Bangko Sentral ng Pilipinas

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 20 NOVEMBER 2003*

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

The Advisory Committee[1] submitted for the consideration of the Monetary Board the following recommendations: (1) maintain the BSP's policy rates at the current levels of 6.75 percent for the overnight reverse repurchase (RRP) rate and 9.0 percent for the overnight repurchase (RP) rate; (2) maintain the current interest rates on the term RRPs, RPs, and Special Deposit Account (SDAs); and (3) maintain the current reserve requirement ratios given the adequate level of liquidity in the system.

These recommendations were based on the following considerations:

- Domestic price conditions have remained benign as headline CPI inflation fell in line with forecasts for October while core inflation estimates continued to be relatively low. Year-on-year headline inflation rose to 3.1 percent in October from 2.9 percent in the previous month. This was within the BSP's inflation forecast of 2.9-3.2 percent for the month. Meanwhile, estimates of core inflation registered marginal increases during the month but remained relatively low. The BSP's main measure of core inflation (CPI less food and energy) was unchanged at 3.5 percent year-on-year in October 2003.

- The outlook for headline inflation remains unchanged. Expectations of subdued inflation continue to be supported by subdued improvements in aggregate demand, soft labor market conditions, the diminished influence of cost-push factors such as energy prices, and broadly stable conditions

* The highlights of the discussions of the 20 November 2003 Monetary Board meeting were approved by the Monetary Board during its meeting held on 18 December 2003.

[1] The Advisory Committee is composed of the Governor of the BSP as Chairman and four members, namely the Deputy Governor for the Banking Services Sector, Research and Treasury, the Deputy Governor for Supervision and Examination Sector, the Managing Director, In-Charge of Research and the Director of the Treasury Department. The 20 November 2003 meeting of the Monetary Board—the 12th meeting for the year to discuss monetary policy issues—followed the Advisory Committee meeting held on 17 November 2003.

in the foreign exchange market. The average annual inflation for 2004 is expected to track broadly the 4-5 percent target.

- The pace and strength of domestic economic activity have shown improvement but remained uneven across indicators. The overall strength of aggregate demand is still moderate. These conditions underpin the Monetary Board's view of generally manageable demand-side price pressures over the near term.

  - Production in the manufacturing sector improved in August 2003 as the growth in the volume of production index (VOPI) accelerated to 7.0 percent year-on-year in August from 4.5 percent in the previous month. Meanwhile, the increase in the value of production index (VAPI) slowed down to 11.9 percent year-on-year in August from 13.1 percent in July.

  - Average capacity utilization of the manufacturing sector was registered at 78.6 percent in August, a slight decline compared to July's reading of 78.8 percent.

  - Demand for Philippine exports rose in September. Earnings from merchandise exports in September 2003 grew by 2.3 percent to $3.264 billion from $3.191 billion during the same month a year earlier. This marked a reversal from the 2.1 percent (revised) decline registered in August.

  - Car sales increased sharply by 81.9 percent year-on-year to 3,170 units in October, a turnaround from the 2.7 percent year-on-year contraction recorded in the previous month. Car sales performance in October was also about twice the sales volume recorded in September at 1,703 units.

  - Power sales by Meralco slowed down to 0.4 percent year-on-year in September following a 6.7 percent annual rise in the August.

- Meanwhile, conditions in the food and energy sectors pointed to generally favorable supply-side influences on prices, going forward. The outlook for food prices remained positive given the continued favorable performance of the agricultural sector. This should help offset any possible rise in utility rates.

  - Agricultural production grew by 2.9 percent in the first nine months of the year, drawing mainly from the robust rebound in the crops sector in the third quarter. The strong performance in palay production in the third quarter augured well for the outlook of the overall agricultural output in 2003. Combined with continued government support, expectations of favorable farm output should help keep food prices relatively stable in the near-term.

- The international price of crude increased slightly to US$27.37 per barrel during the period 1-17 November 2003 from US$27.27per barrel average price in October. The uptick in world oil prices was traced to security and supply concerns as well as the onset of the winter season in the Northern Hemisphere and in other countries. Meanwhile, domestic oil prices also rose in the first week of November to reflect the uptrend in world oil prices in October.

