HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 29 AUGUST 2002*

Background

The Monetary Board held its ninth meeting on monetary policy issues on 29 August 2002. This followed the 27 August 2002 meeting of the Advisory Committee where the members discussed their assessment of the inflation outlook and macroeconomic conditions, which formed the basis for their recommendations for the appropriate monetary policy stance.[1] The Advisory Committee submitted, for the consideration of the Monetary Board, a policy paper and a comprehensive set of economic and financial indicators relevant for the deliberation on monetary policy. In particular, the Monetary Board discussed the factors affecting inflation and inflationary expectations, including agricultural production, movements of the exchange rate, direction of world oil prices, possible adjustments in power and water rates, monetary conditions, trends in demand and output indicators, fiscal developments, developments and outlook in the world economy, and the implications of these factors on the BSP's monetary policy stance.

I. Considerations in the Formulation of the Monetary Policy Stance

Current inflation and the inflation outlook

1. Headline inflation decelerated anew in July 2002, falling to 2.6 percent from 3.0 percent in the previous month. Declining fuel prices as well as lower food inflation were behind this development. The average inflation for the first seven months of the year stood at 3.4 percent, more than a full percentage point lower than the low-end of the government's target range of 4.5-5.5 percent.

* The highlights of the discussions of the 29 August 2002 Monetary Board meeting were approved by the Monetary Board during its meeting held on 3 October 2002.

[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 Managing Director, In-Charge of Research or the Director of the Department of Economic Research, and the Director of the Treasury Department.

2. Among the supply or cost-side factors, food and fuel prices were the main drivers of slower inflation. Food prices continued to benefit from ample supply, while fuel and transport costs have been tempered by reductions in local pump prices during the period 26 June-1 July 2002 as well as the postponement of planned transport fare increases. Although there were signs of improvement, demand-side factors remained generally soft. Real gross domestic product (GDP) grew stronger than expected in the second quarter, rising by 4.5 percent as industry recovered and services continued to gain strength. Bank lending, fell by 3.7 percent as of end-June 2002 from the level a year ago. Meralco power sales have also made a turnaround, rising for two consecutive months, by 2.9 percent and 4.6 percent in April and May, respectively, compared to their levels a year ago. This followed four consecutive months of declining power sales. Cement sales—an indicator of activity in the construction sector—rose by 23.5 percent year-on-year in April, a significant increase over the 4.1 percent growth registered in the same period a year ago. Similarly, the value of building permits surged by 56.7 percent to ₱33.7 billion in the first quarter of 2002 from ₱21.5 billion during the same period in 2001, a further evidence of improving prospects in construction. These developments could be indicative of gradual strengthening in aggregate demand.

The continued deceleration in headline inflation—owing to the positive supply-side factors and the relatively soft but improving demand conditions—provides further indications that inflationary pressures are well under control in the near term.

Agricultural output forecasts

3. The Department of Agriculture (DA) reported that agricultural production in the first semester grew by a respectable 3.2 percent from the level a year ago despite the onset of the monsoon season and the dry spell in some regions of the country. This growth could be attributed largely to gains in the agricultural crops sector, livestock and fishery production. The growth in agricultural production in the first semester was well within the 2.7-3.6 percent growth target of the agricultural sector for the whole year.[2]

[2] Department of Agriculture, Press Release entitled "Agricultural production grows 3.17 percent in the first half," 15 August 2002, www.da.gov.ph

4. As of 16 August 2002, the national rice inventory was estimated at 1.5 million metric tons (MT), equivalent to 59 days of rice sufficiency.[3] Out of the total national rice stock, 30 percent or 452,000 MT is held by the National Food Authority (NFA). The rice import program of the government, through the NFA, could serve as safeguard against the possible adverse impact of the recent typhoons and the El Niño weather phenomenon on palay production. The volume of the country's rice imports as of 26 August 2002 reached 446,804 metric tons out of the total authorized rice imports of 890,000 metric tons for the year.[4]

The favorable performance of the agricultural sector supported by adequate national inventory strengthen expectations of adequate food supply at relatively stable prices.

