HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 11 MAY 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 its monetary policy settings unchanged is based on its assessment that the outlook for inflation remains manageable, with baseline inflation forecasts still expected to settle within the target range of 3.0 percent ±1 percentage point for 2017-2018. The latest baseline forecasts are broadly unchanged from the previous policy meeting as the decline in global and domestic oil prices together with the slight appreciation of the peso were offset by the higher-than-projected March and April 2017 inflation readings. Inflation expectations also remain anchored to the inflation target over the policy horizon. Nonetheless, the MB noted that average headline inflation has remained elevated thus far in 2017 due largely to the recent increases in food prices and underlying inflation pressures.

- The MB observed that the balance of risks surrounding the inflation outlook remains tilted toward the upside, given the transitory impact of the proposed tax reform program as well as possible further adjustments in transportation fares and electricity rates. Meanwhile, prospects for the global economy have improved, but risks remain tilted to the downside.

- The MB was of the view that despite external headwinds, the outlook for domestic economic activity remained intact owing to buoyant household consumption and private investment, increased government spending, ample liquidity, and sustained credit growth.

- The MB also emphasized that the BSP will remain vigilant against any risks to the inflation outlook and will adjust its policy settings as needed to ensure that future inflation remains consistent with the medium-term target while being supportive of sustainable 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 during the 11 May 2017 meeting were approved by the Monetary Board during its regular meeting held on 1 June 2017. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 22 June 2017.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- Inflation in April 2017 was unchanged at 3.4 percent from month-ago level as higher food inflation was counterbalanced by the lower inflation rate of non-food items. However, core inflation increased to 3.0 percent while the alternative measures of core inflation estimated by the BSP showed mixed trends. In terms of trend, the seasonally-adjusted 3-month moving average annualized headline slowed down while core inflation gained momentum in April.

B. Inflation expectations

- Inflation expectations—based on forecast surveys of private sector economists by the BSP and by Consensus Economics—continue to be in line with the within-target inflation outlook. Results of the Consensus Economics survey for April 2017 showed a higher mean inflation forecast for 2017 at 3.3 percent (from 3.2 percent in the previous month's survey) while the mean inflation forecast for 2018 was steady at 3.3 percent. Meanwhile, results of the BSP's April 2017 survey of private sector economists showed steady mean inflation forecasts at 3.4 percent for 2017, 3.5 percent for 2018, and 3.4 percent for 2019.

C. Inflation outlook

- The latest baseline forecasts show a broadly steady and within-target inflation path for 2017-2018. The decline in global and domestic oil prices and the slight appreciation of the exchange rate were offset in part by the higher-than-projected March and April 2017 inflation readings.

- The balance of risks to future inflation remains tilted towards the upside. The estimated impact of the government's fiscal reform program, pending petitions for adjustments in electricity rates, and further transport fare hikes are seen as the main upside risks to inflation. Meanwhile, the uncertainty in the global economic landscape constitutes the main downside risk to inflation.

D. Demand conditions

- Latest indicators of domestic demand continue to point to firm growth prospects over the policy horizon. The Philippine composite PMI remained firmly above the 50-point expansion threshold while business and consumer optimism on the economy remained positive. Trends in other high-frequency demand indicators were also generally positive, with continued increases in the sales volume of automobiles and electricity as well as in the production volume in the manufacturing sector. Faster growth in NG expenditure as a result of efforts to ramp up public spending is also expected to provide a boost to the economy.

E. Supply-side indicators

Developments in Agriculture

- Domestic rice prices have been broadly steady, while total rice stocks are projected to remain at a comfortable level during the first half of 2017. Meanwhile, the probability of *El Niño* dry-weather conditions developing towards Q4 2017 has risen to about 50.0 percent, based on the 13 April 2017 forecast of the Climate Prediction Center and the International Research Institute for Climate and Society. However, PAGASA noted that because of seasonal factors, forecasts from climate prediction models also tend to be highly uncertain during this time of the year.

