# HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON THE MONETARY POLICY STANCE HELD ON 7 FEBRUARY 2019[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 a more manageable inflation environment 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 due to the decline in international crude oil prices and the normalization of supply conditions for key food items. Inflation expectations have also declined further and are now aligned to the inflation target for 2019-2020. At the same time, domestic demand conditions have remained firm, supported by a projected recovery in household spending and the sustained implementation of the government's infrastructure program.

- Meanwhile, the MB observed that relative to the previous meeting, the risks to the inflation outlook remain evenly balanced for 2019 while leaning toward the downside for 2020 given a more uncertain global economic environment, which is seen to temper potential upward pressures from commodity prices in the coming months.

- Given these considerations, the MB deemed the prevailing monetary policy settings as remaining to be appropriate, as previous monetary responses continue to work their way through the economy. The MB also emphasized that the BSP remains vigilant against developments that could affect the outlook for inflation and is prepared to take appropriate policy action as necessary to safeguard its 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 7 February 2019 monetary policy meeting were approved by the Monetary Board during its regular meeting held on 27 February 2019. The next meeting of the Monetary Board on the monetary policy stance is scheduled on 21 March 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 shows that inflation momentum continued to recede in January 2019. Headline inflation decelerated further for the fourth consecutive month in January to 4.4 percent (from 5.1 percent in December, 6.0 percent in November, and 6.7 percent in October and September) as both food and non-food commodities recorded slower price increases. Meanwhile, month-on-month seasonally-adjusted headline inflation registered a small positive increase at 0.1 percent in January, reversing the month-on-month contraction in November and December. This is mainly due to the annual adjustments in excise tax for alcoholic beverages from the sin tax law.

- Core inflation—which excludes selected volatile food and energy items to measure underlying price pressures— eased to 4.4 percent in January from 4.7 percent in December. Likewise, all four alternative measures of core inflation computed by the BSP pointed to moderating inflation pressures in January.

- The diffusion index of price changes and the number of CPI items above threshold were also lower in January.

### B. Inflation expectations

- Mean inflation forecasts of private analysts have reverted to within the inflation target range for 2019 and 2020. Results of the BSP's January 2019 survey of private sector economists showed declining mean inflation forecast for 2019 and 2020 at 3.8 percent and 3.6 percent, respectively, relative to the results in December 2018. Likewise, results of the January 2019 Consensus Economics survey showed a lower mean inflation forecast for 2019 at 3.9 percent from 4.3 percent in the previous survey round. Meanwhile, the mean inflation forecast for 2020 stood at 3.5 percent.

### C. Inflation outlook

- The latest inflation forecasts reaffirm the outlook that the inflation targets for 2019 and 2020 will be achieved. Average inflation is projected to revert within the target range in 2019 at 3.1 percent and in 2020 at 3.0 percent. The downward adjustment in the forecast path for 2019 can be attributed to slower domestic economic activity, lower global crude oil prices, lower-than-expected December 2018 and January 2019 inflation, and peso appreciation. Meanwhile, the inflation forecast for 2020 remains broadly unchanged.

| **Baseline Inflation Forecasts** | | |
|---|---|---|
| | 13 December 2018 MB Meeting | 7 February 2019 MB Meeting |
| 2019 | 3.2 | 3.1 |
| 2020 | 3.0 | 3.0 |

- The risks to future inflation are seen to remain evenly balanced for 2019 while downside risks to the outlook will dominate in 2020. Higher electricity rates, faster-than-expected monetary policy normalization in the US, petitions for transport fare adjustments, and the proposed additional increase in the excise taxes of alcoholic beverages are the main upside risks to inflation. Meanwhile, slower global economic growth due to protectionist policies in advanced economies and geopolitical tensions, the potential renegotiation for lower tariff rates on meat products, and the impact of the re-enacted budget of the National Government on government spending are the main downside risks to inflation.

