BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 12 SEPTEMBER 2013[1]

I. Monetary Policy Decision

The Monetary Board (MB) decided to:

a) Maintain the BSP's policy interest rates at 3.5 percent for the overnight RRP (borrowing) rate and 5.5 percent for the overnight RP (lending) rate;

b) Maintain the current interest rates on term RRPs, RPs and SDA; 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 of a benign inflation environment. Latest baseline forecasts indicated that the future inflation path continued to be broadly in line with the target range of 4.0±1.0 percent in 2013-2014 and 3.0±1.0 percent for 2015, while inflation expectations remained firmly anchored. Domestic economic activity has also been growing at a solid pace, supported by firm demand and buoyant business sentiment.

- At the same time, the MB noted that the balance of risks to the inflation outlook has shifted slightly toward the upside as oil prices have become more volatile amid ongoing geopolitical tensions in the Middle East. Meanwhile, world economic prospects are seen to remain broadly subdued, thus tempering pressures on global commodity prices. The robust growth of lending to the productive sectors of the economy should also support the improvement in the economy's absorptive capacity and help moderate price pressures. As expected, the BSP's operational adjustment of its SDA facility has also contributed to the rise in domestic liquidity (M3) growth in July. As M3 growth rates are expected to normalize once these adjustments have been completed, the temporary period of strong M3 growth is not expected to lead to significant inflationary pressures.

- Going forward, the BSP will continue to pay close attention to the outlook for prices and economic activity to ensure that monetary policy continues to safeguard non-inflationary economic growth.

[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 12 September 2013 meeting were approved by the Monetary Board during its regular meeting held on 3 October 2013. The next meeting of the Monetary Board on monetary policy issues is scheduled on 24 October 2013.

III. Recent Developments and Inflation Outlook

The MB considered the following developments in coming up with its policy decision:

A. Domestic price conditions

- Year-on-year headline inflation declined further in August due largely to lower non-food inflation. Likewise, other indicators fell such as the official core inflation, seasonally-adjusted month-on-month headline inflation, and seasonally adjusted 3-month moving average annualized headline and core inflation. Seasonally-adjusted month-on-month core inflation was steady in August.

- The slower increases in the prices of non-food items were due to the downward adjustment in electricity charges, as a result of lower generation charges at the Wholesale Electricity Spot Market. Similarly, food inflation dropped due to adequate domestic supply of such food commodities as vegetables, sugar, and oil. Slower price increases of meat, fish, and fruits also contributed to lower food inflation for the month.

B. Inflation expectations

- Inflation expectations reflected in forecast surveys of private sector economists by the BSP and by Consensus Economics remain within the target band over the policy horizon. For August 2013, results of the Consensus Economics survey showed slightly lower mean inflation forecasts for 2013 and 2014 at 3.0 percent and 3.7 percent, respectively. Similarly, results of the BSP's survey of private sector economists for August 2013 yielded a slightly lower mean inflation forecast for 2013 of 3.0 percent from 3.1 percent in July, while mean forecasts for 2014 and 2015 were unchanged at 3.6 percent and 3.7 percent, respectively.

C. Inflation outlook

- The outlook for inflation remains broadly in line with the target range over the policy horizon. The latest average baseline inflation forecasts for 2013 – 2014 are lower compared to the previous policy meeting on 25 July 2013. Meanwhile, the mean forecast for 2015 is broadly unchanged. The downward shift in the forecast path is attributed to the lower-than-forecasted actual inflation outturns for July and August as well as the lower actual NCR wage adjustment for 2013. These offset the impact of faster M3 growth and the increase in oil prices.

- The balance of risks to future inflation is now slightly skewed to the upside. Potential increases in oil prices due to the ongoing Syrian crisis, faster M3 growth and expected higher electricity rates in Mindanao constitute the upside risks to inflation. Nonetheless, M3 growth rates are expected to decelerate once the adjustments from the recent fine-tuning of the SDA facility have been completed and, thus, are not expected to translate into significant inflationary pressures.

D. Demand conditions

- Latest indicators point to the continued strength of domestic demand, with GDP increasing by 7.5 percent in Q2 2013. While this is slightly slower than the revised 7.7 percent growth during the first quarter, it is higher relative to the 6.3-percent growth recorded during the same quarter in 2012 and well above the long-run average growth rate. The second-quarter year-on-year performance was supported by growth in all expenditure items, notably household consumption, capital formation, and government spending.

- Meanwhile, based on the Business Expectations Survey (BES), business sentiment has remained buoyant in Q3 2013, although less upbeat compared to the previous quarter. For Q4 2013, the business outlook has turned more bullish with the BES next-quarter index rising to an all-time high of 60 percent since the nationwide survey started in Q4 2006. At the same time, the composite leading economic indicator (LEI) index of the NSCB likewise continued its upward trend in the third quarter, with 8 of the 11 LEIs contributing to the rise in the index.

- On 6 September 2013, the Department of Labor and Employment reported that the Regional Tripartite Wages and Productivity Board-National Capital Region (RTWPB-NCR) approved an additional ₱10.00 (2.2 percent) increase in the basic pay for all private workers in the region, bringing the minimum wage to ₱466.00.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- The Agriculture sector declined slightly by 0.3 percent in Q2 2013 from a growth of 0.6 percent in Q2 2012 due largely to contraction in the production of corn, banana and sugarcane. This was offset partly by higher output for mango, poultry and livestock. Palay production likewise fell in Q2 2013 because of lower harvested area and yield, which in turn, was due to dry weather conditions and insufficient water supply. Lower rice yields were also obseerved due to flooding and the movement of cropping to the first quarter.

