BANGKO SENTRAL NG PILIPINAS

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 11 FEBRUARY 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 manageable inflation dynamics and robust growth conditions continues to support steady monetary policy settings.
  - Average inflation is projected to settle within the target range of 3.0 percent ± 1 percentage point for 2016-2017, while inflation expectations remain firmly anchored within the inflation target band over the policy horizon.
  - The risks surrounding the inflation outlook have shifted slightly 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 prolonged 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 are likely to stay firm, supported by solid private household and capital spending, buoyant market sentiment, and adequate domestic liquidity.
- The Monetary Board also considered that the lingering uncertainty over economic growth prospects across the globe could continue to drive volatility in global financial markets.

[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 on the 11 February 2016 meeting were approved by the Monetary Board during its regular meeting held on 24 February 2016. The next meeting of the Monetary Board on monetary policy issues is scheduled on 23 March 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 decelerated in January 2016 to 1.3 percent on slower price increase of both food and non-food items. Likewise, all core inflation indicators were also lower during the month including, the official rate and the three alternative measures of core inflation. The number of items above threshold also fell relative to the previous month.

- Non-food inflation slowed down due to the price reduction in domestic petroleum products, downward adjustment in electricity rates, and the recently approved provisional rollback in jeepney transport fares.

- At the same time, food inflation also eased slightly as the price of rice continued to decline compared to year-ago levels. Other key food items such as fish, fruits, milk, cheese, and eggs as well as vegetables also posted slower price increases.

- By geographical location, inflation in the National Capital Region (NCR) also slowed down to 0.6 percent from 1.1 percent in the previous month while inflation in areas outside NCR held steady at 1.5 percent.

B. Inflation expectations

- Inflation expectations—based on forecast surveys of private sector economists by the BSP and by Consensus Economics—remain consistent with the within-target inflation outlook. For January 2016, results of the BSP's survey of private economists showed lower mean inflation forecasts for 2016 at 2.4 percent from 2.5 percent in December 2015. However, the mean inflation forecast for 2017 was higher at 2.9 percent (from 2.7 percent). Results of the January 2016 Consensus Economics inflation forecast survey likewise showed a lower mean inflation forecast for 2016 at 2.4 percent (from 2.5 percent). Mean inflation forecast for 2017 stood at 2.9 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 sharp drop in global crude oil prices, the approved provisional rollback in jeepney fares, and the lower-than-projected December 2015 and January 2016 inflation.

- The prevailing balance of risks to future inflation is slightly skewed to the downside. Possible slower global economic activity and a further decline in international oil prices pose downside risks while potential adjustments in electricity rates given pending petitions and the impact of stronger-than-expected El Niño conditions are seen as the key upside risks to inflation.

D. Demand conditions

- Domestic demand conditions remain firm on the back of strong private and government spending, implying that current monetary policy settings continue to provide sufficient stimulus to real sector activity. GDP growth in Q4 2015 at 6.3 percent was stronger than expected, bringing full-year 2015 GDP growth to 5.8 percent. While still below the government's target of 7-8 percent, continuing strength in consumer demand, accelerated government spending, and double-digit growth in fixed capital formation contributed to above-average GDP growth. Likewise, the two major production sectors recorded solid gains, with services and industry contributing 4.1 percentage points and 2.3 percentage points, respectively.

- Consistent with these developments, other indicators continue to point to positive growth momentum. In the Q4 2015 Business Expectations Survey, respondents remained positive for Q1 2016 with the overall confidence index (CI) at 43.9 percent albeit lower due to the typical slowdown in demand after the holiday season, concerns over the adverse effects of El Niño, and uncertainties in the global economy. Meanwhile, consumers' optimism was sustained as the CI based on the Q4 2015 Consumer Expectations Survey was broadly steady at 5.7 percent for Q1 2016 while sentiment was more favorable for the next 12 months, with the CI increasing to 18 percent from 15.8 percent in the previous survey round.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- Agriculture, hunting, forestry and fishery (AHFF) declined by 0.3 percent in Q4 2015. The reduction came mainly from lower fishing (particularly in the production of milkfish, tiger prawn, skipjack, and yellowfin tuna) as well as palay and corn production. The sector's performance was negatively affected by the long dry spell and damage caused by Typhoon "Lando".

