MONETARY POLICY REPORT

MAY 2024

Foreword

The primary objective of monetary policy is to promote low and stable inflation conducive to 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 clearer communication by the Bangko Sentral ng Pilipinas (BSP) of its policy actions and decisions. The *Monetary Policy Report* (MPR) plays a primary part in the BSP's effort at transparency under inflation targeting. It shares with stakeholders, including market participants, the latest assessment of the monetary policy stance based on an analysis of economic and financial prospects. The broad aim is to contribute to making monetary policy more accessible to the public, who, through the report, may better understand and monitor the BSP's commitment to the inflation target.

The MPR, which replaced the quarterly *Inflation Report*, is the flagship BSP publication on monetary policy. It provides the public with a detailed view of the BSP's forecasts and guidance on the likely direction of monetary policy over the next two years. The report conveys 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.

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

The Monetary Board approved this *Monetary Policy Report* at its meeting on 16 May 2024.

ELI M. REMOLONA, JR.
Governor

The Monetary Policy of the Bangko Sentral ng Pilipinas

The BSP Mandate

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

Monetary Policy Instruments

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

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 2024-2028 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.

[1] On 8 September 2023, the overnight RRP facility was transformed into a variable-rate auction format with the policy rate of the BSP renamed to target RRP rate.
[2] The DBCC, created under Executive Order 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 15 December 2023, the DBCC, in consultation with the BSP, decided to retain the inflation target of 3.0 percent ± 1.0 ppt for 2024 and set the same inflation target for 2025–2028.

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. For 2024, the MB is scheduled to hold seven monetary policy meetings to review and decide on monetary policy.

Chairman and Governor
Eli M. Remolona, Jr.

Members
Ralph G. Recto
Benjamin E. Diokno
V. Bruce J. Tolentino
Anita Linda R. Aquino
Romeo L. Bernardo
Rosalia V. De Leon

The Advisory Committee

The Advisory Committee was established as an integral part of the institutional setting for inflation targeting. It is tasked to deliberate, discuss, and make recommendations on monetary policy to the MB. Like the MB, the Committee will meet seven times in 2024 but can have additional regular meetings when necessary.

Chairman

Eli M. Remolona, Jr.
Governor

Members

Francisco G. Dakila, Jr.
Deputy Governor
Monetary and Economics Sector

Chuchi G. Fonacier
Deputy Governor
Financial Supervision Sector

Eduardo G. Bobier
Deputy Governor
Corporate Services Sector

Edna C. Villa
Senior Assistant Governor
Financial Markets

Iluminada T. Sicat
Senior Assistant Governor
Monetary Policy Sub-Sector

Johnny Noe E. Ravalo
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Sol Elizah T. Roxas
Bank Officer VI
Corporate Services Sector

Technical Support Staff Members
Monetary Policy Research Group
Economic and Financial Forecasting Group
Financial Markets Research Group
Real and External Sectors Research Group

2024 Schedule of MB Monetary Policy Meetings and Publication of the *MB Highlights* and the *Monetary Policy Report*

2024	MB Meeting	Publication of MB Highlights	Publication of the Monetary Policy Report (MPR)
January		11 (Thursday) (14 December 2023 MB meeting)	
February	15 (Thursday) (MB meeting no. 1)		16 (Friday) (MPR I, February 2024)
March		14 (Thursday) (15 February 2024 MB meeting)	
April	8 (Monday) (MB meeting no. 2)		
May	16 (Thursday) (MB meeting no. 3)	6 (Monday) (4 April 2024 MB meeting)	24(Friday) (MPR II, May 2024)
June	27 (Thursday) (MB meeting no. 4)	13 (Thursday) (16 May 2024 MB meeting)	
July		25 (Thursday) (27 June 2024 MB meeting)	
August	15 (Thursday) (MB meeting no. 5)		16 (Friday) (MPR III, August 2024)
September		12 (Thursday) (15 August 2024 MB meeting)	
October	17 (Thursday) (MB meeting no. 6)		
November		14 (Thursday) (17 October 2024 MB meeting)	
December	19 (Thursday) (MB meeting no. 7)		20 (Friday) (MPR IV, December 2024)

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Monetary Policy Summary

At its monetary policy meeting on 16 May 2024, the BSP decided to hold the target overnight reverse repurchase (RRP) rate steady at 6.50 percent. The interest rates on the overnight deposit and lending facilities were likewise maintained at 6.0 percent and 7.0 percent, respectively.

The baseline inflation forecast for 2024 is revised downward while that for 2025 is revised upward relative to the projections cited in the February 2024 Monetary Policy Report. Inflation for 2024 is now projected to settle at 3.5 percent on account of lower projected inflation for Q2 2024. Inflation for 2025 is now expected to reach 3.3 percent due to the recent increase in global crude oil prices and the depreciation of the peso.

Average inflation is still seen to settle within the target range over the policy horizon. Nevertheless, inflation is seen to breach the upper end of the target range from May to July 2024. Constraints to the domestic supply of key food items, particularly rice, will continue to exert upside pressures. Positive base effects may also emanate from the slowdown in food and energy inflation during the same period in 2023. Subsequently, inflation is projected to return to within the target range as pressures on food and crude oil prices ease.

However, the risks to the inflation outlook remain skewed to the upside. The risk-adjusted forecasts, which assume that risks will materialize at their assigned probabilities, are seen to reach 3.8 percent in 2024 and 3.7 percent in 2025. The upside risks to the inflation outlook are linked to higher transport charges and toll rates, food prices, electricity rates, and global oil prices. No downside risk was identified.

Inflation expectations continue to be well-anchored. Results of the BSP's survey of external forecasters for May 2024 showed that the mean and median inflation forecasts for 2024 have declined slightly relative to those in the April 2024 survey round. Meanwhile, expectations for 2025 and 2026 remain slightly above the midpoint of the inflation target range. Analysts expect within-target inflation over the policy horizon, although upside risks continue to dominate due mainly to supply chain disruptions.

Domestic growth prospects remain intact over the medium term amid tight financial conditions. Economic growth in 2024 could settle below the government's target as higher global crude oil prices and positive real interest rates temper domestic demand. However, growth is seen to pick up in 2025 on stronger net exports amid an improving global growth outlook. Meanwhile, the latest estimates of the output gap point to the economy operating slightly below potential, thus suggesting possible deflationary pressures going forward.

Keeping monetary policy settings sufficiently tight is appropriate until inflation moves sustainably toward the target range. Risks to the inflation outlook continue to be skewed to the upside over the policy horizon. At this point, keeping monetary policy settings unchanged will allow the BSP to monitor potential risks to the inflation outlook, as the lagged impact of previous monetary policy action is anticipated to fully take hold in the coming months. Preserving the restrictive monetary policy stance will also help keep inflation expectations anchored amid a possible buildup in upside risks to future inflation. Moreover, the BSP reiterates its support for the national government's non-monetary measures to address persistent supply-side pressures on food prices and prevent further second-round effects. Moving forward, the BSP remains ready to adjust its monetary policy settings as necessary, in keeping with its primary mandate to safeguard price stability.

Economic Outlook

1. Baseline Forecasts

The latest baseline forecasts are slightly lower for 2024 and slightly higher for 2025 relative to the projections cited in the February 2024 *Monetary Policy Report*. The forecast for 2024 has declined on account of lower projected inflation for Q2 2024. The forecast for 2025 has increased on account of the recent uptick in global crude oil prices and the depreciation of the peso.

While headline inflation is projected to accelerate above the target range over the near term, inflation is still seen to average within the target range over the policy horizon. Inflation is seen to breach the upper end of the target range from May to July 2024. Domestic supply constraints are seen to continue to exert pressures on the prices of key food items, while positive base effects emanate from the slowdown in food and energy inflation during the same period in 2023. Subsequently, inflation is projected to return to within the target range starting in August 2024 as food and crude oil price pressures ease.

Table 1
BSP Average Baseline Inflation Projections
in percent

	February 2024 *MPR* [a]	**May 2024 *MPR*** [b]
2024	3.6	3.5
2025	3.2	3.3

Source: BSP estimates
[a] Baseline forecasts from the 14 February 2024 monetary policy meeting
[b] Baseline forecasts from the 16 May 2024 monetary policy meeting

The outlook on domestic economic activity remains intact, even as the economy is projected to operate slightly below potential. Economic growth could settle below the DBCC's target of 6.0-7.0 percent for 2024 and 6.5-7.5 percent for 2025.[4] The projected impact of the BSP's policy rate adjustments is likely to peak in H2 2024. Higher global crude oil prices and positive real interest rates could also temper domestic demand. However, stronger net exports amid an improving global growth outlook could support GDP growth.

Meanwhile, estimates from the BSP's Policy Analysis Model for the Philippines (PAMPh)[5] indicate that the output gap may turn slightly negative in 2024 but will likely close in the latter part of 2025. Domestic economic activity could ease as the effects of previous policy interest rate adjustments and declining real incomes, along with the possibility of tepid global growth, temper aggregate demand. On

[4] Based on the 186th DBCC Meeting on 15 December 2023.
[5] The PAMPh is a monetary policy model for a small open economy like the Philippines. It is a semi-structural gap model based on New Keynesian foundations with a general equilibrium framework and forward-looking features that allow for the assessment of the dynamic path of key macroeconomic variables in a theoretically consistent manner. The BSP is currently undergoing a multi-year technical assistance (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.

balance, the latest assessment of the output gap indicates potential deflationary pressures going forward.

Meanwhile, sustained improvements in labor market conditions, continued investment growth, and stable infrastructure spending are seen to continue to drive productivity and potential output.

The peso could weaken but remain within the DBCC's assumptions of ₱55.00-58.00/US$1 for 2024 and 2025.[6] The revised peso outlook for 2024 and 2025 reflects the recent peso depreciation and narrowing interest rate differentials with the US, given market expectations of smaller interest rate reductions by the US Federal Reserve in 2024. The baseline forecasts are consistent with market expectations of a 50-basis-point reduction in the US fed funds rate each in 2024 and 2025.

2. Key Forecast Assumptions

External factors

World GDP growth. Global growth is seen to remain below the historical average of 3.8 percent, reflecting restrictive monetary policies, withdrawal of fiscal support, and low underlying global productivity. Growth in the US could accelerate in 2024 before slowing down in 2025 as gradual fiscal tightening and softening labor market slow aggregate demand. The Euro area is likewise seen to recover from its slow growth in 2023 driven by stronger household consumption. Meanwhile, output in Japan is projected to slow as one-off factors that supported growth in 2023, including a surge in inbound tourism, continue to fade. Similarly, a further slowdown in China is projected from 2024 to 2025 as a post-pandemic boost in consumption and fiscal stimulus ease while weakness in the property sector persists.

In its April 2024 World Economic Outlook (WEO), the International Monetary Fund (IMF) noted that downside risks to the global growth outlook have diminished since October 2023. From a clear tilt toward the downside in 2023, the risks to the outlook now appear more broadly balanced.

Table 2
World GDP Growth
in percent

	February 2024 *MPR*	**May 2024** *MPR*
2024	3.1	3.2
2025	3.2	3.2

Source: WEO (IMF, April 2024), WEO Update (IMF, January 2024)

Dubai crude oil prices.[7] Assumptions for global crude oil prices are higher compared with the previous round. The latest futures path shows a significant rise in crude oil prices for 2024 and 2025. Prices increased in April amid falling global oil

[6] Based on the 187th DBCC Meeting on 22 March 2024.
[7] 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. The Dubai crude oil assumptions in the latest round are based on the average futures path from 26 April to 9 May 2024.

inventories and heightened geopolitical tensions in the Middle East. Moreover, the US Energy Information Administration (EIA) expects voluntary OPEC+ crude oil production cuts, and ongoing geopolitical risks could sustain crude oil spot price near US$90.00/bbl for the remainder of 2024 before falling to an average of US$85.00/bbl in 2025 as global oil production picks up.

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

	February 2024 *MPR*	May 2024 *MPR*
2024	77.53	83.69
2025	73.47	79.11

Source: Bloomberg, BSP estimates

Scenarios of various outturns for world oil prices ranging from US$80-US$130 per barrel were also simulated. These assume that global oil prices are sustained at the stated levels starting June 2024. Holding all things constant, inflation is seen to breach the 2.0-4.0 percent target range if the average price of Dubai crude oil exceeds US$125 per barrel in 2024 and US$95 per barrel in 2025.[8]

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

Year	2024	2025
Baseline Inflation Forecast (US$)	3.5	3.3
80	3.5	3.3
90	3.6	3.8
100	3.7	4.3
110	3.9	4.7
120	4.0	5.1
130	4.1	5.5

Source: BSP estimates

World non-oil prices. Based on the IMFs April 2024 WEO, global prices of non-oil commodities are assumed to increase marginally in 2024 and to decline slightly in 2025. A rebound in agricultural commodity prices drives the latest forecasts for non-fuel commodity inflation. Concerns over *El Niño* put upward pressure on the prices of certain tropical crops, Meanwhile, seafood prices surged as demand outstripped supply growth amid stricter environmental legislation in some countries. However, the prices of cereals and vegetable oils declined owing to abundant global supplies. The risks to the price outlook are seen to be balanced, with larger-than-expected harvests offsetting the impact of further trade disruptions in the Black Sea and new food export restrictions.

[8] It should be noted that the impact of 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 5
World Non-Oil Price Inflation
in percent

	February 2024 *MPR*	May 2024 *MPR*
2024	-0.9	0.1
2025	-0.4	-0.4

Source: WEO (IMF, April 2024), WEO Update (IMF, January 2024)

Federal funds rate.[9] The latest federal funds rate assumptions are higher for 2024 and 2025. In the previous round, the US Federal Reserve is expected to reduce interest rates by a sum of 100 bps in 2024 beginning in May. Based on recent indicators, market players now expect the US Fed to hold the federal funds rate target steady until July 2024. Markets also appear to be pricing in an initial cut of 50 bps in July and December, with an additional total reduction of 75 bps in 2025.

Table 6
Federal Funds Rate
end-period, in percent

	February 2024 *MPR*	May 2024 MPR
2024	4.3	5.0
2025	3.6	4.2

Source: Bloomberg

Domestic factors

Target RRP rate and reserve requirement ratio (RRR). The BSP policy interest rate and reserve requirements are expected to remain unchanged over the policy horizon.

Wages. The baseline forecast assumes minimum wage hikes of ₱28.00 in August 2024 and ₱29.00 in September 2025 for the National Capital Region. This is equivalent to an annual increase of 4.6 percent for both years, in line with historical wage increases.

Fiscal sector. The baseline inflation forecasts are consistent with the government's fiscal deficit assumption of 5.6 percent for 2024 and 5.2 percent for 2025, as stated in the DBCC 's medium-term fiscal program as of March 2024.

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. Excise taxes for fermented liquor, wine, and distilled spirits shall increase by 6.0 percent every year from 2025 onwards.

Tobacco products. Under R.A. No. 11346, signed in July 2019, the tax per pack of cigarettes (0.9 percent of the CPI basket) increases by a standard rate of 5.0 percent every year starting in 2024, following specified increases in the previous years.

[9] Based on futures prices as of 9 May 2024.

