



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON  
MONETARY POLICY ISSUES HELD ON 31 JANUARY 2008\***

The Advisory Committee<sup>1</sup> submitted the following recommendations for the consideration of the Monetary Board:

✍ Adjust the current monetary policy settings as follows:

- (a) Adjust the BSP's policy interest rates downward by 25 basis points to 5.00 percent for the overnight RRP (borrowing) rate and 7.00 percent for the overnight RP (lending) rate;
- (b) Adjust the current interest rates on term RRPs, RPs, and SDAs accordingly; and
- (c) Maintain the current reserve requirement ratios

Further easing of the monetary policy stance was recommended based on the following assessments:

- (a) A generally benign inflation path over the policy horizon;
- (b) The balance of risks to the inflation outlook has remained manageable, both on the supply and demand side;
- (c) A modest cut can help reassure financial markets that the BSP is confident of the inflation outlook, enabling the BSP to digest information on the outcome of recent moves as well as global developments; and
- (d) It will help support domestic demand in the face of a slowdown in global growth.

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\* The discussion presented herein reflects the assessment made by the Monetary Board based on the information available at the time of the policy meeting. The highlights of the discussions of the 31 January 2008 meeting were approved by the Monetary Board during its regular meeting held on 14 February 2008.

<sup>1</sup> 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 Supervision and Examination Sector, the Managing Director of the Treasury Department, and the Managing Director of the Monetary Policy Sub-sector. Effective 21 January 2008, the Director of the Department of Economic Research is no longer a member of the Advisory Committee but continues to serve as Head of the Technical Secretariat.



The Monetary Board then proceeded to review the recent developments and the key considerations in the formulation of the BSP's monetary policy stance.

## **Review of Recent Developments**

### **A. Domestic price conditions**

- ? Headline inflation increased to 3.9 percent in December from 3.2 percent in November. Inflation pressures in December were traced mainly to supply shocks, including increases in the prices of food, fuel, light and water, and energy-related services. Inflation averaged 2.8 percent for 2007, well below the 4.0-5.0 percent target range for the year and was the lowest annual average in 21 years.
- ? Core inflation, which excludes selected food and energy products, was also higher in December. The official core inflation measure published by the National Statistics Office (NSO) rose to 2.6 percent in December from 2.3 percent in November.

### **B. Demand conditions**

- ? Gross Domestic Product (GDP) increased by 6.6 percent in Q3 2007. While this was slower than the 7.1- and 7.5-percent growth posted in the first two quarters, this was faster compared to the 5.1 percent growth in the comparable period last year. GDP growth was boosted by household spending and capital investments on the expenditure side, and by the services sector from the production side.
- ? Year-to-date GDP growth was 7.1 percent, higher than the upper end of the Government's full-year growth target of 6.1-6.7 percent.
- ? A new upward phase of the business cycle has begun in Q1 2007 as validated by actual GDP growth of 7.1 percent. The upward business cycle path continued up to Q3 2007 as expected, with GDP growing by 6.6. percent, higher than the 5.1-percent growth in the same period in 2006.
- ? Based on the Balance of Payments (BOP) data, imports of goods rose by 8.7 percent year-on-year to US\$15.0 billion in Q3 2007. Although still slightly lower than the levels posted in the same quarter last year at 9.6 percent, the imports growth in Q3 2007 was higher compared to the 4.4 percent growth in the previous quarter.
- ? Total exports of goods based on the BOP increased marginally by 1.6 percent in Q3 2007 to US\$12.5 billion. This was a slowdown from the quarter- and year-ago growth of 4.8 percent and 17.1 percent,



respectively. The weak export earnings for the period can be traced to the slowdown in manufactures exports particularly of key products such as electronics and garments which account for almost 70 percent of total export revenues.

? Selected indicators of demand continued to indicate a broad strengthening trend.

✍ The latest report from Colliers showed that land values in Q3 2007 rose by 24.2 percent year-on-year for the Makati Central Business District (CBD) and 17.9 percent year-on-year for Ortigas Center.

✍ Passenger car sales grew although at a slower pace of 4.3 percent year-on-year in December, compared to the 14.8 percent growth in the same period last year and the previous month's sales growth of 9.0 percent. Year-to-date sales, likewise, went up by 7.2 percent, slightly lower than the 7.9 percent growth in the comparable period last year.

✍ Commercial vehicles sales growth accelerated by 31.3 percent year-on-year in December compared to 22.2 percent in November. Year-to-date growth of commercial vehicles also rose by 26.1 percent.

