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# INFLATION REPORT

# Q4 2018

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 2018-2020 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 10 January 2019.

**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 Philippine Statistical Authority (PSA). The policy target is set by the Development Budget Coordination Committee (DBCC)[2] in consultation with the BSP. The inflation target for 2018-2020 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] During its meeting on 2 July 2018, 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.

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## 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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## 2019 SCHEDULE OF MONETARY POLICY MEETINGS, INFLATION REPORT PRESS CONFERENCE AND PUBLICATION OF MB HIGHLIGHTS

| 2019 | Advisory Committee (AC) Meeting | Monetary Board (MB) Meeting | MB Highlights Publication | Inflation Report (IR) Press Conference |
|---|---|---|---|---|
| **Jan** | | | 10 (Thu)<br>(13 Dec 2018 MB meeting) | 18 (Fri)<br>(Q4 2018 IR) |
| **Feb** | 1 (Fri)<br>(AC Meeting No. 1) | 7 (Thu)<br>(MB Meeting No. 1) | | |
| **Mar** | 15 (Fri)<br>(AC Meeting No. 2) | 21 (Thu)<br>(MB Meeting No. 2) | 7 (Thu)<br>(7 Feb 2019 MB meeting) | |
| **Apr** | | | 17 (Thu)<br>(21 Mar 2019 MB meeting) | 26 (Fri)<br>(Q1 2019 IR) |
| **May** | 3 (Fri)<br>(AC Meeting No. 3) | 9 (Thu)<br>(MB Meeting No. 3) | | |
| **Jun** | 14 (Fri)<br>(AC Meeting No. 4) | 20 (Thu)<br>(MB Meeting No. 4) | 6 (Thu)<br>(9 May 2019 MB meeting) | |
| **Jul** | | | 18 (Thu)<br>(20 Jun 2019 MB meeting) | 19 (Fri)<br>(Q2 2019 IR) |
| **Aug** | 2 (Fri)<br>(AC Meeting No. 5) | 8 (Thu)<br>(MB Meeting No. 5) | | |
| **Sep** | 20 (Fri)<br>(AC Meeting No. 6) | 26 (Thu)<br>(MB Meeting No. 6) | 5 (Thu)<br>(8 Aug 2019 MB meeting) | |
| **Oct** | | | 24 (Thu)<br>(26 Sep 2019 MB meeting) | 25 (Fri)<br>(Q3 2019 IR) |
| **Nov** | 8 (Fri)<br>(AC Meeting No. 7) | 14 (Thu)<br>(MB Meeting No. 7) | | |
| **Dec** | 6 (Fri)<br>(AC Meeting No. 8) | 12 (Thu)<br>(MB Meeting No. 8) | 12 (Thu)<br>(14 Nov 2019 MB meeting) | |

## List of Acronyms, Abbreviations, and Symbols

| | |
|---|---|
| AFP | Armed Forces of the Philippines |
| AHFF | Agriculture, Hunting, Forestry and Fishing |
| AONCR | Areas Outside the National Capital Region |
| BAP | Bankers Association of the Philippines |
| BES | Business Expectations Survey |
| BI | Bank of Indonesia |
| BIR | Bureau of Internal Revenue |
| BOC | Bureau of Customs; Bank of Canada |
| BOK | Bank of Korea |
| BOT | Bank of Thailand |
| BPO | Business Process Outsourcing |
| BTr | Bureau of the Treasury |
| CALABARZON | Cavite, Laguna, Batangas, Rizal and Quezon |
| CAMPI | Chamber of Automotive Manufacturers of the Philippines, Inc. |
| CAR | Capital Adequacy Ratio;<br>Cordillera Administrative Region |
| CBD | Central Business District |
| CDS | Credit Default Swaps |
| CES | Consumer Expectations Survey |
| CI | Confidence Index |
| CPI | Consumer Price Index |
| DBCC | Development Budget Coordination Committee |
| DBM | Department of Budget and Management |
| DI | Diffusion Index |
| DND | Department of National Defense |
| DOE | Department of Education |
| DOF | Department of Finance |
| DPWH | Department of Public Works and Highways |
| DSWD | Department of Social Welfare and Development |
| EIA | Energy Information Administration |
| EMBIG | Emerging Market Bond Index Global |
| ERC | Energy Regulatory Commission |
| FCD | Foreign Currency Deposit |
| FDI | Foreign Direct Investment |
| FOMC | Federal Open Market Committee |
| GDP | Gross Domestic Product |
| GIR | Gross International Reserve |
| GNI | Gross National Income |
| GNPL | Gross Non-Performing Loan |
| GOUR | Generation Over/Under Recovery |
| GS | Government Securities |
| GSED | Government Securities Eligible Dealer |
| IMF | International Monetary Fund |
| IMTS | International Merchandise Trade Statistics |
| IPP | Independent Power Producer |
| kWh | Kilowatt Hour |
| LEM | Loans Especially Mentioned |
| LFS | Labor Force Survey |
| LPG | Liquefied Petroleum Gas |
| LSOUR | Lifeline Subsidy Over/Under Recovery |
| MB | Monetary Board |
| MERALCO | Manila Electric Company |
| MISSI | Monthly Integrated Survey of Selected Industries |
| m-o-m | Month-on-Month |
| MTP | Major Trading Partner |
| NCR | National Capital Region |
| NEDA | National Economic and Development Authority |
| NEER | Nominal Effective Exchange Rate |
| NFA | Net Foreign Asset |
| NG | National Government |
| NGCP | National Grid Corporation of the Philippines |
| NIA | National Income Account |
| NNPL | Net Non-Performing Loans |
| NPC | National Power Corporation |
| ODF | Overnight Deposit Facility |
| OP | Office of the President |
| PCE | Personal Consumption Expenditure |
| PISM | Philippine Institute for Supply Management |
| PMI | Purchasing Managers' Index |
| ppt | Percentage Point |
| PSA | Philippine Statistics Authority;<br>Power Supply Agreement |
| PSALM | Power Sector Assets and Liabilities Management |
| PSEi | Philippine Stock Exchange Composite Index |
| PUB | Public Utility Bus |
| QBs | Quasi-Banks |
| q-o-q | Quarter-on-Quarter |
| RBs | Rural Banks |
| REER | Real Effective Exchange Rate |
| RP | Repurchase |
| RR | Reserve Requirement |
| RREL | Residential Real Estate Loan |
| RREPI | Residential Real Estate Price Index |
| RRP | Reverse Repurchase |
| SBL | Substandard or Below Loan |
| SDA | Special Deposit Account |
| SEC | Securities and Exchange Commission |
| SLOS | Senior Bank Loan Officers' Survey |
| SLOUR | System Loss Over/Under Recovery |
| SME | Small and Medium Enterprise |
| TAFPPC | True-up Adjustments of Fuel and Purchased Power Cost |
| TAFxA | True-up Adjustments of Foreign Exchange Related Costs |
| TBs | Thrift Banks |
| TDF | Term Deposit Facility |
| TLP | Total Loan Portfolio |
| TOUR | Transmission Over/Under Recovery |
| TPI | Trading Partner Index |
| TPI-A | Trading Partner Index in Advanced Countries |
| TPI-D | Trading Partner Index in Developing Countries |
| U/KBs | Universal and Commercial Banks |
| VaPI | Value of Production Index |
| VoPI | Volume of Production Index |
| WB | World Bank |
| WESM | Wholesale Electricity Spot Market |
| y-o-y | Year-on-Year |
| y-t-d | Year-to-Date |

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# Overview

**Headline inflation slows down after peaking in Q3 2018.** Headline inflation in Q4 2018 moderated to 5.9 percent from 6.2 percent in the previous quarter, indicating that inflation has reached its peak in Q3 2018. This brought the full year average inflation to 5.2 percent, which is above the National Government's (NG) announced target range of 3.0 percent ± 1.0 percentage point (ppt) for the year.

## Price pressures eased in Q4 2018 after peaking in the previous quarter

The official core inflation rose to 4.9 percent year-on-year (y-o-y) in Q4 2018 from 4.7 percent in Q3 2018. In terms of the BSP-computed alternative measures of core inflation, the weighted median, trimmed mean, and net of volatile items measures of core inflation were also higher at 5.2 percent (from 4.6 percent), 5.2 percent (from 5.0 percent), and 4.9 percent (from 4.7 percent), respectively. The number of CPI items with inflation rates greater than the threshold of 4.0 percent (the upper end of the 2018 inflation target) rose further to 97 items in Q4 2018 from 88 items in the previous quarter, majority of which are food commodities. Collectively, these items accounted for more than half (55.9 percent) of the CPI basket, broadly similar to the quarter-ago share of 56 percent.

**Inflation expectations are higher for 2018 but lower for 2019-2020.** Results of the BSP's survey of private sector economists for December 2018 showed that mean inflation forecast for 2018 was higher relative to the results in September 2018, while mean inflation forecasts were lower for 2019 and 2020. The survey on private sector economists for December 2018 showed that the mean inflation forecast for 2018 rose to 5.4 percent from 5.3 percent in the September 2018 survey. By contrast, mean inflation forecasts for 2019 and 2020 decreased to 4.1 percent and 3.8 percent (from 4.3 percent and 3.9 percent in the previous survey round), respectively.

While analysts expect inflation to remain elevated in the near term, their assessment of the balance of risks to the inflation outlook has shifted toward the downside. Possible downside risks to inflation include declining global oil prices; easing prices of food and non-food items; implementation of non-monetary measures to address domestic food supply issues such as rice importation; the recent and expectations of further policy rate hikes by the BSP; and the recovery of the Philippine peso against the US dollar.

**The domestic economy grew at a slower pace.** The Philippine economy grew by 6.1 percent in Q3 2018. This is lower than the 6.2-percent expansion a quarter ago and 7.2-percent growth a year-ago. On the expenditure side, the slowdown in the Q3 2018 Gross Domestic Product (GDP) growth was due to lower household consumption. Meanwhile, government spending accelerated while gross fixed capital formation continued to grow at double-digit rate. On the production side, the lower GDP growth for the quarter was attributed to the agriculture, hunting, forestry and fishing and the industry sectors.

## Real GDP growth is slightly lower in Q3 2018

High-frequency indicators of domestic activity continue to present mixed signals. The composite Purchasing Managers' Index (PMI) remains firmly above the 50-point mark, pointing to sustained expansion across all sectors. Capacity utilization for the manufacturing sector also suggests that more than half of major manufacturing sectors operate at above 80.0 percent. Energy sales also accelerated. However, vehicle sales have contracted, business outlook has turned less optimistic, and consumer confidence continues to weaken.

**Global economic growth slightly decelerates.** The JP Morgan Global All-Industry Output Index declined to 52.7 in December from 53.2 in November due to a slight decrease in new orders. The US remained one of the best performers although output growth eased slightly from November. The Euro area was the main source of the slowdown, as rates of expansion decelerated in Germany and Spain. In Japan, real GDP contracted by 0.6 percent (revised) in Q3 2018 from a growth of 0.7 percent (revised) in Q2 2018, with the contraction driven by decline in both private and public demand. In China, expansion of real GDP eased to 6.5 percent y-o-y in Q3 2018 from 6.7 percent in Q2 2018 as the government's efforts to tackle debt risks and the country's trade war with the United States began to weigh on growth.

**The domestic financial system remains healthy.** Money supply continued to increase due mainly to sustained demand for credit. Outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, increased by 16.8 percent y-o-y as of November 2018. The sustained increase in bank lending was due largely to loans for production activities.

The peso appreciated in Q4 2018 by 0.52 percent to ₱53.26 from the previous quarter's average of ₱53.54/US$1. The peso's appreciation was due mainly to improving domestic inflation data and strong remittance inflow during the review quarter. However, on a year-to-date (y-t-d) basis, the peso, along with other regional currencies, depreciated against the US dollar by 5.04 percent to close at ₱52.58/US$1 on 28 December 2018.

The country's 5-year sovereign credit default swap (CDS) spread increased to 87 bps from its end-September level of 77 bps. Against other neighboring economies, the Philippine CDS spread stood narrower than Indonesia's 138 bps and Malaysia's 110 bps, but wider than Thailand's 46 bps and Korea's 39 bps spreads.

## The Philippine banking system remains healthy, with asset quality indicators remaining positive and capital adequacy ratios higher than international standards.

Preliminary results of the Q4 2018 Senior Bank Loan Officers' Survey (SLOS) showed that most of the respondent banks continued to maintain their credit standards for loans to both enterprises and households.

**The BSP raises key policy rates in Q4 2018.** At its monetary policy meeting on 15 November 2018, the BSP raised the key policy rate by 25 bps to 4.75 percent for the overnight reverse repurchase or RRP facility. The interest rates on the overnight lending and deposit facilities were likewise raised accordingly.

Meanwhile, in deciding to maintain the BSP's monetary policy settings at its monetary policy meeting on 13 December 2018, the BSP noted that the latest inflation forecasts show a lower path over the policy horizon, with inflation settling within the target band of 3.0 percent ± 1.0 ppt point for 2019-2020. Recent headline inflation readings indicate signs of receding price pressures as constraints on food supply continue to ease with the implementation of various non-monetary measures. Inflation expectations have also steadied given the decline in international crude oil prices and the stabilization of the peso.

## The BSP raised the key interest rate early in the quarter.

**On the basis of new information in the fourth quarter, the BSP now has some latitude to allow the monetary policy adjustments throughout 2018** to work their way through the traditional channels of monetary policy. Latest baseline projections indicate a within-target inflation trajectory in 2019 and 2020, as inflation momentum continues to slow down owing to the decline in international crude oil prices, the normalization of food supply conditions, and the stabilization of the exchange rate. Inflation expectations also appear to have eased, supported by the recent policy actions of the BSP.

Given these developments, the BSP will continue to gauge the impact of its monetary policy responses on domestic economic conditions, as monetary policy works with long and variable lags. At the same time, the implementation of non-monetary measures, including the provisions under the rice tariffication bill, are expected to continue to alleviate the impact of supply-side factors on inflation. The BSP remains vigilant against developments that could affect the outlook for inflation and financial stability, including those emanating from external forces such as tighter global financial conditions and lingering geopolitical risks. Policy communications will also continue to be geared toward anchoring the public's inflation expectations, with the message emphasizing authorities' readiness to undertake further adjustments in the policy interest rate as necessary to safeguard price stability.

# I. Inflation and Real Sector Developments

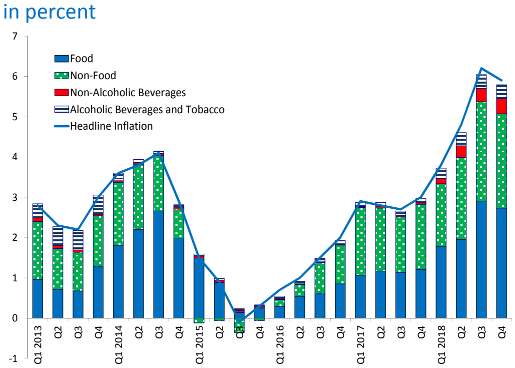
## Prices

**Headline inflation rises.** Headline inflation in Q4 2018 moderated to 5.9 percent from 6.2 percent in the previous quarter, indicating that inflation has reached its peak in Q3 2018.

> Price pressures ease in Q4 2018 after peaking in the previous quarter

This brought the full year average inflation to 5.2 percent, which is above the NG's announced target range of 3.0 percent ± 1.0 ppt for the year.

**Chart 1. Quarterly Headline Inflation** (2012=100)
in percent




Source: Philippine Statistical Authority (PSA), BSP

**Core Inflation.** By contrast, core inflation—which measures generalized price pressures by excluding volatile items such as food and energy—rose to 4.9 percent y-o-y in Q4 2018 from 4.7 percent in Q3 2018.

> Official core inflation is higher in Q4 2018

In terms of the BSP-computed alternative measures for core inflation, the weighted median, trimmed mean, and net of volatile items measures of core inflation were also higher at 5.2 percent (from 4.6 percent), 5.2 percent (from 5.0 percent), and 4.9 percent (from 4.7 percent), respectively.

