



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON  
MONETARY POLICY ISSUES HELD ON 28 AUGUST 2008<sup>1</sup>**

**I. Monetary Policy Decision**

During the meeting, the Monetary Board decided to adjust the current monetary policy settings based on the discussions on the emerging inflation outlook and the balance of risks to the inflation outlook:

- a) Raise the BSP's policy interest rates by 25 basis points to 6.00 percent for the overnight RRP (borrowing) rate and 8.00 percent for the overnight RP (lending) rate;
- b) Adjust accordingly the current interest rates on term RRP, RPs and SDAs; and
- c) Maintain the current reserve requirement ratios.

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

- The members of the Monetary Board discussed the global scenario, focusing mainly on the easing trends in oil and food prices, which, in previous inflation episodes, were the major factors driving inflation. The Board noted that the easing of oil and food prices could have a considerable impact on the inflation outlook in the Philippines.
- However, while global commodity prices have started to ease, it may take some time before the downward impact on inflation could alleviate price pressures. World oil prices are projected to remain volatile and the surge in non-oil commodity prices may take longer than usual to unwind because of tight supply and demand conditions.

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<sup>1</sup> 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 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 Supervision and Examination Sector, the Managing Director of the Treasury Department, and the Managing Director of the Monetary Policy Sub-sector. The highlights of the discussions of the 28 August 2008 meeting were approved by the Monetary Board during its regular meeting held on 11 September 2008. The next meeting of the Monetary Board is scheduled on 9 October 2008.



## *Bangko Sentral ng Pilipinas*

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- In the discussion of the inflation outlook, the members noted that the latest forecasts remained high and continued to show above-target inflation for 2009 as well as in 2008.
- Given the inflation outlook, the Board agreed that a further monetary policy tightening is necessary due to the following reasons:
  - To bring inflation closer to the target and stabilize inflation at a low level over the policy horizon. Considering the lags in monetary policy, the decision to move at this time will have an important bearing on inflation for 2009;
  - To anchor inflation expectations. The business expectations survey for the 3<sup>rd</sup> quarter of 2008 indicates that more business respondents expect inflation to increase. Consensus inflation forecasts also indicate higher inflation numbers for both 2008 and 2009;
  - To bring real interest rates closer to positive territory; and
  - To address the risk that supply-side-driven pressures will continue to feed into demand, as core inflation remains significantly high and is still above the headline inflation target for 2008.
- The Monetary Board decided on a 25-basis point increase in the policy rate given the following considerations:
  - While the inflation forecasts continue to reflect elevated levels, these have moderated compared to the July forecasts, reflecting easing oil and food prices;
  - Inflation may be nearing its peak earlier than expected; and
  - The move reflects the BSP's anti-inflation resolve and improving inflation outlook, where forecasts are lower and assumptions are increasingly becoming more benign.
- The Monetary Board's view is that the growth outlook remains respectable. The economy has enough buoyancy to absorb another rate hike, which is aimed at effective inflation management. This, in turn, will be supportive of continued economic growth over the intermediate and long term.



### **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 climbed to 12.2 percent year-on-year in July, bringing the inflation rate to its highest level since 1991. Core inflation, on the other hand, was slightly down at 6.3 percent in July from 6.6 percent in June.
- The Board also paid particular attention to regional inflation trends, and noted that inflation slowed down in the National Capital Region (NCR) while it went up in areas outside NCR, mainly because of transport costs.

#### **B. Inflation Expectations**

- The Board noted that recent surveys show more respondents expecting inflation to move up:
  - Preliminary results of the latest BES for Q3 2008 indicated that the number of respondents who anticipate inflation to move up in Q3 2008 and Q4 2008 has increased.
  - Similarly, results of the latest CES for Q2 2008 showed that households nationwide expect an increase in the prices of goods and services over the next 12 months.
  - Results of the BSP's Q2 2008 survey of private sector economists/analysts showed higher inflation forecasts for both 2008 and 2009.
  - The Asia Pacific Consensus Forecasts for Philippine inflation also showed rising expectations as of August 2008 relative to the previous month.

