HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 21 NOVEMBER 2002[*]

Background

The Monetary Board held its twelfth meeting on monetary policy issues on 21 November 2002. This followed the 19 November 2002 meeting of the Advisory Committee.[1] The Advisory Committee submitted, for the Monetary Board's consideration, a policy paper containing the committee's assessment of the economic conditions and their implications on the inflation outlook as well as the committee's recommendations for the appropriate stance of monetary policy. During its 21 November 2002, the Monetary Board's discussion revolved around the factors that could influence inflation and inflation expectations including forecasts of agricultural production, movements of the exchange rate, direction of world oil prices, possible adjustments in utility rates, liquidity and credit conditions, demand and output indicators, fiscal developments, world economic conditions and outlook, and the implications of these factors on the BSP's monetary policy stance.

I. Considerations in the Formulation of the Monetary Policy Stance

Domestic Price Developments and Outlook

1. Year-on-year inflation was lower than expected in October 2002 at 2.7 percent compared to 2.9 percent a month earlier, driven mostly by lower prices for food items. Month-on-month headline inflation showed a 0.1 percent decline compared to a 0.2 percent rise in September. The 10-month average inflation of 3.2 percent

[*] The highlights of the discussions of the 21 November 2002 Monetary Board meeting were approved by the Monetary Board during its meeting held on 23 December 2002.

[1] The Advisory Committee is composed of the Governor of the BSP as Chairman and four members, namely the Deputy Governor for the Banking Services Sector, Research and Treasury, the Deputy Governor for Supervision and Examination Sector, the Managing Director, In-Charge of Research or the Director of the Department of Economic Research, and the Director of the Treasury Department.

was significantly lower than the 2002 target of 4.5-5.5 percent. It is also lower than the average of 6.5 percent for the same period in 2001.

2. Economic recovery was shaping up to be weaker than expected and trends in domestic demand continued to be mixed. For example, approved building construction permits, an indicator of construction activity, increased by 25.1 percent in the second quarter compared to a year earlier. Meanwhile, energy sales by Meralco rose by 3.7 percent year-on-year in September 2002 following a 1.5 percent decline in the previous month. However, manufacturing activity remained sluggish. Preliminary results of the Monthly Integrated Survey of Selected Industries (MISSI) published by the National Statistics Office (NSO) showed that the Value of Production Index (VAPI) of the manufacturing industry fell by 8.5 percent in August 2002 compared with year-ago figure. Likewise, the Volume of Production Index (VOPI) fell by 12.0 percent in August 2002 on a year-on-year basis. Capacity utilization in manufacturing also remained fairly low at 74.9 percent for August 2002. Sales of automotive vehicles likewise continued to decline, falling by 17.4 percent in October following a 16.3 percent drop in the previous month. The overall unevenness in demand conditions suggested limited pricing power for producers and therefore, minimal influence on consumer prices over the near term.

The inflation outturn for the first ten months of 2002 remains consistent with the BSP's expectations of below-target inflation for the year. For 2003, average inflation is expected to be in line with the government's target range of 4.5-5.5 percent.

Developments in Agriculture

3. Starting as a weak event in April 2002, El Niño continued to develop through October 2002, characterized by warmer temperatures and fewer tropical cyclones (none in September and October) that have resulted in below-normal rainfall in some parts of the country. The rainfall deficiency is expected to continue to prevail for the next two to three months, and will affect more areas in the country.[2] Most numerical and statistical model forecasts suggested that El Niño

[2] National ENSO Early Warming and Monitoring System (NEEWMS) Group, Climatology and Agrometeorology Branch (CAB), Philippine Atmospheric Geophysical and Astronomical Services Administration (PAGASA), 4 November 2002. Available at http://www.pagasa.dost.gov.ph

conditions would likely persist through early 2003 but would substantially be weaker than the 1997-98 episode.

