Bangko Sentral ng Pilipinas

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 3 JUNE 2010[1]

I. Monetary Policy Decision

The Monetary Board (MB) decided to:

a) Maintain the BSP's policy rates at 4 percent for the overnight RRP (borrowing) rate and 6 percent for the overnight RP (lending) rate;

b) Maintain the current interest rates on term RRPs, RPs, and SDAs; and

c) Maintain the current reserve requirement ratios.

The MB's decision was based on its assessment that the prevailing inflation outlook supported keeping monetary settings unchanged.

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

- The MB's decision was based on the latest BSP baseline projections, which show headline inflation averaging within the target ranges for 2010 and 2011. These projections are slightly lower compared to those for the previous policy meeting as a result of lower energy prices and slower domestic liquidity growth. Liquidity growth has decelerated in recent months as a result of the BSP's withdrawal of liquidity-enhancing measures which were implemented in response to the global financial crisis.

- The Board concluded that the upside risks for the inflation projections (associated mainly with food and energy prices) appeared to have lessened. On the other hand, the strong pickup in exports, consumer

[1] The discussions presented 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 Assistant Governor of the Treasury Department. The highlights of the discussions on the 3 June 2010 meeting were approved by the Monetary Board during its regular meeting held on 17 June 2010. The next meeting of the Monetary Board on monetary policy issues is scheduled on 15 July 2010.

spending, and investments as shown in the first quarter GDP data, if sustained, could point to potential demand-side pressures. Nevertheless, such pressures could be tempered by weaker external demand from major trading partners and the potential impact of fiscal concerns in the euro area.

- In the face of uncertain global economic prospects and with recovery proceeding at different stages and speeds in various parts of the world, together with the flexibility provided by the inflation outlook, the Board viewed as prudent the move to keep policy settings unchanged. At the same time, it will continue to monitor closely the growth in domestic liquidity as Asia's relatively strong cyclical position could attract significant private capital inflows.

III. Recent Developments

The MB considered the following developments:

A. Domestic price conditions

- Year-on-year headline inflation in April remained unchanged from the previous month at 4.4 percent as heavily-weighted food items registered the same inflation rate and non-food inflation rose only marginally compared to March. The following non-food items posted higher inflation rates in April: light, as generation costs continued to increase; and fuel, with higher price increases of LPG year-on-year.

- Core inflation, which excludes certain food and energy items to measure generalized price pressures, was marginally higher in April at 3.9 percent from 3.8 percent (revised) in March due mainly to higher power rates. The net of volatile items measure, one of the three alternative measures of core inflation estimated by the BSP, also rose marginally to 5.7 percent from 5.6 percent (revised). Meanwhile, the trimmed mean and the weighted median measures remained at their previous months' levels of 3.2 percent and 2.8 percent, respectively.

B. Inflation Expectations

- Surveys continued to indicate well-contained inflation expectations over the policy horizon. Results of the May 2010 Asia Pacific consensus forecasts for the country showed steady and within-target inflation forecasts for 2010 and 2011 at 5.0 percent and 4.8 percent, respectively, the same as in the previous month. Meanwhile, results of the BSP's survey of private sector economists for April 2010 yielded a marginally higher but within-target inflation forecast of 4.8 percent for 2010 from 4.7 percent in the previous month. For 2011, the mean inflation forecast was also higher at 4.9 percent from 4.6 percent.

C. Inflation Outlook

- Average headline inflation is expected to settle within the 4.5 percent ± 1.0 percentage point target range for 2010 and the 4.0 percent ± 1.0 percentage point target range for 2011. Relative to the previous estimates, the average baseline inflation forecasts for 2010 and 2011 declined, due mainly to the estimated impact of lower electricity rates for May 2010 and the slight reduction in domestic liquidity growth and local oil price projections, particularly for 2010.

- Upside risks to the inflation outlook include stronger-than-expected domestic demand growth; strong investor interest in commodity assets; constraints to oil and agricultural production; electricity rate hikes; and higher-than-expected wage increases. Meanwhile, a sustained appreciation of the peso could bring inflation below baseline projections. The key source of uncertainty about the inflation outlook is the strength of global economic activity and its effect on commodity demand.

