MONETARY POLICY REPORT

AUGUST 2023

Foreword

The primary objective of monetary policy is to promote a low and stable rate of inflation conducive to a balanced and sustainable economic growth. The adoption in January 2002 of the inflation targeting framework for monetary policy sought to help fulfill this objective.

One of the key features of inflation targeting is greater transparency, which means greater disclosure and communication by the Bangko Sentral ng Pilipinas (BSP) of its policy actions and decisions. The *Monetary Policy Report* or MPR plays a primary part in the BSP's transparency mechanisms under inflation targeting. It shares with stakeholders, including market counterparties, the latest assessment of the stance of monetary policy based on an analysis of economic and financial prospects. The broad aim is to contribute to making monetary policy accessible to the public, who through the report may better understand and monitor the BSP's commitment to the inflation target, promote the anchoring of inflation expectations, and encourage informed debate on monetary policy issues.

The MPR, which replaced the quarterly *Inflation Report*, is the flagship BSP publication on monetary policy that provides the public 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 to the public 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, as well as the risks and uncertainty surrounding the BSP's inflation forecasts.

The government's target for annual headline inflation under the inflation targeting framework has been retained at 3.0 percent ± 1.0 percentage point (ppt) for 2022-2024 by the Development Budget Coordination Committee. The inflation target range continues to be an appropriate quantitative representation of the medium-term goal of price stability that is aligned with the Philippines' current structure of economy and outlook of macroeconomic conditions over the next few years.

The Monetary Board approved this *Monetary Policy Report* at its meeting on 17 August 2023.

ELI M. REMOLONA, JR.
Governor

The Monetary Policy of the Bangko Sentral ng Pilipinas

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 a 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 interest rate on its overnight reverse repurchase (RRP) facility. Other instruments to implement the desired monetary policy stance to achieve the inflation target include (A) increasing/decreasing the reserve requirement (RR), (B) conducting auctions for the term deposit facility (TDF) and BSP Securities Facility,[1] (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.

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 Development Budget Coordination Committee (DBCC)[2] in consultation with the BSP. The inflation target for 2023-2026 is 3.0 percent ± 1.0 ppt.[3]

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] The TDF was introduced under the interest rate corridor (IRC) system implemented on 3 June 2016. The BSP Securities Facility was introduced on 18 September 2020 with the first issuance of the BSP 28-day bills.
[2] The DBCC, created under Executive Order No. 232 dated 14 May 1970, is an inter-agency committee tasked primarily to formulate the National Government's fiscal program. It is composed of the Office of the President (OP), Department of Budget and Management (DBM), National Economic and Development Authority (NEDA), and the Department of Finance (DOF). The BSP attends the Committee meetings as a resource agency.
[3] During the DBCC meeting on 24 April 2023, the DBCC, in consultation with the BSP, decided to retain the current inflation target of 3.0 percent ± 1.0 percentage point (ppt) for 2023–2024 and set the same inflation target for 2025–2026.

The Monetary Board

The powers and functions of the BSP, such as the conduct of monetary policy and supervision over the banking system, are exercised by its Monetary Board (MB), which has seven members appointed by the President of the Philippines. The MB holds eight monetary policy meetings in a year to review and decide on monetary policy.

Chairman and Governor
Eli M. Remolona, Jr.

Members
Benjamin E. Diokno
V. Bruce J. Tolentino
Anita Linda R. Aquino

The Advisory Committee

The Advisory Committee was established as an integral part of the institutional settin for inflation targeting. It is tasked to deliberate, discuss, and make recommendations on monetary policy to the Monetary Board. Like the MB, the Committee meets eight times a year but may also meet between regular meetings when necessary.

Chairman

Eli M. Remolona, Jr.
Governor

Members

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Deputy Governor
Monetary and Economics Sector

Chuchi G. Fonacier
Deputy Governor
Financial Supervision Sector

Eduardo G. Bobier
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Financial Markets

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Technical Support Staff Members

Monetary Policy Research Group
Economic and Financial Forecasting Group
Financial Markets Research Group
Real and External Sectors Research Group

2023 Schedule of Monetary Policy Meetings, Publication of the MB Highlights and Monetary Policy Report

Month	MB meeting	Publication of *MB Highlights*	Publication of the *Monetary Policy Report* (MPR)
January		12 (Thu) (15 December 2022 MB meeting)	
February	16 (Thu) (MB meeting no. 1)		17 (Fri) (MPR I, February 2023)
March	23 (Thu) (MB meeting no. 2)	16 (Thu) (16 February 2023 MB meeting)	
April		20 (Thu) (23 March 2023 MB meeting)	
May	18 (Thu) (MB meeting no. 3)		19 (Fri) (MPR II, May 2023)
June	22 (Thu) (MB meeting no. 4)	15 (Thu) (18 May 2023 MB meeting)	
July		20 (Thu) (22 June 2023 MB meeting)	
August	17 (Thu) (MB meeting no. 5)		18 (Fri) (MPR III, August 2023)
September	21 (Thu) (MB meeting no. 6)	14 (Thu) (17 August 2022 MB meeting)	
October		19 (Thu) (21 September 2023 MB meeting)	
November	16 (Thu) (MB meeting no. 7)		17 (Fri) (MPR IV, November 2023)
December	14 (Thu) (MB meeting no. 8)	14 (Thu) (16 November 2023 MB meeting)	

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Monetary Policy Summary

At its monetary policy meeting on 17 August 2023, the BSP decided to keep the interest rate on the overnight reverse repurchase (RRP) facility at 6.25 percent. The interest rates on the overnight deposit and lending facilities are likewise maintained at 5.75 percent and 6.75 percent, respectively.

The latest baseline inflation forecasts are higher compared to the previous round. Inflation is projected to average at 5.6 percent for 2023; 3.3 percent for 2024; and 3.4 percent for 2025. The upward adjustments in the inflation forecast path over the policy horizon were driven mainly by the significant rise in Dubai crude oil prices in recent weeks. The higher inflation nowcast over the near term, a higher-than-expected minimum wage adjustment, and the depreciation of the peso likewise contributed to the upward revision. These were partly offset by the slower GDP growth outlook and lower assumption for global non-oil prices for 2023 to 2024.

Nonetheless, the inflation path is still projected to return to the target range in Q4 2023 in the absence of further supply-side shocks. On a quarterly basis, inflation is seen to decelerate near the midpoint of the target in Q4 2023 at 3.4 percent and approach the lower end of the target in Q1 2024 at 2.4 percent. However, inflation is projected to accelerate near the upper end of the target range in Q2 to Q3 2024 at 3.6 percent and 3.7 percent, respectively, due to positive base effects, higher crude oil prices, and the lagged impact of minimum wage adjustments, before settling slightly above the midpoint of the target in 2025.

Estimated negative base effects until January 2024 will be favorable for the inflation path. This can be attributed primarily to the normalization of global commodity prices after the sharp uptick in March 2022. On the domestic front, waning impact of transport fare hikes in Q3 and Q4 2022 also contributed to negative base effects for the same period in 2023. However, base effects are estimated to turn positive from February to July 2024.

The balance of risks to the inflation forecast continues to lean toward the upside. The potential impact of additional transport charges, higher domestic prices of key food items facing ongoing supply constraints, higher-than-expected minimum wage adjustment in areas outside NCR, the impact of *El Niño* weather conditions on food prices and utility rates, and higher electricity rates are the major upside risks to the inflation outlook. Meanwhile, the impact of a weaker-than-expected global recovery is the primary downside risk to the outlook.

Inflation expectations for 2024 and 2025 have declined. The August 2023 survey of economists showed a steady mean inflation forecast for 2023 at 5.5 percent relative to the July 2023 survey round. Meanwhile, inflation expectations for 2024 and 2025 continued to settle firmly within the target band, with mean inflation forecasts declining to 3.5 percent in 2024 and 3.4 percent in 2025.

The weaker GDP outturn for Q2 2023 reflected a broad-based slowdown in domestic demand. Household consumption has slowed due to elevated commodity prices, while government spending contracted relative to the

previous year. Accordingly, the latest GDP growth forecasts were adjusted downwards for 2023 and 2024, while the forecast for 2025 was unchanged. The lower growth forecasts reflected the slower-than-expected Q2 2023 GDP growth outturn. Higher crude oil prices contributed to the slower domestic growth prospects for 2023 to 2024. These factors were partly offset by the upward adjustment in the world GDP growth outlook for 2023.

The economy is projected to operate close to potential, on average, in 2023, but the strength of economic activity is likely to moderate over the policy horizon as pent-up demand wanes and prior monetary policy tightening manifests its full impact on the economy. Latest estimates continue to indicate a broadly neutral output gap for 2023 before turning slightly negative for 2024-2025. The foreseen gradual decline in the output gap reflects the impact of prior BSP policy interest rate adjustments on consumption and investment, the likely slowdown in global growth owing in part to tightening monetary conditions across major economies, and a decline in domestic real income owing to high inflation and fiscal consolidation. Nonetheless, the output gap could be supported by the increased value of remittances amid a peso depreciation. Meanwhile, potential output is expected to sustain its recovery given the continued reopening of the economy, improvements in labor market conditions, and continued investment growth.

Based on the latest set of information, the Monetary Board deemed it appropriate to maintain monetary policy settings to allow a moderation of inflation even as authorities continue to assess the emerging risks to the inflation outlook. The downward trajectory of headline inflation and broadly anchored inflation expectations provide room for further assessment of emerging inflation risks and the strength of domestic demand going forward. However, new shocks to prices have emerged since the last monetary policy assessment. The observed increases in the prices of some key commodities, particularly rice and oil, as well the recent depreciation of the peso would require close monitoring as they could contribute to inflationary pressures. Lingering upside risks to the inflation outlook thus warrant continued vigilance against potential second-round effects that could disanchor inflation expectations.

On balance, the sustained disinflation over the past few months provides monetary authorities the scope to maintain monetary policy settings at this juncture. Nevertheless, the balance of risks to the inflation outlook leans toward the upside. This calls for increased vigilance and a steady hand on the BSP's monetary policy levers, as potential second-round effects could rekindle price pressures and dislodge inflation expectations anew.

Looking ahead, the BSP underscores its readiness to respond as necessary to safeguard the inflation target. Any shift in the monetary policy stance will be based on the evolving balance of economic information as they arrive, in keeping with the mandate to ensure price stability.

I. Economic Outlook

1. Baseline Forecasts

The latest baseline forecasts show a broadly higher path relative to the previous *Monetary Policy Report* (MPR) round. Inflation is projected to average at 5.6 percent for 2023 and 3.3 percent for 2024, higher relative to the previous round by 0.1 percentage point (ppt) and 0.5 ppt for 2023 and 2024, respectively. The upward revisions in the forecasts were driven by the significant uptick in global crude oil prices, higher inflation nowcast over the near term, higher-than-expected minimum wage adjustment, and depreciation of the peso. These were partly offset by the slower outlook for domestic economic activity and lower assumption for global non-oil prices for 2023 to 2024. Meanwhile, latest inflation forecast for 2025 is at 3.4 percent.

Nonetheless, inflation is seen to return to the target range in Q4 2023 in the absence of further supply-side shocks. On a quarterly basis, inflation is seen to decelerate near the midpoint of the target in Q4 2023 at 3.4 percent and approach the lower end of the target in Q1 2024 at 2.4 percent. However, inflation is projected to accelerate near the upper end of the target range in Q2 to Q3 2024 at 3.6 percent and 3.7 percent, respectively, due to positive base effects, higher crude oil prices, and the lagged impact of minimum wage adjustments, before settling slightly above the midpoint of the target in 2025.

Table 1. BSP Average Baseline Inflation Projections
in percent

	May 2023 MPR [a]	August 2023 MPR [b]
2023	5.5	5.6
2024	2.8	3.3
2025		3.4

Source: BSP estimates
[a] Baseline forecasts from 18 May 2023 monetary policy meeting
[b] Baseline forecasts from 17 August 2023 monetary policy meeting

Estimated negative base effects until January 2024 will be favorable for the inflation path. This can be attributed primarily to normalization of global commodity prices after the sharp uptick in March 2022 owing to Russia's invasion of Ukraine. On the domestic front, waning impact of transport fare hikes in Q3 and Q4 2022 also contributed to negative base effects for the same period in 2023. However, base effects are estimated to turn positive from February to July 2024.

The inflation path continues to be driven by supply-side factors. Key food commodities continue to face supply constraints on the domestic front, which could be exacerbated by the impact of *El Niño* weather conditions on domestic and international prices of commodities. Global oil prices have likewise risen sharply in recent weeks amid the announced production cuts of OPEC+ members.

Economic headwinds along with the impact of the cumulative monetary policy adjustments could result in GDP growth settling below the DBCC's target of 6.0-7.0 percent for 2023 and 6.5-8.0 percent for 2024 and 2025.[4] The full-year growth forecasts for 2023 and 2024 were adjusted downward from the previous MPR to reflect slower-than-expected Q2 2023 GDP growth outturn of 4.3 percent, benign global economic conditions, and higher global crude oil prices.

Nevertheless, the growth forecasts indicate continued economic expansion, albeit at a slower pace, with projected impact of the BSP's policy rate adjustments peaking in 2024. Growth in the medium term could also be supported by structural reform measures that could enhance investment climate as well economic sentiment in the country.[5] These measures include the recent ratification of the Regional Comprehensive Trade Partnership (RCEP) Agreement which is seen to support greater market access for goods and services, reduced trade barriers, and improved export competitiveness from simplified and harmonized rules.

Complementary to RCEP's ratification is the recent implementation of key economic liberalization laws such as the amendments to the Retail Trade Liberalization Act (RTLA), Foreign Investments Act (FIA), Public Service Act (PSA), and the Build-Operate-Transfer (BOT) Law.

The economy is projected to operate close to potential, on average, in 2023, but the strength of economic activity is likely to moderate over the policy horizon as pent-up demand wanes and prior monetary policy tightening manifests its full impact on the economy. Latest estimates from the BSP's Policy Analysis Model for the Philippines (PAMPh)[6] continue to indicate broadly neutral output gap, or the difference between actual and potential output, for 2023 to fall to slightly negative territory in 2024-2025. The projected gradual decline in the output gap reflects the impact of BSP policy interest rate adjustments on consumption and investment, projected slowdown in global growth owing in part to tightening monetary conditions across major economies, and a decline in real income in the domestic front owing to high inflation and fiscal consolidation. Nonetheless, the output gap could be supported by the increased value of remittances amid a peso depreciation. Meanwhile, potential output is expected to sustain its recovery given the continued reopening of the economy, improvements in labor market conditions, and continued investment growth.

Expansion in domestic liquidity (M3) will continue to support the country's funding requirement. M3 is projected to increase at a steady pace over the policy horizon, albeit at a slower rate than in previous round. The downward adjustment in the M3 growth forecasts reflects the impact of lower domestic demand over the policy horizon, partly offset by the higher domestic liquidity nowcast in Q3 2023.

[4] Based on the on the 185th Development Budget Coordination Committee (DBCC) Meeting on 9 June 2023.
[5] These measures have not been incorporated in the baseline GDP growth forecasts.
[6] 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 (TA) mission with the IMF's Institute for Capacity Development to further improve the structural features and forecasting performance of the PAMPh to serve as the BSP's workhorse model for medium-term forecasting and policy analysis.

2. Key Forecast Assumptions

External Factors

World GDP Growth. The latest global growth assumptions were based on the July IMF World Economic Outlook (WEO) Update and June 2023 GPM Network forecasts. Global growth is seen to slightly accelerate in 2023 and 2024 but remain lower compared to the pre-pandemic trend. However, uncertainty around the global growth outlook remains elevated, with the balance of risks staying on the downside as major forces that affected the global growth in 2022, such as geopolitical tensions and extreme weather-related events, could trigger further tightening in monetary policy in advanced economies.

The slightly higher global growth outlook for 2023 reflects the higher growth projection among advanced economies, particularly the US, UK, and Japan on account of resilient consumption growth in Q1 2023, a reflection of a still-tight labor market that has supported gains in real income. Meanwhile, the global growth assumption for 2024 is broadly unchanged compared to the previous round with the country's Asian trading partners seen to accelerate based on IMF WEO's projections offset by weaker growth in major advanced economies.

Table 2. World GDP Growth
in percent

	May 2023 MPR	August 2023 MPR
2023	2.8	3.0
2024	3.0	3.0
2025	n.a.	3.2

Source: WEO Update (IMF, July 2023); WEO (IMF, April 2023)

In its July 2023 WEO Update, the IMF adjusted its full-year world growth projection for 2023 by 0.2 ppt, remaining low at 3.0 percent, while the forecast is unchanged at 3.0 percent for 2024. Meanwhile, the IMF's preliminary 2025 global growth forecast remains below the pre-pandemic trend at 3.2 percent.

Dubai Crude Oil Prices. Global crude oil prices are set consistent with oil futures market data and the latest assessment by international energy agencies on the outlook for the global oil market. Developments in the domestic oil market are also assumed to broadly follow the trend in the world oil market. The Dubai crude oil assumptions in the latest round are based on the average futures path from 31 July to 9 August 2023.

Table 3. Dubai Crude Oil Price Assumptions
average, in USD per barrel

	May 2023 Monetary Policy Report	August 2023 Monetary Policy Report
2023	77.2	81.9
2024	72.7	82.3
2025	n.a.	78.0

Source: Bloomberg, BSP Estimates

Assumptions for global crude oil prices are significantly higher compared to the previous round. The sharp rise in the global crude oil price path reflects expectation of declining international oil inventories owing to the extended production cuts of OPEC+ countries announced in June and an extension of voluntary cuts through September by Saudi Arabia. Global liquid fuels consumption is also seen to increase in 2023 and 2024 with demand growth coming from non-OECD Asia, led by China and India. Likewise, the US Energy Information Administration (EIA) expects global oil inventories to transition from inventory builds in H1 2023 to consistent inventory draws until Q4 2024, putting upward pressure on global oil prices over the forecast period.

