Bangko Sentral ng Pilipinas

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 12 FEBRUARY 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 MB's decision was based on its assessment that prevailing monetary policy settings remain appropriate. Latest baseline forecasts show a lower inflation path within the target range of 3.0 percent ± 1 percentage point for both 2015 and 2016, while inflation expectations remain firmly anchored. Inflation pressures have moderated further since the previous monetary policy meeting, reflecting mainly the significant decline in international oil prices. At the same time, the Monetary Board observed that prospects for domestic activity continue to be firm, and positive growth dynamics are expected to be supported by buoyant private demand, sustained bank lending growth, and upbeat business sentiment.

- The MB also noted that the risks to the baseline inflation forecast remain broadly balanced, with potential price pressures emanating from pending petitions for adjustments in utility rates and possible power shortages. Meanwhile, downside risks could arise from possible slower-than-expected global economic activity.

- The MB is of the view that the within-target inflation outlook and robust domestic growth support keeping policy settings steady. The MB emphasized that the BSP will continue to monitor developments affecting the inflation outlook to ensure that the monetary policy stance remains consistent with its price and financial stability objectives.

[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 Officer-in-Charge of the Monetary Policy Sub-Sector, and the Assistant Governor of the Treasury Department. The highlights of the discussions on the 12 February 2015 meeting were approved by the Monetary Board during its regular meeting held on 5 March 2015. The next meeting of the Monetary Board on monetary policy issues is scheduled on 26 March 2015.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- Year-on-year headline inflation eased further in January. Other indicators also decelerated such as the official core inflation and seasonally-adjusted 3-month moving average annualized headline inflation.

- The continued deceleration of headline inflation in January was attributed largely to lower prices of selected non-food items. In particular, non-food inflation slowed down due mainly to the reduction in the pump prices of diesel and gasoline (reflecting the continued decline in international oil prices) as well as the downward adjustment in electricity rates driven by lower generation charges. At the same time, food inflation also eased slightly on slower price increases of key food items, particularly rice, corn, meat, milk, oils, and sugar.

- By geographical location, inflation in the National Capital Region (NCR) and areas outside NCR declined further to 1.5 percent and 2.7 percent, respectively, in January from 1.6 percent and 3.0 percent in the previous month.

B. Inflation expectations

- Inflation expectations—as measured in forecast surveys for January—were lower compared to the previous month and aligned to the inflation target. Results of the BSP's January 2015 survey of private sector economists yielded lower inflation forecasts at 3.1 percent for 2015 (from 3.6 percent in December 2014) and 3.4 percent for 2016 (from 3.7 percent). Similarly, the results of the January 2015 Consensus Economics inflation forecast survey for the country showed a lower mean inflation forecast for 2015 of 3.2 percent (from 3.6 percent in December 2014). Meanwhile, the inflation forecast for 2016 based on Consensus Economics inflation forecast survey was 3.5 percent.

C. Inflation outlook

- **The latest outlook for inflation shows a lower path consistent with the target range of 3.0 percent ± 1.0 percentage point for 2015-2016.** The latest baseline inflation projections are on a lower trajectory than that of the last policy meeting, with average headline inflation rates at 2.3 percent in 2015 (from 3.0 percent), and 2.5 percent in 2016 (from 2.6 percent). The downward adjustment in the forecast path could be attributed mainly to the significant markdown in oil prices.

- **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 in the summer months of 2015 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.

D. Demand conditions

- Real GDP grew by 6.9 percent in Q4 2014, stronger than the 5.3-percent growth in the previous quarter and the 6.3-percent increase in the same quarter a year ago. This brought the full-year 2014 real GDP growth to 6.1 percent. On the supply side, growth in 2014 was supported by services and industry, particularly manufacturing. On the demand side, economic activity was driven by resilient private domestic demand and an improved external trade position.

