HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 26 OCTOBER 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 6.50 percent for the Target RRP Rate; and

b) Increase the current interest rates on the overnight deposit facility to 6.00 percent and overnight lending facility to 7.00 percent.

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

- The Monetary Board recognized the need for urgent monetary action to prevent supply-side price pressures from inducing additional second-round effects and further dislodging inflation expectations. The updated baseline projections pointed to an elevated inflation path over the policy horizon as upside risks continue to manifest. Incorporating the impact of various upside and downside risks that have emerged since the previous meeting, the risk-adjusted forecast for 2024 was 4.7 percent (from 3.5 percent previously), well above the Government's target range. The Monetary Board noted that second-round effects have broadened, including transportation fare increases and minimum wage adjustments. Inflation expectations have risen sharply, highlighting the risk of further second-round effects.

- The balance of risks to the inflation outlook continued to lean significantly toward the upside, due mainly to the potential impact of higher transport charges, electricity rates, international oil prices, and minimum wage adjustments in areas outside the National Capital Region. Meanwhile, the effect of a weaker-than-expected global recovery as well as government measures to mitigate the effects of El Niño weather conditions could temper upside inflationary impulses.

- On the output side, latest domestic demand indicators point to dissipating pent-up demand in the near term. Nevertheless, the country's medium-term growth prospects remain largely intact. The Monetary Board is closely monitoring the impact of the increase in interest rates as these work their way through the economy. The Monetary Board also continues to support fiscal efforts to sustain growth through more rapid programmed spending, as well as non-monetary interventions to address persistent supply-side pressures on prices. The Monetary Board supports the economic managers'

[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 November 2023.

timely efforts to extend the effectivity of Executive Order (E.O.) 10, s. 2022 beyond 2023 as well as to reform the Tariff and Customs Code.

- The Monetary Board noted that it would be necessary to keep monetary policy settings tighter for longer until inflationary expectations were better anchored and a sustained downward trend in inflation became evident. Monetary policy will continue to be guided by incoming data, and the Monetary Board is prepared for follow-through monetary policy action as necessary to bring inflation back to a target-consistent path, in keeping with the BSP's price stability mandate.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- Headline inflation accelerated further to 6.1 percent year-on-year (y-o-y) in September 2023 from 5.3 percent in August 2023, bringing the year-to-date average inflation to 6.6 percent, due primarily to faster price increases for food and non-alcoholic beverages, particularly rice, as well as transport. Meanwhile, the official core inflation rate further eased to 5.9 percent y-o-y in September from 6.1 percent in August. Alternative measures of core inflation, except for principal component analysis, likewise declined in September. On a month-on-month seasonally adjusted basis, inflation in September increased to 1.2 percent from 1.1 percent in the previous month.

B. Inflation expectations

- Inflation expectations have also increased. Results of the BSP Survey of External Forecasters for October 2023 showed a higher mean inflation forecast for 2023 at 6.1 percent relative to the September 2023 mean forecast (5.9 percent). Similarly, inflation expectations for 2024 also increased to 4.1 percent (from 3.7 percent). Meanwhile, the mean inflation forecast for 2025 remained at 3.5 percent. Analysts expect inflation to remain elevated due to the higher-than-expected September inflation print and recent supply-side pressures domestically and overseas.

C. Inflation outlook

- The latest staff risk-adjusted inflation forecast for 2024 is 4.7 percent, which is higher than the baseline forecast of 3.5 percent during the September 2023 MB meeting and above the Government's inflation target range of 2.0 to 4.0 percent. The upward adjustment in the 2024 inflation forecast was driven mainly by the higher-than-expected inflation outturn in September 2023, the higher inflation nowcast for October 2023, and the approved provisional jeepney fare increase. The inclusion of potential higher global oil prices due to the conflict between Israel and Palestinian group, Hamas, and the possible non-extension of E.O. 10, s. 2022, which extended the lower adjustments in tariff rates for meat, corn, and rice until 31 December 2023, as among the key upside risks to the inflation outlook also contributed to the increase in the inflation projection for 2024.

- The risks to the inflation outlook for 2024 continued to be skewed significantly to the upside. Transport charges may further increase given pending fare hike petitions, especially for jeepneys. In addition, higher electricity rates may result in the near term from the Supreme Court decision in July 2022 to nullify Energy Regulatory Commission's 2014 order to cap Wholesale Electricity Market prices in November to December 2013. Other key upside risks to the inflation outlook for 2024 are higher global oil prices stemming from possible oil supply disruptions from the Israel-Hamas conflict; higher-than-expected minimum wage adjustment in areas outside NCR; 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 successful implementation of government measures to mitigate impact of *El Niño* weather conditions and the impact of a weaker-than-expected global recovery are the primary downside risks to the outlook.

D. Demand conditions

- Recent data on economic activity point to a modest demand recovery in the near term. Labor market conditions have improved as unemployment and underemployment rates decreased, while the labor force and employment levels and rates increased in August 2023. Merchandise exports also went up in August. The continued double-digit growth in vehicle sales in August likewise suggest that private consumption will remain a main contributor to growth in the near term. At the same time, faster expansion for both volume and value manufacturing indices in August and the recovery of the manufacturing purchasing managers' index (PMI) in September signal possible improvement in the manufacturing sector.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- Nationwide average retail rice prices rose further from month-ago levels in September 2023, due to the uptrend in farmgate prices owing to cost pressures from inputs, as well as the rise in international rice prices, underpinned by uncertainties associated with India's export restrictions and continued purchases by major buyers.

