BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 1 OCTOBER 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 latest baseline forecasts continue to suggest a benign inflation environment over the policy horizon. These forecasts indicate that inflation could settle within the government's target range of 3.0 percent ± 1.0 ppt at 2.3 percent for 2020, 2.8 percent for 2021, and 3.0 percent for 2022. Likewise, inflation expectations have remained well within the government's target range in 2020 and 2021.

- The MB has also taken into consideration that the overall balance of risks to the inflation outlook remain tilted to the downside. 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 utility rates are the main upside risks to inflation.

- In its further assessment of the monetary policy stance, the MB also observed that global economic output has been expanding as lockdowns and other restrictions in response to the COVID-19 pandemic eased in many territories. The projected 2021 recovery is seen to be characterized by persistent social distancing until health risks are addressed, and countries may have to again tighten mitigation measures depending on the spread of the virus. Although manufacturing conditions in the ASEAN region are near stabilization, domestic economic activity is projected to contract at a slower pace in the remaining quarters of 2020 before recovering in 2021 and 2022.

- Based on these remarks, the MB is of the view that the BSP can maintain its continued pause given the benign inflation outlook, anchored inflation expectations, and improving economic activity for the rest of the year. Furthermore, the BSP has room to maintain current policy settings as further fiscal measures come onstream while the impact of the BSP's policy easing measures continue to work their way through the 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 next meeting of the Monetary Board on the monetary policy stance is scheduled on 19 November 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 eased in August to 2.4 percent from 2.7 percent in July on the back of lower food prices. 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 slowed down in August amid adequate domestic supply of key food items.

- Official core inflation, which measures generalized price pressures by excluding selected volatile food and energy items, moderated to 3.1 percent year-on-year in August from 3.3 percent in the previous month.

B. Inflation expectations

- Results of the BSP's survey of private sector economists for September 2020 showed a steady mean inflation forecast for 2020 at 2.5 percent from the August survey. Likewise, the mean inflation forecast for 2021 was unchanged at 2.8 percent. Meanwhile, the mean inflation forecast for 2022 rose to 3.0 percent from 2.9 percent.

C. Inflation outlook

- The latest baseline forecasts continue to suggest benign inflation environment over the policy horizon. Inflation is expected to average at 2.3 percent for 2020, 2.8 percent for 2021, and 3.0 percent for 2022. These forecasts are lower by 0.3 percentage point (ppt), 0.2 ppt, and 0.1 ppt for 2020 to 2022, respectively, compared to the previous round due primarily to the lower-than-expected inflation outturn in August, slightly lower global crude oil prices, and the continued appreciation of the peso.

Baseline Inflation Forecasts		
	20 August 2020 MB Meeting	**1 October 2020 MB Meeting**
2020	2.6	2.3
2021	3.0	2.8
2022	3.1	3.0

- The overall balance of risks to the inflation outlook remain tilted to the downside. 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 utility 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. As business activities resumed in July, both volume and value of production indices decreased at a slower pace, an improvement for the third consecutive month. The preliminary composite PMI has recovered slightly since June but remained below the 50-point expansion threshold. Higher frequency mobility indicators also increased but have yet to reach pre-COVID levels. Except for NCR, unemployment has gone down across regions while cash remittances have bounced back in June-July.

- Meanwhile, the projected decline in GDP for the quarter could be attributed primarily to the overall slowdown in the industry and services sectors, which 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. Similarly, the services sector could continue to contract driven mainly by the slowdown in transport, tourism, and other service activities. Nevertheless, the growth in agriculture is projected to accelerate in the quarter due to higher palay and corn production.

E. Supply-side indicators

Developments in Agriculture

- The liberalization of rice importation is expected to increase the industry-wide rice inventory and consequently help stabilize domestic rice prices. Rice imports were sourced from Vietnam, Myanmar, Thailand, China, India, Pakistan, and much smaller shares of rice imports from Cambodia, Taiwan, Italy, and Spain.

- Based on the assessment of weather conditions as of August 2020, La Niña conditions are present and will likely persist through 2020-2021 (December-January-February).

Oil Price Developments

- International oil prices dropped anew in September 2020 due to concerns over demand recovery amid resurgence of COVID-19 cases around the globe, with energy agencies revising downward their demand forecast for 2020. In tandem with the decline, net adjustments of domestic petroleum prices remained negative on a year-to-date basis.

Developments in the Utilities Sector

- The overall electricity rate went down in September 2020 due to lower generation charge. According to Meralco, this was due to the reduction in fixed costs for generation capacity as Meralco continued to invoke Force Majeure claim in some of its Power Supply Agreements (PSAs). Similarly, cost of power from the Wholesale Electricity Sport Market (WESM) fell on the back of the decrease in demand in Luzon as some areas returned to Modified Enhanced Community Quarantine (MECQ) for the period 4-18 August. Meanwhile, purchases from Independent Power Producers (IPPs) edged higher mainly due to lower average plant dispatch.

