BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 23 SEPTEMBER 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 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 decision of the Monetary Board is based on the assessment of the latest baseline inflation path which indicate a higher inflation path over the policy horizon. Average inflation is seen to settle slightly above the upper end of the target band of 2-4 percent in 2021. This reflects the impact of recent supply disruptions on food prices, which contributed in part to the higher-than-expected inflation outturn in August. Nevertheless, inflation is projected to settle close to the midpoint of the target range in 2022 and 2023. Moreover, inflation expectations remain firmly aligned with the baseline projection path.

- At the same time, the risks to the inflation outlook have tilted towards the upside for the remaining months of 2021 but remains broadly balanced for 2022 and 2023. Upside risks may emanate from pressures on international commodity prices amid improving global demand and lingering supply-chain bottlenecks. The potential effects of weather disturbances and a possible prolonged recovery from the African Swine Fever (ASF) outbreak could also continue to lend upside pressures on prices. Meanwhile, downside risks are seen from the spread of more contagious coronavirus variants, as potential delays in the lifting of containment measures could further dampen prospects for global growth and domestic demand.

- The Monetary Board also noted that the outlook for recovery continues to hinge on timely measures to prevent deeper negative effects on the Philippine economy. To this end, the acceleration of the Government's vaccination program and a recalibration of existing quarantine protocols will be crucial in supporting economic activity while safeguarding public health and welfare.

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[1] The discussions herein reflect the assessment made by the Monetary Board based on a comprehensive set of macroeconomic and financial information available at the time of the policy meeting. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 18 November 2021.

- On balance, the Monetary Board was of the view that prevailing monetary policy settings remain appropriate given the manageable inflation environment and uncertain growth outlook. The Monetary Board reiterated that, together with appropriate fiscal and health interventions, keeping a steady hand on the BSP's policy levers will allow the momentum of economic recovery to gain more traction by helping boost domestic demand and market confidence.

III. Recent Developments and Inflation Outlook

The Monetary Board considered the recent macroeconomic and financial developments listed below in deciding the appropriate monetary policy stance:

A. Domestic price conditions

- Headline inflation rose to 4.9 percent in August 2021, the fastest year-over-year pace since January 2019 amid cost-push factors. Inflation picked up in August as prices on key food items such as vegetable, fish, and meat surged amid supply-side disruptions caused by monsoon rains and the reimposition of stricter quarantine measures due to the emergence of the more infectious and transmissible COVID-19 Delta variant. This development brought the year-to-date average inflation to 4.4 percent, exceeding the government's annual target range of 2-4 percent.

- Core inflation, which excludes selected volatile food and energy items to depict underlying demand-side price pressures, likewise accelerated to 3.3 percent year-on-year in August 2021 from 2.9 percent a month earlier.

B. Inflation expectations

- Inflation expectations remain anchored to the target over the policy horizon. The September 2021 survey results of inflation forecasts show that private sector economists expect inflation to average at 4.3 percent for 2021, slightly higher by 0.1 ppt from the August 2021 survey.[2,3] Meanwhile, the mean inflation forecasts for 2022 and 2023 were within the government's target range of 2-4 percent at 3.2 percent for both periods.

- Similarly, the Q3 2021 results of the BSP's expectations survey on consumers and businesses indicate that both sectors anticipate inflation to remain within the government's 2–4 percent inflation target range for 2021 and 2022.

[2] There were 23 respondents in the BSP's survey of private sector economists in August 2021. The survey was conducted from 10 to 23 August 2021.

[3] There were 21 respondents in the BSP's survey of private sector economists in September 2021. The survey was conducted from 7 to 13 September 2021.

C. Inflation outlook

- The latest baseline inflation forecasts are 4.4 percent for 2021, 3.3 percent for 2022, and 3.2 percent for 2023. The upward revisions in the inflation forecasts are due to the higher-than-expected inflation outturn in August 2021, higher inflation nowcast for September 2021, approved increase in the Suggested Retail Price (SRP) of basic necessities and prime commodities, and the slower-than-expected arrival of imported pork. These factors were partly offset by the slower GDP growth outlook and the peso appreciation. Meanwhile, 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. Inflation is estimated to subsequently 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		
	12 August 2021 MB Meeting	**23 September 2021 MB Meeting**
2021	4.1	4.4
2022	3.1	3.3
2023	3.1	3.2

- The risks to the inflation outlook are now seen to be weighted toward the upside over the near term, but broadly balanced for 2022 to 2023. The potential impact of weather disturbances on the prices of key food items is the major upside risk in the remaining months of 2021. The further uptick in global commodity prices due to strong global demand amid supply chain bottlenecks could also pose upside risks to inflation along with the possibility of a prolonged recovery from the ASF outbreak in the country. Meanwhile, the potential impact on domestic economic growth prospects of delays in the easing of containment measures as well as the weaker-than-expected global recovery due to the rapid spread of new and more virulent Covid-19 variants are the main sources of downside risks.