Table 7
Excise Tax

Year	Cigarettes (₱ per pack)	Fermented Liquor (₱ per liter)	Wine (₱ per liter)	Distilled Spirits	
				Excise Tax (₱ per liter)	Ad Valorem Tax (%)
2024	5% indexation	43.0	63.1	66.0	22%
2025			6% indexation		22%

Sources: Republic Act Nos. 11346 and 11467

Water rates. The Metropolitan Waterworks and Sewerage System (MWSS) approved the rate hike requests of Manila Water Company, Inc. and Maynilad Water Services, Inc. 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 so they may recover their operating, capital, maintenance, and investment expenditures. The second tranche of the rate rebasing adjustment took effect on 1 January 2024, with both Maynilad and Manila Water raising their rates. Both concessionaires are also seen to increase their rates further in 2025 to 2027.

Rice prices. The baseline forecast considers a possible deficit in local rice production in 2024, reflecting the impact on rice prices of *El Niño* as well as higher global prices. Based on the PAGASA climate outlook as of 24 April 2024, the ongoing *El Niño* dry conditions have weakened, but warmer and drier conditions are seen to continue throughout May before reverting to ENSO-neutral conditions.

3. Risks to the Outlook

Compared with the previous round, the risk-adjusted forecasts (RAF) are lower for 2024 but higher for 2025. After incorporating the impact of risks at their assigned probabilities, inflation is seen to reach 3.8 percent in 2024 and 3.7 percent in 2025.

The risks to the inflation outlook continue to be skewed to the upside over the policy horizon. The upside risks to the inflation outlook could emanate from higher transport charges and toll rates, food prices, electricity rates, and global oil prices. Meanwhile, no downside risk was identified.

Table 8
BSP Baseline and Risk-Adjusted Projections
in percent

		February 2024 *MPR*	May 2024 *MPR*
Baseline inflation forecast	**2024**	3.6	3.5
	2025	3.2	3.3
Risk-adjusted inflation forecast	**2024**	3.9	3.8
	2025	3.5	3.7

Nonetheless, the estimated impact of risk is higher for both 2024 and 2025 compared with the estimates made in February 2024, driven by upward adjustments in the impact of higher domestic food prices, higher transport charges, and global oil prices, removal of the measures to mitigate *El Niño* and implementation of higher toll rates. These are partly offset by the lower impact of higher electricity rates.

Table 9
Risk Matrix[10] [11]

Upside Risks	Probability
Higher transport charges	Medium
Higher domestic food prices	Medium
Higher electricity rates	High
Higher global oil prices	Medium

Higher fares for jeepneys, trains, and taxis, as well as higher toll rates, pose upside risks to inflation. On 8 October 2023, the Land Transportation Franchising and Regulatory Board (LTFRB) approved a ₱1.00 provisional increase in the minimum jeepney fare for both traditional and modern jeepneys. As the original petition indicated a ₱5.00 increase, the alternative scenario assumes that the remaining ₱4.00 will likewise be approved. Moreover, the Alliance of Transport Operators and Drivers Association of the Philippines (ALTODAP) filed a petition to increase the minimum fare for traditional jeepneys to ₱15.00. The scenario assumes implementation by Q2 2024 with medium probability, given the recent uptrend in oil prices.

A petition was likewise filed by the MRT-3 management with the Department of Transportation (DOTr) in December 2023 to raise the minimum fare of the rail line from ₱13.00 to ₱16.00. The alternative scenario reflects a high probability of this risk with implementation by Q2 2024.

Similarly, taxi operators filed a petition with the LTFRB in June 2021 to raise the flag-down rate to ₱70.00 should the price of gasoline reach ₱66.00 to ₱70.00. In October 2022, a provisional ₱5.00 increase was granted. The alternative scenario assumes a further increase in the flag-down rate to ₱70.00 by Q2 2024, given the recent uptrend in oil prices. A low probability is assigned to this risk.

Meanwhile, in June 2023, toll rate adjustments for the North Luzon Expressway (NLEX), Subic-Clark-Tarlac Expressway (SCTEX), and sections of the South Luzon

[10] The BSP considers different scenarios that pertain to upside and downside risks to the inflation outlook, which is summarized in a risk matrix. The various scenarios are then assigned probability values. Scenarios that have more than 75 percent probability of taking place over the forecast horizon are incorporated in 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.
[11] The measures to mitigate the impact of *El Niño*, identified as a downside risk in the previous round, has been removed from the matrix following the weakening of *El Niño* weather conditions based on latest climate outlook from PAGASA. Meanwhile, the impact of *El Niño* conditions on domestic food supply has been incorporated in the higher domestic food prices.

Expressway (SLEX) were approved for staggered implementation. The scenario assumes that the second tranche of the toll adjustments in the said expressways will be implemented in Q2 2024, while the third tranche of the adjustment in SCTEX will be implemented in Q1 2025. As said toll adjustments have been approved by the Toll Regulatory Board, a high probability is assigned to this.

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

Ongoing supply constraints on key food commodities could cause an uptick in inflation. Below-normal rainfall conditions could affect local rice and corn production, while African Swine Fever (ASF) and Avian Flu continue to threaten the production of pork and poultry. Meanwhile. reduced fishing activities from rising fuel costs, as well as restrictive imports, could result in insufficient fish supply. Moreover, the deficit in sugar and onion supplies are expected in the absence of sufficient import programs.

Under this risk scenario, elevated prices are assumed to persist until Q3 2024 for rice and until Q4 2024 for the rest of the commodities identified. An overall medium probability is assigned to this risk, given the relative weights of the commodities in the CPI basket.

Electricity rates could increase in 2024. In July 2023, the Supreme Court nullified the Energy Regulatory Commission's (ERC) 2014 decision to cap Wholesale Electricity Market (WESM) prices from November to December 2013. The ERC's decision was made to address the higher prices during the maintenance shutdown of the Malampaya gas field. The risk scenario assumes that an estimated ₱15.77 billion worth of power generation cost will be passed on to consumers with the adjustment spread equally over the next three years starting in June 2024.

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.

The escalation of geopolitical conflict could lead to higher global crude oil prices. The conflict in the Middle East intensifies with the recent exchange of missile strikes between Israel and Iran and continuing attacks in the Red Sea by Houthi Rebels. Meanwhile, the Russia-Ukraine war continues with Ukrainian drones targeted at Russia's oil refineries.

The risk scenario assumes Dubai crude oil prices to average at US$94/bbl from May to December 2024. This is based on the World Bank's Commodity Markets Outlook for April 2024, which assumes a moderate conflict-driven disruption estimated to reduce oil supply by about one million barrels per day.

A medium probability is assigned to this scenario with the increase in regional tensions.

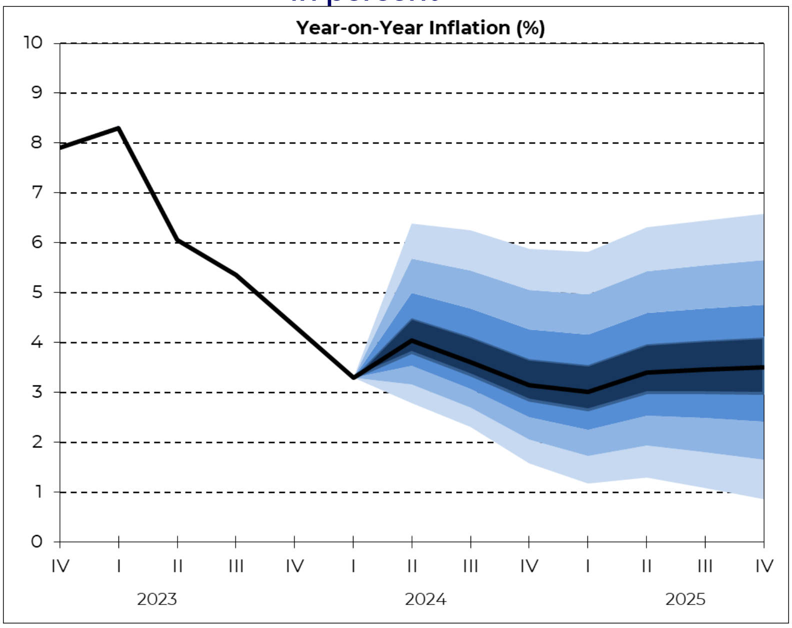
The risks to the inflation outlook continue to be skewed to the upside over the policy horizon. The probability of inflation breaching the high end of the target band in 2024 and 2025 remains high, reflecting the possible impact of the various upside risks on the outlook. Nevertheless, the latest probability distribution shows a slightly higher likelihood of inflation settling within the target range for 2024 compared with the previous round due to the downward adjustment in the baseline forecast. Meanwhile, the probability of inflation breaching the low end of the target range for 2024 and 2025 remains low.

Table 10
Probability Distribution of Inflation Forecasts
in percent

	Pr(<2%)		Pr(2-4%)		Pr(>4%)	
	Feb 2024 MPR	May 2024 MPR	Feb 2024 MPR	May 2024 MPR	Feb 2024 MPR	May 2024 MPR
2024	4.0	5.0	44.6	46.8	51.4	48.2
2025	13.2	10.5	49.7	48.0	37.1	41.5

Source: BSP estimates

Figure 1
Inflation Projection
in percent



Source: BSP estimateS

Table 11
Inflation Projection Ranges at Various Confidence Intervals Using the Fan Chart
in percent

Confidence Interval (%)	Projection Range (%)	
	2024	2025
80	2.7 - 5.0	1.6 - 5.6
90	2.5 - 5.5	1.1 - 6.3

Source: BSP estimates

Box Article No. 1
Monetary Policy Developments

On 8 April 2024, the BSP retained the target RRP rate at 6.50 percent. Accordingly, the interest rates on the overnight deposit and lending facilities also remained at 6.0 percent and 7.0 percent, respectively.

Relative to what was reported in the February 2024 MPR, the baseline inflation path was higher for 2024 but unchanged for 2025. The upward adjustment in the forecast path for 2024 was driven mainly by the uptick in global crude oil prices, higher-than-expected inflation outturns in February and March 2024, and the depreciation of the peso.

		February 2024 MPR[a]	April 2024 Monetary Policy Meeting[b]
Baseline inflation forecast	**2024**	3.6	3.8
	2025	3.2	3.2
Risk-adjusted inflation forecast	**2024**	3.9	4.0
	2025	3.5	3.5

Source: BSP estimates
[a] Baseline forecasts from the 14 February 2024 monetary policy meeting
[b] Baseline forecasts from the 8 April 2024 monetary policy meeting

Meanwhile, the risk-adjusted inflation forecast increased slightly for 2024 but was unchanged for 2025 due to revisions in the baseline forecasts, as the estimated impact of risks was broadly unchanged.

The balance of risks to the inflation outlook was skewed to the upside, with risks emanating from the implementation of higher transport charges, increased electricity rates, higher global oil prices, higher prices of food commodities facing supply constraints, and implementation of a legislated increase in the minimum wage.

The BSP noted that while upside risks to inflation raised inflation expectations, these expectations remained broadly anchored. Meanwhile, the latest demand indicators available at the time suggested that domestic growth prospects were largely intact over the medium term, even as overall activity continued to gradually respond to tighter financial conditions.

Given these considerations, the BSP deemed it appropriate to maintain tight monetary policy settings. The BSP also expressed support for the National Government's policies and programs to address supply-side pressures on the prices of key food commodities.

Finally, the BSP conveyed that it remained ready to adjust its monetary policy settings as necessary, in keeping with the primary mandate to safeguard price stability.

Box Article No. 2
An Evaluation of the BSP's 2023 Forecasting Performance[1]

The BSP regularly evaluates its inflation forecasting performance as part of its continuing efforts to enhance macroeconomic forecasting models and promote transparency in monetary policy formulation.[2] This article offers a summary of the latest assessment of the BSP's forecasting performance for 2023, specifically examining the (a) month-ahead inflation forecasts; (b) annual inflation forecasts; and (c) standard statistics for forecast accuracy, unbiasedness, efficiency, and benchmarking. Compared with the 2022 results, forecast errors in 2023 for both month- and year-ahead forecasts were larger due to significant volatility in commodity prices from continued supply disruptions in key food items and higher oil prices.

A. Month-ahead inflation forecasts

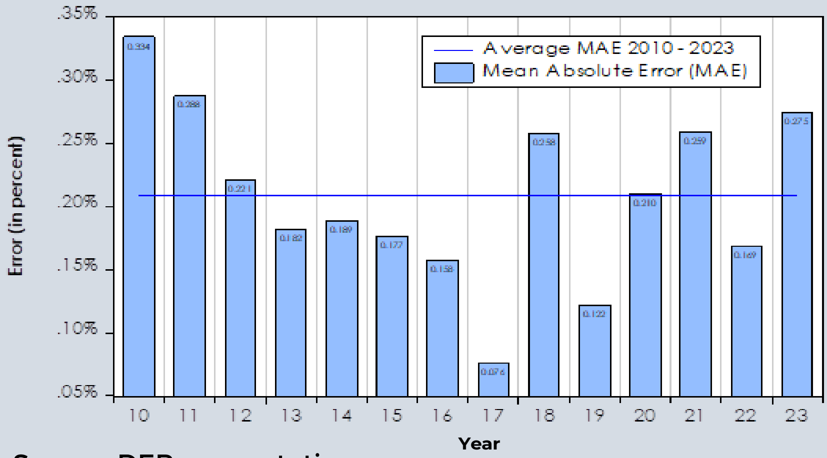
The BSP's month-ahead inflation forecasts in 2023 yielded slightly higher forecast errors compared with those in 2022 and the historical average. Monthly inflation generally settled within the forecast range announced by the BSP in 2023, with breaches only in the forecast ranges for January and October. Nonetheless, the BSP's month-ahead inflation forecasts registered lower forecast errors compared with the median estimates from private sector analysts in Bloomberg's monthly survey.

Headline inflation in January 2023 rose to 8.7 percent year-on-year, exceeding the announced forecast range of 7.5 to 8.3 percent. Headline inflation exceeded the forecast range after electricity rates, domestic fuel prices, and prices of vegetables and meat rose by much more than expected due to supply disruptions and severe weather disturbances. The implementation of higher water rebasing rates and higher excise taxes, as well as the sharper-than-anticipated uptick in rental costs, contributed to the breach.

Meanwhile, inflation in October 2023 decelerated to 4.9 percent and fell below the forecast range of 5.3 to 6.1 percent. Inflation fell below forecast as the prices of vegetables and rice fell faster than anticipated owing to improved weather conditions and additional harvests.

From 2010 to 2023, actual inflation settled within the month-ahead inflation forecast band in 153 out of 167 months (91.6 percent), with a mean absolute error (MAE) of 0.22 ppt (**Chart 1**). The MAE of the BSP month-ahead inflation forecasts rose in 2023 from the 2022 result on account of more volatile changes in monthly inflation.[3] Nevertheless, the uptick in the MAE for 2023 was still in line with previous recent episodes of above-target inflation in 2018 and 2021. The BSP's MAE is also lower than the 0.41-ppt MAE of the month-ahead consensus forecasts from Bloomberg's monthly survey of private sector analysts.

