BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 22 SEPTEMBER 2022 [1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Raise the BSP's current policy interest rate by 50 basis points to 4.25 percent for the overnight RRP rate; and

b) Increase the current interest rates on the overnight deposit facility (ODF) to 3.75 percent and overnight lending facility (OLF) to 4.75 percent.

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

- The decision of the Monetary Board is based on the assessment of the latest baseline inflation outlook which indicate a higher inflation path over the policy horizon. Average inflation is projected to settle above the government's target band of 2-4 percent for 2022 and 2023. The higher inflation forecast path reflects the continued depreciation of the peso and the recently approved nationwide transport fare hikes. Nevertheless, inflation is projected to decelerate back to the midpoint of the target range in 2024 due to the impact of slower domestic and global growth outlook, the lower assumptions for global crude oil and non-oil prices, as well as the BSP's policy rate hikes.

- In deciding to raise the policy rate anew, the Monetary Board has noted that price pressures continue to broaden. The rise in core inflation indicates emerging demand-side pressures on inflation. Moreover, second-round effects continue to manifest, with inflation expectations remaining elevated in September following the approved minimum wage and transport fare increases. Nonetheless, inflation expectations continue to be broadly anchored to the BSP's projected path over the medium term.

- At the same time, the risks to the inflation outlook remain tilted to the upside for 2022 and 2023 but are seen to remain broadly balanced for 2024.

- Given elevated uncertainty and the predominance of upside risks to the inflation environment, the Monetary Board has recognized the need for follow-through action to anchor inflation expectations and prevent price pressures from becoming further entrenched. The domestic economy can

[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 17 November 2022.

accommodate a reasonable tightening of the monetary policy stance, as demand has generally held firm owing to improved employment outturns and ample liquidity and credit.

- At the same time, the Monetary Board also continues to urge the National Government to implement timely non-monetary interventions to mitigate the impact of persistent supply-side pressures on food and other commodity prices. The Monetary Board reiterates its commitment to take all necessary actions to steer inflation towards a target-consistent path over the medium term, consistent with the BSP's primary mandate to promote price and financial 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 in August 2022 edged lower to 6.3 percent year-on-year from 6.4 percent in the previous month owing to slower increases in the prices of volatile food and energy items such as, meat, fish, and fuel. At the same time, negative vegetable inflation due to base effects also contributed to the moderation. Despite the slight deceleration due to lower food and transport inflation, headline inflation has remained above the government's target range since April 2022.

- Meanwhile, core inflation, which depicts underlying demand-side pressures, has also breached the upper end of the target range at 4.6 percent year-on-year in August 2022 from 3.9 percent in July 2022, an indication that second-round effects could translate into more persistent inflation.

B. Inflation expectations

- Inflation expectations have also risen further over the policy horizon. Private sector economists surveyed in September 2022 reported a higher mean inflation forecast for 2022 at 5.5 percent from 5.4 percent in the August 2022 survey.[2] Similarly, the mean inflation forecasts for 2023 and 2024 increased to 4.3 percent (from 4.2 percent) and 3.8 percent (from 3.7 percent), respectively.

- Likewise, the results of the BSP's Q3 2022 expectations survey on businesses and consumers indicate that both sectors anticipate inflation

[2] There were 21 respondents in the BSP's survey of private sector economists in September 2022. The survey was conducted from 6 to 14 September 2022.

to breach the upper end of the government's 2-4 percent target range for 2022 and 2023.

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 5.6 percent for 2022 and at 4.1 percent for 2023. Inflation is projected to decelerate back to the midpoint of the target range at 3.0 percent in 2024. The upward revision in the forecasts for 2022 and 2023 is driven by the higher inflation nowcast for September, the continued depreciation of the peso, and the recently approved nationwide transport fare hikes. Meanwhile, the impact of slower domestic and global growth outlook, lower assumptions for global crude oil and non-oil prices, as well as the BSP's 50-bps policy rate increase in August have driven the downward adjustment in the 2024 inflation forecast.