To determine the impact on the inflation forecasts for 2023 to 2025 of various outturns for world oil prices, scenarios ranging from US$60.00-US$120.00 per barrel were simulated. The scenarios assume that oil prices are sustained at these levels starting September 2023. Inflation is seen to breach the 2.0-4.0 percent target range in if Dubai crude oil price averages above US$95 per barrel in 2024 and above US$105 per barrel in 2025. It should be noted that these oil price scenarios considered only the direct effects and do not incorporate any 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	2023	2024	2025
Baseline Inflation Forecast	5.6	3.3	3.4
US$60	5.4	1.9	3.1
US$65	5.4	2.2	3.2
US$70	5.5	2.5	3.4
US$75	5.5	2.8	3.5
US$80	5.5	3.1	3.6
US$85	5.6	3.4	3.7
US$90	5.6	3.7	3.8
US$95	5.6	3.9	3.9
US$100	5.6	4.1	4.0
US$105	5.7	4.3	4.0
US$110	5.7	4.5	4.1
US$115	5.7	4.7	4.2
US$120	5.7	4.9	4.3

Source: BSP estimates

World Non-Oil Prices. Non-oil commodity prices are expected to remain broadly stable over the policy horizon due to favorable supply conditions amid weakening global demand. The latest assumptions for global non-oil commodities show a slightly larger decline for 2023 to 2024. In the IMF's July 2023 WEO Update, global non-fuel price inflation is seen to decline by 4.8 percent in 2023, 1.4 percent in 2024, and 0.5 percent in 2025. Global non-oil inflation peaked at 24.7 percent in March 2022 following Russia's invasion of Ukraine but has decreased significantly to -8.8 percent year-to-date in May 2023, reflecting improved supply prospects. Meanwhile, the potential impact of *El Niño* weather conditions on global non-oil prices is projected to be muted. This reflects the relatively small weight of global rice prices in the IMF's non-energy price index at only 1.0 percent, which is lower than the weight of rice in the domestic CPI basket.

Table 5. World Non-Oil Price Inflation
in percent

	May 2023 Monetary Policy Report	August 2023 Monetary Policy Report
2023	-2.8	-4.8
2024	-1.0	-1.4
2025	n.a.	-0.5

Source: WEO Update (IMF, July 2023), WEO (IMF, April 2023)

Federal Funds Rate. The latest federal funds rate assumptions, based on the futures prices as of 9 August 2023, are higher compared to previous round. The assumed futures path incorporates the latest Fed decision to raise its policy rate by 25 bps in the July 2023 FOMC meeting, with no further rate adjustments seen until February 2024. Markets are pricing in a 125-bp policy rate reduction in 2024 starting in March 2024 and a net 25-bp cut in 2025. By contrast, the Fed's dot-plot in June 2023 indicates that majority of the members are expecting an additional 25-bp hike for the rest of 2023 before starting to ease in 2024 and 2025.

Table 6. Federal Funds Rate
end-period, in percent

	May 2023 MPR	May 2023 MPR
2023	4.4	5.4
2024	2.9	4.1
2025	n.a.	3.8

Source: Bloomberg

Domestic Factors

RRP Rate and Reserve Requirement Ratio (RRR). The latest baseline forecasts assume that the RRP rate will remain at 6.25 percent over the policy horizon. Meanwhile the RRR was lowered from 12.0 percent to 9.5 percent from July 2023 until end-2025 but is assumed to be operational in nature and will not lead to any increase in domestic liquidity conditions.

Wages. The baseline forecast is consistent with the approved minimum wage increase for NCR of ₱40.00 in July 2023. In addition, minimum wages are assumed rise by ₱28.00 in August 2024 and ₱29.00 in September 2025. The assumed minimum wage increase for NCR is consistent with the uptick in average minimum wage growth from 2015 to 2023.

Fiscal Sector. The baseline inflation forecasts are consistent with government's fiscal deficit assumption of 6.1 percent for 2023, 5.1 percent for 2024, and 4.1 percent for 2025 based on the medium-term fiscal consolidation program of the Development Budget Coordination Committee (DBCC) as of 12 July 2023.

Alcoholic Drinks. The baseline forecasts reflect the impact of annual adjustments in the prices of alcoholic beverages (0.7 percent of the CPI basket) as mandated in Republic Act (R.A.) No. 11467. Higher excise taxes for fermented liquor, wine, and distilled spirits will be implemented on a staggered basis from 2020 to 2024 and shall increase by 6.0 percent every year from 2025 onwards.

Tobacco Products. Republic Act 11346, which took effect on 1 January 2020, increased further the excise tax on tobacco products (0.9 percent of the CPI basket) 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 and subject to a 5.0 percent annual indexation onwards.

Table 7. Excise Tax

Year	Cigarettes (₱ per pack)	Fermented Liquor (₱ per liter)	Wine (₱ per liter)	Distilled Spirits	
				Excise Tax (₱ per liter)	Ad Valorem Tax (%)
2022	60.0	39.0	56.2	52.0	22%
2023	5% Indexation	41.0	59.6	59.0	22%
2024		43.0	63.1	66.0	22%
2025		6% Indexation			22%

Source: Republic Act Nos. 11346 and 11467

Water Rates. The Metropolitan Waterworks and Sewerage System (MWSS) approved the rate hike requests of Manila Water Company and Maynilad Water Services for 2023-2026. The water rate rebasing process is conducted every five years to set the rates for water and sewerage services for water concessionaires to recover its operating, capital, maintenance, and investment expenditures. The rates for Manila Water customers will be higher every January by ₱8.00 per cubic meter starting in 2023, ₱5.00 in 2024, ₱3.25 in 2025, ₱3.00 in 2026, and ₱1.08 in 2027. Meanwhile, the rates for Maynilad customers will be higher every January by ₱3.29 per cubic meter starting in 2023, ₱6.26 in 2024, ₱2.12 in 2025, ₱0.84 in 2026, and ₱0.80 in 2027.

Electricity Rates. Meralco announced on 9 August 2023 a reduction of around ₱0.29 per kilowatt hour, bringing the overall rate for a typical household to ₱10.90 per kWh from the previous month's ₱11.19 per kWh. This translates to decrease of about ₱58.00 in total electricity bill of residential customers consuming 200 kWh. Power utilities in the regions also posted lower rates in August 2023. Davao Light cited decline in the spot market and stabilizing coal prices while Visayan Electric implemented a one-time refund due to over-recoveries of pass-through charges from the first half of the year.

Toll Rates. The Toll Regulatory Board (TRB) has approved the toll rate adjustment for the North Luzon Expressway (NLEX), authorizing the implementation of an additional ₱7.00 in the open system and ₱0.36 per kilometer in the closed system starting 15 June 2023. Under the new toll fee matrix, motorists traveling anywhere within the open system will pay an additional ₱7.00 for Class 1 vehicles (regular cars and SUVs), ₱17.00 for Class 2 vehicles (buses and small trucks) and ₱19.00 for Class 3 vehicles (large trucks).

LRT Fares. The LRT fare hikes have been implemented on 2 August 2023 following three months of deferment. On 11 April 2023, the Department of Transportation (DOTr) has approved the fare hikes for LRT-1 and LRT-2, aimed at supporting operations, managing deficits, and reducing subsidy from the government. However, President Marcos ordered on the same day deferment of implementation of the fare adjustment, pending a thorough study of its impact on inflation. After a discussion on the impact of fare increases with the National Economic and Development Authority (NEDA), the DOTr gave the go signal on 19 June 2023 for the implementation of the fare hikes.

	Type	Current Base Fare	Adjusted Fare
LRT-1	Single journey Ticket	15.00 – 30.00	15.00 – 35.00
	Stored Value Card	12.00 – 29.00	14.00 – 35.00
LRT-2	Single journey Ticket	15.00 – 30.00	15.00 – 35.00
	Stored Value Card	12.00 – 28.00	14.00 – 33.00

3. Risks to the Outlook

The balance of risks to the inflation forecast continues to lean toward the upside. The latest fan chart is skewed towards the upside as reflected in the high probability of inflation breaching high-end of the target band in 2023 to 2025.

Using the 90 percent confidence interval for the fan chart, estimates indicate that average inflation in 2023 will likely settle above the 3.0 percent ± 1.0 percentage point government inflation target range. The probability of average annual inflation settling within target range for 2024 and 2025 is about 50 percent. Meanwhile, the likelihood of inflation breaching the high end of the target range in 2024 has almost doubled to 42.7 percent compared to previous round's 25.2 percent.

The latest probability distribution also shows a slightly lower likelihood of inflation settling within the target for 2024 at 50.1 percent compared to 52.2 percent in the previous round. Meanwhile, the probabilities of inflation breaching the low end of the target range for 2023 to 2025 are less than 10.0 percent.

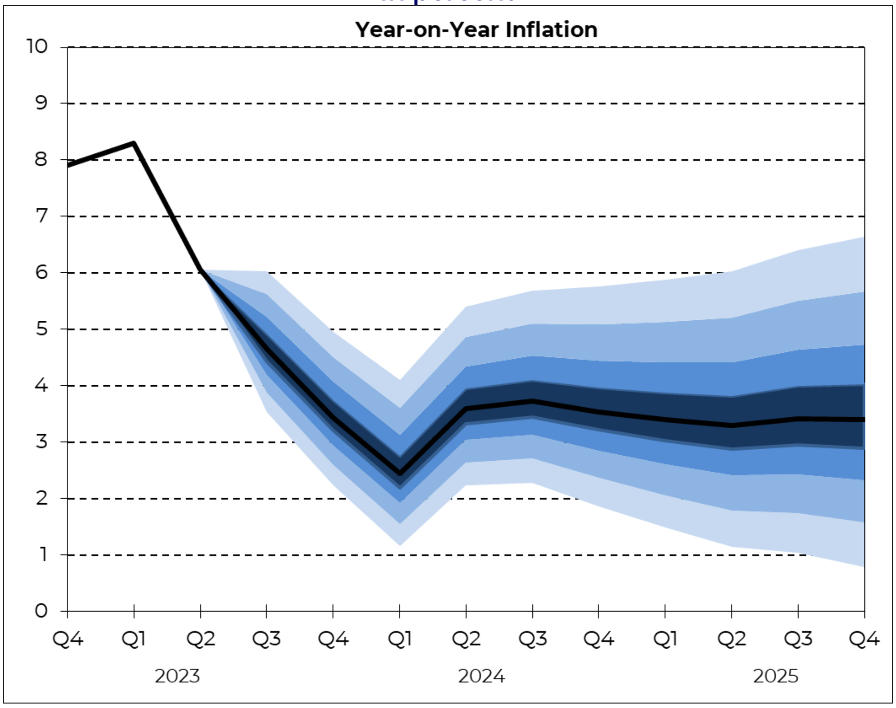
The median of the forecast interval implied by the fan chart of 5.8 percent for 2023, 3.8 percent for 2024, and 3.7 for 2025, are higher than the baseline forecasts of 5.6 percent for 2023, 3.3 percent for 2024, and 3.4 percent for 2025. This illustrates that the balance of risks to the outlook are skewed to the upside.

Table 8. Probability Distribution of Inflation Forecasts
in percent

	Pr(<2%)		Pr(2-4%)		Pr(>4%)	
	May 2023 MPR	Aug 2023 MPR	May 2023 MPR	Aug 2023 MPR	May 2023 MPR	Aug 2023 MPR
2023	0.0	0.0	7.2	4.2	92.8	95.8
2024	22.6	7.2	52.2	50.1	25.2	42.7
2025		9.8		47.5		42.7

Source: BSP estimates

Figure 1. Inflation Projection
in percent



Source: BSP estimates

Table 9. Inflation Projection Ranges at Various Confidence Intervals Using the Fan Chart
in percent

Confidence Interval (%)	Projection Range (%)		
	2023	**2024**	**2025**
80	5.2 – 6.3	2.3 – 5.2	1.6 – 5.7
90	5.1 – 6.4	2.0 – 5.8	1.1 – 6.3

Source: BSP estimates

Table 10. Risk Matrix[7]

	Risks	Probability May 2023 MPR	Probability August 2023 MPR
Upside Risks	Higher domestic food prices	Medium	Medium
	Higher transport charges	Medium	Medium
	Higher wage adjustments	High	High
	Impact of *El Niño* conditions	Medium	Medium
	Higher electricity rates		High
Downside Risks	Lower world GDP growth	Medium	Medium

The estimated impact of upside risks to the inflation outlook outweighs heavily the possible impact of downside risks. The upside risks to the inflation outlook include increased domestic prices of key food items facing supply constraints, potential impact of higher transport charges, higher-than-expected minimum wage adjustment in areas outside NCR (AONCR), increased food prices and utility rates due to *El Niño* weather condition, and higher electricity rates owing to recovery of power generation costs. Meanwhile, the impact of a weaker-than-expected global recovery is the primary downside risk to the outlook.

Higher prices of agricultural commodities facing supply constraints, such as livestock, poultry and eggs, fish, sugar, and onions add to the upside risks to inflation. The scenario assumes that the elevated price levels of these commodities will be sustained from August 2023 to December 2023 if the supply constraints are not addressed.

- **Pork.** Prices remain higher year-on-year as the recovery in hog production continues to be confronted by sporadic resurgence of African Swine Fever (ASF) as well as high feeds and distribution costs. As of 29 June 2023, active ASF cases increased anew to 58 municipalities (from 32 in May 2023) in nine regions (from six in May 2023) based on data from the Bureau of Animal Industry (BAI).

- **Poultry.** While chicken prices have decreased recently on low demand, year-to-date average prices remain higher year-on-year by 6.5 percent. High production costs put a strain on producers' operations, while poultry integrators and commercial raisers remain wary of large expansion due to high cost of feed ingredients and the Avian Influenza (AI) threat. Based on DA's status update as of 9 June 2023, cases of AI are ongoing in five municipalities in two regions.

[7] The BSP considers different scenarios that pertain to upside and downside risks to the inflation outlook, which are summarized in a risk matrix. The various scenarios are then assigned probability values. Scenarios that have a more than 75 percent probability of taking place over the forecast horizon are incorporated into the baseline. The estimated impact of each scenario is then multiplied by the assigned probabilities. 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.

Meanwhile, chicken egg production is seen to decline by 20.0 percent in 2023 due to the decrease in imports of laying hens/layers. Import of breeder materials and laying hens in Q3 and Q4 could be limited by import bans to contain the spread of AI. Episodes of AI were recorded in the country's major sources of laying hens including Europe, the United States and Canada. This sharp decline in imports of layers, along with increase in input costs, and local AI outbreaks contributed to the decline in egg production in the country.

- **Fish.** Declining local output, restrictive imports, higher transport costs from higher oil prices, as well as inclement weather have caused fish prices to increase. Meanwhile, the Office of the President directed the Department of Agriculture (DA) to suspend or hold in abeyance the implementation of FAO No. 266 nationwide pending the final resolution over its constitutionality by the Supreme Court. The order was issued in 2020 by the Bureau of Fisheries and Aquatic Resources (BFAR) as a tool for monitoring and surveillance to strengthen the government's efforts against illegal, unreported, and unregulated (IUU) fishing. If the SC rules FAO No. 266 to be constitutional, it could reduce the number of fishing vessels in operation which can lower further fish supply.

- **Sugar.** Following instructions from the President to maintain adequate buffer stock to prevent prices from fluctuating in the market, the Sugar Regulatory Administration (SRA) has issued import plans for 2023. Sugar Order (S.O.) Nos. 6 and 7 have allowed for the importation of 440,000 MT and 150,000 MT respectively, of refined sugar. The SRA expected refined sugar prices to hover around ₱85-90 per kilo in Metro Manila. However, the importation has yet to translate to lower retail prices. Current prices of refined sugar in NCR based on DA Price Watch as of 8 August 2023 remain at ₱86-110 per kilo.

- **Onions.** Onion prices in Metro Manila markets surged in the H2 2022 amid supply shortfalls. After the harvest season in the H1 2023, average prices nationwide have started to climb again in July to ₱202.81 per kilo for red onion and ₱182.26 per kilo for white onion, from ₱200.26 and ₱181.88 per kilo, respectively, in the previous month. On a year-to-date basis, red onion prices are higher by 84.5 percent from last year's average, white onion prices are up by 117.1 percent.

An overall medium probability is assigned to this risk given the lower combined weights of pork and onions in the CPI basket relative to the weight of the other commodities facing supply constraints.

Commodity	Probability
Pork	High
Poultry and Eggs	Medium
Fish	Medium
Sugar	Medium
Onions	Medium
Total	**Medium**

Higher transport fares and toll rates pose upside risks to inflation. Jeepney and UV Express fares could increase following full implementation of the public utility vehicle (PUV) modernization program. Under the program, the transition from traditional jeepneys and UV Express vehicles to modernized vehicles could raise transport fares to help recover investment costs. Similarly, a fare hike petition was filed with the Department of Transportation (DOTr) for the MRT-3 following the recent adjustments in LRT-1 and LRT-2 fares.

Minimum base fares indicated in the table below are assumed, with implementation in Q4 2023 for the MRT-3 and in Q1-2024 for the modern jeepney.

Line	Current Base Fare	Proposed Adjusted Base Fare
MRT-3	13.00	19.00
Modern Jeepney	14.00	16.00

The Toll Regulatory Board (TRB) has approved the Cavitex Infrastructure Corp.'s (CIC) toll rate adjustments at the CAVITEX Parañaque and Kawit Toll Plazas effective 21 August 2023.[8] The increase in the toll rates is estimated to have spillover effects on the price of other goods and services through higher transport costs.

A medium probability is assigned to this risk given ongoing discussions.

