HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 12 JULY 2007*

The Advisory Committee[1] submitted the following recommendations for the consideration of the Monetary Board:

- Adjust the current monetary policy settings as follows:

(a) Reduce the BSP's policy interest rates to 6.0 percent for the overnight RRP (borrowing) rate and 8.0 percent for the overnight RP (lending) rate;

(b) Remove the tiering scheme;

(c) Adjust the current interest rates on term RRPs, RPs, and SDAs accordingly; and

(d) Maintain the current reserve requirement ratios.

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

A. Domestic price conditions

- Headline inflation slowed down to 2.3 percent in June from 2.4 percent in May. This brought the average inflation rate for the first semester of 2007 to 2.6 percent. The lower inflation was mainly attributable to the slower price increases in fuel, light and water; food, beverages and tobacco; and services.

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* 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 12 July 2007 meeting were approved by the Monetary Board during its regular meeting held on 26 July 2007.

[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.

- Similarly, the official core inflation measure published by the National Statistics Office (NSO) went down to 2.5 percent in June after being pegged at 2.6 percent from March to May.

B. Demand conditions

- Growth in Gross Domestic Product (GDP) in Q1 2007 surged to 6.9 percent, its highest level since Q1 1990. On the demand side, GDP growth was buoyed by robust consumption spending and net exports.

- Selected indicators of demand continued to indicate a broad strengthening trend.

  - Based on data from Colliers International Research, land values in Q2 2007 rose by 6.8 percent year-on-year for the Makati Central Business District (CBD) and 14.2 percent for Ortigas Center. Office and residential rents increased by more than 20 percent over the same period. In real terms, however, land and rental values remained way below their 1997 levels. Meanwhile, office and residential vacancy rates in the Makati CBD continued to decline in Q2 2007.

  - Growth in passenger car sales continued but at a slower pace of 6.1 percent year-on-year in May from 15.5 percent in April. The year-on-year growth in sales of trucks and buses similarly continued but at a slower rate of 16.0 percent in May compared to the blistering rate of 66.1 percent in April.

  - Energy sales by Meralco rose at a slower pace of 2.5 percent year-on-year in April relative to 5.1 percent in March. This reflected the lower growth in electricity demand by the commercial and industrial sectors. Year-to-date energy sales remained broadly unchanged compared to the same period last year.

  - Appliance sales slid slightly by 0.7 percent year-on-year in February after declining by 12.0 percent in January. Similarly, year-to-date sales declined at a slower pace of 6.6 percent compared to 21.2 percent in the first two months of 2006.

  - Average capacity utilization in manufacturing was broadly unchanged in April at 80.1 percent compared to 80.0 percent in March based on the NSO's Monthly Integrated Survey of Selected Industries (MISSI).

  - MISSI data also showed that the value of production index (VAPI) recovered slightly, growing by 0.1 percent year-on-year in April after seven consecutive months of declines. Meanwhile, the volume of production index (VOPI) continued to decline by 1.3 percent year-on-year in April.

? Preliminary NSO data showed that growth in merchandise exports rose to 6.1 percent year-on-year in May from 5.1 percent in April. This was due mainly to higher growth in manufactures (including electronics) and petroleum products. The cumulative growth rate for January to May was 7.7 percent, lower than the previous year's 17.7 percent.

? Merchandise imports recorded a 1.8 percent year-on-year decline in April, reversing the previous month's increase of 8.0 percent. This can be attributed to the decline in imports of capital goods as well as raw materials and intermediate goods. For the first four months of 2007, merchandise imports rose by 3.4 percent, less than half of the 7.6 percent growth in the comparable period in 2006.

? Business sentiment continues to be bullish in Q2 2007 based on the latest Business Expectations Survey (BES). The overall business confidence index (CI) remained above the 40 percent level for the third consecutive quarter, after rising to a record high of 49.4 percent in Q4 2006. The Q2 2007 CI remained strong at 46.4 percent, higher relative to comparable levels year-on-year and quarter-on-quarter.

? Consumer confidence improved based on the Q2 2007 Consumer Expectations Survey (CES). The overall consumer CI was less negative in Q2 2007, indicating that the number of optimistic respondents increased. Consumer confidence for the third quarter and the next 12 months also improved, particularly among households in the NCR where the Q2 2007 confidence indices reached their highest level since the start of the CES in Q3 2004.

? As of end-June 2007, there were six pending petitions for wage increases before six out of 17 Regional Tripartite and Wage Productivity Boards (RTWPBs).

C. Supply side indicators

Developments in Agriculture

? The agriculture sector registered a 4.2 percent growth in Q1 2007, slightly higher than the year-ago growth of 4.1 percent. The major contributions to output growth came from the palay, fishery, livestock and poultry subsectors.

- Current global forecasts point to the potential occurrence of La Niña in Q3 2007. The Philippine Atmospheric, Geophysical and Astronomical Services Administration (PAGASA) noted that four international weather bureaus expect a strong incidence of La Niña in the second semester of 2007. In addition, weather conditions last May met PAGASA's criteria for the start of the rainy season, which peaks between the months of June to August. PAGASA also forecasts one or two tropical cyclones in June and around three or four tropical cyclones per month in July and August.

