

Benjamin E Diokno: Ensuring price stability through monetary policy

Speech by Mr Benjamin E Diokno, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the Breakfast Briefing with the Italian Chamber of Commerce in the Philippines, Inc. (ICCPI), Manila, 17 May 2019.

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To the officers and members of the Italian Chamber of Commerce in the Philippines, (ICCPI), led by its President, Mr. Sergio Boero and Vice President Mr. Lorens Ziller, distinguished guests, ladies and gentlemen, magandang umaga/good morning.

It is a pleasure to be invited as guest speaker in today's breakfast briefing to discuss monetary policy and the overall the strategies of the Bangko Sentral ng Pilipinas. The passage of Republic Act No. 11211, or the Amendments to the BSP Charter (Republic Act No. 7653), definitely bolsters the BSP's commitment to its primary objective of promoting the stability of prices as well as the financial system. The enactment of the said law is both timely and appropriate given notable developments – both in the global and domestic fronts – that have taken place since 1993 when the old BSP Charter took effect.

For this morning's presentation, let me focus on these three discussion points.

First, I will provide an overview of the latest developments in the monetary sector by dissecting inflation numbers in the first four months of 2019 and look into the BSP's inflation outlook for this year and in 2020.

Second, I will focus on the monetary measures that have been pursued by the BSP as well as the non-monetary measures put in place in coordination with other government agencies to help anchor both inflation and inflation expectations following a challenging inflation environment in 2018. This will highlight the crucial role of strong inter-agency coordination to address shocks to inflation.

Lastly, I want to share the BSP's policy thrusts moving forward, particularly in the context of the enactment of the amendments to its charter which strengthens its mandate of safeguarding price and financial stability.

Let me begin with the recent inflation numbers.

It may be recalled that 2018 was a very challenging year for the BSP. Inflation has been on the rise beginning the month of January and peaked in the month of September at 6.7 percent before settling at an average of 5.2 percent for the full year 2018. This inflation rate was 1.2 percentage points (ppts) above the high end of the inflation target range of 2.0 percent to 4.0 percent for the year.

Nonetheless, as projected, inflation has gone down significantly, falling toward the midpoint (at 3.0 percent in April 2019) of the target band in the latest inflation print. This is not surprising given that the price pressures in 2018 were driven by cost-push factors. With the abatement of supply-side pressures, inflation has also started falling within target. The contribution of food inflation (represented by the yellow bar) to overall inflation has dropped markedly especially with rice prices easing in recent months brought about by the continued arrival of imports and the onset of the summer harvest season.

Looking ahead, we expect inflation to remain on a target-consistent path for 2019 and 2020. The latest baseline forecasts (as of 9 May 2019 MB policy meeting) indicate that inflation is projected to average at 2.9 percent for 2019 while inflation forecast for 2020 is slightly higher at 3.1 percent

due largely to the rebound in crude oil prices.

Meanwhile, risks to the inflation outlook remain broadly balanced for 2019 amid risks of a prolonged El Niño episode and higher-than-expected increases in global oil prices. For 2020, the risks continue to lean toward the downside as weaker global economic activity could temper commodity price pressures.

Similarly, forecasts of other institutions generally convey the same expectations. Results of the BSP's April 2019 survey of private sector economists showed lower mean inflation forecast for 2019 at 3.1 percent from 3.3 percent in the previous survey round. The mean inflation forecasts for 2020 and 2021 both declined to 3.3 percent from 3.4 percent. Meanwhile, projections from other institutions also show inflation within target for this year and the next.

Analysts expect inflation to continue easing and settle within the government's target range. However, possible upward pressures are seen to keep inflation from further decelerating.

(Upside risks to inflation): potential rebound in global crude oil prices, adverse weather conditions such as El Niño, higher electricity rates, reduction in the BSP's policy interest rate, and higher domestic demand due to the upcoming midterm elections and school enrollment

(Downside risks to inflation): the lower inflation prints, implementation of non-monetary policy actions to increase domestic food supply and stabilize prices such as the rice tariffication law and the mitigating measures put in place by the Department of Agriculture against the lingering weak El Niño condition, lower global crude oil prices, base effects, stable domestic currency against the US dollar, slower global trade and economic growth, and continued monetary impact of the BSP's policy rate hikes in 2018.

While the BSP is tasked with the primary mandate of safeguarding price stability, in certain circumstances, when price pressures are emanating from the supply side, close coordination with other government agencies is critical to rein in inflation. Thus, a combination of both monetary and non-monetary measures becomes the best strategy to pursue.

In 2018, the BSP took timely and deliberate monetary policy actions in May, June, August, September and November (with a cumulative of 175 bps hike in policy interest rate) to firmly anchor inflation expectations to the inflation target and to arrest any possible risk of second-round effects.

