



## **HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 25 JANUARY 2007\***

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

- 1) 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;
- 2) Maintain the tiering scheme on the aggregate placements by banks with the BSP under the RRP and SDA windows;
- 3) Maintain the current interest rates on term RRPs, RPs, and SDAs; and
- 4) Maintain the current reserve requirement ratios at 10 percent for regular reserves and 11 percent for liquidity reserves on the deposit and deposit substitute liabilities of universal banks (UBs) and commercial banks (KBs) and Non-Bank Financial Intermediaries with quasi-banking and with trust license.

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

### **I. Review of Recent Developments**

#### **Inflation**

- Headline inflation decelerated further to 4.3 percent in December, its lowest level since March 2004. Consistent with the BSP's expectation, the full-year 2006 inflation at 6.2 percent was above the government target but was lower than the average for 2005. The steady decline in inflation over the past year was due mainly to easing oil prices, subsiding base effects, a stronger peso and generally stable food prices.

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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 25 January 2007 meeting were approved by the Monetary Board during its regular meeting held on 15 February 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 Acting Director of the Department of Economic Research.



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- Various measures of underlying inflation—i.e., the official core measure published by the National Statistics Office (NSO) and the alternative measures of core inflation estimated by the BSP—continued to moderate in December.
- Inflation expectations also continued to ease, based on the results of the BSP's survey on inflation forecasts among private sector analysts.

### **Demand**

- Latest data generally showed moderate improvements in demand conditions.
  - Vehicle sales rose in November due to fleet deliveries, the launch of new models and yearend marketing promos. Industry sources reported a 29.5 percent year-on-year increase in passenger car sales and a 26.0 percent growth in truck and bus sales in November.
  - Based on the latest data for the third quarter from Colliers International Research, land values in the Makati Central Business District (CBD) and Ortigas Center continued to rise. The average office vacancy rate in the Makati CBD dropped on the back of sustained demand for office space from call centers and the BPO sector.
  - Latest merchandise trade data showed double-digit growth in both imports and exports.
    - Merchandise import payments increased by 12.5 percent year-on-year in October following a slight decline in September. The year-to-date growth in merchandise imports was 9.2 percent, higher than the previous year's 5.7 percent.
    - Growth in merchandise export earnings slowed to 10.8 percent in November from 15.5 percent in October, due largely to lower export growth of manufactures. Merchandise export growth for January-November 2006 was 15.8 percent, higher than the previous year's 2.8 percent.
  - Total energy sales by Meralco rose modestly by 3.8 percent in November, following a 3.3 percent decline in October. This was due mainly to the upturn in energy consumption by the residential and industrial sectors and higher growth in the commercial sector.



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- Based on the new NSO definition of unemployment, the jobless rate was 7.3 percent in October 2006, slightly lower than the 7.4 percent recorded a year ago. This was also lower than the 8.0 percent unemployment rate in July.<sup>2</sup>
- Appliance sales continued to decline, with total units sold falling by 19.3 percent year-on-year in November.
- Average capacity utilization in manufacturing was broadly unchanged at 80.1 percent in October. About 60 percent of respondent firms reported capacity utilization rates between 70 and 89 percent, while about a third reported rates of below 70 percent.

### **Domestic Liquidity**

- Domestic liquidity or M3 growth accelerated to 18.5 percent year-on-year in November from 16.1 percent in October, based on the data from the BSP's Depository Corporations Survey (DCS).<sup>3</sup> The expansion in liquidity continued to be driven by strong foreign exchange inflows from foreign investments, exports and OFW remittances.
- Bank lending grew at a slower pace of 6.8 percent year-on-year in November from 11.1 percent in October. Commercial bank lending continued to be driven by loans to the financial institutions, real estate and business services sector (FIREBS).

### **Other Domestic Developments**

- Agricultural output increased by 3.9 percent in 2006, up from 2.3 percent a year earlier. The robust performance of the agriculture sector in the first nine months of 2006 offset the impact of the typhoons in the last four months of the year. For the first quarter of 2007, the Bureau of Agricultural Statistics expects rice production to grow by 5.0 percent and corn production by 13.6 percent.<sup>4</sup>
- Despite the favorable outlook for agricultural production, food prices remain at risk from the El Niño dry spell, which is expected to continue until the second quarter of 2007.

