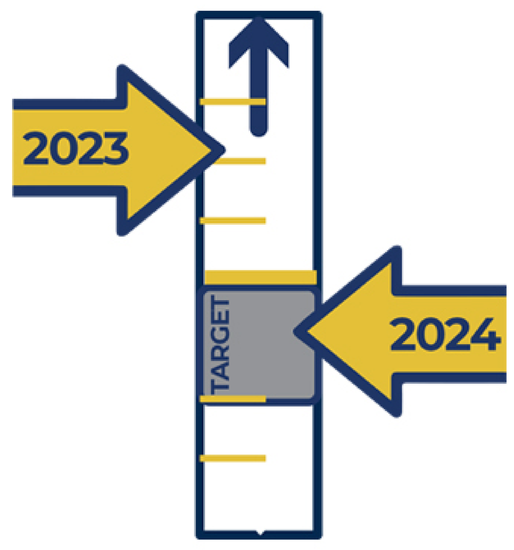
MONETARY POLICY REPORT

FEBRUARY 2023

Visual Summary

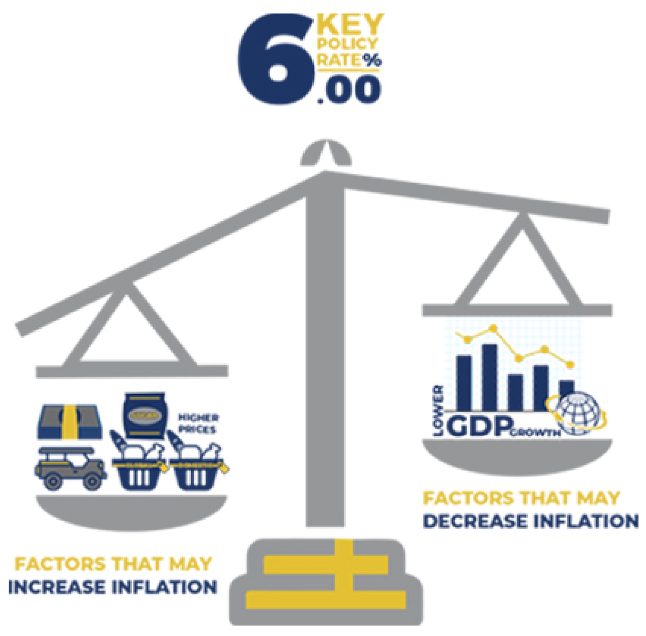
In summary:

The BSP raised the key policy rate to 6.0 from 5.5 percent. Authorities believe higher interest rates are needed to reduce the risk that inflation in 2024 will be higher than the target range of 2.0-4.0 percent.



Based on the BSP's latest estimates, average inflation could reach 6.1 percent in 2023. This is higher than the target range of 2.0 to 4.0 percent.

For 2024, average inflation could return to within-target range at 3.1 percent.



In the latest assessment of the BSP, inflation is more likely to end up higher than the forecast rather than below it.

Factors that could cause inflation to exceed the BSP's latest forecast for 2023 and 2024 include the impact of global food market uncertainties, continued domestic shortages of key food items, additional transport fare hikes amid elevated oil prices, and the possible higher-than-expected wage adjustments in 2023.

On the other hand, weaker-than-expected global economic recovery is the main downside risk to inflation.

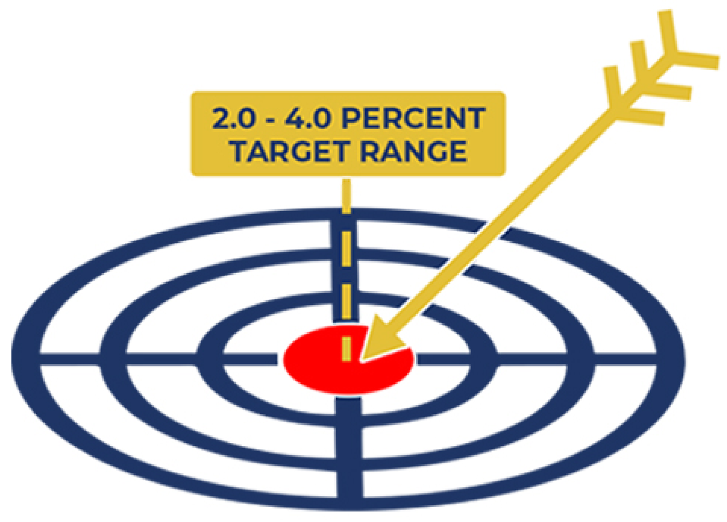
Results of the BSP's survey conducted in February 2023 showed that private sector economists expect inflation to reach 6.0 percent in 2023, 4.0 percent in 2024, and 4.1 percent in 2025.

