BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 18 August 2022 [1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Raise the BSP's current policy interest rate by 50 basis points to 3.75 percent for the overnight reverse repurchase (RRP) rate; and

b) Increase the current interest rates on the overnight deposit facility (ODF) to 3.25 percent and overnight lending facility (OLF) to 4.25 percent.

II. Key Considerations in the Formulation of the Monetary Policy Stance

- The decision of the Monetary Board is based on its assessment that inflation is projected to breach the upper end of the 2-4 percent target range at 5.4 percent. While the forecasts for 2023 and 2024 have declined to 4.0 percent and 3.2 percent, respectively, the inflation target remains at risk over the policy horizon owing to broadening price pressures. Elevated inflation expectations likewise highlight the risk of further second-round effects.

- Upside risks also continue to dominate the inflation outlook up to 2023 due to the potential impact of higher global non-oil prices, the continued shortage in domestic fish supply, the sharp increase in the price of sugar, as well as pending petitions for transport fare increases. Meanwhile, the impact of a weaker-than-expected global economic recovery as well as the resurgence of local COVID-19 infections continue to be the main downside risks to the outlook.

- Equally important, the Monetary Board also noted that despite some moderation in economic activity in recent months, overall domestic demand conditions have generally held firm, supported by improved employment outturns and by ample liquidity and credit.

- In assessing the monetary policy stance, the Monetary Board deemed further monetary action to be necessary to anchor inflation expectations and avoid a further breach in the inflation target over the policy horizon. The favorable growth outcome in the first half of the year also gives the BSP the flexibility to act against inflation pressures while allowing

[1] The discussions herein reflect the assessment made by the Monetary Board based on a comprehensive set of macroeconomic and financial information available at the time of the policy meeting. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 22 September 2022.

domestic demand to sustain its recovery momentum amid prevailing headwinds.

- At the same time, the Monetary Board emphasized that it continues to urge timely non-monetary government interventions to mitigate the impact of persistent supply-side pressures on commodity prices.

- The BSP reassured 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.

III. Recent Developments and Inflation Outlook

The Monetary Board considered the recent macroeconomic and financial developments listed below in deciding the appropriate monetary policy stance:

A. Domestic price conditions

- Headline inflation rose further to 6.4 percent year-on-year in July 2022, the highest recorded inflation since October 2018, from 6.1 percent in June 2022 and 3.7 percent in July 2021. The increase was mostly traced to food items due to some tightness in supply brought about by adverse weather conditions (fish) and low output (sugar). While non-food inflation was steady, transport inflation continued to climb as the slowdown in fuel inflation was more than offset by higher fares. Latest data also indicate broadening price pressures as core inflation measures increased in July while the number of items above the inflation target also went up and exceeded those below target. The majority of these CPI items above threshold are under food, beverages, and tobacco.

B. Inflation expectations

- The August 2022 survey of economists showed a higher mean inflation forecast for 2022, an unchanged mean forecast for 2023, and a lower mean forecast for 2024 relative to the July 2022 survey. Inflation is likely to breach the upper end of the target band in the near term and fall within the upper range of the target over the policy horizon. 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.

C. Inflation outlook

- The latest baseline inflation forecast for 2022 was revised upwards to 5.4 percent, settling above the government's target range of 3.0 percent ± 1.0 ppt. Meanwhile, the forecasts for 2023-2024 declined to 4.0 percent and 3.2 percent, respectively. The upward adjustment in the forecast for 2022 was mainly driven by the higher-than-expected inflation outturns in June and July, the higher inflation nowcast for August, and the continued depreciation of the peso. Meanwhile, the lower forecasts for 2023-2024 can be attributed to lower assumptions for both global crude oil and non-oil prices, slower domestic and global economic growth, and the impact of the BSP's policy rate adjustments in June and July.

Baseline Inflation Forecasts		
	23 June 2022 MB Meeting	**18 August 2022 MB Meeting**
2022	5.0	5.4
2023	4.2	4.0
2024	3.3	3.2

- The risks to the inflation outlook are seen to be tilted to the upside for 2022 and 2023 but are considered to be broadly balanced for 2024. The potential impact of higher global non-oil prices, higher fish prices, a sharp increase in the price of sugar, and additional petitions for transport fare hikes due to elevated oil prices are the major upside risks over the near term. Meanwhile, headwinds from weaker-than-expected global recovery and delays in the easing of the alert levels in some parts of the country due to resurgence of COVID-19 cases continue to be the main downside risks to the outlook.

