HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 14 DECEMBER 2006*

The Advisory Committee[1] submitted the following recommendations for the consideration of the Monetary Board:

1) 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;

2) Maintain the tiering scheme on the aggregate placements by banks with the BSP under the RRP and SDA windows;

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

4) Maintain the current reserve requirement ratios at 10 percent for regular reserves and 11 percent for liquidity reserves on the deposit and deposit substitute liabilities of universal banks (UBs) and commercial banks (KBs) and Non-Bank Financial Intermediaries with quasi-banking and with trust license.

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

- Headline inflation continued to decelerate, falling to 4.7 percent in November from 5.4 percent in October. All commodity groups registered slower price increases except for housing and repairs. Likewise, year-on-year core inflation resumed its decelerating path in November.

- Lower domestic oil prices alongside a stronger peso and subsiding base effects have contributed to the continued easing in price pressures.

* 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 14 December 2006 meeting were approved by the Monetary Board during its regular meeting held on 4 January 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 Acting Managing Director of the Monetary Policy Sub-sector, and the Officer-In-Charge of the Department of Economic Research.

Demand

- Latest data generally showed moderate improvements in demand conditions.

  - Gross Domestic Product (GDP) rose by 4.8 percent in Q3 2006, unchanged from the year-ago rate but lower than Q2 2006's 5.8 percent. This brought the Q1-Q3 2006 GDP growth rate to 5.4 percent, which was higher than the previous year's 4.8 percent.

  - Average capacity utilization in manufacturing was broadly unchanged from the previous month at 80.2 percent in September, with about 60 percent of respondent firms reporting capacity utilization rates between 70 and 89 percent.

  - Growth in merchandise export earnings rose to 15.5 percent in October from 13.2 percent in September. This can be traced to higher export growth of manufactures, particularly electronics. Merchandise export growth for Jan-Oct 2006 was 16.4 percent, higher than the previous year's 3.3 percent.

  - Merchandise imports fell slightly by 0.3 percent in September, due mainly to the slowdown in raw material and intermediate goods imports and the lower import bill on mineral fuels, lubricants and related products. The year-to-date growth in merchandise imports was 8.9 percent, higher than the previous year's 5.9 percent.

  - Passenger car sales increased by 11.3 percent year-on-year in October, higher than the previous month's 9.1 percent. Similarly, sales of trucks and buses increased by 22.8 percent year-on-year in October, up from 18.6 percent in September.

  - Total energy sales by Meralco rose slightly by 0.9 percent year-on-year in September following a decline of 3.7 percent in August, due to the upturn in energy consumption by the commercial and industrial sectors. Meanwhile, sales to the residential sector declined on an annual basis for the sixth consecutive month.

  - Appliance sales continued to decline, with total units sold falling by 49.9 percent year-on-year in October.

  - Based on data from Colliers International Research, land values for the Makati Central Business District (CBD) and Ortigas Center rose by 7.8 percent and 14.1 percent year-on-year in Q3. The average office vacancy rate in the Makati CBD continued to ease due to sustained demand for office space from call centers and the business process outsourcing sector.

- Based on the new NSO definition of unemployment, the jobless rate fell slightly to 8.0 percent in July from 8.2 percent in April, but remained higher relative to the year-ago rate of 7.7 percent.[2]

- Results of the latest Business Expectations Survey (BES) showed that business confidence for Q4 2006 was at an all-time high since the inception of the BES. Business confidence for Q1 2007 also remained favorable. Nevertheless, 55 percent of all BES respondents cited insufficient demand as the top constraint to business.

- By contrast, the Q4 2006 Consumer Expectations Survey (CES) for the National Capital Region showed a slight weakening in consumer outlook for Q4. For Q1 2007, consumers expect conditions to be better, as indicated by the improvement in the quarter-ahead confidence index from the previous survey.

Domestic Liquidity

- Domestic liquidity or M3 growth based on data from the BSP's Depository Corporations Survey (DCS) accelerated to 16.1 percent in October from 14.5 percent in September.[3] This was caused primarily by strong foreign exchange inflows from exports, OFW remittances and foreign investments.

- Growth in commercial bank lending rose to 11.1 percent year-on-year in October from 6.1 percent in September, driven mainly by loans to the financial institutions, real estate and business services (FIREBS) sector; the community, social and personal services sector; and the wholesale and retail trade sector. The significant increase in loans classified under financial intermediation was linked to banks' participation in the open market operations of the BSP.

