## *HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 15 DECEMBER 2022* [1]

### I. Monetary Policy Decision

The Monetary Board decided to:

a) Raise the BSP's current policy interest rate by 50 basis points to 5.50 percent for the overnight RRP rate; and

b) Increase the current interest rates on the overnight deposit facility (ODF) to 5.0 percent and overnight lending facility (OLF) to 6.0 percent.

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

- The latest baseline inflation forecasts continue to show an above-target inflation path over the policy horizon. The updated forecast path shows inflation peaking in December 2022. From there, inflation is seen to decelerate but remain elevated well into the first half of 2023. By Q3 2023, inflation will likely revert to within the 2-4 percent target band before settling close to the lower end of the target range in Q4 2023 and Q1 2024, largely due to base effects. Thereafter, inflation will stabilize and return to the midpoint of the target by Q2 2024.

- The Monetary Board noted that, at present, inflation remains high and broad-based, as seen in the sharp increase in core inflation and the further rise in inflation expectations.

- Meanwhile, the risks to the inflation outlook are strongly tilted to the upside in 2023 but remain broadly balanced for 2024.

- Amid broad-based inflation pressures, persistent upside risks to inflation, and elevated inflation expectations, the Monetary Board deemed it necessary to take aggressive monetary action to bring headline inflation back to within target as soon as possible. Continued monetary tightening will also provide a cushion against external spillovers even as major central banks have signaled a possible slowing down of monetary policy tightening.

- To mitigate the effects of persistent supply-side pressures on commodity prices, the Monetary Board also noted the continuing need for timely non-monetary interventions by the National Government in alleviating supply-side shortages and strengthening farm productivity.

[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 February 2023.

## 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 increased further to 8.0 percent year-on-year (y-o-y) in November 2022 from 7.7 percent in October 2022, the highest recorded rate since November 2008. The rise in inflation in November 2022 was due primarily to higher inflation for food and non-alcoholic beverages. Inflation for rice, fruits, sugar, and vegetables also registered larger increases. Under non-food items, restaurants and accommodation services also contributed to the further uptick in inflation. The resulting year-to-date average inflation of 5.6 percent was above the NG's average inflation target range of 2-4 percent for the year.

- Likewise, core inflation, which depicts underlying demand-side pressures, rose to 6.5 percent in November 2022 from 5.9 percent in October 2022. The higher official core inflation reflected rising food costs, which have driven inflation for other large-weighted CPI items such as other food and non-alcoholic beverages as well as restaurants and accommodation services.

### B. Inflation expectations

- Inflation expectations also rose further. The BSP's survey of private sector economists for December 2022 showed higher mean inflation forecasts for 2022 at 5.9 percent (from 5.7 percent based on the November 2022 survey) and for 2023 at 5.1 percent (from 4.9 percent).

- Similarly, the results of the BSP's Q4 2022 expectations survey on businesses and households indicate that both sectors anticipate inflation to breach the upper end of the government's 2-4 percent target range for 2022 and 2023.

### C. Inflation outlook

- **The latest baseline forecasts continue to show an above-target inflation path,** with average headline inflation seen at 5.8 percent for 2022 and at 4.5 percent for 2023 before decelerating towards the midpoint of the target range at 2.8 percent for 2024. The forecast for 2022 is unchanged, while that for 2023 has been raised due to the higher-than-expected inflation outturn in November, the higher inflation nowcast for December, and the approved water rate increases starting 2023. The impact of these factors was partly offset by the lower crude oil price assumption and the peso appreciation. Meanwhile, the lower forecast for 2024 could be attributed to the further easing in oil prices, the peso appreciation, and lower domestic growth outlook following the cumulative policy rate adjustments of the BSP.

| Baseline Inflation Forecasts | | |
|---|---|---|
| | **17 November 2022 MB Meeting** | **15 December 2022 MB Meeting** |
| 2022 | 5.8 | 5.8 |
| 2023 | 4.3 | 4.5 |
| 2024 | 3.1 | 2.8 |

- **The risks to the inflation outlook remain strongly tilted to the upside in 2023 but broadly balanced for 2024.** The expected upside risks to inflation over the policy horizon stem mainly from elevated international food prices due to high fertilizer prices and supply chain constraints. On the domestic front, trade restrictions, increased prices of fruits and vegetables due to weather disturbances, higher sugar prices, pending petitions for transport fare increases, as well as potential wage adjustments in 2023 could push inflation upwards. Meanwhile, the impact of a weaker-than-expected global recovery continues to be the primary downside risk to the outlook.

## D. Demand conditions

- The Philippine economy is expected to remain on a recovery path over the near term. GDP growth is projected to settle within the DBCC's targets for 2022 and 2023, but slightly below the 6.5-8.0 percent target for 2024.[2] The slower growth is mainly due to the lower global GDP growth assumption for 2023 and the impact of the policy rate adjustments of the BSP.

- Domestic labor market conditions continued to show overall improvement, with the unemployment rate declining to 4.5 percent in October 2022 from 5.0 percent and 7.4 percent a month ago and a year ago, respectively.

## E. Supply-side indicators

Developments in Agriculture

- Nationwide average retail rice prices increased in November 2022 based on the results of the 2018-based PSA Retail Price Survey (RPS) covering all provinces and key cities in the country. The uptick in average rice prices in November 2022 was attributed to the lingering impact of agricultural damages and losses left by strong typhoons that hit the country during the main harvest season.

