HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 1 MARCH 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 4.0 percent for the overnight RRP (borrowing) rate and 6.0 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

- 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. This inflation trajectory is broadly in line with the latest BSP and private sector surveys, which show inflation expectations as being anchored towards the target over the policy horizon.

- The MB noted that the risks to the inflation outlook appear to be broadly balanced, with the subdued pace of global economic activity expected to temper the rise in commodity prices. The upside risks to inflation stem mainly from volatility in international oil prices due to geopolitical tensions in the Middle East and from the impact of strong capital inflows on domestic liquidity growth.

- At the same time, the MB noted that domestic demand has continued to grow at a modest pace, reflecting mainly the impact of weaker external demand. Global economic conditions are expected to stay subdued as fiscal and banking sector headwinds in advanced economies affect global output growth and as market confidence remains fragile. Given these considerations, the MB is of the view that the benign inflation outlook has allowed further scope for a measured reduction in policy rates to support economic activity and reinforce market confidence.

[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 1 March 2012 meeting were approved by the Monetary Board during its regular meeting held on 22 March 2012. The next meeting of the Monetary Board on monetary policy issues is scheduled on 19 April 2012.

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 average headline inflation dropped in January, driven mainly by lower inflation for food, particularly vegetables and sugar. Other indicators also reflected a downtrend, including the following: two out of three alternative measures of core inflation estimated by the BSP, and the number and weight of above-threshold items.

- Lower food inflation due to ample domestic supply of selected food items, particularly vegetables and sugar, led to the continued deceleration of inflation in January. Meanwhile, higher prices of liquefied petroleum gas contributed to the marginal rise in non-food inflation.

B. Inflation expectations

- Inflation expectations continue to be bounded by the target range. Latest results of the BSP's survey of private sector economists and the AP consensus survey show within-target mean inflation forecasts for 2012 and 2013.

C. Inflation outlook

- The latest baseline forecasts indicate that headline inflation is expected to average near the low end of the 3-5 percent target range for both 2012 and 2013 with risks to inflation appearing to be broadly balanced.

- The downside risks to the inflation outlook include concerns over the strength of the global economy and their implication on the pace of economic activity and commodity prices. At the same time, the broadly stable peso could help temper the prices of imported commodities. Meanwhile, there are also upside risks to inflation. These include the impact of geopolitical tensions on oil prices, strong capital inflows and additional petitions for electricity rate adjustments.

D. Demand conditions

- The Philippine economy grew at a modest pace of 3.7 percent in the fourth quarter, bringing the annual growth to 3.7 percent for 2011. Full-year GDP growth was below the government's growth assumption of 4.5-5.5 percent.

- The MB noted that private consumption continued to advance strongly despite strong external headwinds and below-program public spending. Nevertheless, national accounts data in the fourth quarter showed economic growth remaining below trend.

E. Supply-side indicators

Developments in Agriculture

- Agriculture, hunting, forestry and fishing (AHFF) expanded in 2011, a turnaround from the contraction in the previous year. Considerable crop output gains during the first half of the year more than offset the losses from the string of typhoons in the second half.

- Meanwhile, the Bureau of Agricultural Statistics (BAS) projects palay and corn production to grow slightly in the first semester of 2012. This can be attributed to higher harvest area and yield, particularly in Cagayan Valley, Bicol, Caraga and ARMM, with the expected favorable wet weather conditions brought by the La Niña episode.

Oil Price Developments

- Oil prices continued their uptrend in February following the approval of a second international bailout package for Greece, signs of growth in China, and lower unemployment in the US, which boosted market expectations of improved fuel demand in the future. Iran's halting of oil shipments to some countries in Europe, which fueled concerns about oil supply disruptions, also pushed oil prices higher.

Developments in the Utilities Sector

- Electricity rates of Manila Electric Co. (Meralco) inched up in February driven mainly by higher power supply prices from the Wholesale Electricity Spot Market. The National Power Corporation's (NPC) rates also went up on account of the shift to more expensive dry-season rates.

F. Financial market developments

- At the 20 February 2012 auction, T-bill rates rose across the board relative to the rates fetched during the 6 February 2012 auction, as the government sought to align the auction interest rates with the rates in the secondary market. Total tenders reached ₱14.6 billion or less than twice the original offered amount of ₱9.0 billion, reflecting weak demand for T-bills as investors' appetite remained at the longer end of the yield curve. The low volume of tenders was also attributed to investors' anticipation of the Retail Treasury Bond (RTB) offering for the period 21-29 February 2012.

- The PSEi continued to rally in February on the back of an upbeat outlook on local corporate earnings and expectations of a sovereign credit rating upgrade for the Philippines by S&P. Meanwhile, the peso's depreciating trend reversed on account of continued foreign exchange inflows from OF remittances, foreign portfolio investment and foreign direct investments. However, uncertainty arising from the Iran nuclear tensions also continued to weigh down on the peso.

- Debt spreads tightened significantly in February as positive developments in major global markets buoyed demand for emerging market assets. The approval of Greece's second bailout package prompted spreads to tighten to their lowest levels for the year.

Improving economic data from the US and the cut in China's reserve requirement also pushed spreads to narrow during the period. However, the narrowing trend was tempered by persistent concerns over the sustainability of the Greece bailout package combined with sovereign downgrades in selected European countries by Fitch and Moody's, and the rising geo-political tensions in Iran and Syria.

G. Domestic liquidity and credit conditions

- Domestic liquidity or M3 grew at a slower pace of 6.3 percent in December 2011 from 7.2 percent in November 2011 to reach ₱4.7 trillion as net foreign assets (NFA) growth slowed down. While domestic credit growth remained strong on account of higher National Government, corporate and household borrowings, the BSP's SDA operations moderated liquidity growth.

- Bank lending growth, net of banks' RRP placements with the BSP, eased in December to 19.3 percent from the previous month's expansion of 22.5 percent as the growth of loans for production activities and consumer loans decelerated.

- Corporate issuers continue to tap the equity and bond markets. Capital-raising activities in the Philippine Stock Exchange reached ₱109 billion in 2011, higher by 28 percent from the 2010 level of ₱85 billion. However, corporate bond issuances for the same period amounted to only ₱181 billion, lower by 13 percent compared to the 2010 level of ₱208 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).

- The Department of Budget and Management has already released 72 percent of the ₱1 trillion national budget in January. The early release was aimed to jump-start most of the programmed infrastructure projects. Of the ₱208-billion budget allocated for capital outlays, 72 percent has been released for various infrastructure projects.

I. External developments

- The overall balance of global economic activity remains tilted to the downside, with uncertainty still elevated. While there have been encouraging signs from the US, the European economy remains subject to persistent strains from the interlocking sovereign debt and banking crises. The euro area is expected to experience a mild recession in 2012 and possible spillovers via trade and financial channels will likely constrain the growth of advanced economies and their trading partners. In China, recent indicators also suggest weak real sector momentum, especially in the manufacturing sector, although partly policy-driven.