



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY
STANCE HELD ON 20 JUNE 2018¹**

I. Monetary Policy Decision

The Monetary Board decided to:

- a) Increase the BSP's key policy interest rate by 25 basis points to 3.50 percent for the overnight RRP (borrowing) facility, effective 21 June 2018; and,
- b) Adjust the interest rates on the overnight deposit and overnight lending facilities accordingly.

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

- The Monetary Board's decision to raise the BSP's policy interest rate was based on its assessment that inflation expectations remained elevated for 2018 and that the risk of possible second-round effects from ongoing price pressures argued for follow-through monetary policy action.
 - Although inflation expectations remain within the target range for 2019, elevated expectations for 2018 highlight the risk posed by sustained price pressures on future wage and price outcomes.
 - While latest baseline forecasts have shifted lower for 2018-2019, upside risks continued to dominate the inflation outlook, even as various measures of core inflation continued to rise.
 - Moreover, the impact of international oil and commodity price movements on overall inflation is expected to be stronger given prevailing robust aggregate demand conditions.
- Given the above-cited considerations, the Monetary Board believed that further policy action would enable the BSP to reinforce its signal on safeguarding macroeconomic stability in an environment of rising commodity prices and ongoing normalization of monetary policy in advanced economies.
- The Monetary Board likewise reiterated its support for carefully coordinated efforts with other government agencies in implementing non-monetary measures to mitigate the impact of supply-side factors on inflation.

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 20 June 2018 monetary policy meeting were approved by the Monetary Board during its regular meeting held on 12 July 2018. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 9 August 2018.

III. Recent Developments and Inflation Outlook

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

A. Domestic price conditions

- Year-on-year headline inflation rose further to 4.6 percent in May from 4.5 percent in April using the 2012-based consumer price index (CPI) series. This brought the year-to-date average to 4.1 percent, which is above the Government's announced inflation target range of 3.0 percent \pm 1.0 percentage point for 2018. Indicators of broad-based price pressures such as the Philippine Statistics Authority (PSA) core inflation rate, three of five alternative measures of core inflation estimated by the BSP, and the number of above-threshold CPI items, also increased.

B. Inflation expectations

- Mean inflation forecasts from surveys of analysts remained elevated for 2018 but continued to be within target for 2019-2020. Preliminary results of the BSP's June 2018 survey of private sector economists based on the 2012-CPI series showed steady but elevated mean inflation forecasts at 4.5 percent for 2018. For 2019-2020 mean inflation forecasts were likewise both higher but within the 2-4 percent target range at 3.8 percent (from 3.7 percent in the previous survey round). Meanwhile, results of the June 2018 Consensus Economics Survey showed that respondents expect inflation to average higher at 4.4 percent in 2018 (from 4.3 percent in the May 2018 survey). For 2019, mean inflation forecast was unchanged at 3.7 percent.

C. Inflation outlook

- Compared with the previous forecast round, the latest baseline inflation forecasts for 2018 and 2019 were lower at 4.5 percent and 3.3 percent, respectively. However, the balance of risks to the baseline inflation path remained tilted toward the upside.
 - The following were deemed to be the main upside risks to inflation: additional wage adjustments and transport fare hikes due to the increase in excise taxes on petroleum products; pending petitions for adjustments in transport fares and electricity rates; faster-than-expected monetary policy normalization in advanced economies; and the proposed increase in the NFA's buying price of rice from farmers.
 - Meanwhile, slower global economic growth due to protectionist policies in advanced economies and geopolitical tensions along with potential price adjustments from the proposed reform in the rice industry involving the replacement of quantitative restrictions with tariffs and the deregulation of rice imports continue to be the main downside risks to inflation.

Baseline Inflation Forecasts		
	2012-based CPI	
	10 May 2018 MB policy meeting	20 Jun 2018 MB policy meeting
2018	4.6	4.5
2019	3.4	3.3

D. Demand conditions

- Domestic demand continued to be firm, with GDP growth in Q1 2018 at 6.8 percent. GDP growth during the first quarter was supported by increased household spending, capital formation, and public spending on the expenditure side and by the services and industry sectors on the production side. Over the next few quarters, business and consumer confidence were also seen to remain positive, as reflected in the latest results of the business and consumer expectations surveys conducted by the BSP. The Philippine composite Purchasing Managers' Index (PMI) remained above the 50-point threshold in the second quarter, indicating that firms remain in expansion mode.

