BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 17 DECEMBER 2020[1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Maintain the overnight RRP (borrowing) rate at 2.00 percent; and

b) Maintain accordingly the current 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 inflation outlook remained benign. The latest baseline forecasts have risen slightly due to the sharp increase in global crude oil prices and the higher-than-expected food inflation in November. However, since the rise in food prices is transitory, it is expected that the future inflation path will remain firmly within the Government's 2-4 percent target over the policy horizon. The balance of risks to the inflation outlook also leans toward the downside from 2020 until 2022 owing largely to potential disruptions to domestic and global economic activity amid the ongoing pandemic. Meanwhile, inflation expectations remained broadly consistent with the inflation target.

- The Monetary Board noted that the resurgence of COVID-19 cases globally has tempered economic activity with the re-imposition of preventive measures in recent weeks. However, optimism over the delivery of vaccines has lifted market confidence, supporting improved prospects for global growth. On the domestic front, the Monetary Board also observed early indications of improved mobility and sentiment. While recent natural calamities could pose strong headwinds to growth, the further easing of quarantine measures should help facilitate the recovery of the economy in the coming months.

- Given these considerations, the Monetary Board was of the view that monetary policy settings remained appropriate. The Monetary Board believed that an accommodative monetary policy stance, together with sustained fiscal initiatives to ensure public welfare, should quicken the economy's transition toward a sustainable recovery.

[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 8 February 2021.

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 further increased to 3.3 percent in November from 2.5 percent in the previous month. This brought the year-to-date average inflation to 2.6 percent, which remained within the government's 2-4 percent target range. The higher November inflation was due largely to faster price gains of food items as weather-related disruptions from recent typhoons severely affected domestic supply. At the same time, supply shortages induced by the African Swine Fever continued to affect retail prices of pork. By contrast, non-food inflation eased as most commodities under non-food decelerated, while inflation for recreation and culture remained negative given the rollback in lotto ticket prices last August 2020.

- Official core inflation, which excludes selected volatile food and energy items to measure underlying price pressures, increased to 3.2 percent year-on-year in November from 3.0 percent in the previous month.

B. Inflation expectations

- The latest results of the BSP's survey of private sector analysts showed higher mean inflation forecasts for 2020 to 2022. The survey for December 2020 posted higher mean inflation forecast for 2020 to 2.6 percent from 2.4 percent based on the November 2020 survey. Similarly, mean inflation forecasts for 2021 and 2022 rose to 2.9 percent (from 2.7 percent) and 3.0 percent (from 2.9 percent), respectively.

C. Inflation outlook

- The latest baseline forecasts continued to suggest a benign inflation environment over the policy horizon. Inflation is expected to average at 2.6 percent for 2020, 3.2 percent for 2021, and 2.9 percent for 2022. The forecast revisions for 2020-2021 were due largely to the higher-than-expected inflation outturn in November 2020 and the sharp uptick in global crude oil prices. Meanwhile, the forecast for 2022 was broadly unchanged compared to the previous round due primarily to base effects.

Baseline Inflation Forecasts

	Forecast as of 19 November 2020	**Forecast as of 17 December 2020**
2020	2.4	2.6
2021	2.7	3.2
2022	2.9	2.9

- The overall balance of risks to the inflation outlook remained tilted to the downside for 2020 to 2022. The potential impact of a more disruptive pandemic on global and domestic economic growth prospects was the primary downside risk to inflation. Meanwhile, adjustments in utility rates were the main upside risks to inflation.

D. Demand conditions

- Domestic economic activity is projected to contract at a slower pace in the last quarter of 2020 before recovering in 2021 and 2022. The decline in GDP is seen to be driven primarily by further deterioration in the industry and services sectors, which remained heavily affected by the pandemic despite the easing in quarantine measures. In particular, the projected weakness in manufacturing and construction activities is expected to drive the decline in the industry sector, albeit at a slower pace compared to Q3 2020. Similarly, the services sector could continue to contract as a result of the slowdown in transport, tourism, and other services. Meanwhile, the agriculture sector is projected to contract in Q4 2020 due to the impact of weather disturbances on production.

- Forward-looking indicators for manufacturing production suggest slight improvement in business operations but remained below expansion threshold. The preliminary composite PMI in November remained below the 50-point expansion threshold at 46.8, marginally lower by 0.4 index point than the October PMI of 47.2. Despite the slower contraction of the manufacturing index, the composite PMI dipped anew as the services and retail and wholesale sectors decelerated faster in November. The manufacturing sector's better performance was due mainly to the gradual easing of lockdown measures. Respondent-firms were optimistic that the business environment will improve in December.