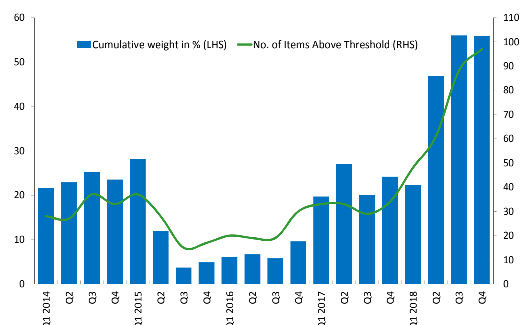
**Table 1. Alternative Core Inflation Measures**
quarterly averages of year-on-year change

| Quarter | Official Headline Inflation | Official Core Inflation | Trimmed Mean [1] | Weighted Median [2] | Net of Volatile Items [3] |
|---|---|---|---|---|---|
| **2014** | **3.6** | **2.6** | **3.3** | **2.8** | **2.8** |
| Q1 | 3.6 | 2.8 | 3.0 | 2.4 | 2.4 |
| Q2 | 3.8 | 2.6 | 3.4 | 3.0 | 2.6 |
| Q3 | 4.1 | 2.7 | 3.6 | 3.2 | 3.0 |
| Q4 | 2.9 | 2.1 | 3.1 | 2.6 | 3.0 |
| **2015** | **0.7** | **1.0** | **1.5** | **1.7** | **2.2** |
| Q1 | 1.5 | 1.3 | 2.6 | 2.7 | 2.9 |
| Q2 | 0.9 | 1.3 | 1.7 | 1.7 | 2.4 |
| Q3 | -0.1 | 0.8 | 0.9 | 1.3 | 1.8 |
| Q4 | 0.3 | 0.8 | 0.9 | 1.2 | 1.8 |
| **2016** | **1.3** | **1.6** | **1.2** | **1.3** | **1.9** |
| Q1 | 0.7 | 1.0 | 0.8 | 1.0 | 1.5 |
| Q2 | 1.0 | 1.2 | 1.1 | 1.4 | 1.8 |
| Q3 | 1.5 | 1.7 | 1.4 | 1.3 | 2.0 |
| Q4 | 2.0 | 2.2 | 1.6 | 1.5 | 2.3 |
| **2017** | **2.9** | **2.4** | **2.2** | **1.8** | **2.7** |
| Q1 | 2.9 | 2.7 | 2.1 | 1.9 | 2.6 |
| Q2 | 2.8 | 2.5 | 2.3 | 1.7 | 2.8 |
| Q3 | 2.7 | 2.3 | 2.1 | 1.6 | 2.7 |
| Q4 | 3.0 | 2.4 | 2.3 | 1.7 | 2.7 |
| **2018** | **5.2** | **4.2** | **4.2** | **4.1** | **4.5** |
| Q1 | 3.8 | 3.0 | 2.9 | 2.8 | 3.8 |
| Q2 | 4.8 | 3.8 | 3.6 | 3.8 | 4.3 |
| Q3 | 6.2 | 4.7 | 5.0 | 4.6 | 4.7 |
| **Q4** | **5.9** | **4.9** | **5.2** | **5.2** | **4.9** |

[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, vegetables sugar, jam, honey, chocolate, and confectionery, electricity, gas, fuels and lubricants for personal transport equipment, and passenger transport by road, which represents 29.5 percent of all items.
Source: PSA, BSP estimates

The number of CPI items with inflation rates greater than the threshold of 4.0 percent (the upper end of the 2018 inflation target) rose further to 97 items in Q4 2018 from 88 items in the previous quarter, majority of which are food commodities.

**Chart 2. CPI Items with Inflation Rates Above Threshold** (2012=100)




Source: PSA, BSP staff estimates

Collectively, these items accounted for more than half (55.9 percent) of the CPI basket, broadly similar to the quarter-ago share of 56 percent.

**Food Inflation.** Food inflation moderated to 7.7 percent year-on-year in Q4 2018 from 8.2 percent in the previous quarter and 3.4 percent in Q4 2017 as supply conditions improved for key food items.

## Food inflation moderates in Q4 2018

Inflation rate for large-weighted commodities like meat, fish, fruit, and vegetables decelerated during the quarter. On the other hand, rice inflation rose to 8.2 percent in Q4 2018 from 7.5 percent in the previous quarter although a slowdown was apparent in the last two months of 2018 (November-December) due to the ongoing harvest season and arrival of rice imports. Inflation for non-alcoholic beverages remained at double-digit rates in Q4 2018 at 12.9 percent, reflecting the implementation of higher excise tax on sweetened beverages. Meanwhile, inflation rate for alcoholic beverage and tobacco was broadly steady in Q4 2018.

**Table 2. Inflation Rates for Selected Food Items**
quarterly averages in percent (2012=100)

| Commodity | 2017 | | | | 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| **Food and Non-Alcoholic Beverages** | **2.9** | **3.1** | **2.9** | **3.3** | **5.0** | **5.9** | **8.5** | **8.0** |
| Food | 3.0 | 3.3 | 3.2 | 3.4 | 5.0 | 5.5 | 8.2 | 7.7 |
| Bread and Cereals | 0.9 | 1.1 | 1.0 | 1.1 | 2.8 | 4.2 | 6.6 | 7.1 |
| Rice | 1.0 | 1.1 | 0.9 | 0.9 | 2.6 | 4.4 | 7.5 | 8.2 |
| Corn | -3.4 | -4.6 | -2.2 | 4.2 | 9.7 | 13.7 | 11.3 | 4.9 |
| Meat | 2.4 | 4.9 | 4.6 | 5.6 | 6.4 | 5.0 | 7.3 | 6.4 |
| Fish | 5.0 | 7.7 | 8.3 | 8.9 | 12.2 | 11.7 | 12.4 | 12.0 |
| Milk, Cheese and Eggs | 2.3 | 2.4 | 2.2 | 2.1 | 2.1 | 2.1 | 2.7 | 2.9 |
| Oils and Fats | 4.6 | 4.9 | 4.5 | 4.3 | 4.0 | 3.2 | 3.8 | 4.8 |
| Fruit | 8.3 | 7.0 | 4.8 | 3.3 | 6.1 | 5.8 | 5.6 | 4.0 |
| Vegetables | 10.2 | 3.3 | 2.6 | 2.1 | 3.9 | 7.4 | 18.8 | 11.7 |
| Sugar, Jam, Honey, Chocolate and Confectionery | 1.1 | -0.4 | -1.2 | -1.9 | -1.4 | 1.4 | 8.9 | 10.4 |
| Food Products, N.E.C. | 0.7 | 0.0 | 0.5 | 0.9 | 2.0 | 3.2 | 4.3 | 5.4 |
| Non-Alcoholic Beverages | 0.9 | 0.9 | 1.1 | 1.2 | 4.6 | 9.9 | 11.5 | 12.9 |
| Alcoholic Beverages and Tobacco | 7.0 | 7.2 | 6.8 | 6.5 | 15.9 | 20.5 | 21.7 | 21.8 |

Source of Basic Data: PSA, BSP

**Non-Food Inflation.** Non-food inflation also eased in Q4 2018, driven primarily by lower international oil prices. Non-food inflation dropped to 3.9 percent in Q4 2018 from 4.1 percent in the previous quarter.

## Non-food inflation also eases

The slowdown in inflation rate could be traced mainly to rent and utilities[4] specifically, electricity, gas, and other fuels decelerated to 6.8 percent year-on-year in Q4 2018 from 10.6 percent in the previous quarter following a series of rollbacks in household liquefied petroleum gas (LPG). Likewise, lower international oil prices also exerted downward pressure on transport inflation as gasoline and diesel prices fell markedly during the quarter.

On the other hand, inflation for transport services increased in Q4 2018 to 5.0 percent from 2.6 percent in the previous quarter due to the transport fare hike of public utility bus (PUB) in November 2018.

Education inflation rate remained negative in Q4 2018, which could be traced to the significant decline in inflation rate for tertiary education following the government's free-tuition program for public tertiary education.

**Table 3. Inflation Rates for Selected Non-Food Items**
quarterly averages in percent (2012=100)

| Commodity | 2017 | | | | 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| **Non-Food** | **2.8** | **2.6** | **2.3** | **2.7** | **2.6** | **3.4** | **4.1** | **3.9** |
| Clothing and Footwear | 2.8 | 2.7 | 2.3 | 1.9 | 2.0 | 2.2 | 2.4 | 2.6 |
| Housing, Water, Electricity, Gas and Other Fuels | 2.9 | 2.9 | 2.0 | 3.2 | 2.7 | 3.5 | 5.2 | 4.3 |
| Electricty, Gas, and Other Fuels | 5.2 | 5.9 | 3.6 | 7.2 | 4.3 | 6.2 | 10.6 | 6.8 |
| Furnishings, Household Equipment & Routine Household Maintenance | 2.4 | 2.4 | 2.2 | 2.1 | 2.4 | 2.9 | 3.5 | 3.8 |
| Health | 3.2 | 2.9 | 2.5 | 1.9 | 2.2 | 2.7 | 4.0 | 4.5 |
| Transport | 5.1 | 4.6 | 5.2 | 5.2 | 4.9 | 6.0 | 7.9 | 7.2 |
| Communication | 0.4 | 0.3 | 0.3 | 0.3 | 0.2 | 0.3 | 0.4 | 0.4 |
| Recreation and Culture | 1.0 | 1.0 | 1.6 | 1.3 | 1.4 | 1.4 | 2.1 | 3.2 |
| Education | 3.1 | 2.8 | 2.1 | 1.9 | 1.8 | 2.5 | -3.8 | -3.8 |
| Restaurant and Miscellaneous Goods and Services | 1.9 | 1.4 | 1.8 | 1.9 | 2.6 | 3.6 | 3.9 | 4.4 |

Source of Basic Data: PSA, BSP

**Private Sector Economists' Inflation Forecasts.** Results of the BSP's survey of private sector economists for December 2018 showed that mean inflation forecast for 2018 was higher relative to the results in September 2018, while mean forecasts were lower for 2019 and 2020.

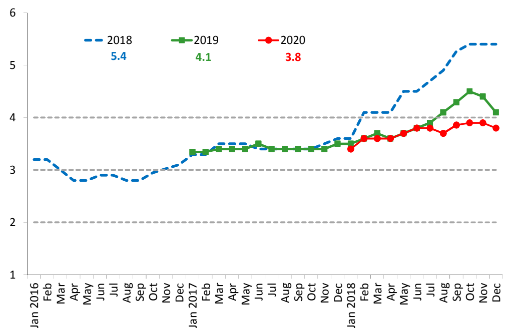
## Private sector economists' mean inflation forecasts for 2018 is higher but lower for 2019 and 2020

[4] This refers to the housing, water, electricity, gas, and other fuels in the CPI basket.

The survey on private sector economists for December 2018 showed that the mean inflation forecast for 2018 rose to 5.4 percent from 5.3 percent in the September 2018 survey.[5] By contrast, mean inflation forecasts for 2019 and 2020 decreased to 4.1 percent and 3.8 percent (from 4.3 percent and 3.9 percent in the previous survey round), respectively.

**Chart 3. BSP Private Sector Economists' Survey***

mean forecast for full year; in percent
January 2016 to February 2018 (2006=100)
March 2018 to December 2018 (2012=100)




*Based on forecasts provided by 27 respondents.
Source: BSP

While analysts expect inflation to remain elevated in the near term, their assessment of the balance of risks to the inflation outlook has shifted toward the downside. Possible downside risks to inflation include declining global oil prices; easing prices of food and non-food items which seemed to have stabilized; implementation of mitigating measures to address domestic food supply issues such as rice importation; the recent and expectations of further policy rate hikes by the BSP; and the recovery of the Philippine peso against the US dollar. On the other hand, the key upside risks to inflation are seen to emanate from potential volatile global oil prices; possible depreciation of the peso against the US dollar; increased demand due to upcoming school enrollment and during the holiday season; geopolitical risks such as trade tensions; and the expected rise in transport fares and utility rates.

**Table 4. Private Sector Forecasts for Inflation**

annual percentage change; December 2018 (2012=100)

| | 2018 | 2019 | | | 2020 |
|---|---|---|---|---|---|
| | FY | Q1 | Q2 | FY | FY |
| 1) Al-Amanah Islamic Bank | 6.00 | 5.50 | 5.20 | 5.00 | 4.50 |
| 2) Asia ING | 6.20 | 4.10 | 4.00 | 3.60 | 3.60 |
| 3) Banco de Oro | 5.40 | 5.50 | 4.60 | 4.00 | 4.00 |
| 4) Bangkok Bank | 5.40 | 5.00 | 4.00 | 4.50 | 4.00 |
| 5) Bank of Commerce | 5.27 | 5.38 | 4.52 | - | - |
| 6) Bank of China Ltd. | 6.00 | 6.00 | 6.00 | 5.50 | 5.50 |
| 7) Bank of the Philippine Islands | 5.30 | - | - | 3.60 | 3.30 |
| 8) Barclays | 5.20 | 4.80 | 4.30 | 3.70 | 3.50 |
| 9) Citibank | 5.20 | 5.00 | 4.10 | 3.50 | 2.90 |
| 10) Chinabank | 5.30 | 4.00 | 4.00 | 4.00 | 3.80 |
| 11) CTBC Bank | 5.30 | 5.50 | 5.30 | 4.90 | 4.20 |
| 12) Deutsche Bank | 4.80 | - | - | 4.40 | - |
| 13) Eastwest bank | 5.30 | 5.40 | 4.20 | 3.50 | 3.50 |
| 14) Korea Exchange Bank | 6.40 | 6.30 | 5.40 | 5.40 | 5.40 |
| 15) Land Bank of the Phils. | 5.20 | 3.70 | 2.60 | 2.10 | 2.50 |
| 16) Maybank | 5.26 | 4.90 | 4.55 | 4.50 | 3.90 |
| 17) Maybank-ATR KimEng | 5.30 | 5.00 | 4.40 | 4.10 | 3.00 |
| 18) Metrobank | 5.20 | - | - | 4.00 | - |
| 19) Mizuho | 5.20 | 5.00 | 4.50 | 4.60 | 4.40 |
| 20) Nomura | 5.20 | 4.90 | 4.10 | 3.70 | 3.20 |
| 21) RCBC | 5.20-5.30 | 4.20-4.70 | 3.80-4.30 | 3.50-4.00 | 3.50-4.00 |
| 22) Robinsons Bank | 5.30 | 4.90 | 4.50 | 4.00 | 3.80 |
| 23) Philippine Equity Partners | 5.30 | - | - | 4.10 | 3.70 |
| 24) Security Bank | 5.30 | 5.10 | 4.60 | 4.20 | 3.70 |
| 25) Standard Chartered | 5.30 | 4.80 | 4.00 | 3.50 | 4.20 |
| 26) Union Bank of the Phils. | 5.30 | 5.00 | 4.20 | 3.90 | 4.00 |
| 27) UBS | 5.30 | 4.80 | 4.40 | 4.00 | 3.30 |
| Median Forecast | 5.3 | 5.0 | 4.4 | 4.0 | 3.8 |
| **Mean Forecast** | **5.4** | **5.0** | **4.4** | **4.1** | **3.8** |
| High | 6.4 | 6.3 | 6.0 | 5.5 | 5.5 |
| Low | 4.8 | 3.7 | 2.6 | 2.1 | 2.5 |
| Number of Observations | 27 | 23 | 23 | 26 | 24 |
| **Government Target** | **3.0±1.00** | **3.0±1.00** | **3.0±1.00** | **3.0±1.00** | **3.0±1.00** |

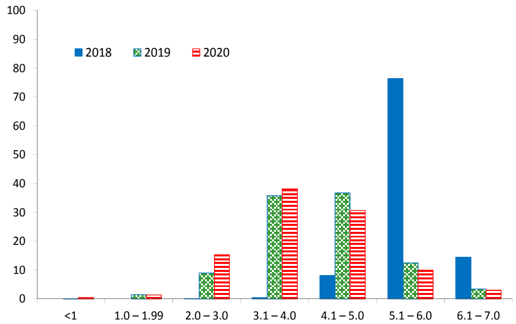
Source: BSP

Meanwhile, inflation is anticipated to moderate over the medium term and revert to within the inflation target band as global oil prices decelerate and as monetary and non-monetary policy measures to temper inflation take effect.

Based on the probability distribution of the forecasts provided by 23 out of 27 respondents, there is a 0.5-percent probability that average inflation for 2018 will settle between the 2-4 percent range, while there is a 99.5-percent chance that inflation will rise beyond 4 percent. For 2019, the respondents assigned a 44.8-percent probability that inflation will fall within the 2-4 percent target range and 53.6-percent chance that inflation will breach the upper end of the target.

[5] There were 27 respondents in the BSP's survey of private sector economists in December 2018. The survey was conducted from 7 to 10 December 2018.

**Chart 4. Probability Distribution for Analysts' Inflation Forecasts* (2018-2020)**




*Probability distributions were averages of those provided by 23 out of 27 respondents.
Source: BSP December 2018 Survey

Results of the December 2018 Consensus Economics inflation forecast survey for the Philippines showed that respondents expect 2018 inflation to increase to 5.3 percent from 5.0 percent in the September 2018 survey.[6] Similarly, mean inflation forecast for 2019 rose to 4.3 percent from 4.0 percent in the previous month's survey.

Based on the Q4 2018 BSP Business Expectations Survey (BES), a smaller number of respondents expect inflation to rise in the current quarter (from a diffusion index of 68.6 percent to 62.1 percent).

## Businesses and consumers still expect a breach in the upper end of target range

Likewise, the number of respondents that expect inflation to increase in the next quarter declined (from 50.1 percent to 24.1 percent). Firms expect the rate of increase in consumer prices to breach the upper end of the government's 2 to 4 percent inflation target range at 6.1 percent in Q4 2018 and 6 percent in Q1 2019.

Results of the Consumer Expectations Survey (CES) for Q4 2018 indicated that consumers expect inflation to breach the upper end of the government's target range of 2-4 percent in the next 12 months at 5.1 percent. This is higher than the 5-percent expected inflation rate in the Q3 2018 survey.

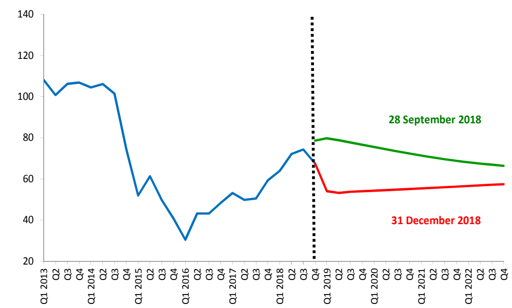
**Energy prices.** Dubai crude oil prices declined by 9.2 percent in Q4 2018 compared to the previous quarter due largely to higher oil production from major producers like Saudi Arabia, Russia, and the US.

## Energy prices fall in Q4 2018 due to higher production and concerns of possible weaker demand

At the same time, the US decision to grant waivers to majority of Iran oil consumers also exerted some downward pressure on global oil prices. Moreover, rising concerns over possible global economic slowdown also dampened demand expectations and contributed to lowering oil price.