D. Demand conditions

- While Q2 2022 gross domestic product (GDP) growth was lower than expected, economic recovery is seen to continue to gain traction over the near term. GDP growth is projected to settle within the Development and Budget Coordination Committee's (DBCC) downward revised target of 6.5-7.5 percent for 2022 and slightly below the 6.5-8.0 percent target for 2023 and 2024. The full year growth forecast for 2022 has been revised downwards from the previous forecast due to the slower-than-expected GDP outturn in Q2 2022, while the lower forecasts for 2023 and 2024 reflects the lower assumptions for global economic growth as well as the impact of higher domestic interest rates. Despite the downgrades in the outlook, domestic growth is still seen to remain robust in the succeeding quarters as a result of looser mobility restrictions amid continued deployment of COVID-19 vaccines and booster shots. Moreover, the implementation of the Corporate Recovery and Tax Incentives for Enterprises (CREATE) Law, Financial Institutions Strategic Transfer (FIST) Act, and the second tranche in the reduction in personal income taxes are seen to further bolster the domestic outlook in 2023-2024.

- At the same time, output is now estimated to return to the pre-pandemic level by Q3 2022. As of Q2 2022, annualized real GDP remained 0.3 percent below its end-2019 level. Prior to the pandemic, the country's GDP was growing by an average of 6.0 percent from 2009 to 2019. Based on the latest GDP forecast, however, the projected GDP level in annualized terms by Q4 2024 is estimated to be lower compared to the trend had there been no pandemic.

- The output gap remains broadly neutral over the policy horizon. Likewise, 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. The policy rate hikes are seen to temper demand in 2024 as real interest rate shifts to positive territory.

- Mobility continued to rise in early August 2022 as majority of the provinces in the country were retained at Alert Level 1 for the month of July and first half of August. Mobility indicators across location categories have reverted to pre-pandemic levels beginning May 2022 using 7-day moving average.

  Changes in mobility coincide with movements in the purchasing manager's index (PMI), which remained above the 50-point expansion threshold in July albeit slower compared to the previous month. While most sectors remained in expansion territory during the month, concerns over rising input costs, logistical constraints, and softer demand for exports contributed to the moderation in the July manufacturing PMI.

- Labor market conditions have improved further, with employment gains reaching 4.05 million in June 2022 higher than the level posted during the pre-pandemic period. Employment rate was at 94.0 percent while unemployment rate was at 6.0 percent.

E. Supply-side indicators

Developments in Agriculture

- Nationwide average retail rice prices increased in July 2022. Rice prices, along with that of other key food items such as meat, fish, corn and sugar, rose due to domestic supply concerns as well as volatile global commodity prices, as a consequence of the Ukraine-Russia conflict and persistent global supply chain disruptions. Recent reports attribute the increase in rice prices to the series of domestic fuel price hikes affecting transportation and logistics costs, as well as farmgate prices, prompting traders and retailers to adjust their selling prices.

- The National Government has rolled out targeted interventions to help boost domestic supply of agricultural commodities and stabilize prices. Domestic supply conditions continue to face challenges emanating from animal diseases, as well as high production costs due to global supply disruptions, and additional uncertainties brought about by the Ukraine-Russia crisis. To cushion the impact of these challenges on the country's food security, the Government implemented crucial non-monetary measures to fill supply gap and boost local production.

Oil Price Developments

- Dubai crude oil prices have mostly declined in July and thus far in August due mainly to concerns over demand prospects following weaker manufacturing PMI data, declines in consumer sentiment, which was further supported by International Monetary Fund's (IMF) downward revision of growth projections for both 2022 and 2023. Worries of a slowdown in economic growth were likewise reflected in supply-demand dynamics, which is projected to be in surplus for the most of 2022 and 2023. Likewise, Brent crude futures price also remained in backwardation.

