HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 22 JUNE 2023 [1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Maintain the current policy interest rate at 6.25 percent for the overnight RRP rate; and

b) Maintain the current interest rates on the overnight deposit facility at 5.75 percent and overnight lending facility at 6.75 percent.

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

- Based on the sum of new information and its assessment of the impact of previous monetary policy actions, the Monetary Board decided that keeping the policy interest rate unchanged was appropriate. The BSP's latest baseline projections continue to reflect a gradual return of inflation to the target band of 2 to 4 percent over the policy horizon. Average inflation for 2023 is projected to settle at 5.4 percent, slightly lower than 5.5 percent previously, while the average inflation forecast for 2024 now stands at 2.9 percent from 2.8 percent. For 2025, inflation is expected to average at 3.2 percent. Meanwhile, inflation expectations for 2023 are also lower, while those for 2024 and 2025 appear to have settled firmly within the target range.

- The Monetary Board also noted that while domestic growth momentum is expected to remain intact over the near term, recent demand indicators suggest a likely moderation in economic activity over the policy horizon, reflecting the impact of the BSP's cumulative policy rate adjustments as well as weak global growth prospects.

- Moreover, both headline and core inflation decelerated further in May 2023 with slower increases in the prices of food and energy-related items, affirming expectations of a return to the target range by year's end. Nevertheless, the balance of risks to the inflation outlook continues to lean towards the upside due to the potential impact of additional transport fare increases and minimum wage adjustments, persistent supply constraints of key food items, El Niño weather conditions, and possible knock-on effects of higher toll rates on agricultural prices. Meanwhile, the impact of a weaker-than-expected global economic recovery remains the primary downside risk to the outlook.

[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 17 August 2023.

- Given these considerations, the Monetary Board deemed it appropriate to maintain current monetary policy settings to allow the BSP to further assess how inflation and domestic demand have responded to tighter monetary conditions. However, lingering upside risks to the inflation outlook also warrant continued vigilance against potential second-round effects. A prudent pause also accords with financial stability considerations as elevated interest rate environment necessitates close monitoring to prevent the potential build-up of financial imbalances, especially amid slower domestic lending activity and tighter global financial conditions.

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

- Headline inflation dropped further to 6.1 percent year-on-year (y-o-y) in May 2023 from 6.6 percent in April 2023 due mainly to slower price increases of food and energy-related items. Official core inflation also declined to 7.7 percent in May 2023. All alternative measures of core inflation likewise declined. On a month-on-month seasonally adjusted basis, inflation rose to 0.3 percent in May 2023 from zero percent in the previous month.

B. Inflation expectations

- Inflation expectations have declined and remain within the target range for 2024 and 2025. The results of the BSP's June 2023 round of survey on private sector economists' inflation expectations showed a lower mean inflation forecast for 2023 at 5.7 percent from 5.8 percent in May 2023 survey round. Similarly, the mean inflation forecast for 2024 eased to 3.5 percent from 3.6 percent. By contrast, the 2025 mean inflation forecast increased to 3.6 percent from 3.5 percent. Analysts expect average inflation in 2023 to settle above the upper end of the government's target range for the year owing mainly to supply shocks.

C. Inflation outlook

- The latest baseline forecasts are broadly unchanged compared to the previous round. Inflation is projected to average at 5.4 percent for 2023 and 2.9 percent for 2024. Meanwhile, the preliminary forecasts indicate that inflation will likely settle at 3.2 percent for 2025.

  The slight downward revision for 2023 mainly reflects the lower-than-expected inflation outturn in May as well as the lower nowcast for June. Meanwhile, the slight uptick in 2024 was driven by the slightly higher GDP growth outlook and peso depreciation, but these were partly offset by the impact of lower crude oil prices.

Baseline inflation forecasts		
	18 May 2023 MB Meeting	**22 June 2023 MB Meeting**
2023	5.5	5.4
2024	2.8	2.9
2025	-	3.2

- The risks to the inflation outlook continue to be skewed toward the upside for both 2023 and 2024. The potential impact of additional transport fare increases, higher domestic prices of key food items facing ongoing supply constraints, higher-than-expected minimum wage adjustments in 2023, the potential impact of El Niño weather conditions on food prices and electricity rates, and possible second-round effects on agricultural prices from higher toll rates are the major upside risks to the inflation outlook. Meanwhile, the impact of a weaker-than-expected global economic recovery remains the primary downside risk to the outlook.

D. Demand conditions

- The economy's growth momentum remains intact for 2023 albeit economic activity is projected to decelerate over the policy horizon, reflecting weak global growth prospects as well as the impact of the cumulative policy rate adjustments of the BSP. Consumer sentiment meanwhile has remained pessimistic for Q2 2023 and less optimistic for Q3 2023 due mainly to higher prices of goods and household expenses and lower incomes, suggesting a potential moderation in consumer spending in the coming months. Nonetheless, latest data on the volume and value indices of factory output indicate faster expansions, supported by overall improved demand conditions amid the continued reopening of the economy in Q2 2023.

