# MONETARY POLICY REPORT

## CONDENSED VERSION

**DECEMBER 2024**

## Editorial Note to Condensed Version

This condensed version of the Monetary Policy Report (MPR) aims to make monetary policy more accessible to the public, enabling them to better understand and act on BSP's views and actions, particularly on inflation and interest rates.

To achieve this, we have shortened most parts but have also skipped over secondary ones. While we have given up some technical details, we hope the audience will gain a clearer understanding of monetary policymaking.

Unlike the MPR, which divides its sections by time period (Economic Outlook and Current Developments), this condensed version divides the body by subject (Inflation and Economy).

## **Foreword**
(From the official Monetary Policy Report)

The primary objective of monetary policy is to promote low and stable inflation conducive to balanced and sustainable economic growth and employment. To help fulfill this objective, the Bangko Sentral ng Pilipinas (BSP) adopted the inflation targeting framework for monetary policy.

One of the key features of inflation targeting is greater transparency. This means greater disclosure and communication by the BSP of its policy actions and decisions. The *Monetary Policy Report* plays a primary part in the BSP's effort at transparency. It shares with stakeholders, including market participants, the latest assessment of the monetary policy stance based on an analysis of economic and financial prospects. The broad aim is to contribute to making monetary policy accessible to the public. Through the *Monetary Policy Report*, the public may better understand and monitor the BSP's commitment to the inflation target.

The *Monetary Policy Report* is the flagship BSP publication on monetary policy. It provides the public with a detailed view of the BSP's forecasts and guidance on the likely direction of monetary policy over the next two years. The report conveys the overall thinking behind the BSP's decisions on monetary policy. The greater part of the report is devoted to forward-looking discussions on inflation and the key macroeconomic variables that affect inflation. It also discusses the risks and uncertainty surrounding the BSP's inflation forecasts.

Under the inflation targeting framework, the Development Budget Coordination Committee (DBCC) has retained the government's annual headline inflation target at 3.0 percent ± 1.0 percentage point (ppt) for 2024–2028. The inflation target range continues to be our quantitative representation of the medium-term goal of price stability, aligned with the current structure of the Philippine economy and the outlook on macroeconomic conditions over the next few years.

The Monetary Board approved this *Monetary Policy Report* at its meeting on 19 December 2024.

## The Monetary Policy of the Bangko Sentral ng Pilipinas

(From the official Monetary Policy Report)

### The BSP mandate

The main responsibility of the BSP is to formulate and implement policy in the areas of money, banking, and credit, with the primary objective of maintaining stable prices conducive to balanced and sustainable economic growth and employment in the Philippines. The BSP also aims to promote and preserve monetary stability and the convertibility of the national currency.

### Monetary policy instruments

The BSP's primary monetary policy instrument is the overnight reverse repurchase (RRP) facility.[1] Other instruments to implement the desired monetary policy stance to achieve the inflation target include (a) increasing/decreasing the reserve requirement;, (b) conducting auctions for the term deposit facility (TDF) and BSP Securities Facility;, (c) adjusting the rediscount rate on loans extended to banking institutions on a short-term basis against eligible collateral of banks' borrowers;, and (d) outright sales/purchases of the BSP's holdings of government securities (GS).

### Policy target

The BSP's target for monetary policy is the average annual Consumer Price Index (CPI), or headline inflation rate, which is compiled and released to the public by the Philippine Statistics Authority (PSA). The policy target is set by the DBCC in consultation with the BSP.[2] The inflation target for 2024–2028 is 3.0 percent ± 1.0 pp.[3]

### The BSP's explanation clauses

Explanation clauses are a prespecified set of acceptable circumstances under which an inflation-targeting central bank may fail to achieve its inflation target. These clauses reflect the fact that there are limits to the effectiveness of monetary policy and that deviations from the inflation target may sometimes occur because of factors beyond the control of the central bank. Under the inflation targeting framework of the BSP, these exemptions include inflation pressures arising from (a) volatility in the prices of agricultural products; (b) natural calamities or events that affect a major part of the economy; (c) volatility in the prices of oil products; and (d) significant government policy changes that directly affect prices, such as changes in the tax structure, incentives, and subsidies.

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[1] On 8 September 2023, the overnight RRP facility was transformed into a variable-rate auction format, with the policy rate of the BSP renamed to target RRP rate.

