BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 19 MAY 2022 [1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Raise the BSP's current policy interest rate by 25 basis points to 2.25 percent for the overnight RRP rate;

b) Increase the current interest rates on the overnight deposit facility (ODF) to 1.75 percent and overnight lending facility (OLF) to 2.75 percent; and

c) Announce the winding down of the provisional advances to the National Government and the reconfiguration of the BSP's government securities purchasing window from a crisis intervention measure into a regular liquidity facility under the interest rate corridor framework.

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

- The decision of the Monetary Board was based on its assessment that the latest baseline forecasts have further shifted higher since the previous monetary policy meeting in March, indicating that elevated inflation pressures could persist over the policy horizon. Average inflation is likely to breach the upper end of the 2-4 percent target range in 2022 at 4.6 percent, while the forecast for 2023 has edged closer to the upper end of the target band at 3.9 percent.

- In assessing the monetary policy stance, the Monetary Board also noted that the balance of risks to the inflation outlook now leans toward the upside for both 2022 and 2023. The upside risks over the near term may be attributed to the potential impact of higher global non-oil prices, transport fare hikes, as well as the continued shortage in domestic pork and fish supply. Meanwhile, the downside risks continue to emanate mainly from the potential impact of a weaker-than-expected global economic recovery and reimposition of local quarantine measures due to the possible resurgence of COVID-19 cases.

[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 23 June 2022.

- Furthermore, the Monetary Board recognized the emergence of second-round effects, particularly higher inflation expectations for 2022-2024 and the recent wage hike developments in some regions.

- On balance, the Monetary Board was of the view that persistent inflationary pressures point to the need for prompt monetary action to anchor inflation expectations. The Monetary Board believed that a timely increase in the BSP's policy interest rate will help arrest further second-round effects and temper the buildup in inflation expectations. The Monetary Board likewise reiterated its support for the sustained implementation of non-monetary interventions to mitigate the impact of persistent supply-side factors on inflation, particularly food supply and prices.

- As the economic recovery continues to gain traction, the BSP shall proceed with the gradual withdrawal of its extraordinary liquidity interventions and the normalization of its monetary policy settings. Alongside the adjustment in the policy rate, the Monetary Board also decided to announce the gradual withdrawal of the extraordinary measures implemented since the height of the COVID-19 pandemic, consistent with the BSP's exit strategy from monetary accommodation. These include the reconfiguration of the BSP's government securities (GS) purchasing window to a regular liquidity facility under the Interest Rate Corridor framework and the winding down of the BSP's provisional advances to the National Government (NG) as the NG fully pays the advances ahead of the maturity schedule on 11 June 2022.

- Looking ahead, the Monetary Board emphasized that the pace and timing of further monetary policy actions by the BSP shall be guided by data outcomes, in keeping with the BSP's 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 rose sharply to 4.9 percent year-on-year in April 2022 from 4.0 percent in March 2022 and 4.1 percent in April 2021. Inflation pressures continued to be driven by higher price increases of food and energy-related CPI items. Inflation for food and non-alcoholic beverages rose to 3.8 percent in April 2022 from 2.6 percent in the previous month. Under food items, heavily weighted CPI items namely, vegetables, meat, and fish were the main drivers of higher food inflation in April. Meat inflation was driven mostly by poultry products amid supply bottlenecks from transport restrictions implemented by local governments with the Avian flu discovery. Meanwhile, transport inflation remained at doubledigit rates amid higher international crude oil prices. Consequently, inflation for utilities particularly, electricity and gas also went up.

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 4.6 percent for 2022 from 4.1 percent in the previous month's survey round. Similarly, the mean inflation forecasts for 2023 increased to 3.6 percent (from 3.4 percent) and to 3.4 percent (from 3.3 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 4.6 percent for 2022 and decelerate to within the target range at 3.9 percent for 2023. The projections are higher compared to the previous forecast run due to the higher-than-expected inflation outturns in March and April 2022, the higher assumption for global non-oil prices, faster GDP growth outlook, and the depreciation of the peso. The actual NCR wage adjustment of 6.1 percent (₱33 per day), which was higher than the originally assumed wage adjustment, was also incorporated in the baseline inflation forecasts.

