BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 24 JUNE 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 accommodative 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 Monetary Board's decision was based on its assessment that the latest baseline inflation forecasts are within target for 2021 to 2023, although supply-side interventions by the government continue to play a crucial role in keeping inflation within the target range. The latest inflation forecast for 2021 is slightly higher compared to the previous forecast due primarily to higher global crude oil prices and more favorable global growth outlook. These factors were partly offset by the lower-than-expected inflation outturn in May 2021 and the continued appreciation of the peso.

- Meanwhile, prospects for the domestic economy are favorable following the easing of quarantine restrictions in the Greater Manila area (NCR, Bulacan, Cavite, Laguna, and Rizal) along with the recovery in the labor market. Domestic output in the second half of 2021 and in 2022 is expected to be driven mainly by the implementation of the CREATE and FIST laws as well as by the recovery in global economic activity.

- Given these key developments, the Monetary Board was of the view that keeping monetary policy settings unchanged would provide a conducive environment for credit growth and support economic recovery prospects amid COVID-19 uncertainty by ensuring that liquidity remains ample and financing costs low. Moreover, timely and robust responses to the pandemic particularly the effective mass deployment of vaccines would contribute to the sustainable recovery of the economy. Providing support to domestic demand remains a key priority for monetary policy given the expected path of inflation and the continued downside risks to economic activity both domestically and externally.

[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 12 August 2021.

III. Recent Developments and Inflation Outlook

The Monetary Board considered the developments listed below in deciding the appropriate monetary policy stance:

A. Domestic price conditions

- Headline inflation was unchanged at 4.5 percent for the third month in a row in May 2021 as lower inflation for rice, fruits, and vegetables tempered some of the upward pressures coming from higher meat and fuel prices. Food inflation eased to 4.9 percent year-on-year in May from 5.0 percent in the previous month as rice prices continued to decline amid the ongoing summer harvest season. At the same time, ample domestic supply given improved weather conditions resulted in lower inflation rates for fruits and vegetables. This, in turn, tempered the upward pressure on headline inflation coming from meat inflation, which remained elevated due to tighter supply caused by the African Swine Fever (ASF) outbreak. Meanwhile, fish inflation rose anew in May to 7.8 percent (from 6.0 percent) due to limited availability of certain types of fish. This brought the year-to-date average inflation to 4.4 percent for the first five months of 2021, higher than the government's annual average target of 2-4 percent.

- Core inflation, which excludes selected volatile food and energy items to depict underlying demand-side price pressures, was also steady at 3.3 percent year-on-year in May relative to the previous month's rate.

B. Inflation expectations

- Results of the BSP's survey of private sector economists for June 2021 showed a steady mean inflation forecast of 4.1 percent for 2021. Meanwhile, the mean inflation forecasts for 2022 and 2023 continue to be within the target but increased slightly to 3.2 percent and 3.1 percent, respectively.

C. Inflation outlook

- The latest baseline inflation forecasts are 4.0 percent for 2021 and 3.0 percent for 2022 and 2023. The latest inflation forecast for 2021 is higher compared to the previous forecast of 3.9 percent due primarily to higher global crude oil prices and more favorable global growth outlook. These factors were partly offset by the lower-than-expected inflation outturn in May 2021 and the continued appreciation of the peso. Inflation is seen to gradually move to within the target by H2 2021 and further to near the low-end of the target band by H1 2022. Subsequently, inflation is projected to approach the high end of the target by end-2022 with the reversal to positive base effects and the stronger recovery in domestic growth, reflecting the impact of the CREATE and FIST laws before decelerating close to the midpoint of the target by 2023.

Baseline Inflation Forecasts		
	12 May 2021 MB Meeting	**24 June 2021 AC Meeting**
2021	3.9	4.0
2022	2.9	3.0
2023	-	3.0

- The risks to the inflation outlook appear to be broadly balanced for 2021 to 2023. The uptick in global commodity prices due to strong global demand amid supply chain bottlenecks could pose upside risks to inflation in the near term. The impact of an earlier-than-expected easing of quarantine measures and stronger global growth are likewise possible sources of price pressures. Meanwhile, the potential impact on domestic economic growth prospects of delays in the easing of containment measures as well as a weaker-than-expected global economic recovery owing to the spread of new COVID-19 variants are the main sources of downside risks.

D. Demand conditions

- There was an upward revision in the staff GDP forecast for 2021, reflecting the higher growth nowcast for Q2 2021 following the easing of quarantine restrictions in the Greater Manila area along with the recovery in the labor market based on the results of the April 2021 Labor Force Survey. The higher projected growth for Q2 2021 is also mainly due to the low base resulting from the sharp contraction in Q2 2020 brought about by the stricter lockdown measures at the height of the pandemic in 2020. Meanwhile, the growth recovery in H2 2021 and 2022 is expected to be driven by the implementation of the CREATE and FIST laws as well as by the recovery in global economic activity. Furthermore, growth is expected to be supported by the relaxation in quarantine measures across the country following the expected mass deployment of vaccines by H2 2021and the implementation of structural reform. Based on the latest projected growth path, real GDP is projected to return to its 2019 level by Q3 2022.

