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HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 23 June 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 2.50 percent for the overnight RRP rate; and

b) Increase the current interest rates on the overnight deposit facility (ODF) to 2.00 percent and overnight lending facility (OLF) to 3.00 percent.

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

- The decision of the Monetary Board is based on its assessment that inflation is projected to breach the upper end of the 2-4 percent target range for 2022 at 5.0 percent and 2023 at 4.2 percent, before it is seen to subsequently decline to 3.3 percent for 2024. The inflation projections have further shifted higher since the May 2022 monetary policy meeting, indicating that elevated inflation pressures could persist over the policy horizon.

- The risks to the inflation outlook continue to lean towards the upside for both 2022 and 2023. Major upside risks in the near term include the potential impact of higher global non-oil prices, higher fish prices, and additional jeepney fare hikes due to rising oil prices. Meanwhile, the impact of a weaker-than-expected global recovery and potential reimposition of quarantine restrictions amid an uptick in infections continue to be the main downside risks to the outlook.

- In assessing the monetary policy stance, the Monetary Board also noted that persistent inflationary pressures from global factors along with limited spare capacity in the domestic economy could lead to mounting second-round effects. Nonetheless, inflation expectations have remained within the target range for 2023-2024.

[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 18 August 2022.

- On balance, the Monetary Board believes that a follow-through increase in the policy rate enables the BSP to withdraw its stimulus measures while safeguarding macroeconomic stability amid strong external headwinds to domestic economic growth. The Monetary Board is of the view that a second policy rate hike of 25-bps at this point would also facilitate a gradual and well-considered pace for policy adjustment, where the appropriate magnitude and timing of adjustment will continue to be guided by prospective data outturns.

- Looking ahead, the Monetary Board emphasized that it is prepared to take all necessary policy action to bring inflation toward a target-consistent path over the medium term and deliver on its primary mandate of price stability.

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 further to 5.4 percent year-on-year in May 2022, the highest recorded inflation since December 2018, from 4.9 percent in April 2022 and 4.1 percent in May 2021. Recent inflationary pressures highlight the large role of external factors on domestic price conditions in particular, the continued rise in international oil prices and global supply chain issues. The rise in food inflation reflects the spillover effects of higher energy costs given sufficient domestic supply in the market. Transport inflation likewise remained at double-digit rates due to higher international oil prices which led to fuel price hikes, which more than offset the modest decline in electricity rates and LPG prices. In addition, the number of CPI items above threshold has further increased suggesting that price pressures are broadening but closer assessment showed that majority of these items are under food, beverages, and tobacco.

B. Inflation expectations

- The June 2022 survey round for inflation expectations showed higher mean inflation forecasts for 2022–2024, with inflation likely to breach the upper end of the target band in the near term and ease close to the midpoint of the target over the policy horizon. Private sector economists expect inflation to average at 4.9 percent for 2022 from 4.6 percent in the previous month's survey round. Meanwhile, the mean inflation forecasts stood at 3.9 percent (from 3.6 percent) for 2023 and 3.6 percent (from 3.4 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 5.0 percent for 2022 and 4.2 percent for 2023. Meanwhile, inflation could decelerate to within the target range at 3.3 percent for 2024. The upward adjustment in the forecasts for 2022 and 2023 was mainly driven by the higher-than-expected inflation outturn in May and higher nowcast for June, the higher assumption for global oil and non-oil prices, the approved provisional jeepney fare hike, and the depreciation of the peso.

Baseline Inflation Forecasts		
	19 May 2022 MB Meeting	**23 June 2022 MB Meeting**
2022	4.6	5.0
2023	3.9	4.2
2024	-	3.3

- The risks to the inflation outlook are tilted to the upside for 2022 and 2023 but is broadly balanced for 2024. The potential impact of higher global non-oil prices, higher fish prices, and petitions for transport fare hikes due to higher oil prices are the major upside risks over the near term. Meanwhile, the impact of a weaker-than-expected global recovery and potential reimposition of quarantine restrictions continues to be the main downside risk to the inflation outlook.