Chart 1
MAE of Inflation Forecasts from 2010 to 2023

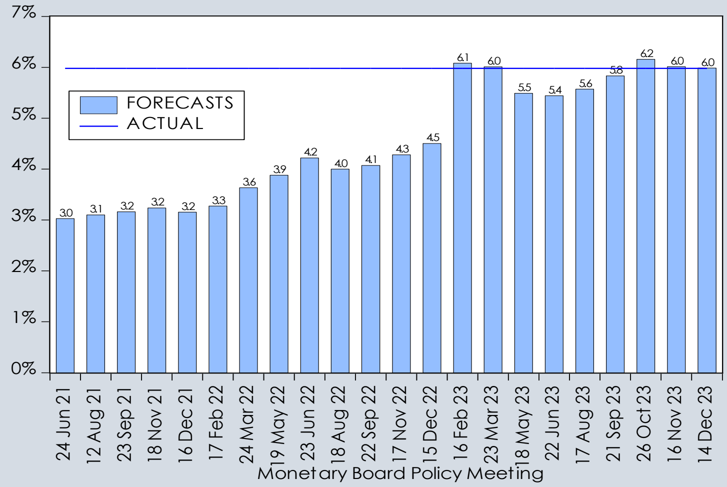


Source: DER computations

B. Annual inflation forecasts

Annual inflation was 6.0 percent for 2023 while the baseline inflation forecasts presented during the BSP monetary policy meetings ranged from 3.0 to 6.0 percent. The annual inflation forecast for 2023 was gradually revised upward throughout 2022, with the exercise first indicating a breach of the inflation target in the 23 June 2022 monetary policy meeting (**Chart 2**). In addition, the BSP's risk-adjusted forecasts[4] shifted toward the upside beginning with the 19 May 2022 monetary policy round in view of upside risks linked to higher food prices, electricity rates, transport fare adjustments, and minimum wage adjustments.

Chart 2
Annual Baseline Inflation Forecasts for 2023

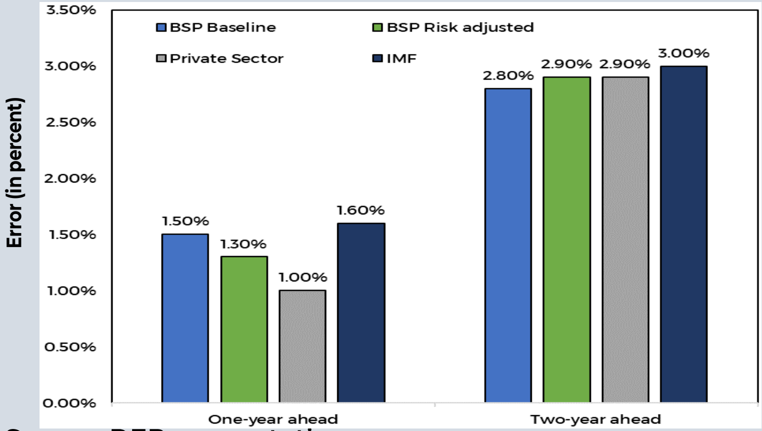


Source: DER computations

Meanwhile, persistent supply shocks in both global and domestic commodity markets prompted upward revisions in the BSP's annual inflation forecasts for 2023. Higher global crude oil prices due to geopolitical tensions and the peso depreciation, in part caused by the monetary policy tightening in advanced economies, drove domestic inflation. Several identified risks also began to materialize in the form of higher food prices, water rates, transport fare adjustments, and higher-than-expected minimum wage adjustments. In response, the BSP revised its annual inflation forecasts for 2023 sharply upward to 6.3 percent during the 16 February 2023 monetary policy meeting from 4.5 percent in the previous meeting.

The forecast errors for the BSP's one-year ahead baseline and risk-adjusted inflation forecasts were higher compared with the private sector's mean one-year ahead forecasts, but lower compared with the IMF's baseline outlook. Meanwhile, the two-year ahead forecasts of the BSP had a slightly lower forecast error compared with both the private sector and the IMF (**Chart 3**). As of December 2022, the BSP's baseline inflation forecast for 2023 stood at 4.5 percent, whereas those for the private sector and IMF were at 5.0 percent and 4.3 percent, respectively. Meanwhile, the BSP's two-year ahead baseline inflation forecast of 3.2 percent had a slightly lower forecast error compared with the private sector's forecast of 3.1 percent and the IMF's 3.0 percent.

Chart 3
One- and Two-year Ahead Absolute Forecast Errors for 2023



Source: DER computations

A counterfactual analysis using actual values of all explanatory variables was also performed to show how the BSP's workhorse model tracked the inflation path for 2023. The exercise uses actual values of the exogenous variables, such as oil prices and non-oil prices, among others, to estimate an ex-post projected path of inflation. This is a way to test the model's validity by making sure that it fits the data well by eliminating the uncertainty from the setting of assumptions for exogenous variables. Assuming that the actual values of all the exogenous variables, as well as the add-ons for food prices, electricity rates, and other add-ons, were known beforehand, the one-year ahead annual inflation forecasts for 2023 would be 5.7 percent if the forecast was made in December 2022. This is equivalent to an MAE of 0.3 ppt for 2023, given the actual inflation of 6.0 percent.

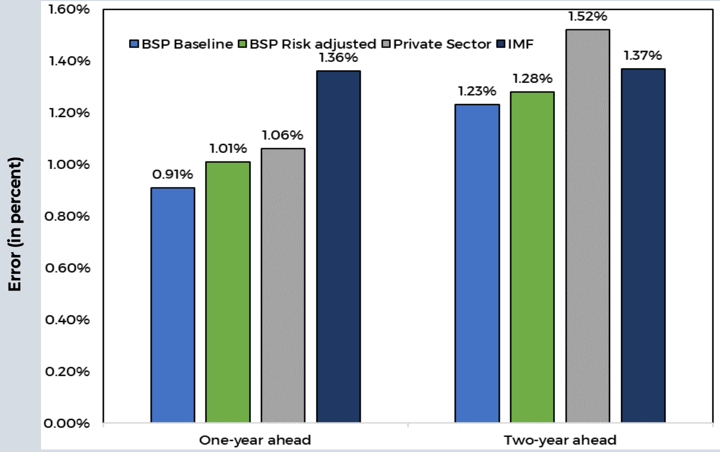
C. Statistical tests and enhancements of models

In terms of accuracy, the BSP's inflation forecasts have a statistically adequate level of precision with lower forecast errors compared to benchmark statistical models over the sample period. Second, tests for unbiasedness and efficiency indicate that the baseline forecasts do not systematically over- or under-predict inflation across the sample period.

Third, benchmarking with the private sector and the IMF forecasts shows that the BSP's baseline forecasts have lower errors across the sample from 2011 to 2023

(**Chart 4**). The BSP's annual inflation forecasts have lower forecast errors compared with the private sector's and the IMF's average from 2011 to 2023. The baseline annual forecasts have slightly lower forecast errors compared with the risk-adjusted forecasts over the period of 2011 to 2023. The MAE of the BSP's baseline and risk-adjusted forecasts were also lower compared with the MAE of the forecasts from the private sector and the IMF. Similarly, the MAE of the BSP's two-year ahead baseline forecast is slightly lower compared with the risk-adjusted forecast, and both baseline and risk-adjusted errors are still lower than those of the private sector and IMF.

Chart 4
One- and Two-year Ahead Annual MAE



Source: DER computations

D. Efforts on model development and capacity building for forecasting and policy analysis

To further enhance the forecasting performance of the BSP models, the Department of Economic Research constantly refines its suite of models to better guide monetary policy analysis and formulation through multi-year technical assistance (TA) projects with the IMF's Institute for Capacity Development (ICD) and the Japan International Cooperation Agency (JICA). For 2024, the DER is continuing its TA with the IMF on the Policy Analysis Model for the Philippines (PAMPh) and will undertake various projects, such as the nowcasting of selected macroeconomic variables, to support the scheduled transition to the PAMPh as the BSP's workhorse model.

Endnotes

1/ The authors are Sanjeev A. Parmanand, Mark Rex S. Romaraog, and Jan Christopher G. Ocampo of the Department of Economic Research.

2/ Results of the previous forecast evaluation were published in Abenoja et al. (2022) and in the Monetary Policy Report in May 2022.

3/ The standard deviation of month-on-month (m-o-m) inflation rose to 0.6 percent in 2023 from 0.3 percent in 2022 due to severe weather disturbances and ongoing geopolitical tensions, which contributed to more volatile movements in commodity prices.

4/ In addition to the baseline forecasts, the BSP considers different scenarios that pertain to upside and downside risks to the baseline inflation outlook and assigns probability values for each. These upside and downside risks are summarized in a risk matrix. The risk-adjusted inflation is equivalent to the baseline inflation forecast plus the probability-weighted impact of the different upside and downside risks to the inflation outlook. The first risk-adjusted forecasts were published last October 2023.

Current Developments

Overview

Headline inflation increases slightly in April 2024. Inflation rose slightly due mainly to the higher year-on-year (y-o-y) increase in the prices of food and non-alcoholic beverages. Food inflation climbed further due to the increase in the prices of vegetables and fish from negative inflation readings in March. Meanwhile, non-food inflation was broadly steady as higher gasoline and diesel prices, which reflect rising international crude oil prices in April, were offset by lower inflation for heavily weighted subcomponents, namely, housing, water, electricity, gas, and other fuels, as well as restaurants and accommodation services.

Core inflation measures show mixed trends. The official core inflation eased further, while preliminary estimates of BSP-computed core inflation measures showed mixed trends.

Global crude oil prices decrease due partly to easing geopolitical risks. Dubai crude oil prices for 1-9 May 2024 decreased from the full-month average price in April 2024. The ongoing ceasefire negotiations between Israel and Hamas, with the aid of international mediators, eased the geopolitical risk premium in world oil prices. However, to date, no agreement has been reached, and Israel's attacks on Gaza continue. Moreover, demand concerns stemming from prospects of higher-for-longer US interest rates as the US Federal Reserve maintained their policy rates last 1 May 2024 continued to contribute to lower global oil prices during the reference period.

Inflation expectations for 2024 ease further. Preliminary results of the BSP's survey of external forecasters for May 2024 showed that the mean inflation forecast for 2024 eased further. For 2025, the mean forecast was steady, while for 2026, the mean forecast increased. Analysts expect within-target inflation over the policy horizon, although settling at the upper end of the target range as uncertainty lingers. Upside risks continue to dominate due mainly to supply chain disruptions.

Domestic economy expands in Q1 2024, suggesting that growth prospects remain broadly intact. Real GDP grew albeit at a slightly slower pace than the government target of 6.0 to 7.0 percent. On the demand side, household spending and investments expanded as government spending rebounded. Exports also recovered, signaling some improvement in external demand. On the production side, the services and agriculture sectors expanded, albeit at a slower pace. Meanwhile, the industry sector grew faster, supported by manufacturing and construction.

Demand indicators continue to signal expansion. The manufacturing sector's preliminary average capacity utilization rate improved to its highest level since 2019. Industries maintained their resources on expectations of improved demand for manufactured goods. The preliminary composite purchasing managers' index (PMI) in April 2024 was also upbeat. Looking ahead, business managers anticipate economic conditions to further improve, albeit softer, for all sectors in May 2024.

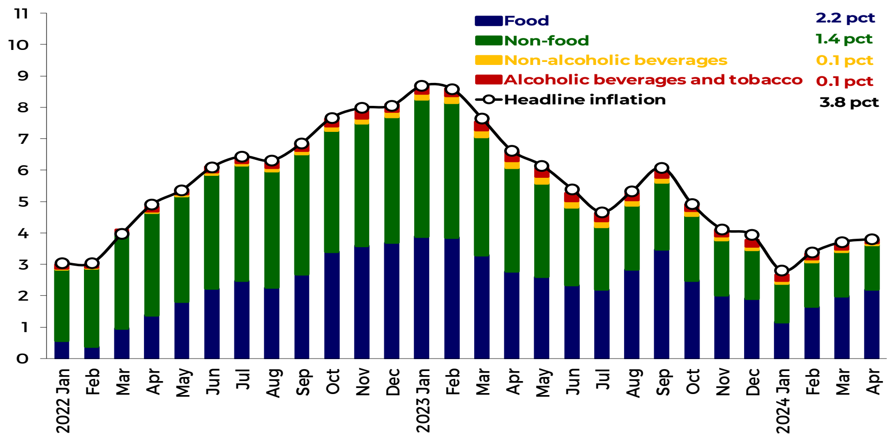
Domestic liquidity remains adequate to support economic activity. Preliminary data showed that domestic liquidity (M3) continued to rise in March 2024. During the same period, bank lending also rose. In terms of credit conditions, lending standards based on the diffusion index method were mixed with a net tightening of credit standards for businesses and maintained loan standards for households. In the government securities market, the Bureau of the Treasury fully awarded bids at auctions amid strong demand.

Prospects for global economic growth improve as overall economic activity exhibits resilience amid tight financial conditions. The JP Morgan All-Industry Output Index increased in March 2024 as new business intakes accelerated. Meanwhile, the IMF slightly raised its 2024 global economic growth projection, reflecting the surprisingly resilient economic activity through the global disinflation of 2022-2023. The resilience of the global economy, despite central bank interest rate increases, has reflected the ability of households in major advanced economies to draw on substantial savings accumulated during the pandemic. However, the pace of global economic expansion is still low by historical standards due to near-term factors, including the still-high borrowing costs and withdrawal of fiscal support, as well as the longer-term effects from the COVID-19 pandemic and Russia's invasion of Ukraine, weak growth in productivity, and increasing geoeconomic fragmentation.

1. Price Conditions

Headline inflation. The y-o-y headline inflation in April 2024 rose slightly from 3.7 percent in March due mainly to the higher increase in the prices of food and non-alcoholic beverages. Meanwhile, non-food inflation was broadly steady for the third consecutive month. On a month-on-month (m-o-m) seasonally adjusted basis, headline inflation slowed down to 0.2 percent in April from 0.3 percent in March.

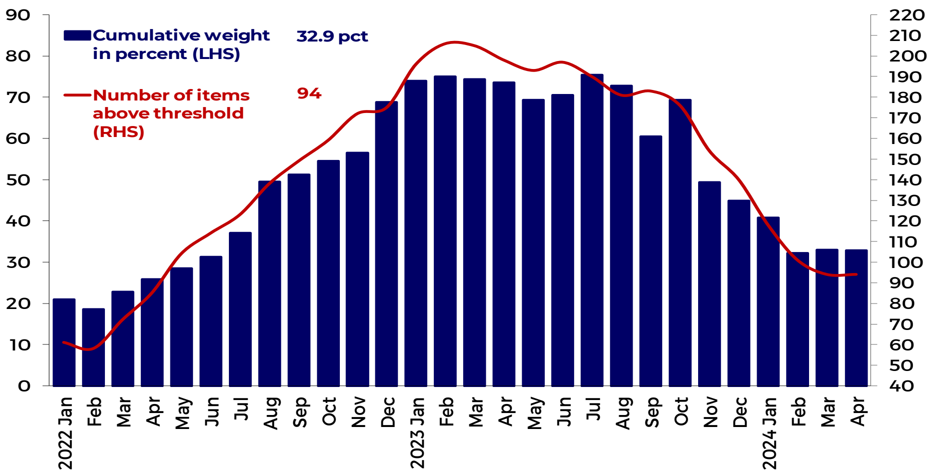
Figure 2
Headline Inflation
(2018=100); in percent



Sources: Philipine Statistical Authority (PSA), BSP

In total, 94 of 315 items had inflation rates above target in April and accounted for a third of the total consumption basket (32.9 percent). Meanwhile, 107 items had inflation rates below target. The remaining 114 items (about 43.9 percent weight in the CPI basket) had inflation rates within target. Of the 94 CPI items that had inflation above target, 65 items were classified under food, non-alcoholic and alcoholic beverages, and tobacco. Nine of the new CPI items were above the 4.0-percent threshold, six of which belonged to the food and non-alcoholic beverages classification.

