



HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 28 MAY 2009¹

I. Monetary Policy Decision

The Monetary Board decided to:

- a) Reduce the BSP's policy rates by 25 basis points to 4.25 percent for the overnight RRP (borrowing) rate and 6.25 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 recommendation to reduce policy rates took into consideration the BSP's resolve to support domestic economic activity to the extent that it remains consistent with the inflation target over the policy horizon.

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

- The Monetary Board noted that there remains some scope to lower policy rates further given the continued favorable inflation outlook:
 - Baseline forecasts continued to indicate that annual average inflation will fall within the target ranges for both 2009 and 2010 with base effects stemming from the inflation trend in 2008 expected to impact short-term inflation dynamics.
 - Inflation expectations remained well-anchored. The results of the BSP and private sector surveys reflected inflation expectations falling within the target ranges for both 2009 and 2010.

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 Assistant Governor of the Monetary Policy Sub-Sector, and the Managing Director of the Treasury Department. The highlights of the discussions on the 28 May 2009 meeting were approved by the Monetary Board during its regular meeting held on 18 June 2009. The next meeting of the Monetary Board on monetary policy issues is scheduled on 9 July 2009.



Bangko Sentral ng Pilipinas

- The downside risks to the inflation outlook continued to dominate as the drop in global demand and lower commodity prices dampen inflationary pressures.
- However, the volatility in global oil prices remained as an upside risk to the inflation outlook. Foreign exchange market volatility is another source of risk to future inflation.
- The Board recognized that maintaining an expansionary policy stance could support household and business confidence as the economy works through a long transition period ahead. The global slowdown this year is expected to hit the country through the trade, remittance, investment, financial market, and confidence channels. So far, remittances and foreign direct investments are holding up. The impact on the trade sector, however, has been more pronounced, as reflected in the precipitous drop in exports.
- The Board also observed that while there were encouraging signs that the global slowdown may be bottoming out, it is too early to conclude that global economic conditions are clearly moving towards normalcy. There are still large imbalances in the global financial markets which could prolong the adjustment process.
- The Board reiterated its resolve to support domestic activity to the extent that the inflation outlook would allow and to address quickly any threat to price stability over the medium term to ensure a non-inflationary recovery.

III. Recent Developments in Economic Indicators

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

A. Domestic price conditions

- Headline inflation dropped further to 4.8 percent year-on-year in April from 6.4 percent in March. This brought the year-to-date average to 6.4 percent from 6.9 percent a month earlier.
- Most major commodity groups registered either lower or negative inflation rates in April. Lower year-on-year food inflation—particularly for rice, meat, and miscellaneous food items—drove down overall headline inflation in April. Meanwhile, only services had a higher positive inflation compared to March because of the higher pump prices of petroleum products in April relative to the previous month.
- Month-on-month headline inflation was higher in April at 0.5 percent from 0.1 percent in March, due mainly to the higher pump prices of



petroleum products and higher electricity rates in April relative to the previous month.

- Core inflation, which excludes specific food and energy items to measure generalized price pressures, was lower at 5.0 percent year-on-year in April from 5.6 percent in March. Likewise, all the alternative core inflation measures estimated by the BSP declined.

B. Inflation Expectations

- Recent surveys showed inflation expectations remained generally well-anchored:
 - Results of the BSP's survey of private sector economists/analysts for April 2009 showed lower average inflation forecast for both 2009 and 2010.
 - The latest private sector consensus forecasts as of May 2009 also showed lower inflation expectations for both 2009 and 2010.
 - Meanwhile, the Consumer Expectations Survey (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.
 - The results of the latest Business Expectations Survey (BES) for Q2 2009, however, indicated that the proportion of respondents that anticipate inflation to move up in Q2 2009 increased, albeit marginally.

C. Inflation Outlook

- Latest baseline forecasts continued to indicate that inflation would settle within the 2009 and 2010 target ranges.
- The risks around the central projection for world output lie mainly to the downside, suggesting some downside risks as well to global commodity prices. Meanwhile, upside risks to inflation include volatility in world oil prices and the exchange rate.

D. Demand conditions

Economic activity weakened substantially in the first quarter, reflecting the overall drag caused by the sharp decline in global economic activity.

- GDP rose at an annual rate of 0.4 percent in Q1 2009 compared to 3.9 percent in the same quarter in the previous year and 2.4 percent in the previous quarter.



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- Merchandise exports continued to fall in March 2009 by 30.9 percent year-on-year. Likewise, merchandise imports declined further by 36.2 percent during the same month.
- Selected demand indicators also moderated:
 - In major central business districts, growth of land values decelerated in Q1 2009, rental rates declined, while office and residential vacancy rates increased.
 - Year-on-year, sales of passenger cars, commercial vehicles, and trucks and buses declined in April.
- Nonetheless, positive developments were noted in some indicators:
 - Energy sales rebounded in March after two months of consecutive declines.
 - Average capacity utilization in manufacturing increased for the second consecutive month from 77.7 percent in February to 79.0 percent in March.
 - Q2 2009 BES results showed business sentiment improved during the quarter and turned positive for the next quarter outlook, driven by improving confidence in the US and global markets and the announcement of the Economic Resiliency Plan of the National Government (NG).

