



## **HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES HELD ON 16 APRIL 2009<sup>1</sup>**

### **I. Monetary Policy Decision**

The Monetary Board decided to:

- a) Reduce the BSP's policy rates by 25 basis points to 4.50 percent for the overnight RRP (borrowing) rate and 6.50 percent for the overnight RP (lending) rate;
- b) Reduce accordingly the current interest rates on term RRP, RPs, and SDAs; and
- c) Maintain the current reserve requirement ratios.

The recommendation to reduce policy rates took into consideration the BSP's commitment to achieve medium-term price stability and its resolve to undertake policy actions that will ensure the soundness and stability of the financial system and provide cushion against continuing headwinds to economic growth.

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

- The Monetary Board noted that there was still room for an additional 25-basis-point reduction given the continued favorable inflation outlook:
  - Baseline forecasts continued to indicate that annual average inflation will fall within the target ranges for both 2009 and 2010.

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<sup>1</sup> The discussions presented herein reflect 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 the Supervision and Examination Sector, the Managing Director of the Monetary Policy Sub-Sector, and the Managing Director of the Treasury Department. The highlights of the discussions on the 16 April 2009 meeting were approved by the Monetary Board during its regular meeting held on 7 May 2009. The next meeting of the Monetary Board on monetary policy issues is scheduled on 28 May 2009.



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- Inflation expectations remained well-anchored. The results of the BSP and private sector surveys reflected stable or declining inflation expectations anchored towards the targets over the policy horizon.
- On balance, inflation risks were slightly skewed to the downside, with increasingly weaker global and domestic demand conditions and lower probability of any significant near-term recovery in commodity prices.
- However, while inflation conditions were seen as generally favorable, a prudent rate move was deemed appropriate given the upside risks to inflation stemming from the:
  - volatility in the peso-dollar exchange rate and oil prices, and
  - possible increases in utility tariffs and food prices.
- Given the expected sustained slowdown in inflationary pressures, considerable monetary stimulus in the pipeline and ample liquidity in the system, the Board decided to continue its measured pace of monetary easing. To date, the BSP has already responded aggressively since the onset of the crisis with both interest rate reductions (total of 125 basis points since December 2008) and a variety of liquidity-enhancing measures to help ensure the functioning of financial markets.
- The Board recognized that monetary policy is an important policy lever in supporting demand to minimize any further corrosive feedback stemming from weakening economic and financial conditions. Lower policy rates will help bring down the cost of borrowing and promote wider access to domestic financing and will help relieve the negative feedback loop of deleveraging. Given the background of extreme uncertainty surrounding the downturn, lowering policy rates could help support growth by encouraging spending, investment, and production.
- The Board also noted that monetary policy cannot single-handedly limit the contractionary effects of the crisis on the economy. Monetary policy should work with other government measures, including more active fiscal policy.



### **III. Recent Developments in Economic Indicators**

The Monetary Board's decision took into account recent developments in various economic indicators:

#### **A. Domestic price conditions**

- Headline inflation dropped to 6.4 percent year-on-year in March from 7.3 percent in February due mainly to lower electricity rates, price rollbacks in diesel and gasoline, recent reduction in jeepney fares, and lower year-on-year inflation for rice, meat, and miscellaneous food.
- Year-on-year core inflation was also lower in March at 5.6 percent from 6.4 percent in February.

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

- Recent surveys showed steady or declining inflation expectations:
  - The Consumer Expectations Survey (CES) for Q1 2009 showed lower inflation expectations for the next 12 months: from 8.8 percent in the previous survey to 8.6 percent.
  - Results of the Business Expectations Survey (BES) for Q1 2009 indicated that the proportion of respondents that anticipate inflation to move up in Q1 2009 has significantly decreased.
  - Results of the BSP's initial monthly (from quarterly) survey of private sector economists/analysts for March 2009 showed unchanged inflation expectations for both 2009 and 2010.
  - Meanwhile, the latest private sector consensus forecasts as of March 2009 showed unchanged inflation expectations for 2009 and slightly lower inflation expectations for 2010.

#### **C. Inflation Outlook**

- Latest baseline forecasts continued to indicate that inflation would settle within the 2009 and 2010 targets.
- Meanwhile, upside risks to inflation include: volatility in world oil prices and the exchange rate, possible increases in utility rates, and potential price pressures coming from a reduction in global cereal output in 2009 as supply responds to lower selling prices, high input costs, and tighter credit conditions.



