BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 27 MARCH 2014[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) Raise the reserve requirement by one percentage point effective on 4 April 2014.

II. Key Considerations in the Formulation of the Monetary Policy Stance

- In deciding to maintain policy rates, the MB noted that the future inflation path is likely to stay within the target ranges of 4±1 percent for 2014 and 3±1 percent for 2015. Inflation expectations also remain broadly aligned with the target over the policy horizon. At the same time, the MB noted that the balance of risks to the inflation outlook continues to be skewed to the upside, with potential price pressures emanating from pending petitions for adjustments in utility rates and from the possible increases in food and oil prices.

- The MB's decision to raise the reserve requirement is intended to guard against potential risks to financial stability that could arise from continued strong liquidity growth and rapid credit expansion.

- The MB concluded that buoyant domestic growth prospects allow some scope for a measured adjustment in the BSP's policy instruments amid the ongoing normalization of monetary policy overseas. The MB further emphasized that the BSP will continue to monitor emerging price and output conditions and will consider further adjustments in its monetary policy tools as necessary to safeguard price and financial stability.

[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 6 February meeting were approved by the Monetary Board during its regular meeting held 10 April 2014. The next meeting of the Monetary Board on monetary policy issues is scheduled on 8 May 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 was slightly lower in February due largely to slower increases in the prices of alcoholic beverages and tobacco products, and transport. Other indicators also decreased such as the official core inflation, seasonally adjusted month-on-month and 3-month moving average annualized headline, and core inflation. By contrast, two out of three alternative measures of core inflation estimated by the BSP and the number of above-threshold items increased.

B. Inflation expectations

- Inflation expectations are still within target but moving near the upper end of the target range for 2015. Results of the BSP's survey of private sector economists for February 2014 yielded steady and within-target mean inflation forecasts of 4.1 percent for 2014 and 3.9 percent for both 2015 and 2016. However, respondents to the Consensus Economics inflation forecast survey expected inflation to average at 4.2 percent (from 4.0 percent) in 2014 and 4.0 percent (from 3.9 percent) in 2015, which is at the upper end of the 3.0 percent ± 1.0 target range.

C. Inflation outlook

- Inflation is projected to remain within the target range of 4.0 percent ± 1.0 percentage point for 2014 and 3.0 percent ± 1.0 for 2015. Latest baseline forecasts show lower inflation forecasts for 2014 and 2015 compared to the previous forecast round. The downward adjustment in the inflation path was attributed mainly to lower-than-forecasted February inflation and the changes in the expected timing of utility and transport rate adjustments. These downward pull factors, however, were partly offset by inflationary pressures coming from the higher-than-expected growth of domestic liquidity in January compared to the previous forecast round.

- The balance of risks to the inflation path remains largely skewed to the upside, with potential price pressures seen emanating from increases in power rates, higher food prices and potential volatility in oil prices. The uncertainty as to when supply-side pressures will dissipate also highlights the potential risk of second-round effects. At the same time, the likelihood of a continued acceleration in liquidity growth could feed into asset market frothiness given continued strong credit growth.

D. Demand conditions

- Domestic demand indicators, including vehicle sales, energy sales and manufacturing output, continue to show positive readings in the first quarter. The PMI of the manufacturing, services and retail/wholesale sectors have remained above 50 percent, which indicated expanding activity.

E. Supply-side indicators

Developments in Agriculture

- The Bureau of Agriculture Statistics (BAS) expects rice production output to grow by 5.4 percent in the first semester of 2014, faster than the previous year's growth of 1.3 percent, due to improvements in harvest area and yields. The increase in the harvest area for rice is attributed to the immediate replanting in typhoon-affected areas, early plantings due to presence of sufficient irrigation water and rainfall, and availability of high-quality seeds from the government, while yield improvements resulted from increased usage of certified seeds and fertilizer as well as reduced incidence of pests and diseases.

- The FAO Food Price Index (FPI) was lower in January 2014 compared to the previous month and year-ago levels due to the decline in prices across food categories except for dairy products. Bumper crops in 2013, along with large export supplies, helped push international cereal prices lower.

