ISSN 1655-5104

INFLATION REPORT
2ND QUARTER 2017

BANGKO SENTRAL NG PILIPINAS

Foreword

The primary objective of monetary policy is to promote a low and stable rate of inflation conducive to a balanced and sustainable economic growth. The adoption in January 2002 of the inflation targeting framework for monetary policy was aimed at helping to fulfill this objective.

One of the key features of inflation targeting is greater transparency, which means greater disclosure and communication by the BSP of its policy actions and decisions. This Inflation Report is published by the BSP as part of its transparency mechanisms under inflation targeting. The objectives of this Inflation Report are: (i) to identify the risks to price stability and discuss their implications for monetary policy; and (ii) to document the economic analysis behind the formulation of monetary policy and convey to the public the overall thinking behind the BSP's decisions on monetary policy. The broad aim is to make monetary policy easier for the public to understand and enable them to better monitor the BSP's commitment to the inflation target, thereby helping both in anchoring inflation expectations and encouraging informed debate on monetary policy issues.

The government's target for annual headline inflation under the inflation targeting framework has been set at 3.0 percent ± 1.0 percentage point (ppt) for 2017-2020 by the Development Budget Coordination Committee (DBCC). This is consistent with the desired disinflation path over the medium term, favorable trends in inflation dynamics, and expected higher capacity of the economy for growth under a low inflation environment.

The report is published on a quarterly basis, presenting an analysis of the various factors affecting inflation. These include recent price and cost developments, inflation expectations, prospects for aggregate demand and output, labor market conditions, monetary and financial market conditions, fiscal developments, and the international environment. An entire section is devoted to a discussion of monetary policy developments in the most recent quarter, while a separate section provides a comprehensive analysis of the BSP's view of the inflation outlook for the policy horizon.

The Monetary Board approved this Inflation Report at its meeting on 13 July 2017.

NESTOR A. ESPENILLA, JR.
Governor

The Monetary Policy of the Bangko Sentral ng Pilipinas

The BSP Mandate

The BSP's main responsibility is to formulate and implement policy in the areas of money, banking and credit, with the primary objective of maintaining stable prices conducive to a balanced and sustainable economic growth in the Philippines. The BSP also aims to promote and preserve monetary stability and the convertibility of the national currency.

Monetary Policy Instruments

The BSP's primary monetary policy instrument is its overnight reverse repurchase (RRP) or borrowing rate. Other instruments to implement the desired monetary policy stance to achieve the inflation target include (a) increasing/decreasing the reserve requirement; (b) conducting auctions for the term deposit facility (TDF);[1] (c) adjusting the rediscount rate on loans extended to banking institutions on a short-term basis against eligible collateral of banks' borrowers; and (d) outright sales/purchases of the BSP's holdings of government securities.

Policy Target

The BSP's target for monetary policy uses the Consumer Price Index (CPI) or headline inflation rate, which is compiled and released to the public by the National Statistics Office (NSO). The policy target is set by the Development Budget Coordination Committee (DBCC)[2] in consultation with the BSP. The inflation target for 2017-2020 is 3.0 percent ± 1.0 ppt.[3]

BSP's Explanation Clauses

These are the predefined set of acceptable circumstances under which an inflation-targeting central bank may fail to achieve its inflation target. These clauses reflect the fact that there are limits to the effectiveness of monetary policy and that deviations from the inflation target may sometimes occur because of factors beyond the control of the central bank. Under the inflation targeting framework of the BSP, these exemptions include inflation pressures arising from: (a) volatility in the prices of agricultural products; (b) natural calamities or events that affect a major part of the economy; (c) volatility in the prices of oil products; and (d) significant government policy changes that directly affect prices such as changes in the tax structure, incentives, and subsidies.

[1] The TDF was introduced under the interest rate corridor system which was implemented on 3 June 2016.
[2] The DBCC, created under Executive Order (E.O.) No. 232 dated 14 May 1970, is an inter-agency committee tasked primarily to formulate the National Government's fiscal program. It is composed of the Office of the President (OP), Department of Budget and Management (DBM), National Economic and Development Authority (NEDA), and the Department of Finance (DOF). The BSP attends the Committee meetings as a resource agency.
[3] On 20 December 2016, the DBCC set an inflation target of 3 ± 1 percentage point for 2017-2018 and approved the inflation target of 3.0 percent ± 1.0 percentage point for 2019-2020 . These decisions were announced to the public on 22 December 2016.

The Monetary Board *

The powers and functions of the BSP, such as the conduct of monetary policy and the supervision over the banking system, are exercised by its Monetary Board, which has seven members appointed by the President of the Philippines. The Monetary Board holds eight (8) monetary policy meetings in a year to review and decide on the stance of monetary policy.

Chairman & Governor
Nestor A. Espenilla, Jr.

Members
Carlos G. Dominguez III
Felipe M. Medalla
Juan De Zuñiga, Jr.
Valentin A. Araneta
Peter B. Favila
Antonio S. Abacan, Jr.

The Advisory Committee **

The Advisory Committee was established as an integral part of the institutional setting for inflation targeting It is tasked to deliberate, discuss, and make recommendations on monetary policy to the Monetary Board. Like the Monetary Board, the Committee meets eight times a year but may also meet between regular meetings, whenever deemed necessary.

Chairman
Nestor A. Espenilla, Jr.
Governor

Members
Diwa C. Guinigundo
Deputy Governor
Monetary Stability Sector

Chuchi G. Fonacier
Sector-in-Charge
Supervision and Examination Sector

Ma. Ramona GDT Santiago
Assistant Governor
Treasury Department

Francisco G. Dakila, Jr.
Managing Director
Monetary Policy Sub-sector

* The Monetary Board of the BSP was comprised of the following members until 30 June 2017: Amando M. Tetangco, Jr. (Governor and Chairman); Carlos G. Dominguez III; Alfredo C. Antonio; Felipe M. Medalla; Armando L. Suratos; Juan D. De Zuñiga, Jr.; and Valentin A. Araneta.

** The Advisory Committee was composed of the following members until 30 June 2017: Amando M. Tetangco. Jr. (Chairman); Diwa C. Guinigundo (Deputy Governor - Monetary Stability Sector); Nestor A. Espenilla, Jr. (Deputy Governor - Supervision and Examination Sector); Ma. Ramona GDT Santiago (Assistant Governor - Treasury Department); and Francisco G. Dakila, Jr. (Managing Director - Monetary Policy Sub-sector)

Technical Staff ***

Head
Zeno Ronald R. Abenoja
Director, Department of Economic Research

Members
Veronica B. Bayangos
Director, Center for Monetary and Financial Policy

Lorelei S. Fernandez
Chief Dealer, Treasury Department

Rosabel B. Guerrero
Director, Department of Economic Statistics

Dennis D. Lapid
Deputy Director, Department of Economic Research

Dennis M. Bautista
Deputy Director, Department of Economic Research

Ma. Mediatriz M. Boelsch
Assistant Chief Dealer, *Treasury Department*

Thea Josefina Natalia W. Santos
Deputy Director, Capital Markets Specialist Group

Jose Recon S. Tano
Director, Office of the Supervisory Policy Department

Lara Romina E. Ganapin
Bank Officer V, Department of Economic Research

Cherrie F. Ramos
Bank Officer V, Department of Economic Research

Jasmin E. Dacio
Bank Officer V, Department of Economic Research

Eduard Joseph DP Robleza
Bank Officer V, Department of Economic Research

Vanessa T. Españo
Bank Officer V, Department of Economic Research

Marites B. Oliva
Bank Officer V, Center for Monetary and Financial Policy

*** Assistant Governor Edna C. Villa of the Office of the Governor served as a member of the Technical Staff of the Advisory Committee until 31 May 2017 and is currently on her secondment to the International Monetary Fund.

2017 Schedule of Monetary Policy Meetings, Inflation Report Press Conferences and Publication of MB Highlights

2017	Advisory Committee Meeting	Monetary Board Meeting	Publication of MB Highlights	Inflation Report Press Conference
Jan			19 (Thu) (22 Dec 2016 MB)	20 (Fri) (Q4 2016 IR)
Feb	3 (Fri)	9 (Thu)		
Mar	17 (Fri)	23 (Thu)	9 (Thu) (9 Feb 2017 MB)	
Apr			20 (Thu) (23 Mar 2017 MB)	21 (Fri) (Q1 2017 IR)
May	5 (Fri)	11 (Thu)		
Jun	16 (Fri)	22 (Thu)	8 (Thu) (11 May 2017 MB)	
Jul			20 (Thu) (22 Jun 2017 MB)	21 (Fri) (Q2 2017 IR)
Aug	4 (Fri)	10 (Thu)		
Sep	15 (Fri)	21 (Thu)	7 (Thu) (10 Aug 2017 MB)	
Oct			19 (Thu) (21 Sep 2017 MB)	20 (Fri) (Q3 2017 IR)
Nov	3 (Fri)	9 (Thu)		
Dec	8 (Fri)	14 (Thu)	7 (Thu) (9 Nov 2017 MB)	

List of Acronyms, Abbreviations, and Symbols

AL	Auto Loans
BES	Business Expectations Survey
BTr	Bureau of the Treasury
CAMPI	Chamber of Automotive Manufacturers of the Philippines, Inc.
CAR	Capital Adequacy Ratio
CBD	Central Business District
CES	Consumer Expectations Survey
CDS	Credit Default Swaps
CI	Confidence Index
COV	Coefficient of Variation
CPI	Consumer Price Index
DBCC	Development Budget Coordination Committee
DOE	Department of Energy
DI	Diffusion Index
DOF	Department of Finance
EIA	US Energy Information Administration
EM	Emerging Market
EMBIG	JP Morgan Emerging Market Bond Index Global
ERC	Energy Regulatory Commission
FCDA	Foreign Currency Differential Adjustment
GDP	Gross Domestic Product
GNI	Gross National Income
GNPL	Gross Non-Performing Loan
GS	Government Securities
IEA	International Energy Agency
IMF	International Monetary Fund
IPP	Independent Power Producer
IRI	International Research Institute for Climate and Society
LFS	Labor Force Survey
LPG	Liquefied Petroleum Gas
LTFRB	Land Transportation Franchising and Regulatory Board
MB	Monetary Board
MEM	Multi-Equation Model
MERALCO	Manila Electric Company
MISSI	Monthly Integrated Survey of Selected Industries
MTP	Major Trading Partner
NBQBs	Non-Bank Financial Institutions with Quasi-Banking Functions
NEDA	National Economic and Development Authority
NEER	Nominal Effective Exchange Rate
NNPL	Net Non-Performing Loan
NFA	Net Foreign Assets; National Food Authority
NG	National Government
NGCP	National Grid Corporation of the Philippines
NPC	National Power Corporation
NPI	Net Primary Income
NPL	Non-Performing Loan
OECD	Organization for Economic Cooperation and Development
OPEC	Organization of the Petroleum Exporting Countries
OF	Overseas Filipinos
PMI	Purchasing Managers' Index
PSA	Philippine Statistical Authority; Power Supply Agreement
PSALM	Power Sector Assets and Liabilities Management Corporation
PSEi	Philippine Stock Exchange Composite Index
RBs	Rural Banks
REER	Real Effective Exchange Rate
ROP	Republic of the Philippines
RP	Repurchase
RR	Reserve Requirement
RRP	Reverse Repurchase
RWA	Risk-Weighted Asset
SDA	Special Deposit Account
SEM	Single-Equation Model
SME	Small and Medium Enterprise
SOSFM	Society of Fellows in Supply Management, Inc.
TB	Thrift Banks
TLP	Total Loan Portfolio
U/KBs	Universal and Commercial Banks
VAPI	Value of Production Index
VOPI	Volume of Production Index
WESM	Wholesale Electricity Spot Market

Contents

Overview

Headline inflation remained generally steady. The average headline inflation for Q2 2017 was at 3.1 percent, generally unchanged from the previous quarter's 3.2 percent but higher than the 1.5 percent a year ago. This brought the year-to-date average to 3.1 percent, within the National Government's announced target range of 3.0 percent ± 1.0 percentage point for 2017. Both food and non-food inflation during the review quarter remained generally steady vis a vis the previous quarter. In contrast, core inflation for Q2 2017 rose to 2.9 percent, higher than 2.7 percent in the previous quarter and 1.7 percent a year ago. Similarly, two of the three alternative measures of core inflation estimated by the BSP increased in Q2 2017 relative to the rates registered in the previous quarter. In particular, the trimmed mean and weighted median were both higher at 2.4 percent (from 2.2 percent) and 2.0 percent (from 1.9 percent). Meanwhile, the net of volatile items was unchanged from the previous quarter's rate of 2.2 percent. The number of items with inflation rates greater than the threshold of 4.0 percent (the upper end of the 2017 inflation target) was lower at 26 items in Q2 2017 from 31 items in the previous quarter, which collectively accounted for 23.8 percent of the CPI basket.

Inflation expectations decline but remain within the range target. The BSP's survey of private sector economists for June 2017 showed that mean inflation forecasts for 2017 and 2018 were lower relative to the results in March 2017. The mean inflation forecasts for 2017 and 2018 declined to 3.3 percent and 3.4 percent, from 3.4 percent and 3.5 percent in March, respectively. Meanwhile, average inflation forecast for 2019 was higher at 3.5 percent in June from 3.4 percent in March with the National Government's proposed tax reform program (Package 2) identified as one of the upside risks. The lower inflation expectations for 2017 and 2018 could be attributed to the slower rate of increase in global oil prices due to the increased production of shale oil in the US; lower electricity rates in June 2017 which reflected Meralco's refund to customers; and lingering uncertainty over the prospects of the global economy. In contrast, results of the May 2017 Consensus Economics inflation forecast survey showed higher mean inflation forecast for 2017 at 3.3 percent, from 3.2 percent in March, and a steady inflation rate in 2018 at 3.3 percent.

Domestic economic activity stays firm. Real GDP continued to grow, at 6.4 percent in Q1 2017, albeit slower than the quarter- and year-ago expansion of 6.6 percent and 6.9 percent, respectively. On the expenditure side, the moderation in GDP growth was due to the slowdown in household and government spending and fixed capital investments. Meanwhile, higher imports during the quarter weighed down on net total exports. On the production side, the deceleration in the real GDP could be attributed to the lower growth in the industry and services sectors, offsetting the positive turnaround in agriculture.

Q2 inflation inches closer to midpoint of 2017 target range

Higher-frequency demand indicators likewise support the view of firm economic prospects in the near term. Vehicle sales continued to grow in the first two months of Q2, although at a slower pace. Similarly, growth in energy sales slowed down as electricity consumption normalized from last year's impact of the El Niño phenomenon and national elections. The composite Purchasing Managers' Index as of May 2017 remained firmly above the 50-point expansion threshold, indicating sustained strong economic activity ahead. In addition, results of the BSP's latest business and consumer expectations surveys showed a general optimism for the review quarter although a slight deterioration in the confidence index was noted for the quarter ahead due in part to seasonal factors such as the onset of the rainy season and start of classes.

Global economy improves steadily. The JP Morgan Global All-Industry Output Index as of June 2017 continued to signal an expansion in global activity as key economies gain further growth traction. At the same time, global inflation is expected to remain benign in the near and long term with the strengthening of major currencies. For Q1 2017, the US economy gained further strength on the back of positive contributions from fixed investments, exports and private consumption. Meanwhile, inflation declined slightly even as unemployment rate remained broadly steady.

Moreover, the US manufacturing PMI continued to signal an expansion. Similarly, the euro area continued to recover in Q1 amid benign inflation as economic sentiment reported positive readings. The Chinese economy likewise grew faster in Q1, supported by higher government infrastructure spending, credit, and real estate investments, amid steady inflation. In addition, China's manufacturing PMI shifted to expansion territory. On the other hand, Japan grew at a slower pace, weighed down by weak public investment. Inflation remained below 1 percent as outlook on manufacturing remained positive. India's real GDP likewise slowed down as inflation declined although composite PMI continued to point to an expansion. Meanwhile, the Nikkei ASEAN manufacturing PMI eased slightly as countries in the region showed mixed growth outlook.

Domestic financial system gets boost from domestic factors amid external volatility. Despite the uncertainty affecting global financial markets coming from the US Federal Reserve's decision to raise interest rates and the volatility in global oil prices, the country's sustained growth in Q1 2017 as well as the optimism generated by the National Government's proposed tax reform program provided significant boost to investor sentiment. The peso appreciated against the US dollar by 0.27 percent to average ₱49.86/US$1 from the previous quarter's average of ₱49.99/US$1. The Philippine stock exchange index likewise rose by 7.1 percent, quarter-on-quarter, to average near the 8,000 mark at 7,770.8 index points. Debt spreads narrowed for the most part of Q2 as geopolitical tensions abated and the US economy continued to strengthen. Investor demand for government securities remained healthy as evidenced by over-subscriptions to the Bureau of the Treasury's regular auctions. In addition, the banking system saw a continued increase in assets, lending, and deposits, as capital adequacy ratios remained comfortably above the BSP's prescribed levels and international norms. Moreover, based on the latest round of the survey on senior bank loan officers, bank lending standards for loans to both enterprises and households were broadly unchanged in Q2 2017, indicating a generally stable supply of credit.

Monetary policy settings were maintained in Q2 2017. The BSP kept steady the key policy interest rate for its overnight reverse repurchase or RRP facility at the May and June monetary policy meetings. The reserve requirement ratios were likewise left unchanged. The BSP's decision to keep the policy rate unchanged was based on the assessment that the inflation environment remains manageable while inflation expectations continue to be firmly anchored to the target over the policy horizon.

Latest baseline forecasts of the BSP show that inflation would likely settle near the midpoint of the government's target range of 3.0 percent ± 1.0 percentage point in 2017 to 2019. Inflation is projected to peak in Q3 2017, driven by positive base effects and the continued strength in domestic economic activity before reverting back to the midpoint of the target range in 2018-2019.

The risks to future inflation remain tilted toward the upside. The impact of the government's fiscal reform program and the pending petitions for adjustments in electricity rates are the main upside risks to inflation. Meanwhile, the uncertainty in the global economic landscape continues to be the main downside risk to inflation.

Prevailing monetary policy stance remains appropriate

Current monetary policy settings remain appropriate. The prevailing inflation outlook supports the view of keeping the policy rates steady, with the latest baseline inflation projection path still tracking the midpoint of the target range in 2017-2019. The latest baseline inflation forecast path is slightly lower due to the decline in global crude oil prices, moderation in domestic growth momentum, lower-than-projected inflation outturns in Q2 2017, and peso appreciation. Credit and liquidity conditions likewise support the view of the appropriateness of prevailing policy settings. Placements in the BSP's open market operations remain healthy, indicating the continued excess reserve position of the banking system.

The balance of risks to the inflation outlook remains tilted toward the upside which argues for maintaining vigilance in setting the stance of monetary policy going forward. The initial impact of the government's tax reform program and pending petitions for adjustments in electricity rates are seen as the main upside risks to the baseline forecast. The lingering uncertainty in the global economic landscape poses as the main downside risk to inflation. Going forward, the BSP will need to watch closely for indications of increasing underlying inflationary pressures and the realization of the upside risks to inflation.

I. Inflation and Real Sector Developments

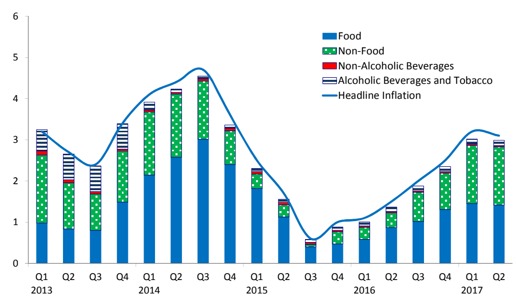
Prices

Headline Inflation. Headline inflation in Q2 2017 was at 3.1 percent,[4] generally unchanged from the previous quarter's 3.2 percent but higher than 1.5 percent a year ago. This brought the year-to-date (ytd) average inflation to 3.1 percent which is within the National Government's (NG) announced target range of 3.0 percent ± 1.0 percentage point (ppt) for 2017.

Q2 2017 headline inflation edges closer to midpoint of target range

Food inflation in Q2 2017 held steady compared to the previous quarter as higher prices of selected food commodities specifically, meat and fish, were counterbalanced by lower prices of vegetables and fruit products. Likewise, non-food inflation was also unchanged at 2.4 percent from the previous quarter as downward adjustment in the prices of domestic petroleum products were offset by price increases in transport and education services.

Chart 1. Quarterly Headline Inflation (2006=100)
in percent



Source: Philipine Statistical Authority (PSA), BSP

Core Inflation. In contrast, core inflation, which excludes some food and energy items to measure generalized price pressures, rose further to 2.9 percent in Q2 2017, higher than 2.7 percent in the previous quarter and 1.7 percent a year ago. Similarly, two out of three alternative measures of core inflation estimated by the BSP increased in Q2 2017 relative to the rates registered in the previous quarter. In particular, the trimmed mean and weighted median were both higher at 2.4 percent (from 2.2 percent) and 2.0 percent (from 1.9 percent). Meanwhile, the net of volatile items was unchanged from the previous quarter's rate of 2.2 percent.

