



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON  
MONETARY POLICY ISSUES HELD ON 24 APRIL 2008\***

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

- Maintain the current monetary policy settings as follows:
  - (a) Maintain the BSP's policy interest rates at 5.0 percent for the overnight RRP (borrowing) rate and 7.0 percent for the overnight RP (lending) rate;
  - (b) Maintain the current interest rates on term RRPs and RPs; and
  - (c) Maintain the current reserve requirement ratios.

The recommendation to keep monetary policy settings unchanged was based on the following assessments:

- (a) The inflation environment has become more challenging. Depending on the movements in oil and non-oil commodity prices, inflation could settle above the 2008 inflation target range but will be within the 3.5 percent  $\pm$  1.0 percentage point target range for 2009.
- (b) The factors driving inflation have come mostly from the supply side, and the use of monetary instruments against such influences may have less effect compared with direct supply-side intervention measures. Meanwhile, demand conditions—while strengthening—have been growing apace with the economy's growth prospects.
- (c) The balance of risks to the inflation outlook is tilted to the upside. Core inflation has drifted upward, with the March 2008 reading at its highest level since November 2006. The pending requests for wage and transport fare adjustments could raise the upside risks to inflation coming from demand-side pressures.

\* 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 24 April 2008 meeting were approved by the Monetary Board during its regular meeting held on 8 May 2008.

<sup>1</sup> 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 Supervision and Examination Sector, the Managing Director of the Treasury Department, and the Managing Director of the Monetary Policy Sub-sector.



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- (d) However, global economic growth could be adversely affected by a prolonged slowdown in the US economy which could, in turn, temper demand pressures and moderate price increases in global oil and non-oil commodities.

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

## **Review of Recent Developments**

### **A. Domestic price conditions**

- Headline inflation rose to 6.4 percent year-on-year in March from 5.4 percent in February, bringing the year-to-date average to 5.6 percent. All major commodity groups, led by food, posted higher year-on-year inflation rates relative to the previous month.
- Core inflation, which measures the underlying trend in inflation by excluding specific food and energy items, was similarly higher in March. The official core inflation measure published by the National Statistics Office (NSO) increased to 4.8 percent in March from 4.0 percent in February.
- It was noted that inflation is on the rise not only in the Philippines but also in other countries (China, Indonesia, Thailand, Korea, South Africa, Brazil, and Chile) due largely to the rise in energy and food prices.

### **B. Demand conditions**

- Gross Domestic Product (GDP) increased by 7.4 percent in Q4 2007, sustaining the third quarter's revised growth rate and exceeding the 5.5 percent expansion posted in Q4 2006. GDP growth was boosted by household spending and capital investments on the expenditure side, and by the services sector from the production side.
- Full-year GDP growth for 2007 was 7.3 percent, higher than the upper end of the Government's full-year growth target of 6.1-6.7 percent.
- For Q1 2008, the business cycle path remained broadly steady, indicating a continuing expansion phase.
- NSO data showed that merchandise imports continued to accelerate for the fifth consecutive month in January 2008, registering a 27.7 percent increase. Merchandise exports likewise grew by 10.7 percent year-on-year in February.



