BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 24 SEPTEMBER 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 price and output conditions support maintaining current monetary policy settings. Latest baseline forecasts indicate that average inflation could fall below the inflation target range of 3 percent ± 1 percentage point for 2015 due to the successive low inflation outturns in recent months. However, inflation is projected to return gradually to a path consistent with the inflation target for 2016-2017. Meanwhile, inflation expectations also remain anchored within the inflation target band over the policy horizon.

- The Monetary Board noted that upside risks could come from the impact of stronger and protracted El Niño dry weather conditions on food prices and utility rates as well as pending petitions for power rate adjustments. In addition, the Monetary Board considered the weakness in the global economy and the continuing uncertainty in the global financial markets.

- The Monetary Board likewise is of the view that domestic demand conditions remain firm, supported by buoyant business and consumer sentiment and ample domestic liquidity.

- Given these considerations, the Monetary Board believes that the benign inflation outlook and the economy's underlying growth momentum provide ample room to keep monetary policy settings unchanged at this time.

[1] The discussions herein reflect the assessment made by the Monetary Board based on a comprehensive set of economic information available at the time of the policy meeting. The highlights of the discussions on the 24 September 2015 meeting were approved by the Monetary Board during its regular meeting held on 15 October 2015. The next meeting of the Monetary Board on monetary policy issues is scheduled on 12 November 2015.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- Year-on-year headline inflation eased further to 0.6 percent in August from 0.8 percent in July. Other indicators also decreased such as the official core inflation, two out of three alternative measures of core inflation estimated by the BSP, and the number and weight of the above-threshold CPI items. Meanwhile, the seasonally-adjusted 3-month moving average annualized headline and core inflation rates were higher during the month.

- The lower August headline inflation was traced mainly to slower price increases in both food and non-food items following favorable supply conditions. Food inflation decelerated further as price increases of most food items slowed down while prices for bread and cereals, including rice and corn, declined relative to year-ago levels. Likewise, non-food inflation slowed further owing to the downward adjustment in electricity rates as a result of lower generation charges from Independent Power Producers (IPPs) and from the Wholesale Electricity Spot Market (WESM) as well as price rollbacks for kerosene, LPG, diesel, and gasoline.

- By geographical location, inflation in the National Capital Region (NCR) eased to 0.2 percent in August from 0.8 percent in July. Meanwhile, inflation in areas outside NCR was steady at 0.8 percent.

B. Inflation expectations

- Inflation expectations depicted in the Consensus Economics and the BSP survey of private sector economists remained within the target range over the policy horizon. Results of the August 2015 BSP's survey of private sector economists and of the September 2015 Consensus Economics survey showed that inflation is expected to settle slightly below the target range in 2015. Nonetheless, inflation forecasts for 2016-2017 stayed close to the midpoint of the target range.

- Meanwhile, respondents for both Consumer Expectations Survey (CES) and Business Expectations Survey (BES) expect inflation to increase for the current quarter up to the near term. Results of the CES for Q3 2015 indicated that inflation is expected to be stronger over the next 12 months, with more respondents anticipating higher inflation for the year than earlier predicted. Similarly, results of the BES for Q3 2015 indicated that more respondents expected inflation to increase for the current and next quarters compared to those who said otherwise.

C. Inflation outlook

- Inflation could settle slightly below the low-end of the government's announced target range in 2015 and approach the midpoint of the target range in 2016 – 2017. The reduction in the forecasted inflation path for 2015 could be attributed mainly to lower global crude oil prices and lower-than-expected GDP growth. Meanwhile, the forecasted inflation could be higher in 2016 – 2017 mainly due to expectations of a longer *El Niño* episode and potential exchange rate volatilities.

- The risks to future inflation remain broadly balanced. Slower global economic activity, fiscal underspending, and petitions for lower transport fares continue to pose downside risks while potential adjustments in electricity rates given pending petitions and the impact of stronger-than-expected El Niño conditions are the upside risks to inflation.

D. Demand conditions

- The Q2 2015 GDP data showed some recovery in growth momentum, with the economy expanding year-on-year by 5.6 percent. Domestic sources of growth continue to support output expansion. Accelerated consumer and government spending and increased investments drove the second quarter growth, offsetting the negative percentage contribution of net exports. Meanwhile, the services and industry sectors continued to be the main drivers of growth on the production side.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- The average retail price of regular-milled rice continued to decrease in August-September from peak levels 12 months ago due partly to the arrival of the additional rice importation. Meanwhile, the average retail price of well-milled rice was broadly steady.

