



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON
MONETARY POLICY ISSUES HELD ON 20 DECEMBER 2007***

The Advisory Committee¹ submitted the following recommendations for the consideration of the Monetary Board:

✍ Adjust the current monetary policy settings as follows:

- (a) Adjust the BSP's policy interest rates downward by 25 basis points to 5.25 percent for the overnight RRP (borrowing) rate and 7.25 percent for the overnight RP (lending) rate;
- (b) Adjust the current interest rates on term RRPs, RPs, and SDAs accordingly; and
- (c) Maintain the current reserve requirement ratios

Further easing of the monetary policy stance was recommended based on the following assessments:

- (a) A generally benign inflation path over the policy horizon;
- (b) The balance of risks to the inflation outlook has remained manageable, both on the supply and demand side;
- (c) It sends a positive signal to markets about the BSP's confidence on the durability of the benign inflation outlook, as well as the BSP's credibility and ability to anchor inflation expectations; and
- (d) It is a pre-emptive move to soften the impact on the domestic economy of a possible US and global economic slowdown, which could have a serious impact on monetary and financial stability.

The Monetary Board then proceeded to review the recent developments and the key considerations in the formulation of the BSP's monetary policy stance.

* 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 20 December 2007 meeting were approved by the Monetary Board during its regular meeting held on 3 January 2008.

¹ The Advisory Committee is composed of the Governor of the BSP as Chairman and five 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, the Managing Director of the Monetary Policy Sub-sector, and the Director of the Department of Economic Research.



Review of Recent Developments

A. Domestic price conditions

- ? Headline inflation increased to 3.2 percent in November from 2.7 percent in October. Inflation pressures in November were linked mainly to increases in the prices of food and energy-related items. Year-to-date inflation averaged slightly higher at 2.7 percent compared to the 2.6 percent recorded in January to October 2007.
- ? The official core inflation measure published by the National Statistics Office (NSO) decelerated to 2.3 percent in November from 2.4 percent in October. While the official core inflation went down, alternative measures estimated by the BSP went up.

B. Demand conditions

- ? Gross Domestic Product (GDP) increased by 6.6 percent in Q3 2007. While this was slower than the 7.1- and 7.5-percent growth posted in the first two quarters, this was faster compared to the 5.1 percent growth in the comparable period last year. GDP growth was boosted by household spending and capital investments from the expenditure side, and by the services sector from the production side.
- ? Year-to-date GDP growth was 7.1 percent, higher than the upper end of the Government's full-year growth target of 6.1-6.7 percent.
- ? Based on BOP data, imports of goods rose by 4.6 percent in Q2 2007 to US\$ 14.1 billion. Meanwhile, exports of goods increased by 5.0 percent in Q2 2007 to US\$ 12.2 billion.
- ? Preliminary data (NSO) for September indicated an 8.9 percent import growth year-on-year, accelerating from the 0.4 percent and 2.1 percent growth recorded in the previous year and in the previous month. The surge in imports was due to the higher cost of imported commodities such as petroleum crude, feeding stocks, and other basic food items like rice and dairy products. Meanwhile, merchandise exports registered a 10.5 percent year-on-year growth in October after expanding by 4.6 percent in September. This was due mainly to the recovery of electronics and the strong performance of agro-based exports.
- ? Selected indicators of demand continued to indicate a broad strengthening trend.
- ✍ Based on the latest data from Colliers, and values in Q3 2007 rose by 24.2 percent year-on-year for the Makati Central Business District (CBD) and 17.9 percent for Ortigas Center.