Exchange rate developments

5. The peso-dollar exchange rate averaged ₱51.81/US$1 for the period 1-27 August 2002, ₱1.17 higher relative to its average in July. The peso fell to a year-low of ₱52.34 on 26 August 2002. The recent weakness of the peso could be attributed to the market's continued concerns over the rising fiscal deficit; the resignations of key Cabinet officials and the weakness in regional currencies owing to the concerns over the vulnerability of emerging markets, including the Philippines to the Brazilian debt contagion. The seasonal demand for foreign exchange of oil companies combined with banks' short covering also contributed to the pressure on the peso. The peso, however, exhibited lower volatility during the period 1-27 August 2002 as the standard deviation declined to 31 centavos from 36 centavos in July.[5]

6. On a trade-weighted basis and in real terms, the peso appreciated slightly relative to the basket of currencies of major trading partners by about 0.1 percent in July 2002 relative to the level in December 2001. By contrast, the peso tracked a depreciation trend vis-à-vis the currency baskets of competitor countries as reflected in the decline in the real effective exchange rate (REER) of the peso against the broad and narrow baskets of competitor currencies by

[3] Estimated based on the daily consumption of 25.7 MT of rice; The security level benchmark for rice sufficiency of the NFA is 15 days (Source: NFA).
[4] Source: NFA
[5] Based on real time foreign exchange transactions in the Philippine Dealing System (PDS)

about 1.5 percent and 8.1 percent, respectively. These developments indicated that the country's external competitiveness weakened slightly relative to its major trading partners, but improved compared to the broad and narrow baskets of competing countries' currencies.[6]

Despite the recent weakening trend, the peso remains broadly stable and supportive of the low inflation environment.

Oil price developments

7. The price of Dubai crude in the international market reached US$25.97 per barrel on 23 August 2002 to settle at an average US$24.96 for the period 1-23 August 2002. This was slightly higher than the US$24.67 per barrel average price posted in July 2002. Concerns over the intensification of the US-Iraq conflict and its impact on the production of Middle East countries have contributed to the recent uptick in oil prices.

8. In the domestic market, oil companies have raised the pump prices of gasoline and fuel products on 10-11 August 2002 by 30 centavos per liter. Similarly, some oil companies have also raised the price of liquefied petroleum gas (LPG) by a range of ₱5.00-₱10.00 per 11 kilogram (kg.) on 25-27 August 2002.[7] The net increase in domestic oil prices in 2002 thus far, stood at ₱1.21 per liter for gasoline, diesel and kerosene.[8]

The uptick in domestic pump prices of petroleum products reflects the lagged impact of the recent increase in world oil prices and the depreciation of the peso.

9. In the futures market, the price of the benchmark Brent crude oil was slightly higher as October 2002 deliveries settled at US$27.00 per barrel.[9] Meanwhile, crude oil futures prices for West Texas Intermediate (WTI) climbed

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[6] The basket of major trading partners' currencies include those of US, Japan, Germancy and the United Kingdom. The broad basket is composed of the currencies of Singapore, South Korea, Taiwan, Malaysia, Thailand, Indonesia and Hong Kong while the narrow basket is composed of the currencies of Indonesia, Malaysia and Thailand.

[7] The price per 11 kg of LPG was raised by ₱5.00 by Liquigas, ₱10.00 by Total Corporation and ₱9.00 by Pilipinas Shell Corporation and Petron Corporation on 25-27 August 2002. (Source: Department of Energy)

[8] In 2001, pump price of petroleum products declined by ₱1.81 per liter for gasoline and ₱ 1.30 per liter for kerosene and diesel oil (Source: Department of Energy).

