



HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 13 MARCH 2008*

The Advisory Committee¹ submitted the following recommendations for the consideration of the Monetary Board:

- Maintain the current monetary policy settings as follows:
 - (a) Maintain the BSP's policy interest rates at 5.0 percent for the overnight RRP (borrowing) rate and 7.0 percent for the overnight RP (lending) rate;
 - (b) Maintain the current interest rates on term RRPs and RPs; and
 - (c) Maintain the current reserve requirement ratios.
- Effect the following refinements in the SDA facility:
 - (a) Reduce the number of tenors offered by closing the two-, three-, and six-month tenors; and
 - (b) Reduce the interest rates on the remaining tenors as follows:

Tenors	From (In percent)	To (In percent)
One Week	5.09375	5.0625
Two Weeks	5.18750	5.1250
One Month	5.25000	5.1875

- Implement non-monetary measures, particularly closer coordination with the concerned government agencies involved in monitoring prices and ensuring adequate supply of commodities.

* 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 13 March 2008 meeting were approved by the Monetary Board during its regular meeting held on 27 March 2008.

¹ 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 continues to serve as Head of the Technical Secretariat for the Advisory Committee, but is no longer a member of the Advisory Committee.



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The recommendation to keep monetary policy settings unchanged was based on the following assessments:

- (a) Given the lag in the impact of monetary policy action on the real economy, a steady monetary policy stance now would be in response to the within-target inflation outlook for 2009.
- (b) The inflation pressures are mostly emanating from external supply shocks. On balance, the risks to the inflation outlook are manageable as there are also mitigating factors, such as the relative firmness of the peso, the slowdown in the US economy and the oil import tariff reduction scheme.
- (c) The upside risks to inflation suggest that the best approach would be to wait until more information on the factors affecting domestic inflation becomes available and in the meantime, allow enough time for previous easing moves to work their way through the real sector.

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 rose to 5.4 percent year-on-year in February from 4.9 percent in January 2008, bringing the year-to-date average to 5.1 percent. Except for fuel, light, and water, all major commodity groups registered higher inflation rates relative to the previous month.
- Core inflation, which measures the underlying trend in inflation by excluding specific food and energy items, was also higher in February. The official core inflation measure published by the National Statistics Office (NSO) climbed to 4.0 percent in February from 3.4 percent in January.
- It was noted that inflation is on the rise not only in the Philippines but also in other countries (China, Indonesia, Thailand, Korea, South Africa, Brazil, and Chile) due largely to the rise in energy and food prices.

B. Demand conditions

- Gross Domestic Product (GDP) increased by 7.4 percent in Q4 2007, sustaining the third quarter's revised growth rate and exceeding the 5.5 percent expansion posted in the comparable period last year. GDP growth was boosted by household spending and capital investments



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on the expenditure side, and by the services sector from the production side.

- Full-year GDP growth for 2007 was 7.3 percent, higher than the upper end of the Government's full-year growth target of 6.1-6.7 percent.
- For Q1 2008, the business cycle path remained broadly steady, indicating a continuing expansion phase.
- NSO data showed that merchandise imports continued to accelerate year-on-year for the fourth consecutive month in December 2007, registering a 19.7 percent increase. Merchandise exports likewise grew by 21.3 percent year-on-year in the same month.
- Selected indicators of demand indicated a broad strengthening trend.
 - Based on estimates from Colliers International Research, land values in Q4 2007 rose by 30.3 percent year-on-year for the Makati central business district and 20.9 percent year-on-year for the Ortigas Center.
 - Passenger car sales also expanded although at a slower pace of 4.3 percent year-on-year in December 2007, compared to the 14.8 percent increase in the same period last year.
 - Commercial vehicles sales growth accelerated by 31.3 percent year-on-year in December compared to 22.2 percent in November.
 - The sales of trucks and buses decreased by 11.3 percent year-on-year in December, a reversal of the 36.1 percent growth registered in the same period last year.
 - Energy sales of Meralco increased marginally by 0.1 percent year-on-year in December, a slowdown from the month- and year-ago growths of 1.0 percent and 3.6 percent, respectively. Year-to-date energy sales were up by 4.6 percent in 2007 from the 1.1 percent growth in 2006.
 - Retail sales for November 2007 nearly doubled to ₱16.4 billion, compared to the ₱8.5 billion average monthly sales posted in the comparable month of the previous year. Data is based on the sales of top ten taxpayers in retail trade for the period January to November 2007.
 - 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.