D. Demand conditions

- The staff's full-year growth forecast for 2021 and 2022 were revised downwards to reflect the lower Q3 2021 growth nowcast due to the implementation of stricter quarantine measures in August 2021 for NCR and key provinces. In addition, the lower full-year projected forecast factored in the 2021 GDP growth target for the country, which was revised downwards to 4-5 percent from 6-7 percent by the Development Budget Coordination Committee (DBCC) on 18 August 2021[4] amid closure of non-essential industries as infection cases continued to escalate. The latest

[4] https://www.dbm.gov.ph/index.php/secretary-s-corner/press-releases/list-of-press-releases/1922-dbcc-reviews-growth-assumptions-for-fy-2021.

forecasts also show that the country's real GDP will return to its 2019 level by Q4 2022. This implies that the economy will likely operate below full capacity in the near term with firms and households gradually adjusting to post-pandemic economic conditions over time.

- Mobility indicators have trended upward in recent months amid revised levels of stringency associated with quarantine protocols implemented by the National Government. (NG). Unlike in the ECQ periods in 2020 where the NG shut down around 75 percent of the economy,[5] most industries and services continued to operate during the 2021 ECQ period such as takeout and delivery, food preparation establishments, as well as business process outsourcing (BPOs) and export-oriented businesses.

- Substantial spare capacity remains in the labor market. While employment and unemployment rates indicate an improvement in July 2021 at 93.1 percent and 6.9 percent, respectively, these figures are still not at par yet to the pre-pandemic conditions. Moreover, the quality of employment shows a rather slow recovery as employment gains were mostly low-skilled and less remunerative. The employment rate in July 2021 translated to 41.7 million employed individuals, lower than in the previous month at 45.1 million and the pre-pandemic level of 42.5 million in January 2020, but slightly higher nevertheless than the same period a year ago at 41.3 million.

E. Supply-side indicators

Developments in Agriculture

- Nationwide average rice prices show mixed trends in August 2021 based on the 2nd phase of the Philippine Statistics Authority (PSA) Retail Price Survey (RPS). Rice prices generally increase during the lean months of July to September when domestic production is low. The expected increase in rice prices has been kept at bay, with some cities even registering declines in prices between the 1st and 2nd phase surveys in August, as domestic rice supply is augmented by private sector rice imports. Nonetheless, domestic retail rice prices remained generally stable as envisioned with the enactment of the Republic Act (R.A.) No. 11203.

- Meanwhile, the Department of Agriculture (DA) has also rolled-out temporary measures targeted to help stabilize domestic supply of agricultural commodities such as pork, rice, and fish.

- On the developments in the ASF situation in the country, the Department of Agriculture (DA) reported that ASF incidence was down to only 16 cities and municipalities from the total of 579 cities and municipalities affected when ASF hit the country in 2019, which may be attributed mainly to the impact of stricter surveillance and monitoring efforts under the *BABay ASF*

[5] Estimate from the National Economic Development Agency. Presented during the press briefing on the release of Q2 2021 National Accounts in August 2021.

(Bantay ASF sa Barangay) program, as well as the hog repopulation initiative implemented by the DA in partnership with local government units (LGUs), hog raisers, and the private sector.

- On weather conditions, ENSO-neutral conditions will likely transition to La Niña with 70 to 80 percent probability from December 2021 – February 2022. La Niña conditions will likely re-emerge during the months of October to December 2021 and may persist until Q1 2022.

<u>Oil Price Developments</u>

- International oil prices picked up anew in September 2021 due to lower COVID-19 cases in China and other countries in Asia as well as production disruptions caused by Hurricane Ida in the US Gulf of Mexico. However, expectations of higher supply exerted some downward pressure on oil prices, which tempered the increase. This development ensued following the OPEC+ decision to raise output along with Saudi Arabia's move to lower official selling prices of crude oil to Asia. Meanwhile, futures prices remained in backwardation, which suggests that crude oil prices would decline going forward.

