



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON
MONETARY POLICY ISSUES HELD ON 29 JUNE 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) 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 inflation expectations.

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

I. Review of Recent Developments

Inflation

- The headline inflation rate continued to slow down to 6.9 percent in May from 7.1 percent in the previous month. This was due to slower price increases for all major commodity groups in the CPI basket with the

* The arguments and information presented herein were the ones prevailing at the time of the Monetary Board decision on 29 June 2006. The highlights of the discussions of the 29 June 2006 meeting were approved by the Monetary Board during its meeting held on 20 July 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.



Bangko Sentral ng Pilipinas

exception of clothing and services. Similarly, core inflation—defined as headline inflation after excluding volatile food and energy items—slowed down in May to 6.1 percent from 6.3 percent in the previous month.

- World spot prices of crude oil rose slightly in June owing to lingering geopolitical issues, particularly in Iran and Nigeria. Following the trend in the global oil market, domestic pump prices of gasoline, kerosene and LPG as of 19 June 2006 increased by ₱1.50, ₱1.50 and ₱0.31, respectively, relative to their end-May levels.

Demand

- Selected demand indicators suggested limited pressures on prices.
 - Based on the results of the Monthly Integrated Survey of Selected Industries (MISSI), which covers 509 establishments, manufacturing firms utilized 80.1 percent of their capacity in April, unchanged from March.
 - Total energy sales by the Manila Electric Company (Meralco) increased slightly by 1.1 percent in April relative to the same month in 2005. This was lower than the previous month's growth rate due to the slower rise in consumption by commercial and industrial users and the decline in demand from residential users.
 - Sales of passenger cars picked up by 22.1 percent, while sales of trucks and buses rose by 40.8 percent year-on-year in May, based on data from the Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI) and the Truck Manufacturers Association (TMA).
 - Appliance sales continued to decline, with volume falling by nearly 20 percent in April relative to the same month in 2005.
 - Based on estimates of Colliers International Research, land values in the Makati Central Business District (CBD) and Ortigas Center continued to rise by 15.0 percent year-on-year during the first quarter of 2006. Meanwhile, vacancy rates of office and residential buildings declined to 7.0 percent and 12.0 percent, respectively, from 9.1 percent and 13.6 percent in the same quarter in 2005.
 - Merchandise exports expanded briskly by 20.5 percent year-on-year in April. However, this was lower than the March growth rate of 26.3 percent due to the slower rise in exports of manufactured goods.
 - Merchandise imports registered a lower year-on-year growth rate of 7.4 percent in April compared to 8.0 percent in March. Contributing to this was the decline in imports of mineral fuels, lubricants and related



Bangko Sentral ng Pilipinas

materials; consumer goods; and goods classified under special transactions. The country's top import, electronic products, surged 16.9 percent in April.

- Based on the new NSO definition of unemployment, the jobless rate declined slightly year-on-year to 8.2 percent in April 2006. Relative to the previous survey in January 2006, it increased with the seasonal entry of new graduates into the labor force.²
- The results of the latest Business Expectations Survey (BES) and Consumer Expectations Survey (CES) of the BSP suggest improving optimism for the second and third quarters of 2006.

Domestic Liquidity

- Domestic liquidity, as measured by M3, rose at a faster pace of 9.7 percent year-on-year in April, based on data from the BSP's Depository Corporations Survey (DCS).³ The expansion in liquidity was fueled mainly by the increase in net foreign assets due to the continued inflows from overseas Filipino workers (OFW) remittances and direct investments. Latest available data reflected a further acceleration in domestic liquidity at 12.7 percent in May.
- Outstanding loans of commercial banks (KBs) increased modestly by 1.3 percent in April relative to the same month in 2005. Loan growth in April came from the following sectors: financial institutions, real estate and business services; agriculture, fisheries and forestry; community, social and personal services sector; mining and quarrying; and electricity, gas and water.

Other Domestic Developments

- On the wage front, the Regional Tripartite Wage and Productivity Board (RTWPB) in the National Capital Region (NCR) approved Wage Order NCR-12 increasing the daily minimum wage of private sector workers in the NCR by ₱25 (or 8 percent) to ₱350. Other RTWPBs have been conducting consultations and deliberations on possible wage adjustments in other regions.

² The same trend was observed for the jobless rate using the old NSO definition of unemployment. Beginning in April 2005, the NSO released a new definition of unemployment, which covers all persons 15 years old and over 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 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.



- The near-term outlook for agriculture, particularly for *palay* production, remains favorable. The Bureau of Agricultural Statistics (BAS) estimates a 16 percent year-on-year increase in *palay* output for the second semester of 2006, on expectations of normal weather conditions and higher yield and harvest area.
- The peso depreciated against the US dollar in June on higher risk aversion in global financial markets alongside concerns over the impact on growth of further hikes in the US federal funds target rate.
- The National Government posted a budget surplus of ₱5.8 billion in May. This brought the fiscal balance for the first five months to a deficit of ₱44.2 billion, lower than the deficit incurred during the same period in 2005 and was only 48.9 percent of the deficit programmed for the first semester of 2006.

External Developments

- The global economy continued to grow in early 2006 on the renewed strength of personal consumption and investments, the improvement in employment conditions and corporate profits, and the continued growth of services and manufacturing in major economies. Risks to global economic growth include the continued volatility in world oil prices, rising global interest rates, and the potential impact on consumer demand of higher commodity prices.
- The US Federal Open Market Committee and the European Central Bank raised their key policy rates by 25 basis points each during their latest policy meeting on 10 May and 8 June 2006, respectively. Meanwhile, the Bank of England's Monetary Policy Committee kept its key repo rate steady in June, noting that inflation remained close to target despite some upside risks in the near-term. The Bank of Japan kept its uncollateralized overnight call rate steady at zero.

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

- The evidence on current and expected inflation continued to support the maintenance of policy settings in the meantime. Core inflation and other recent data continued to paint a scenario of limited demand-based pressures, while latest BSP forecasts remained suggestive of a deceleration in inflation in the second half, leading to within-target inflation in 2007.



Bangko Sentral ng Pilipinas

- In addition, inflation expectations appeared to be well-contained, judging from the results of the BSP's surveys among households and private sector analysts.
- Nevertheless, the Monetary Board recognized that the balance of risks to the inflation outlook remains tilted toward the upside, linked mainly to movements in oil prices. The current high oil price environment is likely to be sustained in the near term given a tight demand-supply balance in the international oil market. Along with likely adjustments in domestic power costs, this points to a continuing environment of supply-side pressures. Such a prospect increases the risks to inflation expectations and the likelihood of second-round effects, particularly on wage-setting.
- The Monetary Board agreed that managing the risks to inflation expectations and the risk of potential second-round effects on wage- and price-setting remains the key policy priority.
- The Monetary Board also pointed out that rising global interest rates need to be closely monitored, in view of their impact on capital movements and inflation.
- The Monetary Board reiterated that it remains strongly committed to achieving the inflation target for 2007 and stands ready to act upon evidence of escalating risks to the outlook for inflation and to inflation expectations.

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 recommendations of the Advisory Committee.

The next meeting of the Monetary Board to discuss the monetary policy setting is scheduled on 10 August 2006.