



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON
MONETARY POLICY ISSUES HELD ON 28 JANUARY 2010¹**

I. Monetary Policy Decision

The Monetary Board decided to:

- a) Maintain the BSP's policy rates at 4.00 percent for the overnight RRP (borrowing) rate and 6.00 percent for the overnight RP (lending) rate;
- b) Maintain the current interest rates on term RRP, RPs, and SDAs;
- c) Maintain the current reserve requirement ratios; and
- d) Align the peso rediscount rate with the BSP overnight RRP rate, effective 1 February 2010.

The Monetary Board's decision was based on its view that current monetary policy settings remained appropriate as inflation forecasts continued to be within the target ranges over the policy horizon and economic recovery is expected to proceed at a gradual pace.

The Board also noted that as global credit markets continued to normalize, the risk of contagion from global financial stresses has markedly been reduced in domestic financial markets.

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

- The Monetary Board noted that the prevailing inflation outlook which continued to support the maintenance of current policy settings as inflation is expected to track a target-consistent path over the policy horizon. Emerging baseline forecasts indicate that inflation would

¹ The discussions presented reflect the assessment made by the Monetary Board based on the information available at the time of the policy meeting. The sets of economic information were provided by the technical secretariat of the Advisory Committee (AC). The Advisory Committee is composed of the Governor of the BSP as Chairman and four members, namely: the Deputy Governor of the Monetary Stability Sector, the Deputy Governor of the Supervision and Examination Sector, the Assistant Governor of the Monetary Policy Sub-Sector, and the Managing Director of the Treasury Department. The highlights of the discussions on the 28 January 2010 meeting were approved by the Monetary Board during its regular meeting held on 18 February 2010. The next meeting of the Monetary Board on monetary policy issues is scheduled on 11 March 2010.



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settle slightly above the middle of the 4.5 percent \pm 1.0 percentage point target range for 2010 and at the lower half of the 4.0 percent \pm 1.0 percentage point target range for 2011.

- Inflationary pressures are expected to remain manageable, with demand-side pressures on consumer prices expected to remain subdued over the near term given the modest improvement in domestic demand conditions and stable inflation expectations.
- Inflationary pressures over the near term are also expected to be tempered by global conditions such as adequate inventory levels and the presence of spare capacity in advanced economies. Meanwhile, some major central banks have started to signal a gradual exit from their extraordinary stimulus measures implemented earlier, and this could help reduce global inflation risks going forward.
- The Board also considered the latest assessment on the risks to the inflation outlook which points to persistence in supply-side price pressures due to:
 - possible resurgence in commodity prices in the near term given clearer prospects of recovery in the global economy in 2010,
 - presence of structural weaknesses in the oil industry,
 - tight supply in key agricultural products,
 - prevailing El Niño weather conditions, and
 - pending adjustments in domestic power charges.
- The Monetary Board also noted that domestic demand had started to pick up in Q4 2009. For the first time in 10 months, bank lending net of RRP accelerated in November 2009, reflecting in part the revival of industrial activity as exports growth turned positive in November following 13 consecutive months of contraction. Capacity utilization in the manufacturing sector rose to its highest level since November 2008 while energy sales to the industrial sector posted its highest growth since May 2008.
- The Monetary Board, however, recognized that while recent developments suggest a recovery starting in Q4 2009, there are yet no clear signs of a strong pick-up in the growth of domestic demand. For one, the growth in manufacturing activity could be the result of temporary factors such as an “inventory bounce” and stimulative government spending. With global recovery still uncertain once stimulus measures are withdrawn across countries, keeping policy rates steady remains the appropriate stance for as long as the inflation outlook allows and until there are clearer signs of a self-sustaining growth in domestic demand.



III. Recent Developments

The Monetary Board considered the following developments:

A. Domestic price conditions

- For 2009, headline inflation averaged 3.2 percent, well within the Government's target range of 2.5-4.5 percent for the year.
- December 2009 inflation was higher at 4.4 percent compared to 2.8 percent in November 2009. Inflation pressures in December 2009 were traced mainly to higher prices of petroleum products. The prices of petroleum products increased after the price caps on these items were lifted in mid-November 2009. Meat and rice prices were also higher in December 2009 as the recent weather disturbances continued to impact adversely on the supply of these products.
- Core inflation, which excludes some food and energy items to measure generalized price pressures, was higher in December 2009 at 3.2 percent from 2.7 percent in November 2009.
- Seasonally-adjusted month-on-month headline and core inflation in December 2009 were unchanged from the previous month's levels.

