



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON
MONETARY POLICY ISSUES HELD ON 30 JUNE 2005***

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 7.0 percent for the overnight RRP (borrowing) rate and 9.25 percent for the overnight RP (lending) rate; and
 - (b) Maintain the current interest rates on term RRP, RP, and SDA.
- 2) Maintain the current reserve requirement ratios;
- 3) Continue to articulate support for the intensified use of non-monetary measures to address supply-side risks, particularly those relating to food supply, by strengthening representation and coordination with various government agencies; and
- 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.

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

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

- Headline inflation remained steady for the fourth consecutive month at 8.5 percent in May 2005, bringing the year-to-date inflation to 8.4 percent. Lower year-on-year inflation rates for food, beverage and tobacco (FBT), clothing and services offset higher inflation rates for fuel, light and water

* The highlights of the discussions of the 30 June 2005 Monetary Board meeting were approved by the Monetary Board during its meeting held on 4 August 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 Assistant Governor, Monetary Policy Sub-Sector and the Managing Director of the Treasury Department.



Bangko Sentral ng Pilipinas

(FLW). On a month-on-month basis, inflation eased slightly to 0.5 percent in May from 0.6 percent in April.

- Food and energy-related items remained the primary sources of inflationary pressures. Of the 8.5 percent headline inflation for May, food alone accounted for 3.2 percentage points, FLW, 1.4 percentage points and transport and communication, 1.7 percentage points.
- Core inflation slowed down further to 7.6 percent in May from 7.8 percent in April, bringing the year-to-date average core inflation to 7.9 percent. On a month-on-month basis, core inflation was unchanged at 0.3 percent in May.
- Looking forward, the volatility in oil prices as well as the recent adjustments in wages and transport fares will continue to exert pressures on the headline inflation. The movement in world oil prices, in particular, remains the principal risk to the inflation outlook. These factors are likely to drive up the inflation path in the short-term, but are not expected to have a lasting effect on prices. The ongoing impact of dry weather on crops output may also contribute to pressures on domestic food prices.
- Most indicators of demand continued to suggest sustained but slower growth in economic activity.
 - Average capacity utilization in manufacturing rose slightly to 79.9 percent in April 2005 from 79.8 percent in the previous month.
 - The value of production index (VAPI) for manufacturing rose by 11.7 percent year-on-year in April 2005, higher than the revised March growth rate of 8.7 percent. Year-on-year growth in volume of production index (VOPI) for manufacturing was 1.0 percent in April from nil in March.
 - The first quarter 2005 financial performance of the country's major corporations showed mixed trends.
 - Total merchandise exports recovered from two consecutive months of decline, expanding by 8.8 percent year-on-year in April 2005. This was slightly lower than the previous year's 8.9 percent.
 - After declining in the last four months, merchandise imports rose by 6.5 percent year-on-year in April 2005. The upturn was due largely to rising import bill on fuel, due to higher world oil prices.
 - Passenger car sales increased by 15.9 percent year-on-year in May 2005, lower than the previous month's 35.0 percent.



Bangko Sentral ng Pilipinas

- Energy sales by the Manila Electric Company declined for the third straight month, dropping by 1.6 percent year-on-year in April 2005. The residential sector posted the biggest year-on-year decline in electricity consumption at 4.7 percent.
- The unemployment rate declined to 12.9 percent in April 2005 from 13.7 percent a year ago, but rose from 11.3 percent in January 2005. Using the new definition of unemployment, it declined to 8.3 percent in April 2005 from an estimated 8.9 percent a year ago.²
- The second quarter 2005 BSP Business Expectations Survey showed that business outlook was less optimistic than in the previous quarter but remained positive. The overall business outlook diffusion index (DI) for the second quarter of 2005 was recorded at 12.9 percent, lower than 17.6 percent in the previous survey. The latest Consumer Expectations Survey likewise showed weaker consumer outlook for the second and third quarters of 2005.
- The composite leading economic indicator (LEI) of the National Statistical Coordination Board (NSCB) continued to rise in the second quarter of 2005 to 0.272 from 0.245 in the first quarter.
- The volatility in global oil prices is expected to continue to exert a central influence on the inflation outlook.
 - Agricultural production grew by a slight 0.6 percent year-on-year in the first quarter of 2005, as gains from poultry and fishery production offset the decline in crop production caused by the El Niño-induced drought.
 - World oil prices rose in June due to narrowing refining capacities and the seasonal increase in demand for motor fuel and crude oil in the US. In the domestic market, oil companies raised retail pump prices of petroleum products as the costs of imported crude and petroleum increased from the previous month's levels.
- Liquidity grew steadily, while bank lending growth generally remained modest.

