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KEEPING THE INFLATION TARGET UNCHANGED FOR 2022-2024

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INTRODUCTION

The country is starting to see some early signs of recovery after about two years since COVID-19 pandemic triggered worldwide disruptions. Travel restrictions in most areas were relaxed in late-2021, following the national government's (NG) intensified vaccination drive and decline in the number of new COVID-19 cases in the country. Against this backdrop, domestic output continued to expand. Real gross domestic product (GDP), or the value of final goods and services produced in the economy, grew by 7.7 percent in Q4 2021. The Q4 outturn brought the 2021 full-year GDP growth to 5.6 percent, above the government target range of 5.0-5.5 percent for the year. Business and consumer outlook for the next 12 months also became more optimistic.[2]

However, more stringent restrictions were imposed anew in the National Capital Region (NCR) and nearby provinces in January 2022 because of threats of rising COVID-19 infections and detection of local cases of the Omicron variant.

While there have been encouraging signs of economic pickup, domestic recovery remains in its nascent stage suggesting that the output gap may remain in the negative territory in the early to the middle part of the year. At the same time, supply-demand mismatches amid disruptions in the global supply chains could spill over and pose further upward pressures on the prices of domestic commodities.

Public observance of the standard health protocols and targeted fiscal support remain as the country's defenses against the global health crisis. At the same time, the BSP continues to support the country's economic recovery by ensuring price stability. Low and stable inflation—as represented by the inflation target—remains supportive of the ongoing recovery process and the attainment of the goal of sustainable and balanced growth.

In December 2020, the BSP announced the decision of the Development Budget Coordination Committee (DBCC) to maintain the inflation target at 3.0 percent ± 1.0 percentage point (ppt) for 2022 and to set the same inflation target for 2023 and 2024. During its annual review in 2021, the DBCC, in consultation with the BSP, approved to keep the inflation target unchanged for 2022-2024.[3] This article aims to explain the main considerations that the DBCC factored in the review of the said inflation target.

- The Development Budget Coordination Committee (DBCC) is an inter-agency body that reviews and approves the macroeconomic targets (including the inflation target) and corresponding fiscal and financing programs used in the preparation of the annual National Government (NG) budget. It is composed of:
    - → Department of Budget and Management (DBM),
    - → Department of Finance (DOF),
    - → National Economic and Development Authority (NEDA), and
    - → Office of the President (OP).
- The Bangko Sentral ng Pilipinas (BSP) sits in the committee as a resource institution.

For further reading, please refer to DBM's "About the DBCC", accessible online at www.dbm.gov.ph/index.php/dbcc-matters/about-the-dbcc.

[2] Based on the Q4 2021 BSP Business Expectations Survey (BES), the overall confidence index (CI) increased to 67.6 percent from 56 percent in the previous quarter's survey. Similarly, the CI rose to 23.6 percent from 18.6 percent in the Q3 2021 BSP Consumer Expectations Survey (CES).
[3] BSP Press Release. "Government Maintains Inflation Target Range at 3 Percent ± 1 Percentage Point for 2022-2024". 14 December 2021.

Simply put...

- Real Gross Domestic Product (GDP), or GDP at constant prices, is the value of final goods and services produced in an economy in a given period of time, adjusted for price changes.
- Potential Output is the maximum output that an economy can produce at full capacity.
- Output gap is difference between actual output (GDP) and potential output, expressed as ratio to potential output.
- Inflation is the rate of change in the average prices of goods and services typically purchased by consumers.
- Price stability is characterized by low and stable inflation.
- Inflation targeting is the BSP's framework for conducting monetary policy, which focuses on achieving price stability as the primary objective of monetary policy.

For further reading, please refer to the following resources:

- *IMF's Back to Basics Compilation: "Gross Domestic Product: An Economy's All"*
- *IMF's Back to Basics Compilation: "The Output Gap: Veering from Potential"*
- *BSP's Primers and FAQs: "Inflation Targeting"*

DEMAND-SIDE FACTORS

The economic recovery is expected to gain more traction in 2022-2024. The country's real GDP is projected to return to its pre-pandemic level in the second semester of 2022 with sustained growth over the next few years.

The NG targets real GDP to expand by 7.0-9.0 percent in 2022 and 6.0-7.0 percent in 2023-2024. Intensified government vaccination program, calibrated relaxation of travel restrictions, and the recovery in the external demand may support domestic economic recovery.[4]

The 10-point policy agenda of the Economic Development Cluster (EDC) can also boost and sustain economic recovery and prepare the country for future pandemics. The policy agenda covers the following areas:

1) metrics;
2) vaccination;
3) healthcare capacity;
4) economy and mobility;
5) schooling;
6) domestic travel;
7) international travel;
8) digital transformation;
9) pandemic flexibility bill; and
10) medium-term preparation for pandemic resilience.