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- Average capacity utilization in manufacturing increased to 80.7 percent in December 2007 from 80.5 percent (revised) in October and November 2007 based on the NSO's Monthly Integrated Survey of Selected Industries (MISSI).
- MISSI data also showed a modest improvement in manufacturing activity in December as the value of production index (VAPI) and volume of production index (VOPI) became less negative.
- The Q1 2008 overall business confidence index (CI) remained positive at 29.9 percent as respondent firms with a positive outlook continued to outnumber those with a negative outlook. This index, however, was lower compared to the levels in the previous quarter and a year ago by 18.1 index points and 15.0 index points, respectively.
- The Q1 2008 CES results showed improved consumer confidence after the downturn in the past quarter. The nationwide consumer index (CI) for the first quarter of 2008 increased quarter-on-quarter by 6.5 index points to -27.1 percent.
- 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 cost of living 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 III for government workers remained pending in Congress.

C. Supply-side indicators

Developments in Agriculture

- Latest data from the National Statistical Coordination Board showed that agriculture, fishery and forestry (AFF) output grew by 5.8 percent in Q4 2007 from 1.7 percent in the same period a year ago. AFF accounted for 18.3 percent of total GDP and contributed 1.2 percentage points to total GDP growth. The main growth drivers were palay, corn, fishery, and other crops subsectors.
- Meanwhile, the Department of Agriculture is carrying out "oil price-cushioning" programs not only to mitigate the adverse impact of



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surging crude oil prices on consumers but also to perk up farm productivity that will, in turn, improve rural income.

- Recent equatorial Pacific sea surface temperature trends and model forecasts indicate that La Niña conditions will continue up to March-May. However, half of these forecasts show a possibility that the La Niña episode would persist up to June-August.
- Latest data from NFA indicate that as of 29 February, the country's total rice inventory at 1.9 million metric tons (MT) is roughly the same as the previous month's level but higher than the previous year's level at 1.8 million MT.
- Retail prices of commercial rice continued to increase in January 2008. Special and ordinary rice prices nationwide and in areas outside Metro Manila rose as a result of reduced supply coming from the major producing regions following the end of the harvest season.
- World rice prices sustained an upward trend (since January 2007) as the new supplies harvested during the last quarter of 2007 by several major producing countries had already been committed for sale.

Oil Price Developments

- International spot and futures prices were higher in February and early March due to lingering geopolitical concerns and speculation of declining OPEC output ahead of its 5 March 2008 meeting. In the domestic scene, the oil import tariff was increased to two percent effective 1 March, from one percent in the previous month. Meanwhile, pump prices of some petroleum products increased anew on 8 March 2008.
- In the transport sector, petitions for fare increases remained pending with the Land Transportation Franchising and Regulatory Board.

Developments in the Utilities Sector

- National Power Corporation (NPC) rates were higher beginning January, reverting to its dry-season rates. In addition, the Energy Regulatory Commission's final order on the 8th Generation Rate Adjustment Mechanism increased NPC's effective rates starting January 2008.
- However, despite the hike in NPC rates, the electricity rate for final consumers in Metro Manila was still lower by 27 centavos in February due to lower prices in the Wholesale Electricity Spot Market (WESM).



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- For water rates, the Metropolitan Waterworks and Sewerage System (MWSS) has approved the proposed rate increase of Manila Water Company, Inc. starting January 2008 as a result of the rate rebasing mechanism. Meanwhile, the Maynilad rates were reduced.

D. Financial Market Developments

Interest Rates

- During the 18 February 2008 auction, the Bureau of the Treasury (BTr) rejected all bids for ₱6.5 billion worth of Treasury bills due to high bid rates. The Government was able to reject the bids because of its stable cash position.
- Relative to their 31 January levels, secondary market yields of GS on 3 March generally increased across all tenors, reflecting concerns over the financial market uncertainties, the weak performance of the US economy, the high domestic inflation outturn for January and February 2008, and the ongoing Senate investigation of the ZTE broadband deal.

Stock Market

- Lackluster trading at the local bourse which started in December 2007 continued in January to early March 2008 on the possibility of a sharper-than-expected US economic slowdown. In January, the Philippine Stock Exchange Index (PSEi) closed 9.8 percent lower compared to the previous month's level to reach 3,266.0 index points. In February, the PSEi dropped month-on-month by 4.3 percent to close at 3,130 index points. During the first week of March, the PSEi declined and closed at 3,080 index points.

