



HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 4 OCTOBER 2007*

The Advisory Committee¹ submitted the following recommendations for the consideration of the Monetary Board:

- Adjust the current monetary policy settings as follows:
 - (a) Adjust the BSP's policy interest rates downward by 25 basis points to 5.75 percent for the overnight RRP (borrowing) rate and 7.75 percent for the overnight RP (lending) rate;
 - (b) Adjust the current interest rates on term RRPs, RPs, and SDAs accordingly; and
 - (c) Maintain the current reserve requirement ratios.

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

A. Domestic price conditions

- Headline inflation slowed down to 2.4 percent in August from 2.6 percent in July. The lower inflation in August can be traced mainly to the decline in the prices of fruits and vegetables and the slower increase in fuel prices relative to levels a year ago. The average inflation rate for January-August 2007 was maintained at 2.6 percent.
- The official core inflation measure published by the National Statistics Office (NSO) slowed down to 2.9 percent in August from 3.0 percent in July.

* 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 4 October 2007 meeting were approved by the Monetary Board during its regular meeting held on 25 October 2007.

¹ The Advisory Committee is composed of the Governor of the BSP as Chairman and five 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, the Managing Director of the Monetary Policy Sub-sector, and the Director of the Department of Economic Research.



B. Demand conditions

- Latest data for Q2 2007 showed that the growth in Gross Domestic Product (GDP) accelerated to 7.5 percent. On the demand side, GDP growth was buoyed by strong household spending, improving capital investments, and robust government consumption.
- The year-on-year growth in merchandise exports accelerated to 4.5 percent in July from 1.5 percent (revised) in June, due mainly to the higher growth in manufactures, particularly electronics which posted an upturn of 5.1 percent in July after declining by 1.7 percent in the previous month. The cumulative growth rate for January-July was 6.3 percent, considerably lower than the previous year's 17.6 percent.
- Growth in merchandise imports accelerated to 14.3 percent year-on-year in July from 3.8 percent in June. This was due mainly to the upturn in imports of mineral fuels, lubricants and related materials, and the continued growth in imports of raw materials and intermediate goods. For the first seven months of 2007, merchandise import payments rose by 4.1 percent, less than half of the year-ago growth of 10.0 percent.
- Selected indicators of demand continued to indicate a broad strengthening trend.
 - Based on latest data from Colliers, land values in Q2 2007 rose by 6.8 percent year-on-year for the Makati Central Business District (CBD) and 14.2 percent for Ortigas Center. Quarter-on-quarter, the estimated land values in the Makati CBD and Ortigas were 5.6 percent and 6.7 percent higher, respectively.
 - The year-on-year sales of passenger cars rose by 4.6 percent in August, a reversal of the 6.6 percent decline in July. Such growth was attributed to the launch of new models. However, year-to-date sales increased by 4.0 percent, slightly higher than the 3.9 percent growth registered in the comparable period last year. Similarly, the year-on-year sales of trucks and buses grew by 11.9 percent in August, a turnaround from the 13.6 percent decline registered in July. Year-to-date sales of trucks and buses surged by 25.9 percent, from the 9.3 percent growth registered in the same period last year.
 - The year-on-year energy sales by Meralco rose at a faster pace of 6.7 percent in July compared to 5.4 percent in June. Meanwhile, year-to-date energy sales increased by 4.6 percent from 1.7 percent in the comparable period last year.
 - Appliance sales continued to grow although at a slower pace of 9.7 percent year-on-year in June relative to the 15.7 percent growth registered in May. Meanwhile, year-to-date sales rose by 11.2 percent, a turnaround from the 7.5 percent decline in the comparable period last year.



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- Average capacity utilization in manufacturing increased slightly in July to 80.3 percent from 80.2 percent in June based on the NSO's Monthly Integrated Survey of Selected Industries (MISSI).
- MISSI data showed a recovery in manufacturing activity in July. The value of production index (VAPI) recovered after 10 months of consecutive declines, growing at a rate of 1.4 percent year-on-year in July from a 3.0 percent decline in June.
- Results of the latest Business Expectations Survey (BES) for Q3 2007 showed that business confidence remained buoyant. The overall business confidence index (CI) remained at the 40.0 percent mark for the fourth consecutive quarter at 40.9 percent, up by 19.2 index points compared to the year-ago level. Quarter-on-quarter, however, the index fell by 5.5 points.
- Consumer confidence continued to improve in Q3 2007 CES. The nationwide consumer CI for Q3 2007 sustained its improving trend to -23.6 percent from -26.0 percent in Q2. Consumers attributed the favorable economic outlook to the strength of the peso, stable prices of goods and more job opportunities.
- Wage increases were recently approved in two regions while COLA adjustments were approved in three more regions.

C. Supply-side indicators

Developments in Agriculture

- The agriculture industry registered a positive growth (3.9 percent) in Q2 2007. Despite the prolonged dry spell experienced in some key areas of the country, agricultural output growth is expected to continue for the rest of the year, supported by the expected increase in public spending on seed technology and rural infrastructure. In addition, the Department of Agriculture (DA) is undertaking a massive greening project to counter future dry spells.
- Meanwhile, the Department of Science and Technology (DOST) reported the occurrence of the early stage of a weak La Niña event. This implies above-normal rainfall conditions over Visayas and some areas of Luzon from October to December, with below-normal rainfall over most areas of Luzon in November.
- Meanwhile, the swine flu has crept in Nueva Ecija—although minimally—after affecting the hog industry in nearby Bulacan and Pampanga.