E. Supply-side indicators

Developments in Agriculture

- *Palay* production grew by 5.1 percent in Q1 2009 to reach 3.9 MMT given sufficient irrigation, declining fuel cost, and the availability of seeds. Corn production, on the other hand, dropped by 3.4 percent in Q1 2009 due to the adverse effects of continuous rains during the period.
- *Palay* production for Q2 and Q3 2009 is expected to grow by 1.8 percent and 2.4 percent year-on-year, respectively. Meanwhile, corn production for Q2 2009 is forecast at 1.3 MMT, 1.0 percent lower than the Q2 2008 output, due to excessive rains and the early harvest in Q1. For Q3 2009, corn harvest is expected to rebound and increase by 2.3 percent relative to the same period in 2008.
- FAO's April 2009 report on Crop Prospects and Food Situation continued to suggest an overall decline in world cereal production in 2009 from the previous year's record output due to a decline in the



Bangko Sentral ng Pilipinas

area planted to cereals of major exporting countries, adverse weather conditions, and high input costs.

Oil Price Developments

- The spot price of Dubai crude oil was higher in April 2009 relative to the previous month and remained elevated as of 18 May on rising optimism for a global economic rebound that could boost oil demand. Prices in the futures market also increased. Some economists anticipate that oil prices could be higher in the second half of 2009 if economic policies adopted by major economies succeed in reversing demand falls and if members of the Organization of Petroleum Exporting Countries (OPEC) comply with agreed output cuts.
- Oil companies again raised the price of gasoline by ₱1.00 per liter on 26 May. This adjustment was the third price increase of this product during the month. The prices of kerosene and diesel were raised earlier on 19 May by ₱0.50 per liter each. Meanwhile, the price of LPG remained at its 5 May level when it fell by ₱0.25 per liter. This brings the year-to-date net adjustment in the prices of gasoline products to ₱8.00 for unleaded gasoline, - ₱1.69 for diesel, - ₱3.49 for kerosene, and ₱2.26 for LPG.
- In the transport sector, a petition to restore the minimum jeepney fare to ₱7.50 (from the existing ₱7.00) was filed by the Alliance of Concerned Transport Operators (ACTO) with the Land Transportation and Franchising Regulatory Board (LTFRB) on 18 May 2009.

Developments in the Utilities Sector

- The increase in Meralco's distribution rates was offset by lower generation costs resulting in a net reduction in retail electricity rates in May. In April, the ERC approved Meralco's pending application to increase distribution-related charges under the performance-based rate (PBR) mechanism starting May 2009. However, this was offset by the lower generation cost of Meralco's suppliers with cheaper natural gas and improved dispatch. In addition, the Currency Exchange Rate Adjustment (CERA) refund which was implemented in March also contributed to tempering electricity costs.
- On a net basis, Maynilad rates were lower by ~~₱2.03~~ per cubic meter in the second quarter. The ₱1.38 increase in the basic charge of Maynilad from ₱25.86 per cubic meter to ₱27.24 was offset by the refund ordered by the Metropolitan Waterworks and Sewerage System Regulatory Office (MWSS-RO) from gains due to prepayments of dollar-denominated loans.



F. Financial Market Developments

Government Securities Market

- Relative to their 30 April levels, the yields and term spreads (secondary market yields of GS net of overnight reverse repurchase or RRP rates) generally declined across all tenors on 20 May 2009. Yields declined as bond prices rose with increased buying activity due to the favorable inflation outlook and expectations of additional policy rate cuts by the BSP in the months ahead.

Interest Rate and Interest Rate Differentials

- The differential between the BSP policy rate and the US federal funds rate continued to narrow as of end-April, following the BSP's most recent 25-basis-point cut in the policy rate. Adjusted for the risk premium, the differential continued to widen in the same period with the decline in the risk premium, encouraging capital inflows.
- The cumulative 150-basis-point policy rate cut of the BSP from 18 December 2008 to 16 April 2009 appears to have been passed on partially by banks to their borrowers. Actual bank lending rates declined by 51.4 basis points during the period 11-15 May 2009 to reach 8.758 percent relative to 9.272 percent for the period 8-12 December 2008.

Stock Market

- The Philippine Stock Exchange Index (PSEi) recovered in April and sustained the upbeat trend in May, reflecting renewed investors' appetite sparked by positive news that the recession may have reached its bottom. On 25 May, the index reached 2,334.6 index points, the highest level posted since 7 October 2008.