- Reflecting the uptrend in international oil prices, domestic fuel prices also increased, which prompted transport groups to file petitions for a fare hike. The Land Transportation Franchising and Regulatory Board (LTFRB) approved a two-peso increase in minimum fare for public utility jeepneys nationwide effective 1 July 2022. Various petitions from transport groups representing the public utility jeepneys (PUJs) across the country cited higher diesel pump price, additional expense incurred in compliance with COVID-19 protocols (i.e., onboard disinfection items), and higher operational costs (i.e., lubricants, spare tires). Aside from the PUJ minimum fare hike, various city councils have also approved an increase in tricycle fares in different cities.

F. Financial market developments

- For the period 1-5 August, the peso averaged ₱55.50/US$1 appreciating by 0.71 percent from the average in July amid expectations of a slower pace of US Fed monetary policy tightening following the dovish comments from US Fed Chair Jerome Powell in the latest FOMC meeting.

G. Domestic liquidity and credit conditions

- Liquidity conditions remain at an adequate level to support economic activity. Preliminary data show that domestic liquidity (M3) grew by 6.9 percent year-on-year in June, the same rate of expansion as in May.

- Domestic credit conditions have also continued to improve despite the recent monetary tightening. Lending activity grew at a faster pace as the country's manageable COVID-19 caseload continues to support market confidence. Preliminary data show that outstanding loans of universal and commercial banks (U/KBs), net of RRP placements with the BSP, expanded anew at 12.0 percent year-on-year in June relative to the 10.7-percent uptick in May.

H. Fiscal developments

- The NG recorded a deficit of ₱674.2 billion for January - June 2022 which is 5.8 percent lower than recorded in the same period in 2021. Netting out the interest payments in NG expenditures, the primary deficit amounted to ₱417.0 billion, which is 17.0 percent lower than the amount recorded in 2021.

- The baseline inflation forecasts are consistent with government's fiscal deficit assumption of 7.6 percent for 2022, 6.1 percent for 2023, and 5.1 percent for 2024 based on the medium-term macroeconomic assumptions of the DBCC as of 8 July 2022.

I. External developments

- On the external front, global economic output expanded at a slower pace in July 2022 as manufacturing output stagnated while service sector activity growth eased to a six-month low. Economic activity contracted in the US, Germany, and Italy, but this was partially offset by the expansions recorded in France, Spain, China, India, Brazil, and Russia. The JP Morgan All-Industry Output Index fell to 50.8 in July from 53.5 in June due mainly to the decline in new export business.

  In addition, in the July 2022 World Economic Outlook Update, the IMF further downgraded its full-year economic growth projections for 2022 and 2023 relative to the April 2022 WEO forecasts. The downward revision of the global GDP outlook is due mainly to decreased economic activity amid prolonged COVID-19 restrictions in China as well as war-related supply disruptions emanating from Eastern Europe. The recovery momentum of private consumption slowed in the first half of the year as successive supply shocks and the resulting surge in inflation eroded the purchasing power of households. The sustained increase in prices and the resulting broad-based deterioration in living standards have prompted monetary authorities to tighten financial conditions faster than previously communicated

- Global financial conditions have continued to tighten. Eleven central banks out of the 15 regularly monitored by the DER have raised their respective policy rates since July, namely, Bank Negara Malaysia, Bank of Korea, Reserve Bank of New Zealand, Bank of Canada, BSP, European Central Bank, Federal Reserve, Reserve Bank of Australia, Bank of England, Reserve Bank of India, and Bank of Thailand.

  By contrast, Bank of Japan, People's Bank of China, and Bank Indonesia maintained their respective policy rates during their most recent monetary policy meetings to boost the expansion of economic activity and mitigate the potential impact of a global slowdown on domestic business prospects.

  On 27 July 2022, the Federal Reserve raised the Fed Funds target rate by 75 basis points to 2.25-2.50 percent in order to moderate rising price pressures emanating from sustained wage growth amid the persistent tightness in the US labor market. Despite increased risk of a global economic slowdown in view of the rapid tightening of financial conditions, the Federal Open Market Committee anticipates that further rate hikes will be appropriate in the next policy meetings to anchor inflation expectations and successfully achieve its dual mandate of promoting price stability as well as maximum sustainable employment.