- As quarantine measures in NCR and surrounding provinces have eased, mobility activity has also been gradually rising closer to pre-COVID baseline figures in locations such as grocery and pharmacy, parks, and retail and recreation. As a result, mobility numbers under residential have been declining, implying that people are staying less at home. Meanwhile, transit stations remained subdued amid limited public transportation options despite easing containment measures in the country.

E. Supply-side indicators

Developments in Agriculture

- Domestic retail rice prices remained stable, owing to ample supply of the grain, and moved closer to international prices as envisioned with the enactment of R.A. No. 11203.

- Meanwhile, tropical cyclones (TCs) made landfall in parts of the country and caused damage to the agriculture sector. As of 27 November 2020, the Department of Agriculture recorded total damage and losses of ₱15.3 billion brought about by TCs Nika, Ofel, Pepito, Quinta, Rolly, Siony, and Ulysses. Among the commodities affected, rice recorded the most damage and losses with estimated value of ₱5.4 billion, followed by high value crops at ₱4.8 billion.

- According to the latest climate advisory of the Philippine Atmospheric, Geophysical and Astronomical Services Administration, moderate to strong La Niña is expected to continue until April 2021, which is anticipated to adversely affect vulnerable areas and sectors of the country since a La Niña event is associated with above normal rainfall condition.

Oil Price Developments

- International oil prices increased in the first week of December 2020 compared to the full-month average in November, driven by market optimism over successive announcements of an effective COVID-19 vaccine and expectations of lower supply from the Organization of the Petroleum Exporting Economies and its partners (OPEC+). In the domestic front, prices of petroleum products continue to post a net decline compared to end-2019.

Developments in the Utilities Sector

- The overall electricity rate decreased in November 2020 due to lower power generation charges. This may be attributed to improved supply conditions in the Luzon grid given lower electricity demand due to weather disturbances and less generation capacity on outage. Consequently, the cost of power from the Wholesale Electricity Spot Market declined. Similarly, purchases from Independent Power Producers edged lower as a result of lower Malampaya natural gas prices due to its quarterly repricing and the slight appreciation of the peso against the US dollar. Meanwhile, charges from Power Supply Agreements increased due to the forced outage of San Gabriel.

F. Financial market developments

- For the first week of December 2020, the peso appreciated against the US dollar amid market optimism over news of progress in the development of a vaccine against COVID-19 as well as the release of lower-than-expected Philippine unemployment data for October 2020. The seasonal increase in overseas Filipino remittances amid the holiday season likewise supported the peso.

G. Domestic liquidity and credit conditions

- Domestic liquidity growth slowed in October. Preliminary data showed that domestic liquidity (M3) expanded by 11.8 percent year-on-year to about ₱13.5 trillion in October. This was slower than the 12.2-percent (revised) growth in September. Likewise, bank lending eased to 1.9 percent in October from 2.6 percent (revised) in the previous month. The overall slowdown in bank lending growth reflected the combined effects of muted business confidence and banks' stricter loan standards attributed mainly to continued disruptions in business operations.

- Liquidity in the financial system remained ample as a result of the BSP's extraordinary liquidity-enhancing measures. The increased liquidity in the financial system is reflected in the continued oversubscriptions in the T-bill and T-bond auctions by the Bureau of the Treasury in November and December 2020, which have resulted in full awards on the back of strong demand for government securities amid manageable inflation expectations. Similar oversubscriptions have been observed in TDF, RRP, and the BSP bills auctions, while transactions in the interbank market and overnight lending facility of the BSP have diminished significantly.

H. Fiscal developments

- The National Government recorded a ₱940.6 billion fiscal deficit for the first ten months of 2020. Netting out the interest payments in NG expenditures, the primary deficit amounted to ₱605.5 billion, from the ₱33.8 billion primary deficit recorded in the previous year.

I. External developments

- Global economic activity continued to expand, reflecting the sustained improvement in demand conditions. However, overall economic activity in the euro area returned to contraction amid the re-imposition of mobility restrictions to stem the resurgence of COVID-19 infections. The JP Morgan Global All-Industry Output Index eased slightly to 53.1 in November from 53.3 in October as global service sector business activity expanded at a slower rate. Five out of the six sub-sectors covered by the survey registered output expansions during the month, with growth acceleration in the consumer goods and investment goods categories. All-industry output grew in the US, China, Germany, India, Brazil, and Australia. Contractions were seen in Japan, France, the UK, Italy, Spain, Russia, and Ireland.

- Meanwhile, manufacturing conditions in the ASEAN region stabilized. The Nikkei ASEAN Manufacturing PMI rose to the neutral 50.0-threshold in November due to expansion in factory production and a renewed increase in new orders. Across the seven monitored countries, Singapore, Thailand, and Indonesia showed improvements in manufacturing operations during the month, while Myanmar and Malaysia continued to contract. Manufacturing conditions were broadly steady in the Philippines and in Vietnam.