.00 percent; and

b) Maintain the accommodative levels of overnight deposit and overnight lending rates at 1.50 percent and 2.50 percent, respectively.

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

- The decision of the Monetary Board was based on its assessment that inflation could settle above the government's target range in 2022, reflecting the impact of higher global commodity prices. At the same time, the latest baseline forecasts show inflation returning to within the target range of 2-4 percent over the policy horizon as supply-side influences subside. Meanwhile, inflation expectations continue to be anchored within the inflation target band.

- In assessing the monetary policy stance, the Monetary Board also noted that while upside risks to inflation have increased for 2022, the balance of risks to the outlook remain broadly balanced for 2023. Upside risks over the near term continue to emanate from the shortage in domestic pork and fish supply as well as from the potential impact of higher oil prices on transport fares. Meanwhile, downside risks are linked mainly to the lingering threat of COVID-19 infections, as the emergence of new variants could temper the global economic recovery and prompt the reimposition of domestic containment measures.

- Meanwhile, the Monetary Board further observed that domestic economic activity has gained stronger traction with the easing of remaining mobility

[1] The discussions herein reflect the assessment made by the Monetary Board based on a comprehensive set of macroeconomic and financial information available at the time of the policy meeting. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 19 May 2022.

restrictions. However, heightened geopolitical tensions and a resurgence in COVID-19 infections in some countries have also clouded the outlook for global economic growth. Supply-chain disruptions could also contribute to inflationary pressures, and thus warrant closer monitoring to enable timely intervention in order to arrest potential second-round effects.

- On balance, the Monetary Board sees scope to maintain the BSP's monetary policy settings in order to safeguard the momentum of economic recovery amid increased uncertainty, even as it continues to develop its plans for the gradual normalization of its extraordinary liquidity measures. Given the potential broadening of price pressures over the near term, the BSP stands ready to respond to the buildup in inflation pressures that can disanchor inflation expectations, in keeping with its price and financial stability objectives.

III. Recent Developments and Inflation Outlook

The Monetary Board considered the recent macroeconomic and financial developments listed below in deciding the appropriate monetary policy stance:

A. Domestic price conditions

- **Headline inflation in February 2022 was steady at 3.0 percent as improvements in domestic supply conditions tempered significant price gains from higher petroleum prices.** Food inflation decelerated due to lower inflation for meat as well as fish and seafood. Meanwhile, non-food inflation continued to rise given the surge in global oil prices from the Russia-Ukraine conflict. This is shown in the higher inflation for energy-related CPI items such as, transport and utilities. The upward adjustment in gasoline and diesel prices boosted transport inflation while higher LPG and kerosene prices along with increase in electricity rates also led to double-digit inflation for electricity, gas, and other fuels.

B. Inflation expectations

- Inflation expectations are higher but remained anchored to the target over the policy horizon. Private sector economists expect inflation to average at 3.8 percent for 2022 from 3.5 percent in the previous month's survey round. Meanwhile, the mean inflation forecasts stood at 3.3 percent (from 3.1 percent) for 2023 and 3.2 percent (from 2.9 percent) for 2024.

C. Inflation outlook

- **The latest baseline forecasts indicate that inflation could settle above the government's target range of 3.0 percent ± 1.0 ppt at 4.3 percent for 2022 to fall within the target range at 3.6 percent for 2023.** The projections are higher compared to the previous forecast run due to the higher assumptions for global crude oil and non-oil prices as well as the depreciation of the peso. These reflect the impact of the Russia-Ukraine conflict on commodities and financial markets. The higher contribution of supply-side factors to the inflation outlook was partly offset by the slower GDP growth outlook for 2022.

Baseline Inflation Forecasts		
	14 February 2022 MB Meeting (2018-based)	24 March 2022 MB Meeting (2018-based)
2022	3.7	4.3
2023	3.3	3.6

- The risks to the inflation outlook appear to continue to be tilted to the upside for 2022 but are seen as broadly balanced for 2023. The potential impact of higher global non-oil prices, the continued shortage in domestic pork supply, higher fish prices and possible jeepney fare hikes due to higher oil prices are the major upside risks over the near term. Meanwhile, the prospects of a weaker-than-expected global recovery as well as the possible reimposition of quarantine measures domestically due to spread of new COVID-19 variants are the main sources of downside risks.

