Bangko Sentral ng Pilipinas

HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 6 MAY 2004*

The Advisory Committee[1] submitted the following recommendations for the consideration of the Monetary Board: (1) maintain the BSP's policy rates at the current levels of 6.75 percent for the overnight reverse repurchase (RRP) rate and 9.0 percent for the overnight repurchase (RP) rate; (2) maintain the current interest rates on the term RRPs, RPs, and Special Deposit Accounts (SDAs); and (3) maintain the current reserve requirement ratios.

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

The above recommendations were based on the following considerations:

- Headline inflation in April rose to 4.1 percent year-on-year from 3.8 percent in the previous month using the 1994-based series for consumer price index (CPI). The increase in April inflation was due mainly to higher prices of selected food items, gasoline and other oil products and selected construction materials as well as the adjustment in transport fares. The average inflation for the first four months of the year was 3.7 percent, lower than the Government-announced target of 4.0-5.0 percent.

- Based on the new CPI series released by the National Statistics Office (NSO) using 2000 as the reference or base year, inflation remained at 4.2 percent in April 2004, bringing the average inflation for the first four months to 4.1 percent.

- Meanwhile, core inflation, defined as CPI inflation after excluding food and energy items, increased to 4.3 percent in April from 4.0 percent in

* The highlights of the discussions of the 6 May 2004 Monetary Board meeting were approved by the Monetary Board during its meeting held on 3 June 2004.

[1] The Advisory Committee is composed of the Governor of the BSP as Chairman and four members, namely the Deputy Governor for the Banking Services Sector, Research and Treasury, the Deputy Governor for Supervision and Examination Sector, the Assistant Governor, In-Charge of Research and the Director of the Treasury Department. The 6 May 2004 meeting of the Monetary Board—the 5th monetary policy meeting for 2004—followed the Advisory Committee meeting held on 3 May 2004.

the previous month (1994=100). Similarly, the 2000-based core inflation edged up to 4.7 percent in April from 4.6 percent in March.

- Forecasts generated by the BSP inflation forecasting models indicated a slight uptrend in the 2004-2005 inflation, broadly tracking the government-announced target of 4.0-5.0 percent. The higher inflation is in line with expectations of improvements in real sector activity and the emergence of some cost-side risks.

- Selected indicators of demand showed steady yet subdued improvements. Some soft spots in the domestic economy remain as indicated by the still fairly high unemployment rate and sizable level of underutilized resources.

  - The value of production index (VAPI) for manufacturing grew for the third consecutive month in February 2004 by 4.8 percent following the 0.8 percent contraction reported in November 2003. However, the February growth rate was slower than the 5.5 percent growth rate registered a month ago. Meanwhile, the volume of production index (VOPI) for manufacturing was unchanged year-on-year in February as against the 0.7 percent drop in the previous month.

  - Average capacity utilization in manufacturing increased slightly to 78.5 percent in February 2004 from 78.3 percent in January, but was higher than the 76.7 percent a year ago. About 13.7 percent of the responding establishments operated at full capacity (90-100 percent) in January 2004, 48.5 percent reported operation at 70-89 percent capacity, and 37.8 percent operated below 70 percent capacity.

  - Exports posted a 7.6 percent increase in February 2004, higher than the 4.1 percent growth recorded in the previous month as well as the 6.1 percent growth posted a year ago. This brought the January-February 2004 exports annual growth to 5.8 percent.

  - Total merchandise imports reported by the NSO continued to expand for the fifth consecutive month but at a decelerated pace of 6.3 percent in February 2004 from 9.0 percent in January 2004 and from 21.4 percent a year ago.

  - Passenger car sales continued to post double-digit year-on-year growth rates for six straight months at a hefty 86.3 percent based on March 2004 preliminary data.

- Registered energy sales by the Manila Electric Company (Meralco) increased by 7.8 percent year-on-year in March 2004 from 6.2 percent in February.

▪ The favorable outlook for agricultural production should help ensure stable food prices and offset, in part, the possible cost-push pressures on inflation. The potential cost-side risks to inflation could come from the observed uptrend in world oil prices, the resulting adjustment in transport fares and the possible increases in user charges in the utility sector.

- The outlook for agricultural production remained positive consistent with expectations of normal weather conditions and continued implementation of government programs to assist the agricultural sector. The Bureau of Agricultural Statistics (BAS) forecasted *palay* production to increase by 10.8 percent in the first quarter and by 8.7 percent in the second quarter of the year. Meanwhile, corn production is estimated to rise by 12.5 percent and 8.3 percent in the first and second quarters of the year, respectively. In turn, robust agricultural production should help foster stable food prices, going forward.

- The international price of Dubai crude oil increased in April following reaffirmation of an oil production cut by the Organization of Oil Exporting Countries (OPEC) effective 1 April 2004. The rising hostilities in the Middle East, which could threaten the stability of oil supply, also contributed to the upward pressure in world oil prices. In the domestic market, pump prices of gasoline and other fuel products increased to reflect the higher world crude oil prices in the previous month. These developments led to the adjustment in the minimum fare for the regulated transport sector.

- There are anticipated price increases in the utilities sector, given that Meralco has filed a petition with the Energy Regulatory Commission (ERC) for an adjustment in its generation charge. Moreover, the ERC has also approved an increase in the Incremental Currency Exchange Rate Adjustment (ICERA) of the National Power Corporation (NPC).