[9] Source: Asian Wall Street Journal, 27 May 2002, The futures price for Brent crude—a close substitute for Dubai crude— is used as indicator of future world oil prices since futures data on Dubai crude are not readily available.

above US$30.00 per barrel for September deliveries due to rising fears that a possible US attack on Iraq could cause large-scale disruptions of oil supplies from the Middle East.[10] Reports that the Organization of Petroleum Exporting Countries (OPEC) would keep production tight for member-countries, that Iraq has reduced its oil production by 1.3 million barrels per day and that US oil inventories were declining have also heightened supply concerns. These developments could exert pressures on the general price level and inflation expectations. An increase in domestic oil prices following an increase in world oil prices could raise average annual CPI inflation directly by about 0.15 percentage points. This could trigger a second round effect on the prices of other commodities estimated to be about twice that of the direct impact, raising the average annual inflation for 2002 by about 0.48 percentage points.[11]

Uncertainties concerning geo-political developments and other supply concerns could pose upside pressures on the spot international price of crude oil and could subsequently raise domestic oil prices. In turn, an increase in local oil prices could feed into adjustments in the prices of other goods and services, including wages and transport fares.

Petitions for upward adjustment in user charges on utilities

10. The purchased power adjustment (PPA) charges of the Meralco have declined by a cumulative ₱1.59 for the period May-July 2002. The reduction in PPA charges of Meralco was due mainly to the reduction in the purchased power cost adjustment (PPCA) of the National Power Corporation (NPC).[12] Apart from the recent reduction in power rates, electricity rates could also go down further with the establishment of Wholesale Electricity Spot Market (WESM) and the introduction of Special Program to Enhance Electricity Demand (SPEED) .

11. The Electric Power Industry Reform Act of 2001 (R.A. 9136) provided for the creation of an electricity spot market where generators will compete against

[10] AP World Politics, "Crude prices above US$30 per barrel for the first time since May 2001," 22 August 2002
[11] These findings were based on the simulation results using Input-Output (I-O) analysis and the structural inflation forecasting model for estimating the total impact and direct impact of an oil price increase on inflation, respectively. This simulation was based on the assumption that the average price of Dubai crude would increase to $30 per barrel for the period September –December 2002.
[12] Upon the orders of President Arroyo, NPC reduced its PPCA to ₱0.40/kwh effective 8 May 2002 (Source: Meralco News Online, Credit Adjustment in July Bills, 6 June 2002, www.meralco.com.ph).

each other for the right to supply power to distributors.[13] Based on DOE's estimates, the operations of the proposed WESM could reduce further the cost of electricity by about ₱0.40/kwh.[14] The DOE also planned to introduce SPEED—a price incentive scheme for large end-users of electricity. This program is aimed at enhancing demand for electricity by providing price incentives to large users so that excess power capacity could be utilized. Under the SPEED scheme, NPC and Meralco would grant industrial users a fixed discount of ₱0.80/kwh and ₱0.92/kwh, respectively, for incremental use of energy above a specified base load.[15] However, this price incentive scheme might not be implemented yet as the Energy Regulatory Commission (ERC) still has to evaluate and approve the SPEED.

12. Meanwhile, the ERC has yet to decide also on Meralco's proposed graduated power rate adjustments as contained in its petition for the "unbundling" of power rates, submitted on 2 April 2002. The proposed rates would likely raise the cost of electric power consumption by an average of ₱0.65/kwh or about 10.3 percent across all residential users.[16] Meanwhile, the proposed power rate increases for commercial and industrial establishments would be moderate, estimated at about 2.7 percent and 3.2 percent, respectively.

