



## **HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 1 JUNE 2006\***

The Advisory Committee<sup>1</sup> 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; and
- 3) Continue to articulate the BSP's support for the Government's use of non-monetary measures to address supply-side risks to basic commodity prices and continue representation and coordination with concerned government agencies for this purpose.

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**

#### **Inflation**

- Headline inflation decelerated to 7.1 percent in April from 7.6 percent in March, as inflation for all commodity groups slowed down. Average inflation for the first four months of the year was 7.2 percent. Meanwhile, year-on-year core inflation slowed in April following two consecutive months of increases, bringing the year-to-date core inflation to 6.2 percent.

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\* The arguments and information presented herein were the ones prevailing at the time of the Monetary Board decision on 1 June 2006. The highlights of the discussions of the 1 June 2006 meeting were approved by the Monetary Board during its meeting held on 29 June 2006.

<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 Director of the Department of Economic Research.



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- World spot prices of crude oil rose in May on geopolitical concerns; but futures prices softened due to reports of ample US gasoline inventories and the International Energy Agency's (IEA) downward revision of its forecast for global oil demand growth in 2006. Meanwhile, domestic pump prices of gasoline, diesel, kerosene and LPG increased during the period.

### **Demand**

- Selected demand indicators suggested limited pressures on prices.
  - Growth in real Gross Domestic Product (GDP) accelerated to 5.5 percent in the first quarter of 2006 from 4.2 percent a year earlier and 5.3 percent in the fourth quarter of 2005. Meanwhile, the country's Gross National Product (GNP) rose by 5.8 percent, helped by the sustained growth in Net Factor Income from Abroad (NFIA).
  - Average capacity utilization in manufacturing rose minimally to 80.1 percent in March 2006 from 80.0 percent in the previous month.
  - Growth in total energy sales by the Manila Electric Company (Meralco) rose to 6.9 percent year-on-year in March from 4.6 percent in February. This could be attributed to higher growth in consumption by commercial and industrial users.
  - Passenger car sales declined at a faster pace of 17.7 percent year-on-year in April from 2.0 percent in the previous month, based on data from the Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI); while appliance sales continued to decline, registering a 14.7 percent reduction in volume in March.
  - Growth in merchandise export earnings accelerated to 26.3 percent year-on-year in March from 14.9 percent in February due mainly to higher growth in exports of manufactured goods, particularly electronic products. Total merchandise imports rose at a faster pace of 8.0 percent in March compared to 4.6 percent in February, due to the upturn in imports of raw materials and intermediate goods; faster growth in imports of minerals fuel, lubricants and related materials; and an increase in imports of consumer goods.
  - Unemployment rose slightly in January 2006 to 10.7 percent from 10.3 percent in October 2005 but was lower than the year-ago figure of 11.3 percent, based on the old NSO definition of unemployment. Based on the new definition of unemployment, the jobless rate



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likewise increased to 8.1 percent in January from 7.4 percent in October.<sup>2</sup>

- The results of the latest Business Expectations Survey (BES) of the BSP indicated improving business optimism for the second and third quarters of 2006.

## **Domestic Liquidity**

- Growth in domestic liquidity increased somewhat, while outstanding loans of commercial banks fell slightly.
  - Domestic liquidity growth increased to 9.6 percent in April from 9.1 percent year-on-year in March (revised), based on data from the BSP's Depository Corporations Survey (DCS).<sup>3</sup>
  - Outstanding loans of commercial banks (KBs) declined by 0.5 percent year-on-year in March 2006. On a monthly basis, KB loans declined by 1.6 percent.