▪ In the financial sector, the modest growth in domestic liquidity was accompanied by relatively weak bank lending. Meanwhile, nominal interest rates softened slightly in April as political uncertainties eased as reports showed increasing lead of the incumbent President in the electoral polls. This led to a narrowing of the margins between domestic interest rates and foreign market rates.

- Domestic liquidity (M3) grew by 4.8 percent (revised) year-on-year in March 2004, up from 4.4 percent in January and February.

- The loans outstanding of commercial banks declined by 1.5 percent year-on-year as of end-February 2004 following a minimal 0.8 percent rise in the previous month.

- The yield for the bellwether 91-day T-bill eased during the 26 April 2004 to 7.161 percent from the 15 March 2004 auction rate of 7.616 percent. The decline in nominal interest rates along with the recovery in the demand for government securities in April could be attributed, in part, to easing concerns over domestic political conditions.

- The peso strengthened in April, buoyed by the seasonal increase in inflows from OFW remittances in time for the school opening in June and the decision of a large US pension fund, the California Employees Retirement System (Calpers) to keep the Philippines in its list of investment sites. The peso appreciated by about 41 centavos to average ₱55.89/US$1 for the period 1-30 April 2004 from its March 2004 average of ₱56.30/US$1.

- In the fiscal sector, the budget deficit of the National Government for the first three months of 2004 reached ₱56.8 billion. This level was lower than the program for the first quarter and the deficit for the same period in 2003, both amounting to ₱58.9 billion.

- Global economic recovery has increasingly become well established as reflected in the vigorous upturn in industrial production and business investment, accompanied by marked improvements in business and consumer confidence for most regions in the beginning of 2004. However, global imbalances remain, such as the large current account deficit of the US as against large surpluses elsewhere and significant fiscal deficits in many industrial and emerging economies.

  - The strong pick up of US economy has gained further momentum in the first quarter of 2004. Household spending continued to move up while improvement in business activity has become more widespread. At the same time, labor market conditions somehow strengthened suggesting that the missing piece in the US economic recovery has been gradually falling into place.

- In the euro area, the strong external demand, rising corporate profits and sharp pick-up in fixed investment underpinned the observed growth. While these factors pointed to an overall positive outlook for the economy, uncertainties related to weak domestic demand and sluggish labor market conditions suggest continued weak spots in the euro area economic activity.

- In the UK, latest indicators on employment, consumption spending and external trade supported the view that the British economy was poised to grow above trend.

- Japan's economic recovery continued to gain momentum, boosted by strong export performance and growing business fixed investment.

- Amid sustained indications of stronger economic activity, monetary authorities in the US, the UK, Japan, and although at a less brisk pace—the euro area—kept their monetary policy settings unchanged during the latest policy meetings. In its monetary policy statement on 4 May 2004, the Federal Open Market Committee (FOMC) noted that "with inflation low and resource use slack, policy accommodation can be removed at a pace that is likely to be measured."[2] This hinted that the US Federal Reserve is not likely to raise the federal funds target immediately.

II. Review of the Monetary Policy Stance

- Based on the information provided by the Advisory Committee, the members of the Monetary Board noted that there has been no significant change in either the inflation outlook or in prevailing macroeconomic and financial conditions since the previous assessment of the policy stance by the Monetary Board on 15 April 2004.

- At the same time, the members of the Monetary Board expressed the view that the continued evidence of double-digit unemployment, spare manufacturing capacity, decline in bank lending and tepid export growth over the past several quarters indicated that significant demand-driven pressures on consumer prices would not likely materialize in the near term.

[2] Federal Reserve Press Release, 4 May 2004

- Meanwhile, the Monetary Board's assessment of developments in the macroeconomy showed that cost-side factors—notably transport fares, utility charges, labor costs, fuel costs and the dollar cost of imports—remained the principal source of risk to the inflation outlook.

- The Advisory Committee presented estimates of the impact of the various cost-side risks to the average annual inflation in 2004 and 2005.

- In the short term, monetary authorities believed that the economy could still face inflation risks from sentiment-driven volatile movements in the nominal exchange rate. They noted that the volatility in the foreign exchange market could be linked in part, to the possible resurgence of concerns over the political environment and the sustainability of the recent gains in tracking the fiscal deficit target towards fiscal consolidation over the medium term. Thus, the members of the Monetary Board stressed the importance of continuously monitoring the developments and trends in the financial sector as well as in the real sector.

- Overall, the members of the Monetary Board were of the view that the outlook for inflation remained to be manageable over the near term relative to the Government's target of 4-5 percent in 2004. At the same time, the Monetary Board underscored the need to monitor closely the emerging risks to the inflation outlook over the policy horizon.

III. Monetary Policy Decision

- After an assessment of the balance of risks to inflation and the evidence that have been made available since the last meeting on monetary policy presented by the Advisory Committee, the Monetary Board approved unanimously the following policy measures:

    a. Maintain the BSP's policy rates at the current levels of 6.75 percent for the overnight RRP rate and 9.0 percent for the overnight RP rate;

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

    c. Maintain the current reserve requirement ratios.

The next meeting of the Monetary Board to discuss the monetary policy setting was scheduled on 3 June 2004.