BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 12 AUGUST 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 inflation is seen to average slightly above the upper end of the target band of 2-4 percent in 2021 but projected to ease towards the midpoint of the target range in 2022 and 2023 with the continued and timely implementation of non-monetary initiatives and reforms to mitigate supply-side pressures on meat and other food prices.

- Meanwhile, the risk of a protracted COVID-19 pandemic due to virus resurgence remains high and prospects for sustainable recovery remain largely dependent on the progress of the vaccine rollout. Moreover, economic slack is likely to persist amid the significant uncertainty brought about by the detection of local transmission of the more contagious Delta variant of COVID-19.

- Given these key developments, the Monetary Board decided to maintain the current accommodative monetary policy settings by keeping the current policy interest rate unchanged. Amid the expected manageable inflation path and well-anchored expectations in 2022-2023, providing support to overall domestic demand remains a key priority for monetary policy. It remains prudent for the BSP to maintain its ongoing stimulus as prospects of delays in the easing of containment measures as well as a weaker-than-expected global recovery owing to the spread of new COVID-

[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 23 September 2021.

19 variants continue to cloud the outlook for domestic economic activity. Continued monetary policy support, therefore, remains a necessary complement to expansionary fiscal policy measures in reviving aggregate demand and helping to reduce potential long-term economic scarring.

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 fell to 4.0 percent in July 2021 from 4.1 percent in June as lower non-food inflation offset the increase in food inflation arising from the uptick in vegetable inflation. Food inflation was higher at 5.1 percent year-on-year in July relative to June as a surge in vegetable inflation outpaced the deceleration in meat inflation. Vegetable inflation rose in July owing to adverse weather conditions which limited the supply of vegetables, as well as higher transport costs. On the other hand, the decline in meat inflation could be partly attributed to additional supply from importation. Meanwhile, rice inflation remained negative in year-on-year terms while month-on-month inflation increased with the ongoing lean season. Fish inflation rose anew in July to 9.3 percent (from 8.7 percent in June) as adverse weather conditions brought about by typhoon Fabian limited fishing activities. This brought the year-to-date average inflation to 4.4 percent for the first seven 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, also eased to 2.9 percent year-on-year in July from 3.0 percent in the previous month.

B. Inflation expectations

- Results of the BSP's survey of private sector economists for July 2021 showed a higher mean inflation forecast of 4.2 percent for 2021, and lower mean inflation forecasts for 2022 and 2023. The mean inflation forecasts for 2022 and 2023 decreased to 3.1 percent and 3.0 percent, respectively, showing that inflation expectations remain broadly anchored within the target range over the policy horizon.

C. Inflation outlook

- The latest baseline inflation forecasts are 4.1 percent for 2021 and 3.1 percent for 2022 and 2023. The latest inflation forecast for 2021 to 2023 are slightly higher compared to the previous forecasts due primarily to higher global crude and non-oil prices, depreciation of the peso, and the impact of delayed arrivals of imported pork. These factors were partly offset by the lower GDP growth projections and lower-than-expected inflation outturn for June 2021. Inflation is seen to remain above the target range in Q3 2021 but is expected to decelerate to within the target in Q4 2021. Inflation is projected to decelerate close to the low end of the target range in Q1 2022 due to negative base effects as global oil and non-oil prices moderate from their high levels in the previous year. Meanwhile, inflation is estimated to approach the high end of the target by end-2022 with the reversal to positive base effects and the stronger projected recovery in domestic economic activity before decelerating close to the midpoint of the target by 2023.

Baseline Inflation Forecasts		
	24 June 2021 MB Meeting	12 August 2021 MB Meeting
2021	4.0	4.1
2022	3.0	3.1
2023	3.0	3.1

- 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 possibility of extended recovery period for the domestic swine industry or a prolonged African swine fever (ASF) outbreak in the country could keep prices elevated until 2022. 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

- The staff full-year GDP growth forecast for 2021 was revised downwards to reflect the lower Q3 2021 growth nowcast following the implementation of stricter quarantine measures in August 2021 for the National Capital Region (NCR) and key provinces due to the local transmission of the Delta variant of COVID-19. This however was partly offset by the higher-than-projected growth in Q2 2021. In Q2 2021, the domestic economy grew by 11.8 percent which was higher than the nowcast. On the production side, the higher-than-projected growth outturn reflected largely the 20.8-

percent expansion in industry, driven by the acceleration in manufacturing and construction. Meanwhile, the recoveries in household consumption and gross capital formation were the key upside drivers of GDP on the expenditure side. The latest GDP forecast path also shows real GDP returning to its 2019 level by Q3 2022.

- Mobility indicators have been generally trending upward but still below baseline since May 2021. However, in the last two weeks of July 2021, mobility slowed due mainly to the recent flooding in Luzon and Visayas brought about by typhoon Fabian and southwest monsoon as well as the implementation of General Community Quarantine (GCQ) with heightened restrictions amid confirmed local transmission of the delta variant in NCR.

- All major employment indicators point to unchanged labor market conditions in June 2021 compared to May, except for underemployment rate. Based on the latest round of the labor force survey (LFS), the relatively less stringent quarantine measures in major economic areas in the country have helped to broadly sustain the improved level of economic activity in June. This led to an increase in the employment rate in June relative to May and the pre-pandemic level in January 2020. Nevertheless, timely and robust responses to the pandemic, particularly the effective mass deployment of vaccines would contribute to the sustainable recovery of the domestic economy. On this front, vaccination has ramped up recently with the continued arrival of vaccine supplies. In total, the Philippines has vaccinated around 11.6 percent of the population or 13.38 million people as of 8 August 2021.

