Bangko Sentral ng Pilipinas

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 5 NOVEMBER 2009[1]

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 RRPs, RPs, and SDAs; and

c) Maintain the current reserve requirement ratios.

The Monetary Board's decision took into consideration the prevailing assessment of price and output conditions over the policy horizon which continued to suggest that current monetary settings remained appropriate.

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

- The Monetary Board considered the latest outlook on inflation which continued to suggest that current monetary policy settings remain appropriate. The forecasted inflation path shifted slightly higher but was still within target. The uptick in inflation starting September was partly statistical, as base effects which contributed to low inflation readings during the earlier part of the year have started to abate. Meanwhile, initial estimates on agriculture losses resulting from the recent typhoon-related calamities were not expected to result in a significant and long-lasting deviation of the forecasted inflation path from target.

[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 5 November 2009 meeting were approved by the Monetary Board during its regular meeting held on 3 December 2009. The next meeting of the Monetary Board on monetary policy issues is scheduled on 17 December 2009.

- Demand-side pressures on consumer prices remained limited while inflation expectations remained well anchored to the target range over the policy horizon. However, compared to the balanced assessment of the inflation outlook in the previous review, the Board is of the view that the balance of risks surrounding the inflation outlook is slightly tilted to the upside as upside pressures persisted while downside pressures diminished. Upside risks to the inflation outlook included adverse weather conditions due to El Niño, possible increases in utility rates due to cost recoveries, and a delayed unwinding of large stimulus programs in advanced economies. There were also additional upside risks to the inflation outlook, including the stronger-than-earlier-expected rebound in global economic activity and unaccounted typhoon-related damages which could affect domestic food supplies. Downside risks to the projected inflation path consisted of a subdued global economic recovery, and the recent appreciation of the peso.

- With a still manageable inflation environment, the Board noted that there was sufficient latitude to balance risks to the inflation outlook against the need to preserve stimulus to economic activity. While domestic growth prospects have turned positive, global recovery was expected to be modest. Global imbalances are far from being resolved and financial markets are still in the process of deleveraging, warranting the need for authorities to maintain the current policy environment until recovery strengthens. In addition, keeping a steady hand on policy settings could support the reconstruction efforts in the wake of the recent calamities.

- The Board reiterated its support for non-monetary government measures to address supply-side risks to consumer prices. While monetary policy should not react to supply-side price shocks caused by the recent calamities, monetary authorities are mindful that such shocks could give rise to second-round price effects and feed into inflation expectations.

III. Recent Developments in Economic Indicators

The Monetary Board's decision took into account recent developments in various economic indicators:

A. Domestic price conditions

- Headline inflation increased to 1.6 percent year-on-year in October from 0.7 percent in September. Meanwhile, month-on-month headline inflation was higher at 0.6 percent in October from 0.2 percent in September. The year-to-date average of 3.2 percent is well within the target range of 2.5-4.5 percent for 2009.

- The uptick in inflation was due mainly to the markedly higher prices of fruits and vegetables owing to crop losses and delivery bottlenecks in the wake of recent weather-related calamities. Rice and meat prices were also higher year-on-year. Meanwhile, the inflation rates of services and fuel, light, and water remained negative in October.

- Core inflation, which excludes specific food and energy items to measure generalized price pressures, was slightly lower at 2.7 percent year-on-year in October from 2.8 percent in the previous month.

B. Inflation Expectations

- Recent surveys showed that inflation expectations remained generally well anchored. Relative to previous surveys, the Asia Pacific consensus forecast for October and the BSP's survey of private sector economists for September showed within-target average inflation forecasts for 2009 and 2010.

- Results of the Q3 2009 Consumer Expectations Survey (CES) showed marginally lower inflation expectations for the next 12 months, while the Q3 2009 Business Expectations Survey (BES) indicated a sharp decrease in the number of respondents expecting inflation to increase in the third quarter.

C. Inflation Outlook

- Emerging baseline inflation forecasts indicated that inflation would settle at the lower half of the 3.5 percent $\pm$ 1.0 percentage point target range for 2009 and the 4.5 percent $\pm$ 1.0 percentage point target range for 2010.

- Since the previous policy meeting, upside risks to the inflation outlook remained, such as a stronger-than-expected rebound in economic activity and its potential tightening effect on commodity supply-demand balances; adverse weather conditions due to El Niño; possible increases in utility rates due to cost recoveries; and a delayed unwinding of large stimulus programs in advanced economies. Unaccounted damages caused by the typhoons was also expected to add inflationary pressures in the near term. Meanwhile, downside risks to the projected inflation path consisted of a stalled global economic recovery and its pull on commodity prices, as well as the impact on consumer prices of the recent appreciation of the peso.

