HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 9 AUGUST 2018[1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Increase the BSP's key policy interest rate by 50 basis points to 4.00 percent for the overnight RRP (borrowing) facility, effective 10 August 2018; and,

b) Adjust the interest rates on the overnight deposit and overnight lending facilities accordingly.

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

- The Monetary Board's decision to raise the BSP's policy interest rate was based on its assessment that the latest baseline inflation forecasts have shifted higher over the policy horizon, indicating some risk of inflation exceeding the target in 2019. Upside risks also continue to dominate the inflation outlook, as the sustained increase in core inflation suggests broadening price pressures amid resilient aggregate demand conditions. Meanwhile, inflation expectations remain elevated, although staying within the target of 3.0 percent ± 1.0 percentage point for 2019.

- Given the considerations cited above, the Monetary Board deemed stronger monetary action to be necessary to rein in inflation expectations and prevent sustained supply-side price pressures from driving further second-round effects, even as the previous monetary policy responses continue to work their way through the economy.

- The Monetary Board believed that the series of policy rate adjustments thus far in 2018 will help reduce further the risks to inflation, including those emanating from the ongoing normalization of monetary policy in advanced economies and its impact on the foreign exchange market, and bring inflation toward a target-consistent path over the medium term. Favorable conditions arising from sustained domestic growth also suggest that the economy can accommodate a further tightening of monetary policy settings.

- The Monetary Board likewise reaffirmed its support for carefully coordinated efforts with other government agencies in implementing non-monetary measures to further mitigate the impact of supply-side factors on inflation.

[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 August 2018 monetary policy meeting were approved by the Monetary Board during its regular meeting held on 30 August 2018. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 27 September 2018.

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 rose further to 5.7 percent in July 2018 from 5.2 percent in June 2018 using the 2012-based consumer price index (CPI) series. This brought the year-to-date average to 4.5 percent, which is above the Government's announced inflation target range of 3.0 percent ± 1.0 percentage point for 2018. Similarly, core inflation, which excludes certain volatile food and energy items to measure underlying price pressures, increased to 4.5 percent in July from 4.3 percent in the previous month. The number of CPI items above the 4-percent threshold and the diffusion index of price changes have likewise increased compared to that in the previous month. Meanwhile, three of four alternative measures of core inflation estimated by the BSP registered a slight decrease in July.

B. Inflation expectations

- Mean inflation forecasts from surveys of private sector economists continued to show elevated inflation expectations for 2018-2020. Preliminary results of the BSP's July 2018 survey of private sector economists showed higher mean inflation forecasts at 4.7 percent for 2018 (from 4.5 percent in the June survey) and 3.9 percent for 2019 (from 3.8 percent). Meanwhile, the mean inflation forecast for 2020 was unchanged at 3.8 percent. The survey by Consensus Economics in July also showed a higher mean inflation forecast for 2018 at 4.5 percent (from 4.4 percent) but a steady inflation forecast for 2019 at 3.7 percent.

C. Inflation outlook

- Compared with the previous forecast round, the latest baseline inflation forecasts for 2018 and 2019 were higher at 4.9 percent and 3.7 percent, respectively. Preliminary inflation forecast for 2020 is 3.2 percent, which is within the 3.0 percent ± 1.0 percentage point target range. In addition, the risks to future inflation remained on the upside.

    - Additional wage adjustments and transport fare hikes due to the increase in excise taxes on petroleum products, electricity rates, faster-than-expected monetary policy normalization in advanced economies, and the proposed increase in the NFA's buying price of *palay* are the main upside risks to inflation.
    - Meanwhile, the slower global economic growth due to protectionist policies in advanced economies and geopolitical tensions along with the proposed reform in the rice industry involving the replacement of quantitative restrictions with tariffs and the deregulation of rice imports are seen as the main downside risks to inflation.

Baseline Inflation Forecasts		
	2012-based CPI	
	20 Jun MB	9 Aug MB
2018	4.5	4.9
2019	3.3	3.7
2020	n.a.	3.2

D. Demand conditions

- The 6.0-percent GDP growth in Q2 2018 reflected the continued strength in domestic economic activity. The sustained economic expansion during the second quarter was supported by increased household spending, capital formation, and public spending on the expenditure side and by the services and industry sectors on the production side. Over the next few quarters, business and consumer confidence are also seen to remain positive, as reflected in the Q2 2018 results of the business and consumer expectations surveys conducted by the BSP.