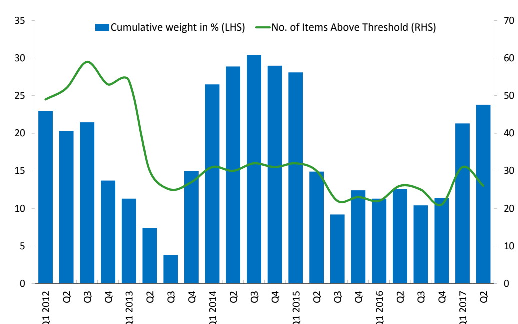
Table 1. Alternative Core Inflation Measures
quarterly averages of year-on-year change

Quarter	Official Headline Inflation	Official Core Inflation	Trimmed Mean [1]	Weighted Median [2]	Net of Volatile Items [3]
2014	**4.1**	**3.0**	**3.5**	**2.9**	**2.6**
Q1	4.1	3.0	3.3	2.6	2.8
Q2	4.4	3.0	3.6	3.2	2.6
Q3	4.7	3.3	3.8	3.1	2.8
Q4	3.6	2.7	3.3	2.7	2.4
2015	**1.4**	**2.1**	**1.9**	**1.9**	**1.8**
Q1	2.5	2.5	3.0	3.0	2.3
Q2	1.7	2.2	2.1	2.2	1.9
Q3	0.6	1.6	1.3	1.2	1.5
Q4	1.0	1.8	1.3	1.3	1.5
2016	**1.8**	**1.9**	**1.6**	**1.8**	**1.6**
Q1	1.1	1.6	1.2	1.3	1.3
Q2	1.5	1.7	1.5	1.7	1.3
Q3	2.0	2.0	1.8	2.1	1.7
Q4	2.5	2.5	1.9	1.9	2.0
2017	**3.1**	**2.8**	**2.3**	**2.0**	**2.2**
Q1	3.2	2.7	2.2	1.9	2.2
Q2	**3.1**	**2.9**	**2.4**	**2.0**	**2.2**

[1] The trimmed mean represents the average inflation rate of the (weighted) middle 70 percent in a lowest-to-highest ranking of year-on-year inflation rates for all CPI components.
[2] The weighted median represents the middle inflation rate (corresponding to a cumulative CPI weight of 50 percent) in a lowest-to-highest ranking of year-on-year inflation rates.
[3] The net of volatile items method excludes the following items: bread and cereals, meat, fish, fruit, vegetables, gas, solid fuels, fuels and lubricants for personal transport equipment, and passenger transport by road, which represents 39.0 percent of all items. The series has been recomputed using a new methodology that is aligned with PSA's method of computing the official core inflation, which re-weights remaining items to comprise 100 percent of the core basket after excluding non-core items. The previous methodology retained the weights of volatile items in the CPI basket while keeping their indices constant at 100.0 from month to month.
Source: PSA, BSP estimates

The number of items with inflation rates greater than the threshold of 4.0 percent (the upper end of the 2017 inflation target) was lower at 26 items in Q2 2017 from 31 items in the previous quarter. Majority of these items were food commodities. Collectively, these items accounted for 23.8 percent of the CPI basket, slightly higher than the quarter-ago share of 21.3 percent.

Chart 2. CPI Items with Inflation Rates Above Threshold



Source: Philippine Statistics Authority, BSP staff estimates

[4] It should be noted that Q2 2017 CPI figures were adjusted to exclude Lanao del Sur for May and June 2016 and 2017.

Food Inflation. Food inflation was steady in Q2 2017 from the previous quarter but higher compared to the same period in 2016. Selected food commodities posted higher price increases particularly, meat, fish, as well as oils and fats. At the same time, rice prices increased reflecting the differences in production patterns across provinces as lower production were registered in certain provinces due to pest infestation, and floods during vegetative stages.

Some tightness in domestic supply pushes food inflation in Q1 2017

However, these developments were counterbalanced by lower price increases in fruits and vegetables due to ample supply. Moreover, year-on-year (y-o-y) inflation rate of corn, sugar, jam, honey, and chocolate turned negative in Q2 2017, which further tempered the rise in food inflation during the quarter.

Table 2. Inflation Rates for Selected Food Items
quarterly averages in percent (2006=100)

Commodity	2016				2017	
	Q1	Q2	Q3	Q4	Q1	Q2
Food and Non-Alcoholic Beverages	**1.6**	**2.3**	**2.7**	**3.5**	**3.8**	**3.8**
Food	1.6	2.4	2.8	3.6	4.0	4.0
Bread and Cereals	-1.2	-0.2	0.9	1.5	1.8	2.1
Rice	-2.0	-0.9	0.5	1.4	2.0	2.3
Corn	1.7	2.6	2.5	1.9	0.7	-0.4
Meat	1.0	2.2	2.0	1.6	2.4	4.5
Fish	2.8	2.7	4.3	4.9	6.9	8.3
Milk, Cheese and Eggs	1.2	1.5	2.0	2.2	2.4	2.4
Oils and Fats	0.3	2.1	3.9	4.6	6.1	6.7
Fruit	3.3	4.4	7.0	9.2	7.9	7.2
Vegetables	10.3	12.9	9.9	11.7	10.6	4.4
Sugar, Jam, Honey	6.4	5.0	3.4	3.0	1.1	-1.5
Food Products, N.E.C.	3.1	-1.0	-2.4	-0.1	1.2	0.2
Non-Alcoholic Beverages	1.2	1.2	1.2	1.3	1.2	1.1
Alcoholic Beverages and Tobacco	4.9	5.5	6.0	6.3	6.0	6.2

Source of Basic Data: PSA, BSP

Non-Food Inflation. Non-food inflation in Q2 2017 likewise held steady as some major commodity groups posted mixed readings. Clothing and footwear, medical products and out-patient services as well as recreation and culture posted slower price increases during the quarter. Meanwhile, the price reduction in domestic pump prices namely, unleaded gasoline and diesel—influenced by the downward trend in global oil prices—were offset by higher inflation of transport services. By contrast, (y-o-y) inflation rate for heavily-weighted CPI commodities specifically, electricity, gas, and other fuels rose during the quarter as higher electricity charges were counterbalanced by the slower price increase of LPG and solid fuels.

Oil-related CPI items continue to heavily influence non-food inflation

Table 3. Inflation Rates for Selected Non-Food Items
quarterly averages in percent (2006=100)

Commodity	2016				2017	
	Q1	Q2	Q3	Q4	Q1	Q2
Non-Food	**0.5**	**0.6**	**1.2**	**1.5**	**2.4**	**2.4**
Clothing and Footwear	1.9	2.3	2.6	2.6	2.8	2.4
Housing, Water, Electricity, Gas and Other Fuels	-1.0	-1.0	0.2	1.2	2.9	3.1
Electricty, Gas, and Other Fuels	-6.9	-6.7	-3.2	-0.2	6.0	6.8
Furnishings, Household Equipment & Routine Maintenance of the House	1.5	1.6	2.1	2.4	2.3	2.3
Health	1.9	2.4	2.7	2.6	2.6	2.5
Transport	0.3	0.0	0.0	0.9	2.7	2.7
Transport Services	1.2	0.7	0.3	0.7	1.5	2.6
Communication	0.1	0.2	0.1	0.1	0.2	0.3
Recreation and Culture	1.1	1.6	1.7	1.7	1.8	1.4
Education	3.6	3.0	1.8	1.8	1.8	1.9
Restaurant and Miscellaneous Goods and Services	1.6	2.2	2.4	2.2	2.1	1.6

Source of Basic Data: PSA, BSP

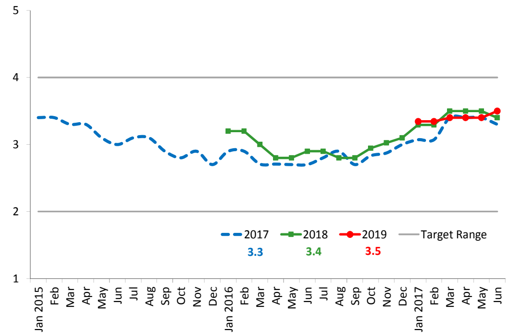
Private Sector Economists' Inflation Forecasts. Results of the BSP's survey of private sector economists for June 2017 showed that the mean inflation forecasts for 2017 and 2018 were lower relative to the results in March 2017.[5] By contrast, mean forecast for 2019 was higher.

Mean inflation forecasts for 2017 and 2018 are lower

In particular, the mean inflation forecast for 2017 declined to 3.3 percent in June 2017 from 3.4 percent in March 2017. Likewise, mean inflation forecast for 2018 declined to 3.4 percent in June 2017 from 3.5 percent in March 2017. Meanwhile, average inflation forecast for 2019 was higher at 3.5 percent in June 2017 from 3.4 percent in March 2017.

[5] There were 30 respondents in the BSP's survey of private sector economists in June 2017. The survey was conducted between 19 June to 3 July 2017.

Chart 3. BSP Private Sector Economists' Survey
mean forecast for full year; in percent

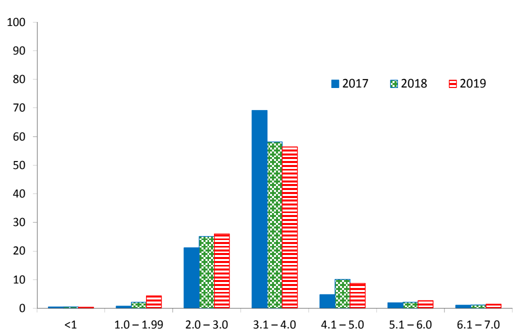


Source: BSP

Analysts attributed their lower 2017 inflation forecast to the following: slower rate of increase in global oil prices as increased production of shale oil in the US counteracted the supply cuts agreed upon by the OPEC members; lower electricity rates in June 2017 which reflected Meralco's refund to customers; and lingering uncertainty over the prospects of the global economy. Meanwhile, the key upside risks to inflation outlook were seen to emanate from the depreciation of the peso, proposed tax reform (i.e., fuel and vehicle excise taxes), government spending on infrastructure, transport fare hike, base effects, adverse weather conditions in the latter part of 2017, another Fed rate hike in the second half of 2017, and US protectionism.

Based on the probability distribution of the forecasts provided by 24 out of 30 respondents, there was a 90.3-percent probability that average inflation for 2017 will settle between the 2-4 percent range. For 2018, the respondents assigned an 83.2-percent probability that inflation will fall within the 2-4 percent target range.

Chart 4. Probability Distribution for Analysts' Inflation Forecasts*
2017-2019



*Probability distributions were averages of those provided by 23 out of 30 respondents.
Source: BSP Survey

Results of the May 2017 Consensus Economics inflation forecast survey for the Philippines showed higher mean inflation forecast for 2017. Respondents expect 2017 inflation to settle at 3.3 percent, higher than the March 2017 survey's mean forecast of 3.2 percent.[6] On the other hand, respondents' mean inflation forecast for 2018 was steady at 3.3 percent.

Table 4. Private Sector Forecasts for Inflation, June 2017
annual percentage change

	2017			2018	2019
	Q3	Q4	FY	FY	FY
1) Al-Amanah Islamic Bank	3.00	3.50	3.50	3.50	3.50
2) ANZ	3.10	2.70	3.00	3.20	3.50
3) Asia ING	2.90	3.00	3.10	3.50	3.50
4) Banco De Oro	3.54	3.48	3.40	3.50	3.50
5) Bangkok Bank	3.50	3.60	3.50	3.80	4.00
6) Bank of Commerce	2.77	2.16	2.79	-	-
7) Bank of China	3.00	3.30	3.60	3.60	3.80
8) Bank of the Philippine Islands	3.30	3.00	3.30	3.90	3.20
9) Barclays	3.50	3.20	3.30	3.00	-
10) Chinabank	3.40	3.20	3.30	3.30	3.30
11) CTBC Bank	3.20	3.30	3.20	3.50	3.70
12) Deutsche Bank	-	-	-	3.20	3.30
13) Eastwest Bank	3.25	3.50	3.50	3.50	3.75
14) Global Source	3.65	3.54	3.42	3.46	-
15) IDEA	2.90	3.20	3.10	3.50	3.90
16) Korea Exchange Bank	4.60	4.60	4.50	4.50	4.50
17) Land Bank of the Phils	3.20 - 3.40	3.10 - 3.30	3.10 - 3.30	2.90 - 3.10	2.90 - 3.10
18) Maybank	3.65	3.60	3.40	3.35	3.48
19) Maybank-ATR KimEng	3.40	3.40	3.30	3.50	3.40
20) Metrobank	-	-	3.50	3.60	-
21) Multinat'l Inv. Banc	3.20	3.00	3.13	3.00	-
22) Mizuho	3.20	3.20	3.30	3.20	-
23) Nomura	3.20	3.30	3.30	3.70	-
24) Phil. Equity Partners	3.37	3.40	3.28	3.57	-
25) RCBC	3.10 - 3.40	2.80 - 3.30	3.00 - 3.30	3.00 - 3.50	3.20 - 3.70
26) Robinsons Bank	3.30	3.20	3.20	3.00	2.00
27) Security Bank	3.40	3.10	3.30	3.40	3.50
28) Standard Chartered	3.10	2.90	3.10	3.00	3.20
29) UBS	3.1	2.9	3.2	4.10	-
30) Union Bank	3.30	3.20	3.20	3.00	3.20
Median Forecast	3.3	3.2	3.3	3.5	3.5
Mean Forecast	**3.3**	**3.2**	**3.3**	**3.4**	**3.5**
High	4.6	4.6	4.5	4.5	4.5
Low	2.8	2.2	2.8	3.0	2.0
Number of Observations	28	28	29	29	21
Government Target	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**

Source: BSP

Based on the Q2 2017 BSP Business Expectations Survey (BES), a slightly smaller number of respondents expected inflation to increase in the current quarter relative to the previous quarter (from a diffusion index of 51 percent to 49.4 percent).

Inflation expectations close to the midpoint of the target

There were more firms that expected inflation to increase in the next quarter (from a diffusion index of 38.6 percent to 41.1 percent).

[6] There were 19 respondents in the Consensus Economics' survey in May 2017.

Meanwhile, results of the BSP Consumer Expectations Survey (CES) for Q2 2017 indicated that consumers expect inflation to decline over the next 12 months to 2.9 percent from 3.1 percent in the Q1 2017 survey. Nonetheless, broadly the same number of respondents (as in the previous survey) expect prices of basic goods and services to go up in the next 12 months.

Energy prices. The average price of Dubai crude oil declined by 6.3 percent in Q2 2017 compared to the previous quarter. Dubai crude oil prices dropped below US$50 per barrel mostly in June 2017 due largely to rising concerns that the Organization of Petroleum Exporting Countries' (OPEC)-led production cuts would be insufficient to draw down the global oil surplus.

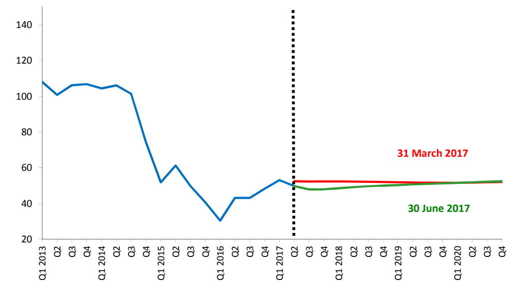
Recent supply developments weigh down on global oil prices in Q2 2017

Dubai crude oil prices fell in Q2 2017 driven largely by a confluence of factors namely, rising US crude and petroleum production, with US stockpiles remaining above its five-year average. At the same time, US tight oil production expanded to 4.5 million barrels per day in May[7] 2017, which was the highest since November 2015. This is consistent with the continued rise in US active crude oil and gas rigs.[8]

In the case of OPEC production, Iraq has recently boosted its exports to the US by 848,000 barrels for the week ending 2 June 2017 to a total of 1.14 million barrels. By contrast, exports from Saudi Arabia fell by 747,000 barrels during the same period.[9,10] Moreover, Nigeria—one of the exempted OPEC members from the agreement—could also undermine OPEC's efforts in addressing the supply glut following Royal Dutch Shell's decision to lift export restrictions.[11] Lastly, production from Libya, another exempted OPEC member, has reached its highest production since 2014 according to the National Oil Corporation (NOC).

Similar to oil spot prices, estimated futures prices of Dubai crude oil as of end-June, which are based on movements of Brent crude oil, showed a lower path for August 2017 to April 2020 compared to the estimates in the previous quarter.[12]

Chart 5. Spot and Estimated Prices of Dubai Crude Oil



*Futures prices derived using Brent crude futures
Source: Bloomberg, BSP

Latest estimates from the US Energy Information Administration (EIA)[13] show that demand could outstrip supply in 2017 as supply projections were adjusted downward compared to its previous month's (May 2017) reported projections, reflecting OPEC's decision in May 2017 to voluntarily extend production cuts by nine months (or up to March 2018).

Supply projections were also revised downward in 2018 to take into account the potential impact of the OPEC agreement in inventory and possible extension of the agreement beyond March 2018. Nevertheless, oil market is still projected to remain in surplus in 2018 partly due to expectations of non-compliance among participating members of OPEC non-compliance in 2H 2018.

US EIA's oil demand forecasts for 2017 and 2018 were higher relative to the previous month's forecasts. Latest estimates of oil demand is at 98.46 mb/d (from 98.30 mb/d) and 100.08 mb/d (99.93 m/d) for 2017 and 2018, respectively. This suggests a consumption growth of 0.2 percent for 2017 and 0.1 percent for 2018. Meanwhile, both

[7] Based on data from US EIA URL: https://www.eia.gov/energyexplained/data/U.S.%20tight%20oil%20production.xlsx

[8] Based on Baker Hughes data, total US crude oil and gas rigs increased to 940 rigs for the week ending 30 June 2017 from the year-ago level of 431 rigs (1 July 2016).

[9] It should be noted that Iraq pledged to reduce output by 210,000 barrels—the second largest adjustment in the OPEC-led agreement.

[10] Data sourced from Bloomberg based on US Department of Energy (DOE) Weekly Preliminary US crude imports from Iraq.

[11] Based on US EIA data, Nigeria produced around 1.52 million barrels in May 2017.

[12] Future prices derived using Brent crude futures data. Data as of 31 March 2017 Source: BSP-staff calculations, Bloomberg

[13] US EIA, Short-Term Energy Outlook, June 2017, https://www.eia.gov/outlooks/steo/

the IEA[14] and OPEC[15] projected global demand for 2017 to increase by 1.3 mb/d each.

On a cumulative basis, net adjustments of domestic petroleum prices turned negative in the first half of 2017. Net adjustment of gasoline, kerosene, diesel, and LPG declined by ₱2.73 per liter, ₱2.83 per liter, ₱1.45 per liter, and ₱0.41 per liter, respectively. The following table summarizes the actual price adjustments of oil products so far in 2017.

Table 5. 2017 Actual Adjustments in Domestic Prices (average prices of Caltex, Petron and Shell)

Domestic Oil Products	Year-to-Date (June 2017)					
	Increase		Decrease		Net Adjustments	
	Number	Amount (₱/liter)	Number	Amount (₱/liter)	Number	Amount (₱/liter)
Gasoline	10	12.65	12	-15.38	-2	-2.73
Kerosene	10	4.75	13	-7.58	-3	-2.83
Diesel	11	6.50	13	-7.95	-2	-1.45
LPG	2	5.29	3	-5.70	-1	-0.41

Source: Department of Energy (DOE)

Power. Overall electricity rates in the Meralco franchise area increased in Q2 2017 due to higher generation costs. For the review quarter, the average generation charge went up by ₱0.31 per kilowatt hour (kWh) to ₱4.61 per kWh from ₱4.31 per kWh in Q1 2017.

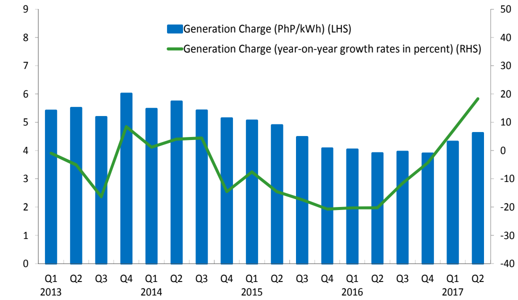
Higher generation rates lead to an upward adjustment in retail electricity prices

The upward adjustment in the generation cost was due mainly to the increase in the cost of power sourced from the Independent Power Producers (IPPs) and higher Wholesale Electricity Spot Market (WESM) prices. Low dispatch resulted in higher IPP costs while the increase in WESM prices was due to plant outages and higher demand. At the same time, the increase in generation charge factored in the pass-on charge arising from the Malampaya shutdown on 28 January to 16 February 2017. The increases largely offset the downward movement of generation charges in May and June, as well as the refund of over-recovery on pass-through charges from January 2014 to December 2016 reflecting in the June 2017 bill.

[14] IEA, June 2017 Oil Market Report, www.iea.org

[15] OPEC, June 2017 Monthly Oil Market Report, www.opec.org

Chart 6. Meralco's Generation Charge
Ph₱/kWh; year-on-year growth rates in percent



Source: Meralco

Meanwhile, there are potential sources of upside pressures on electricity charges. Meralco has existing petitions for rate increases with ERC which include the petition to implement the Maximum Average Price for 2012, 2013, 2014, and 2015, amended application for a rate increase in the January 2014 billing (consisting of incremental fuel costs and deferred generation cost to be collected monthly for six months); and petitions for the refund of generation over/under recovery (GOUR), transmission over/under recovery (TOUR), system loss over/under recovery (SLOUR), and lifeline subsidy over/under recovery (LSOUR) for the period January-December 2011. In addition, the Power Sector Assets and Liabilities Management (PSALM) has several pending petitions with ERC for the recovery of True-Up Adjustments of Fuel and Purchased Power Costs (TAFPPC), Foreign Exchange Related Costs (TAFxA) and Purchased Power Costs and Foreign Exchange Related Costs by the National Power Corporation (NPC), and NPC's Stranded Debt portion of the universal charge. Likewise, the National Grid Corporation of the Philippines (NGCP) also filed several petitions to recover connection charges and residual sub-transmission charges for 2011-2013 and the costs of repair on damages caused by force majeure events such as earthquake, flooding, landslides, and lightning incidents in 2011-2012.

Aggregate Demand and Supply

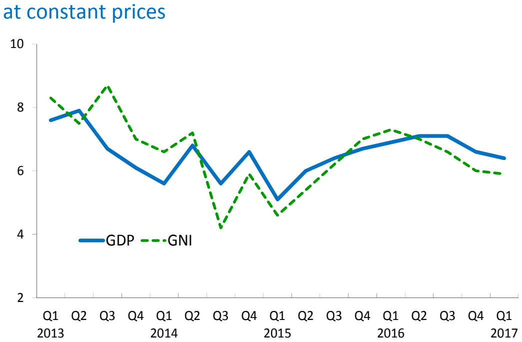
The Philippine economy sustained growth at 6.4 percent in Q1 2017, albeit slower than the quarter- and year-ago acceleration of 6.6 percent and 6.9 percent, respectively.

Real GDP growth stays firm

On the expenditure side, the slower pace of GDP growth was due to the deceleration in consumer and government spending and fixed capital investments as well as the higher growth of total imports, which weighed down net exports. On the production side, the slowdown could be attributed to the lower growth rates of industry and services, offsetting the growth turnaround in agriculture.

Gross national income (GNI) growth was lower at 5.9 percent in Q1 2017 compared to the previous quarter's growth of 6 percent and the year-ago growth of 7.3 percent. Net primary income grew by 3.9 percent in Q1 2017, higher than the 3.3-percent growth in the previous quarter but lower than the 9.4-percent increase in Q1 2016. The lower growth in net primary income in Q1 2017 compared to a year ago can be attributed mainly to higher compensation outflows and property expense.