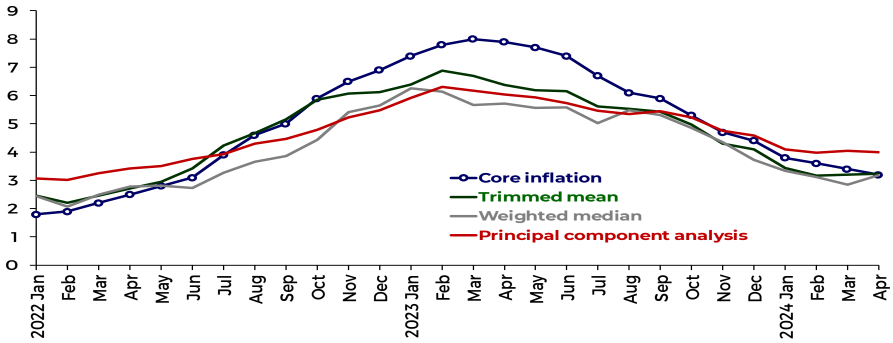
Figure 3
CPI Items with Inflation Rates Above Threshold (2018=100)



Sources: PSA, BSP staff estimates

Core inflation. The official core inflation eased further to 3.2 percent in April 2024 from 3.4 percent in March. Meanwhile, preliminary estimates of BSP-computed core inflation measures showed mixed trends.

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 inflation rose in April 2024 due to the increase in vegetables and fish inflation from negative inflation readings in March. Moreover, rice inflation remained elevated at double-digit rates, albeit slower compared with the previous month's rate.

Non-food inflation. Non-food inflation was broadly steady despite higher gasoline and diesel prices amid the continued increase in international crude oil prices. Higher gasoline and diesel prices were offset by lower inflation for heavily weighted subcomponents, namely, housing, water, electricity, gas, and other fuels, as well as restaurants and accommodation services.

Table 12
Inflation rates for Selected Food Items (2018=100)
year-on-year; in percent

Commodity	Apr 2023	Mar 2024	Apr 2024
Food and non-alcoholic beverages	**7.9**	**5.6**	**6.0**
Food	8.0	5.7	6.3
Cereals and cereal products	5.4	17.3	16.9
Cereals	3.3	22.4	22.1
Rice	2.9	24.4	23.9
Corn	8.4	-2.6	-0.6
Flour, bread and other bakery products, pasta products, and other cereals	11.7	4.6	4.1
Meat and other parts of slaughtered land animals	4.2	2.0	1.0
Fish and other seafood	7.0	-0.9	0.4
Milk, other dairy products, and eggs	13.0	2.3	1.9
Oils and fats	11.7	-4.6	-4.4
Fruits and nuts	14.7	7.9	6.9
Vegetables tubers, cooking bananas and pulses	10.0	-2.5	4.3
Sugar, confectionery and desserts	33.7	-2.9	-2.8
Ready-made food and other food products, n.e.c.	9.5	4.3	4.8
Non-alcoholic beverages	7.2	2.6	2.3
Alcoholic beverages and tobacco	**12.7**	**6.7**	**4.9**

Sources of basic data: PSA, BSP

Table 13
Inflation Rates for Selected Non-Food Items (2018=100)
year-on-year, in percent

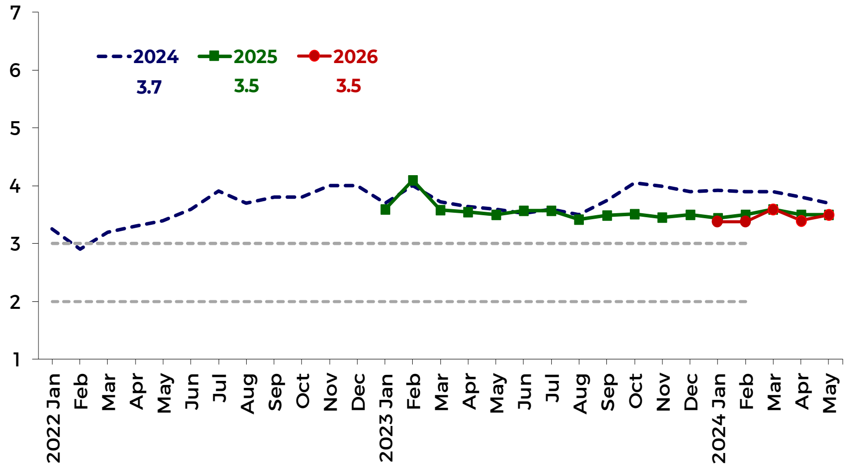
Commodity	Apr 2023	Mar 2024	Apr 2024
Non-food	**5.5**	**2.4**	**2.4**
Clothing and footwear	5.1	3.6	3.6
Housing, water, electricity, gas and other fuels	6.5	0.5	0.4
Electricty, gas, and other fuels	7.6	-4.7	-5.1
Furnishings, household equipment & routine household maintenance	6.1	3.2	3.1
Health	4.1	3.2	3.0
Transport	2.6	2.1	2.6
Passenger transport services	13.3	3.0	2.4
Information and communication	0.7	0.4	0.5
Recreation, sport and culture	4.7	3.9	3.8
Education services	3.6	3.8	3.8
Restaurant and accommodation services	8.6	5.6	5.4
Financial services	0.0	-0.6	-0.6
Personal care and miscellaneous goods and services	5.7	3.6	3.5

Sources of basic data: PSA, BSP

2. Inflation Expectations

Preliminary results of the BSP's survey of external forecasters (BSEF) for May 2024 showed that the mean inflation forecast for 2024 further eased from 3.8 percent in April 2024.[12] By contrast, mean forecasts for 2025 were unchanged at 3.5 percent but were higher for 2026 from 3.4 percent.

Figure 5
BSP Survey of External Forecasters
mean forecast for full year; in percent



*Based on forecasts provided by 20 respondents. The survey was conducted from 9 to 15 May 2024.
Source: BSP

Analysts expect within-target inflation over the policy horizon, although settling at the upper end of the target range as uncertainty lingers. Upside risks continue to dominate due mainly to supply chain disruptions.

The main upside risks to the inflation forecast are: (1) elevated prices of basic goods (particularly oil and food, including rice) owing to supply-side pressures brought by the geopolitical conflict in the Middle East; (2) adverse impact of *El Niño*; and (3) potential negative effect of *La Niña* in the second half of the year.

Meanwhile, a few analysts cited downside risks from (1) easing albeit still elevated food and non-food inflation, such as rice and oil; and (2) waning inflationary pressures on prices as *El Niño* and base effects weaken in the near term.

[12] There were 20 respondents in the BSP's survey of external forecasters in May 2024, based on submissions from 9 to 15 May 2024.

Table 14
BSP Survey of External Forecasters
annual percentage change; May 2024

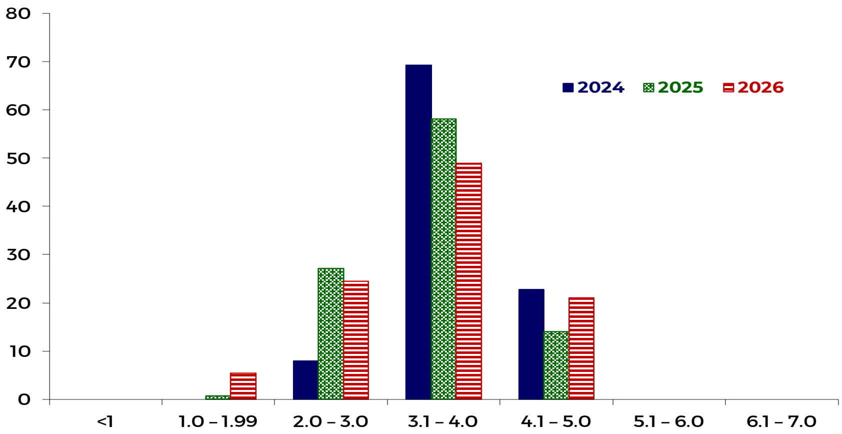
	2024			2025	2026
	Q2	Q3	FY	FY	FY
1) Al-Amanah Islamic Bank	5.60	5.60	5.00	5.00	5.00
2) ANZ	4.00	3.80	3.80	3.00	-
3) Asia ING	4.00	3.30	3.40	3.50	3.50
4) Bangkok Bank	3.80	3.70	3.70	3.50	3.50
5) Bank of Commerce	4.16	3.75	3.61	-	-
6) Barclays	4.00	3.50	3.70	3.40	-
7) Citibank	3.90	3.50	3.60	3.30	-
8) CTBC Bank	4.10	3.00	3.50	3.50	3.60
9) Deutsche Bank	-	-	3.80	3.50	-
10) Eastwest Bank	4.10	3.80	3.70	3.80	3.50
11) eManagement for Business and Marketing Services	3.96	3.66	3.44	4.22	4.25
12) Land Bank of the Phils	4.30	4.20	4.00	3.60	2.00
13) Maybank Investment Banking Group	4.00	3.50	3.50	3.00	3.00
14) Metrobank	-	-	4.00	4.20	-
15) Mizuho	4.10	3.50	3.50	2.80	-
16) Modular Asset Management	3.80	3.20	3.20	3.10	3.50
17) Philippine Equity Partners	4.20	3.60	3.60	3.10	-
18) Standard Chartered	-	-	3.50	3.50	-
19) Sun Life Investment Management and Trust Corp.	4.00	2.50	3.80	2.70	3.00
20) Union Bank of the Phils.	4.10	4.00	3.80	3.70	3.50
Median Forecast	4.0	3.6	3.7	3.5	3.5
Mean Forecast	**4.1**	**3.7**	**3.7**	**3.5**	**3.5**
High	5.6	5.6	5.0	5.0	5.0
Low	3.8	2.5	3.2	2.7	2.0
Number of Observations	17	17	20	19	11
Government Target	**3.0±1.01**	**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 15 out of 20 respondents, there is a 77.2-percent chance (from 71.5 percent) that inflation will settle within the 2-4 percent target range in 2024. Meanwhile, there is a 22.8-percent probability (from 28.3 percent) that inflation will breach the upper end of the target range. For 2025, the probability that inflation will fall within the target band increased to 85.3 percent (from 78.2 percent). For 2026, there is the 73.5-percent probability (from 76.5 percent) that inflation will settle within the target band.[13]

[13] Histogram results of the BSP's survey of private sector economists for May 2024 showed that majority of the respondent-analysts expect inflation to settle within the 2-4 percent target range for 2024 to 2026.

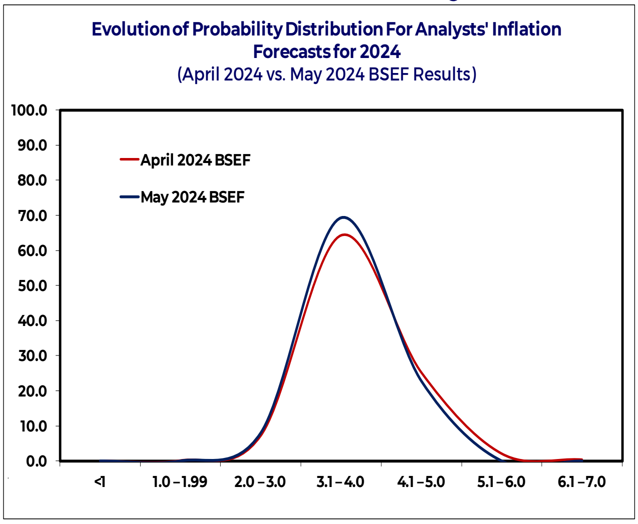
Figure 6
Probability Distribution for Analysts' Inflation Forecasts* (2024-2026)

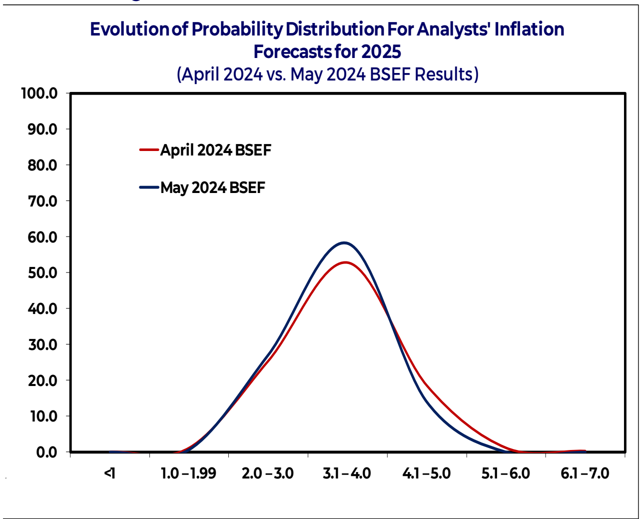


*Probability distributions were averages of those provided by 15 out of 20 respondents.
Source: May 2024 BSP Survey

The results of the survey showed that most of the analysts anticipate current monetary policy settings to remain unchanged in Q2 2024. For Q3 2024, majority of the analysts foresee policy settings to remain unchanged, although about the same number of respondents expect a 25-bp cut in the policy rate during the period. By the end of 2024, the BSP is expected to reduce the policy rate by 25 to 150 bps. For 2025, BSP is seen to further loosen its policy stance by a range of 25 to 250 bps. For 2026, analysts expect an additional reduction of about 50 to 150 bps in the policy rate.

Figure 7
Evolution of Probability Distribution for Analysts' Inflation Forecasts





Relative to the February 2024 MPR, the shape of the May 2024 BSEF's probability distribution for analysts' inflation forecasts for 2024 and 2025 has narrowed, implying an increased probability that inflation will settle within the 2-4 percent target band. This could indicate a further anchoring of inflation expectations. The probability distribution during the February 2024 round showed a fatter distribution, suggesting heightened uncertainty as responses were more dispersed across various inflation outcomes.

Box Article No. 3
Degree of Inflation Expectations Anchoring in the Philippines[1]

The BSP's primary mandate is to promote price stability conducive to a balanced and sustainable economic growth. Price stability is achieved when the average annual inflation is within the 2 to 4 percent inflation target range. The inflation expectations channel is a very important transmission channel of monetary policy as it influences the wage- and price-setting behaviors of firms as well as the savings and investment decisions of households. Thus, well-anchored inflation expectations are key to achieving price stability.