#### **C. Demand conditions**

The Board observed that latest indicators suggest a “cooling” of demand conditions, although demand remained solid:

- GDP grew at a slower rate of 4.6 percent in Q2 2008 compared to the growth posted in the previous quarter and the comparable period last year.



- Monthly NSO data showed merchandise imports were higher at 12.7 percent in June compared to their month- and year-ago growth rates of 10.9 percent and 3.8 percent growth, respectively. Meanwhile, exports registered an 8.3 percent growth in June, an acceleration from their month- and year-ago growth of 3.2 percent and 2.3 percent, respectively.
- Selected demand indicators suggest a slight moderation in demand conditions.
  - Residential vacancy rates in the Makati CBD increased in Q1 2008 relative to a year ago as did office vacancy rates. Meanwhile, Makati CBD data from Jones Lang La Salle in Q1 2008 showed year-on-year increases in office and residential rents of around 18.2 percent and 10.9 percent (in peso terms), respectively.
  - Vehicle sales generally improved in July, boosted by fleet account sales and promotional offers.
  - Year-on-year energy sales of Meralco dipped by 1.0 percent in June, a reversal of the 5.4 percent growth recorded in the same month a year ago. Meanwhile, first semester energy sales grew although at a slower rate of 1.9 percent in the first semester compared to the 4.2 percent growth registered in the same period last year.
  - Appliance sales increased by 17.4 percent year-on-year in June, higher than the 9.7 percent growth a year ago. However, year-to-date growth in appliance sales was lower at 9.0 percent compared to 11.0 percent in the comparable period last year.
  - Average capacity utilization in manufacturing at 80.9 percent in June 2008 was unchanged from its (revised) rate in May but indicated a gradual uptrend starting January this year.
  - The value of production index (VAPI) grew lower at 9.3 percent year-on-year in June 2008 after growing at (revised) 10.6 percent in May 2008. Likewise, the volume of production index (VOPI) grew slower year-on-year in June 2008 at 5.1 percent from the (revised) 7.9 percent growth in May 2008.
- Preliminary results of the Q3 Business Expectations Survey (BES) show business sentiment turning negative for Q3 but optimistic in Q4.
- The Consumer Expectations Survey (CES) results showed a decline in consumer confidence in Q2 2008.



- Wage and COLA adjustments increased in all regions in 2008 by an average of ₱14.85 in the daily compensation of workers nationwide.

## **D. Supply-side indicators**

### Developments in Agriculture

- Latest data from the Bureau of Agricultural Statistics (BAS) showed that agriculture grew by 4.7 percent in the first half of 2008 from 3.7 percent in the same period a year ago.
- The average retail prices of commercial rice have declined since the second week of July. Prices of pork products generally moved downward in July as production rose in Central Luzon and Bicol Region. Meanwhile, prices of poultry products increased during the same period because of low supply due in part to unfavorable weather conditions brought by three typhoons during the month. Prices of beef products were steady in July.
- International cereal prices declined in July, but are expected to remain high at below the peaks of 2007 and 2008 season.

### Oil Price Developments

- Dubai crude oil prices eased starting in the second half of July up to mid-August due mainly to lower US demand and larger-than-expected rise in the US crude and gasoline reserves. However, the average price of Dubai crude was higher for the whole month of July due to continued supply concerns, strong oil demand from emerging markets, and the weak US dollar. Latest estimated futures prices of Dubai crude oil are lower for 2008 and 2009.
- The import tariff on specific crude and refined petroleum products remained at zero in August 2008. Oil companies again reduced the domestic pump prices of most petroleum products on 23 August due to softening oil prices in the world market.
- In the transport sector, the Land Transportation Franchising and Regulatory Board (LTFRB) implemented the increase in transport fares in July. It was also reported that some bus and jeepney operators deferred their subsequent petitions for a provisional fare increase due to the reduction in the domestic pump prices of petroleum products.