Estimated futures prices of Dubai crude oil as of end-December 2018,[7] which are based on movements of Brent crude oil, showed a lower path for 2019-2022 compared to the estimates in the previous quarter.[8]

**Chart 5. Spot and Estimated Prices of Dubai Crude Oil**




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

In its December 2018 report, the US EIA estimates world oil supply to grow by 1.4 percent in 2019 to around 101.8 million barrels per day (mb/d). Global oil consumption is also expected to increase by 1.5 percent to 101.6 mb/d in 2019.[9]

On a cumulative basis, net adjustments of domestic petroleum prices remained generally positive for the full year 2018. Prices of gasoline,

[6] There were 19 respondents in the Consensus Economics' survey in December 2018.

[7] Future prices using Brent crude futures data. Taken as of 31 December 2018.

[8] Future prices derived using Brent crude futures data. Taken as of 28 September 2018 Source: BSP-staff calculations, Bloomberg.

[9] Source: US EIA Short-Term Energy Outlook (December 2018). https://www.eia.gov/outlooks/steo/

kerosene, and diesel went up on a net basis by ₱1.50 per liter, ₱3.19 per liter, and ₱0.25 per liter, respectively. By contrast, household LPG prices decreased by ₱3.05 per liter in end-2018 compared to the end-2017 level.

**Table 5. Actual Adjustments in Domestic Oil Prices (in peso per liter)**

| Domestic Oil Products | Year-to-Date (December 2018) | | | | | |
|---|---|---|---|---|---|---|
| | Increase | | Decrease | | Net Adjustments | |
| | Number | Amount (₱/liter) | Number | Amount (₱/liter) | Number | Amount (₱/liter) |
| Gasoline | 26 | 30.69 | 25 | -29.19 | 1 | 1.50 |
| Kerosene | 27 | 22.61 | 22 | -19.42 | 5 | 3.19 |
| Diesel | 27 | 28.90 | 25 | -28.65 | 2 | 0.25 |
| LPG | 8 | 7.61 | 5 | -10.66 | 3 | -3.05 |

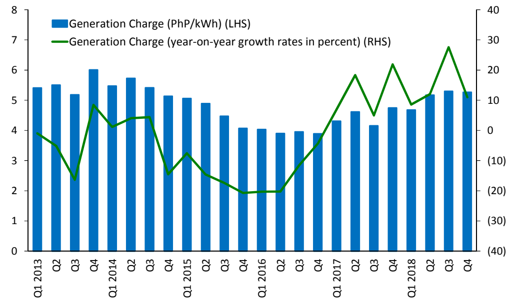
Note: Based on common prices of various market players in Metro Manila.
Source: Department of Energy (DOE)

**Power.** For Q4 2018, the overall electricity rate in the Meralco-franchised area decreased by around ₱0.008 per kilowatt hour (kWh) to ₱10.08 per kWh (from ₱10.16 per kWh in Q3 2018).

## Retail electricity prices decline due mainly to the downward adjustment in generation charge

The downward adjustment was attributed mainly to the average decline in the generation cost by ₱0.03 per kWh to about ₱5.27 per kWh (from ₱5.30 per kWh in Q3 2018). In turn, the reduction of the generation cost in Q4 2018 was primarily due to registered decrease in generation charge from the Power Supply Agreements (PSAs). Despite the depreciation of peso against the US dollar, charges from the PSAs were lower due to higher average plant dispatch of Masinloc and Ilijan plants. Meanwhile, the lower PSA charges were offset by the increases in the cost of powers from the Wholesale Electricity Spot Market (WESM) and the Independent Power Producers (IPPs) as a result of lower availability of power plants in the Luzon grid and the continued weakening of the peso, respectively.

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




Source: Meralco

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[10]

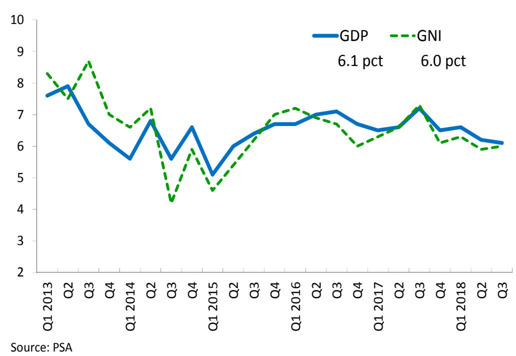
The Philippine economy grew by 6.1 percent in Q3 2018. This is lower than the 6.2-percent expansion a quarter ago and 7.2-percent growth a year-ago.

## Real GDP is slightly lower in Q3 2018

On the expenditure side, the slowdown in the Q3 2018 growth was due to the lower growth in investments and household consumption. On the production side, the lower GDP growth for the quarter was due to the agriculture, hunting, forestry and fishing and the industry sectors.

Gross national income (GNI) growth was slightly higher at 6.0 percent in Q3 2018 compared to the previous quarter's growth of 5.9 percent but was lower than the Q3 2017 growth of 7.3 percent. Likewise, net primary income posted 5.6-percent growth in Q3 2018, higher than the 4.1-percent growth in the previous quarter but lower than the 8.1-percent growth in the same period in 2017.

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



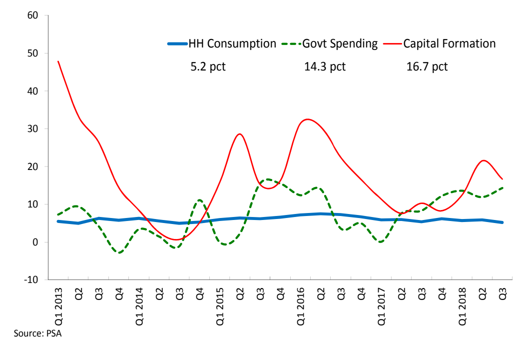

**Aggregate Demand.** On the expenditure side, investments (or capital formation), household spending and government spending contributed 4.8 ppts, 3.5 ppts and 1.5 ppts, respectively to total GDP growth, offsetting the -4.0 ppts contribution of net exports.

[10] Based on National Income Accounts (NIA) released as of 8 November 2018.

## Capital formation is key growth driver in Q3 2018

Household expenditure, which accounted for 66.6 percent of the country's output in Q3 2018, grew by 5.2 percent, slightly lower than the 5.9 percent growth in Q2 2018 and 5.4 percent growth in Q3 2017. This moderation may be on the back of sustained price increases, higher interest rates and weaker consumer sentiment, despite a strong labor market. Moreover, it may be noted that the deceleration in the spending on transport may be brought about by the ₱1.00 increase in public utility jeepney fares that was implemented in July in some areas of the country. The acceleration in the spending on education may be due to the execution of Republic Act No. 10931 or the Universal Access to Tertiary Education Act.

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




Government expenditures grew at a double-digit rate of 14.3 percent in Q3 2018 from 11.9 percent in Q2 2018, which was also higher than the 8.3 percent growth in Q3 2017. The higher growth in government spending may be attributed to the increased disbursements for personnel services due to the implementation of the third tranche of salary increase for civilian employees and military uniformed personnel. Moreover, the maintenance and operating expenses of the government increased as a result of the conditional cash transfer and the unconditional transfer programs, e.g., Pantawid Pamilyang Pilipino Program, being implemented by the Department of Social Welfare and Development (DSWD) as well as the operating requirements of the Department of Education (DOE) for its K-12 program.

Capital formation decelerated to 16.7 percent in Q3 2018 from 21.5 percent in Q2 2018 with moderate growth in investments in durable equipment, and intellectual property products. Investment in construction increased in both the private and public sector because of the implementation of infrastructure projects such as the Pasig-Marikina River Channel Improvement Project and other road construction/ improvement/widening projects of the Department of Public Works and Highways (DPWH). Moreover, the Department of National Defense (DND) also purchased military communication equipment under the Armed Forces of the Philippines (AFP) Modernization Program.

**Table 6. Gross Domestic Product by Expenditure Shares**

at constant 2000 prices; growth rate in percent

| BY EXPENDITURE ITEM | 2017 | | | | 2018 | | |
|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 |
| Household Consumption | 5.9 | 6.0 | 5.4 | 6.2 | 5.7 | 5.9 | 5.2 |
| Government Consumption | 0.1 | 7.6 | 8.3 | 12.2 | 13.6 | 11.9 | 14.3 |
| Capital Formation | 11.4 | 7.6 | 10.3 | 8.3 | 12.4 | 21.5 | 16.7 |
| Fixed Capital Formation | 13.8 | 7.0 | 7.8 | 9.4 | 8.8 | 21.2 | 16.5 |
| Exports | 17.4 | 21.4 | 18.8 | 20.6 | 6.5 | 12.6 | 14.3 |
| Imports | 18.7 | 18.6 | 17.2 | 18.1 | 9.6 | 18.5 | 18.9 |

Source: PSA

Overall exports grew by 14.3 percent in Q3 2018, higher than the 12.6 percent growth in Q2 2018 due to the acceleration in exports of goods (16.9 percent in Q3 2018 from 13.9 percent in Q2 2018). This outweighed the slowdown in the exports of services, which grew by 2.2 percent from 8.4 percent in the last quarter.

The fast acceleration in the exports of goods may be primarily driven by the continued growth in the exports of semiconductors (from 21.2 percent in Q2 2018 to 27.7 percent in Q3 2018). On the other hand, the exports of services slowed to 2.2 percent growth in Q3 2018 from 8.4 percent growth in Q2 2018 and 27.7 percent growth in Q3 2017. This may be the effect of the tempered growth in both travel and miscellaneous services due to the moderation in tourist arrivals during the period.

In the same manner, overall imports increased by 18.9 percent for Q3 2018, slightly higher than the 18.5 percent growth in Q2 2018. This expansion was due to the slightly lower growth of the imports of goods (20.5 percent in Q3 2018 from 21.1 percent in Q2 2018), which was counteracted by the acceleration in the imports of services growing more than twice its growth in the previous quarter (10.6 percent in Q3 2018 from 5.2 percent in Q2 2018). The growth in the imports of goods for Q3 2018 was due to the growth in the imports of electronics, specifically semiconductors, and transport equipment. Meanwhile, the acceleration in the imports of services may be attributed to the strong growth in travel, insurance, and miscellaneous services.

**Other Demand Indicators.** High-frequency indicators of domestic activity continue to present mixed signals. The composite PMI remains firmly above the 50-point mark, pointing to sustained expansion across all sectors. Capacity utilization for the manufacturing sector also suggests that more than half of major manufacturing sectors operate at above 80.0 percent. Energy sales also accelerated. However, vehicle sales have contracted, business outlook has turned less optimistic, and consumer confidence continue to weaken.

## Property Prices

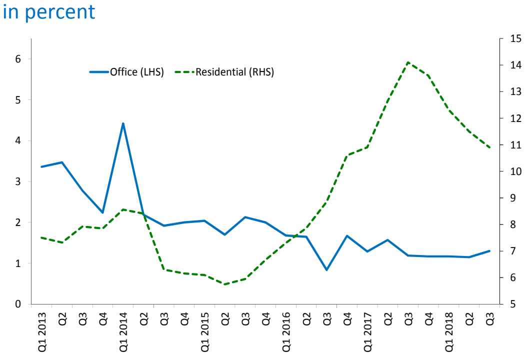
**Vacancy Rates.** The overall office vacancy rate in Metro Manila slightly decreased to 4.8 percent in Q3 2018 from 4.9 percent in the previous quarter due to sustained office demand.

Office vacancy rates slightly decrease

Office vacancy rates in Makati Commercial and Business District (CBD) in Q3 2018 was marginally higher at 1.3 percent from 1.2 percent in the previous quarter. Office vacancy rate in the Ortigas Center (3.6 percent from 3.9 percent) declined, while office vacancy rates in the Manila Bay Area (2.2 percent from 1.9 percent) and Fort Bonifacio (4.7 percent from 3.8 percent) increased in Q3 2018 compared to the previous quarter due to the delivery of new buildings. The overall office vacancy rate in Metro Manila is projected to reach about 5.0 percent by end-2018 with the upcoming supply being matched with sustained demand.

Similarly, the overall residential vacancy rate in Metro Manila decreased to 10.8 percent in Q3 2018 from 11.3 percent in Q2 2018 due to the strong demand across all residential submarkets together with the slower delivery of residential units. According to Colliers, the slower-than-scheduled delivery of residential units was primarily attributed to construction delays brought about by the shortage of construction workers. In particular, vacancy rates were lower in Q3 2018 in the Makati CBD (10.9 percent from 11.5 percent), Fort Bonifacio (14.9 percent from 15.7 percent), Rockwell Center (10.0 percent from 10.3 percent), Ortigas Center (5.0 percent from 5.4 percent), Eastwood City (4.7 percent from 5.2 percent) and Manila Bay area (12.5 percent from 12.9 percent) compared to their quarter-ago levels. The occupancy of residential units went up during the quarter due to stronger leasing demand from both foreign and local professionals working in the CBDs as well as Chinese investors and employees working for offshore gaming companies. Colliers foresees a residential vacancy rate of about 11.0 percent in end-2018, lower than their initial projection of 12-13 percent, due to sustained demand alongside with the slower delivery of residential units.

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



Source: Colliers International Philippines

**Rental Values.** Monthly Grade A office[11] rents in the Makati CBD reached ₱1,075/sq.m. in Q3 2018, representing an increase of 2.9 percent from the previous quarter. Similarly, monthly Grade A office rents in the Makati CBD were higher by 8.6 percent relative to Q3 2017.

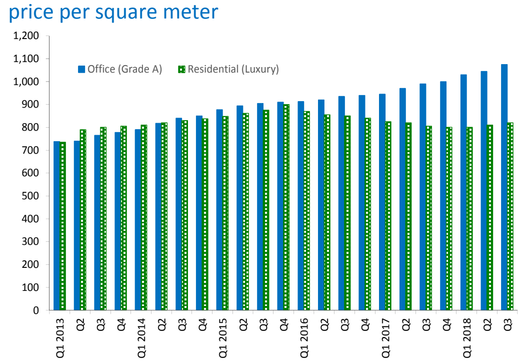
## Office rental values above 1997 levels in nominal terms

The accelerated appreciation in office rental rates was due to the resurgence in demand from business process outsourcing (BPO) firms as well as brisk demand from offshore gaming companies, and traditional companies from the engineering, pharmaceuticals, advertising, online lending, construction and insurance sectors. Office rental values for Grade A offices were above their 1997 levels in nominal terms. In real terms, office rental values were about 57.1 percent of the comparable levels in 1997.

## Luxury rental values decline

Monthly rents for luxury three-bedroom condominium units in the Makati CBD was at ₱820/sq.m. in Q3 2018, increasing by 1.2 percent from the previous quarter. Likewise, monthly rents for the 3-bedroom segment were higher by 1.9 percent compared to the year-ago levels. After declining for nine consecutive quarters, rents in the Makati CBD recovered, albeit at low single-digit growth, due to sustained residential demand from local professionals and foreign offshore gaming employees. Residential rental values for luxury three-bedroom high-rise units were above their 1997 levels in nominal terms but were only about 60.1 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.** Capital values[12] for Grade A office buildings in the Makati CBD in Q3 2018 were higher in nominal terms than their quarter- and year-ago levels. Grade A office capital values in the Makati CBD rose to ₱217,150/sq.m., higher

[11] 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.

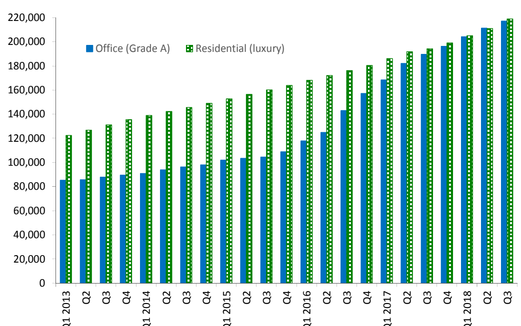
[12] Probable price that the property would have fetched if sold on the date of the valuation. The valuation includes imputed land and building value.

by 2.8 percent and 14.5 percent compared to the quarter- and year-ago levels, respectively. Grade A office capital values were more than two times higher than the 1997 levels in nominal terms. In real terms, office capital values were slightly higher than the comparable levels in 1997.

## Capital values for office and residential buildings rise

Likewise, capital values for luxury residential buildings[13] in Makati CBD in Q3 2018 increased to ₱218,950/sq.m. from their quarter- and year-ago levels. Average prices for three-bedroom luxury residential condominium units grew by 3.8 percent quarter-on-quarter and 12.8 percent y-o-y. Capital values for luxury residential buildings were more than twice their levels in 1997. In real terms, residential capital values were about 88.6 percent of the comparable levels in 1997.

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




Source: Colliers International Philippines

**BSP Residential Real Estate Price Index.**[14] Residential real estate prices were higher by 4.4 percent year-on-year in Q3 2018 as the Residential Real Estate Price Index (RREPI) increased to 116.5 from 111.6 for the same quarter a year ago.

## Residential property prices increase Q3 2018

Year-on-year prices of townhouses, condominium units, and single detached housing units grew by 18.3 percent, 5.8 percent, and 0.2 percent, respectively. Similarly, prices of duplex units (which account for only 0.76 percent of total new housing units reported) also rose by 30.7 percent y-o-y. Quarter-on-quarter (q-o q), the RREPI edged lower by 0.6 percent. The RREPI measures the average change in prices of various types of housing units comprising of single detached house, duplex, townhouse, and condominium unit based on data from housing loans granted by universal, commercial, and thrift banks.

The average residential property prices in both National Capital Region (NCR) and Areas Outside the NCR (AONCR) went up by 6.8 percent and 2.2 percent, respectively, compared to year-ago prices.

## Residential property prices are higher in both the NCR and AONCR

In NCR, price increases were observed across all types of housing units. Meanwhile, the growth in prices of townhouses, duplex housing units, and condominium units outweighed the slight decline in prices of single detached houses in AONCR.