4. Nevertheless, the outlook for the rest of the year and for early 2003 remained positive. With favorable weather conditions brought by the southwest monsoon and the quick turnaround (QTA) planting scheme[3] of the Department of Agriculture (DA), good harvest could be expected in the fourth quarter of 2002. Based on standing crops estimate and an anticipated improvement in palay productivity per hectare, rice production was expected to pick up by 8.9 percent to 5.425 million MT in the fourth quarter, thereby making up for the losses in the third quarter.[4] Thus, full-year palay production for 2002 was expected to grow by 1.2 percent to 13.115 million MT. By contrast, total corn production for 2002 is expected to contract by 4.9 percent to 4.301 million MT. For the first quarter of 2003, estimates indicated that palay output would decline slightly by 1.9 percent year-on-year to 3.0 million MT due to dry weather conditions. Corn output, on the other hand, would recover with a 6 percent increase in the first quarter of 2003 relative to a year ago to record a 1.175 million MT production on account of a 5.9 percent expansion in area intended for planting.

5. As of 15 November 2002, the total rice imports reached 1.231 million MT.[5] Moreover, as of 17 November 2002 the national rice inventory[6] of 1.828 million metric tons (MT) was sufficient to last for 71 days.[7] Of this stock, the share of the NFA amounting to 788.5 thousand MT (or about 43 percent) was sufficient to last for 31 days. This was well above the agency's security benchmark of 15 days for

[3] The quick turnaround scheme (QTA) is part of the *Ginintuang Masaganang Ani* (GMA) Rice Program of the DA which aims to compensate for possible loss in rice output brought about by drought, flooding caused by typhoons, and also to mitigate the impact of El Niño. Under the scheme, irrigated rice areas which had been harvested in August or early September were immediately replanted with early maturing rice varieties and certified seeds within two to three weeks to make up for the delays in planting during the second quarter. Farmer participants to the program may also avail of fertilizer on credit under the Quedancor. The program expects to produce an additional 339,598 metric tons of rice for 2002. (Source: Department of Agriculture)

[4] The third quarter *palay* output for 2002 of 2.018 million metric tons (MT) was 16.1 percent lower than the previous year's level.

[5] NFA, Grains Situation Report as of the Second Week of November 2002, 17 November 2002

[6] Composed of NFA palay and rice stocks, and commercial and household inventories. Commercial stock is as of 1 November 2002 and household stock is as of 1 October 2002. (Source: NFA, *Grains Situation Report as of the Second Week of November 2002*, 17 November 2002)

[7] Based on the daily consumption of 25.7 thousand MT of rice (Source: NFA)

rice self-sufficiency. Meanwhile, the stock of corn at 313.2 thousand MT was estimated to last for 21 days.[8]

Despite the prospect of the El Niño weather phenomenon, near-term food supply conditions are expected to be favorable given an expected bumper harvest in the fourth quarter and timely government intervention.

Exchange rate developments

6. The peso was mildly weaker against the US dollar thus far in November, averaging at ₱53.09/US$1 for the period 4-18 November 2002 compared to ₱52.94/US$1 in October.[9] The domestic currency was weighed down by market concerns over security as well as the burgeoning fiscal deficit. Nonetheless, the peso was relatively stable during the period, with the standard deviation falling to ₱0.21 for the period 4-18 November compared to the ₱0.23 registered for October 2002.

7. On a real, trade-weighted basis, the peso depreciated relative to the currencies of the major trading partners by about 3.5 percent in October 2002 from its level in December 2001, as shown in the real effective exchange rate (REER).[10] The peso showed a similar depreciation trend over the same period vis-à-vis two sets of currencies of the Philippines' competitor countries. The REER for the broad and narrow baskets of competitor currencies fell by about 4.5 percent and 10.3 percent, respectively. These developments indicated a modest improvement in the country's external price competitiveness.

Security concerns and market apprehension over the large fiscal deficit continue to exert pressure on the exchange rate.