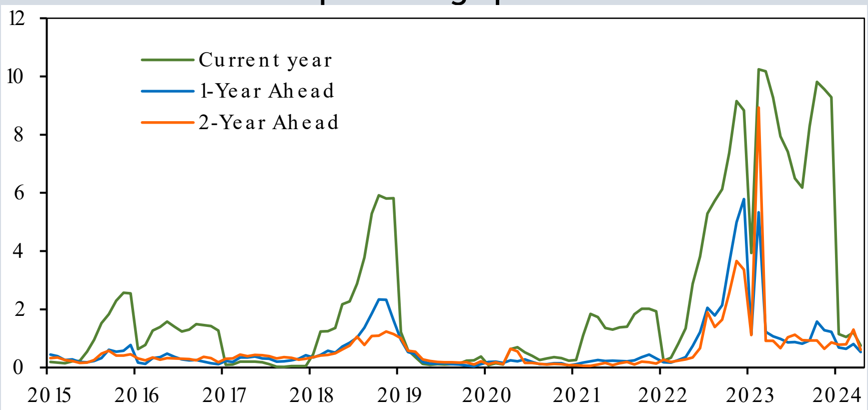
Managing inflation expectations is essential as they can influence actual inflation and can serve as a measure of central bank credibility. Thus, like any central bank, the BSP places great importance in monitoring inflation expectations and has, therefore, introduced survey measures based on various economic agents, such as consumers (Consumer Expectations Survey), businesses (Business Expectations Survey), and professional forecasters (BSP's Survey of External Forecasters or BSEF).[2] This box article considers inflation expectations of professional forecasters.

Measuring the degree of anchoring of inflation expectations is usually done by comparing them to the target range. In this box article, we explore a different approach by using the methodology of Naggert, Rich, and Tracy (2023), which considers both the distance of mean expectations from the target and the variability of inflation forecasts. The premise is that well-anchored inflation expectations must fulfill two conditions: (1) inflation expectations would need to be close to the target and (2) disagreement among forecasters should be minimal. As such, a lower value implies a higher degree of anchoring and vice versa. In calculating the anchoring measure, we use current year, next year, and two-year ahead inflation expectations, as well as the midpoint of the inflation target range.[3]

Chart 1 shows the evolution of the anchoring measures wherein inflation expectations are generally well-anchored, except during periods of supply shocks, which led to either the underachievement or overachievement of the inflation target, e.g., 2015 to 2016, 2018, and 2022 to 2024. For example, anchoring measures deteriorated in 2015 and 2016 as the sustained decline in global oil prices led to lower domestic electricity, transport, and oil prices.[4] Meanwhile, the rise in global oil prices, adverse weather conditions, which affected domestic food supply, as well as the direct and indirect effects of the excise tax reforms led to second-round effects, e.g., an increase in transport fares and minimum wages in 2018.[5] There was an improvement in anchoring measures in 2019 as inflation decelerated due in part to the implementation of the Rice Tariffication Law.

The uptrend in international oil prices, which led to higher domestic fuel pump prices, as well as the negative impact of adverse weather conditions on domestic food supply, led to higher food and energy prices in 2022 and 2023.[6] This resulted in a deterioration of the anchoring measures across all time horizons.

Chart 1
Anchoring Measures
in percentage points

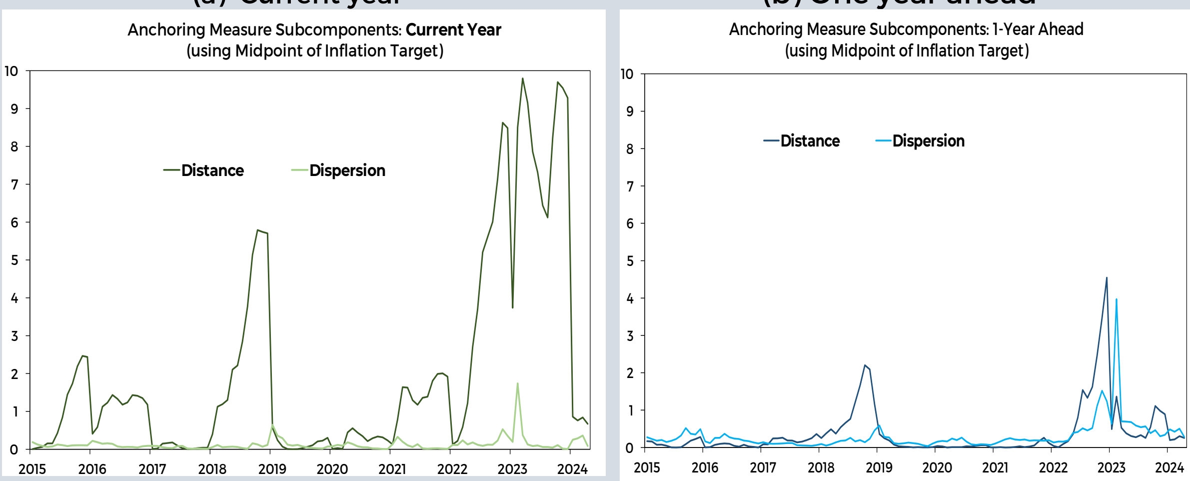


Source: BSP staff calculations

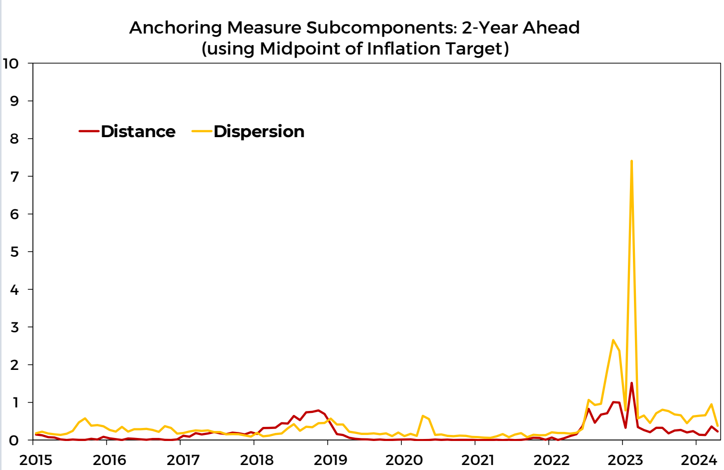
To gain further insights into the anchoring measure behavior, the degree of anchoring measure can be broken down into two components, namely, the *distance* from the midpoint of the target and the level of disagreement or *dispersion* among forecasters. **Chart 2** shows that there appears to be a predominance of distance rather than dispersion for the anchoring measure for the current year's inflation expectation. This is expected given the sensitivity of the current year's inflation expectations to inflation outturns. Nonetheless, the role of dispersion rises for next year and two-year ahead inflation expectations, which could reflect a certain level of uncertainty or differing views among forecasters on the inflation rate path going forward.

Chart 1
Anchoring Measures Subcomponents
In percentage points

(a) Current year (b) One year ahead



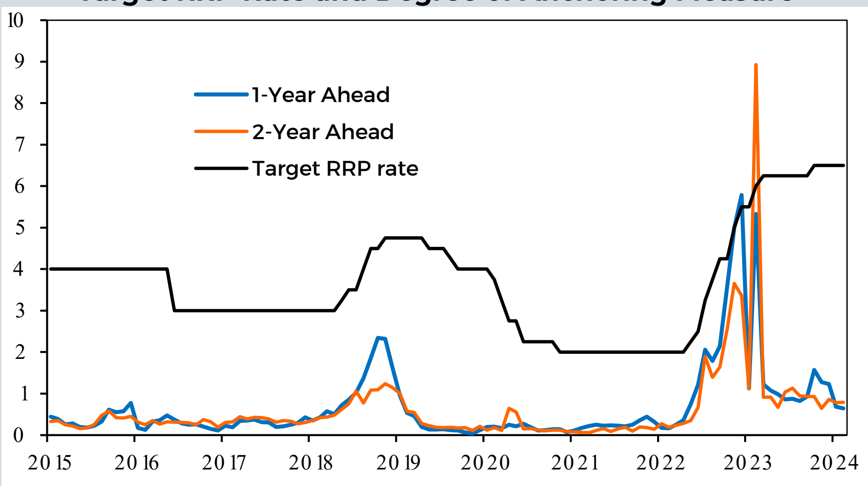
(c) Two years ahead



Source: BSP staff calculations

In responding to supply-driven shocks, the BSP typically allows the initial price increases to "pass-through" as these are considered to be only temporary in nature. However, when evidence of second-round effects emerges, the BSP undertakes timely and pre-emptive actions to steer inflation back to within the target range. Given the most recent supply shock episode, which started in 2022, and the broadening out of inflation pressures alongside the de-anchoring of inflation expectations, the BSP decided to tighten its key policy rate (target RRP rate) by a total of 450 bps between May 2022 and October 2023 (**Chart 3**). Nonetheless, the BSP continued to closely monitor evolving conditions in view of persistent upside risks to the inflation outlook and stood ready to undertake follow-through actions as necessary to keep inflation expectations well-anchored and safeguard the BSP's price stability objective.

Chart 2
Target RRP Rate and Degree of Anchoring Measure



Source: BSP staff calculations.

Endnotes

1/ The authors of this box article are Maria Elena G. Ramirez and Vanessa T. Españo.

2/ A more comprehensive discussion on the different inflation expectations used by BSP is available in Box Article No. 3, *"The BSP's Expectations Surveys as Inputs to Forecasting Inflation Including Second-Round Effects."* Monetary Policy Report, February 2023.

3/ Since 2015, the inflation target has been set at 2.0-4.0 percent.

4/ Source: BSP Open Letters on 2015 and 2016 Inflation.

5/ Source: BSP Open Letter on 2018 Inflation.

6/ Source: BSP Open Letters on 2022 and 2023 Inflation.

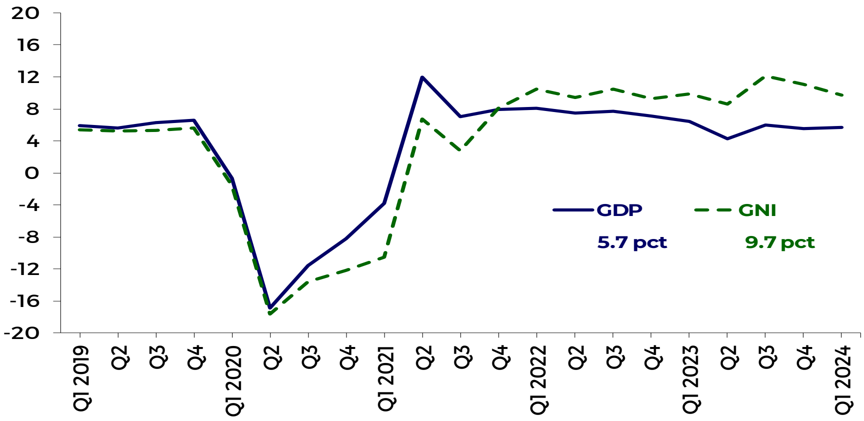
References

Naggert, Kristoph, Robert W. Rich, and Joseph Tracy. 2023. "*The Anchoring of US Inflation Expectations Since 2012.*" Federal Reserve Bank of Cleveland, Economic Commentary 2023-11. https://doi.org/10.26509/frbc-ec-202311

3. Demand Conditions

Output expanded albeit at a slightly slower pace in Q1 2024 from 5.5 percent in Q4 2023 and 6.4 percent in Q1 2023, supported by growth in the industry sector, particularly manufacturing, as well as the services sector. Export performance likewise recovered. Similarly, the gross national income (GNI) rose at a more moderate pace as growth in net primary income eased.

Figure 8
Gross Domestic Product and Gross National Income
at constant 2018 prices; year-on-year growth in percent

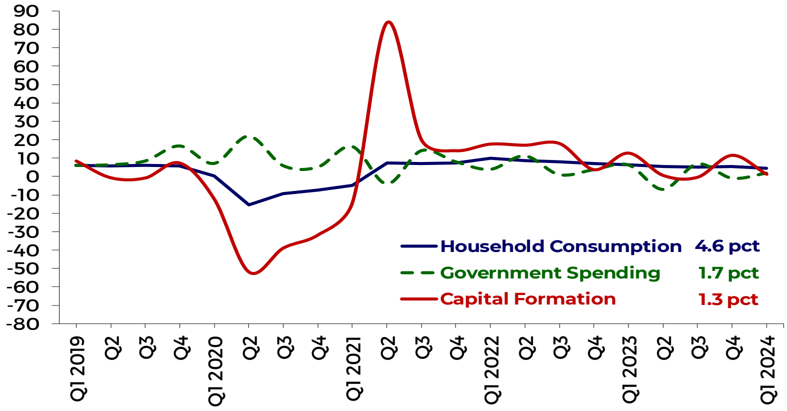


Source: PSA

The Q1 2024 growth was lower than the government target of 6.0 to 7.0 percent. On a seasonally adjusted basis, quarter-on-quarter (q-o-q) GDP growth also slowed down to 1.3 percent in Q1 2024 from 1.8 percent in the previous quarter.

Aggregate demand. Under the expenditure approach, household spending, government spending, investments (or capital formation), and exports contributed 3.5 percentage points (ppts), 0.2 ppt, 0.3 ppt, and 2.1 ppts, respectively to total GDP growth in Q1 2024.

Figure 9
Gross Domestic Product by Expenditure Shares
at constant 2018 prices; growth rate in percent



Source: PSA

Household consumption, which accounted for 74.5 percent of GDP in Q1 2024, grew slower. This was mainly attributed to weaker household spending for food and non-alcoholic beverages, alcoholic beverages, transport, education, restaurants and hotels, and miscellaneous goods and services amid elevated inflation and extreme heat brought about by the ongoing *El Niño*.

Government spending recovered in Q1 2024. Based on the NG's disbursement report,[14] this was due to higher interest payments, larger transfers to Local Government Units (LGUs), and an increase in maintenance and other operating expenses (MOOE).

Capital formation or investments slowed down from previous double-digit growth rates. Contractions were registered in durable equipment and valuables. Construction and breeding stocks, and orchard development also showed sluggish performance.

Meanwhile, external demand improved as overall exports recovered. The growth in exports of goods and services was led by components/devices (semiconductors), electronic data processing, chemicals, tuna, and fresh bananas, as well as business services, travel, telecommunications, computer and information services, transport, and manufacturing services on physical inputs owned by others.

Overall imports also grew albeit moderately. Imports of services continued to grow at double-digit rates, owing to growth in travel, business services, and miscellaneous services. Meanwhile, imports of goods declined due to a contraction in imports of transport equipment, components/devices (semiconductors), industrial machinery and equipment, mineral fuels, lubricants and related materials, and plastics in primary and non-primary forms.

