Eli M Remolona: Message during the Development Budget Coordination Committee Briefing

Message by Mr Eli M Remolona, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), during the Development Budget Coordination Committee Briefing for the House of Representatives on the 2025 National Government Budget, Manila, 6 August 2024.

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Introduction

Honarable Speaker Martin Romualdez, Honorable Chair of the Committee on Appropriations Elizaldy Co, Madam Chair Stella Quimbo, Honorable Representatives present at today's briefing, it is my privilege to present our assessment of the monetary and external sector performance of the country. This is to provide the economic context for the macroeconomic assumptions behind the proposed national government budget for fiscal year 2025.

Price stability

Let me start with price stability. In recent years, the Philippines has been affected by an unusual succession of large supply shocks. These shocks changed the dynamics of inflation, and these were reflected in the changing roles of the various components of our CPI (consumer price index) basket.

In early 2022, these supply shocks showed up largely in energy prices. This is shown in the yellow part of the graph. Later, it was food prices other than rice. And this is shown in the blue part of the graph.

These shocks led to the highest inflation rate we had seen in decades. Since August 2023, however, inflation has been dominated by rice prices. This is shown in the red part of the graph. If inflation were driven just by demand, there would be a more even distribution of these different components of inflation.

The recent development with regard to rice prices is important because the price of rice is a salient price.

In our surveys, when people worry about higher prices, we ask them why. Over 90 percent will say it is because of the price of rice. Indeed, there is strong empirical evidence that suggests that rice prices affect inflation expectations to a very large extent. And these inflation expectations lead to second-round effects. This is why the recent government decision in EO 62 (Executive Order 62) to reduce the tariff on rice will be so helpful in our efforts to tame inflation. In the BSP's (Bangko Sentral ng Pilipinas) latest forecast, the rice tariff reduction will have a very significant downside impact on the inflation trajectory until 2025.

Inflation ahead

Let me now say a bit more about our inflation projections. The chart on the left shows the BSP's forecasts on inflation over the coming months. The darkest part in the middle of the blue graph indicates that we expect average inflation to fall within our target range of 2 percent to 4 percent in 2024 and 2025.

The balance of risks to this latest inflation outlook has shifted to the downside, and this is due largely to the implementation of rice tariff reduction.

We still face some upside risks for inflation. These risks will come from higher domestic prices of food items other than rice from transport charges and from electricity rates.

On the right side, we show the trend in inflation expectations based on our survey of external forecasters. The green line shows how inflation expectations for 2024 have evolved. The blue and red lines are expectations about future inflation rates in 2025 and 2026.

The surveys show inflation expectations are well anchored, implying that we have to worry less about second-round effects of supply shocks.

Evolving inflation conditions show that the BSP can hold its policy settings steady for the time being. If price pressures continue to ease, it will be possible for the BSP to consider a less restrictive monetary policy stance.

Nonetheless, lingering supply concerns and geopolitical risks warrant continued and close monitoring of risks to the inflation outlook.

The national government's policies and programs play an important part in helping ease inflation pressures. Shown here are some of the short-term government initiatives to improve food supply that are expected to help.

One is tariff modification and importation measures, a prominent example of which is EO 62. There is also the strong push to enhance productivity through the provision of high-quality seeds, farm and fishery gear and equipment, and other policies that address supply issues.

Banks remain healthy

Along with price stability, the BSP assigns high priority to financial stability.

I am pleased to report that our banks are in good shape.

Their balance sheets are strong, their operations are profitable, and they are very liquid. The graph shows that our banks remain well-capitalized and highly liquid.

The chart on the left, the brown bar, refers to international standards for capital adequacy. The dark purple bar refers to the banks' actual capital adequacy.

As you can see, the actual capital that banks hold exceeds-very significantly-[the] international standards for capital. The chart on the right shows the liquidity coverage of our banks.

The brown bar is the international standard for liquidity. The actual liquidity held by our banks is much higher, as shown by the dark blue bar. These conditions show that our banks are still in a good position to support growth.

I am also pleased to report that more Filipinos continue to join the formal financial system. The chart on the left shows that the share of digital payments in total transactions has reached 52.8 percent, surpassing our target of 50 percent under the Digital Payments Transformation Roadmap for 2018 to 2023.

The chart on the right shows that account ownership among Filipino adults almost doubled to 56 percent in 2021 from 29 percent in 2019. This significant increase was driven by the pandemic-induced shift to digital financial services, particularly e-money account ownership, which was 8 percent in 2019 and is now 36 percent.

Let me now turn to external inflows. The external sector is a picture of resilience. We have sufficient inflows to maintain an ample level of international reserves, which are our defense against external shocks.

The biggest inflows are from remittances. That is shown on the chart on the left and then business process outsourcing, which is the chart in the middle. As you can see, they are increasing.

In contrast, while we continue to record net foreign direct investment inflows, these have weakened in the recent past.

Nonetheless, we expect our inflows to rise even further next year and continue to contribute to building up our reserves. This chart shows the level of our international reserves. It averaged 101 billion US (United States) dollars in last five years. We expect that it will reach 104 billion this year. These reserves are more than ample to defend the country against external shocks.

Assumptions

Having presented the macroeconomic backdrop, here are the assumptions behind the proposed national budget for fiscal year 2025. We assume, based on our forecasts, that headline inflation will remain within our target range of between 2 percent to 4 percent for both 2024 and 2025.

We assume that the price of Dubai crude oil will be within 65 to 85 [US] dollars per barrel based on Dubai crude oil futures prices. We assume that the exchange rate of the peso will be within 55 and 58 pesos against the US dollar. We also assume that the one-year T-bill (Treasury bill) rate will be between 4.5 percent and 5.5 percent.

The 6-month SOFR (secured overnight financing rate), which is the global benchmark short rate in US dollars, is assumed to be between 3.5 percent and 4.5 percent.

Finally, we assume our exports will grow by 6 percent and our imports by 5 percent as global demand recovers and as international trade normalizes.

Let me end by saying that the BSP will continue to support policies that promote price stability, financial stability, and an efficient payments and settlement system, which we think are essential for sustainable and inclusive growth. Thank you very much.