- Domestic food security faces risks from weather disturbances, spread of animal diseases, volatility in input prices, and trade restrictions pushing up international commodity prices. Nevertheless, the whole-of-government approach is expected to address food inflation and mitigate risks to food security through measures that will fill short-term supply gap, boost local production, and address the effect of El Niño on the agricultural supply.

- Based on the latest PAGASA assessment of weather conditions as of 12 October 2023, prevailing El Niño conditions will likely continue through the northern hemisphere spring season by March to May 2024. According to PAGASA's latest climate outlook as of 27 September 2023, moderate El Niño is present and may further strengthen towards the latter part of 2023. In addition, most climate models predict that the current El Niño episode will likely persist until Q2 2024.

Oil Price Developments

- Dubai crude oil prices declined in the first half of October 2023 from the full-month average price in September 2023 on concerns of weaker demand prospects due to the sluggish economic outturn for China and Europe and tight global monetary policy. Nevertheless, the decrease in global oil prices was limited by the supply cuts of the Organization of the Petroleum Exporting Countries and its partners (OPEC+), especially by the extended additional cuts of Saudi Arabia and Russia until the end of 2023. Moreover, expectations of possible supply disruptions from the Israel-Hamas conflict, which started on 7 October 2023, offset the reduction in international oil prices during the period.

Developments in the Utilities Sector

- Retail electricity rates went up in October 2023, reflecting higher costs from the Independent Power Producers (IPPs) and Power Supply Agreements (PSAs). The persisting supply restriction of the Malampaya natural gas field forced First Gas plants to switch to more expensive fuel (e.g., diesel), which induced higher charges from IPPs. It also resulted in the forced shutdown of the 420-MW First NatGas-San Gabriel power plant on 18-24 September 2023, which partly increased PSA charges.

F. Financial market developments

- The peso was relatively stable, appreciating slightly by 0.03 percent for the period 1-17 October 2023 from the previous month, due to narrower trade deficit and higher personal remittances in August 2023; stronger foreign direct investment inflows in July 2023; and market expectations of a policy rate increase by the BSP amid higher-than-expected inflation in September 2023. These were partly pared by record-high long-term US Treasury yields following signals of a higher-for-longer interest rate environment from the US Federal Reserve amid still-elevated inflation, as well as dampened sentiment amid concerns over escalating geopolitical tensions between Israel and Hamas.

- On a year-to-date basis, the peso depreciated against the US dollar by 1.8 percent on 17 October 2023 from the end-December 2022 closing rate. Most

Asian currencies also weakened against the US dollar on a year-to-date basis.

G. Liquidity and credit conditions

- Domestic liquidity (M3) grew by 6.8 percent y-o-y in August 2023, faster than the 5.7 percent in July 2023. Meanwhile, outstanding loans of universal and commercial banks, net of RRP placements with the BSP increased at a slower rate of 7.2 percent y-o-y in August 2023 from 7.7 percent in July 2023. Past interest rate increases also continue to be transmitted via the interest rate channels.

H. Fiscal developments

- The National Government (NG) is on track with its catch-up programmed spending to sustain growth. While overall NG spending only grew by 3.5 percent in January-August 2023, NG disbursements for combined personnel services (PS), maintenance and other operating expenses (MOOE), and infrastructure and other capital outlays (IOCO) increased by 8.7 percent in January-August 2023 and 26.7 percent in July-August 2023. The double-digit growth in PS, MOOE, and IOCO in July-August 2023 was mainly supported by sizeable capital expenditures of the Department of Public Works and Highways and various rail transport projects of the Department of Transportation as well as disbursements on major social, health, education, and agriculture programs.

- Meanwhile, the NG posted a deficit of ₱732.5 billion in January-August 2023 which is 12.1 percent narrower than the deficit in the same period in 2022. Netting out interest payments, the primary deficit amounted to ₱343.9 billion, 30.2 percent lower than the deficit recorded in 2022.

I. External developments

- Global economic activity has expanded at a more moderate pace due to faster contraction in manufacturing output as well as slower expansion in service-related business activity. The JP Morgan All-Industry Output Index eased marginally due to the dampening effect of tighter global financial conditions on aggregate demand. Meanwhile, manufacturing activity in China based on PMI continued to expand while that in the US, Euro Area, and Japan remained in contraction. ASEAN manufacturing sector also declined for the first time in over two years, with the PMI dropping to 49.6 in September from 51.0 in August.

- The International Monetary Fund (IMF) maintained its 2023 global economic growth projection at 3.0 percent in the October 2023 World Economic Outlook (WEO). Nonetheless, global economic expansion is expected to remain well below the annual average of 3.8 percent until at least 2024 owing in part to declining international trade and deteriorating global manufacturing activity.

- Most central banks have maintained their respective key policy interest rates in September and October 2023 to continue their assessment of the impact of previous monetary policy adjustments. By contrast, two central banks raised policy rates in September 2023 to address the persistence of above-target inflation, while one central bank introduced a rate hike in October 2023 to defend the value of its currency amid heightening global uncertainty and mitigate the impact of imported inflation.