HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 16 NOVEMBER 2023 [1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Maintain the current policy interest rate at 6.50 percent for the Target RRP Rate; and

b) Maintain the current interest rates on the overnight deposit facility at 6.00 percent and overnight lending facility at 7.00 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. The latest projections point to a moderation in the inflation outlook over the policy horizon. Incorporating the impact of various upside and downside risks that have emerged since the previous meeting, the risk-adjusted forecast for 2024 remain above the Government's target range at 4.4 percent (from 4.7 percent in the October meeting) and within the target for 2025 at 3.4 percent (from 3.5 percent). The Monetary Board noted inflation expectations for 2024 have eased to the upper end of the target range.

- The balance of risks to the inflation outlook continued to lean significantly toward the upside, notwithstanding the recent improvement in food supply conditions. Key upside risks are associated with the potential impact of higher transport charges, electricity rates, and international oil prices, as well as of higher-than-expected minimum wage adjustments in areas outside the National Capital Region. Meanwhile, the impact of a weaker-than-expected global recovery as well as government measures to mitigate the effects of El Niño weather conditions could temper upside inflationary impulses.

- On the output side, latest domestic demand indicators point to diminishing pent-up demand in the near term. Nevertheless, the rebound in Q3 GDP growth supports the view that the country's medium-term growth prospects remain largely intact. The Monetary Board is closely monitoring the impact of the increase in interest rates as it works through the economy. The Monetary Board also continues to support fiscal efforts

[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 14 December 2023.

to sustain growth through more rapid programmed spending, as well as non-monetary interventions to address persistent supply-side pressures on prices.

- The Monetary Board noted it would be necessary to keep monetary policy settings sufficiently tight until a sustained downtrend in inflation became fully evident and inflation expectations were firmly anchored. At the same time, monetary policy will continue to be guided by incoming data and the Monetary Board remains prepared to resume monetary policy tightening as necessary to steer inflation towards a target-consistent path, in line with the BSP's price stability mandate.

III. Recent Developments and Inflation Outlook

In assessing the monetary policy stance, the Monetary Board considered the latest macroeconomic and financial developments, which are discussed below:

A. Domestic price conditions

- Headline inflation dropped to 4.9 percent year-on-year (y-o-y) in October from 6.1 percent in September, bringing the year-to-date average inflation to 6.4 percent. Food inflation decreased, particularly rice, with the onset of the harvest season. In addition, lower non-food inflation was supported by the lower inflation rate for restaurants and accommodation services as well as for transport, following the rollbacks in domestic petroleum prices. Moreover, the official core inflation rate further eased to 5.3 percent y-o-y in October from 5.9 percent in September suggesting an easing of underlying demand-based price pressures. Alternative measures of core inflation likewise declined for the month.

B. Inflation expectations

- Preliminary results (from 21 respondents) of the BSP's Survey of External Forecasters for November 2023 showed lower mean inflation forecasts for 2024 at 4.0 percent from 4.1 percent in the October 2023 survey round. Meanwhile, the mean inflation forecasts for 2023 (at 6.1 percent) and for 2025 (at 3.5 percent) are unchanged. Analysts expect inflation to remain elevated but gradually tread the path towards the target range, with risks to the inflation outlook still significantly skewed to the upside due mainly to supply-side shocks and second-round effects.

C. Inflation outlook

- The latest staff risk-adjusted inflation forecasts for 2023 to 2024 are lower compared to the previous round while continuing to indicate a potential breach of the target in 2024. Inflation is projected to average at 6.0 percent for 2023 (from 6.2 percent), 4.4 percent for 2024 (from 4.7 percent), and 3.4 percent for 2025 (from 3.5 percent). The downward revision in the forecasts was driven by the lower-than-expected inflation outturn in

October; the lower inflation nowcast for November; the peso appreciation; and higher real interest rate following BSP's policy rate increase in October.

