BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 23 OCTOBER 2014[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 is based on its assessment of a more manageable inflation environment, based on latest baseline projections indicating within-target inflation for the policy horizon. Latest forecasts show a lower inflation path for 2014-2016, reflecting easing pressures on commodity prices. Inflation expectations have also remained broadly stable and aligned to the inflation target. At the same time, the MB noted that domestic demand conditions continue to be resilient, supported by adequate domestic liquidity and robust bank lending growth.

- The MB was of the view that the risks to the inflation outlook are broadly balanced, with potential price pressures emanating from pending petitions for adjustments in utility rates and possible power shortages. Meanwhile, global economic prospects are likely to stay uneven, thus mitigating upward pressures from commodity prices going forward.

- The MB deemed it prudent for the time being to allow previous monetary responses to continue to work their way through the economy. The MB emphasized that the BSP will remain vigilant against developments that could affect the outlook for inflation and financial stability and is prepared to take appropriate policy action as necessary to safeguard its price and financial stability objectives.

[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 23 October 2014 meeting were approved by the Monetary Board during its regular meeting held on 13 November 2014. The next meeting of the Monetary Board on monetary policy issues is scheduled on 11 December 2014.

III. Recent Developments and Inflation Outlook

The MB considered the following developments in deciding its policy stance:

A. Domestic price conditions

- Year-on-year headline inflation decelerated in September to 4.4 percent from 4.9 percent in August. Other price indicators also slowed down such as the seasonally-adjusted month-on-month and 3-month moving average annualized headline inflation, seasonally-adjusted month-on-month core inflation, and the combined weight of CPI items with above-threshold inflation. Meanwhile, the official core inflation, two out of three alternative measures of core inflation estimated by the BSP, and the number of above-threshold items held steady. Conversely, the seasonally-adjusted 3-month moving-average annualized core inflation rate increased in September.

- The lower inflation in September was attributed largely to slower increases in prices of food, electricity, and domestic petroleum products. Food inflation slowed down on adequate domestic supply of key food items, particularly rice, corn, and vegetables. Likewise, non-food inflation edged lower due mainly to the downward adjustment in electricity rates as a result of lower generation charges in September as well as price reductions in kerosene, LPG, diesel, and gasoline.

- By geographical location, inflation in the National Capital Region (NCR) and areas outside NCR decreased to 3.5 percent and 4.7 percent, respectively, in September from 4.4 percent and 5.0 percent in the previous month.

B. Inflation expectations

- Inflation expectations have remained broadly stable and aligned to the inflation target. Results of the September 2014 BSP's survey of private sector economists yielded steady inflation forecasts for 2014-2016. Results of the October 2014 Consensus Economics survey showed a lower inflation forecast for 2014 and a steady inflation forecast for 2015. The MB noted that recent monetary policy actions along with easing congestion at the Port of Manila and the lower inflation outturn in September should help keep the public's inflation expectations well-anchored.

C. Inflation outlook

- The latest outlook for inflation showed a slightly lower path for 2014-2016. The downward adjustment in the forecasted inflation path is due mainly to the decline in oil prices and lower world GDP growth assumptions. Current forecasts suggest that inflation will still be above the midpoint of the target range for the remainder of 2014. Similarly, inflation will likely hover above the midpoint of the 3.0 percent ± 1.0 percentage point target for most of 2015. Thereafter, inflation is likely to ease to near the midpoint of the target range in 2016.

- Risks to future inflation are more balanced. Pending petitions for utility rate adjustments and looming power shortage pose upside risks to inflation while downside risks could stem from slower global economic activity.

D. Demand conditions

- The MB noted that indicators for domestic demand remain firm but output conditions face downside risks. The monthly survey of purchasing managers suggests that the Philippine economy was still in expansion phase in the third quarter while manufacturing companies continue to operate above the long-term average capacity utilization of 80.0 percent since 2010. However, notwithstanding indications of the underlying strength in domestic demand conditions, economic activity in the second half could be dampened by a slowdown in government expenditures. Slower global economic activity could also exert a downward pull on external demand.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- The retail prices of rice showed mixed trends in September. As of end-September 2014, the average price of well-milled rice declined while the average price of regular-milled rice slightly inched up. Early harvest in some regions contributed to the decline in rice prices.

<u>Oil Price Developments</u>

- Oil prices decelerated further after the International Energy Agency reduced its global oil demand growth forecasts for 2014 and 2015, citing a pronounced slowdown in demand growth and a weaker outlook for Europe and China. Futures prices of oil suggest a downtrend in oil prices, owing to increases in non-OPEC production despite geopolitical tensions in traditional oil-producing countries.

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

- Higher generation costs pushed electricity rates higher in October. According to Meralco, generation charges went up primarily due to a five-day Malampaya restriction in September, which forced some power plants to use more expensive liquid fuel in lieu of natural gas. The depreciation of the peso against the dollar during the month also contributed to the increase in generation charge.

F. Financial market developments

- The market consolidated in the first half of October as investors became wary about the nearing end of the US Federal Reserve's bond buying program. The investors' lackluster appetite were further dragged by concerns over the democracy protests in Hong Kong. The peso also weakened further on concern that an increase in US interest rates will spur capital outflows from emerging markets. Similarly, debt spreads started to widen as yields of Philippine government bonds increased following the rise in BSP policy rates on

11 September. The weaker-than-expected industrial output from China and a shift to a trade deficit from an expected surplus in the Philippines likewise added to the weak sentiment. The widening of spreads was also traced to concerns that the Federal Reserve would soon raise rate which put upward pressure on global bond market yields. Nevertheless, a series of disappointing data releases reinforced views of stalling global growth which was further underpinned after the International Monetary Fund (IMF) cut its global economic growth forecasts for a third time this year and after minutes of the last FOMC meeting acknowledged the global slowdown as a risk to the US outlook.

G. Domestic liquidity and credit conditions

- M3 grew by 18.5 percent in August to ₱7.1 trillion. This pace of increase was faster than the revised 17.9-percent expansion recorded in the previous month. On a month-on-month basis, seasonally-adjusted M3 grew by 0.8 percent, following the 2.3-percent increase (revised) in July. Notwithstanding the uptick in August, domestic liquidity continued to grow broadly in line with the path projected by the BSP.

- Similarly, the outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, grew by 20.2 percent year-on-year in August from 21.1 percent (revised) in July. On a month-on-month seasonally-adjusted basis, commercial bank lending increased by 1.3 percent for loans net of RRPs and by 0.2 percent for loans inclusive of RRPs.

H. Fiscal developments

- The NG fiscal deficit for the period January-August 2014 was ₱25.9 billion, lower than the ₱82.6-billion deficit incurred during the same period in 2013. Meanwhile, netting out the interest payments in the expenditures, the primary surplus amounted to ₱202.7 billion, ₱56.4 billion higher than the level recorded in the period January-August 2013.

I. External developments

- Global growth prospects remain uneven. The outlook for advanced economies is generally positive, but the pace of growth across regions continues to diverge. Economic activity in the US is projected to strengthen further, while the recovery in the euro area and Japan are seen to stay moderate. Meanwhile, major emerging markets, particularly in China and India, are seen to recover modestly, as new policy measures and faster growth in advanced economies support domestic and external demand.