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INFLATION REPORT
4TH 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 11 January 2018.

NESTOR A. ESPENILLA, JR.
Governor

The Monetary Policy of the Bangko Sentral ng Pilipinas

The BSP Mandate

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

Monetary Policy Instruments

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

Policy Target

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

BSP's Explanation Clauses

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

[1] The TDF was introduced under the interest rate corridor system which was implemented on 3 June 2016.

[2] The DBCC, created under Executive Order (E.O.) No. 232 dated 14 May 1970, is an inter-agency committee tasked primarily to formulate the National Government's fiscal program. It is composed of the Office of the President (OP), Department of Budget and Management (DBM), National Economic and Development Authority (NEDA), and the Department of Finance (DOF). The BSP attends the Committee meetings as a resource agency.

[3] On 20 December 2016, the DBCC set an inflation target of 3 ± 1 percentage point for 2017-2018 and approved the inflation target of 3.0 percent ± 1.0 percentage point for 2019-2020 . These decisions were announced by the BSP to the public on 22 December 2016. During its meeting on 22 December 2017, the DBCC decided to keep the current inflation target at 3.0 percent ± 1.0 percentage point for 2018 – 2020.

The Monetary Board *

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

Chairman & Governor
Nestor A. Espenilla, Jr.

Members
Carlos G. Dominguez III
Felipe M. Medalla
Juan 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

Members
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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.

2018 SCHEDULE OF MONETARY POLICY MEETINGS, INFLATION REPORT PRESS CONFERENCE AND PUBLICATION OF MB HIGHLIGHTS

2018	Advisory Committee (AC) Meeting	Monetary Board (MB) Meeting	MB Highlights Publication	Inflation Report (IR) Press Conference
Jan			11 (Thu) (14 Dec 2017 MB meeting)	19 (Fri) (Q4 2017 IR)
Feb	2 (Fri) (AC Meeting No. 1)	8 (Thu) (MB Meeting No. 1)		
Mar	16 (Fri) (AC Meeting No. 2)	22 (Thu) (MB Meeting No. 2)	8 (Thu) (8 Feb 2018 MB meeting)	
Apr			19 (Thu) (22 Mar 2018 MB meeting)	20 (Fri) (Q1 2018 IR)
May	4 (Fri) (AC Meeting No. 3)	10 (Thu) (MB Meeting No. 3)		
Jun	15 (Fri) [1] (AC Meeting No. 4)	21 (Thu) (MB Meeting No. 4)	7 (Thu) (10 May 2018 MB meeting)	
Jul			19 (Thu) (21 Jun 2018 MB meeting)	20 (Fri) (Q2 2018 IR)
Aug	3 (Fri) (AC Meeting No. 5)	9 (Thu) (MB Meeting No. 5)		
Sep	21 (Fri) (AC Meeting No. 6)	27 (Thu) (MB Meeting No. 6)	6 (Thu) (9 Aug 2018 MB meeting)	
Oct			25 (Thu) (27 Sep 2018 MB meeting)	19 (Fri) (Q3 2018 IR)
Nov	9 (Fri) (AC Meeting No. 7)	15 (Thu) (MB Meeting No. 7)		
Dec	7 (Fri) (AC Meeting No. 8)	13 (Thu) (MB Meeting No. 8)	6 (Thu) (15 Nov 2018 MB meeting)	

[1] 15 June 2018 (Friday) may be declared a national holiday in observance of Eidul Fitr. The National Commission on Muslim Filipinos (NCMF) shall inform the Office of the President of the actual date on which the holiday shall fall. The approximate dates shall be determined in accordance with the Islamic calendar (Hijra) or the lunar calendar, or upon Islamic astronomical calculations, whichever is possible or convenient.

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 increase slightly. Average headline inflation in Q4 2017 was higher at 3.3 percent from the quarter- and year-ago rates of 3.1 percent and 2.5 percent, respectively. This brought the full year average inflation to 3.2 percent, well within the target range of 3.0 percent ± 1.0 percentage point for 2017. Inflation pressures during the review quarter were traced mainly to upward adjustments in prices of domestic petroleum products as well as higher price increases in selected services. Meanwhile, core inflation remained steady at 3.1 percent. Based on alternative measures of core inflation, the weighted median measure was unchanged at 1.8 percent while trimmed mean and net of volatile items measures were slightly higher at 2.5 percent (from 2.3 percent) and 2.7 percent (from 2.4 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 range), there was a marginal increase to 25 items (accounting for 23.2 percent of the CPI basket) in Q4 2017 from 24 items in the previous quarter. Majority of these items were non-food commodities.

Inflation expectations rise but remain within the range target. The BSP's survey of private sector economists for December 2017 showed that mean inflation forecasts for 2017 to 2019 were higher relative to the results in September 2017. Mean inflation forecast for 2017 increased to 3.2 percent (from 3.1 percent) on higher crude oil prices and holiday spending, among others. For 2018 and 2019, mean inflation forecasts rose to 3.6 percent (from 3.4 percent) and 3.5 percent (from 3.4 percent), respectively. Analysts attributed the higher 2018 forecast on the impact of the implementation of the National Government's tax reform program. 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 stays firm. Third quarter GDP expanded by 6.9 percent, higher than the 6.7-percent growth a quarter ago but lower than the 7.1-percent acceleration a year ago. This brought the year-to-date GDP to 6.7 percent which remains within the National Government's target of 6.5-7.5 percent for 2017. On the expenditure side, GDP was supported by domestic spending, i.e., household and government, as well as the recovery in external demand. On the production side, the strong performance of industry and services sectors, which offset the moderation in agriculture, propped up domestic growth.

Q4 inflation slightly above midpoint, remains within 2017 target range

Higher-frequency demand indicators show firm economic prospects in the near term.Vehicle sales accelerated at double-digit rates during the review quarter. Similarly, energy sales continued to grow. The composite Purchasing Managers' Index as of November 2017 remained firmly above the 50-point expansion threshold, indicating sustained strong economic activity ahead. For the results of the BSP's expectations survey, business confidence improved for Q4 but turned circumspect for the quarter ahead due mainly to post-holiday slowdown in demand. Meanwhile, consumer optimism remained broadly steady for Q4, on availability of jobs, and well into the next quarter.

Global economic activity improves further. The JP Morgan Global All-Industry Output Index rose to 54.4 in December as output growth accelerated in both the manufacturing and service sectors, underpinned by a notable increase in new business. The upbeat outlook is mirrored in the brisker growth among key advanced economies. In the US, Q3 real GDP expanded by 2.3 percent as inflation fell to 2.1 percent in December due primarily to the decrease in the gasoline price index. Moreover, manufacturing PMI for December was at 59.7 on gains in new orders. Similarly in the euro area, Q3 GDP growth was faster at 2.6 percent with inflation in December expected at 1.4 percent due to lower energy price index. The euro area composite PMI increased to 58.1 in December on domestic demand and export orders. Japan's Q3 GDP likewise expanded by 2.1 percent as inflation in November was at 0.6 percent. Manufacturing PMI rose to 54.2 in December, due to faster growth in new orders.

Domestic financial system shows strength during the review quarter. Positive outturns on the domestic front such as the strong Q3 GDP, legislative support for the tax reform program and the recent credit rating upgrade resulted in upbeat investor sentiment on Philippine assets. The Philippine stock exchange index rose by 4.2 percent, quarter-on-quarter, to average 8,354.1 index points during the review quarter. Debt spreads narrowed generally while sovereign credit default swaps remained low relative to regional peers. However, the peso continued to depreciate, averaging ₱50.93/US$1 on a quarter-on-quarter basis due mainly to expectations of firmer GDP in the US. Nonetheless, investor demand for government securities remained healthy as evidenced by oversubscriptions to the Bureau of the Treasury's regular auctions as well as its issuance of the ₱255-billion Retail Treasury Bonds in December. In addition, the banking system saw 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 Q4 2017, indicating stable supply of credit.

Monetary policy settings were maintained in Q4 2017. The BSP decided to maintain its policy interest rate at 3.0 percent at the November and December monetary policy meetings. Reserve requirement ratios were likewise kept steady.

The BSP's decision to keep the policy rate steady was based on the assessment that the inflation environment has been broadly unchanged as inflation expectations continue to be firmly anchored to the target over the policy horizon.

Prospects for domestic economic activity are likely to remain firm owing to buoyant consumer and business sentiment, as reflected in high-frequency demand indicators. At the same time, commodity prices are expected to be manageable, reflecting ample supply conditions. Moreover, prevailing credit and liquidity conditions remain in line with the overall requirements of the economy.

Prevailing monetary policy stance remains appropriate

Prevailing monetary policy settings are seen to be appropriate to the latest outlook. The current setting of monetary policy can be deemed appropriate for the time being given prevailing conditions for inflation as well as output. Latest baseline inflation projection path tracks the midpoint of the target range in 2018-2019 due mainly to the rise in global crude oil prices.

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 – continue to be within target over 2018-2019. Moreover, output conditions are expected to remain positive due to sustained domestic activity and the recovery of external demand.

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. Price pressures could initially develop with the eventual implementation of the tax reform program in 2018. Although movements in food and oil prices, and changes in tax rates form part of the BSP's explanation clauses under inflation targeting, the BSP will watch closely for indications of increasing underlying inflationary pressures and risks of second-round effects in the near term.

I. Inflation and Real Sector Developments

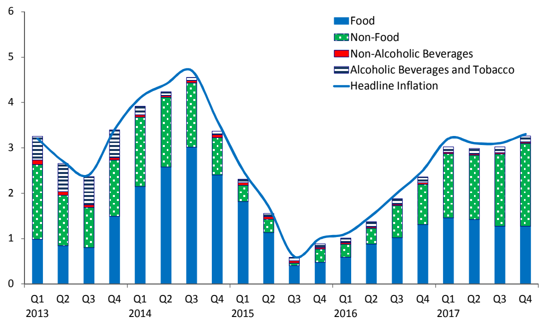
Prices

Headline inflation rise slightly. Headline inflation for Q4 2017 increased to 3.3 percent[4] from the quarter- and year-ago rates of 3.1 percent and 2.5 percent, respectively. This brought the full year average inflation to 3.2 percent, well within the National Government's (NG) announced target range of 3.0 percent ± 1.0 percentage point (ppt) for 2017.

> Headline inflation slightly above midpoint of target range

Inflation pressures in Q4 2017 were traced mainly to upward adjustments in prices of domestic petroleum products as well as higher price increases in selected services.

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



Source: Philipine Statistical Authority (PSA), BSP

Core Inflation. Core inflation, which measures generalized price pressures by excluding volatile items such as food and energy, was steady at 3.1 percent in Q4 2017. In terms of the BSP-computed alternative measures for core inflation, the weighted median measure was likewise unchanged at 1.8 percent. Meanwhile, trimmed mean and net of volatile items measures of core inflation were slightly higher at 2.5 percent (from 2.3 percent) and 2.7 percent (from 2.4 percent), respectively.

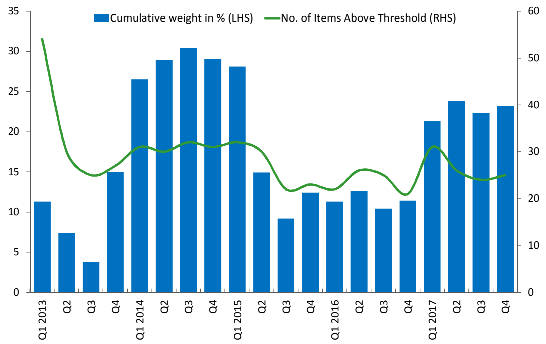
Table 1. Alternative Core Inflation Measures
quarterly averages of year-on-year change

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	**3.2**	**2.9**	**2.4**	**1.9**	**2.4**
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
Q4	**3.3**	**3.1**	**2.5**	**1.8**	**2.7**

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

The number of items with inflation rates greater than the threshold of 4.0 percent (the upper end of the 2017 inflation target) increased slightly to 25 items in Q4 2017 from 24 items in the previous quarter. Majority of these items were non-food commodities. Collectively, these items accounted for 23.2 percent of the CPI basket, slightly higher than the quarter-ago share of 22.3 percent.

Chart 2. CPI Items with Inflation Rates Above Threshold



Source: Philippine Statistics Authority, BSP staff estimates

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

Food Inflation. Food inflation was steady in Q4 2017. Prices of selected agricultural products such as, corn, meat, and fish went up as recent weather disturbances that hit the country continued to adversely impact domestic supply. At the same time, the higher demand during the holiday season also further contributed to the price increase.

Prices of major food items remain steady during the quarter

Nevertheless, these factors were counterbalanced by slower price adjustments for rice, milk, cheese, and eggs as well as fruit and vegetables. It should also be noted that the year-on-year (y-o-y) inflation of sugar, jam, and honey remained negative for the third consecutive quarter in Q4 2017. Meanwhile, alcoholic beverages and tobacco increased to 6.5 percent in Q4 2017 from 6.3 percent in Q3 2017.

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

Commodity	2016				2017			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Food and Non-Alcoholic Beverages	**1.6**	**2.3**	**2.7**	**3.5**	**3.8**	**3.8**	**3.5**	**3.4**
Food	1.6	2.4	2.8	3.6	4.0	3.9	3.5	3.5
Bread and Cereals	-1.2	-0.2	0.9	1.5	1.8	2.0	1.6	1.4
Rice	-2.0	-0.9	0.5	1.4	2.0	2.3	1.7	1.1
Corn	1.7	2.6	2.5	1.9	0.7	-0.4	0.8	5.4
Meat	1.0	2.2	2.0	1.6	2.4	4.5	4.0	5.3
Fish	2.8	2.7	4.3	4.9	6.9	8.2	9.2	9.8
Milk, Cheese and Eggs	1.2	1.5	2.0	2.2	2.4	2.4	2.1	1.8
Oils and Fats	0.3	2.1	3.9	4.6	6.1	6.7	5.8	5.7
Fruit	3.3	4.4	7.0	9.2	7.9	7.2	6.0	4.1
Vegetables	10.3	12.9	9.9	11.7	10.6	4.4	2.5	0.7
Sugar, Jam, Honey	6.4	5.0	3.4	3.0	1.1	-1.5	-2.6	-3.2
Food Products, N.E.C.	3.1	-1.0	-2.4	-0.1	1.2	0.2	0.6	1.1
Non-Alcoholic Beverages	1.2	1.2	1.2	1.3	1.2	1.1	1.1	1.0
Alcoholic Beverages and Tobacco	4.9	5.5	6.0	6.3	6.0	6.2	6.3	6.5

Source of Basic Data: PSA, BSP

Non-Food Inflation. Inflation for non-food went up during the quarter at 3.1 percent from 2.7 percent in Q3 2017 owing to price hikes of domestic petroleum products, largely influenced by rising imported crude oil prices. Electricity prices went up in Q4 2017 with higher cost of power from the Wholesale Electricity Spot Market (WESM). Likewise, inflation for services also accelerated in particular, postal and catering services.

