



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON
MONETARY POLICY ISSUES HELD ON 20 AUGUST 2009¹**

I. Monetary Policy Decision

The Monetary Board decided to:

- a) Maintain the BSP's policy rates at 4.00 percent for the overnight RRP (borrowing) rate and 6.00 percent for the overnight RP (lending) rate;
- b) Maintain the current interest rates on term RRP, RP, and SDAs; and
- c) Maintain the current reserve requirement ratios.

The recommendation to maintain the present monetary settings took into consideration the BSP's latest assessment that the prevailing monetary settings are appropriate given current financial and economic conditions.

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

- The Monetary Board noted that since the transmission of monetary policy actions to the real economy works over a two-year period, maintaining current policy settings is appropriate to allow prior substantial monetary stimulus measures to fully work their way through the system.
- The Board recognized that a pause will provide policymakers more time to assess the impact of recent monetary measures as well as to consider incoming data on the trend of economic activity and the balance of risks to inflation and output.

¹ The discussions presented herein reflect the assessment made by the Monetary Board based on the information available at the time of the policy meeting. The sets of economic information were provided by the technical secretariat of the Advisory Committee (AC). The Advisory Committee is composed of the Governor of the BSP as Chairman and four members, namely: the Deputy Governor of the Monetary Stability Sector, the Deputy Governor of the Supervision and Examination Sector, the Assistant Governor of the Monetary Policy Sub-Sector, and the Managing Director of the Treasury Department. The highlights of the discussions on the 20 August 2009 meeting were approved by the Monetary Board during its regular meeting held on 10 September 2009. The next meeting of the Monetary Board on monetary policy issues is scheduled on 1 October 2009.



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- The Board is mindful that keeping present monetary settings is deemed prudent in light of continued double-digit growth in liquidity as capital reflows continue because of improved market confidence.
- Meanwhile, the favorable inflation outlook allows the BSP to keep a steady hand on policy settings.
 - Inflation is projected to remain broadly on target for 2009 and 2010.
 - Inflation expectations remained well anchored.
 - The balance of risks to the inflation outlook is favorable as demand-side pressures are tempered by prospects of a gradual global recovery. However, upside risks are also present, including the possible uptrend in oil prices, the rebound of commodity prices ahead of the global recovery, the onset of El Niño, and the possibility that the extensive macroeconomic stimulus measures in advanced economies would hike inflationary pressures over the medium term.
- The Board also noted that banks continue to pass on lower interest rates on loans while the latest BSP Senior Bank Loan Officers' survey show that bank credit standards and demand for credit have remained largely unchanged.
- The Board also recognized that there are some encouraging signs of an economic rebound as domestic leading indicators have started to improve.
- The Board also agreed to maintain the current monetary policy stance that is conducive to credit and investment growth, to the extent that the inflation outlook would allow.

III. Recent Developments in Economic Indicators

The Monetary Board's decision took into account recent developments in various economic indicators:

A. Domestic price conditions

- Headline inflation continued to fall in July, dropping to 0.2 percent year-on-year from 1.5 percent in June. This brought the year-to-date average down to 4.3 percent and within the target range for 2009. All major commodity groups registered lower or negative inflation rates in July.



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- On a month-on-month seasonally-adjusted basis, headline inflation was -0.2 percent in July from -0.1 percent (revised) in June.
- Core inflation, which excludes specific food and energy items to measure generalized price pressures, was lower at 3.6 percent year-on-year in July from 3.9 percent in June. Likewise, two of the three alternative core inflation measures estimated by the BSP declined. Year-on-year, the trimmed mean dropped to 1.9 percent from 2.6 percent and the net of volatile items measure to 1.3 percent from 1.8 percent. Meanwhile, the weighted median was unchanged from the previous month at 2.9 percent. Seasonally-adjusted month-on-month core inflation was unchanged from the previous month at 0.1 percent.

B. Inflation Expectations

- Recent surveys showed inflation expectations remained generally well-anchored:
 - Relative to previous surveys, the Asia Pacific consensus forecast for August and the BSP's survey of private sector economists for July showed lower average inflation forecasts for 2009.
 - Similarly, preliminary results of the Q3 2009 Business Expectations Survey indicated a sharp decrease in the number of respondents expecting inflation to increase in the current quarter.

