



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY
STANCE HELD ON 13 AUGUST 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 prevailing price and output conditions support maintaining current monetary policy settings. Latest baseline forecasts indicate that average inflation is likely to settle slightly below the target range for 2015 but will nevertheless remain within the target range of 3.0 percent \pm 1 percentage point over the rest of the policy horizon. The forecasts are also supported by well-anchored inflation expectations.
- The MB likewise noted that upside risks to the inflation outlook continue to emanate from pending petitions for power rate adjustments and the impact of stronger-than-expected El Niño dry weather conditions on food prices and utility rates. Meanwhile, a modest rise in food and commodity prices, and slower global economic activity could pose downside risks to inflation.
- The MB observed that recent benign inflation outturns have been the result of favorable supply-side conditions, which are largely seen as having a transitory impact on the inflation path. Over the policy horizon, inflation is projected to rise gradually and stabilize within the lower half of the inflation target range. At the same time, the MB noted that recent developments on the global front require careful monitoring, as they could pose threats to financial stability.
- Given these considerations, the MB was of the view that current monetary policy settings remained appropriate. The MB reiterated that it will continue to monitor closely domestic

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 13 August 2015 meeting were approved by the Monetary Board during its regular meeting held on 3 September 2015. The next meeting of the Monetary Board on monetary policy issues is scheduled on 24 September 2015.

and external developments to ensure that the monetary policy stance stays in line with maintaining price and financial stability.

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 0.8 percent in July. Other indicators of price pressures also decreased, such as the official core inflation rate, two out of three alternative measures of core inflation estimated by the BSP, and the number and weight of the above-threshold CPI items. Meanwhile, the seasonally-adjusted month-on-month headline and core inflation and the 3-month moving average annualized core inflation rate were higher, while the seasonally adjusted 3-month moving average annualized headline inflation rate was broadly steady during the month.
- Slower food inflation due to adequate domestic supply of key food items—particularly rice, fish, milk, fruits, and sugar—helped push inflation down. Meanwhile, non-food inflation was steady as the slight uptick in actual rentals for housing and out-patient health services was offset by the decline in electricity, gas, and other fuels and operation of personal transport equipment. The inflation for electricity, gas, and other fuels likewise fell as a result of the downward adjustment in electricity rates and price reductions in kerosene and LPG, while inflation in operation of personal transport equipment declined on lower pump prices of diesel and gasoline
- By geographical location, inflation in the National Capital Region (NCR) rose to 0.8 percent in July from 0.6 percent in June. By contrast, inflation in areas outside NCR decelerated to 0.8 percent in July from 1.4 percent a month earlier.

B. Inflation expectations

- Inflation expectations depicted in forecast surveys of private sector economists by the BSP and by Consensus Economics are lower but continue to be within the target band over the policy horizon. Results of the July 2015 BSP's survey of private sector economists yielded generally lower mean inflation forecasts for 2015 at 2.1 percent (from 2.3 percent in June) and for 2016 at 3.0 percent (from 3.1 percent). Meanwhile, the mean forecast for 2017 was slightly higher at 3.1 percent from 3.0 percent in the previous month. Similarly, results of the July 2015 Consensus Economics inflation forecast survey showed lower mean inflation forecasts for 2015 and 2016 at 2.1 percent (from 2.4 percent in June) and 3.4 percent (from 3.5 percent), respectively.

C. Inflation outlook

- Inflation could settle slightly below the low-end of the government's announced target range in 2015. The reduction in the forecasted inflation path for 2015 could be attributed mainly to the lower-than-projected inflation in June and July 2015 as well as the continued reduction in global crude oil prices. Petitions for upward adjustments in transport fares

were also removed from the baseline forecasts as a result of the decline in domestic price of petroleum products. Moreover, the forecast path shows that inflation could rise gradually to approach the midpoint of the target range in 2016 – 2017.

- Slower global economic activity and moderate pressures on international commodity prices continue to pose downside risks, while potential adjustments in electricity rates given pending petitions and the impact of stronger-than-expected El Niño conditions are the upside risks to inflation.

D. Demand conditions

- Indicators of domestic demand remain firm. The composite Purchasing Managers' Index (PMI) has remained above the 50-point expansion threshold in May, while vehicle and energy sales continue to be robust. Meanwhile, the Philippine business cycle was still on an expansion phase in Q2 2015.

