HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 22 MARCH 2018[1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) maintain the overnight RRP (borrowing) rate at 3.0 percent; and

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

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

- The Monetary Board's decision was based on its assessment that while recent inflation outturns showed an elevated path in 2018, the latest baseline forecasts continued to show inflation remaining within the inflation target in 2018 and moderating further in 2019. The Monetary Board also considered that prospects for domestic activity continue to be firm on the back of robust domestic demand, strong growth in credit and liquidity, and a sustained recovery in global economic growth.

- At the same time, the Monetary Board observed that the risks to the inflation outlook remained weighted toward the upside owing mainly to price pressures emanating from pending petitions for adjustments in minimum wages and transportation fares. Nevertheless, non-monetary measures such as institutional arrangements in setting transportation fares and minimum wages, unconditional cash transfers, as well as transport subsidies are expected to help mitigate these inflationary impulses. In addition, the proposed reforms in the rice industry could also help temper price pressures.

- Meanwhile, the Monetary Board noted that inflation expectations have started to rise and will therefore need to be monitored closely in the coming months. It was also observed that economic growth remained solid enough to absorb some policy tightening if warranted.

- Given these considerations, the Monetary Board agreed that the BSP should remain watchful against any signs of second-round effects and inflation becoming broader based. The Monetary Board also expressed a firm intent to take immediate and appropriate measures to ensure that the monetary policy stance continued to support the BSP's price and financial stability objectives.

[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 22 March 2018 monetary policy meeting were approved by the Monetary Board during its regular meeting held on 12 April 2018. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 10 May 2018.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- Inflation has increased for a second consecutive month but remained in line with the BSP's baseline forecast scenario. The new 2012-based CPI series showed a higher headline inflation rate for February at 3.9 percent from 3.4 percent in January. This was traced mainly to faster price increases of selected food and non-food items. At the same time, upward adjustments in domestic pump prices of gasoline and diesel also led to higher transport inflation during the month. The year-to-date average of 3.7 percent using the 2012-based basket was within the Government's announced inflation target range of 3.0 percent ± 1.0 percentage point for 2018. Likewise, headline inflation for February rose to 4.5 percent from 4.0 percent in the previous month using the 2006-based CPI series. This brought the year-to-date average to 4.2 percent, which is above the Government's inflation target of 2-4 percent for the year.

- Other inflation indicators also showed an uptick, including the three alternative measures of core inflation, the seasonally adjusted month-on-month headline inflation, and the number and weight of above-threshold items. Meanwhile, CPI items with inflation below 4-percent threshold continue to account for the bulk of the total weight in the CPI basket.

B. Inflation expectations

- Inflation expectations have risen based on the latest forecast surveys of private sector economists by the BSP and by Consensus Economics. Results of the BSP's March 2018 survey of private sector economists based on the 2006-CPI series showed higher mean inflation forecasts of 4.4 percent (from 4.1 percent previously) for 2018, and 3.7 percent (from 3.6 percent) for 2019 and 2020. In comparison, the 2012-based mean inflation forecast for 2018 was at 4.1 percent, while the mean forecasts for 2019 and 2020 were at 3.7 percent and 3.6 percent, respectively. Meanwhile, results of the Consensus Economics survey for February 2018 showed higher mean inflation forecast at 3.9 percent (from 3.6 percent a month ago) for 2018 and 3.6 percent (from 3.5 percent) for 2020.

C. Inflation outlook

- Compared with the previous forecast round, the latest baseline inflation forecasts for 2018 were higher while the average baseline inflation forecasts for 2019 are broadly unchanged for both 2006- and 2012-based consumer price index (CPI).

Baseline Inflation Forecasts				
	2012-based CPI		**2006-based CPI**	
	8 Feb MB	22 Mar MB	8 Feb MB	22 Mar MB
2018	3.8	3.9	4.3	4.5
2019	3.1	3.0	3.5	3.5

- The balance of risks to the baseline inflation path was judged to remain tilted toward the upside. Additional wage adjustments and transport fare hikes due to the increase in excise taxes on petroleum products, pending petitions for adjustments in jeepney fares and electricity rates, and faster-than-expected monetary policy normalization in the US were seen as the key upside risks to inflation. Meanwhile, the slower global economic growth due to protectionist policies in advanced economies and geopolitical tensions in Asia and Middle East along with the proposed tariffication of quantitative restrictions (QR) on rice imports continued to be the main downside risks to inflation.

