HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 19 NOVEMBER 2020[1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Reduce the overnight RRP (borrowing) by 25 basis points (bps) to 2.00 percent; and

b) Reduce accordingly the current levels of overnight deposit and overnight lending rates to 1.50 percent and 2.50 percent, respectively.

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

- The Monetary Board's (MB) decision to cut the BSP's policy interest rate was based on its assessment of a manageable inflation environment. The latest baseline forecasts indicate that inflation could settle within the government's target range of 3.0 percent ± 1.0 percentage point at 2.4 percent for 2020, 2.7 percent for 2021, and 2.9 percent for 2022. At the same time, inflation expectations have remained well-anchored over the policy horizon.

- In assessing the monetary policy stance, the MB also noted that the overall balance of risks to the inflation outlook remains tilted to the downside for 2020 to 2022. Downside risks to inflation over the policy horizon emanate mainly from the potential impact of a more disruptive COVID-19 epidemic on global and domestic economic growth. Meanwhile, adjustments in the power rates is the main upside risk to inflation.

- The MB also observed that the outlook for global economic growth have slightly improved following the easing of lockdown measures among major economies. Nevertheless, the pace of the recovery remains uneven amid a resurgence in COVID-19 cases in many jurisdictions. Furthermore, the MB noted that economic contraction in the first three quarters of 2020 was driven by decline in consumption and investment, reflecting the impact of the enforcement of necessary measures to contain the spread of the COVID-19 virus. At the same time, the impact of recent natural calamities could pose strong headwinds to domestic economy recovery in the coming months.

- Given these considerations, the MB is of the view that there is a room for a reduction in the policy rate to bolster economic activity and boost market confidence amid heavy downside risks to growth. The continued accommodative monetary policy settings will provide an environment of affordable financing to support investments and consumption under an inclusive and sustainable economic recovery. In addition, the further reopening of the economy and additional fiscal support should foster confidence in firms and households and aid in a strong rebound in 2021.

[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 17 December 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 to 2.5 percent in October from 2.3 percent in the previous month. This brought the year-to-date average inflation to 2.5 percent, which remains within the government's 2-4 percent target range. Price pressures In October stemmed mainly from higher food and non-alcoholic beverages component. In particular, meat inflation increased due mainly to some tightness in pork supply amid the spread of African Swine Fever virus. Likewise, fish inflation went up as the lean fishing season combined with adverse weather conditions limited catches and disrupted unloading in fish ports. By contrast, non-food inflation eased during the month as lower international oil prices led to rollbacks in gasoline and diesel prices.

- Official core inflation, which excludes selected volatile food and energy items to measure underlying price pressures, moderated to 3.0 percent year-on-year in October from 3.2 percent in the previous month. The diverging trend of headline and core inflation may have been due in part to the exclusion of meat and fish price index (sub-classes level)—the main drivers for the increase in headline inflation—from the core CPI index.

B. Inflation expectations

- The latest results of the BSP's survey of private sector analysts show steady mean inflation forecast for 2020. The survey for November 2020 showed unchanged mean inflation forecast for 2020 at 2.4 percent. Likewise, the mean inflation forecast for 2022 remained at 2.9 percent while the mean inflation forecast for 2021 declined to 2.7 percent from 2.8 percent in the previous survey round.

C. Inflation outlook

- The latest baseline forecasts indicate that inflation is expected to settle firmly within the 3.0 percent ± 1.0 percentage point target range for 2020 to 2022. Inflation is expected to average at 2.4 percent for 2020, 2.7 percent for 2021, and 2.9 percent for 2022. The forecast for 2020 was revised upwards by 0.1 percentage point (ppt) due to the higher-than-expected inflation outturn in September and October 2020. Meanwhile, forecasts for 2021 and 2022 were both lower by 0.1 ppt compared to the previous round mainly from slower domestic economic activity, lower global crude oil prices, and a stronger peso.

Baseline Inflation Forecasts		
	Forecast as of 1 October 2020	**Forecast as of 19 November 2020**
2020	2.3	2.4
2021	2.8	2.7
2022	3.0	2.9

- The overall balance of risks to the inflation outlook remain tilted to the downside for 2020 to 2022. The potential impact on global and domestic economic growth prospects of a more disruptive COVID-19 pandemic due to social distancing measures and recurring waves of infection is the primary downside risk to inflation. Meanwhile, adjustments in electricity rates is the main upside risk to inflation.

D. Demand conditions

- Domestic economic activity is projected to remain in contraction for the last quarter of 2020 before recovering in 2021 and 2022. The latest nowcast for Q4 2020 indicates that the economy could contract but at a slower pace. The industry and services sector remain heavily affected despite some easing in quarantine measures. In particular, the projected weakness in manufacturing and construction activities is expected to drive the decline in the industry sector, albeit at a slower pace compared to Q2 2020 in line with the slight improvements recorded in the MISSI data. Similarly, the services sector could continue to contract driven mainly by the slowdown in transport, tourism, and other service activities. Moreover, the growth in agriculture is projected to decelerate in the quarter due to the impact of weather disturbances on production.