B. Inflation Expectations

- Surveys showed well-contained inflation expectations for 2010 and 2011.
- Results of the BSP's survey of private sector economists for December 2009 yielded a within-target but slightly higher inflation forecast for 2010. Expected inflation for 2010 increased to 4.8 percent from 4.6 percent in the previous month. For 2011, the mean inflation forecast was also slightly higher at 4.7 percent from 4.5 percent.
- Meanwhile, results of the latest Asia Pacific consensus forecasts as of January 2010 also showed within-target but slightly higher inflation for the Philippines for 2010. Respondents to the survey expect inflation for 2010 at 4.8 percent, up from 4.6 percent in December 2009. For 2011, respondents to the survey expect inflation at 4.7 percent, also within the BSP's target.



C. Inflation Outlook

- The latest baseline forecasts indicate that inflation would settle slightly above the middle of the 4.5 percent \pm 1.0 percentage point target range for 2010 and at the lower half of the 4.0 percent \pm 1.0 percentage point target range for 2011.
- The risks around the central projection for inflation lie mainly on the upside, including a stronger-than-expected world economic recovery; a possible resurgence in global commodity prices; constraints to investments in the oil and agriculture sectors; adverse weather conditions; persistence of domestic supply tightness in key agricultural sectors; and higher-than-anticipated adjustments in electricity rates.
- Downside risks to the inflation outlook include a weak economic recovery and its likely downward pull on commodity prices, and a sustained appreciation of the peso due to the weakening of other currencies and the strong inflows of foreign exchange.

D. Demand conditions

- Latest demand indicators signaled a pick-up in demand activity starting Q4 2009. Exports entered positive territory in November after 13 consecutive months of contraction. Other leading indicators mirrored this trend: capacity utilization in the manufacturing sector rose to its highest level since November 2008 while energy sales to the industrial sector posted its highest growth since May 2008. This development could indicate that the manufacturing sector has started to recover in Q4 2009. Household and government spending likewise accelerated in Q4 2009. As a result, GDP growth accelerated to 1.8 percent in Q4 from 0.4 percent in the previous quarter.

E. Supply-side indicators

Developments in Agriculture

- Agriculture, fishery and forestry (AFF) contracted by 2.8 percent in the fourth quarter, reflecting the impact of a series of tropical storms that damaged crops, livestock, poultry, and fishery. *Palay* production declined further by 13.9 percent from negative 2.2 percent in Q4 2008 and a 1.5 percent growth in the previous quarter.
- As of 15 January 2010, the country's total rice inventory is sufficient to last for 77 days. After tropical storms "Ondoy" and "Pepeng" destroyed about 1.3 MMT of paddy rice or an equivalent of 850 TMT of milled rice, the NFA has advanced its purchase program for 2010.



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- Due to the decline in the rice production in Q4 2009, rice prices increased in areas outside Metro Manila (AOMM) in most weeks of December 2009 and in the first two weeks of January 2010. Rice prices in Metro Manila (MM), however, were steady because of NFA intervention.
- Preliminary data from the Bureau of Agriculture Statistics (BAS) showed that the prices of beef products were generally stable in December, but a slight increase in prices was noted for pork and dressed chicken. This reflected some supply tightness for both products with the higher demand during the holiday season. Meanwhile, refined sugar prices generally increased, breaching the suggested price band in most trading centers, influenced by the trend in world prices.
- In the global market for cereals, Food and Agriculture Organization's (FAO) December 2009 Food Outlook forecasts world cereal production in 2009 to be 2.0 percent below the previous year's global high, and is expected to be the second largest crop on record. Most of the reduction in output was expected to come from coarse grain and rice. The decline in cereal output was largely due to smaller plantings, in response to generally lower cereal prices. It was also due to adverse weather conditions in a number of major cereal-producing countries.
- In December, international corn and wheat prices declined while rice prices increased. The uptrend in rice prices reflected strong import demand in the global market after storms destroyed crops in the Philippines, widening a shortfall in the world's biggest buyer, and after drought reduced harvests in India.
- The current El Niño episode has reached moderate strength and will likely be prevalent in the first semester of 2010.

Oil Price Developments

- Spot price of Dubai crude as well as prices in the oil futures market recovered in January 2010 on increased demand for heating oil during the prolonged winter in the US and Europe as well as positive market reaction on reports that China's demand for oil jumped by 25 percent in December 2009.
- Latest readings for the oil supply-demand balance indicate a moderate increase in crude oil prices in the near term. Noting that there is still uncertainty on the strength and durability of world economic recovery, OPEC members decided to maintain current oil production levels during their 22 December 2009 meeting in Angola.



- As of 25 January, domestic retail prices of unleaded gasoline, diesel, and kerosene posted a net increase of ₱1.62 per liter, ₱1.00 per liter, and ₱0.49 per liter, respectively.