Chart 7. Gross Domestic Product (GDP) and Gross National Income (GNI)
at constant prices



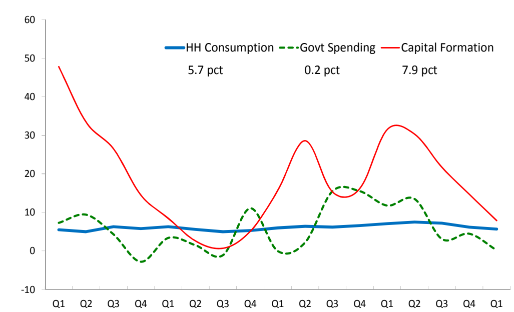
Source: PSA

Aggregate Demand. Household and government spending as well as fixed capital investments contributed 4 ppts, 0.02 ppt, and 3.4 ppts, respectively, to total GDP growth, offsetting the negative contribution of net exports (-0.2 ppt).

Slower household spending due to higher unemployment and inflation in Q1 2017

Household expenditure, which accounted for 69.4 percent of GDP, increased by 5.7 percent in Q1 2017, albeit slower than the 6.2-percent growth in the previous quarter and the 7.1-percent growth in the same period last year. The slower growth of household spending was brought about by the decline in the consumption of alcoholic beverages and tobacco, and recreation and culture. Household spending on health, transport, and communication also decelerated. Meanwhile, consumption of food and non-alcoholic beverages as well as household expenditures for clothing and footwear, housing, water, electricity, gas and other fuels, furnishings, household equipment and routine household maintenance, education, and restaurants and hotels improved compared to the previous quarter. Miscellaneous goods and services expanded at a steady rate of 8 percent. The slowdown in household consumption can be attributed to the following: a) dissipated election-related spending, b) higher unemployment rate at 6.6 percent in Q1 2017 from 4.4 percent a quarter ago, and c) higher inflation rate at 3.2 percent in Q1 2017 from 2.4 percent in Q4 2016, particularly food inflation (4 percent from 3.5 percent).

Chart 8. Gross Domestic Product by Expenditure Shares
at constant prices



Source: PSA

The growth in capital formation slowed down to 7.9 percent in Q1 2017 from 14.7 percent in Q4 2016 due to the deceleration in fixed capital investments (11.8 percent in Q1 2017 from 18.5 percent in Q4 2016) and the ₱2.2-billion inventory withdrawals in Q1 2017 compared to the ₱17.5-billion additional inventory during the same period last year. The slowdown in fixed capital investments can be attributed mainly to lower growth in:

- durable equipment (12.5 percent in Q1 2017 from 26.3 percent) as road vehicles, which accounted for almost half of durable equipment (41 percent), grew by only 8.7 percent from 27.8 percent;[16]
- breeding stock and orchard development and intellectual property products; and
- public construction spending at 2 percent (from 19.2 percent)

Meanwhile, private construction expanded by 11.9 percent, higher than the 6.9-percent growth in the previous quarter, reflecting the double-digit growth in building permits at 16.4 percent.

Government expenditures grew marginally by 0.2 percent in Q1 2017, lower than the 4.5-percent increase in Q4 2016 due to the decline in maintenance and other operating expenditures of various government agencies, and delays in the implementation and procurement of various government programs. Moreover, the slowdown can be attributed to base effects from higher expenses recorded during the election period in 2016.

Table 6. Economic Performance
at constant 2000 prices; growth rate in percent

BY EXPENDITURE ITEM	2016				2017
	Q1	Q2	Q3	Q4	Q1
Household Consumption	7.1	7.5	7.2	6.2	5.7
Government Consumption	11.8	13.5	3.1	4.5	0.2
Capital Formation	31.5	30.3	21.7	14.7	7.9
Fixed Capital Formation	28.3	30.3	25.4	18.5	11.8
Exports	10.2	10.6	9.0	13.4	20.3
Imports	21.1	25.4	13.3	15.4	17.5

Source: PSA

Overall exports growth accelerated in Q1 2017 to 20.3 percent from 13.4 percent a quarter ago. The expansion in exports of goods (22.3 percent from 12.8 percent) offset the slowdown in exports of services (14.3 percent from 15.7 percent a quarter ago). Growth in exports of goods was driven mainly by the double-digit expansion of semiconductors (23.4 percent from 3.8 percent), electronic data processing (28.7 percent from 1.6 percent), and articles of apparel and clothing accessories (97.6 percent from 1.7 percent). Meanwhile, the lower growth in exports of services was due primarily to the further contraction of travel services (-18.1 percent from -14.3 percent) and slowdown in growth of government services (34.2 percent from 42.8 percent) and miscellaneous services[17] (20.2 percent from 22.7 percent).

Overall imports grew by 17.5 percent in Q1 2017, faster than the quarter-ago increase of 15.4 percent, owing to higher expansion in imports of goods and services. The double-digit rise in semiconductors (33.8 percent from 8.6 percent), electronic data processing (27.9 percent from 25.5 percent), and other goods (13.4 percent from 5.5 percent) contributed mainly to the 20.8-percent growth in imports of goods in Q1 2017 from 20.6 percent a quarter ago. Similarly, growth in imports of services increased to 4.4 percent (from 0.5 percent a quarter ago) due largely to the higher growth in imports of travel services (9 percent from 3.8 percent) and the expansion of miscellaneous services[18] (2.1 percent from -7.1 percent).

Other Demand Indicators. Higher-frequency demand indicators continued to support the view of firm economic activity. The property sector continued to exhibit strong demand due to the BPO sector, vehicle sales remained strong while the composite Purchasing Managers' Index stayed firmly above the 50-point expansion threshold. Similarly, business and consumer confidence showed a general optimism for the review quarter.

Property Prices

Vacancy Rates, Makati CBD. The office vacancy rate in the Makati central business district (CBD) in Q1 2017 remained steady at 0.9 percent relative to the previous quarter but was lower than last year's 1.7 percent.

Demand from BPO, traditional offices and offshore gaming keep office vacancy low

[16] Imports growth of land transport equipment[16] (excluding passenger cars and motorized cycle) was lower at 20.6 percent (from 29 percent). Data is based on the Philippine Imports by Major Type of Goods, Philippine Statistics Authority.

[17] Computer services

[18] Construction and financial services

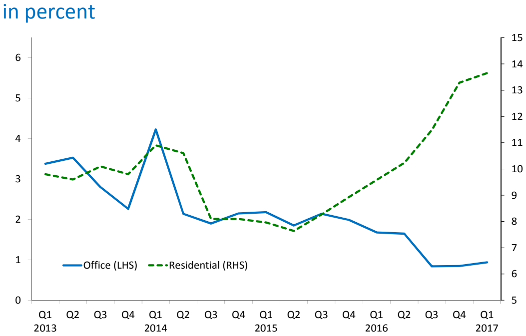
Office vacancy rates have remained low, even with the completion of new office projects, due to strong demand from a more diversified tenant portfolio from different sectors. According to Colliers, a large majority of the office units were already leased prior to completion, reflecting strong pre-leasing demand which is expected to be sustained in 2017. Colliers expects office vacancy rate to remain tight at 2.0 percent in Q1 2018 due to robust demand amid limited office supply.

Meanwhile, the residential vacancy rate in the Makati CBD increased slightly to 13.7 percent in Q1 2017 from 13.3 percent in the previous quarter.

Completion of new units in Makati CBD leads to higher residential vacancy rate

The residential vacancy rate in Q1 2017 was also higher than the year-ago level of 9.6 percent due to the delivery of new residential units in the affordable and mid-income segments. In the next twelve months, Colliers foresees that vacancy rates will rise to about 14.3 percent due to considerable increase in projected residential supply.

Chart 9. Vacancy Rates
(Makati Central Business District)
in percent



Source: Colliers International Philippines

Rental Values, Makati CBD. Monthly Grade A office[19] rents in the Makati CBD reached ₱950/sq.m. in Q1 2017, representing an increase by 2.7 percent and 4.4 percent relative to the previous quarter and year, respectively.

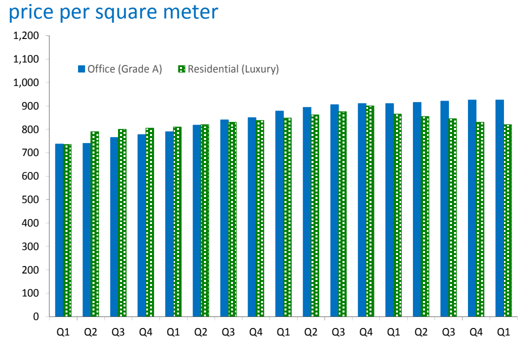
Office rental values increase in nominal terms

Notwithstanding a slowdown in demand from BPO tenants, office rental rates continued to increase during the quarter due to sustained and diversified demand from companies in various sectors such as information technology, trading, construction, online shopping and offshore gaming, as well as government agencies. Office rental values for Grade A offices were above their 1997 levels in nominal terms. In real terms, office rental values were about half of the comparable levels in 1997.

Luxury rental values decline

Monthly rent for luxury three-bedroom condominium units in the Makati CBD was at ₱820/sq.m. in Q1 2017, declining by 1.2 percent from the previous quarter. Likewise, monthly rents for the 3-bedroom segment were lower by 5.2 percent compared to the year-ago levels. Residential rental rates in the Makati CBD as well as other CBDs within Metro Manila, e.g. Fort Bonifacio and Rockwell, continued to drop due to the addition of new residential units from the delivery of a number of residential projects during the quarter. Residential rental values for luxury three-bedroom high-rise units were above their 1997 levels in nominal terms but were only about 72.7 percent of their 1997 levels in real terms.

Chart 10. Rental Values
(Makati Central Business District)
price per square meter



Source: Colliers International Philippines

19 Grade A office refers to office units that are located within the CBD but not in the core area and have quality access to and from the secondary or main avenues. Meanwhile, in terms of general finish, Grade A office buildings have high quality presentation and maintenance.

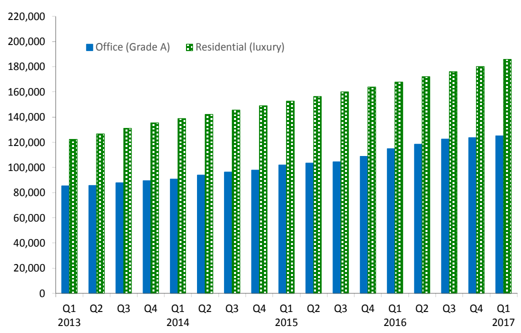
Capital Values, Makati CBD. Capital values[20] for office buildings in the Makati CBD in Q1 2017 were higher in nominal terms than their quarter- and year-ago levels in 1997.

Capital values for office and residential buildings rise

Grade A office capital values in the Makati CBD rose to ₱125,100/sq.m., higher by 1.1 percent and by 8.8 percent compared to the quarter- and year-ago levels, respectively. Grade A office capital values were also higher than the 1997 levels in nominal terms. Nevertheless, in real terms, office capital values were about 66.2 percent of the comparable levels in 1997.

Likewise, capital values for luxury residential buildings[21] in Makati CBD in Q1 2017 increased to ₱185,950/sq.m. from their quarter- and year-ago levels. Average prices for three-bedroom luxury residential condominium units grew by 3.2 percent quarter-on-quarter and 10.7 percent year-on-year. Capital values for luxury residential buildings were above their 1997 levels in nominal terms. In real terms, residential capital values were about 80.3 percent of the comparable levels in 1997.

Chart 11. Capital Values (Makati Central Business District)
price per square meter



Source: Colliers International Philippines

[20] Probable price that the property would have fetched if sold on the date of the valuation. The valuation includes imputed land and building value.
[21] In terms of location, luxury residential units are located within the CBD core and have quality access to/from and have superior visibility from the main avenue. Meanwhile, in terms of general finish, luxury residential units have premium presentation and maintenance.

BSP Residential Real Estate Price Index (RREPI).[22] Residential real estate prices went up by 1.1 percent in Q1 2017 as the Residential Real Estate Price Index (RREPI) rose to 117.2 from 115.9 for the same quarter a year ago. The y-o-y growth in residential real estate prices in Q1 2017 was slightly higher compared to the 0.3-percent increase registered a quarter ago. [23]

Residential real estate prices rise in Q1 2017

The y-o-y growth in prices of condominium units was faster at 2.7 percent from 1.8 percent in Q4 2016, while prices of single detached units edged higher at 0.4 percent, recovering from a 1-percent decline in the previous quarter. Meanwhile, prices of townhouses slowed down to 1.3 percent from 6.2 percent a quarter ago.

The average residential property prices in both NCR and AONCR also increased by 1.1 percent in Q1 2017 compared to year-ago prices. In NCR, growth in real estate prices reverted to positive territory from a negative growth in Q4 2016 while those in AONCR moderated for the same period. In NCR, the higher growth in prices of single detached houses and townhouses outweighed the slower increase in prices of condominium units. Meanwhile, in AONCR, the double-digit increase in prices of condominium units offset the

[22] The RREPI measures the average changes in prices of different types of housing units over a period of time across different geographical regions where the growth rate of the index measures house inflation. It is computed as a weighted chain-linked index based on the average appraised value per square meter weighted by the share of floor area of housing units.
[23] For Q1 2017, about seven in ten real estate loans were for the purchase of new housing units (69 percent). By type of housing unit, 48.4 percent of residential property loans were for the acquisition of condominium units, followed by single detached units (43.3 percent) and townhouses (7.9 percent). The number of loans granted increased for all types of housing units compared to their year-ago levels, with condominium units posting the highest growth of 26.9 percent. By area, condominium units were the most common house purchases in NCR while single detached houses were prevalent in AONCR. By region, NCR accounted for 44.8 percent of the total number of residential real estate loans granted during the quarter, followed by CALABARZON (29.3 percent), Central Luzon (6.7 percent), Central Visayas (5.7 percent), Western Visayas (5.1 percent), Davao Region (3.2 percent) and Northern Mindanao (1.5 percent). Together, these seven regions accounted for 96.3 percent of total housing loans granted by banks.

slight decline in prices of single detached houses and townhouses.[24]

Table 7. Residential Real Estate Price Index

Q1 2014=100; growth rate in percent

Quarter	Residential Real Estate Price Index [1] Overall	NCR	AONCR
2015 Q2	110.3	114.7	106.2
Q3	111.0	115.6	107.0
Q4	113.6	116.2	111.3
2016 Q1	115.9	116.5	115.5
Q2	122.8	117.8	125.7
Q3	113.4	115.4	112.2
Q4	113.9	114.9	113.2
2017 Q1	117.2	117.8	116.8
Year-on-Year Growth Rates			
2015 Q2	13.5	17.6	9.9
Q3	4.7	8.0	2.8
Q4	5.2	5.8	6.2
2016 Q1	9.4	10.0	9.0
Q2	11.3	2.7	18.4
Q3	2.2	-0.2	4.9
Q4	0.3	-1.1	1.7
2017 Q1	1.1	1.1	1.1
Quarter-on-Quarter Growth Rates			
2015 Q2	4.2	8.3	0.2
Q3	0.6	0.8	0.8
Q4	2.3	0.5	4.0
2016 Q1	2.0	0.3	3.8
Q2	6.0	1.1	8.8
Q3	-7.7	-2.0	-10.7
Q4	0.4	-0.4	0.9
2017 Q1	2.9	2.5	3.2

[1] Based on bank reports on residential real estate loans granted per BSP Circular No. 892 dated 16 November 2015.

Source: BSP

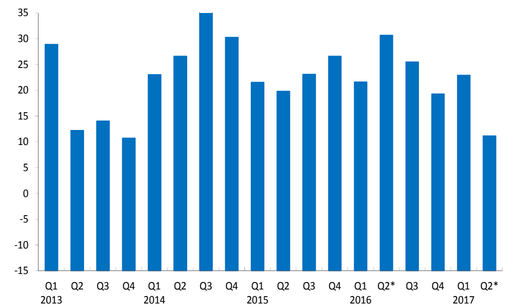
Vehicle Sales. Sales of new vehicles from CAMPI[25] members grew by 11.2 percent y-o-y in the first two months of Q2 2017, albeit slower than the 30.7-percent growth recorded in the same period a year ago, due to the slowdown in sales of passenger cars and commercial vehicles.

Growth in sales of new vehicles show moderation

Sales of passenger cars grew by 3.6 percent y-o-y in April-May 2017 compared to the 16.4-percent growth in the same period in 2016. New passenger car sales accrued to a total of 21,552 units in the first two months of Q2 2017 from 20,813 units in the same period a year ago.

Chart 12. Vehicle Sales

number of units



* April - May

Source: Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI)

The growth in commercial vehicle sales, which account for about 67.0 percent of total vehicle sales, also slowed down to 15.5 percent y-o-y in the first two months of Q2 2017 relative to the 40.3-percent growth in the same period in 2016. Commercial vehicles sold during the quarter reached 42,955 units from 37,201 units in April-May 2016.

Energy Sales. Meralco's energy sales for Q2 2017 (April-May) grew by 2.6 percent, significantly slower than the 12.7-percent growth reported in the same period a year ago.

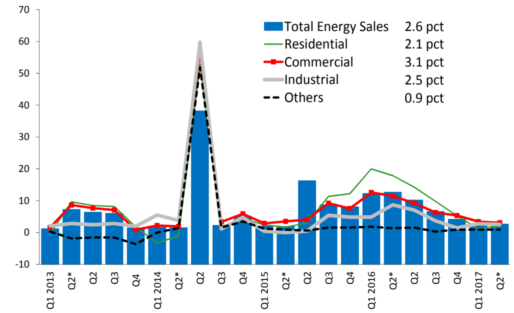
Energy sales increase

Energy sales from the residential sector, commercial sector and industrial sector grew by 2.1 percent, 3.1 percent, and 2.5 percent, respectively. According to Meralco, the slower growth in energy sales was mainly driven by normalization of electricity consumption during the first months of 2017 from significant increases due to El Niño phenomenon and election-related activities in 2016.

[24] Price indices for duplex units exhibit more volatility due to relatively small number of reported real estate loans.

[25] Vehicle sales data is gathered on a monthly basis by the Chamber of Automotive Manufacturers of the Philippines (CAMPI). CAMPI represents the local assemblers and manufacturers of vehicle units in the Philippine automotive industry. The following are the active members of CAMPI: (1) Asian Carmakers Corp., (2) CATS Motors, Inc., (3) Columbian Autocar Corp., (4) Honda Cars Philippines, Inc., (5) Isuzu Philippines Corp., (6) Mitsubishi Motors Philippines Corp., (7) Nissan Motor Philippines Corp., (8) Suzuki Philippines Inc., (9) Toyota Motor Philippines Corp. and (10) Universal Motors Corp.

Chart 13. Energy Sales
year-on-year growth in percent



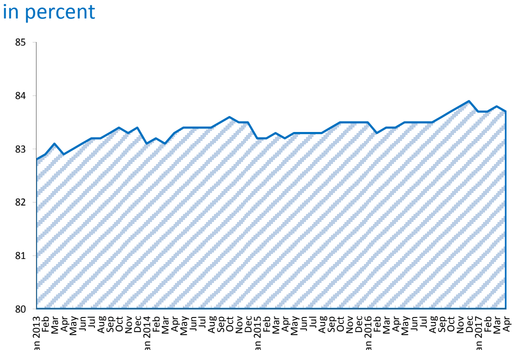
*April-May 2017
Source: Meralco, BSP calculations

Capacity Utilization. Based on the Philippine Statistics Authority's Monthly Integrated Survey of Selected Industries (MISSI), the average capacity utilization rate of the manufacturing sector declined slightly to 83.7 percent in April 2017 from 83.8 percent a month ago.

Capacity utilization in manufacturing remains above 80 percent

Of the 686 respondent-establishments, 57.3 percent operated at least at 80.0 percent capacity in April 2017. Data showed that most of the manufacturing companies have been operating above the 80.0 percent capacity since 2010.

Chart 14. Monthly Average of Capacity Utilization for Manufacturing
in percent



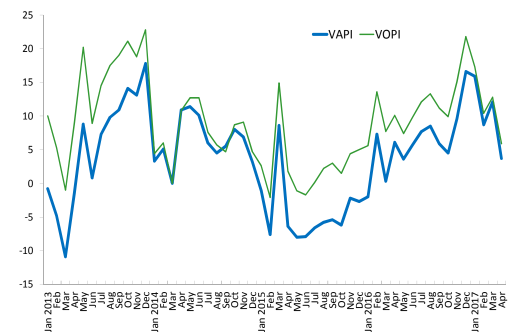
Source: PSA

Volume and Value of Production. Preliminary results of the MISSI showed that volume of production index (VoPI) grew by 5.9 percent y-o-y in April 2017, albeit slower than the previous month's growth at 12.8 percent (revised).

Manufacturing output sustains growth

Of the 20 major industries in the sector, 13 industries posted expansions led by petroleum products (51.7 percent), food manufacturing (11 percent), fabricated metal products (95.6 percent), basic metals (28.5 percent), transport equipment (23.8 percent), footwear and wearing apparel (21.8 percent), furniture and fixtures (76.9 percent), tobacco products (10 percent), and paper and paper products (36.5 percent).

Chart 15. Volume and Value Indices of Manufacturing Production
year-on-year in percent



Source: PSA

Similarly, the value of production index (VaPI) expanded by 3.7 percent in April 2017, lower than the 12.1-percent growth a month ago (revised). This was led by the following sub-sectors: petroleum products (78.1 percent), basic metals (34.4 percent), transport equipment (21.7 percent), footwear and wearing apparel (24.5 percent), tobacco products (11.4 percent), furniture and fixtures (27.7 percent), fabricated metal products (11.2 percent), and printing (12.2 percent).

Business Expectations. Business outlook on the economy turned more favorable for Q2 2017, with the overall confidence index (CI) of the latest Business Expectations Survey (BES)[26] rising to

[26] The Q2 2017 BES was conducted during the period 3 April - 16 May 2017. Respondents, which were drawn from the combined list of the Securities and Exchange Commission's Top 7,000 Corporations in 2010 and Business World's Top 1,000 Corporations in 2015, consisted of 588 companies in NCR and 897 firms in AONCR and covered all 17 regions nationwide. The survey response rate for this quarter was higher at 83.4 percent (from 82.9 percent in the previous

43.0 percent from 39.4 percent in Q1 2017. This means that more businesses are optimistic about the country's economic prospects in Q1 2017 compared to the previous quarter.