- The Food and Agriculture Organization (FAO) Food Price Index (FPI) posted the sharpest recorded drop since December 2008. The index average of 155.7 points in August 2015 was lower by 8.5 points (5.2 percent) and 42.6 points (21.5 percent) from the month-ago and year-ago levels, respectively. Except for meat prices which were broadly stable during the review period, all prices declined during the month due to ample global supply and favorable production outlook.

- In August 2015, the sea surface temperatures (SST) reflected El Niño conditions gradually intensifying to a strong level. The consensus of El Niño Southern Oscillation (ENSO) prediction models indicate that the El Niño conditions in August have strengthened and will likely persist until the end of 2015, with around 75-percent chance that it will continue until May 2016.

Oil Price Developments

- Dubai crude prices further declined in August and through most of September on concerns of weaker global demand coupled with worries that global supply glut could persist. Concerns over an oversupplied oil market intensified as international oil agencies projected that global production of oil will continue to outpace demand till end-2016 combined with Iran's released statement that it will raise output to defend its market share.

Developments in the Utilities Sector

- Electricity rates fell for the fourth consecutive month in September due to lower generation cost. According to Meralco, the decrease was mainly driven by the lower generation costs from Independent Power Producers and Power Supply Agreements as a result of higher dispatch level in August.

F. Financial market developments

- The Philippine stock market index dipped in early September but rebounded ahead of the US FOMC meeting on 16-17 September 2015. The local index declined in early September as deepening fears of a global growth slowdown amid weaker-than-expected manufacturing data from China, the US and Europe weighed heavily on investor sentiments. However, during the week of the two-day US Fed policy meeting, the local index rallied and traded above the 7,000 mark on expectations that the timing of the US interest rate hike will be pushed back to the latter part of 2015.

- The peso weakened during the first half of September as the peso was weighed down by the weak exports data for July. The peso was also under slight pressure ahead of the 16-17 September 2015 FOMC meeting. Nevertheless, the sustained inflows of foreign exchange from overseas Filipino remittances, BPO and tourism receipts, foreign portfolio investments, as well as the ample level of the country's gross international reserves provided support to the peso.

- After debt spreads widened in August following China's move to devalue its currency, debt spreads slightly eased in the first half of September as investors await for the result of the FOMC meeting. Debt spreads widened after the FOMC meeting as investors flock to safe-haven bonds, bidding up prices of US Treasury bonds which pushed yields down and widened spreads with emerging market bonds.

G. Domestic liquidity and credit conditions

- Domestic liquidity (M3) grew by 8.5 percent year-on-year in July 2015 to reach ₱7.7 trillion. This was slightly slower than the 9.3-percent expansion recorded in June. On a month-on-month seasonally-adjusted basis, M3 increased by 0.7 percent. Money supply continued to expand due largely to sustained demand for credit. The sustained expansion of M3 indicated that money supply remains sufficient to support economic growth.

- Outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, expanded by 13.5 percent in July from 14.5 percent in June. On a month-on-month seasonally-adjusted basis, commercial bank lending increased by 1.0 percent for loans net of RRPs and by 1.1 percent for loans inclusive of RRPs. The bulk of bank loans continued to be channeled to key production sectors.

H. Fiscal developments

- Stepped up fiscal spending in July, which turned the first semester fiscal surplus into a deficit for the period January-July 2015 should help sustain growth momentum. The National Government (NG) recorded a fiscal deficit of ₱18.5 billion in January-July, albeit lower than the ₱55.7 billion deficit incurred during the same period in 2014. Meanwhile, netting out the interest payments in the expenditures, the primary surplus amounted to ₱190.7 billion, ₱38.5 billion or 25.3 percent higher than the level recorded in the same period a year ago.

I. External developments

- Global economy is expanding at a moderate pace but prospects remain uneven. Economic growth in the US, euro area, and Japan picked up pace, while activity declined across emerging markets, particularly in China and Russia. The growth slowdown in China and soft conditions in the rest of East Asia have clouded the outlook for the global economy. Global financial markets have been considerably more volatile of late, associated with developments in China and the uncertainty about the timing of the Fed lift-off.