ISSN 1655-5104

INFLATION REPORT
3rd 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 12 October 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.

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[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.

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Members
Carlos G. Dominguez III
Felipe M. Medalla
Juan D. 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.

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Governor

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Deputy Governor
Monetary Stability Sector

Ma. Cyd Tuaño-Amador
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Ma. Ramona GDT Santiago
Assistant Governor
Treasury Department

Johnny Noe E. Ravalo
Assistant Governor
Office of Systemic Risk Management

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)

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Alvin Joshua P. Fama
Acting Bank Officer V, Office of Systemic Risk Management

Sol Elizah T. Roxas
Bank Officer VI, Provident Fund Office

*** 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 remains steady. The average headline inflation for Q3 2017 remained steady from the previous quarter's rate of 3.1 percent but was higher than the year ago's 2.0 percent. 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. Food inflation was lower during the review quarter as prices of major items eased. Meanwhile, non-food inflation increased, driven primarily by upticks in domestic fuel prices. Core inflation for Q3 continued to rise to 3.1 percent from 2.9 percent a quarter ago and 2.0 percent in the previous year. Meanwhile, alternative measures of core inflation were mixed. The net of volatile items measure accelerated to 2.4 percent from 2.2 percent in the previous quarter. By contrast, trimmed mean and weighted median were slightly lower at 2.3 percent (from 2.4 percent) and 1.8 percent (from 1.9 percent), respectively. In terms of the number of items with inflation rates greater than the threshold of 4.0 percent (the upper end of the 2017 inflation target), Q3 was lower at 24 items from 26 items in the previous quarter which collectively accounted for 22.3 percent of the CPI basket.

Inflation expectations stay within the range target. The BSP's survey of private sector economists for September 2017 showed that the mean inflation forecast for 2017 declined to 3.1 percent from 3.3 percent in June 2017. In contrast, mean forecast for 2018 remained steady at 3.4 percent. Meanwhile, the mean inflation forecast for 2019 declined to 3.4 percent in the September survey from 3.5 percent in the previous survey. On the other hand, results of the June 2017 Consensus Economics inflation forecast survey showed higher mean inflation forecasts for 2017 and 2018. Respondents expect 2017 inflation to settle at 3.3 percent, from 3.2 percent in the March survey. Likewise, the mean inflation forecast for 2018 increased to 3.4 percent from 3.3 percent in the previous survey.

Domestic economy sustains firm growth. Real GDP sustained its growth in Q2 at 6.5 percent. This was marginally higher than the 6.4-percent expansion in the previous quarter but lower than last year's 7.1 percent. This brought GDP growth for the first half of the year to 6.4 percent, still on track to achieve the National Government's target of 6.5-7.5 percent. On the expenditure side, GDP grew on the back of government spending and the sustained growth in private consumption. On the production side, growth was supported by the strong outturns from the industry and agriculture sectors, offsetting the slower growth in the services sector.

Q3 inflation remains close to midpoint of 2017 target range

Higher-frequency demand indicators also point to continued firm economic prospects in the near term. Vehicle sales increased during the review quarter, although at a slower pace. Similarly, energy sales have continued to grow but at a slower rate than a year ago. Meanwhile, the composite Purchasing Managers' Index as of August 2017 remained firmly above the 50-point expansion threshold, indicating sustained strong economic activity ahead. Moreover, while results of the BSP's latest business confidence were less buoyant in Q3 on seasonal factors, upbeat outlook was noted for the quarter ahead. Similarly, consumer sentiment weakened slightly during the review quarter due to expectations of higher commodity prices but turned optimistic in the succeeding quarter.

Global economic activity picks up pace. The JP Morgan Global All-Industry Output Index rose to 54.0 in September, supported by manufacturing and service activity. Nevertheless, global inflation is still expected to remain subdued as most central banks continue to see below-target inflation. In the US, Q2 real GDP grew faster at 2.2 percent as inflation rose to 2.2 percent in September due primarily to the increase in the energy index. Moreover, manufacturing PMI posted a higher reading of 60.8 percent in September as new orders continued to expand. Similarly in the euro area, Q2 GDP growth was faster at 2.3 percent as inflation in September was at 1.5 percent due to higher prices of transport fuels. The euro area composite PMI for September also increased to 56.7 as new orders expanded. Meanwhile, GDP growth in China remained unchanged at 6.9 percent in Q2 as inflation in September eased to 1.6 percent due mainly to lower food prices. Manufacturing PMI continued to signal an expansion at 51.0. Japan's Q2 GDP likewise remained broadly steady at 1.4 percent as inflation in August was at 0.7 percent. Manufacturing PMI increased to 52.6 in September, owing to stronger demand. For the entire ASEAN region, manufacturing PMI rebounded to 50.3 in September due to improvements in both output and total new orders.

Domestic financial system remains resilient amid uncertainty. Despite general cautiousness fueled by the possibility of further monetary tightening by the US Federal Reserve and geopolitical tensions on the international front, the country's sustained growth in Q2 2017 as well as the optimism generated by the National Government's tax reform program provided support to positive investor sentiment. The Philippine stock exchange index rose by 3.2 percent, quarter-on-quarter, to average 8,015.7 index points. Debt spreads generally narrowed during the review quarter. Meanwhile, the peso depreciated against the US dollar by 1.93 percent to average ₱50.84/US$1 from the previous quarter's average of ₱49.86/US$1. On the other hand, 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, while capital adequacy ratios remained comfortably above the BSP's prescribed levels and international norms. At the same time, based on the latest round of the BSP survey on senior bank loan officers, bank lending standards for loans to both enterprises and households were broadly unchanged in Q3 2017, indicating a generally stable supply of credit.

Monetary policy settings were maintained in Q3 2017. The BSP decided to maintain its policy interest rate at 3.0 percent at the August and September monetary policy meetings. Reserve requirement ratios were likewise kept steady.

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.

Moreover, domestic growth fundamentals are expected to remain intact as high-frequency indicators continue to suggest aggregate demand will remain positive. Meanwhile, business and consumer sentiment eased in Q3 2017 but remained positive. Domestic liquidity and bank lending likewise support the appropriateness of present policy settings. In addition, recovery in the global economic growth has broadened even as risks to output remain on the downside.

Prevailing monetary policy stance remains appropriate

Prevailing monetary policy settings are seen as still appropriate to the latest outlook. The prevailing inflation outlook supports keeping the policy rates steady with latest baseline inflation projection path tracking the midpoint of the target range in 2017-2019. The latest baseline inflation forecast path is higher due mainly to the rise in global crude oil prices and the depreciation of the peso. 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 potential for slower global economic growth due to policy uncertainty in advanced economies and geopolitical tensions continues to be the main downside risk to inflation.

Inflation dynamics meanwhile remain manageable given well-contained inflation expectations over the policy horizon. Moreover, prospects for aggregate demand are expected to remain positive while prevailing credit and liquidity conditions remain in line with the overall requirements of the economy.

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. Nevertheless, 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

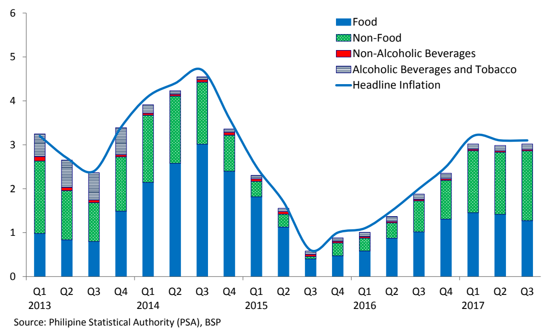
Prices

Headline Inflation. Headline inflation in Q3 2017 remained steady from the previous quarter's rate at 3.1 percent.[4] This brought the year-to-date (y-t-d) average inflation to 3.1 percent, which is well within the National Government's (NG) announced target range of 3.0 percent ± 1.0 percentage point (ppt) for 2017.

Headline inflation remains close to midpoint of target range

Q3 2017 inflation rate was unchanged as higher prices of items relating to transport were counterbalanced by downward adjustment in electricity charges and slower price increases of selected food items.

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



Core Inflation. Core inflation, which measures generalized price pressures by excluding volatile items such as food and energy, was higher at 3.1 percent in Q3 2017 from 2.9 percent in the previous quarter. Meanwhile, the BSP's alternative measures of core inflation were mixed. The net of volatile items accelerated to 2.4 percent from 2.2 percent in the previous quarter. By contrast, trimmed mean and weighted median were slightly lower at 2.3 percent (from 2.4 percent) and 1.8 percent (from 1.9 percent), respectively.

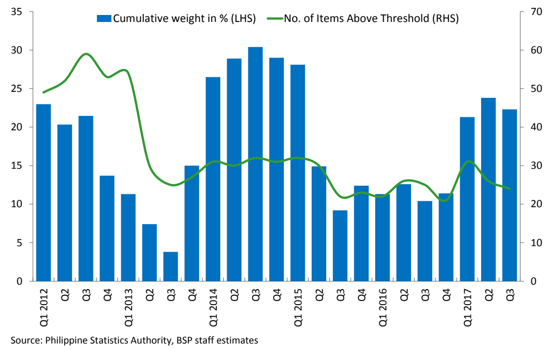
Table 1. Alternative Core Inflation Measures
quarterly averages of year-on-year change

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**	**2.9**	**2.3**	**2.0**	**2.3**
Q1	3.2	2.7	2.2	1.9	2.2
Q2	3.1	2.9	2.4	1.9	2.2
Q3	**3.1**	**3.1**	**2.3**	**1.8**	**2.4**

[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 in the CPI basket with inflation rates greater than the threshold of 4.0 percent (the upper end of the 2017 inflation target) was lower at 24 items in Q3 2017 from 26 items in the previous quarter. Majority of these items were non-food commodities. Collectively, these items accounted for 22.3 percent of the CPI basket, slightly lower than the quarter-ago share of 23.8 percent.

Chart 2. CPI Items with Inflation Rates Above Threshold



Food Inflation. Food inflation was lower in Q3 2017 from the previous quarter as inflation rates of major food items such as rice, meat, fish, fruits, vegetables, as well as oils and fats eased during the quarter. At the same time, year-on-year

[4] It should be noted that prices for Marawi City in Lanao del Sur were imputed using data from Lanao del Norte for comparability.

(y-o-y) inflation of sugar, jam, and honey remained negative from the previous quarter.

Prices of major food items ease during the quarter

These developments were tempered slightly by increases in the prices of corn and fish during the quarter due to some tightness in domestic supply caused by adverse weather conditions.

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

Commodity	2016				2017		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Food and Non-Alcoholic Beverages	**1.6**	**2.3**	**2.7**	**3.5**	**3.8**	**3.8**	**3.5**
Food	1.6	2.4	2.8	3.6	4.0	3.9	3.5
Bread and Cereals	-1.2	-0.2	0.9	1.5	1.8	2.0	1.6
Rice	-2.0	-0.9	0.5	1.4	2.0	2.3	1.7
Corn	1.7	2.6	2.5	1.9	0.7	-0.4	0.8
Meat	1.0	2.2	2.0	1.6	2.4	4.5	4.0
Fish	2.8	2.7	4.3	4.9	6.9	8.2	9.2
Milk, Cheese and Eggs	1.2	1.5	2.0	2.2	2.4	2.4	2.1
Oils and Fats	0.3	2.1	3.9	4.6	6.1	6.7	5.8
Fruit	3.3	4.4	7.0	9.2	7.9	7.2	6.0
Vegetables	10.3	12.9	9.9	11.7	10.6	4.4	2.5
Sugar, Jam, Honey	6.4	5.0	3.4	3.0	1.1	-1.5	-2.6
Food Products, N.E.C.	3.1	-1.0	-2.4	-0.1	1.2	0.2	0.6
Non-Alcoholic Beverages	1.2	1.2	1.2	1.3	1.2	1.1	1.1
Alcoholic Beverages and Tobacco	4.9	5.5	6.0	6.3	6.0	6.2	6.3

Source of Basic Data: PSA, BSP

Non-Food Inflation. Meanwhile, non-food inflation in Q3 2017 increased as some major commodity groups particularly, transport, education, and restaurants and miscellaneous goods and services posted higher price adjustments. The higher inflation rate for transport was driven by price increases for air passenger and sea fares as well as the fare hike approved by the Philippine National Railway (PNR) Board. At the same time, upward adjustments of gasoline and diesel prices, largely influenced by the higher international price of crude oil—also contributed to the increase in non-food inflation for the quarter. This was slightly offset by lower electricity rates during the quarter.

Higher gasoline and diesel prices contribute to 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	Q3
Non-Food	**0.5**	**0.6**	**1.2**	**1.5**	**2.4**	**2.4**	**2.7**
Clothing and Footwear	1.9	2.3	2.6	2.6	2.8	2.3	2.0
Housing, Water, Electricity, Gas and Other Fuels	-1.0	-1.0	0.2	1.2	2.9	3.1	2.9
Electricty, Gas, and Other Fuels	-7.0	-6.8	-3.2	-0.2	6.0	6.8	5.5
Furnishings, Household Equipment & Routine Maintenance of the House	1.5	1.6	2.1	2.4	2.3	2.3	1.9
Health	1.9	2.4	2.7	2.6	2.6	2.4	2.4
Transport	0.3	0.0	0.0	0.9	2.7	2.8	4.3
Transport Services	1.2	0.7	0.3	0.7	1.5	2.6	4.4
Communication	0.1	0.2	0.1	0.1	0.2	0.2	0.3
Recreation and Culture	1.1	1.6	1.7	1.7	1.8	1.4	1.4
Education	3.6	3.0	1.8	1.8	1.8	1.9	2.3
Restaurant and Miscellaneous Goods and Services	1.6	2.2	2.4	2.2	2.1	1.6	2.2

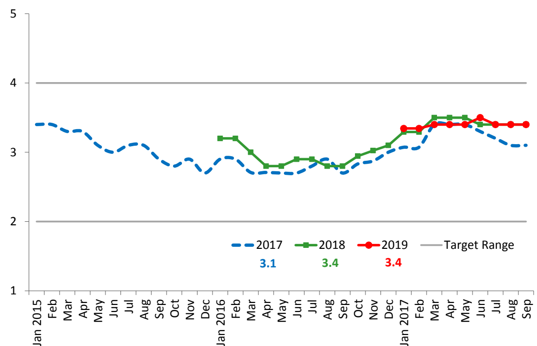
Source of Basic Data: PSA, BSP

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

Mean inflation forecasts for 2017 and 2019 are lower

In particular, the mean inflation forecast for 2017 declined to 3.1 percent in September 2017 from 3.3 percent in June 2017. Likewise, mean inflation forecast for 2019 declined to 3.4 percent in September 2017 from 3.5 percent in June 2017. Meanwhile, average inflation forecast for 2018 was unchanged at 3.4 percent during the same review period.

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



Source: BSP

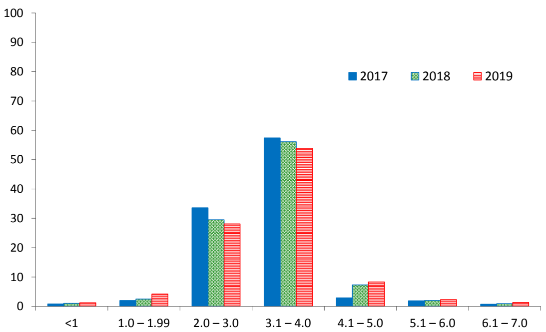
[5] There were 29 respondents in the BSP's survey of private sector economists in September 2017. The survey was conducted between 6 to 28 September 2017.

Most analysts expect full year 2017 inflation to remain close to the midpoint of the government's target range of 2-4 percent amid relatively balanced risks to inflation. Nonetheless, analysts noted possible upside risks to inflation such as volatile global oil prices, weaker peso, initial implementation of the comprehensive tax reform program, government spending on infrastructure, rise in utility rates, robust consumer spending during the holiday season, and base effect. On the other hand, a key downside risk to inflation was seen to emanate from global economic recovery.

Based on the probability distribution of the forecasts provided by 23 out of 29 respondents, there was a 91 percent probability that average inflation for 2017 will settle between the 2-4 percent range. For 2018, the respondents assigned an 85.7 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 29 respondents.
Source: BSP Survey

Results of the June 2017 Consensus Economics inflation forecast survey for the Philippines showed higher mean inflation forecasts for 2017 and 2018. Respondents expect 2017 inflation to settle at 3.3 percent, higher than the March 2017 survey's mean forecast of 3.2 percent.[6] Likewise, respondents' mean inflation forecast for 2018 rose to 3.4 percent from 3.3 percent in the March 2017 survey.

