# HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 29 JANUARY 2009[1]

## I. Monetary Policy Decision

The Monetary Board decided to:

a) Reduce the BSP's policy rates by 50 basis points to 5.0 percent for the overnight RRP (borrowing) rate and 7.0 percent for the overnight RP (lending) rate;

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

c) Maintain the current reserve requirement ratios.

The policy decision to reduce policy rates was arrived at in the process of balancing the BSP's concern over price stability and its resolve to undertake policy actions that will ensure the soundness and stability of the financial system.

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

- The Monetary Board discussed the deteriorating global conditions in the context of the policy actions required of monetary authorities. The members gave particular attention to the developments in Asian equity markets, where risk-averse investors have generally fled. In view of these developments, the Board noted that there was a need for stronger policy responses, particularly in the form of fiscal stimulus and financing packages as well as macro-prudential reforms.

[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 for the Monetary Stability Sector, the Deputy Governor for the Supervision and Examination Sector, the Managing Director of the Monetary Policy Sub-Sector, and the Managing Director of the Treasury Department. The highlights of the discussions on the 29 January 2008 meeting were approved by the Monetary Board during its regular meeting held on 19 February 2009. The next meeting of the Monetary Board on monetary policy issues is scheduled on 5 March 2009.

- Given the current global conditions, the Board reduced policy rates on the basis of the following key considerations:

  - The inflation outlook has become more favorable. The BSP's latest baseline forecasts indicate that inflation would continue to decelerate and settle within the target range for 2009 and 2010;

  - Inflationary pressures have continued to ease as indicated by the following:

    1. Second-round effects from earlier commodity price spikes appear to have peaked;
    2. The balance of risks has tilted on the downside due to the softening of commodity prices; and
    3. Base effects have been coming down;

  - Inflation expectations remain well anchored. The results of the initial monthly survey of private sector economists/analysts, the latest Consumer Expectations Survey (CES), Business Expectations Survey (BES) and the January Asia Pacific Consensus Forecasts showed lower expected inflation relative to the previous surveys. Meanwhile, core inflation, which is associated with inflation expectations and demand pressures, has slowed down in December.

  - The macroeconomic environment of lower interest rates can provide a boost to credit and investment activity. In general, monetary easing could help promote an orderly functioning of financial markets and could help shore up market confidence, which is the most pressing concern in this crisis.

  - There is greater scope for monetary policy easing to complement the government's economic sustainability plan. This could further increase the potential for the economy to grow more robustly compared to a situation that is both without monetary easing and fiscal stimulus.

- The Board recognized the need for a more decisive action during a financial crisis. With the global economy entering a pronounced slowdown, a sharp fall in aggregate demand is inevitable. Weak economic activity ultimately fuels financial system stress, resulting in a negative feedback loop that could intensify the impact of the economic slowdown. Therefore, in times when the risks of financial disruptions are high, there is greater risk of underestimating the threats to growth. The Board therefore agreed that policy should support a macroeconomic environment that will continue to broadly improve consumer confidence and promote investment spending via monetary policy easing.

- The Board was of the view that the current macroeconomic environment also calls for a rapid adjustment in the policy settings rather than the gradualist approach commonly pursued during normal times, particularly given the escalating downside risks to external demand. The effects of the unfolding global financial crisis are already reaching the real sector through the trade channel. Thus, given the downside risks and the heightened uncertainty on the duration of the global downturn, additional policy easing could help stimulate domestic demand and encourage investment.

- The members noted that despite the positive impact of a 50-basis-point cut on liquidity, the BSP's econometric estimates indicate that this move will not push inflation beyond the target range for both 2009 and 2010.

- Nevertheless, the Board was aware that the upside risks to inflation stemming from the volatility in the exchange rate and oil prices remain. Although the peso has recovered somewhat, higher risk aversion and the slowdown in global growth affected dollar inflows adversely, and may lead to a peso depreciation. Meanwhile, oil prices remain vulnerable due to production cutbacks and supply disruptions.

## III. Recent Developments in Economic Indicators

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

### A. Domestic price conditions

- Headline inflation dropped further in December to 8.0 percent year-on-year from 9.9 percent in November.

### B. Inflation Expectations

- Recent surveys showed significantly-improved inflation expectations:

    - The latest BES for Q4 2008 indicated a lower proportion of respondents that anticipate inflation to move up in Q4 2008.
    - Results of the latest CES for Q4 2008 showed lower inflation expectations for the next 12 months.
    - The Asia Pacific Consensus Forecasts showed lower inflation expectations for the Philippines as of January 2009 relative to the previous month.

- Results of the BSP's initial monthly (from quarterly) survey of private sector economists/analysts showed inflation is expected to fall within the target range for 2009 and 2010.

**C. Inflation Outlook**

- Emerging inflation forecasts indicate that inflation would settle within the 2009 and 2010 targets.

- On the downside, latest projections for global and domestic agricultural production generally suggest an improvement in the supply and demand balance for food.