Business outlook upbeat in Q2, less so for the next quarter due to seasonal factors

Respondents cited the following factors for their more optimistic outlook: (a) anticipated increase in demand during summer (due to the expected arrival of local and foreign tourists), enrolment and harvest periods, (b) increase in orders and production volume, (c) expansion of businesses and new product lines, (d) introduction of new and enhanced business strategies and processes, and (e) inflows of investments with the continuing trust in government leadership. Their more positive outlook was also driven by expectations of higher disbursements by the government on infrastructure and other development projects, and brisker business due to the Philippines' hosting of the 30th Association of Southeast Asian Nations (ASEAN) Leaders' Summit.

Table 8. Business Expectations Survey

BUSINESS OUTLOOK INDEX		Current Quarter	Next Quarter
2015	Q1	45.2	58.2
	Q2	49.2	47.3
	Q3	41.4	53.1
	Q4	51.3	43.9
2016	Q1	41.9	49.6
	Q2	48.7	45.3
	Q3	45.4	56.8
	Q4	39.8	34.5
2017	Q1	39.4	47.2
	Q2	43.0	42.7

Source: BSP

The sentiment of businesses in the Philippines mirrored the improved business confidence in Hong Kong, South Korea, Canada, France, Germany, and Netherlands but was in contrast to the weaker outlook of those in the US, UK, Thailand, and New Zealand.

quarter). The response rate was higher for NCR at 81.5 percent (from 80.1 percent in the previous quarter) and lower for AONCR at 84.7 percent (from 84.8 percent in Q1 2017).

For the quarter ahead (Q3 2017), business outlook was less optimistic. The next quarter CI at 42.7 percent was lower than the 47.2 percent in the previous survey. According to respondents, seasonal factors were behind their less upbeat outlook, given the expected interruption of business activities during the rainy season, and lower consumer demand as households prioritize school enrolment expenses over other expenditures.

Consumer Expectations. Consumers' optimism improved for Q2 2017 as the overall confidence index (CI) climbed to a double-digit record high of 13.1 percent in the latest Consumer Expectations Survey (CES).[27]

Consumer confidence for Q2 remains optimistic but turns circumspect in next quarter

This is the fourth consecutive quarter that consumer confidence registered positive reading, indicating that the number of households with optimistic views increased and continued to be greater than those with pessimistic views. According to respondents, the following reasons were behind their rising optimism:
(a) improvements in the peace and order situation, (b) additional family income due to higher salary and stronger business activity, (c) availability of more jobs and increase in the number of employed family members, and (d) effective government policies. Their more positive outlook was also boosted by the assistance from government (e.g., Pantawid Pamilyang Pilipino Program (4Ps) and increase in pension of retirees), expected higher Overseas Filipino remittances, and anticipated good harvest.

[27] The Q2 2017 CES was conducted during the period 1-12 April 2017, prior to the declaration of martial law in Mindanao by President Rodrigo Duterte on 23 May 2017. The CES samples, which were drawn from the Philippine Statistics Authority (PSA) Master Sample List of Households, were generated using a stratified multi-stage probability sampling scheme. It has a sample size of 5,631 households, of which 2,799 (49.7 percent) were from NCR and 2,832 (50.3 percent) from AONCR.

Table 9. Consumer Expectations Survey

CONSUMER OUTLOOK INDEX		Current Quarter	Next 3 Months	Next 12 Months
2015	Q1	-10.0	4.4	17.3
	Q2	-16.2	-0.4	16.4
	Q3	-11.6	5.8	15.8
	Q4	-8.1	5.7	18.0
2016	Q1	-5.7	9.1	25.4
	Q2	-6.4	5.6	26.6
	Q3	2.5	27.3	43.8
	Q4	9.2	18.8	33.4
2017	Q1	8.7	16.5	31.7
	Q2	13.1	13.6	34.3

Source: BSP

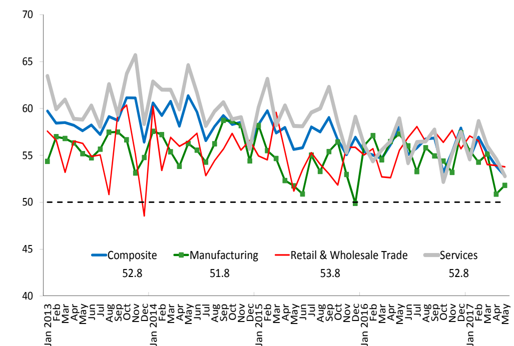
The confidence of consumers in the Philippines mirrored the improved sentiment of consumers in Indonesia, South Korea, Taiwan, Thailand, and the Euro Area, but was in contrast to the weakened views of those in Australia, Canada, Japan, Switzerland, United Kingdom and the United States for Q2 2017. Meanwhile, consumer sentiment in France remained unchanged.

For the next quarter (Q3 2017), consumer sentiment turned less optimistic as the CI declined to 13.6 percent (from 16.5 percent in the previous quarter's survey), but improved for the year ahead to 34.3 percent (from 31.7 percent). Respondents' less favorable outlook for the next quarter stemmed from concerns about (a) increase in prices of goods, (b) expectations of higher expenses for their children's education (e.g., tuition fees), and (c) lower income or no increase in income. For the year ahead, consumers attributed their more upbeat outlook to the anticipated: (a) additional family income due to higher salary and stronger business activity, (b) availability of more jobs and additional working family members, (c) improvements in the peace and order situation, and (d) influx of more investors in the country.

Purchasing Managers' Index.[28] The composite PMI remained firmly above the 50-point expansion threshold[29] in May 2017. However, the May 2017 PMI is lower at 52.8 from 53.9 in April 2017 mainly due to the slower rate of expansion of the services sector. This is the second lowest reading[30] since data on the composite PMI was made available in October 2010.

PMI remains above the 50-point expansion threshold

Chart 16. Purchasing Managers' Index



Source: Philippine Institute of Supply Management (PISM)

The manufacturing PMI accelerated slightly by 0.9 index points to 51.6 in May 2017 from 50.9 in April 2017. According to 70 percent of 55 respondent-establishments, the sector's marginal improvement may be attributed to relatively higher demand, sales, customers, and production, and partially due to business expansions in May from month-ago level. This was evident in the faster rate of expansion of the New Orders Index and Production Index. The Supplier Deliveries Index remain below the 50-point threshold (with PMI of 49.9), nevertheless, this is an improvement from the previous month's reading at 49.4. Meanwhile, all firms in the export categories posted better performance in May as the PMIs rose above the 50-point threshold. In particular, firms with export volume between 26 percent and 50 percent of total revenues recovered from a contraction at 48.5 in April to 57.7 in May. On a per sector basis, six of the twelve manufacturing subsectors expanded compared to the month-ago levels that include food and beverages; fuel and chemicals; non-metallic minerals; fabricated metal; electronics, communication, and medical equipment; and motor vehicles. Firms expect a slower expansion for the sector in June 2017.

[28] Data based on the monthly purchasing managers' index report of the Philippine Institute for Supply Management.

[29] The actual formula used to calculate the PMI assigns weights to each common element and then multiplies them by 1.0 for improvement, 0.5 for no change, and 0 for deterioration. As a result, an index above 50 indicates economic expansion, and an index below 50 implies a contraction. PMI surveys are conducted on the last week of the month.

[30] The lowest reading was in January 2016 when the composite PMI was at 52.77.

By contrast, the services PMI declined by 1.8 index points to 52.8 in May 2017 from 54.6 in the previous month. The sector's lackluster performance was due mainly to the slower growth of four out of six indices, despite steady business activities and new orders in May. In particular, the Employment Index – which measures the change in the percentage of total positions actually filled up – showed contraction at 48.6. Business Price Charge Index (BPCI) was relatively steady with a PMI of 50.4. This is the third time that BPCI hovered within the 50-51 point range. All firms by export activity decelerated in May. In particular, firms with export volume between 26 percent and 50 percent of total revenues decelerated by 11.7 points to a PMI of 48.3 in May from 60 in April. Meanwhile, three of the 13 subsectors indicated contraction in May (i.e., banking and financial intermediation, real estate, and business and knowledge processing), while nine subsectors expanded (i.e., electricity, gas, and water; construction; hotels and restaurants; transportation including travel agency; provident and insurance; renting of goods and equipment; miscellaneous business activities; health and social work; and processing education). The postal and telecommunications subsector was steady in May. Firms expect a turnaround for the sector in June 2017.

The retail and wholesale PMI was broadly steady with a PMI of 53.8 in May from 53.9 in April. The sector's minimal expansion was due mainly to cutbacks in purchases, number of positions actually filled up in the company, and inventories. Nonetheless, all the indices expanded above the 50-point threshold. Meanwhile, the PMI of the retail subsector increased slightly by 0.4 index points to 55.22 in May. By contrast, the PMI of the wholesale subsector declined by 1.39 index points to 50.98 from the month-ago level. Firms expect the sector to accelerate in June 2017.

External Demand

Exports. Exports of goods expanded by 16.3 percent y-o-y in Q1 2017 from 3.6 percent in the previous quarter. The growth in exports in Q1 2017 is a turn-around from the 6.7-percent contraction posted in Q1 2016.

Exports of goods rise

The notable expansion in foreign shipments of coconut products, other agro-based products, forest products, mineral products and manufactures outweighed the decline in exports of sugar and related products, fruits and vegetables, and petroleum products.

Table 10.Exports of Goods
growth rate in percent

COMMODITY GROUP	2016 Q1	2016 Q4	2017 Q1
Coconut Products	-42.5	74.2	133.2
Sugar and Products	393.4	296.8	-73.2
Fruits and Vegetables	6.3	76.3	-23.3
Other Agro-Based Products	-22.2	42.7	17.4
Forest Products	-51.1	68.4	178.6
Mineral Products	-36.4	24.9	61.7
Petroleum Products	58.4	22.1	-26.3
Manufactures	-4.2	-0.8	13.8
Special Transactions	-28.5	-23.1	37.3
Total Exports	**-6.7**	**3.6**	**16.3**

Source: BSP staff computations based on data from the PSA

Imports. Imports of goods grew by 15.1 percent in Q1 2017 from 16.9 percent and 12.1 percent registered in Q4 2016 and Q1 2016, respectively.

Imports of goods increase

The sustained growth in imports was due to the expansion in inward shipments across all import commodities namely, capital goods, raw materials and intermediate goods, mineral fuels and lubricant and consumer goods.

Table 11. Imports of Goods
growth rate in percent

COMMODITY GROUP	2016 Q1	2016 Q4	2017 Q1
Capital Goods	54.3	32.7	6.0
Raw Materials and Intermediate Goods	-1.0	6.8	15.3
Mineral Fuels and Lubricants	-31.4	0.0	56.7
Consumer Goods	20.3	22.9	12.5
Special Transactions	43.6	26.2	-17.3
Total Imports	**12.1**	**16.9**	**15.1**

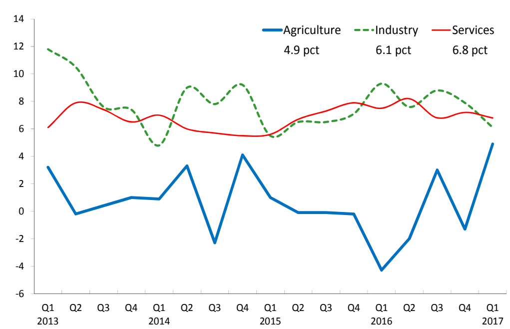
Source: BSP staff computations based on data from the PSA

Aggregate Supply. On the production side, the first quarter growth of the economy was driven mainly by services (contributing 3.8 ppts), industry (contributing 2.1 ppts) and agriculture (contributing 0.5 ppt).

Services sector continues to support supply-side growth

The services sector expanded by 6.8 percent in Q1 2017, lower than the 7.2-percent growth in Q4 2016. The slowdown in growth was due to the deceleration of real estate, renting and business activities (6.9 percent from 9.1 percent), transport, storage and communication (4.9 percent from 6.4 percent), and public administration and defense and compulsory social security (5.5 percent from 13.3 percent). The growth of real estate, renting and business activities was slower compared to that of the previous quarter on account of the lower growth of renting and other business activities (10.4 percent from 14.4 percent) and real estate (6.5 percent from 7.5 percent). Similarly, the slowdown in transport, storage and communication was due to the lower growth of land (6.8 percent from 9.5 percent), air (8.5 percent from 11.8 percent) transport as well as communication (2.6 percent from 4.7 percent). Meanwhile, trade and repair of motor vehicles, motorcycles, personal, and household goods, financial intermediation and other services increased from a quarter ago.

Chart 17. Gross Domestic Product by Industrial Origin (at constant prices)
year-on-year growth in percent



Source: PSA

The industry sector grew by 6.1 percent in Q1 2017, a slowdown compared to 7.9 percent in Q4 2016. This can be attributed to the lower growth in construction (8.2 percent from 10.7 percent) and electricity, gas and water supply (EGW) (1.4 percent from 9.2 percent) and contraction in mining and quarrying by 20 percent from a positive growth of 10.8 percent. The deceleration in the growth of construction was due to the lower growth of public construction. Likewise, the slowdown in the growth of EGW stemmed from the lower growth of electricity and water supply and decline of steam industry. The negative growth of mining and quarrying was due to the contraction of copper, nickel, crude oil, natural gas and condensate and other non-metallic mining, and the lower growth of stone quarrying, clay and sandpits. Meanwhile, manufacturing increased by 7.5 percent from 7 percent a quarter ago. This can be mainly attributed to the growth of food manufactures (9.8 percent from 8.3 percent), and radio, television and communication equipment and apparatus (1 percent from -4.7 percent).

The agriculture, hunting, forestry and fishery (AHFF) sector expanded by 4.9 percent from a negative growth of 1.3 percent a quarter ago. The growth drivers were palay (12.4 percent from -3.6 percent), corn (23.4 percent from -0.1 percent), and poultry production (1.9 percent from 1 percent), and fishing (0.7 percent from -3.8 percent). The growth in the agriculture sector can be attributed to good climate and favorable weather conditions.

Table 12. Economic Performance
at constant 2000 prices; growth rate in percent

BY INDUSTRIAL ORIGIN	2016				2017
	Q1	Q2	Q3	Q4	Q1
Agri., Hunting, Forestry and Fishing	-4.3	-2.0	3.0	-1.3	4.9
Agriculture and Forestry	-4.0	-1.3	4.3	-0.7	5.7
Fishing	-5.9	-5.2	-2.6	-3.8	0.7
Industry Sector	9.3	7.6	8.8	7.9	6.1
Mining and Quarrying	11.4	-4.0	-2.0	10.8	-20.0
Manufacturing	8.0	6.2	6.8	7.0	7.5
Construction	14.2	13.5	17.2	10.7	8.2
Electricity, Gas and Water Supply	10.2	10.3	9.6	9.2	1.4
Service Sector	7.5	8.2	6.8	7.2	6.8
Transport, Storage and Communication	5.3	7.0	4.6	6.4	4.9
Trade and Repair of Motor Vehicles, Motorcycles, Personal and Household Goods	7.5	8.9	6.3	6.5	7.1
Financial Intermediation	9.7	6.9	8.5	5.5	7.4
Real Estate, Renting and Business Activities	8.7	8.8	8.9	9.1	6.9
Public Administration and Defense; Compulsory Social Security	5.2	6.4	3.7	13.3	5.5
Other Services	7.3	9.0	6.8	6.0	7.6

Source: PSA

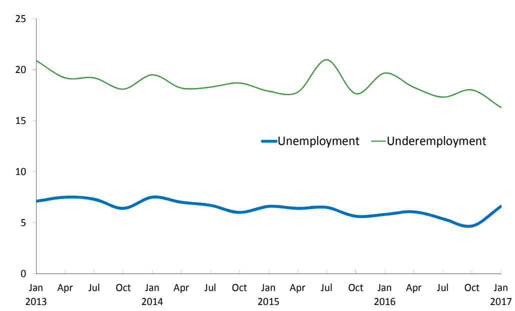
Labor Market Conditions

The Philippine labor market reported a relatively better performance in April 2017 as both unemployment and underemployment rates improved compared to their levels a year ago.

Philippine labor market weakens in Q1 2017

From 6.1 percent in April 2016, the country's unemployment rate declined to 5.7 percent in April 2017, the lowest recorded unemployment rate in all April rounds of the labor force survey (LFS) since 2005.[31] The underemployment rate also posted a remarkable improvement as it settled at 16.1 percent in April 2017, not only lower than the 18.3 percent rate a year ago but also the lowest in all LFS rounds in the past 12 years. These latest developments in the Philippine labor market condition need to be sustained[32] in order to realize the target of the government of 3 to 5 percent unemployment rate and 16 to 18 percent underemployment rate in areas outside the national capital region in 2022.[33] However, measures to improve the condition of employment among the youth have to be strengthened as youth unemployment rate even rose to 14.9 percent in April 2017 from 14.7 percent a year ago, farther away from the 8 percent target of the government in 2022.

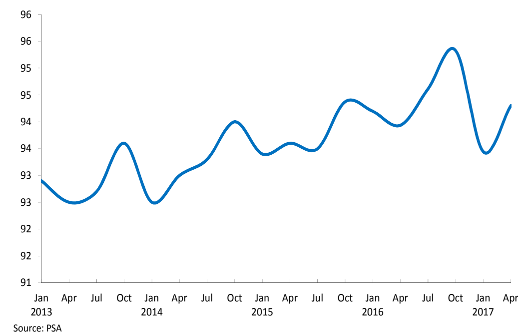
Chart 18. Unemployment and Underemployment
in percent



Total labor force declined by 1.3 percent as labor force participation rates of both men and women declined partly due to the implementation of the K to 12 program,[34] although the latter posted a greater decline (-1.6 percentage point (ppt) for men and -2.7 ppt for women) during the period.[35]

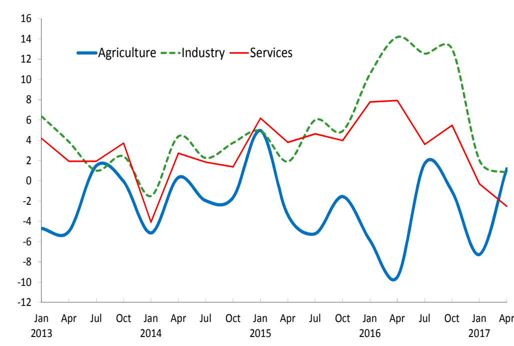
In April 2017, the country's employment rate increased to 94.3 percent from 93.9 percent in April 2016. However, this was primarily due to lower level of labor force as the level of employment declined by 1.0 percent to 40.3 million from the 40.7 million level a year ago.

Chart 19. Employment Rate
in percent



The decline in total employment was attributed mainly to lower employment in services sector (-2.4 percent growth),[36] which offset the slight improvement in employment in agriculture (1.2 percent) and industry (0.5 percent) sectors.

Chart 20. Employment by Sector
in percent



[31] Starting April 2005, the Philippine Statistics Authority has adopted the new unemployment definition based on international standard per NSCB Resolution No. 15 series of 2004.
[32] NEDA (2017), "Improvements in Employment must be sustained to meet PDP targets - NEDA," NEDA Press Release, 9 June.
[33] Philippine Development Plan (PDP), 2017-2022.

[34] Based on PDP, the implementation of the senior high school program starting in 2016 has increased school participation and, therefore, reduced labor market participation.
[35] This is considered as a challenge in meeting the PDP target to increase labor force participation of women to 51.3 percent by 2022 (Source: NEDA [2017]).
[36] Out of total employment, services sector accounts for 55.4 percent while the shares of agriculture and industry sectors are 26.1 percent and 18.5 percent, respectively.

The lower employment in services sector in April 2017 or a net employment loss of 557,000 was contributed mainly by wholesale and retail trade (-5.4 percent growth rate) and other service activities (-8.6 percent) possibly due to the end of election campaign activities and stricter enforcement of contractual arrangements.[37] Meanwhile, employment in agriculture appears to have started recovering from the adverse effect of weather disturbances as the sector posted a net employment gain of 125,000 in April 2017. Employment in the industry sector also posted a net employment gain of 39,000 as increases in employment in manufacturing (1.6 percent growth rate), construction (0.5 percent) and mining and quarrying (3.9 percent) sub-sectors surpassed the reduction in employment in utilities (-23.1 percent) sub-sector. The increases in employment in manufacturing and mining and quarrying sub-sectors reflect the renewed positive outlook of exporting firms that had anticipated increases in the volume of export production.[38] Most of the employed are still wage and salary workers (61.3 percent share) reflecting the possible continued strength of the Philippine economy in the second quarter of 2017. The share of vulnerable workers who are susceptible to external shocks and economic downturns (i.e., self-employed and unpaid family workers) slightly dropped but remained high at 34.9 percent.

[37] NEDA (2017).
[38] NEDA (2017).

The 5.7 percent unemployment rate in April 2017 is equivalent to 2.4 million unemployed individuals. Most of the unemployed are still high school (junior high school with 33.5 percent share) and college (20.6 percent) graduates. Meanwhile, the unemployment rate among the youth (15-24 age group) of 14.9 percent is still more than double the national unemployment rate and more than thrice the unemployment rate of 25 to 54 age group (3.9 percent). In addition, most of the country's underemployed remained in the services (44.4 percent share) and agriculture (35.9 percent share) sectors and more than half are visibly underemployed (62.3 percent share).[39,40] The country's overall mean hours of work (hours per week) declined to 40.3 in April 2017 from 42.2 a year ago.

[39] Visible underemployment refers to the proportion of employed individuals who are working for less than 40 hours and seeking additional hours of work. More than two-fifths (46.7 percent) of the visibly underemployed are in the agriculture sector.
[40] The invisible underemployment (underemployed full-time workers or those who work 40 hours or more per week but still wanted more work) has 37.7 percent share. Most (56.8 percent) of these are in services sector.

II. Monetary and Financial Market Conditions

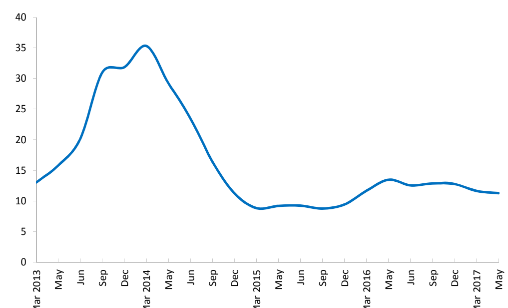
Domestic Liquidity

Domestic liquidity (M3) grew by 11.3 percent y-o-y in May to ₱9.6 trillion, sustaining the expansion of 11.6 percent recorded in end-Q1 2017.

