BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 21 SEPTEMBER 2023 [1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Maintain the Target Reverse Repurchase (RRP) rate at 6.25 percent; and

b) Maintain the current interest rates on the overnight deposit facility at 5.75 percent and overnight lending facility at 6.75 percent.

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

- Based on the sum of new information and its assessment of the impact of previous monetary policy actions, the Monetary Board decided that keeping the policy interest rate unchanged was appropriate. Latest BSP baseline projections show a slightly higher inflation path. Nonetheless, inflation is still projected to revert to the 2 to 4 percent target range by Q4 2023 in the absence of further supply-side shocks. While food and transport prices continue to drive headline inflation, core inflation has moderated further, implying an easing in underlying pressures. In addition, inflation expectations remain anchored to the target range over the policy horizon.

- Average inflation is now seen to reach 5.8 percent in 2023 from 5.6 percent previously, while the forecast for 2024 likewise rose to 3.5 percent from 3.3 percent. For 2025, the forecast is unchanged at 3.4 percent. The upward adjustments in the 2023 and 2024 projections reflect the spillovers from weather disturbances, rising global crude oil prices, and the recent depreciation of the peso. The balance of risks to the inflation outlook remains skewed toward the upside. The major upside risks to the inflation outlook are the potential impact of further adjustments in transport fares and electricity rates.

- The Monetary Board noted that recent indicators of domestic economic activity pointed to waning pent-up demand, even as fiscal efforts continue to focus on support through programmed spending. Past interest rate increases, which continue to be transmitted via the interest rate channels also weighed on credit.

[1] The discussions herein reflect the assessment made by the Monetary Board based on macroeconomic and financial information available at the time of the monetary policy meeting. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 16 November 2023.

- Given these considerations, the Monetary Board deemed it appropriate to maintain prevailing monetary policy settings while emphasizing the BSP's focus on resuming monetary policy tightening action to respond to emerging upside risks to the inflation outlook and potential second-round effects that could dislodge inflation expectations. The Monetary Board also reiterated the need for non-monetary intervention, including the temporary reduction of import tariffs with calibrated volumes and timely arrival of import commodities. The BSP also continues to prioritize the restoration of inflation towards a target-consistent path over the medium term, in line with its primary mandate to ensure price stability.

III. Recent Developments and Inflation Outlook

The Monetary Board considered the recent macroeconomic and financial developments discussed below in assessing the monetary policy stance:

A. Domestic price conditions

- Headline inflation rose again to 5.3 percent year-on-year (y-o-y) in August from 4.7 percent in July, bringing the year-to-date average inflation to 6.6 percent, due mainly to faster price increases for food and non-alcoholic beverages as well as transport. In contrast, the official core inflation rate further decelerated to 6.1 percent y-o-y in August from 6.7 percent in July. Alternative measures of core inflation, except for weighted median, likewise declined in August from the preceding month. On a month-on-month seasonally adjusted basis, inflation in August 2023 moved at a faster pace at 1.1 percent from nil growth in the previous month.

B. Inflation expectations

- Inflation expectations have increased but remain well within the target range for 2024 and 2025. The results of the BSP Survey of External Forecasters for September 2023 showed a higher mean inflation forecast for 2023 at 5.9 percent relative to the August 2023 mean forecast (5.5 percent). Inflation expectations for 2024 and 2025 also increased to 3.7 percent (from 3.5 percent) and 3.5 percent (from 3.4 percent), respectively. Analysts expect inflation to accelerate anew due to recent supply-side shocks domestically and overseas. They also anticipate further upside risks to the inflation outlook, due mainly to supply disruptions, particularly from the adverse impact of weather disturbances and trade restrictions.

C. Inflation outlook

- The latest staff baseline inflation forecasts are higher compared to the previous round for 2023 and 2024. Inflation is projected to average at 5.8 percent for 2023 and 3.5 percent for 2024. Meanwhile, baseline inflation projection for 2025 remained unchanged at 3.4 percent.

  The upward adjustments in the inflation forecast for 2023 and 2024 were driven mainly by the higher-than-expected outturn for August 2023 and higher inflation nowcast for September 2023. Higher global oil prices and the depreciation of the peso likewise contributed to the upward revision.

Baseline inflation forecasts		
	17 August 2023 MB Meeting	**21 September 2023 MB Meeting**
2023	5.6	5.8
2024	3.3	3.5
2025	3.4	3.4

- The risks to the inflation outlook are still tilted to the upside for 2023 to 2025 and may trigger a possible breach of the inflation target in 2024. The potential impact of higher transport charges is among the major risks to the inflation outlook given the fare increase petitions filed by transport groups in August 2023 due to elevated oil prices. In addition, higher electricity rates may result in the near term from the Supreme Court decision in July 2022 to nullify Energy Regulatory Commission's 2014 order to cap Wholesale Electricity Market prices in November to December 2013. Other key upside risks to the inflation outlook are the impact of El Niño weather conditions on food prices and utility rates; higher-than-expected minimum wage adjustments in areas outside NCR; and higher domestic prices of key food items facing ongoing supply constraints. Meanwhile, the impact of a weaker-than-expected global recovery remains the primary downside risk to the outlook.

