Bangko Sentral ng Pilipinas

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 15 APRIL 2004*

The Advisory Committee[1] submitted for the consideration of the Monetary Board the following recommendations: (1) maintain the BSP's policy rates at the current levels of 6.75 percent for the overnight reverse repurchase (RRP) rate and 9.0 percent for the overnight repurchase (RP) rate; (2) maintain the current interest rates on the term RRPs, RPs, and Special Deposit Accounts (SDAs); and (3) maintain the current reserve requirement ratios.

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

The above recommendations were based on the following considerations:

- Headline inflation (1994-based CPI) picked up slightly to 3.8 percent in March 2004 from 3.4 percent in February. The acceleration in inflation was due mainly to increases in the prices of selected food items and in the prices of gasoline and other oil products. This brought the average inflation for the first quarter to 3.5 percent. Based on 2000 CPI series, inflation rose slightly to 4.2 percent in March from 4.0 percent a month ago.

- Similarly, core inflation (1994-based CPI series) edged up to 4.0 percent in March from 3.7 percent in February. The 2000-based core inflation also increased slightly to 4.6 percent in March from 4.4 percent in the previous month.

- The overall outlook for inflation for 2004-2005 continued to point to a moderate uptrend but will continue to be in line with the Government's target of 4.0-5.0 percent. The higher projected inflation over the policy

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* The highlights of the discussions of the 15 April 2004 Monetary Board meeting were approved by the Monetary Board during its meeting held on 6 May 2004.

[1] The Advisory Committee is composed of the Governor of the BSP as Chairman and four members, namely the Deputy Governor for the Banking Services Sector, Research and Treasury, the Deputy Governor for Supervision and Examination Sector, the Assistant Governor, In-Charge of Research and the Director of the Treasury Department. The 15 April 2004 meeting of the Monetary Board—the 4th monetary policy meeting for 2004—followed the Advisory Committee meeting held on 12 April 2004.

horizon is consistent with expectations of improvements in aggregate demand and emergence of cost-side price pressures.

- Demand indicators continued to show modest signs of improvements as evidenced by the rise in manufacturing, car sales, merchandise exports and imports, as well as energy sales. However, there continued to be evidence of resource use slack as the fairly high unemployment rate and spare capacity in manufacturing persisted.

  - The value of production index (VAPI) for manufacturing rose by 5.4 percent (revised) in January 2004, up from the 4.0 percent (revised) growth registered in December 2003. This was the second month of continued increase following the 0.8 percent contraction reported in November 2003. The volume of production index (VOPI) for manufacturing continued to decline although at a slower pace of 0.6 percent year-on-year in January 2004 as against the 1.8 percent (revised) drop in the previous month.

  - Average capacity utilization in manufacturing decreased slightly to 78.3 percent (revised) in January 2004 from 78.4 percent in December 2003, but it was higher than the 76.6 percent recorded a year ago. About 13.7 percent of the responding establishments operated at full capacity (90-100 percent) in January 2004, 48.5 percent reported operation at 70-89 percent capacity, and 37.8 percent operated below 70 percent capacity.

  - Passenger car sales continued to post double-digit year-on-year growth rates for six straight months at a hefty 86.3 percent based on March 2004 preliminary data. However, the combined sales of passenger cars and trucks declined by 18.0 percent, year-on-year in March due mainly to the decline in sales of trucks ranging by 18-45 percent depending on the category.

  - Data on exports from the National Statistics Office (NSO) showed a 7.6 percent increase in February 2004, higher than the 4.1 percent growth recorded in the previous month as well as the 6.1 percent growth posted a year ago. This brought the January-February 2004 exports annual growth to 5.8 percent.

  - Total merchandise imports reported by the NSO continued to expand for the fourth consecutive month but at decelerated pace of 9.0 percent year-on-year in January 2004 from 14.9 percent in December 2003 and from 39.6 percent a year ago.

- Based on the results of the Labor Force Survey conducted by the NSO, the unemployment rate rose to 11.0 percent in January 2004 from 10.6 percent in January 2003. Unemployment rose as 1.74 million entered the labor force, exceeding the 1.40 million net jobs that were generated.

- Registered energy sales by the Manila Electric Company (Meralco) increased by 6.2 percent year-on year in February 2004 following a 7.6 percent drop in January.

▪ Prospects for agricultural production remained favorable, given the continued Government programs along with forecast of normal weather conditions. However, some supply-side risks could emanate from the volatile movements of oil prices in the world market and the resulting transport fare adjustments. In addition, possibility of adjustments of wages and utility charges could also exert pressures on consumer prices going forward.

- Forecasts indicated robust rice and corn production in the first semester of 2004. The Bureau of Agricultural Statistics (BAS) projected *palay* harvest to grow by 10.8 percent in the first quarter of 2004 followed by an 8.7 percent growth in the second quarter. Meanwhile, corn output is expected to post a 12.5 percent and 8.3 percent growth in the first and second quarter of 2004, respectively.

- The international price of Dubai crude oil rose in March on concerns over oil production cut by OPEC beginning April. Similarly, in the futures market, the price of Brent crude increased, driven by the surging demand for oil in the US and China coupled with concerns over possible supply disruption given the volatile situation in the Middle East. In the domestic market, pump prices of gasoline and other fuel products increased to reflect the higher crude oil prices in the past months as well as the depreciation of the peso. These developments led to the adjustment in the minimum fare for the regulated transport sector beginning in April 2004.

- Meanwhile, recent developments in the utilities sector pointed to potential price increases in user charges. Meralco was reported to have filed a petition to raise generation charge while the Manila Water Company announced an increase in its foreign currency differential adjustment charge.