Other Domestic Developments

- Growth in agricultural output accelerated to 4.1 percent in Q3 2006 from 1.7 percent in Q3 2005. The major contributors to growth in the sector were rice, fishery, and livestock production.

- The ongoing dry spell may be strengthening. The Philippine Atmospheric, Geophysical and Astronomical Services Administration (PAGASA) expects the El Niño episode to intensify in the next three months and to continue through April-June 2007.

[2] Starting April 2005, the new Labor Force Survey (LFS) questionnaire was used to estimate the unemployed, which included all persons who were 15 years old and over as of their last birthday and were reported as without work, currently available for work, and seeking work or not seeking work due to valid reasons. The old unemployment definition did not consider the criterion on availability for work.

[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.

- Nevertheless, full-year rice production is projected to grow by 5.0 percent. For Q1 2007, the Bureau of Agricultural Statistics expects a year-on-year increase of 4.6 percent in rice production and 4.8 percent in harvest area.[4]

- Meanwhile, the spot price of Dubai crude oil rose in November on geopolitical concerns and the advent of cold weather conditions in Northeastern US. Futures prices also rose on signals of further OPEC production cut and concerns over higher demand for winter heating oil in the US. However, current reports also point to milder winter conditions in the US, which may support a decline in crude oil prices in the weeks ahead. Meanwhile, domestic pump prices of gasoline, kerosene and diesel were reduced to reflect earlier declines in world oil prices.

- Treasury bill rates during the 20 November 2006 auction generally declined relative to the 23 October 2006 rates, reflecting ample liquidity in the financial system.

- The peso continued to strengthen against the US dollar on the back of sustained inflows from OFW remittances, export earnings and foreign investments. The upgrade of the Philippines' sovereign credit outlook by Moody's Investor Service in November contributed to the appreciation of the peso.

- The National Government (NG) incurred a fiscal deficit of ₱5.8 billion in October, which brought the year-to-date budget deficit to ₱56.3 billion, 51.3 percent lower than the deficit for Jan-Oct 2005. The NG's fiscal deficit for the first ten months was less than half of the full-year program of ₱125 billion.

External Developments

- The global economy continued to expand at a fairly solid pace in Q3 2006, supported by robust services output, buoyant labor market conditions, and still-favorable financial conditions. The pace of growth in Japan and emerging Asia continued to pick up while economic expansion in the Euro Area is seen to be more broad-based. However, there is evidence of some moderation in global growth with the slowdown in US GDP growth. A number of risks remain, including volatility in oil prices, the possibility of a disorderly unwinding of global imbalances, and an unexpected tightening of financial conditions. With regard to price developments, the recent declines in oil prices have translated into an easing of consumer price inflation in a number of countries.

- The major central banks decided to maintain their policy rates at current levels. The US Federal Open Market Committee maintained its target for

[4] BAS, Rice and Corn Situation Outlook Volume 20, No. 4, available online at http://www.bas.gov.ph

the federal funds rate at 5.25 percent in its 12 December 2006 policy meeting, noting the moderation in economic growth. The Bank of England's Monetary Policy Committee voted to keep the official bank rate steady at 5.0 percent during its 6-7 December meeting. The Bank of Japan decided to maintain current policy settings as it encouraged the uncollateralized overnight call rate to remain at around 0.25 percent in its November monetary policy meeting.

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

- The Monetary Board agreed that the sum of new information since the previous policy meeting argued for keeping policy settings unchanged. Latest inflation readings remained in line with the forecast path, given easing oil prices and a firm peso. Equally important, inflation expectations also remained well-anchored.

- The Monetary Board also believed that the policy action in November should be given time to work its way through the various channels of monetary policy, including the credit channel.

- Nevertheless, despite recent benign readings in inflation, the Monetary Board noted that there continue to be upside risks to future inflation. Domestic power costs could be adjusted upward in 2007, while food prices may come under pressure if the mild El Niño dry spell becomes prolonged. The outlook for international crude oil prices also remains vulnerable to geopolitical disruptions. With these potential supply-side pressures, the Monetary Board remains watchful of a rise in the public's inflation expectations.

- At the same time, continued strong foreign inflows could imply added potential inflation pressures from surges in liquidity growth that, if sustained, could have adverse implications for inflation over the medium term.

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 on the monetary policy stance is scheduled on 25 January 2006.