- The risks to the inflation outlook remain significantly skewed to the upside over the policy horizon. Transport charges may further increase given pending fare hike petitions particularly for jeepneys, taxis, and the Metro Rail Transit system. In addition, electricity rates could increase in 2024 following the Supreme Court decision in July 2022 to nullify the Energy Regulatory Commission's 2014 order to cap Wholesale Electricity Spot Market prices in November to December 2013. Other key upside risks to the inflation outlook for 2024 include the higher global oil prices stemming from possible oil supply disruptions from the Israel-Hamas conflict; higher-than-expected minimum wage adjustment in areas outside NCR; higher prices of key commodities due to the non-extension of E.O. 10, s. 2022; the additional impact of a strong *El Niño* episode on food prices and utility rates; and higher domestic food prices due to supply constraints. Meanwhile, the impact of a weaker-than-expected global recovery and successful implementation of government measures to mitigate the impact of *El Niño* weather conditions are the primary downside risks to the outlook.

D. Demand conditions

- The Philippine economy grew stronger than expected at 5.9 percent in Q3 2023, faster than the 4.3 percent growth in the previous quarter and supported by consumer and government spending. This brought the year-to-date real GDP growth to 5.5 percent. Recent indicators likewise affirm the view of a stronger recovery in the near term. Labor market conditions have been broadly stable relative to the preceding month with a higher share of wage and salaried workers alongside a decline in underemployment indicating an improvement in the quality of employment. Furthermore, the continued growth in vehicle sales in September likewise suggests that private consumption will remain a main contributor to overall growth in the near term.

- The country's growth prospects remain intact for 2023 to 2025 despite global headwinds and tighter financial conditions. The projected GDP growth could settle below the Development Budget Coordination Committee's target of 6-7 percent for 2023 and 6.5-8.0 percent for 2024 and 2025. These estimates reflect primarily the impact of subdued global economic conditions as well as the lagged impact of the policy rate adjustments. Nevertheless, the full-year growth forecasts for 2023 to 2025 have been adjusted upwards from the previous forecast round, reflecting largely the faster-than-expected growth outturn in Q3 2023, supported by consumer and government spending and by higher growth nowcast for Q4 2023. However, this could be offset partly by the impact of higher real policy rate as well as the estimated impact on agriculture of *El Niño* weather conditions.

E. Supply-side indicators

Developments in Agriculture

- **Nationwide average retail rice prices declined in October 2023,** indicative of the trend during the onset of the main harvest season. It likewise reflects the recent month-on-month decrease in international prices from Vietnam and Thailand. Nonetheless, on a year-on-year basis, rice prices remain elevated driven by more expensive farmgate prices due to cost pressures from inputs, and external factors such as uncertainties associated with India's export restrictions and the impact of *El Niño* on global and regional rice production.

- Based on the latest PAGASA assessment of weather conditions as of 12 October 2023, prevailing El Niño conditions will likely continue through the northern hemisphere spring season by March to May 2024. According to PAGASA's latest climate outlook as of 25 October 2023, moderate *El Niño* is present and may further strengthen towards the latter part of 2023. In addition, most climate models predict that the current El Niño episode will likely persist until Q2 2024.

Oil Price Developments

- Dubai crude oil prices declined in the first week of November 2023 from the full-month average price in October 2023 as fears of potential oil supply disruptions from the Israel-Hamas conflict have eased following continued diplomatic efforts. Moreover, oil demand concerns arising from the weak economic outturns in China and Eurozone, especially in terms of manufacturing activity, have weighed down crude oil prices. Nonetheless, upside risks to oil prices remain, stemming from possible oil supply disruptions given ongoing conflict between Israel and Hamas especially if the conflict spreads across the Middle East region, involving other major economies such as the US, and destroys energy/oil production-related infrastructure in the region.

