BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 13 SEPTEMBER 2012[1]

I. Monetary Policy Decision

The Monetary Board (MB) decided to:

a) Maintain the BSP's policy interest rates at 3.75 percent for the overnight RRP (borrowing) rate and 5.75 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

- The MB's decision was based on its assessment that the inflation environment remained benign. While inflation forecasts have risen slightly due to the higher August inflation and recent increases in global oil and other commodity prices, the future inflation path remained well within the target. Market expectations of inflation were also at levels broadly consistent with the inflation target.

- The MB decided to keep policy rates unchanged as the risks surrounding the inflation outlook were seen to be broadly balanced. Weak global economic prospects continued to temper the inflation outlook, as a possible easing in global demand could contribute to moderate international commodity prices. The sustained stability of the peso against the US dollar could also temper inflationary pressures in the future.

- Nonetheless, the MB was mindful of potential upside risks to the inflation outlook, including pending electricity rate adjustments and expectations of higher international prices for some grains due to adverse weather conditions abroad. Moreover, underlying demand-side pressures continued to be firm, supported by ample domestic liquidity and brisk credit activity.

- On balance, the MB was of the view that prevailing monetary policy settings remained appropriate. This is supported by the manageable inflation outlook and robust domestic growth, especially as the cumulative 75-basis-point reduction in policy rates and other operational adjustments earlier in the year continued to work their 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 13 September 2012 meeting were approved by the Monetary Board during its regular meeting held on 27 September 2012. The next meeting of the Monetary Board on monetary policy issues is scheduled on 19 October 2012.

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 accelerated in August, driven mainly by higher inflation for food, electricity, fuel and transport. Other indicators such as year-on-year core inflation and seasonally-adjusted month-on-month (m-o-m) headline inflation also reflected an uptrend. By contrast, seasonally-adjusted m-o-m core inflation slowed down in August.

- The uptick in inflation was due mainly to higher food, electricity, fuel, and transport prices. Tight domestic supply conditions, triggered by the recent weather-related production disruptions led to higher retail prices of food, particularly vegetables, fish, sugar, fruits, rice, and meat. Likewise, the increase in the prices of electricity, gas, and other fuels (due, in turn, to higher LPG and kerosene prices) and the upward adjustment in electricity charges as a result of the scheduled maintenance shutdown of the Malampaya pipeline contributed to the rise in inflation. The series of upward price adjustments in gasoline and diesel also pushed transport inflation higher.

B. Inflation expectations

- Inflation expectations based on the BSP private sector forecast and AP Consensus surveys were generally higher but remained within the 3-5 percent target range over the policy horizon. Results of the August survey from the BSP survey of private sector economists showed higher inflation forecasts for 2012 to 2014 compared to July.

C. Inflation outlook

- Although the forecast inflation path for 2012-2013 is slightly higher compared to the forecast path in the previous round, the latest baseline forecasts indicate that inflation could settle within the government-announced target range of 3-5 percent for 2012-2013. Higher-than-projected actual inflation in August and the increase in oil prices led to the slight upward shift in forecast inflation path for 2012-2013. The latest forecasts also incorporated the estimated impact of the recent petition for jeepney fare increase. Meanwhile, the emerging inflation forecast for 2014 shows average headline inflation settling within the 3-5 percent target range.

- The risks to future inflation appear to be broadly balanced. Downside risk to inflation outlook continues to persist owing to lingering concerns over the strength of the global economy and its implication on the pace of economic activity. Meanwhile, additional petitions for electricity rate adjustments as well as upside pressures on non-oil commodity prices in the international market constitute the upside risks to inflation.

D. Demand conditions

- The Philippine economy posted a higher-than-expected growth of 5.9 percent in Q2 2012. While slower than the 6.3 percent growth (revised) recorded in Q1 2012, this is an improvement from the 3.6 percent growth in the same period in 2011 and well above the long-run average growth rate of GDP. Fiscal policy support through early release of allotments to government agencies and higher infrastructure spending contributed to growth in the second quarter.

- Looking ahead to the succeeding quarters, results of the Q3 2012 consumer expectations survey showed higher confidence index for the third and fourth quarters and the year ahead. Meanwhile, business confidence was lower in Q3 2012 amid concerns over the impact of recent weather disturbances but reached an all-time high for Q4 2012. Some leading indicators for the second semester also indicated robust domestic demand in July: PMI readings for manufacturing, services, and retail and wholesale sectors remained above 50 while volume sales of automobiles and electricity consumption continued to grow.

E. Supply-side indicators

Developments in Agriculture

- The growth in agriculture, hunting, forestry and fishing slowed to 0.7 percent in Q2 2012 from a growth of 8.3 percent in the same period a year ago. The expansion in the production of palay, poultry, coconut, corn and rubber was pulled down by the contraction in the production of sugarcane, fishing and livestock sub-sectors.

- Meanwhile, the Bureau of Agricultural Statistics projects palay and corn production to continue to expand in Q3 and Q4 2012. Typhoon Gener and the strong monsoon rains appear to have marginal effect on domestic rice and corn production based on staff estimates.

- On the international front, after three consecutive months of decline, the Food and Agriculture Organization (FAO) food price index (FPI) rose by 12 points to 212.8 points in July 2012, albeit still well below the peak of 238 points recorded in February 2011. The sharp rebound was driven largely by the rise in grain and sugar prices as well as increases in oils/fats prices. Nevertheless, the FAO FPI was broadly steady at 212.6 points in August as international prices of cereals and oils/fats changed little but sugar prices fell sharply, compensating for rising meat and dairy prices.