[6] There were 18 respondents in the Consensus Economics' survey in June 2017.

Table 4. Private Sector Forecasts for Inflation, September 2017

annual percentage change

	2017		2018	2019
	Q4	FY	FY	FY
1) Al-Amanah Islamic Bank	3.30	3.10	3.20	3.30
2) ANZ	3.00	3.00	3.30	3.50
3) Asia ING	3.00	3.10	3.60	3.70
4) Banco De Oro	2.80	3.40	3.50	3.50
5) Bangkok Bank	3.00	3.00	3.50	3.70
6) Bank of Commerce	3.18	3.12	-	-
7) Bank of China	3.20	3.20	3.30	3.40
8) Barclays	2.80	3.00	3.00	-
9) Chinabank	3.20	3.10	3.30	3.30
10) Citibank	2.70	3.00	3.50	3.20
11) CTBC Bank	3.40	3.20	3.70	4.00
12) Deutsche Bank	-	3.00	3.30	-
13) Eastwest Bank	3.25	3.15	3.50	3.75
14) Global Source	2.70	3.00	3.60	-
15) IDEA	3.50	3.20	3.70	3.90
16) Korea Exchange Bank	3.05	3.45	3.45	3.45
17) Land Bank of the Phils	3.00 - 3.30	2.90 - 3.20	2.90 - 3.20	2.90 - 3.30
18) Maybank	3.35	3.13	3.20	3.28
19) Maybank-ATR KimEng	2.90	3.00	3.50	3.40
20) Metrobank	-	3.10	3.60	3.80
21) Mizuho	3.00	3.00	2.90	-
22) Nomura	2.70	3.00	3.90	3.30
23) Phil. Equity Partners	3.00	3.10	3.45	-
24) RCBC	2.80 - 3.10	2.90 - 3.10	3.00 - 3.40	3.20 - 3.70
25) Robinsons Bank	3.30	3.20	3.00	2.00
26) Security Bank	2.90	3.00	3.60	3.70
27) Standard Chartered	3.00	3.10	3.20	3.20
28) UBS	2.50	2.90	3.50	-
29) Union Bank	3.20	3.10	3.50	3.80
Median Forecast	3.0	3.1	3.5	3.5
Mean Forecast	**3.0**	**3.1**	**3.4**	**3.4**
High	3.5	3.5	3.9	4.0
Low	2.5	2.9	2.9	2.0
Number of Observations	27	29	28	22
Government Target	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**

Source: BSP

Based on the Q3 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 49.4 percent to 35.9 percent).

Inflation expectations close to the midpoint of the target

Similarly, there were more firms that expect inflation to increase in the next quarter (from a diffusion index of 41.1 percent to 42.3 percent).

Meanwhile, results of the BSP Consumer Expectations Survey (CES) for Q3 2017 indicated that consumers expect inflation to increase over the next 12 months to 3.2 percent from 2.9 percent in the Q2 2017 survey. Nonetheless, a lower number of respondents (as in the previous survey) expect prices of basic goods and services to rise and stay close to the midpoint of the government's target range of 2-4 percent in the next 12 months.

Energy prices. The average Dubai crude oil prices in Q3 2017 went up by 1.4 percent compared to the previous quarter due mainly to supply disruptions in both the Organization of Petroleum Exporting Countries (OPEC) and non-OPEC countries, which also led to heightened uncertainty in the market.

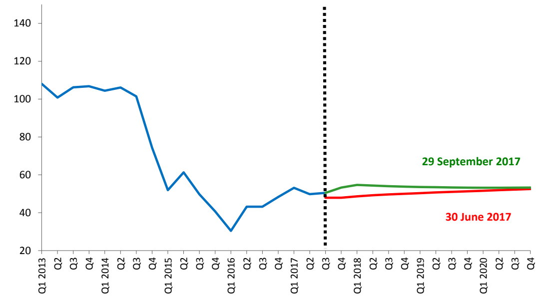
Uncertainty in the oil market rises amid production outages and geopolitical tensions

Oil prices increased due to supply disruptions in both OPEC and non-OPEC countries. In particular, Libya's production dropped in August as armed factions restricted the flow from its largest oil field, Sharara. Meanwhile, tensions between Turkey and the Kurdish region in Iraq also rose, which resulted in Turkey threatening to restrict Kurdish crude shipments through its territory, which further contributed to the oil price increase.

At the same time, refinery shutdowns in the US caused by Hurricane Harvey followed by recovery and simultaneous increase in refinery demand also further boosted crude oil prices during the quarter. US commercial crude oil inventory also mostly declined in Q3 2017. Based on data from the US Energy Information Administration (EIA), commercial crude oil stockpiles have declined by more than 300,000 barrels (6 percent) for the week-ending 22 September 2017 compared to end-June 2017.

Similar to oil spot prices, estimated futures prices of Dubai crude oil as of end-September, which are based on movements of Brent crude oil, showed a higher path for 2017 to 2020 compared to the estimates in the previous quarter.

Chart 5. Spot and Estimated Prices of Dubai Crude Oil



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

In terms of oil outlook, the US EIA[7] expects the demand-supply gap to be almost nil in 2017 however, oil supply is still projected to slightly outstrip demand in 2018 as demand forecasts were revised downwards relative to the previous month's forecast due partly to lower consumption from non-OECD countries and China. OECD oil demand were adjusted upwards, which was consistent with the assessment of the International Energy Agency (IEA). The IEA noted that consumption in OECD countries, namely, in Europe and the US were strengthening, albeit with a slight dip in Q3 2017 for the latter due to Hurricanes Harvey and Irma.

On a cumulative basis, net adjustments of domestic petroleum prices turned mostly positive in the first three quarters of 2017. Net adjustments in gasoline, kerosene, diesel, and LPG went up by ₽0.37 per liter, ₽2.17 per liter, ₽4.05 per liter, and ₽3.19 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 (September 2017)					
	Increase		Decrease		Net Adjustments	
	Number	Amount (P/liter)	Number	Amount (P/liter)	Number	Amount (P/liter)
Gasoline	19	17.05	15	-16.68	4	0.37
Kerosene	19	10.50	16	-8.33	3	2.17
Diesel	21	13.30	15	-9.25	6	4.05
LPG	4	9.81	4	-6.62	0	3.19

Source: Department of Energy (DOE)

Power. Overall electricity rates in the Meralco franchise area decreased in Q3 2017 due to lower generation costs. For Q3 2017, the average generation charge went down by ₽0.46 per

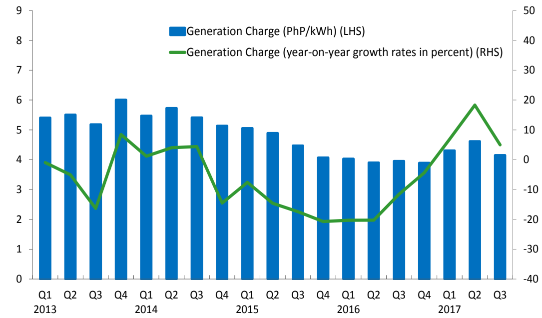
[7] September 2017 US EIA Short-term energy outlook

kilowatt hour (kWh) to ₽4.15 per kWh from ₽4.61per kWh in Q2 2017.

Lower generation rates lead to downward adjustment in retail electricity prices

The lower generation cost in Q3 2017 was due mainly to the larger increases in generation charges in Q2 2017 compared to the slight upward adjustments in generation charges during the review period. Moreover, the overall cost in Q3 2017 reflected the 3-month installment (June - August 2017) of the refund of over-recovery on pass-through charges (about ₽6.9 billion) from January 2014 to December 2016 as granted by the Energy Regulatory Commission (ERC) on 11 May 2017.

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

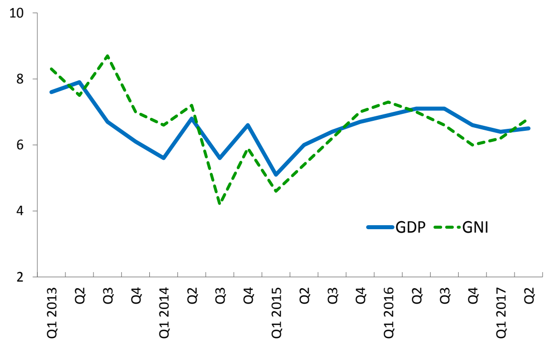
The Philippine economy grew by 6.5 percent in Q2 2017, marginally higher than the 6.4-percent growth in the previous quarter but lower than the 7.1-percent acceleration in the same period last year.

Real GDP growth stays firm

On the expenditure side, GDP grew on the back of government spending and the sustained growth in private consumption. On the production side, the growth in GDP was due to the strong performance of the industry and agriculture sectors, offsetting the slower growth of the services sector. Meanwhile, relative to the same period last year, the lower growth can be attributed to the slowdown in household and government spending and capital formation (on the expenditure side) and in the industry and services sectors (on the production side).

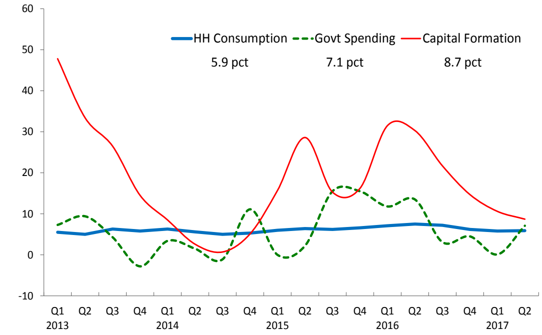
Gross national income (GNI) grew by 6.8 percent in Q2 2017, exceeding the previous quarter's growth of 6.2 percent but lower than the year-ago expansion of 7 percent. Net primary income rose by 8.6 percent in Q2 2017, higher than the 5.4-percent growth in the previous quarter and the 6.1-percent increase in the same period last year. The higher growth in Q2 2017 can be attributed to the acceleration of compensation inflows and slowdown of property expenses.

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



Source: PSA

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



Source: PSA

Aggregate Demand. On the expenditure side, household and government spending as well as investments contributed 3.9 ppts, 0.9 ppt, and 2.2 ppts, respectively, to total GDP growth, offsetting the negative contribution of net exports (-0.4 ppt).

Higher household spending due to lower unemployment rate in Q2

Household expenditure, which accounted for 66.2 percent of the country's output, rose by 5.9 percent in Q2 2017, slightly higher than the 5.8-percent expansion a quarter ago. The faster increase of household consumption was brought about by the higher growth of food and non-alcoholic beverages, alcoholic beverages and tobacco, housing, water, electricity, gas and other fuels, furnishings, household equipment and routing household maintenance, transport, and restaurants and hotels. Clothing and footwear, health, communication, education, and miscellaneous goods and services likewise expanded but at a slower pace. Meanwhile, recreation and culture declined further compared to a quarter ago. The growth in household spending can also be attributed to the following: (a) lower unemployment rate at 5.7 percent in Q2 2017 from 6.6 percent in Q1 2017, (b) additional income from release of mid-year bonuses, and (c) marginal easing of the inflation rate to 3.1 percent in Q2 2017 from 3.2 percent in Q1 2017.

Capital formation growth decelerated by 8.7 percent in Q2 2017 from 10.6 percent in Q1 2017 due to the slower growth in fixed capital investments (9.4 percent in Q2 2017 from 14.7 percent a quarter ago) and to the higher withdrawals of inventories in Q2 2017 at ₱5 billion from ₱1.3 billion in the same period last year. Notably, the main drivers of capital formation growth were the following: durable equipment (contributing 4.4 ppts) and construction (contributing 3.1 ppts).

The quarter-on-quarter (q-o-q) slowdown in fixed capital investments was traced to the following:

- lower growth of investments in durable equipment (8.7 percent in Q2 2017 from 16.9 percent in Q1 2017) brought about by lower investments in transport equipment, particularly road vehicles which accounted for 31.6 percent of durable equipment, as well as general industrial machinery and equipment.
- decelerated growth in construction at 7.3 percent (from 10.8 percent) as private construction rose by only 4.7 percent from 13 percent. This mirrored the 25.2 percent decline in building permits in Q2 2017.

Meanwhile, government infrastructure spending recovered with public construction expanding by 12 percent in Q2 2017, substantially higher than the 1.9-percent growth in the previous quarter. Similarly, growth of breeding stock and orchard development and intellectual property products accelerated in Q2 2017 compared to a quarter ago.

Government expenditures expanded by 7.1 percent in Q2 2017 compared to 0.1 percent a quarter ago. Improved government spending was due to higher expenditure for personnel services of government agencies following the release of mid-year bonus in May, as well as the creation and filling up of positions, and releases of pension and retirement gratuity and terminal leave benefits of employees in various agencies.

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

BY EXPENDITURE ITEM	2016				2017	
	Q1	Q2	Q3	Q4	Q1	Q2
Household Consumption	7.1	7.5	7.2	6.2	5.8	5.9
Government Consumption	11.8	13.5	3.1	4.5	0.1	7.1
Capital Formation	31.5	30.3	21.7	14.7	10.6	8.7
Fixed Capital Formation	28.3	30.3	25.4	18.5	14.7	9.4
Exports	10.2	10.6	9.0	13.4	20.3	19.7
Imports	21.1	25.4	13.3	15.4	18.6	18.7

Source: PSA

Overall exports grew by 19.7 percent in Q2 2017, slightly lower than the 20.3-percent growth a quarter ago. The slowdown in growth of exports of services (9.9 percent from 12.4 percent) outweighed the slight acceleration in exports of goods (23 percent from 22.8 percent a quarter ago). The lower growth in exports of services was due primarily to the decelerated growth in exports of miscellaneous services (e.g., technical, trade-related, and other business services, computer services, and manufacturing services on physical inputs owned by others) at 6.5 percent from 15.5 percent, transportation services (0.4 percent from 20.5 percent) and insurance services (13.5 percent from 44.3 percent) as well as the contraction in government services exports by 13.7 percent from an increase of 34.5 percent. Meanwhile, travel services grew by 32.2 percent from a decline of 6.4 percent a quarter ago. The sustained growth in exports of goods was driven mainly by the double-digit expansion of exports of semiconductors (24.9 percent from 23.4 percent), ignition wiring sets (22.8 percent from 6.5 percent), and other goods (20 percent from 16.4 percent).

Overall imports increased by 18.7 percent in Q2 2017, marginally faster than its quarter-ago growth of 18.6 percent, owing to higher expansion of imports of services by 10.7 percent from 4.7 percent. The double-digit rise in imports of services was due to the higher growth of imports of miscellaneous services (e.g., technical, trade-related, and other business services) at 11.3 percent from 3.6 percent, travel services (10.5 percent from 9.0 percent), insurance services (13.8 percent from 12.8 percent), and government services (5.9 percent from 3.5 percent) as well as the expansion of transportation services by 9.3 percent from a contraction of 3.4 percent. Meanwhile, the slowdown of growth of imports of goods to 20.6 percent in Q2 2017 from 22.2 percent a quarter ago can be attributed mainly to the continued contraction in imports of telecommunication (-44.7 percent from -45.0 percent), decline in payments for imported office equipment and artificial resins by 16.4 percent and 4.4 percent, respectively, and decelerated growth of imports of base metals (34.2 percent from 80.1 percent) and other commodities (2.7 percent from 16.9 percent). Notably, the expansion in imports of goods was driven mainly by semiconductors (36.9 percent from 35.7 percent), transport equipment (33.6 percent from 14.8 percent), and electronic data processing (67.8 percent from 24.2 percent).

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

Property Prices

Vacancy Rates, Makati CBD. The office vacancy rate in the Makati central business district (CBD) in Q2 2017 was slightly higher at 1.3 percent relative to the quarter-ago level of 0.9 percent but lower than the year-ago level of 1.7 percent.

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

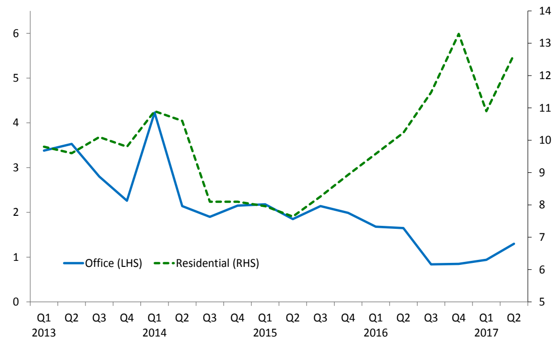
The marginal increase in office vacancy in the Makati CBD as well as in other areas such as Ortigas Center and Manila Bay Area is due to the addition of office supply following the delivery of new buildings.