Domestic liquidity continues to expand…

Money supply continued to increase due largely to continued demand for credit. Domestic claims grew by 14.3 percent in May from 16.4 percent in end-Q1 2017 on sustained growth in credits to the private sector. Net claims on the central government also increased by 8.9 percent in May from 15.0 percent at the end of the previous quarter as a result of increased borrowings by the National Government.

Chart 21. Domestic Liquidity
year-on-year growth rates in percent



Source: BSP

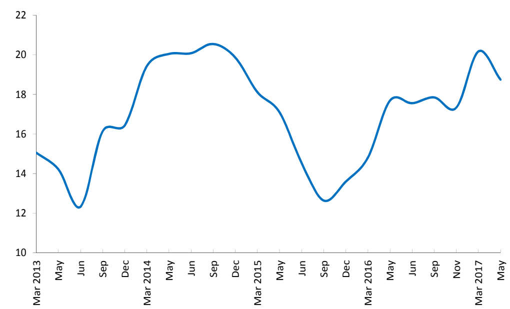
Meanwhile, the growth in net foreign assets (NFA) moderated to 4.6 percent y-o-y in May from 6.8 percent in end-Q1 2017. The BSP's NFA position expanded during the period on the back of robust foreign exchange inflows coming mainly from overseas Filipinos' remittances and business process outsourcing receipts. The NFA of banks likewise expanded due mainly to the growth in banks' foreign assets resulting from higher loans and investments in marketable debt securities.

Preliminary data as of May 2017 show that outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, grew by 18.7 percent y-o-y relative to the 20.2 percent and 17.6 percent growth posted at end-Q1 2017 and end-Q2 2016, respectively.

…as lending sustains growth due to production activities

The sustained increase in bank lending was due largely to loans for production activities, which expanded by 17.6 percent y-o-y in May 2017 from 18.9-percent growth in end-Q1 2017 and 17.7-percent rise in end-Q2 2016.

Chart 22. Loans Outstanding of Commercial Banks
year-on-year growth rates in percent



Source: BSP

The expansion in production loans was driven primarily by increased lending to the following sectors: real estate activities; electricity, gas, steam and airconditioning supply; manufacturing; wholesale and retail trade, repair of motor vehicles and motorcycles; and, information and communication.

Meanwhile, loans for household consumption grew by 23.6 percent y-o-y as of end-May 2017, higher than the 24.5 percent and 18.7 percent growth recorded in end-Q1 2017 and end-Q2 2016, respectively.

Monetary Operations

For Q2 2017, majority of the BSP's monetary operations had been through the term deposit facility (TDF). Market demand for the 7-day TDF remained strong with average bid-to-cover ratio unchanged at 1.5 from the previous quarter while demand for the 28-day TDF weakened with average bid-to-cover ratio at 0.7 from 1.2 in Q1 2017. The results of the auction during the review quarter reflected market players' preference for shorter tenors amid global economic developments. Meanwhile, the average bid-to-cover ratio for the RRP facility was stable at 1.6 in Q2 2017.

Beginning 17 April 2017, the conduct of the RRP auction was moved from 2:30pm to 5:00pm. In addition, starting 3 May 2017, the offered volumes for the 7-day TDF was increased by ₱10 billion to ₱40 billion, while the offered volume for the 28-day TDF was reduced by ₱10 billion to ₱140 billion. The TDF auctions are still conducted every Wednesday while the RRP auction is a daily fine-tuning operation.

Credit Conditions

Credit Standards. Results of the Q2 2017 Senior Bank Loan Officers' Survey (SLOS)[41] showed that most of the respondent banks continued to maintain their credit standards for loans to both enterprises and households during the quarter based on the modal approach.[42] This is the 33rd consecutive quarter since Q2 2009 that the majority of respondent banks reported broadly unchanged credit standards.

Banks generally maintain credit standards during the quarter

Meanwhile, the diffusion index (DI) approach[43,44] pointed to a net tightening of credit standards for loans extended to enterprises while those for households were unchanged. In the previous quarter, credit standards for corporate lending likewise showed a net tightening while those for household lending were also unchanged based on the DI approach.

Lending to Enterprises. Most banks (90.0 percent of banks that responded to the question) indicated that credit standards for loans to enterprises remained unchanged during the quarter using the modal approach. However, results based on the DI approach indicated net tightening of credit standards for business loans attributed to less favorable economic outlook, respondent banks' perception of stricter financial system regulations and reduced tolerance for risk. In terms of specific credit standards, the net tightening of overall credit standards is reflected in respondent banks' stricter loan covenants for loans across all firm sizes (except micro enterprises) and increased use of interest rate floors for loans to micro, small and medium enterprises.[45]

[41] The survey consists of questions on loan officers' perceptions relating to the overall credit standards of universal/commercial banks (U/KBs) in the Philippines, as well as to factors affecting the supply of and demand for loans by both enterprises and households. Survey questionnaires were sent to 35 U/KBs, of which, 32 banks responded to the current survey representing a response rate of 91.4 percent. As of end-April 2017, U/KB loans accounted for about 87.4 percent of the banking system's gross total outstanding loans net of interbank loans and RRP agreements with BSP and other banks.
[42] In the modal approach, the results of the survey are analyzed by looking at the option with the highest share of responses.

[43] In the diffusion index approach, a positive diffusion index (DI) for credit standards indicates that the proportion of banks that have tightened their credit standards are greater compared to those that eased ("net tightening"), whereas a negative DI for credit standards indicates that more banks have eased their credit standards compared to those that tightened ("net easing").
[44] From Q1 2010 to Q4 2012 survey rounds, the BSP used largely the DI approach in the analysis of survey results. Beginning in Q1 2013, the BSP used both the modal and DI approaches in assessing the results of the survey.
[45] The survey questionnaire asks banks to describe changes in six specific credit standards: (1) loan margins (price-based); (2) collateral requirements; (3) loan covenants; (4) size of credit lines; (5) length of loan maturities; and (6) use of interest rate floors. A loan covenant is an agreement or stipulation laid down in loan contracts, particularly contracts with enterprises, under which the borrower pledges either to take certain action (an affirmative covenant), or to refrain from taking certain action (a negative covenant); this is consequently part of the terms and conditions of the loan. Meanwhile, an interest rate floor refers to a minimum interest rate for loans. Greater use of interest rate floor implies tightening while less use indicates otherwise.

Table 13. General Credit Standards for Loans to Enterprises (Overall)

	2016				2017	
	Q1	Q2	Q3	Q4	Q1	Q2
Tightened Considerably	3.3	0.0	0.0	3.4	0.0	0.0
Tightened Somewhat	6.7	9.7	6.9	3.4	6.7	10.0
Remained Basically Unchanged	**86.7**	**87.1**	**93.1**	**89.7**	**93.3**	**90.0**
Eased Somewhat	3.3	3.2	0.0	3.4	0.0	0.0
Eased Considerably	0.0	0.0	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0
Diffusion Index for Credit Standards	**6.7**	**6.5**	**6.9**	**3.4**	**6.7**	**10.0**
Weighted Diffusion Index for Credit Standards	**5.0**	**3.2**	**3.4**	**3.4**	**3.3**	**5.0**
Mean	2.9	2.9	2.9	2.9	2.9	2.9
Number of Banks Responding	**30**	**31**	**29**	**29**	**30**	**30**

Note: A positive diffusion index for credit standards indicates that more banks have tightened their credit standards compared to those that eased ("net tightening"), whereas a negative diffusion index for credit standards indicates that more banks have eased their credit standards compared to those that tightened ("net easing").
Source: BSP

In terms of borrower firm size, banks' responses showed net tighter overall credit standards across firm sizes based on the DI approach.

Results based on the modal approach showed that most of the respondent banks anticipate unchanged credit standards over the next quarter. Meanwhile, the DI approach showed that some respondent banks expect overall credit standards for business loans to tighten over the next quarter largely on account of banks' less favorable economic outlook and expectations of stricter financial system regulations.

Lending to Households. The results of the survey also showed that most respondent banks (81.8 percent) kept their overall credit standards unchanged for loans extended to households during the quarter based on the modal approach. Likewise, results based on the DI approach reflected unchanged credit standards, given the equal number of respondent banks that indicated a tightening of credit standards and those that answered easing of credit standards. In particular, credit standards for auto loans were unchanged based on the DI approach. The maintained overall credit standards were attributed by respondent banks to their unchanged tolerance for risk and stable profile of their household borrowers. In terms of specific credit standards, results based on the DI approach indicated overall unchanged collateral requirements, loan covenants and loan maturities.

Table 14. General Credit Standards for Loans to Households (Overall)

	2016				2017	
	Q1	Q2	Q3	Q4	Q1	Q2
Tightened Considerably	0.0	0.0	0.0	5.0	0.0	0.0
Tightened Somewhat	9.5	8.3	9.1	0.0	0.0	9.1
Remained Basically Unchanged	**81.0**	**83.3**	**90.9**	**95.0**	**100.0**	**81.8**
Eased Somewhat	9.5	8.3	0.0	0.0	0.0	9.1
Eased Considerably	0.0	0.0	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0
Diffusion Index for Credit Standards	**0.0**	**0.0**	**9.1**	**5.0**	**0.0**	**0.0**
Weighted Diffusion Index for Credit Standards	**0.0**	**0.0**	**4.5**	**5.0**	**0.0**	**0.0**
Mean	3.0	3.0	2.9	2.9	3.0	3.0
Number of Banks Responding	**21**	**24**	**22**	**20**	**21**	**22**

Note: A positive diffusion index for credit standards indicates that more banks have tightened their credit standards compared to those that eased ("net tightening"), whereas a negative diffusion index for credit standards indicates that more banks have eased their credit standards compared to those that tightened ("net easing").
Source: BSP

Over the next quarter, results based on the modal approach indicated that majority of the respondent banks anticipate maintaining their overall credit standards. Meanwhile, the DI approach showed expectations of overall net easing of credit standards, particularly for housing, auto and personal/salary loans, on the back of respondent banks' increased tolerance for risk and anticipated improvement in the profitability and liquidity of their portfolio, along with expectations of improvement in household borrowers' profile in Q3 2017.

Loan demand. Responses to the survey question on loan demand indicated that the majority of the respondent banks continued to see stable overall demand for loans from both enterprises and households. Using the DI approach, however, results showed a net increase in loan demand[46] across all firm sizes and all types of household loans. The net increase in loan demand of firms was largely attributed by banks to higher requirements of borrower firms for working capital and accounts receivable financing. Meanwhile, respondent banks attributed the net increase in demand for household loans largely to low interest rates and banks' more attractive financing terms, among others.

[46] The "DI for loan demand" refers to the percentage difference between banks reporting an increase in loan demand and banks reporting a decrease. A positive DI for loan demand indicates that more banks reported an increase in loan demand compared to those stating the opposite, whereas a negative DI for loan demand implies that more banks reported a decrease in loan demand compared to those reporting an increase.

Demand for loans from both enterprises and households remain stable

Over the next quarter, most of the respondent banks expect unchanged loan demand from both firms and households. However, a larger proportion of respondents expect overall demand for corporate and household loans to increase further in the next quarter relative to those who indicated the opposite. Respondent banks cited expectations of higher working capital and accounts receivable financing needs and investments in plant and equipment of borrower firms as the key factors behind the expected increase in demand for business loans. Meanwhile, the anticipated net increase in household loan demand was attributed by respondent banks to expectations of more attractive financing terms offered to clients along with higher household consumption and low interest rates.

Real Estate Loans. Most of the respondent banks (95.5 percent) also indicated unchanged credit standards for commercial real estate loans in Q2 2017. The DI approach, however, continued to indicate a net tightening of overall credit standards for commercial real estate loans for the sixth consecutive quarter. The tighter overall credit standards for commercial real estate loans reflected respondent banks' wider loan margins, reduced credit line sizes, stricter collateral requirements and loan covenants, shorter loan tenors, and increased use of interest rate floors. Over the next quarter, while majority of the respondent banks foresee maintaining their credit standards for commercial real estate loans, DI-based results point to expectations of continued net tightening of credit standards for the said type of loan.

Credit standards for real estate loans remain steady

Demand for commercial real estate loans was also unchanged in Q2 2017 based on the modal approach. A number of banks, however, indicated increased demand for the said type of loan on the back of increased accounts receivable financing needs, improvement in customers' economic outlook, banks' more attractive financing terms and lower interest rates. Over the next quarter, although most of the respondent banks anticipate generally steady loan demand, a number of banks expect demand for commercial real estate loans to continue to increase.

Meanwhile, in the case of housing loans extended to households, most of the respondent banks (84.2 percent) reported unchanged credit standards. However, a larger proportion of respondents reported tighter credit standards for housing loans relative to those who indicated the opposite. The net tightening of credit standards for housing loans was attributed by respondent banks largely to their reduced tolerance for risk, a decline in borrowers' profiles and perceived stricter financial system regulations. Over the next quarter, results based on the modal approach showed that a large majority of banks expects unchanged overall credit standards for housing loans. However, the DI approach pointed to expectations of a net easing of overall credit standards for housing loans as respondent banks foresee an improvement in the profitability and liquidity of their portfolio, an increase in banks' deposit base and higher tolerance for risk. At the same time, results continued to show increased demand for housing loans in Q2 2017 as well as expectations of a continued increase in demand for the said type of loan in the next quarter.

Interest Rates

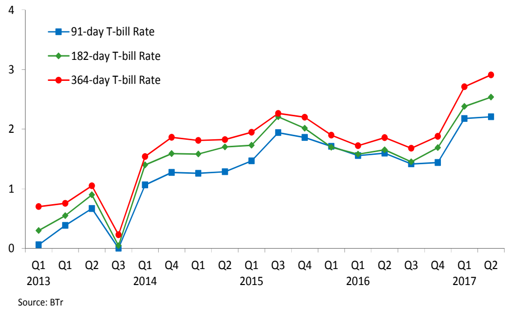
Primary Interest Rates

In Q2 2017, the average 91-day, 182-day, and 364-day T-bill rates in the primary market increased to 2.206 percent, 2.537 percent, and 2.909 percent from 2.179 percent, 2.380 percent, and 2.710 percent, respectively, in Q1 2017.

T-bill rates in the primary market continue to increase

The results of the auction reflected market players' continued strong demand for shorter-tenored government securities in view of recent developments in the US economy.

Chart 23. Treasury Bill Rates
in percent

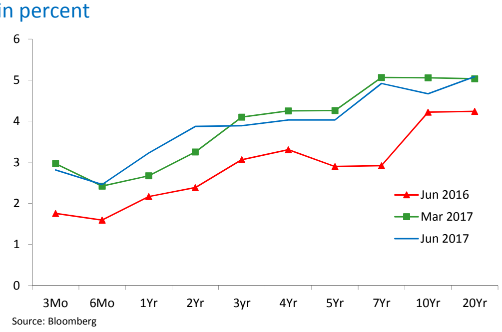


Yield Curve. As of end-June 2017, the secondary market yield for government securities (GS) declined generally except for the 6-month, 1-year, 2-year and 20-year GS relative to the end-March 2017 levels, as it tracked the downward movement of the benchmark US Treasury yields and amid buying activity as banks serviced their clients' requirements.

Yield curve decline generally in end-June 2017

Debt paper yields were lower by a range of 14.5 bps (7-year GS) to 38.6 bps (10-year GS) compared to end-March 2017 levels.

Chart 24. Yields of Government Securities in the Secondary Market
in percent



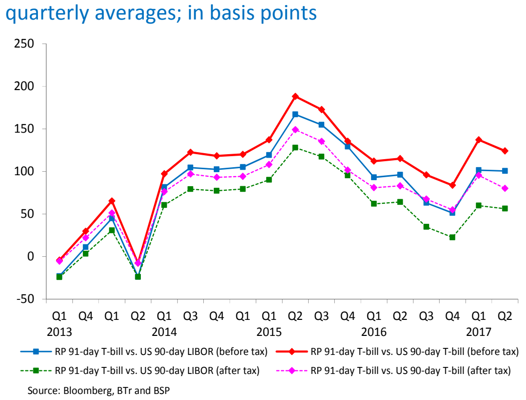
Relative to year-ago levels, the secondary market yields of GS for all maturities increased by a range of 45.1 bps for the 10-year GS to 199.7 bps for the 7-year GS.

Interest Rate Differentials. The average differentials between domestic and US interest rates, gross and net of tax, narrowed in Q2 2017 relative to the previous quarter.

Interest rate differentials narrow

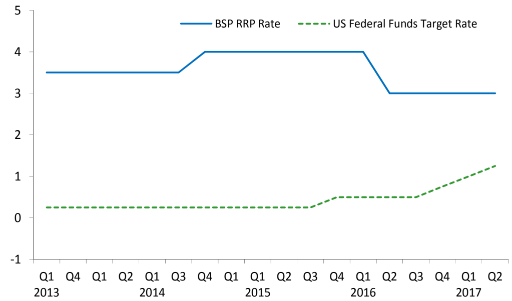
The average 91-day RP T-bill rate rose q-o-q by 12.2 bps to 2.206 percent in Q2 2017 from 2.084 percent in Q1 2017. Likewise, the average US 90-day LIBOR and the US 90-day T-bill rate increased by 13.4 bps and 25.1 bps, respectively, to 1.202 percent and 0.965 percent in Q2 2017. These developments led to narrower positive gross and net of tax differentials between the 91-day RP T-bill rate and US interest rates. Domestic interest rates rose due mainly to investors' strong appetite for short-dated tenors following the US Fed's interest rate hike in June 2017; optimism over the country's growth performance in Q1 2017 and good prospects for the government's tax reform package and tax amnesty plan. Meanwhile, foreign interest rates rose during the quarter following the release of stronger-than-expected US data on consumer sentiment, personal consumption, Q1 2017 GDP growth, home sales, inflation, and unemployment rate vis a vis lower-than-expected US data on manufacturing activity, durable goods order, housing and retail sales, services sector growth, jobs and exports.

Chart 25. Interest Rate Differentials
quarterly averages; in basis points



The positive differential between the BSP's overnight borrowing or RRP rate and the US Fed funds target rate narrowed to a range of 175-200 bps in Q2 2017 from 200-225 bps in Q1 2017, reflecting the impact of the 25-bp increase in the US Fed funds target rate to 1.00-1.25 percent on 15 June 2017.

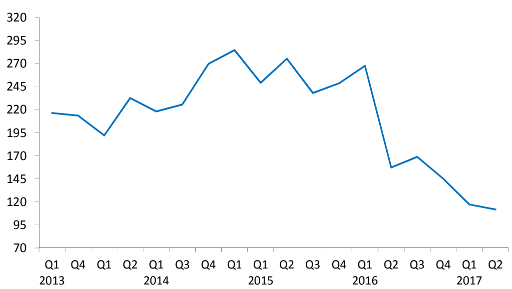
Chart 26. BSP RRP Rate and US Federal Funds Target Rate
in percent



Source: Bloomberg and BSP

Similarly, the interest rate differential between the BSP's overnight RRP rate and the US Fed funds target rate adjusted for risk[47] narrowed further to 112 bps as of end-June 2017 from 117 bps in end-March 2017. This development could be traced to the decrease in the positive interest rate differential between the BSP's RRP rate and the US Fed funds target rate and a lower risk premium.

Chart 27. Risk-Adjusted Differentials
in basis points



Source: Bloomberg and BSP

Meanwhile, the lower risk premium in end-June 2017 could be attributed to the 29-bp decrease in the 10-year ROP note to 2.87 percent and the 9-bp decrease in the 10-year US note to 2.24 percent. The 10-year US and 10-year ROP notes declined on investors' demand for safe-haven assets following the heightened geopolitical risks in Europe, Syria and North Korea; the US Fed's interest rate hike in June 2017; and the release of mixed US economic data amid the increasing political uncertainty in the Trump administration.

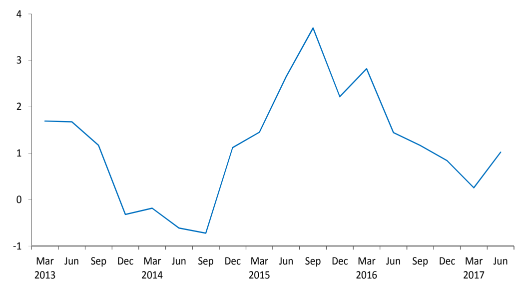
[47] The difference between the 10-year ROP note and the 10-year US Treasury note is used as proxy for the risk premium.

Domestic real lending rate[48] increased to 1.0 percent in June 2017 from 0.3 percent in March 2017. This was due to the 60-bp decline in inflation to 2.8 percent combined with the 10-bp rise in actual bank lending rate[49] to 3.8 percent in June 2017.

Real lending rate increases

The Philippines' real lending rate is the third lowest in a sample of 10 Asian countries in June 2017, with India recording the highest real lending rate at 7.2 percent while Japan posted the lowest at 0.6 percent.

Chart 28. Philippines' Real Lending Rate
in percent



Source: PSA and BSP

Financial Market Conditions

Despite the uncertainty affecting global financial markets coming from the US Federal Reserve's decision to raise interest rates and the volatility in global oil prices, the country's sustained growth in Q1 2017 as well as the optimism generated by the National Government's proposed tax reform program provided significant boost to investor sentiment.

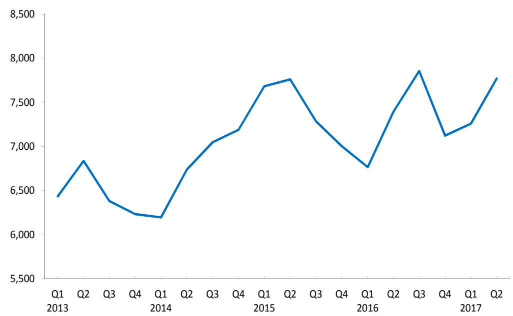
Domestic financial market conditions reflect external uncertainty

[48] Real lending rate is measured as the difference between actual bank lending rate and inflation.
[49] The actual bank lending rate for the Philippines is the weighted average interest rate charged by reporting commercial banks on loans and discounts granted during the period.

The domestic financial market remained resilient, supported by the sustained strong growth of the economy.

