



HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 4 MAY 2006*

The Advisory Committee¹ 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;
- 3) Emphasize the short-term nature of the impact of the RVAT on prices in the BSP's policy pronouncements on the stance of monetary policy; and
- 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.

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

The Advisory Committee's recommendations were based on the following considerations:

- Headline inflation was unchanged at 7.6 percent year-on-year in March, as lower inflation for services and steady inflation for clothing and food, beverages and tobacco (FBT) offset higher inflation for housing and repairs, fuel, light and water (FLW) and miscellaneous items. Average headline inflation for the first quarter of 2006 was 7.3 percent. Meanwhile,

* The arguments and information presented herein were the ones prevailing at the time of the Monetary Board decision on 4 May 2006. The highlights of the discussions of the 4 May 2006 meeting were approved by the Monetary Board during its meeting held on 1 June 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 Director of the Department of Economic Research.



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year-on-year core inflation rose for the second consecutive month in March, bringing the year-to-date core inflation to 6.1 percent.

- World spot and futures prices of Dubai crude oil meanwhile rose in April owing to supply disruptions in key oil-producing economies, along with sustained strong global demand for oil. Refinery maintenance operations in the US and Asia also added to upward pressures on oil prices. Meanwhile, domestic pump prices of gasoline, diesel and kerosene increased although that of LPG declined.
- Selected indicators generally suggest soft demand conditions.
 - Latest production indices indicate weaker manufacturing activity. Average capacity utilization in manufacturing in February 2006 declined slightly to 80.0 percent from a revised 80.1 percent in the previous month. The volume of production index (VOPI) posted a year-on-year decline of 11.8 percent in February, a faster fall compared to 8.2 percent in January. Meanwhile, the value of production index (VAPI) for the manufacturing industry increased by 5.1 percent year-on-year in February, lower than the previous month's 9.6 percent.
 - Growth in total energy sales by the Manila Electric Company (Meralco) rose to 4.6 percent year-on-year in February from 1.1 percent in the previous month. This was due to the upturn in consumption by residential users and faster growth in consumption by the commercial sector.
 - Passenger car sales fell at a slower pace of 2.0 percent year-on-year in March 2006 compared to 15.6 percent in February, based on data from the Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI).
 - Appliance sales continued to decline, registering a 14.7 percent decline in volume in March. On a month-on-month basis, appliance sales posted a 20.7 percent growth, reversing the 8.3 percent decrease in February.
 - Based on the audited financial statements filed with the Philippine Stock Exchange (PSE) in April-May 2006, the country's major corporations experienced solid revenue growth in 2005. Some firms, however, showed weak profit growth on the back of higher operating expenses.
 - Based on the external trade data released by the National Statistics Office (NSO) on 25 April 2006, total merchandise export earnings rose by 14.8 percent year-on-year in February, faster than the previous



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month's 0.9 percent. This was due largely to the strong growth in manufactured exports.

- Total merchandise imports rose at a slightly slower pace of 4.6 percent in February compared to 5.0 percent in January. This was due to the lower growth in imports of minerals fuels, lubricants and related materials; the decline in imports of consumer goods; and the drop in imports of raw materials and intermediate goods. Meanwhile, payments for electronic products, which comprised 48.0 percent of the total import bill in February, declined slightly by 1.1 percent.
- Unemployment rose slightly in January 2006 to 10.7 percent from 10.3 percent in October 2005 but was lower than the year-ago figure of 11.3 percent, based the old NSO definition of unemployment. Based on the new definition of unemployment, the jobless rate likewise increased to 8.1 percent in January from 7.4 percent in October.²
- The latest Consumer Expectations Survey (CES) and Business Expectations Survey (BES) of the BSP showed improving optimism for the first and second quarters of 2006.
- Based on the latest available data for the fourth quarter of 2005, agricultural output grew by 4.0 percent in real terms, the highest rate recorded in the past five quarters. For 2005, the agriculture sector expanded by 2.0 percent, lower than the previous year's 4.9 percent.
- Growth in domestic liquidity and bank lending decelerated based on latest available data. Treasury bill (T-bill) auction rates were generally lower.
 - Domestic liquidity rose by 7.6 percent year-on-year in March 2006, based on data from the BSP's Depository Corporations Survey (DCS). This was a deceleration from the 9.4 percent year-on-year increase registered in the previous month.³
 - Outstanding loans of commercial banks (KBs) grew by 2.4 percent year-on-year in February 2006, slower compared to the 3.0 percent rise in the previous month. On a month-on-month basis, KB loans

² Beginning in April 2005, a new Labor Force Survey (LFS) questionnaire was used to estimate the number of unemployed, which includes all persons who are 15 years old and over as of their last birthday and are reported as: (1) without work and currently available for work and seeking work; or (2) without work and currently available for work but not seeking work for the following reasons: (a) tired/believed no work available; (b) awaiting results of previous job application; (c) temporary illness/disability; (d) bad weather; and (e) waiting for rehire/job recall. The old definition of unemployment did not consider the availability criterion.

