BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 14 DECEMBER 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 is based on its assessment that the outlook for the inflation environment has been broadly unchanged. This is indicated by the latest baseline forecasts remaining within the target range of 3.0 percent ± 1 percentage point for 2018-2019. Inflation expectations also continue to be firmly anchored to the target over the policy horizon.

- The MB also recognized that the overall balance of risks to the inflation outlook remains tilted toward the upside due in part to possible higher crude oil prices. While there may be potential transitory effects on consumer prices from the proposed tax reform program, various mitigation measures and the resulting improvement in output and productivity are also expected to temper the impact on inflation over the medium term. Meanwhile, the proposed reforms in the rice industry involving the replacement of quantitative restrictions with tariffs and the deregulation of rice imports could serve to reduce inflation.

- At the same time, geopolitical tensions and lingering uncertainty over macroeconomic policies in advanced economies continued to pose downside risks to the near-term prospects for global economic growth. Nonetheless, the Monetary Board emphasized that the outlook for domestic economic activity are likely to remain firm owing to buoyant consumer and business sentiment and ample liquidity. Moreover, as credit continues to expand in line with output growth, the Monetary Board remains watchful over evolving liquidity and credit conditions and their 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 14 December 2017 monetary policy meeting were approved by the Monetary Board during its regular meeting held on 5 January 2018. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 8 February 2018.

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 November 2017) is well-within the Government's inflation target range of 3.0 percent ± 1.0 percentage point for the year. Year-on-year headline inflation eased to 3.3 percent in November from 3.5 percent in the previous month due to slower price increases in selected food items. The deceleration was slightly offset by the rise in non-food inflation as a result of higher energy and fuel costs.

- Core inflation—which excludes certain volatile food and energy items to better capture underlying price pressures— increased to 3.3 percent in November from 3.2 percent in the previous month. Meanwhile, alternative measures of core inflation showed mixed movements during the month but the general uptrend continued.

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. Results of the BSP's survey of private sector economists for November 2017 showed that mean inflation forecasts for 2017 and 2019 were steady at 3.3 and 3.4 percent, respectively. However, the mean inflation forecast for 2018 was higher at 3.5 percent from 3.4 percent in the previous survey round.

C. Inflation outlook

- Average inflation was projected to draw close to the midpoint of the target range of 3.0 percent ± 1.0 percentage point in 2017 and would settle slightly above the midpoint of the target range for 2018-2019. The baseline inflation forecasts were generally unchanged compared to the previous forecast round.

- The risks to future inflation remained weighted toward the upside. The transitory impact of the government's tax reform program, higher global crude oil prices, 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 as well as the proposed reform in the rice industry involving the replacement of quantitative restrictions with tariffs and the deregulation of rice imports over the medium term continued to be the main downside risks to inflation.

D. Demand conditions

- Latest demand indicators affirm the earlier assessment that domestic demand conditions would remain relatively firm. The economy grew by 6.9 percent in the third quarter, faster compared to the 6.7 percent growth in the previous quarter but slower compared to 7.1 percent in the third quarter in 2016. This brought year-to-date growth to 6.7 percent, which is within the government's growth target of 6.5-7.5 percent in 2017. On the expenditure side, both domestic and external demand fueled output growth. On the supply side, growth was driven by the services sector while growth in the industry sector was supported by robust growth in manufacturing.

- Higher frequency indicators supported the positive outlook for domestic demand. Capacity utilization of the manufacturing sector has remained above 80 percent while PMI readings have been consistently above the 50-percent expansion threshold. Latest data on NG spending showed that expenditure excluding interest payments has increased. Plans for increased fiscal spending are likewise expected to boost activity and support the growth momentum.

E. Supply-side indicators

Developments in Agriculture

- The Agriculture, Hunting, Forestry and Fishing (AHFF) sector expanded by 2.5 percent in Q3 2017, brought about by output increases in *palay*, coconut, sugarcane, banana, pineapple, tobacco, peanut, mongo, cassava, sweet potato, tomato, and rubber.

- According to the National Food Authority (NFA), the country's total rice inventory as of end-October 2017 stood at 1,969.3 thousand metric tons (TMT), estimated to last for about 62 days.

- The MB noted the staff's estimates that inflation could decline over the medium term with rice import tariffication. The estimates are based on the current version of the House Bill (as of 20 November 2017, pending before the House Committee on Agriculture and Food) amending R.A. 8178.

- Weather forecast models (as of November 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. According to PAGASA, most climate models suggest weak La Niña for remainder of 2017 to Q1 2018, coinciding with end of harvest and 2nd cropping season.

Oil Price Developments

- Global crude oil prices have settled at above-US$60 per barrel in November 2017 reflecting the recent upward pressures on global oil prices as a result of the production cut agreement extension by major oil producers (OPEC and non-OPEC). Crude oil prices are expected to remain flat or slightly higher over the near term as a result of expectations of lower supply with the extended production cuts.

Developments in the Utilities Sector

- The overall electricity rate decreased in December 2017 due mainly to lower generation charge brought about by the improved power supply situation. At the same time, generation charges from Power Supply Agreements (PSAs) and Independent Power Producers (IPPs) registered decreases due to the strengthening of peso against the US dollar.

F. Financial market developments

- The Philippine Stock Exchange index (PSEi) declined to 8,129.62 index points as of 6 December from end-October level of 8,365.26 index points amid dampened investor sentiment following the index rebalancing of Morgan Stanley, reports on the latest missile testing by North Korea and the decline in US stocks due to the passage in the US Senate of the Republican tax reform bill.

- In the last quarter of the year, optimism on US tax reform plans and expectations that the next Fed Chair would be more hawkish weighed on the peso. Nonetheless, the peso appreciated in early December as domestic inflation eased in November. The peso likewise strengthened by optimism on the passage of the local tax reform bill, FDI flows, upbeat local economic growth and Fitch's debt rating upgrade on the Philippines.

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 14.8 percent (from 14.5 percent) while bank lending growth decelerated to 19.9 percent (from 21.1 percent) in October 2017.

H. Fiscal developments

- Fiscal spending remains on track as NG expenditures (excluding interest payments) increased by 10.0 percent year-on-year in January-October 2017. The NG also recorded a fiscal deficit of ₱234.9 billion for the period January – October 2017, higher by 9.0 percent compared to the ₱216.0-billion deficit posted in the previous year.

I. External developments

- Global economic activity maintained its momentum in November. The JP Morgan Global All-Industry Output Index posted a steady rate of expansion in November at 54.0, the same reading in October as inflows of new business continued to rise. The rates of expansion picked up in China, Russia, and Australia, but slowed in the US, Japan, the UK, and India. Meanwhile, economic activity in Brazil remained in the contraction territory.

- The US Fed raised its fed funds rate by 25 bps to 1.25-1.50 percent on 13 December 2017 to support further strengthening in the labor market and sustained return to 2-percent inflation.