Price hikes in petroleum products 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	Q4
Non-Food	**0.5**	**0.6**	**1.2**	**1.5**	**2.4**	**2.4**	**2.7**	**3.1**
Clothing and Footwear	1.9	2.3	2.6	2.6	2.8	2.3	2.0	1.8
Housing, Water, Electricity, Gas and Other Fuels	-1.0	-1.0	0.2	1.2	2.9	3.1	2.9	3.9
Electricty, Gas, and Other Fuels	-7.0	-6.8	-3.2	-0.2	6.0	6.8	5.5	9.1
Furnishings, Household Equipment & Routine Maintenance of the House	1.5	1.6	2.1	2.4	2.3	2.3	1.9	1.8
Health	1.9	2.4	2.7	2.6	2.6	2.4	2.4	2.2
Transport	0.3	0.0	0.0	0.9	2.7	2.8	4.3	3.6
Transport Services	1.2	0.7	0.3	0.7	1.5	2.6	4.4	3.0
Communication	0.1	0.2	0.1	0.1	0.2	0.2	0.3	0.4
Recreation and Culture	1.1	1.6	1.7	1.7	1.8	1.4	1.4	1.5
Education	3.6	3.0	1.8	1.8	1.8	1.9	2.3	2.2
Restaurant and Miscellaneous Goods and Services	1.6	2.2	2.4	2.2	2.1	1.6	2.2	2.8

Source of Basic Data: PSA, BSP

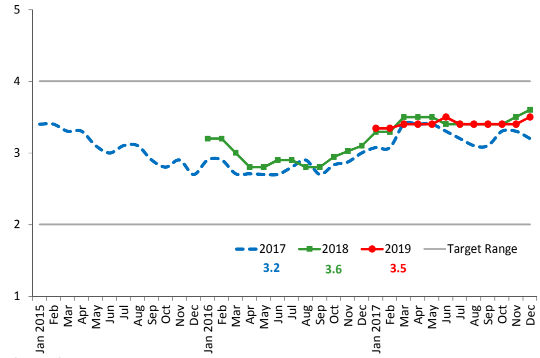
Private Sector Economists' Inflation Forecasts. Results of the BSP's survey of private sector economists for December 2017 showed that mean inflation forecasts for 2017 to 2019 were higher relative to the results in September 2017.[5]

Mean inflation forecasts for 2017 to 2019 are higher

In particular, the mean inflation forecast for 2017 increased to 3.2 percent from 3.1 percent in the September 2017 survey, which analysts attributed to higher crude oil prices, robust consumer spending during the holiday season, rise in utility rates, and adverse weather conditions that affected the supply of some seafood items.

[5] There were 28 respondents in the BSP's survey of private sector economists in December 2017. The survey was conducted from 7 to 27 December 2017.

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

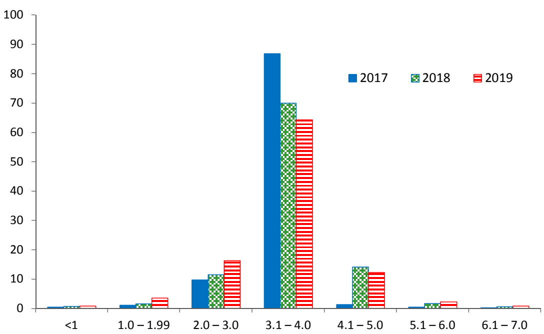


Source: BSP

Likewise, mean inflation forecast for 2018 and 2019 rose to 3.6 percent (from 3.4 percent in the September 2017 survey) and 3.5 percent (from 3.4 percent), respectively. For 2018, analysts noted possible upside risks to inflation such as the implementation of the government's tax reform program (i.e., Tax Reform for Acceleration and Inclusion), volatile global oil prices, weakening peso, rise in utility rates and food prices, higher transport fare, and higher government spending. On the other hand, a key downside risk to inflation was seen to emanate from global economic slowdown due to some geopolitical tensions in the Middle East, as well as in Korea; the slower growth of China's economy; the risk of recession and deflation in Japan and the Euro zone.

Based on the probability distribution of the forecasts provided by 23 out of 28 respondents, there was a 96.5 percent probability that average inflation for 2017 will settle between the 2-4 percent range. For 2018, the respondents assigned an 81.4 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 28 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 increased to 3.4 percent from 3.3 percent in the March 2017 survey.

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

	2017	2018			2019
	FY	Q1	Q2	FY	FY
1) Al-Amanah Islamic Bank	3.40	3.10	3.40	3.50	3.30
2) ANZ	3.10	3.90	4.10	4.20	3.80
3) Asia ING	3.20	3.60	3.80	3.70	3.60
4) Banco De Oro	3.20	3.02	3.42	3.40	3.30
5) Bangkok Bank	3.30	3.50	3.60	3.60	3.70
6) Bank of Commerce	3.18	-	-	-	-
7) Bank of China Ltd.	3.20	3.50	3.60	3.60	3.60
8) Barclays	3.20	3.00	3.20	3.10	3.20
9) Citibank	3.10	3.30	3.90	3.60	3.20
10) Chinabank	3.40	3.20	3.30	3.30	3.30
11) CTBC Bank	3.20	3.50	3.30	3.60	4.00
12) Deutsche Bank	3.20	-	-	3.40	-
13) Eastwest Bank	3.20	3.50	3.60	3.60	3.50
14) Korea Exchange Bank	3.05	3.45	3.45	3.45	3.45
15) Land Bank of the Phils	2.90 - 3.20	3.20 - 3.50	3.30 - 3.60	3.40 - 3.70	3.40 - 3.70
16) Maybank	3.10	3.14	3.20	3.28	3.45
17) Maybank-ATR KimEng	3.20	3.60	3.80	3.60	3.40
18) Metrobank	3.20	-	-	3.80	3.50
19) Multinational Inv. Banc	3.16	3.20	3.40	3.50	-
20) Mizuho	3.20	3.20	3.30	3.30	-
21) Nomura	3.20	4.30	4.50	4.30	3.10
22) RCBC	3.10 - 3.30	3.10 - 3.60	3.70 - 4.20	3.60 - 4.10	3.50 - 4.00
23) Robinsons Bank	3.50	3.30	3.40	3.50	2.50
24) Philippine Equity Partners	3.18	3.38	3.87	3.81	3.53
25) Security Bank	3.20	3.50	3.50	3.60	3.60
26) Standard Chartered	3.20	3.20	3.60	3.50	3.20
27) Union Bank of the Phils.	3.20	3.60	3.80	3.80	4.00
28) UBS	3.30	3.20	3.60	3.80	3.40
Median Forecast	3.2	3.4	3.6	3.6	3.5
Mean Forecast	**3.2**	**3.4**	**3.6**	**3.6**	**3.5**
High	3.5	4.3	4.5	4.3	4.0
Low	3.1	3.0	3.2	3.1	2.5
Number of Observations	28	25	25	27	24
Government Target	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**

Source: BSP

Based on the Q4 2017 BSP Business Expectations Survey (BES), a higher number of respondents expected inflation to increase in the current quarter relative to the previous quarter (from a diffusion index of 35.9 percent to 50.1 percent).

Inflation expectations close to the midpoint of the target

By contrast, the number of respondents that expect inflation to increase in the next quarter decreased (from 42.3 percent to 31.9 percent).

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

Meanwhile, results of the BSP Consumer Expectations Survey (CES) for Q4 2017 indicated that consumers expect higher inflation over the next 12 months at 3.6 percent from 3.2 percent in the Q3 2017 survey. A higher number of respondents (from the previous survey) expect inflation to rise but remain within the government's target range of 2-4 percent in the next 12 months, which is indicative of strong inflationary expectations.

Energy prices. The average Dubai crude oil prices in Q4 2017 increased significantly by 17.5 percent compared to the previous quarter due to the Organization of the Petroleum Exporting Countries' (OPEC) decision to further extend its production cut agreement as well as to supply outages during the quarter.

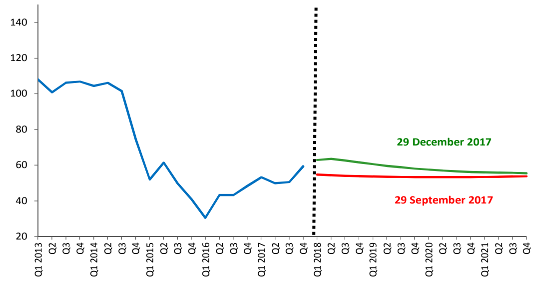
Oil prices rise further in Q4 2017 on supply-side factors

Dubai crude oil prices increased markedly during the quarter due to OPEC's and selected non-OPEC producers' decision on 30 November 2017 to amend its 'Declaration of Cooperation' and extend its agreement to reduce production through the whole year of 2018.[7] At the same time, concerns on supply likewise rose during the quarter due to production disruptions amid reports of an oil pipeline explosion in Libya and geopolitical tension in Iraq following Kurdistan Region's vote for independence in late September 2017.

Meanwhile, US commercial crude oil stockpiles have also been on a downtrend for most of the quarter. Based on data from the US Energy Information Administration (EIA), crude oil total inventory (excluding Strategic Petroleum Reserves) dropped to 424.5 million barrels for the week ending 29 December 2017,[8] around 8.7 percent lower than the end-September level.[9]

Similar to oil spot prices, estimated futures prices of Dubai crude oil as of end-December 2017, which are based on movements of Brent crude oil, showed a higher path for 2018 to 2021 compared to the estimates in the previous quarter.[10]

Chart 5. Spot and Estimated Prices of Dubai Crude Oil



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

In terms of the oil outlook, the US EIA expects supply to outstrip demand in 2018. Forecast for global oil demand was revised upward relative to the previous month's forecast due mainly to higher consumption from the non-Organization for Economic Cooperation and Development (OECD) countries and China.[11] By contrast, EIA reduced its global oil supply forecast relative to the previous month's report[12] on lower OPEC output due to their announced extension of the agreement on crude oil supply reduction.

On a cumulative basis, net adjustments of domestic petroleum prices turned mostly positive in 2017. Net adjustment of gasoline, kerosene, diesel, and LPG went up by ₱1.67 per liter, ₱4.42 per liter, ₱6.20 per liter, and ₱5.87 per liter, respectively. The following table summarizes the actual price adjustments of oil products during the year.

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

Domestic Oil Products	Year-to-Date (December 2017)					
	Increase		Decrease		Net Adjustments	
	Number	Amount (₱/liter)	Number	Amount (₱/liter)	Number	Amount (₱/liter)
Gasoline	25	21.10	20	-19.43	5	1.67
Kerosene	27	14.55	21	-10.13	6	4.42
Diesel	30	17.50	18	-11.30	12	6.20
LPG	6	12.72	5	-6.85	1	5.87

Source: Department of Energy (DOE)

[7] Declaration of Cooperation, OPEC http://www.opec.org/opec_web/en/press_room/4696.htm
[8] Source: US EIA Weekly Petroleum Status Report, https://www.eia.gov/petroleum/supply/weekly/
[9] Based on data from the US EIA Weekly Petroleum Status Report for the week ending 29 September 2017.

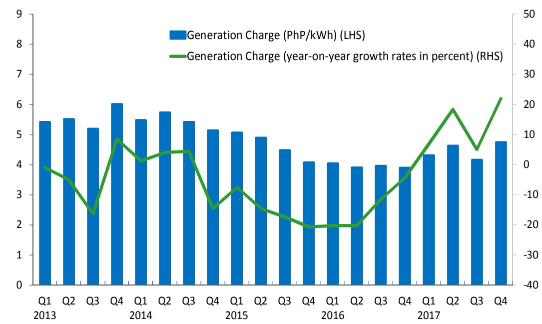
[10] Future prices derived using Brent crude futures data. Data as of 29 September 2017 Source: BSP-staff calculations, Bloomberg
[11] Source: US EIA, Short-Term Energy Outlook, December 2017.
[12] Source: US EIA, Short-Term Energy Outlook, November 2017.

Power. Overall electricity rates in the Meralco franchise area increased in Q4 2017 due to higher generation costs. For Q4 2017, the average generation charge went up by ₱0.59 per kilowatt hour (kWh) to ₱4.73 per kWh from ₱4.15 per kWh in Q3 2017.

Higher generation rates lead to upward adjustment in retail electricity prices

The upward adjustment in the generation cost in Q4 2017 was due primarily to the completion of the installment of the refund of over-recovery on pass-through charges (about ₱6.9 billion) in August 2017, which reduced the generation cost for September relative to October's. At the same time, the higher charges of power from the Wholesale Electricity Spot Market (WESM), Independent Power Producers (IPPs) and Power Supply Agreements (PSA), due mainly to the peso depreciation coupled with lower plant dispatch, placed an upward pressure on generation charges.

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 6.9 percent y-o-y in Q3 2017, higher than the 6.7-percent expansion in the previous quarter but lower than the 7.1-percent growth in the same period last year.

Robust outturns for Q3 GDP

On the expenditure side, GDP expanded on the back of government spending as well as the sustained double-digit growth of total exports, which offset the slowdown in private consumption and fixed capital investment. On the production side, the faster growth in GDP was due to the strong performance in the industry and services sectors, offsetting the slower growth in agriculture.

Gross national income (GNI) accelerated by 6.7 percent in Q3 2017, slightly lower than the quarter-ago's growth of 6.8 percent but higher than the 6.6-percent increase in Q3 2016. Net primary income grew by 5.7 percent in Q3 2017, lower than the 7.0-percent growth in the previous quarter but higher than 4.1-percent in Q3 2016. This can be attributed to the slowdown in the growth of property income.

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

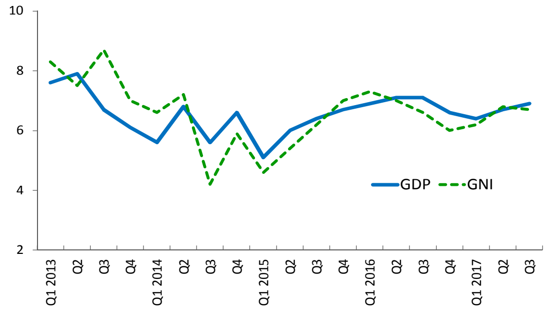
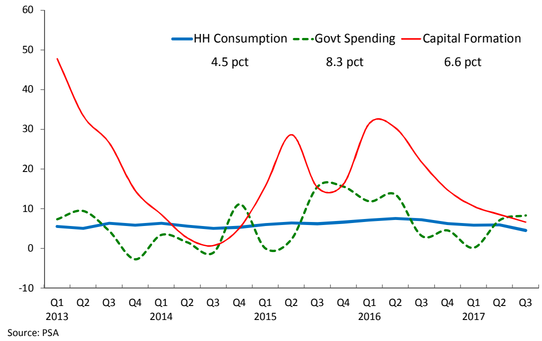


Chart 8. Gross Domestic Product by Expenditure Shares
at constant prices



Aggregate Demand. On the expenditure side, household and government spending as well as investments contributed 3 percentage points (ppts), 0.9 ppt, and 1.8 ppts, respectively, to total GDP growth. The 10.1-ppt contribution of exports outweighed the slowdown of imports (8.9 ppt) resulting in the 1.2-ppt contribution of net exports.

Higher household spending due to lower unemployment rate in Q3

Household expenditure, which accounted for 66.7 percent of total GDP, rose by 4.5 percent in Q3 2017, albeit lower than the 5.9-percent growth a quarter ago and the 7.2-percent increase in the same period last year. The slower quarter-on-quarter (q-o-q) expansion was due to the contraction in consumption of alcoholic beverages and tobacco, and clothing and footwear and the decelerated growth in spending on food and non-alcoholic beverages, housing, water, electricity, gas and other fuels, health, transport, restaurants and hotels and miscellaneous goods and services. Meanwhile, growth in expenditures on furnishings, household equipment and routine, communication, recreation and culture, and education propped up household expenditure. The firm growth in household spending can also be attributed to the following factors: (a) lower unemployment rate in Q3 2017 at 5.6 percent from 5.7 percent in Q2 2017, (b) additional income from Christmas bonuses, and (c) stable inflation rate at 3.5 percent in Q3 2017 from 3.4 percent in Q2 2017.

Growth in capital formation decelerated to 6.6 percent in Q3 2017 from 8.5 percent in Q2 2017 due to the slower growth in fixed capital investments (7.1 percent in Q3 2017 from 9.4 percent a quarter ago) and higher withdrawals in inventories in Q3 2017 at ₱16.4 billion from ₱12.9 billion in the same period last year.

The q-o-q slowdown in fixed capital investments was attributed to the following:

- decelerated growth in construction spending (2.8 percent in Q3 2017 from 7.6 percent) as growth in private construction, which accounted for 79.9 percent of the total construction investment, decelerated to 0.6 percent from 5.1 percent a quarter ago and 18.5 percent a year ago;
- slightly lower growth of investments in durable equipment (8.3 percent in Q3 2017 from 8.8 percent) as growth of investments in road vehicles, which accounted for 55.7 percent of durable equipment, dropped to 7.9 percent from 13.8 percent; and
- lower growth in breeding stock and orchard development and intellectual property products.

Meanwhile, government infrastructure spending improved with public construction expanding by 12.6 percent in Q3 2017, slightly higher than the 12.1-percent growth in the previous quarter.

The main drivers of capital formation growth were the following: durable equipment (contributing 4.8 ppts) and public construction (contributing 2.3 ppts).

