Economic outlook

I. Baseline forecasts

Inflation is estimated to settle within the 2.0–4.0 percent target range over the policy horizon. Inflation will likely decline in August and September 2024 due to negative base effects from the previous year's uptick in global oil and rice prices. Lower rice tariffs, the gradual arrival of rice imports, and a downtrend in global commodity prices will also contribute to the deceleration.

The higher inflation in July 2024 was largely temporary. As expected, inflation in July accelerated due to higher electricity rates, fuel prices, and school fees, following the start of the academic year. Inflation is expected to revert to the target range, beginning in August, due to lower rice prices and negative base effects. This forecast already considers the impact of electricity rate adjustments and the temporary rise in commodity prices from Typhoon Carina. In the meantime, core inflation has been declining since March 2023. Core inflation is the part of inflation that is most closely influenced by monetary policy.

Favorable global supply factors support the inflation downtrend from Q4 2024 to 2025. Global oil prices remain in backwardation (i.e., when current prices are higher than futures prices). At the same time, global non-oil prices could decelerate, with global growth remaining below historical averages. Meanwhile, robust domestic demand is seen to contribute positively to the inflation path.

Compared with the baseline forecasts cited in the previous MPR, the latest baseline forecasts are lower for 2024 and 2025, owing to the tariff reduction on rice imports, lower-than-expected inflation print in Q2 2024 and lower global crude oil price assumptions. The impact of these factors was partly offset by higher assumptions for global non-oil prices and minimum wage adjustments.

Table 1
BSP Average Baseline Inflation Projections
in percent

	May 2024 Monetary Policy Report[a]	August 2024 Monetary Policy Report[b]
2024	3.5	3.4
2025	3.3	3.1
2026	–	3.2

Source: Bangko Sentral ng Pilipinas estimates

[a] Baseline forecasts from the 16 May 2024 monetary policy meeting
[b] Baseline forecasts from the 15 August 2024 monetary policy meeting

The outlook on domestic economic activity remains firm. The latest baseline forecasts suggest that economic growth could settle within the DBCC's target of 6.0–7.0 percent for 2024. However, it could fall below the 6.5–7.5 percent and 6.5–8.0 percent targets for 2025 and 2026, respectively.[4] Growth prospects are relatively

[4] Based on the 188th DBCC meeting on 27 June 2024

stable for the rest of the year, driven by robust construction spending and the timely implementation and expanded coverage of various government programs.

The economy is on track to grow near potential. The overall balance of demand and supply conditions, as captured by the output gap or the difference between actual and potential output, indicates limited demand-based inflation pressures over the policy horizon.

Estimates from the BSP's Policy Analysis Model for the Philippines (PAMPh)[5] indicate that the output gap will remain slightly negative in 2024 and 2025 but will close in 2026. Higher consumption, driven by higher real wages and stable overseas Filipino (OF) remittances, could offset the negative impact of previous policy interest rate adjustments on demand. This will bring domestic output closer to its potential over the policy horizon. Meanwhile, improvements in labor market conditions and continued investment growth could sustain potential output. Productivity growth is also expected to improve further due to robust economic activity and stable infrastructure spending. Moreover, key reforms could shore up investments and business activity, and help accelerate the country's potential output.

The exchange rate outlook over the policy horizon remains within the DBCC's assumptions of ₱56.00–₱58.00/US$1 for 2024 and ₱55.00–₱58.00/US$1 for 2025 and 2026.[6] The exchange rate is projected to appreciate over the policy horizon, with the expected seasonal OF remittance inflows during the holiday season. This is despite an assumed wider policy rate differential against the United States (US). The forecasts consider a 100-basis point (bp) reduction in the US federal funds rate in 2024 and a further 125-bp rate cut in 2025 in line with market expectations.