D. Demand conditions

- Over the near term, economic recovery is seen to continue to gain traction. Domestic growth will likely settle close to the upper bound of the DBCC's target of 7.0-8.0 percent for 2022 and within the 6.0-7.0 target for 2023 and 2024. The implementation of the Corporate Recovery and Tax Incentives for Enterprises (CREATE) Law, Financial Institutions Strategic Transfer (FIST) Act, and the second tranche in the reduction in personal income taxes are seen to further bolster the domestic outlook. Likewise, GDP growth rates for 2023 and 2024 are projected to be sustained with the impact of the government's fiscal reform measures.

- The full-year growth forecast for 2022 remains robust, with a slight downward revision due to the slower world GDP outlook. Moreover, the initial forecast for Q2 2022 indicates that the expansion could further accelerate with the continued easing of community quarantine restrictions. Domestic growth is also seen to remain firm in the succeeding quarters in view of the 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 output gap is expected to have closed in Q1 2022 and is seen to be broadly neutral throughout the policy horizon as economic recovery continues to gain traction. Likewise, potential output is expected to sustain its recovery with productive capacity growing at pace with actual output given the continued reopening of the economy, gradual improvements in employment conditions, and continued investment growth.

- Mobility continued to rise in June with the shift to the least stringent COVID-19 alert level as new infections fall following the surge in early 2022. Majority of the provinces in the country were retained at Alert Level 1 in May and early June with indicators across location categories reverting to pre-pandemic levels beginning May 2022 using 7-day moving average.

  Changes in mobility coincided with the improvement in the purchasing manager's index (PMI) which remained above the 50-point expansion threshold in May as domestic demand improved with the reopening of more businesses as well as employees returning to work under Alert Level 1. However, while most sectors registered above expansion threshold levels, concerns on rising input costs contributed to the moderation in the May numbers from the highs recorded in April 2022

- Labor market indicators in April 2022 suggest a sustained improvement in employment conditions amid easing mobility restrictions and increased economic activity. Employment rate rose to 94.3 percent while unemployment rate declined to 5.7 percent. The employment level in April 2022 is also higher than the pre-pandemic level by about 3.1 million.

- In response to the sustained increase in energy prices as well as the long lag since previous wage adjustments, all 17 regional wage boards have approved new wage orders for their respective jurisdictions in May and June. The average nominal minimum wage increase for all 17 regions is 13.1 percent.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- Nationwide average rice prices increased slightly in May 2022, along with other key food items such as meat, fish, and vegetables, amid rising input costs (e.g., cost of fuels, fertilizers) which is further aggravated by the impact of the Ukraine-Russia conflict on global supply chains and commodity prices. The PSA reported seeing spillover effects of increased transportation costs on the food basket due to higher fuel prices.

- The National Government has rolled out targeted interventions to help stabilize domestic supply of agricultural commodities. The measures implemented likewise aim to mitigate the potential impact of the supply chain disruptions stemming largely from the geopolitical tensions between Russia and Ukraine, exacerbated further by the reimposition of lockdown measures in China and weather disturbances. These measures include rice importation to augment rice supply in the domestic market, grant of fertilizer subsidies to rice farmers to Improve agricultural productivity, lower tariff rates on pork imports until end-2022 alongside efforts to speed up hog repopulation, to name a few.

Oil Price Developments

- Dubai crude oil prices rose anew in May and in June 2022 to more than US$100 per barrel due to the European Union's (EU) sanctions on Russian crude oil imports and expectations of demand recovery amid easing COVID-19 restrictions in Shanghai and Beijing. Uncertainty in the oil price path remains elevated due to geopolitical developments in Eastern Europe and the Middle East, global economic prospects given higher fuel prices, China's reopening, and possibility of COVID-19 resurgence.