- Forward-looking indicators for manufacturing production suggest momentum remained disrupted. The preliminary composite PMI in October 2020 remained below the 50-point expansion threshold at 48.0, albeit higher than the September PMI of 46.3. This may be attributed to the slower contraction of the manufacturing and retail and wholesale sectors, as well as the expansion of the services sector (the first time since March), due largely to a rebound in overall demand following the gradual easing of quarantine restrictions across the country.

- On the other hand, while quarantine measures in NCR and surrounding provinces have eased mobility has increased in locations such as groceries and pharmacies, parks, and retail and recreation but still below their pre-pandemic levels. This could affect retail sales and spending for other non-essentials goods and services, impacting consumption growth in the near-term.

E. Supply-side indicators

Developments in Agriculture

- Domestic retail rice prices continue to decline due to ample supply and move closer to international prices as envisioned with the enactment of R.A. No. 11203.

- Meanwhile, tropical cyclones (TCs) made landfall in parts of the country and caused damage to the agriculture sector. As of 4 November 2020, the Department of Agriculture recorded total damage and losses of ₱5.6 billion brought about by TCs Nika, Ofel, Pepito, Quinta, and Rolly. Among the commodities affected, rice recorded the most damage and losses followed by high value crops.

- According to the latest climate advisory of the Philippine Atmospheric, Geophysical and Astronomical Services Administration,[2] weak to strong La Niña is expected until April 2021, which is anticipated to adversely affect vulnerable areas and sectors of the country.

Oil Price Developments

- International oil prices continued to decline thus far in November on demand concerns amid resurgence of COVID-19 and re-imposition of lockdown measures in Europe, along with higher production from Libya and upcoming easing of OPEC+ production cuts. In the domestic front, prices of domestic petroleum products continued to post a net decline compared to end-2019.

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

Developments in the Utilities Sector

- The overall electricity rate went up in October 2020 due to higher power generation charges. This was primarily due to the tightened supply conditions in the Luzon grid and heightened demand conditions, pushing cost of power from the Wholesale Electricity Spot Market to go up. Similarly, charges from Power Supply Agreements increased as there were no more Force Majeure claims for the September supply, along with the rise in demand. Meanwhile. purchases from Independent Power Producers edged lower mainly due to higher average plant dispatch.

F. Financial market developments

- For the first two weeks of November 2020, the peso appreciated against the US dollar due partly to market expectation of a slower contraction in the country's Q3 2020 Gross Domestic Product (GDP) and news of the election of Democrat candidate Joseph Biden during the US presidential election.

G. Domestic liquidity and credit conditions

- Domestic liquidity growth eases in September. Preliminary data show that domestic liquidity (M3) expanded by 12.3 percent year-on-year to about ₱13.5 trillion in September. This was slower than the 13.7-percent expansion in August. Likewise, bank lending eased to 2.8 percent in September from 4.7 percent in August.

- The general decline in bank growth partly reflects banks' reduced tolerance for risk, decline in loan demand due, in turn, to weak business and income prospects and observed shift by non-financial corporates to alternative sources of funds. Moreover, the banking system's non-performing loan (NPL) ratio increased as of end-August 2020. Meanwhile, provisions on loan losses increased to 107.3 percent from 91.4 percent end- March 2020. Nevertheless, banks regularly monitor their lending portfolios for possible early warning signals of significant deterioration in asset quality.

- Liquidity in the financial system remains ample as a result of the BSP's extraordinary liquidity-enhancing measures. The increased liquidity in the financial system is reflected in oversubscriptions in the T- bill and T-bond auctions by the Bureau of the Treasury in November 2020, which have resulted in full awards on the back of strong demand for GS amid manageable inflation expectations. Similar oversubscriptions have been observed in TDF, RRP, and the BSP bills auctions, while transactions in the interbank market and overnight lending facility (OLF) of the BSP have diminished significantly.

H. Fiscal developments

- The National Government (NG) recorded a ₱879.2 billion fiscal deficit for the first nine months of 2020. Netting out the interest payments in NG expenditures, the primary deficit amounted to ₱566.2 billion, a turnaround from the ₱5.2 billion primary deficit recorded in the previous year.

I. External developments

- Global economic output continues to show signs of recovery amid improving demand conditions. Nonetheless, resurgence of COVID-19 cases continues to dampen sentiment and prospects for a sustained recovery as containment measures are reimposed. The JP Morgan Global All-Industry Output Index rose from 52.5 in September to 53.4 in October. Five out of the six sub-sectors covered by the survey registered output growth during the month, solid growth recorded in business services, financial services, intermediate goods, and investment goods. Output expanded in the US, mainland China, India, and Australia. Contractions were registered in Japan and Kazakhstan. Economic activity in the Euro area stagnates, with the composite PMI easing in October as the economic recovery in the region stalled with the reimposition of containment measures to fight the resurgence of COVID-19 infections in many jurisdictions.

- Meanwhile, manufacturing conditions in the ASEAN region continue to deteriorate. Across the seven monitored countries, Thailand, Vietnam, and Singapore registered improvement in operating conditions. Meanwhile, Indonesia, Malaysia, Myanmar, and the Philippines recorded contractions in their respective operating conditions in October.