Oil and Transport Price Developments

- After increasing in July, oil prices further advanced in August on account of falling crude oil stockpiles in the US amid tensions in the Middle East and on expectations of a favorable resolution to the European debt crisis. High international prices of oil were reflected in the four rounds of increases in the domestic pump prices of petroleum products in August.

- On 30 August 2012, several transport groups filed for an additional ₱2.00 in minimum jeepney fare before the Land Transportation Franchising and Regulatory Board (LTFRB). The transport groups also filed for an immediate implementation of a ₱0.50 provisional jeepney fare hike while public hearing for their petition is ongoing.

Developments in the Utilities Sector

- In August, the generation charge of Meralco increased following the upward adjustment in the charges from the Wholesale Electricity Spot Market as natural gas-fired power plants utilized more expensive liquid condensate fuel following the scheduled maintenance shutdown of the Malampaya pipeline in July. Likewise, the generation cost from independent power producers (IPPs) increased with the series of power outages at the Quezon Power Philippines, Ltd. The higher generation charges from the WESM and other IPPs offset the cheaper wet-season rates from the National Power Corporation.

F. Financial market developments

- The PSEi moved sideways in August and closed 3.0 percent lower than the end-July level but still higher by 17.8 percent year-to-date. Investors continued to trade cautiously over concerns that the current rise in global oil prices due to geopolitical tensions will pose a further risk to the global economy as major economies, including the US and China, are already contending with the slower growth and fallout from the European debt crisis. Markets were also anticipating news of additional stimulus from the US Fed and the ECB while investors weighed the economic impact of the enhanced monsoon rains that affected Metro Manila and surrounding provinces in early August.

- In August, the peso slightly depreciated by 0.4 percent relative to the previous month following the release of weak global economic data. The strength of the US dollar also pressured the peso to revisit 42-levels given less chances of more US stimulus measures. On the local front, lower-than-expected growth in Philippine exports and slower growth of Overseas Filipinos' remittances in June weighed on the peso.

- Debt spreads eased to new lows for the year in August. Sentiment improved on expectations the ECB may resume buying government bonds to bring down cropping borrowing costs of indebted Euro zone members such as Spain and Italy. Expectations of China and US taking stimulus steps improved risk appetite for emerging market bonds, tightening spreads to its narrowest in the past four months. However, worries over China's growth and unclear signs of stimulus measures by the ECB and US Fed contributed in the slight expansion of spreads by end of August.

G. Domestic liquidity and credit conditions

- Domestic liquidity or M3 grew faster in July at 8.7 percent year-on-year from 7.1 percent in June. Money supply growth continued to be driven by the sustained expansion of net foreign assets (NFA). Meanwhile, net domestic assets (NDA) decelerated due to the faster expansion of the net other items account owing to higher placements of eligible counterparties in the BSP SDA facility. Claims on the private sector accelerated during the month, consistent with the sustained increase of bank lending in July.

- The growth of outstanding loans of commercial banks, net of banks' reverse repurchase (RRP) placements with the BSP, grew at a faster pace of 16.0 percent in July from the previous month's expansion of 14.9 percent. Loans for production activities—which comprised more than four-fifths of banks' aggregate loan portfolio—grew by 16.4 percent in July from 15.1 percent a month earlier. Meanwhile, the growth of consumer loans eased slightly to 15.4 percent from 15.8 percent in June due mainly to the slowdown in auto loans.

- Corporates continued to tap capital markets for financing. Corporate bond issuances for the period January-July 2012 reached ₱199.3 billion, 29 percent higher than the 2011 level of ₱154.9 billion. Likewise, the total equity raised in the Philippine Stock Exchange (PSE) during the same period amounted to ₱91.1 billion, 49 percent higher than the year-ago level.

H. Fiscal developments

- The fiscal deficit in the period January-July 2012 was ₱73.7 billion, ₱30.0 billion higher than the deficit incurred during the same period last year. This represented 40.2 percent of the ₱183.3 billion programmed deficit for Q1-Q3 2012. Revenue collections increased by 12.1 percent while expenditure was higher by 15.1 percent.

I. External developments

- Recent developments in the global economy suggest that growth is likely to remain weak. The JP Morgan Global All-Industry Output Index fell anew to 51.1 in August from 51.7 in July as the growth in the manufacturing sector activity declined due to weaker levels of new orders and falling international trade flows. Meanwhile, the services sector continued to expand modestly.

- The US economic recovery cools amid increasingly cautious business and consumer sentiments. Advance estimates showed that real GDP grew slower in Q2 2012 compared to Q1 2012. The deceleration primarily reflected the slowdown in personal consumption expenditure and residential and nonresidential fixed investments, which was offset partly by the smaller decrease in federal government spending and by the acceleration in exports.

- Prospects in the euro area remain bleak. The economic contraction in the euro area continued to deepen, as GDP fell by 0.4 percent y-o-y and by 0.2 percent q-o-q in Q2 2012. The composite PMI for the euro area was little changed at 46.3 in August from 46.5 in July, reflecting the continued decline in new work intakes in the manufacturing and service sectors across the region.

- Economic activity remains sluggish in China. Real GDP growth eased to 7.8 percent y-o-y in Q2 2012 from 8.1 percent in the previous quarter while the manufacturing PMI remained below the 50-percent growth threshold in August.