



HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 15 DECEMBER 2005*

The Advisory Committee¹ submitted the following recommendations for the consideration of the Monetary Board:

- 1) Maintain the current monetary policy settings as follows:
 - (a) 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; and
 - (b) Maintain the current interest rates on term RRPs, RPs, and SDAs.
- 2) Maintain the current reserve requirement ratios;
- 3) Continue to articulate support for the use of non-monetary measures to address supply-side risks, particularly those related to food supply and oil, by strengthening representation and coordination with various government agencies; and
- 4) Encourage public support for energy conservation and efficiency measures and support exploration/use of alternative sources of energy.

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

The Advisory Committee's recommendations were based on the following considerations:

- Headline inflation rose slightly to 7.1 percent in November bringing the year-to-date average inflation to 7.7 percent. This marginal rise in inflation coincided with the removal of certain exemptions under the Reformed Value Added Tax (RVAT) law. Meanwhile, core inflation maintained its decelerating trend, indicating the continued absence of demand-side price pressures.

* The highlights of the discussions of the 15 December 2005 Monetary Board meeting were approved by the Monetary Board during its meeting held on 12 January 2006.

¹ 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 Director of the Department of Economic Research.



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- Food and energy items continued to account for more than half of the November inflation rate: food accounted for almost 3.0 percentage points, while fuel, light and water (FLW) along with transport and communication (which includes gasoline and diesel) accounted for a combined 2.3 percentage points.
- Selected indicators of demand suggest continued growth in economic activity.
 - Manufacturing activity showed some improvement. Average capacity utilization in manufacturing was marginally higher at 80.3 percent in September 2005 from 80.2 percent in the previous month. The value of production index (VAPI) for manufacturing increased by 9.7 percent year-on-year in September, lower than the revised August growth rate of 17.9 percent. Meanwhile, the volume of production index (VOPI) declined by 5.0 percent in September, a reversal from the 5.0 percent expansion in August.
 - Merchandise imports increased by 7.8 percent year-on-year in September, a deceleration from the 10.1 percent growth in the previous month.
 - The country's major corporations posted strong revenue growth in the first nine months of 2005. Some firms, however, experienced slower profit growth in the third quarter due to higher operating expenses and financing charges.
 - Unemployment eased to 10.9 percent in July 2005 from 11.7 percent a year ago and 12.7 percent in April 2005, using the old definition of unemployment. Based on the new definition of unemployment, the jobless rate declined to 7.7 percent in July from 8.3 percent in April.²
 - Property values rose while office vacancy rates declined during the third quarter, based on estimates by Colliers International Research.
 - Results of the fourth quarter 2005 Business Expectations Survey (BES) and Consumer Expectations Survey (CES) indicated improvements in business and consumer outlook for the fourth quarter of 2005 and for the first quarter of 2006.

² Starting April 2005, the new Labor Force Survey (LFS) questionnaire was used to estimate the number of unemployed, which include all persons who are 15 years old and over as of their last birthday and are reported as: (1) without work and currently available for work and seeking work; or (2) without work and currently available for work but not seeking work for the following reasons: (a) tired/believed no work available; (b) awaiting results of previous job application; (c) temporary illness/disability; (d) bad weather; and (e) waiting for rehire/job recall. The old definition of unemployment did not consider the availability criterion.



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- The composite leading economic indicator of the National Statistical Coordination Board (NSCB) rose to 0.223 in the fourth quarter of 2005 from 0.060 in the previous quarter, indicating a continued rise of economic activity in the fourth quarter.
- Other data, however, point to weakening demand.
 - Economic growth weakened in the third quarter, reflecting the dampening effects of higher oil and consumer prices as well as the sluggish performance of the agriculture sector. The country's gross domestic product (GDP) registered a 4.1 percent growth for the third quarter of 2005, down from 6.2 percent a year ago. This brought GDP growth for the first nine months to 4.6 percent.
 - Merchandise exports declined by 1.2 percent year-on-year in September. This was traced to softening foreign demand for electronics exports, which decreased by 2.1 percent and accounted for 67.3 percent of the aggregate export revenue in September.
 - Passenger car sales fell by 4.0 percent in October, following the 0.1 percent rise in the previous month, based on the data of the Chamber of Automotive Manufacturers of the Philippines, Inc.
 - Energy sales by the Manila Electric Company fell by 3.1 percent year-on-year in October, with declines observed in all consumer categories (residential, commercial and industrial).
 - Appliance sales fell for the eleventh straight month by 24.7 percent year-on-year in October.
- Agricultural output grew at a slower pace of 1.7 percent in the first nine months of 2005 compared to 6.6 percent in the previous year, as the crops subsector contracted due to lower *palay*, corn and sugarcane production, while the other subsectors posted modest increases.
- World oil prices eased in November owing to milder-than-expected weather conditions in the Northern Hemisphere and news of rising crude oil inventories in the US. Consequently, domestic pump prices of oil products were reduced in November to reflect the softening trend in global oil prices. However, in early December, world oil prices rose on higher demand for heating oil alongside colder weather conditions in the US Northeast.
- Meanwhile, the growth in domestic liquidity and bank lending decelerated based on the latest data for October. Treasury bill (T-bill) auction rates continued to decline on 29 November 2005, the last auction date for the year.



