BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 16 DECEMBER 2021 [1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Keep the overnight RRP (borrowing) rate unchanged at 2.00 percent; and

b) Maintain the accommodative levels of overnight deposit and overnight lending rates at 1.50 percent and 2.50 percent, respectively.

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

- The decision of the Monetary Board is based on the assessment that, while latest inflation forecasts for 2021 and 2022 are higher, the projected inflation path remains within the inflation target band of 2-4 percent over the policy horizon. Supply-side price pressures are also being actively addressed through non-monetary measures. Meanwhile, inflation expectations continue to be anchored within the inflation target band.

- The risks to the inflation outlook continue to lean towards the upside for 2022 while remaining broadly balanced for 2023. Upside risks are linked mainly to the potential impact of continuing constraints on the supply of key food items and petitions for transport fare hikes. Strong global demand amid lingering supply-chain bottlenecks could also exert further upward pressures on international commodity prices. The effective implementation of non-monetary interventions to ensure adequate domestic food supply must be sustained in order to mitigate potential supply-side pressures on inflation. Meanwhile, the emergence of new COVID-19 variants continues to pose downside risks to the outlook for growth and inflation. Nonetheless, the Monetary Board observed that economic growth now appears to be on firmer ground, supported by the Government's accelerated vaccination program and calibrated relaxation of quarantine protocols. In particular, credit activity has gradually recovered in recent months, reflecting improved business activity and market sentiment.

- Upon consideration of these key developments, the Monetary Board sees enough scope to keep a patient hand on the BSP's policy levers owing to

[1] The discussions herein reflect the assessment made by the Monetary Board based on a comprehensive set of macroeconomic and financial information available at the time of the policy meeting. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 17 February 2022.

a manageable inflation environment. At the same time, downside risks to the economic recovery emanate from the emergence of new COVID-19 variants as well as the potential tightening of global financial conditions. Hence, preserving ongoing monetary policy support at this juncture shall help sustain the economy's momentum over the next few quarters.

III. Recent Developments and Inflation Outlook

The Monetary Board considered the following macroeconomic and financial developments in deciding on the monetary policy stance:

A. Domestic price conditions

- Headline inflation eased to 4.2 percent in November 2021 on the back of lower food inflation. Inflation for food slowed down in November, driven by slower price increases of major food items such as, meat, fish, and vegetables. This was due in part to base effects from the significant price increases for these commodities a year ago. By contrast, energy-related inflation continued to drive non-food inflation higher as a result of the increase in electricity rates and still elevated domestic petroleum prices. The year-to-date average inflation to 4.5 percent is above the government's annual target range of 2-4 percent.

- At the same time, demand-driven inflation has remained subdued. Core inflation, which excludes selected volatile food and energy items to depict underlying demand-side price pressures, eased in November to 3.3 percent year-on-year (from 3.4 percent in the previous month). Year-to-date core inflation is at 3.3 percent.

B. Inflation expectations

- Meanwhile, the December 2021 survey round for inflation expectations reflected steady mean inflation forecasts for 2021 and lower mean inflation forecasts for 2022-2023. Private sector economists expect inflation to average at 4.4 percent for 2021.[2] By contrast, mean inflation forecasts for 2022 and 2023 declined to 3.3 percent (from 3.5 percent) and 3.1 percent (from 3.2 percent), respectively.

- Similarly, the preliminary Q4 2021 results of the BSP's Consumer Expectations Survey showed that households anticipate inflation to remain within the government's 2–4 percent inflation target range in 2021 and 2022.

C. Inflation outlook

- The latest baseline inflation forecasts are 4.4 percent for 2021, 3.4 percent for 2022, and 3.2 percent for 2023. Inflation is seen to ease below the high

[2] There were 20 respondents in the BSP's survey of private sector economists in December 2021. The survey was conducted from 9 to 13 December 2021.

end of the target range by December 2021 and further decelerate to below the midpoint of the target range in Q1 2022 due to negative base effects as global oil and non-oil prices moderate from their high levels in the previous year. Inflation is then expected to accelerate close to the high end of the target range by Q3 2022 due to the continued recovery in domestic economic activity and the reversal to positive base effects, before decelerating close to the midpoint of the target by 2023. At the same time, inflation forecasts for 2021 and 2022 are slightly higher due mainly to the higher-than-anticipated inflation outturn in November 2021 partly offset by the decline in the average global oil prices. Meanwhile, forecast for 2023 is broadly unchanged compared to the previous round.