Table 15
Gross Domestic Product by Expenditure Shares
at constant 2018 prices; growth rate in percent

Expenditure Shares	2023		2024
	Q1	Q4	Q1
Household Final Consumption Expenditure	6.4	5.3	4.6
Government Final Consumption Expenditure	6.2	-1.0	1.7
Gross Capital Formation	12.8	11.6	1.3
Gross Fixed Capital Formation	10.9	10.2	2.3
Exports of Goods and Services	1.1	-2.5	7.5
Imports of Goods and Services	4.2	2.0	2.3

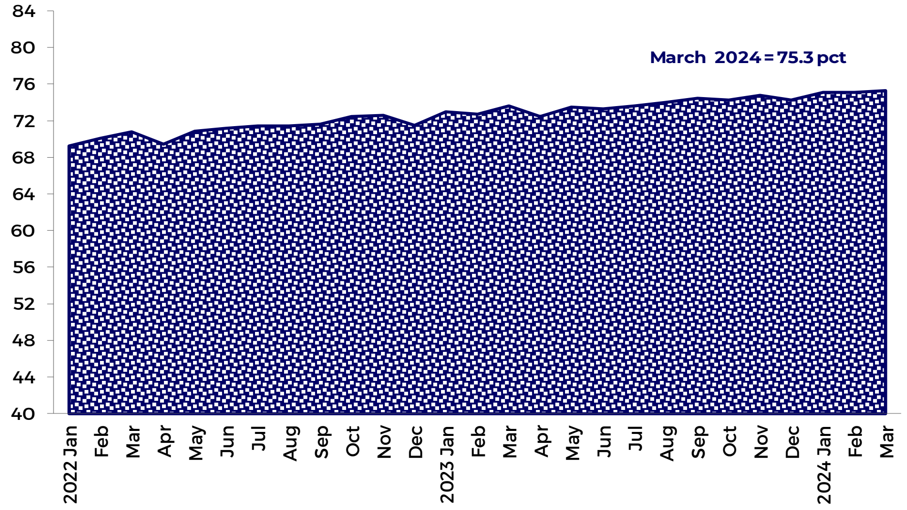
Source: PSA

Other demand indicators

Capacity utilization. The manufacturing sector's preliminary average capacity utilization rate improved in March 2024, based on the PSA's Monthly Integrated Survey of Selected Industries (MISSI).

[14] Based on latest available DBM report on NG Disbursement Performance as of February 2024. DBM Report on the National Government Disbursement Performance (February 2024). Retrieved from: https://www.dbm.gov.ph/index.php/reports/ng-disbursement-performance?view=article&id=2750&catid=201.

Figure 10
Monthly Average of Capacity Utilization for Manufacturing
(2018=100); in percent



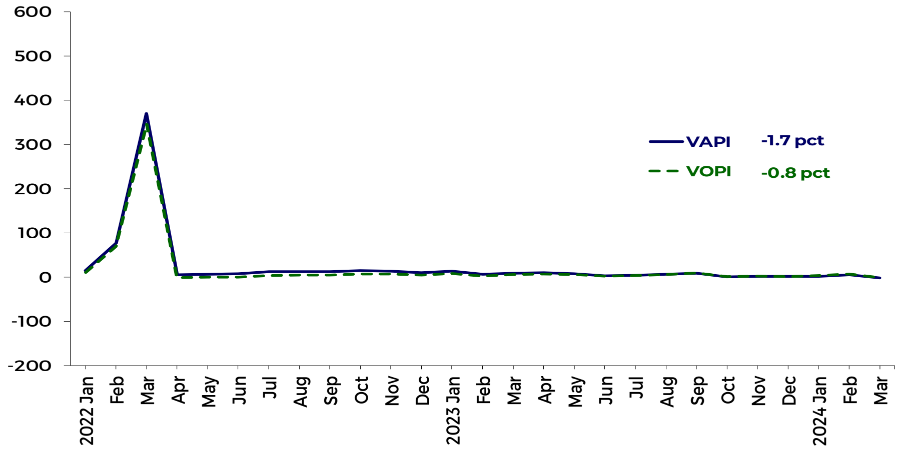
Source: PSA

Of the 618 respondent-establishments surveyed by the PSA, about 52.9 percent operated at or above the 80.0 percent capacity level in March 2024 (from 52.0 percent in February 2024).[15] Average capacity utilization has increased to its highest level since 2019, as industries have maintained their resources based on expectations of improved demand for manufactured goods. Of the 22 major industries, four industries, led by the manufacture of machinery and equipment except electrical products, operated above the 80 percent capacity level, while the remaining 18 industries operated at 60 to 79 percent capacity range.

Volume and value of production. Preliminary results of the MISSI showed that factory output, as measured by the volume of production index (VoPI), declined in March 2024. Of the 22 subsectors, the manufacture of chemical and chemical products posted the highest y-o-y expansion, followed by the manufacture of wearing apparel; coke and refined petroleum products; while the manufacture of wood, bamboo, cane, rattan articles and related products posted the largest contraction for the month.

[15] Monitoring the response rate helps the BSP understand the quality of data reported and how representative it can be. The response rate of surveyed establishments increased to 64.1 percent (preliminary) in March 2024 from 57.2 percent (preliminary) in February 2024. The revised response rate for February 2024 was 73.3 percent.

Figure 11
Volume and Value Indices of Manufacturing Production
2018=100; year-on-year in percent



Source: PSA

Similarly, the value of production index (VaPI) decreased in March 2024. Of the monitored subsectors, manufacture of chemical and chemical products; wearing apparel; and coke and refined petroleum products posted the highest expansions. Meanwhile, the manufacture of wood, bamboo, cane, rattan articles and related products contracted the most.

Table 16
Growth in Volume of Production Index by Industry Division
2018=100; year-on-year; in percent

Gainers		Mar-24
1)	Chemical and Chemical Products	29.1
2)	Wearing Apparel	13.1
3)	Coke and Refined Petroluem Products	10.2
4)	Machinery and Equipment Except Electrical	7.8
5)	Furniture	6.8
6)	Computer, Electronic and Optical Products	5.3
7)	Fabricated Metal Products, except Machinery and Equipment	4.8
8)	Beverages	4.5
9)	Leather and Related Products, Including Footwear	0.9
Losers		**Mar-24**
1)	Wood, Bamboo, Cane, Rattan Articles and Related Products	-24.2
2)	Electrical Equipment	-18.2
3)	Tobacco Products	-17.1
4)	Textiles	-16.8
5)	Other Non-Metallic Mineral Products	-16.0
6)	Printing and Reproduction of Recorded Media	-14.1
7)	Other Manufacturing and Repair and Installation of Machinery and Equipment	-13.8
8)	Transport Equipment	-12.1
9)	Basic Pharmaceutical Products and Pharmaceutical Preparations	-9.2
10)	Rubber and Plastic Products	-9.2
11)	Basic Metals	-8.2
12)	Food Products	-8.1
13)	Paper and Paper Products	-3.8

Source: PSA

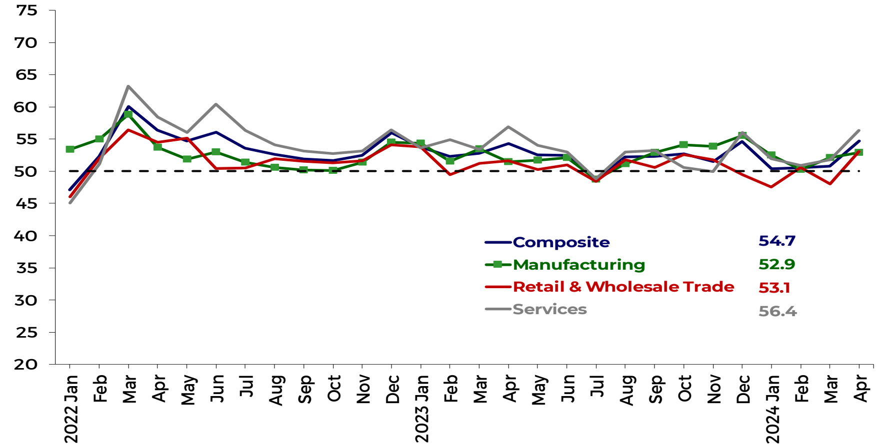
Table 17
Growth in Value of Production Index by Industry Division
2018=100; year-on-year; in percent

Gainers		Mar-24
1)	Chemical and Chemical Products	26.4
2)	Wearing Apparel	11.9
3)	Coke and Refined Petroluem Products	9.4
4)	Beverages	8.2
5)	Computer, Electronic and Optical Products	7.5
6)	Machinery and Equipment Except Electrical	6.8
7)	Furniture	5.6
8)	Leather and Related Products, Including Footwear	4.8
9)	Fabricated Metal Products, except Machinery and Equipment	0.3
Losers		**Mar-24**
1)	Wood, Bamboo,Cane, Rattan Articles and Related Products	-26.4
2)	Other Non-Metallic Mineral Products	-18.4
3)	Electrical Equipment	-17.5
4)	Textiles	-17.5
5)	Other Manufacturing and Repair and Installation of Machinery and Equipment	-14.5
6)	Printing and Reproduction of Recorded Media	-14.3
7)	Basic Metals	-11.4
8)	Transport Equipment	-11.0
9)	Tobacco Products	-10.7
10)	Rubber and Plastic Products	-10.1
11)	Basic Pharmaceutical Products and Pharmaceutical Preparations	-8.5
12)	Food Products	-7.2
13)	Paper and Paper Products	-5.5

Source: PSA

Purchasing managers' index.[16] The preliminary composite PMI was higher in April 2024 (from 50.8 in March).[17] Overall economic activity improved markedly as all economic sectors expanded faster for the month. Looking ahead, business managers anticipate economic conditions to further improve, albeit softer, for all sectors in May 2024.

Figure 12
Purchasing Managers' Index Diffusion Index



Source: Philippine Institute of Supply Management (PISM)

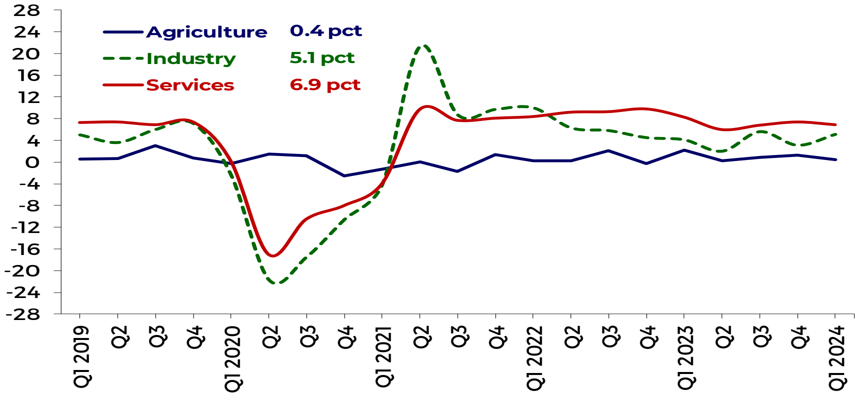
4. Supply Conditions

Aggregate supply. On the production side of the economy, output for the services, agriculture, and industry sectors continued to expand in Q1 2024. The services sector remained the top contributor, driven by accommodation and food services, and finance and insurance activities, which posted double-digit gains during the quarter.

The agriculture sector's performance also expanded in Q1 2024, although at a slower pace. This was due mainly to the reported output reductions for palay, and livestock, as well as banana, coconut including copra, fishing and aquaculture, cassava, and abaca.

[16] Data based on the monthly PMI report of the Philippine Institute for Supply Management (PISM).
[17] 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.

Figure 13
Gross Domestic Product by Industrial Origin
at constant 2018 prices



Source: PSA

The industry sector improved compared with previous quarters. This can be traced mainly to the faster growth in the manufacturing of food products, wearing apparel, computers, electronic and optical products, chemical and chemical products, coke and refined petroleum products, and electrical equipment.

Table 18
Gross Domestic Product by Industrial Origin
at constant 2018 prices; growth rate in percent

Industrial Origin	2023		2024
	Q1	Q4	Q1
Agriculture, Forestry, and Fishing	2.2	1.3	0.4
Industry Sector	4.1	3.1	5.1
Mining and Quarrying	-2.1	10.3	0.3
Manufacturing	2.2	0.5	4.5
Electricity, Steam, Water and Waste Management	6.9	5.5	6.3
Construction	11.0	8.4	7.0
Service Sector	8.3	7.4	6.9
Wholesale and Retail Trade and Repair of Motor Vehicles and Motorcycles	6.8	5.2	6.4
Transportation and Storage	14.6	9.4	5.6
Accomodation and Food Service Activities	28.0	18.1	13.9
Information and Communcation	4.5	5.0	4.2
Financial and Insurance Activities	8.2	12.0	10.0
Real Estate and Ownership of Dwellings	3.1	5.5	4.1
Professional and Business Services	7.7	6.1	7.5
Public Administration and Defense; Compulsory Social Security	1.5	6.2	3.8
Education	6.8	8.1	4.6
Human Health and Social Work Activities	7.6	6.4	8.5
Other Services	37.0	11.6	8.5

Source: PSA

Oil market developments. The spot price of Dubai crude oil decreased for the period 1-9 May 2024 compared with the full-month average price in April 2024. The ongoing ceasefire negotiations between Israel and Hamas, with the aid of international mediators, eased the geopolitical risk premium in world oil prices. However, to date, no agreement has been reached, and Israel's attacks on Gaza continue. Moreover, demand concerns stemming from prospects of higher-for-longer US interest rates as the US Fed maintained policy rates last 1 May 2024 continued to contribute to lower global oil prices during the reference period.

Nonetheless, upside risks to oil prices remain. The uncertainty induced by the on-going conflict in the Middle East, especially with the continued strikes of Israel in Gaza, as well as the Russia-Ukraine war continued to drive the uptick in global oil prices.

On the demand side, the recovery in Chinese exports and imports, especially in crude oil imports[18] in April 2024 offset the decline in oil prices. Plausible rate cuts by other central banks, which increase expectations of higher oil demand, could also provide support for higher oil prices in the near term. For instance, the Swiss National Bank started the rate-cutting cycle among major central banks in March 2024. Sweden's Riksbank also made its first rate cut since 2016 on 8 May 2024. Further, while the Bank of England (BOE) maintained its policy rate at its 9 May 2024 meeting, several members of its Monetary Policy Committee supported a 25-bp cut. The BOE Governor also signaled possible rate cuts in the next scheduled policy meetings.

On the domestic front, week-on-week domestic prices for gasoline, kerosene, and diesel declined by ₱5.90 per liter, ₱1.05 per liter, and ₱0.90 per liter, respectively, as of 7 May 2024.

Developments in the agriculture sector. The Agriculture, Forestry, and Fishing (AFF) posted a growth of 0.4 percent in Q1 2024, slower than in previous quarters.[19] The positive contribution of poultry, egg, sugarcane, coffee, and other agricultural crops was dampened by the lower output in palay, livestock, banana, and coconut, including copra, fishing and aquaculture, cassava, and abaca.

Crop production, which contributed more than half (57.6 percent) of the total value of production in agriculture and fisheries, declined by 0.3 percent in Q1 2024.[20] The contraction in production may be attributed to the negative impact of *El Niño* on crops, with palay declining by 2.0 percent in Q1 2024. This was partly offset by improvements in the production of other crops, such as onion (28.6 percent), coffee (25.2 percent), and sugarcane (17.2 percent).

Likewise, Q1 2024 livestock production, which accounted for 13.9 percent of total agricultural output, decreased by 3.6 percent. While local hog production has shown improvement since the African Swine Fever (ASF) outbreak, it has yet to return to the pre-ASF level. ASF remains a threat to hog repopulation efforts, and the ASF vaccine is still undergoing trials and processes for government approval.
The fisheries sector, which comprised 12.5 percent of the total value of production in agriculture and fisheries, also recorded a contraction of 1.3 percent in Q1 2024. The government underscores the need to upgrade and expedite the development of more aquaculture farms and mariculture parks to support the fisheries sub-sector.