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- On the price front, international and domestic retail prices of rice are on a gradual uptrend. Global prices of food products like dairy, corn, and wheat have also risen.
- In response to the recent price increases of rice, the National Food Authority (NFA) is implementing measures to ensure the stability of the supply and price of rice during the lean months in Q3.

Oil price developments

- International spot and futures prices were higher in September on expectations of increased global demand for oil and supply concerns due to the hurricane season. Meanwhile, domestic pump prices were raised by another ₱0.50 per liter on 29 September. In the transport sector, the approved increase in minimum transport fare will not be implemented in 2007.

Developments in the utilities sector

- On top of the successive rate cuts by NPC and Meralco in the third quarter of 2007, consumers will enjoy another round of power rate reductions following the ERC's decision to lower NPC rates starting October.
- However, electricity rates could still increase due to the restoration of the Automatic Generation Rate Adjustment (AGRA), Meralco's pending petitions, ERC's recent ruling on the alleged 'price manipulation' in the WESM, and the approval of Meralco's distribution charge starting 2008 under the performance-based rate (PBR) application. Meanwhile, even with the relatively firm peso, the MWSS has approved an increase in water rates in the fourth quarter.

D. Monetary conditions

Interest rate developments

- The interest rate differential between the BSP policy rate and the US Fed funds rate and that between the RP and US T-bill rates widened in September with the cut in the target for the federal funds rate.
- With the decline in inflation, the Philippines' real lending rate for August increased and was the fourth highest in a sample of 10 Asian countries.
- Primary T-bill rates and secondary market yields for GS in September generally decreased.



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Domestic liquidity and credit conditions

- Growth in domestic liquidity or M3 sustained a decelerating trend for the fourth consecutive month at 14.9 percent year-on-year in August from 18.7 percent in July. On a month-on-month basis, seasonally adjusted M3 declined by 1.6 percent in August from a 0.8 percent expansion in July.
- Outstanding loans of commercial banks, thrift banks and rural banks (net of reverse repurchase or RRP placements) expanded by 6.9 percent year-on-year in July compared to the 4.7 percent growth posted in the previous month. This was a substantial improvement from the 0.5 percent expansion registered in the same month a year ago.
- Consumer credit increased by 22.0 percent year-on-year in Q2 2007. This was higher than the year-ago growth recorded at 15.0 percent but slightly lower than 22.2 percent registered in Q1 2007.

E. Financial market developments

- The local bourse experienced some volatility in August, but has since recovered starting in the second week of September.
- The peso weakened slightly by 1.2 percent in August relative to July to average P46.14/US\$1, but strengthened anew to average P46.05/US\$1 in September.

F. Fiscal developments

- The National Government's (NG's) fiscal operations recorded a ₱13.9 billion surplus in August 2007. This brought the fiscal deficit of the NG in the first eight months to ₱25.5 billion, 25.4 percent lower than the ₱34.2 billion deficit incurred during the same period last year.

G. External developments

- Latest data suggest that the global economy will continue growing, although at a slower pace, against the backdrop of a weaker-than-expected US housing recession. Growth is mainly supported by buoyant economic activity in emerging markets.
- Negative risks to the global economic outlook have increased recently, mainly because of the tensions caused by the US subprime mortgage problem on global capital markets.



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- Economic prospects in the Euro area and Japan remain positive—with modest output growth in Q2—while China and India continue to gain significant roles as drivers of global economic growth.
- Rising inflationary pressures remain on the back of increasing resource utilization and rising global commodity prices.
- Central banks show differing policy directions, with the Federal Reserve loosening monetary policy settings while the Bank of Japan, European Central Bank, and Bank of England have maintained a neutral stance.

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

- The Monetary Board considered that the overall conditions for future inflation and output support the case for policy easing. Inflation is likely to fall well below the 4.0-5.0 percent target range in 2007 and within the 4.0 percent \pm 1 percentage point target in 2008. Liquidity growth decelerated for the fourth consecutive month in August; weather conditions have broadly normalized, supporting favorable supply of agricultural products; and recent wage adjustments are not expected to generate additional inflationary pressures.
- The Monetary Board noted that, while risks to the inflation outlook remain, these have on balance moderated. The continued strength of the peso provides a buffer against rising global commodity prices, including food and oil, while the impact of strong foreign exchange inflows on domestic liquidity has been mitigated by recent policy measures.
- The Monetary Board will continue to monitor developments in the global economy. The Board will also remain watchful of any emerging risk to future inflation to ensure stable prices, which is a precondition to robust and durable economic growth.

III. Monetary Policy Decision

- Given the above considerations, the Monetary Board decided to adjust the current monetary policy settings as follows:
 - (a) Adjust the BSP's policy interest rates downward by 25 basis points to 5.75 percent for the overnight RRP (borrowing) rate and 7.75 percent for the overnight RP (lending) rate;
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 - (c) Maintain the current reserve requirement ratios.

The next meeting of the Monetary Board on the monetary policy stance is scheduled on 15 November 2007.