HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 20 NOVEMBER 2008[1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Maintain the BSP's policy rates at 6.00 percent for the overnight RRP (borrowing) rate and 8.00 percent for the overnight RP (lending) rate;

b) Maintain the current interest rates on term RRPs, RPs and SDAs; and

c) Maintain the current reserve requirement ratios.

The policy decision to keep interest rates steady was arrived at in the process of balancing the BSP's concern over price stability and its resolve to undertake policy actions that will ensure the soundness and stability of the financial system.

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

- The Monetary Board noted that while the recent coordinated rate cuts by central banks signaled the strong commitment of the international central banking community to address the macroeconomic implications of the global financial turmoil, country specific factors remain the major consideration in the monetary policy assessment.

- The Monetary Board considered the various arguments for a policy rate cut and for keeping rates steady. It decided to keep policy rates unchanged based on the following considerations:

[1] The discussions presented herein reflect the assessment made by the Monetary Board based on the information available at the time of the policy meeting. The sets of economic information were provided by the technical secretariat of the Advisory Committee (AC). 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 Managing Director of the Monetary Policy Sub-sector. The highlights of the discussions on the 20 November 2008 meeting were approved by the Monetary Board during its regular meeting held on 11 December 2008. The next meeting of the Monetary Board on monetary policy issues is scheduled on 18 December 2008.

- The inflation outlook reflects a decelerating inflation path over the policy horizon, but still shows a breach of inflation targets for 2009 and possibly for 2010.

- The increasing contribution of core inflation to headline inflation and the persistent upsurge in core inflation indicate that generalized domestic price pressures are still in the pipeline although they have been tempered as reflected in the decelerating month-on-month trend.

- Sources of upside risks continue to be present. These are the following:

    1. Inflation expectations are still high although they have shown some moderating.

    2. An interest rate cut could have important implications on the stability of foreign exchange market conditions. A weaker peso impacts the prices of imported commodities and utility rates, among other things, and therefore on inflation and on inflation expectations.

    3. Tight international demand-supply balances in key commodities remain, as considerable demand from emerging economies is expected to continue, while supply responses to rising relative prices have been slow to adjust.

    4. Upward pressures may also be coming from possible wage adjustments under the salary standardization law and new calls for a legislated across-the-board adjustment in private sector wages.

- Latest demand indicators provide mixed signals, but on balance they point to the underlying strength in demand conditions, providing a reasonable impetus to keep monetary policy settings steady.

- Another important factor that the Board took into consideration was that the growth slowdown and financial stress are not expected to be as severe in the Philippines as in those countries that have already cut rates. In those countries that have cut rates and have announced financial packages, one of the most potent sources of the economic drag is the wealth effect which operates through equities and pensions. This is not the case for the Philippines.

- Real interest rates remain in deep negative territory.

- The Board believes that a decline in policy rates will not remedy the problem of liquidity distribution. Recent policy measures (the reduction in reserve requirement and the increase in the rediscounting budget) should ensure an adequate funding environment even without a rate cut.

- The Board recognized that the BSP faced multiple and contemporaneous challenges of stabilizing the financial system, nursing the economy through a period of slower growth, and closely monitoring the inflation outlook. However, with the underlying resilience in domestic demand as reflected in demand indicators, the Board believed that the Philippine economy may still see respectable growth this year and in 2009.

- The Board concluded that keeping policy rates steady would provide the BSP with more flexibility in responding to future shocks that could besiege the economy going forward.

III. Recent Developments in Economic Indicators

The Monetary Board's decision took into account the recent developments in various economic indicators:

A. Domestic price conditions

- Headline inflation dropped further to 11.2 percent year-on-year in October from 11.8 percent in September, with lower price increases seen in food and petroleum products.

- However, core inflation was higher in October at 7.8 percent compared to 7.5 percent in the previous month.

B. Inflation Expectations

- Recent surveys showed inflation expectations leveling off from previous sharp increases.

    - Q4 2008 BES indicated moderation in inflation expectations with less respondents expecting inflation to move up.
    - The BSP's quarterly inflation survey showed a lower increase in inflation expectations in Q3 2008 from Q2 2008.
    - AP Consensus forecasts for Philippine inflation showed that the monthly trend increase in inflation expectations is less steep relative to the second quarter and in the early part of the third quarter.

C. Demand conditions

Latest data showed a moderation in demand conditions amid the global economic downturn and the still high prices of fuel and food.

- GDP grew at a slower rate of 4.6 percent in Q2 2008 compared to the 4.7 percent and 8.7 percent growth rates posted in the previous quarter and the comparable period last year, respectively. GNP also decelerated to 5.5 percent.

- Monthly NSO data showed merchandise imports increased marginally by 1.1 percent in August 2008, compared to their month- and year-ago growth rates of 16.0 percent and 2.1 percent, respectively.

- Meanwhile, exports growth decelerated in September at 1.2 percent from the month-and year- ago growth of 6.1 percent and 5.1 percent, respectively.

- Selected demand indicators suggest some moderation in demand conditions.

    - Sales of passenger cars decelerated to 12.4 percent year-on-year in September relative to month-ago and year-ago levels of 20.6 percent and 17.9 percent, respectively. Meanwhile, sales of commercial vehicles posted a lower decline of 0.8 percent from a negative growth of 3.1 percent in August, but still substantially lower than the 26.8 percent year-on-year growth in September 2007. Likewise, sales of trucks and buses increased by 9.2 percent year-on-year in September, from the 2.7 percent growth posted in August 2008, but was lower than the 11.4 percent growth registered in September last year.

