HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 14 MAY 2015[1]

I. Monetary Policy Decision

The Monetary Board (MB) decided to:

a) Maintain the BSP's key policy interest rates at 4.00 percent for the overnight RRP (borrowing) facility and 6.00 percent for the overnight RP (lending) facility;

b) Maintain the current interest rates on term RRPs, RPs and SDAs; and

c) Maintain the current reserve requirement ratios.

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

- The Monetary Board's decision was based on its assessment that current monetary policy settings remain appropriate given a manageable inflation environment. Latest baseline forecasts continue to indicate that inflation is likely to settle within the lower half of the target range of 3.0 percent ± 1 percentage point for 2015-2016, while inflation expectations remain firmly anchored given the recent string of inflation outturns.

- The Monetary Board likewise observed that the risks to the inflation outlook continue to be broadly balanced, with upside risks emanating from pending petitions for adjustments in electricity rates and possible power shortages. Meanwhile, downside risks remain for global growth, even as prospects have become more evenly balanced.

- At the same time, the Monetary Board noted that domestic demand conditions remain robust, owing to solid private demand and buoyant business sentiment. In the months ahead, ample domestic liquidity and higher public spending are expected to support domestic economic activity and sustain the economy's momentum.

- Given these considerations, the Monetary Board believes that prevailing monetary policy settings are appropriately calibrated to the outlook for inflation and domestic economic activity. Going forward, the BSP will continue to monitor domestic and external developments to ensure that the monetary policy stance remains in line with maintaining price and financial stability.

[1] The discussions presented reflect the assessment made by the Monetary Board based on the information available at the time of the policy meeting. A comprehensive set of economic information was provided by the Technical Secretariat of the Advisory Committee (AC). The AC is composed of the Governor of the BSP as Chairman and four members, namely: the Deputy Governor of the Monetary Stability Sector, the Deputy Governor of the Supervision and Examination Sector, the Assistant Governor of the Treasury Department, and the Managing Director of the Monetary Policy Sub-Sector. The highlights of the discussions on the 14 May 2015 meeting were approved by the Monetary Board during its regular meeting held on 4 June 2015. The next meeting of the Monetary Board on monetary policy issues is scheduled on 25 June 2015.

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 decelerated further in April. Other indicators also decreased such as the official core inflation, all alternative measures of core inflation estimated by the BSP, the seasonally-adjusted month-on-month and 3-month moving average annualized core inflation, and the weight of the above-threshold CPI items.

- The continued deceleration of headline inflation in April was driven largely by the slower increases in food prices. In particular, food inflation edged lower as most food commodities, particularly rice, corn, meat, milk, oils, and fruits posted lower price increases due to ample domestic supply. Likewise, non-food inflation eased slightly as a result of the continued decline in electricity rates and domestic petroleum prices in year-on-year terms as well as the slower price increases in clothing and footwear items, health-related products and services, and restaurants and miscellaneous goods and services.

- By geographical location, inflation in the National Capital Region (NCR) and areas outside NCR decelerated to 1.5 percent and 2.3 percent, respectively, in April from 1.9 percent and 2.6 percent in March.

B. Inflation expectations

- Inflation expectations are in line with the target range for 2015-2016, based on information from the latest surveys of private sector analysts. Results of the April 2015 BSP's survey of private sector economists yielded lower mean inflation forecast for 2015 at 2.6 percent and generally unchanged inflation forecasts for 2016 and 2017 at 3.3 percent. Meanwhile, results of the April 2015 Consensus Economics survey showed unchanged mean inflation forecasts at 2.7 percent for 2015 and 3.5 percent for 2016.

C. Inflation outlook

- The latest baseline inflation forecasts continued to indicate that inflation will likely settle in the lower half of the 2-4 percent target range for both 2015 and 2016. The slight increase in the forecasted inflation path for 2015 could be attributed mainly to higher oil prices and the impact of the increased likelihood that the current El Niño episode could extend to the second half of the year.

- The distribution of risks to the baseline inflation forecast continues to be broadly balanced. Pending petitions for utility rate adjustments and the potential power shortages are seen to pose upside risks to the baseline inflation forecasts. Meanwhile, downside risks are linked mainly to possible slower-than-expected global economic activity (which could further drive international oil prices downward).

