BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 23 MARCH 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 is based on its assessment that the outlook for inflation remains manageable, consistent with favorable growth prospects. While the average headline inflation for the first two months of 2017 has risen due to the recent increases in food and oil prices as well as base effects, latest baseline forecasts are slightly lower than previous forecasts and within the target range of 3.0 percent ± 1 percentage point for 2017-2018. Inflation expectations also remain anchored to the inflation target over the policy horizon.

- The MB also observed that the balance of risks surrounding the inflation outlook remains tilted toward the upside, given the transitory impact of the proposed tax reform program as well as possible adjustments in transportation fares and electricity rates. Meanwhile, lingering uncertainty over the prospects of the global economy, due in part to possible shifts in macroeconomic policies in advanced economies, continues to pose a key downside risk to the inflation outlook.

- The Monetary Board also noted the beneficial effects on inflation of the removal of quantitative restrictions on rice importation. The Board emphasized that domestic economic activity is projected to stay firm, supported by buoyant household consumption and private investment, increased government spending, and ample credit and liquidity.

[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 23 March 2017 meeting were approved by the Monetary Board during its regular meeting held on __ April 2017. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 11 May 2017.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- Inflation in February 2017 increased to 3.3 percent from 2.7 percent in January 2017, which is the highest outturn since November 2014. The higher February inflation reading was due mainly to higher prices of food, electricity, and domestic petroleum products. Likewise, the official core inflation as well as all alternative measures of core inflation increased in February. Meanwhile, the seasonally-adjusted 3-month moving average annualized headline and core inflation rates continued to decelerate in February, indicating a moderate inflation momentum.

B. Inflation expectations

- Inflation expectations—based on forecast surveys of private sector economists by the BSP and by Consensus Economics—continue to be in line with the within-target inflation outlook. Results of the Consensus Economics survey for March 2017 showed higher mean inflation forecasts for 2017 at 3.2 percent (from 3.1 percent in the previous month) while mean inflation forecast for 2018 was steady at 3.3 percent. Meanwhile, results of the BSP's February 2017 survey of private sector economists showed steady mean inflation forecasts for 2017 at 3.1 percent and for 2018 and 2019 at 3.3 percent.

C. Inflation outlook

- The latest baseline forecasts show lower and within-target inflation path for 2017-2018. The upward impact of higher-than-projected February 2017 inflation, weaker exchange rate, and higher electricity rates due to the Malampaya maintenance shutdown were offset by slightly lower domestic oil prices and domestic liquidity growth.

- The balance of risks to future inflation remains tilted to the upside. The impact of the government's fiscal reform program, pending petitions for adjustments in electricity rates, and further transport fare hikes are the main upside risks to inflation. Meanwhile, the lingering uncertainty in the global economic landscape poses as the main downside risk to inflation.

D. Demand conditions

- Latest indicators of domestic demand continue to broadly point to firm growth prospects over the policy horizon. The Philippine composite PMI remained firmly above the 50-point expansion threshold at 54.7 in January 2017, albeit lower than in the previous month due to seasonal factors. Business optimism on the economy remained steady and positive for Q1 2017 and higher for the next quarter. Trends in other high-frequency demand indicators are also generally positive, with continued increases in sales volume of automobiles and electricity as well as production volume in the manufacturing sector. Strong NG expenditure growth resulting from the initiatives of the Duterte administration to ramp up public spending as evident in the second semester of 2016 is also expected to provide a boost to the economy.

E. Supply-side indicators

Developments in Agriculture

- The quantitative restrictions (QR) on rice will expire by end-June 2017. The MB noted that the removal of quantitative restrictions on rice importation will have beneficial effects on inflation. Enhancing economic efficiencies in the rice supply chain would translate to rice affordability for consumers, including farmers. However, the negative impact on the country's agriculture sector of the possible influx of cheaper rice imports should be compensated by a comprehensive government support package that will boost agricultural productivity and increase the competitiveness of the sector.

- As of 9 March 2017, most El Niño-Southern Oscillation (ENSO) prediction models indicated ENSO-neutral conditions are favored to continue at least through June- -July-August 2017 with increasing chances for El Niño developing in July-August-September.

Oil Price Developments

- Oil price outlook remains uncertain due to supply developments. Global crude oil prices have eased slightly in March 2017 with prices remaining flat over the medium term as suggested by futures prices signaling that the world oil market is close to achieving balance between supply and demand. However, despite the relatively high compliance of OPEC members in their production targets, there is uncertainty on whether the member countries would renegotiate voluntary supply reductions in H2 2017. At the same time, the resumption of shale oil production in the US could limit price pressures for the year.

Developments in the Utilities Sector

- The overall electricity rate went up by around ₱0.66 per kilowatt hour (kWh) to ₱9.67 per kWh in March 2017 due mainly to higher generation cost. Average generation charge went up by ₱0.58 per kWh to ₱4.90 per kWh in March 2017, which includes one-third of the differential amount computed by the ERC. According to Meralco, the increase in generation cost reflected the "pass on" charge approved by the Energy Regulatory Commission (ERC) which arose from the Malampaya maintenance shutdown on 28 January to 16 February 2017.

F. Financial market developments

- In the domestic financial markets, the peso continued to weaken in early March, with the peso depreciating by 0.9 percent on year-to-date basis as of March 21. The weakness of the peso could be attributed to strong corporate demand for dollars and import requirements. At the same time, market sentiment stemming from external developments continues to affect the foreign exchange market. Nevertheless, the peso is expected to remain broadly stable on account of the country's strong macroeconomic fundamentals as well as sustained inflows of foreign exchange from overseas Filipino remittances, foreign direct investments, and BPO and tourism receipts.

G. Domestic liquidity and credit conditions

- Liquidity and credit conditions indicate that overall monetary conditions remain supportive of domestic economic activity. Domestic liquidity increased by 12.4 percent while bank lending grew by 17.9 percent in January 2017. Meanwhile, open market operations (OMO) by the BSP were generally oversubscribed since January with strong demand for TDF placements driving down the WAIR for 7-and 28-days tenors.

H. Fiscal developments

- The latest fiscal data reflected the efforts to step up government spending. The National Government (NG) recorded a fiscal deficit of ₽353.4 billion for 2016, almost three times higher compared to the ₽121.7 billion deficit incurred in 2015. Netting out the interest payments in NG expenditures, the primary deficit amounted to ₽49.0 billion, a turnaround from the ₽187.7 billion primary surplus recorded in 2015.

I. External developments

- Data on economic activity and inflation in the global economy have improved in recent months. The pace of economic activity in the US, euro area, and Japan remained steady, while production improved in China and India. The sharp increase in energy prices led to higher inflation in the US and euro area while the uptick in the prices of food, tobacco, and liquor pushed up inflation in China. Stronger growth along with stronger inflationary pressures, including higher commodity prices, are seen to affect the future stance of monetary policy in advanced economies. On March 15, the US Federal Reserve raised the federal funds rate by 25 basis points to a range of 0.75-1.0 percent as was expected by the market, marking its third increase since the global financial crisis. The FOMC also signaled two possible further rate increases in 2017.