HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 16 MAY 2024 [1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Maintain the Target RRP Rate at 6.50 percent; 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

- The Monetary Board deemed it appropriate to maintain the BSP's monetary policy settings until inflation settles firmly within the target range. Inflation expectations also continued to be broadly anchored, with mean and median forecasts staying within the target range for 2024 to 2026. However, the risks to the inflation outlook continue to lean toward the upside due mainly to higher transport charges and toll rates, increased prices of food commodities amid prolonged global supply constraints, higher electricity rates, and elevated global oil prices.

- On domestic economic activity, the Philippine economy grew by 5.7 percent year-on-year (y-o-y) in Q1 2024, higher than the 5.5 percent growth recorded in the preceding quarter. The sustained strength of domestic demand as well as higher export orders bolstered activity in the manufacturing and services sectors. Even as overall activity continues to adjust to tighter financial conditions, alternative demand indicators continued to show that domestic growth prospects over the medium term remain largely intact.

- The National Government's non-monetary measures to address persistent supply-side pressures remain crucial in tempering inflationary impulses and preventing further second-round effects. Nevertheless, the Monetary Board stands ready to adjust monetary policy settings as necessary in keeping with its primary mandate to safeguard price stability.

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:

[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 27 June 2024.

A. Domestic price conditions

- Headline inflation rose marginally to 3.8 percent y-o-y in April 2024 from 3.7 percent in March 2024 owing primarily to the higher y-o-y increase in food and non-alcoholic beverages. In particular, rice inflation remained elevated, although the rate of price increase slowed compared to the previous month. Meanwhile, the official core inflation rate eased in April, while alternative measures remained largely unchanged from the rates recorded in March.

B. Inflation expectations

- Preliminary results of the BSP's survey of external forecasters for May 2024 showed that expectations remained broadly anchored. The mean inflation forecast for 2024 eased to 3.7 percent from 3.8 percent in the April survey round. By contrast, the mean inflation forecast for 2025 remained at 3.5 percent, while the mean inflation forecast for 2026 increased to 3.5 percent from 3.4 percent. Meanwhile, median inflation forecasts showed the same trends.

- Analysts continue to expect inflation to average close to the upper end of the target range over the policy horizon, as upside risks owing to supply chain disruptions continue to dominate their outlook.

C. Inflation outlook

- The latest baseline inflation path is lower for 2024 but marginally higher for 2025 compared to the previous forecast in April. Inflation is expected to remain above the target range until July 2024. Domestic supply constraints continue to exert pressures on the prices of key food items such as rice and corn, while positive base effects emanate from the deceleration in food and energy inflation during the same period in 2023. Nevertheless, inflation is projected to return to within the target range starting in August 2024 as pressures on food and crude oil prices ease.

- The latest risk-adjusted inflation forecast is estimated at 3.8 percent for 2024 and 3.7 percent for 2025. Compared to the previous forecast, the risk-adjusted projections are lower for 2024 but higher for 2025, reflecting the adjustments in the baseline forecasts.

- Meanwhile, the estimated impact of inflation risks is slightly higher compared to the forecasts from the April 2024 policy meeting. Risk estimates for the transport sector have increased due to proposed jeepney fare hikes, higher taxi flagdown rates, and approved toll fee adjustments. Additionally, risk weights on electricity rates, food prices, and energy costs have been revised upward due to supply constraints resulting from prolonged geopolitical tensions in the Middle East and Eastern Europe, as well as the impact of El Niño weather conditions on agricultural production and energy demand.

D. Demand conditions

- Domestic growth prospects remain intact for 2024 and 2025 based on BSP staff estimates. GDP growth is projected to remain robust in H1 2024, decelerate in H2 2024 due to positive real interest rates following the BSP's tightening cycle, and subsequently pick up in 2025. This outlook is consistent with the expected shift to a slightly negative output gap in 2024 to 2025, suggesting that the growth momentum of the economy remains firm.

E. Supply-side indicators

Developments in Agriculture

- The Agriculture, Forestry, and Fishing (AFF) sector expanded at a slower pace in Q1 2024 as crop production declined amid the adverse effects of El Niño. The modest improvement in AFF output in Q1 2024 may be attributed to the positive contribution of poultry, egg, sugarcane, coffee, other agricultural crops, and support activities to AFF. However, these gains were partly offset by the lower output in palay, livestock, banana, coconut including copra, fishing and aquaculture, cassava, and abaca.