[13] 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.

[14] 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.

**Table 7. Residential Real Estate Price Index By Area**

Q1 2014=100; growth rate in percent

| Quarter | Residential Real Estate Price Index [1] (By Area) | | |
|---|---|---|---|
| | Overall | NCR | AONCR |
| 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 |
| Q4 | 117.4 | 127.6 | 111.1 |
| 2018 Q1 | 116.3 | 121.6 | 112.6 |
| Q2 | 117.2 | 126.5 | 111.9 |
| Q3 | 116.5 | 126.2 | 110.5 |
| | Year-on-Year Growth Rates | | |
| 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 |
| Q4 | 5.7 | 8.8 | 3.0 |
| 2018 Q1 | 2.1 | 2.7 | 0.9 |
| Q2 | 4.8 | 5.1 | 4.1 |
| Q3 | 4.4 | 6.8 | 2.2 |
| | Quarter-on-Quarter Growth Rates | | |
| 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 |
| Q4 | 5.2 | 8.0 | 2.8 |
| 2018 Q1 | -0.9 | -4.7 | 1.4 |
| Q2 | 0.8 | 4.0 | -0.6 |
| Q3 | -0.6 | -0.2 | -1.3 |

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

Source: BSP

For Q3 2018, seven in ten (71.0 percent) residential real estate loans (RRELs) were for the acquisition of new housing units. By type of housing unit, 53.2 percent of residential property loans were for the purchase of condominium units, followed by single detached units (38.3 percent), and townhouses (7.6 percent). By area, majority of the RRELs granted in the NCR were for the purchase of condominium units, while RRELs granted in AONCR were for single detached houses. By region, NCR accounted for 57.4 percent of the total number of RRELs granted during the quarter, followed by AONCR - CALABARZON (23.4 percent), Central Luzon (5 percent), Central Visayas (4.2 percent), Western Visayas (3.3 percent), Davao Region (2.4 percent), and Northern Mindanao (1.4 percent). Together, the NCR and the six other regions accounted for 97.1 percent of total housing loans granted by banks.

**Table 8. Residential Real Estate Price Index By Housing Type**

Q1 2014=100; growth rate in percent

| Quarter | Residential Real Estate Price Index [1] (By Housing Type) | | | | |
|---|---|---|---|---|---|
| | Overall [2] | Single Detached/ Attached | Duplex [3] | Townhouse | Condominium Unit |
| 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 |
| Q4 | 117.4 | 104.6 | 102.6 | 116.4 | 143.3 |
| 2018 Q1 | 116.3 | 107.4 | 131.5 | 122.4 | 130.9 |
| Q2 | 117.2 | 104.4 | 99.0 | 127.7 | 141.1 |
| Q3 | 116.5 | 103.6 | 115.5 | 127.5 | 138.6 |
| | Year-on-Year Growth Rates | | | | |
| 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 |
| Q4 | 5.7 | -0.3 | 17.3 | 8.1 | 14.2 |
| 2018 Q1 | 2.1 | -0.6 | 44.2 | 13.8 | 2.0 |
| Q2 | 4.8 | 0.8 | -4.4 | 13.3 | 9.1 |
| Q3 | 4.4 | 0.2 | 30.7 | 18.3 | 5.8 |
| | Quarter-on-Quarter Growth Rates | | | | |
| 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 |
| Q4 | 5.2 | 1.2 | 16.1 | 8.0 | 9.4 |
| 2018 Q1 | -0.9 | 2.7 | 28.2 | 5.2 | -8.7 |
| Q2 | 0.8 | -2.8 | -24.7 | 4.3 | 7.8 |
| Q3 | -0.6 | -0.8 | 16.7 | -0.2 | -1.8 |

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

[2] No index generated for apartments due to very few observations.

[3] Indices for duplex exhibit more volatility due to relatively small number of reported real estate loans.

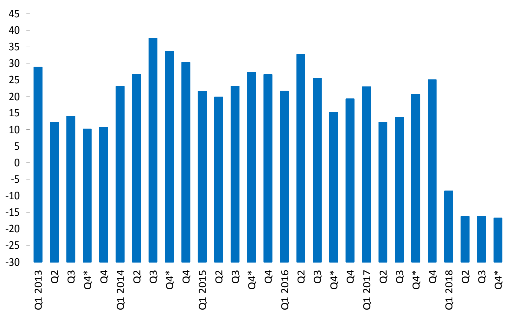
Source: BSP

**Vehicle Sales.** The growth of sales of new vehicles from CAMPI[15] members contracted by 16.7 percent y-o-y in the first two months of Q4 2018 from the 20.6-percent growth recorded in the same period a year ago as sales of both passenger cars and commercial vehicles continued to decline following the imposition of higher excise tax on automobiles in 2018.

## Sales of new vehicles decline

Sales of passenger cars posted a steeper decline of -21.0 percent y-o-y in October-November 2018 from the 0.2-percent contraction in the same period in 2017. New passenger car sales accrued to a total of 18,641 in the first two months of Q4 2018 units from 23,587 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)

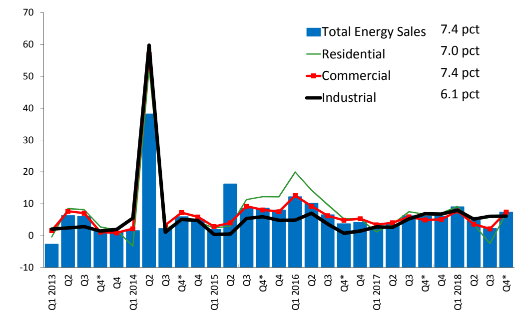
Commercial vehicle sales, which account for about 71.0 percent of total vehicle sales, dropped by 14.8 percent y-o-y in the first two months of Q4 2018 relative to 32.8-percent growth in the same period of 2017. Commercial vehicles sold during the quarter reached 45,767 units from 53,723 units in October-November 2017.

**Energy Sales.** Meralco's energy sales for Q4 2018 (October–November) grew by 7.4 percent, faster than the 6.1-percent growth reported in the same period a year ago.

## Energy sales accelerate

Energy sales from the residential sector, commercial sector, and industrial sector increased by 7.0 percent, 7.4 percent, and 6.1 percent, respectively.

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




*October-November
Source: Meralco, BSP calculations

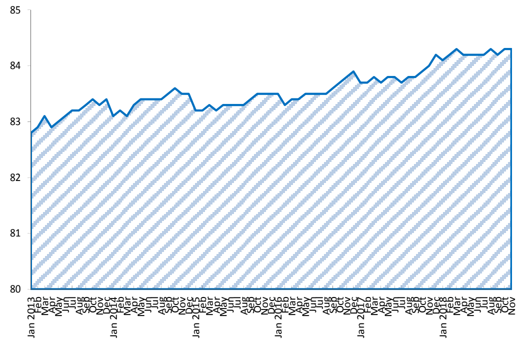
**Capacity Utilization.** Based on the Philippine Statistics Authority's (PSA) Monthly Integrated Survey of Selected Industries (MISSI), the average capacity utilization rate of the manufacturing sector stood at 84.3 percent in November 2018, unchanged from the month-ago level.

## Capacity utilization in manufacturing remains above 80 percent

Of the 606 respondent-establishments, 60 percent operated at least at 80.0 percent capacity in November 2018. Data showed that most of the manufacturing companies have been operating above the 80.0 percent capacity since 2010.

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

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



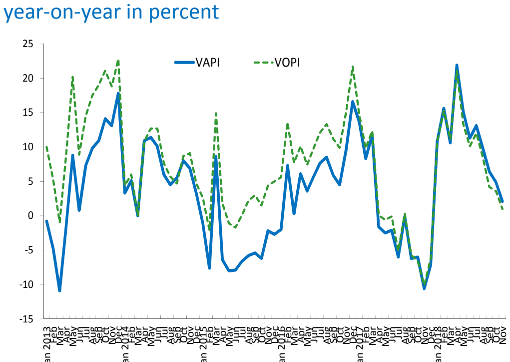
Source: PSA

**Volume and Value of Production.** Preliminary results of the MISSI showed that volume of production index (VoPI) grew by 1.0 percent y-o-y in November 2018 from a 3.6-percent (revised) growth in the previous month.

## Manufacturing sustains growth

The rise in VoPI was due to the expansion in the production of 14 out of 20 major industries namely, petroleum products (22 percent), electrical machinery (11 percent), textiles (45.8 percent), beverages (11.7 percent), miscellaneous manufactures (25.6 percent), tobacco products (21.1 percent), paper and paper products (15 percent), basic metals (2.6 percent), non-metallic mineral products (3.8 percent), transport equipment (2.4 percent), rubber and plastic products (1.8 percent), fabricated metal products (3.2 percent), furniture and fixtures (3.7 percent), and wood and wood products (3.4 percent).

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




Source: PSA

Likewise, the value of production index (VaPI) grew by 2.1 percent in November from a 4.9-percent (revised) growth a month ago. This was due to the significant expansion of the following sub-sectors: petroleum products (35.8 percent), electrical machinery (18.2 percent), beverages (26 percent), textiles (54.4 percent), tobacco products (45.3 percent), miscellaneous manufactures (30.8 percent), paper and paper products (20.7 percent), and non-metallic mineral products (10.6 percent).

**Business Expectations.** Business outlook on the economy turned less optimistic for Q4 2018, with the overall confidence index (CI) [16] of the BES[17] declining to 27.2 percent from 30.1 percent in the previous quarter. This means that the number of optimists declined but continued to be greater than the number of pessimists during the quarter.

## Business outlook turns less optimistic in Q4 2018

Respondents attributed their less optimistic sentiment during the fourth quarter to: (a) higher inflation driven by rising raw material costs and global oil prices, (b) weakening peso, (c) higher interest rates (i.e., borrowing costs), (d) decrease in volume of sales and orders, and (e) lack of supply of raw materials.

The sentiment of businesses in the Philippines mirrored the less buoyant business outlook in the US, UK, Australia, France, Hong Kong, South Korea and Thailand. However, business sentiments in Canada, Brazil, Hungary, and the Netherlands were more upbeat.

[16] The CI is computed as the percentage of firms that answered in the affirmative less the percentage of firms that answered in the negative with respect to their views on a given indicator. A positive CI indicates an optimistic outlook while a negative CI indicates a pessimistic outlook.

[17] The BES is a quarterly survey of a random sample drawn from the combined list of firms from the Securities and Exchange Commission's (SEC) Top 7,000 Corporations and BusinessWorlds' Top 1,000 Corporations. The Q4 2018 BES was conducted during the period 1 October-23 November 2018.

**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 |
| 2018 | Q1 | 39.5 | 47.8 |
| | Q2 | 39.3 | 40.4 |
| | Q3 | 30.1 | 42.6 |
| | Q4 | 27.2 | 29.4 |

Source: BSP

Respondents expected the less bullish business conditions to continue for the quarter ahead (Q1 2019) as the index remained positive, but lower at 29.4 percent from 42.6 percent in the previous quarter. This is the lowest next quarter reading since Q3 2009.

Respondents attributed their weaker outlook for Q1 2019 primarily to the usual slowdown in consumer demand after the holiday season. Moreover, sentiment of firms was tempered by expectations of a peso depreciation, which increases the costs of imports, as well as higher inflation and interest rates.

**Consumer Expectations.** Consumer outlook continued to weaken in Q4 2018 as the CI [18] of the CES[19] declined to -22.5 percent from -7.1 percent in the previous quarter. The negative index indicates that the pessimists outnumbered the optimists for Q4 2018.

## Consumer confidence continue to weaken in Q4 2018

The bleak consumer outlook for Q4 2018 was due to the following: (a) higher prices of commodities; (b) low salary or income; (c) increase in household expenses; (d) no increase in income; and (e) upsurge in the number of unemployed persons. Respondents also noted the occurrence of typhoons and other calamities in the previous quarter as reasons behind their weaker sentiment for Q4 2018.

The sentiment of consumers in the Philippines for Q4 2018 mirrored the more pessimistic confidence of those in Japan, Taiwan, Thailand, and the United Kingdom but was in contrast to the more optimistic views of consumers in China, Czech Republic, Italy, and the United States.

**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 |
| 2018 | Q1 | 1.7 | 8.8 | 24.0 |
| | Q2 | 3.8 | 8.7 | 23.1 |
| | Q3 | -7.1 | 3.8 | 13.0 |
| | Q4 | -22.5 | -0.8 | 10.7 |

Source: BSP

The less favorable consumer sentiment was carried to the year ahead as the CI for the next three months reverted to negative territory at -0.8 percent from 3.8 percent in the previous quarter, and the CI for the next 12 months declined to 10.7 percent from 13.0 percent a quarter ago.

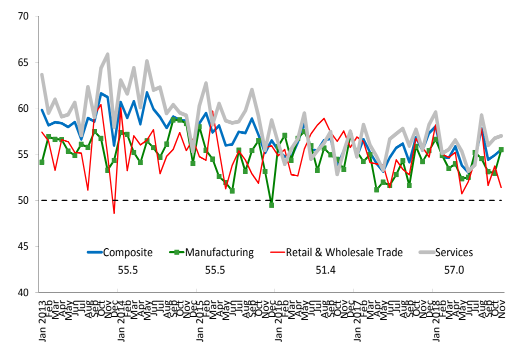
Similar to the current quarter, consumer outlook was less buoyant for the next quarter and the year ahead due to expectations of: (a) higher prices of goods, (b) low salary or income, (c) rise in expenditures, (d) no increase in income, and (e) high unemployment rate.

[18] The CI is computed as the percentage of households that answered in the affirmative less the percentage of households that answered in the negative with respect to their views on a given indicator. A positive CI indicates an optimistic outlook while a negative CI indicates a pessimistic outlook.
[19] The CES is a quarterly survey of a random sample of about 5,609 households in the Philippines. The Q4 2018 BES was conducted during the period 1-13 October 2018.

**Purchasing Managers' Index.**[20] The composite PMI in November 2018 remained firmly above the 50-point expansion threshold at 55.5,[21] slightly higher than the October 2018 level. The faster rate of expansion of the manufacturing and services sectors offset the deceleration of the wholesale and retail sector.

## PMI remains firmly above the 50-point expansion threshold

**Chart 16. Purchasing Managers' Index**




Source: Philippine Institute of Supply Management (PISM)

The manufacturing PMI increased by 2.5 index points to 55.5 in November from 53 in October. This is consistent with business managers' expectations of a turnaround in November which was attributed to robust demand, higher number of customers, increased production, and launching of new products. All the sectors in review expanded month-on-month (m-o-m) with the Inventories Index having the biggest increment. Consequently, the Supplier Deliveries Index, which measures the lead time of delivery of goods to clients, increased due to the strong demand during the month. On a per sector basis, seven subsectors grew at a faster pace namely food and beverages (with a PMI of 66.3); chemical/fuel (60.9); publishing (60.3); communication and medical equipment (56.8); textiles/clothing (56.4); non-metallic minerals (54.1); and paper and paper products (52.3). Rubber and plastic and motor vehicles decelerated, while the following posted a contraction: basic metals, fabricated metal, and machinery. Meanwhile, survey respondents expect a possible deceleration for the sector in December.

Similarly, services PMI rose slightly by 0.3 index point to 57 in November from 56.7 a month ago due mainly to the peak season for sector expansion. Business managers noted increased demand, clients, and projects during the month which is reflected in the expansion of all sectors in review, particularly the Business Activity and New Orders Indices. Meanwhile, eight of the 13 subsectors expanded faster in November (electricity, gas, and water; construction; transportation, including travel agency; postal and telecommunications; banking and financial intermediation; real estate; renting of goods and equipment; miscellaneous business activities; and business and knowledge processing), two subsectors expanded at a slower rate (hotels and restaurants, as well as health and social work), while the other two subsectors posted contraction (provident and insurance, as well as education). Prospects were less favorable for the sector in the month ahead.

Meanwhile, the retail and wholesale PMI decreased by 2.3 index points to 51.4 in November from 53.7 in the previous month, attributed mainly to cyclical downturn. The sector's deceleration was evident in the contraction of the Employment Index and the slower rate of expansion of the Sales Revenues Index and Inventories Index. The Supplier Deliveries Index, however, increased due to the holiday season road and port congestion. On the one hand, the PMI of the retail subsector increased slightly by 0.9 index point to 53.4 in November from 52.4 in October. On the other hand, the PMI of the wholesale subsector declined by 3.3 index points to 50.1 in November due mainly to the significant decrease in the Sales Index. Managers are expecting the sector to further decelerate in December.

### External Demand[22]

**Exports.** Exports of goods increased by 1.5 percent year-on-year in Q3 2018, recovering from the 1.3-percent contraction in Q2 2018.

## Exports of goods increase

[20] Data based on the monthly purchasing managers' index report of the Philippine Institute for Supply Management (PISM).

[21] 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.

[22] International Merchandise Trade Statistics (IMTS) concept

In the previous year, exports posted a 17.2-percent growth in the third quarter. The expansion in foreign shipments of fruits and vegetables, forest products, mineral products, petroleum products and manufactures offset the decline in exports coconut products, sugar and related products, and other agro-based products during the quarter.