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

Nevertheless, office vacancy rates have remained tight during the quarter even with the completion of new office projects, due to sustained strong demand from a more diversified tenant portfolio. Furthermore, according to Colliers, office vacancy rates will stay below the 5-percent levels for the rest of 2017 since majority of the new office units were already pre-leased prior to completion.

The residential vacancy rate in the Makati CBD increased to 12.7 percent in Q2 2017 from 10.9 percent in the previous quarter and 10.2 percent in the same quarter of 2016. The residential vacancy rate in the Makati CBD as well as in other locations, i.e., Fort Bonifacio, Rockwell Center, Ortigas Center and Eastwood City, rose due to the completion of new residential units. Colliers foresees that residential vacancy rates will reach 16.0 percent in 2018 given the expected additional residential supply but will revert to a 10-percent vacancy range in 2019 and 2020.

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



Source: Colliers International Philippines

Rental Values, Makati CBD. Monthly Grade A office[8] rents in the Makati CBD reached ₱960/sq.m. in Q2 2017, representing an increase of 3.8 percent from the previous quarter. Similarly, monthly Grade A office rents in the Makati CBD were higher by 4.9 percent relative to Q2 2016.

Office rental values increase in nominal terms

Office rental rates continued to increase amid the slight recovery in demand from BPO tenants as well as sustained strong demand from various sectors such as offshore gaming, financial services, pharmaceutical, telecommunications, manufacturing and 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 51.9 percent of the comparable levels in 1997.

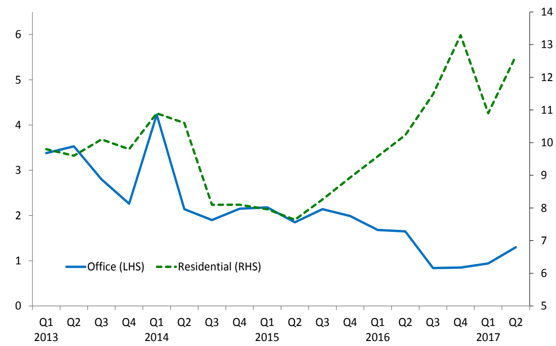
Monthly rents for luxury three-bedroom condominium units in the Makati CBD was at ₱810/sq.m. in Q2 2017, declining by 0.6 percent from the previous quarter.

Luxury rental values decline

Likewise, monthly rents for the 3-bedroom segment were lower by 5.3 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 as the rental market became more competitive due to the ample supply of residential units across CBDs and in alternative locations outside CBDs. Residential rental values for luxury three-bedroom high-rise units were above their 1997 levels in nominal terms but were only about 71.6 percent of their 1997 levels in real terms.

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



Source: Colliers International Philippines

[8] 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.

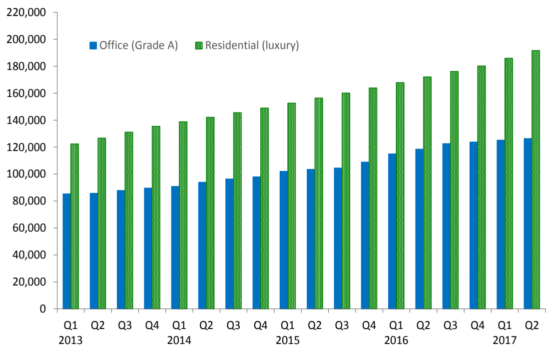
Capital Values, Makati CBD. Capital values[9] for office buildings in the Makati CBD in Q2 2017 were higher in nominal terms than their quarter- and year-ago levels.

Capital values for office and residential buildings rise

Grade A office capital values in the Makati CBD rose to ₱126,350/sq.m., higher by 1.0 percent and by 6.7 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 66.7 percent of the comparable levels in 1997.

Likewise, capital values for luxury residential buildings[10] in Makati CBD in Q2 2017 increased to ₱191,700/sq.m. from their quarter- and year-ago levels. Average prices for three-bedroom luxury residential condominium units grew by 3.1 percent quarter-on-quarter and 11.4 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 82.6 percent of the comparable levels in 1997.

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



Source: Colliers International Philippines

[9] Probable price that the property would have fetched if sold on the date of the valuation. The valuation includes imputed land and building value.
[10] 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).[11] The Residential Real Estate Price Index (RREPI)[12] decreased in Q2 2017, reflecting an easing in the growth of residential property prices during the quarter. Residential real estate prices went down by 4.6 percent y-o-y in Q2 2017, a reversal from the 1.2-percent and 11.6-percent growth registered in Q1 2017 and Q2 2016, respectively.

Residential real estate prices decline in Q2 2017

The RREPI in the National Capital Region (NCR) increased while that in Areas Outside NCR (AONCR) declined in Q2 2017. Residential real estate prices in NCR grew by 2.5 percent y-o-y in Q2 2017, slower than the 1.2-percent and 2.3-percent increase in Q1 2017 and Q2 2016, respectively. Meanwhile, residential real estate prices in AONCR contracted by 8.2 percent, a reversal of the 1.2-percent growth in the previous quarter and 18.0-percent expansion in the same quarter in 2016.

[11] 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.
[12] For Q2 2017, about eight in ten real estate loans were for the purchase of new housing units (75.3 percent). By type of housing unit, 45.3 percent of residential property loans were for the acquisition of single detached units, followed by condominium units (44.8 percent) and townhouses (9.6 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 44.9 percent of the total number of residential real estate loans granted during the quarter, followed by CALABARZON (28.9 percent), Central Luzon (6.7 percent), Central Visayas (5.7 percent), Western Visayas (5.7 percent), Davao Region (3.1 percent) and Northern Mindanao (1.3 percent). These seven regions accounted for 96.3 percent of total housing loans granted by banks.

Table 7. Residential Real Estate Price Index By Area

Q1 2014=100; growth rate in percent

Quarter	Residential Real Estate Price Index (By Area)		
	Overall	NCR	AONCR
2015 Q2	109.5	114.6	105.9
Q3	110.3	115.5	106.8
Q4	113.1	115.8	111.2
2016 Q1	115.3	116.5	114.6
Q2	122.2	117.2	125.0
Q3	112.9	116.0	111.2
Q4	113.3	115.0	112.4
2017 Q1	116.7	117.9	116.0
Q2	116.6	120.1	114.7
Year-on-Year Growth Rates			
2015 Q2	14.3	17.7	12.9
Q3	5.0	8.0	4.0
Q4	6.0	5.6	7.5
2016 Q1	9.6	10.4	9.1
Q2	11.6	2.3	18.0
Q3	2.4	0.4	4.1
Q4	0.2	-0.7	1.1
2017 Q1	1.2	1.2	1.2
Q2	-4.6	2.5	-8.2
Quarter-on-Quarter Growth Rates			
2015 Q2	4.1	8.6	0.9
Q3	0.7	0.8	0.8
Q4	2.5	0.3	4.1
2016 Q1	1.9	0.6	3.1
Q2	6.0	0.6	9.1
Q3	-7.6	-1.0	-11.0
Q4	0.4	-0.9	1.1
2017 Q1	3.0	2.5	3.2
Q2	-0.1	1.9	-1.1

Source: BSP

The easing in residential real estate prices was also seen in the decrease in the price of single detached/attached housing units, offsetting the rise in the prices of duplex,[13] townhouse and condominium units. Prices of single detached/attached units contracted by 9.9 percent y-o-y compared to the 0.3-percent and 18.7-percent increase registered in Q1 2017 and Q2 2016, respectively. Meanwhile, the price of duplex housing units went up by 5.1 percent, recovering from the 15.6-percent decline in the previous quarter as well as the 12.2-percent contraction in the same period in 2016. The prices of townhouses and condominium units also increased by 2.9 percent (from 1.2 percent in Q1 2017 and 14.2 percent in Q2 2016) and 5.1 percent (from 3.2 percent in Q1 2017 and -0.3 percent in Q2 2016), respectively.

[13] Indices for duplex exhibit more volatility due to the relatively small number of real estate loans reported for duplex housing units. Real estate loans for duplex units accounted for only 0.3 percent of the total new housing units reported.

Table 8. Residential Real Estate Price Index By Housing Type

Q1 2014=100; growth rate in percent

Quarter	Residential Real Estate Price Index (By Housing Type)				
	Overall	Single Detached/ Attached	Duplex	Townhouse	Condominium Unit
2015 Q2	109.5	103.9	97.4	104.6	118.8
Q3	110.3	105.7	100.0	105.1	117.9
Q4	113.1	110.4	100.5	110.7	116.8
2016 Q1	115.3	112.1	93.7	115.5	120.3
Q2	122.2	123.3	85.5	119.9	118.6
Q3	112.9	108.3	83.8	110.0	121.5
Q4	113.3	109.4	75.9	117.5	119.0
2017 Q1	116.7	112.4	79.1	116.9	124.1
Q2	116.6	111.1	89.9	123.4	124.7
Year-on-Year Growth Rates					
2015 Q2	14.3	16.7	0.5	2.8	17.2
Q3	5.0	6.2	12.4	-2.7	7.1
Q4	6.0	8.7	-5.2	5.2	4.0
2016 Q1	9.6	8.2	-9.8	7.5	13.3
Q2	11.6	18.7	-12.2	14.6	-0.2
Q3	2.4	2.5	-16.2	4.7	3.1
Q4	0.2	-0.9	-24.5	6.1	1.9
2017 Q1	1.2	0.3	-15.6	1.2	3.2
Q2	-4.6	-9.9	5.1	2.9	5.1
Quarter-on-Quarter Growth Rates					
2015 Q2	4.1	0.3	-6.3	-2.6	11.9
Q3	0.7	1.7	2.7	0.5	-0.8
Q4	2.5	4.4	0.5	5.3	-0.9
2016 Q1	1.9	1.5	-6.8	4.3	3.0
Q2	6.0	10.0	-8.8	3.8	-1.4
Q3	-7.6	-12.2	-2.0	-8.3	2.4
Q4	0.4	1.0	-9.4	6.8	-2.1
2017 Q1	3.0	2.7	4.2	-0.5	4.3
Q2	-0.1	-1.2	13.7	5.6	0.5

Source: BSP

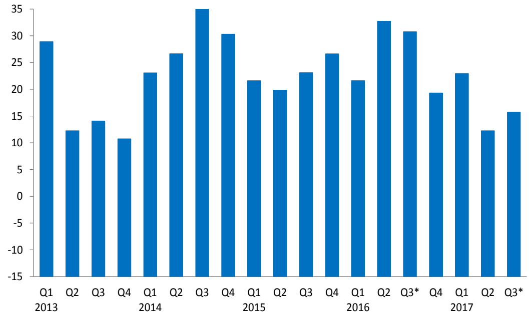
Vehicle Sales. Sales of new vehicles[14] grew by 15.7 percent y-o-y in the first two months of Q3 2017, albeit slower than the 30.8-percent growth recorded in the same period a year ago, reflecting the slowdown in the sales of both passenger cars and commercial vehicles.

Growth in sales of new vehicles show moderation

Sales of passenger cars expanded at a lower rate of 7.1 percent y-o-y in July-August 2017 compared to the 8.8-percent growth in the same period in 2016. New passenger car sales accrued to a total of 23,959 units in the first two months of Q3 2017 from 22,366 units in the same period a year ago.

[14] 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 Philippine Corp., (8) Suzuki Philippines Inc., (9) Toyota Motor Philippines Corp., and (10) Universal Motors Corp.

Chart 12. Vehicle Sales
number of units



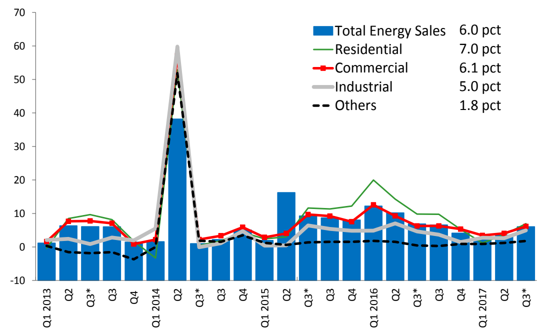
* July - August
Source: Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI)

The growth in commercial vehicle sales, which account for about 66.8 percent of total vehicle sales, also slowed down to 20.5 percent y-o-y in the first two months of Q3 2017 relative to 47.4-percent growth for the same period in 2016. Commercial vehicles sold during the quarter reached 48,301 units from 40,073 units in July-August 2016.

Energy Sales. Meralco's energy sales for Q3 2017 (July - August) grew by 6.0 percent, slower than the 6.9-percent growth reported in the same period a year ago. Energy sales from the residential sector, commercial sector and industrial sector grew by 7.0 percent, 6.1 percent, and 5.0 percent, respectively.

Energy sales continue to grow

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



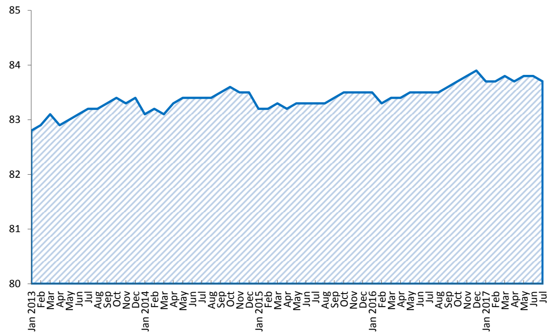
*July-August 2017
Source: Meralco, BSP calculations

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 stood at 83.7 percent in July 2017, relatively unchanged from the month-ago level.

Capacity utilization in manufacturing remains above 80 percent

Of the 695 respondent-establishments, 57.9 percent operated at least at 80.0 percent capacity in July 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



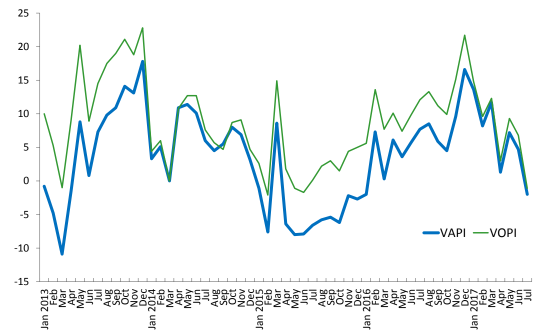
Source: PSA

Volume and Value of Production. Preliminary results of the MISSI showed that volume of production index (VoPI) posted a contraction of 1.1 percent year-on-year in July 2017 from a 6.8-percent (revised) growth in the previous month.

Manufacturing output posted contraction

The slight reduction in overall output was led by the double-digit decline in production of chemicals (-52.6 percent), rubber and plastic products (-13.9 percent), and textiles (-20.3 percent). At the same time, more than half of the sector's gainers in terms of output posted slower expansions in July, which also contributed to the sector's lackluster performance.

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



Source: PSA

The value of production index (VaPI) also contracted by 2 percent in July 2017 from a 4.7-percent growth a month ago (revised). The decline was led by the following sub-sectors: chemical products (-54.2 percent), rubber and plastic products (-19.1 percent), and textiles (-23.6 percent).

Business Expectations. Business outlook on the economy turned less optimistic for Q3 2017, with the overall confidence index of the Business Expectations Survey (BES)[15] (CI) declining to 37.9 percent from 43 percent a quarter ago. This means that the number of optimists declined but continued to be greater than the number of pessimists during the quarter. The confidence level, although lowest in three years, remains to be robustly positive.

Business sentiment less buoyant but improves for the quarter ahead

Respondents cited the following factors behind their less buoyant outlook in Q3: (a) seasonal factors such as slowdown of business activities during the rainy season, slack in demand during the planting and closed milling season, as well as the closed fishing season in Davao Gulf from July to September, (b) Marawi crisis and declaration of martial law in Mindanao, which affected people's mobility going to and within Mindanao, (c) depreciating peso, (d) increasing prices, (e) stiffer competition, and (f) damages and power outages caused by the earthquake in the Visayas.

Table 9. 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
	Q3	37.9	51.3

Source: BSP

The sentiment of businesses in the Philippines mirrored the less buoyant business outlook in the US, Canada, the Netherlands, New Zealand, and Thailand but was in contrast to the more bullish views of those in Germany and Hong Kong and steady outlook in France.

For the quarter ahead (Q4 2017), business outlook turned more positive, as the next quarter CI rose to 51.3 percent from 42.7 percent in the previous quarter's survey results. This suggests that growth could accelerate in the last quarter of 2017. Respondents' more positive outlook for Q4 2017 was due to expectations of: (a) an uptick in consumer demand during the holiday, harvest and milling seasons, (b) continued rollout of government infrastructure and other development projects, (c) continued increase in orders and projects translating to higher volume of production, (d) expansion of businesses and new product lines, (e) introduction of new and enhanced business strategies and processes, (f) expected favorable weather condition for agricultural products, and (g) positive impact of the proposed tax reform program.

