BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 18 NOVEMBER 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 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 its assessment that inflation is likely to decelerate in the remaining months of 2021 with full-year inflation slightly exceeding the upper end of the target band. Meanwhile, the inflation forecasts for 2022 and 2023 are seen to return to within target range of 2-4 percent as the sharp rise in global crude oil prices, the stronger recovery in domestic growth, and the slight depreciation of the peso were mostly offset by the recent lower-than-expected inflation outturns. Moreover, inflation expectations remain firmly aligned with the baseline projection path.

- In assessing the monetary policy stance, the Monetary Board also noted that the risks to the inflation outlook have shifted slightly toward the upside for 2022 even as they remain broadly balanced for 2023. Upside risks may emanate from the potential impact of weather disturbances on prices of key food items, petition for jeepney fare hikes due to higher oil prices, uptick in international non-oil commodity prices amid strong global demand and supply-chain bottlenecks, and the possibility of prolonged shortage in pork supply. Meanwhile, main sources of downside risks include the negative impact on domestic economic growth prospects of possible delays in the easing of containment measures and a weaker-than-expected global recovery due to the spread of new and more virulent COVID-19 variants.

- The Monetary Board likewise observed that economic growth appears to be gaining solid traction, driven by improved mobility and sentiment amid the calibrated easing in quarantine protocols and progress in the Government's vaccination rollout. Nonetheless, the Monetary Board noted

[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 16 December 2021.

that sustained measures to safeguard public health and welfare remain crucial to facilitate the recovery in investment and employment.

- On balance, the Monetary Board was of the view that there remains scope to hold monetary policy settings steady amid a manageable inflation environment. The Monetary Board maintains that keeping a patient hand on the BSP's policy levers, along with appropriate fiscal and health interventions, will help sustain the economic recovery over the next few quarters.

- Looking ahead, the Monetary Board emphasized that the BSP will continue to prioritize providing policy support for the economy while keeping an eye on the potential risks to future inflation. At the same time, the BSP stands ready to respond to potential second-round effects arising from supply-side pressures, in line with its price and financial stability objectives.

III. Recent Developments and Inflation Outlook

The Monetary Board considered the recent macroeconomic and financial developments listed below in deciding the appropriate monetary policy stance:

A. Domestic price conditions

- Headline inflation eased to 4.6 percent in October 2021, stemming from slowdown in food inflation. Inflation for food slowed down in October, mainly driven by price stabilization for meat and fish prices with the availability of imported supply. Conversely, non-food inflation increased due to higher energy-related price upticks. This brought the year-to-date average inflation to 4.5 percent, exceeding the government's annual target range of 2-4 percent.

- Core inflation, which excludes selected volatile food and energy items to depict underlying demand-side price pressures, inched up to 3.4 percent year-on-year in October 2021 from the previous month's print of 3.3 percent.

B. Inflation expectations

- The November 2021 survey round on inflation expectations show steady mean inflation forecasts for 2021 and 2023 and a higher mean inflation forecast for 2022 - albeit still within the government's target range of 2-4 percent. The results of inflation forecasts show that private sector economists expect inflation to average at 4.4 percent for 2021.[2,3] By

[2] There were 21 respondents in the BSP's survey of private sector economists in October 2021. The survey was conducted from 6 to 26 October 2021.

[3] There were 21 respondents in the BSP's survey of private sector economists in November 2021. The survey was conducted from 9 to 12 November 2021.

contrast, the mean inflation forecasts for 2022 increased to 3.5 percent (from 3.4 percent in the previous month's survey round) while it remained at 3.2 percent for 2023.

C. Inflation outlook

- The latest baseline inflation forecasts are 4.3 percent for 2021, 3.3 percent for 2022, and 3.2 percent for 2023. The inflation path is seen to revert to within the target in November 2021 and further decelerate close to the low end of the target range in Q1 2022. This may be attributed to the expected further moderation in food inflation due to the direct supply-side measures implemented by the National Government as well as the negative base effects due to the deceleration in the uptick of global oil and non-oil commodity prices. The lower inflation forecast for 2021 is due to the lower-than-expected inflation prints in September and October 2021. Meanwhile, the inflation forecasts for 2022 and 2023 were unchanged compared to the previous round as the sharp rise in global crude oil prices, the stronger recovery in domestic growth, and the slight depreciation of the peso were mostly offset by the recent lower-than-expected inflation outturns.