[18] Shipments from China grew 1.5 percent y-o-y in April 2024 by value from -7.5 percent in March, which marked the first contraction since November. Meanwhile, Chinese imports for April increased 8.4 percent, reversing a 1.9 percent fall in March. Chinese crude oil imports in April also rose by 5.45 percent y-o-y. Reuters (9 May 2024). "China's exports and imports return to growth, signaling demand recovery." https://www.reuters.com/world/china/chinas-exports-return-growth-april-imports-beat-forecast-2024-05-09/
[19] Based on the Q1 2024 National Accounts report published by the Philippine Statistics Authority on 9 May 2024.
[20] The growth rates of the subsectors and commodities are based on the January to March 2024 Performance of Philippine Agriculture report published by PSA on 8 May 2024.

Meanwhile, poultry production increased by 5.9 percent, which contributed 16.0 percent to total agricultural output. The improvement in poultry production may be attributed to recoveries from Avian Influenza (AI). Based on DA's latest status update as of 3 May 2024, there are only six regions or eight provinces with remaining AI cases.

Global food prices. The Food and Agriculture Organization (FAO) All Rice Price Index[21] averaged 135.7 points in April 2024, lower by 1.7 percent from 138.1 points in March 2024 but still 9.3 percent above the year-ago level of 124.2 points. The m-o-m decline was due to improved supply conditions amid ongoing rice crop harvest and the depreciation of the Thai baht against the US dollar.

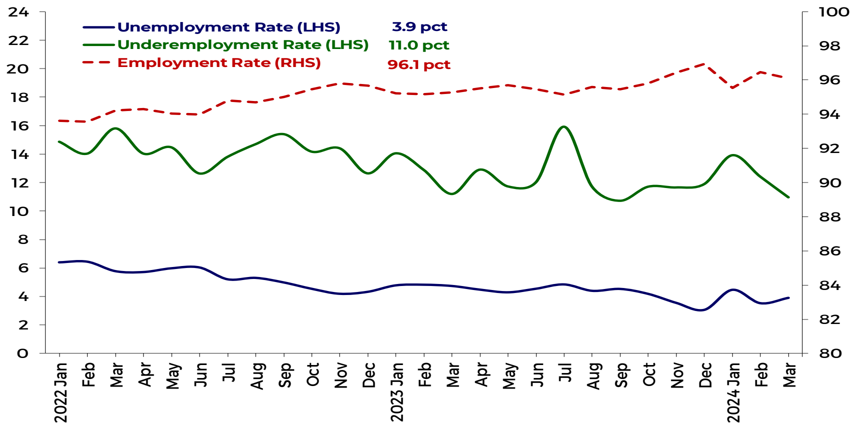
As of April 2024, quotes for 5% broken rice varieties from Vietnam, Thailand, and Pakistan increased by 32.3 percent, 26.2 percent, and 26.4 percent, respectively.

The FAO Food Price Index increased slightly to 119.1 points in April 2024 relative to the month-ago level of 118.8 points, although still lower than the year-ago level of 128.7 points. The m-o-m increase was attributed to higher prices of cereals, vegetable oils, and meat owing to strong import demand and weather-related supply disruptions, which outweighed price declines of sugar and dairy products.

5. Labor Market Conditions

The unemployment rate slightly increased in March 2024 from 3.5 percent in February. This is equivalent to about two million unemployed Filipinos during the month, higher compared with 1.8 million in the previous month. The underemployment rate was lower in March 2024, from 12.4 percent in February 2024, mainly due to a notable decrease in visible[22] underemployment.

Figure 14
Labor Market Indicators
in percent



Source: PSA

[21] 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.
[22] Visibly underemployed persons are those who worked for less than 40 hours a week during the survey period and want additional hours of work or an additional job.

6. Monetary Operations

As of 26 April 2024, the total outstanding amount absorbed in the BSP liquidity facilities settled at ₱1.544 trillion. Term instruments, particularly the BSP bills (BSPB) and term deposit facilities (TDF) accounted for most of the BSP's monetary operations with a combined share of 69.2 percent.[23] Meanwhile, the overnight reverse repurchase (ON RRP) facility and overnight deposit facility (ODF) had shares of 21.4 percent and 9.4 percent, respectively.

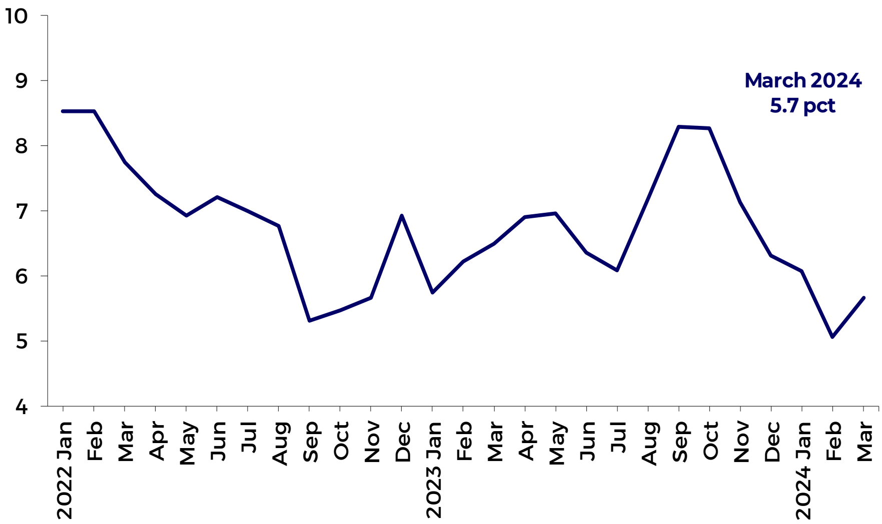
At the 26 April 2024 auction, the ON RRP rate settled at 6.0529 percent, 0.29 bp higher than the target RRP rate of 6.5 percent. The year-to-date (y-t-d) average spread between the ON RRP rate and the target RRP rate narrowed to 2.35 bps from the y-t-d average of 3.04 bps of the previous month.

Meanwhile, interest rates for the TDF and the BSPB decreased but remained within the interest rate corridor and above the ON RRP rate, as market participants were assigned a premium for the longer duration. At the 24 April 2024 auctions, the weighted average interest rates (WAIRs) in the 7-day and 14-day TDFs declined by 0.84 bp and 1.56 bps to 6.5300 percent and 6.5668 percent, respectively. Similarly, the WAIRs for the 28-day and 56-day BSPBs fell by 0.22 bp and 1.39 bps to 6.6804 percent and 6.6643 percent, respectively, in the auctions on 26 April 2024.

7. Financial Conditions

Domestic liquidity. Preliminary data showed that domestic liquidity (M3) grew in March from 5.1 percent (revised) in February to about ₱17.2 trillion. On a m-o-m seasonally adjusted basis, M3 increased by about 0.9 percent.

Figure 15
Domestic Liquidity
year-on-year growth rate; in percent



Source: BSP

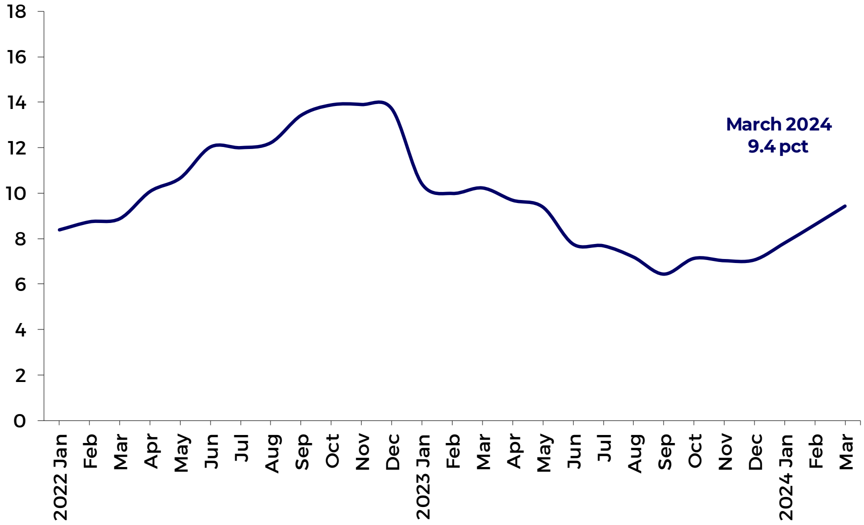
[23] Out of the 69.2 percent, BSPB and TDF had a share of 50.1 percent and 19.1 percent, respectively.

Domestic claims continued to drive the expansion in M3, as claims on the private sector grew with the sustained expansion in bank lending to non-financial private corporations and households. Net claims on the central government also expanded with the decline in deposits by the national government with the BSP.

On the liabilities side, the growth in M3 was driven mainly by the expansion 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, grew from 8.6 percent in February. On a m-o-m seasonally adjusted basis, outstanding universal and commercial bank loans, net of RRPs, went up by 1.3 percent.

Figure 16
Loans Outstanding of Commercial Banks
year-on-year growth rate; in percent



Source: BSP

Meanwhile, outstanding loans to residents, net of RRPs, increased by 9.5 percent in March from 8.7 percent in the previous month. Outstanding loans to non-residents[24] rose by 9.1 percent in March after expanding by 6.5 percent in the previous month. Outstanding loans for production activities increased by 7.7 percent in March from 6.8 percent in February mainly due to the rise in loans to major sectors, particularly real estate activities (11.5 percent); electricity, gas, steam, and air conditioning supply (10.1 percent); wholesale and retail trade, and repair of motor vehicles and motorcycles (6.6 percent); construction (18.3 percent); manufacturing (4.9 percent); and transportation and storage (14.3 percent).

Similarly, consumer loans to residents increased by 25.4 percent in March, from 25.2 percent in February, driven by the rise in credit cards, motor vehicles, and salary-based general-purpose consumption loans.

[24] Outstanding loans to non-residents include loans by UKB's foreign currency deposit units (FCDUs) to non-residents.

Credit standards

In Q1 2024, bank respondents see unchanged credit standards from enterprises as well as loan demand based on the modal approach. Over the following quarter, most of the participating banks anticipate a broadly steady business loan demand.

Lending to enterprises. Based on the modal approach, results for Q1 2024 showed that most respondents retained loan standards for firms. Meanwhile, the diffusion index (DI) approach indicated a net tightening of lending standards across all borrower firm sizes due to a deterioration of borrowers' profiles and the profitability of bank portfolios, as well as the lower risk tolerance of banks.

Over the next quarter, the modal approach showed participant banks' anticipation of steady lending standards for enterprises. Meanwhile, the DI method pointed to expectations of tightening loan standards given the deterioration in the profitability and liquidity of banks' portfolios and borrowers' profiles.

Table 19
General Credit Standards for Loans to Enterprises (Overall)

	2021				2022				2023				2024
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Tightened considerably	10.6	8.0	4.2	4.2	10.0	6.5	10.4	4.3	6.7	4.3	2.1	0.0	0.0
Tightened somewhat	14.9	20.0	20.8	14.6	16.0	13.0	8.3	12.8	13.3	4.3	10.6	12.0	11.8
Remained basically unchanged	**66.0**	**70.0**	**70.8**	**75.0**	**72.0**	**76.1**	**77.1**	**80.9**	**73.3**	**89.1**	**80.9**	**88.0**	**86.3**
Eased somewhat	8.5	2.0	4.2	6.3	2.0	4.3	4.2	2.1	6.7	2.2	6.4	0.0	2.0
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
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
Diffusion index for credit standards	**17.0**	**26.0**	**20.8**	**12.5**	**24.0**	**15.2**	**14.6**	**14.9**	**13.3**	**6.5**	**6.4**	**12.0**	**9.8**
Number of banks responding	**47**	**50**	**48**	**48**	**50**	**46**	**48**	**47**	**45**	**46**	**47**	**50**	**51**

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

Lending to households. In Q1 2024, both the modal and DI methods revealed that surveyed banks maintained the lending standards for households due to the unchanged risk tolerance of banks, the steady profitability of their asset portfolios, and the stable economic outlook and profile of borrowers.

Table 20
General Credit Standards for Loans to Households (Overall)

	2021				2022				2023				2024
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Tightened considerably	9.4	5.7	5.6	2.9	2.5	5.4	5.4	5.7	3.0	3.0	0.0	0.0	0.0
Tightened somewhat	9.4	20.0	11.1	8.6	12.5	5.4	10.8	8.6	18.2	9.1	15.6	11.8	11.4
Remained basically unchanged	**75.0**	**68.6**	**69.4**	**65.7**	**62.5**	**73.0**	**64.9**	**71.4**	**51.5**	**69.7**	**68.8**	**70.6**	**77.1**
Eased somewhat	6.3	5.7	13.9	17.1	17.5	13.5	18.9	14.3	27.3	12.1	12.5	14.7	11.4
Eased considerably	0.0	0.0	0.0	5.7	5.0	2.7	0.0	0.0	0.0	6.1	3.1	2.9	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
Diffusion index for credit standards	**12.5**	**20.0**	**2.8**	**-11.4**	**-7.5**	**-5.4**	**-2.7**	**0.0**	**-6.1**	**-6.1**	**0.0**	**-5.9**	**0.0**
Number of banks responding	**32**	**35**	**36**	**35**	**40**	**37**	**37**	**35**	**33**	**33**	**32**	**34**	**35**

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 Q2 2024, modal results showed a higher number of bank respondents anticipating maintained loan standards for households. However, the DI approach has indicated a net tightening of credit standards, largely due to expectations of banks of a deterioration in the profitability of their portfolios and on borrowers' profiles, as well as banks' reduced risk tolerance.

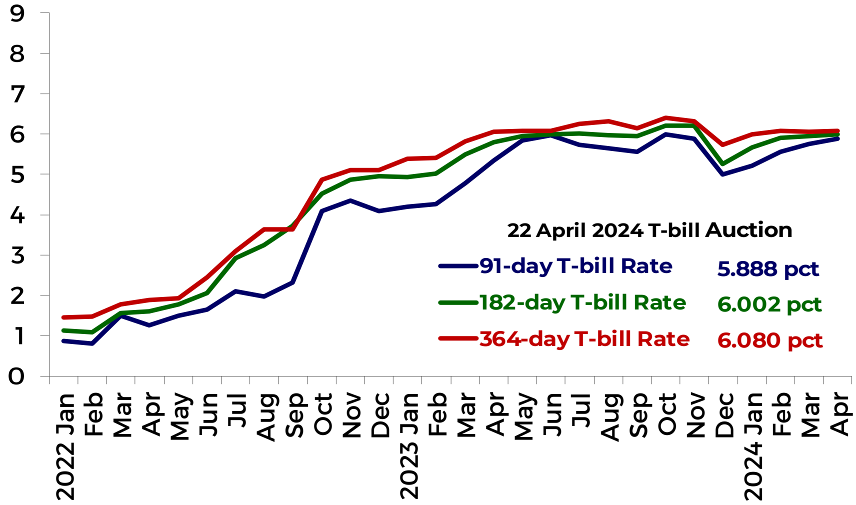
Loan demand. In Q1 2024, most surveyed banks reflected a steady household loan demand based on the modal results. On the other hand, the DI method showed a net increase in demand across all key household loan categories, driven by increasing household consumption and more attractive financing terms offered by banks.

For Q2 2024, modal results indicated that most respondent banks expect credit demand from households to remain basically unchanged. Meanwhile, according to the DI method, there is an anticipated net increase in consumer loan demand mainly due to higher household consumption and favorable financing terms offered by banks.

