



HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 10 AUGUST 2006*

The Advisory Committee¹ 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 RRP, RP, and SDA.
- 2) Maintain the current reserve requirement ratios at 10 percent for regular reserves on the deposit liabilities of universal banks (UBs) and commercial banks (KBs), and 11 percent for liquidity reserves on the deposit liabilities of UBs and KBs; and
- 3) Continue to articulate the BSP's support for the Government's use of non-monetary measures to address supply-side risks to basic commodity prices and continue representation and coordination with concerned government agencies for this purpose.

The Monetary Board then proceeded to review the recent developments and the key considerations in the formulation of the BSP's monetary policy stance.

I. Review of Recent Developments

Inflation

- The headline inflation rate eased anew in July to 6.4 percent from 6.7 percent in the previous month. This was traced to slower price increases for food, beverage and tobacco (FBT), housing and repairs (H&R), and services. Similarly, core inflation—defined as headline inflation after

* The discussion presented herein reflects the assessment made by the Monetary Board based on the information available at the time of the policy meeting. The highlights of the discussions of the 10 August 2006 meeting were approved by the Monetary Board during its regular meeting held on 24 August 2006.

¹ 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 Officer-In-Charge of the Department of Economic Research.



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excluding volatile food and energy items—eased further to 5.4 percent from 5.8 percent in June.

- World spot prices of crude oil rose in July as the conflict between Israel and Lebanon continued. However, futures prices softened on news of diplomatic efforts by the US and Britain, which led to expectations that the Israeli-Hezbollah conflict would not spread in the region. Nevertheless, domestic pump prices of gasoline, kerosene, diesel and LPG rose during the period.

Demand

- Latest data showed generally improving demand conditions.
 - Based on the results of the Monthly Integrated Survey of Selected Industries (MISSI), which covers 509 manufacturing establishments, average capacity utilization rose to 80.3 percent in May from 80.1 percent in April.
 - Merchandise export earnings increased at a faster pace of 20.6 percent year-on-year in June from 17.3 percent in May. This can be traced to the strong growth in manufactures, particularly electronic products.
 - Growth in total merchandise imports accelerated to 15.2 percent year-on-year in May. This was due to faster growth in imports of capital goods, particularly telecommunication equipment and electrical machines, and the pickup in imports of mineral fuels.
 - Based on the new NSO definition of unemployment, the jobless rate rose slightly to 8.2 percent in April 2006 from 8.1 percent in January 2006, but was lower compared to 8.3 percent in April 2005. The same trend was observed for the jobless rate using the old NSO definition of unemployment.²
 - Passenger car sales increased by 6.6 percent year-on-year in June, lower compared to the 22.1 percent growth in May, based on data from the Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI). Meanwhile, sales of trucks and buses fell by 29.8 percent year-on-year in June following a 40.8 percent rise in May.

² Beginning in April 2005, the NSO released a new definition of unemployment, which covers all persons 15 years old and over 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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- Appliance sales continued to decline, with total units sold falling by 15.7 percent year-on-year in June.
- Growth in total energy sales by the Manila Electric Company (Meralco) declined marginally by 0.2 percent in May after an increase of 1.1 percent in April. This was due to reduced energy consumption by all sectors except the commercial sector.

Domestic Liquidity

- Domestic liquidity, as measured by M3, rose by 13.4 percent year-on-year in June based on preliminary data from the BSP's Depository Corporations Survey (DCS).³ This was an acceleration from the 12.7 percent increase registered in May. Continued expansion was driven by the sustained dollar inflows from overseas Filipino workers' remittances and portfolio investments.
- Outstanding loans of commercial banks (KBs) declined by 0.6 percent year-on-year in June. The following sectors registered a decline in outstanding loans: construction; agriculture; manufacturing; electricity, gas and water; and transport, storage and communication.

