HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 20 AUGUST 2020[1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) maintain the overnight RRP (borrowing) at 2.25 percent; and

b) keep the current levels of overnight deposit and overnight lending rates at 1.75 percent and 2.75 percent, respectively.

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

- The Monetary Board's (MB) decision to maintain the BSP's policy interest rate was based on its assessment that the inflation environment remains benign. The latest baseline forecasts indicate that inflation could settle within the government's target range of 3.0 percent ± 1.0 percentage point at 2.6 percent for 2020, 3.0 percent for 2021, and 3.1 percent for 2022. Consistent with the latest baseline inflation forecasts, inflation expectations have remained well within the government's target range.

- In assessing the monetary policy stance, the MB also considered that the overall balance of risks to the inflation outlook remains tilted to the downside for 2021 to 2022. The potential impact of a more disruptive COVID-19 epidemic on global and domestic economic growth is seen as the primary downside risk factor to inflation over the policy horizon. Meanwhile, adjustments in power and water rates are the main upside risks to inflation.

- The MB also observed that the outlook for global economic growth remain subdued and uncertain amid a resurgence in COVID-19 cases in many jurisdictions. The future path of global economic recovery remains subject to downside risk and dependent upon containment of the virus. Furthermore, the MB noted the sharp contraction in domestic output in the first half of 2020 reflecting the impact of the enforcement of necessary measures to contain the spread of the virus in the country. At the same time, early signs of recovery were observed in domestic economic activity with the gradual easing of lockdown restrictions, supported by ample liquidity in the financial system.

- Given these considerations, the MB is of the view that monetary policy settings remain appropriate for the time being. A prudent pause will enable the cumulative 175-basis-point-reduction in the policy rate as well as other monetary and regulatory relief measures by the BSP to fully work their way through the economy, even as the National Government continues to implement interventions to bolster economic activity and protect human lives and livelihoods.

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[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 next meeting of the Monetary Board on the monetary policy stance is scheduled on 1 October 2020.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- Year-on-year headline inflation has increased in June and July 2020 to 2.5 percent and 2.7 percent, respectively. This brought the year-to-date average inflation to 2.5 percent, which remains within the government's 2-4 percent target range. Headline inflation increased in June-July driven mainly by rising transport costs such as, higher domestic petroleum prices and tricycle fare hikes. By contrast, inflation rates have eased for selected key food items such as, fish, fruits, and vegetables.

- Official core inflation, which measures generalized price pressures by excluding volatile food and energy items, rose to 3.3 percent year-on-year in July, driven by higher transport fares. Meanwhile, the month-on-month change in the seasonally-adjusted CPI at 0.4 percent was unchanged from the previous month's rate.

B. Inflation expectations

- Results of the August 2020 BSP survey of private sector economists show a higher mean inflation forecast for 2020 and steady mean inflation forecasts for 2021 and 2022. The mean inflation forecasts for 2021 and 2022 were unchanged at 2.8 percent and 2.9 percent, respectively.

C. Inflation outlook

- The latest baseline forecasts continue to suggest benign inflation environment over the policy horizon. Inflation is expected to average at 2.6 percent for 2020, 3.0 percent for 2021, and 3.1 percent for 2022. These forecasts are higher by 0.3 percentage point (ppt), 0.4 ppt, and 0.1 ppt for 2020 to 2022, respectively, compared to the previous round due primarily to the higher-than-expected inflation outturns for June and July as well as the continued increase in global crude oil prices. These were partly offset by the sharper contraction in domestic economic growth and continued appreciation of the peso.

Baseline Inflation Forecasts		
	Forecast as of 25 June 2020	**Forecast as of 20 August 2020**
2020	2.3	2.6
2021	2.6	3.0
2022	3.0	3.1

- The overall balance of risks to the inflation outlook remains tilted to the downside for 2021 to 2022. The potential impact of a more disruptive COVID-19 pandemic on global and domestic economic growth is seen as the primary downside risk factor to inflation over the policy horizon. Meanwhile, adjustments in power and water rates are the main upside risks to inflation.

D. Demand conditions

- Domestic economic activity is projected to contract at a slower pace in the remaining quarters of 2020 before recovering in 2021 and 2022. The preliminary nowcast for GDP growth indicates that the economy could contract further in Q3 2020. The decline in GDP for the quarter could be driven primarily by the further deterioration in the performance of both the industry and services sectors, which remain heavily affected despite some easing in quarantine measures.

Among the major industries, however, only the agriculture sector recorded an expansion of 1.6 percent in Q2 2020 from -0.3 percent in the previous quarter.

- Forward-looking indicators for manufacturing production suggest momentum remained disrupted. Notwithstanding a further improvement from the June PMI of 43.5, the preliminary composite PMI in July 2020 continued to settle below the 50-point expansion threshold at 45.0. The slower contraction of manufacturing and services more than offset the marginal decline of the retail and wholesale sector. The manufacturing sector's better performance was due to the gradual easing of lockdown measures and travel restrictions, wherein more firms re-opened and operated during the month.

- At the same time, limited improvements in mobility indicators suggest that the public is opting to stay at home, which could affect retail sales and spending for other non-essentials, the same factors that pulled down consumption growth in the previous quarter.

E. Supply-side indicators

Developments in Agriculture

- Domestic rice prices continue to increase amid disruption to the food supply chain due to quarantine measures combined with strong local demand for rice amid relief efforts.

- Meanwhile, according to the latest climate advisory of the Philippine Atmospheric, Geophysical and Astronomical Services Administration,[2] cool ENSO-neutral conditions will likely persist across the tropical Pacific Ocean between end-October and November 2020.

