Bangko Sentral ng Pilipinas

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 2 NOVEMBER 2006*

The Advisory Committee[1] 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 at 10 percent for regular reserves and 11 percent for liquidity reserves on the deposit liabilities of universal banks (UBs) and commercial banks (KBs) and Non-Bank Financial Intermediaries with quasi-banking and with trust license.

3) Adopt a tiering scheme on the aggregate placements by banks with the BSP under the RRP and SDA windows as follows:

   (a) First ₱5 billion – current BSP published rates;

   (b) In excess of ₱5 billion up to ₱10 billion – current BSP published rates less 200 basis points;

   (c) In excess of ₱10 billion – current BSP published rates less 400 basis points.

4) Continue to articulate the BSP's support for the Government's use of non-monetary measures to address supply-side risks to basic commodity prices and continue representation and coordination with concerned government agencies for this purpose.

* 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 2 November 2006 meeting were approved by the Monetary Board during its regular meeting held on 23 November 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 Officer-In-Charge of the Department of Economic Research.

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 continued to slow down, falling to 5.7 percent in September. All commodity groups registered slower price increases except for clothing, for which inflation remained steady at 3.1 percent for the past three months. Likewise, core inflation decelerated anew to 5.0 percent from 5.3 percent in August.

- The easing was driven mainly by lower oil prices. The spot price of Dubai crude oil continued to soften in October on news of rising US crude inventories. Similarly, local retail prices of gasoline, kerosene and diesel were also reduced during the period.

Demand

- Available data generally showed mixed improvements in demand conditions.

  - Average capacity utilization in the manufacturing sector was relatively unchanged at 80.3 percent in August compared to 80.2 percent in July with about 60 percent of respondent firms reporting capacity utilization rates between 70 and 89 percent.

  - Growth in merchandise export earnings accelerated to 21.3 percent in August. This was largely on account of the stronger growth in manufactured exports, which comprised 87.5 percent of total. In particular, electronics exports were up by 14.7 percent in August compared to only 1.3 percent in July.

  - Growth in merchandise imports rose slightly to 15.3 percent in August from a revised rate of 14.8 percent in July with faster growth in imports of raw materials and intermediate goods.

  - Passenger car sales increased by 9.1 percent year-on-year in September, higher than the previous month's 6.5 percent. Similarly, sales of trucks and buses rose by 18.6 percent year-on-year in September, up from 16.1 percent in August.

  - Total energy sales by the Manila Electric Company (Meralco) declined by 3.7 percent in August following a modest increase of 1.8 percent in

July. This was due to reduced energy consumption by the residential, commercial and industrial sectors.

- Appliance sales remained weak, with total units sold falling by 16.6 percent year-on-year in August.

- Based on the new NSO definition of unemployment, the jobless rate declined to 8.0 percent in July 2006 from 8.2 percent in the previous quarter, but remained higher relative to the year-ago rate of 7.7 percent.[2]

Domestic Liquidity

- Demand for money increased further in September as domestic liquidity or M3 growth based on data from the BSP's Depository Corporations Survey (DCS) accelerated to 14.5 percent year-on-year from 12.4 percent in August.[3] The expansion in liquidity was traced largely to the increase in the net foreign assets of depository corporations on the back of strong foreign exchange inflows from overseas Filipino workers (OFW) remittances, export receipts and portfolio investments.

- Nevertheless, private credit remained weak. Growth in outstanding loans of commercial banks (KB) slowed to 2.5 percent year-on-year in August from the 4.3 percent growth posted in the previous month.

Other Domestic Developments

- A dry spell is ongoing and could affect food production. The Philippine Atmospheric, Geophysical and Astronomical Services Administration (PAGASA) confirmed that an El Niño dry spell is in its early stage of development. These dry weather conditions may continue until early 2007.

- The Bureau of Agricultural Statistics (BAS) estimates a 0.8 percent decline in rice production in the fourth quarter, given intensive planting by farmers early in the year. Nonetheless, full-year production is still expected to reach an all all-time high of 15.4 million metric tons, 5.7 percent higher than last year's harvest, because of strong first semester output.[4]

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[2] 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.