- ✍ Sales of passenger cars increased by 21.2 percent year-on-year in October, bringing the growth of year-to-date sales to 7.3 percent, an acceleration from the 5.3 percent growth registered in the same period last year and the 5.7 percent growth in September.
- ✍ Sales of trucks and buses grew modestly by 3.7 percent year-on-year in October, a slowdown compared to the 22.8 percent increase last year and the 11.4 percent growth in September; while year-to-date sales increased by 21.1 percent in October, higher than the 12.0 percent growth registered in the same period last year.
- ✍ The year-on-year energy sales of Meralco grew by 1.9 percent in September, higher than the 0.9 percent increase in the same month last year but significantly lower than the previous month's sales growth of 9.3 percent. Similarly, year-to-date energy sales increased by 4.8 percent, also an improvement from the 1.0 percent registered in the comparable period last year.
- ✍ Retail sales recorded significant growth during the period January-August at ₱88.5 billion, reflecting a 40.5 percent growth against the 27.9 percent recorded in the same period of the previous year.
- ✍ The volume of appliance sales increased by 28.9 percent year-on-year in October, a significant increase from the 1.5 percent recorded in September. Year-to-date sales likewise grew by 7.2 percent, a turnaround from the 8.1 percent decline in the comparable period last year.
- ✍ Average capacity utilization in manufacturing increased slightly in September to 80.6 percent from a revised rate of 80.5 percent in August, based on the NSO's Monthly Integrated Survey of Selected Industries (MISSI).
- ✍ MISSI data also showed a slight improvement in manufacturing activity in September. The value of production index (VAPI) recovered to 0.7 percent in September compared to the 4.5 percent (revised) year-on-year decline in August. Meanwhile, the volume of production index (VOPI) continued to fall year-on-year in September, although at a slower pace of 1.0 percent, from a sharper fall of 5.7 percent (revised) in August.
- ? Q4 2007 Business Expectations Survey results showed that business confidence is still high, as the confidence index (CI) rose quarter-on-quarter by more than seven index points to 48.0 percent.
- ? Q4 2007 Consumer Expectations Survey results showed consumer confidence has weakened after strengthening during the past two



quarters. The nationwide CI for Q4 declined quarter-on-quarter by 10.0 index points to settle at -33.6 percent. Consumers' apprehension may have partly reflected the concerns regarding uncertainty on the orderly conduct and outcome of the *barangay* election, political noise, and threats of terrorism during the survey period (October 2007).

- ? Based on the preliminary results of the October 2007 Labor Force Survey, the unemployment rate declined to 6.3 percent in October 2007 from 7.3 percent in October 2006.
- ? A lower-than-petitioned minimum wage increase in Region I and an additional cost-of-living allowance in Region VIII were approved recently, leaving one pending petition for a similar increase filed with a regional wage and productivity board. The proposal for the ₱125 daily wage hike for private sector employees and the Salary Standardization Law III for government workers were re-filed in Congress.

C. Supply-side indicators

Developments in Agriculture

- ? Agriculture, fishery and forestry (AFF) output grew by 5.6 percent in Q3 2007 from 3.6 percent in the same period a year ago. Growth in AFF during the period, which accounted for 17.3 percent of total GDP, was driven by the fishery, corn and *palay* subsectors. Meanwhile, the Department of Agriculture is pushing for a concerted effort by all sectors to sustain the growth momentum of the farm sector in 2008 onwards in the face of the recent tightening in global supply and surging prices of commodities.
- ? Based on recent global observations, a La Niña episode of moderate strength is currently taking place over the central and eastern equatorial Pacific. Majority of statistical and model forecasts from international climate centers predict that La Niña will continue through early 2008.
- ? Meanwhile, retail prices of commercial rice continued to decrease in November. The National Food Authority recently increased the support price of *palay*, boosting its procurement activities as more farmers sold their harvest to the agency.
- ? International rice prices have continued to strengthen since January 2007, reflecting a tightening of market conditions in key exporting countries and a rebound in import demand, particularly in Asia. International prices for all major cereals have likewise remained high and some registered considerable gains from the previous season.



- ? The prices of poultry products generally softened in October after successive increases in the previous months due to the slowdown in production brought by the prolonged dry spell.

Oil Price Developments

- ? International spot prices were lower as of 16 December on worries that US inflation could dampen global oil demand and expectations that OPEC will raise its oil output in February 2008. In the domestic scene, the prices of petroleum products were raised anew on 8 December 2007.
- ? In the transport sector, the Land Transportation Franchising and Regulatory Board is conducting hearings with the transport sector to discuss petitions for fare increases.