**Table 11. Exports of Goods**
growth rate in percent

| COMMODITY GROUP | 2017 | 2018 | |
|---|---|---|---|
| | Q3 | Q2 | Q3 |
| Coconut Products | 30.4 | -7.3 | -36.2 |
| Sugar and Products | 4,637.7 | -70.6 | -71.5 |
| Fruits and Vegetables | 12.8 | -11.1 | 35.0 |
| Other Agro-Based Products | 7.8 | -10.5 | -0.8 |
| Forest Products | 662.8 | 98.2 | 46.8 |
| Mineral Products | 67.3 | -16.1 | 0.5 |
| Petroleum Products | 54.3 | 38.0 | 71.1 |
| Manufactures | 13.4 | 0.05 | 1.1 |
| Special Transactions | 22.1 | 21.7 | 31.4 |
| **Total Exports** | **17.2** | **-1.3** | **1.5** |

Source: BSP staff computations based on the Foreign Trade Statistics of the PSA

**Imports.** Imports grew by 22.2 percent in Q3 2018 from 19.6 percent in Q2 2018 and 8.7 percent in Q3 2017 due to the faster expansion in the importation of capital goods, and raw materials and intermediate goods, as well as the sustained growth in inward shipments of mineral fuels and lubricants, and consumer goods.

## Imports of goods increase

**Table 12. Imports of Goods**
growth rate in percent

| COMMODITY GROUP | 2017 | 2018 | |
|---|---|---|---|
| | Q3 | Q2 | Q3 |
| Capital Goods | 3.9 | 17.6 | 21.8 |
| Raw Materials and Intermediate Goods | 7.0 | 17.9 | 23.1 |
| Mineral Fuels and Lubricants | 34.8 | 34.5 | 31.4 |
| Consumer Goods | 9.5 | 17.3 | 14.6 |
| Special Transactions | -29.4 | 57.8 | 42.5 |
| **Total Imports** | **8.7** | **19.6** | **22.2** |

Source: BSP staff computations based on the Foreign Trade Statistics of the PSA

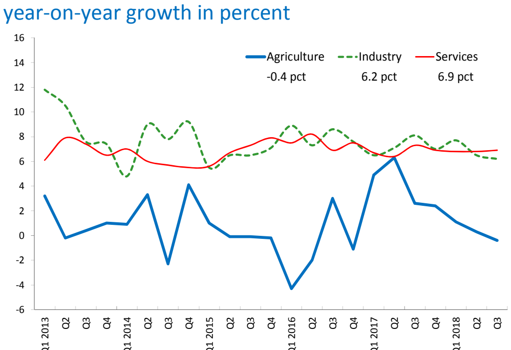
**Aggregate Supply.** On the production side, growth was largely due to the services sector, which accounted for 4.1 ppts of GDP growth. The industry sector and the Agriculture, Hunting, Forestry and Fishing (AHFF) sector contributed 2.1 ppts and -0.1 ppt, respectively.

## Services sector continues to support supply-side growth

The services sector grew by 6.9 percent in Q3 2018 from the 6.8 percent growth in Q2 2018. The growth in services sector was mainly driven by the sub-sector on trade and repair of motor vehicles, motorcycles, personal and household goods, which contributed 1.7 percentage points. However, the said sub-sector decelerated to 5.6 percent in Q3 2018 from 6.2 percent growth in Q2 2018. The slower growth in the trade and repair of motor vehicles, motorcycles, personal and household goods sub-sector may be attributed to the less positive sentiment of businesses, weaker household consumption, and the drop in the sales of passenger cars and commercial vehicles.

The industry sector grew at 6.2 percent in Q3 2018, which was lower than 6.5 percent growth in Q2 2018. The main contributor to the growth in the sector was construction, growing at 16.1 percent in Q3 2018 and 14.1 percent in the previous quarter. The double-digit growth in construction was primarily driven by the continued rise in both private and public construction activities in the third quarter.

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




Source: PSA

The slower growth in the VoPI and VaPI for Q3 2018 reflected the manufacturing sub-sector's slowdown. The drop in the manufacture of chemical and chemical products, particularly drugs and medicine, was partly due to the strict regulation of controlled chemical and chemical products and the high rates charged by shipping companies for transporting chemicals. As for the lower growth in the food manufactures, this may be due to the weaker household demand for food. Moreover, the less optimistic outlook may have partly influenced the reduction in manufacturing growth. Meanwhile, the faster growth in the manufacture of beverage industries, wood, bamboo, cane and rattan articles, paper and paper products, petroleum and other fuel products, non-metallic mineral products, fabricated metal products, office, accounting and computing machinery, transport equipment, furniture and fixtures, and miscellaneous manufactures helped temper the deceleration in growth of the sub-sector.

The contraction of the mining and quarrying sub-sector may be the result of the suspension of mining activities in selected areas, particularly in the Cordillera Administrative Region (CAR) and Central Visayas, and the higher excise tax in both metallic and non-metallic minerals.

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

| BY INDUSTRIAL ORIGIN | 2017 | | | | 2018 | | |
|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 |
| Agri., Hunting, Forestry and Fishing | 4.9 | 6.3 | 2.6 | 2.4 | 1.1 | 0.3 | -0.4 |
| Agriculture and Forestry | 5.6 | 8.1 | 3.7 | 3.0 | 1.9 | 0.2 | -0.2 |
| Fishing | 1.2 | -2.7 | -2.1 | -0.1 | -3.6 | 0.4 | -1.1 |
| Industry Sector | 6.5 | 7.1 | 8.1 | 7.0 | 7.7 | 6.5 | 6.2 |
| Mining and Quarrying | -17.8 | 19.2 | 7.9 | 5.4 | 6.9 | -6.9 | -1.1 |
| Manufacturing | 7.7 | 8.0 | 10.1 | 7.9 | 7.6 | 5.5 | 4.0 |
| Construction | 9.7 | 4.3 | 4.0 | 4.3 | 8.8 | 14.1 | 16.1 |
| Electricity, Gas and Water Supply | 1.7 | 3.0 | 3.4 | 5.5 | 6.4 | 3.7 | 5.0 |
| Service Sector | 6.7 | 6.4 | 7.3 | 6.9 | 6.8 | 6.8 | 6.9 |
| Transport, Storage and Communication | 4.2 | 3.3 | 3.6 | 4.9 | 6.6 | 6.1 | 5.4 |
| Trade and Repair of Motor Vehicles, Motorcycles, Personal and Household Goods | 7.3 | 5.8 | 7.3 | 8.7 | 6.2 | 6.2 | 5.6 |
| Financial Intermediation | 7.0 | 9.4 | 8.9 | 5.2 | 7.8 | 7.6 | 7.6 |
| Real Estate, Renting and Business Activities | 7.0 | 8.1 | 7.8 | 6.6 | 4.9 | 4.3 | 5.3 |
| Public Administration and Defense; Compulsory Social Security | 5.5 | 8.4 | 8.2 | 8.5 | 13.2 | 15.0 | 17.8 |
| Other Services | 7.3 | 4.9 | 7.5 | 6.3 | 6.9 | 7.0 | 7.5 |

Source: PSA

The AHFF sector contracted in Q3 2018 to 0.4 percent from 0.3 percent in Q2 2018. The contraction was due to the negative growth in agriculture, which contributed -0.2 percentage points of the -0.4 percent growth of AHFF. The decline in the production of agricultural products was caused by several typhoons, namely–Henry, Inday, Josie, and Ompong, and excessive rainfall brought by the southwest monsoon. Meanwhile, fishing growth declined by 1.1 percent in Q3 2018 from 0.4 percent in Q2 2018.

## Labor Market Conditions

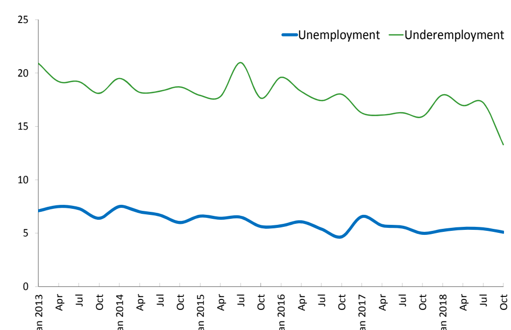
The Philippine labor market improved in terms of quality but slightly deteriorated in terms of quantity in the October 2018 round of the Labor Force Survey (LFS). The country's underemployment rate improved while the overall employment rate, unemployment rate and youth unemployment rate deteriorated compared to the same period a year ago.

## Labor market shows improvement

During the period, the underemployment rate and the employment rate declined to 13.3 percent (the lowest in 13 years) and 94.9 percent, respectively from 15.9 percent and 95.0 percent in the same period a year ago. Meanwhile, the unemployment rate and the youth unemployment rate rose to 5.1 percent and 13.3 percent, respectively from 5.0 percent and 11.9 percent for the same period.

For the full year, the unemployment rate averaged at 5.3 percent, an improvement from the 5.7 percent unemployment rate in 2017 and is the upper end of the government's target range for 2018 of 4.7 percent to 5.3 percent. This brought the country closer to the government target of reducing the overall unemployment rate to 3.0-5.0 percent by 2022.

**Chart 18. Unemployment and Underemployment**
in percent

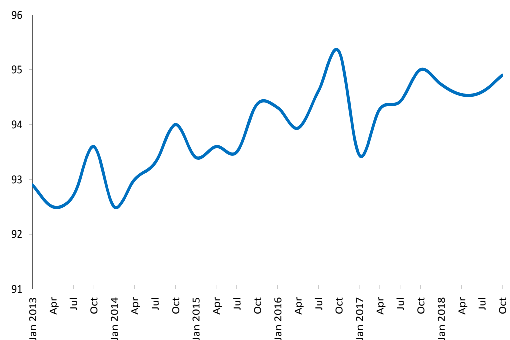



Source: PSA

The youth unemployment rate averaged at 13.4 percent for the full year, which is an improvement from the 14.4 percent youth unemployment rate in 2017 but is still far-off from the 8.0-percent target by 2022. Meanwhile, the 13.3 percent underemployment rate in the last quarter of 2018 was not sufficient to substantially improve the full year average of 16.4 percent, which is slightly higher compared to the 16.2 percent underemployment rate in 2017.

The 94.9-percent employment rate in October 2018 is equivalent to 218,000 employment losses compared to the level in October 2017, which brings the total number of employed individuals to 41.3 million in the last quarter of 2018. The main reason for the slight decline in employment was employment losses in both the agriculture and services sectors.

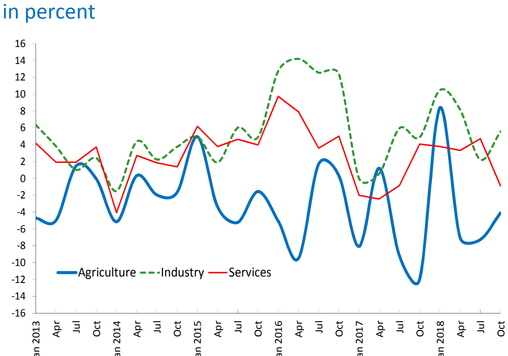
**Chart 19. Employment Rate**
in percent



Source: PSA

Employment in the services sector declined by 0.9 percent (equivalent to 204,000), due mainly to lower employment in the wholesale and retail trade (-3.1 percent) and transportation and storage (-3.1 percent) that could be attributed partly to higher inflation and fuel cost.

**Chart 20. Employment by Sector**
in percent



Source: PSA

Employment in the agriculture sector continued to decline by 4.0 percent (equivalent to net employment loss of 419,000). Meanwhile, the industry sector posted a net employment gain of 405,000 (5.4 percent) due mainly to strong employment in the construction (11.0 percent) and manufacturing (1.5 percent) sub-sectors. For the full year, the average employment generated was only 826,000, which is below the government's target of 900,000 - 1.1 million employment generation for 2018.[23]

The 5.1-percent unemployment rate in October 2018 is equivalent to 2.2 million unemployed individuals, higher by 17,000 compared to the unemployment level in October 2017. In terms of highest grade completed, majority of the unemployed are still the junior high school graduates (27.5 percent) and college graduates (24.0 percent). In terms of age, the bulk belongs to the 15-24 age group (44.6 percent), followed by the 25-34 age group (30.3 percent).

Meanwhile, the 13.3-percent underemployment rate in October 2018 is equivalent to 5.5 million underemployed individuals, or 1.1-million reduction in the number of employed individuals who wanted more work. The majority of the underemployed are visible (57.0 percent) and are employed in the services sector (43.2 percent) and agriculture sector (37.9 percent). Other aspects of employment quality also improved during the period as evidenced by the higher share of remunerative work or wage and salary workers (64.4 percent in October 2018 from 62.3 percent in October 2017) and the increase in overall mean work hours (hours per week) (42.8 in October 2018 from 41.7 in October 2017), which could imply that economic activity has increased in the last quarter of 2018.

To further improve the employment condition in the country, the government recognizes the need to improve social protection programs for workers while providing flexibility for firms to adjust to the changing market conditions by simplifying regulations, for example, for the issuance of business permits and licenses and by reducing fees.[24]

[23] NEDA (2018),"Unemployment Drops to Lowest in Over a Decade," NEDA Press Release, 5 December.
[24] NEDA (2018).

## II. Monetary and Financial Market Conditions

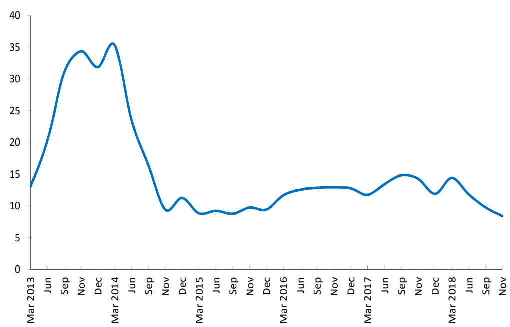
### Domestic Liquidity

Domestic liquidity (M3) grew by 8.4 percent y-o-y in November to ₱11.3 trillion, slower than the 9.8-percent expansion as of end-Q3 2018.

Domestic liquidity continues to increase

Money supply continued to increase due mainly to sustained demand for credit. Domestic claims grew, albeit slower, by 14.6 percent in November from the 14.8-percent expansion in end-Q3 2018 as credit to the private sector continued to grow. On the other hand, net claims on the central government expanded by 12.1 percent in November from 11.4 percent in end-Q3 2018.

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




Source: BSP

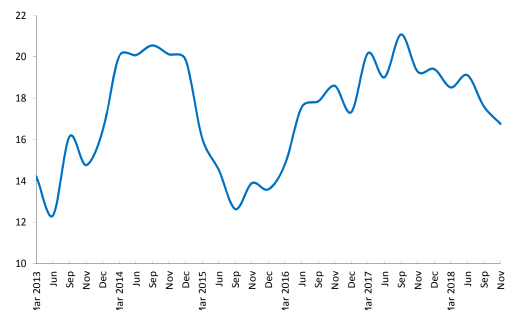
Meanwhile, net foreign assets (NFA) in peso terms contracted by 3.2 percent y-o-y in November, from a decline of 0.9 percent in end-Q3 2018. The BSP's NFA position contracted further in November, reflecting the y-o-y decrease in gross international reserves. The NFA of banks also contracted as banks' foreign assets grew at a slower pace relative to the growth in their foreign liabilities. Banks' foreign assets expanded slower as growth in loans and investments in marketable debt securities eased.

Outstanding loans of commercial banks, net of RRP placements with the BSP, increased by 16.8 percent y-o-y as of November 2018, slower than the 17.6-percent and 19.4-percent growth rates posted at end-Q3 2018 and end-Q4 2017, respectively.

...as lending sustains growth due to production activities

The sustained increase in bank lending was due largely to loans for production activities, which expanded by 17.2 percent y-o-y in November 2018 from 17.4-percent growth in end-Q3 2018 and 18.6-percent rise in end-Q4 2017. The expansion in production loans was driven primarily by increased lending to the following sectors: wholesale and retail trade, repair of motor vehicles and motorcycles; financial and insurance activities; real estate activities; manufacturing; electricity, gas, steam and airconditioning supply; and, construction.

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




Source: BSP

Meanwhile, loans for household consumption grew by 13.8 percent as of November 2018, lower than the 18.2-percent and 20.8-percent growth rates recorded in end-Q3 2018 and end-Q4 2017, respectively.

## Monetary Operations

As of end-Q4 2018, majority of the BSP's liquidity absorbing monetary operations had been through the overnight reverse repurchase (RRP) facility, comprising about 70.2 percent of total outstanding amount of liquidity absorbed in BSP liquidity facilities. Meanwhile, placements in the overnight deposit facility (ODF) and the term deposit facility (TDF) made up the remaining 29.8 percent.

Consistent with the BSP's assessment of prevailing liquidity conditions and taking into account the seasonal increase in demand for cash ahead of the holidays, total offer volumes for the weekly TDF auctions were generally lower in Q4 2018 relative to the previous quarter. The average bid-to-cover ratios for the 7-day, 14-day, and 28-day tenors were recorded at 1.1, 1.3, and 1.3 compared to 1.2, 1.2, and 1.1, respectively, in the previous quarter. On the other hand, the average bid-to-cover ratio for the daily RRP facility was steady at about 1.0 during the quarter.

## Credit Conditions

**Credit Standards.** Results of the Q4 2018 Senior Bank Loan Officers' Survey (SLOS) showed that most of the respondent banks[25] continued to maintain their credit standards for loans to both enterprises and households during the quarter based on the modal approach.[26]

### Majority of banks keep credit standards steady

This is the 39th consecutive quarter since Q2 2009 that the majority of respondent banks reported broadly unchanged credit standards.

Meanwhile, the diffusion index (DI) approach[27,28] continued to indicate a net tightening of credit standards for both loans to enterprises and households. In the previous quarter, credit standards for loans to enterprises and households also showed a net tightening based on the DI approach.

**Lending to Enterprises.** Most banks (71.1 percent of banks that responded to the question) indicated that they maintained their credit standards for loans to enterprises during the quarter using the modal approach.