Oil Price Developments

- International oil price continued to rise in July 2020 but was broadly steady in early August as considerable uncertainty over global demand prospects weighed down on prices despite the OPEC+ production cuts. Domestic petroleum prices still posted a net decrease on a year-to-date basis in Metro Manila despite retail outlets imposing a 10-percent tariff increase.

Developments in the Utilities Sector

- The overall electricity rate declined in August 2020 due to lower power generation charges. The decrease in cost of power from the Wholesale Electricity Spot Market (WESM) was due to improved supply situation in the Luzon grid with lower average plant capacity outage. Meanwhile, generation charge from the Power Supply Agreements (PSAs) increased due to lower average plant dispatch and lower Force Majeure (FM) claims[3] in August compared with the previous month.

F. Financial market developments

- In July 2020, the peso appreciated against the US dollar compared to the previous month on market optimism amid Moody's Investors Service's affirmation of the country's credit rating; the continued growth in the gross international reserves (GIR); wider balance of payments (BoP) surplus in May 2020; news of progress in the development of an antiviral drug for COVID-19; and the State of the Nation Address (SONA) of President Duterte, which outlined some measures to support economic recovery amid the pandemic.

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[2] Seasonal Climate Outlook Report as of 22 July 2020.

[3] Due to the significant reduction in power demand in its service area during the implementation of community quarantine protocols, Meralco invoked the Force Majeure provision in its Power Supply Agreements (PSAs) for the duration of the lockdown, reducing fixed charges for generation capacity that would have been charged by suppliers.

G. Domestic liquidity and credit conditions

- Domestic liquidity growth eases in June. Preliminary data show that domestic liquidity (M3) expanded by 14.9 percent year-on-year to about ₱13.6 trillion in June. This was slower than the 16.7-percent expansion in May. Meanwhile, bank lending grew by 9.6 percent in June, though slower than the 11.3-percent growth in May.

- Weakened corporate sector performance in the first half of 2020 reflected in part the slowdown in bank lending. A general decline in net income was reported by firms across key industries based on reports submitted in Q1 2020. Similarly, Q2 2020 earnings performance showed further declines in net profits. Banks continue to note higher loan loss provisioning as a source of the decline in earnings.

- Credit growth is expected to improve over the coming months with continued policy support as the economy gradually reopens and as the BSP's monetary and regulatory measures gain further traction. In terms of alternative compliance with reserve requirements (RR), preliminary data show that for the reserve week ending 23 July 2020, 97 banks have extended loans to micro, small, and medium enterprises (MSMEs) with an average daily balance of ₱84.2 billion. Meanwhile, 13 banks provided loans to large enterprises with average daily loan balance of ₱12.3 billion for the reserve week ending 23 July 2020. Moreover, the Philippine banking system remains well-capitalized to sustain credit activity with a risk-based capital adequacy ratio (CAR) of 15.3 percent on solo basis and 15.9 percent on consolidated basis as of end-March 2020.

- Notwithstanding the Retail Treasury Bond (RTB) offering of the Bureau of the Treasury (BTr),[4] liquidity in the financial system remain ample as a result of the implementation of the BSP's liquidity-enhancing measures. In fact, as the BSP see improvements in domestic liquidity dynamics and market functioning, the BSP started recalibrating its monetary operations. The BSP reopened gradually its TDF for the 7-, 14-, and 28-day tenors. At the same time, the BSP increased the RRP offer volume to its pre-enhanced community quarantine (ECQ) level. These reconfigurations are operational adjustments that are meant to provide better traction on short-term market interest rates while keeping monetary policy accommodative.

H. Fiscal developments

- The National Government (NG) recorded a ₱560.4 billion fiscal deficit for the first half of 2020. Netting out the interest payments in NG expenditures, the primary deficit amounted to ₱372.7 billion, a turnaround from the ₱137.4 billion primary surplus recorded in the previous year.

- Driving economic activity will hinge on the deployment of additional fiscal measures to support domestic demand including extending wage subsidies and loans to support household incomes and ensure employment for displaced workers. Various legislative measures are currently pending in the Senate and Congress to further stimulate incomes and demand.

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[4] The public offer period for the 3-year RTBs was scheduled on 16 July – 7 August 2020, while the settlement date was set on 12 August 2020

I. External developments

- There are signs of recovery in global economic activity amid substantial policy stimulus and easing of restrictions. The JP Morgan Global All-Industry Output Index rose to a six-month high of 50.8 in July from 47.8 in June. Five out of the six sub-sectors covered by the survey registered output growth during the month, with the fastest rate of expansion posted by consumer goods producers. Meanwhile, nine out of the 13 countries for which data are available showed expansions, with the strongest performances recorded in Australia, France, and the UK. Downturns continued in Japan, India, Brazil, and Kazakhstan. Manufacturing conditions in the ASEAN region continue to be below the 50-mark despite the recent upturn in the Nikkei ASEAN Manufacturing PMI to 46.5 in July from 43.7 in the previous month as both output and new orders decreased at softer rates in July than in June. However, it should be noted that downside growth risks are still present with the emergence of COVID-19 cases, which could lead to further disruptions in economic activity.

- The worldwide PMI surveys indicated some strengthening of global economic growth in July particularly in developed economies amid rebounding activity from COVID-19 lockdowns notably in Europe as well as sustained robust expansion in China. US business activity stabilized but remained subdued by virus containment measures. There are likewise concerns that global growth could slow again after the initial rebound amid rising worries over second waves of virus infections.