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HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 10 AUGUST 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 was based on its assessment that the inflation environment continues to be manageable. While inflation forecasts have risen slightly due to the recent increase in global oil prices, the future inflation path continues to be within the target for 2017-2019. Meanwhile, inflation expectations also remain firmly anchored to the Government's 3 percent ± 1 percentage point target over the policy horizon.

- The Monetary Board also recognized that the balance of risks to the inflation outlook continues to be on the upside. While the proposed tax reform program may exert potential transitory pressures on prices, various social safety nets and the resulting improvement in productivity would likely temper the impact on inflation over the medium term.

- At the same time, while output prospects for the global economy have improved, downside risks to external demand remained, due in part to geopolitical tensions and lingering uncertainty over macroeconomic policies in advanced economies. The outlook for domestic economic activity continues to be firm, supported by buoyant consumer and business sentiment and ample liquidity. Moreover, as credit activity expands in line with output growth, the economy's improving absorptive capacity is likewise seen to be sustained, thus mitigating inflation pressures over the long run.

[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 August 2017 monetary policy meeting were approved by the Monetary Board during its regular meeting held on 31 August 2017. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 21 September 2017.

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 inflation rate of 3.1 percent (as of July 2017) was still well within the Government's target range of 3.0 percent ± 1.0 percentage point for the year. The slightly higher July inflation reading resulted from price movements in non-food components, in particular the rail transport fare increase, upward price adjustments for gasoline and diesel products, the increase in electricity rates due to higher generation charges, and increased rental rates for housing.

- Core inflation – which excludes volatile food and energy items to capture underlying price pressures – fell to 2.1 percent in July from 2.6 percent in June. Meanwhile, three (out of four) alternative measures of core inflation (trimmed mean, net of volatile items, and principal component analysis) employed by the BSP saw an increase during the month.

B. Inflation expectations

- Inflation expectations—based on forecast surveys of private sector economists by the BSP and by Consensus Economics—continued to be in line with the BSP's within-target inflation outlook. Results of the BSP's June 2017 survey of private sector economists showed lower mean inflation forecast for 2017 at 3.3 percent (from 3.4 percent) and for 2018 at 3.4 percent (from 3.5 percent). By contrast, mean inflation forecast for 2019 was higher at 3.5 percent from 3.4 percent. Results of the Consensus Economics survey in June 2017 showed steady mean inflation forecasts for 2017 at 3.3 percent and higher forecast for 2018 at 3.4 percent (from 3.3 percent).

C. Inflation outlook

- Average inflation was projected to settle within the target range of 3.0 percent ± 1 percentage point for 2017-2019. The latest average baseline inflation forecasts were higher compared to those from the previous forecast round due to the increase in global crude oil prices, the depreciation of the peso, and slightly faster domestic liquidity growth, which were partly offset by the downward revision in June inflation and the lower-than-projected July inflation.

- The balance of risks to future inflation remained weighted toward the upside. The transitory impact of the government's fiscal reform program and the pending petitions for adjustments in electricity rates were considered as the main upside risks to inflation. Meanwhile, the possibility of slower global economic activity continued to be the main downside risk to inflation.

D. Demand conditions

- Domestic demand conditions remained firm and prospects continued to remain favorable. New information since the previous monetary policy meeting suggested that the economy would continue to grow above its historical average rate in Q2 2017 as indicated by the

BSP's business cycle and nowcast models. Business and consumer optimism for Q2 2017 have also remained positive. Capacity utilization of the manufacturing sector continued to hold firm above 80 percent while PMI readings have been consistently above the 50-point expansion threshold. NG expenditures (excluding interest payments) increased by 10 percent year-on-year while the primary balance recorded a deficit in January – June 2017.

E. Supply-side indicators

Developments in Agriculture

- The MB noted the latest report from the National Food Authority (NFA) which showed that the country's total rice inventory stood at 2,520.2 thousand metric tons (TMT), estimated to last for about 80 days. The combined stocks of the commercial and household sectors were broadly unchanged from month-ago levels due to ample supply from the concluded summer harvest season.

- As of 13 July 2017, most El Niño-Southern Oscillation (ENSO) climate prediction models from international meteorological institutions favored the continuation of ENSO-neutral weather conditions through Q1 2018.

Oil Price Developments

- Average Dubai crude oil prices inched higher in July but remained below US$50 per barrel amid speculation that Saudi Arabia could further reduce its oil exports and reported weekly declines in US crude and gas oil inventory. However, downside risks to global oil prices remained with supply dynamics still a key factor in the rebalancing process. According to the latest Energy Information Administration (EIA) report, global oil market could be closer to balance in the next 18 months.

Developments in the Utilities Sector

- The overall electricity rate slightly increased by ₱0.08 per kilowatt hour (kWh) in July 2017 due mainly to the rise in power generation charges. According to Meralco, the upward adjustment in the generation cost was primarily due to higher generation charges from Independent Power Producers (IPPs) and the Wholesale Electricity Spot Market (WESM). The higher charges from IPPs and WESM were mainly a result of lower dispatch of power plants, the depreciation of the peso, and billing adjustments. The increases offset the lower cost of power from Power Supply Agreements (PSAs).

F. Financial market developments

- As of 8 August 2017, the peso depreciated by 1.43 percent to close at ₱50.44/US$1 from the end-December closing rate of ₱49.72/US$1. The depreciation of the peso was attributed mainly to the following factors: (i) the country's higher-than-expected trade deficit in May; (ii) the release of upbeat US economic data; and (iii) market players' cautiousness ahead of the US Fed's policy meeting on 25-26 July 2017. Meanwhile, the Philippine Stock Exchange index (PSEi) rose to a peak of 8,102.3 on 21 July as a result of buying activity by foreign investors.

G. Domestic liquidity and credit conditions

- Prevailing credit and liquidity conditions continued to support the appropriateness of present policy settings. Domestic liquidity increased by 13.2 percent while bank lending grew by 19.0 percent in June 2017. Demand for credit remained the principal driver of money supply growth, offsetting the slowdown of net foreign assets. Broad-based bank lending growth reflected solid demand for loans across key economic sectors and households. The MB noted that indicators of credit expansion were within various internally monitored thresholds, indicating that the current pace of credit growth remained at acceptable limits.

H. Fiscal developments

- The National Government (NG) recorded a fiscal deficit of ₱154.5 billion for the period January - June 2017, higher by 28 percent compared to the ₱120.3-billion deficit posted in the same period in 2016. After excluding interest payments from NG expenditures, the primary deficit amounted to ₱2.9 billion, a turnaround from the ₱33.4-billion primary surplus recorded in the previous year.

I. External developments

- In its July 2017 World Economic Outlook (WEO) Update, the IMF maintained its world GDP growth forecasts of 3.5 percent in 2017 and 3.6 percent in 2018. The IMF viewed the risks to the global growth outlook as being broadly balanced in the near term, while still being skewed to the downside over the medium term. Meanwhile, the US Federal Open Market Committee (FOMC) kept its policy rate unchanged during its 25-26 July meeting but indicated that US Fed balance sheet normalization was likely to begin “relatively soon”.