Bangko Sentral ng Pilipinas

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 11 DECEMBER 2014[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 MB's decision was based on its assessment that the inflation environment has become more manageable, with the risks to the inflation outlook remaining broadly balanced over the policy horizon. Latest baseline forecasts showed a lower inflation path for 2014-2016 relative to the previous policy meeting, reflecting in large part the subdued outlook for global commodity prices. Inflation expectations were also generally lower and remained aligned to the inflation target. Meanwhile, output growth moderated in Q3 2014 as agricultural production declined amid unfavorable weather conditions and as public spending slowed down.

- The MB noted that while global economic conditions remained challenging, prospects for domestic activity continue to be firm, supported by strong domestic private demand, robust bank lending growth, and buoyant business sentiment.

- The MB is of the view that prevailing monetary policy settings remain appropriate given the manageable inflation outlook and favorable domestic growth prospects. The MB emphasized that the BSP will continue to monitor evolving price and output developments and remain prepared to take appropriate measures as necessary to ensure that the monetary policy stance continues to support an environment characterized by 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 Monetary Policy Sub-Sector, and the Assistant Governor of the Treasury Department. The highlights of the discussions on the 11 December 2014 meeting were approved by the Monetary Board during its regular meeting held on 8 January 2015. The next meeting of the Monetary Board on monetary policy issues is scheduled on 12 February 2015.

III. Recent Developments and Inflation Outlook

The MB considered the following developments in deciding its policy stance:

A. Domestic price conditions

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

- The continued deceleration of headline inflation in November was driven largely by the lower prices of electricity and domestic petroleum products along with the slower increases in food prices. Non-food inflation edged lower due mainly to lower pump prices of diesel and gasoline (reflecting declines in international oil prices), price reductions in kerosene and LPG as well as the downward adjustment in electricity rates as a result of lower generation charges. Similarly, food inflation slowed down on adequate domestic supply of key food items, particularly rice, corn, meat, oils, vegetables, and sugar.

- By geographical location, inflation in the National Capital Region (NCR) and areas outside NCR decreased to 2.4 percent and 4.0 percent, respectively, in November from 3.6 percent and 4.5 percent a month ago.

B. Inflation expectations

- Inflation expectations—reflected in forecast surveys in November—were generally lower compared to the previous month and aligned to the inflation target. Results of the BSP's November 2014 survey of private sector economists yielded lower inflation forecasts for 2014 and 2015 at 4.2 percent (from 4.3 percent in October) and 3.9 percent (from 4.0 percent) respectively. Meanwhile, the mean inflation forecast for 2016 was steady at 3.8 percent. Results of the November 2014 Consensus Economics inflation forecast survey for the country showed a steady mean inflation forecast for 2014 at 4.3 percent and a lower mean inflation forecast for 2015 at 3.7 percent (from 3.9 percent in October).

C. Inflation outlook

- The latest outlook for inflation showed a lower path for 2014-2016. The downward adjustment in the forecasted inflation path could be attributed mainly to lower oil prices and lower-than-projected inflation in October and November 2014. Current forecasts suggest that inflation is likely to settle slightly above the midpoint of the 4.0 percent ± 1.0 percentage point target range in 2014 and 3.0 percent ± 1.0 percentage point target range in 2015. It is expected to be close to the lower-end of the 3.0 percent ± 1.0 percentage point target range for 2016.

- Risks to future inflation are broadly balanced. Pending petitions for utility rate adjustments and looming power shortage pose upside risks to inflation while downside risks could stem from slower global economic activity.

D. Demand conditions

- GDP growth decelerated in Q3 2014 to 5.3 percent, driven mainly by government underspending. The slowdown was across the board but the composition of growth remained similar to that seen in the first half of 2014. Growth in the third quarter was driven on the production side by the industry (particularly manufacturing) and services sectors. On the demand side, household consumption, fixed capital formation, and net exports supported growth, indicating resilience and underlying strength in private demand.

- Other indicators continued to point to positive growth momentum in the fourth quarter. Business expectations turned more upbeat in Q4 2014 compared to Q3 2014, driven by expectations of an acceleration in the roll-out of infrastructure and other development projects under the public-private partnership (PPP) program and the favorable macroeconomic conditions in the country. The results of the monthly Purchasing Managers' Index (PMI) survey likewise indicated that domestic output continue to expand in October 2014 after slowing down in Q3 partly due to supply chain problems. The sustained expansion in bank lending also supports the view that underlying domestic demand remains strong.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- The Agriculture sector contracted in Q3 2014 mainly driven by production cutbacks on *palay*, corn, coconut including copra, and poultry, which were adversely affected by typhoons Glenda and Luis, and the monsoon rain. Forestry and fishing sub-sector also posted negative growth during the quarter. Meanwhile, the retail prices of rice eased in November 2014 due to the ongoing harvest season.

<u>Oil Price Developments</u>

- Oil prices decreased further in October on weak global demand outlook. Oil prices continued to drop in November as Saudi Arabia's price cuts bolstered concerns of a global glut in oil supply. Tracking the movement of international oil prices, the domestic pump prices of petroleum products, except LPG, were lowered on 18 November.

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

- Lower generation costs pulled electricity rates lower in November. According to Meralco, the decline was primarily due to the improved availability of power plants and lower fuel cost for the supply month of October.

F. Financial market developments

- The local bourse surged in early November due to the news of fresh stimulus from Japan. For the remainder of the month, investor sentiment was boosted by easing domestic inflation in October; post-election rally in US equity prices; selective buying over better-than-expected corporate earnings in Q3, especially of listed companies in the real estate sector, and the OECD’s optimism about the country’s growth prospects. Most regional markets also rose in November on the back of upbeat investor sentiment following stimulus announcement by China and Japan. Peso weakened over the US dollar on concerns that an increase in US interest rates would spur capital outflows from emerging markets. Meanwhile, debt spreads also narrowed in November.

G. Domestic liquidity and credit conditions

- M3 grew by 15.4 percent in October to ₱7.2 trillion. This pace of increase was slower than the 16.2-percent expansion recorded in the previous month. On a month-on-month basis, seasonally-adjusted M3 rose by 0.9 percent, following the 0.3-percent increase (revised) in the previous month.

- Similarly, the outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, grew by 21.1 percent in October. Similarly, bank lending inclusive of RRPs expanded by 20.0 percent from the 19.5 percent growth posted in the previous month. On a month-on-month seasonally-adjusted basis, commercial bank lending increased by 1.4 percent for loans net of RRPs and by 1.2 percent for loans inclusive of RRPs.

H. Fiscal developments

- The fiscal deficit for the period January-September 2014 was ₱31.1 billion, lower than the ₱101.2-billion deficit incurred during the same period in 2013. Meanwhile, netting out the interest payments in the expenditures, the primary surplus amounted to ₱226.3 billion, ₱69.4 billion higher than the level recorded in the period January-September 2013.

I. External developments

- The outlook for the global economy continued to show divergence in growth paths for the major economies. On the one hand, economic activity in the US has continued to strengthen. On the other hand, there was greater unease over the prospects of other large economies resulting from the sharp decline in Japanese GDP growth and the Chinese economy’s moderating growth. The recovery in the euro area remained fragile. Moreover, concerns over deflation or a protracted period of very low inflation, an indication of substantial output gaps in advanced economies, also remain.