BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 26 SEPTEMBER 2019[1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) reduce the overnight RRP (borrowing) rate by 25 basis points (bps) to 4.00 percent; and

b) reduce the current overnight deposit and overnight lending rates by 25 bps to 3.50 percent and 4.50 percent, respectively.

II. Key Considerations in the Formulation of the Monetary Policy Stance

- The Monetary Board's (MB) decision to reduce the BSP's policy interest rate was based on its assessment that the broad range of recent economic data pointed to a continued deceleration in the inflation momentum and well-anchored inflation expectations. The latest baseline forecasts continued to indicate that inflation will likely settle within the lower half of the target band of 3.0 percent ± 1.0 percentage point from 2019 up to 2021.

- In deciding on the stance of monetary policy, the MB also noted that the balance of risks to the inflation outlook has shifted toward the upside for 2020, but remained tilted to the downside for 2021. Upside risks to inflation over the near term emanate mainly from volatility in oil prices due to geopolitical tensions in the Middle East and from the potential impact of the African Swine Fever outbreak on food prices. Meanwhile, the subdued pace of global economic activity remained the key downside risk to the inflation outlook.

- At the same time, the Monetary Board observed that prospects for global economic growth are likely to remain weak owing mainly to uncertainty in trade policies of major economies. Firm domestic spending and progress on policy reforms will serve as a buffer against global headwinds.

- The MB believed that the benign inflation outlook provided room for a further reduction in the policy rate to support economic growth and reinforce market confidence. Looking ahead, authorities will continue to monitor the emerging cumulative impact of monetary policy easing on the domestic economy to ensure that monetary policy settings remain consistent with maintaining price stability.

[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 8 August 2019 monetary policy meeting were approved by the Monetary Board during its regular meeting held on 17 October 2019. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 14 November 2019.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- Price pressures eased further in August 2019 as food inflation decelerated due to lower prices of rice, corn, sugar, electricity, and petroleum. Headline inflation declined to 1.7 percent in August from 2.7 percent in the previous month. This brought the year-to-date average inflation to the midpoint (3.0 percent) of the government's target range of 2-4 percent. Likewise, non-food inflation decreased to 2.1 percent (from 2.5 percent) driven largely by lower prices of energy-related CPI items. In particular, electricity rates decreased in August in Meralco-serviced areas due to lower generation costs. At the same time, easing global oil prices owing to deepening trade tensions and external uncertainties also resulted in downward adjustments in domestic petroleum products during the month.

  Relative to the previous month's levels, both seasonally-adjusted month-on-month inflation and non-seasonally-adjusted month-on-month inflation were slightly lower.

- The official core inflation rate—which measures generalized price pressures by excluding volatile items such as food and energy—also slowed down to 2.9 percent in August 2019 from 3.2 percent in the previous month. Similarly, all four alternative measures of core inflation estimated by the BSP decreased in August 2019.

B. Inflation expectations

- Results of the BSP's September 2019 survey of private sector economists showed a steady mean inflation forecast for 2019 at 2.7 percent relative to the August 2019 survey round. Likewise, the mean inflation forecasts for 2020 and 2021 both remained at 3.1 percent.

C. Inflation outlook

- The latest staff baseline forecasts indicate that average inflation will continue to ease over the near term, but is expected to settle within the 3.0 percent ± 1.0 percentage point target range for 2019 to 2021. Inflation is projected to average at 2.5 percent for 2019, lower relative to the previous forecast of 2.6 percent during the August policy meeting. The downward revision in the inflation forecast was due to lower global crude oil prices and slower domestic economic growth. Meanwhile, the forecasts for 2020 and 2021 were unchanged at 2.9 percent.

Baseline Inflation Forecasts

	8 August 2019 MB Meeting	26 September 2019 MB Meeting
2019	2.6	2.5
2020	2.9	2.9
2021	2.9	2.9

- The risks to the inflation outlook appear to be weighted toward the upside for 2020, but are tilted to the downside in 2021. Petitions for electricity rates and transport fare adjustments, the proposed increase in the excise taxes of alcoholic beverages, the possible impact of African Swine Fever (ASF) on meat prices, and higher global oil prices were the main upside risks to inflation highlighted during the discussion. Meanwhile, slower global economic growth due to the escalation of protectionist policies in advanced economies as well as geopolitical tensions were seen as the main downside risks to inflation.

