



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON
MONETARY POLICY ISSUES HELD ON 23 AUGUST 2007***

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

- Maintain the current monetary policy settings as follows:
 - (a) The BSP's policy interest rates at 6.0 percent for the overnight RRP (borrowing) rate and 8.0 percent for the overnight RP (lending) rate;
 - (b) Maintain the current interest rates on term RRPs, RPs, and SDAs; and
 - (d) Maintain the current reserve requirement ratios.

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

A. Domestic price conditions

- Headline inflation rose to 2.6 percent in July from 2.3 percent in June. The higher inflation was mainly attributable to higher price increases in fuel, light and water; food, beverages and tobacco; and services. The average inflation rate for January-July 2007 remained at 2.6 percent.
- The official core inflation measure published by the National Statistics Office (NSO) rose to 3.0 percent in July from 2.5 percent in June.

* 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 23 August 2007 meeting were approved by the Monetary Board during its regular meeting held on 6 September 2007.

¹ The Advisory Committee is composed of the Governor of the BSP as Chairman and five 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, the Managing Director of the Monetary Policy Sub-sector, and the Director of the Department of Economic Research.



B. Demand conditions

- Latest data for Q1 2007 showed that growth in Gross Domestic Product (GDP) surged to 6.9 percent. On the demand side, GDP growth was buoyed by robust consumption spending and net exports.
- Selected indicators of demand continued to indicate a broad strengthening trend.
 - Based on latest data from Colliers International Research, land values in Q2 2007 rose by 6.8 percent year-on-year for the Makati Central Business District and 14.2 percent for Ortigas Center. Colliers expects land values to rise further by 9-10 percent year-on-year in Q2 2008 given increased pricing power of developers in both office and residential segments; impressive take-up in residential pre-sales market; and pre-lease take-up in the office market.
 - The year-on-year sales of passenger cars declined by 10.3 percent in June, from a growth of 6.1 percent in May, due mainly to the low stocks of new models. However, year-to-date sales increased by 5.9 percent, more than three times the 1.6 percent growth registered in the comparable period last year. Meanwhile, sales of trucks and buses continued to grow and at a faster pace of 19.9 percent in June relative to 16.0 percent in May. Year-to-date sales of trucks and buses surged by 38.7 percent, from the 0.6 percent growth registered in the same period last year.
 - The year-on-year energy sales by the Manila Electric Company (MERALCO) rose although at a slower pace of 5.4 percent in June compared to 5.8 percent in May. The lower growth rate was due mainly to the deceleration in demand growth of the residential and commercial sectors. Meanwhile, year-to-date energy sales increased by 4.2 percent relative to the 1.7 percent registered in the comparable period last year.
 - Sales of appliances continued to grow although at a slower pace of 9.7 percent year-on-year in June relative to the 15.7 percent growth registered in May. Meanwhile, year-to-date sales rose by 11.2 percent, a turnaround from the 46.1 percent decline in the comparable period last year.
 - Average capacity utilization in manufacturing rose slightly to 80.2 percent in May compared to 80.1 percent in April based on the Monthly Integrated Survey of Selected Industries (MISSI) of the National Statistics Office (NSO).



