



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON
MONETARY POLICY ISSUES HELD ON 12 JANUARY 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 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; and
- 4) Encourage public support for energy conservation and efficiency measures and support exploration/use of alternative sources of energy.

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

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

- Headline inflation eased in December, with slower price increases for most commodity groups. The recent easing in the price of imported oil, the strengthening of the peso, and the ongoing harvest season helped keep price pressures in check. Meanwhile, core inflation also continued to

* The arguments and information presented herein were the ones prevailing at the time of the Monetary Board decision on 12 January 2006. The highlights of the discussions of the 12 January 2006 meeting were approved by the Monetary Board during its meeting held on 9 February 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.



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decelerate, indicating the continued absence of demand-side price pressures.

- Food and energy items accounted for more than half of the December inflation rate: food contributed 2.6 percentage points while fuel, light and water (FLW) along with transport and communication (which includes gasoline and diesel) accounted for a combined 2.1 percentage points.
- The price of Dubai crude oil rose in December 2005 and climbed further during the first week of January 2006 due to supply- and demand-related market concerns. Meanwhile, domestic retail prices of petroleum products were stable in December 2005 and were reduced at the beginning of January, in response to the earlier decline in world crude oil prices as well as the continued appreciation of the peso.
- Selected indicators of demand suggest continued growth in economic activity.
 - Manufacturing activity showed some improvement. Average capacity utilization was slightly higher at 80.4 percent in October 2005 compared to 80.3 percent in September. The value of production index (VAPI) for manufacturing increased by 13.9 percent year-on-year in October, higher than the 10.3 percent growth in September. Year-on-year growth in the volume of production index (VOPI) for manufacturing showed an increase of 4.6 percent in October from the 4.5 percent contraction in the previous month.
 - The country's major corporations posted strong revenue growth in the first nine months of 2005. Some firms, however, experienced slower profit growth in the third quarter due to higher operating expenses.
 - Unemployment eased to 10.3 percent in October 2005 from 10.9 percent both in the same month in 2004 and in July 2005, using the old definition of unemployment. Similarly, based on the new definition of unemployment, the jobless rate declined to 7.4 percent from 7.7 percent in July.²
 - Property values rose while office vacancy rates declined during the third quarter, based on estimates by Colliers International Research.

² Starting April 2005, the new Labor Force Survey (LFS) questionnaire was used to estimate the number of unemployed, which include 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.



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- Results of the fourth quarter 2005 Business Expectations Survey (BES) and Consumer Expectations Survey (CES) indicated improvements in business and consumer outlook for the fourth quarter of 2005 and for the first quarter of 2006.
- Other data, however, point to weakening demand.
 - Economic growth weakened in the third quarter, reflecting the dampening effects of higher oil and consumer prices as well as the sluggish performance of the agriculture sector. The country's gross domestic product (GDP) registered a 4.1 percent growth for the third quarter of 2005, down from 6.2 percent a year ago. This brought GDP growth for the first nine months to 4.6 percent.
 - Merchandise imports declined by 3.1 percent year-on-year in October, from a 7.8 percent increase in September.
 - Merchandise exports declined for the second straight month by 1.6 percent in November from 3.2 percent in October. The decline was traced to weaker foreign demand for electronics exports, which fell by 1.6 percent and accounted for 68.1 percent of the aggregate export revenue during the month.
 - Passenger car sales fell by 4.0 percent year-on-year in October, following a 0.1 percent rise in the previous month, based on the data of the Chamber of Automotive Manufacturers of the Philippines, Inc (CAMPI).
 - Energy sales by the Manila Electric Company declined by 1.3 percent year-on-year in November due to reduced consumption of residential and industrial users.
 - Appliance sales fell for the eleventh straight month by 24.7 percent year-on-year in October.
- Agricultural output grew at a slower pace of 1.7 percent in the first nine months of 2005 compared to 6.6 percent in the previous year, as the crops subsector contracted due to lower rice, corn and sugarcane production, while the other subsectors posted modest increases.
- The expansion in domestic liquidity slowed, while growth in bank lending remained modest. Treasury bill (T-bill) auction rates continued to decline on 9 January 2006.



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- Based on preliminary Depository Corporations Survey (DCS) data, growth in domestic liquidity (M3) decelerated to 11.9 percent year-on-year in November from 13.9 percent in the previous month.³
 - Outstanding loans of commercial banks (KBs) grew by 1.3 percent year-on-year to ₱1.5 trillion as of end-October 2005. This was higher than the 0.5 percent growth in September.
 - T-bill rates declined during the 9 January 2006 auction relative to the previous auction on 29 November 2005. T-bill rates continued to ease due to ample liquidity, alongside the decision of the National Government (NG) to reduce its T-bill offering for the first quarter of 2006.
- The peso continued its appreciating trend in December on account of strong dollar inflows as well as improving outlook for the fiscal sector.
 - For the first 11 months of 2005, the NG's fiscal deficit reached ₱122.8 billion, which is 23.3 percent lower than the year-ago figure and equivalent to only 68.2 percent of the full-year target deficit. Revenues for the first 11 months grew by 15.1 percent to reach ₱733.7 billion, while expenditures rose by 7.4 percent to ₱856.5 billion.
 - The global economy's growth momentum continued based on data for the third quarter of 2005, driven by the robust output performance of the services sector and the moderate recovery of manufacturing in most major economies. On the price front, the recent decline in oil prices has contributed to easing global inflation pressures. At the same time, inflation expectations remained generally well-anchored.

II. Review of the Monetary Policy Stance

- The Monetary Board noted that recent evidence of easing inflation pressures supports an unchanged policy setting. Easing energy prices, favorable food prices, and the appreciation of the peso should help keep price pressures at bay in the near term.
- In addition, demand-side pressures on consumer prices appear to be still limited given the sustained deceleration in core inflation, indications of easing money growth, and the slowdown in aggregate demand, particularly consumer spending. There has also been relatively little indication thus far of second-round effects from ongoing supply shocks.

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.



- Nonetheless, there continue to be a number of risks to the inflation outlook. World energy prices continue to be the dominant source of uncertainty in the outlook for inflation given limited global surplus production capacity.
- Moreover, there is still the risk of second-round effects given the expected price pressures in the pipeline. Potential shifts in the public's inflation expectations likewise continue to be a policy concern, given the possibility of a sustained deviation of inflation from government targets over the policy horizon.
- The Monetary Board reiterates that it remains committed to the BSP's price stability objectives and will continue to closely monitor the evolving conditions for consumer prices, aggregate demand, domestic liquidity, and other factors in order to determine the appropriate stance of monetary policy and undertake action if necessary.

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
 - 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 9 February 2006.