[8] Source: NFA. Based on the 14.6 thousand MT daily requirement of the corn industry but excludes those held by commercial livestock and poultry producers, corn processors, and corn mixed feeds.
[9] Based on real-time foreign exchange transactions in the Philippine Dealing System (PDS)
[10] The basket of the major trading partners is composed of the currencies of the US, Japan, Germany and the United Kingdom. The broad basket of competitor countries is composed of the currencies of Singapore, South Korea, Taiwan, Malaysia, Thailand, Indonesia and Hong Kong while the narrow basket is composed of the currencies of Indonesia, Malaysia and Thailand only.

Oil price developments

8. Dubai crude oil prices in the international market fell sharply by 12.2 percent to average at US$23.10 per barrel for the period 1-13 November 2002 from US$26.31 per barrel in October 2002. International prices softened following Iraq's decision to comply with the UN resolution on arms inspection, and the imminent threat of war is perceived as having fallen.[11] In the futures market, the price of the benchmark Brent crude oil also declined sharply as December 2002 deliveries fell to US$23.58 per barrel from US$27.83 per barrel quoted in the previous month.[12]

9. The downtrend in international prices prompted local oil companies to roll back prices for certain oil products. On 19 November 2002, prices for premium and regular gasoline were reduced by ₱0.25 per liter, while those for diesel and kerosene fell by ₱0.20 per liter from their October 2002 levels.[13] By contrast, the price of liquefied petroleum gas (LPG) rose for the fifth time since 10 August 2002, to ₱12.09 per liter as of 19 November 2002, an increase of ₱0.67 compared to October and ₱2.37 from the beginning of the year.

The international spot prices of crude products ease in November as the prospects of a war in the Middle East began to wane, prompting local oil companies to effect a similar reduction in the local pump prices of oil. In turn, lower domestic oil prices could help soften the cost-side pressures on inflation. In the near term, the direction of oil prices would depend largely on the developments of the UN arms inspection in Iraq as well as on movements in the foreign exchange market.

Developments in the Utilities Sector

10. The National Power Corporation (NPC) has started to implement the Energy Regulatory Commission's (ERC) approved unbundled rates for its generation

[11] IMF *Global Markets Monitor*, 14 November 2002

[12] Source: *Asian Wall Street Journal*, 11 November 2002. The futures price for Brent crude oil—a substitute for Dubai crude—is used as an indicator of future world oil prices since futures data on Dubai crude are not available.

[13] Source: Department of Energy (DOE)

charges.[14] It could be recalled that, pursuant to the pertinent provisions the Electric Power Industry Reform Act of 2001, NPC filed on 26 December 2001 its petition for the unbundling of power rates. The ERC-approved unbundled rates for generation charges were ₱2.1913 per kwh in Luzon, ₱2.0837 per kwh in Visayas and ₱1.0217 per kwh in Mindanao.[15]

11. Meanwhile, the ERC has still to reach a decision on Meralco's unbundling application. Meralco noted that its proposed new rates as contained in its petition for the unbundling of power rates could raise the cost of electric power consumption by an average of ₱1.12 per kwh.[16] This was equivalent to an estimated 19.6 percent increase from the November 2001 average tariff of ₱5.73/kwh.[17]

12. The ERC has explained that the unbundling of power rates per se will neither increase nor decrease the rates.[18] However, the use of a new test or base year in determining utility revenue requirements may change existing rate levels.[19]

13. On the other hand, adjustments in water rates could be expected in 2003. The Metropolitan Waterworks and Sewerage System (MWSS) is expected to release soon its decision on the petitions for an increase in the water charges filed by Manila Water Company (MWCI) and Maynilad Water Services Inc. (MWSI).