II. Key forecast assumptions

External factors

World gross domestic product growth. Global growth is expected to remain stable in 2024 and 2025, based on the International Monetary Fund (IMF)'s July 2024 World Economic Outlook (WEO) Update. The US economy is expected to slow down due to fiscal tightening and a softening labor market. Meanwhile, the recovery in the eurozone, backed by growth in the services and manufacturing subsectors, is expected to continue, as higher real disposable incomes drive private consumption. Investment demand is also projected to improve, with easing financial conditions amid gradual monetary policy accommodation.

Growth prospects for China have improved, following stronger private consumption and exports. Additionally, the Japanese economy is seen to rebound, as consumption spending strengthens on improved optimism among local consumers.

[5] The PAMPh is a monetary policy model for a small open economy like the Philippines. It is a semi-structural gap model based on New Keynesian foundations, with a general equilibrium framework and forward-looking features that allow for the assessment of the dynamic path of key macroeconomic variables in a theoretically consistent manner. The BSP is currently undergoing a multi-year technical assistance mission with the IMF's Institute for Capacity Development to further improve the structural features and performance of the PAMPh, making it the BSP's workhorse model for medium-term forecasting and policy analysis.
[6] Based on the 188th DBCC meeting on 27 June 2024

The risks to the global growth outlook remain broadly balanced, with emerging near-term risks stemming from persistent inflation and geopolitical concerns. Upside risks continue to emanate from short-term fiscal impulses from election spending in major economies in 2024 and faster-than-expected monetary policy easing.

Table 2
World Gross Domestic Product Growth
in percent

	May 2024 Monetary Policy Report	August 2024 Monetary Policy Report
2024	3.2	3.2
2025	3.2	3.3

Sources: World Economic Outlook (WEO) Update (International Monetary Fund [IMF], July 2024); WEO Update (IMF, April 2024)

Dubai crude oil prices. Global crude oil prices are set according to oil futures market data for the period 25 July 2024 to 7 August 2024. Domestic oil market prices, in turn, are assumed to broadly track the downward trend in world oil prices.

Table 3
Dubai Crude Oil Price Assumptions
average; in US$ per barrel

	May 2024 Monetary Policy Report	August 2024 Monetary Policy Report
2024	83.69	80.70
2025	79.11	74.13
2026	–	71.36

Sources: Bloomberg; Bangko Sentral ng Pilipinas estimates

Assumptions for global crude oil prices are lower compared with the previous round. Spot prices declined during the last week of July 2024, partly due to signs of slowing global oil demand growth, particularly in China. The US Energy Information Administration still expects that the recent round of production cuts by the Organization of the Petroleum Exporting Countries (OPEC)+ will reduce global oil inventories over the next three quarters and partly offset the slowdown in demand. Supply conditions are anticipated to return to moderate inventory levels in H2 2025, following the expiration of voluntary OPEC+ supply cuts in Q4 2024 and as production growth outside OPEC+ begins to outweigh global demand growth.

To determine the impact of potential world oil price outcomes on the inflation forecasts for 2024–2026, scenarios ranging from US$80 to US$130 per barrel were simulated. The scenarios assume oil prices will remain at these levels starting September 2024. Keeping all else constant, inflation could breach the 2.0–4.0 percent target range if Dubai crude oil prices average above US$90 per barrel in 2025 and above US$100 per barrel in 2026. These oil price scenarios consider only direct effects and do not incorporate potential second-round effects on transport fares, food prices, and wage increases, among others.

Table 4
Impact of Alternative Dubai Crude Oil Price Scenarios on Inflation
in percentage points

Year	2024	2025	2026
Baseline inflation forecast (US$)	3.4	3.1	3.2
80	3.4	3.3	3.5
90	3.5	3.9	3.7
100	3.5	4.3	3.9
110	3.6	4.7	4.1
120	3.6	5.1	4.2
130	3.6	5.5	4.3

Source: Bangko Sentral ng Pilipinas estimates

World non-oil prices. Global non-oil commodity prices are assumed to ease over the policy horizon, based on the IMF's July 2024 WEO Update. The emergence of *La Niña,* which causes wetter conditions favorable for agricultural production, could alleviate price pressures on food commodities. Nonetheless, non-oil prices are higher compared with the previous round. Price pressures may also emanate from renewed trade or geopolitical tensions. Disruptions in the Red Sea due to the Middle East conflict could further increase near-term risks to inflation by raising the cost of imported goods along the supply chain.