D. Demand conditions

- Over the near term, economic recovery appears likely to continue to gain traction. The latest nowcast estimate for Q1 2022 is higher compared to the previous round due mainly to the earlier shift to Alert Level 1 in NCR and other surrounding provinces. The easing of restrictions is expected to support manufacturing activities as well as raise demand for tourism-related activities as well as other contact-intensive services, which suffered greatly during the pandemic. The negative impact of the Russian-Ukraine conflict on economic activity is not yet fully realized during the quarter but could become more apparent in subsequent periods.

  On a full year basis, latest output growth forecast for 2022 is lower compared to the previous forecast. The downward adjustment in 2022 growth forecast is due largely to the impact of slower global growth amid the tightening of global monetary policy in advance economies, the resurgence of COVID-19 cases in several Asian economies, and the indirect economic impact of Russia's invasion of Ukraine.

- Mobility indicators have trended upward in February and early March 2022 with the shift to less stringent alert levels as new COVID-19 infections fell after the surge in January 2022. Using the 7-day moving average, visits across location categories increased following the shift to Alert Level 2 nationwide on 27 February 2022 and further to Alert Level 1 on 1 March 2022 for select areas in the Philippines. The relaxation of protocols involved the lifting of restriction on indoor and outdoor capacity for businesses as well as interzonal and intrazonal travel without regard to age or comorbidity. Consequently, mobility index in households declined with the rise in mobility for other location categories.

  Changes in mobility coincided with the signs of improvement in purchasing manager's index (PMI) in February 2022 amid the implementation of Alert Level 2 nationwide. Most sectors registered above 50-point expansion threshold for the month due to strengthening of domestic demand along with increase in new orders and output.

- Labor market conditions in January 2022 indicate better-than-expected outcomes despite the more restrictive shift to Alert Level 3 in Metro Manila and nearby regions following the rapid increase of the more transmissible Omicron variant infections. Employment rate rose to 93.6 percent while unemployment rate edged down to 6.4 percent. While the January 2022 unemployment rate is still above the pre-pandemic records, the outturns during the survey under review is an improvement vis-à-vis the previous survey rounds in December 2021 and January 2021.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- Nationwide average rice prices increased in February 2022. Nonetheless, domestic retail rice prices remained generally steady, supported by sustained import arrivals, and improved local harvest amid the ongoing planting season.

- Meanwhile, the National Government has also rolled-out targeted measures to help stabilize domestic supply of agricultural commodities amid disruptions brought about by the pandemic, natural calamities, and animal diseases. The interventions implemented also aim to mitigate the potential impact of the recent crisis between commodity exporters

Ukraine-Russia, which will likely cause disruption in the global commodity supply chain and therefore may affect prices of agricultural commodities.

- On weather conditions, prevailing La Niña conditions will likely persist through the Northern Hemisphere summer (June-July-August 2022), with a 40 to 50 percent chance of La Niña to continue or transition to ENSO-neutral thereafter.

<u>Oil Price Developments</u>

- Oil prices surged in early March 2022 as geopolitical conflict in Eastern Europe intensified with imposition of Western sanctions on Russia. After reaching over US$130 per barrel on 8 March, oil prices retreated following reports of ceasefire talks and COVID-related lockdown in China. The futures price curve remained in backwardation, broadly reflecting forecasts that supply would exceed demand for most of 2022 and 2023. Nevertheless, the significant jump in global oil prices has spilled over to domestic fuel prices, with diesel being the most affected due to the products' exposure to Russia.