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[14] An explanation of the unbundling of power rates and it will affect rates charged to consumers may be found in the "FAQ on the Unbundling of Rates" on the ERC website at http://www.erc.gov.ph/unbundling.asp

[15] Source: National Power Corporation Rate Schedule, NPC

[16] Source: Meralco, Application to ERC for unbundling of rates, dated 26 December 2001, as mandated under Sec. 36 of RA 9136

[17] Source: Meralco, Application to ERC for unbundling of rates, dated 26 December 2001, as mandated under Sec. 36 of RA 9136

[18] ERC, "FAQ on the Unbundling of Rates", http://www.erc.gov.ph/unbundling.asp

[19] The test year prescribed under the Uniform Filing Requirements (UFR) in determining utility revenue requirements was FY 2000 to obtain a closer estimate of the cost of providing electricity service to consumers since the passage of RA No. 9136 in 2001.

Water rates are likely to increase in 2003 while the outlook on power rates remains uncertain at the moment as the ERC has yet to decide on Meralco's proposed unbundling of power rates. The impact of the unbundled rates would also have to be weighed against the possible impact of the establishment of the Wholesale Electricity Spot Market and the introduction of the Special Program to Enhance Electricity Demand.

Interest rates and interest rate differentials

14. As of 11 November 2002, the differentials between the RP 91-day T-bill rate (net of withholding tax) and the 90-day LIBOR and US 90-day T-bill rate widened further to 286.1 basis points and 304.1 basis points, respectively, from the 245.5 basis points and 266.0 basis points registered on 14 October 2002.[20]

15. The differential between the BSP's policy interest rate (overnight borrowing or RRP rate) and the US federal funds target rate also widened to 575 basis points from 525 basis points following the reduction in the US federal funds target rate by 50 basis points—the lowest since July 1961—while the BSP policy rates remained steady at their 15 March 2002 level.[21]

16. Similarly, adjusted for the risk premium—that is, the differential between the BSP policy interest rate and the US federal funds target rate less the risk premium—the differential in the RP-US policy rates widened in the first half of November by an average of 99 basis points. The 50 basis point increase in the differential between the BSP policy rate and the US federal funds target rate as well the decline in the risk premium (from 497 basis points in 14 October 2002, to 476 basis points in 11 November 2002) for RP sovereign bonds accounted for this widening trend.[22]

17. The yields on short-term government securities declined across all tenors during the Bureau of Treasury's (BTr) 11 November 2002 auction. The decline in

[20] Review period covered in the last policy paper on the "Review of the BSP's Monetary Policy Stance," considered by the Monetary Board on 23 October 2002

[21] The current BSP policy rates are also at their lowest level in more than ten years.

[22] There are indications, however, that the risk premium may be increasing. The US$500 million 10-year dollar-denominated sovereign bonds issued by the NG in November 2002 had a coupon yield spread of 507 basis points over comparable US Treasury bonds (Department of Finance Press Release dated 19 November 2002).

the yields could also have been influenced by the 50 basis points cut in the federal funds target rate as well as the prevailing ample liquidity in the financial system.

The RP-US interest rate differentials rise as foreign interest rates eased following the recent US fed rate cut. Meanwhile, the risk premium for RP sovereign bond registers a decline in November relative to its October level but continues to be on the upside due to concerns over the rising fiscal deficit.

18. During the period 4-6 November 2002, the Philippines' real lending rate (based on the low-end of the range of banks' lending rates) increased to 5.48 percent from the 5.26 percent registered during the review period 10-16 October 2002[23]. This was due to the increase in the nominal lending rate which was accompanied by a decline in the inflation rate. The RP real lending rate of 5.48 percent was the fourth lowest in a sample of Asian countries.

The Philippine real lending rate increases but remains to be lower than the real lending rates of almost all Asian countries surveyed.

19. The yield curve for government securities in the secondary market as of 11 November 2002 generally shifted downward—except for the short term maturities—relative to that which prevailed on 14 October 2002[24] as banks competed for government papers, given their excess liquidity position. Likewise, compared to the yield curve that prevailed at the beginning of 2002, the latest yield curve showed a downward shift.

As the banking system remains awash with liquidity, investments continue to flow into government papers leading to a general decline in their yields in the secondary market.