Government expenditures increased by 8.3 percent in Q3 2017 (from 7.1 percent in the previous quarter) following the disbursement for social protection programs, the filling up of government positions, and the implementation of the second tranche of the salary adjustment based on Executive Order No. 201, series of 2016, which increases the base pay of civilian, military, and uniformed personnel.

Table 6. Gross Domestic Product by Expenditure Shares
at constant 2000 prices; growth rate in percent

BY EXPENDITURE ITEM	2016				2017		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Household Consumption	7.1	7.5	7.2	6.2	5.8	5.9	4.5
Government Consumption	11.8	13.5	3.1	4.5	0.1	7.1	8.3
Capital Formation	31.5	30.3	21.7	14.7	10.6	8.5	6.6
Fixed Capital Formation	28.3	30.3	25.4	18.5	14.7	9.4	7.1
Exports	10.2	10.6	9.0	13.4	20.3	20.4	17.2
Imports	21.1	25.4	13.3	15.4	18.6	18.7	13.9

Source: PSA

Overall exports grew by 17.2 percent in Q3 2017, lower than the 20.4-percent growth a quarter ago. The slowdown in growth of exports of goods (17.4 percent from 23.5 percent) was outweighed by the acceleration in exports of services (16 percent from 11 percent a quarter ago). The lower growth in exports of goods was due primarily to the decline in growth of exports of ignition wiring sets (7 percent from 27.9 percent), and other export goods (6.2 percent from 20.2 percent). Meanwhile, the sustained growth in exports of services was driven mainly by the expansion of exports of miscellaneous services[13] (9 percent from 7.3 percent) and transportation services (16.5 percent from 10.6 percent).

Overall imports increased by 13.9 percent in Q3 2017, slower than the quarter-ago growth of 18.7 percent, owing to the lower expansion of imports of goods by 14.4 percent from 20.9 percent. The slowdown in growth of imports of goods was due to the decelerated growth of imports of base metals as well as sustained contraction of imports of telecommunication, and payments for imported office equipment and artificial resins. Meanwhile, the double-digit rise in imports of services was due to the higher growth in imports of miscellaneous services (e.g., technical, trade-related, and other business services) at 17.2 percent from 8.9 percent and transportation services by 14.5 percent from 12.7 percent.

[13] Export of miscellaneous services include technical, trade-related, and other business services, computer services, and manufacturing services on physical inputs owned by others.

Other Demand Indicators. Higher-frequency demand indicators support the view of continued firm economic activity in the near term. The property sector showed sustained demand from residential and office segments, vehicle sales accelerated at double-digit rates while the composite Purchasing Managers' Index stayed firmly above the 50-point expansion threshold. Similarly, business and consumer confidence indicate broad optimism in Q4 and the quarter ahead.

Property Prices

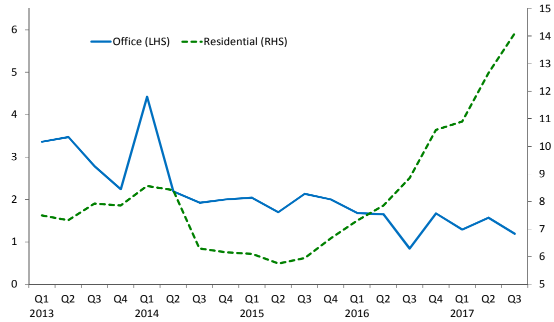
Vacancy Rates, Makati CBD. The overall office vacancy rate in Metro Manila rose to about 5.6 percent in Q3 2017 from 4.5 percent in Q2 2017 due to record high completions in office buildings. In particular, vacancy rates in the Fort Bonifacio and Manila Bay Area increased during the quarter while vacancy rates in the Makati CBD and Ortigas area were broadly stable.

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

Furthermore, with the sizeable upcoming supply, Colliers expects overall vacancy rates in Metro Manila to rise to above 6 percent by the end of 2017 and about 8 percent in 2018.

According to Colliers, the overall residential vacancy rate in Metro Manila also increased to about 12.7 percent in Q3 2017 from 11.7 percent in Q2 2017 due to the influx of residential condominium developments.

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



Source: Colliers International Philippines

Except for Ortigas Center, all major CBDs within Metro Manila registered higher vacancy rates in Q3 2017 compared to the previous quarter. Colliers foresees that residential vacancy rates will range to about 15–17 percent in 2018 and then taper down to low double-digit levels in 2019.

Rental Values, Makati CBD. Monthly Grade A office[14] rents in the Makati CBD reached ₱990/sq.m. in Q3 2017, representing an increase of 2.1 percent from the previous quarter. Similarly, monthly Grade A office rents in the Makati CBD were higher by 5.9 percent relative to Q3 2016.

Office rental values increase in nominal terms

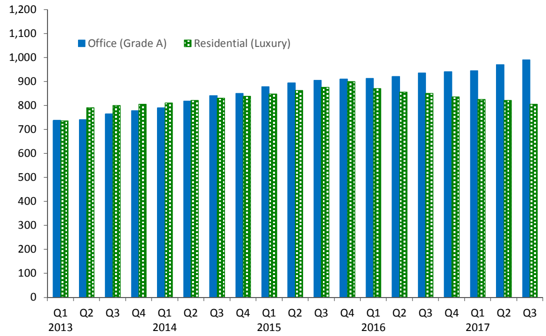
Office rental rates continued to increase amid strong demand from a diversified tenant mix from the following sectors: business process outsourcing (BPO) firms; traditional companies, i.e., non-BPO and government agencies; and, offshore gaming. Office rental values for Grade A offices were above their 1997 levels in nominal terms. In real terms, office rental values were about 53.0 percent of the comparable levels in 1997.

Meanwhile, monthly rents for luxury three-bedroom condominium units in the Makati CBD was at ₱805/sq.m. in Q2 2017, declining by 1.8 percent from the previous quarter. Likewise, monthly rents for the 3-bedroom segment were lower by 5.3 percent compared to the year-ago levels.

Luxury rental values decline

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 70.5 percent of their 1997 levels in real terms.

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



Source: Colliers International Philippines

Capital Values, Makati CBD. Capital values[15] for Grade A office buildings in the Makati CBD in Q3 2017 were higher in nominal terms than their quarter- and year-ago levels.

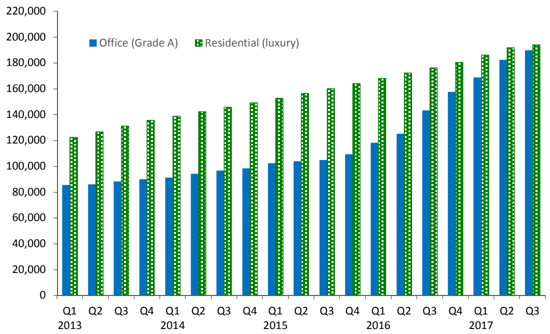
Capital values for office and residential buildings rise

Grade A office capital values in the Makati CBD rose to ₱189,600/sq.m., higher by 4.1 percent and by 32.6 percent compared to the quarter- and year-ago levels, respectively. Grade A office capital values were three times higher than the 1997 levels in nominal terms. In real terms, office capital values are almost at comparable levels in 1997.

[14] 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.

[15] Probable price that the property would have fetched if sold on the date of the valuation. The valuation includes imputed land and building value.

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



Source: Colliers International Philippines

Likewise, capital values for luxury residential buildings[16] in Makati CBD in Q3 2017 increased to ₱194,050/sq.m. from their quarter- and year-ago levels. Average prices for three-bedroom luxury residential condominium units grew by 1.2 percent quarter-on-quarter and 10.2 percent year-on-year. Capital values for luxury residential buildings nearly doubled from their levels in 1997. In real terms, residential capital values were about 82.8 percent of the comparable levels in 1997.

BSP Residential Real Estate Price Index (RREPI).[17]
Residential real estate prices went up by 1.8 percent in Q3 2017, as the Residential Real Estate Price Index (RREPI) [18] rose to 111.6 from 109.6 for the same quarter a year ago. Year-on-year, prices of townhouses and condominium units grew faster at 7.3 percent and 3.6 percent, respectively, compared to the previous quarter. Meanwhile, prices of single detached housing units grew at a slower rate of 0.8 percent.[19] On a q-o-q basis, however, the RREPI remained broadly steady.

[16] 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.

[17] 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 new housing units.

[18] For Q3 2017, about eight in ten real estate loans were for the purchase of new housing units (76.7 percent). By type of housing unit, residential property loans were for the acquisition of condominium units (48.0 percent), followed by single detached units (40.8 percent) and townhouses (10.8 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 47.4 percent of the total number of residential real estate loans granted during the quarter, followed by CALABARZON (29.0 percent), Central Luzon (6.4 percent), Central Visayas (5.2 percent), Western Visayas (4.3 percent), Davao Region (3.0 percent) and Northern Mindanao (1.6 percent). These seven regions accounted for 96.9 percent of total housing loans granted by banks.

Residential real estate prices rise in Q3 2017

The average residential property prices in both the National Capital Region (NCR) and Areas Outside NCR (AONCR) increased by 2.2 percent and 1.8 percent, respectively. In NCR, the higher growth in prices of townhouses and condominium units offset the decline in prices of single detached houses and duplex units. In AONCR, prices of single detached houses, townhouses, and condominium units grew while that of duplex units declined.

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	105.5	113.9	99.7
Q3	105.6	115.5	99.3
Q4	107.6	116.6	101.8
2016 Q1	106.9	113.4	103.3
Q2	111.7	116.1	109.3
Q3	109.6	115.7	106.2
Q4	111.1	117.3	107.9
2017 Q1	113.9	118.4	111.6
Q2	111.8	120.4	107.5
Q3	111.6	118.2	108.1
Year-on-Year Growth Rates			
2015 Q2	5.7	4.9	12.9
Q3	-0.4	6.8	-4.1
Q4	1.1	4.6	0.8
2016 Q1	1.3	3.5	1.8
Q2	5.9	1.9	9.6
Q3	3.8	0.2	6.9
Q4	3.3	0.6	6.0
2017 Q1	6.5	4.4	8.0
Q2	0.1	3.7	-1.6
Q3	1.8	2.2	1.8
Quarter-on-Quarter Growth Rates			
2015 Q2	4.1	8.6	0.9
Q3	0.1	1.4	-0.4
Q4	1.9	1.0	2.5
2016 Q1	-0.7	-2.7	1.5
Q2	4.5	2.4	5.8
Q3	-1.9	-0.3	-2.8
Q4	1.4	1.4	1.6
2017 Q1	2.5	0.9	3.4
Q2	-1.8	1.7	-3.7
Q3	-0.2	-1.8	0.6

Source: BSP

[19] Prices of duplex units (which account for only 0.3 percent of total new housing units reported) declined by 8.6 perecnt y-o-y.

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	105.5	97.9	97.9	96.8	120.0
Q3	105.6	97.3	101.9	97.7	122.1
Q4	107.6	100.6	99.8	101.2	121.1
2016 Q1	106.9	98.9	114.7	107.3	123.2
Q2	111.7	105.8	98.5	109.3	123.9
Q3	109.6	102.6	96.7	100.5	126.4
Q4	111.1	104.9	87.5	107.7	125.5
2017 Q1	113.9	108.0	91.2	107.6	128.3
Q2	111.8	103.6	103.6	112.7	129.3
Q3	111.6	103.4	88.4	107.8	131.0
	Year-on-Year Growth Rates				
2015 Q2	5.7	12.8	1.0	-6.7	7.4
Q3	-0.4	-2.2	14.5	-1.1	5.8
Q4	1.1	2.3	-5.8	5.0	2.3
2016 Q1	1.3	-0.9	10.4	4.0	8.7
Q2	5.9	8.1	0.6	12.9	3.3
Q3	3.8	5.4	-5.1	2.9	3.5
Q4	3.3	4.3	-12.3	6.4	3.6
2017 Q1	6.5	9.2	-20.5	0.3	4.1
Q2	0.1	-2.1	5.2	3.1	4.4
Q3	1.8	0.8	-8.6	7.3	3.6
	Quarter-on-Quarter Growth Rates				
2015 Q2	0.0	-1.9	-5.8	-6.2	5.9
Q3	0.1	-0.6	4.1	0.9	1.7
Q4	1.9	3.4	-2.1	3.6	-0.8
2016 Q1	-0.7	-1.7	14.9	6.0	1.7
Q2	4.5	7.0	-14.1	1.9	0.6
Q3	-1.9	-3.0	-1.8	-8.1	2.0
Q4	1.4	2.2	-9.5	7.2	-0.7
2017 Q1	2.5	3.0	4.2	-0.1	2.2
Q2	-1.8	-4.1	13.6	4.7	0.8
Q3	-0.2	-0.2	-14.7	-4.3	1.3

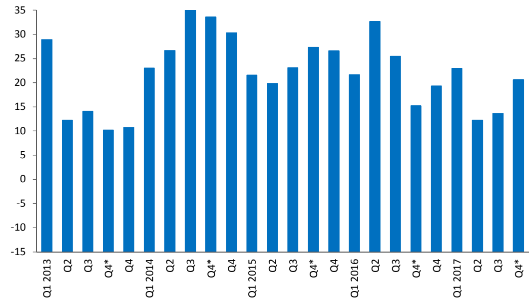
Source: BSP

Vehicle Sales. Sales of new vehicles from CAMPI[20] members grew by 20.6 percent y-o-y in the first two months of Q4 2017 from the 15.2-percent growth recorded in the same period a year ago, reflecting the expansion in the sales of commercial vehicles which offset the slight contraction in the sales of passenger cars.

Brisk growth in sales of new vehicles continue

Sales of passenger cars declined by 0.2 percent y-o-y in October-November 2017 compared to the 8.0-percent growth in the same period in 2016. New passenger car sales accrued to a total of 23,587 in the first two months of Q4 2017 units from 23,642 units in the same period a year ago.

Chart 12. Vehicle Sales
number of units



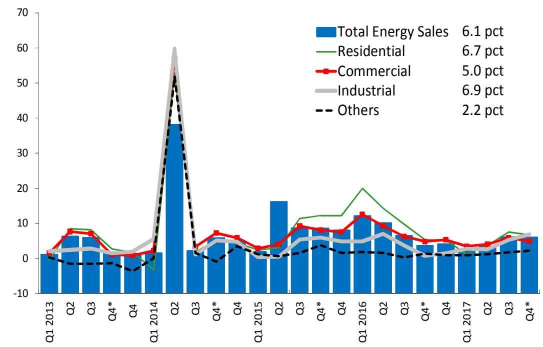
* October - November
Source: Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI)

The growth of commercial vehicle sales, which account for about 69.5 percent of total vehicle sales, accelerated to 32.8 percent y-o-y in the first two months of Q4 2017 relative to 19.8-percent growth in the same period of 2016. Commercial vehicles sold during the quarter reached 53,723 units from 40,456 units in October-November 2016.

Energy Sales. Meralco's energy sales for Q4 2017 (October - November) grew by 6.1 percent, faster than the 3.7-percent growth reported in the same period a year ago. Energy sales from the residential sector, commercial sector and industrial sector grew by 6.7 percent, 5.0 percent, and 6.9 percent, respectively.

Energy sales increase

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



*October-November 2017
Source: Meralco, BSP calculations

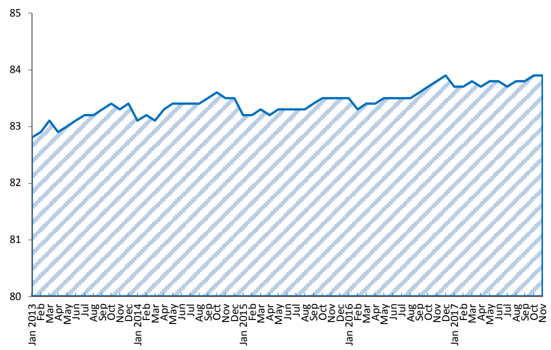
[20] Vehicle sales data is gathered on a monthly basis by the Chamber of Automotive Manufacturers of the Philippines (CAMPI). CAMPI represents the local assemblers and manufacturers of vehicle units in the Philippine automotive industry. The following are the active members of CAMPI: (1) Asian Carmakers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

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 83.9 percent in November 2017, unchanged from the month-ago level.