E. Supply-side indicators

Developments in Agriculture

- Industry-wide rice supply conditions remained adequate with the current inventory as of end-June 2018 amounting to 73 days' consumption. Domestic retail prices of rice continued to increase in July 2018. Nonetheless, public and private sector rice importations and the implementation of a suggested retail price (SRP) of well-milled rice in Metro Manila are expected to temper the rise in rice prices during the lean months. Moreover, the increased likelihood of the passage of the proposed rice tariffication bill could also help push down the retail prices of rice.

Wage Developments

- The Monetary Board noted that wage adjustments have been approved for 11 regions thus far in 2018. Meanwhile, wage petitions have been filed in two regions as of 31 July 2018.

Oil Price Developments

- Average crude oil prices remained elevated in June-July 2018 but slightly lower compared to May 2018 due to expectations that some Organization of Petroleum Exporting Countries (OPEC) members would raise output to compensate for the declining production in Venezuela. At the same time, oversupply concerns emerged due to continued rise in US oil production, while concerns of a global trade war could also lead to a slowdown in demand.

- The Monetary Board noted that higher global oil prices spilled over to domestic petroleum prices and was also factored in by various public transport groups in their fare hike petitions. In July 2018, the Land Transportation Franchising and Regulatory Board (LTFRB) approved a one-peso provisional increase for public utility jeepneys (PUJs) in NCR, Region III, and Region IV and a ₱2.50 increase in Region VI, while the majority of transport fare petitions were still scheduled for public hearings. Meanwhile, the *Pantawid Pasada Program* subsidy for jeepney drivers will be implemented in 2H 2018.

Developments in the Utilities Sector

- The overall electricity rate rose in July 2018 due to higher generation charges. The upward adjustment in the generation cost from the Wholesale Electricity Spot Market (WESM) was attributed to the increase in demand for power in Luzon grid. At the same time, cost of power from the Independent Power Producers (IPPs) and Power Supply Agreements (PSAs) went up as a result of the depreciation of peso against the US dollar.

F. Financial market developments

- The Philippine Stock Exchange index (PSEi) rose in July and early August due to positive investor sentiment arising from good initial Q2 2018 earnings reports and anticipation of positive Q2 2018 GDP growth. Fitch Ratings' and Moody's Investor Service's affirmation of the country's investment-grade credit rating as well as President Rodrigo Duterte's State of the Nation Address (SONA) also supported the PSEi. Furthermore, China's announcement of new fiscal stimulus measures also boosted demand for equities in the region. Meanwhile, the peso depreciated in nominal terms against the US dollar during the same period on safe-haven buying activity amid lingering trade war concerns between the US and its major trading partners i.e., China and the European Union, as well as hawkish remarks from US Federal Reserve Chairman Jerome Powell which strengthened expectations of a gradual monetary tightening path by the US Federal Reserve.

G. Domestic liquidity and credit conditions

- Liquidity and credit growth conditions remained manageable. In June 2018, domestic liquidity growth decelerated to 11.7 percent (from 14.3 percent in May) while the expansion of bank lending likewise slowed down to 19.1 percent (from 19.3 percent). Meanwhile, Term Deposit Facility (TDF) rates as well as other market interest rates increased following the 25-bps hike in the BSP's policy rate effective 21 June 2018.

H. Fiscal developments

- Efforts to raise infrastructure spending provided a boost to domestic activity. The National Government (NG) recorded a fiscal deficit of ₱193.0 billion for the first semester of 2018, 25 percent higher than the previous year's deficit level due to improved fiscal revenue collections alongside a strong increase in government spending.

I. External developments

- Global economic expansion had become less broad-based with the overall balance of risks skewed to the downside. In July 2018, the IMF maintained its global economic growth projections for 2018 and 2019 relative to its April 2018 forecasts.

- The US Federal Reserve kept the federal funds rate target range unchanged at 1.75 to 2.0 percent at the conclusion of its meeting on 1 August 2018, in view of realized and expected labor market conditions and based on its assessment that risks to the inflation outlook remain balanced. Nonetheless, the Federal Open Market Committee noted that it expects that further gradual increases in the federal funds rate target range will be consistent with the sustained expansion of US economic activity, strong labor market conditions, and inflation near the 2-percent objective over the medium-term.