Wage adjustments in areas outside NCR (AONCR) could be higher than expected due to elevated domestic inflation. Under this scenario, an 8.0 percent increase in the minimum wage for AONCR is assumed for 2023 relative to the baseline scenario of 7.0 percent which is consistent with actual minimum wage increase in NCR. In 2022, wage hikes in AONCR ranged from 7.7 percent to 20.5 percent, higher than the 6.1 percent hike in NCR. Pending wage petitions in AONCR range from ₱100 to ₱640.

A high probability is assigned to this risk following the wage hike implemented in NCR in July 2023 and the expected approval of wage increases in regions 3, 4A, 5, 6 and 7 by September 2023.

Impact of *El Niño* conditions could lead to higher food and utility prices. Based on the latest advisory from PAGASA, *El Niño* is present and will likely persist until at least Q2 2024 which coincides with the optional cropping and summer harvest for rice.[9] *El Niño* increases the likelihood of below-normal rainfall conditions, which could bring negative impacts such as dry spells and droughts in some areas of the country and in turn, dampen water resources and agricultural productivity. A moderate *El Niño* is assumed in this scenario.

While impact of *El Niño* on inflation is expected to be temporary, the weather phenomenon poses additional upside risk on the prices of food and utilities, especially with a severe episode that could result in disruption on food supply as well as increase in consumption amid limited availability of water and electricity.

[8] Toll rate increases of ₱2.00 for Class 1 vehicles, ₱3.00 for Class 2 vehicles, and ₱4.00 for Class 3 vehicles will be implemented for the Parañaque toll plazas. Meanwhile, increases of ₱9.00 for Class 1 vehicles, ₱16.00 for Class 2 vehicles, and ₱25.00 for Class 3 vehicles will be implemented for the Kawit toll plazas. The CIC has yet to announce the implementation of the adjustments.

[9] *El Niño* conditions are associated with higher likelihood of more severe tropical cyclones from July to September due to the interaction between the southwest monsoon and warmer sea-surface temperatures.

- **Electricity.** Electricity rates could rise in Q4 2023 to Q2 2024 owing mainly to the warm and dry weather condition associated with El Niño. A substantial increase in demand for power which could not be supported by power supply reserves could lead to a declaration of Yellow or Red Alerts in the transmission grids, resulting in higher generation charges from the Wholesale Electricity Spot Market (WESM) and independent power producers (IPPs). In addition, due to lower generation from hydropower plants, local electric cooperatives may have to tap more expensive alternative sources of power generation.

  Under this scenario, a 3.0 percent month-on-month increase in electricity prices is assumed for the period October 2023 to June 2024, based on the average increase in the overall electricity rate during the *El Niño* episode in 2018-2019.

  A medium probability is assigned to this risk. While an increase in electricity prices is projected given the impact of the *El Niño* episode, there are also other factors driving power rates such as the movements of the peso against the US dollar and fuel charges.

- **Domestic food prices.** The DER study on macroeconomic effects of temperature shocks in the Philippines[10] showed negative impact of temperature shocks on aggregate output growth after controlling for ENSO events particularly, *El Niño*. The study also looked into the marginal effects of temperature shocks on the country's top agricultural crops. Results show that temperature shocks have significant negative effect on *palay* and corn production, which constitute 8.9 percent and 0.5 percent of the CPI basket, respectively.

  In this scenario, a moderate *El Niño* episode is assumed from August 2023 to June 2024 with increase in temperature of 1.0 degree Celsius. Consequently, higher temperatures are estimated to negatively affect production and result in higher prices based on the price elasticity estimates from the Southeast Asian Regional Center for Graduate Study and Research on Agriculture (SEARCA).[11]

  A medium probability is assigned to this risk given PAGASA's forecast of a moderate *El Niño* episode.

- **Imported rice prices.** International rice prices, particularly from Vietnam and Thailand which comprise majority of the Philippine rice imports, continued their upward trend in July due to strong demand, mounting concerns over global supply brought about by *El Niño* conditions, and trade restrictions. In addition, India has imposed rice export ban with the delay in the onset of monsoon rains. This poses further threat to food inflation globally with India as the world's biggest rice exporter, accounting for 40 percent of the global export volume. The ban could put pressure on other suppliers and on existing rice inventories and buffer stocks.

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[10] Armas, J., R. Asi, D. Mandap, and G. Moral (forthcoming). "Macroeconomic effects of temperature shocks in the Philippines: evidence from impulse responses by local projections".
[11] Lantican, F. et. al. (2013). Estimating the Demand Elasticities of Rice in the Philippines. Southeast Asian Regional Center for Graduate Study and Research on Agriculture (SEARCA) Los Baños, Laguna, Philippines.

A medium probability is assigned to this risk given the discussion above.

Electricity rates could increase in 2024. In July 2023, the Supreme Court nullified Energy Regulatory Commission's (ERC) decision back in 2014 to cap Wholesale Electricity Market (WESM) prices in November to December 2013. The ERC's decision was made to address the higher prices during the maintenance shutdown of the Malampaya gas field. An estimated ₱22 billion worth of power generation cost could be passed on to consumers starting in January 2024 and spread over two until December 2025.

A high probability is assigned to this risk as the ERC is set to release an order that will authorize the collection of the said power generation cost.

Meanwhile, slowdown in global economic activity is the primary downside risk to the outlook. Based on the IMF's April 2023 WEO, global growth is estimated to decelerate to 2.8 percent in 2023 before rising to 3.0 percent in 2024, with the assumption that the recent financial sector stress in major AEs is contained. Meanwhile, the IMF's alternative global growth scenario incorporating further global financial sector stress indicates that world growth could decline further to 2.5 percent in 2023. Downside risks continue to dominate with moderate tightening in credit conditions and sharper contractionary effects of synchronous central bank rate hikes adding to possible faltering of China's COVID recovery and escalation of conflict between Russia and Ukraine.

World GDP growth is assumed to be lower by 0.3 ppt for 2023 and 0.2 ppt for 2024 based on the IMF's alternative scenario to global growth.

A medium probability is assigned to this risk reflecting IMF's view of lower global growth due to financial instability.

Box Article No. 1: Monetary Policy Developments

At its monetary policy meeting on 22 June 2023, the BSP kept the interest rate on the overnight reverse repurchase (RRP) facility at 6.25 percent. The interest rates on the overnight deposit and lending facilities were thus retained at 5.75 percent and 6.75 percent, respectively.

Relative to the May 2023 MPR, the baseline inflation forecast presented during the 22 June 2023 policy meeting was broadly unchanged at 5.4 percent for 2023 and 2.9 percent for 2024 compared to the previous forecasts of 5.5 and 2.8 percent, respectively. 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 peso depreciation due to the higher federal funds rate assumption but was partly offset by lower crude oil prices.

Table A. BSP Average Baseline Inflation Projections

in percent

	May 2023 Monetary policy meeting [a]	June 2023 Monetary policy meeting
2023	5.5	5.4
2024	2.8	2.9
2025	n.a.	3.2

Source: BSP estimates
[a] Published in the Monetary Policy Report-May 2023

Both headline and core inflation decelerated further in May due mainly to slower increases in the prices of food and energy-related items, affirming expectations of a return to the target range by year's end. However, the balance of risks to the inflation outlook continued 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 remained the primary downside risk to the outlook.

The BSP deemed it appropriate to maintain 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 warranted continued vigilance against potential second-round effects.

In view of this, the BSP signaled its readiness to resume monetary tightening as necessary, in line with its data-dependent approach to ensuring price and financial stability.

II. Current Developments

Overview of current developments

Headline inflation decelerates further in July 2023. The y-o-y headline inflation slowed to 4.7 percent in July 2023 from 5.4 percent in June 2023. This brought the y-t-d average at 6.8 percent which is above the NG's average inflation target range of 2.0-4.0 percent for the year. Food and non-alcoholic beverages inflation stood at 6.3 percent, lower than 6.7 percent in the previous month. Similarly, Inflation for non-food items moderated to 3.3 percent from 4.1 percent in the previous month.

Core inflation slows down, indicating some easing in underlying price pressures. The official core inflation slowed down to 6.7 percent in July 2023 from 7.4 percent in the previous month. Likewise, the alternative measures for core inflation, namely the trimmed mean, weighted median and principal component analysis, declined to 5.6 percent (from 6.2 percent), 5.0 percent (from 5.6 percent) and 5.5 percent (from 5.7 percent), respectively.

Global crude oil prices rise amid production cuts. The spot price of Dubai crude oil in the first week of August 2023 increased compared to the full-month average price in July 2023. On the supply side, the rise in oil prices was due to additional supply cuts; supply disruptions in several oil-producing countries in July 2023; and lower US crude oil inventories. On the demand side, China's economic stimulus measures and the upward revision by the IMF of the 2023 growth outlook pushed up oil prices.

Inflation expectations for 2023 remain steady and point to easing for 2024 and 2025. Results of the BSP's August 2023 survey round on private sector economists' inflation expectations showed unchanged mean inflation forecast from the July survey round at 5.5 percent for 2023. Meanwhile, the mean inflation forecasts for 2024 and 2025 declined to 3.5 percent (from 3.6 percent) and 3.4 percent (from 3.6 percent), respectively. Analysts expect inflation to continue easing in the near term owing largely to negative base effects. Risks to the inflation outlook, however, remain tilted to the upside.

The domestic economy grows at more moderate pace in Q2 2023. Real GDP expanded by 4.3 percent y-o-y in Q2 2023, slower than 6.4 percent in the previous quarter and the 7.5-percent growth posted in Q2 2022. This brought y-t-d growth to an average of 5.3 percent for the first half of 2023, lower than the 6-7 percent target of the DBCC for 2023. On the demand side of the economy, household consumption grew by 5.5 percent while government spending contracted by 7.1 percent. Moreover, growth in investments was flat. On the supply side of the economy, the services sector continued to expand although at a slower pace of 6 percent. The industry sector likewise moderated to 2.1 percent. Meanwhile, the agriculture sector grew by 0.2 percent.

The other demand indicators signal a weakening in economic prospects. The manufacturing sector's preliminary average capacity utilization rate in June 2023 stood at 73.2 percent, slightly lower than 73.4 percent in the previous month. Most of the industries surveyed slightly reduced their capacity amid modest demand.

Meanwhile, the preliminary composite Purchasing Manager's Index (PMI) in July 2023 fell in contraction territory at 48.1 index points from 52.4 points (revised) in the previous month. This may be attributed to declines in the manufacturing, retail and wholesale, and services sectors. There was also a general anticipation of weaker prospects across all sectors.

Labor market conditions remain favorable. The unemployment rate in June 2023 was at 4.5 percent. This was marginally higher than the 4.3 percent unemployment rate in May 2023 but lower than 6.0 percent in June 2022. Meanwhile, the Regional Tripartite Wage and Productivity Board (RTWPB) for the National Capital Region (NCR) granted a ₱40-increase in basic pay for the region's non-agricultural and agriculture sectors. The wage order took effect on 16 July 2023.

Domestic liquidity remains adequate, providing support to financial market activity. Domestic liquidity (M3) grew by 6.6 percent y-o-y to about ₱16.3 trillion in May 2023, similar to the growth recorded in the previous month. During the same period, bank lending expanded by 9.4 percent y-o-y in May 2023 from 9.7 percent in April. On the other hand, bank lending standards based on the diffusion index showed varied results pointing to a net tightening of loan standards to firms and a net easing of lending standards for consumers. In the government securities market, the auctions of the BTr were awarded in full amid strong demand. Consequently, secondary market yields showed mixed trends with yields declining in the short-end of the curve, while those in the belly and long-end of the curve increased.

Global growth outlook improves but remains dominated by downside risks. The JP Morgan All-Industry Output Index eased to 52.7 in June from 54.4 in May due to the dampening effect of tight global financial conditions on aggregate demand. Meanwhile, the IMF revised upward its 2023 global economic growth projection to 3.0 percent from 2.8 percent. Nonetheless, global economic expansion is expected to remain well below the annual average of 3.8 percent[12] until at least 2024. On balance, risks to the global growth outlook remain pointed to the downside.

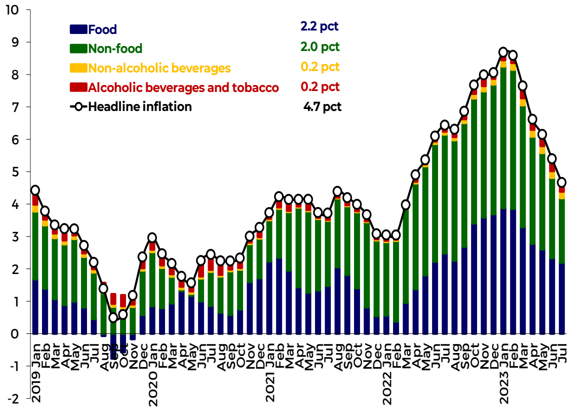
[12] Historical average global growth from 2000 – 2019

1. Price Conditions

Headline inflation. The y-o-y headline inflation decelerated for the sixth consecutive month to 4.7 percent in July 2023 from 5.4 percent in June 2023 and 6.4 percent in July 2022. The resulting y-t-d average of 6.8 percent, however, is still above the NG's average inflation target range of 2.0-4.0 percent for the year. The downtrend in overall inflation was driven mainly by lower inflation for housing, water, electricity, gas, and other fuels in July on moderate increases in rents, the reduction in power rates, as well as the rollback in LPG prices. On a month-on-month seasonally adjusted basis, inflation was nil in July from 0.1 percent in the previous month.

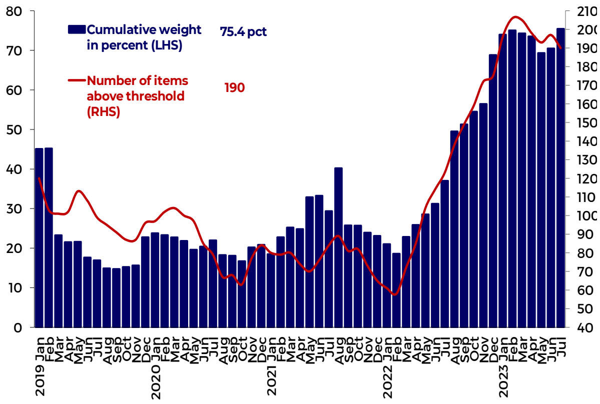
Preliminary estimates showed that, out of the 315 total CPI items,[13] the number of items with inflation rates above the threshold of 4.0 percent decreased to 190 in July 2023 from 197 items in the previous month.[14] Of these 190 CPI items, 113 are classified under food, beverages (non-alcoholic and alcoholic beverages), and tobacco. These 190 items accounted for 75.4 percent of the total CPI weight. Meanwhile, the number of CPI items below target increased to 70 items in July 2023 from 65 items in the previous month. These 70 items accounted for 13.8 percent of the total CPI weight, from 13.3 percent in June 2023. The remaining 55 CPI items in July 2023 (which accounted for 10.8 percent of the total CPI weight) were within threshold.

Figure 2. Headline Inflation
2018=100; in percent



Source: Philipine Statistical Authority (PSA), BSP

Figure 3. CPI Items with Inflation Rates Above Threshold (2018=100)



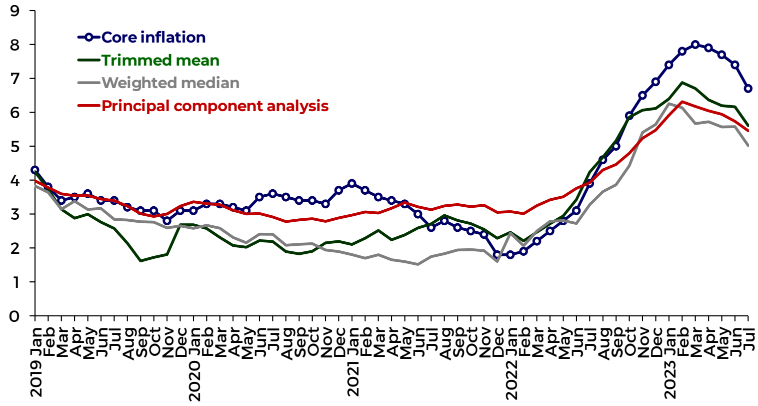
Source: PSA, BSP staff estimates

Core inflation. The official core inflation, which measures generalized price pressures by excluding selected volatile food and energy items, slowed down to 6.7 percent in July 2023 from 7.4 percent in the previous month. Similarly, the trimmed mean and the weighted median eased to 5.6 percent and 5.0 percent in July 2023, respectively, from 6.2 percent and 5.6 percent in June 2023. Core inflation using the principal component analysis likewise decreased to 5.5 percent in July 2023 from 5.7 percent in the previous month. The decline can be traced to

[13] There are 315 items at the 6-digit level of the 2018-based CPI.
[14] It should be noted that this exercise has some bias due to rounding given that inflation for 6-digit is computed with an expanded decimal place especially with the threshold set at 4.0 percent or 2.0 percent. For instance, inflation rates that is equivalent to 4.01 are classified as above 4.0 percent while CPI items with inflation rate at 1.98 is also classified below threshold.

easing inflation of heavily weighted items such as, housing (rent) as well as restaurants and accommodation services.

Figure 4. Estimates of Core Inflation Measures
year-on-year; in percent



Note: Core inflation excludes ten (10) volatile food and energy CPI items from the headline CPI equivalent to around 29.6 percent of total basket. This includes (1) cereals (rice and corn); (2) meat, fresh, chilled and frozen; (3) fish, live, fresh, chilled and frozen; (4) dates, figs, and tropical fruits; (5) other vegetables, fresh and chilled; (6) fruit-bearing vegetables; (7) electricity; (8) liquefied hydrocarbons; (9) diesel; and (10) gasoline. In total, this accounts for around 29.6 percent of total CPI basket.
Sources: PSA and BSP staff calculations using 5-digit disaggregation for the BSP-computed core inflation namely, trimmed mean, and weighted median.

Food inflation. Food and non-alcoholic beverages inflation stood at 6.3 percent, lower than 6.7 percent in the previous month. Most food commodities, particularly fish and sugar, posted slower price increases. Meanwhile, meat prices declined amid decreased consumer demand.