Baseline Inflation Forecasts		
	23 September 2021 MB Meeting	**18 November 2021 MB Meeting**
2021	4.4	4.3
2022	3.3	3.3
2023	3.2	3.2

- The risks to the inflation outlook are now seen to be weighted slightly toward the upside for 2022 but remains broadly balanced for 2023. The potential impact of weather disturbances on the prices of key food items, jeepney fare hike petitions, and the possibility of a prolonged recovery in domestic pork supply are the major domestic upside risks. Furthermore, the uptick in global prices of non-oil commodities due to strong global demand amid supply chain bottlenecks are additional external sources of upward price pressures. Meanwhile, the negative impact on domestic economic growth prospects of possible delays in the easing of containment measures as well as a weaker-than-expected global recovery owing to the spread of new and more virulent COVID-19 variants are the main sources of downside risks. Additionally, proposals for a six-month suspension in the excise taxes of petroleum products could temporarily reduce inflation, but the impact is seen to be offset once the excise tax rates revert to previous levels.

D. Demand conditions

- The staff's full-year growth forecasts for 2021 and 2022 were revised upwards to reflect the higher-than-expected Q3 2021 growth figure as well as the easing of quarantine measures in Metro Manila and surrounding provinces. In addition, election-related spending is expected to contribute to domestic economic activity in the first half of 2022. Meanwhile, the economic recovery in 2022 to 2023 is expected to be supported by the implementation of the CREATE and FIST laws as well as improvements in external demand buoyed by stronger outlook in the country's major trading partners. The latest forecasts also show that the country's real GDP will return to its 2019 level by Q3 2022. This implies that the economy will likely operate below full capacity in the near term with firms and households gradually adjusting to post-pandemic economic conditions over time.

- Mobility indicators have trended upward in recent months as the National Government moved to a more granular approach to lockdowns with the implementation of the Alert Levels System. Mobility data from Google are at an all-time-high since March 2020 and this is likewise mirrored in the near-normal congestion levels for Manila.

- Substantial spare capacity remains in the labor market. The unemployment rate slightly increased in September to 8.9 percent as major economic areas in the country remained under stringent and blanket quarantines during the month. Meanwhile, the labor force participation rate declined as more young people resumed classes in public schools. Nonetheless, some of the employment losses brought on by the onset of the pandemic in 2020 have been gradually recovered as the employment level in September 2021 was above the pre-pandemic level. However, the quality of employment shows a rather slow recovery as the recent employment gains were mostly low-skilled and nonremunerative.

E. Supply-side indicators

Developments in Agriculture

- **Nationwide average rice prices fall in October survey amid the onset of the main harvest season.** Moreover, private sector import arrivals continued to boost the supply of rice. Based on the results of the PSA Retail Price Survey (RPS) from selected trading centers in key cities per region, average prices of regular milled rice (RMR) in key cities outside NCR declined in the second phase of the October survey round. RMR prices in NCR likewise fell, and the nationwide average price for RMR eased. Meanwhile, even as well milled rice (WMR) prices in NCR declined significantly as the harvest from nearby provinces boost supply, the nationwide average still recorded a marginal increment in the latest round as average prices of WMR in key cities outside NCR inched up in the second phase of the October 2021 survey round.

- Meanwhile, the Department of Agriculture (DA) has rolled-out temporary measures targeted to help stabilize domestic supply of agricultural commodities such as pork, rice, and fish.

- On the developments in the African Swine Fever (ASF) situation in the country, the DA reported that as of 23 October 2021, ASF-affected areas were down to only 20 cities and municipalities in 5 provinces from the total of 624 cities and municipalities in 50 provinces affected since ASF hit the country in 2019. The improvement may be attributed mainly to the impact of stricter surveillance and monitoring efforts under the *BABay ASF* program, as well as the hog repopulation initiative implemented by the DA in partnership with local government units (LGUs), hog raisers, and the private sector.

- On weather conditions, weak La Niña conditions persist and are expected to continue until Q1 2022. For the period November 2021 to February 2022, around 3 – 6 tropical cyclones (TCs) may enter or develop within the Philippine Area of Responsibility (PAR). Two to three TCs will likely develop in November, one to two in December, and zero to one TC per month for the period January-April 2022.