Baseline Inflation Forecasts		
	24 March 2022 MB Meeting	**19 May 2022 MB Meeting**
2022	4.3	4.6
2023	3.6	3.9

- The risks to the inflation outlook are tilted to the upside for 2022 and 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 potential impact of a weaker-than-expected global recovery as well as the reimposition of local quarantine measures due to the resurgence of COVID-19 cases are the main sources of downside risks.

D. Demand conditions

- Over the near term, economic recovery is seen to continue to gain traction, with the latest GDP growth forecast showing a return to pre-pandemic level earlier than previously projected. Domestic growth is seen to remain robust in the succeeding quarters in view of the implementation of the Corporate Recovery and Tax Incentives for Enterprises (CREATE) Law and Financial Institutions Strategic Transfer (FIST) Act, and looser mobility restrictions amid continued widespread deployment of COVID-19 vaccines and booster shots. The eventual re-opening of the global economy as restrictions ease, vaccination rates increase, and labor market conditions improve is seen to bolster domestic recovery through increased exports and remittances.

- The latest output growth forecast for 2022 is higher compared to the previous estimates due mainly to the higher-than-expected GDP outturn in Q1 2022, and the impact of looser community quarantine restrictions across the country and election-related spending on domestic demand.

- Output gap is now expected to have closed in Q1 2022 and remain broadly neutral during the year as economic recovery continues to gain traction. Potential output is expected to increase with the country's productive capacity growing at pace with actual output amid the continued resumption of economic activities, gradual improvements in employment conditions and external demand, as well as negative interest rates.

- Mobility indicators continued to pick up in April 2022 with the shift to the least stringent alert level as new COVID-19 infections fell after the surge in early 2022. Using the 7-day moving average, visits across most location categories increased and has now reverted to pre-pandemic levels.

  Changes in mobility coincided with the signs of improvement in the purchasing manager's index (PMI) in March 2022 amid the implementation of more relaxed quarantine measures nationwide. All sectors registered above 50-point expansion threshold supported mainly by the relaxation of mobility restrictions and renewed demand.

- Employment conditions in March 2022 suggest sustained improvement which may be attributed to easing mobility restrictions and rebound of economic activity. Employment rate rose to 94.2 percent while unemployment rate declined to 5.8 percent. The employment outcome in March 2022 is also greater than the level posted during the pre-pandemic period by 10.4 percent or about 4.43 million employment gains.

- The Department of Labor and Employment (DOLE) announced on 14 May 2022 that the Regional Tripartite Wage and Productivity Boards (RTWPBs) raised the daily minimum wage of non-agricultural workers in NCR by ₱33.00 to ₱570.00. The minimum wage for NCR remained unchanged since November 2018.

  Likewise, the RTWPB for Region VI (Western Visayas) has approved a ₱55 and ₱110 increase in basic pay for the region's non-agriculture, industrial, and commercial establishments employing more than 10 workers and those employing 10 or less workers, respectively. This will bring the new minimum wages in the region to ₱450 for establishments with more than 10 workers and ₱420 for establishments with 10 or less workers. Meanwhile, agriculture workers have been granted a ₱95 increase in basic pay which brings the new minimum wage to ₱410 for the sector.

E. Supply-side indicators

Developments in Agriculture

- Nationwide average rice prices increased in April 2022. Despite the ongoing summer harvest, rice prices have increased slightly, along with other key food items such as meat, fish, and vegetables, partly due to higher global commodity prices, as a consequence of the conflict in Eastern Europe and persistent global supply chain disruptions.

- To address the potential impact of supply-side pressures on domestic food prices, the NG has 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.

Oil Price Developments

- Dubai crude oil prices eased in April 2022 relative to the month-ago level, albeit still over US$100 per barrel given continuing geopolitical conflict in Eastern Europe, declaration of force majeure on oilfields in Libya, and weather-related disruptions in Kazakhstan. The uptrend was counterbalanced by concerns over weaker demand prospects amid China's stringent lockdown measures to stem the surge of COVID-19 cases. Moreover, the significant oil stock release announced by the International Energy Agency (IEA) and the US has also exerted downward pressure on oil prices. However, oil prices started rising anew in early May 2022 due to worries over potentially tighter supply as the European Union considered imposing sanctions on Russian crude oil.