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- MISSI data in May showed a pull-back from renewed manufacturing activity in the previous month. The value of production index (VAPI) declined in May, falling by 5.5 percent year-on-year after a rebound in the previous month. Similarly, the volume of production index (VOPI) fell further by 7.1 percent year-on-year in the same period.
- Latest NSO data for June 2007 showed that growth in merchandise exports slowed down to 1.6 percent year-on-year from 6.1 percent in May. This was due mainly to the slower growth in manufactures (including electronics) which accounted for 84 percent of total merchandise exports. The cumulative growth rate for Jan-June was 6.6 percent, lower than the previous year's 18.2 percent.
- Merchandise imports declined for the second consecutive month in May, dropping by 3.4 percent year-on-year. This was due mainly to the decline in imports of capital goods as well as mineral fuels, lubricants and related materials. For the first five months of 2007, merchandise imports rose by a modest 2.0 percent, less than one-fourth of the 9.5 percent growth in the comparable period in 2006.
- Preliminary results of the latest Business Expectations Survey (BES) for Q3 2007 showed that business confidence remained buoyant. The overall business confidence index (CI) remained above the 40 percent level for the fourth consecutive quarter at 40.9 percent, or 19.2 index points higher than the year-ago level. Business activity is expected to improve in Q4 2007 as suggested by the surge in the index to 53.0 percent, the highest level since the inception of the BES in Q2 2001.
- Based on the Q2 2007 Consumer Expectations Survey, consumer confidence improved. The overall consumer CI was less negative in Q2 2007, indicating that the number of optimistic respondents increased. Consumers were more upbeat about the country's economic condition as well as their own family income and financial situations, attributing the former to the strength of the peso, stable prices and more job opportunities.
- A ₱12-increase in the minimum wage in National Capital Region (NCR) was approved in August 2007, while the 10 percent increase in the salaries of government employees was implemented in July 2007. The proposal for the Salary Standardization Law (SSL) III for government workers was re-filed in the new Congress, while the proposal for the ₱125 daily wage hike for private sector employees needs to be re-filed. Meanwhile, there are five (5) remaining formal petitions for wage increases with the Regional Tripartite Wage and Productivity Boards.



C. Supply-side indicators

Developments in Agriculture

- Agricultural output grew by 3.5 percent in the first semester of 2007 from 5.2 percent in the same period a year ago. The fishery subsector, which accounts for roughly 27 percent of total output, was the key growth driver as it registered a 7.2 percent gain.
- The Department of Science and Technology reported that the dry spell has ended in NCR and the Ilocos, Central Luzon, and Calabarzon regions after three storms swept the country in the last two weeks of August.
- Water levels at Ambuklao and Binga dams are above-normal, while those in Angat, San Roque, and La Mesa dams may be considered normal. The Philippine Atmospheric, Geophysical and Astronomical Services Administration warned, however, that possible La Niña conditions may bring typhoons, floods and landslides in the last quarter of the year. Meanwhile, water reserves at Magat and Pantabangan dam in Cagayan Valley remain at critical levels. If below-normal rainfall conditions in the Cagayan Valley and Bicol region persist until the end of the month, the Government could declare a drought in these areas.
- The Department of Agriculture reported that despite a prolonged dry spell in the previous months, the high-value commercial crops sector (bananas, mangoes and vegetables) is expected to surpass growth targets this year.

Oil price developments

- International spot and futures prices were lower in mid-August on concerns that global oil demand may weaken amid worries on the US economy. Meanwhile, domestic prices of gasoline products remained at their end-July levels while LPG prices increased in early August. In the transport sector, the Land Transportation Franchising and Regulatory Board is set to implement the restoration of the ₱7.50-minimum fare for public utility jeepneys.

Developments in the utilities sector

- Power rates could be adjusted upwards after the Energy Regulatory Commission allowed MERALCO to automatically reflect adjustments in its generation rates despite reduced National Power Corporation charges last March 2007. Meanwhile, an average reduction of two percent in water rates is in effect from July to September 2007.



D. Monetary conditions

Interest rate developments

- During the 13 August 2007 auction, T-bill rates increased across all tenors, as T-bill offerings faced competition from other investment facilities available in the market (e.g. the special deposit account (SDA) facility of the BSP).
- Relative to their 11 July levels, secondary market yields of Government Securities (GS) in end-July and on 14 August showed mixed trends. Secondary market yields for the 3-month, 6-month, and 1-year GS rose on continued fiscal concerns and as the Bureau of the Treasury rejected bids. Meanwhile, the rates for the 2- to 20-year tenors fell, indicating a vote of confidence by the market on the twin moves implemented by the BSP last July.

Domestic liquidity and credit conditions

- Growth in domestic liquidity or M3 slowed down to 19.4 percent year-on-year in June from the 20.5 percent (revised from 21.1 percent) increase registered in the previous month. Growth in the net foreign assets of depository corporations continued to drive M3, although at a slower pace of 31.1 percent from 32.4 percent in May. Net domestic assets likewise posted a decelerating growth trend at 3.8 percent from 5.7 percent in the previous month.
- Outstanding loans of commercial banks, thrift banks and rural banks—including reverse repurchase (RRP) placements—grew by 5.1 percent year-on-year in June from the 4.5 percent growth recorded in May. This was also higher than the 1.3 percent growth in the same period last year. Net of banks' RRP placements with the BSP, bank lending grew by 4.7 percent year-on-year in June compared to the 6.9 percent growth posted in the previous month. This was an improvement from the 1.8 percent expansion registered in the same month a year ago.
- Consumer credit rose by 22.2 percent year-on-year in Q1 2007. This was higher than the year-ago growth recorded at 21.1 percent. More specifically, auto loans, credit card receivables and residential real estate loans expanded by 19.9 percent, 22.3 percent and 24.0 percent, respectively.

