HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 23 MARCH 2023[1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Raise the BSP's current policy interest rate by 25 basis points to 6.25 percent for the overnight RRP rate; and

b) Increase the current interest rates on the overnight deposit facility (ODF) to 5.75 percent and overnight lending facility (OLF) to 6.75 percent.

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

- Inflation is projected to continue tracking an elevated path over the near term driven mainly by broad-based price pressures stemming from strong domestic demand and supply-side constraints. Projected inflation could remain above 4.0 percent until Q3 2023, which would be equivalent to 19 consecutive months of above-target inflation outturns. Meanwhile, inflation is projected to decelerate close to the lower end of the target range by Q1 2024 due mainly to negative base effects and the expected decline in global oil and non-oil prices.

- Since November 2008, the Monetary Board noted that headline inflation accelerated to its fastest pace in January 2023. While headline inflation has eased slightly, various measures of core inflation continue to rise, indicating a further broadening of price pressures. The risks to the inflation outlook remain significantly skewed to the upside for both 2023 and 2024.

- The Monetary Board deemed it necessary for a continued monetary action and increased vigilance until there is firm evidence that inflation is reverting to the target in a sustained manner. Monetary policy continues to be focused on anchoring inflation expectations, which remain near the upper end of the inflation target band. Follow-through monetary tightening will help anchor inflation expectations by underlining the BSP's commitment to its price stability objective.

- The Monetary Board was of the view that the strong near-term gross domestic product (GDP) growth path has continued to feed into price pressures, both for goods and services. Nonetheless, the domestic economy is seen to be able to maintain its momentum despite a tighter monetary

[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 18 May 2023.

policy stance. In a high-inflation environment with robust pent-up demand, inflation expectations will require closer monitoring until a deceleration in headline inflation becomes evident.

- The Monetary Board also considered the rise in core inflation rates which suggests a continued widening of price pressures, even as supply-side pressures on non-core elements (food and energy prices) may be slowly starting to abate. Nevertheless, the marginal decline in headline inflation in February does not yet signify the beginning of broad disinflation. With inflation proving to be more persistent than expected, the BSP will need to raise real interest rates to positive territory to temper the emergence of further second-round effects.

- The Monetary Board also noted that further monetary tightening will also preserve the buffer against external spillovers amid heightened uncertainty and volatility emanating from financial sector distress in the US. Meanwhile, the domestic banking sector remains sound and stable, which allows for a measured increase in the monetary policy rate without compromising financial 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

- Inflation increased slightly in February 2023, implying the strong persistence of inflation. Headline inflation settled at 8.6 percent year-on-year (y-o-y) in February 2023 due mainly to lower transport inflation amid price rollbacks for petroleum products.

- Meanwhile, core inflation measures indicate a further broadening of price pressures, as both core goods and services inflation are still rising sharply. The official core inflation rose further to 7.8 percent in February 2023. Alternative core inflation measures, particularly trimmed mean and principal component, likewise increased.

B. Inflation expectations

- Inflation expectations stay elevated for 2023, and remain near the upper end of the inflation target range for 2024 and 2025, which suggests that the public's expectations continue to be at risk of being disanchored by further shocks. The March 2023 survey of economists showed a slightly higher mean inflation forecast for 2023 at 6.1 percent (from 6.0 percent based on the February 2023 survey round). Meanwhile, the mean inflation forecasts for 2024 and 2025 have declined to 3.7 percent and 3.6 percent (from 4.0 percent and 4.1 percent, respectively). Analysts expect inflation to remain above the upper end of the government's target range in 2023 owing to supply shocks and demand-side price pressures. However,

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inflation is seen to start decelerating by March this year due to base effects and the BSP's policy rate increases since May 2022.

C. Inflation outlook

- The latest baseline forecasts indicate that inflation will remain elevated in the coming months with inflation averaging at 6.0 percent for 2023 and at 2.9 percent for 2024. The forecasts for 2023 and 2024 were adjusted downwards by 0.1 percentage point for both years from the previous forecasts of 6.1 percent and 3.0 percent, respectively. The downward revisions mainly reflect the slower domestic and global growth outlook, as well as the cumulative impact of BSP's policy rate adjustments. These factors were partly offset by the peso depreciation seen over the policy horizon.