Non-food inflation. Inflation for non-food items also moderated to 3.3 percent from 4.1 percent in the previous month. Lower electricity rates and LPG prices, as well as slower increases in rents, pushed down non-food inflation. The continued decline in y-o-y transport inflation, owing in part to base effects, also contributed to the moderation of headline inflation.

Table 11. Inflation Rates for Selected Food Items
2018=100; year-on-year; in percent

Commodity	Jul 2022	Jun 2023	Jul 2023
Food and non-alcoholic beverages	**6.9**	**6.7**	**6.3**
Food	7.1	6.7	6.3
Cereals and cereal products	4.5	5.7	5.9
Cereals	3.6	3.7	4.3
Rice	2.1	3.6	4.2
Corn	27.6	5.3	5.8
Flour, bread and other bakery products, pasta products, and other cereals	6.8	11.0	10.1
Meat and other parts of slaughtered land animals	9.9	0.3	-1.7
Fish and other seafood	9.2	6.2	4.5
Milk, other dairy products, and eggs	4.5	11.2	9.7
Oils and fats	18.4	5.6	2.0
Fruits and nuts	3.6	11.4	8.4
Vegetables tubers, cooking bananas and pulses	5.6	12.7	21.8
Sugar, confectionery and desserts	17.6	28.9	21.4
Ready-made food and other food products, n.e.c.	5.2	8.5	7.8
Non-alcoholic beverages	3.1	7.0	6.8
Alcoholic beverages and tobacco	**8.5**	**11.6**	**10.9**

Source of basic data: PSA, BSP

Table 12. Inflation Rates for Selected Non-Food Items
2018=100; year-on-year; in percent

Commodity	Jul 2022	Jun 2023	Jul 2023
Non-food	**6.1**	**4.1**	**3.3**
Clothing and footwear	2.5	5.1	4.8
Housing, water, electricity, gas and other fuels	5.7	5.6	4.5
Electricty, gas, and other fuels	14.5	5.2	2.5
Furnishings, household equipment & routine household maintenance	3.1	6.0	5.8
Health	2.4	3.9	3.9
Transport	18.1	-3.1	-4.7
Passenger transport services	7.2	11.2	7.2
Information and communication	0.5	0.7	0.7
Recreation, sport and culture	2.2	4.8	4.7
Education services	0.6	3.6	3.7
Restaurant and accommodation services	3.4	8.2	7.9
Financial services	0.0	0.0	0.0
Personal care and miscellaneous goods and services	2.8	5.8	5.6

Source of basic data: PSA, BSP

Box Article No. 2: Goods and Services Inflation in the Philippines

Like the rest of the world, the Philippines has had to cope with several shocks to the economy in recent years. These include the surge in global commodity prices and shocks to the domestic agriculture sector, alongside their attendant first- and second-round effects. These, in turn, led to a broad-based increase in consumer prices in 2022, with both headline and core inflation breaching the upper end of the target band of 2 to 4 percent for the year. Since then, inflation has decelerated as both food and energy prices eased after peaking in early 2023. This box article takes a closer look at the factors driving inflation pressures by separating the goods and services components of the consumer price index (CPI), thus providing a way to gauge second-round effects of inflation in the Philippines.

The CPI measures goods and services typically purchased by households. The structure of the Philippine CPI published by the Philippine Statistics Authority (PSA) follows the Philippine Classification of Individual Consumption According to Purpose (PCOICOP),[1] which divides the CPI into thirteen (13) major components. For this exercise, the staff classified the CPI into two groups—goods or services—using the 188 sub-class (i.e., 5-digit level) items of the CPI. The goods component consists of durable, semi-durable, and non-durable items. Non-durable goods account for the bulk of the goods component, as they include major CPI items such as food and energy (i.e., gasoline, diesel). Meanwhile, the share of services-related CPI items is around 34 percent of the total CPI basket. Services inflation is mostly influenced by heavily-weighted components such as housing (rent) as well as restaurant and accommodation services. Using this distribution (Table A), we compute for the goods and services inflation for the Philippines.

Table A. Weight Distribution of Goods and Services in the CPI basket

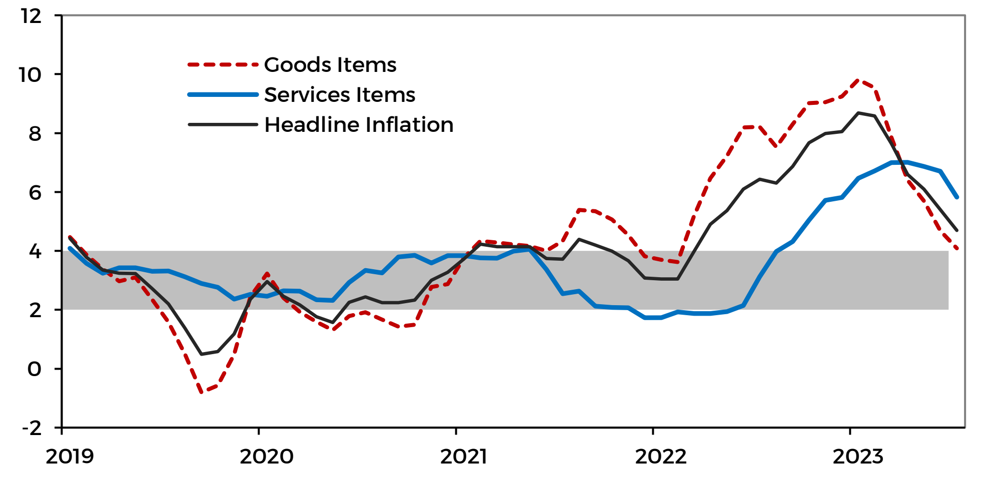
in percent

	Description	CPI	Goods	Services
No.	**All groups**	**100.0**	**65.6**	**34.4**
01	Food and non-alcoholic beverages	37.7	37.7	0.0
02	Alcoholic beverages and tobacco	2.2	2.2	0.0
03	Clothing and footwear	3.1	3.1	0.1
04	Housing, water, electricity, gas, and other fuels	21.4	8.4	13.0
05	Furnishings, household equipment and routine household maintenance	3.2	2.4	0.8
06	Health	2.9	1.8	1.1
07	Transport	9.0	4.3	4.7
08	Information and communication	3.4	1.1	2.3
09	Recreation, sport and culture	1.0	0.7	0.3
10	Education services	2.0	0.0	2.0
11	Restaurants and accommodation services	9.6	0.0	9.6
12	Financial services	0.0	0.0	0.0
13	Personal care, and miscellaneous goods and services	4.5	3.9	0.6

Source: PSA and BSP staff estimates.
Note: Figures may not add up due to rounding.

As expected, goods inflation picked up ahead of services inflation in 2022 (Chart 1), emulating the trend between headline and core inflation. The increase in goods inflation coincided with the surge in food and energy prices brought about by supply disruptions. Estimated goods inflation jumped from 3.1 percent year-on-year in February 2022 to 5.1 percent in March 2022 as global oil and non-oil commodity prices increased sharply amid the conflict between Russia and Ukraine. Furthermore, successive shocks to the food supply chain caused by animal diseases, low domestic production, weather disturbances, and trade restrictions likewise pushed up prices of different food commodities in 2022.

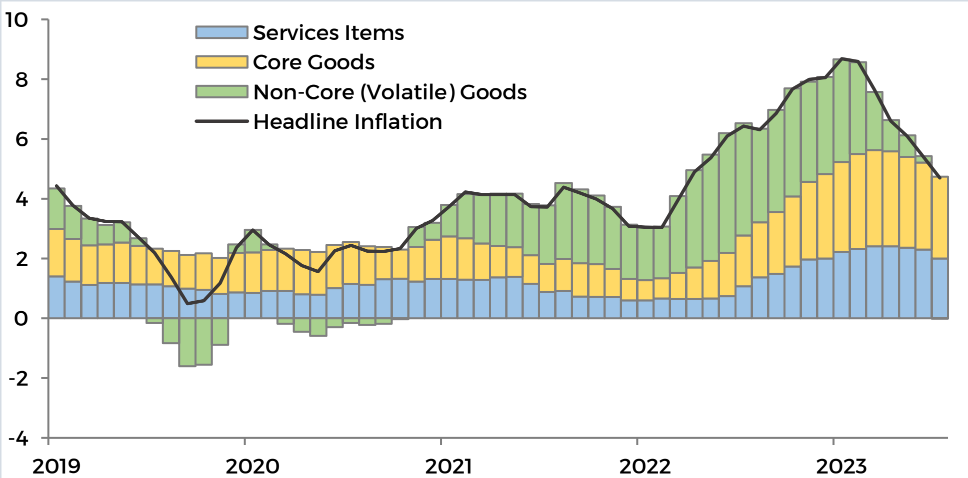
Chart 1. Goods and Services Inflation
(In percent)



Source: PSA and DER staff calculations.

We note that the bulk of goods price inflation are from food and energy items, some of which are typically stripped from the core CPI as they tend to be highly volatile. Using the same list of excluded items from the official core CPI, we could distinguish between core and non-core goods as shown in Chart 2. Inflation for non-core goods items appears to have dissipated in 2023, reflecting the significant decline in global oil prices from 2022 levels, the moderation in food inflation, and the downward impact of base effects given the surge in consumer price inflation a year ago. Meanwhile, core goods inflation has also gone down in recent months, although its contribution to overall inflation remains substantial at 2.7 percentage points in July 2023 as certain food commodities such as, bakery goods, fruits, and sugar remained elevated.

Chart 2. Contribution of Goods and Services Price Inflation



Sources: PSA and BSP staff calculations.
Note: Non-core goods refers to the volatile food and energy items excluded from the official core CPI.

On the other hand, services inflation has been broadly behaved (within target) for the past three years and only breached the upper end of the target in the second half of 2022. At present, its contribution to headline inflation remains significant, but it has also started to moderate. The price changes in services could be traced to second-round effects from the approved fare hikes and passthrough of high energy and food costs to other components of the CPI.

The results of the decomposition exercise could also explain why the decline in core inflation appears to be slower than headline inflation, given that some of the pressure from the items that initially pushed up inflation has waned in recent months as shown in the shrinking contribution of non-core goods inflation. This exercise further implies that the deceleration in headline inflation in early 2023 is driven by a narrow set of goods namely, food and energy items that were originally the main drivers of inflationary pressures. Nonetheless, recent figures have shown a broad-based downtrend in both core goods and services inflation.

Another benefit to separating goods and services inflation is in monitoring second-order effects. Services inflation mostly reflects the indirect impact of high food and energy prices, as transmitted onward to the transport and restaurants component of the CPI basket. Central banks typically respond to second-round effects to minimize the generalized impact on inflation and inflation expectations. In this case, services inflation could be used as an additional/supplementary indicator of demand-side pressures along with other alternative core measures already being monitored.[2]

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[1] A standard classification of consumption expenditures in the Philippines. The structure of the PCOICOP has five levels of disaggregation: (a) Division (2-level), (b) Group (3-level), (c) Class (4-digit), (d) Sub-Class (5-digit), and (e) item (6-digit).

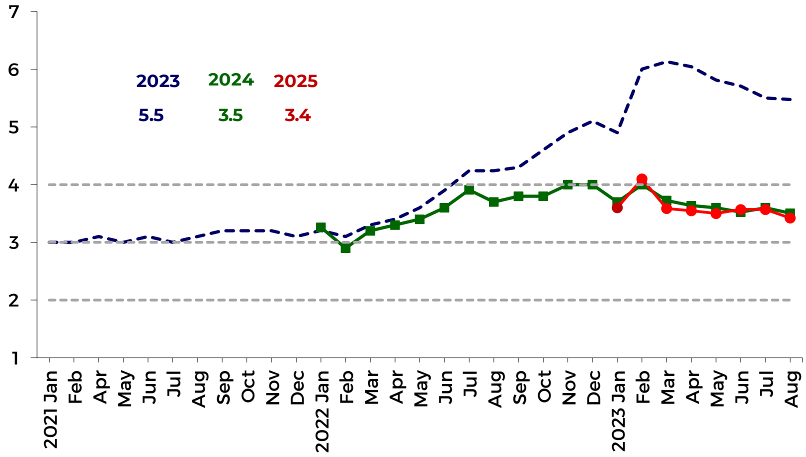
[2] Aside from the official core inflation published by the PSA, the BSP also computes for other core measures using trimmed mean, weighted median, and principal component analysis.

2. Inflation Expectations

The BSP's survey of private sector economists for August 2023 showed mean inflation forecast of 5.5 percent for 2023, unchanged from the results of the previous month's survey round.[15] Meanwhile, the mean inflation forecasts for 2024 and 2025 declined to 3.5 percent (from 3.6 percent) and 3.4 percent (from 3.6 percent), respectively.

Figure 5. BSP Private Sector Economists' Survey

mean forecast for full year; in percent



*Based on forecasts provided by 26 respondents. The survey was conducted from 5-9 August 2023.
Source: BSP

Analysts expect inflation to continue easing in the near term owing largely to negative base effects. Risks to the inflation outlook, however, remain tilted to the upside due mainly to supply disruptions, particularly the potential adverse impact of *El Niño*.

The upside risks to inflation are seen to emanate mainly from (1) high prices of basic goods (including food and oil) and services (e.g., restaurant and accommodation services) due to supply factors attributed mainly to weather disturbances such as typhoons and the threat of *El Niño*, as well as the adverse impact of trade restrictions on selected food items and oil production cuts by OPEC member states; and (2) second round effects, emanating particularly from higher transport fares and wages. The main downside risk cited by a few analysts include the lagged effect of the BSP's successive monetary policy tightening, which is expected to temper inflation.

[15] There were 26 respondents in the BSP's survey of private sector economists in August 2023. The survey was conducted on 5-9 August 2023.

Table 13. Private Sector Forecasts for Inflation

annual percentage change; August 2023

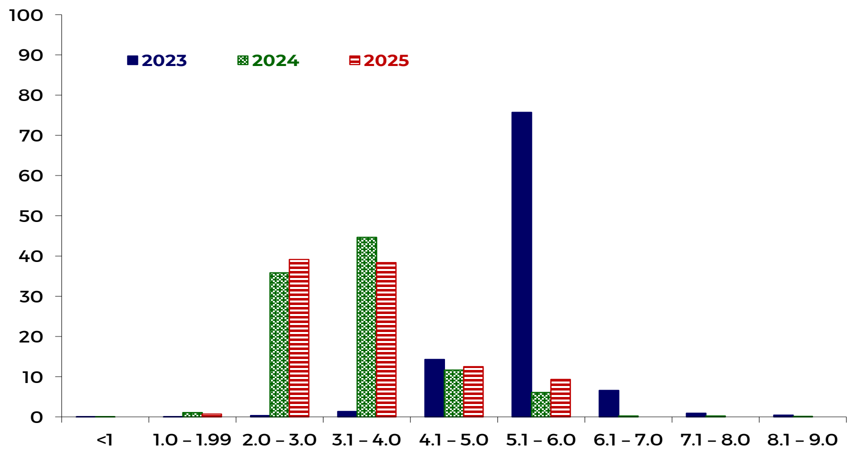
	2023			2024	2025
	Q3	Q4	FY	FY	FY
1) Al-Amanah Islamic Bank	4.80	4.50	6.00	6.00	6.00
2) ANZ	4.40	2.60	5.30	3.00	3.00
3) Asia ING	4.20	3.70	5.60	3.30	3.50
4) Bangkok Bank	4.60	3.50	5.60	3.50	3.50
5) Bank of Commerce	4.44	2.87	5.41	-	-
6) Bank of the Philippine Islands	4.40	3.20	5.40	3.00	3.00
7) Barclays	4.30	3.00	5.50	3.30	-
8) CTBC Bank	4.90	3.70	5.60	3.40	3.00
9) Deutsche Bank	-	-	6.00	4.00	-
10) Eastwest Bank	4.00	1.90	5.00	4.00	3.00
11) eManagement for Business and Marketing Services	4.53	3.28	5.54	4.50	5.48
12) Korea Exchange Bank	4.80	3.50	5.60	3.50	3.60
13) Land Bank of the Phils	4.50	3.00	5.40	2.90	2.60
14) Maybank	4.60	3.60	5.60	3.70	3.50
15) Maybank Investment Banking Group	4.40	2.90	5.50	3.00	3.00
16) Metrobank	-	-	5.60	4.60	-
17) Mizuho	5.00	4.00	5.00	4.00	3.00
18) Modular Asset Management	4.80	3.30	5.60	2.90	3.40
19) Nomura	4.30	2.70	5.30	3.10	-
20) RCBC	4.70	3.30	5.60	2.80 - 3.30	3.20 - 3.70
21) Robinsons Bank	4.30	2.40	5.20	4.00	3.50
22) Philippine Equity Partners	4.47	3.04	5.47	2.68	-
23) Security Bank	4.20	3.20	5.40	3.70	3.50
24) Standard Chartered	4.50	3.10	5.60	2.60	-
25) Sun Life Investment Management and Trust Corp.	4.50	3.50	5.00	3.50	2.80
26) Union Bank of the Phils.	4.50	3.10	5.50	2.40	2.20
Median Forecast	4.5	3.2	5.5	3.4	3.4
Mean Forecast	**4.5**	**3.2**	**5.5**	**3.5**	**3.4**
High	5.0	4.5	6.0	6.0	6.0
Low	4.0	1.9	5.0	2.4	2.2
Number of Observations	24	24	26	25	19
Government Target	**3.0±1.02**	**3.0±1.01**	**3.0±1.01**	**3.0±1.01**	**3.0±1.00**

Source: BSP

Based on the probability distribution of the forecasts provided by 22 out of 26 respondents, analysts assigned a narrow 1.7-percent (from 2.8 percent) probability that average inflation for 2023 will settle within the 2-4 percent range, while there is near certainty (a 98.3-percent chance, from 97.2 percent a month ago) that inflation will exceed 4.0 percent. Meanwhile, the probability that inflation will fall within the target band in 2024 increased to 80.5 percent (from 76.7 percent), while there is a 77.5 percent chance (from 71.6 percent) of inflation settling well-within the target band in 2025.