Stock Market. For Q2 2017, the Philippine Stock Exchange index (PSEi) rose by 7.1 percent, q-o-q, to average 7,770.8 index points.

Chart 29. Quarterly Average PSEi
In basis points



Source: Philippine Stock Exchange, BSP

Despite external volatility, the country's sustained growth for Q1 2017 as well as optimism that the tax reform program will help fund the Government's infrastructure program boosted investor sentiment and drove the index to reach the 8,000 mark in early June. However, downward pressures from the slump in oil prices and the US Federal Reserve's decision to raise interest rates for the second time this year took some points off the index.

Sustained growth and NG's tax reform program boosted the stock index in Q2 2017

In April, the benchmark index traded passed the 7,700 mark as net foreign buying surged on expectations of better economic growth for the quarter. However, concerns over the US Fed's plan to trim its balance sheet later this year, the US missile attacks in Syria, growing tensions between Washington and North Korea, and the presidential elections in France partly tempered the index's rally. The PSEi closed the month at 7,661.0 on 27 April, higher by 4.8 percent relative to the previous month's closing index and by 12.0 percent, y-t-d.

The PSEi continued to rally in May amid positive feedback from the country's hosting of the 30th ASEAN Summit, which buoyed trading sentiments, and the sustained GDP growth for Q1 2017. Moreover, the US Fed's decision to keep rates unchanged as well as the favorable results in the French presidential polls helped boost sentiment. However, disappointing earnings reported by some blue chip companies, particularly telecommunications firms, (e.g., PLDT, Globe and Cebu Pacific),[50] investors' repositioning of their portfolios ahead of two IPO offerings (Eagle Cement Inc. and Cebu Landmasters Inc.) and the declaration of martial law in Mindanao saw the benchmark index move sideways as investors took on a wait-and-see stance. Nonetheless, the PSEi closed the month of May at 7,837.1 index points, higher than April's closing index by 2.3 percent and by 14.6 percent y-t-d.

In June, the PSEi reached the 8,000 mark in the first half of the month before retreating as the month drew to a close. The Congress' approval of the tax reform package, which raised expectation that this may lead to a credit rating upgrade in the future, and the release of positive PMI data for the month of May offset the impact on the market of the attack at a casino and hotel complex on 2 June. However, the market's rally was moderated by the hike in the US Federal funds rate on 14 June; concerns over hawkish comments by several US Fed officials that raised the possibility that the US regulator will tighten rates anew before end-2017; the slump in crude oil prices; and the possible negative impact on investments of the inclusion of China's A shares into the MSCI index. Early reports that the country's BOP swung to a deficit in May and Credit Suisse's cautious economic outlook on the Philippines dragged the index below the 8,000 level posted in the early part of the month. On 30 June 2017, the PSEi closed at 7,843.2 index points, higher by 7.3 percent, q-o-q, or 14.9 percent, y-t-d, and relative to May's closing index by 0.1 percent.

Tracking the q-o-q rally in the PSEi, total market capitalization increased by 6.5 percent q-o-q to reach ₱16.3 trillion in June. Preliminary data from the PSE also showed that foreign investors were net buyers of ₱40.3 billion local shares during the period, a reversal from the ₱18.3 billion net sales recorded in the preceding quarter. Moreover,

[50] In particular: index heavyweight PLDT, Inc. reported that its consolidated net income dropped by ₱1.9 billion or 26 percent from a year ago to ₱4.969 billion in the first quarter; Ayala-led Globe reported a net income of ₱3.8 billion in the first quarter, down 13 percent from ₱4.3 billion a year earlier; and Cebu Pacific Air said its net profit fell 68.2 percent to ₱1.283 billion from ₱4.037 billion for the same period.

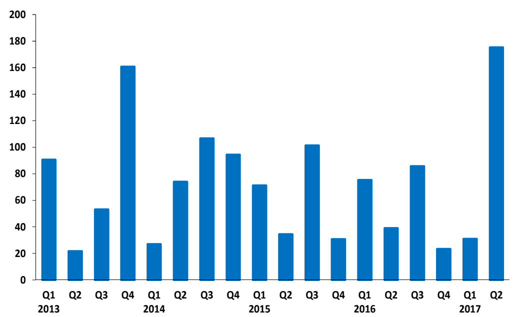
data from Bloomberg showed that the price-earnings ratio for locally listed firms rose from the 20.1x in end-March to 21.4x as of 29 June 2017.

Government Securities. Results of the T-bill auctions conducted in Q2 2017 (April - June) continue to show robust demand for T-bills with total subscription for the quarter amounting to ₱266.1 billion, about 3.0 times the ₱90.0-billion total offered amount. The oversubscription for the quarter, at ₱176.1 billion, was higher than the ₱30.9-billion oversubscription in the previous quarter.

Demand for local GS remains robust

The Bureau of Treasury (BTr) awarded in full the ₱6.0-billion, ₱5.0-billion, and ₱4.0-billion offered amounts for the 91-, 182-, and 364-day T-bills, respectively, in all auctions of the quarter except for the 364-day T-bill on 10 April 2017. The BTr awarded in full all tenors as the interest rates fetched during the auction were in line with market expectations.

Chart 30. Total Oversubscription of T-bill Auctions



Source: Bureau of the Treasury

Sovereign Bond and CDS Spreads. In April, debt spreads took a negative turnaround and widened amid the heightened geopolitical tensions in the Middle East and the Korean peninsula. Investors went extra cautious as geopolitical tensions were compounded by the mixture of political uncertainty particularly in the Euro Area, messy Brexit and unsure Trump policy developments.

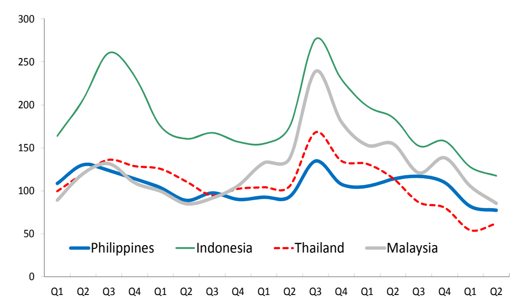
Debt spreads narrower on improved US economic data

In May, debt spreads narrowed slightly as geopolitical tensions tempered, with the pro-EU centrist Emmanuel Macron winning the French presidency (in a decisive victory over the far-right Front National leader, Marine Le Pen) and vowing to unite a divided and fractured France and Europe. His victory was hailed by the international community as holding back a tide of populism after the Brexit vote and Donald Trump's victory in the US election.

In June, debt spreads narrowed further as the US Fed raised interest rates for the second time in 2017 by 25 bps to a range of 1.00 to 1.25 percent signaling that the US economy is recovering. Domestically, the Congress approved the government's first tax reform package boosting further investor confidence.

As of end-June, the Philippines' 5-year sovereign credit default swaps (CDS) stood at 77 bps, lower than the 82 bps in end-1Q 2017. It has remained lower than Indonesia's 117 bps and Malaysia's 85 bps in the current quarter. Likewise, the EMBIG Philippines ended the quarter narrower at 95 bps when compared to the previous quarter's closing of 98 bps.

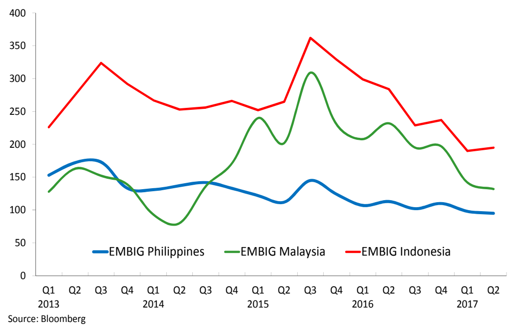
Chart 31. 5-Year CDS Spreads of Selected ASEAN Countries
in basis points



Source: Bloomberg

Likewise, the EMBIG Philippines ended the quarter narrower at 95 bps when compared to the previous quarter's closing of 98 bps.

Chart 32. EMBIG Spreads of Selected ASEAN Countries
in basis points



Banking System

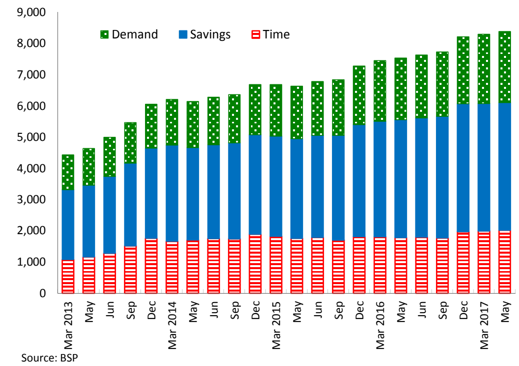
The Philippine banking system remained resilient in supporting long-term economic growth and stable financial condition. During the review quarter, banks' balance sheets exhibited sustained growth in assets and deposits.

Philippine banking system posts sustained growth in assets and deposits

Furthermore, asset quality indicators remained healthy while capital adequacy ratios continued to be above international standards, even with the implementation of the tighter Basel III framework.

Savings Mobilization. Savings and demand deposits remained the primary sources of funds for the banking system. Banks' total deposits[51] as of end-May 2017 amounted to ₱8.4 trillion, 11.3 percent or ₱0.9 trillion higher than the year-ago level. Relative to the previous quarter, total deposits grew by 1.0 percent due mainly to the expansion in demand and time deposits by 2.5 percent and 1.1 percent, respectively. Meanwhile, foreign currency deposits owned by residents (FCD-Residents) reached ₱1.8 trillion during the same period, posting a year-on-year and quarter-on-quarter growth of 15.9 percent and 0.9 percent, respectively.[52]

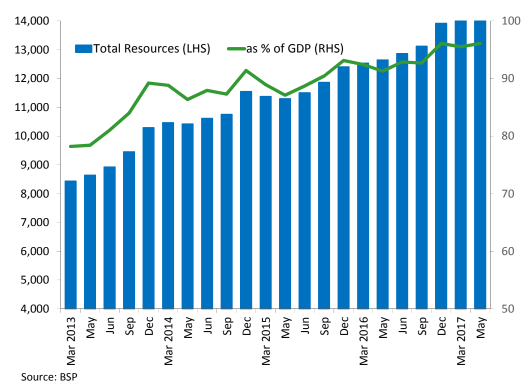
Chart 33. Deposit Liabilities of Banks
in billion pesos



Institutional Developments. The total resources of the banking system grew by 12.3 percent to reach ₱14.2 trillion as of end-May 2017 from ₱12.6 trillion a year ago, and by 0.6 percent from ₱14.1 trillion as of end-March 2017. As a percent of GDP, total resources stood at 96.1 percent.[53]

Total resources of the banking system continue to rise

Chart 34. Total Resources of the Banking System
levels in billion pesos; share in percent



The number of banking institutions (head offices) decreased to 599 offices as of end-March 2017 from the levels recorded a year ago at 622 offices and as of end-December 2016 at 602 offices. This

[51] This refers to the total peso-denominated deposits of the banking system.

[52] FCD-Residents, along with M3, forms part of a money supply measure called M4. Meanwhile, M3 consists of savings deposits, time deposits, demand deposits, currency in circulation, and deposit substitutes.

[53] GDP as of Q1 2017

indicated continued consolidation of banks as well as the exit of weaker players in the banking system.

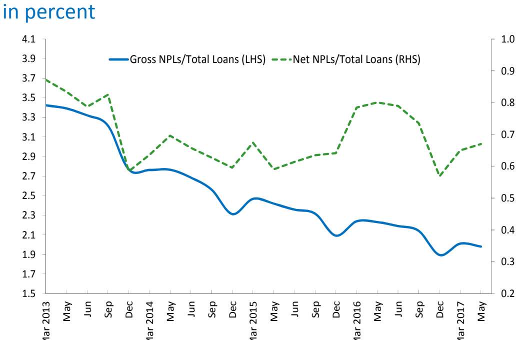
By banking classification, banks (head offices) consisted of 42 U/KBs, 59 thrift banks (TBs), and 498 rural banks (RBs). Meanwhile, the operating network (head offices and branches/agencies) of the banking system expanded to 11,278 offices in end-March 2017 from 10,849 offices a year ago and 11,178 offices in end-December 2016, due mainly to the increase in the branches/agencies of U/KBs and RBs.

The Philippine banking system's gross non-performing loan (GNPL) ratio improved to 2.0 percent as of end-May 2017 relative to the 2.2 percent registered a year ago but remained unchanged with respect to the end-March 2017 ratio.

Asset quality of Philippine banks remain healthy

Banks' initiatives to improve their asset quality along with prudent lending regulations helped maintain the GNPL ratio below its pre-Asian crisis level of 3.5 percent.[54]

Chart 35. Ratios of Gross Non-Performing Loans and Net Non-Performing Loans to Total Loans
in percent



Source: BSP

Similarly, the net non-performing loan (NNPL) ratio declined to 0.7 percent as of end-May 2017 relative to the previous year's ratio of 0.8 percent but remained unchanged with respect to the end-March 2017 ratio of 0.7 percent. In computing for the NNPLs, specific allowances for credit losses on Total Loan Portfolio (TLP) are deducted from the GNPLs. Said allowances decreased to ₱103.0 billion in end-May 2017 from ₱104.6 billion posted as of end-March 2017.[55]

The Philippine banking system's GNPL ratio of 2.0 percent was higher relative to that of Malaysia (1.2 percent) and South Korea (1.4 percent) but lower than that of Indonesia (2.9 percent) and Thailand (3.0 percent).[56]

The loan exposures of banks remained adequately covered as the banking system registered an NPL coverage ratio of 114.3 percent as of end-May 2017. This was higher than the previous year's ratio of 111.2 but slightly lower than the end-March 2017 ratio of 114.9 percent.

The capital adequacy ratio (CAR) of universal and commercial banks (U/KBs) at end-December 2016 decreased slightly to 14.4 percent on solo basis, relative to the previous quarter ratio of 15.4 percent. Likewise, the CAR, on a consolidated basis, fell to 15.1 percent from the quarter ago ratio of 16.2 percent. Nonetheless, these ratios remained well above the BSP regulatory threshold of 10.0 percent and international minimum of 8.0 percent.

U/KBs' CAR remain above international and regulatory standards

The CAR of Philippines' U/KBs, on a consolidated basis, of 15.1 percent was in line with that of South Korea (15.1 percent), but lower relative to that of Malaysia (17.0 percent), Thailand (18.0 percent) and Indonesia (20.6 percent).[57]

---

[54] The 3.5 percent NPL ratio was based on the pre-2013 definition.

[55] This type of provisioning applies to loan accounts classified under loans especially mentioned (LEM), substandard-secured loans, substandard-unsecured loans, doubtful accounts and loans considered as loss accounts.

[56] Sources: Malaysia – Bank Negara Malaysia, Quarterly Bulletin for Q1 2017 (Banking System's Impairment ratio, net of impairment provisions, Q1 2017); South Korea – Financial Supervisory Service, Press release (Domestic Banks' Substandard or Below Loans [SBLs] ratio, Q1 2017); Indonesia – IMF and financial stability reports (Banks' Nonperforming Loans to Gross Loans Ratio, Q4 2016); and Thailand – Bank of Thailand (Total Financial Institutions' Gross NPLs ratio, Q1 2017).

[57] Sources: South Korea - Financial Supervisory Service, Press release (Domestic Banks' Capital Ratio, Q1 2017); Malaysia – Bank Negara Malaysia, Quarterly Bulletin for Q1 2017 (Banking System's Total Capital Ratio, Q1 2017); Thailand – Bank of Thailand (Commercial Banks' Capital Funds Percentage of Risk

Exchange Rate

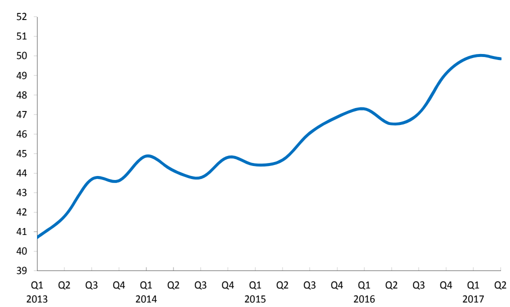
The peso appreciated against the US dollar in Q2 2017. On a quarter-on-quarter basis, the peso appreciated against the US dollar by 0.27 percent to average ₱49.86/US$1 from the previous quarter's average of ₱49.99/US$1.

The peso depreciates against the US dollar

The appreciation of the peso during the review period was due mainly to expectations of upbeat Philippine GDP growth for Q1 2017 and good prospects about the government's tax reform efforts. Meanwhile, on a year-on-year basis, the peso depreciated by 6.70 percent relative to the ₱46.52/US$1 average in Q2 2016.[58]

Chart 36. Quarterly Peso-Dollar Rate

PHp/US$; average per quarter



Source: Reference Exchange Rate Bulletin, Treasury Department, BSP

In April 2017, the peso strengthened against the US dollar by 0.83 percent to average ₱49.86/US$1 relative to the ₱50.28/US$1 average in March. The peso's appreciation was due mainly to optimism about the country's expected strong growth performance in Q1 2017 and amid good prospects about the government's tax reform package and tax amnesty plan.[59] In addition, the general weakness of the US dollar due to the drop in US Treasury yields amid geopolitical concerns in North Korea and Syria provided strength to the peso.[60]

The peso remained steady in May as it posted the same monthly average as the previous month's ₱49.86/US$1 as mitigating factors helped ease some weakening pressure on the peso. During the month, the following factors adversely affected the peso: (i) heightened caution among market players during the US Fed's two-day policy meeting on 2 to 3 May; (ii) terrorist attack in the UK; and (iii) negative sentiment due to the declaration of martial law in the Mindanao region.[61] However, these were partly offset by: (i) strong Philippine growth prospects for Q1 2017; (ii) weaker-than expected April 2017 US inflation; (iii) general weakness of the US dollar arising from political uncertainties in the US; and (iv) positive market sentiment in Asian markets following an upgrade of Indonesia's credit ratings.

The appreciation of the peso continued in June, albeit marginally, as it averaged ₱49.85/US$1 or 0.02 percent stronger than the previous month's average. The peso's slight appreciation was on the back of: (i) bullish comments released by Moody's on 5 June which cited the passage of the first tranche of the government's tax reform package on 31 May at the House of Representatives as "credit positive"; and (ii) weaker-than-expected US jobs data in May.[62] Investors were also seen trading on the sidelines, awaiting results of the monetary policy meetings at the US Federal Reserve and European Central Bank and the United Kingdom's general election.

On a year-to-date basis, the peso depreciated against the US dollar by 1.5 percent on 30 June 2017 as it closed at ₱50.47/US$1. This is in contrast with the strengthening of most Asian currencies during the same period.[63]

Assets, April 2017); and Indonesia – IMF and financial stability reports (Commercial Banks, Regulatory Capital to Risk-Weighted Assets Ratio Q4 2016).

[58] Dollar rates (per peso) or the reciprocal of the peso-dollar rates were used to compute for the percentage change.

[59] On 7 April 2017, Finance Secretary Carlos G. Dominguez's announced that the Philippines will follow Indonesia's lead in implementing a tax amnesty as it seeks to boost revenue to pay for the Government's spending plans. Meanwhile, on 4 April, Socioeconomic Planning Secretary Ernesto Pernia announced that the first quarter 2017 gross domestic product (GDP) is expected at 7 percent. The government targets GDP growth for the entire year to be within the range of 6.5 to 7.5 percent.

[60] Reuters reported that North Korea warned of a nuclear attack on the United States should the latter show any sign of aggression after a US Navy strike group hovered towards the western Pacific. The US, meanwhile, fired cruise missiles at the Shayrat base on 6 April 2017 in response to the chemical attack on a town in Syria, which US President Donald Trump blamed on the Damascus regime.

[61] On 23 May 2017, President Rodrigo Duterte placed Mindanao under martial law after government forces clashed with Islamic State (IS)-inspired Maute group led by Isnilon Hapilon in Marawi City, Lanao del Sur. The bombing incident in a concert in Manchester, UK likewise added pressure to the peso.

[62] The US Labor department reported weaker-than-expected non-farm jobs data (i.e. 138,000 new jobs) in May 2017.

[63] Based on the last done deal transaction in the afternoon.

Table 15. Year-to-Date Changes in Selected Dollar Rates

appreciation/(-depreciation); in percent

	2013	2014	2015	2016	2017*
Korean Won	1.1	-4.3	-6.6	-2.6	5.3
Thai Baht (Onshore)	-4.6	-0.7	-8.9	0.1	5.5
Singaporean Dollar	-2.7	-4.5	-6.0	-2.0	5.1
Indian Rupee	-11.4	-2.9	-4.9	-2.9	4.8
Indonesian Rupiah	-19.1	-2.1	-9.8	2.3	0.0
Philippine Peso	**-7.0**	**-0.7**	**-5.0**	**-5.3**	**-1.5**
Japanese Yen	-16.3	-12.5	-0.5	3.3	4.4
Malaysian Ringgit	-5.5	-6.3	-18.6	-4.2	4.5
Chinese Yuan	2.6	-2.7	-4.3	-6.6	2.4
New Taiwan Dollar	-1.9	-6.2	-3.6	1.9	6.3

Notes:
- Negative value represents depreciation of the currency against the US dollar.
- YTD changes are computed as the percent change between the closing prices for the year indicated versus the closing prices for the preceding year.
* Data as of 4:00 p.m., 30 June 2017
Source: Treasury Department - BSP

Nonetheless, the sustained inflows of foreign exchange from overseas Filipino remittances, foreign direct investments, BPO and tourism receipts, as well as the ample level of the country's gross international reserves and the country's robust economic growth, continued to provide support to the peso.[64]

Meanwhile, the volatility of the peso's daily closing rates (as measured by the coefficient of variation) stood at 0.55 percent during the review quarter, slightly higher than the 0.54 percent registered in the previous quarter.[65] Relative to other currencies in the region, the volatility of the peso remained in the middle of the pack.[66]

On a real trade-weighted basis, the peso gained external price competitiveness in Q2 2017 against the basket of currencies of all trading partners (TPI), trading partners in advanced (TPI-A) and developing countries (TPI-D). Relative to Q1 2017, the real effective exchange rate (REER) index of the peso decreased by 1.79 percent, 3.35 percent, and 0.71 percent, against the TPI, TPI-A, and TPI-D baskets, respectively. The nominal depreciation of the peso coupled with narrowing inflation differential contributed in the general decline in the REER.[67,68]

Relative to Q2 2016, the peso likewise gained external price competitiveness in Q2 2017 against the TPI, TPI-A, and TPI-D baskets. This developed as the nominal depreciation of the peso offset the impact of widening inflation differential against these currency baskets, resulting to a decrease in the REER index of the peso by 3.85 percent, 3.30 percent, and 4.23 percent against the TPI, TPI-A, and TPI-D baskets, respectively.