C. Inflation Outlook

- Emerging baseline inflation forecasts indicate that inflation would settle between the low end and the middle of the 3.5 percent \pm 1.0 percentage point target range for 2009 and slightly below but close to the low end of the 4.5 percent \pm 1.0 percentage point target range for 2010.
- Though prospects are for a sluggish recovery in the global economy, surges in world commodity prices over the policy horizon could be likely given the early rally in commodity prices.

D. Demand conditions

- Latest information from various leading indicators show that economic conditions have started to improve: capacity utilization in the manufacturing sector is gradually improving, the rate of decline in exports appears to be abating, energy sales growth turned positive, and business confidence became bullish in the third quarter.



E. Supply-side indicators

Developments in Agriculture

- Based on farmers' planting intentions, *palay* production for Q3 and Q4 2009 is expected to grow by 3.7 percent and 4.0 percent from the Q3 and Q4 2008 levels of 3.5 million metric tons (MMT) and 6.2 MMT, respectively.
- Meanwhile, corn production for Q3 2009 is forecast at 2.5 MMT, 9.5 percent higher than the actual output in the same quarter a year ago. For Q4 2009, corn harvest is expected to reach 1.4 MMT, about 1.2 percent higher than the actual production in Q4 2008.
- It is expected that world cereal production will decline in 2009 from the previous year's record output as farmers have been discouraged by poor expected returns on their crops due to the sharp decline in grain prices and high input costs.
- El Niño conditions now prevail across equatorial Pacific Ocean and will likely intensify in the months ahead.

Oil Price Developments

- Dubai crude oil prices were lower in July with increasing US oil inventories and growing concerns over an extended recession which could keep global oil demand weak. However, oil prices increased in the first half of August with increased consumption and better US economic prospects. Prices in the futures market also increased in mid-August.
- In the domestic market, oil companies raised the prices of gasoline, kerosene, and diesel on 11 August. This brought the year-to-date net increase in the prices of gasoline products to ₱13.50 for unleaded gasoline, ₱3.67 for diesel, ₱2.76 for kerosene, and ₱5.82 for LPG.

Developments in the Utilities Sector

- Year-on-year, retail electricity rates were lower by an average of 1.6 percent in July; month-on-month, rates increased slightly by 0.4 percent. According to Meralco, they were able to maintain low electricity rates for the past three months due to lower prices at the Wholesale Electricity Spot Market (WESM) and cheaper natural gas.



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- Meralco power rates were also lower for August because of the start of the wet season and the relatively stable prices at the WESM.
- On 13 July, the Energy Regulatory Commission (ERC) approved the rules for Prepaid Retail Electricity Service (PRES). With the issuance of these rules, distribution utilities (DUs) may now file their applications with the ERC to offer PRES to their residential customers using a prepaid metering system.
- In July, the National Telecommunications Commission (NTC) issued new policies to promote consumer welfare. These new orders include: the rules on prepaid cards which increased the validity period per amount purchased; additional rules and regulations on broadcast messaging service which addressed the issue on spam; and reduction of voice call unit of billing to six seconds per pulse instead of one minute per pulse.

F. Financial Market Developments

Government Securities Market

- Relative to their 30 June levels, the secondary market yields of GS generally declined across all tenors on 18 August. Yields decreased with the increase in bond prices, reflecting the impact of the BSP's policy interest rate reduction on 9 July 2009. News of the successful sale of \$750 million worth of US dollar-denominated ROP bonds also influenced the decline in yields as this implied that the NG's domestic sourcing of funds could be reduced. In addition, the positive sentiment generated by the country's credit rating upgrade by Moody's Investors Service also contributed to the decline in yields.

Interest Rate and Interest Rate Differentials

- The differential between the BSP policy rate and the US federal funds rate continued to narrow in July, following the BSP's most recent 25-basis-point policy rate cut. With the decline in the risk premium, the risk-adjusted differential narrowed in July.
- The cumulative 200-basis-point policy rate cut of the BSP from 18 December 2008 to 9 July 2009 appeared to have been passed on partially by banks to their borrowers. Actual bank lending rates declined by 140 basis points during the period 10-14 August 2009.



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Stock Market

- The Philippine Stock Exchange Index (PSEi) continued to be upbeat in July and early August. Stock market trading in July 2009 sustained an upbeat mood reflecting positive market sentiments as the US bourse continued to rally on the back of good earnings of several US companies, coupled with encouraging local news of the BIR overshooting its target for June, S&P's decision maintaining the country's credit rating, and the BSP reducing further its policy rate on 9 July. However, the index was on a downtrend in the third week of August as the market mirrored the Dow's downward movement.