Other Domestic Developments

- In July, the Regional Tripartite Wage and Productivity Boards (RTWPBs) across the country approved increases in the basic minimum wage or in the cost-of-living allowance of workers in their respective regions. The average increase in non-agricultural nominal wages was relatively moderate at 6.6 percent and was within the BSP's expectations. The NCR RTWPB granted an increase of ₱25 (or 8 percent) in the minimum wage of private sector workers in the region.
- The near-term outlook for agriculture, particularly for rice production, remains favorable. The Bureau of Agricultural Statistics (BAS) estimates a 16 percent year-on-year increase in rice output for the second semester of 2006, on expectations of normal weather conditions and higher yield and harvest area.
- Treasury bill (T-bill) auction rates eased across all tenors on 31 July 2006 relative to 26 June 2006 due to strong demand for T-bills amid ample liquidity and an improving fiscal position.

³ 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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- Positive market sentiment from the easing of political uncertainties and improvements in the fiscal position—as reflected by the oversubscription in the country's US\$750 million bond issue on 25 July 2006—caused the peso to strengthen in nominal terms against the US dollar. Dollar inflows from overseas Filipino workers, portfolio investments, and export earnings likewise supported the local currency.
- The National Government achieved a fiscal surplus for the third straight month in June. This brought the first semester budget deficit to ₱31.5 billion, which was 53.3 percent lower than the deficit for the same period in 2005 and ₱58.9 billion below the programmed deficit for the first six months.

External Developments

- The global economy continued to grow in the second quarter on the renewed strength of personal consumption, the continued growth of services, gains in employment, and improvements in corporate profitability in major economies. However, recent developments indicated a rebalancing in the composition of global demand. The pace of growth in the Euro area and Asia has continued to pick up while the US has shown some signs of slowing down. Risks to global economic growth include the continued volatility in world oil prices, rising global interest rates, and the potential impact on consumer demand of increases in commodity prices.
- Major central banks in the world raised their policy rates in response to growing inflation pressures in their respective economies. In July, the Bank of Japan decided to encourage the uncollateralized overnight call rate to remain at around 0.25 percent, indicating a tightening of the policy stance. The Bank of England's Monetary Policy Committee raised its policy rate to 4.75 percent in August, noting that the increase was necessary to bring inflation back to target in the medium-term. The European Central Bank (ECB) Governing Council also raised its policy interest rates by 25 basis points in August to help anchor medium to longer-term inflation expectations. Meanwhile, the US Federal Open Market Committee kept the federal funds target rate steady at 5.25 percent in August after 17 successive increases, noting that US economic growth has moderated.

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

- The Monetary Board agreed that the evidence on output and inflation supported a steady policy setting. Latest BSP forecasts continued to show a decelerating path for inflation over the policy horizon, with the likelihood that the target headline inflation rate in 2007 of 4-5 percent will be achieved, in the absence of additional cost-push shocks. The



sustained decline in core inflation also implied reduced demand pressures on consumer prices. Moderate improvements in demand indicators and weak credit activity also suggested a scenario of limited demand-based price pressures.

- Nevertheless, the Monetary Board were also in agreement that the balance of risks to the future path of inflation remains tilted toward the upside, mainly on account of the outlook of higher oil prices. The prospect of sustained high international oil prices, along with associated adjustments in power and possibly transport costs, implies a continuing environment of supply-side pressures. Meanwhile, more than ample liquidity in the banking system can also be a source of concern.
- Given these considerations, the Monetary Board recognized the need to remain focused on managing the risks to inflation expectations, assessing the likelihood of second-round effects, and closely monitoring developments in liquidity conditions. To this end, prospective policy pronouncements will continue to reiterate the Monetary Board's strong commitment to achieving the inflation target for 2007 and its readiness to act against emerging risks to the outlook for inflation and to inflation expectations.

III. Monetary Policy Decision

- After considering the risks to inflation and the evidence that has become available since its previous meeting on monetary policy, the Monetary Board unanimously approved the recommendations of the Advisory Committee.

The next meeting of the Monetary Board to discuss the monetary policy setting is scheduled on 21 September 2006.