Capacity utilization in manufacturing remains above 80 percent

Of the 646 respondent-establishments, 59.7 percent operated at least at 80.0 percent capacity in November 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



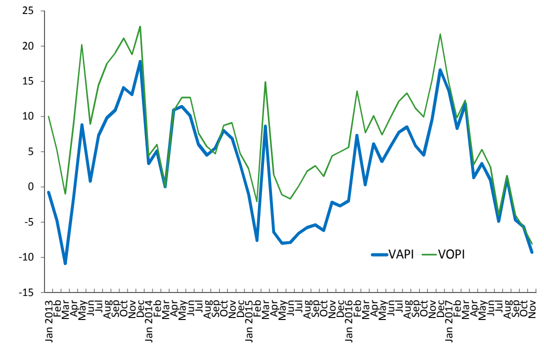
Source: PSA

Volume and Value of Production. Preliminary results of the MISSI showed that volume of production index (VoPI) posted a contraction of 8.1 percent year-on-year in November 2017 from a 5.8-percent (revised) contraction in the previous month.

Manufacturing output posts contraction

The cutback in output was due to the decline in the production of chemical products (-62.7 percent), tobacco products (-48.3 percent), footwear and wearing apparel (-23.9 percent), textiles (-33.8 percent), rubber and plastic products (-8.4 percent), and food manufacturing (-0.3 percent). Moreover, five major sub-sectors grew at a slower pace in November that include electrical machinery, fabricated metals, furniture and fixtures, printing, beverages, and leather products.

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



Source: PSA

The value of production index (VaPI) also posted a contraction of 9.3 percent in November 2017 from a 5.7-percent (revised) contraction a month ago. This was attributed to the following sub-sectors: chemical products (-63.6 percent), tobacco products (-47.4 percent), footwear and wearing apparel (-25.9 percent), food manufacturing (-4.1 percent), textiles (-33.6 percent), rubber and plastic products (-13.7 percent), and leather products (-5.8 percent).

Business Expectations. Business outlook on the economy turned more upbeat for Q4 2017, with the overall confidence index (CI) of the Business Expectations Survey (BES)[21] rising to 43.3 percent from 37.9 percent for Q3 2017. This means that the number of optimists increased and continued to be greater than the number of pessimists during the quarter. The review quarter's confidence level was also higher compared to its year-ago level of 39.8 percent.

[21] The Q4 2017 BES was conducted during the period 2 October – 20 November 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 585 companies in NCR and 888 firms in AONCR and covered all 16 regions nationwide. The survey response rate for this quarter was higher at 84.0 percent (from 83.6 percent in the previous quarter). The response rate was higher for NCR at 80.3 percent (from 80.0 percent in the previous quarter) and higher for AONCR at 86.4 percent (from 86.0 percent in Q3 2017).

Q4 business sentiment upbeat but moderates for next quarter

Respondents cited the following factors behind their more buoyant outlook for Q4: (a) expected increase in orders and consumer purchases during the Christmas holidays, (b) increasing number and expansion of businesses, (c) higher disbursements for the government's infrastructure and other development projects, (d) favorable macroeconomic conditions in the country, particularly manageable inflation and low interest rates, and (e) expansion of export markets and stronger demand for Philippine products.

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
	Q4	43.3	39.7

Source: BSP

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

For the quarter ahead (Q1 2018), business outlook turned less optimistic, with the next quarter CI declining to 39.7 percent from 51.3 percent in the previous quarter's survey results. Respondents attributed their less positive outlook mainly to the usual slowdown of demand after the holiday season. Other reasons cited by firms were lag in business transactions at the beginning of the year (e.g., delay in renewal of contracts and drydock season for the shipping industry), stiffer business competition, concerns on the effect of the new excise tax rates to the automobile industry, and higher inflation.

Consumer Expectations. Consumer outlook was broadly steady for Q4 2017, with the overall confidence index (CI) of the Consumer Expectations Survey (CES)[22] decreasing slightly to 9.5 percent from 10.2 percent for Q3 2017. This means that the optimists continued to outnumber the pessimists but the margin for the current quarter was slightly lower relative to a quarter ago.

Consumer confidence broadly steady for Q4 and the next quarter

Respondents indicated that their continued positive sentiment during the current quarter was on account of additional family income and higher salary, and availability of more jobs leading to an increase in the number of employed family members. However, their slightly less favorable outlook, which counterbalanced their positive views, was due to concerns on: (a) higher prices of goods and household expenditures, (b) peace and order situations, (c) occurrence of calamities such as typhoons, and (d) poor health and high medical expenses.

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
	Q4	9.5	17.5	32.0

Source: BSP

The outlook of consumers in the Philippines mirrored the steady sentiment of consumers in the Netherlands and Cyprus. Meanwhile, consumers in

[22] The Q4 2017 CES was conducted during the period 2-14 October 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 5,581 households, of which 2,722 (48.8 percent) were from NCR and 2,859 (51.2 percent) from AONCR.

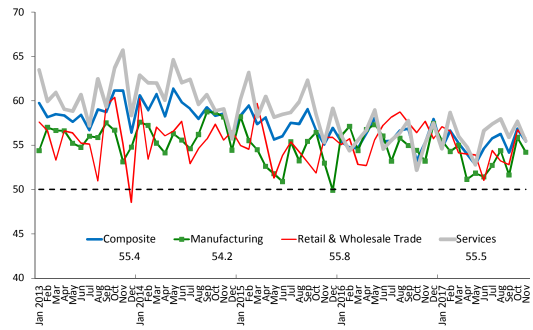
Australia, Canada, Euro Area, Japan, South Korea, Switzerland, Taiwan, Thailand, and the United States registered more favorable sentiment while those in France, Indonesia, and United Kingdom reported weakened views for Q4 2017.

For the next quarter (Q1 2018), consumers' optimism likewise remained steady, as the CI showed a marginal decline to 17.5 percent from 17.8 percent in the previous quarter's survey. Meanwhile, consumer outlook for the year ahead was less upbeat as the CI declined slightly to 32 percent from 33.7 percent a quarter ago.

Purchasing Managers' Index (PMI). [23] The composite PMI in November 2017 remained firmly above the 50-point expansion threshold at 55.4,[24] albeit lower than the composite PMI of 56.8 in October 2017. This was due to the slower rate of expansion of all the sectors in review.

PMI remains firmly above the 50-point expansion threshold

Chart 16. Purchasing Managers' Index



Source: Philippine Institute of Supply Management (PISM)

The manufacturing PMI decreased by 1.7 index points to 54.2 in November 2017 from 55.9 in October 2017, which is in line with sector managers' expectation during the month. The sector typically slows down in November after a production build up in October. This is evident in the slower expansion of all the indices, except the Supplier Deliveries Index which showed firms' longer lead time of deliveries due to delays brought about by traffic congestion. All firms by export category also posted some slowdown in November led by firms with export volume between 26 percent and 50 percent of total revenues, which dropped by 6 index points. By contrast, the PMI of firms with export volume of up to 25 percent of total revenues increased to 61.6. On a per sector basis, 11 of the 12 manufacturing subsectors expanded in November led by food and beverages (with a PMI of 66.2); machinery (59.5); fuel and chemicals (56.4); non-metallic minerals (56.3); publishing and printing (54.6); textiles and clothing (52.2); and fabricated metals (50.5). On the other hand, basic metals posted contraction during the month. Meanwhile, survey respondents expect the sector to decelerate further in December 2017 due to shorter working days during the holiday season.

Likewise, the services PMI went down by 2.2 index points to 55.5 in November from 57.7 in the previous month. Firms attributed the sector's lackluster performance to seasonal downtrend, which is evident in the slower expansion of all the indices, except the Outstanding Business Index. In particular, the Business Activity Index declined as demand usually subsides in November. Similarly, Price Charge Index decreased as companies kept their prices relatively competitive, while the Employment Index went down as firms refrained from hiring new employees. Meanwhile, 12 of the 13 subsectors expanded in November, while the postal and telecommunications subsector indicated contraction. Prospects are less robust in December 2017.

The retail and wholesale PMI decreased slightly by 0.9 index points to 55.8 in November from 56.7 a month ago. The sector's performance was due to the slower expansion of the Purchases Index and Sales Revenues Index. By contrast, the Supplier Deliveries Index rose as it took firms longer delivery time due to traffic congestion. The Employment Index and Inventories Index also increased to meet the holiday demand. Meanwhile, the PMI of the retail subsector declined to 56.8 in November from 57.8 in October. Similarly, the PMI of the wholesale subsector went down to 52.3 in November from 55 a month ago. Firms expect the sector to expand in December 2017.

[23] Data based on the monthly purchasing managers' index report of the Philippine Institute for Supply Management.
[24] 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.

External Demand[25]

Exports. Exports of goods expanded at a slower rate at 8.4 percent in Q3 2017 from 12.7 percent in the previous quarter. Nevertheless, the growth in exports in Q3 2017 is a turn-around from the 1.8-percent contraction posted in Q3 2016.

Exports of goods moderate

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	
	Q3	Q2	Q3
Coconut Products	12.0	31.9	26.3
Sugar and Products	-67.5	2,804.4	3,043.5
Fruits and Vegetables	11.0	7.0	1.5
Other Agro-Based Products	8.3	24.7	0.6
Forest Products	-21.6	724.7	619.6
Mineral Products	0.8	112.5	53.2
Petroleum Products	-56.1	-6.3	-46.9
Manufactures	-2.0	7.3	4.0
Special Transactions	-26.2	31.0	209.1
Total Exports	**-1.8**	**12.7**	**8.4**

Source: BSP

Imports. The growth of imports slowed down to 3.9 percent in Q3 2017 from 5.1-percent and 12.6 percent growth registered in Q2 2017 and Q3 2016, respectively.

Imports of goods slow down

Nonetheless, the sustained growth in imports during the quarter was due to the expansion in inward shipments of raw materials and intermediate goods, mineral fuels and lubricant, and consumer goods, offsetting the contraction in the importation of capital goods.

[25] International Merchandise Trade Statistics (IMTS) concept

Table 12. Imports of Goods
growth rate in percent

COMMODITY GROUP	2016	2017	
	Q3	Q2	Q3
Capital Goods	30.9	4.6	-2.9
Raw Materials and Intermediate Goods	-2.2	6.5	3.2
Mineral Fuels and Lubricants	-10.4	10.0	31.1
Consumer Goods	39.6	1.2	6.0
Special Transactions	34.5	-31.4	-35.0
Total Imports	**12.6**	**5.1**	**3.9**

Source: BSP

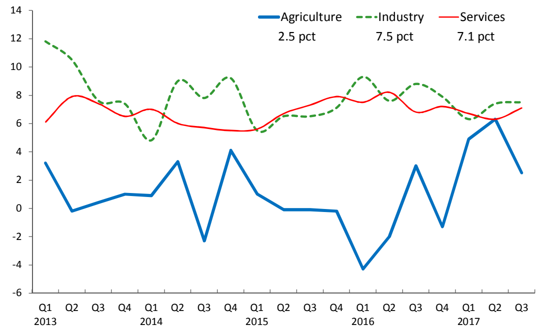
Aggregate Supply. On the production side, the third quarter GDP growth was mainly driven by services (contributing 4.2 percentage points) and industry (contributing 2.5 percentage points). Agriculture contributed 0.2 percentage point.

Services sector continues to support supply-side growth

The services sector output increased by 7.1 percent in Q3 2017, higher than the 6.3 percent growth in Q2 2017. The expansion is due to the improvement in growth of trade and repair of motor vehicles, motorcycles, personal, and household goods (6.8 percent from 5.7 percent), public administration and defense and compulsory social security (8.2 percent from 7.6 percent), transport, storage and communication (3.9 percent from 3.4 percent), and other services (7.7 percent from 4.9 percent). On public administration and defense, the higher growth 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.

Meanwhile, financial intermediation, and real estate, renting and business activities and spending decreased from a quarter ago (8.6 percent from 9.1 percent and 7.7 percent from 8.3 percent, respectively). Financial intermediation slowed down due to the lower expansion of banking institutions, insurance, and activities auxiliary to financial intermediation compared to a quarter ago. The real estate, renting and business activities grew slower compared to that of the previous quarter on account of lower growth of real estate (7.7 percent from 12.8 percent in Q2 2017) and slight decline in the growth of ownership of dwellings (2.9 percent from 3.0 percent in the previous quarter).

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



Source: PSA

Industry grew slightly stronger at 7.5 percent in Q3 2017 compared to 7.4 percent in Q2 2017. This can be attributed to the faster growth of manufacturing (9.4 percent from 7.9 percent) and electricity, gas and water supply (EGW) (3.3 percent from 2.9 percent) which outweighed the deceleration in the growth of mining and quarrying (4.6 percent from 12.5 percent), and construction (3.8 percent from 7.1 percent). The higher growth of manufacturing can be mainly attributed to the growth of paper and paper products, publishing and printing, chemical and chemical products, non-metallic mineral products, basic metal industries, machinery and equipment except electrical, office, accounting and computing machinery, electrical machinery and apparatus, furniture and fixtures, and miscellaneous manufactures. On EGW, the accelerated growth came from increased electricity production. Meanwhile, the deceleration in the growth of construction (6.3 percent from 9 percent) was due to the lower growth of private construction.

The growth in the agriculture, hunting, forestry and fishery (AHFF) sector decelerated to 2.5 percent in Q3 2017 from 6.3 percent, a quarter ago. The slower growth of AHFF for the quarter was largely due to the contraction in forestry and decline in agriculture. Under agriculture, the decline in the growth can be traced with the deceleration in the growth of sugarcane, cassava, poultry, and agricultural activities and services and the contraction of corn and other crops. The growth in agriculture can be attributed to favourable weather conditions and increased usage and availability of good quality seeds.

Table 13. Gross Domestic Product by Industrial Origin
at constant 2000 prices; growth rate in percent

BY INDUSTRIAL ORIGIN	2016				2017		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Agri., Hunting, Forestry and Fishing	-4.3	-2.0	3.0	-1.3	4.9	6.3	2.5
Agriculture and Forestry	-4.0	-1.3	4.3	-0.7	5.6	8.1	3.7
Fishing	-5.9	-5.2	-2.6	-3.8	1.2	-2.7	-2.6
Industry Sector	9.3	7.6	8.8	7.9	6.3	7.4	7.5
Mining and Quarrying	11.4	-4.0	-2.0	10.8	-18.0	12.5	4.6
Manufacturing	8.0	6.2	6.8	7.0	7.6	7.9	9.4
Construction	14.2	13.5	17.2	10.7	9.0	7.1	3.8
Electricity, Gas and Water Supply	10.2	10.3	9.6	9.2	1.5	2.9	3.3
Service Sector	7.5	8.2	6.8	7.2	6.7	6.3	7.1
Transport, Storage and Communication	5.3	7.0	4.6	6.4	4.2	3.4	3.9
Trade and Repair of Motor Vehicles, Motorcycles, Personal and Household Goods	7.5	8.9	6.3	6.5	7.4	5.7	6.8
Financial Intermediation	9.7	6.9	8.5	5.5	7.0	9.1	8.6
Real Estate, Renting and Business Activities	8.7	8.8	8.9	9.1	7.1	8.3	7.7
Public Administration and Defense; Compulsory Social Security	5.2	6.4	3.7	13.3	5.5	7.6	8.2
Other Services	7.3	9.0	6.8	6.0	7.2	4.9	7.7

Source: PSA

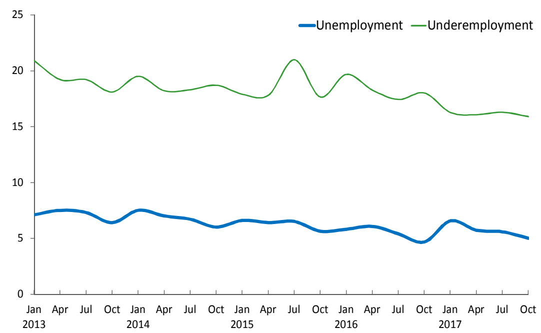
Labor Market Conditions

The Q4 labor market, as reported in the October 2017 round of the labor force survey (LFS), were mixed when compared to year-ago rates (October 2016 LFS). However, the October 2017 results showed improvement from a quarter ago (July 2017 survey).