Capital markets

Primary GS market and rates. During the 22 April 2024 treasury bill (T-bill) auction, the average interest rates for the 91-day, 182-day, and 364-day rose by 1.8 bps, 2.9 bps, and 3.6 bps, respectively, from the rates fetched during the 15 April 2024 auction.

Figure 17
Treasury Bill Rates
in percent



Source: BTr

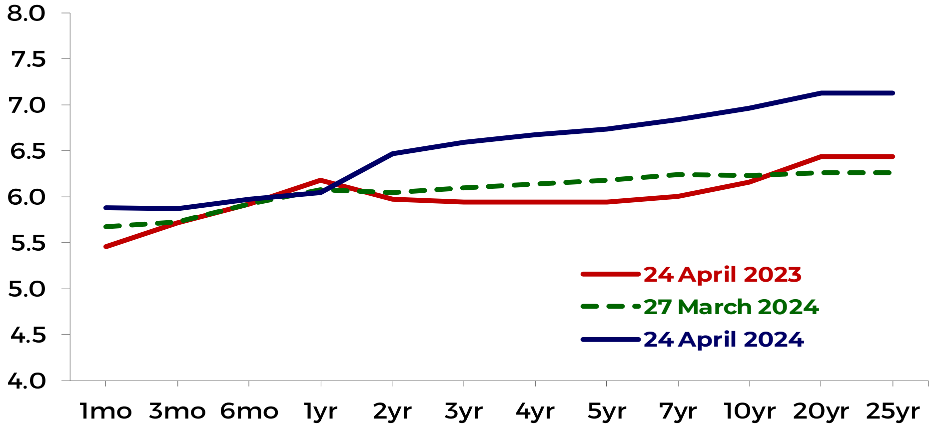
The Bureau of the Treasury (BTr) Auction Committee awarded in full the offered amounts of ₱5.0 billion each for the 91-day, 182-day, and 364-day T-bills. Total tenders for all maturities reached about ₱44.8 billion, or about 3.0 times the total amount offered of ₱15.0 billion.

On 23 April 2024, the BTr partially awarded ₱16.6 billion of the re-issued 20-year T-bonds with a remaining life of 19 years and 10 months. These T-bonds fetched an average interest rate of 7.017 percent, higher than the 6.189 percent average interest rate quoted for the same paper when it was last offered on 19 March 2024. The auction was oversubscribed, with tenders reaching around ₱34.9 billion or 1.2 times the offered amount of ₱30.0 billion.

Secondary market GS yield curve. On 24 April 2024, secondary market GS yields increased across tenors (excluding the 1-year tenor) relative to the end of March 2024, as market players adjusted their expectations of a rate cut due to less dovish comments from the BSP and the US Fed. However, the losses in the bond market were limited by some bargain hunting as yields hit y-t-d highs. Consequently, the spreads in secondary market rates over the BSP overnight RRP rate on 24 April 2024 were generally narrower relative to end-March 2024 levels.

As of 24 April 2024, the spreads between the 10-year and 1-year GS rates and the 10-year and 5-year GS rates widened to 91.3 bps (from 15.8 bps as of end-March 2024) and to 22.3 bps (from 4.9 bps as of end-March 2024) mainly due to the increase in the 10-year GS rate.

Figure 18
Yields of Government Securities in the Secondary Market
in percent



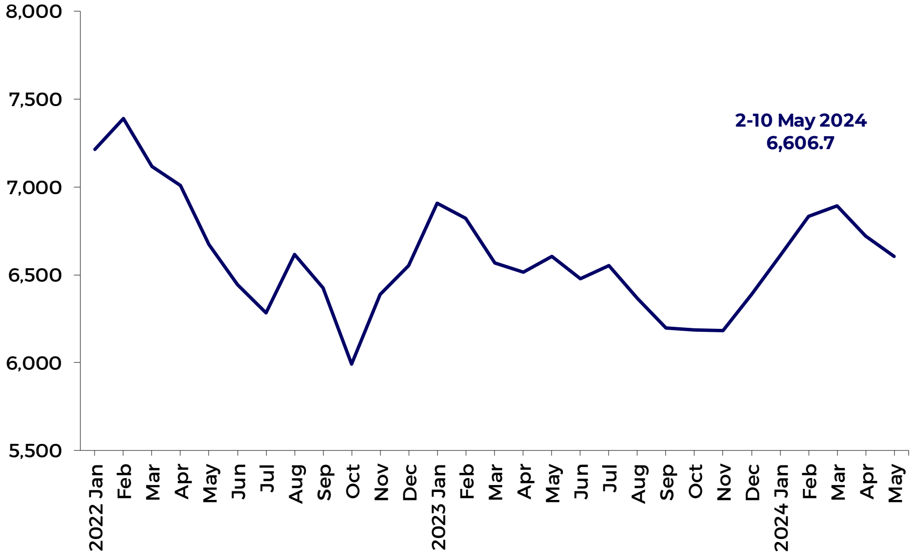
Source: Bloomberg

Stock market. On 2-10 May 2024, the Philippine Stock Exchange Index (PSEi) was broadly unchanged from the previous month's average of 6,651.8 index points. The main index was supported by reports of slower-than-expected US employment data in April, which partly strengthened expectations of a rate reduction from the US Fed.[25]

However, gains were tempered by lower-than-expected Philippine GDP growth in Q1 2024,[26] a higher unemployment rate in March,[27] and the broadly unchanged headline inflation in April. By the end of the review week, the decision by the US Fed to retain its monetary policy[28] further contributed to the decline in the domestic equities market.

[25] On 3 May, the S&P 500 rose by 1.3 percent to 5,127.79, marking its largest gain since late February. The softer-than-expected employment report, showing a growth of 175,000 jobs in April (missing a year) (the lowest since October 2023), along with the smallest annual change in average hourly earnings since May 2021 (3.9 percent). (reuters.com)
[26] The country's gross domestic product (GDP) posted a year-on-year growth of 5.7 percent in the first quarter of 2024, higher than the previous quarter's growth of 5.5 percent. (psa.gov.ph)
[27] The Philippines' unemployment rate in March 2024 was estimated at 3.9 percent, higher than the 3.5 percent estimate in February 2024. However, this was lower than the recorded unemployment rate in March 2023 at 4.7 percent. (psa.gov.ph)
[28] US Fed Chair Powell stated that following three months of higher-than-anticipated price increases in the first quarter of 2024, it will now take longer than previously anticipated for policymakers to be assured that Federal Open Market Committee's (FOMC) inflation target of 2.0 percent will be reached. (reuters.com)

Figure 19
Philippine Stock Exchange Index
index points



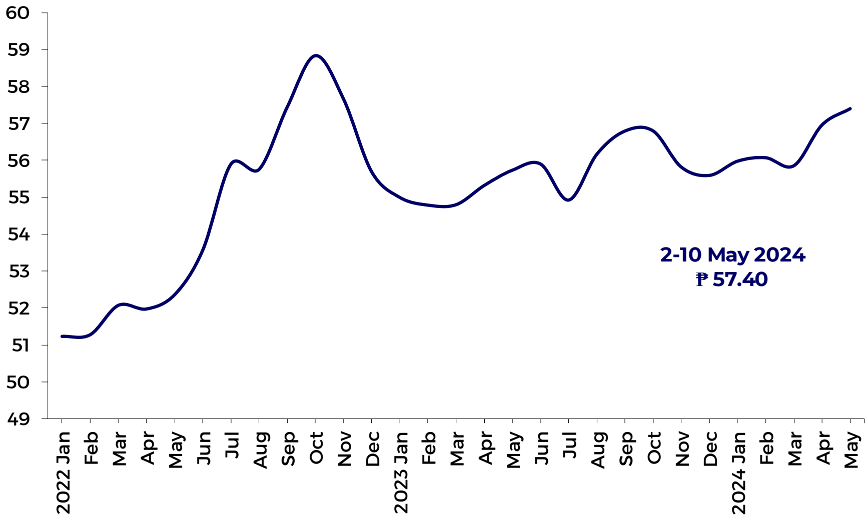
Sources: Philippine Stock Exchange, BSP

Exchange rate. On 2-10 May 2024, the peso depreciated[29] by 0.79 percent relative to the previous month's average of ₱56.95/US$1. This depreciation was attributed to broad US dollar strength following US Fed pronouncements on the need for US monetary policy to remain restrictive for longer. On the domestic front, dampened market sentiment amid (1) lower-than-expected GDP growth in Q1 2024; (2) rising inflation, as well as the persistence of upside risks to inflation further weighed down on the peso. These factors were partly offset, however, by net foreign direct investment (FDI) inflows in February[30] and hints of easing geopolitical tensions in the West Philippine Sea.[31]

As of 10 May 2024, the peso closed at ₱57.42/US$1, depreciating by 3.57 percent against the US dollar on a y-t-d basis. Nevertheless, it has remained less volatile relative to most currencies in the region, as indicated by a coefficient of variation of 1.16 percent.[32]

[29] For the week 2-10 May, the peso appreciated by 0.36 percent to an average of ₱57.40/US$1 from the previous week's (22-30 April) average of ₱57.61/US$1.
[30] The growth of foreign direct investment (FDI) net inflows was sustained in February 2024, posting a 29.3 percent increase year-on-year to reach US$1.4 billion from the US$1.1 billion net inflows in February 2023.
[31] President Ferdinand Marcos Jr. stated that the Philippines will not resort to water cannons or any offensive weapons in the West Philippine Sea, noting the Philippine Navy and Coast Guard's mission to ease tensions in the disputed waters. (Reuters)
[32] The peso's year-to-date volatility, as measured by the coefficient of variation stood lower than that of the Japanese yen, Thai baht, South Korean won, and Indonesian rupiah, but higher than the Chinese yuan, Singaporean dollar, and Malaysian ringgit.

Figure 20
Peso-Dollar Rate
PHP/US$



Source: Reference Exchange Rate Bulletin, Treasury Department, BSP

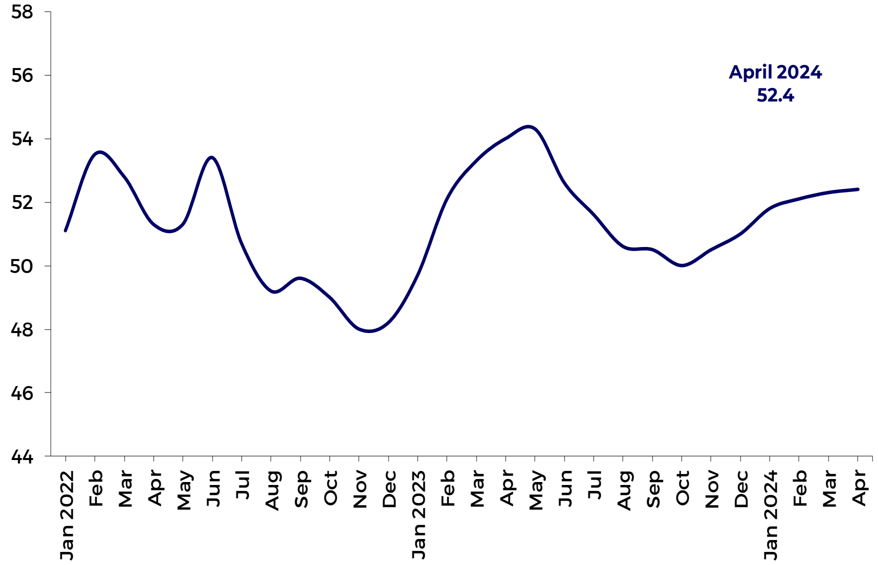
On a real trade-weighted basis, the peso appreciated y-o-y in April against the basket of currencies of all trading partners (TPI), trading partners in advanced (TPI-A) and developing (TPI-D) countries, as indicated by the increase in the REER index of the peso by 3.68 percent, 3.01 percent, and 3.58 percent, respectively. This appreciation was traced mainly to the combined impact of the widening inflation differentials with trading partner countries and the nominal appreciation of the peso.[33,34]

[33] 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 the 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 developing partner countries which includes China, Singapore, South Korea, Hong Kong, Malaysia, Taiwan, Indonesia, Saudi Arabia, United Arab Emirates, and Thailand.
[34] 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. The NEER index, meanwhile, represents the weighted average exchange rate of the peso vis-à-vis a basket of foreign currencies.

8. External Developments

Global economic activity continued to expand amid strong demand and improved business optimism. In April 2024, the JP Morgan All-Industry Output Index increased as new business expanded faster mainly due to higher trade volumes from international markets. Economic activity rose in almost all the countries covered except Canada.[35]

Figure 21
JP Morgan Global All-Industry Output Index
index points



Source: Markit Economics

In the April 2024 WEO, the IMF raised its 2024 global economic growth projection to 3.2 percent from 3.1 percent in the January WEO Update, reflecting the surprisingly resilient economic activity through the global disinflation of 2022-2023. Growth in employment and incomes remained steady, indicating supportive demand developments and a supply-side expansion amid an unanticipated boost to labor force participation. Despite significant central bank interest rate increases, the global economy has demonstrated resilience, reflecting the ability of households in major advanced economies to draw on the substantial savings accumulated during the pandemic.

However, the pace of expansion remains low compared with historical standards primarily due to near-term factors, such as still-high borrowing costs, the withdrawal of fiscal support, the longer-term effects from the COVID-19 pandemic, Russia's invasion of Ukraine, weak growth in productivity, and increasing geo-economic fragmentation.

[35] 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.

For advanced economies (AEs), the IMF 2024 baseline growth estimate improved owing to the revision to US growth and stronger household consumption in the euro area. Likewise, the 2024 growth forecast for emerging markets and developing economies (EMDEs) saw a slight increase, as the moderation in emerging and developing Asia was offset by rising growth for economies in the Middle East, Central Asia, and sub-Saharan Africa.

Risks to the global outlook are now broadly balanced. The IMF cited the following upside risks to the revised baseline growth forecasts: (1) short-term fiscal boost in the context of elections; (2) further supply-side surprises allowing for faster monetary policy easing; (3) spurs to productivity from artificial intelligence; and (4) structural reform momentum gathering.

Meanwhile, the following downside risks to global growth remain plausible: (1) new commodity price spikes amid regional conflicts; (2) persistent inflation and financial stress; (3) faltering recovery of China; (4) disruptive fiscal adjustment and debt distress; (5) distrust of government eroding reform momentum; and (6) intensified geo-economic fragmentation.

Policy actions by other central banks. In their April meetings, the Reserve Bank of India, Bank of Thailand, Bank of Canada, Reserve Bank of New Zealand, European Central Bank, Bank of Korea, People's Bank of China, and Bank of Japan maintained their respective key policy interest rates, as they continued to assess the impact of previous monetary policy adjustments.

Meanwhile, Bank Indonesia raised its benchmark interest rate by 25 bps to 6.25 percent to shore up the weak rupiah, which has fallen to four-year lows on rising risk aversion and a delay in the expected timing of the US Fed's reduction in interest rates.

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By post: BSP Monetary Policy Report
c/o Department of Economic Research
Bangko Sentral ng Pilipinas
A. Mabini Street, Malate, Manila
Philippines 1004

By e-mail: bspmail@bsp.gov.ph