✍ The sales of trucks and buses further decreased by 11.3 percent year-on-year in December, relative to the 9.6 percent decline in the previous month, and reversing the 36.1 percent growth registered in the same period last year. Year-to-date sales rose by 13.6 percent in December, reflecting a slight slowdown from the 16.4 percent growth registered in the same period last year.

✍ Energy sales of Meralco increased although at a slower pace of 1.0 percent year-on-year in November relative to the 3.8 percent increase in the same month last year and 10.9 percent in October. Nonetheless, year-to-date energy sales rose by 5.0 percent, higher than 0.9 percent posted in the comparable period last year.

✍ Retail sales recorded significant expansion during the period January-August at ₱88.5 billion, reflecting a 40.5 percent growth against the 27.9 percent recorded in the same period of the previous year.

✍ Appliance sales increased by 13.3 percent year-on-year in December, a turnaround from the 2.9 percent decline registered in the same month last year and higher than the 12.5 percent growth in November. Sales rose by 9.7 percent in 2007, reversing the 7.3 percent decline recorded in 2006.



- ✍ Average capacity utilization in manufacturing sustained a gradual uptrend since early 2007 as it increased slightly in October to 80.5 percent from a revised rate of 80.4 percent in September, based on the NSO's Monthly Integrated Survey of Selected Industries (MISSI).
- ✍ MISSI data showed a slight improvement in manufacturing activity in October. The value of production index (VAPI) managed to grow although at a slow rate of 0.4 percent in October, up from the decline in September of 1.0 percent (revised) year-on-year. On a seasonally-adjusted basis, however, the month-on-month VAPI declined at a slower rate of 0.6 percent from a 1.8 percent decline in September. Meanwhile, the volume of production index continued to fall year-on-year in October but at a slower 1.7 percent when compared to the 2.7 percent (revised) decline in September 2007.
- ? Q4 2007 Business Expectations Survey results showed that business confidence is still high, as the confidence index (CI) rose quarter-on-quarter by more than seven index points to 48.0 percent.
- ? Q4 2007 Consumer Expectations Survey results showed consumer confidence has weakened after strengthening during the past two quarters. The nationwide CI for Q4 declined quarter-on-quarter by 10.0 index points to settle at -33.6 percent. Consumers' apprehension may have partly reflected the concerns regarding uncertainty on the orderly conduct and outcome of the *barangay* election, political noise, and threats of terrorism during the survey period (October 2007).
- ? Based on the preliminary results of the October 2007 Labor Force Survey, the unemployment rate declined to 6.3 percent in October 2007 from 7.3 percent in October 2006.
- ? The National Wage and Productivity Commission has completed the round of wage and COLA adjustments in all regions in 2007, increasing the minimum compensation of workers by an average of around 3.3 percent nationwide. Meanwhile, the proposal for the ₱125 daily wage hike for private sector employees and the Salary Standardization Law (SSL) III for government workers remained pending in Congress.



### **C. Supply-side indicators**

#### Developments in Agriculture

- ? Agriculture, fishery and forestry (AFF) output grew by 5.6 percent in Q3 2007 from 3.6 percent in the same period a year ago. Growth in AFF during the period, which accounted for 17.3 percent of total GDP, was driven by the fishery, corn and *palay* subsectors. Meanwhile, the Department of Agriculture is pushing for a concerted effort by all sectors to sustain the growth momentum of the farm sector in 2008 onwards in the face of the recent tightening in global supply and surging prices of commodities.
- ? Based on the recent equatorial Pacific sea surface temperature trends and the latest global climate forecasts, the La Niña episode of moderate strength, which started last August 2007, has persisted over the central and eastern equatorial Pacific.
- ? Meanwhile, retail prices of commercial rice increased anew in December. Special and ordinary rice prices nationwide and in areas outside Metro Manila rose due to limited stock of rice caused by rains in certain areas during the month.
- ? Effective 19 November 2007, the NFA granted an additional ₱0.50 per kilogram price increase on palay sold to the agency as La Niña incentive for individual farmers and farmer cooperatives during the agency's procurement operations until March 31, 2008. This is in line with the agency's commitment to provide better income for rice farmers and a stable supply of affordable and quality rice for consumers.
- ? Meanwhile, international rice prices have continued to strengthen since January 2007. International prices for all major cereals likewise remained high and some registered considerable gains in the October-November season from the September-August season.
- ? The prices of poultry products generally increased in December. The price of chicken increased by ₱5 - ₱10 per kilogram in December following the surge in demand during the season.