[15] The Q3 2017 BES was conducted during the period 3 July - 18 August 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 586 companies in NCR and 894 firms in AONCR and covered all 16 regions nationwide. The survey response rate for this quarter was higher at 83.6 percent (from 83.4 percent in the previous quarter). The response rate was higher for NCR at 80.0 percent (from 81.5 percent in the previous quarter) and higher for AONCR at 86.0 percent (from 84.7 percent in Q2 2017).

Consumer Expectations. Consumer sentiment weakened but remained positive for Q3 2017, with the overall confidence index (CI) of the Consumer Expectations Survey (CES) [16] decreasing to 10.2 percent from 13.1 percent for Q2 2017. Despite the decline in the CI, consumer confidence remained high, registering the second highest reading since the start of the nationwide survey in Q1 2007.

Consumer confidence in Q3 weakens but turns upbeat for the next quarter

The positive albeit lower CI indicates that the number of optimists declined but continued to outnumber the pessimists. According to respondents, their less favorable outlook for the current quarter was due to the following reasons: (a) anticipated higher prices of commodities which could lead to higher household expenditures, (b) peace and order situation particularly in Marawi City in Mindanao, (c) low or no increase in income, and (d) expected increase in the number of unemployed persons. Respondents also cited other concerns on occurrence of calamities during the third quarter and poor health.

Table 10. 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
	Q3	10.2	17.8	33.7

Source: BSP

[16] The Q3 2017 CES was conducted during the period 1 - 15 July 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 5,597 households, of which 2,763 (49.4 percent) were from NCR and 2,834 (50.6 percent) from AONCR.

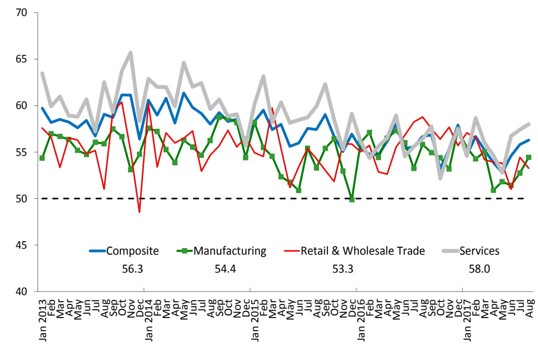
The sentiment of consumers in the Philippines mirrored the weaker outlook of consumers in Australia, the euro area, France, Thailand, and United Kingdom but was in contrast to the improved views of those in Canada, Indonesia, Japan, South Korea, Switzerland, Taiwan, and the United States for Q3 2017.

For the next quarter (Q4 2017), consumer sentiment turned more upbeat as the CI increased to 17.8 percent from 13.6 percent in the previous quarter's survey. Respondents' more optimistic outlook for the next quarter stemmed from expectations of (a) additional income and salary increase, (b) improvement in peace and order situation, and (c) availability of more jobs. Meanwhile, consumer outlook for the year ahead remained broadly steady with the CI at 33.7 percent from 34.3 percent for Q2 2017.

Purchasing Managers' Index. [17] The composite PMI remained firmly above the 50-point expansion threshold[18] in August 2017, an improvement from the composite PMI of 55.8 in July 2017. This may be attributed to the faster rate of expansion in the manufacturing and services sectors.

PMI remains firmly above the 50-point expansion threshold

Chart 16. Purchasing Managers' Index



Source: Philippine Institute of Supply Management (PISM)

[17] Data based on the monthly purchasing managers' index report of the Philippine Institute for Supply Management.
[18] 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.

The manufacturing PMI increased by 1.7 index points to 54.4 in August 2017 from 52.8 in July 2017, which was in line with sector managers' expectation during the month. High demand, business expansions, and new product developments were cited as main reasons for the sector's August performance. This was evident in the continued expansion of the New Orders Index, Production Index, Employment Index, and Inventories Index. In particular, inventories increased due to firms' preparation ahead of the holiday season. As a result, the Supplier Deliveries Index posted a contraction. All firms by export category also posted faster expansions in August led by firms with export volume of up to 25 percent of total revenues. On a per sector basis, 10 of the 12 manufacturing subsectors expanded in August led by food and beverages (with a PMI of 59.9); machinery (58.6); fabricated metals (55.3); non-metallic minerals (54.9); communication, electronics, and medical equipment (53.6); basic metals (51.7); and textiles (51.2). On the other hand, publishing and printing as well as paper and paper products both posted contractions during the month. Meanwhile, survey respondents expect the sector to decelerate in September 2017.

Likewise, the services PMI increased by 0.6 index points to 58.0 in August 2017 from 57.4 in the previous month. Firms attributed the sector's growth to increased demand, product developments, company/branch expansions, and other related management initiatives. All six indices posted expansions during the month, with the most notable increase in the Business Activity Index with a PMI of 62.3, as well as Average Operation Costs Index. All firms by export activity also accelerated in August, except for firms servicing local clients. In particular, firms with export volume between 26 percent and 50 percent of total revenues increased significantly with a PMI of 83.3. Meanwhile, 12 of the 13 subsectors expanded in August (i.e., electricity, gas, and water; construction; hotels and restaurants; transportation, including travel agency; banking and financial intermediation; provident and insurance; real estate; renting of goods and equipment; miscellaneous business activities; health and social work; business and knowledge processing; and education), while the postal and telecommunications subsector indicated contraction. Prospects are favorable for the sector in the month ahead.

By contrast, the retail and wholesale PMI decreased by 1.2 index points to 53.3 in August from 54.4 a month ago, which supply chain executives anticipated in their July prediction as supply chain managers recognize August as the "ghost" month. The sector's lackluster performance was due largely to weaker demand. This was evident in the slower rate of expansion of the Purchases Index, Sales Revenues Index, and Supplier Deliveries Index. Meanwhile, the PMI of the retail subsector increased slightly by 0.45 index points to 54.7 in August from 54.2 in July. By contrast, the PMI of the wholesale subsector eased by 1.7 index points to 51.4 in August from 53.1 a month ago. Firms expect the sector to slowdown further in September 2017.

External Demand

Exports. Exports of goods expanded by 12.7 percent in Q2 2017 from 16.3 percent in the previous quarter. The growth in exports in Q2 2017 was a turn-around from the 4.8-percent contraction posted a year ago.

Exports of goods rise

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

Table 11. Exports of Goods
growth rate in percent

COMMODITY GROUP	2016	2017	
	Q2	Q1	Q2
Coconut Products	-15.1	133.2	31.9
Sugar and Products	-72.0	-73.2	2,804.4
Fruits and Vegetables	-20.2	-23.3	7.0
Other Agro-Based Products	-14.6	17.4	24.7
Forest Products	-79.5	178.6	724.7
Mineral Products	-38.7	61.7	112.5
Petroleum Products	4.7	-26.3	-6.3
Manufactures	-1.6	13.8	7.3
Special Transactions	10.3	37.3	31.0
Total Exports	**-4.8**	**16.3**	**12.7**

Source: BSP

Imports. Imports of goods grew at a slower pace of 5.1 percent in Q2 2017 from the 15.1-percent and 33.8-percent growth registered in Q1 2017 and Q2 2016, respectively.

Imports of goods increase

Nevertheless, the sustained growth in imports during the quarter 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 12. Imports of Goods
growth rate in percent

COMMODITY GROUP	2016	2017	
	Q2	Q1	Q2
Capital Goods	82.8	6.0	4.6
Raw Materials and Intermediate Goods	19.4	15.3	6.5
Mineral Fuels and Lubricants	-10.7	56.7	10.0
Consumer Goods	39.3	12.5	1.2
Special Transactions	83.8	-17.3	-31.4
Total Imports	**33.8**	**15.1**	**5.1**

Source: BSP

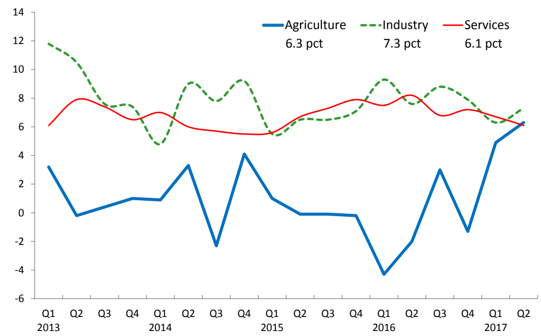
Aggregate Supply. On the production side, Q2 economci growth was driven mainly by the services sector (contributing 3.5 ppts), industry sector (contributing 2.5 ppts) and agriculture sector (contributing 0.5 ppt).

Services sector continues to support supply-side growth

The services sector output increased by 6.1 percent in Q2 2017, lower than the 6.7-percent growth in Q1 2017. The slowdown in growth was due to the slower growth in trade and repair of motor vehicles, motorcycles, personal, and household goods (6.3 percent from 7.4 percent), financial intermediation (6.1 percent from 7.0 percent), transport, storage and communication (3.5 percent from 4.2 percent), and other services (5.0 percent from 7.2 percent). The deceleration in trade and repair of motor vehicles, motorcycles, personal, and household goods came from the slowdown in wholesale and retail trade services. Financial intermediation services growth eased due to the lower expansion of activities of banking institutions, insurance, and those auxiliary to financial intermediation compared to a quarter ago. The slowdown in transport, storage and communication services can be attributed to the lower growth of land and water transport and storage and services incidental to transport. On other services, the softened growth stemmed from the decelerated growth of education, and health and social work as well as from the decline in recreational, cultural and sporting activities.

Meanwhile, real estate, renting and business activities and public administration and defense and compulsory social security spending increased from a quarter ago (7.9 percent from 7.1 percent and 7.6 percent from 5.5 percent, respectively). The growth in real estate, renting and business activities sector was faster compared to that of the previous quarter on account of higher growth of real estate subsector (14.3 percent from 6.3 percent). On public administration and defense, the higher growth of 7.6 percent compared to a quarter ago was due to the increased disbursement for personnel services and funding for the creation and filling of positions in various government agencies.

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



Source: PSA

The industry sector grew stronger at 7.3 percent in Q2 2017 compared to 6.3 percent in Q1 2017. This can be attributed to the faster growth in manufacturing (7.9 percent from 7.6 percent) and electricity, gas and water supply (EGW) (2.4 percent from 1.5 percent) and expansion of mining and quarrying by 13.7 percent from a contraction of 18 percent. The higher growth of manufacturing can be attributed mainly to the growth in radio, television and communication equipment and apparatus and fabricated metal products production. On EGW, the accelerated growth came from increased electricity production. The positive growth of mining and quarrying was due largely to the expansion of nickel mining, stone quarrying, clay and sandpits, and other non-metallic mining. Meanwhile, the deceleration in the growth of construction

(6.3 percent from 9.0 percent) was due to the lower growth of private construction.

The agriculture, hunting, forestry and fishery (AHFF) sector expanded further in Q2 2017 by 6.3 percent from 4.9 percent a quarter ago. The growth for the quarter came largely from the growth of corn (45.9 percent from 23.4 percent) and sugarcane production (157.2 percent from 1.0 percent), and the broadly steady growth of palay production (11.7 percent from 12.4 percent). The growth in the agriculture sector can be attributed to favorable weather conditions and increased usage and availability of good quality seeds.

Table 13. Economic Performance
at constant 2000 prices; growth rate in percent

BY INDUSTRIAL ORIGIN	2016				2017	
	Q1	Q2	Q3	Q4	Q1	Q2
Agri., Hunting, Forestry and Fishing	-4.3	-2.0	3.0	-1.3	4.9	6.3
Agriculture and Forestry	-4.0	-1.3	4.3	-0.7	5.6	8.1
Fishing	-5.9	-5.2	-2.6	-3.8	1.2	-2.9
Industry Sector	9.3	7.6	8.8	7.9	6.3	7.3
Mining and Quarrying	11.4	-4.0	-2.0	10.8	-18.0	13.7
Manufacturing	8.0	6.2	6.8	7.0	7.6	7.9
Construction	14.2	13.5	17.2	10.7	9.0	6.3
Electricity, Gas and Water Supply	10.2	10.3	9.6	9.2	1.5	2.4
Service Sector	7.5	8.2	6.8	7.2	6.7	6.1
Transport, Storage and Communication	5.3	7.0	4.6	6.4	4.2	3.5
Trade and Repair of Motor Vehicles, Motorcycles, Personal and Household Goods	7.5	8.9	6.3	6.5	7.4	6.3
Financial Intermediation	9.7	6.9	8.5	5.5	7.0	6.1
Real Estate, Renting and Business Activities	8.7	8.8	8.9	9.1	7.1	7.9
Public Administration and Defense; Compulsory Social Security	5.2	6.4	3.7	13.3	5.5	7.6
Other Services	7.3	9.0	6.8	6.0	7.2	5.0

Source: PSA

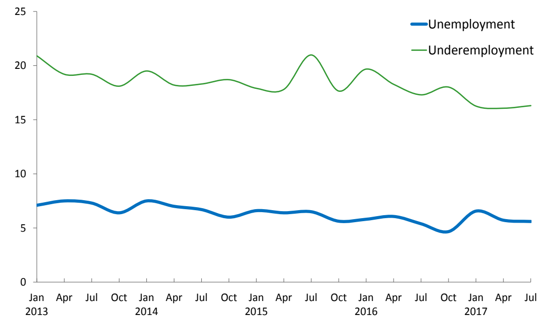
Labor Market Conditions

The Philippine labor market reported mixed results in the July 2017 round of the labor force survey (LFS). While underemployment rate improved compared to its level a year ago, the overall unemployment and youth unemployment rates increased together with a lower employment rate.

Philippine labor market show mixed results in Q3 2017

From 17.4 percent in July 2016, the country's underemployment rate declined to 16.3 percent in July 2017, the lowest recorded underemployment rate in all July rounds of the LFS since 2005.[19] However, this was not matched by an improvement in unemployment and employment rates, as the former increased to 5.6 percent in July 2017 from 5.4 percent a year ago, while the latter slightly dropped to 94.4 percent from 94.6 percent in July 2016. The youth unemployment rate also increased during the period as it reached 15.2 percent, from 13.5 percent in the same period in 2016.

Chart 18. Unemployment and Underemployment
in percent



Source: PSA

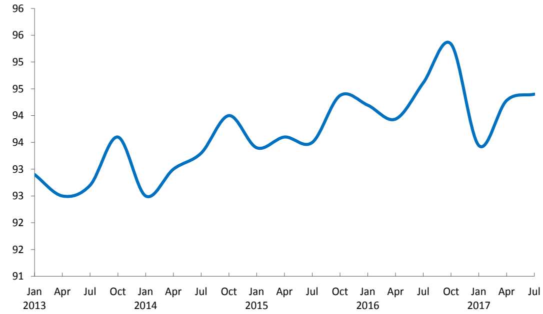
These latest developments highlight the need to push for more reforms to improve the country's labor market condition since for the first three quarters of 2017, only underemployment rate moved closer to the government's targets – the underemployment rate averaged at 16.2 percent while overall unemployment and youth unemployment rates averaged at 6.0 percent and 15.2 percent, respectively. In the Philippine Development Plan (PDP) 2017-2022, the target of the government is to reduce the underemployment rate in areas outside the National Capital Region to 16 to 18 percent in 2022, the country's unemployment rate to 3-5 percent, and the youth unemployment rate to 8 percent.

The decline in the country's employment rate in July 2017 was attributed primarily to greater decline in employment (-1.9 percent) compared to the drop in the labor force (-1.7 percent).[20]

[19] 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.

[20] This was partly attributed to K to 12 program. Based on PDP, the implementation of the senior high school program starting in 2016 has increased school participation and, therefore, reduced labor market participation.

Chart 19. Employment Rate
in percent



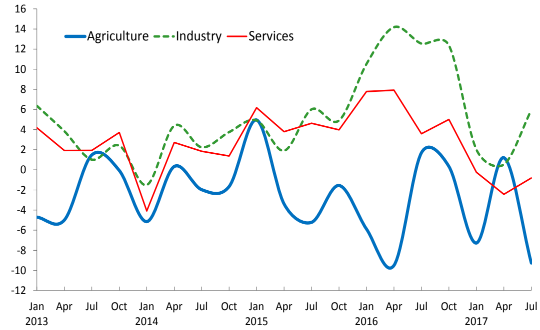
Source: PSA

The contraction in employment during the period was the third consecutive quarter of employment losses in 2017. This was attributed mainly to lower employment in agriculture (-9.2 percent) and services (-0.8 percent) sectors, which accounted for 25 percent and 56 percent of the country's total employment, respectively. Employment losses from these two sectors offset the 6.0-percent improvement in industry employment which provided 19 percent of the total employment level in July 2017.