[2] The DBCC, created under Executive Order (Exec. Ord.) No. 232 dated 14 May 1970, is an interagency committee tasked primarily to formulate the national government (NG)'s fiscal program. It is composed of the Office of the President, Department of Budget and Management (DBM), National Economic and Development Authority (NEDA), and the Department of Finance. The BSP attends the Committee meetings as a resource agency.

[3] During the meeting on 15 December 2023, the DBCC, in consultation with the BSP, decided to retain the inflation target of 3.0 percent ± 1.0 pp for 2024 and set the same inflation target for 2025–2028.

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## Monetary policy decision

### Interest rate adjustment

On 19 December 2024, the Bangko Sentral ng Pilipinas (BSP) cut its key monetary policy interest rate, the target reverse repurchase (RRP) rate,[4] by 25 basis points (bps) from 6.00 percent to 5.75 percent.

BSP also reduced its overnight deposit and lending rates for banks by 25 basis points each to 5.25 percent and 6.25 percent, respectively.[5]

Table 1
**BSP Overnight Rates**

| Adjustment | Previous Rate | New Rate |
|---|---|---|
| Target reverse repurchase rate | 6.00% | 5.75% |
| Overnight deposit rate | 5.50% | 5.25% |
| Overnight lending rate | 6.50% | 6.25% |

### Reason behind the decision

BSP's baseline forecasts for average inflation are 3.3 percent for 2025 and 3.5 percent in 2026. These are within the government's inflation target range of 2.0 to 4.0 percent this year up to 2026.

While inflation rose slightly in November 2024, BSP views this as temporary and expects inflation to remain manageable. The increase was primarily driven by higher prices of certain food items affected by weather disturbances and seasonal factors.

The balance of risks to inflation leans toward the upside due to potential increases in electricity rates, transport fares, and domestic food prices. Lower rice prices resulting from tariff reductions pose a downside risk. Given these factors, BSP determined that a measured reduction in policy interest rates was appropriate.

The Monetary Board is scheduled to meet again on 13 February 2025 to review monetary policy settings.

## Inflation forecast

[4] The Target RRP is BSP's main instrument for signaling its monetary policy stance. BSP uses repurchase agreements to buy (repurchase) and resell (reverse repurchase) government securities from banks, increasing and reducing the money supply, or the funds the banks have available to lend, respectively. The Target RRP rate represents the rate BSP aims for banks to pay to buy back the securities.
[5] BSP also uses overnight deposit and lending to manage money supply. The overnight deposit rate is what BSP pays for overnight deposits. The overnight lending rate is what BSP charges for overnight loans.

### Inflation forecasts

Based on BSP's latest estimates, inflation for 2025 and 2026 will likely settle within the government's target range of 2.0-4.0 percent.

Similarly, economists from the private sector expect inflation to settle within the target range until 2026, suggesting that inflation expectations remain well-anchored. Well-anchored inflation expectations mean banks, businesses, and consumers generally view future inflation to remain close to BSP's forecasts and within the government's target range.

Table 2
**Inflation Forecasts**
BSP vs. Private-Sector Economists

| Year | a. BSP's baseline forecasts *(more likely scenario, says BSP)** | b. BSP's risk-adjusted forecasts *(scenario if risks happen, says BSP)** | c. Private-Sector Economists' Forecasts** |
|---|---|---|---|
| 2025 | 3.3 | 3.4 | 3.1 |
| 2026 | 3.5 | 3.7 | 3.2 |

*BSP's baseline and risk-adjusted forecasts from the 19 December 2024 monetary policy meeting

**Private sector economists' forecasts are based on forecasts provided by 24 respondents. The survey was conducted from 6-12 December 2024.

### a. BSP's baseline inflation forecasts

BSP's baseline inflation forecasts, which represent its estimates for most likely inflation rates, considered the following external and domestic factors:

<u>**External factors**</u>

**World gross domestic product growth.** Global output growth is assumed to remain below trend from 2025 to 2026, based on the International Monetary Fund's October 2024 World Economic Outlook and the Global Projection Model Network's November 2024 forecasts.

**Global crude oil prices.** Futures prices have declined due to market expectations of higher US oil production and weaker global demand as well as the likelihood of global oversupply.

**World non-oil prices.** The expected easing in non-oil prices will mainly stem from a decline in agricultural commodity prices, particularly cereals, with global production potentially reaching a record high in 2024–2025.