Developments in the Utilities Sector

- Retail electricity rates went up in November 2023, reflecting higher transmission charges following significant increase in the National Grid Corporation of the Philippines' (NGCP) ancillary service charge for regulating reserves. In addition, generation charge and other charges also rose during the month due to higher charges from the Wholesale Electricity Spot Market (WESM) and Independent Power Producers (IPPs). Tight supply conditions in the Luzon grid pushed WESM charges upward while the increase in price of Malampaya natural gas following its quarterly repricing led to the rise in IPP charges.

F. Financial market developments

- The peso was relatively stable, depreciating slightly by 0.01 percent for the period 1-27 October 2023 from the previous month due to higher long-term US Treasury yields following signals of a higher-for-longer interest rate environment from the US Federal Reserve amid still-elevated inflation as well as dampened sentiment amid concerns over escalating geopolitical tensions between Israel and Palestinian group, Hamas. On the domestic side, lingering tension in the West Philippine Sea as well as the lower gross international reserves as of end-September 2023 weighed down the peso. Nonetheless, these factors were partly offset by the narrowing trade deficit as well as higher personal remittances in August; stronger foreign direct investment inflows in July; expectations of further monetary policy tightening by the BSP; and narrower balance of payments deficit in September.

- On a year-to-date basis, the peso depreciated against the US dollar by 2.1 percent on 27 October 2023 from the end-December 2022 closing rate. Most Asian currencies also weakened against the US dollar on a year-to-date basis.

G. Liquidity and credit conditions

- Domestic liquidity (M3) grew by 7.9 percent y-o-y in September 2023, faster than the 6.8 percent growth in August 2023. Meanwhile, outstanding loans of universal and commercial banks, net of RRP placements with the BSP increased at a slower rate of 6.5 percent y-o-y in September 2023 from 7.2 percent in August 2023. Past interest rate increases also continue to be transmitted via the interest rate channels.

H. Fiscal developments

- While overall expenditures of the National Government were marginally short by 1.1 percent relative to the Q1-Q3 2023 expenditure program, spending for personnel services (PS), maintenance and other operating expenses (MOOE), and infrastructure and other capital outlays (IOCO) recorded a double-digit y-o-y growth of 22.2 percent in Q3 2023, and therefore, exceeded their combined expenditure program for Q1-Q3 2023 by 1.4 percent. Higher IOCO spending in Q3 2023 was mainly supported by capital outlay projects of the Department of Public Works and Highways as well as the direct payments made for various rail transport projects of the Department of Transportation. On the other hand, the uptick in MOOE in Q3 2023 can be attributed mainly to disbursements for the banner programs of the Department of Social Welfare and Development and the Department of Agriculture, as well as the Department of Health's payment of Public Health Emergency Benefits and Allowances and implementation of Medical Assistance for Indigent Patients program.

- Meanwhile, the NG posted a deficit of ₱983.5 billion in January-September 2023 which is 2.9 percent narrower than the deficit in the same period in

2022. Netting out interest payments, the primary deficit amounted to ₱523.4 billion, 14.6 percent lower than the deficit recorded in 2022.

I. External developments

- Global economic activity has expanded at a more moderate pace due to faster contraction in manufacturing output as well as slower expansion in service-related business activity. The JP Morgan All-Industry Output Index eased to 50.0 in October from 50.5 in September 2023 as new order intakes and new business exports contracted in both the manufacturing and service sectors. Meanwhile, manufacturing activity in China slipped to contraction territory following deterioration in construction; wholesale and retail; accommodation and catering; leasing and businesses services; and information transmission, software, and information technology services. The protracted property crisis and soft global demand remain major headwinds for the country. Likewise, the US, euro area, and Japan PMIs remained in contraction, reflecting persistently weak demand conditions. ASEAN manufacturing sector continued to decline, with the PMI dropping to 49.6 in October.

- The Reserve Bank of Australia increased its cash rate target by 25 basis points to address the persistence of above-inflation target. On the other hand, the US Federal Reserve, Bank of England and Bank Negara Malaysia maintained their respective key policy interest rates as they continue to assess the impact of previous monetary policy adjustments.