The agriculture sector was again adversely affected by weather disturbances that hit the country during the review period, resulting in net employment loss of 1 million. The lower employment in the services sector or a net employment loss of 189,000 was mainly due to wholesale and retail trade (6.6 percent reduction) and education (9.3 percent decline), reflecting the stricter enforcement of labor laws and the implementation of the K-12 program.[21]

Meanwhile, net employment gain in the industry sector of 434,000 was attributed to higher employment in construction (10.3 percent growth rate) and manufacturing (3.6 percent) subsectors, reflecting greater production and build-up activities in the third quarter of 2017.

Chart 20. Employment by Sector
in percent



Source: PSA

The 5.6 percent unemployment rate in July 2017 was equivalent to 2.4 million unemployed individuals. However, while the latest unemployment rate was higher compared to the same period a year ago, this remained the second lowest rate among all July figures since 2005.[22] Most of the unemployed were still high school (junior high school with 33.1 percent share) and college (21.3 percent) graduates. The unemployment rate among the youth (15-24 age group) of 15.2 percent was about three times the national unemployment rate and four times the unemployment rate of 25-54 age group (3.8 percent). In addition, most of the country's underemployed remained in the services (46.8 percent share) and agriculture (33.1 percent share) sectors but more than half were not visibly underemployed (53.1 percent share).[23,24] The country's overall mean hours of work (hours per week) declined to 42.2 in July 2017 from 42.6 a year ago.

[21] According to NEDA, the subsectors in services which recorded employment losses are consistent with the priority establishments and industries being closely watched by the government under the Department of Labor and Employment's Labor Law Compliance System or a pro-worker reform that started in 2013 to ensure the employers' compliance with a comprehensive checklist of laws. The recent changes in labor policies regarding contractual workers may have also affected the hiring decision of firms (Source: NEDA [2017], "NEDA Concerned Over Job Loss, Vows to Improve Situation," NEDA Press Release, 13 September 2017).

[22] NEDA (2017).
[23] The invisible underemployment refers to underemployed full-time workers or those who work 40 hours or more per week but still wanted more work. Most (51.5 percent) of these are in services sector.
[24] 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 (44.1 percent) of the visibly underemployed are in the agriculture sector.

II. Monetary and Financial Market Conditions

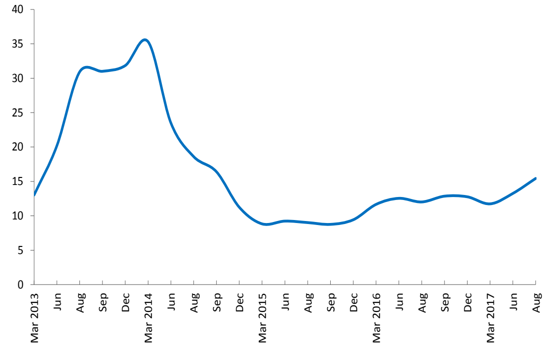
Domestic Liquidity

Domestic liquidity (M3) grew by 15.4 percent y-o-y in August to about ₱10.1 trillion, faster than the 13.3-percent expansion recorded in end-Q2 2017.

Domestic liquidity growth accelerates

Money supply continued to increase due largely to continued demand for credit. Domestic claims grew by 16.9 percent in August from 15.4 percent in end-Q2 2017 on sustained growth in credits to the private sector. Net claims on the central government also increased by 16.7 percent in August from 14.0 percent at the end of the previous quarter as a result of continued borrowings by the National Government.

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



Source: BSP

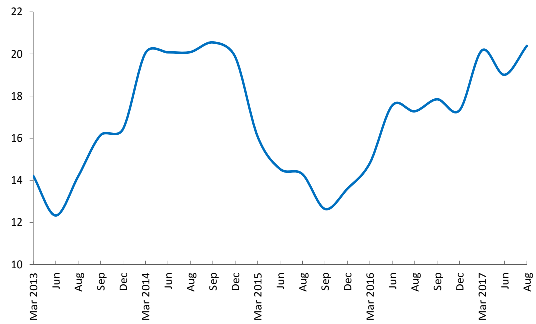
Likewise, the growth in net foreign assets (NFA) accelerated to 6.4 percent y-o-y in August from 2.8 percent in end-Q2 2017. The BSP's NFA position expanded during the review period on the back of robust foreign exchange inflows coming mainly from overseas Filipinos' remittances and business process 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 August 2017 show that outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, grew by 20.4 percent y-o-y relative to the 19.0 percent and 17.8 percent expansion posted at end-Q2 2017 and end-Q3 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 19.5 percent y-o-y in August 2017 from 17.9-percent growth in end-Q2 2017 and 17.4-percent rise in end-Q3 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; wholesale and retail trade, repair of motor vehicles and motorcycles; manufacturing; information and communication; other community, social and personal activities; agriculture, forestry and fishing; and, financial and insurance activities.

Meanwhile, loans for household consumption grew by 22.8 percent y-o-y as of end-August 2017, higher than the 22.5 percent and 22.3 percent growth recorded in end-Q2 2017 and end-Q3 2016, respectively.

Monetary Operations

For Q3 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 at 1.1 from 1.5 in Q2 2017, while bid-to-cover ratio for the 28-day TDF improved slightly to 0.8 from 0.7 in the previous quarter. The results of the auction during the review quarter reflected banks' continued preference for shorter tenors and other lending activities that offer higher returns and greater tradability. The average bid-to-cover ratio for the RRP facility was at 1.1 in Q3 2017 reflecting healthy demand.

Starting 6 September 2017, the offered volumes for the 28-day TDF was decreased by ₱30 billion to ₱110 billion, while the offered volume for the 7-day TDF was retained at ₱40 billion. The TDF auctions are conducted every Wednesday while the RRP auction is a daily fine-tuning operation.

Credit Conditions

Credit Standards. Results of the Q3 2017 Senior Bank Loan Officers' Survey (SLOS) showed that a majority 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. This is the 34th consecutive quarter since Q2 2009 that the majority of respondent banks reported broadly unchanged credit standards.

Majority of banks keep credit standards steady

Meanwhile, the diffusion index (DI) approach , 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 (88.9 percent of banks that responded to the question) indicated that their credit standards for their loans to enterprises remained unchanged during the quarter using the modal approach.

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

	2016				2017		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Tightened Considerably	3.3	0.0	0.0	3.4	0.0	0.0	0.0
Tightened Somewhat	6.7	9.7	6.9	3.4	6.7	10.0	7.4
Remained Basically Unchanged	**86.7**	**87.1**	**93.1**	**89.7**	**93.3**	**90.0**	**88.9**
Eased Somewhat	3.3	3.2	0.0	3.4	0.0	0.0	3.7
Eased Considerably	0.0	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	100.0
Diffusion Index for Credit Standards	**6.7**	**6.5**	**6.9**	**3.4**	**6.7**	**10.0**	**3.7**
Weighted Diffusion Index for Credit Standards	**5.0**	**3.2**	**3.4**	**3.4**	**3.3**	**5.0**	**1.9**
Mean	2.9	2.9	2.9	2.9	2.9	2.9	3.0
Number of Banks Responding	**30**	**31**	**29**	**29**	**30**	**30**	**27**

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

However, results based on the DI approach indicated a net tightening of credit standards for business loans attributed to respondent banks' less favorable economic outlook, perceptions of stricter financial system regulations, and banks' reduced tolerance for risk as well as a decline in borrowers' profiles. In terms of specific credit standards, the observed net tightening of overall credit standards is reflected in respondent banks' stricter loan covenants and increased use of interest rate floors particularly for loans to large middle-market enterprises and small- and medium-sized enterprises (SMEs).

In terms of borrower firm size, banks' responses indicated a net tightening of overall credit standards for loans to large middle-market enterprises and SMEs, while overall credit standards for loans to top corporations and micro-enterprises showed a net easing based on the DI approach.

Results based on the modal approach showed that most of the respondent banks anticipate unchanged credit standards in the next quarter. Meanwhile, the DI approach showed that some respondent banks expect their overall credit standards for business loans to tighten over the next quarter largely on account of banks' less favorable economic outlook and the decrease in the profitability of banks' portfolio.

Lending to Households. The results of the survey also showed that most respondent banks (90.0 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 housing 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, among others. In terms of specific credit standards, results based on the DI approach indicated overall unchanged collateral requirements, loan covenants and use of interest rate floors.

Table 15. General Credit Standards for Loans to Households (Overall)

	2016				2017		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Tightened Considerably	0.0	0.0	0.0	5.0	0.0	0.0	0.0
Tightened Somewhat	9.5	8.3	9.1	0.0	0.0	9.1	5.0
Remained Basically Unchanged	**81.0**	**83.3**	**90.9**	**95.0**	**100.0**	**81.8**	**90.0**
Eased Somewhat	9.5	8.3	0.0	0.0	0.0	9.1	5.0
Eased Considerably	0.0	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	100.0
Diffusion Index for Credit Standards	**0.0**	**0.0**	**9.1**	**5.0**	**0.0**	**0.0**	**0.0**
Weighted Diffusion Index for Credit Standards	**0.0**	**0.0**	**4.5**	**5.0**	**0.0**	**0.0**	**0.0**
Mean	3.0	3.0	2.9	2.9	3.0	3.0	3.0
Number of Banks Responding	**21**	**24**	**22**	**20**	**21**	**22**	**20**

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 the majority of the respondent banks anticipated maintaining their overall credit standards. Meanwhile, the DI approach showed expectations of an overall net easing of credit standards, particularly for housing, credit card and auto loans, on the back of respondent banks' increased tolerance for risk and anticipated improvement in the profitability of their portfolio, along with a more favorable economic outlook.

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 across all firm sizes and all types of household loans (except personal/salary 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.

Demand for loans from firms 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 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 and continued low interest rates along with higher household consumption.

Real Estate Loans. Most of the respondent banks (84.2 percent) also indicated unchanged credit standards for commercial real estate loans in Q3 2017. The DI approach, however, continued to indicate a net tightening of overall credit standards for commercial real estate loans for the seventh 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, and increased use of interest rate floors. Over the next quarter, while the majority of the respondent banks foresee maintaining their credit standards for commercial real estate loans, DI-based results point to expectations of a continued net tightening of credit standards for the said type of loan.

Majority of banks maintain credit standards for real estate loans

Demand for commercial real estate loans was also unchanged in Q3 2017 based on the modal approach. A number of banks, however, indicated increased demand for commercial property loans on the back of increased working capital needs, 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 (88.9 percent) reported unchanged credit standards. 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 for housing loans. The maintained credit standards for housing loans was attributed by respondent banks largely to their unchanged tolerance for risk and stable profile of borrowers. 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 expect to have higher tolerance for risk and also see an improvement in the profitability of their respective portfolios. At the same time, results continued to show increased demand for housing loans in Q3 2017 as well as expectations of a continued increase in demand for the said type of loan in the next quarter.

Interest Rates

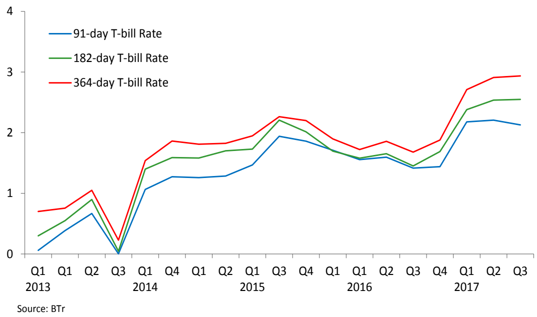
Primary Interest Rates

In Q3 2017, the average 182-day and 364-day T-bill rates in the primary market increased to 2.548 percent and 2.936 percent from 2.537 percent and 2.909 percent, respectively, in the previous quarter. Meanwhile, the average 91-day T-bill rate slightly decreased to 2.128 percent from 2.206 percent in Q2 2017.

182- and 364 day T-bill rates in the primary market increase

The results of the auction reflected market players' continued strong preference for shorter-tenored notes amid geopolitical concerns overseas.

Chart 23. Treasury Bill Rates
in percent

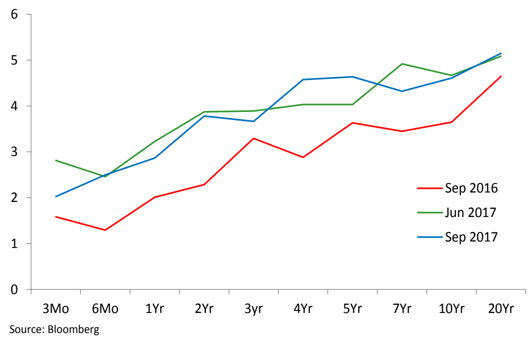


Yield Curve. As of end-September 2017, the secondary market yield for government securities (GS) declined generally except for the 6-month, 4-year, 5-year and 20-year GS relative to the end-June 2017 levels, as market players invested their excess liquidity and serviced their clients' requirements.

Yield curve decline generally in end-September 2017

Debt paper yields were lower by a range of 6.1 bps (10-year GS) to 78.9 bps (3-month GS) compared to end-June 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 37.3 bps for the 3-year GS to 169.7 bps for the 4-year GS.

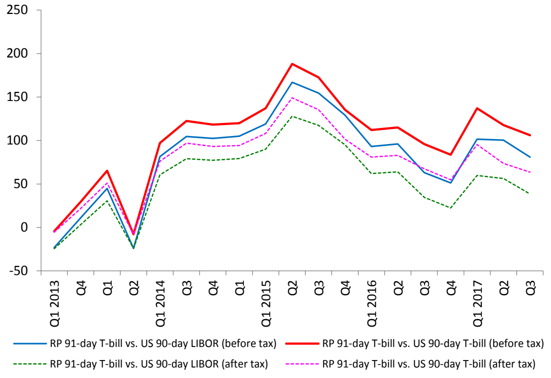
Interest Rate Differentials. The average differentials between domestic and US interest rates, gross and net of tax, narrowed further in Q3 2017 relative to the previous quarter.

Interest rate differentials continue to narrow

The average 91-day RP T-bill rate declined q-o-q by 8.2 bps to 2.124 percent in Q3 2017 from 2.206 percent in Q2 2017. However, the average US 90-day LIBOR and the US 90-day T-bill rate increased by 11.3 bps and 3.5 bps, respectively, to 1.315 percent and 1.063 percent in Q3 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 declined due mainly to investors' strong appetite for shorter-tenored notes following the optimism over the country's growth performance in Q2 2017. Meanwhile, foreign interest rates rose during the quarter following the release of higher-than-expected US data on personal spending, Q2 2017 GDP growth, durable goods order, factory and manufacturing activities, inflation rate and unemployment rate vis a vis lower-than-expected US data on home sales, consumer sentiment, industrial production, home sales, non-farm payrolls and retail sales.

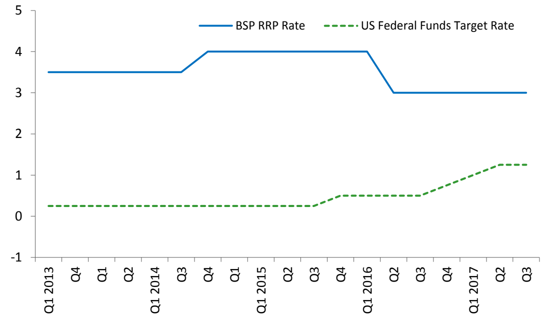
Chart 25. Interest Rate Differentials
quarterly averages; in basis points



Source: Bloomberg, BTr and BSP

The positive differential between the BSP's overnight borrowing or RRP rate and the US Fed funds target rate was unchanged at 175-200 bps in Q3 2016, as the policy settings for both central banks were kept steady.

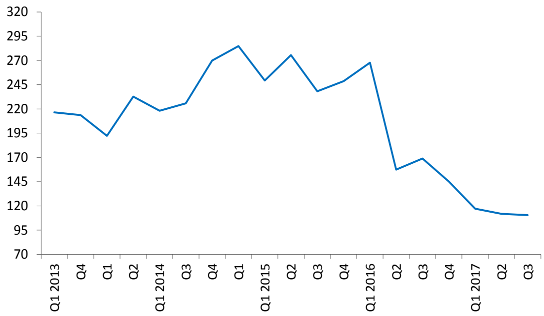
Chart 26. BSP RRP Rate and US Federal Funds Target Rate
in percent



Source: Bloomberg and BSP

Meanwhile, the interest rate differential between the BSP's overnight RRP rate and the US Fed funds target rate adjusted for risk[25] narrowed marginally to 111 bps as of end-September 2017 from 112 bps in end-June 2017. This development could be traced to a slightly higher risk premium, following the 3-bp and 1-bp increases in the 10-year ROP note and 10-year US Note to 2.90 percent and 2.25 percent, respectively.

