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HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 9 NOVEMBER 2017[1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Maintain the overnight RRP (borrowing) rate at 3.0 percent;

b) Maintain the current overnight deposit and overnight lending rates; and

c) Maintain the current reserve requirement ratios.

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

- The Monetary Board's (MB) decision to keep monetary policy settings unchanged was based on its assessment that the outlook for the inflation environment remains manageable. While inflation has trended higher due mainly to higher utility rates and fuel prices, latest forecasts continue to show the future inflation path staying within the Government's 3 percent ± 1 percentage point target range for 2018-2019. Inflation expectations also remain anchored close to the midpoint of the inflation target range over the policy horizon.

- The MB also recognized the balance of risks to the inflation outlook continues to lean toward the upside due to possible higher crude oil prices. The proposed tax reform program of the National Government (NG) may exert potential transitory pressures on prices, although various social safety nets and the resulting improvement in output and productivity are also expected to temper the impact on inflation over the medium term. On the other hand, the proposed reform in the rice industry involving the replacement of quantitative restrictions with tariffs and the deregulation of rice imports could temper inflation.

- At the same time, geopolitical tensions and lingering uncertainty over macroeconomic policies in advanced economies posed downside risks to near-term prospects for global economic growth. Nonetheless, the outlook for domestic economic activity remained firm, supported by positive consumer and business sentiment and ample liquidity. Moreover, while credit continues to expand in line with output growth, the Monetary Board remains watchful over evolving liquidity and credit conditions and their potential implications for price and financial stability.

[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 during the 9 November 2017 monetary policy meeting were approved by the Monetary Board during its regular meeting held on 28 November 2017. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 14 December 2017.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- The year-to-date actual inflation of 3.2 percent (as of October 2017) is within the Government's inflation target range of 3.0 percent ± 1.0 percentage point for the year. October headline inflation rose to 3.5 percent from 3.4 percent in the previous month on faster price increases for selected food and non-food commodities. The higher October inflation was driven by increases in non-food items such as electricity, domestic petroleum products, and air and sea passenger fares. Likewise, food inflation went up as prices of corn, meat, and vegetables rose, offsetting the price slowdowns for rice, fish and fruit.

- Core inflation—which excludes certain volatile food and energy items to better capture underlying price pressures—eased to 3.2 percent in October from 3.3 percent in the previous month. Meanwhile, alternative measures of core inflation remained below 3 percent in October.

B. Inflation expectations

- Inflation expectations—based on private sector economist forecasts surveyed by the BSP—continued to be in line with the BSP's within-target inflation outlook. Preliminary results of the BSP's October 2017 survey of private sector economists showed higher expectation for 2017 at 3.2 percent (from 3.1 percent) while mean inflation forecasts for 2018 and 2019 remained steady at 3.4 percent.

C. Inflation outlook

- Average inflation was projected to settle slightly above the midpoint of the NG's target range of 3.0 percent ± 1.0 percentage point in 2017-2019. The latest average baseline inflation forecasts for 2017-2019 were higher compared to the previous forecast round due to the sharp rise in global crude oil prices, slightly higher domestic liquidity growth, depreciation of the peso, and marginally higher-than-projected September 2017 inflation.

- The risks to future inflation remained weighted toward the upside. The impact of the government's fiscal reform program and pending petitions for adjustments in transport fares and electricity rates are the main upside risks to inflation. Meanwhile, the slower global economic growth due to policy uncertainty in advanced economies and geopolitical tensions continues to be the main downside risk to inflation.

D. Demand conditions

- High frequency indicators supported the continued positive outlook for domestic demand. Capacity utilization of the manufacturing sector has remained above 80 percent while Purchasing Managers Index (PMI) readings have been consistently above the 50-percent expansion threshold. Increased fiscal spending is likewise expected to boost domestic activity and support the growth momentum. GDP in Q3 2017 is forecasted to grow close to the low end of the NG's target.

E. Supply-side indicators

Developments in Agriculture

- According to the National Food Authority (NFA), the country's total rice inventory as of end-September 2017 stood at 2,078.6 thousand metric tons (TMT), estimated to last for about 66 days.

- The MB noted the staff's estimates that inflation could decline over the medium term with import tariffication. The estimates are based on the current version of the House Bill (as of 11 October 2017, pending before the House Committee on Agriculture and Food) amending R.A. 8178.

- Weather forecast models (as of October 2017) of the International Research Institute for Climate and Society – Climate Prediction Center predicted an increasing chance of La Niña weather conditions in Q4 2017 – Q1 2018.

Oil Price Developments

- Global crude oil prices were higher in October 2017, hovering at mid-US$50 per barrel due to supply-side factors, including declining US commercial crude oil inventories, market expectations of an OPEC cut extension, and geopolitical events in the Middle East resulting in supply outages. The prices of domestic petroleum products were adjusted upward in October 2017, generally tracking the movement of international oil prices.

Developments in the Utilities Sector

- The overall electricity rate slightly increased in October due mainly to higher generation charge brought about by the completion of the installment of the refund from over-recovery on pass-through charges from January 2014 to December 2016. At the same time, generation charges from Power Supply Agreements (PSAs) and Independent Power Producers (IPPs) registered increases due to higher fuel prices and lower average plants dispatch, respectively, offsetting the decline in the cost of power from the Wholesale Electricity Spot Market (WESM).

F. Financial market developments

- The Philippine Stock Exchange index (PSEi) rallied, closing at 8,521.81 index points as of 7 November 2017, amid (i) expected enactment of the NG's tax reform package designed to help finance public infrastructure programs; (ii) positive investor sentiment over domestic Q3 2017 earnings and end of the drawn-out conflict in Marawi City; and (iii) higher-than-expected US manufacturing and services PMIs recorded in September.

- Meanwhile, the peso depreciated on a year-to-date basis in October 2017 up to the first week of November 2017 amid strong corporate demand and expectations of the US Fed turning more hawkish.

G. Domestic liquidity and credit conditions

- Prevailing credit and liquidity conditions continued to support the appropriateness of present monetary policy settings. Domestic liquidity increased by 14.5 percent while bank lending grew faster by 21.1 percent in September 2017. M3 growth eased compared to the previous month as borrowings by the NG grew at a slower pace while net foreign assets of the BSP declined relative to the previous month. Meanwhile, bank lending registered faster expansion in September 2017 amid increased lending to the production sectors.

H. Fiscal developments

- Fiscal spending remains on track as NG expenditures (excluding interest payments) increased by 10.0 percent year-on-year in January-August 2017. The NG also recorded a fiscal deficit of ₱176.2 billion for the period January – August 2017, higher by 27.0 percent compared to the ₱138.4-billion deficit posted in the previous year.

I. External developments

- Economic activity in the US, euro area, and Japan grew at a faster pace, while output growth in India and China decelerated. Meanwhile, the IMF raised its global economic growth projections for 2017 and 2018 taking into account the stronger-than-expected expansion in advanced economies for 2017 and expectations of robust economic activity in China and in emerging Europe for 2017 and 2018.

- The US Fed kept its policy rate unchanged during its 31 October - 1 November 2017 Federal Open Market Committee (FOMC) meeting to support further strengthening in the labor market and sustained return to 2-percent inflation. The FOMC noted that inflation is expected to stabilize around the 2-percent target over the medium term. Meanwhile, on 2 November 2017, the Bank of England increased its Bank Rate by 25 bps to 0.5 percent to return inflation to the target amid falling unemployment.