



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY
STANCE HELD ON 25 JUNE 2015¹**

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 was based on its assessment that the monetary policy stance remained appropriate given within-target inflation forecasts. Latest baseline forecasts indicate that inflation is likely to settle within the lower half of the target range of 3.0 percent \pm 1 percentage point for 2015 and 2016. The forecasts are also supported by well-anchored inflation expectations following recent inflation outturns.
- The Monetary Board likewise noted that the risks to the inflation outlook continue to be broadly balanced, with upside risks emanating from pending petitions for power rate adjustments and the potential impact of stronger-than-expected El Niño dry weather conditions on food prices and utility rates. Meanwhile, slower global economic activity could pose downside risks to inflation.
- At the same time, the Monetary Board observed that despite the slower-than-expected output growth in the first quarter of 2015, domestic demand conditions remain firm owing to solid private household and capital spending as well as buoyant business confidence. Ample domestic liquidity and planned higher public spending are also expected to support economic activity in the coming months.
- Given these considerations, the Monetary Board is of the view that current monetary policy settings remain appropriately calibrated. Going forward, the BSP will continue to monitor domestic and external developments to ensure that the monetary policy stance remains consistent with its price and financial stability objectives conducive to sustained economic growth.

¹ The discussions herein reflect the assessment made by the Monetary Board based on a comprehensive set of economic information available at the time of the policy meeting. The highlights of the discussions on the 25 June 2015 meeting were approved by the Monetary Board during its regular meeting held on 16 July 2015. The next meeting of the Monetary Board on monetary policy issues is scheduled on 13 August 2015.

III. Recent Developments and Inflation Outlook

The MB considered the following developments in deciding on the monetary policy stance:

A. Domestic price conditions

- Year-on-year headline inflation eased further to 1.6 percent in May. Other indicators of price pressures also decreased such as the official core inflation rate, all alternative measures of core inflation estimated by the BSP, the seasonally-adjusted month-on-month and 3-month moving average annualized headline and core inflation rates, and the number and weight of the above-threshold CPI items.
- Moderate price increases for most food items helped push down headline inflation in May. In particular, key items such as rice, corn, meat, fish, milk, oils, and fruits posted lower price increases due to adequate domestic supply. Similarly, non-food inflation eased further due mainly to the downward adjustment in electricity rates resulting from lower generation charges in the Wholesale Electricity Spot Market (WESM) and from independent power producers as well as the lower prices of domestic petroleum products in year-on-year terms.
- By geographical location, inflation in the National Capital Region (NCR) and areas outside NCR eased to 0.7 percent and 1.8 percent, respectively, in May from 1.5 percent and 2.3 percent in the previous month.

B. Inflation expectations

- Inflation expectations depicted in forecast surveys of private sector economists by the BSP and by Consensus Economics are well within the target band over the policy horizon. Results of the BSP's May 2015 survey of private sector economists yielded generally lower mean inflation forecasts for 2015-2017. The mean inflation forecast for 2015 was steady at 2.6 percent, while the mean inflation forecasts for 2016 and 2017 were lower at 3.2 percent (from 3.3 percent in April) and 3.1 percent (from 3.3 percent), respectively. Similarly, results of the June 2015 Consensus Economics inflation forecast survey for the country showed a lower mean inflation forecast for 2015 at 2.4 percent (from 2.6 percent in May) and steady inflation forecast for 2016 at 3.5 percent.

C. Inflation outlook

- The latest outlook for inflation remained within the target range of 3.0 percent \pm 1.0 percentage point for 2015-2016. Compared to the previous forecast round, the latest baseline inflation forecast for 2015 is lower mainly on account of the lower-than-projected inflation in May 2015 and the downward adjustment in the 2015 GDP growth projection. These were offset in part by the impact of petitions for the upward adjustment in jeepney and taxi fares. The latest average baseline inflation forecast for 2016 is also slightly lower.
- The distribution of risks to the baseline inflation forecast continues to be broadly balanced. On the one hand, potential adjustments in electricity rates given pending petitions and the impact of stronger-than-expected El Niño dry weather conditions on food prices and utility

rates represent upside risks to inflation. On the other hand, slower global economic activity poses a downside risk to inflation.

