



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON
MONETARY POLICY ISSUES HELD ON 6 APRIL 2006***

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

- 1) Maintain the current monetary policy settings as follows:
 - (a) Maintain the BSP's policy interest rates at 7.5 percent for the overnight RRP (borrowing) rate and 9.75 percent for the overnight RP (lending) rate; and
 - (b) Maintain the current interest rates on term RRP, RP, and SDAs.
- 2) Maintain the current reserve requirement ratios;
- 3) Continue to articulate the BSP's support for the Government's use of non-monetary measures to address supply-side risks to basic commodity prices and continue representation and coordination with concerned government agencies for this purpose; and
- 4) Emphasize the short-term nature of the impact of the RVAT on prices in the BSP's policy pronouncements on the stance of monetary policy.

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

The Advisory Committee's recommendations were based on the following considerations:

- 2) Headline inflation was unchanged at 7.6 percent year-on-year in March, as lower inflation for services and steady inflation for clothing and food, beverages and tobacco (FBT) offset higher inflation for housing and repairs, fuel, light and water (FLW) and miscellaneous items. Average headline inflation for the first quarter of 2006 settled at 7.3 percent.

* The arguments and information presented herein were the ones prevailing at the time of the Monetary Board decision on 6 April 2006. The highlights of the discussions of the 6 April 2006 meeting were approved by the Monetary Board during its meeting held on 4 May 2006.

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 Director of the Department of Economic Research.



Meanwhile, year-on-year core inflation rose for the second consecutive month in March, bringing the year-to-date core inflation to 6.1 percent

- ? The international spot price of crude oil declined in March as the winter season ended. However, futures prices rose on expectations of higher demand for gasoline and other transport fuel for the summer season in the US, Europe and Asia. Domestic pump prices of petroleum products saw mixed trends: gasoline and LPG prices fell while diesel and kerosene rose in March.
- ? Latest turnouts for selected indicators indicate soft demand conditions
 - ✍ Production indices generally showed a decline in manufacturing output. Average capacity utilization in manufacturing in January 2006 declined slightly to 80.2 percent from 80.4 percent in the previous month. The volume of production index (VOPI) for manufacturing posted a year-on-year decline of 2.8 percent in January compared to 0.1 percent in the previous month. Meanwhile, the value of production index (VAPI) increased by 16.1 percent year-on-year, higher than the previous month's 12.8 percent.
 - ✍ Growth in total energy sales by the Manila Electric Company (Meralco) fell to 1.1 percent year-on-year in January from 4.0 percent in the previous month. This was due to reduced consumption by residential users and the slowdown in commercial and industrial demand for power.
 - ✍ Passenger car sales registered a 15.6 percent year-on-year decline in February 2006 based on data from the Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI). This was a reversal of the 16.7 percent growth in January. According to CAMPI and the Truck Manufacturers Association (TMA), the early months of the year are historically sluggish months for the industry.
 - ✍ Appliance sales continued to fall, registering a 17.4 percent decline in volume in January 2006. On a month-on-month basis, appliance sales posted a 9.4 percent growth, reversing the 35.4 percent decrease in December 2005.
 - ✍ Total merchandise export earnings declined by 0.9 percent year-on-year in January 2006 due mainly to the decline in manufactures. This was a reversal of the 16.8 percent expansion in the previous month.
 - ✍ Total merchandise imports rose by 5.1 percent year-on-year in January 2006, a deceleration from the revised growth of 28.9 percent in the previous month. Payments for electronic products, which comprised 42.9 percent of the total import bill, declined by 7.9 percent.



- ✍ Unemployment rose slightly in January 2006 to 10.7 percent from 10.3 percent in October 2005 but was lower than the year-ago figure of 11.3 percent, based on the old National Statistics Office (NSO) definition of unemployment. Based on the new definition of unemployment, the jobless rate also increased to 8.1 percent in January from 7.4 percent in October.²
- ✍ The latest Consumer Expectations Survey (CES) and Business Expectations Survey (BES) of the BSP showed improving optimism for the first and second quarters of 2006.
- ? Based on the latest available data for the fourth quarter of 2005, agricultural output grew by 4.0 percent in real terms, the highest rate recorded in the past five quarters. For 2005, the agriculture sector expanded by 2.0 percent, lower than the previous year's 4.9 percent.
- ? Growth in domestic liquidity and bank lending rose based on latest available data. Treasury bill (T-bill) auction rates were generally lower.
- ✍ Domestic liquidity grew at a faster pace of 9.4 percent year-on-year in February from 8.4 percent in the previous month, based on data from the BSP's Depository Corporations Survey (DCS).³
- ✍ Outstanding loans of commercial banks (KBs) grew by 3.0 percent year-on-year in January 2006 compared to a 0.9 percent rise in the previous month. Banks' lending activities were channeled to the following sectors: financial institutions, real estate and business services (FIREBS) community, social and personal services, agriculture, fisheries and forestry sector.
- ✍ Relative to the 27 February 2006 auction, the T-bill rate eased across all tenors on 3 April 2006 due to improving fiscal outlook. Relative to the 27 March 2006 auction, T-bill rate for the 91-day tenor rose slightly by 1.5 basis points, while that for the 182-day and 364-day tenors eased by 19.4 basis points and 26.0 basis points.
- ? The peso continued to gain against the US dollar due to growing investors' confidence. The peso was also supported by strong dollar

² Beginning in April 2005, a new Labor Force Survey (LFS) questionnaire was used to estimate the number of unemployed, which includes all persons who are 15 years old and over as of their last birthday and are reported as: (1) without work and currently available for work and seeking work; or (2) without work and currently available for work but not seeking work for the following reasons: (a) tired/believed no work available; (b) awaiting results of previous job application; (c) temporary illness/disability; (d) bad weather; and (e) waiting for rehire/job recall. The old definition of unemployment did not consider the availability criterion.