D. Demand conditions

- Latest domestic demand indicators confirmed that economic activity is picking up. GDP posted a higher-than-expected growth in Q1 2010 at 7.3 percent. Growth rates in Q4 2009 and Q1 2009 were recorded at 2.1 percent and 0.5 percent, respectively. On the expenditure side, expansion was driven by the accelerated growth in all major segments. Capital formation rebounded strongly, growing by 24.3 percent. On the production side, industry and services contributed 4.8 percentage points and 3.1 percentage points to GDP growth, respectively. Meanwhile, agriculture, fishery, and forestry (AFF) declined, reflecting the impact of the weather disturbances which commenced in the latter part of 2009.

- The seasonally-adjusted estimates of GDP point to improved growth, with GDP expanding by 3.0 percent quarter-on-quarter in Q1 2010 from 1.4 percent in Q4 2009, supported by the expansion in industry and services.

- Gross National Product (GNP) grew by 9.5 percent in Q1 2010 from 4.1 percent in Q4 2009 and 3.3 percent in the same period last year. The acceleration in GNP growth was due to the sustained increase in overseas Filipinos' (OF) remittances which contributed to the 24.9 percent increase in net factor income from abroad. Meanwhile, property income posted a lower rate of contraction in the quarter.

- Leading indicators suggest sustained growth momentum through the second quarter as capacity utilization in the manufacturing sector remained at historic highs and energy sales to the industrial sector continued to post double-digit expansions. Results of the second quarter Business Expectations Survey also indicate a more robust economic activity in the second half of the year.

- As of end-April 2010, there were ten pending petitions with the regional wage boards for across-the-board wage increases ranging from ₱20 to ₱129.

E. Supply-side indicators

Developments in Agriculture

- Latest data from the NSCB showed that agriculture, fishery and forestry (AFF) declined in Q1 2010, reflecting the impact of the El Niño weather condition, particularly on the production of palay, corn, and sugarcane. AFF, which accounted for 17.9 percent of GDP, contracted by 2.5 percent in the first quarter from a growth of 2.1 percent in the same period last year and a contraction of 2.9 percent in the previous quarter.

- As of 21 May 2010, the country's total rice inventory stood at 3.4 MMT, higher than the month- and year-ago levels of 3.1 MMT and 2.8 MMT, respectively. The latest inventory level is sufficient to last for 93 days based on the average daily rice requirement of 36.3 thousand MT. Meanwhile, about 1.7 MMT or 73.9 percent of the total National Food Authority Council-approved volume of importation for 2010 (2.3 MMT) had arrived as of 20 May 2010.

- Rice prices were steady in Metro Manila (MM) but declined in areas outside MM (AOMM) in April and May. However, rice prices reflected some upward pressure in AOMM in the second week of May with the approach of the end of the summer harvest season.

- Prices of meat and fish products were generally stable in April while prices of refined sugar declined in most trading centers. Meanwhile, most monitored fruits and vegetables registered higher prices in a number of trading centers in April.

- The intensity of the El Niño weather condition waned from moderate to weak during the second half of April. Overall, the tropical Pacific is cooling gradually and is expected to return to neutral conditions by June 2010.

- In the global market, the FAO noted that latest information confirmed a further improvement in the global cereal supply situation in the current 2009/10 marketing year, with output exceeding consumption significantly and inventories climbing to an 8-year high. However, the IMF noted that global stock-to-use ratios for major grains like corn, rice, and wheat remained significantly below their long-term averages, reflecting rapid demand growth in recent years and sluggish supply response.

Oil Price Developments

- Dubai crude oil prices climbed in April and in the first week of May on improved confidence in the momentum of the global economic recovery. However, market optimism was not sustained in the subsequent weeks as oil prices declined generally with the resurgence of concerns that Greece's debt crisis could derail global economic recovery and reports of rising US oil inventory (a sign of weak demand).

- Oil prices in the futures market also decreased. The price of Brent crude oil for July 2010 deliveries declined to US$74.43 per barrel on 18 May 2010, lower by US$12.20 per barrel or 14.1 percent relative to its month-ago level of US$86.63 per barrel.

- As of 22 May, domestic retail prices of unleaded gasoline, diesel, and kerosene posted a year-to-date net increase of ₱1.88 per liter, ₱1.74 per liter, and ₱0.74 per liter, respectively. Meanwhile, the price of LPG declined by ₱0.31 per liter during the same period.