#### Oil Price Developments

- ? International spot prices were higher as of 24 January 2008 on continued geopolitical risks while futures prices fell in reaction to the recent developments in the US economy which pointed to lower global demand for oil. In the domestic scene, the Department of Energy



approved the reduction of tariff on imported oil products effective 1 February 2008; major players will cut diesel prices as a result.

- ? In the transport sector, petitions for fare increases remained pending with the Land Transportation Franchising and Regulatory Board.

## Developments in the Utilities Sector

- ? In addition to the higher generation charge passed on to consumers in January, electricity rates in Metro Manila are expected to go up over the near term. The increase will come from the Energy Regulatory Commission's (ERC) approval of Meralco's petition to recoup its under-recoveries during the period when the Automatic Generation Rate Adjustment was suspended and the implementation of Meralco's new distribution charge under the performance-based rate application. The effect of these increases on electricity costs will be slightly tempered by the ERC's final order on the 7th Incremental Currency Exchange Rate Adjustment (ICERA) which will lower the ICERA charge for Luzon starting February. For Visayas and Mindanao, ICERA charges were maintained.
- ? For water rates, the Metropolitan Waterworks and Sewerage System has approved the rate increase of Manila Water Company, Inc. starting January 2008 as a result of rate rebasing. Meanwhile, Maynilad rates were reduced as the increase in its basic charge was more than offset by the higher discount resulting from the foreign currency differential adjustment charge.

## **D. Financial Market Developments**

### Interest Rates

- ? During the 21 January 2008 auction, the average rates increased by 1.6 basis points for the 182-day T-bill while average rates for the 364-day T-bills both declined by 30.9 basis points, to reach 4.675 percent and 5.271 percent, respectively. Meanwhile, the average bid rate for the 91-day T-bill at 3.673 percent was broadly equal to 3.672 percent, the average bid rate during the 3 December 2007 auction. The Auction Committee made a full award of ₱2.0 billion and ₱3.0 billion, respectively, for the 182- and 364-day T-bills; and a partial award of ₱960.0 million for the 91-day T-bill.
- ? As of 23 January, the yields for secondary GS continued to decline and the yield curve flattened. Relative to the 28 December level, secondary rates declined across all tenors (except for the 20-year and 25-year tenors) following the 75 basis points emergency rate cut by



the US Fed and on expectations that the BSP will make a similar move.

## Stock Market

- ? The stock market performance in 2007 was generally upbeat. The average composite index surged to 3,442.9 index points in 2007, which was 42.7 percent higher than the level posted in 2006. However, trading at the Philippine Stock Exchange became volatile in the last two months of 2007 partly due to the impact of recent developments in both the international and domestic front. The market's volatility resumed in January 2008 on renewed concerns over the possibility of a US recession after reports showed the biggest drop in the US manufacturing sector after ten months of expansion coupled with an increase in the US unemployment rate. Share prices rebounded on 23 January 2008 following the US Fed's 75-basis-point emergency cut in its target for the federal funds rate on 22 January 2008.

## Foreign Exchange

- ? The peso appreciated by 3.6 percent in December 2007 to average ₱41.67/US\$1 relative to November 2007. This was sustained in 2008 when the peso reached its highest level since February 2000 on 15 January to average ₱40.52/US\$1, buoyed by strong inflows of remittances due to the holiday season. The steady stream of foreign portfolio and direct investments to the country, reflecting favorable investor sentiment, as well as export earnings also provided support to the peso.
- ? Year-to-date movements on 22 January 2008 saw the Philippine peso depreciating by 0.8 percent while the Japanese yen appreciated by 5.9 percent against the US dollar. Nonetheless, market optimism returned after an unexpected cut by 75 basis points in the US Federal Reserve's (US Fed) benchmark interest on 22 January 2008.

## Global Bond and Credit Default Spreads

- ? Debt spreads peaked over concerns of a global economic slowdown. From end-2007 to the first three weeks of January 2008, debt spreads widened with new record-high oil prices and gloomy US data. Reports showed that the price of Brent crude oil breached the historic milestone of US\$100 a barrel on 3 January while news of an increase in the US unemployment rate and the biggest drop in the US manufacturing activity in ten months increased worries that a global slowdown might be on the way.