Baseline Inflation Forecasts		
	16 February 2023 MB Meeting	**23 March 2023 MB Meeting**
2023	6.1	6.0
2024	3.1	2.9

- The risks to the inflation outlook remain significantly skewed toward the upside for 2023 and 2024. Inflation has proven to be much more persistent than originally expected at the beginning of supply shocks, and both BSP and the market have been consistently surprised on the upside in the past year. The potential impact of transport fare increases, higher electricity rates and elevated domestic prices of key food items facing supply constraints, such as sugar, as well as above-average wage adjustments in 2023 are the major upside risks to the inflation outlook. Meanwhile, the impact of a weaker-than-expected global recovery is the primary downside risk to the outlook.

D. Demand conditions

- The outlook for domestic economic activity remains strong for 2023, within the DBCC's growth target range,[2] in view of the normalization of post-pandemic conditions, higher net exports with China's reopening, return of domestic and foreign tourism, as well as greater MSME activities induced by the resumption of face-to-face classes. Meanwhile, the relatively slower forecast for 2024 reflects weaker global growth prospects as well as the impact of the BSP's cumulative policy rate adjustments.

- Domestic labor market conditions continued to show overall improvement. While the 4.8-percent unemployment rate in January 2023 was marginally higher than the 4.3 percent unemployment rate in December 2022, unemployment rate during the month was considerably lower than the 6.4 percent and 5.3 percent rates recorded a year ago and during the pre-pandemic period, respectively.

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[2] Government growth targets based on the 183rd Development Budget Coordination Committee (DBCC) Meeting on 5 December 2022.

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E. Supply-side indicators

Developments in Agriculture

- Nationwide average retail rice prices increased in February 2023. The uptick in average rice prices for the month coincides with the end of the traditional main harvest season and the start of the optional cropping season in the first quarter of the year.

- Prices of key food items rose mainly due to lingering supply-side issues and spillover effects of the Russia-Ukraine conflict leading to persistent global supply chain bottlenecks and soaring prices of fuel, feeds, and fertilizers. Likewise, increasing food inflation highlights the country's vulnerability to natural calamities, animal diseases, and volatility in global commodity prices. It also exposes gaps in the agricultural value chain as well as indicate non-competitive practices. To cushion the impact of these challenges on the country's food security, the Government implemented crucial non-monetary measures to fill short-term supply gap (e.g., temporary reduction of tariff rates and time-bound increase in import volumes and expansion of import sources) and boost local production (e.g., longer-term productivity-enhancing programs).

  At the same time, on 7 March 2023, President Ferdinand R. Marcos, Jr. approved the creation of the Inter-agency Committee on Inflation and Market Outlook (IAC-IMO)[3] which will serve as an advisory body to the President and the Cabinet on measures to mitigate inflation and ensure food and energy security while balancing the interests of local food producers, consumers, and the overall economy.

- Based on the latest assessment of weather conditions as of 9 March 2023, La Niña conditions concluded and has transitioned to ENSO-neutral, which will likely persist until June-July-August 2023 season. The latest assessment of PAGASA points to an increased likelihood of an El Niño event occurring by July-August-September 2023 season. However, uncertainty remains high during the third quarter of each year due to spring prediction barrier, which is typically associated with lower forecast accuracy. Nonetheless, it is worthy to note that an El Niño event is often associated with drought due to delayed onset of rains and weak monsoon activity, which may dampen water resources and agricultural productivity.

Oil Price Developments

- Dubai crude oil prices were generally steady in the first half of March 2023 compared to the full-month average in February. International crude oil prices have been highly volatile in recent weeks driven by both demand and

[3] The IAC-IMO will be co-chaired by the Department of Finance (DOF) and the National Economic and Development Authority (NEDA). The Department of Budget and Management (DBM) will be the vice-chairperson of the IAC-IMO and the members are composed of the Department of Agriculture (DA), Department of Trade and Industry (DTI), Department of Energy (DOE), Department of Science and Technology (DOST), and the Department of the Interior and Local Government (DILG). The PSA, BSP and the Philippine Competition Commission (PCC) will serve as the IAC-IMO's resource institutions.

