HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 13 DECEMBER 2018[1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) maintain the overnight RRP (borrowing) rate at 4.75 percent; and

b) maintain the current overnight deposit and overnight lending rates.

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

- In deciding to maintain the BSP's monetary policy settings, the Monetary Board (MB) noted that the latest inflation forecasts show a lower path over the policy horizon, with inflation settling within the target band of 3.0 percent ± 1.0 percentage point for 2019-2020. Recent headline inflation readings indicated signs of receding price pressures as constraints on food supply continue to ease with the implementation of various non-monetary measures. Inflation expectations have also steadied given the decline in international crude oil prices and the stabilization of the peso.

- Meanwhile, the MB observed that the risks to the inflation outlook have become more evenly balanced for 2019 and leans toward the downside for 2020 amid a more uncertain global economic environment, which could further mitigate upward pressures from commodity prices in the coming months.

- Given these considerations, the MB deemed it prudent for the time being to keep monetary policy settings steady and allow previous monetary responses to continue to work their way through the economy. The MB reiterated that it remains vigilant against developments that could affect the outlook for inflation and financial stability.

- The MB continued to emphasize its readiness to take further policy action as appropriate to safeguard its price stability mandate.

[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 13 December 2018 monetary policy meeting were approved by the Monetary Board during its regular meeting held on 3 January 2019. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 7 February 2019.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- The latest inflation outturn confirms the BSP's assessment that price pressures have started to ease in Q4 2018. Headline inflation decelerated further to 6.03 percent year-on-year in November 2018 from 6.68 percent in October and 6.70 percent in September. The year-to-date average of 5.2 percent is above the Government's announced inflation target range of 3.0 percent ± 1.0 percentage point for 2018. The lower inflation reading was attributed largely to slower price increases in both food and non-food commodities. Month-on-month seasonally-adjusted headline inflation turned negative in November at -0.3 percent from 0.4 percent in October 2018. The lower inflation reading was attributed largely to slower price increases in both food and non-food commodities.

- Meanwhile, core inflation—which excludes selected volatile food and energy items to measure underlying price pressures—rose further to 5.1 percent in November from 4.9 percent in the previous month. However, the directions of the alternative measures of core inflation computed by the BSP were mixed in November 2018. Two of the four alternative measures declined (trimmed mean and net of volatile items), while the weighted median increased and the principal component analysis remained steady relative to previous month's level.

- The number of CPI items above the 4-percent threshold increased but accounted for a slightly lower share in terms of weight. Similarly, the diffusion index of price changes also rose in November 2018 compared to that in the previous month, suggesting still broader inflation pressures.

B. Inflation expectations

- Mean inflation forecasts of private analysts were generally lower. Results of the BSP's December 2018 survey of private sector economists based on the 2012-CPI series showed unchanged mean inflation forecast for 2018 at 5.4 percent relative to the results in November 2018. Meanwhile, the mean inflation forecast for 2019 and 2020 decreased to 4.1 percent (from 4.4 percent) and 3.8 percent (from 3.9 percent), respectively, during the survey period.

C. Inflation outlook

- The latest inflation forecasts further strengthen the outlook that the inflation targets for 2019 and 2020 will be achieved. Average inflation is projected to reach 5.2 percent in 2018 (from 5.3 percent in the previous policy meeting), and revert to the target range in 2019 at 3.2 percent (from 3.5 percent) and 2020 at 3.0 percent (from 3.3 percent). The downward adjustment in the forecast path for 2019-2020 can be attributed primarily to the significant decline in global crude oil prices, lower-than-expected November 2018 inflation, approved rollback in jeepney fares, and the latest monetary policy adjustment by the BSP, which resulted in a stronger peso and slower domestic liquidity growth.

Baseline Inflation Forecasts		
	2012-based CPI	
	15 Nov MB	13 Dec MB
2018	5.3	5.2
2019	3.5	3.2
2020	3.3	3.0

- The risks to future inflation are seen as evenly balance for 2019. Meanwhile, downside risks to the outlook will dominate in 2020 largely due to downside risks to global growth.

  - Higher electricity rates, faster-than-expected monetary policy normalization in advanced economies, and the proposed increase in the sin taxes of alcoholic beverages are the main upside risks to inflation.
  - The slower global economic growth due to protectionist policies in advanced economies and geopolitical tensions, along with the potential renegotiation for lower tariff rates on meat products continue to be the main downside risks to inflation.