**Federal funds rate.** Markets expect the US Federal Reserve to cut rates by 25 bps in December 2024, followed by a cumulative 75-bp cut in 2025 and a 25-bp cut in

2026. This outlook comes after recent improvements in the US job market and stable inflation rates.

**Domestic factors**

**Target RRP rate and reserve requirement ratio (RRR).** The baseline inflation forecasts account for the 25-bp reduction in the policy rate during the 16 October 2024 monetary policy meeting and the 250-bp cut in the RRR to 7.0 percent effective 25 October 2024.

**Wages.** A higher minimum wage increase has been assumed, following the approval of wage hikes in 16 of the 17 regions as of 05 December 2024. The previous assumption only considered the minimum wage adjustment in the National Capital Region.

**Fiscal sector.** The baseline inflation forecasts align with the government's fiscal deficit assumption, based on the medium-term fiscal program set by the DBCC as of 02 December 2024. Borrowing to finance the deficit can increase demand, potentially putting upward pressure on inflation, while interest rate adjustments by the central bank help manage borrowing costs and inflationary pressures.

**Alcoholic drinks and cigarettes.** After staggered increases, excise taxes on alcoholic drinks shall increase by 6.0 percent, starting 2025. Excise taxes on cigarettes are rising by 5%, starting this year.

**Water rates.** The Metropolitan Waterworks and Sewerage System has allowed Manila Water Company and Maynilad Water Services to hike rates up to 2027.

**Electricity rates.** Electricity rates in areas serviced by the Manila Electric Company have increased beginning October 2024, following the Energy Regulatory Commission's approval of increases related to liquefied natural gas supplies.

**Lower rice tariff.**[6,7] In June 2024, the government cut the tariff on imported rice from 35% to 15%. This is seen to help lower prices of imported rice.

**Exchange rate.** The exchange rate could settle slightly above the government's assumptions for 2025 and 2026.[8] The exchange rate is projected to depreciate over the policy horizon due to the slower pace of monetary policy easing by the US Federal Reserve, together with the recent near-term movements of the peso.

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[6] The President signed EO No. 62 on 20 June 2024, reducing the tariff on rice from 35.0 percent to 15.0 percent to help lower the price of imported rice. The reduced rice tariff is effective from 7 July 2024 until 2028, subject to a review every four months.

[7] NEDA announced the approval of the new Comprehensive Tariff Program from 2024 to 2028, which includes tariff reductions on other essential items in the energy and manufacturing sectors while keeping the prevailing low rates on key agricultural products.

[8] The DBCC exchange rate assumptions as of 2 December 2024 are ₱57.00–₱57.50/US$1 for 2024, ₱56.00–₱58.00/US$1 for 2025, and ₱55.00–₱58.00/US$1 for 2026.

### b. BSP's risk-adjusted inflation forecasts

BSP's risk-adjusted inflation forecasts show potential deviation from baseline forecasts if certain risks materialize.

Risks refer not only to factors that could cause prices to go up (upside risks) but also factors that could cause prices to go down (downside risks).

Table 3
**Risks[9] to Inflation and Probabilities**

| | Risks | Probability |
|---|---|---|
| **Upside risks** | Higher transport charges | Medium |
| | Higher domestic food prices | Medium |
| | Higher electricity rates | High |
| **Downside risk** | Effect of lower tariff on imported rice | Medium |

For 2025 and 2026, upside risks are seen to carry a larger effect on inflation than the downside risk. Nevertheless, after incorporating the estimated impact of the risks at their assigned probabilities, inflation is still projected to remain within the target range.

Below are the factors that BSP considered for its risk-adjusted inflation forecasts:

**Transport fares**. Higher fares for jeepneys, trains, taxis, and domestic air travel pose upside risks to inflation.

**Electricity rates**. The Supreme Court's July 2023 decision, nullifying Wholesale Electricity Spot Market price caps for late 2013, may lead to higher generation charges being passed on to consumers, increasing electricity rates.

**Food supply constraints**. Domestic production of corn, pork, fish, and sugar is projected to remain below demand due to the lingering effects of El Niño, African Swine Fever, and Avian Influenza, potentially driving up inflation.

**Rice tariffs**. Reduced tariffs on rice imports could further lower prices of locally produced rice with a medium probability of impact.

### c. Inflation expectations of economists from the private sector

BSP also monitors the forecasts of economists from the private sector. These are their own estimates of future inflation.

