BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 24 OCTOBER 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, RPs and SDA; 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 of a benign inflation environment. Latest baseline forecasts indicate that the future inflation path remains in line with the target range of 4.0±1.0 percent in 2013-2014 and 3.0±1.0 percent for 2015. Inflation expectations also continue to be firmly anchored. The Monetary Board also noted that while global economic conditions remain challenging, prospects for domestic activity remain robust, supported by buoyant domestic demand and favorable consumer and business sentiment.

- At the same time, the MB noted that the risks to the inflation remain unchanged. With the bulk of lending going to the productive sectors of the economy, the improvement in the economy's absorptive capacity is expected to be sustained, helping to moderate price pressures.

- Going forward, the MB recognized the need to monitor emerging price and output conditions to ensure that monetary policy remains in line with price stability while being supportive of economic growth.

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 inched up in September to 2.7 percent from 2.1 percent in August. Likewise, other indicators increased such as the official core inflation, seasonally-adjusted month-on-month headline and core inflation, seasonally adjusted 3-month moving average annualized headline and core inflation, and number and weight of above-threshold

[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 24 October 2013 meeting were approved by the Monetary Board during its regular meeting held on 14 November 2013. The next meeting of the Monetary Board on monetary policy issues is scheduled on 12 December 2013.

items. Meanwhile, two out of three alternative measures of core inflation estimated by the BSP were steady in September.

- The uptick in inflation for September was attributed largely to higher food prices and electricity charges. Tight domestic supply conditions, triggered by the recent weather-related production disruptions, led to higher prices of key food items, particularly corn, fish, and meat. Rice prices were also higher due to the lean season. Meanwhile, the upward adjustment in electricity rates as a result of higher generation and transmission charges contributed to the rise in non-food inflation.

B. Inflation expectations

- Inflation expectations—reflected in forecast surveys of private sector economists by the BSP and by Consensus Economics—continue to support the benign inflation outlook. For September 2013, results of the BSP's survey of private economists showed lower mean inflation forecasts for 2013, 2014 and 2015 at 2.9 percent (from 3.0 percent in August), 3.5 percent (from 3.6 percent), and 3.6 percent (from 3.7 percent), respectively. Similarly, results of the Consensus Economics survey in October showed lower mean inflation forecasts for 2013 and 2014.

C. Inflation outlook

- The outlook for inflation remains broadly in line with the target range over the policy horizon. The latest average baseline inflation forecasts are broadly unchanged for 2013 and 2015 but slightly higher for 2014. The upward adjustment in the inflation path for 2014 could be attributed mainly to the higher-than-forecasted actual inflation in September. Meanwhile, the risks to future inflation rmeained broadly unchanged.

D. Demand conditions

- Domestic demand conditions remain fairly buoyant. Output expansion is expected to be sustained over the coming quarters with higher-frequency indicators of demand, including vehicle sales, energy sales, and manufacturing output (based on the MISSI), still growing robustly. The Purchasing Managers' Indices (PMI) of the manufacturing and services sectors have continued to point to expansion, although the retail/wholesale (R/W) sector was below the 50-threshold. The respondents cited decrease in orders and unstable prices and decrease in the production of suppliers as the main reasons for the decline. Nevertheless, purchases of the R/W sector was in expansion mode in preparation for the Christmas season.

- Measures of consumer and business sentiment, while declining slightly for Q3, turned bullish for the next quarter. These demand indicators are consistent with the results of the latest business cycle analysis of the BSP and various leading economic indicators monitored by the BSP and NSCB which all point to a continued economic upturn. Seven out of eleven BSP leading and coincident indicators and eight out of eleven NSCB composite leading economic indicators suggest continued positive economic growth in Q3 2013.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- Favorable supply conditions have kept prices of meat, fish, fruits and refined sugar generally stable in September 2013 compared to their month-ago levels. Meanwhile, prices of some monitored vegetables rose in September after Typhoon Odette affected key vegetable-producing areas in the northern and central parts of Luzon.

- Retail prices of rice eased in October 2013 signaling the onset of the main harvest season.According to the NFA, rice prices are expected to continue to trend downwards with the main harvest likely to reach its peak level between mid-October and November 2013. However, the downtrend in prices may be moderated by the impact of Typhoon Santi on production, particularly in Region III which is a key supplier of rice stocks in Metro Manila.

