Bangko Sentral ng Pilipinas

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

I. Monetary Policy Decision

The Monetary Board (MB) decided to:

a) Reduce the BSP's policy interest rates by 25 basis points to 4.25 percent for the overnight RRP (borrowing) rate and 6.25 percent for the overnight RP (lending) rate;

b) Reduce accordingly 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 inflation outlook remains comfortably within the target range, with inflation expectations well-anchored. Latest baseline forecasts indicate that average annual inflation rates are likely to fall within the lower half of the 3-5 percent target range up to 2013. Pressures on global commodity prices are seen to continue to abate amid weaker global growth prospects.

- The MB noted that the global economic environment had become more challenging amid renewed uncertainty, much of it linked to the ongoing Euro crisis. With the resolution of the European sovereign debt crisis expected by market players to be a drawn-out process, uncertainty and risk aversion are likely to weigh down on global sentiment. Meanwhile, the US economy, despite signs of improvement, remains susceptible to financial market volatility amid ongoing discussions on a long-term fiscal debt-reduction plan.

- Against this background, the MB believed that the overall balance of global economic activity going forward appears to be tipping towards a further slowdown and the Philippine economy is likely to face external headwinds in 2012. The MB concluded that the benign inflation outlook allowed some scope for a reduction in policy rates to help boost economic activity and support market confidence. While the Philippine economy continues to expand, sustained domestic spending is expected to compensate for weaker external demand.

[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 January 2012 meeting were approved by the Monetary Board during its regular meeting held on 2 February 2012. The next meeting of the Monetary Board on monetary policy issues is scheduled on 1 March 2012.

- However, the MB also took into account the risks surrounding the inflation outlook. The impact of sustained capital inflows on domestic liquidity and the effect of geopolitical tensions in major oil-producing countries on global oil supplies are seen to continue to pose upside risks to inflation.

III. Recent Developments and Inflation Outlook

The MB considered the following developments in coming up with its policy decision:

A. Domestic price conditions

- The year-on-year average headline inflation in 2011 at 4.4 percent (2000=100) and 4.8 percent (2006=100) was within the Government's target for the year. Meanwhile, December inflation dropped further after peaking in October, driven mainly by lower inflation for food, particularly rice, vegetables and sugar. Other indicators also reflected a downtrend, notably various measures of core inflation and the cross-sectional distribution of CPI price changes.

B. Inflation expectations

- Inflation expectations continued to be bounded by the target range. Latest results of the BSP's survey of private sector economists and the AP consensus survey showed steady mean forecasts for 2012, indicating that inflation expectations remained anchored to the target over the policy horizon.

C. Inflation outlook

- The outlook for inflation over the policy horizon continues to be manageable. Latest baseline inflation forecasts using the 2006-based CPI series reflect a decelerating path, with average annual inflation for 2012-2013 falling close to the lower bound of the target range of 3-5 percent.

- The downside risks to the inflation outlook have intensified due to concerns over the strength of the global economy. At the same time, the broadly stable peso could help temper the prices of imported commodities. Meanwhile, the upside risks to inflation could emanate from the impact of the geopolitical risks in the MENA region on global oil supplies, sustained strong capital inflows and additional petitions for electricity rate adjustments.

D. Demand conditions

- Output dynamics appear to be weaker. The business cycle analysis by the BSP indicated that the economy has been growing below its long-term growth trend. Furthermore, surveys suggest households and businesses could turn more cautious in the ensuing period.

E. Supply-side indicators

Developments in Agriculture

- The Bureau of Agricultural Statistics (BAS) revised downwards its forecast for 2011 palay production, reflecting the adverse effects of typhoons Mina, Juaning, Pedring and Quiel on standing crops. However, *palay* and corn production for 2011 are still expected to exceed their 2010 levels due to significant gains recorded in the first half which more than offset the crop damages triggered by the typhoons in the second half.

Oil Price Developments

- The continuing tensions in the MENA region, modest improvement in the US economy and combined efforts to resolve the Euro zone crisis have exerted upward pressures on oil prices in recent months. However, downward pressures brought about by uncertainties on the global economy and the contagion effects of the European debt crisis are still expected to persist in the near term.

Developments in the Utilities Sector

- Electricity rates of Manila Electric Co. (Meralco) decreased in December resulting from reduced power supply cost. Meralco noted that the decrease in prices in the electricity spot market was brought about by the recovery of the Malampaya natural gas pipeline, which helped ease power supply conditions.

F. Financial market developments

- At the 9 January 2012 auction, interest rates for the 91-day and 182-day T-bills declined relative to the rates fetched during the 12 December 2011 auction on account of strong demand amid a high level of market liquidity and ahead of possible policy actions by the BSP. Meanwhile, the interest rate for the 364-day T-bill went up, reflecting weak demand (tenders amounted to ₱2.9 billion compared to the ₱3.5 billion offered amount). Market expectations that the interest rate environment may be affected by possible policy actions by the BSP dampened investors’ appetite for the said tenor.

- In December, concerted efforts of key central banks to extend financial assistance to banks in the Euro zone calmed investors, boosting stock markets around the globe and bringing down premia on emerging market debt securities. Favorable US economic data, which reflected a steady pick up in the US economy, likewise buoyed market sentiment. However, the peso came under pressure during the same period, following the International Monetary Fund’s downward revision of its growth forecast for the Philippine economy and the sluggish performance of the export sector. However, the sustained flow of OF remittances tempered the further depreciation of the peso.

G. Domestic liquidity and credit conditions

- Domestic liquidity or M3 grew at a faster pace of 7.2 percent in November 2011 from 6.9 percent in October 2011 to reach ₱4.4 trillion. Higher growth in net foreign assets (NFA) continued to fuel liquidity expansion, while net domestic assets contracted at a slower rate as the sustained strong expansion in the net other items account (which includes, among other things, SDA placements of trust entities as well as revaluation and capital and reserve accounts) was moderated by the acceleration in the growth of net domestic credits. Reflecting the continued strong growth of bank lending to firms and households, net domestic credits expanded, supported by credit extended to both private and public sector.

- Bank lending growth, net of banks' reverse repurchase (RRP) placements with the BSP, rose slightly in November to 22.5 percent from the previous month's expansion of 22.2 percent. Commercial banks' loans have been growing steadily at double-digit growth rates since January 2011.

- Corporate issuers continue to tap the equity and bond markets. Capital-raising activities in the Philippine Stock Exchange reached ₱109 billion for the period January-November 2011, higher by 30 percent from the 2010 level of ₱84 billion. However, corporate bond issuances for the same period amounted to only ₱173 billion, lower compared to the 2010 level of ₱201 billion.

H. Fiscal developments

- The fiscal deficit in January-November 2011 was ₱96.3 billion, 64.3 percent lower than the ₱269.8 billion deficit incurred during the same period in 2010. The lower deficit figure is attributed to increased revenue collections (13.1 percent year-on-year) coupled with lower government spending (-2.1 percent year-on-year).

I. External developments

- The global economic environment has become more challenging amid renewed uncertainty. While the US economy has shown signs of improvement, it remains susceptible to financial market volatility amid the failure of Congress to settle on a long-term debt-reduction plan. In contrast, the Euro area economy has become notably weaker and it remains uncertain how the current situation would be resolved. Developments in Europe continue to pose increasing downside risks to the global economy. With the resolution of the European sovereign debt crisis expected to be a drawn-out process, uncertainty and risk aversion are likely to weigh down on both the real sector and global financial markets. Most analysts now expect the European economy to record minimal growth in 2012. Against this background, the overall balance of global economic activity appears to be tipping towards a further slowdown going forward.