



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON
MONETARY POLICY ISSUES HELD ON 9 MARCH 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 RRPs, RPs, 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:

- In line with the BSP's expectations, headline inflation rose to 7.6 percent in February from 6.7 percent in January. This coincided with the increase in the Value Added Tax (VAT) rate. Similarly, core inflation inched up during the month following eleven consecutive months of sustained deceleration.

* The arguments and information presented herein were the ones prevailing at the time of the Monetary Board decision on 9 March 2006. The highlights of the discussions of the 9 March 2006 meeting were approved by the Monetary Board during its meeting held on 6 April 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

- The price of Dubai crude oil declined in February 2006 as geopolitical tensions between Iran and Western nations subsided and demand for heating oil dropped with the end of the winter season. Meanwhile, domestic retail prices of petroleum products saw a net increase in February due to the adjustment in the VAT rate for petroleum products. The impact of the higher VAT rate on oil products was partly offset by easing oil prices and the strengthening of the peso during the period.
- Selected demand indicators suggest general weakness in economic activity despite improvements.
 - Manufacturing activity remained sluggish. Average capacity utilization in manufacturing in December 2005 remained at the previous month's level of 80.4 percent. The value of production index (VAPI) for the manufacturing industry increased by 12.9 percent year-on-year in December, lower than the 16.1 percent growth in November. Likewise, the volume of production index (VOPI) posted a year-on-year growth of 0.1 percent in December, a deceleration from the November growth of 10.8 percent.
 - Total energy sales by the Manila Electric Company (Meralco) rose by 4.0 percent year-on-year in December, higher than the previous month's 1.3 percent, on account of increased consumption of commercial and industrial users during the holiday season.
 - Passenger car sales registered a 16.7 percent year-on-year growth in January 2006, higher compared to the 4.6 percent growth in the previous month, based on the data of the Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI).
 - Property values rose while office vacancy rates declined during the fourth quarter of 2005, based on data from Colliers International Research.
 - Total merchandise export earnings rose by 16.8 percent year-on-year in December 2005, a reversal of the 1.5 percent decline in November. Exports of electronic products, which accounted for 67.6 percent of the aggregate export revenue in December, increased by 15.7 percent.
 - Total merchandise imports rose by 21.7 percent year-on-year in December, an acceleration from the previous month's 1.4 percent. Payments for electronic products, which comprised 46.6 percent of the total import bill, increased by 22.9 percent.



Bangko Sentral ng Pilipinas

- Unemployment fell slightly in October to 10.3 percent from 10.9 percent both in the same month in 2004 and in July 2005, based on the old National Statistics Office (NSO) definition of unemployment. Similarly, based on the new definition of unemployment, the jobless rate decelerated to 7.4 percent from 7.7 percent in July.²
- The latest Business Expectations Survey (BES) of the BSP showed improving optimism for the first and second quarters of 2006.
- The composite leading economic indicator of the National Statistical Coordination Board (NSCB) rose to 0.155 for the first quarter of 2006 from 0.078 in the previous quarter, suggesting a continued rise of economic activity during the quarter.
- Agricultural output grew by 4.0 percent in real terms in the fourth quarter of 2005, 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 continued to slow, while growth in bank lending remained modest. Treasury bill (T-bill) auction rates were also generally lower.
 - Based on preliminary Depository Corporations Survey (DCS) data, growth in domestic liquidity (M3) decelerated further to 8.4 percent year-on-year in January from 9.6 percent in the previous month.³
 - Outstanding loans of commercial banks (KBs) grew by 0.9 percent year-on-year in December 2005 following a 2.1 percent rise in the previous month.
 - Relative to the 6 February 2006 auction, the T-bill rate for the 91-day tenor rose on 20 February 2006 as the Auction Committee accepted higher yields to align the primary market rates with that in the secondary market. However, the T-bill rates for the 182-day and 364-day tenors declined on ample liquidity and improving fiscal outlook. The Auction Committee subsequently rejected all bids at the 27 February 2006 auction to prevent yields from rising.

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.



- The peso strengthened in February despite political uncertainty, boosted by positive sentiment from better-than-expected GDP performance for 2005 and the implementation of the VAT rate increase in the same month. The peso was also supported by capital inflows following the initial public offering of First General Corporation and the upgrade on the country's credit rating outlook by Standard and Poor's and Fitch Ratings.
- The NG posted a ₱15.4-billion fiscal deficit in January 2006, ₱5.5 billion below the programmed ceiling of ₱20.9 billion and 6.4 percent lower than the fiscal deficit for the comparable month in 2005. Revenues grew by 12.9 percent to reach ₱72.6 billion, while expenditures rose by 8.9 percent to ₱88.1 billion.
- Global economic activity remained fairly robust based on data for the fourth quarter despite indications of softening economic activity. The solid performance of the services sector and the renewed strength of manufacturing underpinned growth in the major economies. Sustained gains in labor market conditions along with the steady improvements in business and consumer confidence have aided recovery in domestic demand. On the price front, the recent surge in oil prices contributed to a slight uptrend in global inflation. However, inflation expectations remain generally well-contained. The recent responses of monetary authorities in major economies were generally cautious with the Bank of England, Bank of Japan and European Central Bank opting to keep monetary policy settings unchanged. The US Federal Reserve, meanwhile, continued to raise its policy rate.

II. Review of the Monetary Policy Stance

- In its discussion of the latest data, the Monetary Board agreed that prevailing conditions continue to provide room for the BSP to keep its policy rates steady in the near term. Despite the immediate impact of the VAT, the February inflation rate was within the BSP's forecast range for the month, and thus remained consistent with the projected path for inflation. The latest BSP forecasts continue to show a decelerating trend for inflation beginning in the second half of 2006. Forecast inflation is still above the inflation target for 2006, but remains within the inflation target range after adjusting for the expected impact of supply shocks.
- In addition, modest improvements in aggregate demand and bank lending amid a sustained slowdown in liquidity growth imply limited demand-side pressures on prices. Positive investor sentiment has also continued to strengthen the peso exchange rate, thus providing continued stability to domestic prices of imports.



- The Monetary Board agreed that the outlook for inflation continues to be accompanied by various risks. The two-percentage point hike in the VAT rate, for example, has already prompted a round of one-time price increases, although it is not expected to fuel sustained inflation. Mitigating government measures against the impact of the VAT rate hike will also help cushion its effect on consumer prices.
- International oil prices also remain a key source of additional inflation pressure, as the global oil market remains sensitive to uncertainties about worldwide supply. The prospect of continued cost-side pressures may also lead to calls for wage increases.
- Against this backdrop, the Monetary Board agreed that the BSP should remain focused on achieving the inflation target for 2007 and addressing the risks to future inflation. Managing the risk of potential second-round effects in wage- and price-setting remains a key priority for monetary policy, and authorities continue to watch closely for indications of any adverse shift in inflation expectations. The Monetary Board will continue to assess the evolving conditions for consumer 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 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



Bangko Sentral ng Pilipinas

- 4) 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. Policy pronouncements concerning the stance of monetary policy should 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 6 April 2006.

J:_aaMB Policy and Minutes\Highlights\2006 MB Minutes\MB minutes 09-03-2006 meeting.doc