Baseline Inflation Forecasts		
	18 August 2022 MB Meeting	**22 September 2022 MB Meeting**
2022	5.4	5.6
2023	4.0	4.1
2024	3.2	3.0

- The risks to the inflation outlook remain tilted to the upside for 2022 and 2023 but are seen to remain broadly balanced for 2024. On the one hand, the potential impact of higher global non-oil prices, pending petitions for further transport fare hikes, increased prices of food items owing to weather disturbances, and the sharp rise in sugar prices are the major upside risks to the inflation outlook. On the other hand, the impact of a weaker-than-expected global economic recovery is the primary downside risk to the outlook.

D. Demand conditions

- The Philippine economy is projected to remain on the recovery path over the near term. GDP growth is projected to settle within the DBCC's target of 6.5-7.5 percent for 2022 and slightly below the 6.5-8.0 target for 2023 and 2024.[3] At the same time, the latest Philippine Business Cycle reading remained in the positive territory for the fifth (5^{th}) consecutive quarter and is above the medium-term growth average of 3.6 percent (i.e., five-year average) and long-term growth average of 5.5 percent (i.e., ten-year average), indicating sustained growth momentum.

- Mobility indicators continued to rise in early September as majority of the provinces in the country retained their alert levels. Mobility indicators across location categories have reverted to pre-pandemic levels beginning

[3] Government growth targets based on the 182^{nd} Development Budget Coordination Committee (DBCC) Meeting on 8 July 2022.

May 2022 based on their 7-day moving averages. Meanwhile, the implementation of full face-to-face classes by November 2022 is expected to lower mobility in households and, consequently, increase mobility to other location categories**.**

E. Supply-side indicators

Developments in Agriculture

- Nationwide average retail rice prices increased in August 2022 based on the results of the 2018-based PSA Retail Price Survey (RPS) covering all provinces and key cities in the country. While domestic production is seasonally low during the lean months, recent reports attribute the increase in rice prices more to the series of domestic fuel price hikes affecting transportation and logistics costs, as well as farmgate prices, prompting traders and retailers to adjust their selling prices.

- Domestic supply conditions continue to face challenges emanating from animal diseases, as well as high production costs due to global supply disruptions, and additional uncertainties brought about by the Ukraine-Russia crisis. To cushion the impact of these challenges on the country's food security, the Government has implemented crucial non-monetary measures to fill supply gaps and boost local production, such as rice imports to augment rice supply in the domestic market, extension of lower tariff rates on pork imports, relaxation of quantitative import restrictions for sugar processors over the near-term, among others. On a longer-term basis, non-government measures for food security and sustainability include restructuring the food value chain from research and development up to retail, and promotion of urban aquaculture and agriculture as well as unconventional production systems, among others.

- On weather conditions, based on the latest assessment as of 8 September 2022, prevailing La Niña conditions will likely persist through 2022, and weaken by the January-February-March 2023 season. Nonetheless, La Niña event is associated with above normal rainfall conditions, which could improve availability of water supply in harvest areas and potentially enhance agricultural production, particularly during dry season.

Oil Price Developments

- Global oil prices have been volatile recently though Dubai crude oil prices have been generally declining in the first half of September 2022 as concerns over weaker demand outlook offset worries over supply tightness. On the one hand, concerns over supply disruption and OPEC+ decisions to reduce production continue to exert upward pressures on oil prices. On the other hand, Saudi Arabia has decided to lower its official selling prices for October for most of the world's regions. Meanwhile, the futures market remained in backwardation as of 16 September 2022.

- On domestic oil prices, the downward trend in global oil prices has manifested in the recent rollbacks in domestic pump prices. However, fuel cost remains elevated, prompting the approval of several transport fare increase petitions (i.e., for jeepneys, buses, taxis). On 16 September 2022, the Land Transportation Franchising and Regulatory Board (LTFRB) decided to collectively raise transport fares across several public transport vehicles.

