Nestor A Espenilla, Jr: Opening remarks for the Q2 2018 BSP Inflation Report Press Briefing

Opening remarks by Mr Nestor A Espenilla, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), for the Q2 2018 BSP Inflation Report Press Briefing, Manila, 20 July 2018.

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A pleasant morning to everyone. Welcome to the press conference on the BSP's Inflation Report for the Second Quarter of 2018. Today, we wish to discuss with you the developments and the analysis that underpinned the BSP's monetary policy decisions during the second quarter of the year. Our objective is to enable market participants and the general public to better understand the underlying developments as well as the reasoning and analysis behind the BSP's policy actions.

We begin with the global economic environment. The overall prospects for global output growth have improved since our last briefing in April, owing to faster rates of expansion in key economies. In particular, economic activity in advanced economies has gained further traction. Consequently, the unwinding of accommodative monetary policy in the US and other advanced economies will likely continue and drive capital flows away from emerging economies, including the Philippines. Meanwhile, global inflation remains elevated in Q2 2018 amid geopolitical tensions between the United States and some key oil producers. Nevertheless, plans by major producers like Saudi Arabia and Russia to boost production, coupled with higher output coming from the US, could exert downward pressure on oil prices.

In the Philippines, we continue to feel the weight of supply-side price pressures, as reflected in the uptick in the prices of certain food items and domestic petroleum products. Average headline inflation using the new 2012-based Consumer Price Index (CPI) series rose to 4.8 percent during the quarter from 3.8 percent a quarter ago, bringing the year-to-date average to 4.3 percent. This is higher than the upper end of the National Government's target range of 2-4 percent for the year. Similarly, core inflation increased to 3.8 percent in Q2 2018 higher than the quarter- and year-ago rates of 3.0 percent and 2.5 percent, respectively.

Moreover, inflation expectations of private sector economists also increased during the quarter, with analysts attributing their higher projections to volatile global oil prices, a weaker peso, and the transitory effects of recent tax measures on the prices of domestic goods and services.

Meanwhile, domestic output expansion remains robust on account of the expansion in capital formation and household consumption, as well as strong performance of the services and industry sectors. Recent high-frequency sector indicators of economic activity also continue to point to firm growth prospects in the near term.

The growth momentum was also supported by a strong and stable Philippine banking system. During the review quarter, banks' balance sheets exhibited sustained growth in assets and deposits. Furthermore, asset quality indicators remained healthy while capital adequacy ratios continued to be above international standards. Domestic liquidity also remained ample, driven by robust credit growth.

However, amid this resilience, the Philippine economy is being tested by external headwinds emanating from the recent and planned interest rate hikes by the US Fed and brewing trade tensions among key economies. These are exerting depreciation pressures on the peso. The country's current account deficit and higher inflation also dampened investor sentiment during the quarter.

These developments formed the backdrop for the BSP's policy decisions during the second quarter of 2018. In brief, the BSP raised its policy rate by 25 basis points each in May and June, bringing the overnight reverse repurchase (RRP) rate to 3.50 percent from 3.0 percent a quarter ago. The interest rates on the overnight lending and deposit facilities were likewise raised accordingly.

In deciding to hike the policy rate during the quarter, the Monetary Board noted that the increase in inflation expectations and in the risks of possible second-round effects argued for timely and decisive monetary policy actions from the BSP. Although inflation expectations remain within the target range for 2019, elevated expectations for 2018 highlighted the risk posed by sustained price pressures on future wage and price outcomes. Equally important, upside risks continued to dominate the inflation outlook, as various measures of core inflation continued to rise. Meanwhile, the BSP kept a close eye on developments in the foreign exchange market and noted their potential impact on inflation in the coming months.

The BSP believes that its monetary policy actions during the quarter signal its strong commitment to safeguard macroeconomic stability in an environment of rising commodity prices and ongoing normalization of monetary policy in advanced economies. The BSP likewise reiterates its support for carefully coordinated efforts with other government agencies in implementing non-monetary measures to help mitigate the impact of supply-side factors on inflation and social welfare.

Accordingly, the BSP will sustain its utmost vigilance. In particular, we are taking into account the potential price pressures of excessive volatility in the foreign exchange market. While we believe that our fundamentals remain solid and healthy, sustained pressures on the peso could adversely affect inflation expectations. Further, some demand side pressure may also be already feeding into inflation. All of these warrant a firm and timely monetary response. Therefore, let me say that the BSP is considering strong follow-through monetary adjustment at the next meeting of the Monetary Board in August. The pace and magnitude of policy tightening will necessarily be dependent on our comprehensive and rigorous assessment of all relevant data and forecasts. This is consistent with our long-standing disciplined approach to inflation targeting. We stand by our primary mandate of promoting price stability conducive to a balanced and sustainable growth of the economy.

In a moment, we will provide you with a more detailed discussion of the factors behind the Monetary Board's recent decisions and its assessment of price and output conditions. Also, we will have a brief discussion of the results of the BSP's latest quarterly loan officers' survey. We look forward to your questions at the end of these two presentations. Thank you and good morning.