Developments in the Utilities Sector

- ? A lower generation charge was passed on in November to electricity users following the reduction in the 8th Generation Rate Adjustment Mechanism and 7th Incremental Currency Exchange Rate Adjustment of the National Power Corporation in October 2007. However, the generation charge was raised in December as Meralco passed on its recovery of purchased power costs resulting in a ₱0.06/kwh increase in its generation charge.
- ? For water rates, on a cumulative basis, there was a net increase in Metro Manila for 2007, but this was tempered by the appreciation of the peso which resulted in a negative foreign currency differential adjustment for the whole year.

D. Financial Market Developments

Interest Rates

- ? Weighted average T-bill rates in the primary market were broadly lower as of 3 December relative to November. During the 3 December auction, the Auction Committee made a full award of the ₱2.0 billion and a partial award of the ₱2.5 billion offerings for the 182-day and 364-day T-bills, respectively, but rejected the bids for the ₱1.5 billion offering for the 91-day T-bills.
- ? As of 12 December, the yields for secondary market GS continued to decline and the yield curve flattened. Yields declined further on 12 December as the markets factored in their expectation of another reduction in the BSP's policy rates on 20 December.



Stock Market

- ? The stock composite index trended upwards in the first two weeks of October but retreated during the last two transaction days as investors cashed in on their gains in anticipation of the long weekend. In the first two weeks of November, the stock market was volatile due to a confluence of external developments, namely: surge in oil prices, huge subprime mortgage-related write-offs, continued weakening of the US dollar, and expectations of a possible economic slowdown in the US economy by next year. However, the stock market index rose anew in the first two weeks of December on expectations that the US Fed will further reduce its target rate on 11 December 2007.

Foreign Exchange

- ? The peso appreciated by 2.7 percent in November 2007 to average ₱43.17/US\$1 from the ₱44.32/US\$1 average in October. The peso reached its highest level since April 2000 on 13 December 2007 to average ₱41.14/US\$1, buoyed by strong inflows from OF remittances due to the holiday season. Further, the steady stream of foreign portfolio and direct investments to the country, reflecting favorable investor sentiment, as well as export earnings provided support to the peso.
- ? Year-to-date movements saw most Asian currencies strengthening vis-à-vis the US dollar as of 18 December 2007 from its 29 December 2006 level, led by the Philippine peso's 16.8 percent gain. However, the South Korean won and the Indonesian rupiah depreciated by 1.0 percent and 4.3 percent, respectively.

Global Bond and Credit Default Spreads

- ? Debt spreads have widened significantly since late October due to renewed credit concerns as large international banks have been reportedly writing off losses on their holdings of mortgage-backed securities. Debt spreads have narrowed since August but renewed concerns that the US subprime mortgage crisis could drag on widened spreads towards the end of October. EMBI+Philippine spreads widened to 246.0 from 171.0 basis points, while the Philippine credit default swap spreads likewise widened to 188.5 from 132.4 basis points.

E. Domestic Liquidity and Credit Conditions

- ? In October, domestic liquidity or M3 grew by 11.4 percent year-on-year, maintaining the same growth momentum as in the previous month. Net foreign assets (NFA) of depository corporations continued to drive M3 growth, even as NFA growth slowed down slightly to 29.7



percent year-on-year from 32.2 percent in September. This trend is associated with the continued foreign exchange inflows from OF remittances, exports, and direct and portfolio investments.

- ? Growth in outstanding loans of commercial banks, thrift banks, and rural banks (net of reverse repurchase or RRP transactions) grew by 7.1 percent year-on-year in October, from the 6.9 percent (revised) growth recorded in September. Gross of banks' RRP placements with the BSP, bank lending growth slowed down to 3.2 percent year-on-year in October from 4.8 percent (revised) in September, as banks' RRP placements with the BSP declined with the shifting of funds to special deposit accounts or SDAs.
- ? Capital-raising activities by Philippine Stock Exchange-listed companies reached ₱84.4 billion during the first ten months of the year, almost twice the level reached in the same period last year.
- ? As of end-September 2007, the stock of bank loans outstanding rose by ₱21.4 billion relative to the end-December 2006 level. As of end-October 2007, issuances of equity capital and bonds by the private sector including banks totaled ₱146.4 billion. Excluding issuances by banks, the total amount of equity and bonds issued during the same period reached ₱106.1 billion.