D. Demand conditions

- Domestic demand continued to be firm. Trends in high-frequency demand indicators have remained generally positive: volume sales of automobiles and electricity remained on the rise, while the composite PMI has stayed above the 50-point threshold. However, both business and consumer outlook turned less optimistic albeit still positive. Expansion in bank lending activities has also remain fairly strong. The government's commitment to sustain implementation of the programmed infrastructure spending could also provide a boost to domestic activity. GDP growth in Q1 2018 is projected to be consistent with the Government's target and remains within the estimated potential output for the past six years.

E. Supply-side indicators

Developments in Agriculture

- The Monetary Board also briefly discussed the progress of the proposed tariffication of QRs on rice imports. The final form of the bill is currently being drafted and will be submitted to the House of Representative's Committee on Rules for plenary deliberations. Staff analysis indicated that tariffication of rice imports could lower domestic rice prices.

Wage Developments

- The Monetary Board noted that wage petitions have been filed in three regions, including NCR and Regions VI and VII as of 8 March 2018. Nevertheless, these wage petitions are in accordance with the rule that allows new wage petitions after the expiration of the 12-month period since the last wage order.

Oil Price Developments

- Average crude oil prices were lower in February 2018 but remained above US$60 per barrel on rising US oil production with exports shipping to Asia threatening market share of selected OPEC producers. At the same time, declining global crude inventories, geopolitical tensions, and unplanned supply outages mainly among OPEC countries have supported intermittent spikes in oil prices. Meanwhile, futures prices remained in backwardation—wherein future-dated contracts are lower than current prices—still partly driven by expectations of a resumption of shale oil production in the US.

- On the domestic side, the higher excise and VAT tax has been fully implemented in the domestic petroleum products in January 2018. Since the last policy meeting, only the TNVS and bus transport groups have submitted a formal petition to the LTFRB.

Developments in the Utilities Sector

- The overall electricity rate increased in February and March 2018 due mainly to higher generation charge. The upward adjustment in power generation costs in February was primarily due to the higher capacity fees, peso depreciation and lower average plant dispatch. In March, the increase in the generation charge was due to tighter supply conditions in Luzon and continued depreciation of the peso. The increase in the total electricity rate already reflected the impact of the recent adjustments in energy taxes.

F. Financial market developments

- The Philippine Stock Exchange index (PSEi) continued to consolidate on concerns over higher inflation and interest rates while foreign investors continued to be net sellers in March. Meanwhile, the peso depreciated against the US dollar in March following recent protectionist pronouncements of US President Trump on steel imports and ahead of the conclusion of the monetary policy meetings of the US Federal Reserve (on 20-21 March) and the BSP (on 22 March).

G. Domestic liquidity and credit conditions

- Credit and liquidity conditions continued to support the appropriateness of present monetary policy settings. Domestic liquidity growth accelerated by 12.8 percent in January 2018, while bank lending growth slowed down to 19.1 percent.

- Total bids received and liquidity absorbed thru the BSP's open market operations (OMOs) and overnight deposit facility increased in March relative to the previous month, following the 1.0 percent reduction in reserve requirements (RR). Meanwhile, the IBCL rate marginally declined after the RR reduction albeit still hovering close to the policy rate.

H. Fiscal developments

- Fiscal spending remained on track as NG expenditures (excluding interest payments) increased by 12.0 percent year-on-year in 2017. The NG also recorded a fiscal deficit of ₱350.6 billion for in 2017, although slightly lower than the previous year's level due to stronger-than-programmed receipts.

I. External developments

- Global economic activity continued to strengthen in February. The JP Morgan Global All-Industry Output Index rose to 54.8 in February from 54.6 in January due to the faster expansion in new orders. Economic activity increased at faster rates in the US, the UK, Brazil, Russia, and Australia. Meanwhile, growth slowed slightly in China and Japan while India experienced a mild contraction in economic activity.

- Economic conditions in the US have seen a sustained recovery, prompting further rate hikes by the Federal Reserve. On 21 March 2018, the FOMC decided to raise the fed funds rate target by 25 bps to 1.5-1.75 percent, in view of the further strengthening of the labor market and moderate expansion in economic activity. The FOMC expressed the view that with further gradual adjustments in the monetary policy stance, economic activity would expand at a moderate pace in the medium term and labor market conditions would remain strong. Meanwhile, US inflation on a 12-month basis was expected to stabilize around the 2-percent inflation objective over the medium term.