D. Demand conditions

- Latest information showed increasing signs of stabilization in economic activity. The BSP's business cycle model indicated the beginning of an economic upturn in Q3 2009, although at a modest pace. Various leading indicators also showed that economic conditions have started to improve: capacity utilization in the manufacturing sector sustained its upward trend, energy sales continued to grow, and book-to-bill ratio in August and September remained above 1.

E. Supply-side indicators

Developments in Agriculture

- As of 16 October 2009, the National Food Authority (NFA) reported that the country's total rice inventory stood at 2.29 MMT, lower than the previous month's level of 2.35 MMT but higher than the year-ago level of 2.22 MMT. The latest inventory level is sufficient to last for 65 days.

- With the government's projection that the impact of tropical storms (TS) “Ondoy” and “Pepeng” on rice stocks could be felt in early 2010, the NFA initially imported 250 thousand MT of rice on 30 October 2009, earlier than the usual December auction. The date of delivery has been tentatively set between January and April 2010.

- Rice prices were steady in Metro Manila (MM) but declined in areas outside Metro Manila (AOMM) in September 2009 and the first half of October. Generally, rice prices in the areas affected by TS “Ondoy” and “Pepeng” were stable due to the intensified rice distribution of the NFA and the implementation of the price control law by the Department of Trade and Industry. Meanwhile, the start of the harvest season accounted for the decline in the prices of commercial rice (special and ordinary) in AOMM.

- International prices of rice, corn, and wheat declined in September. Global rice prices fell on the back of sluggish demand and rescission of export restrictions while corn prices fell with the increase in stocks due to record production in the US. The reduced demand for feeds in the US following the losses in its meat and dairy industries provided further downward pressure to corn prices. Meanwhile, the continued decline in wheat prices was attributed to the rising global production which boosted inventories. In the US, the world's biggest exporter of wheat, stockpiles exceeded expectations on slack domestic demand and better-than-expected production.

- El Niño conditions now prevailed across the equatorial Pacific Ocean. The latest observations and international forecast models indicated that El Niño could strengthen and last through the first quarter of 2010.

Oil Price Developments

- Dubai crude oil prices were higher in October on improved US economic recovery prospects and falling oil inventories. The spot price of Dubai crude oil was higher by US$5.51 per barrel in October at US$73.15 per barrel from US$67.64 per barrel in September.

- Prices in the futures market also increased. The price of Brent crude oil for December 2009 deliveries rose to US$77.77 per barrel on 19 October 2009, higher by US$5.77 per barrel or 8.0 percent relative to its month-ago level of US$72.00 per barrel.

- Given signs of global economic recovery, the Organization of Petroleum Exporting Countries (OPEC) and International Energy Agency (IEA) revised upward their 2009 oil demand forecasts. Likewise, the Energy Information Administration (EIA) expected that world oil consumption will grow in the fourth quarter of 2009. OPEC, EIA, and IEA projected that demand will also increase in 2010 with most of the growth coming from emerging economies.

- In the domestic market, oil companies reduced the prices of gasoline, kerosene, and diesel on 27 October, in compliance with Executive Order No. 839. The prices of these products were reduced by ₱1.25 per liter, ₱1.50 per liter, and ₱2.00 per liter, respectively, effectively reverting to their respective price levels prior to the 20 October increase. Meanwhile, the price of LPG was unchanged from its 8 September level when it was increased by ₱0.91 per liter.

Developments in the Utilities Sector

- Retail electricity rates have declined for the past six months. Year-on-year, retail electricity rates were lower by an average of 9.3 percent in October; month-on-month, rates also declined by 1.6 percent. Meralco reported that power rates were lower in October due to lower NPC and WESM rates, stable fuel costs, and stronger peso.

F. Financial Market Developments

Government Securities Market

- Relative to their 30 September levels, the yields and term spreads (secondary market yields of GS net of overnight reverse repurchase or RRP rates) generally decreased across most tenors on 28 October. Yields decreased with the increase in bond prices, as market sentiment improved and concerns on the budget deficit eased on the back of pronouncements made by the Government, reassuring the market that there are other available financing options at its disposal.

Interest Rate and Interest Rate Differentials

- The differential between the BSP policy rate and the US federal funds rate remained steady in October 2009. With the decline in the risk premium, the risk-adjusted differential widened in September and as of 16 October 2009, potentially encouraging capital inflows.

- The cumulative 200-basis-point policy rate cut of the BSP from 18 December 2008 to 9 July 2009 appeared to have been passed on partially by banks to their borrowers. Actual bank lending rates declined by 172.3 basis points during the period 12-16 October 2009~~,~~ to reach 7.579 percent relative to ~~the~~ 9.302 percent for the period 8-12 December 2008. This implied an 86.2 percent pass-through by banks.