13. The Manila Waterworks and Sewerage System (MWSS) Board has decided to freeze temporarily water rate hikes this year. In an earlier petition, the water concessionaires, Manila Water Company (MWC) and Maynilad Water Services Inc. (MWSI) proposed an increase in their water rates by ₱1.00 and ₱6.00 per cubic meter, respectively, representing an average increase of 26.8 percent from current levels.[17] The MWSS indicated that the proposed increase in water rates could be implemented in 2003.[18] Given the relatively

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[13] Pursuant to RA No. 9136, the Power Sector Assets and Liabilities Corp. (PSALM) shall manage an orderly sale and privatization of all existing independent power producers (IPP) contracts and generation facilities of the NPC. After the sale and privatization of generation companies and IPP contracts owned by the NPC, these private companies are expected to participate in retail competition under the WESM for the sale of power to distributors.

[14] The target date for the full commercial operations of WESM is December 2003 (Source: Department of Energy).

[15] Source: Department of Energy: "PEPOA pledges support on SPEED pricing program", 1 August 2002, www.doe.gov.ph

[16] According to Meralco, the unbundling of power rates is not expected to result in any power rate increase for residential users at the lowest consumption bracket. (Source: Meralco, Press Release entitled, "Meralco Submits New Alternative on Rate Unbundling," 2 April 2002)

[17] The current water rates charged by MWC and MWSI are ₱6.75 and ₱15.46 per cubic meter, respectively.

[18] MWC services Metro Manila's east zone which covers Mandaluyong City, Pasig City, Pateros, San Juan, Taguig, and portions of Makati City, Manila City, Marikina City and Quezon City as well as Angono, Antipolo, Baras, Binangonan, Cainta, Jala-Jala, Morong, Pililia, Tanay, Teresa, Rodriguez and San Mateo, all in Rizal. MWSI services Metro Manila's west zone which covers Valenzuela, Bulacan, Malabon, Navotas, parts of Quezon City and Makati City, Manila City, Pasay City, Las Piñas, Parañaque City, Muntinlupa City and areas in Cavite.

small share of water to the CPI basket of 0.7 percent, the proposed increase in water rates is estimated to result in an increase in the CPI inflation by a minimal 0.1 percentage point in 2003.[19]

Power rates are likely to remain low for the rest of the year with the planned implementation of WESM and SPEED while deferred adjustments in Meralco rates and water rates could result into an increase in utility charges in 2003.

Interest rates and interest rate differentials

14. The differentials between RP interest rates and foreign interest rates continued to widen in August 2002 as RP market interest rates trended upward while foreign interest rates declined steadily. As of 19 August 2002, the differentials between the RP 91-day T-bill rate (net of RP withholding tax) and the 90-day LIBOR and US 90-day T-bill rate widened further to 2.2 percent and 2.3 percent respectively, up from the levels registered in the previous four months.

15. The differential between the BSP's policy interest rate (overnight borrowing or RRP rate) and the US federal funds target rate was unchanged at 525 basis points as the BSP policy rates and the US federal funds target rate remained steady at their 15 March 2002 and December 2001 levels, respectively.

16. However, adjusted for the risk premium—as measured by the differential between the 10-year ROP note and the 10-year US Treasury note—the differential between the BSP policy interest rate and the US federal funds target rate narrowed significantly in August by an average of 61 basis points, as the risk premium rose to an average of 464 basis points in the same period.

17. In the domestic market, the RP 91-day T-bill rate for the month of August demonstrated a generally increasing trend as the yield rose from an average of 4.77 percent in July to 4.978 percent at the 19 August 2002 auction.

The differentials between the RP interest rate and foreign interest rates have increased in August. However, adjusted for risk premium, the

[19]Based on analysis using input-output (I-O) tables published by the National Statistical Coordination Board (NSCB)

differentials have narrowed down. These developments indicate the need to monitor closely factors that could impact adversely on market sentiment and expectations.

18. For the period 8-14 August 2002, the spread of the RP lending rate over the benchmark 91-day T-bill rate narrowed anew to 304 basis points from 317 basis points during the period 11-17 July 2002[20] as the increase in the low-end of banks' lending rate (by about 8 basis points) was accompanied by a larger increase in the RP 91-day T-bill rate (by about 10 basis points). This differential was below the average of 358 basis points for a sample of countries, which have displayed a general decrease in lending rates during the review period.

