



**HIGHLIGHTS OF THE MEETING OF THE MONETARY BOARD ON MONETARY POLICY ISSUES
HELD ON 1 DECEMBER 2011¹**

I. Monetary Policy Decision

The Monetary Board (MB) decided to:

- a) Maintain the BSP's policy rates at 4.5 percent for the overnight RRP (borrowing) rate and 6.5 percent for the overnight RP (lending) rate;
- b) Maintain the current interest rates on term RRPs, RPs, and special deposit accounts (SDAs); and
- c) Maintain the current reserve requirement ratios.

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

- The MB's decision is based on its assessment that the inflation outlook continues to be manageable, with within-target headline inflation and well-contained inflation expectations. Latest baseline forecasts indicate that the annual inflation rates for 2011-2013 are likely to fall within the 3-5 percent target range.
- The MB also took into account the data showing subdued domestic economic activity in the third quarter, weak global economic activity and continued concerns over Europe's sovereign and banking sectors. Notwithstanding the resilience of domestic private consumption, growth of aggregate demand remained modest due to strong external headwinds and lower-than-program fiscal spending.
- The MB considered the risks surrounding the inflation outlook to remain tilted to the downside. Weak global economic recovery is likely to be reflected in easing global demand and commodity price pressures. At the same time, the MB also noted that some upside risks to prices remain, including potential increases in liquidity due to sustained capital inflows.

¹ The discussions presented reflect the assessment made by the Monetary Board based on the information available at the time of the policy meeting. A comprehensive set of economic information was provided by the Technical Secretariat of the Advisory Committee (AC). The AC is composed of the Governor of the BSP as Chairman and four members, namely: the Deputy Governor of the Monetary Stability Sector, the Deputy Governor of the Supervision and Examination Sector, the Assistant Governor of the Monetary Policy Sub-Sector, and the Assistant Governor of the Treasury Department. The highlights of the discussions on the 1 December 2011 meeting were approved by the Monetary Board during its regular meeting held on 15 December 2011. The next meeting of the Monetary Board on monetary policy issues is scheduled on 19 January 2012.

III. Recent Developments and Inflation Outlook

The MB considered the following developments in coming up with its policy decision:

A. Domestic price conditions

- Year-on-year headline inflation rose in October, driven mainly by higher inflation for food, particularly fruits and vegetables. Other indicators also reflected an uptrend, including the following: the year-on-year core inflation, the three alternative measures of core inflation estimated by the BSP, and the number and weight of above-threshold items. Meanwhile, the seasonally-adjusted month-on-month headline and core inflation were unchanged.
- Using the 2000-based CPI series, core inflation, which excludes some food and energy items to measure generalized price pressures, edged higher to 3.9 percent in October compared with 3.5 percent in September.

B. Inflation expectations

- Inflation expectations continue to be target range-bound. However, latest results of the BSP's survey of private sector economists and the AP consensus survey indicate a slight increase in the mean inflation forecast for 2011, taking into account the October inflation outturn.

C. Inflation outlook

- Despite higher baseline forecasts, headline inflation is still projected to settle within the targeted range of 3-5 percent for 2011-2013. The inflation forecast trajectory was slightly higher relative to that for the previous policy meeting as actual inflation for October settled close to the upper end of the forecast range for the month. Higher oil prices also contributed to higher inflation forecasts.
- Nevertheless, inflation is expected to have peaked in October as base effects gradually drop out, and assuming that there would be no new adverse supply shocks toward year-end. The year-to-date averages of 4.5 percent (2000-base year) and 4.8 percent (2006-base year) are both within the inflation target range for 2011.
- Meanwhile, the balance of risks to the inflation outlook remains slightly tilted to the downside as inflation pressures are expected to be held back by slower global economic recovery. Global commodity prices, while still at high levels, have generally declined over recent months. Meanwhile, the upside risks to inflation could emanate from the liquidity impact of strong capital inflows.

D. Demand conditions

- The Philippine economy grew at a modest pace of 3.2 percent in the third quarter, bringing cumulative GDP growth to 3.6 percent year-on-year, which is lower than the government's target of 4.5 percent for 2011. A silver lining, however, has been the resilience in private consumption which continued to advance strongly, indicating the strength of consumer spending despite strong external headwinds and lower-than-program fiscal spending.

E. Supply-side indicators

Developments in Agriculture

- The Bureau of Agricultural Statistics (BAS) revised downwards its forecast for 2011 palay production, reflecting the adverse effects of typhoons Mina, Juaning, Pedring and Quiel on standing crops. However, *palay* and corn production for 2011 are still expected to exceed their 2010 levels due to significant gains recorded in the first half which more than offset the crop damages triggered by the typhoons in the second half.
- Meanwhile, the MB noted the increase in export prices in recent months, driven by increased rice-support program in Thailand and flooding in some Asian countries, with Thailand being the worst hit. Given this supply outlook, the MB was of the view that timely government importation may help to augment domestic supply.