- In the power sector, the Manila Electric Company (Meralco) has a pending petition with the Energy Regulatory Commission (ERC) for a 13.58 centavos rate adjustment of its charges, representing a 2.3 percent increase over the current overall average rate of ₱5.9893 per kwh.

- Money and credit demand continued to grow, although the pace of improvement has been modest. At the same time, nominal and real interest rates registered marginal increases in early November as the market priced in concerns over the domestic political front.

  - Domestic liquidity (M3) grew at a moderate pace of 3.4 percent (revised) year-on-year as of end-September 2003, slower than the 3.8 percent growth posted in August.

  - Credit demand continues to improve. Loans outstanding of commercial banks rose further by 3.9 percent year-on-year in September from 3.8 percent rise in the previous month. This marked the 13th month of sustained positive year-on-year growth in commercial bank lending.

  - Treasury bill (T-bill) rates continued to trend up in October and early November, fueled mainly by concerns over domestic political developments. In addition, banks' anticipation of the National Government's (NG) issuance of retail treasury bonds (RTBs) on 27 November also exerted some pressure on market interest rates. During the 10 November 2003 T-bill auction, the average yield on the benchmark 91-day T-bill went up by 29.6 basis points relative to the previous auction on 27 October 2003 to settle at 6.262 percent, the highest since the 26 May 2003 auction.

- The domestic currency weakened against the US dollar during the review period due to increased dollar demand by banks, oil companies, and other corporates. Uncertainties in the political arena also weighed down on the peso. However, the expected inflow of OFW remittances for the holiday season should help prop up the local currency.

- The National Government (NG) fiscal deficit for October reached ₱21.17 billion, 5.2 percent better than the ₱22.33 billion programmed for the month due mainly to the turnaround in revenue collections and continued prudent spending. This brought the first ten months of 2003 fiscal deficit to ₱163.88 billion, still ₱8 billion or 4.7 percent better than the program of ₱171.88 billion.

- The prospects for external demand remain uneven. Output growth in the US has strengthened while the pace and scope of improvements have been less strong in other major economies and the rest of the world. The sustained growth of the UK economy has been driven mainly by the expansion in household spending and the housing sector. Similarly, steady improvements in Japanese exports and share prices as well as the slowdown in deflation provided encouraging signs for the economy's gradual recovery. Meanwhile, economic growth in the euro area remained subdued.

  - The US economy continued to show tangible signs of a turnaround as GDP growth accelerated in the third quarter, fueled mainly by sharp gains in consumer and business spending as result of the stimulus from tax cuts and low mortgage refinancing rates. Meanwhile, the continued fall in the number of initial jobless claims, slowdown in job losses in manufacturing and the decline—though only slightly—in the overall unemployment rate in October point to improving prospects in US labor market conditions.

  - The euro area economy slowed down in the second quarter. However, the European Central Bank (ECB) noted that indicators pointed increasingly to a gradual improvement in economic activity, suggesting that the euro area economy is poised for a slow but gradual recovery.[2]

  - The UK economy continued to strengthen as household spending and corporate investment showed stronger-than-expected growth.

[2] European Central Bank (ECB), Press Conference, 'Introductory Statement by ECB President Jean-Claude Trichet"6 November 2003; available at http: //www. ecb.int/key/03/sp031106

Moreover, recent data revisions on national income and output revealed that economic growth has been stronger in the past. With said revisions, the estimate of the recent path of aggregate demand has also been raised.[3] The continuing build-up in household debt and expansion in the housing sector suggested underlying upside pressures on future inflation.

