



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON  
MONETARY POLICY ISSUES HELD ON 15 NOVEMBER 2007\***

The Advisory Committee<sup>1</sup> submitted the following recommendations for the consideration of the Monetary Board:

- Adjust the current monetary policy settings as follows:
  - (a) Adjust the BSP's policy interest rates downward by 25 basis points to 5.50 percent for the overnight RRP (borrowing) rate and 7.50 percent for the overnight RP (lending) rate;
  - (b) Adjust the current interest rates on term RRPs, RPs, and SDAs accordingly; and
  - (c) Maintain the current reserve requirement ratios

Further easing of the monetary policy stance was recommended based on the following assessment:

- (a) Benign inflation outlook over the policy horizon;
- (b) The policy move is supportive of non-inflationary growth, and the balance of risks is manageable;
- (c) Positive signal to markets about the BSP's confidence on the durability of the benign inflation outlook; and
- (d) A pre-emptive move by monetary authorities to soften the impact on the domestic economy of a possible global economic slowdown, which could have a serious impact on monetary and financial stability.

The Monetary Board then proceeded to review the recent developments and the key considerations in the formulation of the BSP's monetary policy stance.

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\* The discussion presented herein reflects the assessment made by the Monetary Board based on the information available at the time of the policy meeting. The highlights of the discussions of the 15 November 2007 meeting were approved by the Monetary Board during its regular meeting held on 29 November 2007.

<sup>1</sup> The Advisory Committee is composed of the Governor of the BSP as Chairman and five 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, the Managing Director of the Monetary Policy Sub-sector, and the Director of the Department of Economic Research.



## **Review of Recent Developments**

### **A. Domestic price conditions**

- Headline inflation was unchanged at 2.7 percent in October. Prices for food, beverages and tobacco were broadly stable while light registered lower price levels. Meanwhile, higher prices were recorded for fuel, water and services. The average inflation rate for January-October 2007 was maintained at 2.6 percent. Inflation pressures in October continued to be influenced largely by movements in the prices of cereals, fuel, and gasoline products.
- The official core inflation measure published by the National Statistics Office (NSO) decelerated to 2.4 percent in October from 2.7 percent in September. Month-on-month, core inflation was unchanged in October.

### **B. Demand conditions**

- GDP growth accelerated to 7.5 percent in Q2 2007 on the back of strong consumption spending and expanding investments.
- The 7.1 percent GDP growth for Q1 2007 validated the upturn phase of the Philippine business cycle. The upward business cycle path was expected to continue in Q2 2007 and it did, with GDP growing by 7.5 percent.
- Data from the NSO showed that the growth in merchandise imports decelerated appreciably to 1.8 percent year-on-year in August from 14.2 percent in July. For the first eight months of 2007, merchandise import arrivals rose by 3.8 percent, less than half of the year-ago growth of 10.8 percent. Month-on-month, merchandise import arrivals slid by 1.4 percent in August, after increasing by 7.2 percent in July.
- Data from the NSO showed that merchandise exports registered a 4.7 percent year-on-year growth in September after declining by 4.0 percent in August. For the first nine months of 2007, merchandise exports rose by 4.9 percent, less than one-third of the year-ago growth of 17.6 percent. Month-on-month, merchandise exports increased by 6.6 percent in September after falling by 2.0 percent in August.
- Selected indicators of demand continued to indicate a broad strengthening trend.
  - Based on the latest data from Colliers, land values in Q3 2007 rose by 24.2 percent year-on-year for the Makati Central Business District (CBD) and 17.9 percent for Ortigas Center.



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- Sales of passenger cars surged by 18.4 percent year-on-year in September, four times the 4.6 percent growth in August. Year-to-date sales increased by 5.7 percent, higher than the 4.5 percent growth registered in the comparable period last year.
- Sales of trucks and buses increased but at a slightly slower pace of 11.4 percent year-on-year in September compared to 11.9 percent in August. Year-to-date sales of trucks and buses rose by 24.1 percent, up from the 10.4 percent growth registered in the same period last year.
- Latest data indicate that the energy sales by Meralco rose at a faster pace of 6.7 percent year-on-year in July compared to 5.4 percent in June. Year-to-date energy sales increased by 4.6 percent, higher than the previous year's 1.7 percent. The higher growth rate was attributed by Meralco to the growing economy, widening customer base and higher energy consumption, particularly in the commercial sector.
- The volume of appliance sales increased by 1.5 percent year-on-year in September, a turnaround from the 2.0 percent decline in August. Year-to-date sales likewise grew by 5.0 percent, reversing the 7.0 percent decline in the comparable period last year.
- Average capacity utilization in manufacturing declined slightly in August to 80.4 percent from a revised rate of 80.7 percent in July, based on the NSO's Monthly Integrated Survey of Selected Industries (MISSI).
- MISSI data showed a decline in manufacturing activity in August. The value of production index (VAPI) declined during the month by 3.6 percent year-on-year, reversing the previous month's recovery of 2.1 percent (revised). The volume of production index (VOPI) similarly fell year-on-year by 4.7 percent in August after increasing by 1.5 percent (revised) in the previous month.
- Latest data for Q3 2007 showed that business confidence remained buoyant. The overall business confidence index (CI) remained at the 40.0 percent mark for the fourth consecutive quarter at 40.9 percent, up by 19.2 index points compared to the year-ago level. For Q4 2007, respondents expected that business activity would surge as the index climbed to 53.0 percent, the highest level since the survey was first conducted in Q2 2001.
- Latest data for Q3 2007 showed that consumer confidence continued to improve. The nationwide consumer CI for the quarter sustained its improving trend to -23.6 percent from -26.0 percent in Q2 2007. The more upbeat consumer outlook for the current quarter was buoyed by



favorable economic conditions, higher family incomes and better family financial positions.