## **D. Demand conditions**

Recent indicators suggest that aggregate demand conditions are under strong pressure as consumer spending continued to show restraint and as weaker global economic activity took its toll on exports.

- GDP posted a modest growth of 4.5 percent in Q4 2008 compared to 6.4 percent in the same quarter in the previous year and 5.0 percent in the previous quarter.
- Merchandise exports showed a record decline of 41.0 percent year-on-year in January 2009.
- Merchandise imports declined further by 34.5 percent in January 2009.
- Selected demand indicators moderated:
  - Sales of commercial vehicles, and trucks and buses declined in February while sales of passenger cars decelerated.
  - Energy sales declined by 9.9 percent year-on-year in January, pulled down by the negative growth across sectors except streetlights.
  - Average capacity utilization in manufacturing dropped markedly to 77.5 percent in January 2009, indicating a trend decline starting November 2008.
  - MISSI figures indicate slower manufacturing activity in January 2009.
  - Results of the first quarter 2009 consumer and business expectations surveys show sustained bearish sentiment.

## **E. Supply-side indicators**

### Developments in Agriculture

- Average retail prices of rice declined beginning in the fourth week of March 2009 due to the increase in supply following the summer harvest season.
- FAO's report on Crop Prospects and Food Situation suggests an overall decline in world cereal production in 2009 from the previous



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year's record output due to a decline in the area planted to cereals of major exporters, adverse weather conditions, and high input costs.

- Meanwhile, with the risks to the outlook for global GDP growth weighted heavily on the downside for 2009 and 2010, the expected future path for global commodity prices will be lower for the same period compared to 2008.

### Oil Price Developments

- The spot price of Dubai crude was higher by US\$2.50 per barrel in March 2009 at US\$45.59 per barrel from US\$43.09 per barrel in February. Prices were influenced by expectations that recent moves by the US government to revive the economy would boost demand for oil. The weak US dollar also gave support to oil prices.
- Notwithstanding the recent boost in expectations, given the current global economic condition, the Energy Information Administration (EIA) still projects that annual world oil consumption would decline by almost 1.4 million barrels per day (bbl/d) in 2009. Likewise, both OPEC<sup>2</sup> and the International Energy Agency (IEA) estimated that global oil demand for 2009 will fall by 1.0 million bbl/d and 1.2 million bbl/d, respectively.<sup>3</sup>
- Prices in the futures market also increased. The price of Brent crude oil for May 2009 deliveries rose to US\$52.75 per barrel on 2 April 2009, higher by US\$9.59 per barrel or 22.2 percent relative to its month-ago level of US\$43.16 per barrel.
- Oil companies raised the prices of petroleum products on 14 April 2009. This brings the year-to-date net adjustment in the prices of gasoline products to ₱6.00 for unleaded gasoline, - ₱2.44 for diesel, - ₱4.24 for kerosene, and ₱2.51 for LPG.
- In the transport sector, the National Council for Consumer Protection (NCCP) filed a petition with the Land Transportation and Franchising Regulatory Board (LTFRB) requesting the reduction in bus and jeepney fares.

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<sup>2</sup> OPEC Monthly Oil Market Report, March 2009, [www.opec.org](http://www.opec.org)

<sup>3</sup> International Energy Agency, Oil Market Report Highlights, 13 March 2009, [www.iea.org](http://www.iea.org)



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## Developments in the Utilities Sector

- Transco's petition before the ERC to recover ₱1.8-billion worth of damages incurred from the series of super typhoons in 2006 was approved. This allowed Transco to collect force majeure pass-through amounts from its Luzon and Visayas customers in 2009.
- Effective March 2009, Meralco implemented the ₱0.040/kwh refund under the CERA. This offset the ₱0.025/kwh increase in generation charge and resulted in a net reduction of ₱0.015/kwh in the March billing. The higher cost of supply from both the Wholesale Electricity Spot Market (WESM) and the NPC due to warmer weather caused the slight increase in generation charge in March.

## **F. Financial Market Developments**

### Government Securities Market

- Relative to their 31 March 2009 levels, the yields and term spreads (secondary market yields of GS net of overnight reverse repurchase or RRP rates) generally decreased across all tenors on 13 April 2009. The yield curve shifted downward as bond prices increased, on expectations that the BSP will cut its policy rates further to support economic growth during its 16 April 2009 Monetary Board policy meeting. In addition, positive sentiments also continued to contribute to lower yields as market participants reacted to the news that the BSP's average 2009 inflation forecast has declined to 3.5 percent from 3.9 percent.

