MONETARY POLICY REPORT

FEBRUARY 2022

Technical Summary

At its monetary policy meeting on 17 February 2022, the BSP decided to maintain its key policy interest rate at 2.0 percent for the overnight reverse repurchase (RRP) facility. The corresponding interest rates on the overnight deposit and lending facilities were also kept at 1.5 percent and 2.5 percent, respectively. While the latest inflation forecasts for 2022 and 2023 are slightly higher, the projected inflation path is expected to settle within the 2-4 percent target range over the policy horizon. Moreover, the higher inflation path in 2022, attributed primarily to higher domestic food and oil inflation, are reflective of the trends in the international commodities market. Nonetheless, imported oil and food inflation is projected to ease in 2023 as global supply chain disruptions are expected to dissipate.

Inflation is seen to decelerate in early 2022 but could accelerate towards the upper end of the band in Q2 before moving back to within the target range. The initial deceleration of inflation is due mainly to negative base effects from the uptick in pork prices from the previous year. However, inflation is projected to accelerate slightly above the target range in Q2 2022 driven by elevated global oil and non-oil prices and positive base effects. Nonetheless, inflation is projected to decelerate back to within the target in Q3 2022 and in Q4 2022.

Domestic supply-side price pressures are also being actively addressed through direct non-monetary measures. It is important to refine these measures as needed to address supply shortfalls of key commodities. Given that volatility in oil has again increased, it is important to remain vigilant in implementing measures that could help avoid second round effects in terms of fare hikes and undue wage adjustments, as needed.

Risks to the inflation outlook appear to be slightly on the upside for 2022 but is broadly balanced for 2023. The potential impact of higher global food prices, the continued shortage in domestic pork supply, and jeepney fare hikes due to higher oil prices are the major upside risks over the near term. Meanwhile, the possible impact on domestic economic growth prospects of delays in the easing of containment measures as well as a weaker-than-expected global recovery owing to the spread of new COVID-19 variants are the main sources of downside risks. Risks to the global growth outlook are tilted to the downside in view of tight labor markets in advanced economies as well as uncertainty on inflation and monetary policy.

Meanwhile, the February 2022 survey shows inflation expectations are still within the government's target range of 2-4 percent, albeit with higher mean inflation forecasts for 2022. Private sector economists expect inflation in 2022 to average at 3.5 percent from 3.4 percent in the previous month's survey round. Meanwhile, the mean inflation forecasts for 2023 and 2024 stood lower at 3.1 percent (from 3.2 percent) and 2.9 percent (from 3.3 percent), respectively.

Economic recovery appears to be gaining traction. The projected expansion forQ1 2022 is partly dampened by the shift to Alert Level 3 from Alert Level 2 in NCR and other major provinces in January 2022. Based on NEDA estimates, this could reduce the country's GDP by ₱3.0 billion a week. In addition, the Technical Staff baseline forecasts assume that majority of the country will shift to Alert Level 1 by Q2 2022, which is consistent with the removal of most social mobility restrictions. NEDA estimates indicate that shift from Alert Level 2 to Alert Level 1 could result in weekly increase in domestic demand of ₱23.6 billion.[2]

Preserving ongoing policy support remains a priority given the uncertainty over domestic economic prospects, possible delays in achieving vaccination rate targets, along with the risks surrounding the global oil and food price outlook as well as the monetary policy normalization in advanced economies. There is a risk of a protracted pandemic due to virus resurgence with prospects for sustainable recovery continuing to largely depend on the progress of the COVID-19 vaccine and booster shots rollout as well as ramped-up health system measures.

While the eventual re-opening of the global economy given eased restrictions in some countries will contribute to domestic recovery through improvements in exports and remittances, domestic monetary policy support along with expansionary fiscal policy will also continue to help spur domestic demand and mitigate the extent of economic scarring that could affect the growth trajectory over the long term.

Given estimates pointing to the closing of the output gap by the second semester of 2022 amid sustained demand recovery, the BSP continues to refine the timeline and strategy for the gradual exit from pandemic-related measures and accommodative policy settings. Particular attention is being given to the normalization of monetary conditions prior to the eventual tightening. Some groundwork for the exit has been initiated with the significant decline in BSP activity at the secondary government securities market since the last quarter of 2020 and the reduction in the amount of provisional advances to the NG this year. The gradual shift towards eventual normalization of BSP's extraordinary accommodative measures will be appropriately communicated before it is initiated to help BSP remain ahead of the curve.

Looking ahead, the BSP affirms its support for the economy while keeping an eye on the potential risks to future inflation. The BSP stands ready to respond to potential second-round effects arising from supply-side pressures, in line with its price and financial stability objectives.

[1]DBCC joint statement dated 7 January 2022 https://neda.gov.ph/dbcc-joint-statement-on-the-surge-of-covid-19-cases/

[2]The P23.6 billion impact from a shift to Alert Level 2 to Alert Level 1 was based on NEDA's estimates presented during the Economic Journalists Association of the Philippines' (EJAP) virtual economic forum last 28 October 2021. This is the sum of the impact for both NCR (+10.3b) and AONCR (+13.3b).