- Meanwhile, upside risks to inflation include: volatility in world oil prices and the exchange rate, near-term risks to electricity rates, and additional wage increases.

**D. Demand conditions**

Latest data showed a moderation in demand conditions amid the global economic downturn and previously elevated prices (particularly higher fuel and food costs) which had slowed down the demand for commodities and services.

- GDP posted a modest growth of 4.5 percent in Q4 2008 compared to 6.4 percent in the previous year and 5.0 percent in the previous quarter.

- Merchandise imports declined anew by 31.5 percent in November 2008.

- Export growth was still negative at 11.4 percent in November, reflecting weaker foreign demand.

- Selected demand indicators moderated:

  - Sales of passenger cars, commercial vehicles, and trucks and buses declined in December, as restraints in supply and the spillover effect of the US economic slowdown influenced the decisions of prospective clients.

  - Energy sales decelerated in December, pulled down by the negative growth in the industrial sector.

  - Average capacity utilization in manufacturing declined marginally.

  - MISSI figures indicate slower manufacturing activity in November 2008.

- The increase in land and rental values has generally moderated compared to 2007.

## E. Supply-side indicators

Developments in Agriculture

- Average retail prices of rice increased anew in the second week of January 2009.

- Meanwhile, the International Rice Research Institute (IRRI) warned that rice prices could remain highly volatile in 2009.

Oil Price Developments

- Dubai crude oil prices continued to ease in December due to the significant deterioration in oil demand as the global economic climate continued to worsen. However, oil prices increased in January, driven by the war in Gaza and the gas disputes between Russia and Ukraine.

- Prices in the futures market continued to fall on account of the weaker global demand for oil.

- Oil companies raised the prices of gasoline products recently, but reduced the prices of kerosene and diesel further on 24 January 2009.

- In the transport sector, another provisional reduction for jeepney and bus fares nationwide was implemented starting 15 December 2008 up to 15 March 2009.

Developments in the Utilities Sector

- The Energy Regulatory Commission (ERC) dismissed the petition of the National Power Corporation (NPC) to increase basic rates in Luzon. However, NPC rates in Luzon increased beginning January 2009 due to the new Generation Rate Adjustment Mechanism (GRAM) and the Incremental Currency Exchange Rate Adjustment (ICERA) approvals.

- Meanwhile, the planned increase in water rates for 1 January 2009 was deferred.

## F. Financial Market Developments

- Domestic financial markets remain heavily influenced by the deteriorating global financial market conditions.

Interest Rate and Interest Rate Differentials

- The positive differential between the BSP policy rate and the US target federal funds rate increased in December, but risk-adjusted differentials continued to be negative as of 14 January 2009. Meanwhile, the differential between the domestic and foreign interest rates tightened, given the larger decline in domestic rates during the period. Real lending rates turned positive for the first time since March 2008 as inflation declined steadily beginning September, reaching 8.0 percent by December.

Stock Market

- Stock trading remained weak in January 2009, as concerns over the deepening and prolonged US economic slowdown pushed risk-averse investors to remain on the sidelines.

Foreign Exchange

- The peso strengthened from the accumulation of overseas Filipinos' remittances during the long holiday season, as well as the upswing in market confidence sustained by the easing inflation outlook for 2009.

- However, other regional currencies (except the Japanese Yen), continued to depreciate in January 2009 relative to their end-2008 close.

Global Bond and Credit Default Swap Spreads

- For the period 22-26 January, emerging market bond spreads generally tightened from this month's peak (15 January) as global gains in stocks rekindled demand somewhat for riskier emerging market assets.

- The cost of protecting the country's debt from default increased as the Philippine five-year credit default swaps (CDS) spread went up in January 2009 from the end-2008 level. Against neighboring economies, the Philippine CDS spread has remained below Indonesia's level, but was higher than those of Malaysia and Thailand.

## G. Domestic Liquidity and Credit Conditions

- Domestic liquidity sustained its strong growth in November due to the robust expansion in both net domestic assets (NDA) and net foreign assets (NFA).

- Meanwhile, bank lending growth was relatively lower in November.

- The equity raised in the Philippine Stock Exchange in 2008 was lower than the level reached in 2007, while corporate bond issuances increased significantly in 2008.

### H. Fiscal developments

- The fiscal deficit in January-November 2008 reversed the previous year's surplus for the same period.

### I. External developments

- Aggregate demand worldwide fell sharply in December as economies experienced large falls in real and financial wealth levels.

- Inflationary pressures have clearly subsided globally due to the significant declines in commodity prices and decelerating global demand:

    1. The US economy is deteriorating sharply;

    2. Euro area indicators point to a marked deterioration in economic activity;

    3. Sluggish domestic demand and a further slowdown in exports characterize the Japanese economy; and

    4. Economic activity decelerated sharply in emerging Asia, as reflected in the overall weakening in domestic demand and deteriorating consumer and business confidence.