- In Japan, the foundation for a gradual recovery of the economy has been set as shown by the steady improvements in business fixed and investment net exports. Other components of final demand consisting of private consumption, housing investment and public investment, however, remained weak.[4]

- In general, the prospects for world economic recovery has improved considerably compared to those prevailing in the early part of 2003. However, the pattern and pace of strength as well as the nature of risks varied widely across economies. As a result, the major central banks have responded differently. The US Federal Reserve, the ECB and the Bank of Japan (BOJ) have opted to leave their monetary policy settings unchanged, while, the Bank of England (BOE) and the Reserve Bank of Australia (RBA) tightened theirs. The BOE raised its repo rate by 25 basis points to 3.25 percent during its 6 November 2003 meeting while the RBA increased its official cash rate by 25 basis points to 5.0 percent on 5 November 2003.

II. Review of the Monetary Policy Stance

- During the Monetary Board's deliberation on monetary policy stance, the members expressed the view that the prevailing balance of risks for consumer prices has not altered significantly over the past six months. They noted that the inflation environment has remained very benign because of moderate demand, and the outlook continued to suggest an on-target path for inflation for the next several quarters. At the same time, they also pointed out that the risk of a deflationary episode remained low because private consumption spending continued to be robust while private investment has shown signs of a recovery.

[3] Bank of England, Minutes of Monetary Policy Committee Meeting, 8 and 9 October 2003; available at http://www.bankofengland.co.uk

[4] Bank of Japan, Monetary Policy Meetings," Monthly Report of Recent Economic and Financial Developments October 2003 (The Bank's View)," 31 October 2003; available at http://www.boj.or.jp/en/seisaku/ 03/seisak_f.htm

- Some members of the Monetary Board expressed the view that expectations of a subdued path for both inflation and domestic demand over the next several quarters support the argument for undertaking monetary stimulus without undue risk of a rise in demand-pull inflation. They argued that monetary policy stance should continue to recognize the liquidity needs of economic growth against a backdrop of essentially benign inflation.

- Meanwhile, the members of the Monetary Board also noted that concerns about the possibility of disorderly conditions in the foreign exchange market due to political developments and shifts in market sentiment suggest the need for caution in formulating the monetary policy stance. At the same time, however, they pointed out that monetary policy should discern and weigh carefully factors that could exert long-duration pressures on consumer prices. They stressed that this would help preclude the risk of having the policy stance respond to the noise rather than the signal generated by economic data.

- With the information presented by the Advisory Committee, the Monetary Board deliberated on the following possible courses of monetary policy action to the Monetary Board:

  a. An active approach through further monetary easing to increase the stimulus to economic activity and respond to the lingering weakness in overall demand; and

  b. Cautious optimism in the form of maintaining the current monetary policy settings to preserve the ongoing stimulus to the real sector.

  - Further easing of the monetary policy stance:

    The members of the Monetary Board argued that easing the current monetary policy settings would help build up momentum for economic activity and the observed improvement in consumer confidence. However, they also maintained the view that there is a need for monetary authorities to guard against excessive easing, particularly given the ample liquidity in the system. Moreover, they also believed that there is some ambiguity on whether further relaxation would translate to a significant improvement in credit growth and aggregate demand.

- Maintaining current monetary policy stance:

  As in the previous review of the monetary policy stance by the Monetary Board, the members of the Monetary Board raised the following points in favor of maintaining the current monetary policy stance: (a) the outlook for 2004 inflation suggests average inflation will be in line with the target, implying that monetary tightening may not be necessary; (b) there continues to be evidence of sufficient liquidity to fuel the economy's growth requirements, hence, further easing may not be necessary; and (c) the monetary policy stance should remain sufficiently cautious to guard against any possible renewed price pressures that may emerge over the near term.

III. Monetary Policy Decision

- After a careful assessment of the balance of risks on inflation and inflationary expectations and the evolving domestic and external conditions as presented by the Advisory Committee, the Monetary Board, by a unanimous vote, approved the following policy measures:

  a. Maintain the BSP's policy rates at the current levels of 6.75 percent for the overnight RRP rate and 9.0 percent for the overnight RP rate;

  b. Maintain the current interest rates on the term RRPs, RPs, and SDAs; and

  c. Maintain the current reserve requirement ratios given the adequate level of liquidity in the system.

The next meeting of the Monetary Board to discuss the monetary policy setting was scheduled on 18 December 2003.

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