Figure 6. Probability Distribution for Analysts' Inflation Forecasts*

(2023-2025)



*Probability distributions were averages of those provided by 22 out of 26 respondents.
Source: August 2023 BSP Survey

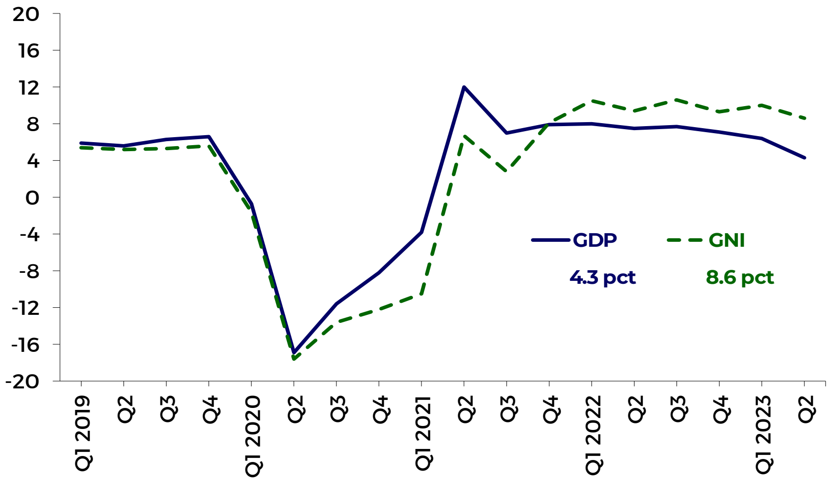
Most of the analysts expect the BSP to take a pause from its tightening cycle for the rest of the year. However, some analysts are looking at one last rate increase by 25 bps in Q3 2023 and a possible reversal by 25 bps in Q4 2023. For 2024, all the analysts anticipate the BSP to reduce the key policy rate by a range of 50 to 225 bps, and additional loosening of 25 to 200 bps in 2025.

Meanwhile, all respondent-analysts expect inflation to breach the upper end of the government's 2-4 percent target range in 2023. For 2024 and 2025, most analysts are expecting inflation to decelerate to within the 2-4 percent target range.

3. Demand Conditions

Real GDP expanded by 4.3 percent y-o-y in Q2 2023, slower than 6.4 percent in the previous quarter and the 7.5-percent growth posted in Q2 2022. Output growth in Q2 2023 was supported by domestic demand but was tempered by elevated commodity prices, the lagged effects of interest rate hikes, contraction in government spending, and slower global economic growth.[16]

Figure 7. Gross Domestic Product and Gross National Income
at constant 2018 prices; year-on-year growth, in percent



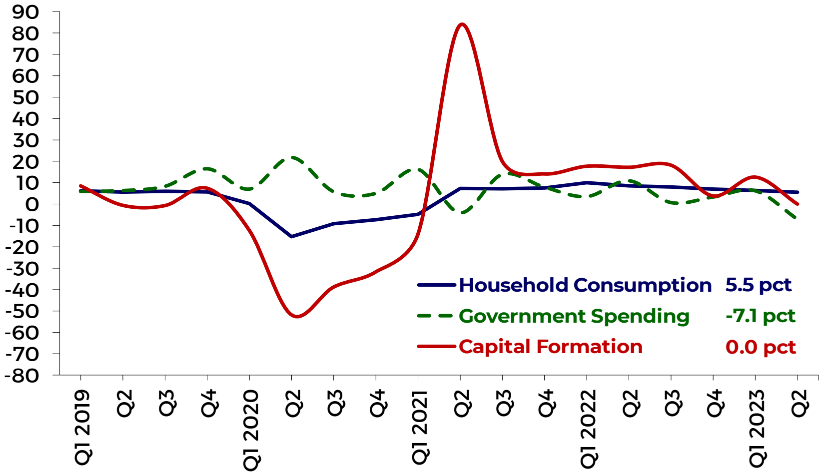
Source: PSA

The gross national income in Q2 2023 grew by 8.6 percent y-o-y in Q2 2023, lower than the 10.0-percent growth in Q1 2023 and 9.4-percent growth in Q2 2022. Net primary income accelerated to 90.6 percent in Q2 2023 from the 82.4-percent growth in Q1 2023 and 66.8 percent in Q2 2022. On a seasonally-adjusted basis, q-o-q GDP declined by 0.9 percent in Q2 2023 from the 1.0-percent growth in Q1 2023.

Aggregate demand. Under the expenditure approach, household consumption, and net exports contributed 3.7 percentage points (ppts) and 0.9 ppt, respectively, to total GDP growth in Q2 2023. Meanwhile, government spending weighed it down by 1.3 ppt. Investments (or capital formation) was nil as it contracted during the quarter.

[16] Based on the Joint Statement by the Economic Managers on the Philippine Economic Performance for Q2 2023.

Figure 8. Gross Domestic Product by Expenditure Shares
at constant 2018 prices; growth rate in percent



Source: PSA

Household consumption, which accounted for 68.8 percent of GDP in Q2 2023, expanded by 5.5 percent y-o-y in Q2 2023. This was lower than 6.4 percent in the previous quarter and 8.5 percent in the previous year. The growth in private consumption was mainly attributed to sustained increase in spending on transport, restaurants and hotels, housing, water, electricity, gas and other fuels, miscellaneous goods and services, and education.

Government expenditures declined by 7.1 percent in Q2 2023. This was a reversal from the expansions by 6.2 percent in the previous quarter and 10.9 percent in the previous year. The significant slowdown was due to lower disbursements for capital transfers to Local Government Units (LGUs) and maintenance and other operating expenses (MOOE), as well as the absence of election-related spending in H1 2023.[17]

Capital formation was almost flat in Q2 2023 from the 12.6-percent in Q1 2023 and 17.2-percent growth in Q2 2022. This was due mainly to weaker performance of fixed capital investment amid higher interest rates.

Overall exports grew by 4.1 percent in Q2 2023 from the 1.0 percent and 4.9 percent in Q1 2023 and Q2 2022, respectively. Exports of services grew markedly, supported by travel services, miscellaneous services, government goods and services, telecommunications, computer and information services, business services, and insurance and pension services.

In contrast, overall imports eased by 0.4 percent in Q2 2023 from 4.7 percent and 14.5 percent in Q1 2023 and Q2 2022, respectively. Declines were registered in imports of goods particularly, electronic data processing, chemical and chemical products, base metals, other imports of goods, and mineral fuels, lubricants and related materials.

[17] DBM Report on the National Government Disbursement Performance (May 2023). Retrieved from: https://www.dbm.gov.ph/index.php/dbcc-matters/reports/ng-disbursement-performance/reports/2711-2023-ng-disbursement-performance

Table 14. Gross Domestic Product by Expenditure Shares
at constant 2018 prices; growth rate in percent

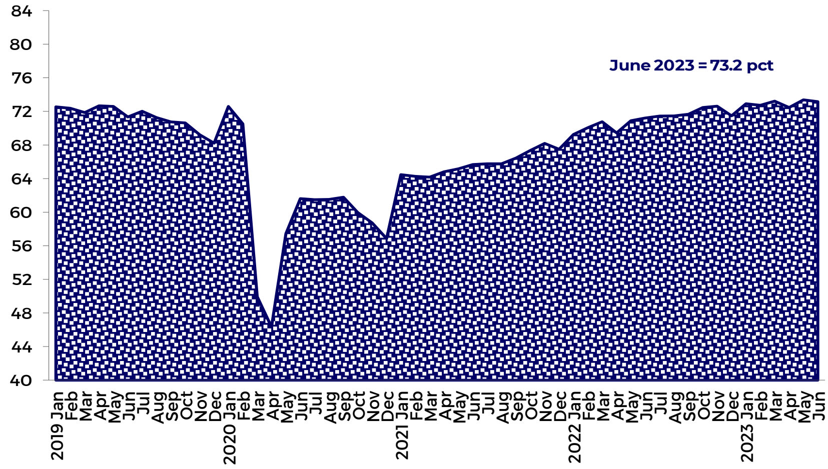
Expenditure Shares	2022	2023	
	Q2	Q1	Q2
Household Final Consumption Expenditure	8.5	6.4	5.5
Government Final Consumption Expenditure	10.9	6.2	-7.1
Gross Capital Formation	17.2	12.6	0.0
Gross Fixed Capital Formation	12.5	10.9	3.9
Exports of Goods and Services	4.9	1.0	4.1
Imports of Goods and Services	14.5	4.7	0.4

Source: PSA

Other demand indicators

Capacity utilization. The manufacturing sector's preliminary average capacity utilization rate stood at 73.2 percent in June 2023, marginally lower than the previous month's revised 73.4 percent based on the Philippine Statistics Authority's Monthly Integrated Survey of Selected Industries (MISSI).

Figure 9. Monthly Average of Capacity Utilization for Manufacturing
2018=100; in percent



Source: PSA

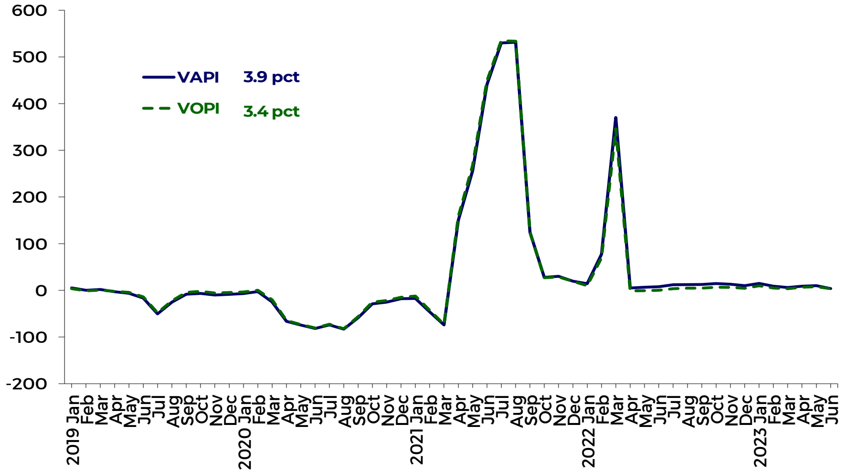
Of the 640 respondent-establishments surveyed by the PSA, about 47.0 percent operated at or above the 80.0 percent capacity level in June 2023, lower than the 49.6 percent recorded in May 2023. The response rate of surveyed establishments is at 67.3 percent (preliminary) in June, similar to the previous month's preliminary response rate.

Average capacity utilization remained high but eased marginally in June 2023 as most of the industries slightly reduced their capacity amid modest demand. Of the 22 major industries, three industries operated above the 80 percent capacity level, while 18 industries operated at the 60-79 percent capacity range. The remaining industry operated at a capacity less than 60 percent.

The average capacity utilization of the following top five subsectors with the biggest share to manufacturing GVA generally decreased in June 2023 from month-ago levels, particularly the manufacture of beverages; chemicals and chemical products; food products; and basic metals. Meanwhile, average capacity utilization for computer, electronic and optical products increased.

Volume and value of production. Preliminary results of the MISSI showed that factory output, as measured by the volume of production index (VoPI), grew by 3.4 percent y-o-y in June 2023. This was slower than the 7.7-percent (revised) growth recorded in May 2023, but better than the 0.04-percent contraction in June 2022. Of the 22 subsectors, there were nine that posted year-on-year expansions, while the remaining 13 subsectors recorded contractions.

Figure 10. Volume and Value Indices of Manufacturing Production
2018=100; year-on-year, in percent



Source: PSA

Similarly, the value of production index (VaPI) grew by 3.9 percent in June 2023, slower than the previous month's (revised) growth of 9.9 percent as well as the previous year's 7.8-percent increase. Of the 22 subsectors, a total of eight posted y-o-y expansions, while the remaining 14 subsectors recorded contractions.

Table 15. Growth in Volume of Production Index by Industry Division

2018=100; year-on-year; in percent

Gainers	Jun-23
1) Printing and Reproduction of Recorded Media	34.6
2) Transport Equipment	30.6
3) Electrical Equipment	29.5
4) Other Manufacturing and Repair and Installation of Machinery and Equipment	23.6
5) Basic Pharmaceutical Products and Pharmaceutical Preparations	20.0
6) Coke and Refined Petroluem Products	15.4
7) Basic Metals	15.0
8) Wood, Bamboo, Cane, Rattan Articles and Related Products	3.7
9) Chemical and Chemical Products	0.6
Losers	**Jun-23**
1) Fabricated Metal Products, except Machinery and Equipment	-36.4
2) Wearing Apparel	-34.5
3) Furniture	-28.2
4) Machinery and Equipment Except Electrical	-21.6
5) Tobacco Products	-20.5
6) Leather and Related Products, Including Footwear	-13.0
7) Other Non-Metallic Mineral Products	-8.4
8) Beverages	-7.7
9) Paper and Paper Products	-7.2
10) Computer, Electronic and Optical Products	-7.0
11) Rubber and Plastic Products	-4.7
12) Food Products	-3.2
13) Textiles	-0.5

Source: PSA

Table 16. Growth in Value of Production Index by Industry Division

2018=100; year-on-year; in percent

Gainers	Jun-23
1) Printing and Reproduction of Recorded Media	37.4
2) Electrical Equipment	28.9
3) Transport Equipment	26.1
4) Other Manufacturing and Repair and Installation of Machinery and Equipment	24.3
5) Basic Pharmaceutical Products and Pharmaceutical Preparations	19.7
6) Basic Metals	9.3
7) Coke and Refined Petroluem Products	6.7
8) Wood, Bamboo,Cane, Rattan Articles and Related Products	3.1
Losers	**Jun-23**
1) Fabricated Metal Products, except Machinery and Equipment	-33.4
2) Wearing Apparel	-32.3
3) Furniture	-25.5
4) Machinery and Equipment Except Electrical	-20.2
5) Tobacco Products	-17.2
6) Leather and Related Products, Including Footwear	-9.9
7) Other Non-Metallic Mineral Products	-7.4
8) Computer, Electronic and Optical Products	-4.7
9) Chemical and Chemical Products	-4.3
10) Rubber and Plastic Products	-4.1
11) Paper and Paper Products	-3.8
12) Beverages	-2.7
13) Textiles	-0.7
14) Food Products	-0.4

Source: PSA

Purchasing managers' index.[18] The preliminary composite PMI in July 2023 decreased to 48.1 index points from 52.4 (revised) in the previous month, below the 50-point threshold indicating a faster pace of contraction in economic activity.[19] This may be attributed to contractions in the manufacturing, retail and wholesale, and services sectors. Furthermore, business managers from all sectors anticipate economic conditions to slow down further in August 2023.

The PMI for the services sector fell by 4.8 index points to 48.2 in July 2023, its third consecutive m-o-m decline, a decline relative to the revised index of 53.0 in June 2023. This may be attributed to contractions in Business Activity, New Orders, and Outstanding Business. Indicators of operating conditions likewise deteriorated as demand for services weakened. Employment in the sector continued its slow pace of expansion amid the approved wage hike for minimum earners in Metro Manila. Furthermore, prospects for the sector remains to be less favorable in August 2023.

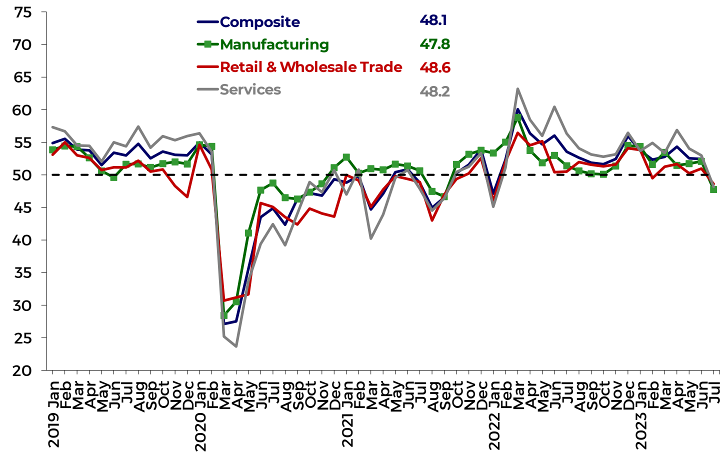
The manufacturing sector also declined to 47.8 index points in July 2023, the sector's first contraction since September 2021, from the previous month's revised index of 52.1. This was due to the faster m-o-m contractions of New Orders, Production, and Inventory. Consequently, unfavorable demand conditions for the

[18] Data based on the monthly PMI report of the Philippine Institute for Supply Management (PISM).
[19] The actual formula used to calculate the PMI assigns weights to each common element and then multiplies them by 1.0 for improvement, 0.5 for no change, and 0 for deterioration. As a result, an index above 50 indicates economic expansion, and an index below 50 implies a contraction. PMI surveys are conducted on the last week of the month.

sector contributed to the decline in Employment. Moreover, the increase in Lead Time implied renewed delivery delays. Looking ahead, manufacturing firms anticipate business conditions to slow down in August 2023.

Similarly, the retail and wholesale PMI decreased to its lowest in nearly two years at 48.6 index point in July 2023 from last month's 51.0 points. This was due to declines in the volume of goods purchased by clients (Purchases), Sales Revenues, and Employment. Lead Time also increased. By contrast, the available stocks of materials, merchandise and products ready for resale (Inventory) expanded faster for the month. Meanwhile, business managers from the retail and wholesale sector expect business activities to weaken in the month ahead.

