HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 5 MARCH 2009[1]

I. Monetary Policy Decision

The Monetary Board decided to:

a) Reduce the BSP's policy rates by 25 basis points to 4.75 percent for the overnight RRP (borrowing) rate and 6.75 percent for the overnight RP (lending) rate;

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

c) Maintain the current reserve requirement ratios.

The policy decision to reduce policy rates 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 there is sufficient flexibility to continue to ease monetary conditions given favorable inflation conditions.

  - Baseline forecasts continued to indicate that annual average inflation will fall within the target ranges for both 2009 and 2010.

  - Inflation pressures are expected to remain subdued as commodity price pressures remain on the downside while

[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 the Supervision and Examination Sector, the Managing Director of the Monetary Policy Sub-Sector, and the Managing Director of the Treasury Department. The highlights of the discussions on the 5 March 2009 meeting were approved by the Monetary Board during its regular meeting held on 19 March 2009. The next meeting of the Monetary Board on monetary policy issues is scheduled on 16 April 2009.

prospects of an economic slowdown reduced inflationary pressures further.

- Inflation expectations remained well anchored. The results of the BSP and private sector surveys reflected declining inflation expectations anchored towards the target over the policy horizon.

- Additional policy stimulus is expected to provide cushion against the headwinds to economic growth. Although growth has remained resilient towards the end of 2008, investor sentiment has become more clouded. Business sentiment has turned more cautious based on the BSP's latest business confidence survey. In the fourth quarter of 2008, gross capital formation contracted, and if sustained, economic growth over the medium term could further slow down. Industrial production in the fourth quarter, while showing a sustained annual growth rate, declined on a deseasonalized quarter-on-quarter basis, while exports fell to a record low in December.

- The Board also recognized that an accommodative monetary policy, combined with the expansionary measures taken earlier provided liquidity to the system resulting in the reduction of lending rates. This should help reinforce confidence in the financial markets by ensuring smooth credit intermediation as the impact of global financial market strains is expected to be quite persistent and may still carry considerable risks to domestic credit conditions.

- While inflation conditions are generally favorable, a prudent rate move seems appropriate given the upside risks to inflation stemming from the:

    1. volatility in the peso-dollar exchange rate and oil prices,
    2. increases in utility rates, and
    3. potential price pressures coming from the agricultural commodities sector

- The Board also considered proceeding along the course of a more measured policy easing as preemptive policy moves of the past few months, including other liquidity-enhancing measures, already put substantial stimulus in the pipeline. By frontloading the rate cuts, the BSP acted preemptively to address potential risks to growth and financial stability, gaining sufficient policy space for maneuver should potential inflation risks materialize.

- The Board also believed that a more calibrated monetary easing this time is circumspect should the planned fiscal stimulus come on stream and exert inflationary pressures.

- The Board opted to take a more prudent approach that will allow more time to observe new data and gauge how much, if any, additional stimulus is needed while closely monitoring the inflation outlook.

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 inched up in February to 7.3 percent year-on-year from 7.1 percent in January.

B. Inflation Expectations

- Recent surveys showed moderating inflation expectations:

    - The latest CES for Q1 2009 showed lower inflation expectations for the next 12 months: from 8.8 percent in the previous survey to 8.6 percent.

    - Results of the latest BES for Q1 2009 indicated that the proportion of respondents that anticipate inflation to move up in Q1 2009 has significantly decreased.

    - Results of the BSP's initial monthly (from quarterly) survey for January 2009 of private sector economists/analysts showed inflation is expected to fall within the target range for 2009 and 2010.

    - The latest private sector consensus forecasts showed lower inflation expectations as of February 2009 relative to the previous month and is also expected to be within-target for 2009 and 2010.

C. Inflation Outlook

- Emerging inflation forecasts continued to indicate that inflation would settle within the 2009 and 2010 targets. Latest inflation forecasts incorporate the lower projections for oil prices and GDP growth.

- Meanwhile, upside risks to inflation include: volatility in world oil prices and the exchange rate, possible increases in utility rates, and potential pressures coming from agricultural commodities prices.

D. Demand conditions

Recent indicators suggest that aggregate demand conditions are under strong pressure as consumer spending continued to show restraint and as weaker global economic activity took its toll on exports.

- GDP posted a modest growth of 4.5 percent in Q4 2008 compared to 6.4 percent in the previous year and 5.0 percent in the previous quarter.
- Merchandise exports showed a record decline of 40.4 percent year-on-year in December 2008.
- Merchandise imports declined further by 34.2 percent in December 2008.
- Selected demand indicators moderated:
    - The increase in land and rental values has generally moderated in the fourth quarter of 2008 while office and residential vacancy rates increased.
    - Sales of passenger cars, commercial vehicles, and trucks and buses declined in December, as restraints in supply and the spillover effect of the US economic slowdown could have started to influence the decisions of prospective clients.
    - Energy sales decelerated in December, pulled down by the negative growth in the industrial sector.
    - Average capacity utilization in manufacturing dropped further in December 2008.
    - MISSI figures indicate slower manufacturing activity in December 2008.
    - Results of the first quarter consumer and business expectations surveys show sustained bearish sentiment.

