HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 25 APRIL 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 and RPs;

c) Set the Special Deposit Account (SDA) rate at 2.0 percent across all tenors; and

d) Maintain the current reserve requirement ratios.

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

- The MB's decision to maintain the BSP's policy interest rates was based on its assessment of a manageable inflation environment over the policy horizon. The latest projected inflation path has continued to track the lower half of the 3-5 percent target range for 2013 and 2014, while inflation expectations remain firmly anchored.

- Moreover, the MB considered the prevailing risks to the inflation outlook to be evenly balanced. Uncertainty over the strength of the global economy and the relative firmness of the peso are the key downside risks to the broad outlook for prices. However, power rate adjustments and the possibility of a sustained surge in liquidity owing to strong capital inflows could push inflation higher as well.

- Following its move to rationalize the SDA facility in January and March, the MB also decided to set the interest rates on the SDA facility to 2.0 percent, applicable to all tenors.

- The MB noted that the benign inflation environment and robust domestic growth prospects provided scope for further enhancing the efficiency of the operations for absorbing liquidity through the SDA facility. The adjustment is in line with the BSP's continuing efforts to fine-tune its monetary policy instruments in order to gain greater flexibility in conducting monetary operations, and also to ensure adequate liquidity for economic activity.

[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 25 April 2013 meeting were approved by the Monetary Board during its regular meeting held on 9 May 2013. The next meeting of the Monetary Board on monetary policy issues is scheduled on 13 June 2013.

- Going forward, the MB recognized the need to continuously monitor emerging demand and price developments to ensure that monetary policy settings remain consistent with price stability while being supportive of economic growth. The MB also reiterated its readiness to employ macroprudential measures as necessary to pre-emptively address any potential misalignment in asset prices.

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 decelerated in March, driven by lower inflation for both food and non-food items. Likewise, the number and weight of above-threshold items declined. Meanwhile, the official core inflation was steady in March, while the alternative measures of core inflation estimated by the BSP were slightly higher.

- Moderate food inflation due to ample domestic supply of key food items, particularly vegetables, fruits, corn, fish, sugar, and oils, led to benign headline inflation in March. Likewise, slower price increases for non-food items, due largely to the reduction in the prices of domestic petroleum products, helped push down inflation for the month.

B. Inflation expectations

- The benign inflation environment is supported by well-anchored inflation expectations. Inflation expectations based on forecast surveys of private sector economists by the BSP and by Asia Pacific (AP) Consensus remain within the target band for 2013-2014. For April 2013, results of the AP Consensus survey yielded lower mean inflation forecasts for 2013-2014. Meanwhile, results of the March 2013 BSP survey showed generally unchanged mean inflation forecasts for 2013-2015.

C. Inflation outlook

- Headline inflation is projected to remain within the target range for the forecast horizon. Compared to the previous policy meeting, baseline inflation forecast for 2013 has been revised downward due primarily to lower oil prices. In contrast, the average headline inflation forecast for 2014 was higher in the current forecasting round owing mainly to the higher M3 forecast for 2014.

- The risks to the inflation outlook remain broadly balanced. Downside risks to the inflation outlook continue to stem mainly from uncertainty in the strength of the global economy. At the same time, the outlook of a stronger peso given continued foreign exchange inflows is seen to temper imported inflation. Meanwhile, upside pressures on prices could emanate from possible power rate adjustments. The possibility of a continued strong surge in liquidity also constitutes an upside risk to inflation.

D. Demand conditions

- The outlook for overall economic activity has remained generally positive, with growth expected to stay near or above the trend over the course of the year. The national accounts data scheduled for release on 30 May will help to confirm whether the present growth momentum will be sustained, and provide further indication of the strength of domestic demand. The Purchasing Managers' Indices (PMI) of the manufacturing, retail/wholesale and services sectors have continued to point to expansion while motor vehicle sales have been strong in Q1. Energy sales also continue to grow, driven by higher consumption by industrial and commercial sectors. Measures of consumer sentiment, while broadly steady for Q1, has turned bullish for the next quarter and the year ahead. Consistent with improving business and consumer sentiment and favorable funding conditions, bank lending has continued to grow at double-digit rates.

- Meanwhile, export growth was negative in the early part of Q1, in line with the weak export performance of the rest of the region. Nevertheless, the March set of regional PMI data releases suggest a positive production momentum, with new orders generally rising across the region.

E. Supply-side indicators

Developments in Agriculture

- Favorable supply conditions have kept prices of meat, fish, fruits and refined sugar generally stable in March 2013 compared to their month-ago levels. The Bureau of Agricultural Statistics (BAS) projects palay and corn production to expand in Q1 2013 on account of increased yields and harvest area but could decline in Q2 2013 as some farmers were reluctant to plant amid expectations of dry weather conditions given pronouncements of a possible occurrence of El Niño during the year.

- Meanwhile, the FAO food price index (FPI) was higher in March relative to February, driven largely by increased dairy prices amid prolonged dry weather in New Zealand. Nevertheless, the FPI remained lower than the year-ago level and below its peak in February 2011. Prices for the other commodity groups were broadly stable.