For December 2024, these inflation expectations are not far from BSP's own forecasts and are within the inflation target range. These indicate that inflation expectations are well-anchored.

[9] Upside risks are factors that could push inflation higher than expected. Downside risks are factors that could cause inflation to be lower than expected.

Private-sector economists expect the following downside risks to their inflation forecasts:

- lower rice prices amid the implementation of Executive Order No. 62, dated 20 June 2024
- lower oil prices

On the other hand, they expect the following upside risks:

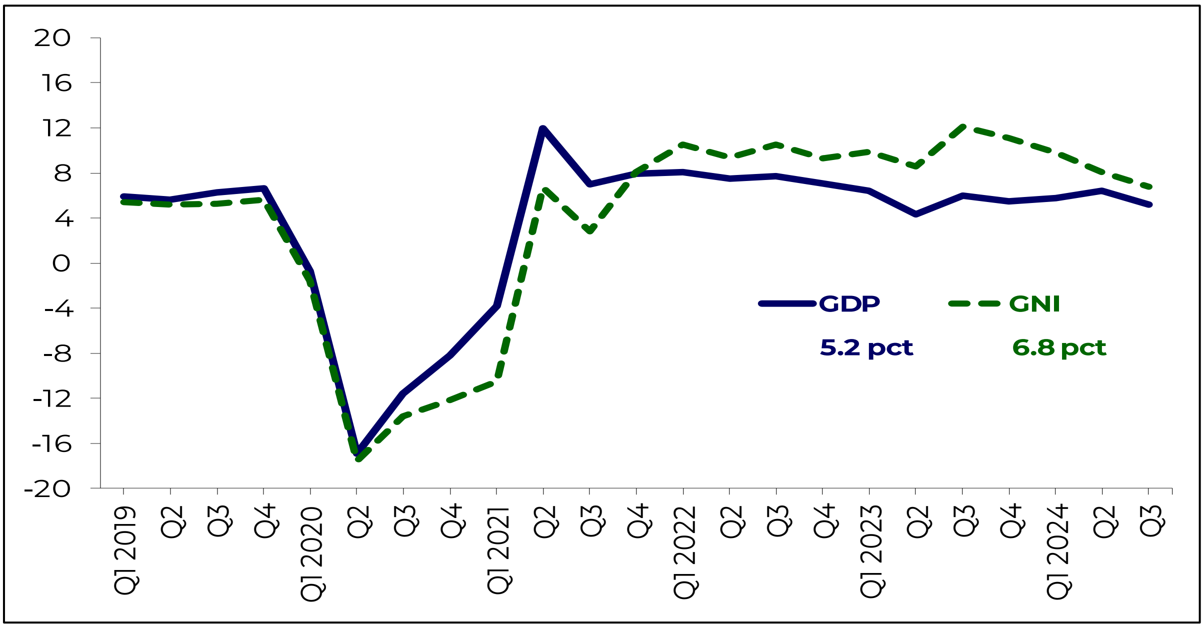
- supply disruptions due to geopolitical tensions and adverse weather conditions
- potential spike in electricity rates
- higher-than-expected wage adjustments
- protectionist US trade policies

## Recent Developments

Economic growth from Q1 2024 to Q3 2024 was at 5.8 percent, below the government target of 6.0–7.0 percent for 2024.

The growth in Q3 2024 was supported by domestic demand, particularly investments and household consumption. Gross national income grew by a slower pace, reflecting a slightly subdued growth in net primary income.

Figure 1
**Gross Domestic Product and Gross National Income**
at constant 2018 prices; year-on-year; growth rate in percent

