HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 10 NOVEMBER 2016[1]

I. Monetary Policy Decision

The Monetary Board (MB) 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 inflation continues to be manageable, with a gradual return to the inflation target range expected over the policy horizon.

    - While latest forecasts indicate that average inflation is likely to settle slightly below the lower edge of the 3.0 percent ± 1.0 percentage point target range in 2016, it is projected to rise toward the mid-point of the target range in 2017 and 2018.

    - The overall balance of risks surrounding the inflation outlook remains tilted to the upside owing largely to the pending petitions for adjustments in electricity rates along with the proposed tax policy reform program. Slower global economic activity continues to be a key downside risk. Meanwhile, inflation expectations remain broadly consistent with the inflation target over the policy horizon.

- The MB also observed that prospects for global economic growth remain modest and uneven since the previous meeting. Moreover, monetary policies in major advanced economies continue to be asynchronous and the prospects uncertain. On the other hand, domestic economic activity is seen to remain firm, supported by solid private household consumption and investment, buoyant business and consumer sentiment, and adequate credit and domestic liquidity. Higher fiscal spending is also expected to further boost domestic demand in the near term.

[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 10 November 2016 meeting were approved by the Monetary Board during its regular meeting held on 24 November 2016. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 22 December 2016.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- Both headline inflation and official core inflation were steady at 2.3 percent in October.

- Inflation pressures in October can be attributed to higher price increases of selected food items as weather-related production disruptions caused by typhoons "Karen" and "Lawin" pushed up inflation of food products such as, vegetables and fruits. Meanwhile, slower price increases of meat and fish were registered during the month. At the same time, inflation readings for most non-food subcomponents were also unchanged from the previous month's level. Year-on-year inflation of electricity, gas, and other fuels eased owing to lower electricity rate which offset the higher prices of domestic petroleum products.

- Likewise, all three measures of core inflation were unchanged in October. The trimmed mean, weighted median, and net of volatile items remained at 1.9 percent, 2.1 percent, and 1.9 percent, respectively.

B. Inflation expectations

- Inflation expectations—measured using forecast surveys of private sector economists by the BSP and by Consensus Economics—continue to affirm the BSP's within-target inflation outlook. Results of the BSP's October 2016 survey of private sector economists showed a steady mean inflation forecast at 1.8 percent for 2016 but higher mean inflation forecasts for 2017 and 2018 at 2.8 percent (from 2.7 percent) and 2.9 percent (from 2.8 percent), respectively. Meanwhile, results of the Consensus Economics survey for September 2016 showed a slightly lower mean inflation forecast for 2016 at 1.8 percent from (1.9 percent) while the mean inflation forecast for 2017 was steady at 2.9 percent.

C. Inflation outlook

- The latest baseline forecasts show that inflation could settle below the low end of the government's target range of 3.0 percent ± 1.0 percentage point for 2016 and average near the midpoint of the target range in 2017-2018. Inflation is projected to increase modestly towards the low end of the target range in the fourth quarter of the year, driven by higher oil prices, a weaker exchange rate and the continued strength in domestic economic activity.

- The risks to future inflation are deemed to be on the upside. The pending petitions for adjustments in electricity rates along with the National Government's proposed fiscal reform program and the expected second-round effect on transport fares of the higher excise taxes on petroleum products represent the main upside risks to the baseline inflation outlook while slower global economic activity constitutes the main downside risk.

D. Demand conditions

- High-frequency indicators such as monthly vehicle and energy sales support the continued positive outlook for domestic demand. Capacity utilization of the manufacturing sector has remained consistently above 80 percent with volume of production index growing by 13.2 percent year-to-date while PMI readings have been consistently above the 50-percent expansion threshold. Stepped-up fiscal spending in Q3 2016 is likewise expected to boost activity and support the growth momentum over succeeding quarters. However, downside risks remain as weak external conditions continue to prevail. Nonetheless, indicators of economic activity show a firm albeit subdued pace of economic activity across the globe.

E. Supply-side indicators

Developments in Agriculture

- International food prices increased in September. The FAO Food Price Index (FPI) averaged 170.9 points in September 2016, up by 4.9 points (2.9 percent) month-on-month and 15.6 points (10.1 percent) year-on-year. Higher dairy and sugar prices underpinned last month's increase.

- According to PAGASA's latest climate advisory, cool ENSO-neutral conditions have been detected in the tropical Pacific region as of October 2016. Most climate prediction models point to either cool ENSO-neutral or borderline La Niña conditions persisting until December 2016 – February 2017.

Oil Price Developments

- Dubai crude oil prices increased further in October following the Organization of Petroleum Exporting Countries' (OPEC's) preliminary agreement to limit production and stabilize prices. However, this increase was tempered recently by rising doubts on whether the agreement would become final given contradicting positions within the organization.