Baseline Inflation Forecasts		
	15 November 2021 MB Meeting	**16 December 2021 MB Meeting**
2021	4.3	4.4
2022	3.3	3.4
2023	3.2	3.2

- The risks to the inflation outlook are weighted slightly on the upside for 2022, but are broadly balanced for 2023. The potential impact of weather disturbances on the prices of key food items and petitions for jeepney fare hikes due to higher oil prices are the upside risks over the near term. The uptick in global prices of non-oil commodities due to strong global demand amid supply chain bottlenecks along with the possibility of a prolonged shortage in pork supply are additional sources of upward price pressures. Meanwhile, the potential impact on domestic growth prospects of delays in the easing of containment measures as well as a weaker-than-expected global recovery owing to the spread of new COVID-19 variants are seen as the main sources of downside risks. In addition, proposals for a six-month suspension in the excise taxes of petroleum products could temporarily reduce inflation, but the impact will like be reversed once excise tax rates revert to previous levels.

D. Demand conditions

- Economic recovery appears to be gaining traction with domestic output projected to expand in Q4 2021, driven by the further loosening of quarantine classification from Alert Level 3 to Alert Level 2 of the whole of Philippines.[3] Similarly, economic expansion is expected to continue in 2022 and 2023, supported by the implementation of the Corporate Recovery and Tax Incentives for Enterprises (CREATE) Law and Financial Institutions Strategic Transfer (FIST) Act as well as improvements in external demand.

- Mobility indicators have trended upward in recent months following the nationwide rollout of the Alert Levels System by the National Government

[3] Per IATF Resolution No. 151-C Series of 2021, all provinces in the country were placed under level 2 except for Apayao. However, Apayao was classified under level 2 effective 3 December 2021 as per IATF Resolution No. 152 Series of 2021.

(NG). For the first week of December, the increase in mobility for the Philippines can also be attributed to seasonal factors related to the Christmas holidays. Driving indicators like Apple and Waze continued to rise in December albeit still below baseline, suggesting that economic activity while still below pre-pandemic levels, has been improving with the shift to less stringent quarantine measures.

The impact of easing restrictions on economic activity can also be seen in data on purchasing managers' indices (PMIs). The composite PMI published by the Philippine Institute for Supply Management (PISM) increased to 50.3 in October, breaching the 50-point expansion threshold. Likewise, the IHS Markit Philippines Manufacturing PMI grew faster in November after gaining 0.7 index point to 51.7 from 51.0 in October. The manufacturing sector expanded for the third consecutive month as easing quarantine restrictions, increased vaccinations, and declining COVID-19 cases underpinned demand recovery.

- The major employment indicators point to better labor market conditions relative to a year ago and the previous month (except for the underemployment rate). The implementation of less stringent quarantine measures in major economic areas in the country resulted in greater economic activities in October 2021, based on the latest round of the labor force survey (LFS). Some of the employment losses since the start of the pandemic In 2020 have also been gradually recovered with the employment level in October 2021 rising above the pre-pandemic level.

E. Supply-side indicators

Developments in Agriculture

- Nationwide average rice prices showed mixed trends based on the November (2nd phase) price survey. Nonetheless, domestic retail rice prices remained generally stable as envisioned with the enactment of R.A. No. 11203.

- Meanwhile, livestock production, particularly the local hog sector contracted at a slower pace in Q3 2021 relative to the previous quarter, which could be attributed to declining African Swine Fever (ASF) cases amid stricter surveillance and monitoring efforts under the *Bantay ASF sa Barangay* program, as well as the hog repopulation initiative implemented by the Department of Agriculture (DA) in partnership with local government units (LGUs), hog raisers, and the private sector. The DA has also rolled-out temporary measures targeted to help stabilize domestic supply of agricultural commodities such as pork, rice, and fish.

- On weather conditions, according to the latest climate advisory of the Philippine Atmospheric, Geophysical and Astronomical Services Administration[4], weak La Niña conditions persist and are expected to

[4] Seasonal Climate Outlook Report as of 24 November 2021.

continue through Q1 2022. La Niña event is associated with above normal rainfall condition, which is anticipated to adversely affect highly vulnerable areas and sectors of the country.

Oil Price Developments

- International oil prices in early December 2021 declined sharply due to demand concerns amid rising cases in Europe along with the emergence of the COVID-19 omicron variant. This downtrend was also supported by the decision of the US, UK, and other Asian countries to release oil reserves to ease elevated prices. Despite demand concerns, Saudi Arabia decided to raise its price for buyers in Asia and the US.

- The futures price curve remained in backwardation, though the path appears to be noticeably lower compared to early November given increased downside risks to global oil demand. In addition, significant uncertainty remains over developments concerning the Omicron variant and possible government responses.