> Q4 labor market show mixed results from a year ago

Unemployment rate in the October 2017 LFS increased to 5.0 percent from 4.7 percent a year ago. In contrast, underemployment improved to 15.9 percent from 18.0 percent in the previous year. Meanwhile, employment rate was generally steady at 95.0 percent from 95.3 percent a year ago.

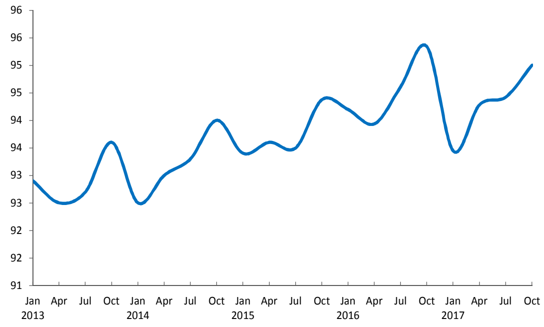
Chart 18. Unemployment and Underemployment
in percent



Source: PSA

The 5.0 percent unemployment rate in October 2017 was equivalent to 2.2 million unemployed individuals. Males comprised 64.2 percent of the unemployed. In terms of age, the 15 to 24 age group comprised 43.9 percent of total unemployed while the 25 to 34 age group made up 28.9 percent. By educational attainment, 20.4 percent of the unemployed were college graduates, 14.1 percent were college undergraduates, and 30.6 percent have completed junior high school.

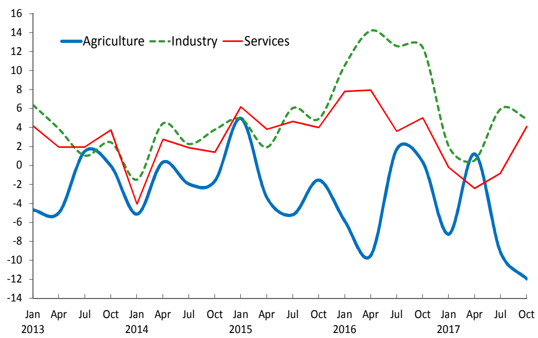
Chart 19. Employment Rate
in percent



Source: PSA

Of the employed persons, workers in the services sector made up the largest proportion. These workers accounted for 57.0 percent of the total employed in October 2017. Workers in the agriculture sector composed the second largest group making up 25.0 percent while those in the industry sector comprised the remaining 18.1 percent of the total employed.

Chart 20. Employment by Sector
in percent



Source: PSA

II. Monetary and Financial Market Conditions

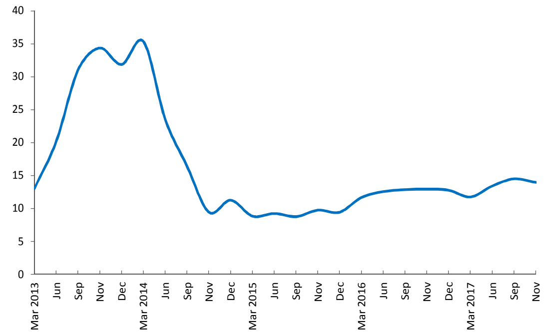
Domestic Liquidity

Domestic liquidity (M3) grew by 14.0 percent y-o-y in November to about ₱10.4 trillion, slower than the 14.5-percent expansion recorded in end-Q3 2017.

Domestic liquidity continues to expand

Money supply continued to increase due largely to sustained demand for credit. Domestic claims grew by 14.7 percent in November, albeit slower than the 16.1 percent expansion in end-Q3 2017 as growth in credit to the private sector eased. Meanwhile, net claims on the central government increased by 10.2 percent from 10.0 percent at the end of the previous quarter as a result of continued borrowing by the National Government.

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



Source: BSP

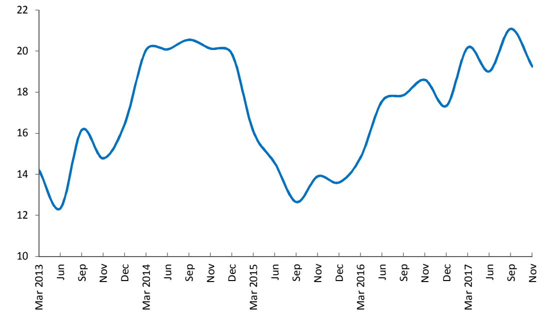
Likewise, the growth in net foreign assets (NFA) accelerated to 1.9 percent y-o-y in November from 0.1 percent in end-Q3 2017. The BSP's NFA position was supported during the review period by steady foreign exchange inflows coming mainly from overseas Filipinos' remittances and business process outsourcing receipts. The NFA of banks expanded due mainly to the growth in banks' foreign assets resulting from higher loans and investments in marketable debt securities.

Preliminary data as of November 2017 show that outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, grew by 19.2 percent y-o-y relative to the 21.1-percent and 17.3-percent expansions posted at end-Q3 2017 and end-Q4 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 18.5 percent y-o-y in November 2017 from 20.7-percent growth in end-Q3 2017 and 16.9-percent rise in end-Q4 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; financial and insurance activities; manufacturing; and, information and communication.

Meanwhile, loans for household consumption grew by 20.6 percent y-o-y as of end-November 2017, higher than the 20.0-percent growth recorded in end-Q3 2017 but lower than the 23.4-percent increase in end-Q4 2016.

Monetary Operations

For Q4 2017, market demand for the 7-day TDF remained strong with average bid-to-cover ratio at 1.1 in Q4 2017. Meanwhile, bid-to-cover ratio for the 28-day term deposit facility (TDF) stood at 0.8. The results of the auction during the review quarter reflected the strong demand for other instruments such as the ₱255-billion issuance by the NG of the five-year Retail Treasury Bonds (RTBs) which was offered on 20-27 November 2017, as well as higher demand for cash by banks in view of the December holidays. Similarly, the average bid-to-cover ratio for the RRP facility was at around 1.0 in Q4 2017.

The offered volume for the 28-day TDF during the review quarter was calibrated downwards, consistent with the BSP's liquidity forecasts. From ₱100 billion in October, the offered volume was decreased to ₱90 billion in November and ₱40 billion for 6 and 13 December. Meanwhile, the 28-day tenor was not offered during the 20 and 27 December auctions. On the other hand, the offered volume for the 7-day TDF was maintained 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 Q4 2017 Senior Bank Loan Officers' Survey (SLOS)[26] showed that most of the respondent banks continued to maintain their credit standards for loans to both enterprises and households during the quarter based on the modal approach.[27] This is the 35th 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[28,29] showed a net easing of credit standards for loans extended to both enterprises and households. In the previous quarter, credit standards for corporate lending showed a net tightening while those for household lending were unchanged based on the DI approach.

Lending to Enterprises. Most banks (88.9 percent of banks that responded to the question) indicated that credit standards for loans to enterprises remained unchanged during the quarter using the modal approach.

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

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

Meanwhile, results based on the DI approach indicated a net easing of credit standards for business loans, attributed to improved profitability and liquidity of respondent banks' portfolios, a more favorable outlook on the economy, and banks' increased tolerance for risk, among others. In terms of specific credit standards, the net easing of overall credit standards is reflected in respondent banks' increased credit line sizes, less

[26] The survey consists of questions on loan officers' perceptions relating to the overall credit standards of universal/commercial banks (U/KBs) in the Philippines, as well as to factors affecting the supply of and demand for loans by both enterprises and households. Survey questionnaires were sent to 35 U/KBs, of which, 30 banks responded to the current survey representing a response rate of 85.7 percent. As of end-October 2017, U/KB loans accounted for about 87.8 percent of the banking system's gross total outstanding loans net of interbank loans and RRP agreements with BSP and other banks.

[27] In the modal approach, the results of the survey are analyzed by looking at the option with the highest share of responses.

[28] In the diffusion index approach, a positive diffusion index (DI) for credit standards indicates that the proportion of banks that have tightened their credit standards are greater compared to those that eased ("net tightening"), whereas a negative DI for credit standards indicates that more banks have eased their credit standards compared to those that tightened ("net easing").

[29] From Q1 2010 to Q4 2012 survey rounds, the BSP used largely the DI approach in the analysis of survey results. Beginning in Q1 2013, the BSP used both the modal and DI approaches in assessing the results of the survey.

strict collateral requirements, and longer loan maturities.[30]

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

Results based on the modal approach showed that most of the respondent banks anticipate unchanged credit standards over the next quarter. Meanwhile, the DI approach showed that more respondent banks expect overall credit standards for business loans to tighten over the next quarter compared to those that expect the opposite, largely on account of banks' perception of stricter financial system regulations.

Lending to Households. The results of the survey also showed that most respondent banks (90.5 percent) kept their overall credit standards unchanged for loans extended to households during the quarter based on the modal approach. Meanwhile, results based on the DI approach reflected a net easing of credit standards. In particular, credit standards for credit card loans and auto loans eased, which was attributed by respondent banks to the improvement in the profitability of their portfolio, their increased tolerance for risk, and improvement in the profile of their household borrowers, among others. In terms of specific credit standards, results based on the DI approach indicated overall increase in the sizes of credit lines and less strict collateral requirements and loan covenants.

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

	2016				2017			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Tightened Considerably	0.0	0.0	0.0	5.0	0.0	0.0	0.0	0.0
Tightened Somewhat	9.5	8.3	9.1	0.0	0.0	9.1	5.0	0.0
Remained Basically Unchanged	**81.0**	**83.3**	**90.9**	**95.0**	**100.0**	**81.8**	**90.0**	**90.5**
Eased Somewhat	9.5	8.3	0.0	0.0	0.0	9.1	5.0	9.5
Eased Considerably	0.0	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	100.0
Diffusion Index for Credit Standards	**0.0**	**0.0**	**9.1**	**5.0**	**0.0**	**0.0**	**0.0**	**-9.5**
Weighted Diffusion Index for Credit Standards	**0.0**	**0.0**	**4.5**	**5.0**	**0.0**	**0.0**	**0.0**	**-4.8**
Mean	3.0	3.0	2.9	2.9	3.0	3.0	3.0	3.1
Number of Banks Responding	**21**	**24**	**22**	**20**	**21**	**22**	**20**	**21**

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

Over the next quarter, results based on the modal approach indicated that majority of the respondent banks anticipated maintaining their overall credit standards. Meanwhile, the DI approach showed expectations of overall net tightening of credit standards, particularly for credit card and personal/salary loans, on the back of respondent banks' perception of stricter financial system regulations and reduced tolerance for risk.

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[31] across all firm sizes and all types of household loans. The net increase in loan demand of firms was largely attributed by banks to the improvement in customers' economic outlook. Meanwhile, respondent banks attributed the net increase in demand for household loans to higher household consumption, 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

[30] The survey questionnaire asks banks to describe changes in six specific credit standards: (1) loan margins (price-based); (2) collateral requirements; (3) loan covenants; (4) size of credit lines; (5) length of loan maturities; and (6) use of interest rate floors. A loan covenant is an agreement or stipulation laid down in loan contracts, particularly contracts with enterprises, under which the borrower pledges either to take certain action (an affirmative covenant), or to refrain from taking certain action (a negative covenant); this is consequently part of the terms and conditions of the loan. Meanwhile, an interest rate floor refers to a minimum interest rate for loans. Greater use of interest rate floor implies tightening while less use indicates otherwise.

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

proportion of respondents expect overall demand for corporate and household loans (except credit card loans) to increase further in the next quarter relative to those who indicated the opposite. Respondent banks cited expectations of higher investment in plant or equipment, increased working capital needs, and improvement in the economic outlook 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 low interest rates along with higher household consumption.

Real Estate Loans. Most of the respondent banks (73.7 percent) indicated unchanged credit standards for commercial real estate loans in Q4 2017. The DI approach, however, continued to indicate a net tightening of overall credit standards for commercial real estate loans for the 8th consecutive quarter. The tighter overall credit standards for commercial real estate loans reflected respondent banks' wider loan margins, reduced credit line sizes, stricter collateral requirements and loan covenants, shorter loan maturities, and increased use of interest rate floors. Over the next quarter, while majority of the respondent banks foresee maintaining their credit standards for commercial real estate loans, DI-based results point to expectations of continued net tightening of credit standards for the said type of loan.

Majority of banks maintain credit standards for real estate loans

Demand for commercial real estate loans was also unchanged in Q4 2017 based on the modal approach. A number of banks, however, indicated increased demand for the said type of loan on the back of increased investment in plant and equipment, improvement in borrower firms' economic outlook, banks' more attractive financing terms and lower interest rates. Over the next quarter, although most of the respondent banks anticipate generally steady loan demand, a number of banks expect demand for commercial real estate loans to continue to increase.

Meanwhile, in the case of housing loans extended to households, results based on both modal and DI approaches point to unchanged credit standards as all of the respondent banks (100.0 percent) reported that they maintained credit standards. The unchanged credit standards for housing loans was attributed by respondent banks largely to unchanged profile of household borrowers, their stable economic outlook as well as unchanged tolerance for risk for the said type of loan. Over the next quarter, results based on both the modal and diffusion index approaches likewise showed that banks foresee unchanged overall credit standards for housing loans on the back of their unchanged tolerance for risk, their stable economic outlook, and steady profile of housing loan borrowers. At the same time, results continued to show increased demand for housing loans in Q4 2017 as well as expectations of a sustained increase in demand for the said type of loan in the next quarter.

Interest Rates

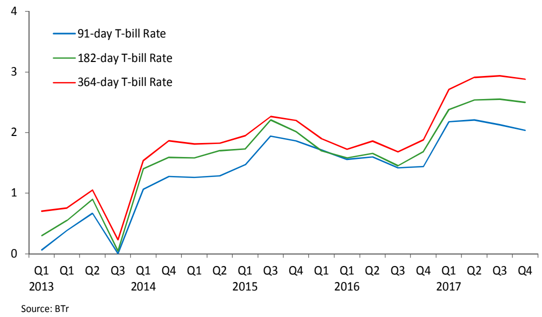
Primary Interest Rates

In Q4 2017, the weighted average interest rates for 91-day, 182-day and 364-day T-bills in the primary market decreased to 2.034 percent, 2.497 percent, and 2.878 percent, respectively, from 2.128 percent, 2.548 percent, and 2.936 percent in the previous quarter.

T-bill rates in the primary market decrease

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

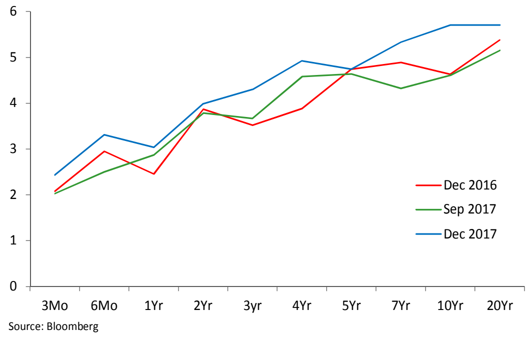


Yield Curve. As of end-December 2017, the secondary market yield for government securities (GS) for all tenors rose relative to the end-September 2017 levels, following the US Federal Reserve interest rate hike on 13 December 2017.

Yield curve rose in end-December 2017

Debt paper yields were higher by a range of 10.6 bps (5-year GS) to 109.0 bps (10-year GS) compared to end-September 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 likewise increased by a range of 0.1 bp for the 5-year GS to 107.1 bps for the 10-year GS.

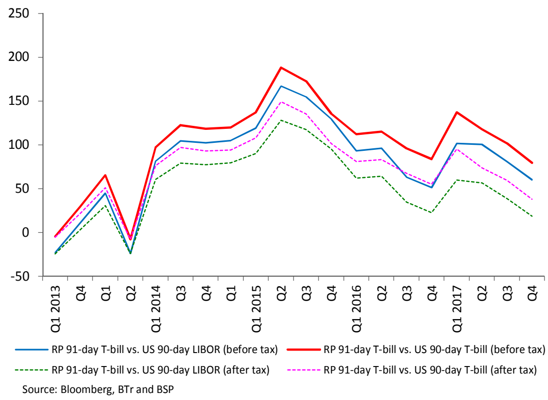
Interest Rate Differentials. The average differentials between domestic and US interest rates, gross and net of tax, narrowed further in Q4 2017 relative to the previous quarter.