## **Financial Market and Other Domestic Developments**

- Compared with the auction on 2 May 2006, T-bill rates rose across all tenors on 15 May 2006 to realign with those prevailing in the secondary market. The T-bill rates for the 91-day, 182-day and 364-day tenors rose by 23.2 basis points, 15.2 basis points and 15.6 basis points, respectively, to 5.0 percent, 5.734 percent and 5.955 percent.
- The peso weakened against the US dollar in May due largely to higher corporate demand for US dollars and expectations of further interest rate increases by the US Federal Reserve. Nonetheless, overseas workers' remittances, export receipts, portfolio investment inflows, and the possibility of a sovereign credit rating upgrade provided some support to the peso.
- The January to April 2006 fiscal deficit of the National Government was ₱50.0 billion, lower than the ₱60.1 billion deficit incurred during the same

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<sup>2</sup> Beginning in April 2005, a new Labor Force Survey (LFS) questionnaire was used to estimate the number of unemployed, which includes 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.

<sup>3</sup> M3 refers to the stock of broad money based on data on the Depository Corporations Survey (DCS). The DCS, which replaced 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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period in 2005. Growth in revenue collections (16.1 percent) continued to outpace that of disbursements (10.0 percent).

## **External Developments**

- Global economic momentum continued to broaden on renewed strength of domestic consumption and investments in major economies. Sustained gains in employment, favorable financial conditions, and steady improvements in business and consumer confidence also underpinned global expansion. The resiliency of the services sector remained a major driver of growth in most economies, while the solid pick-up in manufacturing activity lent further support to growth. However, a number of uncertainties remained, notably the sustained volatility in international oil prices and the prospect of a considerable increase in global interest rates.
- Except for the US Federal Open Market Committee (which raised its policy rate during its 10 May 2006 meeting), the recent responses of monetary authorities to the outlook for inflation and growth in their respective economies were generally cautious. The Bank of England's Monetary Policy Committee voted to keep the key repo rate steady during its 3-4 May 2006 meeting, noting that inflation remained close to target despite some upside risks in the near-term relating mainly to higher commodity and energy prices. Similarly, the European Central Bank voted to keep its key refinance rate unchanged at 2.5 percent, noting that wage dynamics had remained moderate over the recent quarters while growth in wages was expected to remain contained. The Bank of Japan, meanwhile, voted to maintain its uncollateralized overnight call rate at zero following the change in its operating target for money market operations in March.

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

- The expected path of inflation remained the chief argument for keeping policy settings steady. Even after accounting for recent increases in oil prices, latest BSP forecasts continued to suggest a deceleration in inflation beginning in the second half of 2006. There were also indications that average inflation for 2007 could hit the 4-5 percent target in the absence of new supply shocks.
- Furthermore, core inflation and other demand indicators continued to point to limited demand-based pressures on prices. Meanwhile, inflation expectations remained well-anchored and there was relatively little indication of second-round effects from supply shocks.



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- Nevertheless, the Monetary Board recognized that the balance of risks to future inflation remained on the upside and closely related to movements in oil prices. Steady world oil demand against a backdrop of limited surplus production capacity would likely keep world oil prices high. Oil prices would likely be vulnerable to market concerns of geopolitical risks in major oil-producing economies. Possible adjustments in domestic power costs could also lead to a continuing environment of supply-side pressures. Such a scenario could increase the risk of an adverse shift in the public's inflation expectations as well as second-round effects in wage- and price-setting.
- Given that price pressures were mainly rooted in the supply side, the Monetary Board agreed that its key policy priority remained that of managing the risks to inflation expectations and the risk of potential second-round effects on wage- and price-setting. At the same time, the Monetary Board agreed it would continue to support non-monetary measures to address high oil prices by concerned government agencies.

### **III. Monetary Policy Decision**

- Upon assessment of the balance of risks to inflation and the evidence that had become available since its previous meeting on monetary policy, the Monetary Board unanimously approved the measures recommended by the Advisory Committee, with the following additional measure:
  - Increase the focus of the BSP's public information campaign on the dynamics and sources of price pressures in order to help guide the public's inflation expectations.

The next meeting of the Monetary Board to discuss the monetary policy setting is scheduled on 29 June 2006.