HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 19 APRIL 2012[1]

I. Monetary Policy Decision

The Monetary Board (MB) decided to:

a) Maintain the BSP's policy interest rates at 4.0 percent for the overnight RRP (borrowing) rate and 6.0 percent for the overnight RP (lending) rate;

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

- Latest baseline forecasts continue to indicate that inflation will likely settle near the lower half of the 3-5 percent target range in 2012 and 2013, with a downward adjustment in the forecasted inflation path for 2012-2013 compared to the previous policy meeting. Consistent with the inflation forecast trajectory, inflation expectations based on the latest BSP and private sector surveys have remained well anchored.

- Meanwhile, the MB noted that the balance of risks to the inflation outlook now leans slightly toward the upside as oil prices have remained elevated and at risk from ongoing tensions in the Middle East as well as strong demand from emerging economies. The pressures on oil prices constitute the main source of upside risk to the inflation outlook because of their adverse implications on inflation expectations and on the prices of other goods and services. Other upside risks relate to the impact of sustained foreign exchange inflows on domestic liquidity. Meanwhile, the weak global economy and the stable peso could provide a moderating effect on inflation.

- The uncertainty in the factors affecting the outlook for inflation supports the need for a pause in monetary policy adjustment. A prudent pause allows policymakers to better assess how the upside and downside risks to inflation will play out and enables the prior cumulative 50-basis-point reduction in policy rates to continue to work its way through the economy.

[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 19 April 2012 meeting were approved by the Monetary Board during its regular meeting held on 3 May 2012. The next meeting of the Monetary Board on monetary policy issues is scheduled on 14 June 2012.

- The MB also noted that prospects for overall domestic economic activity have gradually strengthened. For the first two months of 2012, government spending accelerated, merchandise exports growth recovered while bank lending growth maintained its momentum. Recent indicators of global economic activity have also improved modestly, although sovereign debt concerns in Europe have continued to weigh down on the global outlook. The monetary policy easing undertaken since January combined with the adequate liquidity in the system and early disbursement by the NG to fast track government spending should give the economy enough room to continue to grow.

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 average headline inflation has continued to slow down in March, driven mainly by lower inflation for non-food items, particularly power rates. Other price indicators also reflected a downtrend, including the following: the year-on-year core inflation, seasonally-adjusted month-on-month core inflation, three alternative measures of core inflation estimated by the BSP, and the number and weight of above-threshold items.

- Food inflation also held steady as some food commodities showed slower price movement. In particular, slower increases in the prices of vegetables and sugar due to favorable domestic supply conditions, helped pull down inflation.

B. Inflation expectations

- Inflation expectations continue to be well anchored. Inflation expectations based on the BSP and private sector forecast surveys remain within the 3-5 percent target range over the policy horizon. Similarly, data from the latest business and consumer expectations surveys also showed an improved inflation outlook. Results from the Q1 2012 Consumer Expectations Survey (CES) indicated that consumers expect lower inflation over the next 12 months while findings from the Business Expectations Survey (BES) for Q1 2012 showed a smaller number of respondents anticipating inflation to move up in both the current and succeeding quarters.

C. Inflation outlook

- The latest baseline forecasts continue to point to within-target inflation for 2012 and 2013. The downward adjustment in the forecasted inflation path for 2012-2013 compared to the previous policy meeting is attributed mainly to the lower-than-forecasted actual inflation in February and March which offset the impact of higher oil prices.

- The MB also considered various alternative scenarios for the inflation forecast, taking into consideration both the upside and downside risks to inflation and possible second-round effects from oil price shocks. Using these alternative scenarios, average inflation for 2012 and 2013 are expected to remain within target over the policy horizon.

- However, the balance of risks appeared to have tilted to the upside. The uptrend in oil prices and the potential second-round effects that it could generate are the principal risks to future inflation. Moreover, additional petitions for electricity rate adjustments and sustained strong capital inflows could fuel inflationary pressures.

- Meanwhile, the downside risks to inflation include continued uncertainty over the strength of the global economy and its implications on the pace of economic activity. At the same time, the broadly stable peso could help temper the prices of imported commodities.

D. Demand conditions

- There have been recent signs that domestic activity and exports have picked up. Merchandise exports grew for the first two months of 2012 as electronic exports recovered after 11 consecutive declines. This is consistent with the US semiconductor book-to-bill ratio of 1.01—the highest recorded since October 2010. Bank lending growth maintained its momentum while consumer confidence improved in the first quarter. Other demand indicators, including energy and vehicle sales and capacity utilization rates showed moderate increases.

E. Supply-side indicators

Developments in Agriculture

- Favorable supply conditions have kept prices of meat, fish, sugar and fruits generally stable in the first quarter. Meanwhile, after posting considerable crop output gains in 2011, the Bureau of Agricultural Statistics (BAS) projects palay and corn production to grow slightly in the first semester of 2012 due to higher harvest area and yield, with the expected favorable wet weather conditions brought by the La Niña episode.

- In addition, the MB noted that the FAO food price index was broadly stable in March after climbing for two consecutive months, with indices of cereals, sugar and meat prices remaining largely unchanged from last month's level.