**D. Demand conditions**

- The pace of the country's economic expansion was sustained in Q4 2018 at 6.1 percent, bringing annual GDP growth in 2018 to 6.2 percent. The Philippine economy is expected to continue to expand above its long-term growth trend in Q1 2019, supported by firm domestic demand amid the continued implementation of the government's infrastructure program. The mid-term election is also expected to provide a modest boost to economic activity in the first half of the year.

**E. Supply-side indicators**

Developments in Agriculture

- Domestic rice prices decreased due to the continued arrival of rice imports of both the government and the private sector, and increased supply during the recent harvest season.

- On 15 January 2019, the Senate transmitted the rice tariffication bill to the Office of the President for signature. The bill, which was earlier approved by the bicameral committee in November 2018, would lapse into law after 30 days and will be effective 15 days after being published. The shift to tariffication of rice imports is expected to promote lower domestic rice prices. 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.

- The National Food Authority (NFA) Council finalized and approved the guidelines for out-quota importation by the private sector, which was published on 23 November 2018. As of 18 January 2019, 174 firms/cooperatives have applied for the out-quota rice importation for a total of 1.186 million metric tons.

Oil Price Developments

- Global crude oil prices started rising past the US$60.00 per barrel level in January 2019 with the implementation of the production cut by the Organization of Petroleum Exporting Countries (OPEC). In tandem with global oil price movements and the direct impact of the second tranche of the excise reforms, domestic pump prices also increased in January. Nevertheless, international crude oil prices are expected to remain subdued due to excess global supply and muted demand.

Developments in the Utilities Sector

- The overall electricity rate decreased in January 2019 due mainly to lower generation charges contracted by parties under the Power Supply Agreements (PSAs) and those registered in the Wholesale Electricity Spot Market (WESM). Lower charges from PSAs were brought about by a reduction in capacity fees as a result of the annual reconciliation of outage allowances done at the end of the year for PSAs approved by the Energy Regulatory Commission. At the same time, charges from WESM also went down due to the improvement in the Luzon power situation.

## F. Financial market developments

- The local bourse rallied and the peso appreciated in January until the first few days of February amid improved investor sentiment following lower domestic inflation outturns for December 2018 and January 2019, as well as the US Federal Reserve's (US Fed) decision to keep policy rates steady in its first Federal Open Market Committee (FOMC) meeting in 2019. The Philippine Stock Exchange Index closed at 8,058.45 index points on 6 February 2019, 8.2 percent higher than the end-December 2018 level of 7,450.01. As of 4 February 2019, the peso appreciated against the US dollar at ₱52.41/US$1 from the end-December 2018 closing rate of ₱52.58/US$1.

## G. Domestic liquidity and credit conditions

- In December 2018, credit growth slowed down to 15.6 percent from 16.8 percent. However, domestic liquidity growth increased slightly to 9.2 percent (from 8.5 percent in November) due to the expansion in net foreign assets. Meanwhile, TDF rates as well as other market interest rates (deposit and lending rates) increased following the 175-bps cumulative hike in the BSP's key policy rate in 2018.

## H. Fiscal developments

- Strong fiscal spending is expected to support the country's growth momentum in 2019. National Government (NG) expenditure excluding interest payments increased by 27 percent in January-November 2018. Government proceeds from the oil excise tax hike that took effect starting January 2019 is also expected to help keep the fiscal program on track during the year, even as the re-enactment of the budget is expected to temporarily curtail government expenditures and disrupt procurement activities.

## I. External developments

- Global economic activity expanded at a modest pace due to subdued growth in both the manufacturing and services sectors. Economic activity in the euro area and India eased owing to weaker production and new work. Similarly, US manufacturing activity slowed down amid subdued demand.

- Potential spillovers from tighter global financial conditions, policy uncertainty, and geopolitical risks remain the key downside risks to global growth over the medium term. The downward revision of the International Monetary Fund of its global economic growth projections in January reflected the broader slowdown in global economic activity. The slowdown can be attributed to the escalation of trade tensions between the US and China along with weaker momentum in major European economies.

- The US Fed's decision to keep the Fed funds target rate unchanged along with its dovish tone during the FOMC meeting on 30 January 2019 further reinforces market expectation that the US Fed may pause in raising interest rates this year.