³ M3 refers to the stock of broad money based on data on the Depository Corporations Survey (DCS). The DCS, which replaced the Monetary Survey (MS) as the basis for measuring domestic liquidity, features an expanded list of surveyed institutions that includes the BSP, commercial banks, thrift banks, rural banks, non-stock savings and loan associations and non-banks with quasi-banking functions.



inflows from portfolio investments, OFW remittances due to school graduation season, the appreciation of regional currencies against the US dollar, and foreign direct investments.

- ? The NG posted a ₱25-billion fiscal deficit in February 2006, ₱2.2 billion below the programmed ceiling of ₱27.2 billion and 6.0 percent lower than the fiscal deficit for the comparable month in 2005. Revenues grew by 32 percent to reach ₱64.3 billion, while expenditures rose by 23.5 percent to ₱89.2 billion. For the first two months of 2006, the NG fiscal deficit stood at ₱48.1 billion or ₱7.7 billion below the program level.
- ? Global economic growth continued despite higher oil prices and various natural disasters over the past year. The United States continued to lead the global expansion amid the economic slowdown in the fourth quarter of 2005, while economic activity in emerging market economies remained strong. The solid performance of the services sector underpinned growth in most economies while a brisk pick-up of manufacturing activity was seen starting mid-2005. Sustained gains in labor market conditions and steady improvements in business and consumer confidence have aided the rebound in domestic demand. While short-term price movements appear to be dominated by developments in global oil prices, inflationary pressures continue to be modest and inflation expectations remain generally well-contained.
- ? Except for the Bank of England which voted to keep the key repo rate at its current level of 4.50 percent during its 8-9 March 2006 Monetary Policy Committee meeting, monetary authorities in major central banks in the world opted to tighten their monetary settings. The US Federal Open Market Committee (FOMC) raised the federal funds target rate by 25 basis points for the fifteenth time since June 2004 to 4.75 percent. The European Central Bank voted to raise the minimum bid rate of the main refinancing operations by 25 basis points to 2.50 percent to help ensure that medium to long-term inflation expectations in the Euro Area remain solidly anchored at levels consistent with price stability. In its March monetary policy meeting, the Bank of Japan (BOJ) decided to change its operating target of money market operations to the uncollateralized overnight call rate, which the BOJ will encourage to remain at zero percent.

II. Review of the Monetary Policy Stance

- ? Members of the Monetary Board agreed that prevailing conditions for prices continue to provide room for the BSP to keep policy rates steady in the near term. In particular, they noted that the recent easing in oil prices and continued stability of the peso should help keep inflation pressures in check. Demand and credit indicators continue to suggest softness, while



liquidity growth has stabilized to single-digit levels. Inflation expectations on the whole appear to remain stable.

- ? The Monetary Board also noted that the outlook for inflation continues to support keeping policy rates steady. The RVAT rate increase in February appears to have caused mainly one-time increases in prices, and sustained pressures do not appear to be a likely prospect. The March inflation rate was within the BSP's forecast range for the month, and was thus consistent with the projected path for inflation. The BSP's projected path for inflation suggests a deceleration in the second half of 2006 as cost-side pressures subside, and a reversion to the inflation target of 4-5 percent by 2007.
- ? Nevertheless, monetary authorities remain alert to the potential sources of additional inflation pressures. Oil market futures data, for example, continue to suggest an outlook of volatile oil prices over the policy horizon, given that expectations of tight global supply remain. Pending adjustments in domestic power transmission charges could also lead to increases in retail energy costs. The continued strength of the peso also increases the potential risk of a disorderly adjustment in the event of a reversal in market sentiment, and authorities thus remain alert to signs of renewed exchange market pressure.
- ? Under these conditions, the Monetary Board agreed that the BSP should remain strongly committed to achieving the inflation target for 2007 and addressing the risks to future inflation. In particular, authorities will monitor closely for potential second-round effects in wage- and price-setting and for indications of any adverse shift in inflation expectations. The Monetary Board will continue to assess thoroughly the conditions for prices, aggregate demand, domestic liquidity and other factors in order to determine the appropriate stance of monetary policy.

III. Monetary Policy Decision

- ? Upon assessment of the balance of risks to inflation and the evidence that has become available since its previous meeting on monetary policy, the Monetary Board unanimously approved the following measures:
 - 1) Maintain the current monetary policy settings as follows:
 - (a) Maintain the BSP's policy interest rates at 7.5 percent for the overnight RRP (borrowing) rate and 9.75 percent for the overnight RP (lending) rate; and
 - (b) Maintain the current interest rates on term RRPs, RPs, and SDAs.



- 2) Maintain the current reserve requirement ratios;
- 3) Continue to articulate the BSP's support for the use of non-monetary measures to address supply-side risks, particularly those relating to food supply, energy conservation, and the development of alternative energy sources, by strengthening representation and coordination with various government agencies; and
- 4) Increase the focus of the BSP's public information campaign on the dynamics and sources of price pressures in order to help guide the public's inflationary expectations. Official policy pronouncements concerning the stance of monetary policy will also emphasize the short-term nature of the impact of the RVAT on prices.

The next meeting of the Monetary Board to discuss the monetary policy setting is scheduled on 4 May 2006.

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