Nonetheless, there are risks to the domestic growth outlook. Possible resurgence of virulent coronavirus variants and reimposition of strict mobility restrictions could limit business operations and dampen market sentiment. Meanwhile, prolonged supply chain disruptions amid improvements in global demand might keep international commodity prices elevated. In addition, the anticipated Federal funds rate lift-off in 2022 may lead to tighter global financial conditions. Furthermore, the damaging effects of natural disasters such as typhoons may hamper the country's recovery from the global pandemic.

The latest assessment suggests that the Philippine economy can continue to operate

[4] As of 9 February 2022, a total of 128,700,168 doses have been administered of which 60,674,767 are first doses; 60,013,407 are complete doses; and 8,011,994 are booster doses. Source: DOH, National COVID-19 Vaccination Dashboard. Accessible online at: doh.gov.ph/covid19-vaccination-dashboard.

below full capacity in the near term despite the anticipated recovery. The country's potential output and productive capacity have deteriorated amid reduced investment spending and job losses due to the pandemic. The view that the domestic output gap will continue to be negative in the near term may imply limited price pressures from the demand side.

Thus, appropriate government policy support must remain in place to sustain the country's momentum, particularly during its recovery phase. The following initiatives may help rebuild the country's resilience and boost economic growth.

- Sustained public health measures;
- Efficient utilization of the government budget;
- Effective implementation of economic reforms;[5] and
- Timely passage of important legislations.

Meanwhile, the BSP maintained its monetary policy settings during the Monetary Board meeting on 17 February 2022. However, when domestic developments necessitate a scale-down of policy support as economic recovery gains traction, the BSP will ensure a smooth transition in winding down its time and state bound measures.

SUPPLY-SIDE FACTORS

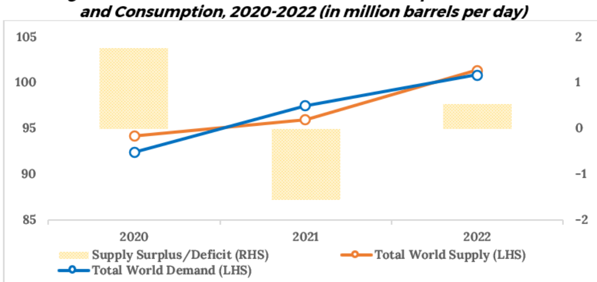
Global oil and food prices are expected to moderate over the medium term following the sharp increases in 2021. Future trends in supply and demand in the international commodities market may be influenced by multiple factors.

Prolonged dislocations in the global supply chain could keep inflation elevated in the near term. Shortage of intermediate inputs (e.g., microchips for cars), disruption in the delivery of shipping containers, and temporary shipping interruptions contribute to existing supply bottlenecks. These supply disruptions may not be resolved quickly and may be extended by increased demand during the holiday season, possible resurgence of COVID-19 infections, and extreme weather events (Kamali and Wang, 2021).

Nonetheless, the International Monetary Fund (IMF) expects that the medium-term outlook for global inflation would likely still be driven by fundamentals, including the speed of recovery and the continued anchoring of inflation expectations. The IMF conducted simulation exercises of a tail scenario marked by a sharp rise in commodity prices and sectoral inflation dispersion over the next 12 months. According to the model, this scenario has less than 0.01 percent probability of materializing. For emerging markets and developing economies, headline inflation is seen to peak by early 2022 but go back to trend by early 2024. Similarly, inflation expectations could overshoot in the short term but are projected to remain anchored over the medium term.[6]

On the global oil market, the balance of total world supply and demand of petroleum is expected to revert from a deficit in 2021 to a small surplus in 2022 **(Figure 1)**. Total crude oil consumption is estimated to rise by about 5 million barrels per day (mb/d) in 2021 from its 2020 levels and to continue to grow by another 2 mb/d in 2022, as the global economy reopens and travel restrictions are eased (US EIA, 2021). Meanwhile, the aggregate supply from oil producers particularly the Organization of Petroleum Exporting Countries and its allies (OPEC+) alongside the US is expected to catch up and outpace the slowdown in oil demand in 2022.

Figure 1. International Petroleum and Other Liquids Production and Consumption, 2020-2022 (in million barrels per day)



Source of raw data:
US Energy Information Administration, Short Term Energy Outlook, November 2021

[5] For instance, the implementation of the Corporate Recovery and Tax Incentives for Enterprises (CREATE) Law and Financial Institutions Strategic Transfer (FIST) Act could shore up investments and business activity and in turn, boost the country's actual and potential output.

[6] IMF (2021) estimated a structural quantile vector autoregression model for advanced economies and emerging markets and developing economies to gauge the balance of risks by looking at broader moments of the density forecast (Koenker and Xiao 2006; Ghysels, Iania, and Striaukas 2018; Montes-Rojas 2019; Chavleishvili and Manganelli 2020; Boire, Duprey, and Ueberfeldt 2021).