[64] As of end-June 2017, country's gross international reserves (GIR) stood at US$81.4 billion (preliminary). This can cover 8.7 months' worth of imports of goods and payments of services and primary income. It is also equivalent to 5.6 times the country's short-term external debt based on original maturity and 3.8 times based on residual maturity. Foreign direct investments (FDI) remained positive and registered a net inflow of US$2.4 billion as of April 2017. Remittances from OF workers continue to flow in from various geographical locations globally. For the period January to May 2017, cash remittances from OFs amounted to US$11.3 billion, which represents a 4.5 percent growth rate year-on-year, slightly higher than the 4.0 percent projection for the year. Business Process Outsourcing (BPO) receipts reached US$5.5 billion as of Q1 2017, growing by 9.9 percent relative to the same quarter last year.

[65] The coefficient of variation is computed as the standard deviation of the daily closing exchange rate divided by the average exchange rates for the period.

[66] The volatility of the peso was higher than that of Indonesian rupiah, Chinese yuan, and Malaysian ringgit but lower than that of Singapore dollar, Thailand baht, Japanese yen, and South Korean won.

[67] The Trading Partners Index (TPI) measures the nominal and real effective exchange rates of the peso across the currencies of 14 major trading partners of the Philippines, which includes US, Euro Area, Japan, Australia, China, Singapore, South Korea, Hong Kong, Malaysia, Taiwan, Indonesia, Saudi Arabia, United Arab Emirates, and Thailand. The TPI-Advanced measures the effective exchange rates of the peso across currencies of trading partners in advanced countries comprising of the US, Japan, Euro Area, and Australia. The TPI-Developing measures the effective exchange rates of the peso across 10 currencies of partner developing countries which includes China, Singapore, South Korea, Hong Kong, Malaysia, Taiwan, Indonesia, Saudi Arabia, United Arab Emirates, and Thailand.

[68] The REER index represents the Nominal Effective Exchange Rate (NEER) index of the peso, adjusted for inflation rate differentials with the countries whose currencies comprise the NEER index basket. A decrease in the REER index indicates some gain in the external price competitiveness of the peso, while a significant increase indicates the opposite. The NEER index, meanwhile, represents the weighted average exchange rate of the peso vis-à-vis a basket of foreign currencies.

III. Fiscal Developments

The National Government (NG) recorded a ₱63.6 billion fiscal deficit for January-May 2017, 15 percent lower than the deficit posted in the previous year.

NG recorded a fiscal deficit for January - May 2017

Netting out the interest payments in NG expenditures, the primary surplus amounted to ₱68.7 billion, 13 percent higher than the amount recorded in January-May 2016.

Table 16. National Government Fiscal Performance
in billion pesos

	2016		2017		Growth Rate (in percent)	
	May	Jan-May	May	Jan-May	May	Jan-May
Surplus/(Deficit)	-17.7	-75.2	-33.4	-63.6	89.0	-15.0
Revenues	199.8	925.4	228.3	996.5	14.0	8.0
Expenditures	217.4	1,000.5	261.7	1,060.2	20.0	6.0

* Totals may not add up due to rounding
Source: Bureau of the Treasury (BTr)

Revenues increased by 8 percent to ₱996.5 billion in January-May 2017 compared to ₱925.4 billion in the same period in 2016. The Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC) contributed ₱716.8 billion and ₱174.9 billion, respectively. The revenues of the BIR and BOC were higher by 9 percent and 13 percent, respectively, compared to their levels a year ago. Meanwhile, income from Bureau of the Treasury (BTr) decreased by 18 percent to ₱48.0 billion.

Expenditures for the period in review amounted to ₱1,060.2 billion, 6 percent higher than the expenditures in January-May 2016. Excluding interest payments, expenditures went up by 7 percent to ₱927.8 billion. Meanwhile, interest payment was ₱3.7 billion lower compared to its year-ago level, reaching ₱132.3 billion in January-May 2017.

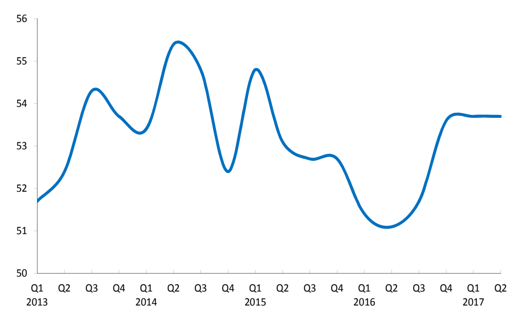
IV. External Developments

The JP Morgan Global All-Industry Output Index decreased slightly to 53.7 in June from 53.8 in May as output growth moderated in both the manufacturing and service sectors. Expansions were faster in the US, euro area, India and Australia, while growth softened in China, Japan, the UK, and Russia.[69]

Global economic activity remains solid

The IMF expects global inflation to remain subdued in the near and long term as core inflation rates are still well below central bank targets in almost all advanced economies. In emerging markets, the rise in inflation is more recent, as the impact of the recovery in fuel prices has only of late started to outweigh the downward pressure caused by slight currency appreciations.

Chart 37. JP Morgan Global All-Industry Output Index
index points



Source: Markit Economics

US. Real GDP expanded by 2.1 percent on a seasonally-adjusted y-o-y basis in Q1 2017, higher than the 2.0-percent growth rate in Q4 2016. On a q-o-q basis, real output growth was at 1.4 percent in Q1 2017 from 2.1 percent in Q4 2016. The q-o-q deceleration in real GDP reflected the slower growth in personal consumption expenditures and downturns in private inventory investment as well as state and local government spending that were partly offset by an upturn in exports and in nonresidential fixed investment.[70] Meanwhile, the manufacturing PMI posted a higher reading of 57.8 in June from 54.9 in May, as new orders and production increased at a faster rate.[71]

Economic growth in the US holds firm

The unemployment rate rose slightly to 4.4 percent in June from 4.3 percent in May. Total nonfarm employment increased by 222,000 in June, with gains in health care, social assistance, financial activities, and mining. Meanwhile, on a y-o-y basis, inflation fell to 1.6 percent in June 2017 from 1.9 percent in May owing to the slower rates of inflation in transportation, housing as well as fuels and utilities.

The Thomson-Reuters/University of Michigan Index of Consumer Sentiment decreased to 95.1 in June from 97.1 in May.[72] Meanwhile, the Conference Board Consumer Confidence Index increased to 118.9 in June from 117.6 in May.[73] Nonetheless, consumers' assessment of current business and labor market conditions generally held steady during the month, as consumers remained broadly optimistic.

Euro Area. On a q-o-q basis, real GDP in the euro area rose slightly by 0.6 percent in Q1 2017 from 0.5 percent in Q4 2016. On a y-o-y basis, real GDP expanded at a faster rate of 1.9 percent in Q1 2017 from 1.8 percent in the previous quarter.[74] Meanwhile, the composite PMI for the euro area eased to 56.3 in June from 56.8 in May as output growth slowed slightly, particularly in the service sector.[75]

---

[69] JP Morgan Global Manufacturing & Services PMI, http://www.markiteconomics.com/

[70] US Bureau of Economic Analysis, "Gross Domestic Product: First Quarter 2017 (Third Estimate)," news release, 29 June 2017. https://www.bea.gov/newsreleases/national/gdp/2017/pdf/gdp1q17_3rd.pdf

[71] Institute for Supply Management, https://www.instituteforsupplymanagement.org

[72] University of Michigan Survey of Consumers, http://www.sca.isr.umich.edu/

[73] The Conference Board, http://www.conference–board.org/

[74] Eurostat news release 90/2017 dated 3 June 2017

[75] Markit Eurozone PMI, http://www.markiteconomics.com/

Activity in the euro area continues to expand

Inflation in the euro area fell to 1.3 percent in June from 1.4 percent in May due to the slower increase in energy prices.[76] The seasonally adjusted unemployment rate was 9.3 percent in May, unchanged from the previous month.[77]

The European Commission's Economic Sentiment Indicator in the euro area rose to 111.1 in June from 109.2 in May due to increases in confidence in the industry, retail trade, and construction sectors. Meanwhile, consumer confidence also improved as consumers' assessment of the future general economic situation, employment, and savings expectations turned more positive.

Japan. On a q-o-q basis, real GDP grew by 0.3 percent in Q1 2017, the same rate of expansion in Q4 2016. On a y-o-y basis, real GDP growth eased slightly to 1.3 percent in Q1 2017 from 1.6 percent in Q4 2016.[78] The economic expansion in Japan was attributed to the increase in private consumption, which partly offset the impact of weak public investment.

Economic growth in Japan maintains its pace

The seasonally adjusted manufacturing PMI declined to 52.4 in June from 53.1 in May due to the slower rates of expansion in volumes of output and new orders.[79]

Inflation remained at 0.4 percent in May from the same rate in April as increases in the prices of food, education, and culture and recreation were offset by the lower prices of furniture and household utensils as well as housing. The seasonally adjusted unemployment rate increased to 3.1 percent in May from 2.8 percent in April.

[76] Eurostat news release 113/2017 dated 03 July 2017
[77] Eurostat news release 103/2017 dated 03 July 2017
[78] Second Estimate. Department of National Accounts, Economic and Social Research Institute, Cabinet Office. http://www/esri.cao.go.jp/
[79] Nikkei Japan Manufacturing PMI, http://www.markiteconomics .com/

China. Real GDP in China expanded by 6.9 percent y-o-y in Q1 2017 from 6.8 percent in Q4 2016. The expansion was attributed to higher government infrastructure spending, credit, and real estate investments. Meanwhile, the seasonally adjusted manufacturing PMI rose to 50.4 in June from 49.6 in May due to marginal increases in production and new orders.[80]

Output growth in China improved in Q1 2017

Inflation was unchanged at 1.5 percent in June from the same rate in May as the impact of lower food, tobacco, and liquor prices were offset by the uptick in the prices of other goods and services, particularly health care.

India. Real GDP in India grew by 6.1 percent y-o-y in Q1 2017 from 7.0 percent in Q4 2016. The latest GDP growth was brought about by the expansion in agriculture, forestry and fishing sectors; mining and quarrying; manufacturing; electricity, gas, water supply and other utility services; trade, hotels, transport and communication; financial, real estate and professional services; and public administration, defense and other services. [81]

Real GDP in India expands at a slower pace

Meanwhile, the composite PMI increased to 52.7 in June from 52.5 in May as stronger upswing in inflows of new business led to output expansion in the service sector during the month.

Inflation fell to 1.5 percent in June from 2.2 percent in May due to the decline in the price indexes of housing as well as fuel and light.

ASEAN Region. The Nikkei ASEAN Manufacturing PMI fell slightly to 50.0 in June from 50.5 in May due to slower expansion in both new orders and employment.

[80] Caixin China General Manufacturing PMI, http://www.markiteconomics.com/
[81] Ministry of Statistics and Programme Implementation. http://mospi.nic.in/

Manufacturing output expansion slows in the ASEAN region

Four of the seven surveyed countries saw growth in their respective manufacturing sectors, with the Philippines as the strongest performer. Vietnam saw a modest increase in its manufacturing output while Thailand and Singapore posted marginal improvements. Meanwhile, Indonesia, Myanmar, and Malaysia each recorded deterioration in the performance of their respective manufacturing sectors.[82]

Policy Actions by Central Banks. On 13-14 June 2017, the US Fed decided to raise the fed funds rate target by 25 bps to 1 - 1.25 percent, in view of realized and projected labor market conditions and inflation. The FOMC continues to expect that US economic conditions will evolve in a manner that will warrant gradual increases in the federal funds rate.

The US Fed raises interest rates in June

Other than the US Fed, most central banks monitored by the BSP have each decided to keep policy rates unchanged, citing manageable domestic inflation and broad-based global economic growth as the basis for their respective monetary policy decisions.

[82] Nikkei ASEAN Manufacturing PMI, http://www.markiteconomics.com/

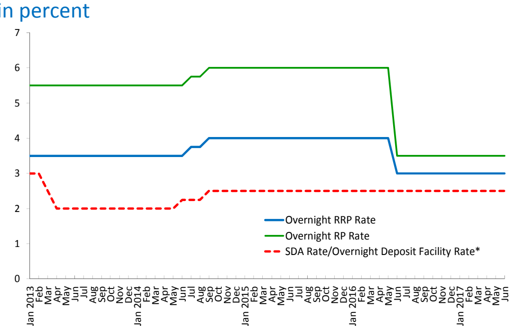
V. Monetary Policy Developments

During the monetary policy meetings in 11 May and 22 June, the BSP decided to maintain the key policy interest rate at 3.0 percent for the overnight reverse repurchase or RRP facility. The corresponding interest rates on the overnight lending and deposit facilities were also kept steady. The reserve requirement ratios were likewise left unchanged.

The BSP maintains monetary policy settings during the quarter

The BSP's decision to keep the policy rate steady is based on its assessment that the inflation environment remains manageable. Latest forecasts indicate a lower path of future inflation, with average inflation remaining within the target range of 3.0 percent ± 1 percentage point for 2017-2019. Inflation expectations also continue to be firmly anchored to the target over the policy horizon.

Chart 38. BSP Policy Rates
in percent



* On 3 June 2016, Special Deposit Accounts (SDAs) were replaced by the Overnight Deposit Facility (ODF) in line with the implementation of the Interest Rate Corridor (IRC) System.
Source: BSP

The BSP also noted that the assessment of risks to the inflation outlook remains tilted toward the upside. While there may be potential transitory impact of the proposed tax reform program, the social safety nets are expected to mitigate the resulting inflationary pressures. The long-run effects on productivity will improve overall supply and further dampen inflation. Meanwhile, prospects for the global economy have improved, but risks to external demand remain tilted to the downside. Nonetheless, the BSP emphasized that while global economic conditions remain challenging, prospects for domestic economic activity continue to be firm owing to buoyant consumer and business sentiment, ample liquidity, and sustained credit growth. In addition, the BSP has considered the potential impact on global financial market conditions of the ongoing monetary policy adjustment in the US, noting that maintaining monetary policy settings at this time would allow the BSP to continue to assess evolving economic developments and calibrate its policy tools as appropriate.

With these considerations, the BSP believes that prevailing monetary policy settings remain appropriate. Going forward, the BSP will remain vigilant against any risks to the inflation outlook and will adjust its policy settings as needed to ensure that future inflation remains consistent with the medium-term target while being supportive of sustainable economic growth.

VI. Inflation Outlook

BSP Inflation Forecasts

The BSP's latest forecasts[83] show that inflation would likely settle near the midpoint of the government's target range of 3.0 percent ± 1.0 percentage point in 2017 to 2019. Inflation is projected to peak in the third quarter of 2017 driven by positive base effects and the continued strength in domestic economic activity before reverting back to the midpoint of the target range in 2018-2019.

The risks to future inflation remain tilted toward the upside. The impact of the government's fiscal reform program and the pending petitions for adjustments in electricity rates are the main upside risks to inflation. Meanwhile, the uncertainty in the global economic landscape continues to be the main downside risk to inflation.

Inflation is expected to fall near the midpoint of the target range in 2017 to 2019

Demand Conditions. Outturns for key demand indicators attest to the view of strong domestic real sector activity. The country's real GDP continued to expand by 6.4 percent in Q1 2017 from 6.6 percent growth in the previous quarter. Household spending and capital formation remained the key drivers of growth although both sectors grew at a slower pace compared to previous quarters. This was compensated in part by the strong performance of exports which posted gains amid improving external demand.

Prospects for the domestic economy continue to remain favorable. Growth is expected to settle within the Development Budget Coordination Committee (DBCC)-approved medium-term assumptions of 6.5-7.5 percent in 2017 and 7.0-8.0 percent for 2018-2022. The expansion in domestic economic activity could continue to pick up due to the robust growth in the services sector and potential recovery in merchandise trade. Private demand is expected to remain firm, aided mainly by sustained remittance inflows and stable inflation. Private capital formation should also contribute to economic growth with construction and investments in durable equipment expected to remain solid, as more infrastructure programs get underway.

High-frequency real sector indicators likewise point to firm growth prospects in the near term. Production indices for the manufacturing sector suggest continued expansion with more than half of all major manufacturing sectors operating at above 80.0 percent capacity. The composite Purchasing Managers' Index (PMI) also remains firmly above the 50-point mark as of May 2017, indicating sustained expansion across all sectors.

The optimistic economic outlook has also been reflected in the results of the BSP expectations surveys as business and consumer confidence indices improved further in Q2 2017. This is in line with the generally favorable macroeconomic conditions.

Supply Conditions. Commodity prices are expected to remain manageable, reflecting ample supply conditions. Food inflation could remain benign over the near term given prospects of favorable domestic supply. Meanwhile, oil prices are projected to remain flat in the medium term as suggested by oil futures prices.

Commodity prices are expected to remain manageable

Global agricultural prices are projected to settle at moderate levels over the medium term. Forecasts by the International Monetary Fund (IMF) and the World Bank suggest benchmark prices of key grains, particularly wheat and rice, could decline or remain flat in 2017 due to improved global supply outlook.

[83] The inflation forecast path in this report refers to the forecasts presented during the 22 June 2017 monetary policy meeting. In the discussion, these forecasts are compared to the forecasts presented in the Q1 2017 Inflation Report which correspond to forecasts on 23 March 2017 monetary policy meeting.

Meanwhile, price of maize is expected to increase in 2017 on account of increasing global demand.[84,85]

In the domestic front, *palay* and corn production could increase in Q2 2017 by 10.5 percent and 44.4 percent, respectively, based on standing crop estimates, due to larger harvest areas and adequate water supply in key producing regions.[86]

International oil prices declined compared to the previous quarter's level despite OPEC's decision to extend its production cut until Q1 2018. The drop in prices of oil was attributed to the continued build-up in US inventories, the resolution of outages in Canada and Libya, and weaker oil import demand.

The latest oil futures prices indicate that global crude oil prices could remain close to US$50.00 per barrel in 2017-2019. Meanwhile, the Energy Information Administration (EIA) expects Brent crude oil prices to average close to US$53.00 per barrel in 2017 and above US$55.00 per barrel in 2018. Similarly, forecasts by the IMF and World Bank point to a moderate rise in global crude oil prices until 2018.[87, 88,89]

Output gap remains positive

The balance of demand and supply conditions as captured by the output gap (or the difference between actual and potential output), provides an indication of potential inflationary pressures in the near term.[90]

Given the latest GDP data, estimates by the BSP show that the output gap remains slightly positive and is broadly stable relative to the previous quarter.[91]

Key assumptions used to generate the BSP's inflation forecasts. The BSP's baseline inflation forecasts generated from the BSP's econometric forecasting models are based on the following assumptions:

1) BSP's overnight RRP rate at 3.0 percent from June 2017 to December 2019;
2) NG fiscal deficits for 2017 to 2019, which are consistent with the DBCC-approved estimates;
3) Dubai crude oil price assumptions consistent with the trend of oil futures prices in the international market;
4) Increase in nominal wage in August 2017, August 2018 and August 2019 consistent with labor productivity growth and historical wage adjustments;
5) Real GDP growth is endogenously determined; and
6) Foreign exchange rate is endogenously determined through the purchasing power parity and interest rate parity relationships.

Risks to the Inflation Outlook

The risks to the inflation outlook may be presented graphically through a fan chart. The fan chart depicts the probability of different inflation outcomes based on the central projection (corresponding to the baseline forecast of the BSP) and the risks surrounding the inflation outlook.

Projected inflation path is lower for 2017 and 2018

Compared to the previous inflation report, the latest fan chart presents a downward shift in the inflation projection for 2017 and 2018. The decrease in the projected inflation path could be attributed mainly to the decline global crude oil prices, slightly slower domestic economic

[84] IMF, Commodity Market Monthly, June 2017, available online at http://www.imf.org
[85] World Bank, Commodity Markets Outlook, April 2017, available online at http://www.worldbank.org
[86] PSA, Updates on April-June 2017 Palay and Corn Forecasts, May 2017, available online at http://www.psa.gov.ph
[87] EIA, Short-Term Energy Outlook, June 2017, available online at http://www.eia.gov
[88] IMF, Commodity Markets Monthly, May 2017, available online at http://www.imf.org
[89] World Bank, Commodity Markets Outlook, April 2017, available online at http://www.worldbank.org
[90] Inflation tends to rise (fall) when demand for goods and services exerts pressure on the economy's ability to produce goods and services, i.e., when the output gap is positive (negative).
[91] Based on the seasonally-adjusted GDP growth

growth, lower-than-projected inflation outturns in Q2 2017, and the slightly stronger peso.

The BSP's review of current inflation dynamics suggests that the risks surrounding the inflation outlook remains tilted to the upside. This assessment is depicted in the latest fan chart, wherein the projection bands above the central projection are greater than the bands below it. The projected impact of the government's broad fiscal reform program along with pending petitions for adjustments in electricity are the main upside risks to inflation. Meanwhile, the lingering uncertainty in the global economic landscape poses as the main downside risk.

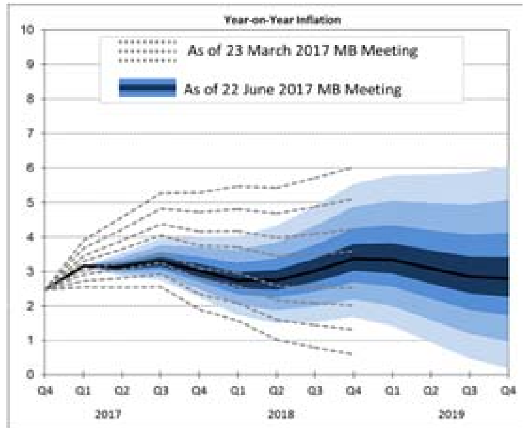
Congress has approved HB 5636 or the Tax Reform for Acceleration and Inclusion (TRAIN) bill on 31 May 2017. The package consists of a reduction in personal income taxes, higher excise tax on petroleum products, higher automobile tax, higher tax on sugar-sweetened beverages, Value Added Tax (VAT)-base expansion, and uniform donor and estate tax. The expected net increase in revenue from these reforms, together with some tax administration measures, are intended largely for funding the government's key infrastructure and social spending programs, which could boost domestic economic activity and raise the country's productive capacity.