- Reflecting the uptrend in international oil prices, domestic fuel prices also increased, which prompted transport groups to file petitions for a fare hike. According to the Land Transportation Franchising and Regulatory Board (LTFRB), several transport groups (from public utility bus (PUB) to jeepneys (PUJs)) across the country have submitted petitions requesting to raise the base fare by a range of 20-67 percent. Aside from LTFRB, BSP regional offices also indicated that regional transport groups were requesting for an increase in PUJ fare.

F. Financial market developments

- The peso appreciated against the US dollar in April 2022 from month-ago level amid positive domestic developments, including (i) the reversal of the country's balance of payments position to a surplus in March 2022; (ii) the affirmation of the Philippines' investment grade credit rating by the Rating and Investment Information, Inc. (R&I) and stable outlook for the Philippine banking system by Moody's; (iii) the upward revision on the country's GDP forecast for 2022 by the International Monetary Fund (IMF); (iv) the statement from the BSP that it is prepared to take pre-emptive action as needed if inflation expectations become at risk or de-anchored; and (v) the narrowing of the government's fiscal gap in March 2022. Adding support to the peso was the expectation of weaker fuel demand due to the lockdown in Shanghai, China caused by a surge in coronavirus cases.

For the week ending 17 May 2022, the peso was relatively steady against the US dollar. The peso was partly buoyed up by positive sentiment following the release of strong domestic data on foreign direct investments for February 2022, overseas Filipino remittances for March 2022, and GDP growth for Q1 2022. However, this was tempered by investor concerns that the US Fed will maintain its aggressive path of interest rate increases to address elevated inflation.

G. Domestic liquidity and credit conditions

- Liquidity in the financial system continued to be ample. Preliminary data show that domestic liquidity (M3) grew by 7.6 percent year-on-year to about ₱15.2 trillion in March 2022, albeit slower than the 8.5-percent (revised) expansion in February 2022. The expansion was driven mostly by higher domestic claims in March. Domestic claims rose by 7.3 percent year-on-year in March from 8.8 percent in the previous month due to the improvement in bank lending to the private sector and expansion in net claims on the central government.

- Credit activity continued to show signs of recovery, reflecting the improvement in business activity amid more relaxed quarantine restrictions. 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 eighth consecutive month at a quicker pace of 8.9 percent year-on-year in March 2022 from 8.8 percent (revised) in February 2022.

H. Fiscal developments

- The Q1 2022 budget deficit of the NG reached ₱316.8 billion which is 1.4 percent higher than the level recorded in 2021. Netting out the interest payments in NG expenditures, the primary deficit amounted to ₱167.5 billion, higher by about 14 percent relative to the amount recorded in 2021.

- The baseline inflation forecasts are consistent with the NG’s fiscal deficit assumption of 7.7 percent for 2022 and 6.1 percent for 2023, based on the medium-term macroeconomic assumptions of the Development Budget Coordination Committee (DBCC) as of 14 December 2021.

I. External developments

- The IMF downgraded its full-year global economic growth forecasts for 2022 and 2023, based on the April 2022 World Economic Outlook report. The ongoing war in Ukraine and the sanctions imposed on Russia are expected to dampen global economic activity in 2022 through direct impacts on both Russia and Ukraine and via global spillovers. The war and related sanctions have contributed to tighter global financial conditions, lower risk appetite, and flight-to-quality flows.

- Several central banks raised their key policy rates in April and early-May 2022 to rein in inflation amid strong economic recovery. This includes Bank of Canada, the Reserve Bank of New Zealand, Bank of Korea, Reserve Bank of Australia, the Reserve Bank of India, and Bank Negara Malaysia.

  On 4 May 2022, the US Federal Reserve (US Fed) decided to raise the target range for the federal funds rate by 50 bps to 0.75 percent to 1.0 percent in line with expectations that with the appropriate tightening in the stance of monetary policy, inflation will return to the Fed's 2-percent objective and labor market conditions will improve. The Russia-Ukraine conflict and supply chain disruptions from China's COVID-related lockdowns are viewed by the Fed as sources of additional upward pressures on inflation that could weigh down US economic activity.

  Based on the latest futures path, an additional 50-bp hike is seen for the US Fed's June and July policy meetings and a 25-bp hike for its September, November, and December meetings, for a cumulative policy rate increase of 250-bp in 2022, already including the 25-bp hike last March and the 50-bp hike in May. The US Fed is seen to further raise its policy rate by 50 bps in 2023.