D. Demand conditions

- Indicators of domestic demand remain firm. Information available to date suggest that the economy is likely to remain on a solid growth path, as indicated by the BSP's business cycle analysis and current activity indicator (CAI) index. In a further sign of strength, trends in high-frequency demand indicators have remained generally positive: volume sales of automobiles and electricity are still rising, the composite PMI has stayed above the 50-point threshold, average capacity utilization rate in the manufacturing sector remained above the long-term average of 80 percent since 2010, and both business and consumer outlook continue to be favorable.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- The retail prices of rice fell in April 2015 amid adequate domestic supply. The average prices of well-milled rice and regular-milled rice both declined, compared to month-ago levels.

- The MB noted that additional rice imports will help mitigate the effects of the current El Niño and ensure stable prices during the lean months.

- The Food and Agriculture Organization (FAO) Food Price Index was also lower in March as prices of almost all commodities, particularly sugar, cereals, vegetable oils, and meat fell year-on-year amid ample supplies. Only the prices of dairy products increased.

- Meanwhile, the Philippine Atmospheric, Geophysical and Astronomical Services Administration(PAGASA) noted in its latest El Niño advisory that the ongoing weak El Niño will likely to continue until mid-2015 with chances of strengthening toward the end of the year.

<u>Oil Price Developments</u>

- International oil prices rose in April amid speculation that the continuing drop in the number of active US oil rigs would curb production. Tracking the movements of international oil prices, the domestic prices of petroleum products, except LPG, were raised on 27 April.

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

- Electricity rates increased in April due to higher generation costs. According to Meralco, generation rates went up mainly on account of the 30-day Malampaya maintenance shutdown (15 March – 13 April 2015), which forced power plants to use more expensive liquid fuel in lieu of natural gas. Consequently, power rates charged by Independent Power Producers (IPPs) and Power Supply Agreements (PSAs) went up.

F. Financial market developments

- The equities market continued to be buoyant in April. The rally in the first half of the month was prompted by the inflow of foreign capital in the local bourse after the Philippine growth forecast was raised by Fitch Rating, S&P and the IMF. Also helping boost the benchmark index higher were expectations that the Fed may push back its first rate hike until later in the year. However, market gains were tempered as investors' concern over high valuations, slower Chinese GDP growth in Q1 2015 and the possibility of Greece's default dampened sentiments.

- The peso strengthened slightly in April as a string of soft US data raised uncertainty on the outlook for higher interest rates in the US. Moreover, the sustained inflows of foreign exchange from overseas Filipino remittances, BPO and tourism receipts, foreign portfolio and direct investments, as well as the ample level of the country's gross international reserves provided stability to the peso.

- Meanwhile, debt spreads narrowed in April as the outcome of the FOMC meeting on 28-29 April also dampened the outlook for the timing of the first interest rate hike by the Federal Reserve while ROP prices were also supported by general buying interest from both local and foreign players who remained bullish on their outlook for the Philippines.

G. Domestic liquidity and credit conditions

- Preliminary data showed that M3 grew by 9.4 percent in March 2015 to ₽7.7 trillion. This was faster than the 8.5-percent expansion recorded in February 2015. On a month-on-month seasonally-adjusted basis, M3 increased by 2.1 percent. Growth in domestic claims continued to drive M3 growth.

- The outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, grew at a slower rate of 13.7 percent in March 2015 from 15.2 percent in February 2015. On a month-on-month seasonally-adjusted basis, commercial bank lending increased for both loans net of RRPs and loans inclusive of RRPs.

H. External developments

- Global growth prospects are more evenly balanced, but downside risks remain. The IMF expects global output to expand by 3.5 percent in 2015 and by 3.8 percent in 2016, broadly in line with the earlier projections in its January 2015 WEO Update.

- However, while the distribution of risks to the global growth outlook is seen to be more evenly balanced, it is still seen to be tilted to the downside. The main upside risk, according to the IMF, continues to emanate from the possible favorable impact of lower oil prices on global demand conditions. On the downside, risks include geopolitical tensions as well as potential global financial market volatility owing to unanticipated timing and magnitude of future monetary policy adjustments in advanced economies, particularly in the US, amid the uneven pace of activity across economies. Global inflation pressures are also seen to remain broadly benign, reflecting largely the impact of the decline in oil prices.