    - Energy sales of Meralco grew marginally in August by 0.5 percent after shrinking by 1.3 percent in the previous month, but was still lower than the 9.3 percent growth posted in the comparable period a year ago. Year-to-date sales registered a 1.3 percent growth, although lower than the 5.2 percent expansion recorded in the same period in 2007.

    - Appliance sales rose dramatically by 18.3 percent year-on-year in September, from the 1.5 percent growth recorded in the same period last year and almost double the 9.4 percent growth in August. Likewise, year-to-date appliance sales increased by 8.0 percent year-on-year compared to 6.9 percent in the period January to September 2007.

- Average capacity utilization in manufacturing declined slightly to 81.3 percent in August from its peak of 81.6 percent in July 2008.

- The value of production index maintained two-digit growth at 12.7 percent year-on-year in August 2008 albeit slower than the 14.2 percent growth (revised) in July 2008. Likewise, the volume of production index grew slower year-on-year in August 2008 at 6.5 percent from the 8.0 percent growth (revised) in July.

- The increase in land and rental values have generally moderated compared to 2007.

D. Supply-side indicators

Developments in Agriculture

- Latest data from the National Income Accounts showed that the agriculture, fishery and forestry sector grew by 4.9 percent in Q2 2008 from 4.2 percent in the same period last year.

- The decline in the average retail prices of commercial rice, which began around the second week of July, continued up to the first week of November.

- International cereal prices continued to fall in October.

Oil Price Developments

- Dubai crude oil prices continued to ease up to mid-November on heightened fears of deteriorating global demand for oil. The spot price of Dubai crude oil was lower in mid-November at $54.12 per barrel from US$67.42 per barrel in October.

- Latest estimated futures prices of Dubai crude oil are lower for 2008 and 2009.

- Oil companies again reduced the prices of gasoline products, diesel, and kerosene by ₱1.00 per liter each on 20 November. The price of LPG likewise fell by ₱1.26 per liter.

- In the transport sector, a provisional reduction in the minimum fare for jeepneys and buses nationwide was implemented on November 7 and 10, respectively.

Developments in the Utilities Sector

- The Energy Regulatory Commission deferred the implementation of its earlier decision allowing Meralco to increase its distribution charge by November 2008 under the performance-based rate (PBR) application.

- In the telecommunications sector, the National Telecommunications Commission mandated telecommunication companies to interconnect their backhaul networks to all cable landing stations to lower service rates as this will dismantle the monopoly in landing stations and backhaul facilities.

E. Financial Market Developments

- Risk aversion and global economic uncertainty continued to dictate financial market sentiment.

Market Interest Rates

- The Fed's easing of its policy rates and the decline in US T-bill rates widened interest rate differentials with the BSP's policy rate. However, risk-adjusted differentials narrowed as sovereign risk spreads increased. Meanwhile, real lending rates remained negative even with the lower September inflation outturn.

Stock Market

- The local bourse was at its worst in October. The Philippine Stock Exchange Index fluctuated in the first two weeks of November, breaching the 1,900-index support level on 18 November. Year-to-date, the index had declined by 48.0 percent.

Foreign Exchange

- The peso continued to weaken amid market concern that the contagion effect of the global financial crisis could lead to a worldwide recession.

- On a year-to-date basis, the peso had depreciated against the US dollar by 17.3 percent on 18 November 2008, closing at ₱49.94/US$1 as the global economic slowdown deterred investment in emerging markets

Global Bond and Credit Default Spreads

- The EMBI+ Philippines spread narrowed on 10 November following China's announcement of a US$586 billion stimulus package to spur growth in its economy. The Philippine five-year credit default swap spread likewise moved in tandem with the region's general easing trend.

- The coordinated liquidity measures by major central banks provided market relief as spreads eased from their peak levels.

F. Domestic Liquidity and Credit Conditions

- The growth of domestic liquidity or M3 accelerated further by 13.5 percent year-on-year in September from 9.8 percent in the previous month and 11.5 percent a year ago. The expansion in domestic liquidity was due to the build-up of both net domestic assets and net foreign assets.

- Outstanding loans of commercial banks including reverse repurchase agreements or RRPs, increased in September by 24.1 percent year-on-year, growing at the same pace as in the previous month. Bank lending net of banks' RRP placements with the BSP accelerated to 24.8 percent in September from 22.1 percent in August.

- The equity raised in the Philippine Stock Exchange for the first ten months of 2008 was only one-fourth of the level reached in the same period in 2007. Meanwhile, bond issuances by the corporate sector in January-October 2008 reached ₱104.3 billion, 68.1 percent higher relative to the comparable period last year, suggesting that local firms have been turning to the corporate bond market to raise funds.

G. Fiscal developments

- The fiscal deficit reached ₱62.3 billion for the period January-October 2008, higher than the ₱41.5 billion deficit for the same period last year.

H. External developments

- Global activity is slowing quickly. Governments across advanced economies were swift to take early, decisive action to shore up confidence and revive credit in their financial markets by unprecedented coordinated rate cuts, rescue packages, and extraordinary liquidity provisioning:

1. The impact of the US financial market turmoil on the real economy has already become apparent. In response, the Federal Reserve cut its policy rate by another 50 bps on 29 October.

2. In response to the financial turmoil, major central banks around the world acted as one to soothe tensions in the financial system by pumping liquidity in global credit markets.

3. Growth has fallen sharply in the Euro area, while inflation seems to have peaked.

4. The headwind from commodity prices seems to be receding in Japan, but the downside risks remain high.