E. Supply-side indicators

Developments in Agriculture

- Industry-wide rice supply conditions remained adequate with the current inventory as of end-May 2018 amounting to 90 days' consumption. At the same time, legislative discussion pointed to an increased likelihood of the passage of the proposed rice tariffication bill which could result in downward adjustment in retail market prices.

Wage Developments

- The Monetary Board noted that wage adjustments have been implemented thus far in 2018 for Regions XII, IV-A, VI, I and CARAGA. Meanwhile, wage petitions have been filed in the NCR and Regions VII, and XI where wage adjustments have reached the end of the prescribed 12-month period between wage changes.

Oil Price Developments

- Average crude oil prices continued to increase in May 2018, reaching US\$75 per barrel following the escalation of tensions in the Middle East and the release of data showing stronger global demand. Nevertheless, global crude oil prices are expected to either remain flat or rise slightly higher over the near term before gradually declining over the medium term as global supply and inventory levels continue to outpace the growth in global demand.
- The Monetary Board noted that various public transport groups have submitted fare-increase petitions to the Land Transportation Franchising and Regulatory Board (LTFRB) in reaction to the expected rise in diesel prices due to the implementation of the TRAIN Act as well as the higher cost of spare parts due to the depreciation of the peso. However, proposed government social mitigating measures such as the *Pantawid Pasada Program* were also seen to assuage further calls for fare adjustments.

Developments in the Utilities Sector

- The overall electricity rate declined in June 2018 due to lower generation and transmission charges as some power plants returned to normal operations after scheduled repairs. The lower generation charges due to higher available supply particularly from the Power Supply Agreements (PSA) offset the higher cost of power sold in the Wholesale Electricity Spot Market (WESM) and by Independent Power Producers (IPPs).

F. Financial market developments

- The Philippine Stock Exchange index (PSEi) rose in May and early June due to positive investor sentiment from strong corporate earnings, robust Q1 GDP growth, and the lower-than-expected inflation outturn in May. Nonetheless, the PSEi declined by 14.6 percent to around 7,300 as of 19 June 2018 from the end-2017 index level of about 8,600. Foreign investors were net sellers in May and early June. Meanwhile, the peso depreciated in nominal terms against the US dollar during the same period on safe-haven buying activity amid geopolitical concerns involving the US, China, North Korea and Italy.

G. Domestic liquidity and credit conditions

- Liquidity and credit growth conditions remained manageable. Domestic liquidity growth slowed down slightly to 14.2 percent while bank lending grew faster at 19.9 percent in April 2018. Meanwhile, the weighted average accepted rates in the TDF increased in May following the 25-bps hike in the BSP's policy rates. Total liquidity absorbed by the BSP nevertheless remained broadly steady in April-May in line with liquidity forecasts as banks preferred to stay liquid in preparation for the settlement of the Retail Treasury Bonds on 13 June 2018.

H. Fiscal developments

- Efforts to raise infrastructure spending provided a boost to domestic activity. The National Government's (NG) recorded a fiscal deficit of ₱105.9 billion for January – April 2018, more than triple the previous year's deficit level at ₱30.2 billion due to increased government spending.

I. External developments

- Global economic expansion improved in May based on PMI data due to stronger growth in the services sector which offset the slower growth in the manufacturing sector. Rates of expansion were faster in the US, euro area, and Australia while slower growth was observed in Japan, India and Russia. Meanwhile, the pace of economic activity moderated in China.
- The Federal Open Market Committee of the Federal Reserve decided to raise by 25 bps the target range for the federal funds rate on 13 June 2018 as inflation have moved close to 2 percent and economic activity has been rising at a solid rate. Meanwhile, on 14 June 2018, the Governing Council of the European Central Bank (ECB) decided to maintain the key ECB interest rates, although it announced the start of the unwinding of its quantitative easing program in December 2018.