The respondents cited the elevated inflation in January 2023, rising demand for goods and services, and supply shocks as factors behind their forecasts.

Domestic demand has already recovered above pre-pandemic levels and is partly driving higher inflation.

Economic growth is projected to settle within the government's target range of 6.0 to 7.0 percent for 2023.

Meanwhile, economic headwinds could result in slower GDP growth in 2024.



The BSP remains firmly committed to bring inflation back to the 2.0-4.0 percent target range over the medium term and is ready to raise interest rates further, if needed.

The BSP also strongly supports the government's timely measures to address persistent supply shortages, especially on food items.

The BSP decided to raise the key policy interest rate to 6.0 percent.

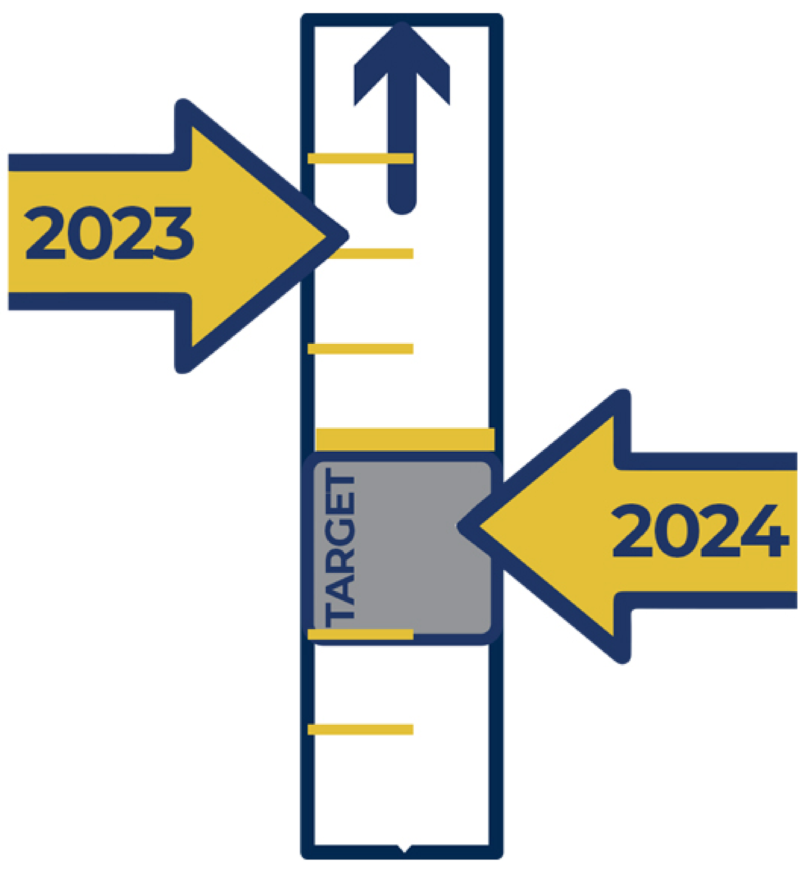
During its monetary policy meeting on 16 February 2023, the BSP's Monetary Board decided to raise the key policy interest rate by 50 basis points (or half a percentage point) to 6.0 from 5.5 percent, effective 17 February 2023.

The upward adjustment in the policy interest rate will help anchor inflation expectations and avoid a breach in the inflation target range in 2024.

The higher policy rate means that banks' interest rate may also rise, which will make it more expensive for households and businesses to borrow. In effect, demand for goods and services, and therefore economic activity, may slow down.

Slower economic activity will lead to expectations of lower inflation in the future; thus, businesses will be less inclined to increase prices for goods and services, and people will not be likely to ask for higher wages.

Inflation outlook leans upward for 2023 and 2024.