- Based on the results of the July 2007 LFS, the unemployment rate declined to 7.8 percent from 8.1 percent in July 2006.
- Minimum wage increases in Region V and Region VII, and an additional cost-of-living allowance in Region XIII were recently approved while there are two petitions for minimum wage increases being reviewed by the National Wages and Productivity Commission. The proposal for the ₱125 daily wage hike for private sector employees and the Salary Standardization Law III for government workers were re-filed in Congress. Meanwhile, the ₱18 across-the-board increase petition in the daily wages in Region I is the only pending application before a regional wage and productivity board.

## **C. Supply-side indicators**

### Developments in Agriculture

- Agriculture grew in Q2 2007 and is expected to sustain its growth, although modestly, for the rest of the year despite the prolonged dry spell and the typhoons experienced in some key areas of the country in Q2 and Q3. Agricultural production will be supported by the expected increase in public spending on seed technology and rural infrastructure. Meanwhile, the DA, through its Ginintuang Masaganang Ani (GMA) Rice Program, is investing in hybrid rice as one of the key solutions to the country's food problems.
- The Department of Science and Technology reported that recent oceanic and atmospheric conditions in the central and eastern equatorial Pacific signify the occurrence of the early phase of a weak La Niña event.
- Retail prices of commercial rice have decreased gradually since the last week of September. However, the National Food Authority is intensifying the monitoring and distribution of government rice nationwide.
- Meanwhile, international rice prices have trended upward but may decline in the coming months. World rice prices have gathered strength since May, but the increase was far smaller compared to the world price increases for other cereals, in particular wheat. Similarly, international prices for all major cereals remained high, with wheat prices hitting record highs in September.



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- After affecting the hog industry in Bulacan, Pampanga, and Nueva Ecija, the swine flu epidemic is under control, according to the Bureau of Animal Industry.

### Oil Price Developments

- International spot and futures prices were higher in early November due to tight fundamentals and speculations in the oil market.
- In the domestic scene, pump prices of petroleum products were raised anew on 10 November 2007.
- In the transport sector, the Land Transportation Franchising and Regulatory Board approved the restoration of the ₱7.50 minimum fare for public utility vehicles in the National Capital Region, Region III, and Region IV effective 2 November 2007.

### Developments in the Utilities Sector

- Meralco reduced its power rates further for residential customers in October as a result of the mandated rate reduction (MRR) on power supply from the National Power Corporation. On top of the MRR, the Energy Regulatory Commission (ERC) granted a provisional authority to the NPC to reflect its lower cost under the 7<sup>th</sup> incremental currency exchange rate adjustment and 8<sup>th</sup> generation rate adjustment mechanism application.
- Meralco reduced the generation charges to its residential customers by ₱0.42/kwh in October.
- However, electricity rates could still increase in the near term due to: 1) restoration of the automatic generation rate adjustment; 2) ERC's ruling readjusting the spot market settlement price, which would translate to a rate increase in the whole of Luzon; and 3) the approval of Meralco's distribution charge starting 2008 under the performance-based rate application.
- Meanwhile, after four quarterly reductions in the foreign currency differential adjustment component of the water tariff, Maynilad Water Company, Inc. and Maynilad Water Services, Inc. have increased their rates for the fourth quarter by ₱0.14 and ₱0.27 per cubic meter, respectively.



## **D. Financial Market Developments**

### Interest Rates

- Weighted average T-bill rates in the primary market were broadly lower as of 5 November relative to September. During the 5 November auction, the Auction Committee made a full award of ₱1.5 billion and ₱2.0 billion worth of T-bills for the 91-day and 182-day tenors, but rejected in full the bids for the ₱2.5 billion worth of 364-day T-bills.
- Relative to the 28 September level, the belly of the yield curve for government securities in the secondary market shifted downward as medium-term tenors declined, while yields on both ends of the curve either declined slightly or remained the same.

### Stock Market

- Stock prices trended upwards in September and early October, but tumbled in mid-October. The rate cuts in the US indicate a positive signal that the local equities market in the medium term may be trending upwards although some traders are expected to cash in on gains in the shorter term. In addition, the country's positive macroeconomic fundamentals also contributed to the uptrend in the stock market index.