Stock Market

- Trading recovered from a month of sluggish activity and generally posted an uptrend in October. On 7 October 2009, the PSEi hurdled past the 2,900 resistance level. However, during the second week of October, the index movement was almost flat with slight downward bias due to investors' profit taking. This generally bearish market sentiment persisted up to the last week of October and early November as the local market tracked the movement of the US market.

Foreign Exchange

- The peso continued to strengthen as it appreciated by 2.6 percent to ₱46.86/US$ in October 2009. The peso reached a daily high of ₱46.25/US$1 on 15 October 2009, the highest level for the year, on the back of a 4 percent year-on-year expected increase in remittances for 2009 and 6 percent growth in 2010. However, towards the end of October, the peso weakened amid concerns on increasing oil prices.

Global Bond and Credit Default Swap Spreads

- Debt spreads continued to tighten (following the same trend during the previous month) on growing signs of global economic recovery fueling demand for higher yielding emerging market assets. However, investors remained mindful of the rising burden of sovereign financing, raising concerns on the sustainability of public sector finances which, in turn, could temper emerging markets' nascent recovery.

G. Domestic Liquidity and Credit Conditions

- Growth in domestic liquidity or M3 remained robust in August. M3 increased by 13.4 percent year-on-year, higher than the 12.9 percent annual growth recorded a month ago. On a monthly basis, seasonally-adjusted M3 growth accelerated to 2.6 percent from 1.5 percent in July. The sustained growth in net foreign assets (NFA), which accelerated to 29.9 percent in August from 21.7 percent in the previous month, continued to drive the expansion in domestic liquidity. This can be traced to the significant increase in the NFA position of the BSP and of other depository corporations. NFA rose as the BSP continued to build up its international reserves while banks reduced their foreign liabilities. The depreciation of the peso compared to a year ago also contributed to NFA expansion.

- Bank lending net of banks' reverse repurchase (RRP) placements with the BSP grew at a slower pace of 5.9 percent in August compared to the 8.7 percent expansion posted in the previous month. Outstanding loans of commercial banks including reverse repurchase agreements (RRPs), meanwhile, increased by 3.1 percent year-on-year to reach ₱2.1 trillion in August 2009, broadly similar to the expansion in July. On a month-on-month seasonally-adjusted basis, commercial banks' lending grew by 0.2 percent (net of RRP) and 2.1 percent (for loans inclusive of RRP) during the month. Latest data showed that loans for production activities expanded year-on-year by 5.7 percent in August, lower than the 8.1 percent growth reported in the previous month, as the expansion of lending to some productive sectors was pulled down by the contraction in other sectors led by manufacturing. Growth in consumption loans likewise moderated to 5.3 percent this month from 8.2 percent in the previous month, following the slower growth in auto loans and credit card lending, and the steeper contraction in other types of consumption loans.

- Total equity raised in the PSE reached ₱7.5 billion for the period January-September 2009, around one third of the level reached in the same period last year at ₱23.4 billion. Equity raised by both financial and non-financial corporations decreased significantly by 51.8 percent and 87.6 percent, respectively. No initial public offerings (IPOs) were recorded in the first nine months of 2009.

- Corporate bond issuance during the first nine months of 2009 was more than twice the level recorded in the comparable period in 2008. Non-financial corporations accounted for the bulk of the bond issues at ₱176.6 billion, which was 74.7 percent of the total corporate bonds issued during the period.

H. Fiscal developments

- The January-September 2009 fiscal deficit reached ₱237.5 billion, more than four times higher than the ₱53.4 billion deficit in the comparable period last year. This exceeded the ₱217.6 billion programmed deficit for the first three quarters by ₱19.9 billion. Revenue collections declined by 4.6 percent to ₱839.8 billion in Q1-Q3 2009 compared to ₱879.9 billion for the same period last year. It was also lower than the Q1-Q3 program at ₱914.2 billion. Meanwhile, the cumulative expenditures for the first nine months of 2009 amounted to ₱1,077.3 billion, 15.4 percent higher than the disbursements in the comparable period in 2008, but lower than the Q1-Q3 program at ₱1,131.8 billion. Excluding interest payments, total disbursements increased by 20.5 percent to ₱842.1 billion.

I. External developments

- Economic indicators increasingly suggested that the contraction in global economic activity is coming to an end, notably in major emerging economies as well as in a number of advanced economies. Although there was still some uncertainty with respect to the economic outlook, the consensus view was that risks to the global economic outlook were now broadly balanced. The October 2009 World Economic Outlook of the International Monetary Fund (IMF) reported that the global recession is ending and the global economy appears to be expanding again. However, global activity was expected to remain below pre-crisis levels.