- The Bureau of Agricultural Statistics (BAS) forecasts rice output to decline in Q3 2013 due to insufficient water supply, intense heat and late onset of rains. Nevertheless, rice production in Q4 2013 is expected to increase as a result of the different government intervention programs including expansion of area harvested and improvement in yield by investing in irrigation. For 2013, palay production is expected to register a higher growth compared to 2012.

- Commercial rice prices have been on an uptrend in recent months, reflecting largely the increase in prices associated with the onset of the lean season. Typhoon damages and alleged price manipulations also contributed to the increase in rice prices. Nevertheless, rice prices are expected to moderate towards the Q4 2013 harvest, particularly as some farmers have started harvesting even before the end of the lean season.

- Meanwhile, the Food and Agriculture Organization (FAO) Food Price Index (FPI) declined by 4.2 points (about 2 percent) to 205.9 points in July 2013 from the revised June 2013 level of 210.1 points. The decline in July, which marked the third consecutive monthly drop, was driven by lower international prices across food commodity groups.

Oil Price Developments

- Oil prices were higher in August due largely to the political unrest in the Middle East, which fanned concerns of oil supply disruption in the region. Oil prices sustained their upward increase in September as escalating tensions in Syria continued to bolster concerns of oil supply disruptions. The month-to-date average spot market price of Dubai crude oil as of 11 September was higher by US$2.73 per barrel compared to the average in August.

Developments in the Utilities Sector

- Overall cost of electricity was lower in August 2013 due to the reduction in the generation charge and other components of the electricity bill. Meralco reported that the generation charge decreased in August 2013 due to the downward adjustments in generation rates purchased from the Wholesale Electricity Spot Market (WESM). The reduction in WESM's generation charges was brought by lower demand for power supply with the onset of the rainy season and the increased output of hydroelectric plants. Cost of power sourced from independent power producers also went down due mainly to lower coal and natural gas prices. Moreover, transmission charge and other bill components were lower.

F. Financial market developments

- The Philippine Stock Exchange Index (PSEi) dipped sharply in August, falling below the 6,000 mark, as foreign investors withdrew from Asian regional bourses on heightened geopolitical tensions over Syria. This further affected investors already worried by the possible early tapering of the US Federal Reserve's quantitative easing program.

  In early September, the local bourse advanced over the better-than-expected Chinese exports data in August and the upward revision in Japan's second quarter GDP. However, the uptick was partly dampened by concerns over the armed conflict in Zamboanga City and the ordered reduction in water rates by the Metropolitan Waterworks and Sewerage System, which weighed on the market.

- Similarly, the peso weakened as the foreign exchange market remained affected by concerns on the tapering of the US Fed's quantitative easing. Furthermore, concerns over possible military actions against Syria have sparked a sell-off in global financial markets, causing volatility in emerging Asian markets. Nonetheless, the increasing level of the country's gross international reserves likewise provided broad stability to the peso. On a year-to-date basis, the peso depreciated against the US dollar by 6.5 percent on 12 September 2013, moving in tandem with Asian currencies except the Chinese yuan, which appreciated vis-à-vis the US dollar.

- Meanwhile, after widening in August, debt spreads generally tightened in early September following the release of upbeat economic data in the US. Improvements in China's exports, factory output and retail sales tempered fears on slowdown concerns in the world's second largest economy. Declining worries over a US attack on Syria likewise contributed to the narrowing trend.

G. Domestic liquidity and credit conditions

- Domestic liquidity or M3 grew by 30.1 percent (preliminary) in July to ₱6.0 trillion. This growth was faster than the 20.0-percent expansion recorded in the previous month. On a monthly basis, seasonally-adjusted M3 expanded at a faster pace of 8.9 percent compared to the 3.7 percent m-o-m growth in June.

- Money supply growth was driven largely by the expansion in credits to the domestic sector. Claims on the domestic sector grew by 11.3 percent in July from 11.1 percent in June due to the continued increase in claims on the private sector (by 14.5 percent), reflecting the sustained growth in bank lending.

- The growth in NFA was likewise faster at 9.3 percent y-o-y in July compared to 6.0 percent in June. The BSP's NFA position improved on the back of steady foreign exchange inflows from remittances, BPO receipts, and portfolio investments. Meanwhile, the NFA of banks increased as banks' foreign assets grew faster than their foreign liabilities. Banks' foreign assets rose due to the growth in their loans and receivables as well as in their deposits and placements with head offices, while banks' foreign liabilities continued to increase due mainly to higher placements and deposits of foreign banks with their local branches and other banks.

- The outstanding loans of commercial banks grew by 12.3 percent in July, the same rate as in June. Meanwhile, on a month-on-month seasonally-adjusted basis, commercial bank lending in July increased by 1.6 percent for loans, with the bulk of loans going to real estate, renting, and business services; wholesale and retail trade; electricity gas and water; construction; and manufacturing.

H. Fiscal developments

- The fiscal deficit in the first semester of 2013 was ₱51.3 billion, higher than the ₱34.4-billion deficit incurred during the same period in 2012. This represented 60.6 percent of the ₱84.7 billion programmed deficit for Q1-Q2 2013. Revenue collections increased by 10.3 percent while expenditures were higher by 12.0 percent.

I. External developments

- Prospects for global economic growth remain modest. Economic recovery in the US and Japan has continued on the back of improving domestic demand and market sentiment, while economic activity in the euro area has begun to stabilize. Meanwhile, the downturn in key emerging economies, notably China and India, has become more apparent. Monetary policy settings across the globe have subsequently remained geared toward promoting domestic demand amid broadly benign inflation pressures, even as policymakers continue to be watchful over the timing of the eventual tapering of unconventional monetary stimulus in advanced economies, particularly in the US.