² Starting April 2005, the new Labor Force Survey (LFS) questionnaire was used to estimate the 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.



Bangko Sentral ng Pilipinas

- Based on preliminary data, the growth in domestic liquidity (M3) rose to 12.1 percent year-on-year in March 2005, based on Depository Corporations Survey (DCS) from 12.0 percent in the previous month.³
- Outstanding loans of commercial banks (KBs) grew by 5.1 percent year-on-year to ₱1.544 trillion as of end-March 2005. This was a slight deceleration from the growth of 5.8 percent recorded in February 2005.
- Relative to the 30 May and 20 June 2005 auctions, T-bill rates for the 91-day and 182-day tenors rose during the 27 June 2005 auction. Meanwhile, all tenders for the 364-day T-bills were rejected on 27 June 2005. The uptick in the T-bill rates reflected the market's cautious response amid persistent political concerns, the weakening peso and sustained volatility in oil prices.
- The peso depreciated against the US dollar in June as market sentiment weakened on political concerns, along with the continued rise in US interest rates which exerted pressures on regional currencies. In addition, the observed narrowing differentials between domestic and foreign interest rates could also lead to potential exchange market pressure in case of adverse impact on capital flows. These pressures remained a risk to future inflation.
- The fiscal deficit of the national government (NG) declined by 40 percent to ₱7.6 billion in May 2005 from a year earlier. This brought the NG's budget deficit for the first five months to ₱67.8 billion, which is 12.4 percent lower than the year-ago level and equivalent to 69 percent of the ₱98.5 billion deficit level programmed for the first semester.
- The pace of global economic activity moderated but remained robust in the second quarter compared to the previous quarters. Growth in the US and China continued to support global activity, while the Japanese economy staged a significant recovery in the second quarter. Consumer spending and exports growth moderated in most economies while labor market conditions remained generally favorable. Manufacturing activity meanwhile eased due in part to higher world oil prices. The inflation outlook in major economies continued to be well-within expectations despite the relatively high current inflation. Forward-looking global economic indicators continued to be consistent with a moderate but solid growth performance in the year ahead. Downside risks to the outlook include widening global imbalances, a possible resurgence of oil prices, and a weaker US dollar.

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.



II. Review of the Monetary Policy Stance

- The members of the Monetary Board noted that the underlying conditions in the inflation environment continued to be driven mainly by rising oil prices. Meanwhile, demand-side pressures remained largely absent amid evidence of moderating consumption growth, modest private credit activity, and general indications of spare capacity in the economy.
- The members of the Monetary Board also pointed out that inflation expectations appeared to be manageable despite the uptrend in oil price pressures, emerging risks from wage and transport fare adjustments, as well as the impact of the VAT reform in the short run.
- The Monetary Board, however, pointed out the need to monitor closely the current pressures in the foreign exchange market. While sentiment-driven and prompted largely by developments in the political front, monetary authorities were of the view that the volatility in the exchange rate could affect inflation expectations. The prospect of narrowing interest rate differentials given the tightening mode of the US also poses an additional risk to the stability of the currency with potential inflationary impact.
- Given these considerations, the members of the Monetary Board emphasized the importance of continued monitoring of indicators of inflation expectations. In addition, the BSP should continue to articulate its readiness to undertake policy action to guard against any further buildup in inflation pressures.
- At the same time, the Monetary Board stressed the need to continue to strengthen transparency and communication of policies and prospects of inflation in order to help manage inflation expectations. The Monetary Board also reiterated that direct non-monetary measures to ensure the availability and timely distribution of basic food products remain crucial in helping cushion the pressures on consumer prices.

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 approved unanimously the following measures:
 - 1) Maintain the current monetary policy settings as follows:
 - (a) Maintain the BSP's policy interest rates at 7.0 percent for the overnight RRP (borrowing) rate and 9.25 percent for the overnight RP (lending) rate; and



Bangko Sentral ng Pilipinas

- (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, by strengthening representation and coordination with various government agencies; and
- 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.

The next meeting of the Monetary Board to discuss the monetary policy setting is scheduled on 28 July 2005.

M:_aaMB Policy and Minutes\Highlights\2005 MB Minutes\MB minutes 30-06-2005 meeting.doc