Chart 27. Risk-Adjusted Differentials
in basis points



Source: Bloomberg and BSP

The 10-year US and 10-year ROP notes rose on investors' demand for safe-haven assets amid the geopolitical tensions between North Korea and the US following the weaker-than-expected impact of Hurricane Irma in Florida and the release of better-than-expected US economic data which supported expectations of another interest rate hike by the US Fed this year.

Domestic real lending rate[26] decreased to 0.1 percent in September 2017 from 1.1 percent in June 2017. This was due to the 70-bp rise in inflation to 3.4 percent combined with the

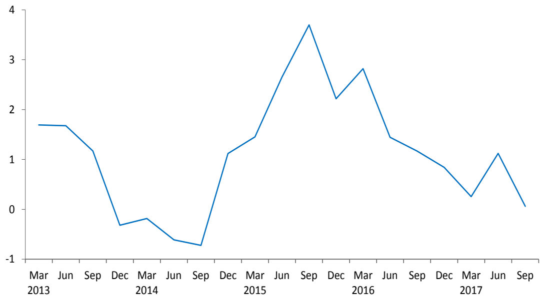
[25] The difference between the 10-year ROP note and the 10-year US Treasury note is used as proxy for the risk premium.
[26] Real lending rate is measured as the difference between actual bank lending rate and inflation.

30-bp decline in actual bank lending rate[27] to 3.5 percent in September 2017.

Real lending rate decreases

The Philippines' real lending rate is the lowest in a sample of 10 Asian countries in September 2017, with Indonesia recording the highest real lending rate at 7.3 percent followed by India at 5.9 percent while Japan posted the second lowest at 0.3 percent.

Chart 28. Philippines' Real Lending Rate
in percent



Source: PSA and BSP

Financial Market Conditions

Despite general cautiousness fueled by the possibility of another rate hike by the US Federal Reserve and geopolitical tensions in the international front, the country's sustained growth in Q2 2017 as well as the optimism generated by the National Government's tax reform program provided support to positive investor sentiment.

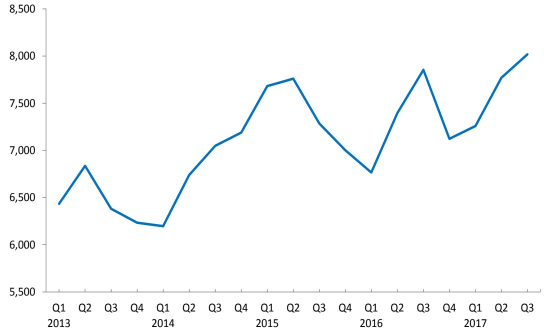
Domestic financial market conditions reflect external uncertainty

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

[27] 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.

Stock Market. In the third quarter of 2017, the Philippine Stock Exchange index (PSEi) rose by 3.2 percent, quarter-on-quarter (q-o-q), to average 8,015.7 index points during the period-in-review.

Chart 29. Quarterly Average PSEi
In basis points



Source: Philippine Stock Exchange, BSP

Optimism over the country's growth prospects and anticipation of the passage of the government's first tax reform package before end-2017 supported the bullishness of the benchmark index. The PSEi closed to its 28th all-time high on 18 September 2017 at 8,294.14 index point, higher by 21.2 percent year-to-date.

Optimism over Philippine growth prospects support the stock index

However, negative sentiments over the terror attack in Barcelona, Spain; along with the US Federal Reserve's planned reduction of its balance sheet starting October; and, continuing geopolitical tensions between the US and North Korea tempered the rally. On the domestic front, the ongoing battle between government troops and militants in Marawi also weighed on local shares and saw the benchmark index close at 8,171.43 index points as of 29 September 2017.

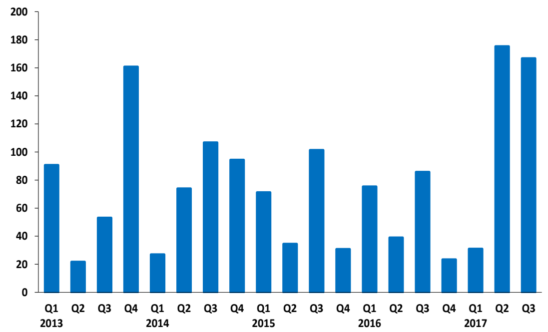
Similarly, total market capitalization went up by 5.1 percent q-o-q to reach ₱17.1 trillion q-o-q. Preliminary data from the PSE also showed that foreign investors continued to be net buyers of ₱33.9 billion worth of local stocks during the review period, following the ₱68.3 billion block sale of one industrial firm and one services corporation. Moreover, the price-earnings ratio for listed firms rose from the 21.46x in end-June to 22.69x in end-September 2017, indicating investors' continued willingness to hold local shares.

Government Securities. Results of the T-bill auctions conducted in Q3 2017 (July - September) continued to show robust demand for T-bills with total subscription for the quarter amounting to ₱271.7 billion, about 2.6 times the ₱105.0-billion total offered amount. The oversubscription for the quarter, at ₱166.7 billion, was lower than the ₱176.1 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, with the exception of the 3-July and 17-July auctions where bids for the respective tenors were partially awarded as market players remained cautious amid an increase in global interest rates. Meanwhile, all bids in the 182-day tenor were rejected on 17-July auction as investors sought rates that were higher than what the government was willing to pay.

Chart 30. Total Oversubscription of T-bill Auctions



Source: Bureau of the Treasury

Sovereign Bond and CDS Spreads. In July, debt spreads narrowed as investor concerns remained muted. This was despite the ongoing battle in Marawi City and martial law in Mindanao, indicating market confidence on the actions taken by the National Government.

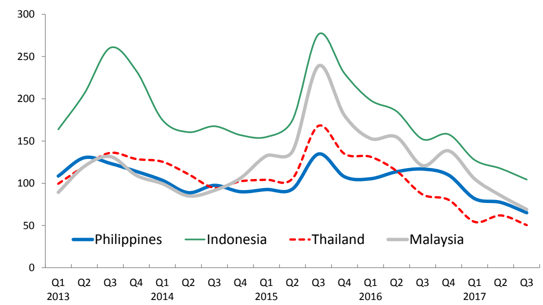
Debt spreads narrower on improved US economic data

In August, debt spreads showed mixed movements as investors were faced with external negative developments and some encouraging growth in the local front. External developments included mainly the geopolitical tensions in the Korean Peninsula that has continued to be elevated. Domestically, investor confidence remained firm as strong economic growth figures were released during the month.

In September, debt spreads returned to its narrowing trend. The market viewed the continuing tension between the US and North Korea as very unlikely to happen. Moreover, sound macroeconomic fundamentals outweighed short-term geopolitical noise. Going forward, investors were on a wait-and-see stance, awaiting for more details about the US Fed's planned balance sheet normalization in the coming months of the year.

As of end-September, the Philippines' 5-year sovereign credit default swaps (CDS) stood at 66 bps, lower than 77 bps in end-2Q 2017. It has remained lower than Indonesia's 104 bps and Malaysia's 69 bps in the current quarter.

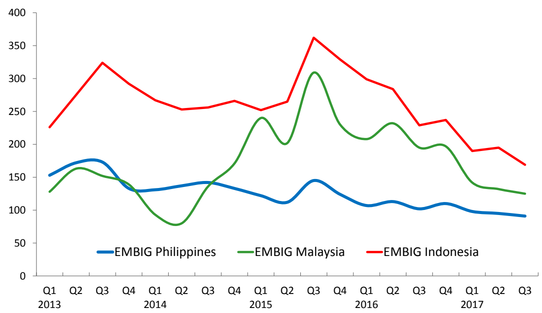
Chart 31. 5-Year CDS Spreads of Selected ASEAN Countries
in basis points



Source: Bloomberg

Likewise, the EMBIG Philippines ended the quarter narrower at 91 bps when compared to the previous quarter's closing of 95 bps.

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



Source: Bloomberg

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.

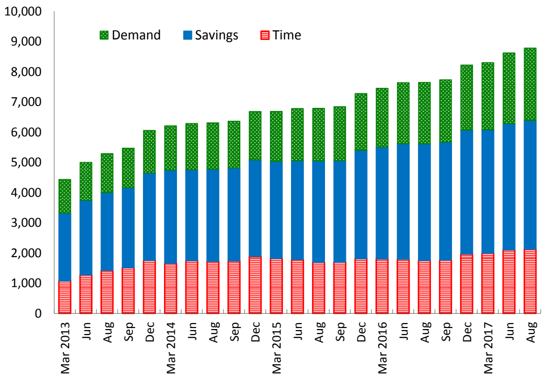
Philippine banking system sustains growth in assets and deposits

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 deposits remained the primary sources of funds for the banking system. Banks' total deposits[28] as of end-August 2017 amounted to ₱8.8 trillion, 14.9 percent or ₱1.1 trillion higher than the year-ago level. Relative to the previous quarter, total deposits grew by 1.9 percent due mainly to the expansion in demand and savings deposits by 2.3 percent and 2.0 percent, respectively. Meanwhile, foreign currency deposits owned by residents (FCD-Residents) reached ₱1.9 trillion during the same period, posting a year-on-year and quarter-on-quarter growth of 20.6 percent and 5.3 percent, respectively.[29]

[28] This refers to the total peso-denominated deposits of the banking system.
[29] 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.

Chart 33. Deposit Liabilities of Banks
in billion pesos

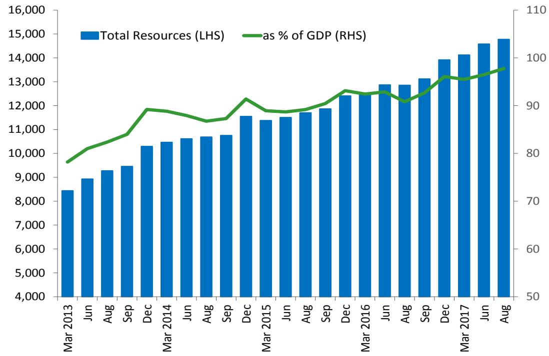


Source: BSP

Institutional Developments. The total resources of the banking system grew by 14.9 percent to reach ₱14.8 trillion as of end-Aug 2017 from ₱12.9 trillion a year ago, and by 1.3 percent as of end-June 2017. As a percent of GDP, total resources stood at 97.8 percent. [30]

Total resources of the banking system continue to rise

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



Source: BSP

The number of banking institutions (head offices) decreased to 595 offices as of end-June 2017 from the levels recorded a year ago at 618 offices and as of end-March 2017 at 599 offices. This 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, 58 thrift banks (TBs), and 495 rural banks (RBs). Meanwhile, the operating network (head offices and branches/agencies) of

[29] GDP as of Q2 2017.

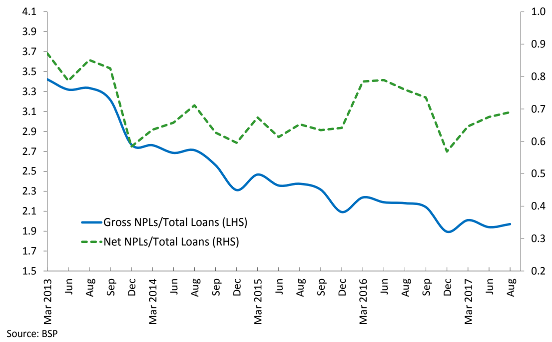
the banking system expanded to 11,393 offices in end-June 2017 from 10,936 offices a year ago and 11,278 offices in end-March 2017, due mainly to the increase in the branches/agencies of U/KBs, TBs, and RBs.

The Philippine banking system's gross non-performing loan (GNPL) ratio improved to 2.0 percent as of end-August 2017 relative to the 2.2 percent registered a year ago but slightly higher with respect to the end-June 2017 ratio of 1.9 percent.

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.[31]

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



Similarly, the net non-performing loan (NNPL) ratio declined to 0.7 percent as of end-August 2017 relative to the previous year's ratio of 0.8 percent but remained unchanged with respect to the end-June 2017 ratio. In computing for the NNPLs, specific allowances for credit losses on Total Loan Portfolio (TLP) are deducted from the GNPLs. Said allowances decreased to ₱103.5 billion in end-August 2017 from ₱101.8 billion posted as of end-June 2017.[32]

The Philippine banking system's GNPL ratio of 2.0 percent was higher relative to that of Malaysia (1.2 percent) and South Korea (1.3 percent) but lower than that of Indonesia (2.9 percent) and Thailand (3.0 percent).[33]

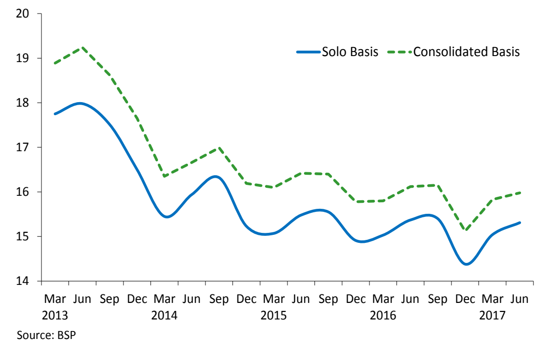
The loan exposures of banks remained adequately covered as the banking system registered an NPL coverage ratio of 114.1 percent as of end-August 2017. This was higher than the previous year's ratio of 112.0 but slightly lower than the end-June 2017 ratio of 114.3 percent.

The capital adequacy ratio (CAR) of U/KBs at end-June 2017 improved to 15.3 percent on solo basis, relative to the previous quarter's ratio of 15.0 percent.

U/KBs' CAR remains above international and regulatory standards

Likewise, the CAR, on a consolidated basis, increased to 16.0 percent from the quarter-ago ratio of 15.8 percent. These figures were well above the BSP regulatory threshold of 10.0 percent and international minimum of 8.0 percent.

Chart 36. Capital Adequacy Ratio of Univeral and Commercial Banks
in percent



The CAR of Philippines' U/KBs, on a consolidated basis, at 16.0 percent was higher than that of

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

[31] 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.

[32] Sources: Malaysia (Banking System's Ratio of net impaired loans to net total loans, August 2017); South Korea (Domestic Banks' Substandard or Below Loans [SBLs] ratio, Q2 2017); Indonesia, IMF and financial stability reports (Banks' Nonperforming Loans to Gross Loans Ratio, Q2 2017); and Thailand (Total Financial Institutions' Gross NPLs ratio, Q2 2017).

South Korea (15.4 percent) but lower than those of Malaysia (17.2 percent), Thailand (18.5 percent) and Indonesia (26.7 percent).[34]

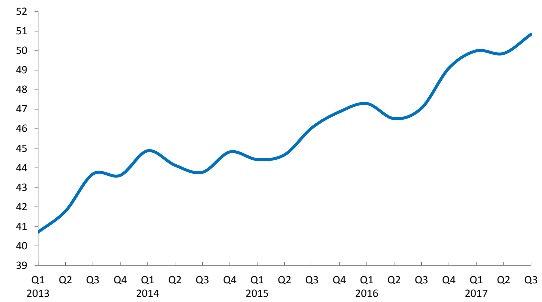
Exchange Rate

On a quarter-on-quarter basis, the peso depreciated against the US dollar by 1.93 percent to average ₱50.84/US$1 from the previous quarter's average of ₱49.86/US$1.

