



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON
MONETARY POLICY ISSUES HELD ON 8 MAY 2003***

Background

The Monetary Board held its sixth meeting for the year on monetary policy issues on 8 May 2003. This followed the 6 May 2003 meeting of the Advisory Committee.¹ The Advisory Committee submitted, for the Monetary Board's consideration, a policy paper containing the committee's assessment of the economic conditions and their implications on the inflation outlook as well as the committee's recommendations for the appropriate stance of monetary policy. During its 8 May 2003 meeting, the Monetary Board's discussion revolved around the factors that could influence inflation and inflation expectations, in particular, the forecasts of agricultural production, movements of the exchange rate, direction of international and domestic oil prices, possible adjustments in utility rates, liquidity and credit conditions, trends in demand and output indicators, fiscal developments, world economic conditions and outlook, and the implications of these factors on the BSP's monetary policy stance.

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

- Headline inflation decelerated to 2.8 percent in April from 2.9 percent in the previous month as the lower food inflation cushioned the impact of higher fuel prices. The BSP's measure of core inflation also eased to 2.5 percent in April from 2.6 percent in March.
- Inflation is expected to be below the Government's target of 4.5-5.5 percent in 2003 but broadly in line with the 4-5 percent target for 2004. This is based on the assessment that (1) the current state of domestic demand continued to support a benign inflation setting and

* The highlights of the discussions of the 8 May 2003 Monetary Board meeting were approved by the Monetary Board during its meeting held on 12 June 2003.

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 Managing Director, In-Charge of Research and the Director of the Treasury Department.



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(2) supply-related influences such as the El Niño and fuel prices have shown evident signs of tapering off.

- Some of the main cost-push risks to future inflation have already receded from the present environment.
 - The impact of the present mild El Niño episode on rice and corn production is expected to weaken as weather conditions improve. Meanwhile, improved planting conditions and government support measures to avert possible supply problems of basic commodities are expected to keep food prices low or stable.
 - The decline in international crude oil prices has led to corresponding cutbacks in the prices of local petroleum products. Compared with end-March 2003 levels, the prices of premium gasoline, kerosene, diesel oil, and liquefied petroleum gas (LPG) as of 5 May 2003 were reduced cumulatively by 60 centavos, 20 centavos, 40 centavos, and ₱1.10, respectively. Domestic oil prices could go down further after local oil companies run down their current inventory of crude and finished products, which were imported at a time of rising world market prices.
 - In the utilities sector, the Supreme Court upheld its 15 November 2002 decision on the Manila Electric Company's (Meralco) overcharging case on 30 April 2003.² While this implies a favorable influence on inflation expectations, the ultimate impact on future inflation would depend also on the final decision of the Energy Regulatory Commission (ERC) on Meralco's pending petition for rate unbundling.³
- Indicators of economic activity continued to show encouraging signs but do not, as yet, provide conclusive evidence of a strong and sustained pickup in demand.
 - The year-on-year rise in the volume of production index (VOPI) slowed to 1.8 percent in February 2003 from 3.7 percent in the previous month. The value of production index (VAPI) likewise slowed to 11.4 percent in February from 12.8 percent in January.

² The Energy Regulatory Commission (ERC) released its decision on the refund scheme for the said case on 12 May 2003.

³ Subsequently, the ERC issued its Order on Meralco's Motion for Reconsideration on its unbundling case on 30 May 2003, allowing Meralco to increase its rate by an average of 17 centavos per kwh compared to the average selling rate in May 2003 (ERC Case No. 2001-646).



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- Average capacity utilization in manufacturing improved slightly to 76.5 percent in February from 76.1 percent in the previous month.
- Commercial bank lending continued to rise for the sixth consecutive month with an increase of 4.4 percent year-on-year in February 2003.
- As of end-December 2002, consumer lending activity continued to strengthen as credit card receivables of both commercial and thrift banks (including their credit card subsidiaries) grew by 5.1 percent compared to the third quarter of 2002 and by 13.8 percent from a year earlier. Credit card receivables comprise about 3 percent of banks' total loan portfolio.
- The year-on-year growth in energy sales of the Manila Electric Company (Meralco)—a leading indicator of overall power consumption—slowed down to 5.6 percent to 1,847 million kwh in February after an 11.6 percent annual rise in the previous month.
- Labor market conditions remained soft in the first quarter, with the unemployment rate remaining at 10.6 percent compared to 10.2 percent in the previous quarter and 10.3 percent in the first quarter of 2002.
- Treasury bill rates were generally higher in April. The general increase in the yields reflected the market's demand for higher premium on T-bills owing to the implementation, beginning 1 April 2003, of the 10 percent value-added tax on banks' earnings from trading securities, which effectively replaced the 5 percent gross receipts tax (GRT)⁴ as well as the market's concerns over the downgrade of the country's credit standing by Standard and Poor's. During the 28 April 2003 auction, the average yield on the benchmark 91-day T-bill reached an 11-month high of 7.34 percent—although this was 12 basis points lower compared to the rate in the previous auction on 14 April 2003. Meanwhile, domestic liquidity (M3) remained adequate

⁴ Of the 10 percent VAT liability on interest income from all government securities, 6 percent is automatically withheld by the BTr as replacement for the old gross receipts tax (GRT), while the remaining 4 percent is remitted by the banks themselves to the government. On 24 April 2003, however, the NG decided to temporarily suspend the withholding of the 6 percent GRT-equivalent portion of the VAT pending clarifications by the BIR on the application of the VAT. This resulted in the slight decline in 91-day T-bill yields on 28 April 2003 compared to the 91-day T-bill yield on 14 April 2003.



