HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 17 NOVEMBER 2005*

The Advisory Committee[1] 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 RRPs and RPs.

2) Maintain the current reserve requirement ratios;

3) Reprice the Special Deposit Account (SDA) to make it more competitive by offering a premium over current SDA rates; and

4) Continue to articulate support for the use of non-monetary measures to address supply-side risks, particularly those related to food supply and oil, by strengthening representation and coordination with various government agencies.

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

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

- Headline inflation was unchanged at 7.0 percent in October, which brought the year-to-date average inflation to 7.9 percent. Core inflation maintained its decelerating trend, indicating a continued absence of demand-side pressures on consumer prices. These price developments are in accordance with BSP's expectations of easing price pressures for the remaining months of 2005.

* The highlights of the discussions of the 17 November 2005 Monetary Board meeting were approved by the Monetary Board during its meeting held on 15 December 2005.

[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.

- Food and energy items continued to account for more than half of the October inflation rate: food accounted for 2.7 percentage points; fuel, light and water (FLW), 1.2 percentage points; and transport and communication (which includes gasoline and diesel), 1.2 percentage points.

- Inflation pressures will continue to be driven by movements in international oil prices while the implementation of the Reformed Value Added Tax (RVAT) law will also likely yield a short-lived but significant impact on prices. The continued rapid growth in domestic liquidity and potential shifts in the public's inflation expectations remain a risk to inflation.

- Selected indicators showed some improvements in demand, but evidence of resource slack remains.

  - Average capacity utilization in manufacturing increased slightly to 80.3 percent in August 2005 from 80.2 percent in the previous month.

  - The value of production index (VAPI) for manufacturing rose by 20.4 percent year-on-year in August, higher than the revised July growth rate of 12.3 percent. The volume of production index (VOPI) climbed by 7.3 percent year-on-year in August from 0.6 percent in July.

  - Preliminary data show that merchandise exports declined by 1.2 percent year-on-year in September. This was traced to softening foreign demand for electronics exports, which decreased by 2.1 percent and accounted for 67.3 percent of the aggregate export revenue in September.

  - Merchandise imports increased by 10.1 percent year-on-year in August, a turnaround from the 3.1 percent contraction in the previous month. Imports of mineral fuels, lubricants and related materials, which comprised 16.2 percent of aggregate imports, posted a 55.2 percent increase in August due to higher world prices and volume of imported fuel, diesel and fuel oil.

  - The country's major corporations posted strong revenue growth for the first six months of 2005. Net income results were mixed, however, as some firms reported slower profit growth.

  - Property values rose while vacancy rates declined during the second quarter, based on estimates by Colliers International Research.

  - The year-on-year growth in passenger car sales in September declined by 0.9 percent, a reversal from the 22.1 percent rise in the previous month based on the data of the Chamber of Automotive Manufacturers of the Philippines, Inc.

- Energy sales by the Manila Electric Company decelerated by 0.1 percent year-on-year in September, as the increase in commercial energy consumption failed to offset the slowdown in the consumption of residential and industrial users.

- Appliance sales fell for the 10th straight month since December 2004, declining by 14.3 percent year-on-year in September. This was a slight improvement from the previous month's 17.9 percent fall and a reversal of the previous year's 8.2 percent expansion.

- The unemployment rate declined to 10.9 percent in July 2005 from 11.7 percent a year ago and 12.7 percent in April 2005, using the old definition of unemployment. Based on the new definition of unemployment, the jobless rate declined to 7.7 percent in July from 8.3 percent in April. [2]

- The third quarter 2005 BSP Business Expectations Survey showed that business optimism in the third quarter declined, but firms expected conditions to improve in the fourth quarter. The latest Consumer Expectations Survey showed weaker consumer outlook for the third and fourth quarters of 2005.

• Agriculture output grew by 1.3 percent in the first half of 2005, lower than the 6.4 percent increase recorded a year ago as the El Niño-induced drought affected adversely the production of major crops such as rice and corn.

