BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 14 DECEMBER 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 new information and its latest assessment of the impact of prior monetary policy adjustments, the Monetary Board decided to maintain the current monetary policy settings of the BSP. The Monetary Board deemed it necessary to keep monetary policy settings sufficiently tight to allow inflation expectations to settle more firmly within the Government's target range.

- The latest risk-adjusted inflation forecast for 2024 has declined to 4.2 percent from 4.4 percent in the previous meeting in November. For 2025, the risk-adjusted inflation forecast was unchanged at 3.4 percent. The balance of risks to the inflation outlook also remained significantly skewed to the upside from 2023 through 2025.

- On domestic economic activity, the Monetary Board noted that the country's medium-term growth prospects remained firm as easing price pressures, improving real wages, and more favorable global economic growth prospects offset the impact of the higher real policy interest rate and El Niño weather conditions on domestic output.

- The Monetary Board emphasized the need to maintain adequately tight monetary policy settings until inflation expectations were firmly anchored and inflation has reverted to the target range. In this regard, the Monetary Board continues to closely monitor the impact of previous monetary policy adjustments on inflation, inflation expectations, and overall economic activity. Should inflation risks further escalate, the Monetary Board stands ready to adjust monetary policy settings as necessary to steer inflation toward a path consistent with the BSP's price stability mandate.

[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 15 February 2024.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- Headline inflation slowed further to 4.1 percent year-on-year (y-o-y) in November 2023 from 4.9 percent in October 2023 and 8.0 percent in November 2022. The downtrend in overall inflation was due mainly to the slower price increases in heavily weighted food and non-alcoholic beverages amid the slower price increases in vegetables, tubers, and plantains, among others. The decline in transport inflation resulting from lower domestic pump prices as well as the deceleration in the price increases for restaurants and accommodation services further contributed to the moderation in overall inflation. In addition, the official core inflation rate further slowed down to 4.7 percent in November 2023 from 5.3 percent in October 2023. Alternative measures of core inflation including trimmed mean and weighted median likewise declined.

B. Inflation expectations

- Results of the BSP's survey of external forecasters for December 2023 showed a lower mean inflation forecast for 2023 of 6.0 percent from 6.1 percent in the November 2023 survey round. Likewise, the mean inflation forecast for 2024 declined further to 3.9 percent from 4.0 percent. By contrast, the mean inflation forecast for 2025 rose marginally to 3.5 percent from 3.4 percent. Analysts expected inflation to remain elevated in the succeeding months but gradually ease toward the target range in 2024, particularly as base effects manifest and as the BSP's policy actions continue to work their way in curbing inflation. Risks to the inflation outlook are likewise seen to continue leaning toward the upside due mainly to supply-side factors 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. The risk-adjusted inflation is projected to average at 6.0 percent for 2023 (from 6.1 percent), 4.2 percent for 2024 (from 4.4 percent), and 3.4 percent for 2025 (unchanged from the previous forecast round). The downward revisions in the forecasts were driven by the lower-than-expected inflation outturn in November, decline in world crude oil prices, and peso appreciation, which offset the inflationary impact of stronger-than-expected domestic economic activity, minimum wage adjustments in areas outside NCR (AONCR), and strong El Niño weather conditions.

- 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 AONCR; 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 following increased private and public 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 remained generally stable compared to the previous month, with the higher share of wage and salaried workers and the decline in underemployment signaling an improvement in employment quality. In addition, the sustained growth in vehicle sales in October likewise suggested that private consumption remained relatively firm despite tighter financial conditions.

- The country's growth prospects remain intact for 2023 to 2025 despite global headwinds and tighter financial conditions. Full-year growth estimates for 2023 to 2025 have been adjusted upwards from the previous forecast round, reflecting the faster-than-expected growth outturn in Q3 2023, supported by strong private and public spending, improved labor conditions, and sustained remittances from overseas Filipinos. However, GDP growth could settle below the Development Budget Coordination Committee's target[2] from 2023 to 2025 as subdued global economic conditions and the lagged impact of the policy rate adjustments weigh on economic activity.

E. Supply-side indicators

<u>Developments in Agriculture</u>

[2] Government growth targets based on the 185th Development Budget Coordination Committee (DBCC) Meeting on 9 June 2023. The DBCC forecasts the economy to grow by 6.0-7.0 percent in 2023 and by 6.5-8.0 percent in 2024 as well as 2025.