E. Financial market developments

- The stock market rallied to record highs in July. For the first two weeks of August, however, stock markets corrected amid weaker performance of major equities markets.



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- Equity raised by Philippine Stock Exchange-listed companies via various capital-raising activities surged by 130 percent to ₱72.5 billion for the first seven months of 2007 from ₱31.5 billion in the comparable period last year. Meanwhile, private corporate bond issues amounted to ₱53.5 billion for the first seven months of 2007, almost three times the year-ago level of ₱19.8 billion.
- The peso averaged ₱45.58/US\$1 for the month of July, appreciating by 1.3 percent against the ₱46.16/US\$1 average in June. Significant foreign inflows into equity offerings of local companies and reports of strong balance of payments position in June sent the peso to its highest level in seven years to average ₱44.79 on 24 July 2007. On a year-to-date basis, the peso appreciated by 7.0 percent against the US dollar as of 14 August 2007. The strengthening of the peso was in line with the movements of regional currencies except the Indonesian rupiah, South Korean won and New Taiwan dollar, which depreciated against the US dollar vis-à-vis their end-2006 level.

F. Fiscal developments

- The National Government registered a surplus in July amounting to ₱1.6 billion. The January to July fiscal deficit of the National Government reached ₱39.4 billion, lower than the deficit of ₱48.5 billion incurred during the same period last year. The lower deficit was partly a result of the remittance to the National Government of the final payment in the net proceeds for the sale of shares of PNOC-EDC, and lower spending, including interest savings due to lower interest rates and stronger peso.

G. External developments

- Latest data suggest that global economic growth will continue, notwithstanding the impact of the low growth in the US economy and its subprime mortgage market shock to global financial markets.
- The difficulties in the US subprime mortgage and credit markets and their impact on financial institutions have caused some volatilities in emerging market economies. The crisis affected banks, hedge funds and finance companies with subprime mortgage exposures, and a number of these institutions have either reported huge losses or filed for bankruptcies. As a result, the US subprime mortgage market shock caused broad sell-offs in major stock markets, resulting in record drops in stock values, as investors cut further losses from their holdings of risky assets that have exposures to subprime mortgages.
- In response, central banks stepped in and provided their respective banking systems with additional liquidity to prevent a credit crunch. On 17 August, the US Federal Reserve, in an effort to restore confidence



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in financial and credit markets, reduced its discount rate by 50 basis points to 5.75 percent.

- The Fed's recent policy moves resulted in partial recoveries among major stock markets led by the US and European stocks. The equities market in the Asian region likewise rose on expectation that risk aversion may have subsided. However, mature equity markets remained jittery as credit concerns persisted.
- Meanwhile, economic prospects in the Euro area and Japan remain on the upside, while China and India continue to gain significant roles as drivers of global economic growth. Global inflation continues to be influenced by developments in energy prices.

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

- The Monetary Board considered the benign inflation outlook and noted that the balance of risks to future inflation has remained essentially unchanged. With the additional monetary measures in place, the growth of domestic liquidity moderated in May and June. Rainfall conditions have normalized in most of Luzon and the approved wage hike for NCR is not expected to generate additional inflationary pressures.
- At the same time, the Monetary Board noted that demand pressures—while on a broadly strengthening trend—continue to be limited. The relatively firm peso also serves to temper price pressures. Inflation expectations also remain subdued, suggesting that markets are confident about the BSP's anti-inflation resolve.
- The Board also noted that the policy moves implemented in May and July need more time to work their way through the system.
- The Board discussed the recent turmoil in global financial markets and noted that this would have a limited impact on the domestic financial system.

III. Monetary Policy Decision

- After considering the balance of risks to inflation 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 4 October 2007.