Monetary aggregates and bank lending

20. Domestic liquidity (M3) growth accelerated to 9.0 percent as of end-September from the 7.7 percent year-on-year increase registered as of end-

[23] Ibid.

[24] Yield curve presented in the previous policy paper on the "Review of the BSP's monetary policy stance," considered by the Monetary Board on 22 October 2002

August.[25] The expansion in the net foreign assets (NFA) of deposit money banks (DMBs) as well as the increase in credits to the public sector (particularly the NG) continued to drive the pace of money growth. The increased foreign assets of the monetary system were due largely to inflows from the foreign exchange remittances by overseas Filipino workers (OFWs).

21. Total outstanding loans of commercial banks (KBs) rose by 1.2 percent year-on-year in September, a turnaround from the year-on-year contraction seen since April 2002. The improvement was traced to increased credit to firms in two major sectors: the community, social and personal services, and the financial institutions, real estate and business services (FIREBS)—which together accounted for 42.7 percent of total KB loans. Meanwhile, the non-performing loans of KBs declined for the third consecutive month to 17.6 percent as of end-August compared to 18.3 percent at the beginning of the year. Although these numbers are far from constituting a trend, they could nevertheless signal the beginning of a recovery in bank lending.

22. The volume of banks' placements under the RRP window increased by ₱11.9 billion to ₱109.7 billion as of 11 November 2002 from the ₱97.9 billion as of end-October 2002. Meanwhile, placements under the SDA declined by ₱9.0 million to reach ₱393 million. Compared to the levels as of end-December 2001, RRP and SDA placements registered an increase of ₱81.5 billion and ₱393 million, respectively, from ₱28.2 billion and zero worth of placements.

The increase in bank lending during the period reflected the aptness of the current interest rate environment in helping provide for the economy's credit requirements as well as the improving quality of banks' loans and assets in recent months. Meanwhile, some banks continue to channel part of their investible funds into the BSP's RRP window.

Domestic stock market movements

23. The average PHISIX for the period 4-14 November 2002 was 1,061.3, higher by 2.0 index points from the 1059.3 average PHISIX posted in October. The slight improvement in the PHISIX could be attributed to bargain hunting of select

[25] This growth, however, is still considerably below the projected year-on-year growth of M3 of about 13 percent for end-2002.

blue chips that have been trading at low prices. In the first week of November, the half-percentage point cut in the federal funds target rate sparked investors' interest in equities and led the market to a 23.2 index point gain on 7 November 2002, its biggest daily gain since 11 September 2002 when the PHISIX rose by 19.8 index points. The market was also greeted by some positive domestic economic news. In particular, the release of the lower-than-expected inflation rate for October and the robust export figure for September (16.8 percent growth year-on-year) elicited favorable responses from investors.

24. Meanwhile, the thin market activity in the local equities market reflected the continued tentativeness among investors. The total volume of transactions for the period 4-14 November 2002 dropped by 549.8 million shares to 985.6 million shares from 1,535.4 million shares traded for the comparable period in October. For the same period, total value turnover fell by ₱55 million to ₱2.65 billion from ₱2.71 billion in the previous month. Foreign investors in the local bourse have also maintained their net selling position in November with foreign selling exceeding foreign buying by ₱214.7 million.[26]

Market analysts expect investors to remain cautious in the near term due to the market's unresolved concerns. Domestic security issues and the widening budget deficit could hinder a strong rally in the market. In addition, the possibility of a US-led offensive against Iraq despite Iraq's acceptance of the terms of the UN resolution on arms inspection remains a concern for most investors.

Fiscal developments

25. The budget deficit of the National Government (NG) continued to widen, reaching ₱166.5 billion as of end-September 2002. This resulted mainly from the continued shortfall in revenue collection along with a slight overspending of 2.3 percent above the expenditure program. The budget deficit was ₱36.5 billion higher than the original 2002 program of ₱130 billion.