- Meanwhile, the Food and Agriculture Organization (FAO) Food Price Index declined by about 4 points (about 1.9 percent) to 201.8 points in August 2013 from the July 2013 level of 205.6 points. The decline in August, which marked the fourth consecutive monthly decrease, was driven largely by lower international prices for cereals and oils.

<u>Oil Price Developments</u>

- Oil prices were higher in September due mainly to escalating tensions in the Middle East, particularly Syria, fueling concerns of oil supply disruption in the region. However, the month-to-date average spot price of Dubai crude oil as of 15 October declined as the budget deliberations deadlock in the US fueled concerns of slower global economic activity and reduced oil demand going forward.

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

- Overall cost of electricity was lower in October 2013 due to the reduction in generation charge and other electric bill components. Meralco reported that the generation charge went down due to the downward adjustments in generation rates purchased from the Wholesale Electricity Spot Market (WESM). The reduction in WESM's generation charges was due to the availability of more hydroelectric power plants. The end of the National Power Corporation's collection of the Incremental Currency Exchange Rate Adjustment also contributed to the reduction of power generation charge. Similarly, power rates of the Power Supply Agreements and Independent Power Producers transmission charge and other bill components declined.

F. Financial market developments

- In October, the PSEi climbed amid improved investor optimism fueled by Moody's upgrade of the Philippines' sovereign rating to investment grade status on 3 October and the country's growth forecast being raised by several institutions (ADB, WB, Fitch Ratings, Goldman Sachs, First Metro Investment Corp. and University of East Asia and the Pacific). Reports of the surge in Philippine exports and factory output in August also helped lift the PSEi in the first half of the month. However, the rally was tempered by growing concerns of a prolonged US government shutdown (that began on 1 October) and rising fears that the US may default if Congress fails to lift the debt ceiling by the 17 October deadline, compounded by Fitch Rating placing the US' AAA rating on negative watch on 15 October. Market volatility eased after President Obama signed the budget bill on 17 October. On 18 October, the PSEi pushed pass the 6,600 mark for the first time since August as it closed higher relative to the end-September level by 6.7 percent at 6,607.83 index points.

- The peso also strengthened during the period 1-16 October to average ₱43.19/US$1. The peso's recovery was underpinned by the decision of the US Fed not to taper its quantitative easing program and the recent credit rating upgrade from Moody's, coupled with easing concerns over the US government default. Similarly, the increasing level of the country's gross international reserves provided broad stability to the peso.[2]

- For the period 1-18 October, debt spreads tightened. The upgrade on the country's credit rating by Moody's completed the country's ascent to investment rank which prompted an increase in demand for Philippine debt papers, translating to a tighter sovereign bond spread.

G. Domestic liquidity and credit conditions

- Domestic liquidity or M3 grew by 30.9 percent (preliminary) in August to reach ₱6.0 trillion. This growth was slightly faster than the 30.1-percent expansion recorded in the previous month and is the fastest on record since 2002. On a monthly basis, seasonally-adjusted M3 was broadly unchanged after expanding by 8.5 percent (revised) month-on-month (m-o-m) in July.

- The temporary period of strong M3 growth is itself not expected to translate into significant inflationary pressures given manageable credit growth. The outstanding loans of commercial banks grew by 14.2 percent in August, from 12.3 percent in July. On a month-on-month seasonally-adjusted basis, commercial bank lending in August increased by 1.8 percent for loans net of RRPs and by 1.0 percent for loans inclusive of RRPs.

H. Fiscal developments

- The fiscal deficit in the period January-August 2013 was ₱82.6 billion, higher than the ₱71.1 billion deficit incurred during the same period in 2012. This represented57.2 percent of the ₱144.5 billion programmed deficit for Q1-Q3 2013. Revenue collections increased by 12.4percent while expenditures were higher by 12.6 percent.

I. External developments

- Prospects for global economic growth remain tepid. In its latest World Economic Outlook (October 2013), the IMF lowered anew its world output projections by 0.3 percentage point and 0.2 percentage point in 2013 and 2014, respectively compared to forecasts released in July 2013. The latest IMF forecasts point to a modest 2.9-percent and 3.6-percent increase in global output for 2013 and 2014, respectively. Fiscal pressures in the US, adjustment fatigue in the euro area (particularly in the periphery economies), tighter financial conditions associated with the eventual exit from unconventional monetary policies, emerging domestic vulnerabilities and capacity constraints in emerging economies, and geopolitical concerns in oil-producing countries represent the downside risks to global growth.

[2] Gross International reserves climbed to US$83.20 billion as of end-August 2013 from US$83.17 billion as of end-July.