19. The Philippines' real lending rate (based on the low-end of the range of banks' lending rates) for the period 8-14 August 2002 increased to 5.4 percent from the 4.9 percent registered during the review period 11-17 July 2002 due to the increase in the nominal lending rate along with the decline in the inflation rate in July. However, the Philippines continued to register one of the lowest real lending rates in the Asian region. In particular, the Philippines' real lending rate of 5.4 percent was the fourth lowest in a sample of Asian countries.

The RP real lending rate increases anew in August but remains lower relative to those of other Asian countries.

20. The yield curve for government securities in the secondary market as of 26 August 2002 shifted upward from that which prevailed on 22 July 2002.[21] However, compared to 4 January 2002, the yield curve has shifted downward, with the general drop in the yields on government securities ranging from 141-380 basis points across all maturities.

The general increase in the yields of government securities in the secondary market is due, in part, to market concerns over the widening budget deficit.

[20] Review period during the last meeting on monetary policy by the Monetary Board on 1 August 2002
[21] Yield curve presented in the last meeting on monetary policy by the Monetary Board on 1 August 2002

Domestic stock market movements

21. Trading in the domestic stock market remained sluggish. The average PHISIX for the period 1-22 August 2002 dropped by 32.3 index points relative to its month ago level as it fell to a year-low of 1,114.9 index points.[22] The bearish sentiment in the market could be attributed to persistent concerns over widening budget deficit, the depreciation of the peso and the lack of positive corporate news.

22. The weakness in the domestic stock market was also evident in the thin volume and value of transactions. The volume of transactions during the period 1-22 August reached 3.5 billion shares, 5.4 percent lower than the 3.7 billion shares registered during the comparable period in the previous month while value turnover slid by 24.6 percent to ₱4.9 billion from ₱6.5 billion during the same period. Meanwhile, foreign investors have remained net sellers for the fifth consecutive month as foreign selling outpaced foreign buying by ₱225.8 million. Total foreign transactions in August accounted for 58 percent of the total transactions, higher than the 38 percent (revised) registered a month ago.[23]

The domestic stock market remains in the consolidation phase in August with bargain hunting providing support to the market. The recovery of the local bourse would depend on the sustainability of the growth in the domestic economy and positive developments in the US and other major economies.

Monetary aggregates and bank lending

23. The growth in domestic liquidity slowed down to 5.1 percent to reach ₱1.55 trillion as of end-June 2002. At this level, however, the growth in M3 decelerated from the 6.9 percent year-on-year growth registered in May 2002. The rise in M3 in June could be attributed partly to the increase in net foreign assets (NFA) of the monetary system, following the increase in investments in foreign currency-denominated securities by banks and the BSP along with the decline in their foreign currency-denominated liabilities. In addition, increased preference for peso deposits relative to foreign currency deposits contributed to the increase in M3.

[22] Source: Philippine Stock Exchange
[23] Ibid.

24. The volume of commercial banks' (KB) loans outstanding reached ₱1.38 trillion as of end-June 2002, about 3.7 percent lower than the level recorded a year ago. The restraint in bank lending could be traced, in part, to banks' cautious stance in extending new loans in an effort to curb any further weakening in the quality of their assets as banks' non-performing loans (NPLs) remained relatively high. As of end-June 2002, the NPL to total loans ratio eased slightly to 18.1 percent from 18.4 percent in the previous month.

25. The volume of banks' placements with the BSP under the RRP window declined by ₱13.0 billion to reach ₱92.9 billion as of 20 August 2002 from ₱105.9 billion as of end-July 2002 while placements under the SDA window declined only slightly to reach ₱5.6 billion from ₱5.7 billion during the same period. Compared to the levels as of end-December 2001, RRP and SDA placements registered an increase of ₱64.7 billion and ₱5.6 billion, respectively, from ₱28.2 billion and zero worth of placements.