Table 5
World Non-Oil Price Inflation
in percent

	May 2024 Monetary Policy Report	August 2024 Monetary Policy Report
2024	0.1	5.0
2025	-0.4	1.6
2026	–	0.4

Sources: World Economic Outlook (WEO) Update (International Monetary Fund [IMF], July 2024); WEO (IMF, April 2024)

Federal funds rate. The latest federal funds rate assumptions are based on the futures prices as of 7 August 2024. The current futures path aligns with market expectations for 2024 of a 50-bp cut in September, followed by a 25-bp cut each in November and December. In 2025, the market anticipates the federal funds rate declining further by 125 bps. Meanwhile, no additional rate reductions have been assumed for 2026 yet. This assumed path came after the US unemployment rate recorded a near three-year high in July 2024 amid a significant slowdown in hiring, growing fears of a weaker labor market, and a potential recession in the US.

Table 6
Federal Funds Rate
end-period; in percent

	May 2024 Monetary Policy Report	August 2024 Monetary Policy Report
2024	4.9	4.4
2025	4.2	3.2
2026	–	3.2

Source: Bloomberg

Domestic factors

Target reverse repurchase rate and reserve requirement ratio. The forecast path assumes no adjustments in both the policy interest rate and the reserve requirement ratio (RRR) over the policy horizon. The target RRP rate and the RRR are kept at 6.5 percent and 9.5 percent, respectively, from August 2024 until the end of 2026.

Wages. The baseline forecast reflected the actual minimum wage hike for the National Capital Region in July 2024. It also considered increases of 5.0 percent each for 2025 and 2026 in line with historical wage adjustments.

Fiscal sector. The baseline inflation forecasts are consistent with the government's fiscal deficit assumption, based on the medium-term fiscal program set by the DBCC as of 27 June 2024.

Table 7
Fiscal Deficit Assumption
in percent

	May 2024 Monetary Policy Report	August 2024 Monetary Policy Report
2024	5.6	5.6
2025	5.2	5.3
2026	–	4.7

Source: Department of Budget and Management

Alcoholic drinks. The baseline forecasts reflected the impact of annual adjustments in the prices of alcoholic beverages (0.7 percent of the CPI basket) in line with Republic Act No. 11467. Higher excise taxes for fermented liquor, wine, and distilled spirits are being implemented on a staggered basis from 2020 to 2024 and shall increase by 6.0 percent yearly from 2025 onward.

Tobacco products. Under Republic Act No. 11346, the excise tax on tobacco products (0.9 percent of the CPI basket) was increased further to fund the Universal Healthcare Act. Under the law, the tax per pack of cigarettes will be raised on a staggered basis to ₱60.00 per pack in 2023, with a 5.0-percent annual indexation thereafter.

Table 8
Excise Tax

<table>
<tr><th rowspan="2">Year</th><th rowspan="2">Cigarettes
(₱ per pack)</th><th rowspan="2">Fermented liquor
(₱ per liter)</th><th rowspan="2">Wine
(₱ per liter)</th><th colspan="2">Distilled spirits</th></tr>
<tr><th>Excise tax
(₱ per liter)</th><th>Ad valorem tax
(%)</th></tr>
<tr><td>2024</td><td rowspan="2">5.0% indexation</td><td>43.00</td><td>63.10</td><td>66.00</td><td>22.0%</td></tr>
<tr><td>2025 onward</td><td>–</td><td>6.0% indexation</td><td>–</td><td>22.0%</td></tr>
</table>

Sources: Republic Act Nos. 11346 and 11467

Water rates. The Metropolitan Waterworks and Sewerage System approved the rate hike requests of the Manila Water Company and Maynilad Water Services for 2023–2027. The water rate rebasing process is conducted every five years to set the rates for water and sewerage services. This allows water concessionaires to recover operating, capital, maintenance, and investment expenditures.

