HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 14 JUNE 2012[1]

I. Monetary Policy Decision

The Monetary Board (MB) decided to:

a) Maintain the BSP's policy interest rates at 4.0 percent for the overnight RRP (borrowing) rate and 6.0 percent for the overnight RP (lending) rate;

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 that average inflation is likely to remain within target over the policy horizon, with well-contained inflation expectations. Latest baseline forecasts indicate that the annual inflation rates for 2012-2013 will settle at the lower end of the 3-5 percent target range.

- The MB decided to keep policy rates unchanged as the economy appears to be moving towards a period of stable inflation and robust growth. The MB took into consideration the latest domestic macroeconomic readings which have improved significantly in the first quarter. GDP growth for Q1 2012 was an upside surprise as exports recovered and public spending gained momentum. Meanwhile, available leading economic indicators likewise paint a generally positive picture in the period ahead.

- Against this economic backdrop, there is scope to maintain current policy settings and allow the cumulative 50-basis-point reduction in policy rates and the operational adjustments in the reserve requirements earlier in the year to continue to work their way through the economy. Adequate liquidity and strong bank lending, spurred by prevailing low interest rates, should also help sustain domestic real sector activity.

- The MB also noted that core inflation remains firm. Oil prices continue to show considerable volatility, while additional petitions for electricity rate adjustments provide potential upside influence on inflation. Meanwhile, the weak global economy

[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 14 June 2012 meeting were approved by the Monetary Board during its regular meeting held on 28 June 2012. The next meeting of the Monetary Board on monetary policy issues is scheduled on 26 July 2012.

can contribute to a moderation in oil and other commodity prices. As such, inflationary pressures and the risk of second-round effects may also ease in the coming months.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- Year-on-year headline inflation decelerated in May, driven mainly by lower inflation for non-food items, particularly electricity, LPG, kerosene, gasoline and diesel. Other indicators also reflected a downtrend, including the following: seasonally-adjusted month-on-month headline and core inflation, and the combined weight of above-threshold CPI components. In contrast, year-on-year core inflation and the number of above-threshold items increased slightly, while the three alternative measures of core inflation estimated by the BSP showed mixed trends.

B. Inflation expectations

- Inflation expectations based on the BSP and private sector forecast surveys remained within the 3-5 percent target range over the policy horizon. Results of the May 2012 survey from the AP Consensus showed lower inflation forecasts for 2012 and 2013 compared to April. Meanwhile, results of the May 2012 BSP survey of private sector economists showed steady inflation forecasts for 2012 and 2014 and a slightly higher forecast for 2013. Similarly, the Q2 2012 business expectations survey indicated that the majority of respondents anticipating inflation to go up in the current survey quarter decreased.

C. Inflation outlook

- Despite the slight increase in the inflation forecast, the latest baseline forecasts continue to point to within-target inflation for 2012 and 2013. The slightly higher baseline forecasts relative to projections from the previous policy meeting on 19 April are due to the higher-than-forecast actual inflation for April as well as the higher-than-expected increase in wages in the National Capital Region (NCR) for 2012. These adjustments offset the lower assumptions for oil prices and world GDP growth, the reduction in jeepney fares, as well as the exclusion of assumptions for transport fare adjustments for taxis and buses.

- Weaker global economic activity represents the primary downside risk to inflation. A slowdown in global economic activity implies lower demand-pull pressures on commodity prices, as reflected in the moderation in oil prices in May. As such, the near-term risk of second-round effects from a sustained uptrend in oil prices has diminished.

- Nevertheless, upside inflation risks remain and underlying domestic price pressures appear to remain firm. At same time, oil prices continue to show considerable volatility while additional petitions for electricity rate adjustments continue to pose an upside risk to inflation.

D. Demand conditions

- The Philippine economy posted a higher-than-expected growth in Q1 2012 of 6.4 percent, as exports recovered and government spending gained momentum. Household consumption expenditures also remained a solid driver of growth. Meanwhile, on the production side, all major sectors grew, led by the services sector.

- Available leading economic indicators likewise continued to advance. Energy and auto sales recorded gains, manufacturing activity as measured in the MISSI continues to expand while latest Philippine PMI readings indicate expansion for manufacturing, services, and retail and wholesale sectors. The book-to-bill ratio has remained above one since February 2012. Overall business confidence also appeared to be stronger in the second quarter though slightly less buoyant in the third quarter due to seasonal factors.

- Meanwhile, the MB noted the increase in minimum wage in NCR which was approved on 17 May 2012. The decision allowed the integration of the ₱22 cost of living allowance (COLA) under the previous wage order into the basic wage and provided additional COLA of ₱30 in the daily minimum wage of all private sector workers in the region which would be payable in two tranches.

E. Supply-side indicators

Developments in Agriculture

- Agriculture, hunting, forestry and fishing (AHFF) expanded in Q1 2012, albeit at a slower pace. The growth of AHFF was driven up by higher poultry, livestock, corn, and coconut production but was tempered by contractions in the production of sugarcane, rice and mango. Nevertheless, the Bureau of Agricultural Statistics (BAS) projects rice and corn production to expand in the second and third quarters of 2012. The projected increase in rice output can be attributed to increased harvest area and yields with sufficient water supply and the "Five in Two" (five croppings within a period of two years) program of the government. Corn production will be supported by the expansion in harvest area and possible early plantings.