- The average retail price of rice declined slightly in December 2015 due to the ongoing main harvest season and the arrival of importations during the period.

- International food prices continue to drop amid ample global supplies. The Food and Agriculture Organization (FAO) food price index (FPI) averaged 154.1 points in December 2015, down by 1.5 points (1.0 percent) from the month-ago level. The decline was due to lower prices of cereal, dairy, and meat. Meanwhile, the prices of vegetable oil and sugar rose.

<u>Oil Price Developments</u>

- Dubai crude oil prices in 2015 are 47.0 percent lower than year-ago levels due largely to oversupply. Prices continue to decline in January 2016 as worries over weak demand also contributed to downward pressure while US EIA estimates demand to outstrip supply only by the second half of 2017. Broadly reflecting international trends, domestic petroleum prices were also lower so far in January 2016.

- Oil demand forecasts from all major energy agencies as of January 2016 were broadly unchanged relative to the previous month's assessment. Meanwhile, crude oil price volatility remains elevated with the geopolitical conflict in the Middle East, particularly between Saudi Arabia and Iran, alongside the recent financial turmoil in China at the start of 2016 pushing implied volatility higher in January 2016.

Developments in the Utilities Sector

- Electricity rates decreased in January 2016 due to lower generation costs. According to Meralco, the reduction was mainly driven by the decrease in generation cost from Power Supply Agreements (PSA) due to the reduction in capacity fees from plants.

F. Financial market developments

- Financial market volatility has increased over the past month over concerns about future performance of the Chinese economy. In addition, rising geopolitical tensions in the Middle East and the nuclear testing by North Korea contributed to market jitters. The Philippine stock index (PSEi) entered bear territory on 11 January 2016, following a global sell-off triggered by concerns over the outlook for global growth. In particular, evidence of slowing Chinese and US manufacturing and the drop in oil prices resulted in market turmoil and volatile trading across global equities market. The peso likewise depreciated in January and early February on continued risk aversion towards emerging market assets. Debt spreads also widened during the period as investors traded on a safe-haven mode, pushing yields of US Treasury bonds lower while raising yields of the relatively risky emerging market bonds higher.

G. Domestic liquidity and credit conditions

- Liquidity and credit are growing at a reasonable pace. Domestic liquidity (M3) grew by 8.3 percent year-on-year in December 2015 to reach ₱8.3 trillion. This was slower than the 9.4-percent (revised) expansion recorded in November. On a month-on-month seasonally-adjusted basis, M3 decreased by 0.2 percent. Money supply continued to expand due largely to sustained demand for credit.

- The outstanding loans of commercial banks, net of RRP placements with the BSP, grew by 13.1 percent in December from 13.9 percent (revised) in November. On a month-on-month seasonally-adjusted basis, commercial bank lending increased by 1.2 percent for loans net of RRPs. The majority of banks' outstanding loans continued to be directed to key production sectors of the economy.

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. Netting out the interest payments in the 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

- Prospects across the globe have become more subdued, with both the IMF and WB reducing their growth projections for 2016 and 2017 largely on account of the continued slowdown in major emerging economies. Meanwhile, economic activity in the advanced economies has stayed firm, underscored by a solid recovery in the US and euro area.

- In January, some central banks in the region eased monetary policy to provide further support for economic activity and ensure sufficient liquidity amid capital outflows. On 14 January 2016, Bank Indonesia reduced its BI rate by 25 bps in line with its previous moves to ease macroprudential policy and lower primary reserves in rupiah. On 21 January 2016, Bank Negara Malaysia decided to cut its statutory reserve requirements (SRR) ratio by 50 bps to ensure sufficient liquidity in the domestic financial system and to support the banking system amid net external outflows. On 29 January, the Bank of Japan announced a negative interest-rate strategy to spur bank lending. The BoJ's target annual increase of ¥80 trillion for its asset purchase program was left unchanged.

- Meanwhile, the FOMC kept its policy rate unchanged during its 27 January meeting but kept its options open for the March meeting. However, based on the Fed Funds futures prices, the market sees lower odds of a March Fed rate hike.