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

| | 2017 | | | | 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| Tightened Considerably | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 3.6 | 2.3 | 6.7 |
| Tightened Somewhat | 6.7 | 10.0 | 7.4 | 3.7 | 3.7 | 10.7 | 18.6 | 20.0 |
| **Remained Basically Unchanged** | **93.3** | **90.0** | **88.9** | **88.9** | **92.6** | **82.1** | **76.7** | **71.1** |
| Eased Somewhat | 0.0 | 0.0 | 3.7 | 7.4 | 3.7 | 3.6 | 0.0 | 0.0 |
| Eased Considerably | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 2.3 | 2.2 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| **Diffusion Index for Credit Standards** | **6.7** | **10.0** | **3.7** | **-3.7** | **0.0** | **10.7** | **18.6** | **24.4** |
| **Number of Banks Responding** | **30** | **30** | **27** | **27** | **27** | **28** | **43** | **45** |

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 pointed to a net tightening of credit standards for the quarter, which was attributed by respondent banks to their perception of stricter financial system regulations and reduced tolerance for risk. In terms of specific credit standards,[29] DI-based results suggested stricter collateral requirements and loan covenants, shortened loan maturities, and increased use of interest rate floors.

In terms of borrower firm size, banks' responses pointed to a net tightening of credit standards for loans across all firm sizes namely, top corporations, large middle-market enterprises, small and medium enterprises (SMEs) and micro-enterprises based on the DI approach.

[25] Starting in the Q3 2018 survey round, the BSP expanded the coverage of the SLOS to include new foreign commercial banks and top thrift banks. Survey questions were sent to a total of 66 banks (42 universal and commercial banks, and 24 thrift banks) for the Q4 2018 survey round, 50 of whom sent their responses representing a response rate of 75.8 percent. For the Q1 2009 - Q2 2018 survey rounds, the survey covered only universal and commercial banks.
[26] In the modal approach, the results of the survey are analyzed by looking at the option with the highest share of responses.
[27] In the diffusion index approach, a positive 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").
[28] 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.
[29] 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.

Over the next quarter, results based on the modal approach showed that most of the respondent banks expect credit standards to remain unchanged. Meanwhile, results based on 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, on the back of respondent banks' expectations of stricter financial system regulations and more uncertain economic outlook, among others.

**Lending to Households.** The results of the survey likewise indicated that most respondent banks (78.6 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 tightening of credit standards for household loans, particularly for housing loans, auto loans, and personal/salary loans.

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

| | 2017 | | | | 2018 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| Tightened Considerably | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 6.3 | 10.7 |
| Tightened Somewhat | 0.0 | 9.1 | 5.0 | 0.0 | 15.8 | 5.9 | 12.5 | 7.1 |
| **Remained Basically Unchanged** | **100.0** | **81.8** | **90.0** | **90.5** | **78.9** | **94.1** | **75.0** | **78.6** |
| Eased Somewhat | 0.0 | 9.1 | 5.0 | 9.5 | 5.3 | 0.0 | 6.3 | 3.6 |
| 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** | **0.0** | **-9.5** | **10.5** | **5.9** | **12.5** | **14.3** |
| **Number of Banks Responding** | **21** | **22** | **20** | **21** | **19** | **17** | **32** | **28** |

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

The overall net tightening of standards for household loans reflected stricter loan covenants and increased use of interest rate floors. Respondent banks attributed the tightening of overall credit standards for household loans largely to their perceptions of stricter financial system regulations and reduced tolerance for risk.

In terms of respondent banks' outlook for the next quarter, results based on the modal approach showed that the majority of the respondent banks anticipate maintaining their overall credit standards. Meanwhile, DI-based results indicated expectations of overall net tightening of credit standards for household loans as respondent banks anticipate stricter financial system regulations and lower 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.

## Demand for loans from firms and households remain stable

Using the DI approach, however, results showed a net increase in loan demand[30] across all firm sizes and all types of household loans. The net increase in loan demand for firms was attributed by banks to their customers' higher working capital requirements and investment in plant or equipment, as well as banks' more attractive financing terms during the quarter. Meanwhile, respondent banks attributed the net increase in loan demand from households to higher household consumption and low interest rates offered by banks, among others.

Over the next quarter, most of respondent banks expect unchanged overall loan demand from firms and households. However, results based on the diffusion index approach suggested expectations of a net increase in overall loan demand for both business and household loans. For business loans, the expected net increase in demand was associated by respondent banks largely to their corporate clients' need for higher working capital requirements. Meanwhile, the anticipated net increase in loan demand from households was attributed by respondent banks to expectations of higher household consumption, lower interest rates, and higher housing investment, among others.

**Real Estate Loans.** Most of the respondent banks (76.7 percent) reported that credit standards for commercial real estate loans were maintained in Q4 2018.

## Majority of banks maintain credit standards for real estate loans

The DI approach, however, continued to point to a net tightening of overall credit standards for commercial real estate loans for the twelfth consecutive quarter due to respondent banks'

[30] 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.

perception of stricter financial system regulations and deterioration in the liquidity of banks' portfolio. The net tightening of overall credit standards for commercial real estate loans reflected respondent banks' wider loan margins, reduced credit line sizes, stricter collateral requirements and loan covenants, shortened loan maturities, and increased use of interest rate floors.

Over the next quarter, while most of the respondent banks anticipate 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 as banks anticipate reduced tolerance for risk.

Demand for commercial real estate loans was also mainly unchanged in Q4 2018 based on the modal approach. Meanwhile, the DI approach indicated a net increase in demand for commercial real estate loans, which banks attributed to their attractive financing terms and increased working capital requirements of real estate loan borrowers. Over the next quarter, although most of the respondent banks anticipate generally steady loan demand, more banks expect demand for commercial real estate loans to increase compared to those expecting the opposite.

Majority of the respondent banks (80.0 percent) reported unchanged credit standards for housing loans extended to households based on the modal approach. Meanwhile, DI-based results suggested a net tightening of credit standards for housing loans due largely to respondent banks' perception of stricter financial system.

Over the next quarter, results based on the modal approach showed that respondent banks expect credit standards for housing loans to remain unchanged. However, using the DI approach, survey results suggested expectations of a net tightening of credit standards for housing loans in Q1 2019 as respondent banks anticipate stricter financial system regulations. Most banks reported unchanged demand for housing loans in Q4 2018 based on the modal approach while DI-based results pointed to a net increase in demand for housing loans during the quarter. Banks' responses likewise indicated expectations of sustained net increase in demand for housing loans over the next quarter.

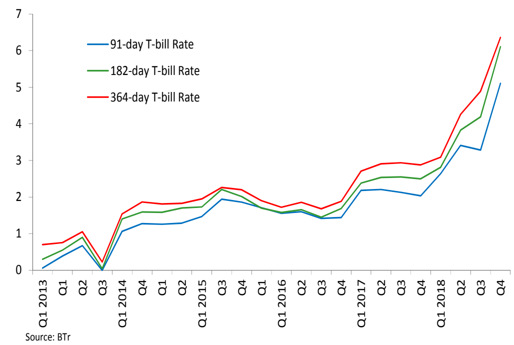
## Interest Rates

### Primary Interest Rates

In Q4 2018, the average 91-, 182-, and 364-day T-bill rates in the primary market increased to 5.105 percent, 6.110 percent, and 6.357 percent from 3.283 percent, 4.190 percent, and 4.895 percent, respectively, in line with recent policy rate hikes by the BSP.

## T-bill rates continue to increase

**Chart 23. Treasury Bill Rates**
in percent




**Yield Curve.**[31] As of end-December 2018, the secondary market yield for government securities (GS) with maturities of 3 months to 5 years rose relative to the end-September 2018 levels, as market players invested their excess liquidity and serviced their clients' requirements.

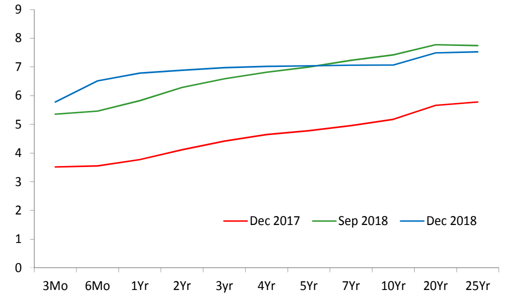
## Yields for GS with shorter tenors rise

Debt paper yields were higher by a range of 4.1 bps (5-year GS) to 105.3 bps (6-month GS) compared to end-September 2018 levels. Meanwhile, yields for GS with tenors of 7 years and above declined by a range of 16.8 bps (7-year GS) to 35.6 bps (10-year GS).

[31] On 29 October 2018, the Bankers Association of the Philippines (BAP) replaced the PDST Reference Rates and launched the PHP BVAL Reference Rates which will be used as the Philippine Peso GS benchmark. The PHP BVAL Reference Rates are calculated by Bloomberg Finance Singapore L.P. and/or its affiliates in an agreement with the BAP.

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

in percent




Source: Bloomberg

Relative to year-ago levels, the secondary market yields of GS for all maturities increased by a range of 175.0 bps for the 25-year GS to 301.5 bps for the 1-year GS.

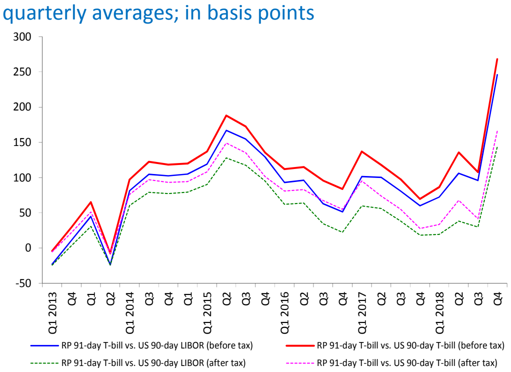
**Interest Rate Differentials.** The average differentials between domestic and US interest rates, gross and net of tax, widened in Q4 2018 relative to the previous quarter.

## Interest rate differentials widen in Q4 2018

The average 91-day RP T-bill rate rose q-o-q by 181.0 bps to 5.105 percent in Q4 2018 from 3.295 percent in Q3 2018. Likewise, the average US 90-day LIBOR and US 90-day T-bill rate rose by 30.8 bps and 20.6 bps, respectively to 2.645 percent and 2.424 percent in Q4 2018.

**Chart 25. Interest Rate Differentials**

quarterly averages; in basis points



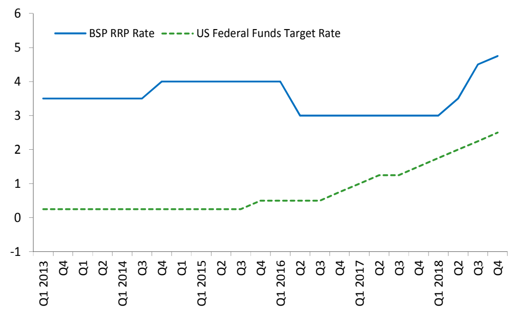

Source: Bloomberg, BTr and BSP

These developments led to wider positive gross and net of tax differentials between the 91-day RP T-bill rate and US interest rates. Domestic and foreign interest rates rose during the quarter following the BSP and the US Fed's 25-bp policy rate hikes.

The positive differential between the BSP's overnight borrowing or RRP rate and the US Fed funds target rate was steady at a range of 225-250 bps in Q4 2018, reflecting the impact of the 25-bp increase in the BSP's RRP rate to 4.75 percent on 15 November 2018 and the quarter point hike in the US Fed funds target rate to 2.25-2.50 percent on 20 December 2018.

**Chart 26. BSP RRP Rate and US Federal Funds Target Rate**

in percent

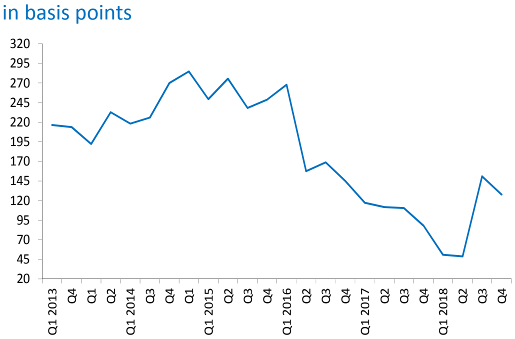



Source: Bloomberg and BSP

Meanwhile, the interest rate differential between the BSP's overnight RRP rate and the US Fed funds target rate adjusted for risk[32] narrowed to 128 bps as of end-December 2018 from 151 bps in end-September 2018. This development could be traced to the higher risk premium following the 39.0-bp decline in the 10-year US note which more than offset the 16.0-bp decline in the 10-year ROP note.

**Chart 27. Risk-Adjusted Differentials**

in basis points



Source: Bloomberg and BSP

The 10-year US note and the 10-year ROP note declined on investor demand for safe-haven assets amid concerns over trade tensions between the US

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

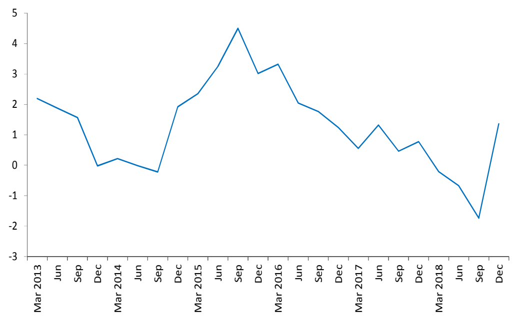
and China and a possible global economic slowdown in 2019 following the release of weaker-than-expected US data in the housing and manufacturing sectors, corporate earnings and equities market.

Domestic real lending rate[33] rose to 1.4 percent in December 2018 from -1.7 percent in September 2018.

## Real lending rate increases

This was due to the 160-bp decline in inflation to 5.1 percent and the 150-bp increase in actual bank lending rate[34] to 6.5 percent in September 2018.

**Chart 28. Philippines' Real Lending Rate**
in percent



Source: PSA and BSP

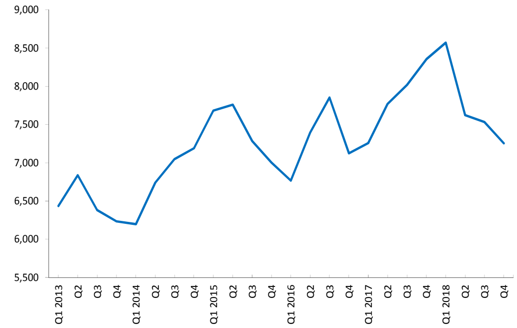
The Philippines' real lending rate at 1.4 percent in December 2018 is the second lowest in a sample of 10 Asian countries, with Indonesia recording the highest real lending rate at 7.3 percent followed by India at 6.9 percent while Japan posted the lowest at 0.2 percent.

### Financial Market Conditions

The domestic financial system in Q4 reflected the volatility stemming primarily from the external environment. Nevertheless, sound banking system and firm economic growth prospects supported investor appetite for domestic assets.

**Stock Market.** In the fourth quarter of the year, the Philippine Stock Exchange index (PSEi) declined to 3.8 percent q-o-q to average 7,247.1 index points for the period in review.

**Chart 29. Quarterly Average PSEi**
In basis points



Source: Philippine Stock Exchange, BSP

In October, local shares dipped and mirrored the global sell-off amidst concerns over the fall in US stocks,[35] escalating trade tensions between the US and China,[36] and slowing global growth. By the middle of November, local shares picked up over the marginal increase in the weight of the Philippines in the MSCI Emerging Markets Index. Moreover, investor sentiments were boosted by Moody's steady outlook for the domestic banking system for the next 12-18 months and by the state visit of Chinese President Xi Jinping's visit to the country, which was expected to bring a number of loan and investment agreements. Towards the end of November, the rally was partly tempered by concerns over the possibility of a reenacted budget for the Philippine government.[37]

The market took a positive turnaround in the first week of December as local shares surged pass the 7,700 mark. Investors became more optimistic due to the US' and China's decision during the G20 Summit to suspend the imposition of new tariffs

[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.

[35] On 26 October, US stocks dropped (with the Nasdaq and S&P 500 losing 3.0 percent and 4.43 percent, respectively) on the release of data on weaker sales of new single family homes in September and some disappointing corporate earnings.
[36] Concerns over the scheduled meeting between US President Donald J. Trump and Chinese President Xi Jinping at the G20 Summit in Argentina in November dampened trading, with US officials saying that Beijing has yet to agree with their request for a meeting during the Summit.
[37] Budget Secretary Benjamin E. Diokno noted that the government will likely see a five-month pause in the implementation of new projects due to the expected delay in the enactment of 2019's proposed ₱3.757 trillion national budget and the ban on public works ahead of the May mid-term elections.

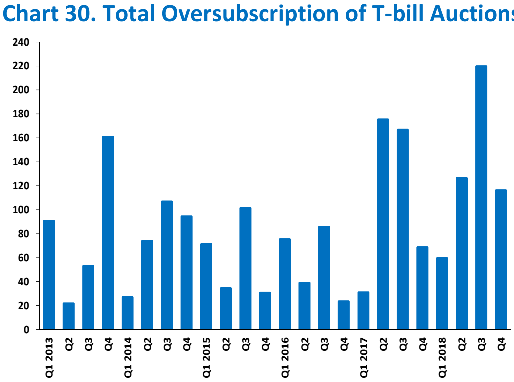
until January next year and on expectations of a tamer domestic inflation for the month of November.[38] The quarter closed at 7,466.02 index points on 28 December 2018, higher by 2.6 percent from its level in September 2018.

**Government Securities.** Results of the T-bill auctions conducted in October-December 2018 continued to show robust demand for short-term government securities with total subscription for the quarter amounting to ₽278.1 billion or about 1.5 times the ₽180.0-billion total offered amount.

