BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 6 FEBRUARY 2020[1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) reduce the overnight RRP (borrowing) rate by 25 basis points (bps) to 3.75 percent; and

b) reduce the current overnight deposit and overnight lending rates by 25 bps to 3.25 percent and 4.25 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 a broadly steady path of inflation for 2020 and 2021, with average inflation remaining within the target band of 3.0 percent ± 1.0 percentage point. At the same time, inflation expectations remained well-anchored over the policy horizon.

- In deciding on the stance of monetary policy, the MB also noted that the risks to the inflation outlook continue to tilt slightly toward the upside in 2020 and toward the downside in 2021. Upside risks to inflation over the near term emanate mainly from potential upward pressures on food prices owing in part to the African Swine Fever outbreak and tighter international supply of rice. Moreover, there continues to be the burden on the economy posed by the ongoing Taal volcano eruption and the aftermath of typhoon Tisoy. However, uncertainty over trade and economic policies in major economies continue to weigh down on global demand, thus mitigating upward pressures on commodity prices.

- At the same time, the MB observed that prospects for global economic growth have weakened further amid geopolitical tensions. At the same time, the MB noted that the spread of the coronavirus disease (COVID-19) could have an adverse impact on economic activity and market sentiment in the coming months.

- The MB agreed that the manageable inflation environment allowed the BSP room for a preemptive reduction in the policy rate to support market confidence. While recent demand indicators still point to a firm outlook for the domestic economy, the Monetary Board believes that a policy rate cut would provide additional policy support to ward off the potential spillovers associated with increased external headwinds.

[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 6 February 2020 monetary policy meeting were approved by the Monetary Board during its regular meeting held on 27 February 2020. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 19 March 2020.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- Average headline inflation for 2019 was registered at 2.5 percent, well within the National Government's 2-4 percent target range for the year and lower than the 5.2 percent recorded in 2018. Meanwhile, year-on-year headline inflation increased further in December 2019, confirming that inflation has bottomed out in September-October 2019. Price pressures came mainly from higher food prices linked to weather-related supply disruptions as well as rising oil prices in the international market.

- Core inflation, which excludes selected volatile food and energy items to measure underlying price pressures, rose to 3.1 percent in December from 2.6 percent in the previous month while all alternative measures of core inflation also rose during the month. Similarly, the alternative core inflation measures were all higher in December 2019.

B. Inflation expectations

- Results of the BSP's January 2020 survey of private sector economists showed slightly higher inflation forecasts relative to the results in the previous month. The mean inflation forecast for 2020 increased to 3.1 percent from 2.9 percent. Likewise, the mean inflation forecast for 2021 went up to 3.2 percent from 3.1 percent. Meanwhile, the 2022 mean inflation forecast stood at 3.1 percent.

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 2021. Inflation is projected to average at 3.0 percent for 2020 and 2.9 percent for 2021. The upward adjustment in the inflation forecasts for 2020 can be attributed to the higher-than-expected December 2019 and January 2020 inflation outturn due to weather-related disturbances, the transitory impact on food prices from the eruption of Taal volcano, and the peso depreciation.

Baseline Inflation Forecasts		
	12 December 2019 MB Meeting	6 February 2020 MB Meeting
2020	2.9	3.0
2021	2.9	2.9

- The risks to the inflation outlook continue to tilt slightly toward the upside in 2020 and toward the downside in 2021. Upside risks to inflation over the near term emanate mainly from potential upward pressures on food prices owing in part to the African Swine Fever outbreak and tighter international supply of rice. Moreover, there continues to be the burden on the economy posed by the ongoing Taal volcano eruption and the aftermath of typhoon Tisoy. However, uncertainty over trade and economic policies in major economies continue to weigh down on global demand, thus mitigating upward pressures on commodity prices.

D. Demand conditions

- Prospects for the domestic economy remain firm over the medium term, supported by resilient domestic demand, particularly as public construction is expected to continue to recover with the timely passage of the 2020 fiscal budget. Nevertheless, the recent spread of the COVID-19 across the region could affect tourist arrivals in the country and dampen growth in sectors dependent on tourist activities.