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- Selected indicators of demand indicated a broad strengthening trend.
  - Based on estimates from Colliers International Research, land values in Q4 2007 rose by 30.3 percent year-on-year for the Makati central business district and 20.9 percent year-on-year for the Ortigas Center.
  - Passenger car sales grew although at a slower pace of 11.4 percent year-on-year in February 2008, compared to the 25.6 percent growth registered in February 2007 and the 28.3 percent increase in January 2008.
  - Commercial vehicle sales continued to grow although at a slower rate of 11.9 percent year-on-year in February 2008, compared to 50.0 percent in February 2007 and 13.3 percent in January 2008. On a year-to-date basis, commercial vehicles also rose by 12.6 percent, lower than the 28.7 percent registered in January-February 2007.
  - On a year-on-year basis, sales of trucks and buses increased by 12.9 percent in February 2008, lower than the 66.0 percent recorded in February 2007 but a reversal of the 21.7 percent contraction in January 2008.
  - Year-on-year energy sales of Meralco increased by 6.0 percent in February 2008, higher than the February 2007 and January 2008 growth rates of 1.1 percent and 4.3 percent, respectively.
  - Appliance sales increased by 26.9 percent year-on-year in February 2008, higher than the 9.5 percent growth in February 2007 and 12.7 percent registered in January 2008.
  - Average capacity utilization in manufacturing was relatively steady for the sixth consecutive month at 80.2 percent in January 2008, based on the revised rates reported in NSO's Monthly Integrated Survey of Selected Industries (MISSI).
  - The value of production index (VAPI) decreased anew at a rate of 1.4 percent year-on-year in January 2008 from declines of 1.3 percent (revised) in December 2007 and 0.5 percent in January 2007. In contrast, the volume of production index (VOPI) grew year-on-year in January 2008 at 0.5 percent from 0.1 percent (revised) in December 2007 and a decline of 3.6 percent in January 2007.
- The Q1 2008 overall business confidence index (CI) remained positive but the lower index for the quarter indicated that more firms expect a slowdown in business activity.



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- Q1 2008 CES results showed improved consumer confidence after the downturn in the past quarter. The nationwide consumer confidence index (CI) for the first quarter of 2008 improved quarter-on-quarter by 6.5 index points to -27.1 percent.
- Based on the preliminary results of the January 2008 Labor Force Survey (LFS), the unemployment rate declined to 7.4 percent in January 2008 from 7.8 percent in January 2007.
- Salaries of government employees are expected to increase by 10 percent effective July 2008. Three petitions for an across-the-board increase in the daily minimum wages in NCR, Region VI, and Region X were filed with their respective wage boards. Meanwhile, the proposal for the ₱125 daily wage hike for private sector employees and the Salary Standardization Law (SSL) III for government workers remained pending in Congress.

### **C. Supply-side indicators**

#### Developments in Agriculture

- Agriculture sustained its growth in Q4 2007 notwithstanding the destruction brought by typhoons that visited certain areas of the country during the quarter as a result of the on going La Niña phenomenon which started in August 2007. According to the Department of Agriculture (DA), agricultural production will be supported by the anticipated rise in public spending on irrigation and other infrastructure, postharvest facilities, research and development (R&D), and agricultural extension work.
- Meanwhile, the DA is poised to advance after the summer harvests its third cropping season for palay under its quick turnaround (QTA) program to take advantage of the weather bureau's forecast of the La Nina phenomenon lasting until mid-2008.
- Latest data from the National Food Authority (NFA) as of 11 April indicate that the country's total rice inventory stood at 1.8 million metric tons (MT), slightly lower than the previous month's level of 1.9 million MT but higher than the previous year's level of 1.5 million MT. In terms of sufficiency, the latest inventory level is sufficient to last for 55 days based on the average daily rice requirement of 33 thousand MT.
- Meanwhile, retail prices of commercial rice continued to increase. Special and ordinary rice prices have been trending upward since the first week of March. Elevated prices of farm inputs (fertilizers, fuel and oil), which pushed up farm gate prices of palay, and speculations of a



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rice shortage as world inventories continue to be depleted (which sent imported rice prices at historic highs), have contributed largely to the uptrend in rice prices.

- The rising costs of feed ingredients, particularly corn, soybean meal, feed wheat, and coconut oil is putting upward pressures on the prices of meat products.
- International prices for all major cereals continued their rise in February and March, largely driven by persistent supply tightness and the imposition of new export restrictions.

### Oil Price Developments

- International spot and future prices were higher in March up to mid-April due to the weak US dollar, the decision of OPEC to keep its output unchanged, and dwindling US crude inventories. In the domestic scene, the oil import tariff was lowered to one percent in April from two percent in March. Meanwhile, pump prices of petroleum products, except for LPG, increased anew by ₱0.50 per liter on 12 April.
- In the transport sector, a provisional increase of ₱0.50 in the minimum fare for jeepneys in NCR, Region III, and Region IV may be implemented by June but the petitions filed by jeepney operators in December 2007 seeking a ₱1.00-₱1.50 increase in the minimum fare for Metro Manila remain pending with the Land Transportation Franchising and Regulatory Board (LTFRB).