## Developments in the Utilities Sector

- Electricity rates in the Meralco franchise area were slightly lower in June due to lower National Power Corporation (NPC) rates. However, the court's decision not to grant a temporary restraining order (TRO) on the implementation of the Energy Regulatory Commission's (ERC) order on the alleged 'price manipulation' in the Wholesale Electricity Spot Market (WESM) is expected to result in higher rates in the Luzon grid.
- On water rates, the Metropolitan Waterworks and Sewerage System-Regulatory Office (MWSS-RO) approved a lower discount under the foreign currency differential adjustments (FCDA) for Q3 2008.
- On the telecommunications sector, the National Telecommunications Commission (NTC) will continue to push for lower interconnection charges to bring down the cost of short message service (SMS) and voice calls.

## **E. Financial Market Developments**

- Inflation concerns, risk aversion, and economic uncertainty in the US continued to dictate financial market sentiments.

## Market Interest Rates

- Market interest rates increased in July, reflecting market participants' expectations of higher BSP policy rates. Consequently, interest rate differentials between RP market interest rates and comparable foreign rates widened, while the spread of lending rates over Treasury bill rates narrowed. Meanwhile, real lending rates remained negative with the higher July inflation outturn.

## Stock Market

- After a semester of lackluster trading, market activity continued to be bearish in July but indicated an uptrend, albeit within narrow range, towards the second week of August. As of 19 August, the PSEi declined on a year-to-date basis by 25.7 percent.

## Foreign Exchange

- The peso appreciated slightly for the period 1–26 August 2008 at ₱44.81/US\$1. The drop in oil prices in the global market as well as expectations of further monetary tightening by the BSP buoyed up the peso in the first week of August.



- On a year-to-date basis, the peso depreciated against the US dollar by 10.3 percent to close at ₱45.995/US\$1 on 26 August 2008. Other currencies that depreciated against the US dollar were the Indian rupee, Thai baht, Korean won and Malaysian ringgit. Meanwhile, other selected Asian currencies maintained their strength against the US dollar, led by the Chinese yuan's 6.6 percent appreciation.

## Global Bond and Credit Default Spreads

- Emerging market bond yields widened over US Treasury notes as mounting concerns on global economic growth escalated amid signs of economic growth slowing in Europe.
- EMBI + Philippine spreads widened to 276 bps on 26 August from 250 bps reported in end-July and from the 177 bps average for 2007. During the same period, Philippine five-year credit default swap (CDS) showed the same trend, widening to 241 bps from 222 bps posted as of end-July and from the 136 bps average the previous year.

## **F. Balance of Payments**

- The balance of payments (BOP) for Q1 2008 yielded a surplus of US\$1.7 billion, 20.8 percent higher than the US\$1.4 billion surplus registered in the same quarter a year ago as both the current and the capital and financial accounts continued to post surpluses.

## **G. Domestic Liquidity and Credit Conditions**

- Based on the Depository Corporations Survey (DCS), the growth of domestic liquidity or M3 accelerated to 3.7 percent in May. The expansion in domestic liquidity continued to be driven by the sustained rise in net foreign assets (NFA) coupled with a slower decline in net domestic assets (NDA).
- Outstanding loans of commercial banks (including RRPBs) grew at a faster pace in May at 15.4 percent year-on-year, higher than the 10.3 percent (revised) and 7.7 percent posted in March and April, respectively.
- Capital-raising activities in the PSE continued to be weak for the period January-July 2008 as local firms are turning to the corporate bond market to raise funds.



#### **H. Fiscal developments**

- The January-July deficit of the NG reached ₱33.4 billion, 15.1 percent lower than the deficit of ₱39.4 billion incurred during the same period last year.
- The public sector external debt-to-GDP ratio in Q1 2008 was 26.1 percent of GDP, lower by 5.3 percentage points compared to the 31.4 percent posted in the comparable period last year.

#### **I. External developments**

- Inflationary pressures continue to mount around the world, particularly in emerging and developing economies. Against this background, several emerging market and developed economies have tightened policy settings recently. The central banks of Taiwan, Thailand, South Korea, Indonesia, and Pakistan hiked rates.
- Meanwhile, the Fed and the Bank of England have started to adopt a hawkish tone, but analysts believe that the Fed will not hike rates on its next policy meeting on 16 September, given the rise in the unemployment rate.