#### **E. Domestic Liquidity and Credit Conditions**

- ? Domestic liquidity grew by 9.0 percent year-on-year in December, broadly similar to the previous month's growth of 9.1 percent. This was lower than the 22.7 percent expansion recorded during the same month a year ago. With the December growth, M3 expansion averaged 17.4 percent in 2007.
- ? Growth in outstanding loans of commercial banks, thrift banks, and rural banks (net of RRPs) grew by 6.9 percent year-on-year in November. This was higher compared to the 4.4 percent growth registered in the same month a year ago but lower than the 7.7 percent expansion posted last month. Gross of RRP placements with the BSP, bank lending growth accelerated by 7.1 percent year-on-year in November from 3.8 percent in October, as banks' placements with the BSP's reverse repurchase (RRP) facility rose
- ? Capital-raising activities by PSE-listed companies reached P89.8 billion in 2007, 57.0 percent higher than the levels reached in the previous year.
- ? As of end-November 2007, the stock of bank loans outstanding rose by ₱115.9 billion relative to the end-December 2006 level. As of 2007, issuances of equity capital and bonds by the private sector including banks totaled ₱167.8 billion. Excluding issuances by banks, the total amount of equity and bonds issued in 2007 reached ₱117.5 billion.

#### **F. Fiscal developments**

- ? The National Government's fiscal position posted a ₱54.1 billion surplus in November compared to a deficit of ₱2.1 billion for the same period last year. This brought the year-to-date (January-November) fiscal position to a surplus of ₱12.6 billion; a reversal of the ₱58.3 billion deficit in the same period last year. The surplus was due mainly to the net proceeds from the sale of PNOC-EDC amounting to ₱47.0 billion.
- ? For the first eleven months, revenue collections grew by 18.3 percent to ₱1,044.3 billion compared to ₱882.4 billion for the same period last year.





## **G. External developments**

- ? Global economic activity is expected to have moderated in 2007 and to slow down further in 2008. The IMF estimates global growth in 2007 to be at 4.9 percent, lower than the 5.0 percent growth in 2006, with mature economies (United States, Euro area, and Japan) leading the slowdown at 2.2 percent from 2.9 percent in the previous year. For 2008, the IMF projects global growth to be at 4.1 percent.
- ? Emerging markets and developing countries sustained strong domestic demand in 2007, cushioning them from the global economic slowdown. However, an export-led slowdown in global economic activity in 2008 could leave them vulnerable.
- ? Meanwhile, global energy and food price increases drove up headline inflation in developed as well as emerging market economies in recent months.
- ? During their unscheduled meeting in January, the Federal Reserve made an emergency move to cut the target for the federal funds rate by 75 basis points, making it the first emergency rate reduction since 2001. The target for the federal funds rate now stands at 3.5 percent from 4.25 percent. The move came as stock markets worldwide from Asia to Europe experienced steep declines on fears of an imminent US recession.

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

- ? The Monetary Board considered the continuing benign inflation outlook across a range of possible scenarios. Inflation is expected to remain within target in 2008 and 2009 and could support another modest cut in policy rates for the January policy meeting. Current forecasts indicate that in the absence of unforeseen shocks, average inflation would remain within the 4.0 percent  $\pm$  1.0 percentage point target for 2008 on average and settle within the 3.5  $\pm$  1.0 percentage point target for 2009.
- ? Given the benign inflation outlook, a modest reduction in policy rates will help support domestic demand should global growth slow down. Demand indicators continue to show modest strengthening, indicating limited price pressures going forward. Inflation expectations remain well anchored and liquidity growth has been decelerating for the last seven months up to November. Core inflation, a measure of the underlying trend in consumer prices, remained lower than headline inflation in December.



- ? The Monetary Board noted that the volatility in world oil prices and higher commodity prices remain the key risks to the inflation outlook. The firm peso, however, is expected to temper the impact of higher import costs on domestic prices. Slower economic activity in the US as well as globally could also moderate price pressures coming from imported oil and food. In addition, the reduction of the oil import tariff effective February is expected to reduce pump prices of petroleum products.
- ? The monetary authorities remain steadfast in their commitment to maintain price stability and will continue to closely monitor evolving monetary and financial conditions, particularly the risks associated with the inflation outlook and potential second-round effects on domestic prices.

### **III. Monetary Policy Decision**

- ? After considering the balance of risks to the inflation outlook and the evidence that has become available since its previous meeting on monetary policy, the Monetary Board approved the recommendations of the Advisory Committee.

The next meeting of the Monetary Board on the monetary policy stance is scheduled on 13 March 2008.