BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 12 DECEMBER 2019[1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) maintain the overnight RRP (borrowing) rate at 4.00 percent; and

b) maintain the current overnight deposit and overnight lending rates at 3.50 percent and 4.50 percent, respectively.

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

- The Monetary Board's (MB) decision to keep the BSP's policy interest rate unchanged was based on its assessment of a benign inflation environment. The latest baseline forecasts continued to indicate that inflation will likely settle within the target band of 3.0 percent ± 1.0 percentage point (ppt) from 2019 to 2021. At the same time, inflation expectations remained well-anchored over the policy horizon.

- In deciding on the stance of monetary policy, the MB also noted that the balance of risks to the inflation outlook continued to lean slightly toward the upside for 2020, but remains tilted to the downside for 2021. Upside risks to inflation over the near term emanate mainly from potential volatility in international oil prices amid geopolitical tensions in the Middle East as well as from the potential impact of the African Swine Fever outbreak and recent weather disturbances on domestic food prices. Meanwhile, uncertainty over trade policies in major economies continue to weigh down on global economic activity and demand which is seen to be the main downside risk to the inflation outlook.

- At the same time, the MB observed that robust domestic demand, improved liquidity conditions owing to recent monetary adjustments, and sustained progress in policy reforms will serve as a buffer against external headwinds. The continued pickup in public spending is also expected to support economic activity.

- The MB agreed that the BSP has scope to keep the policy interest rate unchanged given the benign inflation outlook and firm domestic economic growth prospects. At the same time, keeping monetary policy settings unchanged will enable the recent monetary policy actions to continue working their way through the economy.

[1] The discussions herein reflect the assessment made by the Monetary Board based on a comprehensive set of economic information available at the time of the policy meeting. The highlights of the discussions during the 12 December 2019 monetary policy meeting were approved by the Monetary Board during its regular meeting held on 23 December 2019. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 6 February 2020.

III. Recent Developments and Inflation Outlook

The MB considered the following developments in deciding on the monetary policy stance:

A. Domestic price conditions

- Inflation increased in November 2019, consistent with BSP's forecast path, due to dissipating base effects and higher food and petroleum prices. Headline inflation edged higher to 1.3 percent year-on-year in November 2019 from 0.8 percent in the previous month. This brought the year-to-date average inflation near the midpoint (2.5 percent) of the government's target range of 2-4 percent. The uptick in headline inflation was partially driven by positive base effects during the month amid higher food prices, particularly for meat, fish, vegetables, and dairy relative to the previous year's levels. In the case of non-food items, the impact of continued rollbacks in domestic petroleum prices was offset by the increase in housing rental rates as well as electricity rates for Meralco-serviced areas.

- The PSA core inflation rate—which measures generalized price pressures by excluding volatile items such as food and energy— was steady at 2.6 percent in November. Meanwhile, alternative core inflation measures were either higher (trimmed mean, net of volatile items, and principal component analysis) or lower (weighted median) relative to the previous month's level.

B. Inflation expectations

- Results of the BSP's November 2019 survey of private sector economists for November 2019 showed steady mean inflation forecasts relative to the results in the previous month at 2.5 percent for 2019, 2.9 percent for 2020, and 3.1 percent for 2021.

C. Inflation outlook

- **The latest baseline forecasts indicate that inflation has bottomed out in October 2019 and is likely to settle firmly within the 3.0 percent ± 1.0 percentage point target range by 2019-2021.** Inflation is projected to average at 2.4 percent in 2019 and 2.9 percent in 2020 to 2021. The inflation forecasts for 2019 – 2021 are broadly unchanged as the peso appreciation offset the impact of higher global crude oil prices.

Baseline Inflation Forecasts		
	14 November 2019 MB Meeting	12 December 2019 MB Meeting
2019	2.4	2.4
2020	2.9	2.9
2021	2.9	2.9

- The balance of risks to the inflation outlook over the policy horizon appears to be weighted slightly toward the upside for 2020, but remains tilted to the downside in 2021. Petitions for electricity rates and transport fare adjustments; the proposed increase in the excise taxes of alcoholic beverages; the impact of African swine fever on meat prices; and higher global oil prices are seen as the main upside risks to inflation. Meanwhile, slower global economic growth due to the escalation of protectionist policies in advanced economies as well as geopolitical tensions continue to be the main downside risks to inflation.