### Developments in the Utilities Sector

- With the start of the summer season, more pressures on electricity rates in the coming months are expected. This, however, may be tempered by the broadly steady peso and higher utilization of hydroelectric power plants with the increased rainfall brought about by the La Niña.
- Meanwhile, water rates in Metro Manila were lowered in the second quarter due to the higher discount from the foreign currency differential adjustment (FCDA).

### **D. Financial Market Developments**

- Asian equities, including those in the Philippines, weakened and currencies slid in mid-April amid fears of a regional economic downturn following Chairman Ben Bernanke's remarks in April that the US would barely grow and could fall into recession this semester. Meanwhile, the primary market T-bill rates stayed at their January



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2008 levels while the yield curve for the secondary market shifted upward.

## Interest Rates

- During the 31 March 2008 auction, the Auction Committee decided to make a partial award of 364-day T-bills worth ₱1.9 billion (out of the ₱6.0 billion offered) at an average rate of 5.705 percent, 43.9 basis points higher than the average rate during the previous auction. There were no offerings for the 91-day and 182-day T-bills.
- Compared to their 29 February levels, the secondary market yields rose on 8 April. However, compared to their 12 March levels, the yields were higher at the short- and long-end of the curve, but remained the same or declined for the medium-term maturities.

## Stock Market

- Risk aversion and uncertainties on the severity of the US economic recession continued to dictate stock market sentiments in April 2008. Following three consecutive months of market slowdown due to lack of leads that could spur investors' sentiments coupled with the continued worries over global uncertainties, the PSEi continued to trek down on thin trading. On 9 April, the PSEi slipped back to 2,961.8 index points. By mid-April, stocks slid back due to persistent fears of a US recession, uptick in domestic inflation rate and lack of positive news that kept investors on the sidelines. On 21 April, the PSEi closed at 2,890.9 index points, lower by 2.7 percent compared to the first trading day of the month (1 April).

## Foreign Exchange

- The peso depreciated in March and well into mid-April. The peso depreciated by 1.6 percent in March 2008 to average ₱41.32/US\$1 relative to February 2008 amid rising risk aversion as investors shifted away from emerging market assets due to concerns on the worsening global financial market turbulence and fears of a looming US recession and its impact on the world economy
- On a year-to-date basis, several Asian currencies strengthened vis-à-vis the US dollar as of 21 April 2008, led by the Japanese yen's 8.7 percent appreciation. However, the peso, as well as the Indian rupee, Thai baht and Korean won, depreciated.

## Global Bond and Credit Default Spreads

- Debt spreads showed mixed trends but narrowed towards mid-April 2008. Debt spreads generally eased from end-March 2008 but were still close to their record high levels. The market reacted well to the writedowns by



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large international banks which indicated that banks were finally revealing the true extent of their losses in the credit crisis.

- Meanwhile, reports on the country's fiscal surplus and higher export earnings for the first two months of 2008 improved investors' sentiment. Philippine credit default swap (CDS) spreads narrowed to 216 basis points on 17 April from 221 basis points on 9 April and 240 basis points in end-March.
- Similarly, the EMBI+ Philippine spreads tightened to 227 basis points on 17 April from 258 basis points on 9 April and 272 basis points on 31 March.