E. Supply-side indicators

Developments in Agriculture

- Average retail prices of rice continued to increase in the second week of February 2009.

- Meanwhile, international cereal prices increased in January. The International Rice Research Institute (IRRI) also warned that rice prices could remain highly volatile in 2009.

- FAO's report on Crop Prospects and Food Situation suggests an overall decline in world cereal production in 2009 from the previous year's record output due to a decline in the area planted to cereals of major exporters, adverse weather conditions, and high input costs.

Oil Price Developments

- The spot price of Dubai crude was slightly lower in February, averaging US$43.09 per barrel from US$44.12 per barrel in January. Prices eased on signs of further softening of the demand for oil due to expectations of worsening global economic conditions.

- However, prices in the futures market increased slightly due to supply concerns arising from speculation that OPEC will further cut its oil production during its meeting on 15 March 2009 and reports that Abu Dhabi National Oil Co. (the main oil supplier of the United Arab Emirates) would be limiting its oil supplies to Asia. The drop in the stockpiles of gasoline in the US ahead of the driving season also influenced the increase in futures prices.

- Oil companies reduced the price of petroleum products on 2 March 2009.

- In the transport sector, another provisional reduction of 50 centavos in jeepney fare was implemented effective 23 February 2009.

Developments in the Utilities Sector

- The ERC provisionally approved a lower refund under the 12th GRAM and 11th ICERA for the Luzon grid and the increase in NPC's basic rates.

- Meanwhile, the increase in water rates for the two Metro Manila water concessionaires, which was earlier deferred, was implemented in February.

F. Financial Market Developments

- The interaction between the global financial shock and the recession in major economies, as well as the associated crisis in confidence, continued to pose challenges to domestic financial markets.

Interest Rate and Interest Rate Differentials

- The differential between the BSP policy rate and the US federal funds rate narrowed in January 2009, following the BSP's 50-basis-point cut in its policy rate. Adjusted for the risk premium, the policy interest rate differential turned positive during the first two weeks of February 2009, as sovereign risk spreads improved.

- Meanwhile, the differentials between the domestic and foreign interest rates narrowed during the first two months of 2009.

Stock Market

- Despite the approval by the US Congress of the economic stimulus package, stock trading remained weak in February 2009 as market uncertainties continued to hound investors.

Foreign Exchange

- The peso remained volatile in January to mid-February. On the third week of February, regional currencies weakened as market uncertainty rose following reports that the Euro area suffered its deepest contraction on record in the fourth quarter of 2008. The deep contractions in the Euro area and the US as well as in some Asian economies, particularly Japan, were taken by financial markets as further signs of a more severe global crisis. The peso also weakened as the domestic financial markets reflected the US stock market rout amid rising concern that the global slowdown is more severe than expected while the US stimulus plan might not be sufficient to mitigate the financial crisis. The depreciation of the peso was tempered by the lack of corporate demand for dollars.

- On a year-to-date basis, Asian currencies depreciated, led by the Korean won.

Global Bond and Credit Default Swap Spreads

- As of 24 February, emerging market debt spreads narrowed after climbing close to its year's peak on 17 February. Emerging market bond risks fell as expectations that the US government would nationalize major banks abated, boosting demand for higher-yielding assets.

Following global market developments, the EMBI+ Philippine spread likewise narrowed.

- However, the cost of protecting the Philippine debt from default increased as the Philippine five-year credit default swap (CDS) spread reached its peak for the year on 24 February. Against neighboring economies, the Philippine CDS has remained below Indonesia's CDS level but higher than Malaysia and Thailand.

G. Domestic Liquidity and Credit Conditions

- Domestic liquidity sustained its strong growth in January due to the expansion in both net domestic assets (NDA) and net foreign assets (NFA).

- Meanwhile, bank lending growth continued to expand in January 2009.

- The equity raised in the Philippine Stock Exchange in 2008 was lower than the level reached in 2007, while corporate bond issuances increased significantly in 2008.

H. Fiscal developments

- The full year 2008 fiscal deficit reached ₱68.1 billion, better than the ₱75.0 billion program, but higher than the ₱12.4 billion deficit for the full year of 2007.

I. External developments

- The adverse and protracted impact of the financial turmoil on real economic activity around the world has been accompanied by a strong contraction in international trade.

    - Economic activity continued to decelerate in emerging Asia, driven by the severe and synchronized downturn in external demand which has particularly affected exports and industrial production.

- Nevertheless, analysts note that rock-bottom policy interest rates, plans of massive fiscal stimulus packages, and central banks` other efforts to restore market confidence have helped ease some tensions in financial markets and are buying some time to keep business confidence afloat and lay the groundwork for the global economy to begin a moderate recovery.