Oil Price Developments

- While Dubai crude prices recovered in November, oil prices have continued to trade below US\$110 a barrel. Over the near term, the outlook for crude oil prices remains generally weighted towards the downside in line with the expected slower pace of global economic activity.

Developments in the Utilities Sector

- Electricity rates of Manila Electric Co. (Meralco) increased in November due to an increase in its power supply cost. Meralco noted that the increase in prices in the electricity spot market was brought about by the shutdown of the Malampaya natural gas pipeline for scheduled maintenance.

F. Financial market developments

- At the 28 November 2011 auction, the Auction Committee rejected all bids for the 91-day, 182-day, and 364-day T-bills as investors posted very high bids, reflecting in part the market's preference for longer-tenored government securities. Tenders for the 91-day T-bill reached ₱3.3 billion against the ₱3.0 billion offering while the 182-day and 364-day T-bills were undersubscribed, with tenders amounting to ₱2.9

billion each, compared to the offered amounts of ₱3.0 billion and ₱4.0 billion, respectively.

- In November, overall market sentiment remained cautious on lingering fears about the European debt crisis. Contagion fears increased as markets began to reckon with the possibility that the euro zone's crisis would spill over to economies that had been previously considered relatively free from debt problems. As a result, the turmoil has affected Europe's major economies as yields on bonds issued by Italy, France, Netherlands, and Austria soared to historic highs, which, in turn, translated to a widening of debt spreads of emerging market assets.
- Nonetheless, Asian markets recovered slightly in November following the European Central Bank's (ECB) decision to cut its policy rates to avoid a possible recession, although the peso continued to be weighed down by cautious sentiment.

G. Domestic liquidity and credit conditions

- Domestic liquidity or M3 grew at a slower pace of 7.4 percent in September 2011 from 9.4 percent in August 2011. Higher growth in net foreign assets (NFA) continued to fuel liquidity expansion, but net domestic assets declined further in September, with the faster expansion in the net other items account (which includes, among other things, revaluation and capital and reserve accounts as well as SDA placements of trust entities). The increase in net other items account, which dragged M3 growth in September was due to the rapid expansion in the placements of trust institutions in the SDA window. Meanwhile, net domestic credits expanded further by 9.6 percent as credits extended to the private sector increased, consistent with the continued strong growth of bank lending to firms and households. However, credits extended to the public sector declined anew with the steady increase in National Government (NG) deposits with the BSP and other banks coupled with the decrease in net credits extended to the NG.
- Bank lending growth, net of banks' reverse repurchase (RRP) placements with the BSP, accelerated in September to 21.7 percent from the previous month's expansion of 19.8 percent. Commercial banks' loans have been growing steadily at double-digit growth rates since January 2011. The growth in loans for production activities—which comprised more than four-fifths of commercial banks' total loan portfolio—grew by 22.9 percent in September from 21.5 percent a month earlier. Meanwhile, the growth in consumer loans accelerated to 17.9 percent in September from 13.4 percent in August due mainly to the expansion in credit card receivables, auto loans, and other loans for household consumption.
- Corporate issuers continue to tap the equity and bond markets. Capital-raising activities in the Philippine Stock Exchange reached ₱89 billion for the period January-October 2011, higher by 33 percent from the previous year's level of ₱67 billion. Corporate bond issuances for the same period also increased by ₱1 billion to ₱160 billion.

H. Fiscal developments

- The fiscal deficit in January-September 2011 was ₪53.0 billion, 79.6 percent lower than the ₪259.8 billion deficit incurred during the same period last year. The lower deficit figure is attributed to increased revenue collections (13.7 percent year-on-year) coupled with lower government spending (-7.3 percent year-on-year).

I. External developments

- Advanced economies are expected to continue to struggle to prevent their fiscal imbalances from spilling over to global financial markets, while emerging and developing economies grapple with weaker external demand and overheating pressures.
- Going forward, the MB noted that there is a need to continue to monitor the strength of external demand, especially amid signs of increasing downside risks to the global economy. Economic conditions in Europe could weaken further in the period ahead, posing risks to external demand as well as to financial markets through risk aversion. While European policymakers had made progress in their response to the sovereign debt and banking problems over the past month, confidence remains fragile as leaders have yet to decide on the implementation mechanics of the plan. As a result, the risks to the global economy still appear to lie predominantly on the downside.