- Prospects for the domestic economy remain favorable as private domestic demand is expected to continue to deliver positive impulses to the economy, aided by sustained remittance inflows and low inflation. Sustained and broad-based expansion in bank lending is expected to continue to underpin domestic economic activity. Improved government spending is also seen to further support domestic demand. Capital formation should contribute to economic growth with construction and investments in durable equipment expected to remain strong.

  These positive growth dynamics are reflected in the results of the most recent BSP Consumer Expectations Survey which showed improved consumer sentiment for Q1 2015 as the confidence index (CI) returned to positive territory at 0.7 percent from -1.0 percent a quarter ago while the CI for the next 12 months remained positive and broadly steady. Meanwhile, business outlook for Q1 2015 remained positive albeit less optimistic.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- The Agriculture sector expanded by 4.7 percent in Q4 2014 driven largely by *palay*, corn, banana, and poultry as well as agricultural activities and services. The growth in Agriculture was supported by favorable weather conditions, complemented by increased utilization of high-yielding variety (HYV) seeds, adoption of new farming technology, and government interventions. The forestry and fishing sub-sectors also posted positive growth during the quarter. Meanwhile, the retail prices of rice eased in January 2015 due to the remaining harvest in some areas.

<u>Oil Price Developments</u>

- Oil prices dropped further in January after the Organization of the Petroleum Exporting Countries reaffirmed its position to maintain its oil production target instead of curtailing global supply. Meanwhile, on 3 February, crude oil rebounded from the lowest level in almost six years on signs of stronger economic growth, boosting expectations of increased demand for energy. Tracking the movement of international oil prices, the domestic pump prices of diesel were reduced on 3 February 2015.

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

- Electricity rates declined in January due to lower generation costs. According to Meralco, normal operations of the power plants during the December supply month and lower fuel cost charges from plants under existing Power Supply Agreements contributed to the reduction of generation costs.

F. Financial market developments

- PSEi closed at a record high in January 2015 on the back of the continued decline in oil prices as well as sustained optimism about the Philippine economy given the strong economic growth in 2014. All regional equity markets also rallied in January 2015 as investors reacted favorably to the release of the minutes of the latest meeting of the US Federal Open Market Committee which hinted at delayed hikes in interest rates as well as the decision of the European Central Bank (ECB) to launch a quantitative easing program.

- The peso strengthened slightly over the US dollar as the decision of the ECB to inject fresh funds into the euro zone economy prompted investors to shift back to emerging market assets, including the peso.

- Meanwhile, debt spreads widened in January as the combination of factors such as lower growth forecasts for 2015, sudden move of Swiss National Bank to remove its cap on its currency, tightening US Treasury yields, uncertainty over Greece election, and the cooling Chinese property sector reduced appetite for emerging market bonds, including that of the Philippines.

G. Domestic liquidity and credit conditions

- Preliminary data showed that M3 grew by 9.6 percent in December 2014 to ₽7.6 trillion. This was slightly faster than the 9.2-percent expansion recorded in November 2014. On a month-on-month seasonally-adjusted basis, M3 contracted by 0.7 percent.

- The outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, grew at a slower rate of 16.8 percent in December 2014 from 20.1 percent in November 2014. On a month-on-month seasonally-adjusted basis, commercial bank lending was stable for loans net of RRPs while loans inclusive of RRPs grew by 0.1 percent.

H. Fiscal developments

- The fiscal deficit for the period January-October 2014 was ₽33.6 billion, lower than the ₽112.5-billion deficit incurred during the same period in 2013. Meanwhile, netting out the interest payments in the expenditures, the primary surplus amounted to ₽240.6 billion, ₽74.5 billion higher than the level recorded in the period January-October 2013.

I. External developments

- Economic activity in the US has strengthened, while the recovery in the euro area remains moderate. By contrast, output in Japan has contracted, while growth in major emerging markets, particularly in China and India, continues to be modest. In January, both the IMF and the World Bank downgraded their growth projections for 2015. Global inflation pressures also moderated in light of the continued decline in oil prices. However, deflation also remains a concern, particularly in the euro area and Japan.