- Favorable supply conditions have kept prices of meat, fish, fruits, and vegetables generally stable. Meanwhile, prices of refined sugar inched up in most trading centers due to increased demand during the summer season.

- On the international front, the FAO food price index was lower in April after successive increases in the first quarter of 2012. This was caused largely by declines in sugar, dairy and cereal prices, which more than offset higher oils and meat prices.

Oil Price Developments

- Oil prices fell sharply in May after US crude oil inventories surged to their highest levels. Oil prices in the futures market likewise decreased. The release of weak employment data in the US and Europe also fanned concerns of lower oil demand in the near term. The Organization for Economic Cooperation and Development's (OECD) downward revision of its economic growth forecasts for the euro area and Fitch's and Moody's downgrades of Greece's sovereign rating and of the long-term debt and deposit ratings of 16 Spanish banks, respectively, also dampened oil prices.

- While a resurgence of upside pressures on world oil prices could not be fully discounted, latest futures price data suggest a modest easing in future spot prices. In turn, these developments are likely to have a favorable impact on domestic inflation. Local oil companies have already reduced local pump prices and the LTFRB ordered a rollback in the minimum fare of public utility jeepneys (PUJs). The LTFRB has also dismissed the petitions for fare adjustments by provincial and city bus companies.

F. Financial market developments

- As a result of deteriorating sentiment in global financial markets and higher risk aversion due to the debt crisis in Europe, the local equity market has retreated, the peso has depreciated, and spreads of ROPs over comparable US Treasuries, CDS spreads and EMBI spreads have widened since the previous review of the policy stance. On 31 May, the PSEi closed at 5,091.23 index points, lower by 2.1 percent from the previous month's closing level. In May, the peso depreciated to average at ₱42.90/US$1 compared to the previous month's level of ₱42.66/US$1. The EMBI+ Philippine spread similarly widened to 244 bps from end-April's 198 bps while the Philippines 5-year sovereign credit default swap (CDS) spread rose to 195 bps from previous month's end of 154 bps.

G. Domestic liquidity and credit conditions

- Domestic liquidity or M3 expanded at a faster pace of 9.1 percent year-on-year in April from the 5.6-percent growth recorded a month earlier. Money supply growth continued to be driven by the sustained expansion of net foreign assets (NFA) at 9.3 percent in April. At the same time, net domestic assets (NDA) rebounded by 4.6 percent in April after contracting by 4.2 percent in the previous month due largely to the faster growth in net domestic credits, combined with a slower rise in the net other items account (which includes, among other things, revaluation and capital and reserve accounts as well as placements of authorized counterparties in the BSP SDA facility).

- The growth of outstanding loans of commercial banks, net of banks' reverse repurchase (RRP) placements with the BSP, rose in April to 19.2 percent from the previous month's expansion of 18.7 percent. Loans for production activities—which comprised more than four-fifths of banks' aggregate loan portfolio—grew by 19.7 percent in April from 19.3 percent a month earlier. Meanwhile, the growth of consumer loans slowed down slightly to 17.5 percent from 18.5 percent in the previous month.

- Corporate issuers continue to tap other sources of financing. Corporate bond issuances reached ₱98 billion, 56 percent higher than the year-ago levels. Meanwhile, the total equity raised in the Philippine Stock Exchange (PSE) for the period January-March 2012 amounted to ₱10.2 billion, lower by 45 percent compared to ₱18.6 billion in the previous year.

H. Fiscal developments

- The fiscal deficit in the period January-April 2012 was ₱2.9 billion, a reversal of the ₱0.1 billion surplus incurred during the same period last year. Revenue collections increased by 11.4 percent while expenditure was higher by 12.1 percent. In the first four months of 2012, maintenance and other operating expenses (MOOE) increased by 41 percent while infrastructure spending grew by 49.7 percent.

I. External developments

- The world economy appeared to have lost some momentum since the previous policy meeting. The JP Morgan Global All-Industry Output Index fell from 54.4 in March to 52.3 in April and 52.1 in May due mainly to the downturn in the euro area. Economic conditions in the euro area have continued to deteriorate, fueling uncertainty and posing downside risks to the rest of the world through trade and financial channels.

- Advance estimates showed that GDP growth in the euro area was flat in Q1 2012 while the composite PMI for the euro area declined for a fourth month in a row from January 2012, reaching the lowest level since June 2009. Unemployment in the euro area also rose to a 15-year high in April.

- Despite recent gains, downside risks to the US growth outlook remain present. Potential spillovers from the euro area could continue to hamper US economic growth and employment gains, while the gridlock over a medium-term debt reduction plan continues to limit the scope for fiscal stimulus. Advance estimates showed that GDP growth was slower in Q1 2012 while US unemployment remained elevated in May at 8.2 percent. Nevertheless, the US economy is expected to continue its gradual recovery.

- China's real GDP growth in Q1 2012 was much slower than the previous quarter and year-ago levels. Growth in China is likely to be subdued than in recent years but is expected to be supported by the Chinese government's focus on macro policy to stabilize growth.

- Growth in the rest of Asia is expected to continue, supported by strong domestic demand, but could be restrained to some degree by developments in the advanced economies.