HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 20 JUNE 2019[1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) maintain the overnight RRP (borrowing) rate at 4.50 percent; and

b) maintain the current overnight deposit and overnight lending rates at 4.00 percent and 5.00 percent, respectively.

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

- The Monetary Board (MB) deemed the prevailing monetary policy settings to be appropriate, with latest baseline inflation forecasts settling within the target range of 3.0 percent ± 1.0 percentage point for both 2019 and 2020, while inflation expectations moderating further. The MB also noted that while real sector activity moderated in the first quarter of the year, overall domestic economic activity is likely to remain firm, supported by a projected recovery in household spending and the continued implementation of the government's infrastructure spending program.

- At the same time, the MB observed that the risks to the inflation outlook are broadly balanced for 2019 and 2020. Weaker global economic prospects amid a possible easing in global demand and increased trade tensions continue to temper the inflation outlook. The potential adverse effects of a prolonged El Niño episode remain a key upside risk to inflation.

- On balance, therefore, the MB believed that the manageable inflation outlook and firm domestic growth prospects support keeping monetary policy settings steady for the time being. A prudent pause allows the BSP to observe and assess the impact of prior monetary adjustments including the phased reduction in the reserve requirements to be completed by the end of July.

[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 20 June 2019 monetary policy meeting were approved by the Monetary Board during its regular meeting held on 11 July 2019. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 8 August 2019.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- Inflation increased in May 2019 due mainly to supply-side factors (food price movements linked to adverse weather conditions) and base effects. The 3.2-percent inflation print in May was higher than the 3.0 percent rate in the previous month. This brought the year-to-date average to 3.6 percent, which remained within the government's target range of 2-4 percent. On a geographical basis, inflation also rose in both the National Capital Region (NCR) and areas outside NCR.

  Relative to the previous month's levels, seasonally-adjusted month-on-month inflation increased while non-seasonally-adjusted month-on-month inflation was slightly lower.

- The official core inflation—which excludes certain volatile food and energy items—was slightly higher at 3.5 percent in May 2019 from 3.4 percent in April 2019. By contrast, alternative measures of core inflation were mostly unchanged relative to the previous month's level. Meanwhile, the number of CPI items above threshold was lower compared to April 2019.

- The diffusion index of price changes and the number of CPI items above the threshold of 4.0 percent continued to decline in May.

B. Inflation expectations

- Results of the BSP's June 2019 survey of private sector economists showed lower mean inflation forecasts for 2019 and 2020 at 2.9 percent (from 3.0 percent in the May 2019 survey round) and 3.1 percent (from 3.2 percent), respectively. Similarly, the mean inflation forecast for 2021 was lower at 3.1 percent (from 3.2 percent).

C. Inflation outlook

- The latest staff baseline forecasts indicate that average inflation will settle within the 3.0 percent ± 1.0 percentage point target range in 2019 and 2020. Inflation is projected to average at 2.7 percent for 2019 and 3.0 percent for 2020, slightly lower relative to the previous meeting's forecasts of 2.9 percent for 2019 and 3.1 percent for 2020. The downward revision in the staff inflation forecasts can be attributed to the sharp decline in global crude oil prices and the peso appreciation, which offset the faster liquidity growth resulting from the downward adjustments in the policy rate and reserve requirements.

Baseline Inflation Forecasts		
	9 May 2019 MB Meeting	20 June 2019 MB Meeting
2019	2.9	2.7
2020	3.1	3.0

- The risks to the inflation outlook appear to be broadly balanced for 2019 and 2020. Petitions for electricity rates and transport fare adjustments, the proposed increase in the excise taxes of alcoholic beverages and cigarettes, and the potential impact of a prolonged El Niño episode are the main upside risks to future inflation. Meanwhile, slower global economic growth due to protectionist policies in advanced economies as well as geopolitical tensions and the potential renegotiation for lower tariff rates on meat products continue to be the main downside risks to the projected inflation path.