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<sup>2</sup> 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 unemployment definition did not consider the criterion on availability for work.

<sup>3</sup> The DCS, which replaced 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.

<sup>4</sup> BAS, Rice and Corn Situation Outlook Volume 20, No. 4, available online at <http://www.bas.gov.ph>



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- International oil prices were higher in December but started to ease in early January due to reports of higher oil inventories and milder winter weather conditions in the US. Meanwhile, domestic pump prices of gasoline, diesel and LPG were raised during the period.
- The peso continued to appreciate relative to the US dollar on the back of strong regional currencies and sustained inflows from OFW remittances, export earnings and foreign investments. Expectations of more dollar inflows from fresh government borrowings and the economy's solid fundamentals also contributed to the peso's strengthening.
- The National Government's fiscal deficit for the first eleven months of 2006 of ₱58.3 billion was less than half of the full-year program of ₱124.9 billion.
- Lower T-bill offering, reflecting the improving fiscal position and ample market liquidity, brought T-bill rates during the 22 January 2007 auction down from their levels during the 20 November 2006 auction.

### **External Developments**

- The global economy continued to expand at a fairly robust pace, with signs of a gradual rebalancing in the composition of global growth. Robust services output, buoyant labor market conditions, and favorable financial conditions supported the expansion in most major economies. The pace of growth in Japan and emerging Asia continued to pick up while the upturn in the Euro Area is likely to become broad-based in the months ahead. However, there is evidence of a gradual moderation in the global growth momentum as GDP growth in the US slowed significantly due to the cooling housing market and high oil prices. A number of risks also remain, notably volatility in international oil prices, a disorderly unwinding of global imbalances, and an unexpected tightening of financial markets. Consumer price inflation has declined noticeably in a number of countries.
- The US Federal Open Market Committee (FOMC) maintained its target for the federal funds rate at 5.25 percent in its December policy meeting, noting the moderation in economic growth. Nevertheless, the FOMC continued to note the presence of inflation risks. Monetary authorities in Japan and the Euro area likewise decided to maintain current policy settings during their January monetary policy meetings. On the other hand, the Bank of England's Monetary Policy Committee voted to raise the official bank rate to 5.25 percent during its January meeting to help bring the headline inflation back to target in the medium term.



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

- The Monetary Board noted that the outlook for inflation has largely eased since its previous policy meeting. Supply-side pressures diminished noticeably in recent months. Meanwhile, demand-side pressures continued to be minimal, although latest data showed moderate improvements across demand indicators.
- More importantly, latest BSP forecasts for 2007 and 2008 showed that in the absence of further adverse shocks, average inflation may edge closer to the lower end of the 4.0-5.0 percent target range for 2007 and the 4.0 percent  $\pm$  1.0 percent target for 2008.
- Nevertheless, the Monetary Board believed that, on balance, there continued to be sufficient grounds for caution in the monetary policy stance. More time is needed to allow the impact of the tiering system to fully wind its way through the credit channel. A prudent pause was only appropriate particularly in light of the continued strong growth in liquidity and the downtrend in interest rates.
- Caution in adjusting policy settings was also important in light of various upside risks to inflation, which include various cost-side adjustments. There was also some uncertainty as to whether the recent moderation in supply-side pressures will continue, given the vulnerability of energy prices to geopolitical disruptions and the risk to food prices from a stronger El Niño episode. In addition, inflation expectations, while manageable at present, are also at risk from anticipated increases in public expenditure and possible large adjustments in nominal wages.
- The Monetary Board reiterated its firm commitment to addressing the risks to future inflation and will continue to monitor closely the evolving conditions for consumer prices, aggregate demand, domestic liquidity and other factors in order to determine the appropriate stance of monetary policy.

## **III. Monetary Policy Decision**

- After considering the 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 8 March 2007.