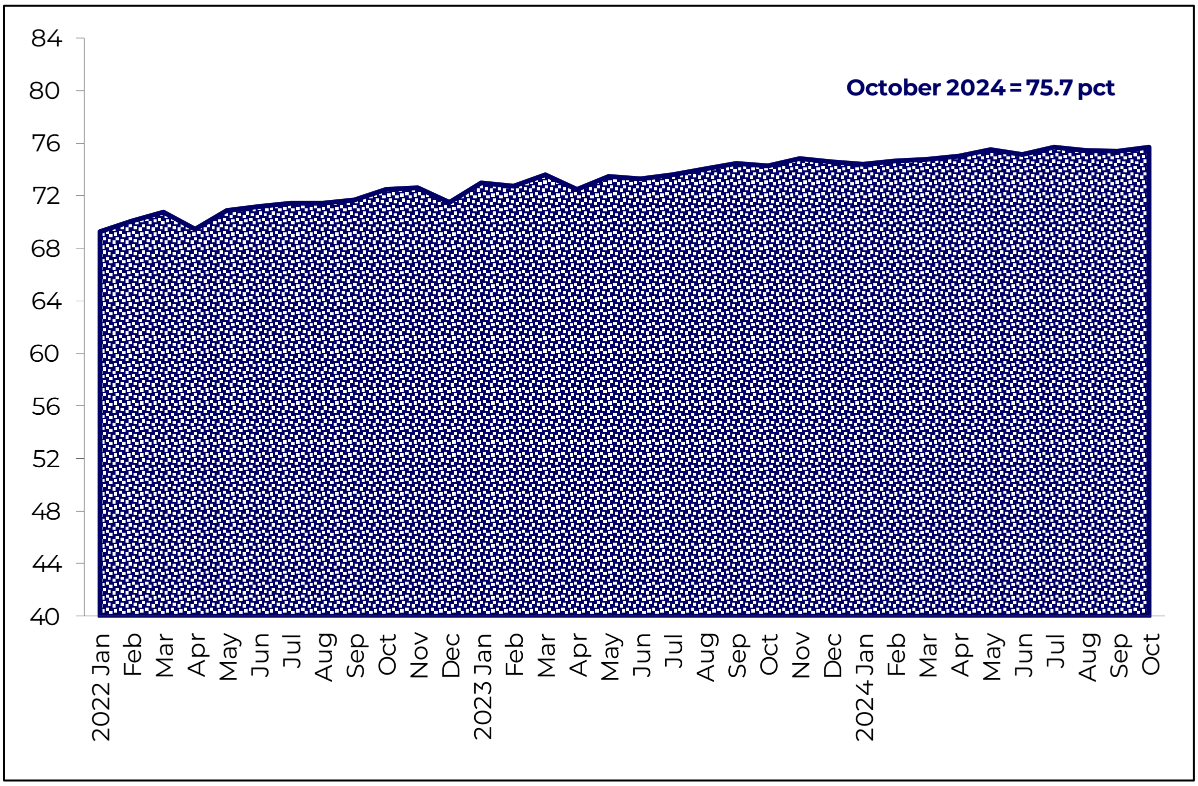



Source: Philippine Statistics Authority

**Domestic demand continues to support output growth.** Based on the Philippine Statistics Authority's (PSA) Monthly Integrated Survey of Selected Industries, the preliminary average capacity utilization rate of the manufacturing sector rose in October 2024.

This increase may suggest higher total output produced by firms amid strong demand. However, an increase in capacity utilization may also be attributed to a decline in the maximum rated capacity of establishments (i.e., largest volume of output possible at which the factory can operate with an acceptable degree of efficiency), taking into consideration unavoidable productive time[10] losses and raw material availability.

Figure 2
**Monthly Average of Capacity Utilization for Manufacturing**
2018=100
in percent