Electricity rates. Electricity rates in areas serviced by the Manila Electric Company (Meralco) and other major distributors are expected to increase until September 2024. This follows the Energy Regulatory Commission's (ERC) decision to stagger the collection of charges from the May 2024 Wholesale Electricity Spot Market (WESM) purchases into four equal monthly installments starting in June 2024. As a result, Meralco's electricity rates for a typical household will increase by ₱0.03 per kilowatt-hour (kWh) from ₱11.60 per kWh in July to ₱11.63 per kWh in August.

Lower tariff on rice imports. The President signed on 20 June 2024 Executive Order No. 62, which reduced the tariff on rice from 35.0 percent to 15.0 percent, to help lower the price of imported rice. NEDA also announced the approval of the new Comprehensive Tariff Program for 2024–2028, which reduces tariffs on other essential items in the energy and manufacturing sectors and retains the prevailing low rates on key agricultural products. The baseline inflation forecast accounted for the direct impact of lower imported rice prices.

Headline inflation is expected to ease in 2024 and 2025. with the impact of lower imported rice prices peaking by January 2025 and stabilizing until July 2025. Lower tariff rates on rice imports may reduce upward pressures on the landed costs of rice, thereby pulling down domestic wholesale and retail prices.

III. Risks to the outlook

The balance of risks to the inflation outlook now leans toward the downside for 2024 and 2025, with a slight tilt toward the upside for 2026. After incorporating the estimated impact of the risks at their assigned probabilities, inflation is still projected to remain within the target range.

The potential spillover to domestic rice prices of the reduction in the tariff on imported rice is the primary downside risk to the outlook. Meanwhile, upside risks could emanate from higher electricity rates. Additionally, higher global oil and food prices as well as peso depreciation could result from possible worsening of geopolitical risks.

Table 9
Baseline and Risk-Adjusted Projections
in percent

		May 2024 Monetary Policy Report	August 2024 Monetary Policy Report
Baseline inflation Forecast	**2024**	3.5	3.4
	2025	3.3	3.1
	2026	–	3.2
Risk-adjusted inflation forecast	**2024**	3.8	3.3
	2025	3.7	2.9
	2026	–	3.3

Source: Bangko Sentral ng Pilipinas

The latest RAFs for 2024 and 2025 are lower compared with the estimates in the previous round. These were driven by downward revisions in the baseline forecasts and the estimated impact of identified risks. The inclusion of possible spillovers from the rice tariff reduction, the removal of higher global oil prices, and the adjustments in the assumed implementation of higher transport fares and staggered collection of higher electricity rates led to a negative total risk estimate.

Table 10
Risk Matrix[7]

	Risks	Probability
Upside risks	Higher transport charges	Medium
	Higher electricity rates	High
Downside risk	Spillover from rice tariff reduction	2024: High 2025: Medium

Source: Bangko Sentral ng Pilipinas

Higher jeepney, train, and taxi fares pose upside risks to inflation. On 8 October 2023, the Land Transportation Franchising and Regulatory Board (LTFRB) approved a ₱1.00 provisional increase in the minimum jeepney fare for both traditional and modern jeepneys. As the petition requested a ₱5.00 increase, the alternative scenario assumes that the remaining ₱4.00 will be approved. Moreover, the Alliance of Transport Operators and Drivers Association of the Philippines filed a petition to increase the minimum fare for traditional jeepneys to ₱15.00. The scenario assumes implementation by Q3 2024. A low probability is assigned to this risk, given the downtrend in oil prices and the absence of follow-up on the petitions.

In December 2023, the Metro Rail Transit Line 3 management filed a petition with the Department of Transportation to raise its minimum fare from ₱13.00 to ₱16.00.

[7] The BSP considers different scenarios to determine both the upside and downside risks to the inflation outlook, which are presented in a risk matrix. The scenarios have assigned probability values. Scenarios with more than 75.0 percent probability of taking place over the forecast horizon are included in the baseline. The estimated impact of each scenario is then multiplied by its assigned probability. The sum of the weighted impact for each year will indicate whether the risks to the outlook are balanced, on the upside, or on the downside.