D. Demand conditions

- The slower expansion of real GDP for Q1 2019 at 5.6 percent from 6.3 percent in Q4 2018, reflected mainly the impact of the delayed passage of the 2019 national budget. Nonetheless, the Philippine economy is expected to remain resilient, supported by sustained private demand and the scaling up of public investment spending.

- Meanwhile, the preliminary composite purchasing managers' index (PMI) remained above the 50-point expansion threshold at 51.8 in May, albeit lower than the April PMI which was at 53.8. Meanwhile, the average capacity utilization rate of the manufacturing sector was broadly steady at 84.3 percent in April 2019, based on the Philippine Statistics Authority's Monthly Integrated Survey of Selected Industries (MISSI).

E. Supply-side indicators

Developments in Agriculture

- Domestic rice prices declined further in April owing to the summer harvest season and the continued arrival of rice imports of both the government and the private sector, despite the ongoing weak El Niño episode.

- The onset of the El Niño phenomenon presents a potential upside risk to food inflation in the near term. According to the Philippine Atmospheric, Geophysical and Astronomical Services Administration's (PAGASA's) latest climate advisory,[2] a weak El Niño condition is expected to continue through 2019 to Q1 2020.

Oil Price Developments

- Average crude oil spot prices generally decreased in May and early June 2019 over possible weakness in oil demand with the escalation of trade conflict between the US and its trading partners. However, upside risks continue to temper the oil price decline such as Organization of the Petroleum Exporting Countries' (OPEC's) decision to extend production cuts. Overall, uncertainties over oil policy and geopolitical direction remain a key factor to the future oil price path. On the domestic front, prices have generally reflected the downward trend in global oil prices. Prices of domestic petroleum products have been declining in recent weeks.

Developments in the Utilities Sector

- The overall electricity rate decreased further in June 2019 due mainly to lower generation charge from the Wholesale Electricity Spot Market (WESM). In turn, charges from the WESM went down despite continued tightness of supply conditions in the Luzon grid. Nevertheless, the decrease in charges from WESM outweighed the increases in generation charges from the Independent Power Producers (IPPs) and Power Supply Agreements (PSAs) partly due to the depreciation of the peso.

[2] Seasonal Climate Outlook Report as of 22 May 2019.

F. Financial market developments

- For the first two weeks of June, the peso appreciated against the US dollar following dovish remarks from the US Federal Reserve, as well as market optimism ahead of the trade negotiations between the United States and China on the sidelines of G20 Summit on 28 and 29 June in Osaka, Japan.

G. Domestic liquidity and credit conditions

- Domestic liquidity slightly increased while credit growth was broadly steady. In April, domestic liquidity grew by 7.0 percent (from 6.1 percent in March) while bank lending grew at a slightly slower rate by 12.7 percent (from 12.9 percent). The increase in M3 growth was due to the expansion in net foreign assets. Meanwhile, TDF rates as well as other market interest rates (deposit and lending rates) have decreased following the 25-bps BSP's key policy rate reduction on 9 May 2019, and the phased reduction in banks' RRR.

H. Fiscal developments

- The catch-up fiscal spending is expected to buoy the growth momentum in 2019. With the 2019 national budget signed by the President in mid-April, government spending is expected to resume for the year. The NG recorded a ₱3.4-billion fiscal deficit for the first four months of 2019, which is ninety-seven percent lower than the deficit recorded in 2018.

I. External developments

- Global economic activity expands at a slightly slower pace as growth in new business moderated. Similarly, US manufacturing activity eased due to slower growth in new orders. Meanwhile, manufacturing activity in Japan contracted as both output and new orders fell. Subdued international trade flows also weighed on global economic growth in April.

- The IMF continues to view the balance of risks to the global outlook as being on the downside. Policy uncertainty such as the state of regulatory and fiscal policies in the US, spillovers from tighter global financial conditions, and geopolitical risks as the primary downside risks to global growth over the medium term.

  The downward revision of the International Monetary Fund of its global economic growth projections in April reflected the slowdown in global activity. Meanwhile, the potential escalation of trade tensions between the US and China on global trade and investments could result in further downward adjustments to world growth projections.