



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON
MONETARY POLICY ISSUES HELD ON 13 JANUARY 2005***

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 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:

- ✍ Both the 1994- and 2000-based headline inflation series continued their uptrend in December 2004. In line with expectations, the full-year 2004 average inflation reached 5.5 percent (1994=100), exceeding the 4-5 percent target for 2004, and 6.0 percent (2000=100).
- ✍ Core inflation (defined as headline inflation excluding selected food and energy products) also edged higher in December 2004. Full-year core

* The highlights of the discussions of the 13 January 2005 Monetary Board meeting were approved by the Monetary Board during its meeting held on 10 February 2005.

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



inflation was registered at 5.5 percent (1994=based) and 5.7 percent (2000=100).

- ✍ The inflation uptrend and the consequent increase in the average annual inflation above the 4-5 percent target in 2004 may be characterized as a predominantly supply-side phenomenon.
- ✍ Forecasts generated by the BSP's inflation forecasting models show that inflation will likely begin to decelerate in the first quarter of 2005 and fall further to the 4-5 percent range in 2006.
- ✍ Although data on consumption and manufacturing activity continued to show positive trends, other indicators pointed to soft spots in the economy.
- ✍ Average capacity utilization in manufacturing rose slightly to 80.1 percent in October 2004 from 79.9 percent (revised) in September and 78.7 percent a year ago.
- ✍ The value of production index (VAPI) for manufacturing increased by 14.8 percent (revised) in October from a 13.4 percent (revised) growth in the previous month. Meanwhile, the growth in volume of production index (VOPI) for manufacturing decelerated to 4.9 percent (revised) year-on-year in October, from a 6.6 percent (revised) increase in September.
- ✍ The country's major corporations posted strong revenue and profit growth in the first nine months of 2004. However, some firms registered marked slowdown in their third quarter income growth from the previous two quarters' outturn.
- ✍ Exports grew at an annual pace of 19.5 percent in November, the fastest since July 2002 when it registered 24.2 percent. This brought the January-November 2004 annual exports growth to 9.9 percent.
- ✍ Merchandise imports grew by 16.3 percent year-on-year in October from 14.8 percent in September. For the January to October 2004 period, the cumulative annual growth of imports stood at 8.8 percent.
- ✍ Passenger car sales declined by 0.8 percent year-on-year in November, from zero growth in October as reported by the Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI). This also represented a significant downturn compared to the 53.2 percent annual growth in November 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.



Bangko Sentral ng Pilipinas

- ✧ Energy sales by the Manila Electric Company (Meralco) declined by 0.2 percent year-on-year in November 2004, a reversal from the 8.0 percent increase in the previous month and 3.6 percent expansion in November 2003.
- ✧ Unemployment rate remained relatively sizeable at 10.9 percent in October 2004 from the 10.2 percent registered for the comparable period in the previous year. The October unemployment rate, however, was lower than the 11.7 percent posted in July 2004. This is still considerably higher than 7.4 percent, the lowest unemployment rate recorded during the peak growth years 1993-1996.
- ✧ Money and credit demand continued to post modest growth while nominal RP interest rates increased during the 3 January 2005 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 6.9 percent (revised) year-on-year in November from the 6.2 percent (revised) rise recorded in the previous month.
- ✧ The total volume of commercial bank (KB) loans rose by 3.6 percent year-on-year as of end-October 2004. This was a slight improvement over the 1.9 percent increase in the previous month.
- ✧ Relative to the 6 December 2004 auction, T-bill rates increased across all tenors during the 3 January 2005 auction. The increase in yields reflected expectations of higher inflation as well as banks' weak appetite for government securities as they remained cautious over the increase in the BTr's offering from ₱11.0 billion to ₱15.0 billion and the possibility that the BSP might raise its policy rates.
- ✧ Supply-side factors would likely continue to exert the central influence on the inflation outlook, particularly the volatility in global oil prices. In addition, the forecasted reduction in agricultural production in the first quarter of 2005—with the onset of a weak El Niño—poses an upside risk to food prices.
- ✧ Agricultural output grew by 6.8 percent in the first nine months of 2004, an improvement from the 2.9 percent growth posted for the comparable period a year ago and the highest since 2000. 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.
- ✧ Dubai crude oil price declined slightly in December 2004 following the build-up in world crude oil stocks and mild weather conditions in the



Northern Hemisphere. Consequently, pump prices of petroleum products in the domestic market eased in December 2004, reflecting the decline in world oil prices. However, in early January 2005, some increases in both the spot price of Dubai crude oil and the futures price of Brent crude oil were observed.