Developments in the Utilities Sector

- Power generation charges from the Independent Power Producers (IPPs) and Power Supply Agreements (PSAs) were adjusted upwards on the back of higher fuel costs. According to MERALCO, the ongoing Malampaya gas supply restriction necessitated the increased use of more expensive alternative fuel to ensure continuous supply.

- In addition, the continued rise in international coal prices contributed to higher cost from PSAs. Meanwhile, the rise in charges from the IPPs and PSAs was partly offset by the decline in charges from Wholesale Electricity Spot Market (WESM) due to improved supply situation in the Luzon grid.

F. Financial market developments

- The Philippine Stock Exchange Index (PSEi) averaged 6,602.2 index points for the period 1-20 September 2022, lower by 0.2 percent from its August average of 6,615.6 index points. The benchmark index was weighed down by investor concerns over the continued policy tightening of the US Federal Reserve, the movements of the peso against the US dollar, and the further weakening of global growth prospects.

- On a year-to-date (YTD) basis, the peso depreciated against the US dollar by 11.28 percent to close at ₱57.48/US$1 on 20 September 2022 from the end-December 2021 closing rate of ₱51.00/US$1. The peso's depreciation reflected the market's expectations of more aggressive policy rate hikes from the US Federal Reserve amid strong US economic data and hawkish comments from US Federal Reserve officials. In addition, concerns over the global economic growth outlook and elevated global inflation continue to drive safe-haven demand for the US dollar.

G. Domestic liquidity and credit conditions

- Domestic liquidity and credit conditions remain adequate to support broad-based economic recovery. Outstanding loans of universal and commercial banks (U/KBs) for both production and consumption activities increased in July 2022.

- Meanwhile, secondary market GS yields increased across all tenors on 27 September 2022, relative to 22-September 2022 yields, ranging from 0.280 basis point (bp) to 29.990 bps. The increase in yields, which already suggested partial passthrough, reflected the ongoing adjustments in short-term market interest rates following the 50-bps policy rate hike on 22 September 2022. The rise in yields could also be attributed to the continued depreciation of the peso against the US dollar amid the hawkish rhetoric of the US Fed.

H. Fiscal developments

- The National Government (NG) recorded a deficit of ₱761.0 billion for January - July 2022 which is 9.1 percent lower than the level recorded in the same period in 2021. Excluding the interest payments in NG expenditures, the primary deficit amounted to ₱451.7 billion, 20.7 percent lower than the amount recorded in 2021. Meanwhile, revenues increased by 16.6 percent to ₱1,746.4 billion in January – July 2022 from ₱1,490.4 billion in the same period last year.

- Despite the constraints, timely social protection measures implemented by the NG are expected to help alleviate the impact of rising crude oil prices on the transportation and agriculture sectors, while sustained efforts to ensure adequate domestic food supply could mitigate further supply-side pressures on inflation. Fiscal support has been deployed through fuel subsidies to the transport sector and vouchers to agriculture sector.

I. External developments

- Global economic activity contracts as manufacturing and services output in major economies such as the US, Japan, Germany, UK, and Italy declined in August 2022. The weakening global growth reflects the deterioration in investors' sentiment, persistent high inflation, and rapid tightening of global financial conditions. Nonetheless, the global economy's rate of contraction was partially offset by the continued expansion in emerging market economies, led by India, Brazil, and ASEAN countries.

- A number of central banks have raised their respective key policy rates in September amid elevated inflation pressures and resurgent demand. The depreciation of EM currencies against the US dollar has coincided with inflationary pressures stemming from elevated global commodity prices. Consequently, inflation in most emerging market economies has broadened in recent months as weather-related disturbances, supply chain issues, and war-related supply disruptions led to the emergence of second-round effects.