Oil Price Developments

- In February, international oil prices rose on news of falling distillate supplies, reflecting increased global demand amid prolonged cold weather conditions in the US. Geopolitical tensions in Russia and Ukraine were also seen to translate to volatility in oil prices given that Russia is a large producer and exporter of crude oil and natural gas, while Ukraine is an important transit point for natural gas supplies to Europe.

Developments in the Utilities Sector

- The overall cost of electricity was lower in March 2014 as Meralco reported a month-month decrease in its generation charge. The reduction in generation charge was driven by the lower cost of power sourced through the Power Supply Agreements. Likewise, power rates from the Independent Power Producers, Wholesale Electricity Spot Market (WESM) and other bill components also went down in March 2014.

- Meanwhile, the Energy Regulatory Commission (ERC) issued an order on 3 March 2014 declaring as void the WESM prices for Luzon during the period 26 October to 25 December 2013 since WESM prices in the supply months of November and December 2013 did not qualify as reasonable, rational, and competitive due to the confluence of factors accompanying the tight supply situation in the market. The ERC also ordered the Philippine Electric Market Corporation to recalculate the WESM prices during the said supply months. Given these developments, Meralco's rate adjustments for December 2013 and January 2014 are expected to be lower than its earlier requests.

F. Financial market developments

- In February, the Philippine Stock Exchange Index (PSEi) rallied on positive corporate earnings and after the release of upbeat US economic data boosted confidence in the US economy. The local bourse was also supported after JP Morgan upgraded its rating on the Philippine market to overweight from neutral in its global emerging markets model portfolio, citing lower valuations in the country and adding that the economy's robust growth may lead to a surprise in earnings growth this year. Lower-than-expected Philippine inflation data (4.1 percent in February versus 4.3 percent expected and 4.2 percent previous) also lifted the market.

- Similarly, the peso strengthened in February as the announcement of the US Fed Chairman helped restore stability in the market, amid signs of a further economic slowdown in China. Meanwhile, sustained inflows from OF remittances, foreign portfolio investments, direct investments, and the ample level of the country's gross international reserves continued to provide broad stability to the peso.

- In February, widening pressures on debt spreads abated on renewed investor preference for emerging market bonds. The statement from the US Fed Chairman, who pledged to maintain her predecessor's policies by scaling back stimulus in measured steps, calmed the market and tempered the rise in yields of emerging market bonds.

G. Domestic liquidity and credit conditions

- Domestic liquidity or M3 grew faster at 38.6 percent (preliminary) year-on-year to ₱6.9 trillion in January 2014 from 32.7 percent in December 2014. On a month-on-month seasonally-adjusted basis, M3 increased by 5.5 percent, following a 1.5-percent contraction in December 2013.

- The higher M3 growth in January reflected statistical base effects resulting from the slower growth in domestic liquidity of 8.8 percent in January 2013.

- Money supply continued to expand due to higher demand for credit in the domestic economy. Domestic claims grew by 16.2 percent in January from 11.6 percent in December 2013 as bank lending accelerated, with the bulk of loans going to manufacturing, utilities, wholesale and retail trade, as well as financial and business services. Public sector credit also climbed by 15.2 percent due to withdrawals by the National Government of its deposits with the BSP to fund the redemption of bonds and spending on public works projects.

- The outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, expanded by 17.1 percent in January 2014 from 16.4 percent in December 2013. On a seasonally-adjusted basis, commercial bank lending increased by 1.6 percent m-o-m in January.

H. Fiscal developments

- The fiscal deficit in the period January-November 2013 was ₱111.5 billion, lower than the ₱127.1 billion deficit incurred during the same period in 2012. This represented 46.8 percent of the ₱238.0 billion programmed deficit for Q1-Q4 2013. Revenue collections increased by 11.2 percent while expenditures were higher by 9.2 percent.

I. External developments

- The MB noted that prospects for global economic growth have been broadly steady. The outlook for the US economy remains upbeat, while economic activity in the euro area and Japan continues to gain traction. Meanwhile, the pace of growth in major emerging markets, particularly in China and India, has remained muted.