D. Demand conditions

- The latest outlook for domestic demand point to stronger economic activity for Q4 2019 and succeeding quarters, supported by continued recovery in public construction, strong tourist arrivals, and expansion in the agriculture sector. Likewise, prospects for domestic economy continue to remain firm over the medium-term.

- In addition, forward-looking indicators for manufacturing production continue to suggest positive momentum in the near term. The average capacity utilization rate of the manufacturing sector rose to 84.5 percent in October from 84.4 percent in September, based on the Philippine Statistics Authority's Monthly Integrated Survey of Selected Industries (MISSI). Meanwhile, the preliminary composite purchasing managers' index (PMI) published by the Philippine Institute for Supply Management remained above the 50-point expansion threshold at 53.2 in November, albeit slightly lower than October PMI reading of 53.6.

- Likewise, overall car sales grew by 3.8 percent year-on-year in October 2019 due to higher passenger and commercial vehicle sales. Total energy sales of Meralco increased by 5.0 percent year-on-year in September 2019 owing to higher energy sales from the residential, commercial, and industrial sectors.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- Domestic rice prices have been stable or trending downwards so far in Q4 2019 as the main harvest season began and as the arrival of rice imports by the private sector continued.

- According to the latest climate advisory of the Philippine Atmospheric, Geophysical and Astronomical Services Administration,[2] ENSO-neutral conditions will likely persist through the remainder of 2019 and are expected to continue until Q2 2020.

<u>Oil Price Developments</u>

- Average Dubai crude oil spot prices increased in November 2019 owing to positive market sentiment towards the US-China phase one trade deal. At the same time, OPEC+ have agreed to extend production cuts until Q1 2020. These recent developments have contributed to the shape of the futures oil prices remaining in backwardation. On the domestic front, prices of petroleum products increased compared to their end-2018 levels.

<u>Developments in the Utilities Sector</u>

- The overall electricity rate increased in November 2019 due to higher power generation charges from the Wholesale Electricity Spot Market during the month. This can be attributed to tighter supply conditions in the Luzon grid and the significantly lower net settlement surplus refund amount.

[2] Seasonal Climate Outlook Report as of 26 November 2019.

F. Financial market developments

- In November, the peso appreciated against the US dollar amid the recent US Federal Reserve rate cut; the release of Philippine inflation data for October which eased to a three-year low; the acceleration in the country's economic growth in Q3 2019; and the rise in gross international reserves (GIR) in October 2019.

G. Domestic liquidity and credit conditions

- Domestic liquidity expanded faster in October. Preliminary data show that domestic liquidity grew faster at 8.5 percent in October (from 7.7 percent in October), while bank lending growth was slower at 9.3 percent in October (from 10.5 percent in the previous month). The higher M3 growth was due the sustained growth in credit to the private sector as a result of higher loans for real estate activities; financial and insurance activities; construction; electricity, gas, steam and airconditioning supply; and wholesale and retail trade, repair of motor vehicles and motorcycles. The expansion in net foreign assets brought about by foreign exchange inflows coming mainly from overseas Filipinos' remittances, business process outsourcing receipts, and foreign portfolio investments also contributed to M3 growth.

- At the same time, expansion in credit activity and the slower growth in bank lending suggest that the transmission of the BSP's 75-basis point (bp) policy rate cut in 2019 as well as the 400-bp reduction in reserve requirement ratio (RRR) may be subject to a considerable time lag.

H. Fiscal developments

- The NG catch-up program for fiscal spending is expected to help sustain the growth momentum in the remainder of 2019. Infrastructure spending by the NG grew by 69.1 percent month-on-month in September from -21.1 percent in August, reflecting the NG's efforts to speed up key projects.

I. External developments

- Growth in global economic activity weakened as expansion in new order inflows slowed down. Manufacturing activity in the US and Japan contracted amid persistently weak demand. Meanwhile, manufacturing activity in China expanded owing to firmer domestic and foreign demand conditions. In other parts of Asia, manufacturing conditions continued to improve for the Philippines as well as Myanmar while the sector remained stagnant for Thailand and Vietnam but in contraction territory for Malaysia, Indonesia, and Singapore.