Lending activities of banks remain weak due to constraints posed by relatively high NPLs. Moreover, the presence of spare capacity combined with the lack of buoyancy in domestic demand have limited firms' need for additional bank financing. Meanwhile, banks' placements with the BSP's RRP and SDA windows have declined in August relative to the levels in July as banks shifted their investments into government securities, particularly in longer-dated instruments.

26. The National Government (NG) budget deficit for the period January-July 2002 was ₱133.1 billion, exceeding the full-year target of ₱130 billion. The continuing weakness in tax revenue collections combined with the frontloading of expenditures for agricultural-related projects—to cushion the possible adverse impact of the El Niño weather disturbance in 2003—have constrained the ability of the NG to rein in the fiscal deficit. In the short-term, a breach of the target deficit could be manageable, given adequate fiscal resources, especially since the NG has earlier on prefunded its financing requirements. In the long run, the sustainability of the fiscal deficits and the costs they impose in terms of debt servicing could pose some constraints on macroeconomic management. Large fiscal deficits could lead to higher domestic borrowings or net drawdowns in the deposits of the NG with the BSP. These alternative measures to finance the deficit have implications on market interest rates and domestic liquidity, which, in turn, could affect inflation and inflationary expectations.

Developments and outlook in the rest of the world

27. The growth of the US economy slowed down to 1.1 percent (in terms of real GDP on an annualized basis) in the second quarter of 2002 from 5.0 percent in the previous quarter. The slower-than-initially anticipated recovery of the US underpinned the decision of the US Fed to keep the federal funds target rate steady at 1.75 percent during its last meeting on 13 August 2002.

28. Consumer sentiment in the US remained soft amidst mixed economic signals. The University of Michigan consumer confidence index fell to 88.1 in July from 92.4 in June and 96.9 in May.[24] The unemployment rate also remained relatively high at 5.9 percent as companies continued to hold back plans to hire additional workers. The continuing uncertainty in the global economic environment suggested the possibility that the US Fed would further cut the federal funds target rate in order to boost economic activity. Trading in the futures markets indicated that investors anticipate a possible rate cut by at least a quarter percentage point before the end of the year.

29. In the euro zone, the European Central Bank (ECB) kept policy rates unchanged during its 1 August 2002 meeting as recent economic and financial developments continued to show mixed signals. The ECB noted that the main risk elements in the outlook on the euro economy relate to the pressures in the labor market, the huge declines in the stock prices which could dampen consumer spending and weaken corporate performance, and the uncertainty in global economic recovery. In Japan, signs of economic rebound in the first quarter have largely been confined to the export sector. The long-standing structural weaknesses in the banking system have constrained the recovery of the Japanese economy.[25] In its latest assessment, the International Monetary Fund (IMF) noted that the Japanese economy continued to face downside risks as growth remained weak amidst a deflationary environment.

External developments in the US and other major economies suggest that the pace of the global economic recovery remains uncertain, reinforcing the market's view that the Fed as well as the central banks in other major economies would uphold their accommodative monetary policy stance. Worries over a possible global market slide and a "double-dip" recession in

[24] University of Michigan, Surveys of Consumers, 2002, www.umich.edu
[25] IMF, World Economic Outlook—Prospects and Policies, September 2002, www.imf.org

the US could put a drag on the growth prospects of emerging economies, including the Philippines.

II. Discussion on the Review of the Monetary Policy Stance

30. The members of the Monetary Board noted that the uneven pattern of indicators continued to point to uncertainty in the strength of the domestic economy as well as the global recovery. While there were signs of improvement in domestic economic activity—as indicated by the higher-than-expected growth in real GDP as well as increases in energy sales by Meralco and in the volume of cement sales—domestic demand still lacked bouyancy. Domestic liquidity growth also decelerated in June as bank lending contracted further. In addition, the pace of global economic recovery led by the US has slowed down due to the sharp falls in the equities market and the spate of revelations of corporate reporting and governance irregularities, which have dented consumer and business sentiment. Given the uncertainty about the timing and pace of the world economic upturn, the Monetary Board believed that monetary policy should thus be focused on providing conditions to lift domestic demand while ensuring that inflationary pressures are well contained.