- In its October 2016 report, the US Energy Information Administration (EIA) showed that demand could still outstrip supply temporarily in Q3 2017 before returning to surplus in Q4 2017. For the period 2016-2017, the global oil market remained generally in surplus though supply forecasts for 2016 and 2017 were in opposite directions. Meanwhile, demand forecasts for 2016 and 2017 were modestly lower compared to the previous month's assessment as projections for Japan and non-OECD countries were lowered for both years.

Developments in the Utilities Sector

- Electricity rates decreased for the third consecutive month in October due to lower generation costs and transmission charges. According to Meralco, the decrease in transmission charges was due mainly to the reduction in the National Grid Corporation of the Philippines' (NGCP) ancillary charges. At the same time, the reduction in the average generation charge was mainly driven by lower generation costs from the Wholesale Electricity Spot Market (WESM) as a result of lower demand in September as compared to August. The said declines offset the increases in the costs of power from Independent

Power Producers (IPPs) and Power Supply Agreements (PSAs) brought about by higher coal prices and the depreciation of the Philippine peso.

F. Financial market developments

- Movements in domestic financial market indicators largely reflected investors' risk-averse attitude as the possibility of a US interest rate increase in December remained on track.

  - Local equities continued to consolidate in October, as the benchmark index retreated due to lingering uncertainties over the US presidential elections and the increased likelihood of a US Fed rate hike in December (on the back of upbeat US retail sales data in September), combined with concerns over the fate of Deutsche Bank and on whether the ECB will taper its monetary stimulus. Moody's move to raise its growth forecast for the Philippines and reports on the continued growth of the Chinese economy in Q3 supported the PSEi in the latter part of the month.

  - The peso weakened against the US dollar in October on the back of positive US manufacturing data and upbeat reports on new home sales and services, which strengthened the case for an increase in US interest rates; robust corporate demand for the US dollar for month-end requirements; and investor concerns on some policies of the current administration. Nonetheless, the sustained inflows of foreign exchange from overseas Filipino remittances, foreign direct investments, BPO and tourism receipts, as well as the Philippines' ample level of gross international reserves and robust economic growth continued to provide support to the peso.

G. Domestic liquidity and credit conditions

- Liquidity and credit conditions indicate that overall monetary conditions remain sufficiently favorable to support domestic economic activity.

  - Domestic liquidity (M3) grew by 12.6 percent (y-o-y) to ₱8.8 trillion in September. This was faster than the 11.9-percent expansion recorded in August. On a month-on-month seasonally-adjusted basis, M3 increased by 1.0 percent.

  - Outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, continued to grow by 17.7 percent in September from 17.3 percent in August. On a month-on-month seasonally-adjusted basis, commercial bank lending for loans net of RRPs increased by 0.9 percent.

H. Fiscal developments

- The latest fiscal data reflected the efforts to step up government spending. The National Government (NG) recorded a fiscal deficit of ₱138.4 billion for the period January-August 2016, ₱135 billion higher than the ₱3.4 billion deficit incurred in the first eight months in 2015. Excluding interest payments from NG expenditures, the primary surplus amounted to ₱78.8 billion, which is lower by ₱143.4 billion from the ₱222.2 billion primary surplus recorded in the same period a year ago.

I. External developments

- Indicators of economic activity show a firm yet subdued pace of economic activity across the globe. The JP Morgan Global All-Industry Output Index improved to 53.3 index points in October from 51.7 in September, as growth in both the manufacturing and service sectors expanded to their fastest pace since July 2014 and November 2015, respectively. Output was observed to expand in the US, Eurozone, China, Russia, Japan and India, while the downturn in Brazil continued.

- Meanwhile, in October, the IMF maintained its growth projections for 2016 and 2017 relative to the July forecasts. The projections reflect the subdued outlook for advanced economies following the Brexit referendum and the weaker-than-expected growth in the US in the first half of 2016. By contrast, growth in emerging and developing economies is seen to be slightly stronger in 2016 relative to the previous year, although spillovers from the ongoing slowdown in China and the persistently weak demand from advanced economies continue to pose a downside risk to the outlook. The inflation environment also remains benign despite the recent increase in commodity prices, particularly for fuels and oil.

- Manufacturing conditions weakened in the ASEAN region with the Nikkei ASEAN Manufacturing PMI declining to 49.2 in October from 50.5 in September.

- Many central banks decided to maintain their policy settings in October. Meanwhile, Bank Indonesia reduced its 7-day reverse repo rate by 25 bps to 4.75 percent from 5.0 percent, effective 21 October 2016, in order to support domestic demand and maintain the Indonesian economy's growth momentum, as inflation was expected to ease near the low end of the inflation target.