### Foreign Exchange

- The peso appreciated by 3.9 percent in October 2007 to average ₱44.32/US\$1 from the ₱46.05/US\$1 average in September. Further, the peso reached its seven-year high on 31 October 2007 to average ₱43.73/US\$1. This developed as the US dollar has generally weakened against the peso and other regional currencies amid fears of a US recession, which were fueled by concerns on US banks' and funds' exposures to the subprime mortgage market as well as the weakness in the US housing prices and employment conditions.
- Year-to-date movements saw most Asian currencies strengthening vis-à-vis the US dollar as of 8 November 2007 from their 29 December 2006 levels, led by the peso's 13.2 percent gain. However, the Indonesian rupiah depreciated by 1.6 percent vis-à-vis the US dollar.

### Global Bond and Credit Default Spreads

- Debt spreads have narrowed since August but renewed concerns that the US subprime mortgage crisis could drag on widened spreads towards the end of October. As of 6 November, EMBI+ global and



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EMBI+ Philippine spreads widened to 204 and 194 basis points, respectively, from their end-October levels while Credit Default Swap spreads climbed to 153 from 132 basis points during the same period.

## **E. Domestic Liquidity and Credit Conditions**

- Growth in domestic liquidity or M3 sustained a decelerating trend for the fifth consecutive month at 11.4 percent year-on-year in September from 14.9 percent in August. Net foreign assets of depository corporations continued to drive M3 growth, although at a slower pace of 32.2 percent year-on-year from 39.7 percent in August.
- Outstanding loans of commercial banks, thrift banks and rural banks (net of reverse repurchase or RRP placements) expanded by 7.5 percent year-on-year in August compared to the 6.9 percent growth posted in the previous month. This was a marked turnaround from the 0.4 percent decline registered in the same month a year ago. Gross of banks' RRP placements with the BSP, bank lending exhibited the same trend, rising by 4.3 percent year-on-year in August from 3.4 percent in July.
- Consumer credit rose by 22.2 percent year-on-year in Q1 2007. This was higher than the year-ago growth recorded at 21.1 percent. More specifically, auto loans, credit card receivables and residential real estate loans expanded by 19.9 percent, 22.3 percent and 24.0 percent, respectively.
- Capital-raising activities by PSE-listed companies reached ₱83.2 billion during the first nine months of the year, exceeding the ₱31.5 billion raised during the comparable period in 2006 and surpassing the ₱57.2 billion raised for the whole year of 2006.
- As of end-August 2007, the stock of bank loans outstanding rose by ₱31.6 billion relative to the end-December 2006 level. Over the same period, issuances of equity capital and bonds by the private sector including banks totaled ₱136.4 billion. Excluding issuances by banks, the total amount of equity and bonds issued during the period January-August 2007 reached ₱104.6 billion.

## **F. Fiscal developments**

- The fiscal deficit of the National Government reached ₱14.5 billion in September. This brought the January-September fiscal deficit to ₱40.0 billion, lower by ₱14.0 billion compared to the programmed ceiling of ₱54.0 billion. The lower deficit resulted mainly from lower spending partly on account of the savings on interest payments due to lower borrowing cost.



## **G. External developments**

- The recent turmoil in global financial markets caused by the US subprime mortgage problem has moderated global growth momentum in Q3 2007. Global growth is expected to slow down, but the overall outlook remains uncertain as the extent of the impact of the housing slump remains protracted and could drag on.
- Buoyant economic activity in emerging markets and the coordinated response of major central banks to improve liquidity conditions will help avoid a serious downturn and possibly reduce the downside risks of tighter credit and financial conditions from spreading into the global real economy.
- Other major central banks, meanwhile, adopted mixed policy directions. The Federal Reserve loosened monetary policy settings while the other three major central banks maintained their neutral stance.

## **II. Key Considerations in the Formulation of the Monetary Policy Stance**

- The Monetary Board considered the continuing benign inflation outlook across a range of possible scenarios. Inflation remains likely to fall well below the 4.0-5.0 percent target range in 2007 and within the lower bound of the 4.0 percent  $\pm 1$  percentage point target in 2008.
- In assessing the upside risks to inflation, the Monetary Board noted that these have remained manageable. Liquidity growth continued to slow down for the fifth consecutive month in September; risks pertaining to agricultural output have moderated; more recent regional wage adjustments are not expected to add price pressures; and inflation expectations remain well-anchored.
- Moreover, monetary measures implemented last May 2007 continue to temper the impact on domestic liquidity of the sustained strong foreign exchange inflows, while the firm peso has cushioned the effect of higher import prices of oil and food, among other commodities.
- The Monetary Board noted that downside risks are present as well. These include the possible moderation in demand pressures and the potential decline in international oil prices if global growth slows down.
- The Monetary Board was of the view that a more accommodative monetary policy stance will help stimulate business activity and could pre-empt any possible slowdown in the global economy, which could have a significant impact on the country's monetary and financial stability.





- The Monetary Board will continue to keep a watchful eye on global and domestic economic developments, particularly factors that could pose threats to the inflation target, mindful that price stability is essential to sustainable economic growth.

### **III. Monetary Policy Decision**

- After considering the balance of risks to inflation and the evidence that has become available since its previous meeting on monetary policy, the Monetary Board approved the recommendations of the Advisory Committee.

The next meeting of the Monetary Board on the monetary policy stance is scheduled on 20 December 2007.