- Prices of key food items have risen as lingering supply-side issues and spillover effects of the Russia-Ukraine conflict have led to persistent global supply chain bottlenecks and soaring prices of fuel, feeds, and fertilizers. Likewise, the country's vulnerability to natural calamities and animal diseases continue to weigh on agricultural production. To cushion the

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

impact of these challenges on the country's food security, the National Government has implemented crucial non-monetary measures to fill short-term supply gaps (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).

- Based on the latest assessment as of 10 November 2022, prevailing La Niña conditions will likely persist through February 2023 and then transition to ENSO-neutral conditions by February-March-April 2023 season. Nonetheless, continuing La Niña conditions may pose the risk of more frequent tropical cyclones and sustained flooding, which could adversely affect the agriculture sector, as well as present upside pressures on inflation. On the other hand, above-normal rainfall conditions associated with La Niña may also boost water supply in harvest areas and thus potentially enhance agricultural production.

Oil Price Developments

- Global crude oil prices declined amid worries over weakening demand due to restrictive financial conditions, slowing global growth, and reduced demand from China. As such, futures prices of Brent crude oil remained in backwardation. Meanwhile, as of November 2022, the US Energy Information Administration (EIA) expects global supply and demand in oil markets to be generally balanced in 2023, although possible additional production cuts from OPEC+ and increased global economic uncertainty pose significant risks to the EIA's outlook.

- Domestic pump prices for gasoline, kerosene, and diesel have declined in recent weeks. However, on a year-to-date basis, prices of gasoline, kerosene, and diesel remained significantly higher compared to end-2021 levels.

Developments in the Utilities Sector

- The overall electricity rate increased in December 2022 due to the completion of distribution-related refunds for residential customers. Three (3) such refunds are still ongoing, which are expected to be completed by December 2022, January 2023, and May 2023.

- Meanwhile, the increase in electricity rates was tempered by the decline in generation charges. Charges from Power Supply Agreements (PSAs) fell as the First Natgas-San Gabriel plant went back online after its scheduled maintenance outage in October. The recent appreciation of the peso against the US dollar also contributed to the reduction in cost. Similarly, cost of electricity from the Wholesale Electricity Spot Market (WESM) decreased on improved supply conditions in the Luzon grid.

## F. Financial market developments

- The peso depreciation against the US dollar slowed down to 9.8 percent year-to-date as of 29 November 2022, from 12.0 percent in October. The peso appreciated on positive market sentiment in November amid lower-than-expected US inflation in October, which fueled optimism that the US Federal Reserve could slow its pace of rate increases, and the decline in global oil prices. On the domestic front, optimism over releases of positive news, specifically, higher gross international reserves (GIR) for October; the lower unemployment rate for September; higher-than-expected GDP growth in Q3 2022; the rise in overseas Filipino (OF) remittances in September; improvement in balance of payments (BOP) data in October; and the reinstatement of investment grade rating for the Philippines by S&P likewise contributed to the appreciation of the peso.

- The Philippine Stock Exchange Index (PSEi) averaged 6,388.9 index points in November, higher by 6.6 percent than its October average. The recovery in the benchmark index could be attributed to improved market sentiment following positive developments in the domestic economy, including: faster-than-expected Q3 2022 GDP growth of 7.6 percent; positive third-quarter corporate earnings reports; and S&P Global Ratings' affirmation of the Philippines' investment-grade credit rating of BBB+ with a stable outlook. Against this backdrop, there was market optimism on the economy's ability to absorb the 75-bp rate increase by the BSP at its November policy meeting. Market expectations of a slower pace of monetary policy tightening by the US Federal Reserve also contributed to renewed investor confidence.

## G. Domestic liquidity and credit conditions

- Domestic liquidity and credit conditions continued to support bank lending and broad-based economic recovery. Preliminary data show that domestic liquidity (M3) grew by 5.4 percent year-on-year to about ₱15.4 trillion in October from 5.2 percent in September. Meanwhile, outstanding loans of universal and commercial banks for both production and consumption activities increased by 12.5 percent in October (from 12.3 percent in September) and 22.6 percent (from 20.6 percent), respectively.

- Secondary market government security yields, especially in the middle of the yield curve, declined on 5 December 2022. Yields fell as banks serviced their client requirements and reinvested their excess funds. The decline in yields at the belly of the curve was also supported by market expectations that the BSP could also move to a slower pace of policy rate increases amid signals from the US Federal Reserve that it could slow the pace of its upcoming rate increases.

## H. Fiscal developments

- Fiscal consolidation continued as the National Government (NG) recorded a deficit of ₱1,1111.8 billion for January - October 2022, 7.6 percent lower than recorded in the same period in 2021. Netting out the interest payments, the primary deficit amounted to ₱678.7 billion, 18.5 percent lower than the amount recorded in 2021.

## I. External developments

- Global economic activity contracted faster in November due to further declines in manufacturing output and service sector revenues amid a broad slump in business activity in major economies such as the United States, the Euro Area, United Kingdom, Japan, China, and Brazil.

- Global economic output contracts for the fourth consecutive month amid a broad slowdown in business activity. The JP Morgan All-Industry Output Index fell further to 48.0 in November from 49.0 in October, reflecting the contractions in output, new business, new export business, and outstanding business. Although price pressures have eased amid the decline in input costs and selling charges, businesses recorded lower revenues as rising interest rates, prolonged geopolitical risks, elevated inflation, and heightened market volatility weighed on private demand. Nonetheless, the global economy's rate of contraction was partially offset by the faster expansion in India.

- Amid major central banks' aggressive monetary policy tightening, global financial conditions have also continued to tighten. Several central banks have raised their respective key policy rates in November to address persistent and broadening price pressures as well as to anchor inflation expectations.