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supply-side factors. On the demand side, optimism over Chinese demand recovery boosted oil prices with Saudi Arabia raising its official selling price (OSP). However, the lower-than-expected GDP forecast combined with concerns from further US Federal Reserve (US Fed) monetary tightening have tempered the increase. Meanwhile, supply disruptions from internal conflicts (union strikes due to pension) in France alongside impact of Europe sanctions on Russian oil exports, as well as the reintroduction of the NOPEC bill[4] to the judiciary committee have also added to the uncertainties in the energy market. Most recently, however, oil prices increased as the turmoil over the Silicon Valley Bank collapse is broadly expected to temper aggressive US Fed rate increases.

- Meanwhile, global oil supply-demand outlook suggests a broadly balanced market for 2023.[5] The US Energy Information Administration's (EIA's) latest projection, as of March 2023, shows a slight surplus in oil supply for both 2023 and 2024. Moreover, demand is projected to increase as China pivoted from its zero-COVID tolerance policy while India is also expected to contribute to demand. This in turn, would compensate for the broadly flat consumption from OECD countries, where demand remained soft due to inflationary pressures. Meanwhile, US EIA also revised their supply projections given the higher-than-expected supply from Russia as the country continued to search for alternative consumers.

Developments in the Utilities Sector

- The overall electricity rate increased in March 2023 due mainly to higher generation charge. According to Meralco, the generation charge rose due to the higher costs from the Wholesale Electricity Spot Market (WESM) and Independent Power Producers (IPPs), which effectively offset the generally flat charges from Meralco's Power Supply Agreements (PSAs). To cushion the impact of higher electricity cost, Meralco deferred the collection of portions of the generation costs as agreed with its suppliers. A total of around ₱1.1 billion deferred costs reduced the generation charge for March, which will be billed on a staggered basis in April and May 2023, as coordinated with the Energy Regulatory Commission.

F. Financial market developments

- The peso appreciated against the US dollar, on a year-to-date basis, by 0.4 percent on 27 February 2023 from the end-December 2022 closing rate. The appreciation is partly on account of positive market sentiment following dovish remarks from the US Fed, which reinforced expectations of a slower pace of monetary policy tightening. In addition, lower global oil prices, the increase in the country's gross international reserves at end-January 2023, as well as the BSP's decision to raise interest rate by 50 basis points during its 16 February 2023 meeting to curb elevated inflation provided support to the peso.

[4] A legislation to pressure the Organization of the Petroleum Exporting Countries (OPEC) into increasing production and preventing the group from making quota cuts.
[5] Based on the US Energy Information Administration (US EIA) Short-Term Energy Outlook report (March 2023).

G. Domestic liquidity and credit conditions

- Domestic credit growth has slowed down, although broader liquidity conditions remain appropriate to sustain the economic recovery. Preliminary data show that domestic liquidity (M3) grew by 5.5 percent y-o-y in January 2023 from the 6.7-percent (revised) growth in December 2022. Meanwhile, preliminary data on outstanding loans of universal and commercial banks for production and consumption activities rose by 9.2 percent in January 2023 (from 12.4 percent (revised) in December 2022) and 20.3 percent (from 25.1 (revised)), respectively.

- Secondary market GS yields increased across all tenors on 7 March 2023 relative to end-January 2023. Yields rose on market participants' cautiousness following the 50-basis point (bp) policy interest rate increase by the BSP on 16 February 2023. The increase in yields was supported by market players' higher expectation of another policy rate increase in anticipation of a higher CPI data in February 2023 based on the BSP inflation forecast.

H. Fiscal developments

- Fiscal consolidation continued as the National Government (NG) recorded a deficit of ₱1.6 trillion for January - December 2022, about 3.4 percent lower than the amount recorded in 2021. Netting out the interest payments, the primary deficit amounted to ₱1.1 trillion, lower by 10.0 percent than the 2021 level.

I. External developments

- Global growth outlook remains weak with risks skewed to the downside. At the same time, global inflation expectations rose further as strong wage gains underpin the sustained increase in the prices of service-based categories such as rent, transportation, and food away from home (restaurants).

- Several central banks have raised their respective key policy rates in March to address price pressures and anchor inflation expectations in their respective jurisdictions.

- Although monetary authorities have intensified their hawkish rhetoric amid the persistence of price pressures, the recent collapse of several banks in the US has also prompted financial markets to forecast lower terminal rates and possible interest rate reductions by the US Fed by late 2023. Interest rate expectations for the US have declined as market participants expected the Federal Reserve to slow down the pace of monetary tightening amid an increased risk of financial instability due to liquidity constraints and broad repricing of asset prices.

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