Oil Price Developments

- Volatility in the oil market rose as prices fell below US$50 per barrel in early May after rebounding in the previous month on rising concerns that an extension of OPEC's production cuts would be insufficient to draw down the global oil surplus. This came following reports of higher US crude production, which counterbalanced the price gains from a possible extension of the OPEC agreement to reduce production beyond 1H 2017.

- Meanwhile, energy industry reports in April suggests that the oil market is closer to closing the gap between supply and demand while IMF assessed the oil price outlook to be balanced with upside risks stemming from production disruptions and geopolitical tensions especially in the Middle East while US shale production and inventories represent downside risks for the market.

Developments in the Utilities Sector

- Electricity rates continued to increase in April 2017 as a result of higher generation costs. According to Meralco, the upward adjustment in the generation cost was due mainly to the increase in the cost of power sourced from independent power producers (IPPs) and the increase in prices at the Wholesale Electricity Spot Market (WESM) caused by plant outages and higher demand. At the same time, the increase in generation charge factored in the pass-on charge approved by the Energy Regulatory Commission (ERC) which is a result of the Malampaya natural gas plant shutdown on 28 January to 16 February 2017.

F. Financial market developments

- In April, the benchmark index rallied while the peso appreciated on expectations of robust domestic growth despite uncertainties overseas. The market-friendly outcome of the first round of French presidential elections and positive expectations for the ASEAN Summit held in the Philippines boosted risk-taking. The peso's appreciation was also due to positive prospects about the government's tax reform package. In addition, the general weakness of the US dollar amid geopolitical concerns in North Korea and Syria provided some support to the peso. However, Philippine sovereign debt spreads widened in April due to factors such as heightened geopolitical tensions in the Middle East and the Korean peninsula; the official start of the Brexit process; and growing concerns over the Trump administration's policies. In the first week of May, debt spreads narrowed slightly following the outcome of the French presidential elections while the peso depreciated on firmer market expectations of a US Fed rate hike in June owing to indications of a stronger labor market as well as faster inflation in the US.

G. Domestic liquidity and credit conditions

- Liquidity and credit conditions indicate that overall monetary conditions remain supportive of domestic economic activity. Preliminary data showed that domestic liquidity increased by 11.2 percent while bank lending grew by 19.7 percent in March 2017. Meanwhile, open market operations (OMO) by the BSP were undersubscribed in April due to the impact of temporary and seasonal factors such as the long public holidays, annual tax collections, and the Bureau of the Treasury's Retail Treasury Bond (RTB) issuance.

H. Fiscal developments

- The latest fiscal data reflected the rise in government expenditures. The National Government (NG) recorded a fiscal deficit of ₱83.0 billion in Q1 2017, lower compared to the ₱112.5 billion deficit posted in the previous year. Revenues increased by 11 percent year-on-year in Q1 2017 to ₱532.4 billion while expenditures amounted to ₱615.4 billion which is higher by 4 percent. Excluding interest payments, expenditures went up by 6 percent to ₱517.5 billion.

I. External developments

- The IMF has raised its global GDP growth forecast for 2017 by 0.1 percentage point to 3.5 percent and kept its 2018 forecast unchanged at 3.6 percent, based on the April 2017 World Economic Outlook (WEO) report. The faster growth expected in 2017 could be attributed to the expansion in commodity-exporting countries from higher commodity prices, stronger-than-expected policy support in China, and faster growth in the Euro Area and Japan due to a recovery in global manufacturing and trade. However, the IMF also noted that the balance of risks to global growth remain titled to the downside despite near-term upside surprises due to improved consumer and market sentiments. The medium-term economic risks to the global outlook stem primarily from the following factors: the potential shift to inward-looking policies among the major economies; faster-than-expected tightening of the US; a rollback in global financial regulation; vulnerabilities in China's financial system due to rapid credit expansion; weak demand and balance sheet problems in parts of Europe.