F. Fiscal developments

- ? The National Government's (NG) fiscal position recorded a ₱1.5 billion deficit in October, lower than the ₱5.8 billion deficit recorded in October 2006. This development brought the January-October 2007 fiscal deficit to ₱41.5 billion, lower than the ₱56.3 billion deficit in the same period last year and the ₱63.0 billion program for the whole year of 2007. Compared to the same period last year, the lower deficit resulted mainly from higher revenues and lower interest payments.
- ? Revenues increased to ₱83.7 billion in October, 4.8 percent higher than the level recorded in the comparable period of the previous year. This brought the January-October 2007 revenues to ₱896.0 billion, 12.6 percent (or ₱100.4 billion) higher than the comparable level recorded in 2006, but 20.0 percent (or ₱222.8 billion) lower than the whole year program for 2007.

G. External developments

- ? Global growth is expected to slow down for the rest of the year until at least mid-2008, but the overall outlook remains uncertain as the extent of the impact of the US housing slump remains protracted and could drag on. Nevertheless, prospects remain brighter in emerging markets as they continue to support global economic growth. The coordinated



responses of major central banks to improve liquidity conditions are also expected to help avoid a serious downturn. On balance, the outlook for growth remains on the downside due to risks relating mainly to the potential for a broader impact of the ongoing reassessment of financial market risks, market confidence, and further oil and non-oil commodity price increases.

- ? The Federal Reserve Bank and the Bank of England eased policy settings during their latest policy meetings. Other major central banks, meanwhile, adopted a neutral stance.
- ? On 12 December, the Bank of Canada, the Bank of England, the European Central Bank, the Federal Reserve, and the Swiss National Bank announced measures designed to address elevated pressures in short-term funding markets. Central bankers took the action after policy interest-rate reductions in the United States, United Kingdom, and Canada failed to ease market concerns that banks will reduce lending, which could send the US and the rest of the world in a global slowdown that is worse than expected.

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

- ? The Monetary Board considered the continuing benign inflation outlook across a range of possible scenarios. In the absence of unforeseen adverse shocks, latest estimates indicate that average inflation forecasts are expected to remain well below the 4.0-5.0 percent target range in 2007, within the 4.0 percent \pm 1.0 percentage point target for 2008, and within the 3.5 percent \pm 1.0 percentage point target for 2009.
- ? Demand indicators have been consistent with modest demand growth, and these have exerted limited price pressures; inflation expectations remain well anchored; and liquidity growth has been decelerating for the last six months up to October, reflecting the impact of the monetary measures implemented by the BSP in May.
- ? Risks to the inflation outlook consist mainly of oil and food price pressures stemming from world markets. The Monetary Board noted that these risks have remained manageable both on the supply and demand sides. While the firm peso has tempered the impact of higher import costs, developments in global oil and non-oil commodity prices bear close monitoring because of possible spill-over effects on domestic prices.
- ? The Monetary Board noted that with a generally benign inflation path going forward, the principal emerging risk to the economy at present is to output. The global economy has yet to exhibit a durable recovery



path—given rising oil prices and the ongoing US subprime mortgage crisis—and a possible weakness in external demand could weigh down on the growth prospects of the Philippine economy. Under such conditions, an accommodative monetary policy stance could provide room to allow demand to continue to grow in order to counter the contractionary impact of a possible US and global slowdown.

- ? The Monetary Board further noted that lowering the policy rates could provide further impetus to growth via stronger investments and bank lending.
- ? The Monetary Board will continue to keep a watchful eye on global and domestic economic developments, particularly on those that could pose threats to the inflation target, mindful that price stability is essential to sustainable economic growth.

III. Monetary Policy Decision

- ? After considering the balance of risks to the inflation outlook and the evidence that has become available since its previous meeting on monetary policy, the Monetary Board approved the recommendations of the Advisory Committee.

The next meeting of the Monetary Board on the monetary policy stance is scheduled on 31 January 2008.