D. Demand conditions

- The Monetary Board noted the slower expansion of real GDP for Q2 2019 at 5.5 percent from 5.6 percent in Q1 2019, reflecting mainly the budget impasse lasting until April 2019, together with slower growth in manufacturing activities due to weak external demand. Nonetheless, firm domestic demand conditions and accelerated NG spending are expected to support domestic growth in the second half of 2019.

- Meanwhile, the preliminary composite purchasing managers' index (PMI) remained above the 50-point expansion threshold at 55.1 in August, faster than the July PMI which was at 53. The average capacity utilization rate of the manufacturing sector stood at 84.3 percent in July, unchanged from the month-ago level, based on the Philippine Statistics Authority's Monthly Integrated Survey of Selected Industries (MISSI).

E. Supply-side indicators

Developments in Agriculture

- Domestic rice prices were generally stable in July until early August, despite significant increases in rice prices observed in Catanduanes and Camiguin, as the continued arrival of rice imports by the private sector tempered the potential impact of the ongoing lean season.

- According to the latest climate advisory of the Philippine Atmospheric, Geophysical and Astronomical Services Administration's (PAGASA's),[2] weak El Niño weather conditions which began in the last quarter of 2018 have already ended, with ENSO-neutral weather conditions seen as likely to persist through the remainder of 2019 and until Q1 2020.

Oil Price Developments

- Average Dubai crude oil spot prices rose in September 2019 due to supply concerns following the drone strike on Saudi Arabia's major oil facilities. However, global oil prices slowly eased after the initial market reaction as production was reported to recover faster than earlier expected. Geopolitical issues in the Middle East also continued to put near-term pressure on prices. Nevertheless, potential slowdown in global growth remained a key downside risk to the oil price path, as indicated by data on oil futures prices.

Developments in the Utilities Sector

- The overall electricity rate decreased in September 2019 due mainly to lower generation charges from the Wholesale Electricity Spot Market (WESM) on the back of improved supply conditions in the Luzon grid. Similarly, generation charges from the Power Supply Agreements (PSAs) fell due to lower fuel prices. Meanwhile, the decrease in generation charges from WESM and PSA offset the higher charges of Independent Power Producers (IPPs) as a result of lower average plant dispatch and peso depreciation against the US dollar.

F. Financial market developments

- In August, the peso depreciated against the US dollar amid renewed global recession concerns as a result of protracted trade conflict between the US and China. Meanwhile, the peso depreciated during the first week of September relative to the average in August amid continued

[2] Seasonal Climate Outlook Report as of 28 August 2019.

US-China trade tension and concerns over the Brexit issues, particularly on whether the UK will leave the European Union with or without a deal.

G. Domestic liquidity and credit conditions

- Domestic liquidity and credit growth expanded faster in July. Domestic liquidity grew by 6.7 percent in July (from 6.4 percent in June), while bank lending increased to 11.1 percent (from 10.5 percent). The higher M3 growth was due the sustained growth in credit to the private sector owing to higher loans for real estate activities; financial and insurance activities; electricity, gas, steam and airconditioning supply; construction; and wholesale and retail trade, repair of motor vehicles and motorcycles. The expansion in net foreign assets also contributed to M3 growth brought about by foreign exchange inflows coming mainly from overseas Filipinos' remittances, business process outsourcing receipts, and foreign portfolio investments.

H. Fiscal developments

- The NG catch-up program for fiscal spending is expected to buoy the growth momentum in 2019. With the signing of the 2019 national budget in mid-April, government spending is expected to resume for the year. The NG recorded a ₱117.9-billion fiscal deficit for the first seven months of 2019, which is fifty-eight percent lower than the deficit recorded in 2018.

I. External developments

- Growth in global economic activity remains subdued as global service sector output eased while the output performance of manufacturing sub-sectors were in contraction territory. In particular, US manufacturing activity posted a slump due mainly to a decrease in new orders amid market concerns on the ongoing US-China trade dispute. Similarly, manufacturing activity in Japan remained in contraction territory as new business placed with Japanese manufacturers declined during the month amid weak domestic and external demand. Manufacturing output growth also contracted in Malaysia, Singapore, and Indonesia.