



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON  
MONETARY POLICY ISSUES HELD ON 16 DECEMBER 2004\***

The Advisory Committee<sup>1</sup> 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 rates at the current uniform rates of 6.75 percent for the overnight RRP (borrowing) rate and 9.0 percent for the overnight RP (lending) rate;
  - (b) Maintain the current interest rates on the term RRP, RP, and Special Deposit Accounts (SDAs); and
  - (c) Maintain the current reserve requirement ratios.
- 2) Continue to articulate support for the use of non-monetary measures to address supply-side risks, particularly those relating to food supply, by strengthening the BSP's representation and coordination with various government agencies.

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

The above recommendations were based on the following considerations:

- ✍ Supply factors continue to drive the headline inflation rate. Inflation in November was recorded at 5.3 percent (1994=100) and 5.7 percent (2000=100).
- ✍ Core inflation (defined as headline inflation excluding selected food and energy products) also edged higher in November, reaching 7.3 percent using the 1994-base CPI and 7.6 percent using the 2000-base CPI.

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\* The highlights of the discussions of the 16 December 2004 Monetary Board meeting were approved by the Monetary Board during its meeting held on 20 January 2005.

<sup>1</sup> 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.



- ✍ Forecasts generated by BSP inflation forecasting models continue to indicate that inflation will exceed the 4.0-5.0 percent inflation target in 2004 and 2005 but should ease back to the target by 2006.
- ✍ Although data on consumption and manufacturing activity continued to suggest expansion in demand, other indicators pointed to soft spots in the economy.
- ✍ Real GDP grew at a robust pace of 6.3 percent in the third quarter, while real GNP expanded by 6.1 percent from a year-ago level. Growth was boosted by the continued growth in personal consumption along with the strong rebound in both investments and exports.
- ✍ Average capacity utilization in manufacturing rose slightly to 80.0 percent in September 2004 from 79.2 percent in August and 78.7 percent in the same month a year ago.
- ✍ The value of production index (VAPI) for manufacturing increased significantly by 13.9 percent in September following a revised annual growth of 3.2 percent in the previous month. Likewise, the volume of production index (VOPI) for manufacturing accelerated by 7.2 percent year-on-year in September, a reversal of the 3.6 percent (revised) contraction in August.
- ✍ Exports grew at an annual pace of 12.3 percent in October from 8.4 percent in the previous month. This brought the January-October 2004 annual exports growth to 8.9 percent.
- ✍ Year-on-year growth in merchandise imports edged up to 14.8 percent in September from 8.9 percent in August. For the January to September 2004 period, the cumulative annual growth of imports stood at 8.0 percent.
- ✍ Growth in passenger car sales was flat in October as reported by the Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI). This came after a 76.6 percent sales increase in the previous month. This also represented a deceleration from the 81.9 percent increase in October 2003. Meanwhile, the combined truck and bus sales posted an 8.7 percent year-on-year growth in October, a reversal from the 7.8 percent dip in September.
- ✍ Energy sales by the Manila Electric Company (Meralco) increased by 8.0 percent year-on-year in October, higher than the 5.7 percent growth in September, and the 0.3 rise in October of last year.



- ✍ Unemployment rate remained relatively high at 11.7 percent in July 2004. Nevertheless, the July 2004 unemployment rate represented an improvement from the 12.6 percent registered for the comparable period in the previous year. This is still considerably higher than 7.4 percent, the lowest unemployment rate recorded during the peak growth years 1993-1996.
- ✍ Demand for money and credit also continued to post modest growth while nominal RP interest rates eased during the 6 December 2004 auction of the Bureau of the Treasury (BTr) relative to the previous auction, leading to narrower spreads over foreign interest rates.
- ✍ Domestic liquidity (M3) grew by 6.2 percent (revised) year-on-year in October, up from the 5.3 percent rise recorded in the previous month but significantly below the double-digit levels posted in the growth years during the pre-Asian crisis period of 1993-1996.
- ✍ Commercial bank lending grew by 1.9 percent year-on-year as of end-September 2004, a marked slowdown from the 5.5 percent increase in the previous month, and lower than the double-digit growth rates registered during the pre-Asian crisis period of 1993-1996.
- ✍ Reference yields for the 91-day fell during the 6 December 2004 auction of the Bureau of the Treasury relative to the previous auction rate. Healthy liquidity in the market helped soften the yields for the 91-day and 182-day T-bills.
- ✍ Supply-side factors continue to dominate the risks to the inflation outlook, chief among them is the continued rise in world oil prices, which will affect the cost of producing other goods and services. On the other hand, the prospect of favorable agricultural output for the rest of the year is expected to provide a cushion for food prices.
- ✍ Agricultural output grew by 6.8 percent in the first nine months of 2004, supporting expectations of a favorable performance for the remainder of the year. However, the onset of a weak El Niño episode poses upside risks to food prices, and highlights the importance of timely intervention measures to limit adverse impact of the said weather disturbance.
- ✍ Reports of increased US oil stocks and buoyant world oil production helped moderate world oil prices in December 2004. In the domestic market, pump prices of petroleum products increased by a range of ₱0.30–₱1.00 during the first two weeks of November, reflecting the general uptrend in world oil prices.