- In the transport sector, petitions for minimum taxi and jeepney fare increases remained pending with the Land Transportation and Franchising Regulatory Board (LTFRB). The petition filed by the Philippine National Taxi Operators Association (PNTOA) on 26 January 2010 requested an increase in the flag-down rate and a charge for succeeding meters and waiting time by ₱10.00 and ₱1.50, respectively. Meanwhile, some jeepney operators are requesting a minimum jeepney fare increase of ₱1.50 to be added to the existing ₱7.00.

Developments in the Utilities Sector

- The Manila Electric Company (Meralco) passed on lower generation cost in May 2010 with lower electricity costs from its suppliers — independent power producers (IPPs) and the Wholesale Electricity Spot Market (WESM). According to Meralco, the use of natural gas for the entire supply month of April (after using condensate fuel from the second week of February to early March during the maintenance shutdown of the Camago-Malampaya gas field) has brought down the costs of electricity generated from its IPPs. In addition, the restoration of some power plants (that earlier underwent preventive maintenance) to normal operations also helped in easing the power supply deficiency.

- Visayas and Mindanao power grids continued to suffer from power supply deficits. In an advisory, the National Grid Corporation of the Philippines noted that Mindanao, which depends on hydro power for more than 50 percent of its electricity requirement, continued to suffer from power supply deficits through the second half of May, albeit to a lesser degree compared to the power deficit posted in March. In the Visayas, power supply remained tight due to structural problems. Meanwhile, the power supply situation in Luzon has already normalized, with gross reserves posting a surplus of 476 megawatts (MW) as of 17 May 2010.

F. Financial Market Developments

Government Securities Market

- Relative to their 19 April 2010 T-bill auction levels, secondary market yields rose across most tenors on 1 June 2010.

Interest Rates and Interest Rate Differentials

- The differential between the BSP policy rate and the US federal funds rate was unchanged in May 2010, but risk-adjusted differentials tightened, reflecting heightened risk aversion amid the sovereign debt crisis in Europe.

- The Philippines' negative real policy interest rate was slightly above the average real policy rate of -0.67 percent in a sample of 16 central banks.

- The Philippines' real lending rate was steady in April 2010 at 3.2 percent relative to the previous month, and was slightly below the mean real lending rate of 3.4 percent in a sample of 10 Asian countries.

- The cumulative 200-basis-point policy rate cut of the BSP from 18 December 2008 to 9 July 2009 has been passed on by banks to their borrowers, with actual bank lending rates declining by 219.6 basis points as of 10-14 May 2010 from 8-12 December 2008 or a pass-through equivalent to 109.8 percent.

Stock Market

- The general direction of the market was influenced mainly by the developments in Europe's sovereign debt problems and by the recently conducted Philippine national elections:

- In early May, the market was dragged by investors' fear that the rescue package for Greece would be inadequate and could trigger a sovereign debt contagion across Europe.
- In the local scene, concerns over a possible failure of elections also added downward pressure on the index. However, immediately after the generally peaceful 10 May elections, the PSEi recovered.
- The market was on a continuous sell down during the second half of the month with concerns in the global market that the crisis in Europe could spread to the US despite the rescue package. Towards the close of the month, the index moved sideways.

- Asian counterparts trekked a path similar to the PSEi as they showed a general uptrend in the first four months of 2010, reflective of the foreign investors' increased risk appetite and preference for the region.

Foreign Exchange

- The peso weakened in May due to renewed risk aversion.
- Year-to-date, the peso depreciated along with the Korean won, Indian rupee, Singaporean dollar, and Taiwan dollar, while the Japanese yen, Thai baht, Malaysian ringgit, and Indonesian rupiah appreciated.
- On a real trade-weighted basis, the peso lost external price competitiveness in April 2010 against the baskets of currencies of major trade partners (MTPs) and competitor countries in the broad series.

Global Bond and Credit Default Swap Spreads

- Spreads widened in the second half of April, weighed down by bearish sentiment on reports of fraud allegations against Goldman Sachs as well as on Greece's and Spain's rating downgrades, prompting investors to dump riskier assets. The negative sentiment continued in the first three weeks of May, resulting in a further widening of debt spreads. Investors continued to pull back from riskier emerging market assets on persistent fears that the Greece's debt crisis could spread to other euro zone countries and hurt the global economy's nascent recovery.
- However, spreads tightened by a few basis points towards the end of May as investor sentiment turned positive over the country's higher-than-expected GDP growth in the first quarter of 2010.