Developments in the Utilities Sector

- The ERC approved the increase in Meralco's distribution charge in 2010. In particular, the distribution charge for residential customers consuming 200 kilowatt-hours (kwh) per month will increase by about 27.5 percent. However, the total electricity bill is not expected to increase by this magnitude as the distribution charge accounts for only about 10 percent of total electricity cost.
- As of end-2009, PSALM had bid out 43.8 percent of the National Power Corporation's (NPC) contracts with independent power producers (IPP) in the Luzon and Visayas grids. This means that PSALM is moving closer to achieving the last precondition for open access and retail competition in the Philippines which is to transfer at least 70 percent of NPC's IPP contracts to the IPP Administrators.
- Water rates in Metro Manila increased effective Q1 2010 due to the annual adjustment of basic rates, which offset the decrease in the foreign currency differential component of the water rates. On a quarter-on-quarter basis, water rates of Manila Water and Maynilad increased by 8.8 percent and 6.9 percent, respectively.

F. Financial Market Developments

Government Securities Market

- Compared to the end of December 2009, movements in the secondary market yields and term spreads as of 25 January 2010 were mixed. Most short-term yield rates declined, whereas some tenors in the middle- and long-end of the yield curve increased. Most investors turned cautious about investing long-term, given mixed signals about domestic fiscal sustainability. The uncertainty regarding the start of the BSP's tightening cycle also influenced investors' decisions.

Interest Rate Differentials

- The differential between the BSP policy rate and the US federal funds rate remained steady in December while the risk-adjusted policy interest rate differential widened in December 2009 as the risk premium declined, thereby encouraging capital inflows.



Stock Market

- The Philippine Stock Exchange Index closed 2009 higher by 63.0 percent compared to the last trading day of December 2008. On the first and second trading weeks of 2010, trading activity was strong, driven by blue chips stocks. However, on the last week of January, the stock index fell due to investors' negative reaction to reports of the Obama administration plans to limit banks' hedging activities and that China will continue to curb lending.

Foreign Exchange

- For the first half of January 2010, the peso appreciated due to massive capital reallocation to emerging market economies and Overseas Filipinos' (OF) remittance inflows. However, since the middle of January 2010, there was renewed risk aversion due to the worsening fiscal situation in Greece, the perception that China will continue to tighten monetary policy, the speculation that the global economy's recovery may be slowing, and worries on the status of the US banking system after President Obama unveiled plans to rein in trading by banks.

Global Bond and Credit Default Swap Spreads

- Debt spreads tightened in the first week of December as Dubai World began talks to restructure less than half of its debt. The significant growth in China's manufacturing sector likewise provided support for the market while higher commodity prices added to optimism that a recovery in developing economies will be sustained.

G. Domestic Liquidity and Credit Conditions

- Domestic liquidity continued to grow in November 2009, albeit at a slightly slower pace of 12.0 percent year-on-year (y-o-y) compared to 12.5 percent in October. On a monthly basis, seasonally-adjusted M3 growth decelerated to 1.1 percent in November from 1.6 percent (revised) in the previous month. The expansion in liquidity continued to be fueled by the sustained growth in net foreign assets (NFA). This can be traced to the steady growth in the NFA positions of both the BSP and the banks as the BSP continued to build up its international reserves, with strong inflows from OF remittances, while banks settled a significant portion of their foreign liabilities.
- Bank lending, net of banks' reverse repurchase (RRP) placements with the BSP, grew by 6.6 percent year-on-year, faster than the previous month's growth of 4.7 percent. Outstanding loans of commercial banks, including RRP, grew by 2.6 percent, unchanged from the growth posted in October 2009. On a month-on-month



seasonally-adjusted basis, commercial banks' lending in November increased by 0.6 percent for loans inclusive of RRPs, and by 2.0 percent for loans net of RRPs. Loans for production activities expanded year-on-year by 6.7 percent in November, higher than the 4.2 percent posted in the previous month. Meanwhile, growth in consumption loans was broadly unchanged.

- Total equity raised in the PSE reached ₱38.8 billion for 2009, higher than the previous year's level at ₱31.6 billion. The total capital raised for the first eleven months of 2009 reached only ₱10.0 billion relative to the ₱30.5 billion recorded in the comparable period in 2008. Private placements in Metro Pacific amounting to ₱27.7 billion brought the total equity raised in 2009 higher than the level reached in 2008.
- Corporate bond issuances amounted to ₱411.8 billion for 2009, significantly higher than the previous year's level at ₱117.4 billion. Non-financial corporations accounted for the bulk of the bond issues at ₱335.6 billion, which is 81.5 percent of the total corporate bonds issued in 2009.

H. Fiscal developments

- The January-November 2009 fiscal deficit reached ₱272.5 billion, more than four times higher than the ₱66.7 billion deficit in the comparable period in 2008, exceeding the ₱250 billion programmed deficit for the full year of 2009.

I. External developments

- Leading indicators in the advanced and emerging economies point to a return to growth, combined with very low global inflation rates. The global composite Purchasing Managers' Index (PMI) showed an acceleration in end-2009, reaching 53.4 in December from 51.0 in November. Nevertheless, uncertainty remains regarding the sustainability of future growth beyond the impact of the stimulus measures.