## **E. Domestic Liquidity and Credit Conditions**

- Domestic liquidity or M3 grew by 6.6 percent year-on-year in February 2008, slower than the growth of 7.2 percent in January 2008. This was also lower than the 22.0 percent expansion recorded in February 2007.
- The slowdown in the growth of domestic liquidity can be traced to both the decline in net domestic assets (NDA) and the slowdown in the growth of net foreign assets (NFA).
- Outstanding loans of commercial banks, thrift banks, and rural banks (excluding reverse repurchase or RRP) continued to expand in February 2008, posting a growth of 9.4 percent year-on-year. This was higher than the 9.3 percent growth in January 2008 and the 5.4 percent growth registered in February 2007. Inclusive of banks' RRP placements with the BSP, bank lending increased by 4.7 percent year-on-year in February 2008, lower than the 5.4 percent expansion in January 2008. This was also lower than the 8.4 percent growth recorded in February 2007.
- Consumer credit increased by 15.9 percent year-on-year in Q4 2007 but this was lower than the 21.1 percent growth recorded in Q4 2006 and the 20.9 percent growth registered in Q3 2007.
- Capital-raising activities in the PSE were weak in the period January-March 2008. Likewise, corporate bond issuances dropped during the first three months of 2008. It is worth noting that for the first three months of 2008, banks account for a larger share of capital-raising in the PSE as well as corporate bond issuances, unlike in the previous year when non-banks accounted for the bigger share.



## **F. Fiscal developments**

- The National Government (NG) posted a fiscal deficit of ₱32.9 billion for the first two months of 2008, higher by ₱14.3 billion than the ₱18.6 billion deficit incurred during the same period in 2007. The lower deficit last year resulted mainly from the sale of Philippine Telecommunications Investment Corporation (PTIC) shares to Metro Pacific Assets Holdings.
- The full-year public sector external debt-to-GDP ratio in 2007 was 26.1 percent of GDP, lower by 5.4 percentage points compared to 31.5 percent in 2006. This can be attributed to the increase in GDP to US\$144.1 billion for 2007 from US\$117.6 billion in 2006. This offsets the increase in the stock of public sector external debt which rose to US\$37.7 billion from US\$37.1 billion in 2006.

## **G. External developments**

- Against the background of financial market volatility and a possible protracted slowdown in the US economy, an extended period of slower growth is expected in the near term as the rest of the world may not be able to decouple from the US despite the strong fundamentals of emerging market economies.
- Central banks are now faced with the challenge of keeping fiscal stimulus, monetary tightening, and exchange rate policies in balance against the backdrop of rising oil and non-oil commodity prices and weakening economic growth.
- The US Fed eased monetary policy settings aggressively while most major central banks remained on hold. The Fed lowered its target for the federal funds rate 75 basis points to 2.25 percent on 18 March 2008.
- As of their latest policy meetings in March or early April 2008, monetary policy settings were maintained in Asia (Indonesia, Thailand, South Korea, Malaysia, India and Japan), New Zealand, Australia and the Euro region, whereas the US, UK, and Canada reduced their policy rates.
- Meanwhile, only Taiwan in Asia increased its policy rates, while Chile and Colombia in Latin America and several Eastern European countries tightened monetary policy settings as well. Meanwhile, China last raised its policy rates by 18 basis points to 7.47 percent in December 2007.





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

- The Monetary Board noted that prevailing price and output conditions suggest that the stance of monetary policy continues to be appropriate for the present.
- The Monetary Board observed that BSP's baseline inflation forecasts indicate that, depending on the movements in oil and non-oil commodity prices, inflation could settle above the 2008 inflation target range but will be within the 3.5 percent  $\pm$  1.0 percentage point target range for 2009.
- In its assessment, the Monetary Board observed that the balance of risks to the inflation outlook is tilted to the upside. Core inflation has drifted upward, with the March 2008 reading at its highest level since November 2006. The pending requests for wage and transport fare adjustments could raise the upside risks to inflation coming from demand-side pressures. On the other hand, the consensus view of a prolonged slowdown in the US economy, and the resulting weaker outlook for global economic growth, could reduce demand pressures and moderate price increases in global oil and non-oil commodities.
- Containing inflation is the BSP's predominant policy objective. It will act decisively and adjust monetary policy settings accordingly as and when second-round effects of supply shocks become evident. The Board noted that the economy's underlying growth momentum provides ample room for a decisive policy response by monetary authorities.

## **III. Monetary Policy Decision**

- After considering the inflation outlook and the balance of risks to the inflation outlook as well as 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 5 June 2008.