The peso depreciated against the US dollar in Q3 2017

The depreciation of the peso during the review period was due partly to hawkish remarks from various US Federal Reserve officials which strengthened the case for one more interest rate hike before the year ends, and the growing optimism towards US President Trump's tax reform program. Meanwhile, on a y-o-y basis, the peso depreciated by 7.44 percent relative to the ₱47.06/US$1 average in Q3 2016.[35]

Chart 37. Quarterly Peso-Dollar Rate
PHp/US$; average per quarter



Source: Reference Exchange Rate Bulletin, Treasury Department, BSP

In July, the peso averaged ₱50.64/US$1, depreciating by 1.56 percent from the previous month's average of ₱49.85/US$1. The weak performance of the peso was due mainly to: (i) the country's higher-than-expected trade deficit in May; (ii) the release of upbeat US economic data, specifically the producer price index (PPI) and jobless claims;[36,37] and (iii) market players' cautiousness ahead of the US Fed's policy meeting on 25 to 26 July.[38]

The peso continued to depreciate in August relative to its July level by 0.46 percent to average at ₱50.87/US$1. The peso depreciation during the month was due partly to: (i) hawkish comments of New York Fed President William Dudley supporting another rate hike this year and the planned unwinding of the US Fed's bond holdings; (ii) heightened concerns following the terrorist attack in Spain; and (iii) rising doubts over the Trump administration's campaign period promise of economic stimulus plans.[39]

In September, the peso averaged ₱51.01/US$1, depreciating further by 0.26 percent relative to the average in August. Sentiment towards the US dollar recovered (i) as a result of the easing of tension between North Korea and the US and; (ii) as the impact of Hurricane Irma was not as strong as expected. Hawkish remarks of US Federal Reserve chair Janet L. Yellen during her speech in the National Association for Business Economics meeting in Cleveland on 26 September and the revival of talks on US President Trump's tax reform program prompted an increase in the demand for US dollars. These developments, in turn, added pressure to the peso.

On a year-to-date basis, the peso depreciated against the US dollar by 2.2 percent on

[33] Sources: South Korea (Domestic Banks' Capital Ratio, Q2 2017); Malaysia (Banking System's Total Capital Ratio, August 2017); Thailand (Commercial Banks' Capital Funds Percentage of Risk Assets, August 2017); and Indonesia, IMF and financial stability reports (Commercial Banks, Regulatory Capital to Risk-Weighted Assets Ratio Q2 2017).
[35] Dollar rates (per peso) or the reciprocal of the peso-dollar rates were used to compute for the percentage change.

[36] The Philippine trade deficit widened to US$2.8 billion in May 2017 as the 17 percent increase in imports surpassed the 14 percent growth in exports. This was also higher than the median estimate of US$1.5 billion in a Bloomberg survey of nine economists.
[37] Reuters reported that according to the US Labor Department, initial claims for state unemployment benefits dropped 3,000 to a seasonally adjusted 247,000 for the week ended July 8, the 123rd straight week that claims remained below 300,000, a threshold associated with a healthy labor market. Reuters added, quoting the Labor Department, that price index for final demand edged up 0.1 percent in June amid sustained increases in the cost of services that offset declining energy prices. The year-on-year increase in the PPI, however, slowed to 2.0 percent from 2.4 percent in May as last year's energy-driven rise dropped out of the calculation.
[38] BusinessWorld reported that while the US Fed might not raise interest rates again this month, it might continue to affirm its plan to adjust interest rates once more before the year ends following strong forecasts of key US economic data on existing home sales, durable goods orders, and second-quarter economic growth.
[39] Reuters reported over 100 people were injured while 13 were killed after a suspected Islamic State militant drove a van into crowds in Barcelona, Spain on 17 August 2017. Meanwhile, US President Trump had decided to disband the American Manufacturing Council and the Strategic and Policy Forum, raising questions on the US leader's ability to organize the business community.

29 September 2017 as it closed at ₱50.82/US$1. This was in contrast with the strengthening of most Asian currencies during the same period.[40]

Table 16. 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	5.6
Thai Baht (Onshore)	-4.6	-0.7	-8.9	0.1	7.4
Singaporean Dollar	-2.7	-4.5	-6.0	-2.0	6.6
Indian Rupee	-11.4	-2.9	-4.9	-2.9	4.0
Indonesian Rupiah	-19.1	-2.1	-9.8	2.3	0.1
Philippine Peso	**-7.0**	**-0.7**	**-5.0**	**-5.3**	**-2.2**
Japanese Yen	-16.3	-12.5	-0.5	3.3	4.0
Malaysian Ringgit	-5.5	-6.3	-18.6	-4.2	6.3
Chinese Yuan	2.6	-2.7	-4.3	-6.6	4.5
New Taiwan Dollar	-1.9	-6.2	-3.6	1.9	6.6

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., 29 September 2017
Source: Treasury Department - BSP

Nonetheless, the sustained inflows of foreign exchange from overseas Filipino remittances, foreign direct investments, BPO receipts, and recovery of exports, as well as the ample level of the country's gross international reserves and robust economic growth, continued to provide support to the peso.[41]

Meanwhile, the volatility of the peso's daily closing rates (as measured by the coefficient of variation) stood at 0.61 percent during the review quarter, slightly higher than 0.55 percent registered in the previous quarter.[42] Relative to other currencies in the region, the volatility of the peso remained in the middle of the pack.[43]

On a real trade-weighted basis, the peso gained external price competitiveness in Q3 2017 against the basket of currencies of all trading partners (TPI), trading partners in advanced (TPI-A) and developing countries (TPI-D). Relative to Q2 2017, the real effective exchange rate (REER) index of the peso decreased by 4.71 percent, 4.84 percent, and 4.62 percent, against the TPI, TPI-A, and TPI-D baskets, respectively. The nominal depreciation of the peso coupled with narrowing inflation differential contributed to the general decline in the REER.[44,45]

Relative to Q3 2016, the peso likewise gained external price competitiveness in Q3 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 5.26 percent, 3.79 percent, and 6.25 percent against the TPI, TPI-A, and TPI-D baskets, respectively.

[40] Based on the last done deal transaction in the afternoon.
[41] As of end-September 2017, country's gross international reserves (GIR) stood at US$81.35 billion (preliminary). This can cover 8.5 months' worth of imports of goods and payments of services and primary income. It is also equivalent to 5.5 times the country's short-term external debt based on original maturity and 3.6 times based on residual maturity. Foreign direct investments (FDI) remained positive and registered a net inflow of US$3.9 billion as of end-July 2017. Remittances from OF workers continue to flow in from various geographical locations globally, for the period January to August 2017, cash remittances from OFs amounted to US$20.7 billion. Exports of goods grew y-o-y by 18 percent in the first half of 2017. As of end-June 2017, business process outsourcing (BPO) and tourism receipts reached US$11.0 billion and US$3.1 billion, respectively.
[42] 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.
[43] The volatility of the peso was higher than that of Indonesian rupiah, but lower than that of the Chinese yuan, South Korean won, Japanese yen, Singapore dollar, Malaysian ringgit, and Thailand baht.
[44] 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.
[45] 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 ₱176.2-billion fiscal deficit for January-August 2017, 27.0 percent higher than the deficit posted in the previous year.

Fiscal deficit is higher for January-August 2017

Netting out the interest payments in NG expenditures, the primary balance reversed into a surplus amounting to ₱46.4 billion, although lower by 41.0 percent compared to the primary surplus a year ago.

Table 17. National Government Fiscal Performance
in billion pesos

	2016		2017		Growth Rate (in percent)	
	Aug	Jan-Aug	Aug	Jan-Aug	Aug	Jan-Aug
Surplus/(Deficit)	32.6	-138.4	28.8	-176.2	-12.0	27.0
Revenues	209.6	1,480.8	230.4	1,601.4	10.0	8.0
Expenditures	177.0	1,619.2	201.6	1,777.6	14.0	10.0

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

For the period January - August 2017, revenues increased by 8.0 percent to ₱1,601.4 billion compared to ₱1,480.8 billion in the same period in 2016. The income from Bureau of Internal Revenue (BIR) increased by 9.0 percent to contribute ₱1,157.7 billion. Moreover, Bureau of Customs' (BOC) revenue recorded an 11.0 percent increase to ₱283.6 billion. Meanwhile, income from Bureau of the Treasury (BTr) decreased by 14.0 percent to ₱67.4 billion.

Expenditures for the period in review amounted to ₱1,777.6 billion, 10.0 percent higher than the expenditures in the previous year. Excluding interest payments, expenditures went up by 11.0 percent to ₱1,555.0 billion. Meanwhile, interest payments were higher by ₱5.4 billion compared to its year-ago level. This brought interest payments for the first eight months of the year to ₱222.6 billion.

Box Article: Macroeconomic Impact of Tax Reform for Acceleration and Inclusion

The proposed Tax Reform for Acceleration and Inclusion (TRAIN) is an essential and timely structural reform that intends to further strengthen the country's macroeconomic condition. Economic growth is strong at potential while inflation remains low, manageable and within target. The National Government's (NG) fiscal deficit and government's ability to pay its debt are on a sustainable path. Furthermore, the country's external payments position is robust, amid sound banking system. However, improving investments remains a major challenge in the country. Compared to its regional peers, the Philippines is underinvesting annually given by its low public capital outlay and the quality of public infrastructure. The proposed tax reform aims to redesign the tax system to be simpler, fairer, and more efficient, and to provide the needed additional revenues that would fun the country's investment needs.[46]

There are two versions of the proposed tax reform. The House of Representatives approved House Bill No. 5636 (TRAIN bill) on 31 May 2017 while a Senate version (SBN 1592) was endorsed in the plenary on 20 September 2017.[47] In general, both versions feature reduction in personal income tax, expansion in the value-added tax base, higher automobile tax, higher excise tax on petroleum products, higher tax on sugar-sweetened beverage, and uniform donor and estate tax.

Both bills consist of complementary programs such as social safety nets[48] and enhancements in the tax administration system. Among the efficiency-enhancing measures are fuel marking for domestic production and importation of oil products and electronic sales reporting system that links sales and purchase data entered on cash register/point of sales (POS) terminals to the servers of the Bureau of Internal Revenue (BIR) servers.

A. Key features of the TRAIN proposals

Personal income tax. The Senate version reduces the annual personal income tax exemption threshold to ₱150,000 from the House's ₱250,000. This results in a tax bracket for individuals earning ₱150,000 to ₱250,000 per year, with tax rate of 15 percent. It retains exemption for dependents as well as current annual exclusion in gross benefits of ₱82,000 whereas the House bill raises it to ₱100,000. Moreover, the highest tax bracket in the Senate version is ₱2 million and above with tax rate of 32 percent. The House version, on the other hand, has the highest tax bracket of ₱5 million and above with tax rate of 35 percent.

For self-employed and/or professionals, both versions prescribe an optional tax rate of eight percent on gross sales and gross receipts. The Senate version clarifies that for mixed income professionals, the optional tax rate applies only to income from business or practice of profession while the compensation income component will be taxed according to the regular income tax schedule. In the House version, however, the option applies only to self-employed and/or professionals earning ₱3 million and below.

Excise tax on petroleum products. In terms of excise taxes on petroleum, the Senate version exempts kerosene products and proposes a gradual incremental increase in taxes on regular and premium gasoline, diesel, and LPG with the highest increase in the first year of implementation. The House version, on the other hand, proposes a declining path for the annual increase in petroleum excise taxes, with higher first-year increment than what is provided for in the Senate version. Both bills provide for suspension of increase in

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[46] Department of Finance (DOF) TRAIN presentation, 18 July 2017.
[47] Senate Bill No. 1592 is expected to be ratified by the end of the year.
[48] The proposed social mitigating measures include: targeted cash transfers, subsidy for public utility vehicles (Pantawid Pasada), subsidy for small power utilities group (Pantawid Kuryente), PUV modernization program, and social welfare card linked to the national ID system.

petroleum excise taxes should international oil prices reach $80 per barrel. Under SBN 1592, an additional escape clause is when inflation exceeds the government's target range.

VAT base expansion. Both versions exempt raw food, healthcare, and socialized housing. Exemptions given to senior citizens, persons with disability (PWDs), business process outsourcing and cooperatives are also retained. The threshold for VAT exemption is raised from ₽1.5 million to ₽3 million.

Excise tax on sugar sweetened beverages. The Senate and House versions of the TRAIN bill adopt different bases for the implementation of excise tax on sugar sweetened beverages. On one hand, the House version uses the source of sugar (local or foreign) as basis of excise taxation whereas the Senate version classifies beverage tax according to usage of caloric and non-caloric sweeteners.

Excise tax on automobiles. Both versions revise the tax schedule of excise tax on automobiles, with luxury vehicles getting the biggest increase. VAT exemption applies on electric and hybrid vehicles.

Estate tax. The Senate version maintains the flat six percent estate tax introduced in HBN 5636 but increases the estate VAT exemption threshold for real estate from ₽1.5 million to ₽5 million. Agricultural lands of up to three hectares are also exempt in the Senate bill provided that the said lands shall be used for agricultural purposes for three years after the death of the decedent.

B. Macroeconomic implications[49]

The NG's proposed fiscal reform package represents an upside risk to inflation. Price pressures could come from higher consumption taxes,[50] at least in the short run, and increased demand from higher infrastructure spending and higher disposable income due to lower personal income tax. Preliminary staff estimates indicate that inflation could remain within-target for 2018 and 2019, notwithstanding the passage of the TRAIN bill and the accelerated infrastructure spending program of the NG. Inflation could rise in 2018 and taper towards the mid-point of the target range in 2019. The social safety nets in the program are designed to mitigate the reduction in purchasing power of the poor and vulnerable. The simulation takes off from assumptions of robust macroeconomic fundamentals, sustained productive infrastructure spending, and minimal transition costs of reforms.

Preliminary estimates also show that GDP growth could fall within the Development Budget Coordination Committee's (DBCC) target range of 7 - 8 percent from 2018 to 2022. Since the new tax revenues will be used to fund sustained and purposeful investments in human and physical infrastructure that would address long-standing infrastructure bottlenecks, the reform is seen to generate gains to the economy in the medium-to-long run. The positive spillover effects on investor sentiment would create a virtuous cycle of higher investment and higher income over the medium to long term. The resulting expansion in productive capacity of the economy is seen to moderate inflationary pressures over the medium to long term.

Strong commitment to budget reforms and tax administrative reforms would lend important additional safeguards. Disciplined fiscal policy anchored on higher taxes, growth-enabling investment, and prudent debt management would reduce fluctuations in real economic activity and facilitate better inflation management and promote greater financial stability.

Given the changing nature of the TRAIN bill, 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 stays aligned with the medium-term target while being supportive of sustainable economic growth.

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[49] Estimations assumed the features of HBN 5636.
[50] These include excise tax on fuel, expanded value-added tax, sugar-sweetened beverage tax, and automobile tax.

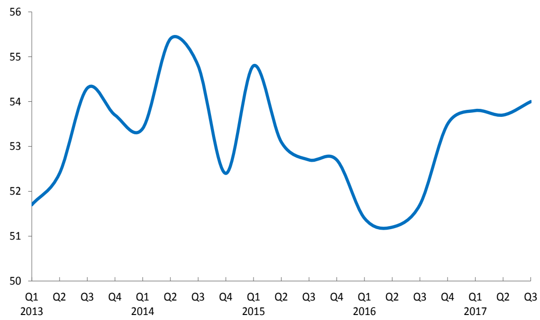
IV. External Developments

The JP Morgan Global All-Industry Output Index held steady at 54.0 in September 2017 from the record in August due to broadly stable rates of expansion in both the manufacturing and service sectors. The rates of expansion accelerated in the euro area, the UK, and Russia, while Brazil returned to growth after contractions in the prior quarter. Output increased at a slower pace in the US, Japan, and Australia.[51]

Global economic activity remains steady

The IMF expects global inflation to remain subdued as inflation rates are still well below central bank targets in almost all advanced economies and in some emerging markets. Headline inflation also softened generally as the impact of the commodity price rebound during the second half of 2016 faded.

Chart 38. JP Morgan Global All-Industry Output Index
index points



*August 2017
Source: Markit Economics

US. Real GDP expanded by 2.2 percent on a seasonally adjusted y-o-y basis in Q2 2017, higher than the 2.0 percent growth rate in Q1 2017. On a q-o-q basis, real output growth was at 3.1 percent from 1.2 percent in Q1 2017. The q-o-q improvement in real GDP reflected positive contributions from personal consumption expenditures and nonresidential fixed investment that were partly offset by a decrease in state and local government spending.[52]

Economic growth in the US holds firm

Meanwhile, the manufacturing PMI posted a higher reading of 60.8 percent in September from 58.8 percent in August as new orders continued to expand at a faster rate. [53]

The unemployment rate declined to 4.2 percent in September from 4.4 percent in August. Total nonfarm employment declined by 33,000 in September, with job losses in food services and drinking places, reflecting the impact of Hurricanes Irma and Harvey. Meanwhile, on a y-o-y basis, inflation rose to 2.2 percent in September from 1.9 percent in August due primarily to the increase in the energy index.

The Thomson-Reuters/University of Michigan Index of Consumer Sentiment decreased to 95.3 in September from 96.8 in August.[54] The Conference Board Consumer Confidence Index declined marginally in September to 119.8 from 120.4 in August.[55] Nonetheless, consumers' assessment of current conditions and short-term business and labor outlook remain favorable despite some downtick in consumer confidence in areas severely affected by Hurricanes Harvey and Irma.