26. The overshooting of the 2002 target deficit is not expected to pose immediate problems for government finances since, as the NG had earlier opted to prefund its financing requirements for 2002. Moving forward, however, the fiscal

[26] Source: Philippine Stock Exchange (Figures as of 14 November 2002)

performance and the prospect of increased public sector borrowing poses risks to inflation and inflation expectations over the policy horizon.

Concerns over the fiscal outlook could pose risks to inflation and inflation expectations over the policy horizon. However, the ample liquidity in the system, the prevailing low interest environment as well as the prefunding efforts of the NG could provide a cushion against the possible adverse impact of a large fiscal deficit.

External Developments

27. The US GDP growth rate of 3.1 percent in the third quarter was less than the 3.7 percent expectation by the US Commerce Department, due primarily to a wider trade deficit and a fall in commercial construction. Other indicators pointed to the weakness in consumer spending and manufacturing activity. The Census Bureau of the US Department of Commerce reported that advance estimates of U.S. retail and food services sales fell 0.7 percent from October 2001 and were virtually unchanged from the previous month. Meanwhile, the Institute of Supply Management's (ISM) manufacturing index fell to 48.5 in October from 49.5 in September, indicating a contraction in manufacturing activity for the second month in a row.[27] Both nonfarm payroll employment and the unemployment rate were unchanged in October, according to the US Bureau of Labor Statistics.[28] On the other hand, price conditions continued to be subdued, with headline inflation remaining low at 0.2 percent in October, lower than the 0.3 percent reported in the previous month.

28. Eurozone economic activity also remained sluggish, although there were some improvements. Euro area GDP growth was 0.4 percent quarter-on-quarter, supported by a recovery in exports and private consumption. The second quarter growth was mainly concentrated in the services sector.[29] The EU forecasted eurozone GDP growth at 0.2-0.5 percent for both the third and fourth quarters.

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[27] ISM *Manufacturing Report On Business,* October 2002. Available at http://www.ism.ws/ISMReport/ROB112002.cfm

[28] Bureau of Labor Statistics, *Employment Situation Summary,* October 2002. Downloaded from http://www.bls.gov/ news.release /empsit.nr0.htm

[29] Statement by ECB President Willem F. Duisenberg at the ECB press conference held on 7 November 2002. Available at http://www.ecb.int/

29. In Asia, Japan's GDP growth slowed to 0.7 percent in the third quarter of 2002 from 1.0 percent in the previous quarter due to weakness in exports. The prospect of slower exports, weakening spending and reduced capital investments together raise concerns over whether Japan's nascent economic recovery may be losing steam.

30. On 6 November 2002, the US Federal Reserve reduced its federal funds target rate by 50 basis points to 1.25 percent (the lowest rate since July 1961), after leaving rates unchanged since 2001. The reduction was sharper than what was expected by market participants, who were predicting only a quarter-point cut.[30] Meanwhile, the Fed move has not triggered similar easing actions by many central banks that held monetary policy meetings after the Fed move, even though the prospect of weakening growth in the US could affect trade with its trading partners. In particular, the European Central Bank, the Bank of England and the Bank of Japan did not follow the US lead.

Global economic recovery remains sluggish, due in part, to increased geopolitical uncertainties. This prompted the US to cut its policy rates sharply while the other major central banks opted to maintain their policy guidelines.

II. Discussion on the Review of the Monetary Policy Stance

31. During the Monetary Board's discussion on the monetary policy stance, the members expressed the view that the available data suggested generally manageable price conditions over the policy horizon. They argued that the observed weakness in overall demand conditions implied that demand-side factors were likely to exert only a minimal influence on consumer prices. On the other hand, they added that supply-side or cost-push factors suggested potential upside pressures on consumer prices, but most of these pressures are likely to be temporary. These inflationary risks arise from serious concerns over the Middle East conflict and the upward pressure they exert on oil prices, the prospect of weaker global economic growth, the uncertainty over the impact of El Niño weather phenomenon on food supply in 2003, possible increases in utility charges, the widening fiscal imbalance and, more recently, exchange rate volatility.