Figure 11. Purchasing Managers' Index
diffusion index

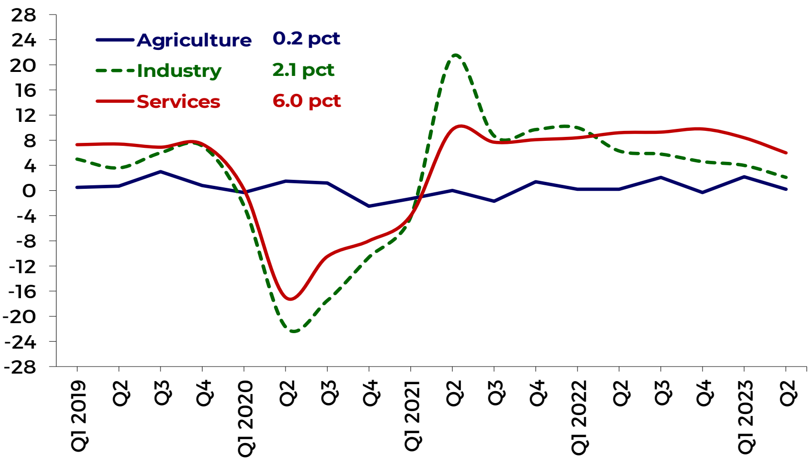


Source: Philippine Institute of Supply Management (PISM)

4. Supply Conditions

Aggregate supply. On the production side of the economy, industry and services sectors contributed 0.6 ppt, and 3.7 ppts, respectively, to total GDP growth in Q2 2023 while agriculture was nil in Q2 2023.

Figure 12. Gross Domestic Product by Industrial Origin
at constant 2018 prices



Source: PSA

The agriculture sector expanded by 0.2 percent y-o-y in Q2 2023, a deceleration from the 2.2 percent in the previous quarter. This was due mainly to a double-digit decline in fisheries (-13.7 percent). Lower output for sugarcane, rubber, corn, forestry and logging, and abaca also contributed to the decline agricultural production in Q2 2023.

The industry sector slowed down in Q2 2023 to 2.1 percent, slower than 4.0 percent in Q1 2023 and 6.3 percent in Q2 2022. The moderation was traced mainly to the easing of construction and manufacturing activities. Construction grew at a slower pace of 3.5 percent in Q2 2023 from 11.1 percent in Q1 2023 and 18.7 percent in Q2 2022, while manufacturing expanded by only 1.2 percent in Q2 2023 from 1.9 percent in Q1 2023 and 2.3 in Q2 2022.

Services sector grew by 6.0 percent in Q2 2023, slower than 8.4 percent in the previous quarter and 9.2 percent in the previous year. The sector's growth was weighed down by public administration and defense; and compulsory social activities. Nonetheless, growth in the services sector was led by the wholesale and retail trade, repair of motor vehicles and motorcycles, financial and insurance activities, and transportation and storage.

Table 17. Gross Domestic Product by Industrial Origin

at constant 2018 prices; growth rate in percent

Industrial Origin	2022	2023	
	Q2	Q1	Q2
Agriculture, Forestry, and Fishing	0.2	2.2	0.2
Industry Sector	6.3	4.0	2.1
Mining and Quarrying	-6.8	-2.2	-3.5
Manufacturing	2.3	1.9	1.2
Electricity, Steam, Water and Waste Management	5.4	7.2	4.8
Construction	18.7	11.1	3.5
Service Sector	9.2	8.4	6.0
Wholesale and Retail Trade and Repair of Motor Vehicles and Motorcycles	9.7	6.8	5.3
Transportation and Storage	27.6	14.6	17.3
Accomodation and Food Service Activities	30.9	27.8	28.3
Information and Communcation	10.6	4.7	4.1
Financial and Insurance Activities	3.7	8.8	5.0
Real Estate and Ownership of Dwellings	4.4	3.2	2.8
Professional and Business Services	8.4	7.8	6.8
Public Administration and Defense; Compulsory Social Security	9.6	1.5	-2.4
Education	5.5	6.6	6.4
Human Health and Social Work Activities	1.5	7.7	8.2
Other Services	39.9	37.0	22.2

Source: PSA

Oil market developments. The spot price of Dubai crude oil in the first week of August 2023 increased compared to the full-month average price in July 2023. This was due mainly to the additional oil supply cuts by Saudi Arabia, Russia, and Algeria as well as oil supply disruptions in several oil-producing countries in July 2023, subdued Russian oil exports in June, and lower US crude oil inventories. On the demand side, China's pledge to provide economic stimulus measures and higher crude oil imports in June 2023 as well as the IMF's upgrade of its global growth outlook for 2023 raised expectations of stronger oil demand and partially pushed up international crude oil prices.

Nonetheless, concerns over weaker demand prospects due to the continued tightening of monetary policy settings, coupled with weak economic outturn for China and the credit rating downgrade of the US by Fitch Ratings, offset gains in international oil prices. Meanwhile, the on-going turmoil between Russia and Ukraine poses upside risks to global oil prices in the near term.

On the domestic front, week-on-week prices for diesel and kerosene as of 1 August 2023 edged up by ₱7.95 per liter and ₱4.02 per liter, respectively, while the local price for gasoline declined by ₱3.20 per liter. Meanwhile, relative to end-2022 prices, diesel and gasoline prices decreased by ₱7.40 per liter and ₱0.35 per liter, respectively, while kerosene price increased by ₱0.77 per liter.

Developments in the agriculture sector. The Agriculture, Forestry, and Fishing (AFF) sector grew modestly by 0.2 percent in Q2 2023, slower than 2.2 percent in Q1 2023. Similarly, based on the q-o-q seasonally-adjusted series, the sector contracted by 1.0 percent during the quarter. Positive contributions to the growth of the sector were mainly from palay, livestock and poultry which mitigated the lower sugarcane and fisheries production.

Crop production, which contributed more than half (56.3 percent) of the total value of production in agriculture and fisheries, increased by 1.2 percent in Q2 2023. This was slower than the 1.7-percent expansion in Q1 2023 and a reversal from the decline of 2.7 percent in Q2 2022.

Likewise, livestock and poultry production, which accounted for 14.8 percent and 15.1 percent of total agricultural output, increased by 0.7 percent and 1.5 percent, respectively.

Meanwhile, the fisheries sector, which comprised 13.8 percent of total value of production in agriculture and fisheries, recorded a contraction of 14.2 percent in Q2 2023.

Global food prices. The FAO All Rice Price Index[20] averaged 129.7 points in July 2023, higher by 2.8 percent from 126.2 points in June and up by 20.0 percent from the previous year's level of 108.4 points. This was the highest level in nearly 12 years as prices in key exporting countries soared driven by strong demand and India's decision to restrict rice exports of non-basmati and broken white rice effective 20 July 2023.

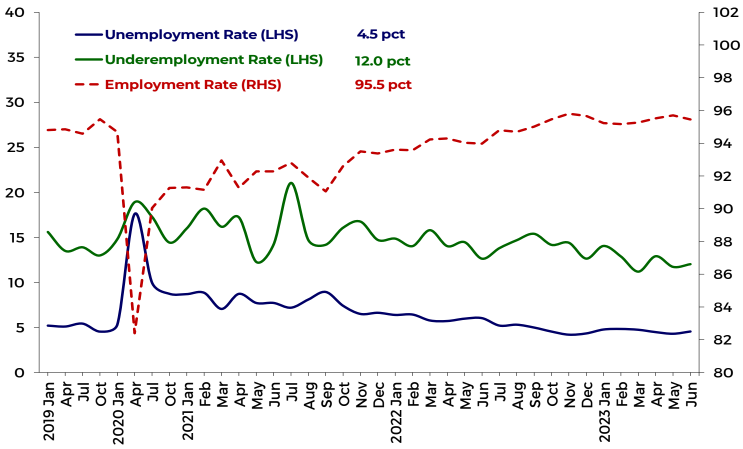
[20] The FAO All Rice Price Index is based on 21 rice export quotations. These quotations are combined into four groups consisting of Indica, Aromatic, Japonica and Glutinous rice varieties.

Similarly, the FAO Food Price Index (FPI) stood at 123.9 points in July 2023, slightly higher than the 122.4 points in June but remained below the previous year's level of 140.6 points. The m-o-m increase was largely attributed to the price uptick in vegetable oils amid global supply uncertainties, which outweighed the price declines for cereals (particularly wheat), sugar, dairy, and meat products owing to favorable supply conditions.

5. Labor Market Conditions

The unemployment rate in June 2023 was at 4.5 percent, marginally higher than 4.3 percent posted in May 2023 but lower than 6.0 percent in June 2022. The unemployment rate in June 2023 translated to about 2.33 million unemployed Filipinos, which was higher than the previous month's level by about 159,000 but lower than previous year's level by about 663,000.

Figure 13. Labor Market Indicators
in percent



Source: PSA

On the other hand, employment rate in June 2023 was at 95.5 percent, slightly lower than 95.7 percent in the previous month but higher than 94.0 percent in the previous year. In absolute terms, there were about 48.84 million employed individuals in June 2023, which was higher by about 581,000 from the month-ago and by about 2.25 million from the year-ago level.

Finally, the underemployment rate in June 2023 stood at 12 percent, higher than 11.7 percent recorded in May 2023 but lower than 12.6 percent in June 2022. The June 2023 underemployment rate corresponded to about 5.87 million Filipinos.

Wage developments. On 30 June 2023, the Regional Tripartite Wage and Productivity Board (RTWPB) for the National Capital Region (NCR) published Wage Order No. NCR-24 which grants a ₱40-increase in basic pay for the region's non-agricultural and agriculture sectors. This will bring the new minimum wage for the region to ₱610.00 from ₱570.00 for non-agricultural workers and ₱573.00 from ₱533.00 for the agricultural sector, service, and retail establishments employing 15 or less workers, and manufacturing establishments regularly employing less than 10 workers. According to the Department of Labor and Employment (DOLE), this is expected to directly benefit 1.1 million minimum wage earners in private establishments for the region. This wage order took effect on 16 July 2023.

Meanwhile, petitions for minimum wage increases have also been filed in Regions III (Central Luzon), IV-A (CALABARZON), V (Bicol), VI (Western Visayas), and VII (Central Visayas). RTWPBs in Central Luzon, CALABARZON and Western Visayas are currently discussing the merit of the petitions. Meanwhile, the RTWPB in Central Visayas is conducting its public consultation in August 2023. According to DOLE, decisions on wage petitions in these regions could be expected by September.

6. Monetary Operations

As of 2 August 2023, the total outstanding amount absorbed in the BSP liquidity facilities stood at about ₱1.522 trillion. The bulk of the BSP's monetary operations to absorb excess liquidity had been conducted through the BSP Securities Facility via BSP Bills (BSPB), comprising about 38.5 percent (or about ₱585.4 billion). Placements in the term deposit facility (TDF) made up nearly a quarter of total placements (or around ₱376.2 billion), while the overnight reverse repurchase (RRP) facility and the overnight deposit facility amounted to ₱340.3 (22.4 percent) and ₱220.1 billion (14.5 percent), respectively.

For the TDF auction on 2 August 2023, the weighted average interest rate (WAIR) for the 7-day TDF rose marginally to 6.5888 percent from 6.5806 percent fetched on 26 July 2023. Similarly, the WAIR for the 14-day TDF went up slightly to 6.5903 percent from 6.5864 percent in the previous auction. In terms of demand, the 7-day and 14-day tenors' bid-to-cover ratios (BCRs) for 2-August TDF auction stood at 1.0091x and 0.9902x, respectively.

For the issuance of BSP bills, the resulting WAIR for the 28-day BSPB rose slightly to 6.7108 percent during the 4 August 2023 auction from 6.7048 percent fetched on 28 July 2023. Similarly, the WAIR for the 56-day BSPB was at 6.7356 percent, higher than the previous auction's WAIR at 6.6999 percent.[21] The BCRs for the 4-August BSPB auction stood at 1.1251x and 0.7618x for the 28-day and 56-day BSPB, respectively.

The auction results for the TDF and BSPB during the review period reflected the pass-through of the BSP's monetary tightening, with liquidity in the financial system remaining adequate. Moreover, eligible counterparties have been shifting their assets towards the BSP Securities amid the need to service client requirements.

For the daily RRP auctions, the BSP shifted to the fixed-rate, full-allotment auction format effective 14 July 2023. Since then, the BSP has awarded, on average, ₱376.149 billion (as of 4 August 2023). On a m-o-m basis, the awarded amount for August averaged at ₱402.847 billion, higher than the July figure[22] of ₱366.441 billion.

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[21] The maiden issuance of 56-day BSPB was on 30 June 2023.
[22] Based on auction results from 14 July to 31 July

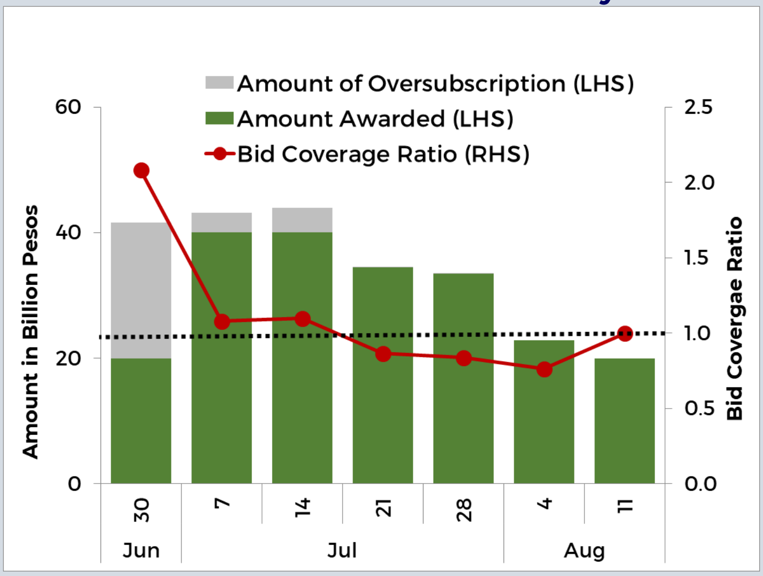
Box Article No. 3: Refinements to Monetary Operations

As part of its ongoing initiatives to enhance its monetary operations under the Interest Rate Corridor (IRC) framework, the BSP continues to refine its monetary policy instruments. Under the BSP Securities Facility (BSP-SF), the BSP introduced a longer tenor to complement the 28-day BSP bill. In addition, the BSP implemented two of the three phased refinements under the series of reforms to the overnight (O/N) RRP facility.

On 30 June 2023, the BSP began offering the 56-day BSP bill (BSPB), an additional tenor alongside the 28-day BSPB under the BSP-SF. Similar to the 28-day BSPB, the 56-day BSBP is offered via competitive auction to eligible counterparties, with the volume offering set in line with prevailing liquidity conditions. The introduction of the 56-day BSPB thus expands the range of BSP's term instruments and increases the BSP's flexibility to respond to changing liquidity conditions while providing guidance to short-term market interest rates.

Market reception to the 56-day BSPB has been favorable, with frequent oversubscriptions observed since the maiden issuance in June. For the first seven auctions, the bid-to-cover ratio ranged from 0.762 to 2.082 times the total offered volume, with an average BCR of 1.103 times the offered amount.

Chart 1. Results of the Auction for 56-day BSP Bills



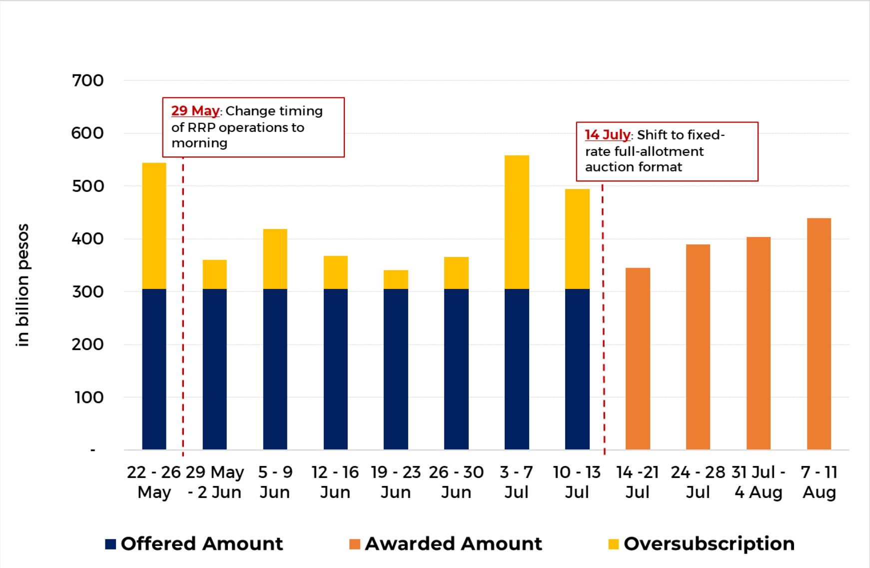
Source: BSP

The BSP is also moving forward in enhancing its daily O/N RRP operations. These refinements have been implemented in phases as part of the broader plan to eventually shift to a variable-rate auction format for the RRP facility.

Phase 1 of the reforms to the RRP facility was on the timing of the daily RRP operations. Starting on 29 May 2023, the schedule of the daily RRP auctions was moved to 11:00-11:30AM (from 4:30-5:00 PM). This reform aligns the schedule of the RRP facility with the other active instruments of the BSP, namely, the BSP-SF and term deposit facility (TDF). This should reinforce the policy guidance of the BSP on short-term market rates at the start of the business day. Conducting the RRP operation at the start of the day will also encourage BSP counterparties to be more forward-looking in managing their daily liquidity requirements. In addition, this reform is seen to result in higher interbank trading activity as banks would have more reason to transact with each other for their liquidity requirements.