- Domestic labor market conditions continued to show overall improvement. The unemployment rate for April 2023 was 4.5 percent, lower than the 4.7 percent and 5.7 percent in March 2023 and April 2022, respectively.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- Nationwide average retail rice prices increased in May 2023. The increase in rice prices reflect the uptrend in farmgate prices during the first four months of the year which was partly attributed to cost pressures from inputs. International rice prices were likewise higher, particularly among the country's major import sources amid high demand from Asian buyers and concerns over the impact of El Niño weather conditions to rice output.

- Domestic food security is continuously threatened by the country's vulnerability to natural calamities, spread of animal diseases, and volatility in input prices. The gap between farmgate and retail prices also exposes challenges in the agricultural value chain as well as indicate non-competitive practices. The whole-of-government approach is expected to address food inflation and mitigate risks to food security through urgent implementation of measures to fill short-term supply gap and boost local production. Moreover, the Department of Agriculture has undertaken and coordinated measures to address the effect of El Niño on the agricultural supply in anticipation of a prolonged dry season.

- Based on the latest assessment of weather conditions as of 8 June 2023, El Niño conditions are present and will likely strengthen in the northern Hemisphere winter season (December-January-February). Consequently, the Philippine Atmospheric, Geophysical and Astronomical Services Administration expects El Niño conditions[2] to prevail in the coming months and will likely persist until Q1 2024.

Oil Price Developments

- Dubai crude oil prices declined in June 2023 from the full-month average in May 2023 as weaker demand prospects outweighed the effects of pronouncements to tighten supply by the Organization of Petroleum Exporting Countries and its partners (OPEC+)[3] and Saudi Arabia. Increased vulnerabilities in the global economy amid continued tightening in monetary policy settings, coupled with weaker-than-expected economic outturn for US and China, and Russia's strong crude oil exports also contributed to the decline in international oil prices.

- Meanwhile, high prices in the near term also indicate a tight global oil market, as reflected in the expected deficit in the International Energy Agency, OPEC, and the US Energy Information Administration (EIA) outlook for the second half of 2023. The expected deficit in the near term is influenced mainly by the production cuts of the OPEC+ as well as the projected increase in fuel demand in non-OECD Asia, especially in China and India. Nonetheless, the US EIA still forecasts minimal excess demand in the liquid fuels market in the first three quarters of 2024, before reverting to a surplus in Q4 2024.

Developments in the Utilities Sector

- The overall electricity rate increased in June 2023 due mainly to the completion of the last distribution-related refund in May. Four Distribution Rate True-Up adjustments were implemented by Meralco from March 2021 to May 2023 as granted by the Energy Regulatory Commission.

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[2] Adopted from the US Climate Prediction Center/NOAA, PAGASA defines El Niño conditions as the one-month observed sea surface temperature anomaly of 0.5°C or greater in the Niño-3.4 region, and an expectation that the 3-month Oceanic Niño Index threshold of 0.5°C or greater will be met (i.e., three overlapping 3-months for example January-February-March, February-March-April, and March-April-May).

[3] The Organization of the Petroleum Exporting Countries + (OPEC +) countries include Russia, Mexico, Kazakhstan, Oman, Azerbaijian, Malaysia, Bahrain, South Sudan, Brunei, and Sudan.

- The increase in charges from the Wholesale Electricity Spot Market reflected tighter supply conditions alongside higher peak demand. Meanwhile, charges from Meralco's Power Supply Agreement and Independent Power Producers declined on the back of improved average plant dispatch and lower coal prices.

F. Financial market developments

- The peso depreciated against the US dollar, on a year-to-date basis, by 0.6 percent on 7 June 2023 from the end-December 2022 closing rate. The depreciation is partly on account of better-than-expected US employment data in May 2023, as well as safe haven buying amid renewed concerns on global growth following the release of weaker Chinese manufacturing Purchasing Managers' Index data.

G. Liquidity and credit conditions

- Credit and liquidity growth are steady. Preliminary data show that liquidity or M3 grew by 6.6 percent year-on-year in April 2023 from the 6.2-percent (revised) growth recorded in the previous month. Meanwhile, preliminary data on outstanding loans of universal and commercial banks for production and consumption activities rose by 9.7 percent year-on-year in April 2023 from 10.2 percent (revised) in March 2023.

- Secondary market GS yields generally decreased on 7 June 2023 relative to end-April 2023. Yields declined following the release of the slower CPI data for May 2023. The decrease in yields was also supported by the market's expectation of a pause of monetary policy tightening of the BSP.

H. Fiscal developments

- Fiscal consolidation continued as the National Government (NG) recorded a deficit of ₱204.1 billion for January – April 2023, 34.6 percent lower than the amount recorded in the same period in 2022. Netting out the interest payments, the primary deficit amounted to ₱15.9 billion, lower by 87.0 percent than the 2022 level.

I. External developments

- Global economic activity expanded faster as increased business activity in the service sector more than offset the contraction in manufacturing output. However, global growth is expected to moderate in 2023 as downside risks continue to dominate the outlook. The World Bank projects the world economy to grow by 2.1 percent in 2023, slower than the 3.1-percent growth estimate in 2022 as the overlapping shocks of the pandemic, the ongoing war in Ukraine, and the sharp tightening of global financial conditions weigh on global economic activity.

- Meanwhile, several central banks have raised their respective key policy interest rates as of 8 June 2023 to address persistence of above-target inflation and anchor inflation expectations in their respective jurisdictions.