- Preliminary information and analysis suggests that the impact of the eruption of Taal Volcano on the domestic economy appears to be limited thus far. Based on NEDA's latest preliminary assessment[2] on Taal Volcano's impact on economic activities, as of 27 January 2020, the total foregone income within the 14-kilometer radius danger zone was estimated at ₱4.3 billion across important industries in CALABARZON, equivalent to only 0.17 percent of the region's 2018 gross regional domestic product (GRDP). The eruption could dampen growth and exert upside inflationary pressures in the near term. However, these adverse effects are likely to be transitory and are expected to dissipate as the situation continues to stabilize.

- Forward-looking indicators for manufacturing production continue to suggest positive momentum in the near term. The preliminary composite purchasing managers' index (PMI) remained above the 50-point expansion threshold at 54.0 in December 2019, higher than the November 2019 PMI reading of 53.1. Car sales also grew by 10.3 percent year-on-year in November 2019 due to higher passenger and commercial vehicle sales. Likewise, total energy sales of Meralco increased by 4.3 percent year-on-year in November 2019 owing to higher energy sales from the residential, commercial, and industrial sectors.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- Domestic rice prices have generally been declining in Q4 2019 as the main harvest season began and as the arrival of rice imports by the private sector continued.

- According to the latest climate advisory of the Philippine Atmospheric, Geophysical and Astronomical Services Administration,[3] ENSO-neutral conditions will likely persist across tropical Pacific Ocean and is expected to continue until September 2020.

<u>Oil Price Developments</u>

- Dubai crude oil spot prices has been generally declining since the second half of January 2020 until early February 2020 due to worries over lower global oil demand amid rising COVID-19 cases. On the domestic front, prices of petroleum products went down compared to their year-on-year levels.

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

- The overall electricity rate declined in January 2020 due to lower power generation charges. This can be attributed to lower cost of power from Power Supply Agreements brought about by a

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[2] NEDA estimates are foregone economic income, which does not yet include the damage to infrastructure, public and also private assets. The agency also stated that the damage brought about by the eruption of Taal Volcano in Batangas is unlikely to disrupt the growth outlook for the year due to its limited scale and impact, but may pose a short-term risk to inflation via food prices.

[3] Seasonal Climate Outlook Report as of 22 January 2020.

reduction in capacity fees as a result of the annual reconciliation of outage allowances as approved by the Energy Regulatory Commission.

F. Financial market developments

- In January 2020, the peso depreciated against the US dollar compared to the previous month amid global market risk aversion and safe-haven buying driven by the geopolitical tension between US and Iran as well as the heightened fears of the potential economic impact of the spread of the COVID-19.

G. Domestic liquidity and credit conditions

- Domestic liquidity expanded faster in December 2019. Preliminary data show that domestic liquidity grew faster at 11.4 percent in December 2019 (from 9.8 percent in November), while bank lending growth was faster at 10.9 percent in December 2019 (from 10.1 percent in the previous month). The higher M3 growth was due the sustained growth in credit to the private sector as a result of higher loans for real estate activities; financial and insurance activities; electricity, gas, steam and airconditioning supply; construction; and information and communication. The expansion in net foreign assets brought about by foreign exchange inflows coming mainly from overseas Filipinos' remittances and business process outsourcing receipts also contributed to M3 growth.

H. Fiscal developments

- With the timely passage of the 2020 fiscal budget, fiscal spending is expected to support the country's growth momentum in 2020. For the first 11 months of 2019, the National Government recorded a ₱409.1 billion fiscal deficit, 14.3 percent lower than the deficit posted in the same period in 2018.

I. External developments

- The International Monetary Fund revised downward its full-year economic growth forecast for 2019, 2020, and 2021 in its January 2020 World Economic Outlook. The downward revisions in the global growth projections reflect negative surprises to economic activity in a few emerging market economies and the impact of increased social unrest.

- For advanced economies, economic growth forecast was revised downwards for 2020 but maintained for 2021 due to the expected slower growth in the US, euro area, and the UK, as well as downgrades to other advanced economies in Asia, notably Hong Kong due to the impact of the pro-democracy protests. Meanwhile, notwithstanding a less positive outlook, growth for EMDEs is expected to improve in 2020 and 2021 relative to 2019, reflecting the projected recovery from deep downturns in some emerging market economies and an ongoing structural slowdown in China. For ASEAN, growth forecasts for 2020 and 2021 were also lower as growth prospects for Indonesia and Thailand have been revised down slightly due to continued slowdown in exports.