Phase 2 of the reform was to switch from a fixed-volume to a full-allotment format. Effective 14 July 2023, all bids received from the counterparties of the BSP will be awarded in full. The full-allotment auction format for the daily O/N RRP facility allows the BSP the flexibility to absorb changes in the level of excess liquidity from the financial system by accepting all tenders. The daily RRP operation likewise ensures stronger traction of the policy rate on short-term market rates.

Chart 2. Results of the RRP Auctions



Source: BSP

Figure 2 shows that, following the change in the RRP auction time to a morning schedule, lower average oversubscriptions (relative to the week prior to implementation) was observed for the week 29 May – 2 June. However, in early July 2023, following the reduction in reserve requirement ratios and before the change in RRP auction format to full allotment, average tendered amounts received during auctions increased and returned to levels when RRP operations were in the afternoon.

A decline in average oversubscriptions in the RRP facility was also observed after the shift to a fixed-rate, full-allotment method for the period 14-21 July. However, as of 11 August, a gradual increase in average daily tenders on a weekly basis has been observed. From only about ₱345 billion for the period 14-21 July, the weekly average tenders received has increased to ₱439 billion for the period 7-11 August.

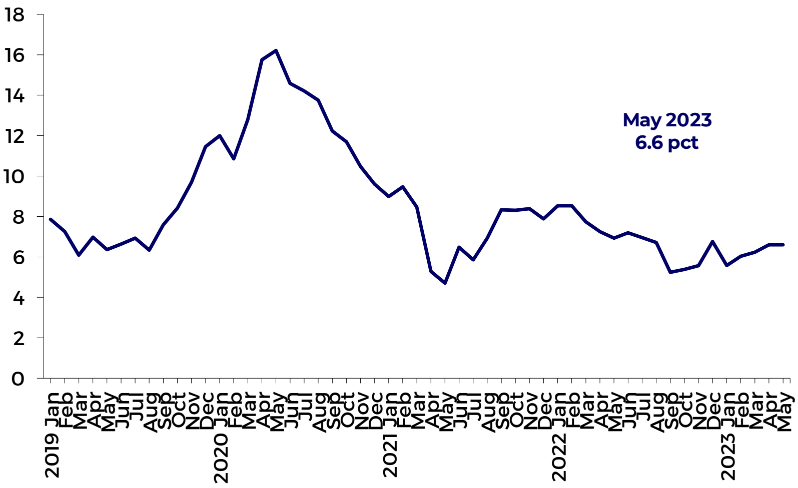
Finally, Phase 3 of the reforms to the RRP facility is to transform from a fixed-rate to a variable-rate auction format with pre-determined offer volume. Transforming the RRP facility into a variable-rate auction format allows more room for interbank market price discovery. The resulting daily RRP rate from the auctions will be a market-determined rate, which is seen to foster the price-discovery process of banks and other financial institutions and thereby support further money market activity. Consequently, this change is expected to promote the more efficient functioning of the transmission mechanism for monetary policy.

7. Financial Conditions

Domestic liquidity. Preliminary data showed that domestic liquidity (M3) grew by 6.6 percent y-o-y to about ₱16.3 trillion in May 2023. This is the same rate of expansion recorded in the previous month. On a m-o-m seasonally-adjusted basis, M3 increased by about 0.3 percent.

Domestic claims rose by 11.4 percent y-o-y in May from 11.9 percent in the previous month. Claims on the private sector grew by 9.3 percent in May from 9.8 percent (revised) in April, driven by the sustained expansion in bank lending to non-financial private corporations and households. Net claims on the central government also expanded by 18.3 percent in May from 20.2 percent (revised) in April owing mainly to the borrowings by the NG.

Figure 14. Domestic Liquidity
year-on-year growth rate, in percent



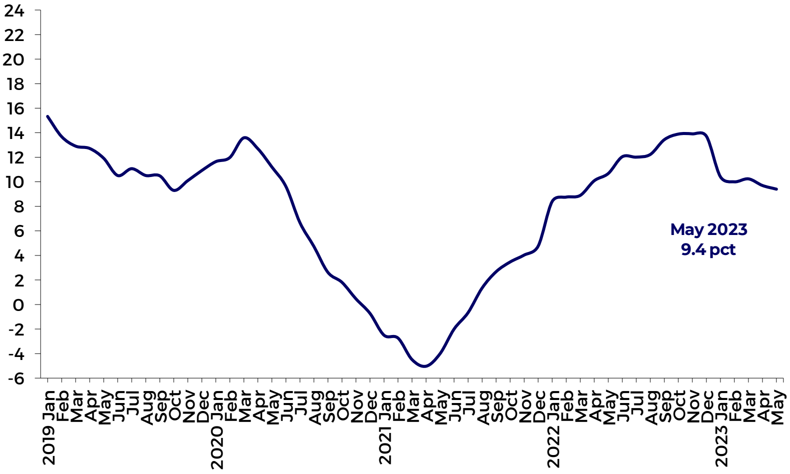
Source: BSP

Net foreign assets (NFA) in peso terms grew by 2.7 percent y-o-y in May following the 0.2-percent contraction in April. The BSP's NFA position expanded by 4.2 percent in May after increasing by 2.5 percent in the previous month. Meanwhile, the NFA of banks declined on account of higher bills payable.

On the liabilities side, the growth in M3 was driven mainly by the increase in time deposits.

Bank lending. Preliminary data indicated that outstanding loans of universal and commercial banks (U/KBs), net of RRP placements with the BSP, expanded by 9.4 percent y-o-y in May 2023 from 9.7 percent in April. On a m-o-m seasonally-adjusted basis, outstanding universal and commercial bank loans, net of RRPs, increased by 0.7 percent.

Figure 15. Loans Outstanding of Commercial Banks
year-on-year growth rate, in percent



Source: BSP

Outstanding loans to residents, net of RRPs, went up by 9.3 percent in May from 9.6 percent in April. Similarly, outstanding loans for production activities rose by 7.9 percent in May after growing by 8.3 percent in the previous month, due mainly to the continued increase in loans to major industries, specifically electricity, gas, steam, and airconditioning supply (14.1 percent); real estate activities (5.5 percent); wholesale and retail trade, and repair of motor vehicles and motorcycles (8.6 percent); information and communication (15.9 percent); and financial and insurance activities (7.3 percent).

Consumer loans to residents grew at a slightly faster rate of 22.7 percent in May from 22.3 percent in April due to the increase in credit card, motor vehicle, and salary loans. Outstanding loans to non-residents[23] also went up by 13.2 percent in May from 12.2 percent in the previous month.

Credit standards

Results of the Q2 2023 Senior Bank Loan Officers' Survey (SLOS)[24] indicated that a higher number of surveyed banks retained their overall lending standards for business and household loans based on the modal approach.[25] Similar with the

[23] Outstanding loans to non-residents include loans by UKB's foreign currency deposit units (FCDUs) to non-residents.
[24] The SLOS consists of questions on loan officers' perceptions relating to the overall credit standards of their respective banks, as well as to factors affecting the supply of and demand for loans to both enterprises and households. The analysis of the results of the SLOS focuses on the quarter-on-quarter changes in the perception of respondent banks. The responses for the Q2 2023 SLOS were gathered between 5 June and 12 July 2023 from 48 banks out of the total 62 bank participants. The response rate of 77.4 percent is higher compared to the response rate of 75.0 percent in the Q1 2023 SLOS. It should be noted that the number of respondents also decreased following the merging of Bank of the Philippine Islands (BPI) and BPI Family Savings Bank, Inc. (BFSBI).
[25] In the modal approach, the results of the survey are analyzed by looking at the option with the highest share of responses. The three options for the modal approach are either 1) tightening, 2) easing, or 3) unchanged credit standards for loans to enterprises and for loans to households.

previous quarter, the diffusion index (DI) method[26,27] showed varied results pointing to a net tightening of loan standards to firms and a net easing of lending standards for consumers.

Lending standards for loans to enterprises. Modal-based results revealed that a larger proportion of respondents (89.1 percent) kept credit standards for businesses unchanged. Meanwhile, the DI approach pointed to a net tightening of overall lending standards[28] across all borrower-firm sizes due to deterioration in the profitability of banks' portfolios; less desirable borrowers' profiles; and reduced tolerance for risk.

Table 18. General Credit Standards for Loans to Enterprises (Overall)

	2020				2021				2022				2023	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Tightened considerably	2.8	20.4	20.5	14.6	10.6	8.0	4.2	4.2	10.0	6.5	10.4	4.3	6.7	4.3
Tightened somewhat	30.6	49.0	27.3	17.1	14.9	20.0	20.8	14.6	16.0	13.0	8.3	12.8	13.3	4.3
Remained basically unchanged	**66.7**	**24.5**	**45.5**	**63.4**	**66.0**	**70.0**	**70.8**	**75.0**	**72.0**	**76.1**	**77.1**	**80.9**	**73.3**	**89.1**
Eased somewhat	0.0	6.1	6.8	4.9	8.5	2.0	4.2	6.3	2.0	4.3	4.2	2.1	6.7	2.2
Eased considerably	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Diffusion index for credit standards	**33.3**	**63.3**	**40.9**	**26.8**	**17.0**	**26.0**	**20.8**	**12.5**	**24.0**	**15.2**	**14.6**	**14.9**	**13.3**	**6.5**
Number of banks responding	**36**	**49**	**44**	**41**	**47**	**50**	**48**	**48**	**50**	**46**	**48**	**47**	**45**	**46**

Note: A positive diffusion index for credit standards indicates that more banks have tightened their credit standards compared to those that eased ("net tightening"), whereas a negative diffusion index for credit standards indicates that more banks have eased their credit standards compared to those that tightened ("net easing").
Source: BSP

Over the next quarter, the modal approach showed expectations of generally unchanged credit standards for businesses while the DI method pointed to bank respondents' anticipations of net tightening of loan standards. Banks foresee an overall net tightening in loan standards for enterprises in Q3 2023 given weakening profitability and liquidity of banks' portfolios; deterioration of borrowers' profiles; and reduced tolerance for risk.

Lending standards for commercial real estate loans (CRELs) in Q2 2023 were broadly steady according to most respondent banks (83.3 percent). Meanwhile, the DI method indicated a net tightening for the 30th consecutive quarter mainly due to weakening of borrowers' profiles and lower risk tolerance. In the next quarter, banks anticipate maintaining their credit standards for CRELS based on both the DI-based method and the modal approach.

Lending standards for loans to households. Majority of the surveyed banks (69.7 percent) broadly retained their loan standards for loans extended to households in Q2 2023. Meanwhile, the DI approach indicated a net easing, particularly for

[26] In the DI approach, a positive DI for credit standards indicates that the proportion of respondent banks that have tightened their credit standards exceeds those that eased (“net tightening”), whereas a negative DI for credit standards indicates that more respondent banks have eased their credit standards compared to those that tightened (“net easing”). Meanwhile, an unchanged credit standards in the DI approach indicates that the proportion of the respondent banks that have tightened their credit standards is equal to those that eased their credit standards.
[27] During the Q1 2010 to Q4 2012 survey rounds, the BSP used the DI approach in the analysis of survey results. Beginning in Q1 2013, the BSP used both the modal DI approaches in assessing the results of the survey.
[28] The net tightening of credit standards for business loans In Q2 2023 is reflected in the reduced size of credit lines, stricter collateral requirements and loan covenants, and more use of interest rate floors.

housing, credit card, and personal/salary loans[29] which was attributed to improved profitability of banks' portfolios; an increase in risk tolerance; less uncertain economic outlook; and more aggressive competition from banks and non-bank lenders.

Table 19. General Credit Standards for Loans to Households (Overall)

	2020				2021				2022				2023	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Tightened considerably	0.0	39.4	16.7	3.7	9.4	5.7	5.6	2.9	2.5	5.4	5.4	5.7	3.0	3.0
Tightened somewhat	21.7	21.2	30.0	11.1	9.4	20.0	11.1	8.6	12.5	5.4	10.8	8.6	18.2	9.1
Remained basically unchanged	**69.6**	**33.3**	**50.0**	**77.8**	**75.0**	**68.6**	**69.4**	**65.7**	**62.5**	**73.0**	**64.9**	**71.4**	**51.5**	**69.7**
Eased somewhat	8.7	6.1	3.3	7.4	6.3	5.7	13.9	17.1	17.5	13.5	18.9	14.3	27.3	12.1
Eased considerably	0.0	0.0	0.0	0.0	0.0	0.0	0.0	5.7	5.0	2.7	0.0	0.0	0.0	6.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Diffusion index for credit standards	**13.0**	**54.5**	**43.3**	**7.4**	**12.5**	**20.0**	**2.8**	**-11.4**	**-7.5**	**-5.4**	**-2.7**	**0.0**	**-6.1**	**-6.1**
Number of banks responding	**23**	**33**	**30**	**27**	**32**	**35**	**36**	**35**	**40**	**37**	**37**	**35**	**33**	**33**

Note: A positive diffusion index for credit standards indicates that more banks have tightened their credit standards compared to those that eased ("net tightening"), whereas a negative diffusion index for credit standards indicates that more banks have eased their credit standards compared to those that tightened ("net easing").
Source: BSP

For the next quarter, the modal approach indicated a generally unchanged credit standards for household loans. Meanwhile, the DI approach showed a net easing in household loan standards in Q3 2023 mainly due to increased risk tolerance and improving profitability of banks' portfolios for this market segment; and more desirable borrowers' profiles.

For housing loans, a higher percentage of bank respondents (73.3 percent) reported maintained overall credit standards. Meanwhile, the DI-based method indicated a net easing which was attributed to improving borrowers' profiles and less uncertain economic outlook. While most respondent banks expect to maintain credit standards for housing loans in Q3 2023, the DI method shows a net easing of housing loan standards for the following quarter.

Loan demand from enterprises. The modal-based approach revealed broadly unchanged loan demand from businesses (69.6 percent). However, the DI method continued to reflect a net increase from across all firm classifications due largely to increased customer inventory financing and accounts receivable financing along with improvement in customers' economic prospects.[30]

For Q3 2023, a larger proportion of respondents indicated expectations of broadly retained loan demand. However, the DI method indicated expectations of a net increase in overall credit demand in the next quarter given businesses' increasing inventory and accounts receivables financing requirements and improvement in customers' economic outlook.

[29] The net easing of credit standards for consumer loans in Q2 2023 is reflected in the narrower loan margins for residential real estate and auto loans along with increased size of credit lines for credit card and personal/salary loans.
[30] The BSP Business Expectations Survey (BES) Q2 2023, business confidence in the economy improved for Q2 2023 stemming from respondent firms' expectations of (1) increase in sales and production due to stronger demand for goods and services across all sectors, (2) continued post-pandemic recovery, (3) fully reopened economy, (4) easing inflation, and (5) seasonal uptick in demand for certain goods such as rice, corn and other cereals, construction materials, electronics, chemicals, food and beverages, metal and steel, and sporting goods and equipment. Correspondingly, business sentiment for the next quarter is less optimistic due to the expected downturn in seasonal production and sales, and lower demand for consumer goods along with fewer construction projects and higher interest rates.

Demand for CRELs in Q2 2023 was broadly steady based on both the modal and DI approaches due to borrowers' stable economic prospects. For Q3 2023, based on the modal approach, most banks anticipate demand for CRELs to be maintained. Meanwhile, DI-based results showed higher loan demand for CRELs on expectations of higher customer inventory and accounts receivable financing needs and improvement in customers' economic outlook.

Loan demand from households. The Q2 2023 survey showed generally unchanged lending demand from households (65.6 percent) based on the modal method. Meanwhile, DI-based results revealed a net increase across all key categories such as housing, credit card, auto, and personal/salary loans attributed to higher household consumption and housing investment as well as banks' more attractive financing terms.

For Q3 2023, more than half of the respondent banks expect maintained loan demand from households. Meanwhile, the DI method, indicated that banks anticipate a net rise in overall consumer loan demand in the next quarter, due largely to expectations of higher household consumption and housing investment.[31]

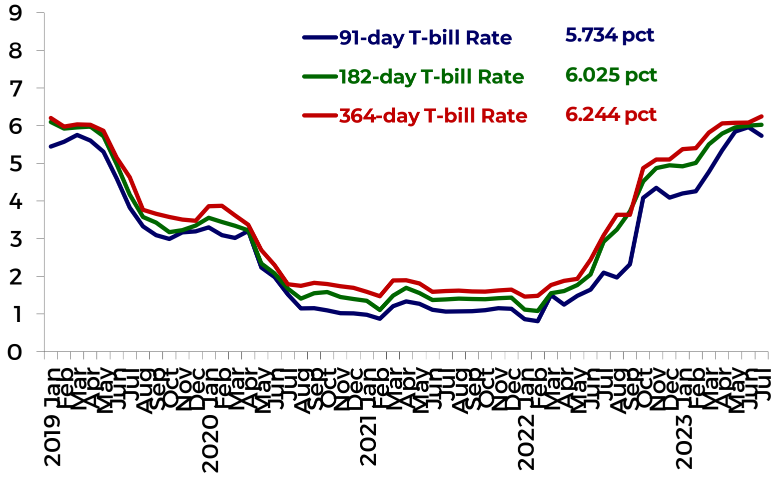
Banks participating in the survey observed maintained loan demand for housing loans in Q2 2023 and expect a similar outcome in Q3 2023. Meanwhile, the DI approach pointed to a net increase in residential real estate loan demand for both the current and next quarter due to higher household expenses and investment for housing.

Primary GS market and rates. On 31 July 2023, the average interest rates for the 90-day and 182-day Treasury bills (T-bills) declined slightly by 38.7 bps and 3.4 bps to 5.224 percent and 5.789 percent, respectively, while the average interest rate for the 364-day T-bills increased by 2.6 bps to 6.210 percent from the rates fetched during the 25 July 2023 auction. The results of the auction reflected market participants' anticipation of lower inflation for July 2023 as well as the expectation that the US Fed would keep its monetary policy settings steady for the rest of the year.