F. Financial market developments

- In September 2020, the peso appreciated against the US dollar due partly to the US Federal Reserve's announcement of a new policy framework, lower global oil prices, the rejection by US Senators of the proposed $500-billion funding for COVID-19 relief measures, and the suspension of leading COVID-19 vaccine trials. On the domestic side, the signing of the Bayanihan to Recover as One Act (Bayanihan 2) into law, as well as the latest decision by the government to further open the economy such as public transportation systems and tourism have likewise supported the peso.

G. Domestic liquidity and credit conditions

- Domestic liquidity growth remains broadly steady in July. Preliminary data show that domestic liquidity (M3) expanded by 14.5 percent year-on-year to about ₱13.6 trillion in July. This was broadly steady from the 14.9-percent growth in June. In contrast, bank lending grew by 6.7 percent in July, slower than the 9.6-percent expansion in the previous month.

- With the ongoing health crisis constraining domestic economic activity, bank lending has continued to slow down as a result of weaker corporate sector performance, declining loan demand, and risk aversion among banks. Risk aversion has been accompanied by a sharp fall in bank profitability in the first half of 2020, weighed down by the increase in loan loss provision of banks in anticipation of an increase in non-performing loans. The banking system's non-performing loan (NPL) ratio increased to 2.7 percent as of end-July 2020, higher than the 2.2 percent as of end-March 2020. Meanwhile, provisions on loan losses increased to 110.9 percent from 91.4 percent as of end-March 2020. Looking ahead, sustained efforts from monetary and fiscal authorities to shore up market confidence will be critical in supporting bank lending activity.

- Structural liquidity surplus remains significantly high at around ₱1.6 trillion (as of 7 September 2020) as a result of the BSP's extraordinary liquidity-enhancing measures. This remains in excess of the peak in system liquidity levels observed in 2016, when bank lending was expanding at a faster rate. The large surplus liquidity in the financial system has resulted in sustained oversubscriptions in the Bureau of the Treasury's T-bill and T-bond auctions, driven by strong GS demand from banks seeking yield. Similar oversubscriptions have been observed in TDF and RRP auctions, while transactions in the interbank market and overnight lending facility (OLF) of the BSP have diminished significantly.

- Accordingly, prevailing accommodative monetary policy settings continue to provide a supportive environment for credit activity, with short-term market interest rates nearing all-time lows. Short-term interest rates have been declining following the 175-basis-points (bps) cumulative policy rate cuts since February 2020. As of 22 September, the average interbank call loan (IBCL) at 1.8 percent, lower relative to the end-December level of 4.2 percent.

- Amid the prevailing low interest rate environment, total corporate bond issuances in January - August 2020 amounted to about ₽540.9 billion, a 67.0-percent increase over the previous year. Similarly, non-financial corporate bond issues reached ₽181.5 billion in January-August 2020 (almost 7x the level reached in the same period a year ago at ₽26.4 billion). The recorded bond issuances partly account for the slower growth in lending. Meanwhile, equity capital raised in the Philippine Stock Exchange (PSE) decreased in January-August 2020 to ₽34.5 billion, a 63.2-percent decline from the same period in 2019.

H. Fiscal developments

- The National Government (NG) recorded a ₱700.6 billion fiscal deficit for the period January-July 2020. Netting out the interest payments in NG expenditures, the primary deficit amounted to ₱453.6 billion, a turnaround from the ₱113.1 billion primary surplus recorded in the previous year.

- Aside from the further reopening of the economy and the expectations of global trade improvement, additional fiscal support and an accommodative monetary policy stance may aid in an early economic recovery in 2020 and a strong rebound in 2021. The recently enacted Bayanihan II together with other upcoming legislations should provide the additional stimulus needed for the local economy to recover.

I. External developments

- Global economic activity continues to improve as lockdowns and other restrictions in response to the COVID-19 pandemic are eased in many territories. The JP Morgan Global All-Industry Output Index rose from 51.0 in July to 52.4 in August, its highest level since March 2019. 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 financial services, followed by producers of consumer and intermediate goods. Output expanded in the US, mainland China, the euro area, the UK, Brazil, and Russia. Contractions were registered in Japan, India, Australia, and Kazakhstan.

- Meanwhile, manufacturing conditions in the ASEAN region are near stabilization. The Nikkei ASEAN Manufacturing PMI rose to 49.0 in August from 46.5 in July due to a stabilization of factory production and a softer decline in total new orders. Across the seven monitored countries, Myanmar and Indonesia registered an improvement in overall conditions. Meanwhile, Malaysia, Thailand, Vietnam, Philippines, and Singapore saw their respective operating conditions deteriorate generally during the month.