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

- The overall electricity rates increased slightly due mainly to higher transmission charge. The higher ancillary service charges, which accounted for about 36 percent of the National Grid Corporation of the Philippines' (NGCP) total transmission charge, resulted in the increase in transmission charge according to MERALCO.

- At the same time, the increase generation charge partly contributed to the rise in the overall electricity rate. Charges from Independent Power Producers (IPPs) rose which was attributed to the continued peso depreciation against the US dollar as well as the increase in Malampaya natural gas prices following quarterly repricing to reflect increases in world crude oil prices. Nonetheless, the increase in IPP charges was offset by the decreases in charges of Power Supply Agreements (PSAs) and the Wholesale Electricity Spot Market (WESM) due to higher energy deliveries and improved power situation in the grid with cooler temperature and improved availability of generating plants, respectively.

F. Financial market developments

- The Philippine stock market exchange index (PSEi) continued to advance to close at 6,970.51 index points as of 10 September 2021, higher by 1.7 percent than the closing index in end-August. This development ensued as investors viewed favorably the affirmation of the country's "A-" rating by the Japan Credit Rating Agency (JCRA), the easing of unemployment rate to 6.9 percent in July 2021, and the 60.4 percent surge in foreign direct investments (FDI) net inflows in June.

- The peso appreciated against the US dollar for the period 01-10 September 2021. This development reflected, in part, market optimism following (i) the arrival of more coronavirus vaccines in the country which fueled hopes for the gradual reopening of the economy; (ii) the BSP's statement of continued policy support if needed to sustain economic recovery; and (iii) increased foreign interest in the local equities market after China tightened its regulation on technology firms.

- The Philippine banking system (PBS) sustained its asset expansion on account of increase in portfolio investments which tempered contraction in loans. Likewise, the PBS maintained adequate capital buffers and strong liquidity position. Banks' profitability also rebounded in the first half of 2021 due to better non-interest income and lower loan loss provisions compared to that recorded in the previous year. Bad debts written off, however, continued to surge. The BSP's existing regulatory relief measures also continue to gain traction as evidenced by the continued grant of new/restructured micro, small and medium enterprises (MSME) loans. Nonetheless, the impact of the pandemic warrants careful monitoring as this would continue to weigh on the performance of the banking system.

G. Domestic liquidity and credit conditions

- Domestic financial market conditions have generally normalized and eased since the onset of the pandemic amid moves towards maintaining the current accommodative monetary policy settings. Prior BSP measures continue to provide ample liquidity in the financial system, with market interest rates trending record-low levels. The current government securities' yield in the secondary market across all tenors are lower relative to December 2019 (pre-pandemic) levels.

- Credit activity, however, has remained weak as uncertainty over the duration of the pandemic as well as increasing risks to corporate and household balance sheets continued to dampen market sentiment.

H. Fiscal developments

- The National Government recorded a ₱837.3 billion fiscal deficit for January – July 2021. Netting out the interest payments in NG expenditures, the primary deficit amounted to ₱569.7 billion, twenty-five percent higher from the ₱453.6 billion deficit 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 growth slowed down to its lowest in August 2021 on the back of rapid spread of the more virulent Delta variant, causing many economies to re-tighten public restrictions and shut down all-but-essential industries. The rate of expansion in manufacturing and services activities decelerated as indicated in the decline of JP Morgan Global All-Industry Output Index to 52.6 in August from 55.8 in the previous month. This development reflected the impact of supply chain disruptions, labor and skill shortages, and escalating COVID-19 cases.

- The growth narratives in manufacturing activity in North America and Euro Area are broadly similar but vary across Asia. Expansion in the US' and Euro Area's manufacturing activity slowed down in August. Meanwhile, the economic growth story in Asia is relatively uneven during the month under review. Contractions in manufacturing activities are reported in ASEAN region, Japan and China but at a varying degree. China's manufacturing PMI contracted to 49.2 in August after a 50.3 reading in July while the Nikkei ASEAN manufacturing PMI continued to record contraction. In contrast, manufacturing conditions return to expansion in India in August 2021.