The Bureau of the Treasury (BTr) Auction Committee awarded in full the offered amounts of ₱5.0 billion each for the 90-day, 182-day, and 364-day T-bills. Total tenders for all maturities reached about ₱45.1 billion, or about 3.0 times the ₱15.0-billion total amount offered.

[31] According to the BSP Consumer Expectations Survey (CES), consumer sentiment for Q2 2023 remained pessimistic due to households' concerns over (1) faster increase in the prices of goods and higher household expenses, (2) lower income, (3) fewer available jobs, (4) and the effectiveness of government policies and programs on inflation management and economic resilience. Meanwhile, the expected increase in consumer loan demand in Q3 2023 can be associated with household respondents indicating that loan proceeds in the last 12 months are used to purchase basic goods followed by expenses for education-related costs and health-related expenses.

Figure 16. Treasury Bill Rates
in percent

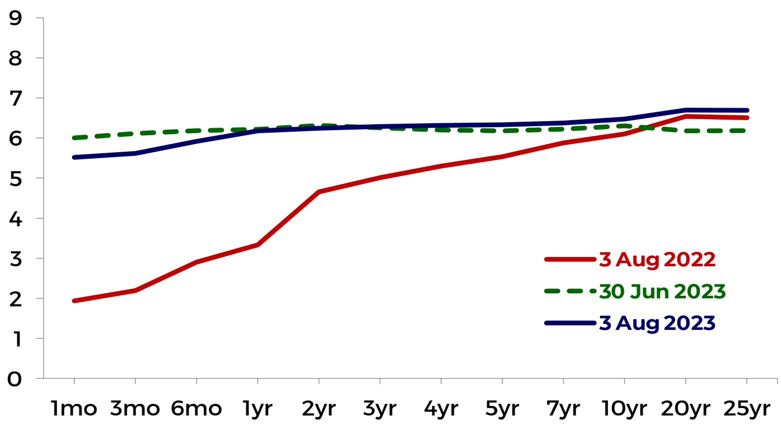


Source: BTr

On 1 August 2023, the BTr made a partial award amounting to about ₱26.6 billion out of the total offering of ₱30 billion for the reissued 10-year Treasury bonds with remaining life of four years and seven months. The average interest rate fetched was 6.337 percent, 53.2 bps higher than the average rate of 5.805 percent during the 6 June 2022 auction for the same series. The auction was oversubscribed with tenders reaching around ₱47.8 billion or 1.6 times the offered amount of ₱30 billion.

Secondary market government securities (GS) yield curve. On 3 August 2023, secondary market GS yields showed mixed trends relative to end-June 2023. Yields declined in the short-end of the curve, while those in the belly and long-end of the curve increased. The yields decreased on buying interest following the increase in the Fed funds rate target range of the US Fed during its monetary policy meeting on 25-26 July 2023, with US Fed Chairman Powell's post-policy statement seen as dovish by market. Meanwhile, yields increased local bond market gains which were limited by some profit-taking. The spreads in secondary market rates over the BSP overnight RRP rate on 3 August 2023 were generally wider relative to end-June 2023 levels.

Figure 17. Yields of Government Securities in the Secondary Market
in percent



Source: Bloomberg

As of 3 August 2023, the spread between the 10-year and 1-year GS rates widened to 29.4 bps (from 8.6 bps as of end-June 2023) due to the decline in 1-year GS rate and the increase in 10-year GS rate. Similarly, the spread between the 10-year and 5-year GS rates widened slightly to 13.8 bps (from 12.6 bps as of end-June 2023) as a result of the slightly larger increase in 10-year GS rate relative to the rise in 5-year GS rate.

Stock market. The Philippine Stock Exchange index (PSEi) averaged 6,551.7 index points in July, higher by 1.1 percent from its June average. The deceleration in inflation contributed to buying activities amid expectations of a more dovish monetary policy stance from the US Fed and a prudent policy pause from the BSP.

However, for 1-2 August 2023, the PSEi averaged marginally lower at 6,538.5 index points. The decline in the local benchmark index could be attributed mainly to negative market sentiment following the US credit rating downgrade by Fitch Ratings.[32] The downgrade in the US credit rating resulted in higher US long-term yields which, in turn, facilitated a net selling. On y-t-d basis, the PSEi closed lower by 1.3 percent at 6,483.3 index points on 2 August.

Figure 18. Philippine Stock Exchange Index
index points

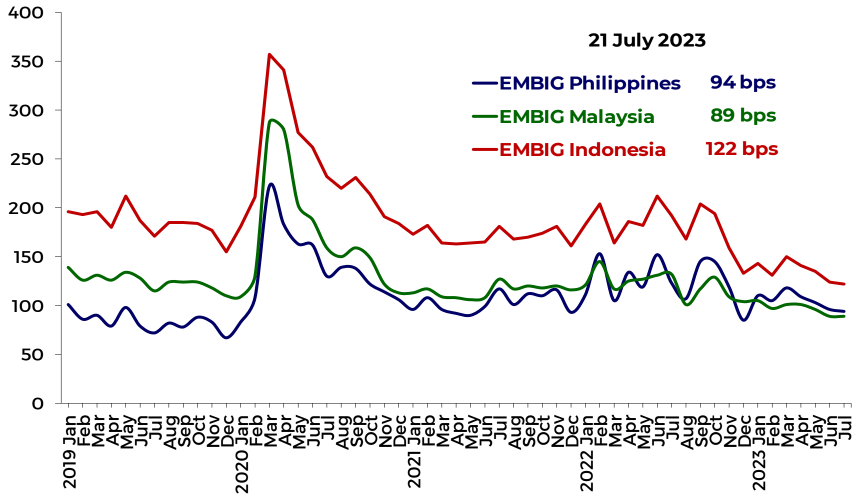
Source: Philippine Stock Exchange, BSP

Sovereign bond and credit default swap spreads. Debt spreads continued to narrow as most central banks maintained monetary policy stance amid easing inflation, following a series of policy tightening. The narrowing of debt spreads in June[33] was mainly on account the US Fed pausing its monetary tightening cycle, following ten (10) consecutive policy rate increases, amid easing price pressures. On the domestic front, the BSP's unchanged key policy rate in May and June along with the reduction in the reserve requirement ratios,[34] the sustained decline in domestic headline inflation, and a robust economic growth outlook for the

[32] Despite the resolution of the debt ceiling crisis in June, Fitch Ratings downgraded the credit rating of the US from AAA to AA+.
[33] CDS spreads averaged 81 bps for the month of June, lower than the 92-bps average in May 2023.
[34] The BSP also implemented a reduction in reserve requirement ratios. This operational adjustment is in line with the BSP's ongoing efforts towards a more active and flexible approach to liquidity management through market-based monetary operations. This includes the inaugural offering on 30 June 2023 of the 56-day BSP Bill, which serves as an additional instrument for absorbing system liquidity.

Philippines provided support to investor sentiment and contributed to the steady decline in risk premiums.

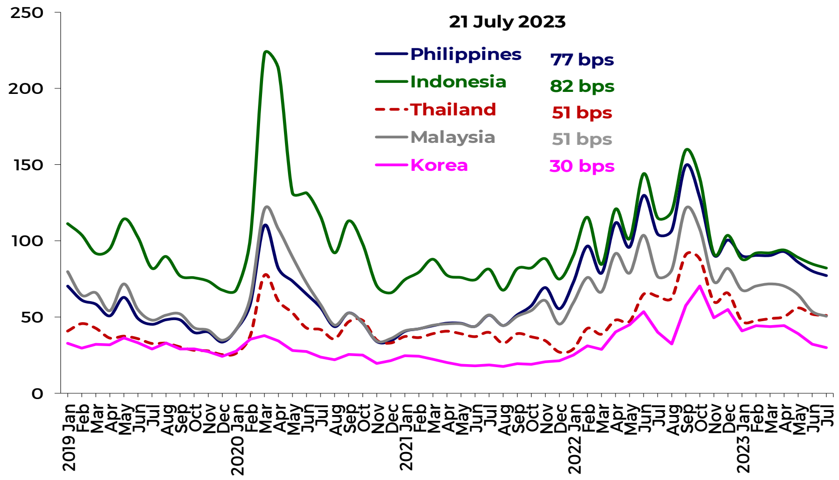
Figure 19. EMBIG Spreads of Selected ASEAN Countries
in basis points



Source: Bloomberg

As of 21 July 2023, the Emerging Market Bond Index Global (EMBIG) Philippines spread, the extra yield investors demand to hold Philippine sovereign debt relative to US Treasuries, narrowed marginally to 94 basis points (bps) from 96 bps in end-June 2023. Similarly, the CDS spread decreased to 77 bps from 80 bps during the same period.

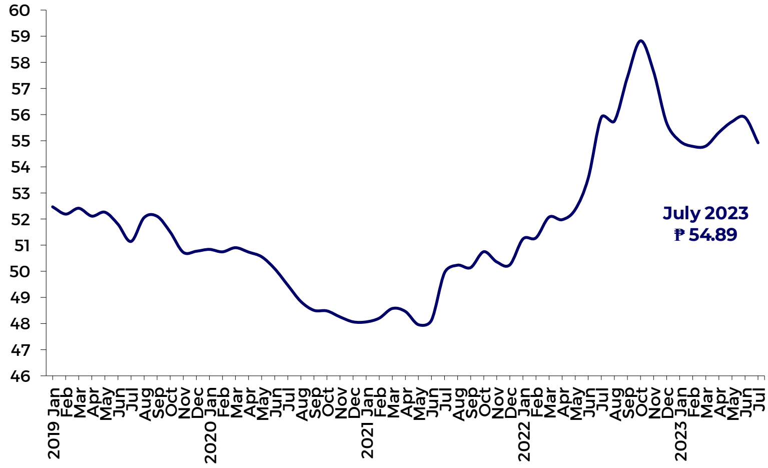
Figure 20. Five-Year Credit Default Swap Spreads of Selected ASEAN Countries
in basis points



Source: Bloomberg

Exchange rate. In July 2023, the peso averaged ₱54.89/US$1, appreciating by 1.74 percent from the ₱55.85/US$1 average in June. The peso strengthened due partly to (i) positive sentiment over the IMF's upward revision of growth outlook for the Philippines in 2023 and ADB's optimistic forecast that the Philippines is expected to post the fastest GDP growth in Southeast Asia this year;[35] (ii) higher personal remittances in May;[36] (iii) lower balance of payments (BOP) deficit in June;[37] and (iv) higher inbound tourism receipts in the first half of the year.[38] In addition, broad US dollar softness amid slower-than-expected US inflation in June likewise provided support to the peso.[39] On a y-t-d basis, the peso likewise appreciated against the US dollar by 1.59 percent to close at ₱54.88/US$1 on 31 July 2023 from the end-December 2022 closing rate of ₱55.76/US$.[40]

Figure 21. Peso-Dollar Rate
PHP/USD



Source: Reference Exchange Rate Bulletin, Treasury Department, BSP

On a real trade-weighted basis, the peso lost external price competitiveness in June 2023 (y-o-y) against the basket of currencies of all trading partners (TPI) and trading partners in developing (TPI-D) countries as indicated by the increase in the REER index of the peso by 065 percent and 1.79 percent, respectively. Meanwhile, the peso gained external price competitiveness against the basket of currencies of trading partners in advanced (TPI-A) countries with the REER index of the peso decreasing by 1.57 percent traced mainly to the nominal depreciation of the peso.[41,42]

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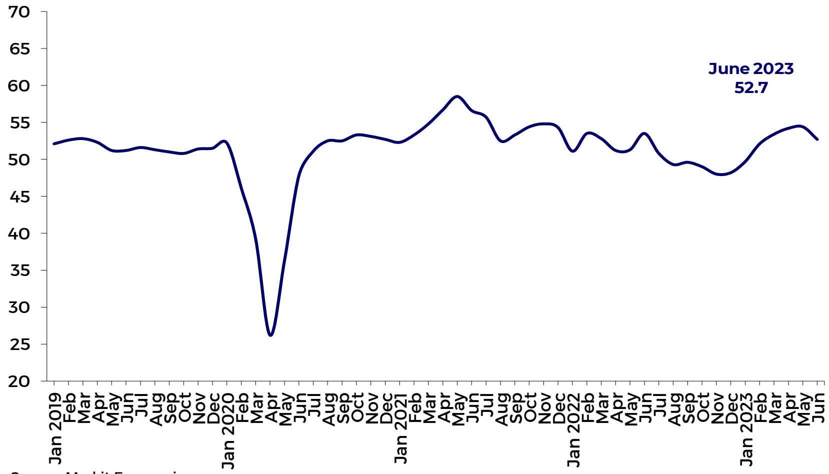
[35] Based on the July 2023 World Economic Outlook, the growth forecast for the Philippines in 2023 increased to 6.2 percent from 6.0 percent in April. Meanwhile, ADB maintained the 6.0 percent growth projection for the country in 2023, the fastest in the Southeast Asian region. (IMF, ADB)
[36] Personal remittances from Overseas Filipinos (OFs) reached US$2.78 billion in May 2023, higher by 2.9 percent than the US$2.70 billion registered in the same month last year. (Bangko Sentral ng Pilipinas)
[37] The country's overall BOP position registered a deficit of US$606 million in June, lower than the US$1.6 billion in the same period last year. (Bangko Sentral ng Pilipinas)
[38] Inbound tourism receipts from January to June 2023 rose to P212.467 billion, 502.02 percent higher than the P35.292 billion tourism revenue from the same period last year. (Source: Department of Tourism)
[39] US Consumer Price Index (CPI) registered a two-year low y-o-y rate in June at 3.0 percent, lower than the 3.1 percent forecast and the posted rate in May at 4.0 percent. (Reuters)
[40] Based on the last done deal transaction in the afternoon.
[41] The Trading Partners Index (TPI) measures the nominal and real effective exchange rates of the peso across the currencies of 14 major trading partners of the Philippines which include US, Euro Area, Japan, Australia, China, Singapore, South Korea, Hong Kong, Malaysia, Taiwan, Indonesia, Saudi Arabia, United Arab Emirates, and Thailand. The TPI-Advanced (TPI-A) measures the effective exchange rates of the peso across currencies of trading partners in advanced countries comprising of the US, Japan, Euro Area and Australia. The TPI-Developing (TPI-D) measures the effective exchange rates of the peso across 10 currencies of partner developing countries which includes China, Singapore, South Korea, Hong Kong, Malaysia, Taiwan, Indonesia, Saudi Arabia, United Arab Emirates, and Thailand.
[42] The REER index represents the Nominal Effective Exchange Rate (NEER) index of the peso, adjusted for inflation rate differentials with the countries whose currencies comprise the NEER index basket. A decrease in the REER index indicates some gain in the external price competitiveness of the peso, while a significant increase

8. External Developments

The JP Morgan All-Industry Output Index eased to 52.7 in June from 54.4 in May due to the dampening effect of tight global financial conditions on aggregate demand. Among the 14 countries included in the survey, only France and Italy recorded contractions in overall economic activity.[43]

Figure 22. JP Morgan Global All-Industry Output Index
index points



Source: Markit Economics

In the July 2023 World Economic Outlook (WEO) update, the International Monetary Fund (IMF) revised its 2023 global economic growth projection to 3.0 percent, slightly higher than the 2.8-percent forecast in the April 2023 WEO. The upward revision in the outlook is primarily driven by the stronger-than-expected recovery in the service sector. In addition, the resolution of the US debt ceiling standoff and reduced risk of global financial instability have tempered adverse risks highlighted in the April 2023 WEO. Nonetheless, global economic expansion is expected to remain well below the annual average of 3.8 percent[44] until at least 2024 owing in part to declining international trade and deteriorating global manufacturing activity.

On balance, risks to the global growth outlook remain pointed to the downside. The IMF cited the following downside risks to the revised baseline growth forecasts: (1) persistence of inflation in view of tight labor market conditions, increased risk of extreme weather-related events (*El Niño*), and continued cost pass-through of previous exchange rate depreciation; (2) repricing of assets as financial markets adjust to rising interest rates; (3) China's underwhelming recovery; (4) heightened risk of sovereign debt distress; and (5) deeper geoeconomic fragmentation amid the prolonged war in Ukraine.

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indicates the opposite. The NEER index, meanwhile, represents the weighted average exchange rate of the peso vis-à-vis a basket of foreign currencies.

[43] JP Morgan Global Composite PMI, https://www.pmi.spglobal.com/. A diffusion index is calculated for each survey variable. The index is the sum of the percentage of 'higher' responses and half the percentage of 'unchanged' responses. The indices vary between 0 and 100, with a reading above 50 indicating an overall increase compared to the previous month, and below 50 an overall decrease.

[44] Historical average global growth from 2000 – 2019

Policy actions by other central banks. Four of the central banks regularly monitored by the BSP have raised their respective policy rates to address the persistence of above-target inflation. By contrast, the Reserve Bank of Australia, Bank Negara Malaysia, Reserve Bank of New Zealand, Bank of Korea, People's Bank of China, Bank Indonesia, and Bank of Japan maintained their respective policy interest rates during their most recent monetary policy meetings. Meanwhile, aside from the BSP, six more central banks are scheduled to meet in August, namely, the Bank of England (3rd), Reserve Bank of India (10th), Reserve Bank of New Zealand (16th), Bank Indonesia (24th), Bank of Korea (24th), and People's Bank of China (TBA).

Table 20. Summary of Monetary Policy Decisions by Other Central Banks

Central bank	Monetary policy decision
Bank of Canada (BOC)	+25 bps to 5.00 percent (12 July 2023)
US Federal Reserve (US Fed)	+25 bps to 5.25 – 5.50 percent (26 July 2023)
European Central Bank (ECB)	+25 bps to 4.25 percent (27 July 2023)
Bank of Thailand (BOT)	+25 bps to 2.25 percent (2 August 2023)

The *BSP Monetary Policy Report* is published four times a year by the Bangko Sentral ng Pilipinas. 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 website:

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