Source: Philippine Statistics Authority

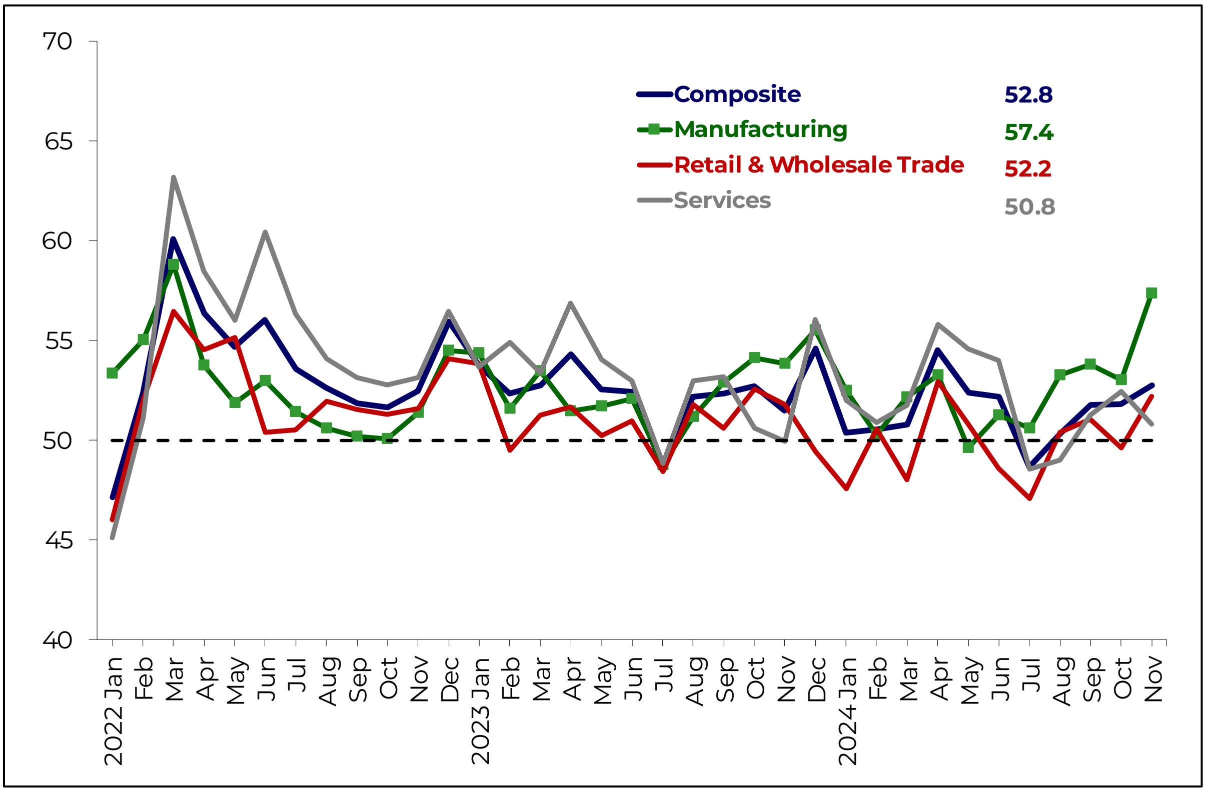
Of the 575 establishments surveyed by the PSA, 55.4 percent operated at or above the 80.0 percent capacity level, an increase from 51.8 percent in September 2024.[11] This points to improved domestic demand conditions.

[10] i.e., due to vacations, holidays, equipment repairs

[11] Monitoring the response rate helps BSP assess the reported data's quality and representativeness. The response rate of surveyed establishments increased from 58.0 percent (preliminary) in September 2024 to 60.2 percent (preliminary) in October 2024. The revised response rate for September 2024 was 72.8 percent.

**Purchasing managers' index.** The preliminary composite purchasing managers' index[12] for November 2024 rose to a seven-month high. Looking ahead, business managers expect firm economic conditions until the end of 2024, supported by improving consumer confidence during the holiday season.

Figure 3
**Purchasing Managers' Index Diffusion Index**




Source: Philippine Institute of Supply Management

**Labor market conditions.** The unemployment rate increased by 3.9 percent in October 2024. Nonetheless, it remained lower than last year's 4.2 percent and the 10-year average of 4.9 percent, indicating improving labor market conditions. The underemployment rate also rose by 12.6 percent but remained lower than the 10-year average rate of 14.5 percent.

**Bank lending.** Bank lending continued to expand, supported by strong demand from households and businesses. Preliminary data showed that outstanding loans of universal and commercial banks, net of RRP placements with BSP, grew at a slightly slower pace year-on-year in October 2024.

[12] A composite indicator of local manufacturing sector's performance

Figure 4
**Outstanding Loans of Commercial Banks**
year-on-year; growth rate in percent


Source: Bangko Sentral ng Pilipinas

Outstanding loans to residents, net of RRPs, decelerated slightly in October 2024. In contrast, outstanding loans to non-residents rose.[13]

Loans for production activities increased, driven by loans to key industries, such as real estate, wholesale and retail trade, repair of motor vehicles and motorcycles, and manufacturing.

Meanwhile, consumer loans grew at a slightly faster rate, mainly due to higher credit card and motor vehicle loans.

[13] Outstanding loans to non-residents include loans extended by U/KBs through their foreign currency deposit units.

The *Monetary Policy Report* is published four times a year by the Bangko Sentral ng Pilipinas (BSP). The report is available as a complete document in PDF format, together with other general information about inflation targeting and the monetary policy of the BSP, on the BSP's website:

***https://www.bsp.gov.ph/SitePages/PriceStability/PriceStability.aspx***

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BSP also welcomes feedback from readers on the content of the *Monetary Policy Report* as well as suggestions on how to improve its presentation. Please send comments and suggestions to the following:

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