- Meanwhile, nationwide average retail rice prices rose further in April 2024 as crop damage from El Niño resulted in lower inventories compared to levels recorded a year ago.

- The climate outlook by the Philippine Atmospheric, Geophysical, and Astronomical Services Administration as of 24 April 2024 indicated that prevailing moderate El Niño conditions have subsided, with an increased likelihood of La Niña developing by H2 2024. While there remains high uncertainty on the occurrence of La Niña due to the impact of the spring prediction barrier on forecast accuracy, strong El Niño events have historically been followed by episodes of La Niña. Pre-developing La Niña is typically associated with below normal rainfall and could delay the onset of the rainy season, which in turn may adversely affect agricultural production.

Oil Price Developments

- The Dubai crude oil spot price decreased in the first week of May from the full-month average price in April. Global oil prices declined amid easing geopolitical tensions in the Middle East following the on-going ceasefire negotiations between Israel and Hamas. Demand concerns stemming from higher-for-longer global interest rates and considerable economic slowdown in several major economies likewise contributed to the decline in crude oil prices.

- Nonetheless, upside risks to oil prices remain. Voluntary production cuts among OPEC+ members as well as unresolved geopolitical conflicts in the Middle East and Eastern Europe could drive oil prices higher in the subsequent quarters.

Developments in the Utilities Sector

- The overall electricity rate increased by 4.2 percent to ₱11.4139 per kWh in May 2024 from ₱10.9518 per kWh in April 2024. The overall rate increased as generation charges rose due to higher costs from the Wholesale Electricity Spot Market and Power Supply Agreements.

F. Financial market developments

- The peso depreciated by 2.25 percent to ₱57.27/US$1 for the period 8 April – 10 May 2024 from the previous monetary policy cycle's average of ₱55.98/US$1 (period covering 15 February to 7 April 2024). The peso weakened due primarily to broad US dollar strength following the release of strong key US economic indicators, prompting hawkish remarks from US Federal Reserve officials. Escalating conflict in the Middle East as well as lingering geopolitical tensions in the West Philippine Sea likewise contributed to the depreciation of the peso.

- On a year-to-date basis, the peso closed at ₱57.42/US$1 on 10 May 2024, depreciating by 3.57 percent against the US dollar from the end-December 2023 closing rate of ₱55.37/US$.

G. Liquidity and credit conditions

- Bank lending activity continued to expand at single-digit rates. Preliminary data showed that outstanding loans of universal and commercial banks, net of reverse repurchase placements with the BSP, grew by 9.4 percent y-o-y in March. This is faster than the 8.6 percent recorded in February 2024 but slower than the year-ago growth rate of 10.2 percent.

H. Fiscal developments

- Overall National Government (NG) spending rose by 10.7 percent y-o-y in Q1 2024. NG revenues also increased by 14.1 percent owing mainly to the growth in both tax and non-tax revenues. On balance, the NG fiscal deficit for Q1 2024 widened to ₱272.6 billion (4.5 percent of GDP) from the previous year's deficit of ₱270.9 billion (4.8 percent of GDP).

I. External developments

- Prospects for global economic growth continue to improve as downside risks to economic activity recede. Global economic activity continued to expand amid strong demand and improved business optimism. In April 2024, the JP Morgan All-Industry Output Index increased as new business expanded faster owing mainly to higher trade volumes from international markets. Economic activity rose in almost all the countries covered except for Canada. Likewise, ASEAN manufacturing activity was sustained in April due to further expansions in new orders and output.

- While most central banks expect inflation to gradually slow toward their respective targets in the subsequent quarters, the recent resurgence in prices for food and energy commodities could complicate the outlook for monetary policy overseas, potentially extending tighter financial conditions beyond market participants' initial expectations.

- At its meeting on 1 May 2024, the US Federal Reserve (Fed) maintained the target range for the federal funds rate at 5.25 - 5.50 percent to keep financial conditions sufficiently tight and bring inflation back toward the Fed's 2 percent objective. With inflationary pressures persisting due to the sustained increase in shelter cost, market participants expect policy interest rates to remain higher for longer.