Monetary Policy Summary

At its monetary policy meeting on 17 November 2022, the BSP decided to raise the interest rate on the overnight reverse repurchase (RRP) facility by 75 basis points to 5.00 percent, effective 18 November 2022. Accordingly, the interest rates on the overnight deposit and lending facilities were raised to 4.50 percent and 5.50 percent, respectively.

Inflation is projected to remain elevated in the near term. The latest forecast path indicates that inflation is likely to peak in Q4 2022 and remain above the National Government's target range of 2-4 percent until Q2 2023. Inflation is then seen to decelerate back to within the target range by Q3 2023 and approach the low end of the target range in Q4 2023 to Q1 2024 due to negative base effects, and eventually stabilize at the midpoint of the target by Q2 2024.

The risks to the inflation outlook are still skewed to the upside, particularly for 2023, but remain broadly balanced for 2024. Major upside risks to the inflation outlook are the potential impact of higher fertilizer prices; trade restrictions and adverse global weather conditions on international food prices; increased prices of fruits and vegetables owing to domestic weather disturbances; petitions for tricycle fare hikes due to elevated oil prices; higher sugar prices; and the possible reinstatement of the full tariff rates on several imports such as pork and rice that were temporarily lowered under Executive Order (E.O.) No. 171. Meanwhile, the impact of a weaker-than-expected global output recovery is the primary downside risk to the outlook.

Inflation expectations have risen further and remain at risk of disanchoring. Private sector economists surveyed in November 2022 reported a higher mean inflation forecast for 2022 at 5.9 percent from 5.7 percent in the October 2022 survey. Similarly, the mean inflation forecast for 2023 and 2024 increased to 4.9 percent (from 4.6 percent) and 4.0 percent (from 3.8 percent), respectively. In addition, the preliminary results of the BSP's Q3 2022 Business Expectations Survey (BES) and Consumer Expectations Survey (CES) indicate that both sectors anticipate inflation to breach the upper end of the target range for 2022 and 2023. The sum of recent data therefore suggests a possible disanchoring of inflation expectations relative to the target range, particularly for 2023.

GDP growth is projected to settle within the DBCC's target range of 6.5-7.5 percent for 2022, but economic headwinds could result in slower GDP growth in 2023 and 2024. The full-year growth forecasts for 2022 and 2023 were adjusted upwards from the August 2022 Monetary Policy Report (MPR) due to the upward revisions in Q2 2022 GDP, the stronger-than-expected growth performance in Q3 2022, and the higher world GDP growth assumption for 2022. Meanwhile, the forecast for 2024 is lower, reflecting slower external demand as well as the impact of the BSP's monetary policy tightening.

Domestic economic activity has recovered above its pre-pandemic level and is projected to reach slightly above potential. Staff estimates indicate that the output gap is projected to turn positive in 2023, largely reflecting the sustained expansion in 2022. Output gap will return to broadly neutral territory in 2024 as the impact of the BSP's policy rate adjustments take hold on the economy. Improved external trade competitiveness and sustained remittances amid peso depreciation, albeit the slowdown in global growth outlook, could drive the higher domestic output gap. Meanwhile, potential output is expected to sustain its recovery given the continued reopening of the economy, improvements in labor conditions, and investment growth.

Expansion in domestic liquidity will continue to support the country's funding requirements. Domestic liquidity (M3) is projected to increase in 2023 and 2024, although at a slower rate than the previous round. The downward revision is primarily due to the lower-than-expected outturns for Q3 2022, as well as higher domestic interest rates following the BSP policy rate hikes in August and September 2022. These were partly offset by the stronger domestic growth outlook for 2022 and 2023. Moreover, based on the BSP's Q3 2022 Senior Bank Loan Officers' Survey, banks have generally maintained their loan standards which, in turn, will help sustain credit activity. Stable loan demand from businesses and consumers was also seen in Q3 2022 and in the next quarter.

In consideration of these factors, the BSP is of the view that a strong monetary action is needed to help reduce the risk of a disanchoring of inflation expectations and inflation becoming entrenched. Inflation has proven to be more persistent than previously expected. The sharp rise in core inflation also reflects second-round effects primarily from the transport fare increases. These developments suggest that inflation expectations remain at risk of rising further, especially amid indications of pent-up demand conditions following the easing of pandemic-induced restrictions.

Further monetary policy action will also help to mitigate the impact of exchange rate fluctuations on inflation expectations, even as the exchange rate pass-through to headline inflation remains manageable. Nonetheless, the BSP must also maintain enough flexibility to respond to spillovers from tighter global financing conditions.

At the same time, further monetary policy tightening may exert pressures on the domestic financial system as prior policy rate increases continue to gain traction on market interest rates. In so far as macro-financial vulnerabilities are concerned amid rapid tightening of financial conditions, macroprudential and supervisory measures currently in place are seen to mitigate the risk.

The BSP also recognizes the importance of complementary action to monetary policy tightening. Addressing high inflation over the policy horizon therefore also requires targeted measures by the National Government to alleviate supply bottlenecks and strengthen farm productivity to prevent inflation from becoming further entrenched. A firm monetary policy response in tandem with timely implementation of targeted fiscal initiatives is crucial in taming inflation and steering the economy towards a sustainable growth path.