G. Domestic Liquidity and Credit Conditions

- Demand for money remained strong as domestic liquidity growth (year-on-year) accelerated to 10.3 percent in March from 9.9 percent in February.

- The sustained expansion of domestic liquidity was due mainly to the strong growth in net foreign assets (NFA). In particular, NFA increased by 18.0 percent with the rise in the NFAs of both the BSP and the banking system. The BSP's NFA continued to expand, recording a 14.0 percent growth, while banks posted a markedly faster NFA growth of 39.8 percent due to the combined acceleration in the growth of foreign assets and the slowdown in the expansion of foreign liabilities. Net domestic assets (NDA) also expanded in March, but at a slower rate of 2.4 percent from 5.9 percent in February, as the growth in credits extended to the public and private sectors moderated.

- Bank lending, excluding banks' reverse repurchase (RRP) placements with the BSP, continued to grow in March, albeit at a slower pace of 5.0 percent from the previous month's expansion of 6.1 percent. Outstanding loans of commercial banks including RRPs, however, declined by 0.9 percent in March, due to the decline in banks' RRP placements with the BSP.

- The growth of loans for production activities—which comprise around 84 percent of banks' total loan portfolio—decelerated to 4.9 percent in March from 5.8 percent a month ago. This developed as credit growth in most sectors led by real estate, renting, and business services was pulled down by the contraction in other sectors such as manufacturing. Nonetheless, the contraction in manufacturing (9.9 percent) eased to single-digit levels since February with the recovery in global trade. Loans for household consumption continued to rise, although at a moderate pace, particularly for credit card and auto loans.

- Results of the Q1 2010 Senior Bank Loan Officers' Survey indicated that banks have generally maintained steady credit standards for loans to enterprises since Q2 2009.

    - Meanwhile, the diffusion index showed that the net tightening of credit standards has generally been declining since Q2 2009.

    - On the demand side, the net demand for loans has been positive for both enterprises and households in the past quarters, indicating that more banks reported an increase in loan demand relative to those that reported a decrease. For households, however, net demand, although positive, has been declining for the last two quarters. This confirms the observation that funding needs of enterprises and households have increased since the financial crisis.

- Total equity raised in the Philippine Stock Exchange (PSE) for the period January-April 2010 reached ₱17.8 billion, a marked improvement compared to the same period in 2009 when capital-raising activity reached only ₱5.3 billion. Likewise, corporate bond issuances posted a significant increase, growing by 25.5 percent year-on-year for the same period to reach ₱92 billion. Bond issuances by the non-financial corporations reached ₱65.5 billion for the first four months of 2010, accounting for 71 percent of the total corporate bond issuances during the period. Meanwhile, bond issuances by financial corporations more than doubled in the period January-April of 2010 at ₱26.5 billion from ₱11.3 billion in the same period in 2009.

H. Fiscal developments

- The fiscal deficit in Q1 2010 reached ₱134.2 billion, higher than the ₱119.7 billion deficit incurred in the same period in 2009. This represents 121.9 percent of the ₱110.1 billion programmed deficit for the first quarter of 2010. Revenue collections increased by 12.9 percent to ₱265.8 billion in Q1 2010 compared to ₱235.4 billion in the same period last year. It also represents 99.8 percent of the first quarter program of ₱266.3 billion. Meanwhile, expenditures for Q1 2010 amounted to ₱400.0 billion, about 12.7 percent higher than the disbursements in the comparable period in 2009, and exceeding the first quarter program of ₱377.2 billion. Excluding interest payments, total disbursements rose by 17.0 percent to ₱291.1 billion. Interest payments also went up by 2.4 percent to reach ₱108.9 billion.

I. External developments

- The IMF's April 2010 World Economic Outlook projected world output this year to rise by 4.2 percent, an upward revision from its January projection of 3.9 percent. Nonetheless, the strength of the global recovery remains conditional—to a large extent—on governments' accommodative fiscal and monetary policies. Moreover, economic activity has been subject to downside risks, as fiscal fragilities have weighed heavily on the economic outlook. In this regard, monetary, fiscal, and financial policymakers will need to put in place mechanisms to rebalance demand from the government to the private sector. Fiscal and monetary policies should also support growth and employment, while taking into consideration the need to adopt strategies to rein in public debt and later bring it down to more prudent levels, particularly in the euro area. Meanwhile, global inflationary pressures have remained low as a result of substantial spare capacity.