▪ In the financial sector, overall liquidity and bank lending continued to register modest growth. Meanwhile, nominal interest rates continued to trend higher in March leading to wider spreads between RP and foreign interest rates. The uptrend in domestic market rates mirrored the higher risk premium associated with the uncertainties in the current political environment. In order to cap further increases in rates, the Bureau of the Treasury opted to reject unreasonably high bids during its regular auctions in March.

- Domestic liquidity (M3) continued to grow steadily by 4.4 percent year-on-year in February.

- Commercial bank lending expanded by a modest 0.8 percent year-on-year to ₱1.45 trillion as of end-January 2004, slower than the 3.8 percent rise registered in the previous month.

- The BTr rejected all bids across all tenors due to the significantly high bids of banks on lingering political concerns ahead of the May presidential elections and the observed thinner liquidity in the financial system as banks anticipate an increase in demand for cash by consumers for tax payments and for long Lenten holiday in April.

- The peso continued to weaken due to a confluence of factors including increased corporate demand for dollars, persistent political jitters, seasonal slowdown in OFW remittances and market concerns over global security issues. The peso weakened by about 21 centavos against the US dollar to average ₱56.30/US$1 in March 2004 from its February 2004 average of ₱56.09/US$1.

- In the fiscal sector, the deficit of the National Government for the first two months of the year reached ₱34.6 billion. The deficit was 58.7 percent of the first quarter target for the year and higher by 9.2 percent than the level a year ago.

- On the external front, global economic recovery continued to strengthen and broaden. Latest indicators in the US, Japan and the UK showed increased industrial production and investments, accompanied by a strong rebound in global trade as well as sustained improvements in business and consumer confidence. Meanwhile, economic recovery in the euro area showed a gradual firming up but continued to be modest. However, global imbalances remained, posed by the large current account deficit of the US against large surpluses elsewhere, significant fiscal deficits in many industrial and emerging economies, and the large unemployment in the euro area along with lack of sustained pick-up in job creation.

- The strong pick-up in economic growth in the second half boosted the overall performance of the US economy in 2003. The overall solid economic performance of the US economy in 2003 was driven largely by the expansion in exports and investments supported by the sustained improvement in business and consumer confidence. In turn, the sustained growth in consumer spending was boosted by accommodative monetary and fiscal stimulus given the low interest rate environment and tax cuts. However, the recovery has not been accompanied by a meaningful improvement in job creation.

- The economic recovery in the euro area has gradually gained a firmer footing. However, while some indicators of economic strength in the euro area pointed to an overall positive outlook for the economy, the response of private consumption had been subdued. The negative trade position and sluggish labor market conditions indicate continued weak spots in the euro area.

- Latest indicators on the UK economy pointed to a strong domestic demand, with robust retail sales and growing consumer borrowing, against a backdrop of stable prices. However, the marked appreciation of the sterling posed a potential threat to the balanced growth as it could weaken the country's prospects for external trade.[2]

- The Japanese economy continued its path of stable recovery, led by strong export performance and growing business fixed investment. The improvement in the employment situation, however, has been slow since firms are determined to keep labor costs low as economy gains further ground.[3] In addition, deflationary pressures continued to persist.

- Amid sustained indications of stronger global economic activity, monetary authorities in the US, the UK, Japan, and the euro area kept their monetary policy settings unchanged during their latest policy meetings.

[2] "Minutes of Monetary Policy Committee Meeting, 3 and 4 March 2004," 17 March 2004, available online at http://www.bankofengland.co.uk/mpc/mpc0403pdf

[3] Bank of Japan, *Monthly Report on Recent Economic and Financial Development (The Bank's View)*, March 2004, available online at http:www.boj.or.jp/en/seisaku/04/seisak_f.htm

II. Review of the Monetary Policy Stance

- During the deliberation on the BSP's monetary policy stance, the Monetary Board noted that cost-side factors continued to represent the principal source of risk to the inflation outlook. This was based on the economic evidence that has become available since the previous assessment of monetary settings. The Monetary Board identified the recent increase in transport fares, possible adjustments in utility charges, and in minimum wages in response to a sharp rise in fuel costs and the dollar cost of imports as likely sources of cost-push inflationary pressures.

- In line with this assessment, the Advisory Committee presented an impact analysis on inflation of the above-cited risks to consumer prices.

- The members of the Monetary Board pointed out that the price adjustments resulting from transport and utility charges are likely to be one-off or transitory developments. More importantly, they emphasized that breaches in the inflation target due to these and other supply-related factors are largely outside the control of monetary policy. Thus, a monetary response to expected price pressures from such developments may not be appropriate.

- The members of the Monetary Board were also of the view that sentiment-driven volatile movements in the exchange rate could also impact adversely on inflation. However, they pointed out that the general difficulty of assessing the information content of asset price shocks imply that policy responses should be accompanied by caution, taking into consideration the potential risks to real sector activity.

- Meanwhile, the members of the Monetary Board believed that demand-side pressures are likely to be largely tempered by the continued presence of unused capacity and subdued demand in the economy.

- Overall, the Monetary Board was of the view that the balance of demand- and supply-side risks indicated a manageable environment for inflation over the policy horizon.

III. Monetary Policy Decision

- After an assessment of the balance of risks to inflation and the evidence that have been made available since the last meeting on monetary policy presented by the Advisory Committee, the Monetary Board approved unanimously the following policy measures:

   a. Maintain the BSP's policy rates at the current levels of 6.75 percent for the overnight RRP rate and 9.0 percent for the overnight RP rate;

   b. Maintain the current interest rates on the term RRPs, RPs, and SDAs; and

   c. Maintain the current reserve requirement ratios.

The next meeting of the Monetary Board to discuss the monetary policy setting was scheduled on 6 May 2004.