## Demand for local GS remains strong

The oversubscription for Q4 2018, at ₽98.1 billion, was lower than the ₽219.1-billion oversubscription in the previous quarter. The Bureau of the Treasury (BTr) awarded in full the ₱4.0-billion, ₱5.0-billion and ₱6.0-billion offered amounts for the 91-, 182- and 364-day T-bills in 7 out of 12 auctions but made partial awards for the other scheduled auctions during the quarter. Meanwhile, results of the T-bond auctions likewise showed strong demand for T-bonds particularly towards the latter part of the quarter on the back of lower inflation expectations.

**Chart 30. Total Oversubscription of T-bill Auctions**




Source: Bureau of the Treasury

In addition to awarding in full the ₽15-billion offered amount in each of the auctions, the BTr opened its tap facility window[39] for four consecutive T-bond auctions (21 November, 27 November, 4 December and 11 December) during the quarter to accommodate excess demand from investors.

**Sovereign Bond and CDS Spreads.** In October, debt spreads widened following the release of the weaker global growth outlook projected by multilateral organizations, such as the World Bank (WB) and International Monetary Fund (IMF), amid rising international trade tensions. In the domestic front, the September inflation data registered a new record-high of 6.7 percent since 2009 due to supply disruptions caused by the onslaught of Typhoon Ompong that placed upward pressure on food prices.

## Debt spreads narrow due to some positive external developments

In November, debt spreads continued to widen as investors searched for safer yielding assets, as indicated by the decrease in the long-term yields of government bonds in advanced economies. Domestically, negative developments persisted as the Q3 GDP growth was weaker than expected at 6.1 percent and slower than the previous quarter's growth of 6.2 percent.

In December, debt spreads narrowed due to positive market reaction over the US Fed rate hike coupled with announcements of a more dovish stance for 2019. Other external developments such as the increased probability of a mutually beneficial and fair agreement between the European Union and the United Kingdom received a warm welcome from investors. Locally, inflation tapered down for two consecutive months from November to December 2018.

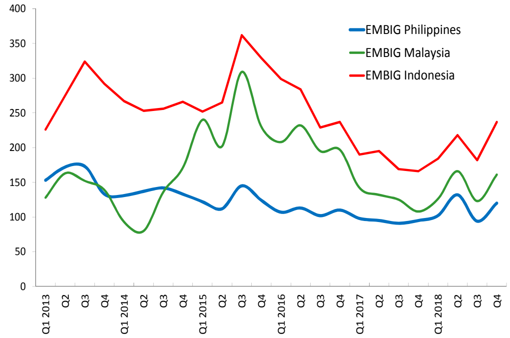
As of 28 December 2018, the extra yield investors demanded to own Philippine sovereign debt over U.S. Treasuries or the Emerging Market Bond Index Global (EMBIG) Philippines spread stood at 116 bps from the end-September level of 94 bps.

[38] On 5 December, PSA reported that headline inflation slowed down to 6.0 percent November. A BusinessWorld poll of 14 economists yielded a 6.3 percent median estimate for November headline inflation in line with market watchers' expectations that the rise in prices has slowed down from October and September's 6.7 percent.

[39] The tap facility window allows Government Securities Eligible Dealers (GSEDs) to access bonds after the initial primary auction.

**Chart 31. EMBIG Spreads of Selected ASEAN Countries**

in basis points

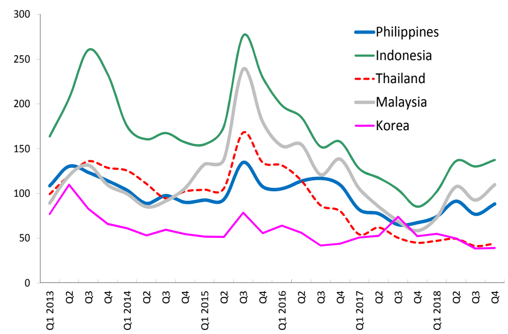



Source: Bloomberg

Similarly, the country's 5-year sovereign CDS increased to 87 bps from its end-September level of 77 bps. Against other neighboring economies, the Philippine CDS traded narrower than Indonesia's 138 bps and Malaysia's 110 bps, but wider than Thailand's 46 bps and Korea's 39 bps spreads.

**Chart 32. 5-Year CDS Spreads of Selected ASEAN Countries**

in basis points




Source: Bloomberg

## Banking System

The Philippine banking system continued to lend support to the country's long-term economic growth and stable financial condition. During the fourth quarter of 2018, banks' balance sheets exhibited sustained growth in assets and deposits.

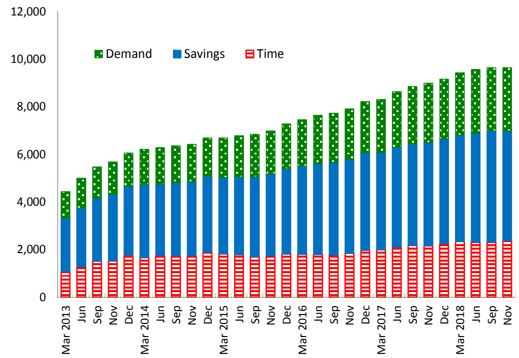
Philippine banking system exhibits steady growth in assets and deposits

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.[40]

**Savings Mobilization.** Savings deposits remained the primary sources of funds for the banking system. Banks' total deposits as of end-November 2018 amounted to ₱9.6 trillion, 7.3 percent higher than the year-ago level.[41] Relative to the end-September 2018 level, total deposits remained the same.

**Chart 33. Deposit Liabilities of Banks**

in billion pesos




Source: BSP

Meanwhile, foreign currency deposits owned by residents (FCD-Residents) reached ₱2.0 trillion as of end-November 2018, posting a y-o-y growth of 4.0 percent. With respect to the end-September 2018 level, FCD-Residents grew marginally by 0.5 percent.[42]

[40] Beginning 1 July 2018, covered institutions (universal banks [UBs], commercial banks [KBs] and their subsidiary banks and quasi-banks [QBs]) must maintain a leverage ratio of no lower than five (5) percent. The leverage ratio is a non-risk based measure, which serves as a backstop to the Capital Adequacy Ratio (CAR). It is designed to constrain the potential build-up of leverage in the banking industry and to promote stability of the financial system. Also, the BSP sets an observation period of six months (from 1 July 2018 to 31 December 2018) for the Net Stable Funding Requirement (NSFR). This is to ensure a smooth transition to the new prudential standard and to allow prompt assessment and calibration of the components of the NSFR. Beginning 1 January 2019, however, the covered institutions (U/KBs) shall maintain an NSFR of 100.0 percent on both solo and consolidated bases.

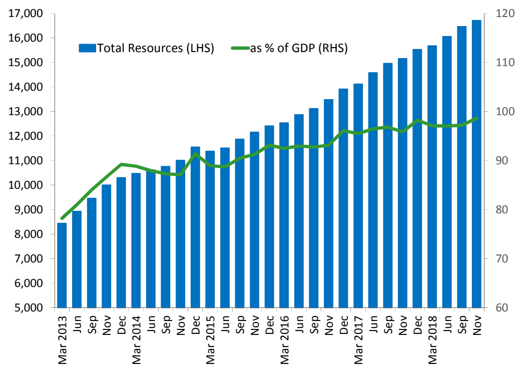
[41] This refers to the total peso-denominated deposits of the banking system.

[42] 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.

**Institutional Developments.** The total resources of the banking system grew by 10.3 percent to reach ₱16.7 trillion as of end-November 2018 from ₱15.0 trillion a year ago and by 1.5 percent from ₱16.5 trillion a quarter ago. As a percent of GDP, total resources stood at 98.6 percent.[43]

## Total resources of the banking system continue to rise

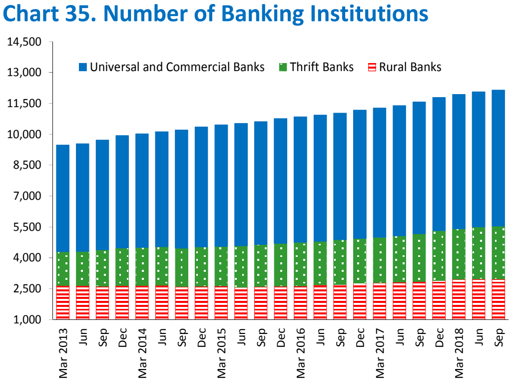
**Chart 34. Total Resources of the Banking System**
levels in billion pesos; share in percent




Source: BSP

The number of banking institutions (head offices) as of end-September 2018 has decreased to 574 offices from 592 a year ago and 581 a quarter ago. The banks' head offices are comprised of 44 U/KBs, 54 TBs, and 476 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

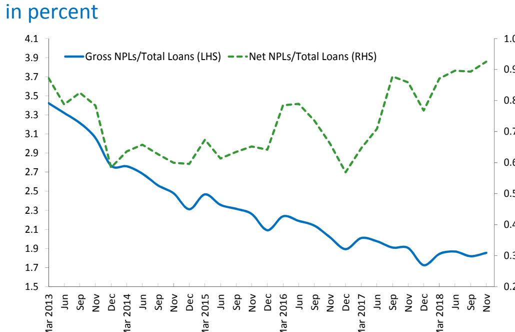
Meanwhile, the operating network (head offices and branches/agencies) of the banking system expanded to 12,148 offices as of end-September 2018 from 11,571 offices a year ago and 12,066 offices a quarter ago, due mainly to the increase in the branches/agencies led by TBs and followed by U/KBs and RBs.

The Philippine banking system's gross non-performing loan (GNPL) ratio was unchanged at 1.9 percent as of end-November 2018 relative to the year-ago level. Meanwhile, this was slightly higher than the end-September 2018 ratio of 1.8 percent.

## Asset quality of Philippine banks remains 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.[44] Meanwhile, net non-performing loan (NNPL) ratio was unchanged at 0.9 percent as of end-November 2018 relative to the previous year's and quarter's 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 ₱91.4 billion in November 2018 from ₱89.9 billion posted as of end-September 2018.[45]

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




Source: BSP

The Philippine banking system's GNPL ratio of 1.9 percent was higher with respect to that of Malaysia (1.5 percent) and South Korea

[43] GDP as of the third quarter of 2018.

[44] The 3.5 percent non-performing loans (NPL) ratio was based on the pre-2013 definition.

[45] 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.

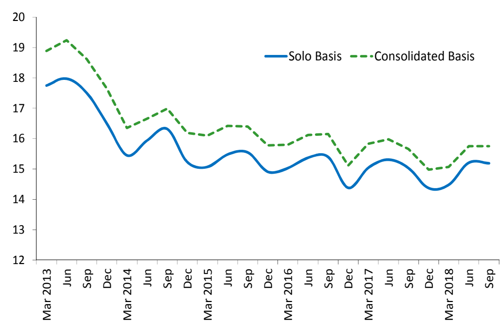
(1.0 percent) but lower than that of Indonesia (2.6 percent) and Thailand (3.0 percent).[46]

The loan exposures of banks remained adequately covered with the banking system's NPL coverage ratio of 108.3 percent as of end-November 2018. This was slightly lower than the previous year's and quarter's ratio of 114.6 percent and 110.9 percent, respectively.

## U/KBs' CAR remains above international and regulatory standards

The CAR of U/KBs at end-September 2018 remained unchanged at 15.2 percent on solo basis and 15.8 percent on a consolidated basis relative to the previous quarter's ratios. These figures remained well above the BSP's regulatory threshold of 10.0 percent and international standard of 8.0 percent.

**Chart 37. Capital Adequacy Ratio of Universal and Commercial Banks**
in percent




Source: BSP

The CAR of Philippine U/KBs, on a consolidated basis, was slightly higher than that of South Korea (15.6 percent) but lower than those of Malaysia (17.2 percent), Thailand (18.4 percent) and Indonesia (22.9 percent).[47]

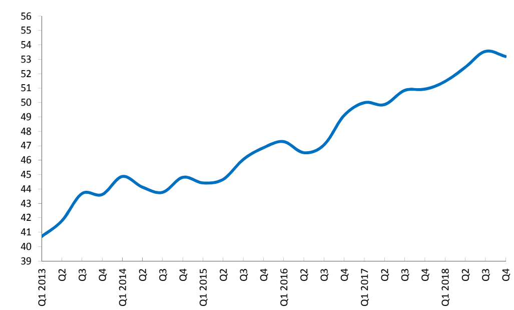
### Exchange Rate

The peso averaged ₱53.26/US$1 in Q4 2018, appreciating slightly by 0.52 percent from the previous quarter's average of ₱53.54/US$1.

## Peso appreciates against the US dollar in Q4 2018

The peso's appreciation was due mainly to improving domestic inflation data and strong remittance inflow during the review quarter. On a y-o-y basis, the peso meanwhile depreciated by 4.38 percent relative to the ₱50.93/US$1 average in Q4 2017.[48]

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




Source: Reference Exchange Rate Bulletin, Treasury Department, BSP

In October 2018, the peso averaged ₱54.01/US$1, depreciating by 0.12 percent from the average in September. The peso's depreciation followed the release of hawkish US Federal Reserve minutes for its 25-26 September 2018 meeting[49], lingering US-China trade tensions and geopolitical concerns in Europe. The peso recovered in November as it averaged ₱52.81/US$1, appreciating by 2.27 percent from the average in October. The peso's appreciation followed the release of domestic inflation data which was within market expectation and the fifth in a series of policy rate hikes by the BSP for the year. Strong remittance inflow likewise provided support to the peso. In December, the peso continued to appreciate as it

[46] Sources: Malaysia (Banking System's Ratio of net impaired loans to net total loans, November 2018); South Korea (Domestic Banks' Substandard or Below Loans [SBLs] ratio, September 2018); Indonesia, IMF and financial stability reports (Banks' Nonperforming Loans to Gross Loans Ratio, September 2018); and Thailand (Total Financial Institutions' Gross NPLs ratio, September 2018).

[47] Sources: South Korea (Capital Ratios of Banks and Bank Holding Companies, September 2018); Malaysia (Banking System's Total Capital Ratio, November 2018); Thailand (Commercial Banks' Capital Funds Percentage of Risk Assets, October 2018); and Indonesia, IMF and financial stability reports (Commercial Banks, Regulatory Capital to Risk-Weighted Assets Ratio, September 2018).

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

[49] In the minutes of the 25-26 September meeting of the policy-setting Federal Open Market Committee (FOMC), central bankers backed raising benchmark rates amid US President Donald J. Trump's view that the tightening moves have gone too far, Reuters reported.

averaged ₱52.77/US$1, which was 0.07 percent higher than the average in November.
On a y-t-d basis, the peso depreciated against the US dollar by 5.04 percent to close at ₱52.58/US$1 on 28 December 2018 from the end-December 2017 closing rate of ₱49.93/US$1. The peso depreciated along with other regional currencies.[50]

Nonetheless, the sustained inflows of foreign exchange from overseas Filipino remittances, foreign direct investments (FDI), BPO receipts, as well as the ample level of the country's Gross International Reserves (GIR) and the country's robust economic growth, are expected to provide support to the peso.

Meanwhile, the volatility of the peso's daily closing rates (as measured by the coefficient of variation) stood at 1.25 percent during the review quarter, higher than the 0.65 percent registered in the previous quarter.[51] The volatility of the peso was slightly higher than the other currencies in the region.

On a real trade-weighted basis, the peso lost external price competitiveness in October and in November 2018 against the basket of currencies of all trading partners (TPI), and trading partners in advanced (TPI-A) and developing (TPI-D) countries relative to Q3 2018 as the real effective exchange rate (REER) index of the peso increased by 1.90 percent, 1.57 percent and 2.10 percent against the TPI, TPI-A and TPI-D baskets, respectively.[52,53]

[50] Based on the last done deal transaction in the afternoon.
[51] 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.

[52] The TPI measures the nominal and real effective exchange rates of the peso across the currencies of 14 major trading partners (MTP) of the Philippines, which include US, Euro Area, Japan, Australia, China, Singapore, South Korea, Hong Kong, Malaysia, Taiwan, Indonesia, Saudi Arabia, United Arab Emirates, and Thailand. The TPI-A 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-D 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.
[53] 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 NG recorded a ₱477.2-billion fiscal deficit for January-November 2018, almost double than the deficit posted in the previous year.

## NG recorded a fiscal deficit for January-November 2018

Netting out the interest payments in NG expenditures, the primary deficit amounted to ₱157.2 billion, a turnaround from the ₱46.5 billion surplus recorded in January-November 2017.

**Table 16. National Government Fiscal Performance**
in billion pesos

| | 2017 | | 2018 | | Growth Rate (in percent) | |
|---|---|---|---|---|---|---|
| | Nov | Jan-Nov | Nov | Jan-Nov | Nov | Jan-Nov |
| Surplus/(Deficit) | -8.6 | -243.5 | -39.1 | -477.2 | 354.0 | 96.0 |
| Revenues | 243.5 | 2,250.0 | 259.7 | 2,618.0 | 7.0 | 16.0 |
| Expenditures | 252.1 | 2,493.5 | 298.8 | 3,095.2 | 19.0 | 24.0 |

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

Revenues increased by 16.0 percent to ₱2,618.0 billion in January-November 2018 compared to ₱2,250.0 billion in the same period last year. The Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC) contributed ₱1,801.0 billion and ₱538.5 billion, respectively. Revenue collections by the BIR and BOC were higher by 11 percent and 30 percent, respectively. Meanwhile, income from BTr increased by 20.0 percent to ₱103.6 billion attributed to higher income from National government deposits investments, and remittance from PAGCOR.

Expenditures for the period in review amounted to ₱3,095.2 billion, 24.0 percent higher than the expenditures in January-November 2017. Excluding interest payments, expenditures went up by 26.0 percent to ₱2,775.2 billion. Meanwhile, interest payment was ₱30.0 billion higher compared to its year-ago level, reaching ₱320 billion in January-November 2018.

