Monetary Policy Summary

At its meeting on monetary policy on 18 August 2022, the BSP decided to raise the interest rate on the overnight reverse repurchase (RRP) facility by 50 basis points to 3.75 percent, effective 19 August 2022. Accordingly, the interest rates on the overnight deposit and lending facilities were raised to 3.25 percent and 4.25 percent, respectively.

Inflation is projected to accelerate over the near term. The forecast path indicates that inflation could peak in Q3 2022 and remain above the target range until Q2 2023 due primarily to supply-side factors. Inflation is seen to decelerate back to within the target range by Q3 2023 as global oil and non-oil prices start to decelerate. The negative base effects from transport fare adjustments in 2022 as well as impact of the BSP's cumulative policy rate adjustments shall also contribute to easing of inflation in H2 2023.

The risks to the inflation outlook are seen to be tilted to the upside for 2022 - 2023 and remain broadly balanced for 2024. Should these risks materialize, the inflation forecast will move further away from the inflation target in 2022 and 2023. The potential impact of higher global non-oil prices, higher fish prices, sharp increase in sugar prices and possible transport fare hikes due to higher oil prices are the major upside risks over the policy horizon. Meanwhile, the potential impact of a weaker-than-expected global recovery as well as delayed lifting of restrictions in some regions continue to be the main sources of downside risks.

Inflation expectations have continued to rise. Private sector economists surveyed in August 2022 reported a higher mean inflation forecast for 2022 at 5.4 percent from 5.3 percent in the July 2022 survey. By contrast, the mean inflation forecast for 2023 was unchanged at 4.2 percent. Meanwhile, mean inflation forecast for 2024 was lower at 3.7 percent from 3.9 percent.

Economic recovery is seen to continue to gain traction over the near term. Real GDP growth is projected to settle within the DBCC's revised target of 6.5-7.5 percent for 2022 but could face headwinds to reach the 6.5-8.0 percent target for 2023 and 2024.[4] The full-year growth outlook for 2022 was adjusted downwards from the previous round due to slower-than-expected GDP outturn in Q2 2022. Meanwhile, domestic growth in 2023 and 2024 could be weighed down by slower global economic activity and tighter liquidity conditions as major central banks normalize monetary policy rates due to elevated inflation.

Domestic economic activity is projected to return to its pre-pandemic level by the second half of 2022. The latest assessment continues to indicate that domestic economic activity will remain firm in the succeeding quarters in view of the looser mobility restrictions amid continued widespread deployment of COVID-19 vaccines and booster shots.

Output gap is projected to remain broadly neutral over the policy horizon. The overall balance of demand and supply conditions, as captured by the output gap or the difference between actual and potential output, provides an indication of

[4] Development and Budget Coordination Committee (DBCC)

potential inflationary pressures in the near term. Estimates from the BSP's Policy Analysis Model for the Philippines (PAMPh)[5] indicate that the output gap likely closed in Q1 2022 and will remain broadly neutral during the year as the economic recovery continues to gain traction. Moreover, potential output is expected to sustain its recovery with productive capacities growing at pace with actual output amid the continued reopening of the economy, sustained improvements in employment conditions, and continued investment growth.

Expansion in domestic liquidity will continue to support the country's funding requirement. Domestic liquidity (M3) is projected to increase at double-digit rates in 2023 and 2024. Nonetheless, the latest M3 growth forecasts are lower compared to the previous round, primarily due to the lower-than-expected outturns in Q2 2022, slower output growth over the policy horizon, and the higher domestic interest rates following the hikes in the BSP's policy rate.

For these reasons, the BSP deemed further monetary action to be necessary to avoid a further breach in the inflation target over the policy horizon. While the latest baseline forecasts indicate that inflation could settle at the upper end of the target in 2023, follow-through policy action by the BSP is warranted to avoid a possible breach in the inflation target amid persistent external spillovers. At the same time, a firm monetary response to rein in price pressures will complement the broader array of targeted responses by the National Government to address domestic supply constraints that are contributing to inflationary pressures.

At the same time, notwithstanding the lower-than-expected Q2 2022 GDP, the recovery in domestic demand is likely to be sufficiently strong to allow further normalization of monetary policy. While the latest forecast for full year 2022 has been revised downward, domestic growth is still seen to remain robust in the succeeding quarters following the relaxation of mobility restrictions which has enabled businesses to reopen and increase capacity. Domestic growth is thus still projected to settle within the DBCC's target range for 2022.

The BSP continues to urge timely non-monetary government interventions to mitigate the impact of persistent supply-side pressures on commodity prices.

The BSP reassures the public of its commitment and readiness to take all necessary actions to steer inflation towards a target-consistent path over the medium term in keeping with its price and financial stability mandates.

[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.