HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 15 NOVEMBER 2018[1]

I. Monetary Policy Decision

The Monetary Board (MB) decided to:

a) Increase the BSP's key policy interest rate by 25 basis points to 4.75 percent for the overnight RRP (borrowing) facility, effective 16 November 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 anew was based on its assessment that the balance of risks to inflation is still weighted to the upside and inflation expectations have remained elevated. While the latest inflation forecasts show inflation settling within the 2-4 percent target band in 2019-2020, after considering the impact of the rice tariffication bill and suspension of the oil excise tax, the MB was of the view that a follow-through policy action would help anchor inflation expectations and preempt further second-round effects.

- The MB deemed it necessary to respond with proactive policy action to help temper the risks to the inflation outlook, including those emanating from the continued uncertainty in the external environment amid tighter global financial conditions and trade tensions among major economies. The MB believes that prospects for the domestic economy remain generally favorable and allow some scope for a measured adjustment in the policy rate.

- The MB continues to emphasize the need for follow-through 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 15 November 2018 monetary policy meeting were approved by the Monetary Board during its regular meeting held on ___ November 2018. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 13 December 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 held steady in October 2018 at 6.7 percent from the previous month's level using the 2012-based consumer price index (CPI) series. This brought the year-to-date average to 5.1 percent, which is above the Government's announced inflation target range of 3.0 percent ± 1.0 percentage point for 2018. Month-on-month seasonally-adjusted headline inflation decelerated further in October 2018 to 0.3 percent from 0.8 percent in the previous month, indicating that inflation momentum has started to slow down.

- Meanwhile, core inflation readings are higher in October. The number of CPI items above the 4-percent threshold and the diffusion index of price changes have likewise increased compared to that in the previous month, suggesting still broader inflation pressures.

B. Inflation expectations

- Mean inflation forecasts from surveys of private sector economists continued to show generally elevated inflation expectations for 2018-2020. Preliminary results of the BSP's November 2018 survey of private sector economists showed mean inflation forecasts at 5.4 percent for 2018 (unchanged from the October survey), 4.4 percent for 2019 (from 4.5 percent), and 3.9 percent for 2020 (unchanged from October). Based on the survey conducted by Consensus Economics in October 2018, mean inflation forecasts are higher at 5.3 percent (from 5 percent) for 2018 and 4.4 percent (from 4 percent) for 2019.

C. Inflation outlook

- Compared with the previous forecast round, the latest baseline inflation forecasts for 2018 and 2020 were slightly higher at 5.3 percent and 3.3 percent, respectively. Meanwhile, baseline inflation forecast for 2019 was lower at 3.5 percent, after considering the estimated impact of the rice tariffication bill and the suspension of the excise tax on oil.

Baseline Inflation Forecasts		
	2012-based CPI	
	27 Sep MB	15 Nov MB
2018	5.2	5.3
2019	4.3	3.5
2020	3.2	3.3

- The risks to future inflation remain on the upside in 2018 and 2019, but downside risks to the outlook are seen to dominate in 2020 due largely to the projected impact of slower global growth.

    - Additional wage adjustments and transport fare hikes, higher electricity rates, and faster-than-expected monetary policy normalization in advanced economies, and the reversion to higher tariffs on key food items are the main upside risks to inflation.
    - Meanwhile, the slower global economic growth due to protectionist policies in advanced economies and geopolitical tensions are the main downside risks to inflation.

D. Demand conditions

- GDP growth decelerated in the third quarter due to lower growth in household consumption. Although lower than the trend, the Q3 2018 GDP growth was higher than the long-run average. Meanwhile, government spending accelerated while gross fixed capital formation continued to grow at double-digit rate. In terms of contribution to growth, domestic demand moderated due weaker consumer spending while net external balance was unchanged. Meanwhile, most recent surveys show business and consumer sentiment turning less sanguine in the third quarter albeit still optimistic in the next few succeeding quarters. Nonetheless, the Philippine composite PMI remained above the 50-point expansion threshold at 55.3 in October 2018 from 54.4 in September. Aggregate demand is also expected to be supported in part by accelerated National Government (NG) spending.

E. Supply-side indicators

<u>Developments in Agriculture</u>

- Domestic rice prices decreased significantly in the provinces of Batangas, Palawan, Aklan, Bukidnon, Sarangani, and Surigao del Sur. This can be partly attributed to 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 14 November 2018, the Senate approved the rice tariffication bill on third and final reading. 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.

<u>Wage Developments</u>

- Two regions namely, the Bicol Region (Region V) and the Northern Mindanao Region (Region X) have their wage petitions approved recently. For Region V, the ₱20.00-₱30.00 increase in basic pay was granted effective 21 September 2018, to be given in two tranches. While for Region X, the ₱27.00-₱35.00 increase became effective on 1 November 2018. In NCR, the Regional Tripartite Wages and Productivity Board-NCR granted the NCR a ₱25.00 increase in basic pay and the integration of the ₱10.00 COLA into the basic pay effective 22 November 2018.

<u>Oil Price Developments</u>

- Global crude oil prices fell significantly in early November 2018 following US decision to issue waivers to majority of Iran oil consumers even as US shale oil production continued to rise. At the same time, Saudi Arabia has increased its output to ensure sufficient supply in the market. The lower demand expectations due to weaker growth outlook has also pushed crude oil prices down.

- 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 decreased in October 2018 due mainly to lower generation charge. According to Meralco, the downward adjustment in the generation cost was primarily due to decrease in generation charge of ₱0.28 per kWh from the Power Supply Agreements (PSAs).

F. Financial market developments

- The Philippine Stock Exchange index (PSEi) entered bear market territory in October 2018 on concerns over rising domestic inflation and interest rates. A less robust outlook for the Philippine economy and a decline in global equity markets also weighed heavily on the local bourse. Meanwhile, the peso further depreciated against the US dollar in October following the release of hawkish US Federal Reserve meeting minutes for its 25-26 September 2018 meeting and amid lingering US-China trade tensions as well as geopolitical concerns in Europe.

G. Domestic liquidity and credit conditions

- Credit growth slowed down while domestic liquidity expanded by single-digit rate. In September 2018, domestic liquidity growth decelerated to 9.7 percent (from 10.4 percent in August) while bank lending growth eased to 17.4 percent (from 18.9 percent). Meanwhile, market interest rates (deposit and lending rates) increased following the 150-bps cumulative hike in the BSP's key policy rate.

H. Fiscal developments

- The ongoing efforts to raise infrastructure spending provided a boost to domestic activity. The NG recorded a fiscal deficit of ₱378.2 billion for January – September 2018, which is 78 percent higher than the previous year's deficit level at ₱213.1 billion due to strong revenue collections and surge in government spending. Netting out interest payments, NG expenditures went up by 26 percent.

I. External developments

- Indicators of global economic activity continue to signal a mild expansion as business activity in accelerated in the service sector but eased slightly in the manufacturing sector. Stronger new work inflows supported economic activity in Japan and in India. Meanwhile, economic activity in the US and in the euro area slowed down due to weaker growth in new business.

- Continued policy uncertainty, spillovers from tighter global financial conditions, and geopolitical risks remain as downside risks to global growth over the medium term. The downward revision of the International Monetary Fund in its global economic growth projections reflects the surprises that suppressed economic activity in some major advanced economies in early 2018, the negative effects of the US-China trade measures implemented or approved between April and mid-September, as well as a weaker outlook for some key emerging market and developing economies arising from country-specific factors, tighter financial conditions, geopolitical tensions, and higher oil import bills.