<u>Developments in the Utilities Sector</u>

- The overall electricity rate increased slightly due mainly to higher generation charge. The upward adjustment in the generation cost was on the back of higher costs from Wholesale Electricity Spot Market (WESM) along with the increases of charges from the Independent Power Producers (IPPs) and Power Supply Agreements (PSAs). IPP charges also rose mainly due to the lower dispatch of Quezon Power and First Gas-San Lorenzo plants as well as the depreciation of the peso against the US dollar. Similarly, charges from PSAs increased as the dispatch of First NatGas-San Gabriel plant continued to be affected by Malampaya facility's inability to supply sufficient natural gas. Lower excess energy deliveries also contributed to the increase in PSA costs.

F. Financial market developments

- The peso depreciated against the US dollar for the period 1-15 March 2022, on negative market sentiment amid (i) rising oil prices following the worsening Russia-Ukraine conflict; (ii) hawkish signals from the US Federal Reserve regarding its planned rate hike this month; and (iii) reports of record-high outstanding national debt of ₱12.0 trillion as of end-January 2022.

- The Philippine banking system (PBS) sustained its asset expansion, particularly its lending and investment portfolios as of end-January 2022. Loan quality improved following steady growth in lending. And double-digit growth in net profit was sustained by hefty increase in income from fees and commission, foreign exchange, and profit from sale/derecognition of non-financial assets. Moreover, risk-based capital adequacy ratio (CAR) and Basel III leverage ratio of Philippine banks as well as liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) remained well-above the BSP's thresholds.

  Meanwhile, the BSP extended the effectivity of some prudential relief measures until end of 2022[2]. The extension of prudential reliefs intends to sustain the momentum of bank lending as well as minimize long term economic scarring brought about by the COVID-19 pandemic.

G. Domestic liquidity and credit conditions

- Liquidity in the financial system continues to be ample. Preliminary data show that domestic liquidity (M3) grew by 9.8 percent year-on-year to about ₱15.3 trillion in January 2022 following a 7.3-percent (revised) expansion in December 2021.

- Credit activity continued to exhibit signs of recovery in recent months, reflecting the improvement in business activity amid easing quarantine restrictions and further progress in terms of vaccination. Preliminary data show that outstanding loans of universal and commercial banks (U/KBs), net of reverse repurchase (RRP) placements with the BSP, expanded anew for the sixth consecutive month at a quicker pace of 8.5 percent year-on-year in January from 4.8 percent (revised) in December 2021.

H. Fiscal developments

- The National Government (NG) full year budget deficit for 2021 reached ₱1,670.1 billion which is twenty-two percent higher than recorded in 2021. Netting out the interest payments in NG expenditures, the primary deficit amounted to ₱1,240.7 billion, twenty-five percent higher than the amount recorded in 2021.

I. External developments

[2] Memorandum No. M-2022-004 dated 17 January 2022 on extension of BSP prudential and operational relief measures.

- Global economic activity expands faster in February 2022 due to eased quarantine restrictions amid declining COVID-19 cases and improving vaccination rates. However, inflationary pressures stemming from protracted supply disruptions weigh on overall economic growth and consumer confidence. The JP Morgan All-Industry Output Index rose to 53.4 in February 2022 from 51.1 in the previous month as output, new business, and employment improved. The imposition of more relaxed quarantine measures supported broad-based demand recovery, with economic output in the UK, Ireland, euro area, and the US growing faster despite persistent inflationary pressures and prolonged supply chain disruptions. Meanwhile, economic activity in Japan contracted as rising input prices and stagnating demand weighed on business activities in the manufacturing and service sectors.

- Several major central banks such as Bank of Canada, the US Federal Reserve, and Bank of England (BOE) have recently raised their policy rates in response to rising inflationary pressures amid strong economic activity. Meanwhile, the European Central Bank (ECB) as well as the Reserve Bank of Australia, Bank Negara Malaysia, Central Bank of the Republic of China (Taiwan), and Bank Indonesia maintained their key policy rates during their most recent policy meetings as monetary authorities deemed it necessary to continue supporting the ongoing economic recovery despite rising inflationary pressures.