E. Supply-side indicators

Developments in Agriculture

- Domestic retail rice prices remained stable as envisioned with the enactment of Republic Act (R.A.) No. 11203. Despite the ongoing lean season, the second phase of the Retail Price Survey show a decline in domestic rice prices in a number of markets in key cities nationwide as private sector rice imports continue to arrive and boost domestic rice supply.

  Meanwhile, the ASF disease continued to spread in most parts of the Philippines. bringing the affected areas to about 50 provinces and resulted in the culling of 479,584 hogs. To provide further support to the recovery of the local hog industry, the inter-agency Minimum Access Volume (MAV) Management Committee (MMC), has approved the guidelines on the calibrated utilization of the MAV plus with effectivity dated 12 July 2021. The MMC resolution indicated that the incoming 200,000 metric tons (MT) of pork meat shipments will be divided into two tranches: (1) the 140,000 MT or 70 percent of the total should arrive within July to October 2021; and (2) the remaining 60,000 MT or 30 percent of the total are expected to arrive by November 2021 to January 2022.

As of 8 July 2021, six local government units (LGUs) in Batangas have been declared as ASF-free, four months after the DA launched the national hog repopulation and 'Bantay ASF sa Barangay' (BABay ASF) programs in the same province in March 2021.

Meanwhile, for the period January-July 2021, the Philippine Crop Insurance Corporation (PCIC) have insured 149,876 hog raisers with about 451,882 heads. This is equivalent to the premium subsidy provided worth ₱123 million out of the ₱4.5 billion amount of cover. In terms of indemnity, the DA through PCIC have paid over ₱20 million to 2,276 farmers for the loss of over 3,000 heads of swine.

- According to PAGASA's July 2021 climate advisory,[2] ENSO-neutral conditions persist and will likely continue until September 2021. Additionally, La Niña is likely to re-emerge by end-October or November 2021 and may persist until Q1 2022.

Oil Price Developments

- International oil price eased slightly in the first week of August amid concerns over slower demand recovery given tighter restrictions in some economies due to the surge in COVID-19 Delta variant cases, along with the OPEC+ decision to raise production. Meanwhile, futures prices remained in backwardation, broadly in line with expectations from energy agencies that global oil supply-demand dynamics will be broadly balanced or at a slight deficit in 2H 2021 as higher production responds to rising world oil demand. Oil prices are expected to decline in 2022 as higher supply from both OPEC and non-OPEC producers exceeds global oil consumption.

Developments in the Utilities Sector

- Overall electricity rates rose 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.

[2] Seasonal Climate Outlook Report as of 21 July 2021. Tentative schedule of the next PAGASA Climate Outlook Forum is on 25 August 2021.

WESM charges rose due to tight supply conditions in the Luzon grid amid the shutdown of power plants, aggravated by a temporary decline in Malampaya natural gas supply production which led to reduced capacity of gas-powered plants. Moreover, charges from the Independent Power Producers (IPPs) went up as power plants affected by the reduced supply from Malampaya resorted to the use of more expensive liquid fuel in order to continue operations and avoid more brown outs. Meanwhile, cost of power from Power Supply Agreements (PSAs) declined.

F. Financial market developments

- The peso depreciated against the US dollar on market cautiousness amid concerns over the spread of the COVID-19 Delta variant and the failure of the Organization of the Petroleum Exporting Countries and its allies (OPEC+) to reach an agreement on oil production, which could lead to higher domestic inflation. Moreover, the hawkish shift in the US Federal Reserve's rate outlook; recovery in imports in May 2021; and the Fitch Ratings' outlook downgrade for the country's sovereign credit rating all added pressure on the peso.

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 6.4 percent year-on-year in June 2021, faster than the 4.7-percent growth in May.

- Credit activity, however, has remained weak as concerns over the spread of new coronavirus variants continued to temper market sentiment and the outlook for economic recovery. Preliminary data show that outstanding loans of universal and commercial banks decreased by 2.0 percent year-on-year in June 2021 following a 4.0-percent contraction in May. Furthermore, latest results of the Senior Bank Loan Officers' Survey (SLOS) continued to reflect a net tightening of overall credit standards for both loans to businesses and consumers in Q2 2021. Respondent banks attributed the tightening of credit standards largely to deterioration in the profiles of borrowers and in the profitability of banks' portfolio, reduced tolerance for risk, as well as a more uncertain economic outlook, among other factors.

H. Fiscal developments

- The National Government (NG) recorded a ₱716.1 billion fiscal deficit for January – June 2021. The cumulative budget deficit was smaller than the projected ₱1.02-trillion deficit as government expenditures are lower than the ₱2.44-trillion program. Meanwhile, netting out the interest payments in NG expenditures, the primary deficit amounted to ₱507.5 billion, thirty six percent higher than the amount recorded in the previous year. The NG continues to have ample fiscal space to help cushion the pandemic's impact and provide further support to economic recovery.

I. External developments

- Global economic output expanded at a slower pace in July, particularly in manufacturing and services. The JP Morgan Global All-Industry Output Index eased during the month as growth in Asia slowed due to the reimposition of quarantine restrictions to mitigate the spread of the highly transmissible Delta COVID-19 variant. The expansion in both manufacturing and service sectors reflect output growth in Germany, US, China, Brazil, and Russia. However, the downturns recorded in Japan, India, and Australia weighed on the global economy's rate of expansion in July.

- Meanwhile, overall manufacturing conditions in the ASEAN region deteriorated based on the latest data on the Nikkei ASEAN Manufacturing PMI in July 2021. Output, new orders, and inventories declined amid surging COVID-19 cases in the region which forced governments to reimpose virus-related restrictions. Across the seven monitored countries, contractions were recorded in Indonesia, Malaysia, Vietnam, Thailand, and Myanmar. Meanwhile, the respective manufacturing sectors of Singapore and Philippines remained above the expansion territory.