[30] IMF *Global Markets Monitor*, 6 November 2002

32. At the same time, the members of the Monetary Board shared the view that the prospects for sustained recovery in domestic economic activity were being clouded by uncertainties in global economic conditions along with signs of weakness in overall domestic demand, such as the contraction in manufacturing activity and car sales. They noted that the increased risk of economic weakness in the US and elsewhere was likely to translate into muted export demand, which could add to existing real sector weakness, particularly in the manufacturing sector. Meanwhile, the members of the Monetary Board also pointed out that the general pattern of domestic demand remained mixed and uneven, based on indications of sizeable spare capacity and soft labor market conditions. However, there appeared to be early indications of a turnaround in credit demand, as shown by the recent spurt in bank lending. The Monetary Board argued that such indications may be viewed as a response to previous monetary easing actions and the resulting low-interest rate environment, and could signal the start of a sustained rise on bank lending.

33. Against this background, the Monetary Board discussions centered on the following policy questions:

a. Given the uncertainty in external conditions and relative softness in domestic demand conditions, should policy rates be reduced to provide the additional stimulus to further perk up the economy? or

b. Given tentative signals of stronger credit demand, should current monetary policy settings be maintained to allow previous policy rate reductions to work their way further through the system while guarding firmly against the risks to the inflation outlook?

34. The Monetary Board discussed the following arguments in support a reduction in key policy rates:

a. Recent inflation readings continued to be relatively benign, thereby strengthening expectations of a manageable inflation environment over the policy horizon despite upside risks to consumer prices which in turn, were largely supply-side and transient in nature.

b. Given a benign outlook for inflation, the tentative overall pattern of domestic demand conditions suggested some room for continued domestic monetary stimulus.

c. The prospect of weaker external demand also argued for further interest rate stimulus.

d. From a policy strategy standpoint, a policy rate cut could serve to brighten confidence.

e. A policy rate reduction is not expected to lead to significant exchange market volatility, since the interest rate differential will simply revert to levels before the US policy move; would remain positive in favor of the peso and thus it would not endanger the government's inflation goal.

35. On the other hand, the Monetary Board cited the following arguments in favor in keeping policy rates steady:

a. The significant extent of monetary easing since December 2000 and the resulting ample liquidity in the financial system should give the economy ample room to expand without the need for further monetary stimulus.

b. The best approach to the problem of weak credit demand may simply be to allow enough time for previous easing to work its way through the real sector.

c. Moreover, there were already some signs of improvement in credit demand, notably the turnaround in the growth of commercial bank lending in September. Although these numbers are far from constituting a trend, they could nevertheless signal the beginning of a recovery in bank lending.

d. Although the widening breach of the 2002 target deficit was not expected to pose immediate problems for macroeconomic management, the possibility of increased government borrowing in 2003 could emerge as a considerable concern for the inflation outlook.

e. Maintaining BSP policy rates at their current levels could lead to a wider interest rate differential that could allow for more room to maneuver in case a foreign exchange market pressure develop over the near term that could threaten the inflation target.

III. Monetary Policy Decision

36. Based on the analysis of data that have become available since the last meeting of the Monetary Board on 23 October 2002 and a careful assessment of the balance of risks on inflation and inflationary expectations, the members of the Monetary Board by a unanimous vote decided as follows:

a. to maintain the BSP's policy rates at the current levels of 7.0 percent for the overnight RRP (borrowing) rate and 9.25 percent for the overnight RP (lending) rate;

b. to maintain the tiering scheme on banks' placements with the BSP under the RRP and SDA windows;

c. to maintain the current interest rates on the term RRPs, RPs, and SDAs; and

d. to maintain the reserve requirements at their current levels given the adequate level of liquidity in the system.

The next meeting of the Monetary Board to discuss the monetary policy setting was scheduled on 19 December 2002.

- The Monetary Board of the Bangko Sentral ng Pilipinas