Interest rate differentials continue to narrow

The average 91-day RP T-bill rate declined q-o-q by 3.9 bps to 2.085 percent in Q4 2017 from 2.124 percent in Q3 2017. However, the average US 90-day LIBOR and the US 90-day T-bill rate increased by 16.9 bps and 18.3 bps, respectively, to 1.484 percent and 1.289 percent in Q4 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.

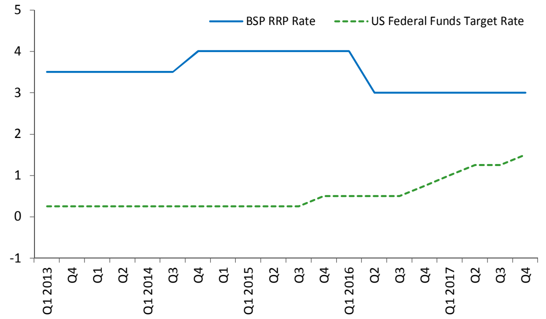
Domestic interest rates declined due mainly to robust demand. In addition, following the ₽255-billion issuance of 5-year Retail Treasury Bonds (RTBs) in November 2017, the NG rejected all bids during the 27-November and 11-December auctions. Meanwhile, foreign interest rates rose during the quarter following the US Fed policy rate hike and the passage of a tax-cut legislation by the US Congress on 22 December 2017.

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



The positive differential between the BSP's overnight borrowing or RRP rate and the US Fed funds target rate narrowed to a range of 150-175 bps in Q4 2017 from 175-200 bps in Q3 2017, reflecting the impact of the 25-bp increase in the US Fed funds target rate to 1.25-1.50 percent on 14 December 2017.

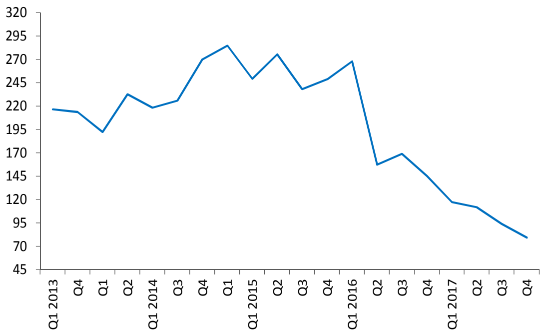
Chart 26. BSP RRP Rate and US Federal Funds Target Rate
in percent



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[32] narrowed further to 79 bps as of end-December 2017 from 94 bps in end-September 2017. This development could be traced to a lower risk premium, following the 18-bp and 8-bp increases in the 10-year US note and 10-year ROP note to 2.27 percent and 2.98 percent, respectively.

Chart 27. Risk-Adjusted Differentials
in basis points



Source: Bloomberg and BSP

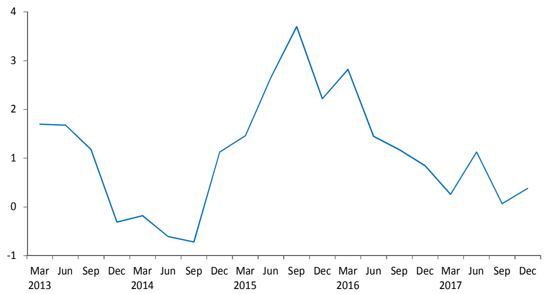
The 10-year US and 10-year ROP notes rose on higher US growth and inflation expectations following the passage of a tax-cut legislation by the US Congress; investors' demand for safe-haven assets amid the geopolitical tensions in North Korea and Iran, and the European Central Bank's (ECB) decision to prolong its bond-buying program; and the release of better-than-expected US data showing lower unemployment and higher wages.

Domestic real lending rate[33] increased to 0.38 percent in December 2017 from 0.06 percent in September 2017. This was due to the 20-bp rise in actual bank lending rate[34] to 3.7 percent in December 2017 combined with the 10-bp decline in inflation to 3.3 percent.

Real lending rate increases

The Philippines' real lending rate is the lowest in a sample of 10 Asian countries in December 2017, with Indonesia recording the highest real lending rate at 7.2 percent followed by Thailand at 5.2 percent while Japan posted the second lowest at 0.4 percent.

Chart 28. Philippines' Real Lending Rate
in percent



Source: PSA and BSP

Financial Market Conditions

The domestic financial system showed solid performance during the review quarter. Positive outturns on the domestic front such as the strong Q3 GDP, legislative support for the tax reform program and the recent credit rating upgrade resulted in upbeat investor sentiment on Philippine assets.

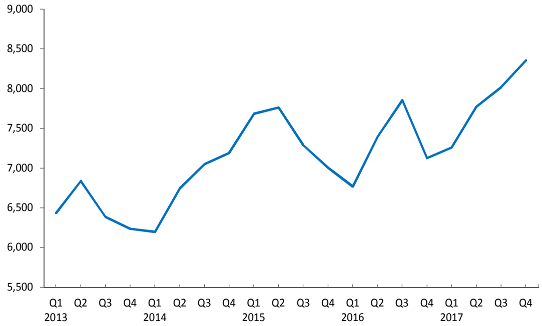
Domestic financial market conditions reflect external uncertainty

Stock Market. The Philippine Stock Exchange index (PSEi) rose by 4.2 percent, q-o-q, in Q4 2017, to average 8,354.1 index points.

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

[34] 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.

Chart 29. Quarterly Average PSEi
In basis points



Source: Philippine Stock Exchange, BSP

The benchmark index surpassed the 8,000-point mark on the following factors: investors' optimism over the end of hostilities in Marawi in October; strong economic prospects following a robust Q3 GDP growth and positive Q3 earnings results; the subdued domestic inflation for November; the signing into law of the Tax Reform for Acceleration and Inclusions (TRAIN) bill; and Fitch Ratings' latest rating upgrade for the Philippines.

Fitch Rating's upgrade and robust Q3 GDP growth boost stock exchange index

Moreover, the nomination of a perceived dovish new Federal Reserve Chief in Jerome Powell,[35] the bullish outlook on the economic performance of the US and Europe, and corporate window dressing towards end-2017 helped the PSEi breach the 8,000 mark. However, the rally was partly tempered by concerns over the missile tests conducted by North Korea.

Mirroring the rally in domestic shares, total market capitalization went up by 2.8 percent q-o-q to reach ₱17.58 trillion as of 29 December 2017. The price-earnings ratio for listed firms rose from the 22.72x in end-September to 23.10x as of 29 December 2017, indicating investors' continued willingness to hold domestic shares. Moreover, preliminary data from the PSE showed that foreign investors were net buyers of ₱0.29-billion worth of domestic stocks during the review period.

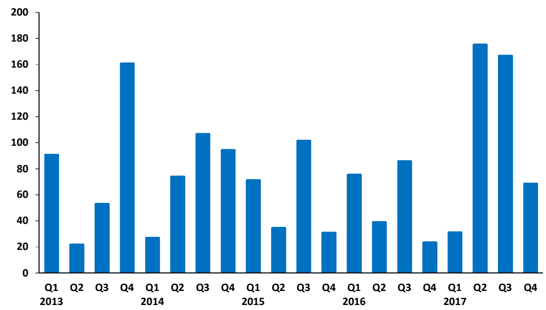
[35] Mr. Powell's moderate stance at a confirmation hearing in November reiterated the US Fed's current policy of increasing interest rates slowly if the pace of economic growth remains steadfast.

Government Securities. Results of the T-bill auctions conducted in Q4 2017 (October - December) continued to show healthy demand for T-bills with total subscription for the quarter amounting to ₱158.5 billion, about 1.8 times the ₱90.0-billion total offered amount. The oversubscription for the quarter, at ₱68.5 billion, was lower than the ₱166.7 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 the 9- and 23-October auctions. For the 16-November auction, the BTr awarded in full the ₱8.0-billion and ₱6.0-billion offered amounts for the 91- and 182-day T-bills, while partially awarding ₱4.5 billion of the offered ₱6.0 billion for the 364-day T-bills. Meanwhile, the BTr rejected all bids for the 91-, 182- and 364-day T-bills during the 27-November and 11-December auctions on account of market players weak appetite, following the ₱255-billion issuance by the NG of the five-year Retail Treasury Bonds (RTBs) which was offered to the public on 20-27 November 2017.

Chart 30. Total Oversubscription of T-bill Auctions



Source: Bureau of the Treasury

Sovereign Bond and CDS Spreads. In October, debt spreads narrowed as investor concerns remained muted. On the domestic front, investor sentiment improved on indications that the Senate would be supporting an immediate passage of the comprehensive tax reform measure. In addition, the Philippine government has declared the end of the Marawi war crisis.

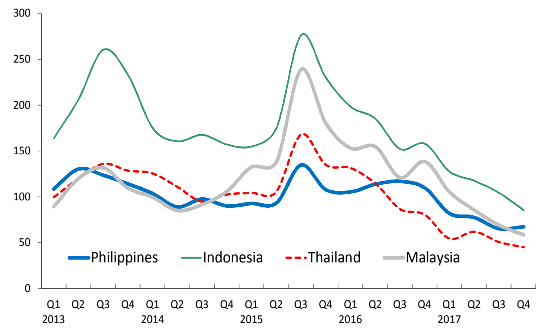
Debt spreads narrower on improved US economic data

In November, debt spreads widened albeit marginally. The country's premium in holding a 5-year government bonds started to rise and peaked in November as uncertainties about the prospects of the US tax reform bill led to a broader "risk-aversion" stance by investors across the globe. At the domestic front, high inflation for October and the decline in remittance figures in September likewise contributed to the widening in debt spreads.

In December, debt spreads eased and narrowed as the US Fed increased interest rates, indicating a healthier and more bullish US economy. Locally, the TRAIN bill was signed into law. It is expected to generate more revenues that will finance the infrastructure needs of the country.

As of end-December, the Philippines' 5-year sovereign credit default swaps (CDS) stood at 59 bps, lower than the 66 bps in end-3Q 2017. It has remained lower than Indonesia's 85 bps while higher than Malaysia's 58 bps and Thailand's 46 bps in the current quarter.

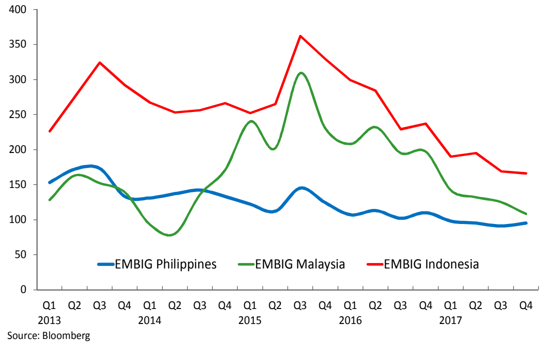
Chart 31. 5-Year CDS Spreads of Selected ASEAN Countries
in basis points



Source: Bloomberg

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

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



Source: Bloomberg

Banking System

The Philippine banking system continued to support long-term economic growth and stable financial condition. Banks' balance sheets exhibited sustained growth in assets and deposits.

Philippine banking system sustains growth in assets and deposits

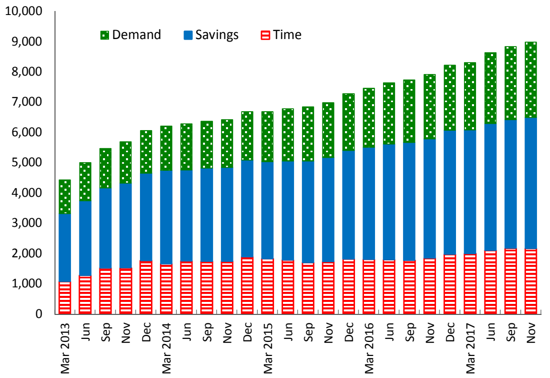
Furthermore, asset quality indicators remained healthy while capital adequacy ratios continued to be above international standards, even with the implementation of the tighter Basel III framework.

Savings Mobilization. Savings deposits remained the primary sources of funds for the banking system. Banks' total deposits[36] as of end-November 2017 amounted to ₱9.0 trillion, 13.6 percent or ₱1.1 trillion higher than the year-ago level. Relative to the previous quarter, total deposits grew by 1.6 percent due mainly to the expansion in demand and savings deposits by 3.2 percent and 1.8 percent, respectively. Meanwhile, foreign currency deposits owned by residents (FCD-Residents) reached ₱1.9 trillion during the same period, posting a y-o-y and q-o-q growth of 11.5 percent and 0.7 percent, respectively.[37]

[36] This refers to the total peso-denominated deposits of the banking system.
[37] 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



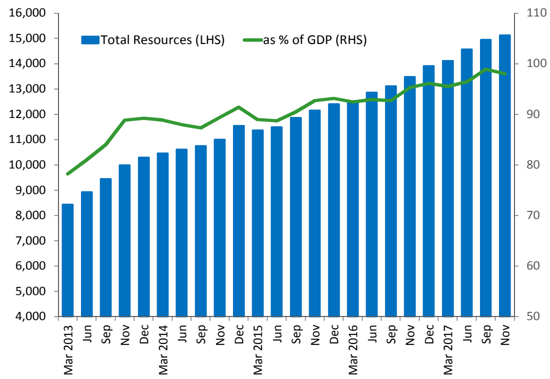
Source: BSP

Institutional Developments. The total resources of the banking system grew by 12.2 percent to reach ₱15.1 trillion as of end-November 2017 from ₱13.5 trillion a year ago, and by 1.2 percent relative to the end-September 2017 level. As a percent of GDP, total resources stood at 98.0 percent.[38]

Total resources of the banking system continue to rise

Chart 34. Total Resources of the Banking System

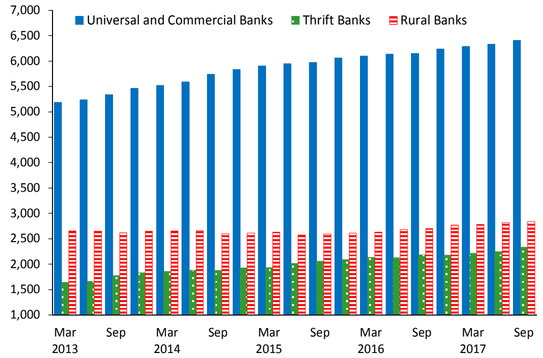
levels in billion pesos; share in percent



Source: BSP

The number of banking institutions (head offices) decreased to 592 offices as of end-September 2017 from 613 offices a year ago and 595 offices a quarter ago. The banks' head offices were comprised of 43 U/KBs, 57 thrift banks (TBs), and 492 rural banks (RBs). This indicated continued consolidation of banks as well as the exit of weaker players in the banking system.

Chart 35. Number of Banking Institutions



Source: BSP

Meanwhile, the operating network (head offices and branches/agencies) of the banking system expanded to 11,571 offices as of end-September 2017 from 11,024 offices a year ago and 11,393 offices a quarter ago, due mainly to the increase in branches/offices across U/KBs, TBs, and RBs.

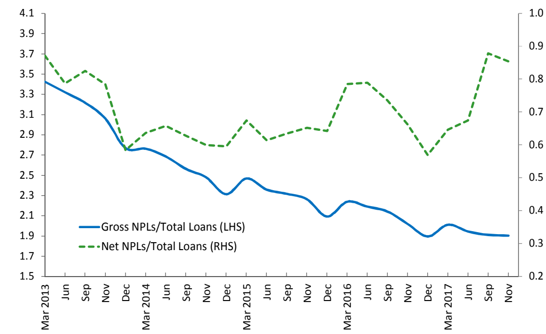
The Philippine banking system's gross non-performing loan (GNPL) ratio improved to 1.90 percent as of end-November 2017 relative to the 2.03 percent registered a year ago and the end-September 2017 ratio of 1.91 percent.

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.[39]

Chart 36. Ratios of Gross Non-Performing Loans and Net Non-Performing Loans to Total Loans

in percent



Source: BSP

[38] GDP as of the third quarter of 2017.

