# HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 8 AUGUST 2019[1]

## I. Monetary Policy Decision

The Monetary Board decided to:

a) reduce the overnight RRP (borrowing) rate by 25 basis points (bps) to 4.25 percent; and

b) reduce the current overnight deposit and overnight lending rates by 25 bps to 3.75 percent and 4.75 percent, respectively.

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

- The Monetary Board's (MB) decision to reduce the BSP's policy interest rate was based on its assessment that the broad range of recent economic data points to a continued deceleration in the inflation momentum, while growth prospects for domestic expansion remain firm. The latest baseline forecasts indicate that inflation will continue to ease and settle within the 3.0 percent ± 1.0 percentage point target range for 2019 - 2021. Meanwhile, amid the projected slowdown in both global and domestic economic growth, the monetary policy easing bias is seen to support domestic demand.

- In deciding on the stance of monetary policy, the MB also noted that prospects for global economic activity are likely to remain weak due largely to sustained trade tensions among major economies. Meanwhile, on the domestic front, the growth outlook continues to be firm on the back of a projected recovery in household spending as well as the accelerated implementation of the government's infrastructure spending program.

- At the same time, the MB observed that the risks to the inflation outlook remain broadly balanced for 2019 and 2020, while they are seen to tilt to the downside for 2021. Weaker global economic prospects continue to temper the inflation outlook. Meanwhile, the potential adverse effects of a prolonged El Niño episode to inflation have subsided.

- The MB believed that a prudent adjustment in its monetary policy settings will allow the BSP to observe and assess the impact of the 25-bps reduction in the policy rate during the previous quarter, including the 200-bps phased reduction in the reserve requirement. Looking ahead, the BSP will continue to monitor the emerging cumulative impact of monetary policy easing on the domestic 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 8 August 2019 monetary policy meeting were approved by the Monetary Board during its regular meeting held on 29 August 2019. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 26 September 2019.

## III. Recent Developments and Inflation Outlook

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

### A. Domestic price conditions

- Inflation momentum eased further owing mainly to lower food prices amid sufficient food supply conditions and the continued arrival of rice imports. Headline inflation decreased in July to 2.4 percent from 2.7 percent in the previous month. This brought the year-to-date inflation rate to 3.3 percent, which is within the 2-4 percent government-announced inflation target range for 2019. Meanwhile, non-food inflation edged up slightly in July due mainly to base effects following the implementation of the free tuition program by the National Government (NG) at the public tertiary level in 2018. Nonetheless, this was offset by the reduction in electricity rates and lower transport inflation.

  Relative to the previous month's levels, both seasonally-adjusted month-on-month inflation and non-seasonally-adjusted month-on-month inflation were slightly lower.

- The official core inflation—which excludes certain volatile food and energy items—also decelerated further to 3.2 percent in July 2019 from 3.3 percent in June. Meanwhile, preliminary data on the alternative core inflation measures showed mixed results.

- The diffusion index of price changes turned negative in July 2019 as the number (and share) of inflation-increasing items is now lower than the number of inflation-decreasing items. In addition, the number of CPI items above the threshold of 4.0 percent decreased in July.

### B. Inflation expectations

- Results of the BSP's July 2019 survey of private sector economists showed lower mean inflation forecasts for 2019 and 2020 at 2.8 percent (from 2.9 percent in the June 2019 survey round) and 3.1 percent (from 3.2 percent), respectively. Meanwhile, the mean inflation forecast for 2021 was steady at 3.1 percent.

### C. Inflation outlook

- The latest staff baseline forecasts indicate that average inflation will continue to ease and settle within the 3.0 percent ± 1.0 percentage point target range for 2019-2021. Inflation is projected to average at 2.6 percent for 2019 and 2.9 percent for 2020, slightly lower relative to the previous monetary policy meeting's forecasts of 2.7 percent for 2019 and 3.0 percent for 2020. The downward revision in the staff inflation forecasts can be attributed to weaker global and domestic GDP growth, lower global crude oil and non-oil prices, and slower domestic liquidity growth. Meanwhile, the preliminary forecast for 2021 indicates that inflation will settle close to the midpoint of the target range.

| **Baseline Inflation Forecasts** | | |
|---|---|---|
| | 20 June 2019 MB Meeting | 8 August 2019 MB Meeting |
| 2019 | 2.7 | 2.6 |
| 2020 | 3.0 | 2.9 |
| 2021 | n.a. | 2.9 |

- The risks to the inflation outlook appear to be broadly balanced for 2019 and 2020, but are tilted to the downside in 2021. Petitions for electricity rates and transport fare adjustments, the proposed increase in the excise taxes of alcoholic beverages, and the potential impact of a prolonged El Niño episode are the main upside risks to future 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 the projected inflation path.

