HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 23 MARCH 2016[1]

I. Monetary Policy Decision

The Monetary Board (MB) decided to:

a) Maintain the BSP's key policy interest rates at 4.00 percent for the overnight RRP (borrowing) facility and 6.00 percent for the overnight RP (lending) facility;

b) Maintain the current interest rates on term RRPs, RPs and SDAs; and

c) Maintain the current reserve requirement ratios.

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

- The Monetary Board's assessment of a manageable inflation outlook and robust growth conditions continues to support keeping monetary policy settings unchanged.
  - Average inflation is projected to settle within the target range of 3.0 percent ± 1 percentage point for 2016-2017, while inflation expectations continue to be firmly anchored within the inflation target band over the policy horizon.
  - The risks surrounding the inflation outlook have remained tilted to the downside. Downward pressures on inflation could arise from slower-than-expected global economic activity and potential second-round effects from lower international oil prices, while upside risks could come from the impact of El Niño dry weather conditions on food prices and utility rates as well as pending petitions for power rate adjustments.
- At the same time, the Monetary Board observed that domestic demand conditions continue to be buoyant, supported by solid private household and capital spending, positive business sentiment, and adequate credit and domestic liquidity.
- The Monetary Board also recognized that uncertainty over economic growth prospects across the globe could continue to drive volatility in global financial markets in the months ahead.

[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 2016 meeting were approved by the Monetary Board during its regular meeting held on 7 April 2016. The next meeting of the Monetary Board on monetary policy issues is scheduled on 12 May 2016.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- Headline inflation dropped further in February to 0.9 percent as prices of both rice and oil-related CPI items continued to decline due to favorable supply conditions. Likewise, most indicators of core inflation were lower during the month, including the official rate, trimmed mean, and the net of volatile items. The number of items above threshold also fell relative to the previous month.

- Food inflation decelerated due to slower price increases in certain key food items such as fish, vegetables, and fruits. At the same time, rice prices have been decreasing relative to year-ago levels since August 2015 due to favorable supply conditions and additional importations.

- In addition, the rollbacks in domestic petrol prices, prompted by low imported oil prices, resulted in petitions for reduction in transport fares—particularly for public utility jeepneys (PUJ). These factors contributed to lower non-food inflation during the month.

- By geographical location, inflation in both the National Capital Region (NCR) and in areas outside NCR slowed down to 0.1 percent and 1.2 percent, respectively.

B. Inflation expectations

- Inflation expectations remain consistent with the within-target inflation outlook. For February 2016, results of the BSP's survey of private economists showed lower mean inflation forecasts for 2016 at 2.2 percent (from 2.4 percent) and unchanged inflation forecasts for 2017 at 2.9 percent. Similarly, results of the March 2016 Consensus Economics inflation forecast survey showed a lower mean inflation forecast for 2016 at 2.2 percent (from 2.4 percent in the previous month) and unchanged mean inflation forecast for 2017 at 3.1 percent.

C. Inflation outlook

- The latest baseline inflation forecasts are lower for 2016-2017. The downward shift in the forecasted inflation path for 2016 and 2017 could be attributed mainly to the lower-than-projected inflation outturn in February.

- The prevailing balance of risks to future inflation remains tilted to the downside. Slower global economic activity and potential second-round effects coming from persistently low international oil prices pose downside risks, while pending petitions for adjustments in electricity rates and the impact of El Niño conditions on food prices and utility rates are seen as key upside risks to inflation.

D. Demand conditions

- Latest indicators of domestic demand continued to point to firm growth prospects over the policy horizon. The Philippine composite purchasing managers' index (PMI) remained firmly above the 50-point expansion threshold at 52.8 as of January. The latest results of the BSP's Business Expectations Survey (BES) also indicated a broadly optimistic sentiment for Q1 and Q2 2016, notwithstanding concerns over the outlook for global growth, the impact of El Niño, and the outcome of the elections. Meanwhile, the unemployment rate fell to 5.8 percent due to sustained job growth in the services and industry sectors.

E. Supply-side indicators

Developments in Agriculture

- The average retail price of rice was broadly stable in February relative to the previous month due mainly to the abundant supply of rice from the main harvest season as well as to the timely arrival of importations.