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

Similarly, the net non-performing loan (NNPL) ratio increased to 0.9 percent as of end-November 2017 relative to the previous year's ratio of 0.7 percent but remained unchanged with respect to the end-September 2017 ratio. In computing for the NNPLs, specific allowances for credit losses on Total Loan Portfolio (TLP) are deducted from the GNPLs. Said allowances increased to ₱90.0 billion in end-November 2017 from ₱86.6 billion posted as of end-September 2017.[40]

The Philippine banking system's GNPL ratio of 1.9 percent was higher with respect to that of South Korea (1.2 percent) and Malaysia (1.2 percent) but lower than that of Indonesia (2.9 percent) and Thailand (3.0 percent).[41]

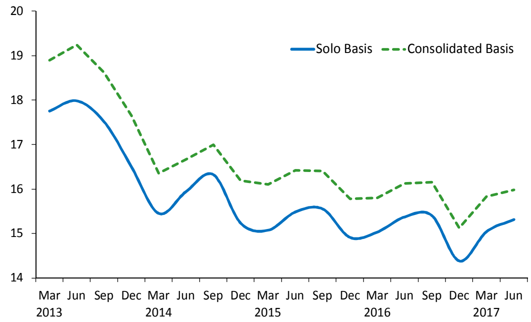
Loan exposures of banks remained adequately covered as the banking system registered an NPL coverage ratio of 114.6 percent as of end-November 2017. This was the same with the ratio registered a year ago but slightly higher than the end-September 2017 ratio of 114.2 percent.

U/KBs' CAR remains above international and regulatory standards

The capital adequacy ratio (CAR) of U/KBs as of end-June 2017 improved to 15.3 percent on solo basis, relative to the previous quarter's ratio of 15.0 percent. 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 37. Capital Adequacy Ratio of Univeral and Commercial Banks

in percent



Source: BSP

The CAR of Philippine U/KBs, on a consolidated basis, was higher than that of South Korea (15.4 percent) but lower than that of Malaysia (17.0 percent), Thailand (18.5 percent) and Indonesia (26.7 percent).[42]

Exchange Rate

On a q-o-q basis, the peso averaged ₱50.93/US$1, depreciating slightly against the US dollar by 0.19 percent from the previous quarter's average of ₱50.84/US$1.

Peso depreciates against the US dollar in Q4 2017

The peso's depreciation during the review period was due partly to the planned US corporate tax cuts and expectations of strong third quarter US GDP. Depreciation pressures were, however, partly offset by the country's stronger-than-expected third quarter GDP growth and the passage of the TRAIN bill into law. On a y-o-y basis, the peso depreciated by 3.59 percent relative to the ₱49.11/US$1 average in Q4 2016.[43]

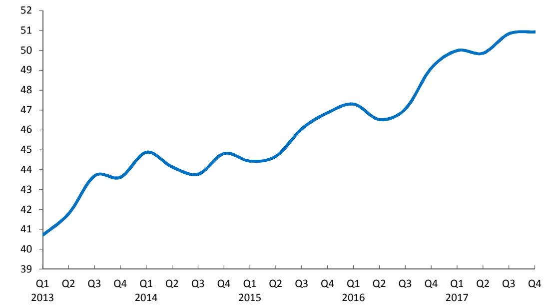
[40] This type of provisioning applies to loan accounts classified under loans especially mentioned (LEM), substandard-secured loans, substandard-unsecured loans, doubtful accounts and loans considered as loss accounts.

[41] Sources: South Korea (Domestic Banks' Substandard or Below Loans [SBLs] ratio, Q3 2017); Malaysia (Banking System's Ratio of net impaired loans to net total loans, November 2017); Indonesia, IMF and financial stability reports (Banks' Nonperforming Loans to Gross Loans Ratio, Q2 2017); and Thailand (Total Financial Institutions' Gross NPLs ratio, Q3 2017).

[42] Sources: South Korea (Domestic Banks' Capital Ratio, Q2 2017); Malaysia (Banking System's Total Capital Ratio, November 2017); Thailand (Commercial Banks' Capital Funds Percentage of Risk Assets, October 2017); and Indonesia, IMF and financial stability reports (Commercial Banks, Regulatory Capital to Risk-Weighted Assets Ratio Q2 2017).

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

Chart 38. Quarterly Peso-Dollar Rate
PHp/US$; average per quarter



Source: Reference Exchange Rate Bulletin, Treasury Department, BSP

In October, the peso averaged ₱51.34/US$1, depreciating by 0.65 percent from the ₱51.01/US$1 average in September as markets turned bullish following reports of better-than-expected US economic data on services and manufacturing; and expectations of stronger third quarter US GDP. The strengthening of the dollar against the euro following the European Central Bank (ECB)'s decision to prolong its bond-buying program likewise added pressure to the peso.

Meanwhile, the peso averaged ₱51.04/US$1 in November, appreciating by 0.60 percent from the October average. The strong performance of the peso was due mainly to: (i) the appointment of widely perceived "dovish" Fed Governor Jerome H. Powell as the new US Fed chair; (ii) growing skepticism on planned corporate tax cut in the US; and (iii) the country's stronger-than-expected Q3 GDP growth. The appreciation of the peso continued in December as it averaged ₱50.39/US$1, gaining 1.28 percent from the November average. The peso's appreciation was due mainly to the passage of the TRAIN bill into law and amid strong OF (overseas Filipino) remittance and profit taking by market players ahead of the holiday season.

On a year-to-date basis, the peso depreciated against the US dollar by 0.42 percent on 29 December 2017 as it closed at ₱49.93/US$1. This is in contrast with the strengthening of monitored Asian currencies during the same period, except for the Indonesian Rupiah which likewise depreciated against the US dollar.[44]

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

Table 16. Year-to-Date Changes in Selected Dollar Rates
appreciation/(-depreciation); in percent

	2013	2014	2015	2016	2017*
Korean Won	1.13	-4.34	-6.61	-2.63	13.16
Thai Baht (Onshore)	-4.59	-0.68	-8.86	0.14	9.69
Singaporean Dollar	-2.72	-4.52	-5.99	-1.99	8.23
Indian Rupee	-11.40	-2.94	-4.93	-2.88	6.27
Indonesian Rupiah	-19.07	-2.08	-9.81	2.32	-0.64
Philippine Peso	**-7.02**	**-0.73**	**-4.97**	**-5.35**	**-0.42**
Japanese Yen	-16.26	-12.46	-0.47	3.33	3.83
Malaysian Ringgit	-5.47	-6.30	-18.55	-4.21	10.69
Chinese Yuan	2.60	-2.70	-4.33	-6.62	6.68
New Taiwan Dollar	-1.95	-6.16	-3.63	1.89	8.76

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 December 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 the country's robust economic growth, continued to provide support to the peso.[45]
Meanwhile, the volatility of the peso's daily closing rates (as measured by the coefficient of variation) stood at 1.02 percent during the review quarter, higher than the 0.61 percent registered in the previous quarter.[46] Relative to other currencies in the region, the volatility of the peso remained in the middle of the pack.[47]

On a real trade-weighted basis, the peso gained external price competitiveness in October and November 2017 against the basket of currencies of all trading partners (TPI), trading partners in advanced (TPI-A) and developing countries (TPI-D). Relative to Q3 2017, the real effective exchange rate (REER) index of the peso decreased by 0.15 percent, 0.23 percent, and 0.41 percent,

[45] As of end-November 2017, country's gross international reserves (GIR) stood at US$80.3 billion (revised). This can cover 8.4 months' worth of imports of goods and payments of services and primary income. It is also equivalent to 5.4 times the country's short-term external debt based on original maturity and 3.7 times based on residual maturity. Foreign direct investments (FDI) remained positive and registered a net inflow of US$5.8 billion as of end-September 2017. Remittances from OF workers continue to flow in from various geographical locations globally, for the period January to October 2017, cash remittances from OFs amounted to US$25.7 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.
[46] 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.
[47] The volatility of the peso was higher than that of Indonesian rupiah, Chinese yuan, Singapore dollar, Japanese yen, and Thailand baht but lower than that of Malaysian ringgit and South Korean won.

against the TPI, TPI-A, and TPI-D baskets, respectively. The nominal depreciation of the peso, partly countered by widening inflation differential, contributed in the general decline in the REER.[48,49]

Relative to Q4 2016, the peso likewise gained external price competitiveness in October and November 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 4.10 percent, 2.68 percent, and 5.06 percent against the TPI, TPI-A, and TPI-D baskets, respectively.

[48] 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.

[49] 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's (NG) fiscal position was in a deficit of ₱243.5 billion for January-November 2017, higher by 4 percent than the deficit posted in the comparable period in 2016.

Fiscal deficit higher for January – November 2017

Netting out the interest payments in expenditures, the NG registered a primary surplus amounting to ₱46.5 billion, lower by 7 percent compared to the primary surplus in 2016.

Table 17. National Government Fiscal Performance
in billion pesos

	2016		2017		Growth Rate (in percent)	
	Nov	Jan-Nov	Nov	Jan-Nov	Nov	Jan-Nov
Surplus/(Deficit)	-19.1	-235.2	-8.6	-243.5	-55.0	4.0
Revenues	209.2	2,030.6	243.5	2,250.0	16.0	11.0
Expenditures	228.4	2,265.8	252.1	2,493.5	10.0	10.0

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

For the period January - November 2017, revenues increased by 11 percent to ₱2,250.0 billion compared to ₱2,030.6 billion in the same period in 2016. Revenue from tax increased as collections from Bureau of Internal Revenue and Bureau of Customs grew by 12 percent and 14 percent, respectively. Meanwhile, non-tax revenues declined as income from Bureau of the Treasury decreased by 9 percent.

On the other hand, expenditures for the period in review reached ₱2,493.5 billion, 10 percent higher than the expenditures in the previous year. Excluding interest payments, expenditures went up by 11 percent to ₱2,203.5 billion. Meanwhile, interest payments were higher by ₱4.6 billion compared to its year-ago level. This brought interest payments for the first eleven months of the year to ₱290.0 billion.

IV. External Developments

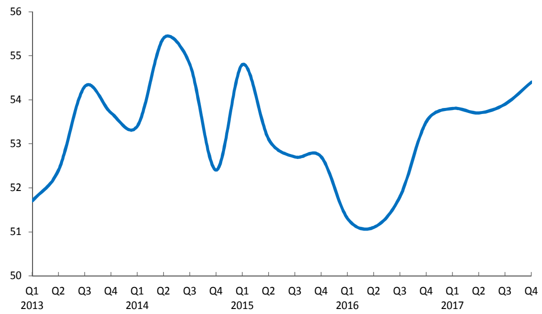
The JP Morgan Global All-Industry Output Index rose to 54.4 in December from 54.1 in November as output growth accelerated in both the manufacturing and service sectors, underpinned by a steep increase in new business.

Global economic activity strengthens further

Economic activity increased at faster rates in China, the UK, India, and Australia. Growth slowed slightly in the US and Russia but remained solid in both cases. Meanwhile, economic activity in Brazil remained in the contraction territory.[50]

Chart 39. JP Morgan Global All-Industry Output Index

index points



*August 2017

Source: Markit Economics

US. Real GDP expanded by 2.3 percent on a seasonally adjusted y-o-y basis in Q3 2017, higher than the 2.2-percent growth rate in Q2 2017. On a q-o-q basis, real output growth rose slightly to 3.2 percent from 3.1 percent in the previous quarter. The q-o-q growth in real GDP reflected positive contributions from personal consumption expenditures, private inventory investment, nonresidential fixed investment, exports, federal government spending, and state and local government spending.[51]

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

[51] US Bureau of Economic Analysis, "Gross Domestic Product: Third Quarter 2017 (Third Estimate)," news release, 21 December 2017. https://www.bea.gov/newsreleases/national/gdp/2017/pdf/gdp3q17_3rd.pdf

Growth in the US economy holds firm

Meanwhile, the manufacturing PMI registered 59.7 in December, higher than the reading of 58.2 percent in November due to gains in new orders and production indexes.[52]

The unemployment rate was 4.1 percent in December, unchanged from the rate posted in November. Total nonfarm employment rose by 148,000 in December, with gains in health care, construction, and manufacturing. Meanwhile, on a y-o-y basis, inflation fell to 2.1 percent in December from 2.2 percent in November due primarily to the decrease in the gasoline price index.

The Thomson-Reuters/University of Michigan Index of Consumer Sentiment decreased to 95.9 in December from 98.5 in November.[53] The Conference Board Consumer Confidence Index likewise fell to 122.1 in December from 128.6 in November.[54] Consumers' optimism about the short-term outlook eased in December while consumers' expectations for the labor market were also less upbeat during the month.

Euro Area. On a q-o-q basis, real GDP growth in the euro area decreased slightly to 0.6 percent in Q3 2017 from 0.7 percent in Q2 2017. On a y-o-y basis, real GDP expanded at a faster rate of 2.6 percent in Q3 2017 from 2.4 percent in Q2 2017.[55]

Output growth in the euro area keeps its momentum

Meanwhile, the composite PMI for the euro area increased to 58.1 in December from 57.5 in November as stronger domestic demand and higher new export orders led to output growth in the manufacturing sector, while the increase in

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

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

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

[55] Eurostat news release 186/2017 dated 7 December 2017

new work spurred growth in service sector activity.[56]

Inflation in the euro area is expected to decrease to 1.4 percent in December from 1.5 percent in November due to lower energy price index.[57] The seasonally adjusted unemployment rate fell slightly to 8.7 percent in November from 8.8 percent in October.[58]

The European Commission's Economic Sentiment Indicator in the euro area rose to 116.0 in December from 114.6 in November due to stronger confidence in the services, retail trade, and construction sectors. Confidence in the industry sector and among consumers likewise improved during the month.

Japan. On a q-o-q basis, real GDP grew by 0.6 percent in Q3 2017, slower than the 0.7 percent expansion in Q2 2017. Meanwhile, on a y-o-y basis, real GDP expanded by 2.1 percent in Q3 2017, faster than the 1.6 percent growth in the previous quarter.[59] The slower q-o-q GDP growth in Japan was due mainly to weaker domestic private and public demand.

Manufacturing conditions in Japan improve

Meanwhile, the seasonally adjusted manufacturing PMI rose to 54.2 in December from 53.6 in November due to faster growth in new orders.[60]

Inflation was higher at 0.6 percent in November from 0.2 in October due primarily to the increase in the price index for fuel, light and water charges. The seasonally adjusted unemployment rate was at 2.7 percent in November, lower than the 2.8 percent recorded in October.

China. Real GDP in China expanded by 6.8 percent y-o-y in Q3 2017, lower than the 6.9-percent growth recorded in the previous quarter. The GDP expansion was driven mainly by the services industry. However, government's efforts to control the property market and debt risks tempered economic activity in China.

Indicators reflect stable Chinese economic activity

Meanwhile, the seasonally adjusted manufacturing PMI rose to 51.5 in December from 50.8 in November due to faster growth of output, total new work, and export sales during the month.[61]

Inflation rose to 1.8 percent in December from 1.7 percent in November due to an uptick in non-food prices.

India. Real GDP in India accelerated to 6.3 percent y-o-y in Q3 2017 from 5.7 percent in the previous quarter. The increase in the GDP growth was due mainly to the expansion in manufacturing; electricity, gas, water supply & other utility services; and trade, hotels, transport & communication and services related to broadcasting.[62]

Economic activity in India continues to expand

Meanwhile, the composite PMI rose to 53.0 in December from 50.3 in November as manufacturing new orders increased.

Inflation rose to 5.2 percent in December from 4.9 percent in November due to price increases in pan, tobacco, and intoxicants; clothing and footwear; housing; fuel and light; and miscellaneous items.

ASEAN Region. The Nikkei ASEAN Manufacturing PMI fell into contraction territory to 49.9 in December from 50.8 in November due to a softer increase in output and largely stagnant new order volumes.

