Bangko Sentral ng Pilipinas

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 18 DECEMBER 2008[1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Reduce the BSP's policy rates to 5.50 percent for the overnight RRP (borrowing) rate and 7.50 percent for the overnight RP (lending) rate;

b) Reduce accordingly the current interest rates on term RRPs, RPs and SDAs; and

c) Maintain the current reserve requirement ratios.

The policy decision to keep interest rates steady was arrived at in the process of balancing the BSP's concern over price stability and its resolve to undertake policy actions that will ensure the soundness and stability of the financial system.

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

- The Monetary Board recognized that the continued expectations of a decelerating inflation path given the moderation in inflationary pressures provided latitude for monetary easing. In particular, the inflation outlook for 2009 has improved further since the last two policy meetings, as the latest baseline inflation forecasts continue to reflect a decelerating path over the next few quarters, with average inflation falling within the target range for 2010.

- The Board noted that the near-term inflation outlook is supported by the downward shift in the balance of risks following the easing of

[1] The discussions presented herein 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 for the Monetary Stability Sector, the Deputy Governor for the Supervision and Examination Sector, the Managing Director of the Monetary Policy Sub-Sector, and the Managing Director of the Treasury Department. The highlights of the discussions on the 18 December 2008 meeting were approved by the Monetary Board during its regular meeting held on 8 January 2009. The next meeting of the Monetary Board on monetary policy issues is scheduled on 29 January 2009.

commodity prices, the moderation in inflation expectations, and the expected slowdown in economic activity. Thus, with commodity prices stabilizing, the Board expects cost and wage pressures to moderate in the near-term, reducing the risks of second-round effects. Additionally, the sooner-than-expected decline in inflation to single-digit level combined with signs of restraint in household spending and bearish consumer sentiment provided authorities with greater policy flexibility.

- The Monetary Board was also of the view that a reduction in policy rates to support growth should help the country ride out the global financial turmoil. The Board expressed concern that the severe global downturn and the deeper-than-expected credit squeeze could spill over to Asian countries like the Philippines, through lower demand for exports, lower remittances, more volatile capital flows, tighter funding conditions, depressed equity prices, and deteriorating loan growth. Given the uncertainty regarding the duration and depth of the global slowdown, the easing of monetary policy could help buoy up consumer spending and assist vulnerable sectors (e.g. manufacturing, trade, finance, construction and real estate, and small and medium enterprises) by reducing borrowing costs.

- The Board believed that given all these developments, building confidence is pivotal. An easing of monetary policy would support confidence and could help prevent the tightening of domestic credit that could further depress economic activity. Preemptive steps taken earlier by the BSP to improve liquidity and enhance its distribution provided support to credit conditions and should be allowed to work their way through the system.

- An important issue discussed at length was the magnitude of the policy move, with the Board subsequently deciding on a 50-basis-point rate cut.

III. Recent Developments in Economic Indicators

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

A. Domestic price conditions

- Headline inflation dropped further in November to 9.9 percent year-on-year from 11.2 percent in October.

B. Inflation Expectations

- Recent surveys showed moderating inflation expectations.

    - The latest BES for Q4 2008 indicated that the proportion of respondents that anticipate inflation to move up in Q4 2008 had decreased.
    - Results of the latest CES for Q4 2008 showed lower inflation expectation for the next 12 months.
    - The Asia Pacific Consensus Forecasts showed declining expectations as of December 2008 relative to the previous month.
    - Results of the BSP's Q3 2008 survey of private sector economists/analysts showed higher inflation forecasts for both 2008 and 2009 but forecast curves had flattened.

C. Demand conditions

Latest data showed a moderation in demand conditions amid the global economic downturn and earlier high prices (higher fuel and food costs) which had slowed down the demand for commodities and services.

- GDP posted a modest growth of 4.6 percent in Q3 2008 compared to the growth posted in the same period last year of 7.1 percent, but was stronger than the previous quarter's (revised) growth of 4.4 percent.

- Merchandise imports increased by 2.5 percent in September 2008 compared to the month- and year-ago growth rates of 1.1 percent and 8.9 percent, respectively.

- Meanwhile, exports growth hit a seven-year low of negative 14.9 percent in October reflecting shrinking foreign demand.

