



## **HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 8 MARCH 2007\***

The Advisory Committee<sup>1</sup> submitted the following recommendations for the consideration of the Monetary Board:

- 1) 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;
- 2) Maintain the tiering system on the aggregate placements by banks with the BSP under the RRP and SDA windows;
- 3) Maintain the current interest rates on term RRPs, RPs, and SDAs; and
- 4) Maintain the current reserve requirement ratios at 10 percent for regular reserves and 11 percent for liquidity reserves on the deposit and deposit substitute liabilities of universal banks (UBs) and commercial banks (KBs) and non-bank financial intermediaries with quasi-banking functions and banks with trust license.

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

### **I. Review of Recent Developments**

#### **Prices**

- Headline inflation decelerated to 2.6 percent in February from 3.9 percent in January. This inflation outturn—the lowest since December 2002—was below the BSP's forecast range for February of 3.0-3.6 percent. All commodity groups in the CPI basket registered slower price increases during the month.

\* 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 8 March 2007 meeting were approved by the Monetary Board during its regular meeting held on 29 March 2007.

<sup>1</sup> 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 Acting Director of the Department of Economic Research.



## *Bangko Sentral ng Pilipinas*

---

- Similarly, the official core inflation measure decelerated to 3.0 percent in February from 3.9 percent in January. Alternative measures of core inflation estimated by the BSP also displayed a decelerating trend.
- International prices of oil rose in February due to supply concerns following production cuts by OPEC and possibly Iran because of continuing disputes over its nuclear program. Similarly, domestic pump prices increased during the month.
- Based on the results of the latest BSP surveys among firms and market analysts, inflation expectations remained in line with the BSP's inflation outlook. The Q1 2007 Business Expectations Survey (BES) indicated that respondent firms anticipate inflation to decelerate in the first quarter. Meanwhile, private sector economists' inflation forecasts for 2007 were lower during the Q4 2006 survey.

### **Demand**

- Latest data continued to indicate moderate demand conditions.
  - Gross Domestic Product (GDP) grew at a slower pace of 4.8 percent in Q4 2006, reflecting the adverse impact of typhoons on agricultural production and the slowdown in industry growth. Although slightly below the government target of 5.5-6.1 percent, the full-year 2006 GDP growth of 5.4 percent was higher than the previous year's 5.0 percent.
  - Based on data from Colliers International Research, developable land values in the Makati Central Business District and Ortigas Center sustained their uptrend in Q4 2006 and are expected to rise further in the next twelve months. Office and residential vacancy rates continued to decline while rents continued to climb.
  - Energy sales by Meralco rose modestly by 3.6 percent year-on-year in December, slightly lower than the 3.8 percent increase in November because of the decline in power consumption by the industrial sector. The full-year growth in energy sales was marginal at 1.1 percent in 2006 compared to 0.6 percent in 2005.
  - Average capacity utilization in manufacturing was unchanged at 80.3 percent in December 2006 based on the NSO's Monthly Integrated Survey of Selected Industries (MISSI). This brought the full-year average capacity utilization to 80.2 percent.
  - Production indices in the MISSI indicated a general weakness in manufacturing activity in December 2006. The Value of Production Index declined for the fourth consecutive month at 3.9 percent year-



## *Bangko Sentral ng Pilipinas*

---

on-year in December. The Volume of Production Index posted year-round decreases, ending the year with a contraction of 9.2 percent.

- Merchandise export earnings dropped by 3.6 percent year-on-year in December, as exports of all commodity groups except mineral products, registered declines. However, the full-year growth in merchandise exports was 14.0 percent, significantly higher than 2005's 4.0 percent.
- Merchandise import payments declined by 1.3 percent year-on-year in December, a reversal of the 13.4 percent rise in the previous month. This reflected mainly the decline in special transactions. The full-year growth in merchandise imports was 8.7 percent, higher than the 7.7 percent rise recorded in 2005.
- Passenger car sales declined by 25.4 percent year-on-year in January, reversing the previous month's growth of 14.8 percent. Meanwhile, sales of trucks and buses rose by 36.8 percent year-on-year in January due to new truck models and deliveries of outstanding orders.
- Latest data for December 2006 showed an upturn in appliance sales with total units sold rising by 28.3 percent year-on-year. On a cumulative basis, appliance sales registered a 17.4 percent contraction following a 22.0 percent decline in 2005.
- Results of the first quarter 2007 BES showed continued business confidence for 2007. Although lower relative to the previous survey, the current (i.e. first) quarter business confidence index was almost double its year-ago level. The confidence index for the next (i.e. second) quarter was the highest level since the inception of the BES in 2001.
- Based on the new NSO definition of unemployment, the jobless rate fell to 7.3 percent in October 2006 from 8.0 percent in the July survey and 7.4 percent in October 2005.<sup>2</sup>

### **Domestic Liquidity**

- Domestic liquidity or M3 growth accelerated to 22.8 percent year-on-year in January from 21.4 percent in the previous month, based on the data

---

<sup>2</sup> Starting April 2005, the new Labor Force Survey questionnaire was used to estimate the unemployed, which included all persons who were 15 years old and over as of their last birthday and were reported as without work, currently available for work, and seeking work or not seeking work due to valid reasons. The old unemployment definition did not consider the criterion on availability for work.