• World oil prices eased in early November as demand for expensive oil weakened and as cold weather conditions in the Northern Hemisphere turned out to be milder than expected. However, tight spare capacity remains a major risk factor in the outlook for oil prices. In the domestic market, pump prices of oil products rose on 1 November 2005 alongside the implementation of the RVAT law.

• In the financial sector, the growth in domestic liquidity and bank lending decelerated. Meanwhile, Treasury bill (T-bill) rates continued to decline during the 10 October 2005 auction.

[2] Beginning in April 2005, the new Labor Force Survey (LFS) questionnaire was used to estimate the number of unemployed, which included all persons who were 15 years old and over as of their last birthday and were reported as without work, currently available for work, and seeking work or not seeking work due to valid reasons. The old definition of unemployment did not consider the availability criterion.

- Based on preliminary Depository Corporations Survey (DCS) data, growth in domestic liquidity (M3) decelerated to 14.8 percent year-on-year in September from 15.0 percent in August.[3]

- Outstanding loans of commercial banks (KBs) grew by 0.5 percent year-on-year to ₱1.505 trillion as of end-September 2005. This was lower than the 3.3 percent growth in August.

- Relative to the 10 October 2005 auction, the T-bill rates for the 91-day, 182-day and 364-day tenors declined during the 14 November 2005 auction. Relative to the 7 November 2005 auction, T-bill rates eased further by 20.8 basis points, 11.4 basis points and 10.2 basis points, respectively. Treasury bill rates continued to ease due to ample liquidity and market optimism concerning fiscal performance with the implementation of the RVAT law.

- The peso appreciated in early November, supported by sustained dollar inflows from overseas remittances, which posted a 28-percent increase from the same period last year. Sentiment was further boosted by positive market reaction to the implementation of the RVAT law.

- The NG recorded a ₱27.7 billion fiscal deficit in September, 10.3 percent lower than the year-ago deficit. Revenue collections rose by 9.9 percent while expenditures grew by 2.6 percent. This brought the NG's budget deficit for the first nine months to ₱108.5 billion, which is ₱37.4 billion below the programmed deficit for the period.

- Global economic expansion remained broadly on track in the third quarter with the robust output performance of the services sector and the moderate recovery of manufacturing activity in most major economies. Meanwhile, the continued prospect of volatility in world oil prices has weighed down on consumer sentiment despite generally favorable labor market conditions.

II. Review of the Monetary Policy Stance

- The Monetary Board noted that there is evidence in favor of keeping policy settings unchanged. The recent easing of foreign crude oil prices, for example, and the appreciation of the peso imply reduced cost-push pressures in the near term. There are also continuing soft spots in the

[3] M3 refers to the stock of broad money based on data on the Depository Corporations Survey (DCS). The DCS, which replaces 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.

economy, based on various indicators of employment, demand and bank credit.

- However, the Monetary Board is of the view that risks to inflation remain present and continue to necessitate the BSP's readiness to respond preemptively. In particular, growth in domestic liquidity, while showing some easing, remains high despite recent increases in the key policy rates and the reserve requirements.

- Potential shifts in the public's inflation expectations also continue to be a major policy concern, given the possibility of a sustained deviation from the government targets until 2007. Deviations of actual inflation from the target over a prolonged period pose a risk that the public may begin to expect inflation to remain persistently well above the targets announced by the Government.

- Looking ahead, therefore, the Monetary Board should continue to monitor closely the evolving conditions for consumer prices, aggregate demand, domestic liquidity and other factors in order to determine the appropriate stance of monetary policy. The Monetary Board remains committed to the BSP's inflation objectives and stands ready to take the necessary action to protect the Government's inflation targets.

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 and RPs.

  2) Maintain the current reserve requirement ratios;

  3) Reprice the SDA to make it more competitive by offering a premium over current SDA rates;

4) Continue to articulate 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

5) Intensify the BSP's public information campaign with greater focus on the dynamics and sources of price pressures in order to help guide inflationary expectations.

The next meeting of the Monetary Board to discuss the monetary policy setting is scheduled on 15 December 2005.