**D. Demand conditions**

- The slower expansion of real GDP for Q2 2019 at 5.5 percent from 5.6 percent in Q1 2019, reflected mainly the budget impasse early in the quarter, together with slower growth in manufacturing activities due to weak external demand. Nonetheless, firm domestic demand conditions and accelerated NG spending are expected to support domestic growth in the second half of 2019.

- Meanwhile, the composite purchasing managers' index (PMI) remained above the 50-point expansion threshold at 53.4 in June, faster than the May PMI which was at 51.5. The average capacity utilization rate of the manufacturing sector stood at 84.3 percent in June, unchanged from the month-ago level, based on the Philippine Statistics Authority's Monthly Integrated Survey of Selected Industries (MISSI).

**E. Supply-side indicators**

Developments in Agriculture

- Domestic rice prices were generally stable in June to early-July, although minimal uptick in rice prices were observed in Bulacan, Nueva Ecija, and Zamboanga del Norte as the summer harvest season tails off.

- A prolonged El Niño episode presents a potential upside risk to food inflation in the near term. Nevertheless, according to the Philippine Atmospheric, Geophysical and Astronomical Services Administration's (PAGASA's) latest climate advisory,[2] the current weak El Niño condition is expected to end and transition to ENSO-neutral condition in August 2019.

Oil Price Developments

- Average crude oil spot prices generally increased in July over weather-related production disruptions in the Gulf of Mexico as well as Venezuela's widespread power outages. Nevertheless, crude oil price gains were limited, as seen in the early-August daily spot prices of Dubai crude oil, due largely to weaker oil demand growth amid the escalation of the US-China trade dispute. Meanwhile, futures prices remained in backwardation—wherein future-dated contracts are lower than current prices—often brought about by geopolitical tensions and supply disruptions which could raise prices in the near term.

Developments in the Utilities Sector

- The overall electricity rate fell in August 2019 due mainly to lower generation charge from the Wholesale Electricity Spot Market (WESM) on the back of improved supply conditions in the Luzon grid. Similarly, generation charges from the Power Supply Agreements (PSAs) decreased

[2] Seasonal Climate Outlook Report as of 24 July 2019

due to lower fuel prices and the appreciation of peso against the US dollar. Meanwhile, the decline in generation charges from WESM and PSA offset the higher charges of Independent Power Producers (IPPs) as a result of quarterly repricing of Malampaya natural gas and continued decline in coal price.

**F. Financial market developments**

- In July, the peso appreciated against the US dollar amid renewed expectation of a US Federal Reserve rate cut following the release of weaker-than-expected US data on housing starts, new jobs, and non-manufacturing sector for June 2019. However, the peso depreciated during the first week of August relative to the average in July, on the back of escalating trade tension between the US and China.

**G. Domestic liquidity and credit conditions**

- Domestic liquidity was broadly steady while credit growth slowed down. In June, domestic liquidity grew by 6.4 percent, unchanged from the rate of expansion in May, while bank lending expanded at a slightly slower rate by 10.5 percent (from 11.9 percent). The increase in M3 growth was due to the expansion in net foreign assets. Meanwhile, domestic market interest rates (deposit and lending rates) have decreased following the 25-bps BSP's key policy rate reduction on 9 May 2019, and the phased reduction in banks' RRR.

**H. Fiscal developments**

- The catch-up in fiscal spending is expected to buoy the growth momentum in 2019. With the 2019 national budget signed by the President in mid-April, government spending is expected to resume for the year. The NG recorded a ₱42.6-billion fiscal deficit for the first half of 2019, which is seventy-eight percent lower than the deficit recorded in 2018.

**I. External developments**

- Growth in global economic activity is steady as global service sector output expanded while the output performance of manufacturing sub-sectors were mixed. The expansion in US manufacturing activity was slower in June as new export orders remained weak. Meanwhile, manufacturing activity in Japan remained in contraction territory amid falling exports. Similarly, manufacturing activity in China entered into contraction as total new business and international sales slumped due largely to continued trade tensions.

- According to the International Monetary Fund (IMF), downside risks have intensified since the April 2019 World Economic Outlook. These risks include escalating trade and technology tensions, the possibility of a protracted risk-off episode that exposes financial vulnerabilities accumulated over years of low interest rates, geopolitical tensions, and mounting disinflationary pressures that make adverse shocks more persistent.

  The downward revision of the IMF of its global economic growth projections in July reflected the weaker-than-expected global activity based on GDP releases so far this year, together with generally softening inflation. For emerging market and developing economies, the lower forecast in July relative to April was due mainly to the expected impact of tariffs on trade and investment activities.