Foreign Exchange

- In the first week of August, the peso, together with other Asian currencies, strengthened due to increased risk appetite following reports of a better-than-expected US GDP growth rate in the second quarter of 2009. Regional currencies strengthened anew in the second week following the report of the US Federal Open Market Committee on 12 August 2009 that economic activity is leveling out and financial market conditions have improved in recent weeks. Moreover, improving consumer confidence and economic outlook in Europe added to the positive news. However, market correction and concern on the National Government's fiscal position weakened the peso compared to other regional currencies.
- On a year-to-date basis, the peso weakened against the US dollar by 1.5 percent on 18 August 2009. Meanwhile, some Asian currencies appreciated against the US dollar given the improved economic outlook for these economies. These currencies include the Indonesian rupiah, the Thai baht, the Korean won, and the Indian rupee.

Global Bond and Credit Default Swap Spreads

- Debt spreads generally narrowed toward end-July to early August, but widened anew in the second and third weeks of August. In the first week of August, the tightening trend continued with debt spreads posting their year's low. The unexpected decline in US job losses in July further sparked demand for higher yielding emerging market assets. However, the narrowing trend was not sustained as increasing pressures were observed starting 10 August, tempering weeks of emerging market bond rally. The drop in China's foreign direct investments for the 10th straight month in July and US' disappointing consumer confidence report raised concerns that global economic recovery may falter.



G. Domestic Liquidity and Credit Conditions

- Domestic liquidity or M3 continued to post double-digit growth in June 2009, albeit at a slower rate of 12.6 percent year-on-year compared to 15.0 percent in the previous month. On a monthly basis, seasonally-adjusted M3 growth decelerated to 0.3 percent in June from 1.1 percent (revised) in May. The expansion in net foreign assets (NFA) continued to drive the growth of liquidity, even as it was lower at 17.6 percent from 19.8 percent in May. The slight slowdown in the growth of NFA followed the slower build-up in the BSP's international reserves even as banks' foreign liabilities continued to decline.
- Growth in commercial banks' outstanding loans including reverse repurchase agreements (RRPs) continued to be in the double-digits at 11.1 percent year-on-year in June from 10.2 percent in May, to reach ₱2.2 trillion at end-June. Net of RRP placements with the BSP, growth in bank lending at 14.3 percent remained strong, albeit slower than the 17.3 percent growth recorded in the previous month. On a month-on-month basis, commercial banks' seasonally-adjusted lending in June grew by 4.5 percent for loans inclusive of RRP placements, but fell by 0.3 percent net of RRP placements.
- Results of the BSP Senior Bank Loan Officers' Survey indicated that bank credit standards and demand for credit remained basically unchanged for enterprises and households for Q2 2009 from Q1 2009.
- Total equity raised in the PSE reached ₱6.1 billion for the first semester of 2009, less than half of the level reached in the same period last year at ₱15.8 billion. Meanwhile, bond issuances by the corporate sector amounted to ₱192.8 billion for the first six months of 2009, more than triple the previous year's level at ₱57.9 billion.

H. Fiscal developments

- The January-June 2009 fiscal deficit reached ₱153.4 billion, more than eight times higher than the ₱18.0 billion deficit in the comparable period last year. This represents 98.9 percent of the ₱155.1 billion program deficit for the first semester. Revenue collections for the first six months of 2009 declined by 4.3 percent to ₱545.7 billion while the cumulative expenditures increased by 18.9 percent to ₱699.1 billion from the comparable period in 2008. Excluding interest payments, total disbursements increased by 24 percent to ₱554.4 billion. Interest payments also rose by 2.7 percent to reach ₱144.7 billion.



I. External developments

- The rate of global economic contraction has been slowing down and there is now stronger conviction that the worst of the slump is over. Economic stimulus programs mitigated systemic failures as financial stress indices receded while commodity price indices rebounded. Nonetheless, the prospects of a quick and sustained turnaround remain tentative.
- Recent trends showed signs of a slow recovery for the US manufacturing sector, but consumer sales continued to decline as unemployment remains high. EU downturn showed further easing in July as the composite PMI rose markedly. Meanwhile, July PMI survey data provided evidence that a recovery is underway in Japan's manufacturing economy. In emerging Asia, China and India continued to show the earliest signs of recovery as most recent data indicated improved demand in Q2 2009.