31. The members of the Monetary Board shared the view that continued moderation in price movements could be expected for the rest of the year. However, the members of the Monetary Board agreed that inflationary headwinds could loom over the policy horizon. The uncertainty over the impact of the El Niño weather on agricultural crop production in 2003, possible uptrend in world oil prices, delayed but eventual adjustment in user charges, the anticipated fiscal underperformance relative to the full-year target budget deficit, and of late, exchange rate volatility posed risks to inflation and inflationary expectations. Indications of potential upside pressures to future inflation and inflationary expectations combined with the uncertainty about the strengthening of domestic demand argued for a cautious monetary policy stance, one that remains supportive of the economy's growth objective while ensuring a low and stable inflation environment.

32. The members of the Monetary Board also discussed the implications of a further easing of monetary policy settings through a reduction either in the BSP's policy rates or in the reserve requirement or both. The members of the Monetary Board pointed out that a further easing of the BSP's monetary policy stance would lead to greater liquidity in the system. However, given that monetary policy affects inflation with a lag, a more accommodative stance now could undermine the attainability of the inflation target in 2003. In particular, the members of the Monetary Board identified the following risk factors to inflation and inflationary expectations that could arise from reducing policy rates:

a. The present scope for monetary easing is already limited by the fact that policy rates have already been reduced to a significant extent over the past year;

b. A reduction in the BSP's policy rates could narrow down further the country's interest rate differentials with foreign interest rates, which could trigger renewed volatility in the foreign exchange market and undermine the stability of the peso, thus impacting adversely on inflation and inflationary expectations;

c. Concerns about the increasing NG's budget deficit could limit the scope of the BSP's monetary policy actions; and

d. Further monetary easing, either through a reduction in the BSP's policy rates or the liquidity reserve requirement, would infuse more liquidity in the system, which is already characterized by ample liquidity, thus generating inflationary pressures.

33. The members of the Monetary Board noted that a reduction in liquidity reserves would infuse additional liquidity into the system estimated at about ₱13.8 billion for every one percentage point cut in the liquidity reserves ratio.[26] Given the ample liquidity in the system—as evidenced by the ability of the system to readily absorb the ₱63.0 billion Retail Treasury Bonds (RTBs), the continued placements by banks in the RRP and SDA windows and the continued oversubscription in the T-bill auctions—a further infusion of liquidity into the system, given the still weak lending activity, could find its way into the foreign exchange market, which could lead to greater volatility in the foreign exchange market and raise inflationary expectations.

[26] Estimated as one percent of the total level of deposits and deposit substitute liabilities of deposit money banks as of end-June 2002 amounting to ₱1381.5 billion

34. The members of the Monetary Board also noted that the BSP has maintained its inflation target for 2003 at 4.5-5.5 percent, given that the economy continues to face some downside risks to inflation.

III. Monetary Policy Decision

35. Based on the analysis of data that have become available since the last meeting of the Monetary Board on 1 August 2002 and a careful assessment of the balance of risks on inflation and inflationary expectations, the members of the Monetary Board—by a unanimous vote—decided as follows:

a. maintain the BSP's policy rates at the current levels of 7.0 percent for the overnight RRP (borrowing) rate and 9.25 percent for the overnight RP (lending) rate;

b. maintain the tiering scheme on banks' placements with the BSP under the RRP and SDA windows;

c. maintain the current interest rates on the term RRPs, RPs, and SDAs; and

d. maintain the reserve requirements at their current levels given the adequate level of liquidity in the system.

The next meeting of the Monetary Board to discuss the monetary policy setting was scheduled on 26 September 2002.

- The Monetary Board of the Bangko Sentral ng Pilipinas