## *Bangko Sentral ng Pilipinas*

---

from the BSP's Depository Corporations Survey (DCS).<sup>3</sup> The expansion in liquidity continued to be driven by strong foreign exchange inflows from OFW remittances, export earnings and foreign investments.

- Outstanding loans by commercial banks grew at a faster pace of 10.1 percent year-on-year in December 2006 compared to 6.8 percent in November. The growth in commercial bank lending continued to be driven by loans to the financial institutions, real estate and business services (FIREBS) sector.
- Consumer credit continued to expand during Q3 2006, based on BSP data on auto loans, credit card receivables and residential real estate loans.

### **Other Domestic Developments**

- The Bureau of Agricultural Statistics expects a 1.4 percent year-on-year increase in both rice and corn production for the first semester of 2007, as the projected robust harvest in Q1 is likely to be offset by a decline in Q2 due to the lingering effect of the El Niño dry spell.<sup>4</sup>
- Robust foreign exchange inflows from OFW remittances, export earnings and foreign investments boosted further the peso. The strengthening of the peso was also supported by solid macroeconomic fundamentals, strong corporate earnings, strong Asian currencies, and the positive assessment on the Philippines given by CalPERS, the biggest US pension fund.
- The National Government's fiscal deficit for 2006 reached ₱62.2 billion, only about half of the full-year programmed deficit of ₱124.9 billion.
- Relative to the 22 January 2007 auction, T-bill rates eased during the 5 March auction, reflecting ample market liquidity.

### **External Developments**

- The global economy expanded at a fairly robust pace in 2006, although data point to a gradual rebalancing in the composition of global growth. The pace of growth in Japan and emerging Asia continued to pick up while the upturn in the Euro Area had become more broad-based. Likewise, the US economy recovered late in the year as the weakness in the housing market showed some signs of leveling off.

---

<sup>3</sup> The DCS, which replaced the Monetary Survey 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.

<sup>4</sup> BAS, Rice and Corn Situation Outlook Volume 21, No. 1, available online at <http://www.bas.gov.ph>



- The recent global market sell-off reflected a broad-based risk reduction in financial markets but the fundamentals of the global economy, especially that of Asia, remain solid. A number of risks are still present, notably the volatility in international oil prices, a disorderly unwinding of global imbalances, and an unexpected tightening of financial markets. Consumer prices continue to be largely influenced by energy price developments.
- The US Federal Open Market Committee (FOMC) kept its federal funds target rate at 5.25 percent for the sixth consecutive time in January, noting indications of firmer economic growth and some improvements in the housing market. Nonetheless, the FOMC maintained that inflation risks remain. Monetary authorities in the Euro area and the UK likewise kept monetary policy settings unchanged during their February policy meetings. Meanwhile, the Bank of Japan increased its policy rate by 25 basis points to 0.5 percent in February, maintaining however that the monetary environment will be kept accommodative to ensure price stability while achieving sustainable growth in the medium to long term.

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

- The Monetary Board noted that the continued moderation in both headline and core inflation would support monetary easing. Reduced supply-side pressures (e.g., the dropping out in February of the base effects of RVAT on the CPI, the continued strengthening of the peso) and continued moderate improvements in demand conditions, were behind the abatement of underlying price pressures. Latest BSP forecasts suggested benign inflation for the rest of the year.
- On balance, however, the Monetary Board believed there continue to be important reasons to maintain the current monetary policy settings. Growth in domestic liquidity has strengthened further in recent months, and may persist given the prospect for sustained strong foreign exchange inflows. The strong growth in domestic liquidity has not triggered a rise in inflationary pressures, in part due to the growing absorptive capacity of the economy. Recent evidence indicated that bank lending has started to increase with the implementation of the tiering scheme.
- The Monetary Board reiterated its firm commitment to addressing the risks to future inflation and will continue to monitor closely the evolving conditions for consumer prices, aggregate demand, domestic liquidity and other factors in order to determine the appropriate stance of monetary policy.



### **III. Monetary Policy Decision**

- After considering the risks to inflation 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 19 April 2007.