Looking ahead, new investment strategies and energy policies can dictate oil price trends over the medium term. The potential shift in investment from traditional new oil production to other projects, e.g., environmental, social, and governance, may limit innovation in oil production (World Bank, 2021). Government policies on the adoption of renewable energies could likewise impact the demand for oil.

However, the outlook in the global oil market is surrounded by elevated uncertainty. Possible resurgence of COVID-19 infections may limit mobility and thus, weigh down demand for oil. Meanwhile, the increased substitution of oil for natural gas in heating and electricity generation can boost global oil consumption (World Bank, 2021). On the supply side, developments on the policy decisions of OPEC+ and drilling activities of US oil producers are sources of risks to the price outlook.

On the global market, food prices are expected to moderate in 2022 to 2024. According to the World Bank's Commodity Markets Outlook in October 2021, the world food price index[7] might decline by about 0.9 to 3.5 percent in 2022-2024 following its estimated increase of 26.1 percent in 2021. Moreover, projections by the IMF World Economic Outlook in October 2021 indicate that the commodity food price index[8] could increase at a slower pace from 27.8 percent in 2021 to 1.9 percent in 2022 before decreasing by about 1.2 to 3.3 percent in 2023-2024. However, trends in the energy prices may be transmitted through the intermediate inputs (e.g., transport, chemicals, and fertilizers); increase in biofuel production; weather conditions (e.g., La Niña), and movements in the US dollar might affect the evolution of global food prices.

MODEL-GENERATED FORECASTS

The BSP's baseline forecasts (as of 18 November 2021 monetary policy meeting) suggest that inflation may revert to the 2.0-4.0 percent target range over the policy horizon. Similarly, results of the BSP's survey of private sector economists for November 2021 and the forecasts by the IMF and the Asian Development Bank (ADB) suggest that inflation in the Philippines could moderate in 2022-2024 from its 2021 levels (Table 1). These provide a strong case for keeping the target unchanged for 2022-2024 at 3.0 percent ± 1.0 percentage point.

REBASING OF THE PHILIPPINE CPI TO BASE YEAR 2018

The Philippine Statistics Authority (PSA) started releasing the 2018-based consumer price index (CPI) on 4 February 2022.[9] Regular rebasing of CPI is important to ensure that the market basket reflects changes in the spending patterns of households over time and monetary policy

Table 1. Inflation Forecasts for the Philippines for 2021-2024 (in %)

	2021	2022	2023	2024
BSP a/	4.3	3.3	3.2	n.a.
BSP's Survey of Private Sector Economists b/	4.4	3.5	3.2	n.a.
IMF c/	4.3	3.0	3.0	3.0
ADB d/	4.1	3.5	n.a.	n.a.

n.a. – not available
a/ BSP, as of 18 November 2021 Monetary Board meeting
b/ BSP, as of November 2021
c/ IMF World Economic Outlook, October 2021
d/ ADB Asian Development Outlook Update, September 2021

[7] Price indices in real 2010 US dollars (2010=100), deflated using the MUV index. The unit value index of manufacture exports (MUV) in US dollar terms for fifteen countries (Brazil, Canada, China, Germany, France, India, Italy, Japan, Mexico, Republic of Korea, South Africa, Spain, Thailand, United Kingdom, and United States).
[8] Commodity Food Price Index includes Cereal, Vegetable Oils, Meat, Seafood, Sugar, Bananas, and Oranges Price Indices, 2016=100
[9] PSA Press Release. "PSA Rebases to 2018 the Consumer Price Index (CPI) for All Income Households". 5 January 2022.

decisions are recalibrated based on a reasonable representation of consumer expenditures. For an inflation-targeting central bank, the choice of price index should reflect the most informative price level in the decision-making process of economic agents (Guinigundo, 2009).

The change in the CPI series has no material impact on the determination of the inflation target. The government inflation target represents the optimal level of inflation consistent with the BSP's primary mandate of price and financial stability, conducive to the balanced and sustainable growth of the Philippine economy. Thus, while a change in the CPI series could affect actual and forecasted inflation, revisions in the composition and weights of CPI intended to update the consumer basket should not significantly influence the choice of optimal inflation target.

CONCLUSION

In summary, the inflation target range of 3.0 percent ± 1.0 ppt continues to be an appropriate quantitative representation of the medium-term goal of price stability given the current structure of the economy, the macroeconomic outlook over the next few years, and the risks surrounding said prospects. The current inflation target band likewise remains supportive of the country's course of recovery from the global health crisis. Going forward, the BSP will continue to monitor closely price developments and stands ready to adjust its policy settings as needed to keep inflation within target.

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