Developments in the Utilities Sector

- The overall electricity rates increased in December 2021 due mainly to higher generation charge. According to Meralco, the upward adjustment in the generation cost was on the back of the inclusion of the first of the four monthly installments covering the deferred costs from the November bill as well as the increase in charges from the Power Supply Agreements (PSAs).[5]

F. Financial market developments

- The peso depreciated slightly against the US dollar for the period 1-13 December 2021 following (i) hawkish statements from the US Federal Reserve amid emerging inflation risks; (ii) concerns over the Omicron variant; and (iii) the release of wider-than-expected Philippine trade deficit in October.[6] Nonetheless, depreciation pressures were partly tempered by positive market sentiment amid (i) the easing of inflation for the third straight month in November; (ii) the decline in unemployment rate in October; (iii) the rise in manufacturing purchasing managers' index (PMI) in November; and (iv) the seasonal increase in Overseas Filipino Workers

[5] The deferred cost pertains to the generation costs arising from the impact of the shutdown of Malampaya natural gas facility on 2-25 October 2021. The Energy Regulatory Commission (ERC) directed Meralco to defer the collection of portions of their suppliers' generation costs and to bill these on a staggered basis beginning this December until March 2022. Meanwhile, charges from the PSA increased due to higher prices of international coal and lower plant dispatch of some PSAs

[6] Data from the Philippine Statistics Authority (PSA) showed that the country's trade deficit widened to $4.01 billion in October from the $2.04-billion gap a year earlier. It was also the biggest deficit since the $4.27 billion posted in January 2019.

(OFW) remittances ahead of the Christmas holiday.[7] The extension of the NG's three-day massive vaccination drive likewise supported the peso.[8]

- Amid continued limitations and economic challenges from the ongoing crisis, the Philippine banking system (PBS) sustained its solid footing characterized by continued growth in assets and deposits, positive net profit, ample capital and liquidity buffers, and adequate loan-loss reserves. Meanwhile, the expiry of mostly of the BSP's relief measures by end-December 2021 has been timed to coincide with the full operationalization of the FIST Act this year. The FIST Act is expected to bolster banks' capital and liquidity position by allowing them to dispose non-performing assets (NPAs). Moreover, the Act will enhance the financial institutions' (FIs) risk-bearing capacity and strengthen their capability to provide financial services to productive sectors of the economy.

G. Domestic liquidity and credit conditions

- Liquidity in the financial system continues to be ample. Preliminary data show that domestic liquidity (M3) expanded by 8.2 percent year-on-year to ₱14.6 trillion in October, slightly slower than the 8.3-percent (revised) growth recorded in September

- At the same time, accommodative monetary policy settings continue to support the normalization and easing of domestic financial market conditions. Credit activity has shown signs of recovery in recent months, reflecting the expansion in business activity amid easing quarantine restrictions, declining COVID-19 cases, and increasing vaccinations. Preliminary data show that outstanding loans of universal and commercial banks (U/KBs), net of RRP placements with the BSP, increased at a faster rate of 3.5 percent year-on-year in October from 2.7 percent in September.

H. Fiscal developments

- The NG recorded a ₱1,203.4 billion fiscal deficit for January – October 2021. Netting out the interest payments in NG expenditures, the primary deficit amounted to ₱832.5 billion, thirty-seven percent higher from the ₱605.5 billion deficit recorded in the previous year. The NG continues to have ample fiscal space to help cushion the pandemic's impact and provide further support to economic recovery.

I. External developments

- Global economic output expanded at a faster rate in November as reduced quarantine restrictions and increased vaccinations supported demand

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[7] The PSA reported that CPI Inflation rate slowed down to 4.2 percent in November from 4.6 percent in October. The unemployment rate fell to 7.4 percent in October from 8.9 percent in September. Meanwhile, the Philippine manufacturing purchasing managers' index (PMI) rose to 51.7 in November from 51 in October. (Source: BusinessWorld online)

[8] The three-day national vaccination drive was extended for two more days. The government had fully vaccinated 37.334 million people as of 2 December 2021. (Source: BusinessWorld online)

conditions in the manufacturing and service sectors. However, prices of raw materials and other production inputs also continued to rise as supply chain disruptions intensified in most advanced economies and their trading partners. The JP Morgan All-Industry Output Index marginally rose to a PMI reading of 54.8 in November from 54.5 in October as higher output, increased new orders, and improving labor prospects underpin demand prospects in the manufacturing and service sectors. In addition, Nikkei ASEAN Manufacturing PMI continued to expand in November at 52.3 as both output and new orders improved due to easing quarantine restrictions. However, the expansion is slower compared to the 53.6 recorded in October as materials shortages and longer delivery times weighed on the sector's overall performance.