Foreign Exchange

- The peso strengthened in the first three weeks of May as investors regained some appetite for regional assets amid signs of easing recessionary pressure in major economies. Sentiment in the domestic financial markets further improved following reports that the Philippine inflation decelerated in April while the inflation outlook remained favorable. Moreover, on 6 May 2009, Fitch Ratings affirmed its rating and kept its outlook stable for the Philippines' debt issuances. Moreover, the news that the NG posted a surplus in April 2009 helped improve market sentiment. Robust overseas Filipinos' remittances ahead of the school opening in June, coupled with weak demand for the US dollar, provided additional leverage to the peso.



Bangko Sentral ng Pilipinas

- As of 25 May 2009, the peso appreciated against the US dollar by 0.7 percent on a year-to-date basis. The peso's appreciation was in line with the strengthening of other Asian currencies.

Global Bond and Credit Default Swap Spreads

- In April and the first three weeks of May, credit risk has fallen as financial markets showed some signs of stabilizing. Emerging markets' debt spreads continued to narrow due to the improved credit quality of most sovereign issuers, balanced supply and demand for sovereign debt and more rapid growth of emerging market economies. Moreover, investors' risk appetite improved as reflected in the strengthening of global equity, currency and commodity markets. The recent Fitch ratings on Philippine debt also contributed to narrowing debt spreads. Following the upbeat sentiment in global financial and commodity markets, credit default swap (CDS) spreads of Asian economies including the Philippines and the emerging markets bond index (EMBI+) spread for the Philippines narrowed during the review period.

G. Domestic Liquidity and Credit Conditions

- The growth of domestic liquidity or M3 increased to 15.6 percent year-on-year in March, higher than the previous month's 14.6 percent. This was also considerably higher than the 2.1 percent expansion recorded during the same month a year ago. On a month-on-month basis, seasonally-adjusted M3 rose by 0.5 percent in March compared to the 0.9 percent decline in the previous month.
- The growth in outstanding loans of commercial banks including reverse repurchase agreements (RRPs) remained strong at 18.9 percent in March. Net of RRP placements with the BSP, lending likewise expanded by 17.8 percent. Bank lending growth, whether gross or net of RRP, was slightly lower when compared to the corresponding expansions in the previous month, which were 22.5 percent and 22.6 percent, respectively.
- However, overall credit standards tightened somewhat in Q1 2009, as reflected in the BSP's survey on senior bank loan officers.
- Total capital raised in the PSE for the period January-April 2009 remained significantly lower compared to that generated in the same period in 2008. Meanwhile, corporate bond issuance during the first four months of 2009 was almost twice the level recorded in the comparable period in 2008.



H. Fiscal developments

- The NG registered a fiscal surplus in April amounting to ₱7.9 billion, lower than the ₱25.8 billion surplus in the comparable period last year. Cumulatively, the fiscal deficit reached ₱111.8 billion for January-April, increasing by more than fourfold from last year's deficit for the same period. This also represented 72.1 percent of the deficit programmed for Q1-Q2 2009.

I. External developments

- Weighed down by sharp declines in exports, business inventories, and home prices, US GDP contracted further in Q1 2009 by 6.1 percent in annualized terms from the 6.2 percent contraction in the fourth quarter of 2008. But there have been small, incipient signs that indicated financial conditions may be improving: market volatility has declined, while funding and credit spreads have narrowed. Compared to the survey two quarters ago, fewer banks have tightened lending standards over the past six months based on the Fed's Senior Loan Officer Survey. The University of Michigan Consumer Sentiment Index and the Conference Board Consumer Confidence Index showed that consumer expectations improved further in April. Despite these initial signs of improvement, however, financial conditions in the US economy have remained tight. Lenders' balance sheets are still encumbered with impaired assets, promoting further deleveraging.
- In the Euro zone, the drop in industrial output, the outlook from surveys, and other monthly indicators suggest that the pace of economic activity declined significantly in Q1 2009.
- External shocks have rapidly fed through domestic demand in Asia. In its May 2009 issue of the Regional Economic Outlook in Asia and the Pacific, the IMF expects growth in Asia to decelerate to 1.3 percent in 2009, as Japan experiences its worst annual performance on record. Quarterly GDP growth is expected to return to positive territory only in 2010, given the strong fiscal response, but underlying growth will remain weak as the fall in exports is expected to spill over to private domestic demand. China's growth is expected to slow down slightly, as the massive program of public investment is expected to compensate for the decline in private investment, thereby supporting demand.
- In general, most central banks either continued their monetary easing, albeit many at a slower pace (Euro region, New Zealand, Canada, Thailand, Indonesia), or decided to maintain policy rates in their latest policy meetings in April/May (Japan, US, UK, Australia, Malaysia, South Korea).