- ✍ The peso strengthened on the back of seasonally strong dollar inflows from OFW remittances during the holiday season and the relative weakness of the dollar in regional currency markets.
- ✍ In the fiscal sector, the National Government's (NG's) budget deficit in November 2004 widened to ₱12.5 billion, higher than the deficit level registered in the comparable month last year of ₱8.3 billion. However, the January-November 2004 NG budget deficit of ₱160.2 billion, was 7 percent lower than the figure recorded in the same period a year ago, providing indication that the full-year fiscal deficit would be within the NG's program.
- ✍ Global economy continued to show sustained but moderating growth as industrial production and private consumption appeared to have slowed down in most economies. Stronger inflationary pressures are expected to persist over the short term owing to the volatility in world oil prices, but the medium-term outlook remains in line with price stability.
- ✍ The US economy continued its solid recovery as shown by the resilient consumer spending and robust expansion of business investment. However, the mounting budget and current account deficit could dampen prospects for sustained economic growth.
- ✍ Economic growth in the euro area slowed down slightly in the third quarter on weaker export gains and subdued private consumption alongside the observed slowdown in production growth in the industries and services sector.
- ✍ UK economic growth moderated in the third quarter of 2004 on account of a decline in investment alongside flat consumption growth and cooling property market.
- ✍ Japan's economic recovery remained on track despite weak movements in industrial production and exports. This was supported by the growth in business investment and improvement in private consumption.
- ✍ The majority of central banks kept their policy settings unchanged during their latest respective monetary policy meetings. However, some, like the US Federal Open Market Committee (FOMC) and the Bank of Thailand



(BOT) raised policy rates by 25 basis points, citing uptrend in inflation and tight labor market conditions.

II. Review of the Monetary Policy Stance

- ✍ The Monetary Board noted that under the inflation targeting approach, the monetary assessment process focuses primarily on forecasted inflation rather than contemporaneous inflation in order to ensure that the monetary policy stance has a forward-looking orientation at all times.
- ✍ Recognizing the time lag required for monetary policy decisions to take full effect (currently estimated at 15–21 months), the Monetary Board noted that monetary actions undertaken at this point will primarily affect inflation in 2006 and may only have a minimal impact in 2005 inflation. The members of the Monetary Board, therefore, agreed that prospective decisions should be oriented toward safeguarding the 2006 inflation target.
- ✍ The members of the Monetary Board also noted the latest staff forecasts showing a declining trend for inflation over the next few quarters. With some easing of international oil prices from peak levels in 2004, latest forecasts indicate that inflation would settle below 5.0 percent in the last quarter of 2005. The 2006 average inflation is expected to be within the 4-5 percent range (2000=100).
- ✍ In addition, the Monetary Board decided to propose an adjustment of the 2005 inflation target to the Development Budget Coordination Committee (DBCC). The members of the Monetary Board also emphasized that the proposed adjustment in the 2005 target is intended mainly to reflect the dynamics of the new inflation data series. In particular, the Monetary Board noted that the 2000 CPI inflation series are higher than the 1994 series. In addition, a revision of the 2005 inflation target takes into account the additional risks on prices that have emerged since the target was originally set in 2004.
- ✍ The members of the Monetary Board pointed out that monetary policy action may be undertaken when the available evidence begins to point more strongly to the following conditions: (1) emergence of demand-side pressures on consumer prices; (2) emergence of inflationary pressures that are over and above those generated by ongoing supply shocks; and (3) increased risk of possible exchange rate market pressures arising from narrowing interest rate differentials which could feed into inflation and inflation expectations.
- ✍ The members of the Monetary Board were of the view that the outlook for inflation and other economic evidence support keeping present policy



settings unchanged, accompanied by a continued readiness to undertake any necessary policy action ahead of time against inflation pressures.

- ✍ Furthermore, the Monetary Board emphasized the need for the BSP to continue supporting measures being undertaken by the Department of Agriculture (DA) to mitigate the negative impact on agricultural production as well as the steps to rehabilitate the typhoon-damaged areas. These intervention measures would help ensure adequate food supply and temper the potential inflationary impact of the El Niño weather disturbance.

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 RRP, 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 10 February 2005.