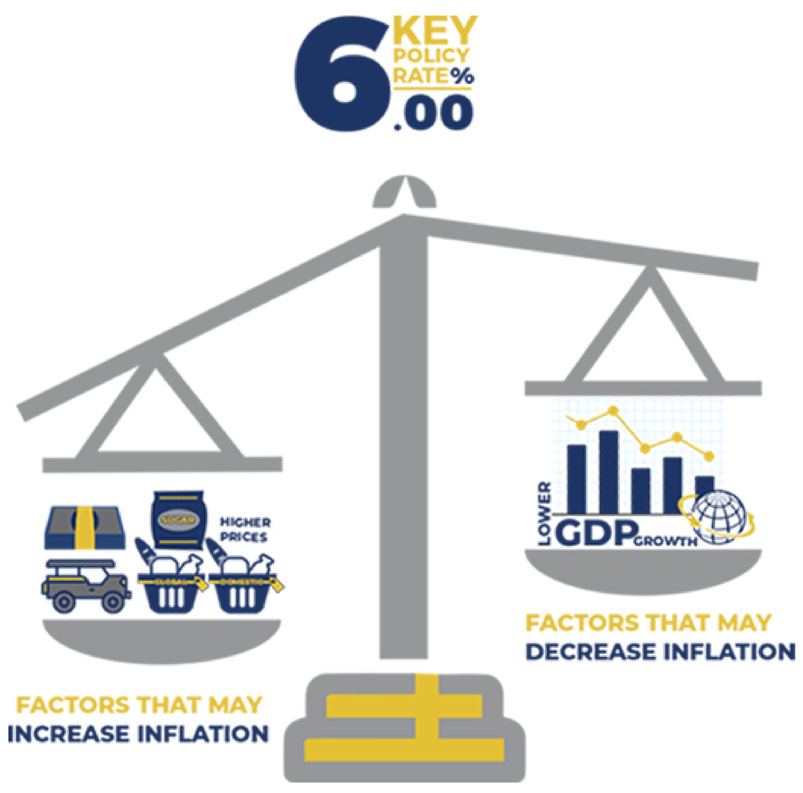
The BSP's latest estimates show that inflation will remain elevated in the coming months to average at 6.1 percent in 2023 before easing to 3.1 percent in 2024.

The latest inflation forecast for 2023 is higher than the 4.5 percent announced in December last year. The updated forecast for next year is also higher than the 2.8 percent announced previously.

The higher inflation forecast for 2023 is due to the following: higher-than-expected actual inflation; elevated prices of food, utilities, and transport; and subsequent upward adjustments on rent and restaurant prices. The upward adjustment also reflects the faster GDP growth outlook for 2023.

Nevertheless, inflation is projected to decelerate close to the low end of the target range by January 2024 due to the likely decline in global oil and non-oil prices as well as "base effects" (a higher inflation rate today is typically, but not always, followed by a relatively lower rate a year from now).

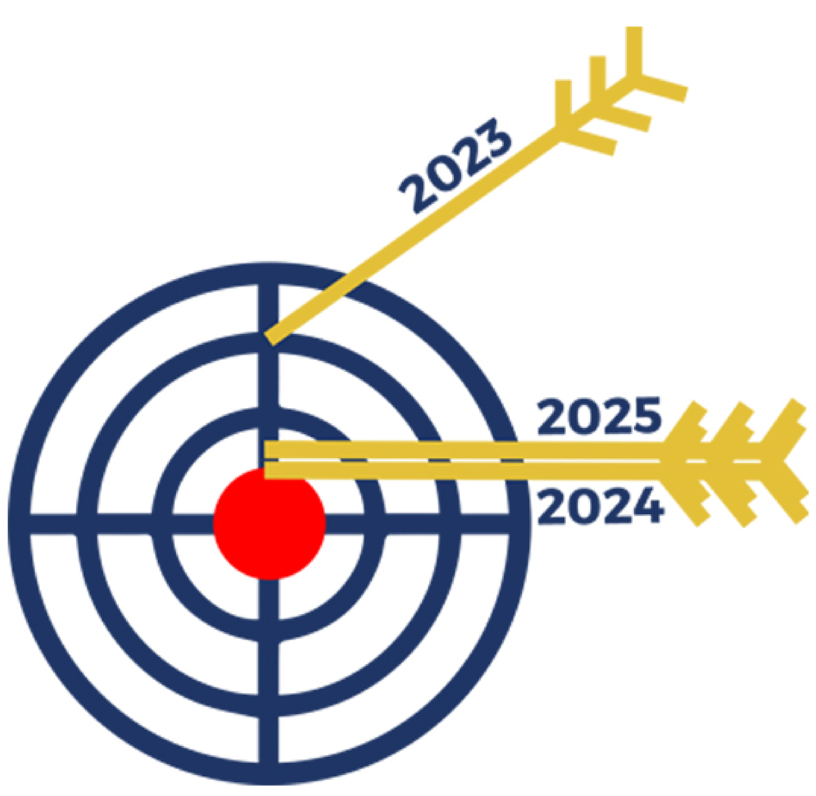
Several factors could push inflation higher in 2023 and 2024.