- International food prices were likewise stable amid ample global supplies. The Food and Agriculture Organization (FAO) food price index (FPI) averaged 150.2 points in February, almost unchanged from the average of 150.0 points in the previous month. The marginal increase was attributed to the higher prices of vegetable oil and meat, which slightly outweighed the decline in the prices of cereal, dairy, and sugar products.

Oil Price Developments

- Dubai crude oil prices rose slightly in March amid reports of plans between Russia and selected OPEC member countries to freeze oil output. The continued decline in US shale oil output, underscored by the decline in active rig counts in the US, likewise added to upward pressures on global oil prices. Following international oil price trends, domestic pump prices have also generally recovered compared to end-2015 levels.

- Oil supply and demand forecasts from major energy agencies as of March were broadly lower relative to the previous month's assessment, reflecting increased downside risks to consumption and production amid expectations of a slowdown in demand from major economies and a decline in output from non-OPEC oil producers.

Developments in the Utilities Sector

- Electricity rates decreased in March due to lower generation costs. According to Meralco, the reduction was driven mainly by the decrease in generation cost from power supply agreements and independent power producers due to the reduced downtimes of the power plants and, to some extent, the reduction in fuel costs.

F. Financial market developments

- Financial market volatility eased over the past month on expectations that the US Federal Reserve (US Fed) would delay further interest rate hikes. However, lingering uncertainty over the global growth outlook amid China's growth rebalancing, divergent monetary policy settings among key jurisdictions, and lower commodity prices continued to weigh down on markets.

- Further stimulus measures from central banks across the globe—particularly in the euro area, Japan, and China—helped support investor sentiment. In line with the rally in other Asian bourses, the Philippine stock exchange index (PSEi) closed higher in March from its end-February level. The peso likewise appreciated against the dollar with the improvement in investors' risk appetite.

G. Domestic liquidity and credit conditions

- Liquidity and credit are growing at a reasonable pace. Domestic liquidity (M3) grew by 11.5 percent year-on-year in January 2016 to reach ₱8.3 trillion. This was faster than the 9.4-percent (revised) year-on-year expansion recorded in December 2015. On a month-on-month seasonally-adjusted basis, M3 increased by 2.6 percent. Money supply continued to expand due largely to sustained demand for credit.

- Outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, expanded by 15.8 percent year-on-year in January from 13.6 percent (revised) year-on-year in December 2015. Similarly, bank lending inclusive of RRPs increased by 15.6 percent year-on-year in January from 12.7 percent (revised) year-on-year in the previous month. On a month-on-month seasonally-adjusted basis, commercial bank lending increased by 1.5 percent for loans net of RRPs and by 1.8 percent for loans inclusive of RRPs.

H. Fiscal developments

- The National Government (NG) recorded a fiscal deficit of ₱46.5 billion for the period January – November 2015, higher by 74 percent from the ₱26.8 billion deficit incurred in the same period in 2014. Excluding the interest payments from total expenditures, the primary surplus amounted to ₱241.3 billion, ₱24.1 billion or 9.1 percent lower than the level recorded in the same period a year ago.

I. External developments

- Economic activity across the globe softened in early 2016. The JP Morgan Global All-Industry Output Index fell to 50.6 in February from 52.6 in January owing to a broad-based slowdown in activity and new business across manufacturing and services. Output in the US stagnated as a contraction in the service sector offset the expansion in the manufacturing sector. Meanwhile, output in the euro area continued to expand, although signs of a slowdown were also noted in Germany, Italy, Spain, and France. Growth in Japan, Russia, and India was modest. Meanwhile, among emerging market economies, the pace of production decelerated in China, while economic activity in Brazil remained on a severe downturn.

- Several central banks eased their monetary policy settings in February. Bank Indonesia reduced the BI rate and its primary reserve requirement ratio in order to support economic growth. The Reserve Bank of New Zealand also lowered its official cash rate, citing evidence of a material decline in long-run inflation expectations. The People's Bank of China reduced its reserve requirement ratio to ensure ample liquidity and encourage credit growth. The European Central Bank reduced the deposit rate further into negative territory and expanded its quantitative easing program in order to stem the increasing risks to its price stability mandate.

- Meanwhile, the US Fed left its policy rate unchanged on 16 March. The FOMC statement was widely seen as adopting a more dovish tone, noting that “global economic and financial developments continue to pose risks”. The US Fed also marked down its near-term inflation projections slightly and lowered its GDP projections for 2016-2017.