Oil Price Developments

- Oil prices advanced in March following US and Europe sanctions on Iran, which limited the country's crude oil shipments, sustained strong demand from emerging markets, and the announcement by the US Fed that it would maintain a low interest environment to stimulate the US economy, raising speculation of increasing oil demand going forward. However, oil prices eased in mid-April amid the resumption of international talks on Iran's nuclear program.

Developments in the Utilities Sector

- Electricity rates of Manila Electric Co. (Meralco) went down in March on account of lower generation charges from the Wholesale Electricity Spot Market (WESM), which in turn, was due to improved availability of power supply among the generating companies, especially the coal-fired power plants. Rates of independent power plants (IPPs) to Meralco also declined due to slightly higher dispatch, lower natural gas prices and the appreciation of the peso.

- Meanwhile, the Energy Regulatory Commission (ERC) approved the petitions of the National Power Corporation and the Power Sector Assets and Liabilities Management Corporation to recover a) incremental fuel and purchased power costs under the Generation Rate Adjustment Mechanism and b) foreign exchange costs under the Incremental Currency Exchange Rate Adjustment Mechanism, which were incurred during the period January 2007 to April 2010.

F. Financial market developments

- During the 16 April 2012 auction, interest rates declined for the 182-day and 364-day T-bills relative to the rates fetched at the 5 and 19 March 2012 auctions. Meanwhile, all bids for the 91-day T-bill were rejected as investors posted bids that were deemed unusually high by the Auction Committee. In addition, the NG was very liquid at this time (in view of the income tax period in March and April) thus, it projected no need for short-term funds. The Auction Committee awarded in full the offered amounts for the 182-day and 364-day T-bills. Total tenders reached ₱14.3 billion or around 1.9 times the offered amount of ₱7.5 billion.

- The PSEi set fresh historic highs as it broke through the 5,000 mark in March, driven by favorable domestic inflation environment, tentative signs of improvement in the US job market and the European Union's approval of the second Greek bailout package, which boosted investors' risk appetite for emerging market equities. The index continued to trade above the 5,000 mark in mid-April following the US Fed's assurance that it would keep policy rates low and the IMF's upgrade of global growth forecast for the first time in more than a year. These favorable developments likewise caused debt spreads to narrow to its lowest levels for the year. For the period 1-19 April, however, debt spreads widened amid concerns of a possible downgrade in Italy's credit rating and weaker US non-farm payroll data relative to the previous month.

- The peso depreciated in March as concerns about the slowing growth in China, along with the soft recovery in the US, caused investors to reduce their exposure to risky assets. For the period 1-18 April, the peso slightly recovered given improving exports and solid support from remittance.

G. Domestic liquidity and credit conditions

- Domestic liquidity or M3 grew at a steady rate of 7.2 percent in February 2012 to reach ₱4.5 trillion. This was the same growth rate recorded a month earlier. Net foreign assets (NFA) continued to grow at a steady pace of 13.1 percent in February while net domestic credits expanded at a stable rate of 13.4 percent on account of higher private and public sector borrowings. However, this was offset by the continued increase in placements with the BSP's SDA facility, which has served to moderate liquidity growth.

- Bank lending growth, net of banks' RRP placements with the BSP, grew at solid pace of 18.0 percent in February, albeit slightly slower than the 19.1 percent expansion in the previous month. Loans for production activities grew by 18.4 percent in February from 19.7 percent a month earlier. Meanwhile, growth of consumer loans accelerated slightly to 20.3 percent in February from 19.9 percent in January, reflecting mainly the growth of credit card receivables.

- Corporate issuers continue to tap the equity and bond markets. Capital-raising activities in the Philippine Stock Exchange for the period January-February 2012 reached ₱5.2 billion, albeit 70 percent lower from the previous year's level of ₱16.9 billion. However, corporate bond issuances for the same period amounted to ₱65.2 billion, higher by 45 percent compared to the previous year's level of ₱45.1 billion.

H. Fiscal developments

- The fiscal deficit in January-February 2012 was ₱5.3 billion, 34.4 percent lower than the ₱8.1 billion deficit incurred during the same period in 2011. The lower deficit figure is attributed mainly to increased revenue collections (14.0 percent year-on-year). Meanwhile, early disbursement by the Department of Budget and Management (DBM) has raised government expenditures in the first two months by 12 percent year-on-year. In January, the DBM also released 72 percent of the ₱1 trillion national budget to jump-start most of the programmed infrastructure projects.

I. External developments

- The MB noted that prospects for global economic activity have improved but downside risks to the global outlook remain. According to the latest assessment of the IMF, global economic activity is gradually strengthening. In the April 2012 World Economic Outlook, the IMF revised upward its global growth forecast for 2012 and 2013 by 0.2 percentage point and 0.1 percentage point, respectively. The IMF noted that improved activity in the US during the second half of 2011 and better policies in the euro area in response to its deepening economic crisis have eased the risk of a sharp global slowdown. Meanwhile, activity is expected to remain relatively solid in most emerging and developing economies. However, downside risks to global growth remain elevated with the recovery expected to be weak and vulnerable due mainly to the legacy of the financial crisis.