- High-frequency data also showed recovery in mobility with the lifting of strict community quarantine measures in the Greater Manila area. Mobility indicators continue to trend upward following the shift to the less restrictive Modified Enhanced Community Quarantine in mid-April 2021 and the announcement of the General Community Quarantine for the first half of June 2021 for the Greater Manila area.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- Domestic retail rice prices remained stable as envisioned with the enactment of R.A. No. 11203. Although domestic rice prices are expected to trend upwards as the summer harvest season end, the easing of regular-milled rice prices in May 2021 could be seen as moderation from the broad-based spike in the prices of agricultural commodities early this year.

Furthermore, the ASF disease continued to spread in most parts of the Philippines bringing the affected areas to about 46 provinces and estimated losses of 3.0 million pigs. To stabilize pork supply, on 10 May 2021, President Duterte signed Executive Order (E.O.) 133, raising the 2021 minimum access volume (MAV) allocation for pork imports from 54,210 metric tons (MT) to 254,210 MT. Additionally, E.O. 134 was issued on 15 May 2021 to further amend tariff rates for pork importation. Under E.O. 134, the tariff rate for imported pork within quota or MAV—whether fresh, chilled, or frozen— will be reduced to 10 percent for the first three months upon the E.O.'s effectivity and 15 percent for the fourth to twelfth month. Meanwhile, tariff rates for imported meat outside of the MAV will be set at 20 percent for the first three months upon the E.O.'s effectivity and 25 percent for the fourth to twelfth month. E.O. 134 supersedes E.O. 128, which had an initial proposal of 5 to 20 percent reduction in pork tariff. Meanwhile, to address concerns on elevated meat prices, the Department of Agriculture and Department of Trade and Industry implemented the standard retail price on imported pork at ₱270 per kilo for *kasim* and ₱350 per kilo for *liempo*, effective 9 April 2021.

- The International Monetary Fund (IMF) non-fuel price index was generally on an upward trend since May 2020, driven by increases in the prices of precious metal, food and beverages, and industrial inputs. This has been the highest level since the 2008-2009 global financial crisis. Based on the latest projections of the IMF, global non-fuel prices could rise temporarily in 2021 as the world economy recovers from the pandemic, but is expected to remain benign over the medium term. In particular, global food price inflation is projected to increase in 2021 owing mainly to higher meat prices with the continued outbreak of the ASF in Asia.

- According to PAGASA's latest climate advisory, La Niña conditions has ended. ENSO-neutral conditions are now present and will likely continue until August 2021.

<u>Oil Price Developments</u>

- Global crude oil prices have been on an uptrend amid optimism as demand outlook continues to strengthen boosted by improving global economic trends despite OPEC+ decision to gradually raise production in the coming months. Nevertheless, oil price path remains uncertain given COVID-19 developments and country responses. Meanwhile, futures prices remained in backwardation given that the energy market is expected to be broadly balanced for H2 2021 as improving demand prospects are matched with supply growth. Implied futures price for oil is expected to decline in 2022 with supply outstripping demand.

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

- Overall electricity rates increased slightly due mainly to higher generation charges. According to Meralco, the higher charges in the Wholesale Electricity Spot Market (WESM) led to the generation charge increase. WESM charges rose due to tight supply conditions in the Luzon grid. The increased WESM charges were offset by the decreases in charges from the Independent Power Producers (IPPs) and Power Supply Agreements (PSAs) due to improved average plant dispatch and appreciation of the peso against the US dollar.

F. Financial market developments

- The peso appreciated against the US dollar on positive market sentiment over the (i) improvement in local trade data on the back of a strong rebound in exports; ii) easing in the country's unemployment rate; (iii) slower-than-expected domestic inflation; (iv) decline in new cases of COVID-19 locally; (v) rise in Gross International Reserves; and (vi) dovish signals from the US Federal Reserve.

G. Domestic liquidity and credit conditions

- Domestic financial market conditions remained stable amid supportive monetary policy settings and ample financial liquidity while market interest rates remained at all-time lows. Liquidity conditions remained at an adequate level to support economic activity. Domestic liquidity (M3) expanded by 5.1 percent year-on-year in April 2021, slower than the 8.3-percent growth in March.

- Credit activity, however, has remained weak as measures to address the still elevated number of COVID-19 cases constrained domestic economic activity and continued to dampen market sentiment. Preliminary data show that outstanding loans of universal and commercial banks declined by 5.0 percent year-on-year in April from a 4.5-percent contraction in March. Likewise, the NPL ratio rose as of end-March 2021. The increase in NPLs was linked mainly to loans extended to real estate activities, individuals for consumption, and non-residents. Nonetheless, the full operationalization of the FIST Act is expected to address the rise in NPLs.

H. Fiscal developments

- The National Government (NG) recorded a ₱365.9 billion fiscal deficit for January – April 2021. Netting out the interest payments in NG expenditures, the primary deficit amounted to ₱216.2 billion, one percent lower from the ₱218.3 billion deficit recorded in the previous year.

I. External developments

- Global economic output expanded faster in April, particularly in manufacturing and services, amid the faster-than-expected recovery of global demand. The JP Morgan Global All-Industry Output Index accelerated in April due mainly to an increase in new orders in both manufacturing and services, reflecting improved international trade flows and the positive outlook for the global economy. Output expanded in the US, UK, Euro Area, and China, while contractions were recorded in Japan and India.

- Meanwhile, overall manufacturing conditions in the ASEAN region remained steady, based on the latest data on the Nikkei ASEAN Manufacturing PMI in April 2021. Across the seven monitored countries, expansions were recorded in Indonesia, Vietnam, Singapore, and Malaysia. Meanwhile, manufacturing conditions weakened in the Philippines, Thailand, and Myanmar.