[3] 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.

[4] BAS, Rice and Corn Situation Outlook Volume 20, No. 3, available online at http://www.bas.gov.ph

- Treasury bill (T-bill) auction rates eased across all tenors on 23 October 2006 relative to 11 September 2006. The decline in yields may be attributed to sustained investor confidence in the government's fiscal performance and ample liquidity among banks.

- The Philippine peso continued to advance against the US dollar due to positive market sentiment given improving economic fundamentals. Strong regional currencies due partly to market expectations of a pause in the US tightening cycle, the BSP's relatively high level of dollar reserves and sustained dollar inflows from OFW remittances, exports and foreign investments likewise contributed to the gains in the peso.

- The National Government (NG) posted a ₱16.2 billion fiscal deficit in September, which brought the year-to-date fiscal deficit to ₱50.4 billion, 53.5 percent lower than the deficit for the comparable period in 2005. The NG's fiscal deficit for the first three quarters of the year is less than half of the full-year program of ₱125 billion.

External Developments

- The global economic expansion has shown some signs of moderation in the second quarter of 2006, with real GDP growth slowing in both the United States and Japan relative to the previous quarter. However, world growth is expected to remain fairly robust for the remainder of the year on account of ongoing improvements in consumer spending, sustained gains in employment, and still-favorable financial conditions. A number of risks remain, notably the volatility in international oil prices, disorderly unwinding of global imbalances, and the unexpected tightening of financial markets—particularly those in industrial countries such as the US and UK where housing markets are richly valued.

- The major central banks decided to maintain their policy rates at current levels. The US FOMC maintained its target for the federal funds rate at 5.25 percent in its 24 October 2006 policy meeting as the country's economic growth slowed significantly in the second quarter, partly reflecting the cooling housing market. However, the Committee maintained that further policy rate increases may be needed going forward to address existing inflation risks. Similarly, the Bank of England's Monetary Policy Committee voted to keep the official bank rate steady at 4.75 percent during its 4-5 October meeting on account of the broadly unchanged inflation outlook during the month relative to August 2006. The Bank of Japan decided to maintain current policy settings as it encouraged the uncollateralized overnight call rate to remain at around 0.25 percent in its 12-13 October 2006 monetary policy meeting.

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

- The Monetary Board was of the view that the improving outlook for inflation, given prevailing demand and supply-side conditions, provides some policy flexibility. Latest forecasts continued to show a generally declining path for inflation, with average inflation for 2007 expected to fall within the 4-5 percent target in the absence of further adverse shocks. The stronger peso should also help keep down the domestic prices of imported commodities, particularly crude oil, while a moderate outlook for agriculture should help ensure stable food prices.

- Meanwhile, the continued easing of core inflation suggests minimal demand-based inflation pressures. Aggregate demand, to date, has shown moderate improvements, driven largely by consumer spending.

- However, the Monetary Board also acknowledged that the balance of risks to the inflation outlook remained on the upside, due to a number of factors. Foremost among these are the potential cost-side pressures arising from the uncertainty in world oil prices. Food prices may also be at risk if the El Niño turns out more severe than expected, which can significantly affect agricultural production. With these potential supply-side pressures, the Monetary Board remained watchful of a rise in the public's inflation expectations.

- The Monetary Board also noted that they will continue to pay close attention to a possible excessive buildup in liquidity conditions that could lead to higher inflation.

- The Monetary Board decided to adopt a tiering scheme on banks' aggregate placements with the BSP under the RP/RRP and SDA windows, effective today, 2 November 2006. The Monetary Board believed that the restoration of the tiering scheme is expected to encourage banks to seek alternatives to placing their excess funds with the BSP, such as lending to the public.

- The Monetary Board reiterated its strong commitment to achieving the inflation targets for the medium term and its readiness to act against emerging risks to the outlook for inflation and to inflation expectations.

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 unanimously approved the recommendations of the Advisory Committee.

The next meeting of the Monetary Board on the monetary policy stance is scheduled on 14 December 2006.