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despite the slowdown in M3 growth to 4.3 percent year-on-year in March 2003 from the previous month's 6.3 percent growth.

- The peso stabilized in April and gained further ground against the US dollar. The peso's recovery, which started around mid-March, could be attributed partly to the reduced uncertainty in the Iraq situation as the market priced in a quick resolution of the conflict in the Middle East. The implementation by the BSP of a number of measures to curb speculative demand for dollars also contributed to the moderation of market volatility. The peso settled at an average of ₱52.76/US\$1 during the month, a 3.4 percent nominal appreciation from its average level in March.
- The National Government's fiscal deficit in the first quarter of 2003 at ₱58.9 billion was slightly above the target of ₱55.2 billion, but lower than the ₱61.2 billion deficit posted a year ago.
- Business and consumer sentiment in the major industrial economies remained cautious, weighed down by weak labor market conditions, sharp falls in equity markets, and lingering geopolitical uncertainties.
 - In the US, real GDP rose by 1.6 percent, year-on-year in the first quarter of 2003, up slightly from the 1.4 percent growth in the fourth quarter of 2002. Consumer spending continued to be resilient as advance estimates of retail and food services sales increased by 2.1 percent in March from a decline of 1.3 percent in the previous month. Likewise, the University of Michigan's consumer sentiment index gained, rising to 86.0 in April from 77.6 in March. Meanwhile, other indicators continued to point to weakness in the economy as the US unemployment rate rose to 6.0 percent in April from 5.8 percent in March. Likewise, the Institute for Supply Management (ISM) manufacturing index has remained below 50 percentage points in April, falling to 45.4 percentage points from 46.2 percentage points in March.
 - In the euro area, recent data suggest that economic growth is likely to remain weak in early 2003. Manufacturing activity for the euro area contracted in March as the purchasing managers index (PMI) fell to 48.4 from previous month's level of 50.1.⁵

⁵ Reuters, "War, and Its Prospect, Shakes World Economy", 1 April 2003, available at <http://www.reuters.com>.



- In Japan, domestic demand has not shown any clear sign of recovery as both public investment and private consumption showed a declining trend. Meanwhile, deflationary pressures have somewhat eased due to the recent uptick in crude oil prices and other international commodity prices.⁶
- Indications of weakness have not yet prompted an easing bias by most of the major central banks. The US Federal Reserve, the European Central Bank and the Bank of England all voted to keep policy interest rates unchanged during their latest monetary policy meetings. However, the Bank of Japan (BOJ) continued to ease liquidity conditions as it decided to raise further its main operating target for money market operations—the target outstanding balance of current accounts held at the BOJ—from “around ¥17-22 trillion” to “around ¥22-27 trillion”. The Bank of Japan also pledged to “provide more liquidity irrespective of the above target when necessary to secure financial market stability.”⁷

II. Review of the Monetary Policy Stance

- The Monetary Board's assessment of the current macroeconomic environment showed that the greater balance of available economic data pointed to demand conditions that continue to support a subdued inflation setting going forward. The members of the Monetary Board noted that BSP's estimates of core inflation continued to track a benign trend, suggesting the relative absence of broad-based price pressures across consumer commodity groups. They argued that this is consistent with the mixed trends in various indicators of aggregate demand, the modest pace of credit creation, sluggish employment and wage conditions, and partial capacity utilization in key sectors such as manufacturing.
- At the same time, the members of the Monetary Board expressed the view that some of the main risks to future inflation associated with cost-push influences, notably the impact on farm prices of the El Niño phenomenon and adverse movements in world oil prices, have to some extent receded from the present environment.

⁶ Takeda, Atsushi, “Japan's Economic Outlook”, *Mizuho Economic Report Vol. 2 No.4*, 10 April 2003.

⁷ Bank of Japan, Monetary Policy Meetings, 30 April 2003, available at <http://www.boj.or.jp/en>.



- The Monetary Board believed that these conditions strengthened expectations that headline inflation would remain broadly in line with the government's target over the policy horizon. Moreover, the Monetary Board's macroeconomic assessment also highlighted the greater risk of economic weakness faced by monetary authorities here as in other parts of the world.
- However, the Monetary Board noted that the major risks to future inflation have not all dissipated. The problem of a possible prolonged exchange rate volatility and its implications for inflation expectations has subsided without recourse to sharp policy rate responses. Hence, the possibility of renewed exchange market pressure should not be entirely discounted, particularly given that market sentiment is also vulnerable to changes in the NG's fiscal performance.
- Given these considerations, the Monetary Board believed that the current monetary policy settings are consistent with the preservation of price stability and are appropriately calibrated to support the economy's growth objectives.

III. Monetary Policy Decision

- After a careful assessment of the balance of risks on inflation and inflationary expectations given the various macroeconomic and financial sector indicators which have become available since its 10 April 2003 monetary policy meeting, the Monetary Board concluded that the current monetary policy stance continued to ensure price stability while remaining supportive of the economy's growth objective. Thus, the Monetary Board, by a unanimous vote, approved the following measures:
 - a. Maintain the BSP's policy rates at the current levels of 7.0 percent for the overnight RRP (borrowing) rate—without the tiering scheme—and 9.25 percent for the overnight RP (lending) rate; and
 - b. Maintain the reserve requirement ratios for banks at their current levels of 9 percent for regular reserves and 8 percent for liquidity reserves.
- For its future discussions, the Monetary Board also agreed to consider the option of reassessing present monetary settings, particularly the



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level of liquidity reserve requirements given that the risks to the inflation outlook have abated.

The next meeting of the Monetary Board to discuss the monetary policy setting was scheduled on 5 June 2003.

- The Monetary Board of the Bangko Sentral ng Pilipinas

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