MONETARY POLICY REPORT

AUGUST 2022

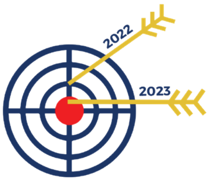
Visual Summary

In summary:

The BSP decided to raise the key policy rate by 50 basis points to 3.75%. This further action is meant to anchor inflation expectations and avoid a breach in the 2.0%-4.0% inflation target range in 2023.

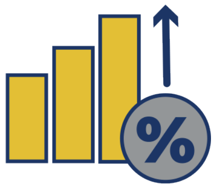
Inflation is projected to remain above the target range until Q2 2023 but will return to within the target range by Q3 2023.

However, factors that could push inflation higher in 2022 and 2023 dominate. These include a shortage in domestic fish supply, a sharp increase in the price of sugar, as well as pending petitions for transport fare increases.



Private sector economists also expect inflation to be higher than target in 2022 and to settle close to the upper end of the target in 2023, before decelerating to within-target range in 2024.

Domestic economic activities are seen to remain strong and return to their pre-pandemic levels by the second half of this year. Domestic growth is still expected to be within the Government's target range for 2022.



The follow-through BSP policy actions will help bring inflation close to the upper limit of the target range by next year. The BSP's actions will complement non-monetary interventions by the National Government to address supply-related problems that are contributing to higher inflation.

The BSP decided to raise the key policy interest rate to 3.75%.

On 18 August 2022, the BSP decided to raise the key policy rate by 50 basis points (bps) to 3.75% effective 19 August 2022.

This further action is meant to anchor inflation expectations and avoid a breach in the inflation target range in 2023.

An increase in the BSP's key policy rate—a move that attracts banks to place more of their funds in the BSP because they will earn higher interest—helps to slow down growth in lending activities; and consequently, helps reduce inflation.

The impact of a BSP policy rate action is normally felt within 12 to 18 months.

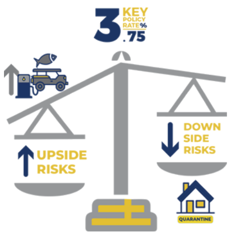
Inflation is projected to accelerate over the near term before slowing down next year.

The latest BSP estimates show that inflation, which has been elevated in recent months, could peak in the third quarter of the year (July-September 2022) and remain above the target range of 2.0%-4.0% until the second quarter of next year (April-June 2023).

Inflation is likely to slow down and settle within the target range by the third quarter of next year (July-September 2023), as global oil and non-oil prices start to ease. The impact of the BSP's policy rate hikes will also help ease inflation in the second half of next year (July-December 2023).

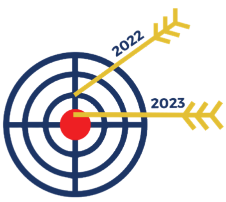
Specifically, latest BSP estimates show that inflation will average 5.4% this year, higher than the previous estimate of 5.0% announced last June 23. Meanwhile, the annual inflation forecast for 2023 is 4.0%, lower than the previous estimate of 4.2% announced in June. Inflation in 2024 is expected to average at 3.2%, lower than the previous forecast of 3.3%.

Several factors could push inflation higher in 2022 and 2023.



Factors that could push inflation higher include elevated global non-oil prices, the continued shortage in domestic fish supply, the sharp increase in the price of sugar, and pending petitions for transport fare hikes (upside risks). Meanwhile, a weaker than expected global recovery and a spike in local COVID-19 infections may weaken demand and could slow down inflation (downside risks).

Private sector economists also expect inflation to be higher than target in 2022 and to settle close to the upper end of the target in 2023 before decelerating in 2024.



A BSP survey of private sector economists conducted in August 2022 shows that inflation expectations for 2022 continued to rise.

In particular, private sector economists also expect inflation to remain elevated this year before easing next year, and further in 2024.

Private sector economists forecast inflation to average at 5.4% this year, 4.2% next year, and 3.7%—which is within target—in 2024.

Analysts expect inflation to breach the upper end of the government's target range in 2022 due to global supply chain disruptions—or problems that hamper the manufacture of goods and services, and/or their delivery to markets; continued depreciation of the peso against the US dollar; and "second round effects."

"Second round effects" happen when inflation caused by supply-side factors—such as higher global oil prices that result in more expensive production of other goods and services—persist, thereby prompting an increase in wages and transport fares as well.

Most of the survey respondents anticipate the BSP to further raise the key policy rate by a range of 25 to 150 bps in the remainder of 2022, and to possibly pause in raising interest rates in 2023 and 2024.

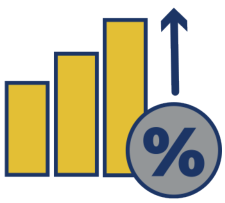
Domestic economic activity is seen to remain strong and to return to its pre-pandemic level by the second half of this year.

The economy grew by 7.4% in the second quarter of this year (April-June 2022), bringing the average growth for the first half of this year (January-June 2022) to 7.8%.

The economy's output is estimated to have already matched its pre-pandemic level within the second half of this year (July-December 2022).

Economic activity in the country is expected to remain firm in the succeeding quarters, as the continually increasing number of vaccinated Filipinos, including those with booster shots, allow easing of mobility restrictions and reopening of businesses.

The follow-through BSP policy actions to manage inflation will reinforce efforts to bring inflation close to the upper end of the target range by next year. The BSP's actions will complement interventions by the National Government to address supply-related problems that are contributing to higher inflation.



Given the BSP estimate that inflation next year will settle at 4.0%, which is the high end of the target range of 2.0%-4.0%, follow-through policy action by the BSP is warranted to avoid a possible breach of the inflation target next year.

This should be complemented by measures by the National Government to address supply issues that cause elevated inflation. Such measures may include subsidies to vulnerable sectors, initiatives to boost food production, and easing restrictions to importation of key commodities.

The BSP reassures the public of its commitment and readiness to take all necessary actions to steer inflation toward a target-consistent path over the medium term in keeping with its price and financial stability mandates.

The BSP raised its key policy interest rate to 3.75%...

This means...

Banks are expected to eventually increase their own lending rates, making borrowing more costly for individuals and businesses. This could lead to reduced spending, slowing down demand, and ultimately resulting in low and stable inflation.

This also means...

Banks may be attracted to deposit more of their funds to the BSP to earn higher interest. As a result, growth in lending activities will slow down, thereby tempering demand and inflation.

View the full 2022 August Monetary Policy Report https://www.bit.ly/MPR_Aug2022