E. Supply-side indicators

Developments in Agriculture

- As of the third week of June 2015, the average retail price of well-milled rice increased as the summer harvest ended, while the price of regular-milled rice was broadly steady.
- The Food and Agriculture Organization (FAO) Food Price Index decreased in June due mainly to the lower prices of dairy and sugar. The decline in the prices of dairy and sugar were brought about by ample supply of dairy products, the abolition of the milk quota system in Europe, uncertainty over China's dairy import demand, and higher-than-expected sugar production in India and Thailand. These aforementioned declines more than offset the rise in prices of cereal and vegetable oil. Cereal prices rose as unfavorable weather conditions adversely affected the supply of wheat and coarse grains, while increased demand from China and India drove the prices of vegetable oils higher.
- The MB noted PAGASA's observation that El Niño conditions in the tropical Pacific Ocean have intensified from weak to moderate last June and have shown signs of intensifying into a strong episode in Q3 2015 before gradually weakening around early 2016.

Oil Price Developments

- Oil prices extended their retreat in July following the signing of the Iran nuclear deal. Dubai crude further declined in early August on expectations of lower demand amidst an oversupplied oil market. Meanwhile, on a year-to-date basis, the domestic prices of petroleum products, except for gasoline, were generally lower as of 4 August 2015.

Developments in the Utilities Sector

- Electricity rates fell for a third consecutive month in July as the provisional decrease in the distribution charge offset the higher generation charge. According to Meralco, settlement prices at the Wholesale Electricity Spot Market and generation charges of Independent

Power Producers increased mainly on account of power plant outages and the use of more expensive alternative fuels due to Malampaya gas restrictions.

F. Financial market developments

- The equities market continued to retreat in July on increased risk aversion amid signs of a slowdown in the Chinese economy. However, the bailout deal between Greece and its creditors as well as expectations of strong domestic corporate earnings in Q2 2015 buoyed market sentiment and tempered the slide.
- The peso weakened in July as favorable indicators of US economic activity reinforced the likelihood of an interest rate hike in the US later this year. The peso depreciated further in early August, breaching the ₱46-level following the devaluation of the Chinese yuan. Nonetheless, the sustained inflows of foreign exchange from overseas Filipino remittances, BPO and tourism receipts, as well as the ample level of the country's gross international reserves provided support to the peso.
- Meanwhile, debt spreads widened in early July amid uncertainty over the Greek debt crisis as well as concerns over the stock market sell-off in China. Debt spreads started to ease by mid-July after Greece and its creditors agreed on a bailout package and after the Chinese government intervened to arrest the stock market rout.
- Volatility in global and local financial markets increased following the devaluation of the yuan by Chinese authorities in early August. Consequently, the Philippine stock market index declined and the peso depreciated, tracking the movement of other bourses and currencies in the region.

G. Domestic liquidity and credit conditions

- Preliminary data show that M3 grew by 9.0 percent year-on-year in June 2015 to reach ₱7.7 trillion. This was slightly slower than the 9.3-percent expansion recorded in May. On a month-on-month seasonally-adjusted basis, M3 decreased by 0.3 percent.
- Outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, expanded by 14.5 percent in June which is the same growth rate as in May. On a month-on-month seasonally-adjusted basis, commercial bank lending for loans net of RRP increased by 0.7 percent.

H. Fiscal developments

- The National Government (NG) recorded a fiscal surplus of ₱13.7 billion for the period January-June 2015, reversing the ₱54.0-billion deficit incurred in the same period in 2014. Netting out the interest payments in the expenditures, the primary surplus amounted to ₱169.9 billion, ₱64.1 billion or 60.6 percent higher than the level recorded in the same period a year ago.

I. External developments

- Growth in the US has found greater traction, increasing the likelihood of a lift-off in interest rates by the US Federal Reserve before the end of the year. Meanwhile, the recovery in the euro area and Japan continues to improve. By contrast, economic activity across major emerging markets weakens further. With these developments, the outlook for global economic growth for 2015 has been downgraded in the July update of the IMF's World Economic Outlook, with the risks to the projections remaining on the downside. Inflation pressures are likely to remain subdued amid soft prospects for the prices of oil and other commodities.