D. Demand conditions

- The Philippine business cycle (measured as the trend cycle of growth rate for industry and services) eased for the third consecutive quarter in Q3 2018 but remained above the long-term growth trend. Forward-looking domestic demand indicators point to less robust economic sentiment, with most recent surveys show business and consumer sentiment turning less sanguine in the fourth quarter. Nevertheless, factory output as well as services continue to be firm. The preliminary composite purchasing managers' index (PMI) remained above the 50-point expansion threshold.

E. Supply-side indicators

Developments in Agriculture

- Domestic rice prices decreased following the onset of the main harvest season in some provinces, as well as the continued arrival of rice imports by the government and the private sector.

- On 22 November 2018, the rice tariffication bill was approved by the bicameral committee. It generally adopted Senate Bill No. 1998 which limits the regulatory powers of the National Food Authority. The bill, which aims to replace the system of imposing quantitative import restrictions on rice with tariffs, is expected to lower rice prices in the market. The bill also earmarks ₱10 billion for the Rice Competitiveness Enhancement Fund or Rice fund which will be allotted for the provision of farm machinery and equipment, seed production, and training on rice farming, among others.

Wage Developments

- Four regions namely NCR, Region II, Region IV-B and Region X have their wage petitions approved in November, bringing the total number of regions with minimum wage adjustments to 16. The average increase in minimum wage so far in 2018 is 7.6 percent.

Oil Price Developments

- International oil prices are expected to moderate going forward due to excess supply and concerns over world oil demand. Global crude oil prices declined sharply to US$60.00 per barrel early in November due to waivers granted to Iran's main export destinations, record production in the US and Saudi Arabia, and increased economic uncertainty following the intensification of the trade war between the US and China.

- In a memorandum dated 8 November 2018, President Duterte approved the recommendation of the economic managers to suspend the scheduled increase in the excise tax on oil in January 2019. The temporary suspension of excise taxes on oil will be subject to review every quarter and is assumed to be implemented only until the first quarter of 2019.

Developments in the Utilities Sector

- The overall electricity rate increased by around ₱0.11 per kilowatt hour (kWh) in November 2018 due to higher generation charge. According to Meralco, the upward adjustment in the generation cost was primarily due to registered increase in generation charge of ₱1.35 per kWh from the Wholesale Electricity Spot Market (WESM).

F. Financial market developments

- In November, the local bourse rallied on improved inflation outlook and investor sentiments following the higher weights given to Philippine stocks in the MSCI emerging markets index; Moody's stable outlook on the domestic banking system; and expectations of potential increases in loans and investments with the agreements made during the visit of Chinese President Xi Jinping to the country. On 28 November, the PSEi closed at 7,382.43 index points, 3.4 percent higher than the end-October level. The peso likewise appreciated against the US dollar to an average of ₱52.81/US$1 in November from the previous month's ₱54.00/US$1 amid the release of domestic inflation data, which was within market expectation; policy rate hike by the BSP; and dovish remarks from US Federal Reserve officials.

G. Domestic liquidity and credit conditions

- Credit growth increased while domestic liquidity slowed due to the contraction in net foreign assets. In October, domestic liquidity growth slowed down to 8.2 percent (from 9.8 percent in September) while bank lending grew at a faster rate by 18.1 percent (from 17.6 percent). Meanwhile, TDF rates as well as other market interest rates (deposit and lending rates) increased following the 175-bps hike in the BSP's key policy rate.

H. Fiscal developments

- Strong fiscal spending is expected to continue to boost activity and support the country's growth momentum. The National Government (NG) recorded a ₱438.1-billion fiscal deficit for January-October 2018, more than double than the deficit posted in the previous year as expenditure growth outpaced an increase in revenue. Netting out the interest payment, NG expenditures grew by 27 percent in the first ten months of 2018.

I. External developments

- Indicators of global economic activity continue to signal a mild expansion, as output growth in the service sector has accelerated but has eased slightly in the manufacturing sector. Stronger new work inflows boost economic activity in India, while stronger new export orders supported manufacturing activity in the US. Meanwhile, economic activity in the euro area declines due to weaker growth in new business.

- While global economic activity remains strong, signs of uneven growth amid rising trade tensions are developing. Over the medium term, continued policy uncertainty, spillovers from tighter global financial conditions, and geopolitical risks remain the key downside risks to global growth.