Given that higher tax revenues will be used to sustain higher investment spending for physical and human capital development, there could be gains to the economy in the medium to long run. With assumptions of sustained and more efficient investment spending as well as healthy macroeconomic fundamentals, the proposed measures could potentially provide demand pressures over the medium term.

In terms of inflationary impact, higher consumption taxes, together with the demand stimulus from the fiscal reform program, are expected to initially generate higher inflation. The crowding-in effect of higher public investment on private investment would result in a beneficial cycle of higher aggregate investment and potential output. The ensuing productivity gains would moderate inflationary pressures over the medium term.

The risks to inflation outlook remain tilted on the upside

Chart 39. Inflation Projection



Source: BSP estimates

The pending petitions of Meralco and Power Sector Assets and Liabilities Management Corp. (PSALM) remain a source of upside risks to inflation. Included in the Meralco petitions are the December 2013 rate adjustment, which is still under the temporary restraining order of the Supreme Court, and the ₱0.65 per kWh adjustment for the January 2014 billing period that is subject to the Energy Regulatory Commission's (ERC) approval. PSALM's petitions meanwhile cover adjustments for fuel and foreign exchange costs.

By contrast, lingering uncertainty over the prospects of the global economy is the main downside risk to the inflation outlook. US President Trump's proposed restrictive trade policies, such as increase in tariffs to China, Mexico and other countries, the repeal of the North American Free Trade Agreement (NAFTA), and withdrawal from the Trans-Pacific Partnership (TPP) agreement, could lead to slower global trade activity and thereby lead to downward price pressures.

The fan chart shows the probability of various outcomes for inflation over the forecast horizon. The darkest band depicts the central projection, which corresponds to the BSP's baseline inflation forecast. It covers 25 percent of the probability distribution. Each successive pair of bands is drawn to cover a further 25 percent of probability, until 75 percent of the probability distribution is covered. Lastly, the lightest band covers the lower and upper 90 percent of the probability distribution. The bands widen (i.e., “fan out”) as the time frame is extended, indicating increasing uncertainty about outcomes. The band in wire mesh depicts the inflation profile in the previous report.

The shaded area, which measures the range of uncertainty, is based on the forecast errors from the past years. In greater detail, it can be enhanced by adjusting the level of skewness of the downside and upside shocks that could affect the inflationary process over the next two years in order to change the balance of the probability area lying above or below the central projection.

VII. Implications for the Monetary Policy Stance

The prevailing inflation outlook supports keeping the policy rates steady, with latest baseline inflation projection path still tracking the midpoint of the target range in 2017-2019. The latest baseline inflation forecast path is lower due to the decline in global crude oil prices, moderation in domestic growth momentum, lower-than-projected inflation outturns in Q2 2017, and peso appreciation.

Meanwhile, the balance of risks to the inflation outlook remains tilted toward the upside which argues for maintaining vigilance in setting the stance of monetary policy going forward. The initial impact of the government's tax reform program and pending petitions for adjustments in electricity rates are seen as the main upside risks to the baseline forecast. The lingering uncertainty in the global economic landscape poses as the main downside risk to inflation.

Inflation dynamics remain manageable given well-contained inflation expectations over the policy horizon. Inflation expectations—based on forecast surveys of private sector economists by the BSP and by Consensus Economics—continue to be within target over 2017-2019. At the same time, recent inflation outturns support the assessment of manageable inflation for this year. Headline inflation decelerated in Q2 2017 to 3.1 percent.

Domestic demand continues to be firm

The economy grew by 6.4 percent in Q1 2017, albeit at a relatively moderate pace as consumer and government spending eased. Nevertheless, domestic growth fundamentals are expected to remain intact. Growth momentum remain above the ten-year average of 5.6 percent. Prospects for the domestic economy also continue to remain favorable. GDP expansion could continue due to solid growth in services and industry as well as improved external trade conditions. Private demand is expected to remain firm, aided mainly by sustained remittance inflows and low inflation.

Private capital formation should also contribute to economic growth, particularly as more Public-Private Partnership (PPP) projects and infrastructure programs get underway. Business confidence remained positive while consumer optimism reached an all-time high in Q2 2017.

However, some indicators suggest potential downside risks to domestic demand with NG spending still relatively slower in the first four months while the Philippine composite PMI in May 2017 posted the lowest reading since data was made available in October 2010. Meanwhile, Philippine unemployment rate went down to 5.7 percent (from 6.6 percent in January 2017 and 6.1 percent in April 2016) while underemployment reached its lowest level in ten years. However, the services sector—which accounts for more than half of the country's total employment—recorded a net employment loss of 557,000 workers.

Prevailing credit and liquidity conditions continue to support the appropriateness of present policy settings. Domestic liquidity increased by 11.3 percent while bank lending grew by 18.7 percent in May 2017. Total bids and placements thru the BSP's open market operations (OMOs) and overnight deposit facility were higher in May relative to the previous month, indicating the continued excess reserve position of the banking system. Strong demand for shorter-dated term deposits continued while the 28-day TDF remained undersubscribed.

Global economic activity improves

The JP Morgan Global All-Industry Output Index rose slightly to 53.7 in May from 53.6 in April due largely to the increase in new orders. Stronger expansion was seen in the US, the euro area, China, Japan, India, and Russia, while growth slowed in the UK. Meanwhile, the US Federal Reserve decided to raise the target range for the federal funds rate to 1.0–1.25 percent on 14 June following its assessment of continued strengthening in the domestic labor market and economic activity. Other than the US Fed, most central banks monitored by the BSP have each decided to keep policy rates unchanged, citing manageable domestic inflation and broad-based global economic growth as the basis for their respective monetary policy decisions.

With the latest inflation forecasts settling around the midpoint of the target range and the continued favorable prospects for sustained growth in the economy, the current settings of monetary policy can be deemed appropriate for the time being. The broad range of recent data points to sustained momentum in domestic economic activity while liquidity and credit continue to grow at a reasonable pace. Nevertheless, the BSP will need to watch closely for indications of increasing underlying inflationary pressures and the realization of the upside risks to inflation.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent) RRP Overnight	Levels (in percent) RP Overnight	Monetary Policy Decisions
2008			
31 Jan 2008	5.00	7.00	The Monetary Board (MB) decided to reduce by 25 basis points (bps) the BSP's key policy interest rates to 5 percent for the overnight borrowing or reverse repurchase (RRP) facility and 7 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and special deposit accounts (SDAs) were also reduced accordingly. In its assessment of macroeconomic conditions, the MB noted that the latest inflation forecasts indicated that inflation would fall within the 4.0 percent ± 1 percentage point target range in 2008 and the 3.5 ± 1 percentage point target range in 2009.
13 Mar 2008	5.00	7.00	The MB decided to keep the BSP's key policy interest rates at 5 percent for the overnight borrowing or RRP facility and 7 percent for the overnight lending or RP facility. The MB also decided to implement immediately the following refinements in the SDA facility: (1) the closure of existing windows for the two-, three-, and six-month tenors; and (2) the reduction of the interest rates on the remaining tenors. The interest rates on term RRPs and RPs were also left unchanged.
24 Apr 2008	5.00	7.00	The MB kept the BSP's key policy interest rates at 5.0 percent for the overnight borrowing or RRP facility and 7.0 percent for the overnight lending or RP facility. The interest rates on term RRPs and RPs were also left unchanged.
5 Jun 2008	5.25	7.25	The MB decided to increase by 25 bps the BSP's key policy interest rates to 5.25 percent for the RRP facility and 7.25 percent for RP facility as emerging baseline forecasts indicate a likely breach of the inflation target for 2008 along with indications that supply-driven pressures are beginning to feed into demand. Given the early evidence of second-round effects, the MB recognized the need to act promptly to rein in inflationary expectations. The interest rates on term RRPs, RPs, and SDAs were also increased accordingly.
17 Jul 2008	5.75	7.75	The MB increased by 50 bps the BSP's key policy interest rates to 5.75 percent for the overnight borrowing or RRP facility and 7.75 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also increased accordingly.
28 Aug 2008	6.00	8.00	The MB increased by 25 bps the BSP's key policy interest rates to 6.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 8.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and SDAs were also increased accordingly.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
6 Oct 2008	6.00	8.00	The MB kept the BSP's key policy interest rates unchanged at 6.0 percent for RRP facility and 8.0 percent for the RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged.
6 Nov 2008	6.00	8.00	The MB decided to keep the BSP's key policy interest rates steady at 6 percent for the overnight borrowing or RRP facility and 8 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged.
18 Dec 2008	5.50	7.50	The MB decided to reduce the BSP's key policy interest rates by 50 bps to 5.5 percent for the overnight borrowing or RRP facility and 7.5 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also adjusted accordingly. Latest baseline forecasts showed a decelerating inflation path over the policy horizon, with inflation falling within target by 2010. This outlook is supported by the downward shift in the balance of risks, following the easing of commodity prices, the moderation in inflation expectations, and the expected slowdown in economic activity.
2009			
29 Jan 2009	5.00	7.00	The MB decided to reduce the BSP's key policy interest rates by another 50 bps to 5 percent for the overnight borrowing or RRP facility and 7 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also adjusted accordingly. Latest baseline forecasts showed a decelerating inflation path over the policy horizon, with inflation falling within target by 2010. The MB based its decision on the latest inflation outlook which shows inflation falling within the target range for 2009 and 2010. The Board noted that the balance of risks to inflation is tilted to the downside due to the softening prices of commodities, the slowdown in core inflation, significantly lower inflation expectations, and moderating demand.
5 Mar 2009	4.75	6.75	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 4.75 percent for the overnight borrowing or RRP facility and 6.75 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. Given possible upside risks to inflation, notably the volatility in oil prices and in exchange rates, increases in utility rates, and potential price pressures coming from some agricultural commodities, the MB decided that a more measured adjustment of policy rates was needed.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
16 Apr 2009	4.50	6.50	The MB reduced key policy rates by another 25 bps to 4.5 percent for the overnight borrowing or RRP facility and 6.5 percent for the overnight lending or RP facility, effective immediately. This rate cut brings the cumulative reduction in the BSP's key policy rates to 150 bps since December last year. The current RRP rate is the lowest since 15 May 1992. Meanwhile, the interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. In its assessment of macroeconomic conditions, the MB noted that the latest baseline inflation forecasts indicated a lower inflation path over the policy horizon, with average inflation expected to settle within the target ranges in 2009 and 2010. In addition, the MB considered that the risks to inflation are skewed to the downside given expectations of weaker global and domestic demand conditions and a low probability of a significant near-term recovery in commodity prices.
28 May 2009	4.25	6.25	The MB decided to reduce the BSP's key policy interest rates by another 25 bps to 4.25 percent for the overnight borrowing or RRP facility and 6.25 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. Baseline forecasts indicated a lower inflation path over the policy horizon, with average inflation expected to settle within the target ranges in 2009 and 2010. In addition, the Monetary Board considered that, on balance, the risks to inflation are skewed to the downside given expectations of weaker global and domestic demand conditions and a low probability of a significant near-term recovery in commodity prices.
9 Jul 2009	4.00	6.00	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 4 percent for the overnight borrowing or RRP facility and 6 percent for the overnight lending or RP facility, effective immediately. The interest rates on term RRPs, RPs, and SDAs were reduced accordingly. This is the sixth time since December 2008 that the BSP has cut its policy interest rates.
20 Aug 2009 **1 Oct 2009** **5 Nov 2009** **17 Dec 2009**	4.00	6.00	The MB kept key policy rates unchanged at 4 percent for the RRP facility and 6 percent for the overnight lending RP facility. The decision to maintain the monetary policy stance comes after a series of policy rate cuts since December 2008 totaling 200 bps and other liquidity enhancing measures.
		2 0 1 0	
28 Jan 2010 **11 Mar 2010** **22 Apr 2010** **3 Jun 2010** **15 Jul 2010** **26 Aug 2010** **7 Oct 2010** **18 Nov 2010** **29 Dec 2010**	4.00	6.00	The MB decided to keep the BSP's key policy interest rates steady at 4 percent for the RRP facility and 6 percent for the RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
2 0 1 1			
10 Feb 2011	4.00	6.00	The MB decided to keep the BSP's key policy interest rates steady at 4 percent for the overnight borrowing or RRP facility and 6 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged.
24 Mar 2011	4.25	6.25	The MB decided to increase by 25 bps the BSP's key policy interest rates to 4.25 percent for the overnight borrowing or RRP facility and 6.25 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also raised accordingly. The MB's decision was based on signs of stronger and broadening inflation pressures as well as a further upward shift in the balance of inflation risks. International food and oil prices have continued to escalate due to the combination of sustained strong global demand and supply disruptions and constraints.
5 May 2011	4.50	6.50	The MB decided to increase the BSP's key policy interest rates by another 25 bps to 4.5 percent for the overnight borrowing or RRP facility and 6.5 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also raised accordingly. Baseline inflation forecasts continue to suggest that the 3-5 percent inflation target for 2011 remains at risk, mainly as a result of expected pressures from oil prices.
16 Jun 2011	4.50	6.50	The MB decided to keep policy rates steady at 4.5 percent for the overnight borrowing or RRP facility and 6.5 percent for the overnight lending or RP facility. At the same time, the Board decided to raise the reserve requirement on deposits and deposit substitutes of all banks and non-banks with quasi-banking functions by one percentage point effective on Friday, 24 June 2011. The MB's decision to raise the reserve requirement is a preemptive move to counter any additional inflationary pressures from excess liquidity.
28 Jul 2011	4.50	6.50	The MB maintained the BSP's key policy interest rates at 4.5 percent for the overnight borrowing or RRP facility and 6.5 percent for the overnight lending or RP facility. At the same time, the Board increased anew the reserve requirement on deposits and deposit substitutes of all banks and non-banks with quasi-banking functions by one percentage point effective on 5 August 2011. The MB's decision to raise the reserve requirement anew is a forward-looking move to better manage liquidity.
8 Sep 2011 **20 Oct 2011** **1 Dec 2011**	4.50	6.50	The MB decided to keep the overnight policy rates steady. At the same time, the reserve requirement ratios were kept unchanged.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
2012			
19 Jan 2012	4.25	6.25	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 4.25 percent for the overnight borrowing or RRP facility and 6.25 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly The MB's decision is based on its assessment that the inflation outlook remains comfortably within the target range, with expectations well-anchored and as such, allowed some scope for a reduction in policy rates to help boost economic activity and support market confidence.
1 Mar 2012	4.00	6.00	The MB decided to reduce the BSP's key policy interest rates by another 25 bps to 4.0 percent for the overnight borrowing or RRP facility and 6.0 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. The MB is of the view that the benign inflation outlook has allowed further scope for a measured reduction in policy rates to support economic activity and reinforce confidence.
19 Apr 2012	4.00	6.00	The MB decided to keep the BSP's key policy interest rates steady at 4 percent for the overnight borrowing or RRP facility and 6 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged.
14 Jun 2012	4.00	6.00	The MB decided to keep the BSP's key policy interest rates steady at 4 percent for the overnight borrowing or RRP facility and 6 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged. The MB's decision was based on its assessment that the inflation environment remains manageable. Baseline forecasts continue to track the lower half of the 3-5 percent target range for 2012 and 2013, while inflation expectations remain firmly anchored. At the same time, domestic macroeconomic readings have improved significantly in Q1 2012.
26 Jul 2012	3.75	5.75	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 3.75 percent for the overnight borrowing or RRP facility and 5.75 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. This is the third time in 2012 that the BSP has cut its policy rates. The MB's decision was based on its assessment that price pressures have been receding, with risks to the inflation outlook slightly skewed to the downside. Baseline forecasts indicate that inflation is likely to settle within the lower half of the 3-5 percent target for 2012 and 2013, as pressures on global commodity prices are seen to continue to abate amid weaker global growth prospects. At the same time, the MB is of the view that prospects for global economic activity are likely to remain weak.
13 Sep 2012	3.75	5.75	The MB decided to keep the BSP's key policy interest rates steady at 3.75 percent for the overnight borrowing or RRP facility and 5.75 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged. The MB's decision was based on its assessment that the inflation environment remains benign,

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
			with the risks to the inflation outlook appearing to be broadly balanced.
25 Oct 2012	3.50	5.50	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. This is the fourth time in 2012 that the BSP has cut its policy rates. The MB's decision was based on its assessment that the inflation environment continued to be benign with latest baseline forecasts indicating that the future inflation path will remain within target for 2012-2014. A rate cut would also be consistent with a symmetric response to the risk of below-target inflation.
13 Dec 2012	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged. The MB's decision was based on its assessment that current monetary settings remained appropriate, as the cumulative 100-basis-point reduction in policy rates in 2012 continued to work its way through the economy.
		2 0 1 3	
24 Jan 2013	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs and RPs were also maintained accordingly. The reserve requirement ratios were kept steady as well. At the same time, the MB decided to set the interest rates on the SDA facility at 3.00 percent regardless of tenor, effective immediately, consistent with the BSP's continuing efforts to fine-tune the operation of its monetary policy tools.
14 Mar 2013	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rate on the RRP was also set at 3.50 percent regardless of tenor. Following its previous decision to rationalize the SDA facility in January 2013, the MB further reduced the interest rates on the SDA facility by 50 bps to 2.50 percent across all tenors effective immediately.
25 Apr 2013	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rate on the RRP was also set at 3.50 percent regardless of tenor. Meanwhile, the SDA rate was further reduced by 50 basis points to 2.0 percent across all tenors.
13 Jun 2013 **25 Jul 2013** **12 Sep 2013** **24 Oct 2013** **12 Dec 2013**	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
2014			
6 Feb 2014	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained.
27 Mar 2014	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained. Meanwhile, the MB decided to increase the reserve requirement by one percentage point effective on 11 April 2014.
8 May 2014	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained. Meanwhile, the MB decided to increase the reserve requirements for U/KBs and TBs by a further one percentage point effective on 30 May 2014.
19 Jun 2014	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs and RPs were also maintained. The reserve requirement ratios were left unchanged as well. Meanwhile, the MB decided to raise the interest rate on the SDA facility by 25 basis points from 2.0 percent to 2.25 percent across all tenors effective immediately.
31 Jul 2014	3.75	5.75	The MB decided to increase the BSP's key policy rates by 25 bps to 3.75 percent for the overnight borrowing or RRP facility and 5.75 percent for the overnight lending or RP facility. The interest rates on term RRPs and RPs were also raised accordingly. The rate on special deposit accounts (SDA) was left unchanged. Meanwhile, the reserve requirement ratios were also kept steady.
11 Sep 2014	4.00	6.00	The MB decided to increase the BSP's key policy rates by 25 bps to 4.0 percent for the overnight borrowing or RRP facility and 6.0 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also raised accordingly. Meanwhile, the reserve requirement ratios were left unchanged.
23 Oct 2014 **11 Dec 2014**	4.00	6.00	The MB decided to maintain the BSP's key policy interest rates at 4.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and special deposit accounts were also kept steady. The reserve requirement ratios were left unchanged as well.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent) RRP Overnight	Levels (in percent) RP Overnight	Monetary Policy Decisions
2015			
12 Feb 2015 **26 Mar 2015** **14 May 2015** **25 Jun 2015** **13 Aug 2015** **24 Sep 2015** **12 Nov 2015** **17 Dec 2015**	4.00	6.00	The MB decided to maintain the BSP's key policy interest rates at 4.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and special deposit accounts were also kept steady. The reserve requirement ratios were left unchanged as well.
2016			
11 Feb 2016 **23 Mar 2016** **12 May 2016**	4.00	6.00	The MB decided to maintain the BSP's key policy interest rates at 4.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and special deposit accounts were also kept steady. The reserve requirement ratios were left unchanged as well.
23 Jun 2016 **11 Aug 2016** **22 Sep 2016** **10 Nov 2016** **22 Dec 2016**	3.00	3.50	The BSP formally adopted an interest rate corridor (IRC) system as a framework for conducting its monetary operations. The shift to IRC is an operational adjustment and not a change in the monetary policy stance. The IRC is a system for guiding short-term market rates towards the BSP policy interest rate which is the overnight reverse repurchase (RRP) rate. The IRC system consists of the following instruments: standing liquidity facilities, namely, the overnight lending facility (OLF) and the overnight deposit facility (ODF); the overnight RRP facility; and a term deposit auction facility (TDF). The interest rates for the standing liquidity facilities form the upper and lower bound of the corridor while the overnight RRP rate is set at the middle of the corridor. The repurchase (RP) and Special Deposit Account (SDA) windows will be replaced by standing overnight lending and overnight deposit facilities, respectively. Meanwhile, the reverse repurchase (RRP) facility will be modified to a purely overnight RRP. In addition, the term deposit facility (TDF) will serve as the main tool for absorbing liquidity. The interest rates for these facilities will be set as follows starting 3 June 2016: • 3.5 percent in the overnight lending facility (a reduction of the interest rate for the upper bound of the corridor from the current overnight RP rate of 6.0 percent); • 3.0 percent in the overnight RRP rate (an adjustment from the current 4.0 percent); and • 2.5 percent in the overnight deposit facility (no change from the current SDA rate).

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
2 0 1 7			
9 Feb 2017 **23 Mar 2017** **11 May 2017** **22 Jun 2017**	3.00	3.50	The MB decided to maintain the BSP's key policy interest rates at 3.0 percent for the overnight reverse repurchase (RRP) facility, 3.5 percent for the overnight lending facility (OLF) and 2.5 percent for the overnight deposit facility (ODF). The reserve requirement ratios were left unchanged as well.

The *BSP Inflation Report* is published every quarter by the Bangko Sentral ng Pilipinas. The report is available as a complete document in pdf format, together with other general information about inflation targeting and the monetary policy of the BSP, on the BSP's website:

www.bsp.gov.ph/monetary/inflation.asp

If you wish to receive an electronic copy of the latest BSP Inflation Report, please send an e-mail to bspmail@bsp.gov.ph.

The BSP also welcomes feedback from readers on the contents of the Inflation Report as well as suggestions on how to improve the presentation. Please send comments and suggestions to the following addresses:

By post: BSP Inflation Report
c/o Department of Economic Research
Bangko Sentral ng Pilipinas
A. Mabini Street, Malate, Manila
Philippines 1004

By e-mail: bspmail@bsp.gov.ph