Euro Area. On a q-o-q basis, real GDP in the euro area rose slightly by 0.6 percent in Q2 2017 from 0.5 percent in Q1 2017. On a y-o-y basis, real GDP expanded at a faster rate of 2.3 percent in Q2 2017 from 2.0 percent in the previous quarter.[56]

Activity in the euro area continues to expand

Meanwhile, the composite PMI for the euro area increased to 56.7 in September from

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[51] JP Morgan Global Manufacturing & Services PMI, http://www.markiteconomics.com/
[52] US Bureau of Economic Analysis, "Gross Domestic Product: Third Quarter 2017 (Second Estimate)," news release, 28 September 2017. https://www.bea.gov/newsreleases/national/gdp/2017/pdf/gdp2q17_3rd.pdf
[53] Institute for Supply Management, https://www.instituteforsupplymanagement.org
[54] Preliminary. University of Michigan Survey of Consumers, http://www.sca.isr.umich.edu/
[55] The Conference Board, http://www.conference–board.org/
[56] Eurostat news release 135/2017 dated 7 September 2017

55.7 in August as new orders expanded amid a renewed surge in demand, particularly in manufacturing.[57]

Inflation in the euro area remained steady at 1.5 percent in September, driven by higher prices of fuels for transport, restaurants & cafés, and tobacco.[58] The seasonally adjusted unemployment rate was 9.1 percent in August, unchanged from the rate posted in July.[59]

The European Commission's Economic Sentiment Indicator in the euro area improved to 113.0 in September from 111.9 in August due to higher confidence in industry, retail trade, and construction sectors. Meanwhile, consumer confidence remained broadly stable, reflecting households' optimistic views on their future financial situation and savings expectations.

Japan. On a q-o-q basis, real GDP grew by 0.6 percent in Q2 2017, faster than the 0.3 percent expansion in Q1 2017. Meanwhile, on a y-o-y basis, real GDP expanded by 1.4 percent in Q2 2017, slower than the 1.5 percent growth in the previous month.[60] The economic expansion in Japan was attributed to the increase in total domestic demand, which offset the contraction in net exports.

Real GDP in Japan expands at a faster pace

Meanwhile, the seasonally adjusted manufacturing PMI increased to 52.6 in September from 52.2 in August as both output and new orders continued to expand at a faster rate owing to stronger demand from domestic and international sources.[61]

Inflation rose to 0.7 percent in August from 0.4 percent in July owing to increases in the cost of utilities, medical care, as well as culture and recreation. The seasonally adjusted unemployment rate was 2.8 percent in August, unchanged from the rate posted in July.

China. Real GDP in China expanded by 6.9 percent y-o-y in Q2 2017, unchanged from the growth recorded in the previous quarter. The expansion was due mainly to the increase in industrial output, which was driven by stronger exports, robust retail sales, and investment-led demand.

Output growth in China is steady in Q2 2017

Meanwhile, the seasonally adjusted manufacturing PMI decreased slightly to 51.0 in September from 51.6 in August due to weaker expansion in total new business and new orders amid subdued demand.[62]

Inflation declined to 1.6 percent in September from 1.8 percent in August due mainly to lower food prices.

India. Real GDP in India decelerated to 5.7 percent y-o-y in Q2 2017 from 6.1 percent in the previous quarter, due mainly to the slower expansion in agriculture, forestry & fishing; mining & quarrying; public administration, defense and other services; trade, hotels, transport and communication; and manufacturing.[63]

Real GDP in India expands at a slower pace

Meanwhile, the composite PMI returned to growth as it registered an index reading of 51.1 in September from 49.0 in August due primarily to the recovery of the Indian service sector from the GST-related contractions registered in the previous months, as signaled by renewed increases in new business and output.

Inflation was unchanged at 3.3 percent in September from the same rate in August,

[57] Flash Markit Eurozone PMI, http://www.markiteconomics.com/
[58] Eurostat news release 156/2017 dated 17 October 2017
[59] Eurostat news release 145/2017 dated 2 October 2017
[60] Second Preliminary Estimate. Department of National Accounts, Economic and Social Research Institute, Cabinet Office. http://www/esri.cao.go.jp/
[61] Flash Nikkei Japan Manufacturing PMI, http://www.markiteconomics .com/
[62] Caixin China General Manufacturing PMI, http://www.markiteconomics.com/
[63] Ministry of Statistics and Programme Implementation. http://mospi.nic.in/

reflecting higher price indexes across all commodity groups except for food and beverages.

ASEAN Region. The Nikkei ASEAN Manufacturing PMI continued to expand with a PMI reading of 50.3 in September from 50.4 in August as output and total new orders continued to grow.

Manufacturing output expansion in the ASEAN is stable

Vietnam led the PMI rankings in August, followed by the Philippines, Indonesia, and Thailand. Meanwhile, Malaysia, Myanmar, and Singapore each recorded deterioration in the performance of their respective manufacturing sectors.[64]

Policy Actions by Central Banks. The Bank of Canada (BOC) raised its overnight rate by 25 bps each on 12 July and 6 September due to the country's stronger-than-expected economic performance and signs that inflation continues to evolve near the 2-percent target.

Central banks' policy actions diverge

By contrast, on 2 August 2017, the Reserve Bank of India (RBI) reduced the policy repo rate under its liquidity adjustment facility from 6.25 percent to 6.0 percent on the back of weak inflation and investment spending.

Similarly, Bank Indonesia (BI) decided to reduce its 7-day reverse repo rate by 25 bps each on 22 August and 22 September. The decisions were based on the BI's assessment that there is a need to support banking intermediation and economic growth amid a low inflation setting.

Meanwhile, on 20 September, the US Fed announced that it will gradually reduce its US$4.5 trillion balance sheet starting October 2017 amid positive economic developments. The Fed currently holds a US$4.5 trillion portfolio of mostly government debt which it accumulated over the years following the 2008 financial crisis.

During the same policy meeting, the Federal Open Market Committee decided to maintain the target range for the federal funds rate at 1.0 - 1.25 percent due to below-target inflation despite improvements in economic activity and labor market outcomes. Inflation on a 12-month basis is expected to remain somewhat below the 2-percent target in the near-term but stabilize around the target rate over the medium-term. Further rate hikes are expected to be "gradual" and will depend on the economic outlook as informed by incoming data.

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

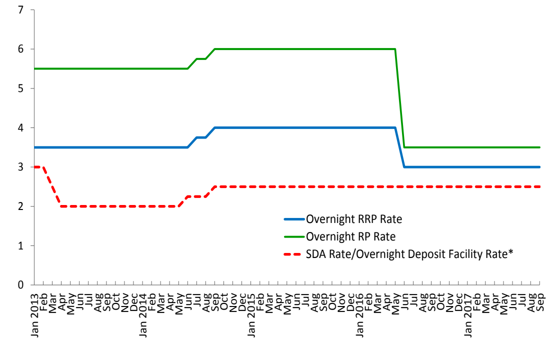
V. Monetary Policy Developments

During the monetary policy meetings in 10 August and 21 September, 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 show the future inflation path will continue to be within the target range for 2017-2019. Inflation expectations remain firmly anchored close to the midpoint of the Government's 3 percent ± 1 percentage point target over the policy horizon.

Chart 39. 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 recognizes that the assessment of risks to the inflation outlook remains tilted toward the upside. While the proposed tax reform program may exert potential transitory pressures on prices, various social safety nets and the resulting improvement in productivity will likely temper the impact on inflation over the medium term. At the same time, while output prospects for the global economy have improved, downside risks to external demand remain, due in part to geopolitical tensions and lingering uncertainty over macroeconomic policies in advanced economies. The outlook for domestic economic activity continues to be firm, supported by buoyant consumer and business sentiment and ample liquidity. Moreover, as credit activity expands in line with output growth, the economy's improving absorptive capacity is likewise seen to be sustained, thus mitigating inflation pressures over the long run. Nonetheless, the MB continues to pay close attention to the evolving economic growth and liquidity conditions and their implications for price and financial stability.

With these considerations, the MB believes that prevailing monetary policy settings continue to be appropriate. Looking ahead, 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 stays aligned with the medium-term target while being supportive of sustainable economic growth.

VI. Inflation Outlook

BSP Inflation Forecasts

The BSP's latest forecasts[65] 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 seen to decelerate close to the midpoint in H1 2018 before rising slightly above the midpoint of the target range in H2 2018 to H1 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 possibility of slower global economic growth due to policy uncertainty in advanced economies and geopolitical tensions continues to be the main downside risk to inflation.

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

Demand Conditions. Outturns for key demand indicators attest to the view of resilient domestic real sector activity. The country's real GDP accelerated to 6.5 percent in Q2 2017 from 6.4 percent growth in the previous quarter. Economic activity was mainly driven by the recovery of government spending and the sustained growth in private consumption. This brought the first semester real output growth to 6.4 percent.

Prospects for the domestic economy continue to remain favorable. Growth is expected to settle within the Development Budget Coordination Committee (DBCC)-approved medium-term growth assumption 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 August 2017, indicating a 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 turns more upbeat in Q4 2017. This is in line with the expectation of brisker operations during holiday season as well as 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 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 will rise slightly in 2017 and 2018 before easing in the medium term.[66,67]

[65] The inflation forecast path in this report refers to the forecasts presented during the 21 September 2017 monetary policy meeting. In the discussion, these forecasts are compared to the forecasts presented in the Q2 2017 Inflation Report which correspond to forecasts on 22 June 2017 monetary policy meeting.

[66] IMF, Commodity Market Monthly, July 2017, available online at http://www.imf.org

[67] World Bank, Commodity Markets Outlook, April 2017, available online at http://www.worldbank.org

In the domestic front, *palay* production could increase by 13.3 percent while corn production could decline by 1.1 percent in Q3 2017 based on standing crop estimates. The expected double-digit growth in *palay* production could be attributed to good weather conditions and the availability of seed and fertilizer support for farmers. Meanwhile, frequent rainfall during the growth stages of corn in most region resulted in the projected decline in corn production.[68,69]

International oil prices increased slightly compared to the previous quarter's level mainly due to temporary disruptions in the petroleum market brought about by Hurricane Harvey as well as geopolitical tensions in Libya that restricted the flow of oil supply.

The latest futures prices indicate that global crude oil prices could remain close to US$50.00 per barrel in 2017-2019. Similarly, the Energy Information Adiministration (EIA) expects Brent crude oil prices to average close to US$50.00 per barrel in 2017 and 2018. In contrast, forecasts by the IMF and Oxford Economics point to a reduction in average global crude oil prices in 2018 with a slight recovery in 2019.[70, 71,72]

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.[73]

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.[74]

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 October 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 futures prices of oil in the international market;
4) Increase in nominal wage in October 2017, October 2018 and October 2019 consistent with labor productivity growth and historical wage increases;
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 higher for 2017-2019

Compared to the previous inflation report, the latest fan chart presents an upward shift in the inflation projection for 2017-2019. The increase in the projected inflation path could be attributed mainly to the rise in global crude oil prices and the depreciation of 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

[68] PSA, Updates on July-September 2017 Palay and Corn Forecasts, 08 September 2017, available online at http://www.psa.gov.ph
[69] PSA, Rice and Corn Situation Outlook, July 2017 Round, 15 August 2017, available online at http://www.psa.gov.ph
[70] EIA, Short-Term Energy Outlook, September 2017, available online at http://www.eia.gov
[71] IMF, Commodity Markets Monthly, July 2017, available online at http://www.imf.org
[72] Oxford Economics, Commodity Price Forecasts, September 2017
[73] Inflation tends to rise (fall) when demand for goods and services exert pressure on the economy's ability to produce goods and services, i.e., when the output gap is positive (negative).
[74] Based on the seasonally-adjusted GDP growth

projection are greater than the bands below it. The projected impact of the government's fiscal reform program along with pending petitions for adjustments in electricity rates are the main upside risks to inflation. Meanwhile, the potential slower global economic growth due to policy uncertainty in advanced economies and geopolitical tensions continues to be the main downside risk to inflation.

Congress has approved HB 5636 or the Tax Reform for Acceleration and Inclusion (TRAIN) bill [75] 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, 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.

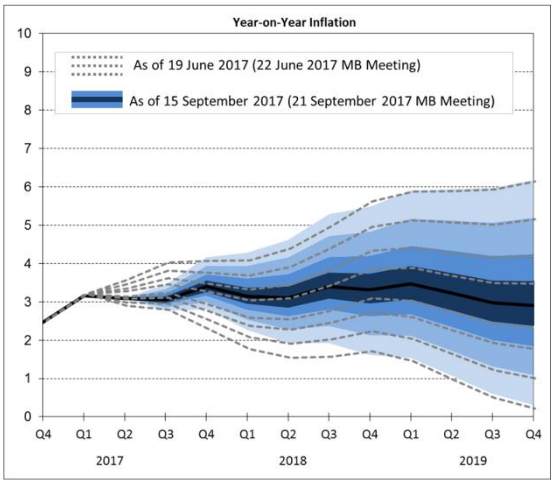
Given that higher tax revenues will be used to sustain higher investment spending for physical and human capital development, there could be gains to productivity in the medium to long run. With assumptions of sustained and more efficient investment spending as well as healthy macroeconomic fundamentals,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

[75] A Senate version of the TRAIN bill (SB 1592) is pending for approval. SB 1592 features a steadier increase in excise tax on petroleum products, lower threshold for personal income tax exemption and revised classification of sugar sweetened beverages. Once approved, consolidation of House and Senate versions will follow.

The risks to inflation outlook remain tilted on the upside

Chart 40. Inflation Projection



Source: BSP estimates

The pending petitions of Meralco and Power Sector Assets and Liabilities Management Corp. (PSALM) is also 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, the likelihood of slower global economic growth is the main downside risk to the inflation outlook. Continued policy uncertainty in the advanced economies, such as the state of regulatory and fiscal policies in the US, spillovers from tighter global financial conditions, the imposition of inward looking policies as well as geopolitical risks could lead to slower global trade 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 tracking the midpoint of the target range in 2017-2019. The latest baseline inflation forecast path is higher due mainly to the rise in global crude oil prices and the depreciation of peso.

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 potential slower global economic growth due to policy uncertainty in advanced economies and geopolitical tensions continues to be 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 remained near the midpoint of the target in Q3 2017 at 3.1 percent.

Domestic demand remains firm

GDP expanded by 6.5 percent year-on-year in Q2 2017 and 6.4 percent in the first half of the year. Growth in the second quarter was supported by sustained growth in household consumption and capital formation, particularly durable equipment and construction. On the production side, the faster growth of the industry sector (particularly manufacturing) and the recovery in agriculture mainly contributed to the overall output expansion. Domestic demand expansion meanwhile was driven by private consumption, government spending, and capital formation. In addition, the negative contribution of net exports has been declining since Q3 2016.

Over the next few quarters, prospects for aggregate demand are expected to remain positive. Consumer sentiment for Q3 2017 remained positive and turned more optimistic in the next quarter (Q4 2017) due to respondents' expectations of additional income, an improvement in peace and order situation and availability of more jobs. Meanwhile, business sentiment turned less optimistic in the third quarter due in part to seasonal factors and ongoing conflict in Marawi but rose for the quarter ahead (Q4 2017) due to anticipated holiday spending and harvest season. Fiscal spending remains on track as NG expenditures (excluding interest payments) increased by 11.0 percent y-o-y in January-August 2017.

Prevailing credit and liquidity conditions remain in line with the overall requirements of the economy. Domestic liquidity increased by 15.4 percent while bank lending grew by 20.4 percent in August 2017. Demand for credit remained the principal driver of money supply growth, offsetting the slowdown of net foreign assets.

Global economy improves

The recovery in global economic growth appears to have broadened. Economic activity in the US, euro area, and Japan expanded faster while GDP growth in China was stronger than expected. Manufacturing is also gaining strength in key parts of the world with the JP Morgan Global Manufacturing PMI reaching 53.1 in August, the highest level observed since May 2011.

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)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
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.
		2 0 0 9	
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.
2010			
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) RRP Overnight	Levels (in percent) RP Overnight	Monetary Policy Decisions
		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) RRP Overnight	Levels (in percent) RP Overnight	Monetary Policy Decisions
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) RRP Overnight	Levels (in percent) RP Overnight	Monetary Policy Decisions
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) RRP Overnight	Levels (in percent) RP Overnight	Monetary Policy Decisions
2017			
9 Feb 2017 **23 Mar 2017** **11 May 2017** **22 Jun 2017** **10 Aug 2017** **21 Sep 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

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