- 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 (including groups for public utility buses or PUBs and jeepneys or PUJs) across the country have submitted petitions requesting to raise the base fare by a range of 20-67 percent. Meanwhile, on 8 June 2022, the LTFRB has approved the provisional 1-peso fare increase for PUJs (modernized or traditional utility jeepneys) in NCR, Region III and IV. This will raise the minimum fare from ₱9.00 to ₱10.00.

F. Financial market developments

- For the period 1-6 June 2022, the peso depreciated further on market expectation of higher inflation in May 2022 and the approval of the EU's partial ban on Russian oil imports, which is expected to push global oil prices higher. In addition, the release of the National Government's (NG) outstanding debt as of end-April 2022, as well as the continued hawkish signals from US Federal Reserve officials regarding the planned pace and extent of US monetary tightening in 2022 added pressure to the peso.

G. Domestic liquidity and credit conditions

- Liquidity in the financial system continued to be sufficient to sustain the economy on a firm recovery path. Preliminary data show that domestic liquidity (M3) grew by 7.3 percent year-on-year following the 7.7-percent (revised) expansion in March.

- Lending activity has also gained further traction as the country's manageable COVID-19 caseload continued to support market confidence. Preliminary data show that outstanding loans of universal and commercial banks (U/KBs), net of reverse repurchase (RRP) placements with the BSP, expanded anew at a faster rate of 10.0 percent year-on-year in April 2022 from 8.9 percent in March, marking the ninth consecutive months of expansion in loans for production activities.

H. Fiscal developments

- The NG recorded a deficit of ₱311.9 billion for January - April 2022 which is 14.8 percent lower than recorded in the same period in 2021. Netting out the interest payments in NG expenditures, the primary deficit amounted to ₱125.3 billion, forty-two percent lower than the amount recorded in 2021.

- The baseline inflation forecasts are consistent with government's fiscal deficit assumption of 7.6 percent for 2022, 6.1 percent for 2023, and 5.1 percent for 2024 based on the medium-term macroeconomic assumptions of the Development Budget Coordination Committee (DBCC) as of 24 May 2022.

I. External developments

- Based on its June 2022 Global Economic Prospects Report, the World Bank (WB) lowered its 2022 and 2023 global economic growth forecasts by 1.2 percent and 0.2 percent, respectively, as heightened and prolonged geopolitical tensions in Eastern Europe destabilized the global economy's recovery from the pandemic-induced recession. The WB likewise emphasized that the sharp tightening of global monetary settings amid elevated inflation could lead to tepid economic growth, higher borrowing costs, and fiscal instability. Meanwhile, uncertainties emerging from the abrupt withdrawal of monetary accommodation, elevated debt levels, and limited fiscal policy space to mitigate inflationary pressures on poor households pose downside risks to the growth outlook for 2022 and 2023.

- Global financial conditions have become less accommodative with several central banks raising their key policy rates in June to rein in inflation amid strong economic recovery. These include Bank of Canada, Reserve Bank of Australia, Reserve Bank of India, Federal Reserve, Central Bank of the Republic of China (Taiwan), and Bank of England. Bank Indonesia also increased its reserve requirement ratio amid tightening of global financial conditions.

  By contrast, the European Central Bank (ECB), Bank of Thailand (BOT), Bank of Japan, and People's Bank of China maintained their respective policy rates during their monetary policy meetings in June to continue supporting economic recovery momentum despite rising global inflationary pressures. Nevertheless, both the ECB and BOT indicated that policy rate hikes would be announced at their next policy meetings on 21 July 2022 and 10 August 2022, respectively.

  On 15 June 2022, the Federal Reserve increased the Fed Funds rate target range by 75 bps to 1.50 – 1.75 percent from 0.75 – 1.00 percent. Based on the latest Fed funds futures path, an additional 50-bp hike is seen for the US Fed's June, July, and September policy meetings and a 25-bp for its November and December meetings. The US Fed is seen to further raise its policy rate by 50 bps in H1 2023 but could reduce it by 25 bps in Q4 2023 due to the expected deceleration in the US economy.