- Nationwide average retail rice prices increased in November 2023 after falling during the start of the peak harvest season in October 2023. Average rice prices increased anew with the end of the harvest season as local traders bid up prices to ensure adequacy of their stocks amid the potential impact of El Niño until the next harvest season as well as the recent uptick in international prices. In particular, export quotes for Vietnam 5% broken rice averaged 6.1 percent higher in November than the previous month as traders executed previously contracted deals amid tightening supply.

- Based on the latest assessment of weather conditions as of 9 November 2023, prevailing El Niño conditions will likely continue through the northern hemisphere spring months from April to June 2024. According to PAGASA's latest climate outlook as of 22 November 2023, strong El Niño is present and may further strengthen toward end-2023 and early part of 2024 as sea surface temperature anomalies reach more than 1.5ºC. In addition, most climate models predict that current El Niño episode will likely persist until Q2 2024.

Oil Price Developments

- Dubai crude oil prices declined in the first week of December 2023 compared to the full-month average price in November 2023. The decline in prices may be attributed to concerns about oil demand as the impact of tight financial conditions and weak global manufacturing activity more than offset the voluntary oil output cuts agreed by OPEC+ for Q1 2024. Uncertainty in the extent and duration of the OPEC+ voluntary oil output reductions also contributed to the decline in global oil prices. However, upside risks associated with potential oil supply disruptions persist amid the ongoing conflict between Israel and Hamas as well as the recent attacks by Yemen's Houthi rebels on several commercial ships in the Red Sea.

Developments in the Utilities Sector

- Retail electricity rates went up in November 2023, reflecting higher transmission charges following a significant increase in the National Grid Corporation of the Philippines' 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 strengthened in early December 2023 amid dovish remarks from the US Federal Reserve signaling a possible pause in monetary policy tightening. The peso was also supported by positive domestic developments, including affirmation from S&P Global of the country's investment credit rating with a "stable" outlook, a narrower budget deficit in October 2023, and the BSP's remarks that monetary policy settings are likely to remain sufficiently tight for some time. However, market sentiment was partly tempered by uncertainty in the global oil market amid the voluntary oil production cuts from OPEC+ and ongoing geopolitical tensions in the West Philippine Sea.

- On a year-to-date basis, the peso closed at ₱55.31/US$1 on 6 December, appreciating by 0.81 percent against the US dollar from the end-December 2022 closing rate of ₱55.76/US$.

G. Liquidity and credit conditions

- Preliminary data showed that domestic liquidity (M3) grew by 8.2 percent y-o-y in October, unchanged from the growth rate recorded in September. Meanwhile, outstanding loans of universal and commercial banks, net of RRP placements with the BSP increased by 7.1 percent y-o-y in October, faster than the 6.5-percent expansion in September.

H. Fiscal developments

- Government catch-up spending was evident in January-October 2023 as overall National Government (NG) expenditures increased to 81.1 percent of the full-year (FY) 2023 expenditure program from only 73.1 percent in January-September 2023. NG spending also expanded by 4.5 percent y-o-y in January-October 2023. The catch-up in NG spending was driven mainly by the combined spending for personnel services (PS), maintenance and other operating expenses (MOOE), and infrastructure and other capital outlays (IOCO). NG disbursements for PS, MOOE, and IOCO grew by 10.7 percent in January-October 2023 following the improved spending performance of government agencies such as the Department of Public Works and Highways; Department of Transportation; Department of Health; Department of Social Welfare and Development; Department of Agriculture; and Department of National Defense.

- Meanwhile, the NG deficit settled at ₱1,017.9 billion in January-October 2023, about 8.5 percent narrower than the deficit in the same period in 2022 and 67.9 percent of the FY 2023 deficit program. Netting out the interest payments in NG expenditures, the primary deficit amounted to ₱498.8 billion, 26.5 percent lower than the deficit recorded in 2022.

I. External developments

- Global economic activity resumed expansion as the improvement in service sector activity offset the decrease in the production volume of the manufacturing sector. The JP Morgan All-Industry Output Index rose to 50.4 in November from 50.0 in October as new order intakes supported a moderate increase in output. Among the 14 countries included in the survey conducted by S&P Global, the fastest rates of expansion were seen in India and Russia, with increases also recorded in the US, China, the UK, Brazil, and Ireland. Meanwhile, Japan, Germany, and France were among the countries that posted contractions. Meanwhile, China's real GDP growth slowed to 4.9 percent in Q3 2023 from 6.3 percent in the previous quarter due to the contraction in construction; wholesale and retail trade; accommodation and catering; leasing and businesses services; and information transmission, among others. ASEAN manufacturing conditions stabilized in November, with the PMI improving to 50.0 from 49.6 in October.