Non-monetary interventions implemented by other government agencies complemented the BSP's monetary actions in addressing inflation pressures especially in the face of strong supply shocks in 2018. These measures include enhanced surveillance of basic goods and agricultural commodities as well as streamlining administrative procedures to address supply bottlenecks.

On 14 February 2019, President Duterte signed Republic Act No. 11203, or the "Act Liberalizing the Importation, Exportation, and Trading of Rice, Lifting for the Purpose the Quantitative Import Restriction on Rice, and for Other Purposes."

The law, which became effective on 5 March 2019, replaces quantitative restrictions with tariffs and provides for the Rice Competitiveness Enhancement Fund giving more incentive to farmers to improve productivity and competitiveness. The implementing rules and regulations were issued on 5 April 2019 and were published in the Official Gazette on 8 April 2019. Since then, as shown in earlier slides, inflation has gone down significantly.

With inflation returning to the target, the BSP decided to reduce the policy interest rate by 25 bps to 4.50 percent during its 9 May 2019 policy meeting. The MB's decision was based on its assessment that the inflation outlook continues to be manageable, with easing price pressures owing to the decline in food prices amid improved supply conditions. Latest baseline forecasts

indicate that inflation remains likely to settle within the target range of 3.0 percent \pm 1.0 percentage point for both 2019 and 2020, while inflation expectations have moderated further.

In deciding this, the MB noted the impact of the budget delays on near-term economic activity, but took the view that the prospects for domestic demand remain firm, to be supported by a projected recovery in household spending and the continued implementation of the government's infrastructure program. In addition, the MB observed that the global economic growth momentum has slowed down in 2019. Meanwhile, indications of slower growth in domestic liquidity and credit require careful monitoring.

At the same time, the MB also noted that the risks to the inflation outlook remain broadly balanced for 2019 amid risks of a prolonged El Niño episode and higher-than-expected increases in global oil prices. For 2020, the risks continue to lean toward the downside as weaker global economic activity could temper commodity price pressures.

Looking ahead, the BSP will continue to monitor developments affecting the inflation outlook to ensure that the monetary policy stance remains consistent with its price stability objective.

On the other hand, the passage of Republic Act No. 11211, or an Act Amending Republic Act No. 7653, known as the 'New Central Bank Act' (signed on 14 February 2019) is a significant milestone for the BSP.

Our three pillars of central banking, that of price stability, financial stability, and an efficient payments and settlements system, were further strengthened with the expansion of the BSP's policy toolkit.

The law restored the central bank's authority to issue its own debt papers as part of its regular monetary operations, establishes a stronger prudential regulatory framework to promote a safe and sound financial system through the expansion of supervisory coverage, and authority to prescribe metrics attuned to international standards and practices.

The amendment likewise empowers further the BSP to oversee the country's payment and settlement systems (PSS), including critical financial market infrastructures that are vital components of the PSS.

Additional notes:

The amended BSP Charter restores the central bank's authority to obtain data from any person or entity from the private and public sectors for statistical and policy development purposes in line with the pursuit of our triad mandates.

The law authorizes the increase in the capitalization of the BSP from Php 50 billion to Php 200 billion, which shall be sourced from dividends declared by the BSP in favor of the National Government. Under the amended Charter, the BSP is also exempt from paying taxes on income derived from its governmental functions. These reforms place the BSP on a stronger position to pursue its mandate amidst a growing economy and the increasing sophistication of the financial system.

Looking ahead, we will continue to vigilantly monitor domestic and global developments to ensure that the BSP is able to sustain the "trend" of achieving its inflation targets. The BSP stands ready to deploy appropriate measures as needed to ensure an inflation environment conducive to a sustainable growth of the Philippine economy.

Future policy actions of the BSP will continue to be guided by the following principles:

- 1) primacy on achieving its inflation objective.

- 2) pre-emptively action if the inflation target is considered to be at risk. And
- 3) policy flexibility using all available tools in our enhanced tool kit, as deemed appropriate to address any threats to our inflation objective.

Let me end my presentation with these key notes. Rest assured that the BSP is strongly committed to take all necessary policy actions to safeguard the government's inflation targets and deliver on its primary mandate of price stability to support the country's growth trajectory. Maintaining price and financial stability that will minimize systemic risks, as well as provide resilience to shocks to the economy will help foster an enabling macro-environment that is conducive to accelerating economic growth and help expand its productive capacity.

Ultimately, the BSP's conduct of its monetary policy will always be anchored on its price stability mandate in support of our collective goal of a Philippine economy that is continuously expanding and thriving, for the benefit of all Filipinos. Thank you.