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[56] Final Markit Eurozone PMI, http://www.markiteconomics.com/
[57] Flash Eurostat news release 1/2018 dated 5 January 2018
[58] Eurostat news release 4/2018 dated 9 January 2018
[59] Second Preliminary Estimate. Department of National Accounts, Economic and Social Research Institute, Cabinet Office. http://www/esri.cao.go.jp/
[60] Flash Nikkei Japan Manufacturing PMI, http://www.markiteconomics .com/
[61] Caixin China General Manufacturing PMI, http://www.markiteconomics.com/
[62] Ministry of Statistics and Programme Implementation. http://mospi.nic.in/

Manufacturing conditions weaken in the ASEAN region

In December, output expanded faster in Vietnam, while a slower rate of expansion was reported in Myanmar. Output in Thailand expanded at a steady pace, while Malaysia, Indonesia, and Singapore slid into contraction.[63]

Policy Actions by Central Banks. On 2 November 2017, the Bank of England (BOE) increased its Bank Rate by 25 bps to 0.5 percent to temper inflation amid falling unemployment. Unemployment in the UK has fallen to a 42-year low and the Monetary Policy Committee (MPC) judges that the level of remaining slack is limited. The MPC likewise noted that the global economy is growing slowly, domestic financial conditions are highly accommodative and consumer confidence has remained resilient. The MPC judges that it is now appropriate to tighten monetary policy modestly to allow for a sustainable return of inflation to the target, with all MPC members agreeing that any future increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

The US Federal Reserve and Bank of England tighten their monetary policy settings

On 13 December 2017, the US Fed decided to raise the target range for the federal funds rate to 1.25–1.5 percent in line with market expectations. The Federal Open Market Committee (FOMC) noted that the stance of monetary policy remains accommodative and that gradual adjustments will support strengthening labor market and economic activity. The move is seen to remain consistent with a gradual rise in inflation to the target level, even as inflation developments will be carefully monitored. The US Fed also maintained that the timing and size of future adjustments will remain data-driven and proceed at a gradual pace.

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

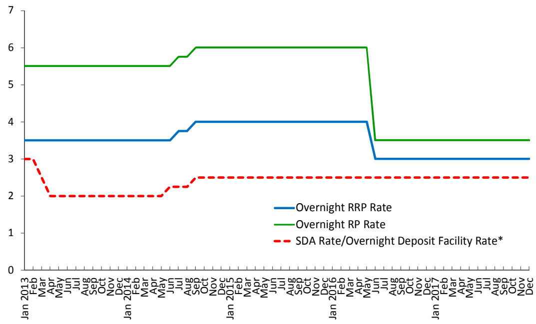
V. Monetary Policy Developments

During the monetary policy meetings on 9 November and 14 December, 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 is based on its assessment that the outlook for the inflation environment has been broadly unchanged. Latest baseline forecasts remain within the target range of 3.0 percent ± 1 percentage point for 2018-2019. Inflation expectations also continue to be firmly anchored to the target over the policy horizon.

Chart 40. 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 overall balance of risks to the inflation outlook remains tilted toward the upside due in part to possible higher crude oil prices. While there may be potential transitory effects on consumer prices from the proposed tax reform program, various mitigation measures and the resulting improvement in output and productivity are also expected to temper the impact on inflation over the medium term. Meanwhile, the proposed reforms in the rice industry involving the replacement of quantitative restrictions with tariffs and the deregulation of rice imports could serve to temper inflation. At the same time, geopolitical tensions and lingering uncertainty over macroeconomic policies in advanced economies continue to pose downside risks to the near-term prospects for global economic growth. Nonetheless, the Monetary Board emphasized that prospects for domestic economic activity are likely to remain firm owing to buoyant consumer and business sentiment and ample liquidity. Moreover, as credit continues to expand in line with output growth, the Monetary Board remains watchful over evolving liquidity and credit conditions and their implications for price and financial stability.

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

VI. Inflation Outlook

BSP Inflation Forecasts

The BSP's latest forecasts[64] show that inflation would likely settle above the midpoint of the government's target range of 3.0 percent ± 1.0 percentage point in 2018 to 2019.

Inflation is expected to settle above the midpoint of the target range in 2018 to 2019

Demand Conditions. Outturns for key demand indicators attest to the view of robust domestic real sector activity. The country's real GDP growth accelerated to 6.9 percent in Q3 2017 from 6.7 percent growth in the previous quarter. Economic activity was mainly driven by stronger government spending and the recovery in external trade. This brought the first three quarter real output growth to 6.7 percent.

Prospects for the domestic economy remain favorable. Growth is expected to settle within the Development Budget Coordination Committee (DBCC)-approved medium-term growth targets of 6.5-7.5 percent in 2017 and 7.0-8.0 percent for 2018-2022. The sustained expansion in domestic economic activity could be bolstered by robust growth in the services sector and the recovery in merchandise trade. Private demand is seen to remain firm, aided mainly by steady 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. Capacity utilization for the manufacturing sector suggests more than half of all major manufacturing sectors operating at above 80.0 percent. The composite PMI also remains firmly above the 50-point mark as of October 2017, indicating sustained expansion across all sectors.

The optimistic economic outlook has also been reflected in the results of the BSP expectations surveys as business and consumer confidence turned more upbeat in Q4 2017. This is in line with the expectation of brisker operations during the 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 or slightly higher 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 2018 before easing in the medium term.[65,66]

In the domestic front, *palay* production could increase by 6.3 percent while corn production could decline by 5.4 percent in Q4 2017 based on standing crop estimates. The continued growth in *palay* production could be attributed to sufficient rainfall conditions during the early planting stages and government programs providing support to high-yielding varieties and fertilizer availability.[67]

International crude oil prices increased slightly compared to the previous quarter's level mainly due to the decision of the OPEC and several non-OPEC producers to extend their production cut agreement until December 2018 with further

[64] The inflation forecast path in this report refers to the forecasts presented during the monetary policy meeting on 14 December 2017. In the discussion, these are compared to the forecasts presented in the Q3 2017 Inflation Report which correspond to the forecasts in the 21 September 2017 monetary policy meeting.

[65] IMF, World Economic Outlook, October 2017, available online at http://www.imf.org

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

[67] PSA, Rice and Corn Situation Outlook Update, 1 September 2017, available online at http://www.psa.gov.ph

production adjustments to be considered in mid-2018.

The latest futures prices indicate that global crude oil prices could remain slightly above US$50.00 per barrel in 2018-2019. The EIA expects Brent crude oil prices to average above US$55.00 per barrel in 2018. Similarly, forecasts by Oxford Economics and World Bank point to a moderate rise in global crude oil prices in 2018. Meanwhile, IMF projects crude oil price to remain close to US$50.00 per barrel. [68, 69,70, 71]

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.[72]

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.[73]

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 January 2018 to December 2019;

2) NG fiscal deficits for 2018 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 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.

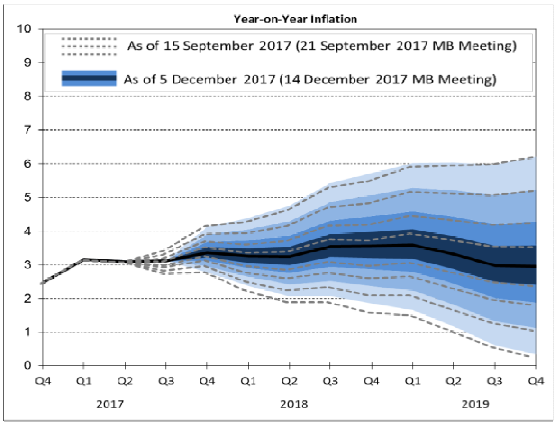
[68] EIA, Short-Term Energy Outlook, November 2017, available online at http://www.eia.gov
[69] IMF, World Economic Outlook, October 2017, available online at http://www.imf.org
[70] Oxford Economics, Commodity Price Forecasts, November 2017
[71] World Bank, Commodity Markets Outlook, October 2017, available online at http://www.worldbank.org
[72] 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).
[73] Based on the seasonally-adjusted GDP growth

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.

Compared to the previous inflation report, the latest fan chart presents a slight upward shift in the inflation projection for 2018-2019. The slight increase in the projected inflation path could be attributed mainly to the rise in global crude oil prices.

Chart 41. Inflation Projection [74]



Source: BSP estimates

The BSP's review of current inflation dynamics suggests that the risks surrounding the inflation outlook remains tilted to the upside. This assessment is depicted in the latest fan chart, wherein the projection bands above the central projection are greater than the bands below it.

The transitory impact of the government's fiscal reform program and pending petitions for adjustments in transport fares and electricity rates are the main upside risks to inflation. Meanwhile, the slower global economic growth due to policy uncertainty in advanced economies and geopolitical tensions as well as the proposed reform in the rice industry involving the replacement of quantitative restrictions with tariffs and the deregulation of rice imports continue to be the main downside risks to inflation.

The TRAIN bill was signed into law on 19 December 2017. The package consists of a reduction in personal income taxes, higher excise tax on petroleum products and coal, higher automobile tax, higher tax on sugar-sweetened beverages, VAT-base expansion, uniform donor and estate tax, higher excise tax on non-metallic minerals and quarry resources, adjustment in the excise tax of tobacco products, doubled documentary stamp tax rates on documents, instruments, loan agreements and papers, higher final tax on foreign currency deposit units and excise tax on cosmetic procedures. 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 future 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 greater aggregate investment and potential output. The ensuing productivity gains would moderate inflationary pressures over the medium term.

[74] 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 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.

The risks to inflation outlook remain tilted on the upside

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.

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 due to the policy normalization of Federal Reserve, the imposition of inward looking policies as well as geopolitical risks could lead to slower global trade and thereby lead to downward price pressures.

In addition, the proposed reform in the rice industry involving the replacement of quantitative restrictions with tariffs and the deregulation of rice imports could also pose downside risk to inflation. The proposed removal of quantitative restriction on rice imports could lead to lower domestic rice prices, which account for 8.9 percent of the CPI basket.

Implications for the Monetary Policy Stance

The prevailing inflation outlook supports keeping the policy rates steady. Moreover, inflation dynamics remain manageable given well-contained inflation expectations over the policy horizon. On output conditions, the positive outlook for economic activity is expected to continue on the strength of both domestic and external demand. In addition, prevailing credit and liquidity conditions remain in line with the overall requirements of the economy.

Nevertheless, 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. In particular, price pressures could initially develop with the eventual implementation of the tax reform program in 2018. Although movements in food and oil prices due to changes in tax rates form part of the BSP's explanation clauses under inflation targeting, the BSP will closely watch indications of increasing underlying inflationary pressures and risks of second-round effects in the near term.

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.
		2009	
29 Jan 2009	5.00	7.00	The MB decided to reduce the BSP's key policy interest rates by another 50 bps to 5 percent for the overnight borrowing or RRP facility and 7 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also adjusted accordingly. Latest baseline forecasts showed a decelerating inflation path over the policy horizon, with inflation falling within target by 2010. The MB based its decision on the latest inflation outlook which shows inflation falling within the target range for 2009 and 2010. The Board noted that the balance of risks to inflation is tilted to the downside due to the softening prices of commodities, the slowdown in core inflation, significantly lower inflation expectations, and moderating demand.
5 Mar 2009	4.75	6.75	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 4.75 percent for the overnight borrowing or RRP facility and 6.75 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. Given possible upside risks to inflation, notably the volatility in oil prices and in exchange rates, increases in utility rates, and potential price pressures coming from some agricultural commodities, the MB decided that a more measured adjustment of policy rates was needed.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
16 Apr 2009	4.50	6.50	The MB reduced key policy rates by another 25 bps to 4.5 percent for the overnight borrowing or RRP facility and 6.5 percent for the overnight lending or RP facility, effective immediately. This rate cut brings the cumulative reduction in the BSP's key policy rates to 150 bps since December last year. The current RRP rate is the lowest since 15 May 1992. Meanwhile, the interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. In its assessment of macroeconomic conditions, the MB noted that the latest baseline inflation forecasts indicated a lower inflation path over the policy horizon, with average inflation expected to settle within the target ranges in 2009 and 2010. In addition, the MB considered that the risks to inflation are skewed to the downside given expectations of weaker global and domestic demand conditions and a low probability of a significant near-term recovery in commodity prices.
28 May 2009	4.25	6.25	The MB decided to reduce the BSP's key policy interest rates by another 25 bps to 4.25 percent for the overnight borrowing or RRP facility and 6.25 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. Baseline forecasts indicated a lower inflation path over the policy horizon, with average inflation expected to settle within the target ranges in 2009 and 2010. In addition, the Monetary Board considered that, on balance, the risks to inflation are skewed to the downside given expectations of weaker global and domestic demand conditions and a low probability of a significant near-term recovery in commodity prices.
9 Jul 2009	4.00	6.00	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 4 percent for the overnight borrowing or RRP facility and 6 percent for the overnight lending or RP facility, effective immediately. The interest rates on term RRPs, RPs, and SDAs were reduced accordingly. This is the sixth time since December 2008 that the BSP has cut its policy interest rates.
20 Aug 2009 **1 Oct 2009** **5 Nov 2009** **17 Dec 2009**	4.00	6.00	The MB kept key policy rates unchanged at 4 percent for the RRP facility and 6 percent for the overnight lending RP facility. The decision to maintain the monetary policy stance comes after a series of policy rate cuts since December 2008 totaling 200 bps and other liquidity enhancing measures.
		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)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
2 0 1 1			
10 Feb 2011	4.00	6.00	The MB decided to keep the BSP's key policy interest rates steady at 4 percent for the overnight borrowing or RRP facility and 6 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged.
24 Mar 2011	4.25	6.25	The MB decided to increase by 25 bps the BSP's key policy interest rates to 4.25 percent for the overnight borrowing or RRP facility and 6.25 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also raised accordingly. The MB's decision was based on signs of stronger and broadening inflation pressures as well as a further upward shift in the balance of inflation risks. International food and oil prices have continued to escalate due to the combination of sustained strong global demand and supply disruptions and constraints.
5 May 2011	4.50	6.50	The MB decided to increase the BSP's key policy interest rates by another 25 bps to 4.5 percent for the overnight borrowing or RRP facility and 6.5 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also raised accordingly. Baseline inflation forecasts continue to suggest that the 3-5 percent inflation target for 2011 remains at risk, mainly as a result of expected pressures from oil prices.
16 Jun 2011	4.50	6.50	The MB decided to keep policy rates steady at 4.5 percent for the overnight borrowing or RRP facility and 6.5 percent for the overnight lending or RP facility. At the same time, the Board decided to raise the reserve requirement on deposits and deposit substitutes of all banks and non-banks with quasi-banking functions by one percentage point effective on Friday, 24 June 2011. The MB's decision to raise the reserve requirement is a preemptive move to counter any additional inflationary pressures from excess liquidity.
28 Jul 2011	4.50	6.50	The MB maintained the BSP's key policy interest rates at 4.5 percent for the overnight borrowing or RRP facility and 6.5 percent for the overnight lending or RP facility. At the same time, the Board increased anew the reserve requirement on deposits and deposit substitutes of all banks and non-banks with quasi-banking functions by one percentage point effective on 5 August 2011. The MB's decision to raise the reserve requirement anew is a forward-looking move to better manage liquidity.
8 Sep 2011 **20 Oct 2011** **1 Dec 2011**	4.50	6.50	The MB decided to keep the overnight policy rates steady. At the same time, the reserve requirement ratios were kept unchanged.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent) RRP Overnight	RP Overnight	Monetary Policy Decisions
2 0 1 2			
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.
			2013
24 Jan 2013	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs and RPs were also maintained accordingly. The reserve requirement ratios were kept steady as well. At the same time, the MB decided to set the interest rates on the SDA facility at 3.00 percent regardless of tenor, effective immediately, consistent with the BSP's continuing efforts to fine-tune the operation of its monetary policy tools.
14 Mar 2013	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rate on the RRP was also set at 3.50 percent regardless of tenor. Following its previous decision to rationalize the SDA facility in January 2013, the MB further reduced the interest rates on the SDA facility by 50 bps to 2.50 percent across all tenors effective immediately.
25 Apr 2013	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rate on the RRP was also set at 3.50 percent regardless of tenor. Meanwhile, the SDA rate was further reduced by 50 basis points to 2.0 percent across all tenors.
13 Jun 2013 **25 Jul 2013** **12 Sep 2013** **24 Oct 2013** **12 Dec 2013**	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained.

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
2017			
9 Feb 2017 **23 Mar 2017** **11 May 2017** **22 Jun 2017** **10 Aug 2017** **21 Sep 2017** **9 Nov 2017** **14 Dec 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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