### Interest Rate and Interest Rate Differentials

- Policy interest rate differentials tightened in March 2009, while improving sovereign risk spreads led to positive risk-adjusted differentials in February and March. The differential between the BSP policy rate and the US federal funds rate narrowed in March 2009, following the BSP's 25-basis-point cut in its policy rate.
- Meanwhile, the after-tax differentials between the domestic and foreign interest rates narrowed in March 2009, and real lending rates declined as the banks' average lending rate declined steadily beginning January 2009 to reach 8.4 percent in March.

### Stock Market

- The Philippine Stock Exchange Index (PSEi) gained further ground in March and early April. In early April, the PSEi sustained an uptrend for five consecutive trading days starting 1 April to 8 April 2009 to close at



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2,072.81 index points. This was way above the 2,000 psychological resistance level, reflecting investors' optimism on account of positive global developments.

## Foreign Exchange

- Despite the reduction in the BSP's key interest rates on 5 March 2009,<sup>4</sup> the peso remained broadly steady as investors gained some appetite for regional stocks as the US dollar weakened on market fears that the plan of the Federal Reserve to buy US\$300 billion worth of US Treasuries could crowd out global markets. However, lingering market concerns on the health of the global financial system, the expected slowdown in capital inflows and OF remittances, and the contraction in exports earnings exerted pressures on the peso.
- In the first half of April 2009, the peso, together with other Asian currencies, strengthened following the rally in the region's equity markets on renewed optimism over signs of improvement in the US economy based on firmer US factory and home sales data. However, on a year-to-date basis, the peso depreciated against the US dollar by 0.3 percent at the close of trading on 14 April 2009.<sup>5</sup>

## Global Bond and Credit Default Swap Spreads

- For the period 3-14 April 2009, debt spreads continued to narrow following weeks of general tightening. The positive market sentiment was buoyed by speculation that Asian economies will recover faster than investors expected as governments in the region boosted spending and reduced borrowings. The announcement of the Group of 20 policy makers that they will triple the amount the IMF can lend to countries likewise provided some relief to the market.

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

- Domestic liquidity or M3 grew by 14.6 percent year-on-year in February, a slowdown from the previous month's growth of 16.1 percent. However, this was higher than the 6.8 percent expansion recorded during the same month a year ago. On a monthly basis,

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<sup>4</sup> The BSP has reduced its policy rates three times from December 2008 given an easing inflation outlook. On 18 December 2008 and 29 January 2009, the BSP reduced its key policy rates by 50 basis points in each occasion while on 5 March 2009, the BSP's key policy rates were reduced by 25 basis points. These policy reductions brought the overnight borrowing or reverse repurchase (RRP) rate and the overnight lending or repurchase (RP) rate to 4.75 percent and 6.75 percent, respectively.

<sup>5</sup> Based on the last done deal in the afternoon.



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seasonally-adjusted M3 declined further by 0.8 percent in February, compared to the 0.4 percent (revised) deceleration posted in the previous month.

- Meanwhile, bank lending activity continued to expand in February. Outstanding loans of commercial banks including reverse repurchase agreements (RRPs) increased by 22.5 percent year-on-year, an acceleration from the previous month's growth of 18.8 percent. Net of RRP placements with the BSP, lending also increased by 22.6 percent year-on-year in February, slightly slower compared to the 24.5 percent expansion in the previous month.
- Capital-raising activities in the PSE remained weak in the period January-March 2009 as companies pushed back plans of selling shares due to unfavorable market conditions. Meanwhile, corporate bond issuances increased during the first three months of 2009.

## **H. Fiscal developments**

- The January to February 2009 deficit of the National Government reached ₱67.0 billion, higher than the deficit of ₱32.9 billion incurred during the same period last year.

## **I. External developments**

- Available indicators over the past three months signaled a deeper and more widespread downturn in the global economy. Notwithstanding the decisive policy measures across the globe, the economic toll of the sharp global downturn has been mounting and has now affected advanced, emerging, and developing economies.
- Amid the resulting weakening in external demand and the possible rise in protectionist sentiments, global trade in 2009 is expected to record the largest decline in 80 years. The financial crisis, therefore, has long-term implications not only for the US, the Euro area and other advanced economies, but for developing economies as well.
- On the upside, inflationary pressures continue to ease, owing to sharply declining commodity prices and weak global demand, and basic consumption spending has remained strong in most, if not all, of Asia.
- However, during the second week of April, markets have gradually turned optimistic on the possibility that the downtrend may be nearing the bottom following tentative but positive developments in the US.