With the proposed fare hike still under review, the alternative scenario assumes implementation by Q3 2024. A high probability is assigned to this risk, following the adjustments in the Light Rail Transit (LRT) Line 1 and LRT Line 2 fares in 2023.

For regular taxis, the LTFRB approved an increase in the flag-down rate to ₱50.00 nationwide. As the LTFRB has yet to announce the hike and post the new rates, the alternative scenario assumes implementation of the increase by Q3 2024. A high probability is assigned to this risk due to the approval of the motion.

Table 11

Transport Fare Adjustments

Transport sector	Current base fare (₱)	Proposed adjustment(₱)	Probability
Public utility jeepney	13.00	17.00	Low
Metro Rail Transit Line 3	13.00	16.00	High
Taxi (flag-down rate)			
Cordillera Administrative Region	40.00	50.00	High
Other regions	45.00	50.00	

Source: Department of Transportation–Land Transportation Franchising and Regulatory Board

An overall medium probability is assigned to the risk of higher transport charges based on the CPI weights of the items considered.

Electricity rates could increase over the forecast horizon. In July 2023, the Supreme Court (SC) nullified the ERC's 2014 decision to cap WESM prices from November 2013 to December 2013. The ERC's decision aimed to address the higher prices during the maintenance shutdown of the Malampaya gas field. This risk scenario assumes that power generation costs will be passed on to consumers, with the adjustment spread equally over the next five years starting in September 2024.

A high probability is assigned to this risk in view of the expected order from the ERC to authorize the collection of said power generation costs, following the SC's decision.

Tariff reduction on rice imports could lead to lower prices of domestically produced rice. The lower tariff is expected to reduce upward pressure on domestic rice prices with higher import volumes, as observed after the passage of the Rice Tariffication Law (RTL). Before the RTL, rice imports accounted for 6.2 percent of total domestic supply from 2015 to 2017. With the RTL, imported rice rose to an average of 16.7 percent of domestic supply from 2019 to 2022.

The probability assigned to this risk is high for 2024 and medium for 2025, with the formalization of the reduced tariff through Exec. Ord. No. 62. The scenario assumes that the price of the remaining 79.2-percent share of the total rice supply, produced domestically, will decline by ₱6.67 per kilogram based on the reduction in the landed cost of imported rice.

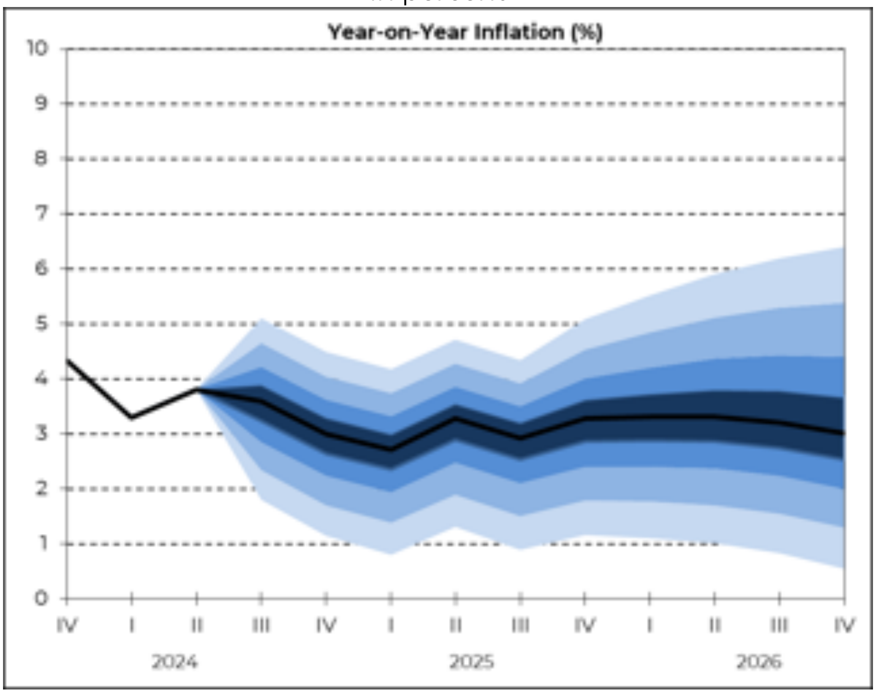
The balance of risks to the inflation outlook is tilted toward the downside for 2024 and 2025, with a slight tilt toward the upside for 2026. Using a 90.0-percent confidence interval for the fan chart, estimates indicate a high probability of average annual inflation settling within 3.0 percent ± 1.0 pp over the policy horizon. The latest probability distribution shows a significantly lower likelihood of inflation breaching the target for 2024 and 2025. Similarly, the probability of inflation breaching the low end of the target range over the policy horizon remains low.