D. Demand conditions

- Recent data on economic activity reflect the impact of weaker domestic and external demand. Business confidence for the current quarter weakened in Q3 2023 but was more upbeat for the next quarter and the next 12 months. Labor market conditions have eased slightly relative to the preceding month as unemployment and underemployment rates increased, while the labor force and employment levels and rates declined as of July 2023. Meanwhile, merchandise exports contracted in July, due to the drop in export values of coconut oil, other mineral products, and other manufactured goods. In contrast, the modest improvement in consumer sentiment for the second half of 2023 and double-digit growth in vehicle sales in July suggest that private consumption will remain a main contributor to growth in the near term. At the same time, faster expansion for both volume and value manufacturing indices from the Monthly Integrated Survey of Selected Industries (MISSI) in July and recovery of the Purchasing Managers' Index (PMI) based on the report of the Philippine Institute for Supply Management (PISM) in August signal possible improvement in the manufacturing sector. The latest outturn in PISM's PMI also show growth in retail and wholesale, and services.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- Nationwide average retail rice prices increased from month-ago levels in August 2023. The upward movement in rice prices reflected the uptrend in farmgate prices due to cost pressures from inputs, as well as the rise in international rice prices, particularly in the quotes from the country's major import sources.

- Domestic food security is continuously threatened by the country's vulnerability to natural calamities, spread of animal diseases, volatility in input prices, and trade restrictions pushing up international commodity prices. The whole-of-government approach is expected to address food inflation and mitigate risks to food security through urgent implementation of measures to fill short-term supply gap and boost local production. Moreover, the Department of Agriculture has undertaken and coordinated measures to address the effect of El Niño on the agricultural supply in anticipation of a prolonged dry season.

- Based on the latest assessment of weather conditions as of 14 September 2023, prevailing El Niño conditions will likely continue through January – March 2024 season. According to PAGASA's latest climate outlook as of 23 August 2023, moderate El Niño is present and may further strengthen towards the latter part of 2023. In addition, most climate models predict that this El Niño episode could persist until at least April 2024.

Oil Price Developments

- Dubai crude oil prices rose in the first week of September 2023 compared to the full-month average price in August 2023, driven primarily by the extension of Saudi Arabia and Russia's voluntary supply cuts until the end of the year as well as lower US crude oil inventories. Nevertheless, concerns of weaker demand prospects due to the sluggish economic outturn for China and tight global monetary policy continue to temper increases in international oil prices.

- High prices in the near term are aligned with the tight global oil market outlook for the second half of 2023.[2] The International Energy Agency (IEA), Organization of the Petroleum Exporting Countries (OPEC) and the US Energy Information Administration (EIA) expect excess demand in H2 2023. However, oil market outlook is mixed for 2024, as the IEA and OPEC forecast a deficit in the oil market, while the US EIA projects a surplus. The expected deficit in the near term is influenced mainly by the production cuts of the OPEC+[3] as well as the projected increase in fuel demand in China.

Developments in the Utilities Sector

[2] August 2023 Outlook

[3] The Organization of the Petroleum Exporting Countries + (OPEC +) countries include Russia, Mexico, Kazakhstan, Oman, Azerbaijian, Malaysia, Bahrain, South Sudan, Brunei, and Sudan.

- Retail electricity rates increased in September 2023, reflecting higher costs from the Power Supply Agreements (PSAs) and Independent Power Producers (IPPs). Charges from PSAs and IPPs rose because of higher fuel prices and the depreciation of the peso against the US dollar. IPP charges also increased due to the restrictions of Malampaya gas supply, which led to increased use of more expensive alternative fuels by First Gas Plants.

F. Financial market developments

- The peso depreciated against the US dollar by 0.9 percent for the period 1-8 September 2023 from the previous month, due to the strengthening of the US dollar following the hawkish pronouncements from the US Federal Reserve. The increase in safe-haven asset demand due to the release of weak services PMI data in China likewise weighed down the peso. Nonetheless, these factors were partly pared by the country's higher foreign portfolio investments in July.

- On a year-to-date basis, the peso likewise depreciated against the US dollar by 1.6 percent on 8 September 2023 from the end-December 2022 closing rate. Most Asian currencies, except for the Indonesian Rupiah, also weakened against the US dollar on a year-to-date basis.

G. Liquidity and credit conditions

- Liquidity and credit growth slightly slowed down. Preliminary data showed that M3 grew by 5.7 percent y-o-y in July 2023, lower than the 5.9 percent expansion recorded in June 2023. Meanwhile, outstanding loans of universal and commercial banks, net of RRP placements with the BSP increased at a slower rate of 7.7 percent y-o-y in July 2023 from 7.8 percent in June 2023. Past interest rate increases also continue to be transmitted via the interest rate channels.

H. Fiscal developments

- The National Government (NG) recorded a deficit of ₱599.5 billion in January-July 2023 which is 21.2 percent lower than the deficit in the same period in 2022. The lower deficit can be traced from the growth in revenues outpacing the percentage increase in expenditures. Meanwhile, netting out the interest payments in NG expenditures, the primary deficit amounted to ₱253.5 billion, 43.9 percent lower than the deficit recorded in 2022.

- The NG is accelerating public spending in line with the fiscal program for 2023 to attain the growth objectives. NG expenditures grew by 2.7 percent in January-July 2023. Specifically, primary expenditures increased by 1.5 percent, partly driven by the recovery in July 2023 primary spending. The 15.3 percent growth in primary expenditure in July 2023 countered the 0.7 percent decline in the first half of 2023.

I. External developments

- Global economic activity has expanded at a more moderate pace due to faster contraction in manufacturing output and slower expansion in service-related business activity. Specifically, the JP Morgan All-Industry Output Index eased to 50.6 in August 2023 from 51.6 in the preceding month. Further, manufacturing activity in China returned to expansion while that of the US and Japan remained in contraction territory, reflecting persistently weak demand conditions. ASEAN manufacturing sector also posted modest expansion, as the S&P Global ASEAN manufacturing PMI rose in August 2023 from July 2023.

- Several central banks have maintained their respective key policy interest rates in August 2023 to continue their assessment of the impact of previous monetary policy adjustments. By contrast, some central banks raised policy rates to address the persistence of inflationary pressures, while one central bank introduced a rate cut to stimulate credit demand and boost economic activity.