D. Demand conditions

- Indicators of domestic demand remain firm. Business outlook continued to be positive for Q2 2015 due to robust consumer demand during the school graduation and enrolment periods, the crop harvest time, and the summer season. The expected increase in government infrastructure spending in the coming months also boosted business confidence for the current quarter. The composite Purchasing Managers' Index (PMI) has likewise remained above the 50-point expansion threshold in April. Meanwhile, the Philippine business cycle was still on an expansion phase, although it has signalled a possible deceleration in economic activity given the first-quarter GDP outturn and the revision of the Q4 2014 GDP data.

E. Supply-side indicators

Developments in Agriculture

- The retail prices of rice decreased in May 2015 amid ample supply from imports and from the ongoing summer harvest. During the third week of May, the average prices of well-milled rice and regular-milled rice were both lower compared to month-ago levels.
- The Food and Agriculture Organization (FAO) Food Price Index was lower in May as prices of almost all commodities, particularly cereals, dairy, and meat products, fell year-on-year amid ample supplies. By contrast, the prices of sugar and vegetable oils increased.
- The baseline forecasts accounted for the prevalence of a “weak to moderate” El Niño episode in the Philippines based on the monitoring and analysis of the Philippine Atmospheric, Geophysical and Astronomical Services (PAGASA). The Monetary Board noted that PAGASA has since revised its outlook and now expects a “moderate to strong” El Niño episode in the second half of the year, which could likely result in a lower-than-normal rainfall pattern in many parts of the country.

Oil Price Developments

- Oil prices increased in May as a result of slowing drilling activity in the US and on geopolitical tensions in the Middle East. Meanwhile, on a year-to-date basis, the domestic prices of petroleum products, except for gasoline, were generally lower as of 9 June 2015.

Developments in the Utilities Sector

- Electricity rates declined in June due to lower generation costs. According to Meralco, generation rates decreased mainly on account of lower fuel costs and higher dispatch of the power plants under power supply agreements. Meanwhile, effective 1 June 2015, the basic water charge for Manila Water Company, Inc. (MWCI) was adjusted downward while that for Maynilad Water Services, Inc (MWSI) was adjusted upward pursuant to the final award issued by the Appeals Panel on the arbitration cases filed by the water concessionaires in 2013.

F. Financial market developments

- The equities market continued to retreat in May amid concerns over the possibility of Greece defaulting on its debt as well as the slower-than-expected first quarter Philippine GDP growth outturn. However, improvements in the US labor market as well as reports of a benign domestic inflation environment and favorable domestic first-quarter earnings buoyed market sentiment and tempered the slide.
- The peso weakened in May as favorable indicators of US employment conditions and manufacturing activity reinforced the likelihood of an interest rate hike in the US later this year. Nonetheless, the sustained inflows of foreign exchange from overseas Filipino remittances, BPO and tourism receipts, foreign portfolio and direct investments, as well as the ample level of the country's gross international reserves provided support to the peso.
- Meanwhile, debt spreads tightened in May as low interest rates in advanced economies, particularly the euro area, drove investors to seek the relatively higher yields of emerging market bonds. Indications of slower activity in China as well as the lower-than-projected Philippine GDP growth in Q1 2015, however, contributed to the widening pressures in emerging market debt spreads later in the month.

G. Domestic liquidity and credit conditions

- Preliminary data show that M3 grew by 9.0 percent year-on-year in April 2015 to ₱7.6 trillion. This was faster than the 8.7-percent expansion recorded in March 2015. On a month-on-month seasonally-adjusted basis, M3 increased by 0.9 percent.
- The outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, grew at a slightly slower pace of 15.4 percent in April 2015 from 16.1 percent in the previous month. On a month-on-month seasonally-adjusted basis, commercial bank lending increased for both loans net of RRP and loans inclusive of RRP.

H. Fiscal developments

- The National Government (NG) recorded a fiscal surplus of ₱135.4 billion for the period January-April 2015, reversing the ₱3.3-billion deficit incurred in the same period in 2014. Meanwhile, after excluding interest payments from total expenditures, the resulting primary surplus amounted to ₱135.4 billion, ₱22.1 billion or 20.0 percent higher than the level recorded in the same period a year ago.

I. External developments

- Growth in the US remains robust, while economic activity in the euro area and Japan appears to have improved. Meanwhile, growth across emerging Asia, including China and India, has remained broadly subdued. On balance, economic growth across the globe is expected to remain uneven, while inflation pressures are likely to remain benign as prospects for the prices of oil and other commodities continue to be soft.