Factors that could cause inflation to exceed the latest forecasts for 2023 and 2024 include the potential impact of uncertainties in the global food market, increased domestic prices of key food items facing supply constraints, additional transport fare hikes due to elevated oil prices, and higher-than-expected wage adjustments in 2023.

On the other hand, the impact of a weaker-than-expected global recovery is the main downside risk to inflation this year and the next.

Inflation expectations from private sector economists further increased.



Results of the BSP's survey of private-sector economists held in February 2023 showed that they expect inflation to reach 6.0 percent this year, higher than the 4.9 percent recorded in last month's survey round.

Similarly, the inflation forecast of private-sector economists for 2024 rose to 4.0 percent from 3.7 percent previously, while the forecast for 2025 increased to 4.1 percent from 3.6 percent.

Analysts expect inflation to remain above the upper end of the government's target range in 2023 given the higher-than-expected January 2023 inflation, higher demand for goods and services, as well as supply shortages.

Domestic economic activity maintains momentum.

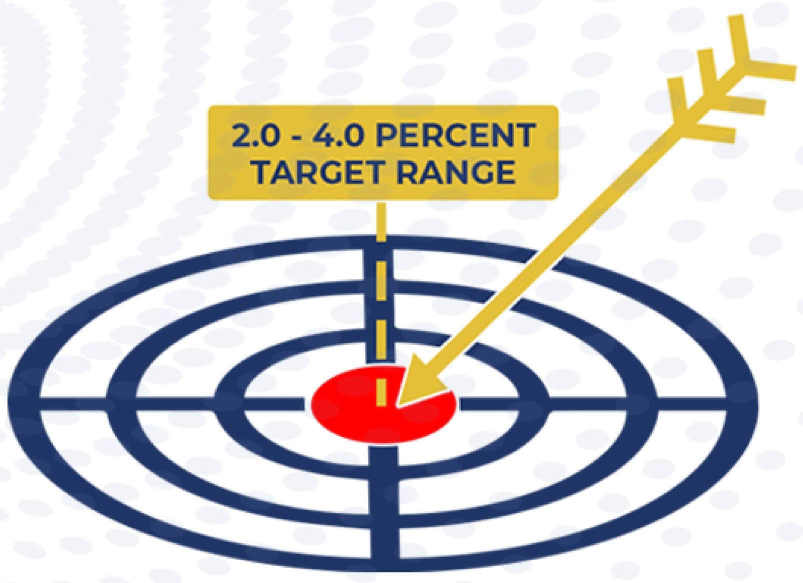
The economy grew by 7.6 percent in 2022, outperforming the government's target of 6.5 to 7.5 percent.

On the demand side, household consumption and investments moderated to a growth of 7.0 percent and 5.9 percent, respectively, compared with the previous year's expansion, while government spending increased by a faster rate of 3.3 percent.

On the production side, the services sector grew strongly by 9.8 percent, the industry sector moderated to growth of 4.8 percent, while the agriculture sector contracted slightly.

The BSP's growth forecasts indicate continued expansion in the near term driven by growth in the industry sector as the economy reopens further. Growth in the services sector is also evident with the improved labor market conditions, increased tourism demand, and resumption of face-to-face classes.

In line with its primary mandate of price stability, the BSP is taking the necessary policy action to bring inflation back to within the 2.0- to 4.0-percent target range for the medium term set by the government.



Inflation is projected to remain elevated in the coming months due to a combination of persistent supply constraints and emerging demand-side pressures. The BSP's latest move to raise its key policy rate anew by 50 basis points is meant to reduce the risk of a breach of the inflation target in 2024 and to prevent inflation expectations from drifting further away from the target band of 2.0 to 4.0 percent.

The main priority of the BSP is to bring inflation back to target, and we remain prepared to take all further action necessary to achieve this. Decisions to further raise interest rates going forward will depend on new data and how it affects our projections for future inflation and GDP growth.

The BSP also continues to reiterate its support for timely and more aggressive whole-of-government actions to mitigate the impact of persistent supply-side pressures on food prices, including measures to increase imports of key commodities and boost domestic food production.

The BSP raised its key policy interest rate to 6.0 percent...

This means...

Banks are expected to eventually increase their own lending rates, making borrowing more costly for everyone. However, if the BSP does not act now, inflation will remain higher for a longer period of time which will be worse for everyone.

View the full 2023 February Monetary Policy Report
https://www.bsp.gov.ph/SitePages/PriceStability/FullReportMPR/MonetaryPolicyReport_Feb2023.aspx