<u>Oil Price Developments</u>

- International oil prices surged for most of October due to some tightness in the global energy market. There has been a strong demand for oil products amid gradual easing of coronavirus-related restrictions, seasonal heating demand with upcoming winter, and gas-to-oil switching amid elevated gas and coal prices. The increase in global oil prices were reflected in the domestic pump prices of petroleum products, which were the main drivers of non-food inflation. Consequently, transport groups have decided to submit a petition with LTFRB requesting for a fare hike in jeepney fares. In response, the government has approved a ₱1.0-billion fuel or cash subsidy to mitigate the impact of higher fuel prices.

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

- **The overall electricity rate increased slightly in October 2021 due mainly to higher transmission charges.** The higher ancillary service charges, which accounted for about 33 percent of the National Grid Corporation of the Philippines' (NGCP) total transmission charge, led to the increase in transmission charge according to MERALCO.

- Meanwhile, the decline in generation charges partly offset the rise in the overall electricity rate. Charges from Wholesale Electricity Spot Market (WESM) fell on the back of lower average capacity on outage and average demand in the Luzon grid for the September 2021 supply month. Similarly, charges from Independent Power Producers (IPPs) also eased. Meralco noted that the cost of the usage of alternative liquid fuel during the Malampaya gas supply restriction in September 2021 is not yet included in the charges and will be billed in subsequent months. The decline in WESM and IPP charges were offset by the increase in charges from Power Supply Agreements (PSAs) as a result of higher fuel prices and the depreciation of the peso against the US dollar.

F. Financial market developments

- In November, the Philippine Stock Exchange index (PSEi) continued to rise on investor optimism over the further easing of restrictions in the country amid the continued decline in COVID-19 cases. On 8 November, the PSEi closed at 7,396.22 index points, higher by 4.8 percent than the closing index in end-October and by 3.6 percent year-to-date. The rise in the index was also supported by reports on improving manufacturing activity and easing headline inflation in October, upward revision in the Q2 GDP estimate to 12 percent, and continued strong Q3 corporate earnings released by index heavyweights.

- The peso appreciated against the US dollar in early November amid positive market sentiment following the release of strong Philippines Purchasing Managers' Index (PMI) data for October 2021. On a year-to-date basis, the peso depreciated against the US dollar along with most Asian currencies, except the Chinese yuan and New Taiwan dollar.

- 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 latest supervisory data on the PBS's non-performing loans (NPL) indicate a continued weakening in loan quality but remaining manageable and within the BSP's expectations.

- The expiration for most of the BSP's relief measures by end-December 2021 has been timed to coincide with the full operationalization of the Financial Institutions Strategic Transfer (FIST) Act by 2021 which 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

- The BSP's current accommodative monetary policy settings support the easing of domestic financial market conditions, with market interest rates at record-low levels and an on-going budding recovery in bank lending. Recently, there is an observed pick up in credit activity, reflecting modest recovery in banks' lending attitude on improved economic prospects. Results of the Q3 2021 SLOS also show that fewer number of banks reported tightened lending standards compared to Q2 2021.

H. Fiscal developments

- **The NG recorded a ₱1,139.1 billion fiscal deficit for January – September 2021.** Netting out the interest payments in NG expenditures, the primary deficit amounted to ₱799.8 billion, forty-one percent higher from the ₱566.2 billion deficit recorded in the previous year. This implies that 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 activity expands in October as businesses resume operations on the back of easing quarantine restrictions, declining COVID-19 cases, and increasing vaccinations. Meanwhile, supply chain disruptions suppress the global economy's recovery momentum.** Services activities registers a faster rate of expansion which reduced the impact of a mild deceleration in the manufacturing, as indicated by the higher PMI reading for the JP Morgan Global All-Industry Output Index of 54.5 in October from 53.3 in the previous month.

- In its October 2021 WEO Update, the IMF lowered its growth projection for 2021 compared to its July 2021 WEO forecasts, citing the worsening pandemic dynamics and the prolonged supply chain disruptions. At the same time, balance of risks to the global growth outlook remains tilted to the downside in view of rising inflation and an abrupt tightening of global financial conditions, continued volatility in financial markets, and worries over the possible emergence of more transmissible and fatal COVID-19 variants.