³ M3 refers to the stock of broad money based on data on the Depository Corporations Survey (DCS). 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.



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increased by 0.3 percent, a deceleration from the 1.2 percent increase registered in January.

- Compared to the auction on 3 April 2006, the T-bill rate eased across all tenors on 2 May 2006. This may be attributed to continued ample liquidity among banks and the reduction in T-bill offerings as a result of the improving fiscal position.
- The peso remained strong in April due to improving investors' confidence in the country's economic fundamentals, particularly the prospects for fiscal sustainability. The peso was also supported by continued dollar inflows from foreign investments and OFW remittances.
- The NG posted a ₱67.6 billion fiscal deficit in the first three months of 2006, ₱4.2 billion below the programmed ceiling of ₱71.8 billion. First quarter revenues grew by 19.4 percent year-on-year to reach ₱205.0 billion, while expenditures rose by 15.9 percent to ₱272.6 billion.
- Global economic momentum broadened in early 2006 despite the continued volatility in international oil prices. The United States continued to lead the global expansion amid the economic slowdown in the fourth quarter, while economic activity in emerging market economies remained strong. The resilience of the services sector remained a major driver of economic activity in most economies while the solid pick-up of manufacturing lent further support to growth. Inflation expectations remained generally well-contained. However, risks to the inflation outlook remain on the upside and include further increases in oil prices.
- Except for the US Federal Open Market Committee which raised its target for the federal funds rate by 25 basis points during its 28 March 2006 meeting, the recent responses of monetary authorities in major economies were generally cautious. The Bank of England's Monetary Policy Committee voted to keep the key repo rate steady during its 5-6 April 2006 meeting, noting that inflation remained close to target, with some upside risks relating mainly to higher oil prices. Similarly, the European Central Bank voted to keep the refinance rate unchanged at 2.5 percent to allow the 25-basis point hike in March 2005 to work its way through the system. The Bank of Japan, meanwhile, voted to maintain the uncollateralized overnight call rate at zero, following the change in its operating target of money market operations in March.

II. Review of the Monetary Policy Stance

- Members of the Monetary Board agreed that prevailing conditions for prices continue to provide room for the BSP to keep policy rates steady in the near term. The Monetary Board cited a number of factors which support the maintenance of current policy settings. First, inflation is



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expected to decelerate by the second half of 2006. Second, average inflation rate by 2007 is expected to hit the targeted 4-5 percent in the absence of renewed domestic or external shocks.

- The Monetary Board also noted the evidence of stable core inflation, limited demand-based pressures, and a relative absence of second-round effects on wage- and price-setting. Inflation expectations were found to remain stable and in support of keeping policy rates unchanged.
- The Monetary Board recognized, however, that the balance of risks to the inflation outlook remains tilted toward the upside, particularly given the recent uptrend in domestic oil prices. The prospect of continued oil price increases in the next few months, along with expected adjustments in domestic power costs, point to a continuing build-up in supply-side pressures. Such a prospect increases not only the risks to inflation expectations but also the likelihood of second-round effects.
- Managing the risks to inflation expectations, as well as the risk of potential second-round effects in wage- and price-setting, thus remains the key policy priority. At the same time, given that price pressures remain rooted in supply-side sources, the Monetary Board will continue to support the use of non-monetary measures by concerned government agencies which can more directly address the cost-push impact of increased transport and energy costs.
- The Monetary Board remains strongly committed to achieving the inflation target for 2007 and addressing the risks to future inflation. The Monetary Board will continue to closely monitor and assess the conditions for prices, aggregate demand, domestic liquidity and other factors in order to guide the appropriate response of monetary policy.

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 unanimously approved the following measures:
 - 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;



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- 3) Continue to articulate the BSP's support for the use of non-monetary measures to address supply-side risks, particularly those relating to food supply, energy conservation, and the development of alternative energy sources, by strengthening representation and coordination with the relevant government agencies; and
- 4) Increase the focus of the BSP's public information campaign on the dynamics and sources of price pressures in order to help guide the public's inflation expectations. Official policy pronouncements concerning the stance of monetary policy will also emphasize the short-term nature of the impact of the RVAT on prices.

The next meeting of the Monetary Board to discuss the monetary policy setting is scheduled on 1 June 2006.

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