BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 25 MARCH 2021[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 inflation is likely to remain elevated in the coming months, reflecting the impact of supply-side constraints on domestic prices of key food commodities such as meat as well as the continuing uptick in international oil prices. Nevertheless, inflation is still seen to return within the target band in 2022 as supply-side influences subside.

- In assessing the monetary policy stance, the Monetary Board also noted that the risks to the inflation outlook remains broadly balanced around the baseline path in 2021 while leaning toward the downside in 2022. Tighter domestic supply of meat products and improved global economic activity could lend further upside pressures on inflation. However, the ongoing pandemic also continues to pose downside risks to the inflation outlook, as the recent surge in virus infections and challenges over mass vaccination programs continue to temper prospects for domestic demand.

- Given these considerations, the Monetary Board was of the view that prevailing monetary policy settings remain appropriate to support the Government's broader efforts to facilitate the recovery of the economy. At the same time, however, the Monetary Board emphasized that the timely implementation of non-monetary interventions is crucial in mitigating the impact of supply-side pressures on inflation and thereby preventing them from spilling over as second-round effects.

[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 13 May 2021.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- Year-on-year headline inflation continued to rise to 4.7 percent in February 2021, which was higher than the 4.2 percent in January 2021 but was within the BSP's monthly range forecast of 4.3-5.1 percent for the month. Inflation accelerated due to higher meat prices as supplies remained tight amid the persistence of the African Swine Fever (ASF) outbreak. The closed fishing season and the colder weather have also limited fishermen's catch, resulting in faster increases in fish prices. Heavily-weighted rice CPI also registered an uptick partly due to the end of the main harvest season. These brought the year-to-date average inflation to 4.5 percent year-on-year, which is higher than the government's 2-4 percent target range.

- Core inflation, which excludes selected volatile food and energy items to depict underlying demand-side price pressures, increased to 3.5 percent in February from 3.4 percent in the previous month. The disparity between the headline and core inflation measures indicates that the recent uptrend has been mostly supply driven and is not broad-based at the moment.

B. Inflation expectations

- The latest results of the BSP's survey of private sector economists for March 2021 showed the mean inflation forecast for 2021 jumping to 4.3 percent from 3.9 percent based on the February 2021 survey. By contrast, the mean inflation forecast for 2022 declined to 3.0 percent from 3.1 percent. Meanwhile, the mean inflation forecast for 2023 remained at 3.0 percent. The BSP's survey of private sector economists was conducted from 5 to 16 March 2021.

C. Inflation outlook

- The latest baseline inflation forecasts are 4.2 percent for 2021 and 2.8 percent for 2022. Inflation is projected to accelerate above the high end of the target range from Q1 to Q3 2021 due to the transitory impact of supply-side price pressures. Positive base effects owing to the deceleration of inflation in the same period in 2020, reflecting the impact of the COVID-19 pandemic on global prices of key commodities, likewise contributed to the inflation uptrend. Nevertheless, the inflation path is seen to decelerate below the midpoint of the target range by end-2021 and Q1 2022 before settling near the midpoint by H2 2022 as global oil and non-oil prices begin to moderate. The upward revision in the baseline inflation forecasts for 2021 and 2022 was due largely to the continued rise in global crude oil prices and the higher-than-expected inflation outturn in February 2021.

Baseline Inflation Forecasts		
	11 February 2021 MB Meeting	**25 March 2021 MB Meeting**
2021	4.0	4.2
2022	2.7	2.8

- The risks to the inflation outlook are seen to be broadly balanced for 2021 but remain on the downside in 2022. Supply-side price pressures from meat prices along with the impact of an earlier rollout of COVID-19 vaccines and stronger global growth on domestic economic activity are the primary upside risks to inflation. Meanwhile, government measures to address the supply constraints, namely the proposed reduction of tariffs on meat and rice imports, provide the main downside risks to inflation. The potential impact on domestic economic growth prospects of potential delays in the country's vaccination program as well as a weaker-than-expected global recovery owing to the spread of new variants of the virus is also a source of downside risks.

D. Demand conditions

- Philippine GDP is projected to contract until Q1 2021. The decline in GDP in the first quarter could be driven primarily by the sectors that remain heavily affected by the pandemic despite some easing in quarantine measures. In particular, the services sector could continue to contract driven primarily by the slowdown in transport, tourism, and other service activities as reflected by the January 2021 Labor Force Survey results. The agriculture sector meanwhile is projected to expand slightly due to improved weather conditions during the quarter. The industry sector could also begin to expand as construction activity picks up based on high-frequency indicators.

- Forward-looking indicators for economic activity suggest a slowdown in business operations. The preliminary composite PMI in February 2021 remained below the 50-point expansion threshold at 46.5, lower by 2.3 index points from the January PMI of 48.8. The lower PMI in February may be attributed to the further contraction of the retail and wholesale and services sectors, as well as the slower expansion of the manufacturing sector.

- Likewise, mobility data as of 28 February 2021 have reverted to below baseline figures in the first two months of 2021. The Google mobility report showed that mobility indicators have fallen below baseline after peaking during the holiday season. Meanwhile, grocery and pharmacy have exceeded the baseline threshold in the last week of February but was still lower than the December 2020 record. Mobility trends for places of work was below the baseline, suggesting that work-from-home arrangements are still in place in February 2021. In addition, transit stations remain subdued given limited public transportation options despite easing containment measures in the country. However, mobility numbers under residential continue to decline, implying that people are staying less at home.