Bangko Sentral ng Pilipinas

- Based on preliminary Depository Corporations Survey (DCS) data, growth in domestic liquidity (M3) decelerated to 14.1 percent year-on-year in October from 14.8 percent in September.³
- Outstanding loans of commercial banks (KBs) grew by 0.5 percent year-on-year to ₱1.505 trillion as of end-September 2005. This was lower than the 3.3 percent growth in August.
- T-bill rates for the 91-day, 182-day and 364-day tenors at the 29 November 2005 auction were lower compared to the two previous auctions on 14 and 21 November 2005. T-bill rates continued to ease due to ample liquidity and market optimism concerning fiscal performance with the implementation of the RVAT law. The weekly decline in T-bill rates occurred ahead of the cancellation of the December T-bill auctions by the Bureau of the Treasury.
- The peso continued to strengthen against the US dollar for a second straight month in November, supported mainly by overseas Filipino worker (OFW) remittances and investment inflows, as well as the improving fiscal outlook.
- For the first 10 months, the National Government (NG) recorded a ₱115.5 billion fiscal deficit, which is 21.8 percent lower than the year-ago figure and equivalent to only 74.0 percent of the deficit target for the period. Revenue collections for the first ten months grew by 14.6 percent to reach ₱661.2 billion, while spending rose by 7.2 percent to ₱776.7 billion. For the month of October, the NG recorded a deficit of ₱7.1 billion, higher than the year-ago deficit but lower than the programmed deficit for the month.
- The global economy's growth momentum continued in the third quarter of 2005, driven by the robust output performance of the services sector and the moderate recovery of manufacturing in most major economies. On the price front, the recent decline in oil prices from their peak level in September have contributed to easing global inflation pressures.

II. Review of the Monetary Policy Stance

- The Monetary Board noted that the balance of economic evidence supports an unchanged policy setting. The current combination of generally favorable supply-side and demand-side pressures should provide a stabilizing influence on inflation expectations in the near term.

³ M3 refers to the stock of broad money based on data on the Depository Corporations Survey (DCS). The DCS, which replaces the Monetary Survey (MS) 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.



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In particular, the recent easing of energy prices, the strengthening of the peso, and the ongoing harvest season alongside normal weather conditions are likely to hold back cost-side inflation pressures.

- Equally important, the deceleration of liquidity growth and the continued easing of core inflation demonstrate the relative absence of demand-based inflation pressures. This is consistent with the observed slowdown in aggregate demand, particularly in consumer spending which remains the key driver of growth. The previous monetary tightening should also be allowed to run its course and impact on both liquidity growth and inflation expectations.
- However, the Monetary Board is of the view that risks to inflation remain present and continue to necessitate the BSP's readiness to respond preemptively. Global energy prices, for example, could surge again and create uncertainty in the inflation outlook given limited global surplus production capacity.
- Adverse shifts in the public's inflation expectations also remain a risk given the relatively high level of inflation relative to the government target. Deviations of actual inflation from the target over a prolonged period may lead the public to expect inflation to remain persistently well above the targets announced by the Government.
- The Monetary Board also views the possibility of second-round effects and the continued presence of ample liquidity in the financial system as potential risks to the inflation outlook.
- Moving forward, the the Monetary Board remains committed to the BSP's inflation objectives and will continue to closely monitor the evolving conditions for consumer prices, aggregate demand, domestic liquidity and other factors in order to determine the appropriate stance of monetary policy and undertake action if necessary.

III. Monetary Policy Decision

- Upon assessment of the balance of risks to inflation and the evidence that has become available since its previous meeting on monetary policy, the Monetary Board unanimously approved the following measures:
 - 1) Maintain the current monetary policy settings as follows:
 - (a) 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; and



Bangko Sentral ng Pilipinas

- (b) Maintain the current interest rates on term RRPs, RPs, and SDAs.
- 2) Maintain the current reserve requirement ratios;
- 3) Continue to articulate support for the use of non-monetary measures to address supply-side risks, particularly those relating to food supply, energy conservation, and the development of alternative energy sources, by strengthening representation and coordination with various government agencies; and
- 4) Intensify the BSP's public information campaign with greater focus on the dynamics and sources of price pressures in order to help guide inflationary expectations.

The next meeting of the Monetary Board to discuss the monetary policy setting is scheduled on 12 January 2006.