Foreign Exchange

- The peso appreciated by 0.6 percent in February 2008 to average ₱40.67/US\$1 relative to its January 2008 level. Furthermore, the peso reached an eight-year high on 28 February to average ₱40.36/US\$1, supported by the sustained inflows of remittances and improved investor sentiment after Moody's Investors Service upgraded its credit outlook for the Philippines. However, market uncertainty rose in February amid the turbulence in the global market and the political noise during the month.
- On a year-to-date basis, a majority of Asian currencies remained firm against the US dollar as of 11 March 2008, led by the Japanese yen's



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9.9 percent gain, while some currencies depreciated, including the Thailand baht (offshore), Indian rupee and Korean won.

Global Bond and Credit Default Spreads

- Debt spreads reached new peaks amid growing financial sector strains. From end-January 2008, debt spreads widened to their highest levels during the year as the market digested the recent economic developments in the US along with the developments in domestic political scene.
- Philippine credit default swap (CDS) spreads widened to 258 basis points on 10 March from the end-January level of 210 basis points. The EMBI+ Philippine spreads mirrored the trend, widening to 279 basis points from 252 basis points during the same period.

E. Domestic Liquidity and Credit Conditions

- Domestic liquidity or M3 grew by 7.2 percent year-on-year in January, a slowdown from the previous month's 9.0 percent. The steady rise in net foreign assets of depository corporations continued to drive the expansion in domestic liquidity.
- Outstanding loans of commercial banks, thrift banks, and rural banks (excluding reverse repurchase or RRP) expanded by 7.8 percent year-on-year in December 2007, from the year-ago and month-ago growth of 6.3 percent and 6.9 percent, respectively.
- Bank lending, gross of banks' RRP placements with the BSP, increased by 9.2 percent year-on-year in December from 7.5 percent in November. This, however, was lower than the 11.2 percent expansion in the same month of 2006.
- Corporate bond issuances surged during the first two months of 2008. Meanwhile, capital-raising activity in the PSE was lower in January 2008 relative to the same period last year. Total equity raised in the PSE reached ₱5.7 billion for the past two months of 2008, ₱5.1 billion lower than the level in the same period in 2007.
- Meanwhile, issuances of equity capital and bonds by the private sector including banks totaled ₱167.8 billion in 2007. 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 (NG) fiscal position posted a deficit of ₱22 billion in December, bringing the full-year deficit to only ₱9.4 billion, an overperformance of ₱53.6 billion compared to the programmed level. The fiscal deficit was also ₱55.4 billion lower than last year's ₱64.8 billion. The favorable fiscal performance can be attributed to the ₱15.9 billion excess revenues due to privatization and lower-than-expected expenditures.
- For the full year of 2007, revenue collections amounted to ₱1,134.6 billion, higher than the comparable figure in 2006 by ₱155.0 billion.

G. External developments

- Simultaneous deterioration in the real and financial sectors characterized the global economy in the first two months of 2008.
- The synchronized falls in the global financial market in January indicated that financial markets consider the global economy as still firmly "coupled." This implies that emerging markets and developing countries, which sustained strong growth in 2007, remain vulnerable to an export-led slowdown, which could have multiplier effects on domestic demand.
- However, a US recession and a global slowdown may be softened by the policy actions of major central banks combined with strong fundamentals. Further downside risks are expected to stem from additional price increases in oil and other commodities.
- During its scheduled 30 January meeting, the Federal Open Market Committee decided to lower further its target for the federal funds rate by 50 basis points to 3 percent. The Bank of England reduced its Official Bank Rate by 25 basis points to 5.25 percent on 7 February 2008, on deteriorating prospects for output growth and continuing disruptions in the global financial markets. Meanwhile, the European Central Bank and the Bank of Japan maintained their key policy rates on concerns over rising inflationary pressures.



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

- The Monetary Board noted that the outlook for inflation provides a strong case to keep monetary policy settings steady.
- The Monetary Board observed that the outlook for inflation in 2008 is influenced by elevated prices of global food and energy products, which could be largely transitory. Since the key risks to the outlook for the remainder of the year are linked to imported oil and non-oil commodity prices, these risks cannot be effectively addressed by monetary policy.
- The supply-side developments are best addressed by non-monetary measures. These include keeping a close watch on the trends in the global commodities market, coordinating closely with concerned government agencies involved in monitoring prices and ensuring the adequate supply of commodities, and communicating carefully the inflation outlook.
- The Monetary Board noted that the emerging inflation outlook for 2009 is consistent with the 3.5 percent (± 1 percentage point) target for that year, even as external supply shocks pose risks to the 4 percent (± 1 percentage point) target for 2008. Given the lag in the impact of monetary policy, any policy move at this time is expected to affect the inflation outcome for 2009.

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 24 April 2008.