Oil Price Developments

- Oil prices declined in March following the release of weak economic data in China and Europe. Oil prices also fell as the financial crisis in Cyprus sparked concerns that the debt crisis in Europe could worsen. In April, oil prices continued to fall after the US Energy Information Administration reported that US crude stockpiles increased to their highest levels in more than 22 years.

Developments in the Utilities Sector

- Potential upside risks to inflation from electricity rates could come from pending petitions for power rate adjustment as well as the likelihood of higher electricity rates in Mindanao as a result of the current power supply shortfall.

F. Financial market developments

- In the first half of April, the PSEi rose by 2.9 percent to 6,891.43 on 15 April 15 from 6,694.71 on 14 March.The PSEi was predominantly supported by the Fitch's action to upgrade the country's credit rating to investment-grade on March 27. In addition, quarter-end window dressing boosted the local bourse. However, profit taking and rekindled jitters over Europe (mainly caused by a political impasse in Italy and new debt concerns in Cyprus) curbed the continued surge of the PSEi. Nevertheless, the PSEi broke the 7,000 level for the first time on 22 April.

- Meanwhile, the peso slightly weakened due to increased risk aversion stemming from renewed concerns about the eurozone's debt crisis following developments in Cyprus. China's weaker-than-expected data on factory output and consumer spending also weighed down on the peso. Likewise, geopolitical tensions in Korea also weighed down on the peso and other regional currencies. Nonetheless, the country's strong economic fundamentals and Fitch's move to upgrade the country's credit rating to investment grade tempered the peso's depreciation.

- Bond spreads eased in early March due to the unexpectedly strong US non-farm payrolls in February and the subsequent decline in US unemployment rate. The improving US macroeconomic environment translated into an increase in US Treasury yields with US 10-year bonds breaching the 2 percent level. This boosted "risk-on" trading of bonds like ROPs, which, in turn, led to a decline in the country's bond yields and tightening in debt spreads. However, spreads subsequently widened as the unfolding Cyprus debt crisis re-ignited concerns about the euro zone's weak banks. In the first half of April, widening pressures abated as debt spreads tightened marginally. The market was surprisingly resilient despite reports of a bank run in the wake of the Cyprus bailout and the US private payroll report coming out weaker than expected. Investors have also shrugged off any lingering jitters over the political tensions between North Korea and South Korea. Sentiment was likewise buoyed by Bank of Japan's unveiling of its new monetary policy plan of quantitative and qualitative monetary easing. Nevertheless, the IMF's downward revision on global growth, reports of cooling housing market in the US, slump in US retail sales, and lower PMI figures, tempered the narrowing trend.

G. Domestic liquidity and credit conditions

- Domestic liquidity or M3 grew by 9.9 percent year-on-year in February 2013 from 10.2 percent in January 2013. Money supply growth was driven by the expansion of net domestic assets (NDA) following the sustained increase in credits to the private sector consistent with the robust lending activity of commercial banks. Meanwhile, net foreign assets (NFA) decreased further in February, due mainly to the continued decline in banks' NFA as their foreign liabilities continued to increase due in part to higher placements and deposits made by foreign banks with their local branches.

- The growth of outstanding loans of commercial banks, net of banks' reverse repurchase (RRP) placements with the BSP, grew by 15.1 percent in February from the previous month's expansion of 15.8 percent. Commercial banks' loans have been growing steadily at double-digit growth rates since January 2011. Loans for production activities—which comprised more than four-fifths of banks' aggregate loan portfolio—grew by 15.2 percent in February from 16.0 percent a month earlier.

- Corporates continue to tap capital markets for financing. Corporate bond issuances for the period January-February 2013 amounted to ₱30.5 billion, while total equity raised in the Philippine Stock Exchange (PSE) during the same period amounted to ₱3.4 billion.

H. Fiscal developments

- While still lower than the programmed level, NG fiscal disbursements have been growing at double-digits in January-February 2013. The fiscal deficit in the period January-February 2013 was ₱31.3 billion, ₱26.0 billion higher than the deficit incurred during the same period in 2012. Revenue collections increased by 2.1 percent while expenditure was higher by 12.4 percent.

I. External developments

- Recent developments on the external front suggest that global economic prospects, on balance, continue to improve. The US economy grew faster in 2012, although the budget sequester continues to represent a major downside risk to future growth. Prospects for Japan have been lifted by incipient signs of recovery, supported by the Bank of Japan's aggressive monetary easing stance. The pace of growth in emerging markets also remains fairly robust on stable domestic demand. However, preliminary data also suggest a weaker-than-expected recovery in China, with GDP growth unexpectedly easing in Q1 2013 from the previous quarter. Moreover, the euro area still faces significant stability challenges from its fiscal and banking sector problems. The broad outlook for the euro area activity remains weighted toward the downside as increased uncertainty dampens market sentiment. Volatility in global financial markets had increased somewhat through March as the Cyprus debt crisis re-ignited concerns about the region's weak banks and raised fears of a contagion that could spread to peripheral economies. Moving forward, global economic growth will likely remain subdued, although monetary policy actions continue to provide support to economic activity.