Table 12
Probability Distribution of Inflation Forecasts
in percent

	Pr(<2%)		Pr(2–4%)		Pr(>4%)	
	May 2024 MPR	August 2024 MPR	May 2024 MPR	August 2024 MPR	May 2024 MPR	August 2024 MPR
2024	5.0	1.3	46.8	91.4	48.2	7.3
2025	10.5	21.7	48.0	58.5	41.5	19.8
2026	–	17.1	–	52.3	–	30.6

Source: Bangko Sentral ng Pilipinas estimates

Figure 1
Inflation Projection
in percent



Source: Bangko Sentral ng Pilipinas estimates

Table 13
Inflation Projection Ranges at Various Confidence Intervals Using Fan Chart
in percent

Confidence interval (%)	Projection range (%)		
	2024	2025	2026
80	2.6–4.0	1.5–4.2	1.4–5.7
90	2.5–4.1	1.0–4.6	0.9–6.0

Source: Bangko Sentral ng Pilipinas estimates

Box Article 1:
Monetary Policy Developments

On 27 June 2024, the Bangko Sentral ng Pilipinas (BSP) maintained the target reverse repurchase (RRP) rate at 6.5 percent. The interest rates on the overnight deposit and lending facilities also remained at 6.0 percent and 7.0 percent, respectively.

The baseline inflation forecasts during the June 2024 monetary policy meeting were slightly lower relative to the May 2024 *Monetary Policy Report*. The balance of risks to the inflation outlook shifted toward the downside for 2024 and 2025, largely due to the impact of lower import tariffs on rice under Executive Order No. 62 dated 20 June 2024. Consequently, the risk-adjusted inflation forecasts declined for both 2024 and 2025.

		May 2024 Monetary Policy Report[a]	**June 2024 Monetary Policy Meeting**[b]
Baseline inflation forecast	**2024**	3.5	3.3
	2025	3.3	3.2
Risk-adjusted inflation forecast	**2024**	3.8	3.2
	2025	3.7	3.1

Source: Bangko Sentral ng Pilipinas estimates

[a] Forecasts from the 16 May 2024 monetary policy meeting (*Monetary Policy Report* round)
[b] Forecasts from the 26 June 2024 monetary policy meeting

During the policy meeting in June, inflation was seen to move closer to the midpoint of the 2.0–4.0 percent target range. Inflation expectations also remained well-anchored. Nonetheless, higher prices of food items other than rice, transport charges, and electricity rates continued to pose upside risks to inflation. Meanwhile, prospects for domestic output growth remained aligned with medium-term trends amid favorable labor market conditions and strong net exports.

On balance, the BSP deemed it appropriate to hold monetary policy settings steady. Price pressures were anticipated to ease further in the second half of the year, with the implementation of Exec. Ord. No. 62 and Administrative Order No. 20 dated 18 April 2024. Moreover, a sustained easing in price pressures would allow more scope for the BSP to consider a less restrictive monetary policy stance going forward. However, uncertainty in the external environment called for caution against potential spillovers, including those in the financial markets.