Oil price developments

- International spot and futures prices remained high on supply concerns related to the US summer driving season and ongoing geopolitical tensions. Meanwhile, domestic prices of petroleum products were raised twice in June. On the transport sector, a 50-centavo minimum fare hike for public utility jeepneys (PUJs) will take effect in Metro Manila, Central Luzon and Southern Tagalog, as soon as the Land Transportation Franchising and Regulatory Board (LTFRB) gets clearance from the National Economic and Development Authority (NEDA).

Developments in the utilities sector

- Despite reduced charges by the National Power Corporation (NPC), electricity rates may be adjusted later on to reflect Transco's higher billing rates. Meanwhile, an average reduction of two percent in water rates will be implemented in Q3 2007.

D. Monetary conditions

Interest rate developments

- During the 2 July 2007 auction, T-bill rates rose relative to their levels in the 21 May 2007 auction.

- Relative to their end-May levels, secondary market yields of GS as of end-June increased except for the yield on the 6-month GS. The yield curve in the secondary market shifted upward, triggered by speculations that there will be less demand for emerging market securities given the rise in the yield for 10-year US Treasuries.

Domestic liquidity and credit conditions

- Growth in domestic liquidity or M3 slowed down to 21.1 percent year-on-year in May from the 26.3 percent increase registered in the previous month. On a month-on-month basis, seasonally adjusted M3 contracted by 1.1 percent in May after a 2.8 percent expansion in April. Growth in the net foreign assets of depository corporations continued to drive M3, albeit at a slower pace of 32.6 percent from 37.9 percent in April. Net domestic assets likewise posted a decelerating growth trend at 6.4 percent from 12.5 percent in the previous month. In particular, growth in credit to the public sector slowed down to 11.8 percent from 18.2 percent during the same period. This was partly offset by the continued expansion in credit to the private sector, which rose by 5.8 percent from 5.2 percent, as lending to entities other than financial corporations was sustained during the month.

? Consumer credit rose by 22.2 percent year-on-year in Q1 2007. This was higher than the year-ago growth recorded at 21.1 percent. More specifically, auto loans, credit card receivables and residential real estate loans expanded by 19.9 percent, 22.3 percent and 24.0 percent, respectively.

Financial market developments

? In May, the stock market sustained its upbeat mood. The continued deceleration in inflation, the strengthening of the peso, bright economic prospects and strong corporate profits helped sustain investors' interest in local stocks.

? Equity raised by PSE-listed companies via various capital-raising activities[2] increased by 41.5 percent to ₱34.8 billion for the first five months of 2007 from ₱24.6 billion in the comparable period last year. Meanwhile, issuances of bonds by private companies reached ₱46.2 billion during the first five months of 2007, more than three times the year-ago level.

E. Exchange rate developments

? The peso averaged ₱46.15/US$1 for the month of June, appreciating by 1.3 percent against the ₱46.75/US$1 average in May,[3] due to continued strong inflows from overseas Filipinos' remittances, foreign direct and portfolio investments, and export earnings.

[2] These consist of initial public offerings (IPOs), follow-on-offerings, stock rights offerings, and private placements.
[3] The figures are based on real time.

F. Fiscal developments

- The National Government (NG) incurred a fiscal deficit of ₱1.7 billion in May, a reversal of the ₱5.8 billion surplus in the same month last year and the ₱12.0 billion surplus in April. The January-May deficit of the NG reached ₱41.8 billion, about 5.4 percent below the deficit in the comparable period last year. The cumulative deficit for the first five months of the year exceeded the ₱31.3 billion program for the first semester of 2007 by ₱10.5 billion.

G. External developments

- Global economic growth remained buoyant, notwithstanding the weaker-than-expected growth in the United States. Steady growth in major economies such as the Euro area and Japan, coupled with the brisk pace of expansion in China and India, sustained the strong global economic performance to date.

- 2007 is the fifth consecutive year of world growth in excess of 4.0 percent, and initial estimates of the International Monetary Fund (IMF) are showing that the world economy is growing this year at a rate faster-than-expected in the previous months. This five-year period of continued growth is the longest period of sustained expansion in three decades, and global inflationary pressures are building up as a result.

- Most major central banks (except for Indonesia, New Zealand, China, UK, Thailand, and Taiwan) maintained key policy rates at their latest policy meetings.

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

- The Monetary Board noted that the recommendation of the Advisory Committee to lower key policy interest rates and remove the tiering scheme—which was assessed to be neutral relative to future inflation and output—is consistent with the forward-looking orientation of inflation targeting, considering the low actual inflation and, more importantly, the benign inflation outlook over the policy horizon. The latest BSP forecasts continue to indicate that inflation is likely to fall below the 4.0–5.0 percent target range in 2007 and stay within the 4.0 percent ± 1.0 percentage point target in 2008.

- The Monetary Board also observed that recent data suggest that the additional liquidity management measures implemented in early May 2007 have begun to exert the desired cooling effect on liquidity conditions. Meanwhile, there are indications that the tiering scheme that has been in effect for the past eight months has had a beneficial impact on bank lending to the productive sectors of the economy. At the same time, the Monetary Board observed that the continued broadening of financial markets means that non-bank sources of financing are becoming increasingly available to the corporate sector, therefore reducing the reliance on bank lending.

? The Monetary Board believes that the neutral stance of monetary policy is appropriate given moderate demand pressures, favorable supply conditions and manageable inflation expectations. Moreover, the Monetary Board considers that neutrality will provide greater flexibility to the monetary authorities in the absence of a clearer direction on potential risks to the inflation outlook, such as liquidity, wage pressures and oil prices.

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 23 August 2007.