- Selected demand indicators suggested some moderation in demand conditions.

    - Sales of passenger cars, trucks and buses, and commercial vehicles declined in October, with the latter posting a bigger decline relative to the previous month.

    - Energy sales decelerated in October.

    - Meanwhile, appliance sales grew significantly in September.

    - Average capacity utilization in manufacturing increased slightly.

- MISSI data registered double-digit growth in manufacturing activity in September 2008 for both the value of production index and the volume of production index.

- The increase in land and rental values has generally moderated compared to 2007.

- The unemployment rate increased.

- However, the Q4 2008 BES showed a less negative Q4 outlook with easing oil prices and expectations of stronger demand during the Christmas holidays. Q4 2008 CES results showed sustained bearish consumer sentiment, though less negative compared to the previous quarter.

D. Supply-side indicators

Developments in Agriculture

- Average retail prices of special rice were generally stable while ordinary rice prices continued to decline in the first week of December.

- International cereal prices continued to fall in the first half of December.

Oil Price Developments

- Dubai crude oil prices continued to ease in November with deepening concerns on easing demand amid the larger-than-expected slowdown in the global economy.

- Latest estimated futures prices of Dubai crude oil for 2009 continue to fall.

- Oil companies again reduced the prices of petroleum products on 12 December.

- In the transport sector, a provisional reduction in the minimum fare for jeepneys and buses nationwide was implemented on 7 and 10 November, respectively. Another round of reduction was implemented on 15 December.

Developments in the Utilities Sector

- Meralco rates were higher in November due to the increase in the cost of natural gas.

- Water rates are expected to increase effective 1 January 2009, after the Metropolitan Waterworks and Sewerage System approved the increase in the basic rate of both Maynilad and Manila Water.

E. Financial Market Developments

- Risk aversion and global economic uncertainty continued to dictate financial market sentiment.

Interest Rate and Interest Rate Differentials

- The positive differential between the BSP policy rate and the US federal funds target rate was unchanged. However, risk-adjusted differentials continued to be negative as pressures on sovereign risk spreads persisted. Meanwhile, the exceptionally low US Government debt yields and easing US interbank rates resulted in wider differentials with Philippine market interest rates. Real lending rates remained negative even with the continued decline in inflation.

Stock Market

- Stock market trading continued its downtrend in November and early December.

Foreign Exchange

- The peso depreciated further in November but strengthened in the first two weeks of December, buoyed up mainly by the strong inflow of remittances ahead of the Christmas season.

Global Bond and Credit Default Swap Spreads

- After their peak levels on 20 November, emerging market bond spreads exhibited a general tightening trend for the period 3-11 December, amid expectations that the largest US spending plan for public works in 50 years will buoy up the global economy and more infrastructure spending will boost demand for commodities exports from most developing economies.

F. Domestic Liquidity and Credit Conditions

- Domestic liquidity grew at a slightly slower pace in October, pulled down by the slower increase in net foreign assets.

- Bank lending (excluding RRPs) likewise slowed down. Meanwhile, bank lending (including RRPs) growth accelerated in October.

- The equity raised in the Philippine Stock Exchange for the period January-November 2008 was only one-third of the level reached in the same period in 2007, while bond issuances by the corporate sector grew by 33.6 percent relative to the comparable period in the previous year.

G. Fiscal developments

- The fiscal deficit was higher for January-October 2008 compared to the comparable period a year ago.

H. External developments

- The prospects for the world economy had deteriorated with remarkable speed, aggravated by a vicious cycle of asset deleveraging in the financial and banking systems and the severe strains in credit conditions:

    1. With the US economy deteriorating sharply, the US Government undertook its biggest bank rescue yet with Citigroup in November. At the same time, the Fed had been engaging aggressively in both qualitative and quantitative easing and had cut its Fed funds rate further to 0-0.25 percent on 16 December.

    2. The Euro area officially entered recession.

    3. Economic conditions have continued to worsen in Japan.

    4. A marked slowdown in Asian economies seemed likely owing to spillovers through trade and financial channels while risks to the near-term outlook were predominantly on the downside.

    5. Central banks such as US, Canada, Thailand, Taiwan, United Kingdom, Euro area and South Korea, among others, made deep cuts in policy rates.