- Overall, the continued implementation of quarantine restrictions, tepid demand recovery of foreign markets, and slower-than-expected global vaccine distribution are expected to weigh on the domestic economy's recovery. Meanwhile, consumer and business sentiment have been aided by expectations of vaccine rollout. Greater fiscal support could also help minimize possible economic scarring and sustain the country's nascent recovery.

E. Supply-side indicators

Developments in Agriculture

- Domestic retail rice prices remained broadly stable, owing to ample supply. Meanwhile, the continued escalation of the ASF outbreak has lowered domestic hog supply, which in turn led to the increase in pork prices. To address this, the Department of Agriculture has rolled-out targeted measures to address concerns on elevated meat prices, help stabilize pork supply, and support the recovery of the local hog industry. These include the mobilization of pork supply from surplus provinces to Metro Areas, hog repopulation program, and ASF control and management programs. In addition, the government is studying the reduction of tariffs for imports of pork to augment domestic supply conditions.

- According to the latest climate advisory of the Philippine Atmospheric, Geophysical and Astronomical Services Administration[2], moderate La Niña conditions prevail and is expected to continue until March 2021. Although La Niña conditions have weakened, PAGASA reiterated that there is still chance of above normal rainfall conditions to occur which might adversely affect highly vulnerable areas and sectors of the country.

Oil Price Developments

- Dubai crude oil prices have surpassed US$60 per barrel thus far in 2021 due to more optimistic demand outlook amid COVID-19 vaccine programs along with OPEC+ decision to extend production cuts with only minimal increases from selected countries. Recent developments continued to exert upward pressure on near-term prices and as such, futures prices remained in backwardation as of 12 March 2021. Meanwhile, the increase in international oil prices has also led to upward price adjustments of selected domestic petroleum products. In the domestic market, price changes of most domestic petroleum products showed mixed trends compared to end-2020 levels. In particular, prices of both kerosene and diesel rose while gasoline prices continued to decline.

Developments in the Utilities Sector

- The overall electricity rate decreased further in March 2021 due mainly to the implementation of the Distribution Rate True-UP refund during the month. The Energy Regulatory Commission (ERC) granted Meralco's petition to refund around ₱13.9 billion to customers, given the difference between the actual weighted average tariff and the ERC-approved interim average rate for distribution-related charges for the period July 2015-November 2020. At the same time, the decline in the overall rate is attributed to the adjustments for over- and under-recoveries.[3] Moreover, lower generation charge[4] also contributed to overall power rate decrease.

F. Financial market developments

- For the period 1-16 March 2021, the peso depreciated against the US dollar, partly owing to risk-off sentiment amid the surge in new coronavirus infections in the country as well as the decline in overseas Filipinos (OF) cash remittances in January 2021 as a result of continued repatriations and tighter restriction measures from host economies.

G. Domestic liquidity and credit conditions

- Domestic liquidity has remained ample amid a benign inflation environment. Preliminary data show that domestic liquidity (M3) expanded by 9.0 percent year-on-year to about ₱14.0 trillion in January. This was slower than the 9.5-percent growth in December. On a month-on-month seasonally-adjusted basis, M3 increased by 0.7 percent.

  Bank lending, however, continues to slow down due to muted business confidence and banks' stricter loan standards attributed mainly to prolonged disruptions in business operations amid

[2] Seasonal Climate Outlook Report as of 24 February 2021.

[3] In an Order released 29 December 2020, ERC directed Meralco to refund over-recoveries in transmission and other charges over a period of approximately three months and to collect an under-recovery in the generation rate for approximately 24 months. Meralco implemented the ERC-approved adjustments starting January 2021. The impact to residential customers, from the months of January to March 2021, is a net refund of around P0.1150 per kWh. [Reference: Meralco]

[4] According to Meralco, the downward adjustment in generation cost was primarily due to higher share of supply from the Wholesale Electricity Spot Market, which registered the lowest charge among suppliers.

the ongoing health crisis. Preliminary data show that outstanding loans of universal and commercial banks fell by 2.4 percent in January following a 0.7-percent decline in December.

- Nevertheless, liquidity in the financial system remained ample as a result of the BSP's extraordinary liquidity-enhancing measures. At the same time, domestic market interest rates have also been declining following the BSP's cumulative 200-bp policy rate cut in 2020. Meanwhile, transactions in the interbank market and overnight lending facility (OLF) of the BSP have diminished significantly.

H. Fiscal developments

- The National Government (NG) recorded a ₱1.371 trillion fiscal deficit for 2020, more than twice the amount recorded in 2019. The wider gap for the year reflected the growth in public spending combined with the reduction in government receipts resulting from the economic impact of the COVID-19 pandemic. Netting out the interest payments in NG expenditures, the primary deficit amounted to ₱991.0 billion, more than three-fold of the amount recorded in the previous year.

I. External developments

- Global prospects have improved amid vaccine rollout although headwinds remain from renewed waves and new virus variants. Global economic output expanded faster amid improved demand conditions in both manufacturing and service sectors. The JP Morgan Global All-Industry Output Index accelerated in February as growth in new orders rose to a three-month high amid improved conditions in several markets and stable new export orders. Output expanded in the US, India, China, Germany, Italy, Russia, and Australia, while downturns were recorded in Japan, the UK, France, and Brazil. Meanwhile, output indicators in the ASEAN region deteriorated. The Nikkei ASEAN Manufacturing PMI fell in February, the first contraction since October 2020. The decline in manufacturing conditions was attributed to renewed contractions in both factory production and order book volumes.