



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON  
MONETARY POLICY ISSUES HELD ON 9 FEBRUARY 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;
- 3) Continue to articulate support for the use of non-monetary measures to address supply-side risks, particularly those related to basic commodity prices, by strengthening representation and coordination with various government agencies; and
- 4) Emphasize the short-term nature of the impact of the RVAT on prices in the BSP's policy pronouncements on the stance of monetary policy.

**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 in January owing mainly to the faster price increases for services and miscellaneous items. Core inflation continued to decelerate, indicating the absence of demand-side price pressures.

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\* The arguments and information presented herein were the ones prevailing at the time of the Monetary Board decision on 9 February 2006. The highlights of the discussions of the 9 February 2006 meeting were approved by the Monetary Board during its meeting held on 9 March 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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- Food and energy items continued to account for more than half of the inflation rate in January: food contributed 2.6 percentage points, while fuel, light and water (FLW) along with transport and communication accounted for a combined 2.1 percentage points.
- The international price of Dubai crude oil rose again in January 2006 on geopolitical concerns. Meanwhile, domestic retail prices of petroleum products were raised twice in the same month following the recent uptrend in international prices and were raised anew on 1 February 2006 in line with the increase in the Value Added Tax (VAT) rate.
- Selected indicators of demand suggest continued growth in economic activity.
  - The growth in the real Gross Domestic Product (GDP) accelerated to 6.1 percent in the fourth quarter of 2005 from 4.5 percent in the third quarter and 5.3 percent in the fourth quarter of 2004. This brought GDP growth for 2005 to 5.1 percent from 6.0 percent in the previous year.
  - The country's major corporations reported 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.
  - Passenger car sales registered a year-on-year growth of 4.6 percent in December, a reversal from the 5.4 percent decline recorded in the previous month, based on the data of the Chamber of Automotive Manufacturers of the Philippines, Inc (CAMPI).
  - Unemployment eased to 10.3 percent in October 2005 from 10.9 percent both in the same month in 2004 and in July 2005, using the old definition of unemployment. Similarly, based on the new definition of unemployment, the jobless rate declined to 7.4 percent from 7.7 percent in July.<sup>2</sup>
  - Property values rose while office vacancy rates declined during the third quarter, based on estimates by Colliers International Research.

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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.



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- Total merchandise imports rose by 1.4 percent year-on-year in November, reversing the previous month's 3.1 percent decline.
- Other data, however, point to weakening demand.
  - Average capacity utilization in manufacturing was slightly lower at 80.3 percent in November 2005 compared to 80.4 percent in October. The value of production index (VAPI) for manufacturing rose by 12.9 percent year-on-year in November, lower than the 15.1 percent growth in October. The volume of production index (VOPI) grew by 4.0 percent year-on-year in November, slightly lower than the 4.4 percent growth registered in the previous month.
  - Merchandise exports declined by 1.6 percent year-on-year in November, slower relative to the 3.2 percent contraction in October. Weak foreign demand for electronic products, which accounted for 68.1 percent of the aggregate export revenues, continued to weigh down total merchandise exports.
  - Total energy sales by the Manila Electric Company (Meralco) declined by 1.3 percent year-on-year in November due to reduced consumption of residential and industrial users. A 3.1 percent reduction was likewise recorded in the previous month.
  - Appliance sales continued to fall, registering a 51.9 percent year-on-year decline in volume in December 2005.
- Agricultural output grew by 4.0 percent in real terms in the fourth quarter of 2005, the highest rate recorded in the past five quarters. For 2005, the agriculture sector expanded by 2.0 percent, lower than the previous year's 4.9 percent.
- The expansion in domestic liquidity slowed, while growth in bank lending remained modest. Treasury bill (T-bill) auction rates were generally higher during the 6 February 2006 auction relative to their levels at the 30 January 2006 auction.
  - Based on preliminary Depository Corporations Survey (DCS) data, growth in domestic liquidity (M3) decelerated further to 9.6 percent year-on-year in December from 11.9 percent in the previous month.<sup>3</sup>

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<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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- Outstanding loans of commercial banks (KBs) grew by 2.1 percent year-on-year in November following a 1.3 percent rise in the previous month.
- Relative to the 30 January 2006 auction, the T-bill rates for the 91-day and 364-day tenors on 6 February 2006 were higher while that for the 182-day tenor was lower. After rejecting all bids for the 91-day tenor for two consecutive weeks, the Auction Committee made a partial award of ₱425 million on 6 February 2006, allowing the 91-day T-bill yield to rise close to the rates in the secondary market. Meanwhile, the T-bill rate for the 182-day tenor declined, prompting the Auction Committee to increase the offer by ₱400 million.
- The peso continued to strengthen in January, boosted by a string of positive developments such as the lower-than-programmed NG fiscal deficit, the higher-than-expected fourth quarter GDP growth, and the scheduled implementation of the second phase of the Reformed VAT Law.
- The NG's fiscal deficit fell to a four-year low in 2005 to ₱146.5 billion, 21.7 percent below the ₱187.1 billion deficit level recorded in 2004 and ₱33.5 billion lower than the ₱180 billion programmed budget gap for 2005. Revenues grew by 13.7 percent to reach ₱759.7 billion, while expenditures rose by 6.2 percent to ₱942.2 billion.
- The global economy's growth momentum remained fairly robust at the end of 2005 despite indications of softening economic activity. The solid performance of the services sector and the renewed strength of manufacturing underpinned growth in most economies. Sustained gains in labor market conditions along with the steady improvements in business and consumer confidence have aided recovery in domestic demand. On the price front, the recent decline in oil prices from their peak level in September have contributed to easing global inflation pressures. At the same time, inflation expectations remained generally well-contained.

### **II. Review of the Monetary Policy Stance**

- The Monetary Board agreed that recent economic data continue to support keeping policy settings unchanged. The sustained easing of core inflation, combined with indications of weaker demand based on consumer spending data and slowing domestic liquidity growth, suggests minimal demand-side pressures on goods and services in the near term. As a result, the impact of rising inputs costs on consumer prices also remains muted. The strength of the peso has also helped to offset the recent pressures on the cost side.



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- Moreover, the Monetary Board expects the impact of the RVAT to consist mainly of one-off increases in prices which are unlikely to fuel a sustained rise in inflation. In addition, mitigating measures are also being planned by the National Government to cushion the impact of the RVAT increase.
- Nonetheless, there continue to be a number of risks to the inflation outlook. Global energy prices remain a key risk factor in the outlook for inflation. Spot and futures of oil have again assumed an upward path given geopolitical tensions in major oil producing countries. In the near term, oil prices are expected to remain sensitive to news relating to supply disruptions given limited surplus production capacity.
- There continues to be a risk of second-round effects from ongoing supply shocks, as well as an adverse shift in inflation expectations due to the RVAT increase. The prospect of a sustained deviation of inflation from the target over the policy horizon poses a particular risk to inflation expectations.
- In view of these risks, the BSP remains focused on achieving the inflation target for 2007 and addressing the risks to future inflation. The Monetary Board will continue to assess 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
    - (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



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- 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. Policy pronouncements concerning the stance of monetary policy should also emphasize the short-term nature of the impact of the RVAT on prices.

The next meeting of the Monetary Board to discuss the monetary policy setting is scheduled on 9 March 2006.

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