- ✍ The peso strengthened slightly against the US dollar owing mainly to remittances from overseas Filipino workers (OFWs) for holiday-related spending.
- ✍ In the fiscal sector, the January-October 2004 NG budget deficit of ₱147.7 billion, was 10 percent lower than the figure recorded in the same period a year ago.
- ✍ Global economic growth showed some signs of moderation as industrial production and private consumption appeared to have slowed down in most economies alongside tapering export growth. On the price front, stronger inflationary pressures are expected to persist over the short term due to world oil prices, but the medium-term outlook remains in line with price stability.
- ✍ US economic activity continued to show strength in terms of sustained improvements in consumer spending, business investment, and employment conditions. However, the large current account deficit could dampen prospects for sustained economic growth.
- ✍ Economic recovery in the Euro area moderated on weaker export growth and subdued consumption spending alongside the observed slowdown of the industries and services sector.
- ✍ The UK economy showed modest growth in the third quarter as private consumption tapered off and the property market cooled down, suggesting that growth for the short term had peaked and further hikes in borrowing rates might be put off until next year.
- ✍ Japan's economic recovery slowed down based on evidence of moderating industrial output and lower export demand for electronics.
- ✍ The majority of central banks kept their policy settings unchanged at their latest respective monetary policy meeting. However, some, like the US Federal Open Market Committee (FOMC) and the Bank of Thailand (BOT) raised policy rates by 25 basis points, citing mounting demand-side pressures and tight labor conditions.

## **II. Review of the Monetary Policy Stance**

- ✍ The members of the Monetary Board noted that the medium-term outlook for inflation remains essentially unchanged despite the recent higher outturns. The overall pattern of price data remains consistent with the assessment that (1) ongoing pressures on inflation remain tied to supply-side influences, and (2) the likely path of future inflation will be hump-shaped, with the average inflation expected to exceed the 4.5 percent



target in 2004-2005 but should ease back towards the same range target by 2006.

- ✍ The Monetary Board also noted some recent positive developments on the price front, notably the direct policy actions undertaken by Department of Agriculture (DA) and the Department of Trade and Industry (DTI) on food prices and the easing conditions in world energy markets which have led to a downward shift in the expected inflation path.
- ✍ The Monetary Board also noted that that overall output conditions continue to indicate slack in the domestic economy with a slight risk of a slower pace of economic activity, particularly in view of indications of reduced business optimism and possible output effects of higher oil prices and recent weather disturbance.
- ✍ On the other hand, the members of the Monetary Board emphasized that the risk of demand-side effects from ongoing supply shocks could increase in the very near term, and therefore merits close attention. The observed rise in various measures of core inflation could signal persistent movements in prices, and consequent adverse changes in inflation expectations. This underscores the need to avoid any spillover from short-term price developments to inflation expectations over the policy horizon.
- ✍ The members of the Monetary Board were, therefore, of the view that the prevailing price and output conditions supports keeping present policy settings unchanged but suggests a greater need for the continued readiness among monetary authorities to undertake necessary policy action ahead of time against inflation pressures to guide and prevent unfavorable shifts in the public's inflation expectations.
- ✍ At the same time, the Monetary Board believes that direct action against supply-side risks should remain a key policy priority, and all possible avenues for non-monetary intervention in key commodities should continue to be explored and pursued.
- ✍ On the basis of the discussion, the members of the Monetary Board agreed unanimously to maintain current monetary policy settings.



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

✍ Upon assessment of the balance of risks to inflation and the evidence that has become available since its previous meeting on monetary policy, the Monetary Board approved unanimously the following measures:

- 1) Maintain the current monetary policy settings as follows:
  - (a) Maintain the BSP's policy rates at the current uniform rates of 6.75 percent for the overnight RRP (borrowing) rate and 9.0 percent for the overnight RP (lending) rate;
  - (b) Maintain the current interest rates on the term RRPs, RPs, and SDAs; and
  - (c) Maintain the current reserve requirement ratios.
- 3) Continue to articulate support for the use of non-monetary measures to address supply-side risks, particularly those relating to food supply, by strengthening the BSP's representation and coordination with various government agencies.

The next meeting of the Monetary Board to discuss the monetary policy setting is scheduled on 13 January 2005.

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