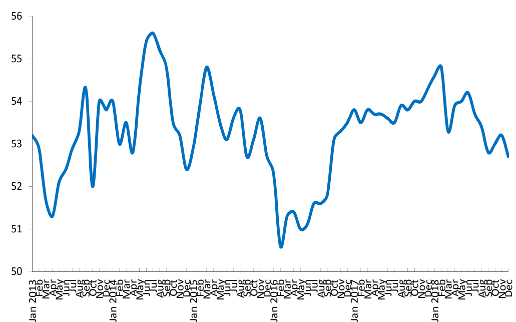
# IV. External Developments

The JP Morgan Global All-Industry Output Index declined to 52.7 in December from 53.2 in November due to a slight decrease in new orders.

## Global economic activity expands at a slower pace

During the month, economic activity expanded faster in China, the UK, and Brazil. The US remained one of the best performers although output growth eased slightly from November. The euro area was the main source of the slowdown, as rates of expansion decelerated in Germany and Spain. For the first time in two-and- a-half years, economic activity in France contracted.[54]

**Chart 39. JP Morgan Global All-Industry Output Index**
index points



Source: Markit Economics

**US.** Real GDP expanded by 3.4 percent on a seasonally adjusted q-o-q basis in Q3 2018, slower than the 4.2-percent growth rate in Q2 2018. On a y-o-y basis, real output grew by 3.0 percent, slightly faster than the 2.9 percent expansion in the previous quarter. The expansion in real GDP during the third quarter reflected positive contributions from personal consumption expenditures (PCE), private inventory investment, state and local government spending, federal government spending, and nonresidential fixed investment. These movements were partly offset by negative contributions from exports and residential fixed investment. [55]

## US economy expands in Q3 2018

Meanwhile, the manufacturing PMI decreased to 54.1 in December from 59.3 percent in November as new orders and production fell amid weaker demand.[56]

The unemployment rate rose to 3.9 percent in December from 3.7 percent in November. Total nonfarm payroll employment increased by 312,000 during the month, with employment gains in health care, food services and drinking places, construction, manufacturing, and retail trade. Meanwhile, on a y-o-y basis, inflation was 1.9 percent in December, lower than the 2.2-percent inflation in November. The decrease in inflation was attributed mainly to the sharp decline in the gasoline price index.

The Conference Board Consumer Confidence Index decreased to 128.1 in December from 136.4 in November.[57] Meanwhile, the Thomson-Reuters/University of Michigan Index of Consumer Sentiment increased to 98.3 in December from 97.5 in November.[58] Consumers were generally less optimistic on income and job prospects amid the decline in stock prices. While consumers' assessment of job prospects during the month were more negative, a majority of the surveyed respondents expected unemployment to remain steady in the year ahead.

**Euro Area.** On a q-o-q basis, real GDP growth in the euro area was 0.2 percent in Q3 2018, lower than the 0.4 percent GDP growth in Q2 2018. On a y-o-y basis, real GDP expanded by 1.6 percent in Q3 2018 from 2.2 percent in Q2 2018.[59]

## Output growth in the euro area eases

[54] JP Morgan Global Manufacturing & Services PMI, http://www.markiteconomics.com/
[55] US Bureau of Economic Analysis, "Gross Domestic Product: Third Quarter 2018 (Third Estimate)," news release, 21 December 2018. https://www.bea.gov/system/files/2018-12/gdp3q18_3rd_1.pdf
[56] Institute for Supply Management, https://www.instituteforsupplymanagement.org
[57] The Conference Board, http://www.conference–board.org/
[58] Flash estimate. University of Michigan Survey of Consumers, http://www.sca.isr.umich.edu/
[59] Eurostat news release 174/2018 dated 14 November 2018

Meanwhile, the composite PMI for the euro area decreased to 51.1 in December from 52.7 in November, reflecting the slowdown of growth in production and new work.[60]

Inflation in the euro area is seen to decrease to 1.6 percent in December from 1.9 percent in November due to lower inflation for energy as well as food, alcohol, and tobacco.[61] The seasonally adjusted unemployment rate decreased to 7.9 percent in November from 8.0 percent in October.

The European Commission's Economic Sentiment Indicator in the euro area decreased to 107.3 in December from 109.5 in November due to lower confidence in industry, services, construction, and among consumers, while confidence improved slightly in retail trade.

**Japan.** On a q-o-q basis, real GDP contracted by 0.6 percent (revised) in Q3 2018 from a growth of 0.7 percent (revised) in Q2 2018. Meanwhile, on a y-o-y basis, real GDP was broadly steady in Q3 2018 from a 1.4-percent expansion in the previous quarter.[62] The lower y-o-y GDP growth in Q3 2018 versus the previous quarter was driven by the contraction in both private and public demand.

## Manufacturing activity in Japan improves

Meanwhile, the seasonally adjusted manufacturing PMI rose slightly to 52.6 in December from 52.2 in November due to increases in both output and new orders.[63]

Inflation decreased to 0.8 percent in November from 1.4 percent in October due mainly to slower price increases for food; transportation and communication; and culture and recreation. The seasonally adjusted unemployment rate increased to 2.5 percent in November from 2.4 percent in October.

**China.** Real GDP in China expanded by 6.5 percent y-o-y in Q3 2018 from 6.7 percent in Q2 2018. The Chinese economy posted a slower rate of expansion in Q3 as the government's efforts to tackle debt risks and the country's trade war with the United States began to weigh on growth.

## Chinese manufacturing activity falls to contrraction territory

Meanwhile, the seasonally adjusted manufacturing PMI fell to 49.7 in December from 50.2 in November due to a renewed decline in total new work received by Chinese manufacturers during the month.[64]

Inflation fell to 2.2 percent in November from 2.5 percent in October as increases in the prices of both food and non-food items were slower during the month.

**India.** Real GDP in India expanded by 7.1 percent y-o-y in Q3 2018 from 8.2 percent in the previous quarter. Albeit slower, the latest GDP expansion was driven mainly by growth in manufacturing; electricity, gas, water supply and other utility services; construction; and public administration, defense, and other services.[65]

## Economic activity in India slows down in December

Meanwhile, the composite PMI decreased to 53.6 in December from 54.5 in November as the slowdown in growth of services activity was accompanied by a weaker increase in manufacturing production.

Inflation fell to 2.2 percent in December from 2.3 percent in November due mainly to the sustained decrease in the prices of food and beverages.

**ASEAN Region.** The Nikkei ASEAN Manufacturing PMI fell slightly to 50.3 in December from 50.4 in November as new orders improved only marginally while export orders continued to decline amid a downturn in overseas demand.

[60] Markit Eurozone PMI, http://www.markiteconomics.com/
[61] Eurostat news release 1/2018 dated 4 January 2019
[62] Second Preliminary Estimate. Department of National Accounts, Economic and Social Research Institute, Cabinet Office. http://www/esri.cao.go.jp/
[63] Nikkei Japan Manufacturing PMI, http://www.markiteconomics .com/
[64] Caixin China General Manufacturing PMI, http://www.markiteconomics.com/
[65] Ministry of Statistics and Programme Implementation. http://mospi.nic.in/

## Overall manufacturing conditions in the ASEAN region is weaker

Output growth was faster in Myanmar and Indonesia, but slower in Vietnam and the Philippines. Meanwhile, manufacturing conditions recovered in Thailand. Malaysia and Singapore remained in the contraction territory.[66]

**Policy Actions by Central Banks.** In December, the US Fed and the Bank of Thailand (BOT) decided to raise their respective policy rates by 25 bps. Aside from the BSP, the Bank of Korea (BOK) and Bank Indonesia (BI) also raised their respective policy rates by 25 bps in November. Meanwhile, Bank of Canada (BOC) also decided to raise its target for the overnight rate in October.

## A number of central banks tighten their monetary policy settings

On 19 December 2018, the US Fed raised the target range for the federal funds rate by 25 bps to 2.25 to 2.5 percent, in view of realized and expected labor market conditions and inflation. Employment gains in the US labor market continued to strengthen in recent months while household spending remained robust. In addition, overall inflation and inflation other than food and energy in the US remained near the Fed's 2-percent objective.

Similarly, on 19 December 2018, the BOT increased the policy rate by 25 bps to 1.75 percent in order to curb financial stability risks. The BOT also assessed that there was a reduced need for accommodative monetary policy as the prolonged low policy rate had already contributed to economic expansion, at levels consistent with its potential and the inflation target.

On 30 November 2018, the BOK decided to raise the base rate by 25 bps to 1.75 percent amid concerns on the property sector boom in Seoul, elevated household debt, and potential capital outflows which may arise from the widening interest rate gap between South Korea and the United States.

On 15 November 2018, the BI Board of Governors decided to raise the BI 7-day reverse repo rate by 25 bps to 6 percent, reflecting mainly the efforts of the BI to reduce current account deficit to within a manageable threshold. The latest increase in the policy rate also aimed to strengthen the attractiveness of the Indonesian financial markets, amid expectations of a global policy rate hike in the next few months.

On 24 October 2018, the BOC raised its target for the overnight rate by 25 bps to 1.75 percent based on the Governing Council's assessment that the policy rate needed to rise to a neutral stance to achieve the inflation target. The BOC likewise indicated that the pace of future rate increases would continue to take into account how the economy would adjust to higher interest rates given the elevated level of household debt as well as the implications of developments in global trade policy on the inflation outlook.

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

# V. Monetary Policy  Developments

At its monetary policy meeting on 15 November 2018, the BSP raised the key policy rate by 25 bps to 4.75 percent for the overnight reverse repurchase or RRP facility. The interest rates on the overnight lending and deposit facilities were likewise raised accordingly.

## The BSP raised the key policy rate early in the quarter...

While the latest inflation forecasts show inflation settling within the target band of 3.0 percent ± 1.0 ppt in both 2019 and 2020, after considering the impact of non-monetary measures, including the rice tariffication bill and the suspension of the oil excise tax, the BSP decided to raise the policy rate by 25 bps given the upside risks to the inflation outlook and given that inflation expectations have remained elevated as supply-side and possible wage pressures continue to drive price developments.

Equally important, the BSP believes that prospects for the domestic economy remain generally favorable and allow some scope for a measured adjustment in the policy rate to rein in inflation expectations and preempt further second-round effects. The BSP deemed it necessary to respond with proactive policy action to help temper the risks to the inflation outlook, including those emanating from the continued uncertainty in the external environment amid tighter global financial conditions and trade tensions among major economies.

## ...and thereafter maintains its monetary policy stance

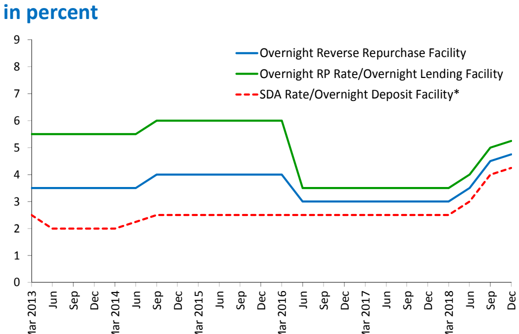
Meanwhile, in deciding to maintain the BSP's monetary policy settings at its monetary policy meeting on 13 December 2018, the BSP noted that the latest inflation forecasts show a lower path over the policy horizon, with inflation settling within the target band of 3.0 percent ± 1.0 ppt point for 2019-2020. Recent headline inflation readings indicate signs of receding price pressures as constraints on food supply continue to ease with the implementation of various non-monetary measures. Inflation expectations have also steadied given the decline in international crude oil prices and the stabilization of the peso.

The risks to the inflation outlook have become more evenly balanced for 2019 and leans toward the downside for 2020 amid a more uncertain global economic environment, which could further mitigate upward pressures from commodity prices in the coming months.

Given these considerations, the BSP deemed it prudent for the time being to keep monetary policy settings steady and allow previous monetary responses to continue to work their way through the economy. The BSP reiterates that it remains vigilant against developments that could affect the outlook for inflation and financial stability.

The BSP reassures the public of its strong commitment to take further policy action as appropriate to safeguard its price stability mandate.

**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

# VI. Inflation Outlook

## BSP Inflation Forecasts

The latest baseline forecasts indicate that inflation has started to ease with average inflation for 2019 and 2020 projected to settle within the 3.0 percent ± 1.0 percentage point target range. The decline in the forecast path for 2019-2020 can be attributed primarily to the significant reduction in global crude oil prices, lower-than-expected inflation outturns in October to December 2018, estimated impact of the tariffication of rice, and the cumulative impact of the BSP's monetary policy adjustments, which resulted in a stronger peso and slower domestic liquidity growth.

The risks to the inflation outlook is broadly balanced for 2019, but on the downside for 2020. Higher electricity rates, faster-than-expected monetary policy normalization in advanced economies, and the proposed increase in the sin taxes of alcoholic beverages are the main upside risks to inflation.

Meanwhile, slower global economic growth due to protectionist policies in advanced economies and geopolitical tensions, along with the potential renegotiation on the concessions for lower tariff rates on meat products continue to be the main downside risks to inflation.

Inflation has started to ease and could settle within the target range in 2019 – 2020

**Demand Conditions.** Domestic economic activity grew by 6.1 percent in Q3 2018, slower than the 7.2-percent growth registered in Q3 2017 and the revised 6.2-percent growth in Q2 2018. On the expenditure side, growth was driven by stronger exports and the acceleration in government consumption. On the production side, the industry and services sectors continue to be the primary drivers of growth.

Economic activity in the Q4 2018 could be driven by the continued strength in both public and private construction with the implementation of the government's infrastructure spending program as well as the expected rebound in the tourism-related sectors with the reopening of the Boracay.

Looking ahead, prospects for the domestic economy continue to remain firm. GDP expansion could be supported by robust growth in the services sector and public construction. Private capital formation should likewise contribute to economic growth with construction and investments in durable equipment expected to remain solid as the government's projects and other infrastructure programs get underway, given ample liquidity conditions.

High-frequency real sector indicators point to firm growth prospects in the near term. Capacity utilization for the manufacturing sector suggests that more than half of all major manufacturing sectors are operating at above 80.0 percent. The composite PMI also remains above the 50-point mark as of November 2018, suggesting sustained expansion across all sectors.

However, results of the BSP expectations surveys have indicated that consumer and business confidence have turned less optimistic for Q4 2018.

**Supply Conditions.** Food inflation could subside over the near term due to the implementation of non-monetary measures to ease import requirements. In addition, the impending passage of the rice tariffication law could further contribute to downward price pressures moving forward. Meanwhile, subdued global oil prices due to excess global supply and concerns over slowing demand could further temper additional prices pressures.

Lower oil prices and improved domestic food supply conditions have contributed to decelerating price pressures

Global non-oil prices have started to decline following the deceleration in energy prices. Moreover, downside risks on commodity prices could emanate from weaker global growth and escalating trade tensions. The imposition of tariffs by the US and the consequent retaliation of other economies have affected global trade and overall market sentiment.[67]

In the domestic front, palay production could decline by 1.3 percent, while corn production may start to recover by 11.3 percent in Q4 2018 based on standing crop estimates. The projected reduction in palay production could be attributed to lower harvest areas.[68]

The proposed reforms in rice importation could significantly lower food prices in 2019. With the impending implementation of the rice tariffication law and the accelerated the issuance of certifications for the private sector's out-quota rice importation by the NFA, the liberalization of rice importation policy could drive down domestic rice prices closer to the levels from major import sources for rice such as Thailand and Vietnam.

International crude oil prices declined significantly compared to the previous quarter's level owing mainly to waivers granted to Iran's main export destinations, record production in the US, Russia, and Saudi Arabia, and concerns over global demand. Meanwhile, uncertainties surrounding the oil market could emanate from supply dynamics and the intensification of the trade disputes between the US and China.

The latest futures prices indicate that global crude oil prices could remain subdued in 2019-2020. Similarly, the Energy Information Administration (EIA) along with other international agencies expect crude oil prices to remain benign moving forward, but with considerable uncertainty due to potential production decisions by the OPEC.[69]

## Output gap remains neutral and broadly stable

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.[70]

Given the latest GDP data, estimates by the BSP show that the output gap remains neutral and broadly stable relative to the previous quarter.[71]

**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 4.75 percent from December 2018 to December 2020;
2) NG fiscal deficits for 2019 to 2020, 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 November 2019 and November 2020 consistent with labor productivity growth and historical wage increases;
5) Real GDP growth is endogenously determined; and
6) Foreign exchange rate is endogenously determined through the purchasing power parity and interest rate parity relationships.

### Risks to the Inflation Outlook

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

Compared to the previous inflation report, the latest fan chart presents a downward shift in the inflation projection for 2019-2020. The lower projected inflation path could be attributed mainly to the significant reduction in global crude oil prices, lower-than-expected inflation outturns in

[67] IMF, World Economic Outlook, October 2018, available online at http://www.imf.org
World Bank, Commodity Markets Outlook, October 2018, available online at http://www.worldbank.org
[68] PSA, Rice and Corn Situation Outlook, November 2018, available online at http://www.psa.gov.ph
[69] EIA, Short-Term Energy Outlook, December 2018, available online at http://www.eia.gov

[70] 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).
[71] Based on the seasonally-adjusted GDP growth

October to December 2018, estimated impact of the tariffication of rice, and the cumulative impact of the BSP's monetary policy adjustments, which resulted in a stronger peso and slower domestic liquidity growth.

## Projected inflation path is lower for 2019 – 2020

The BSP's review of current inflation dynamics suggests that the risks surrounding the inflation outlook is broadly balanced in 2019 before tilting to the downside in 2020. This assessment is depicted in the latest fan chart, wherein the projection bands below the central projection are greater than the bands above it.

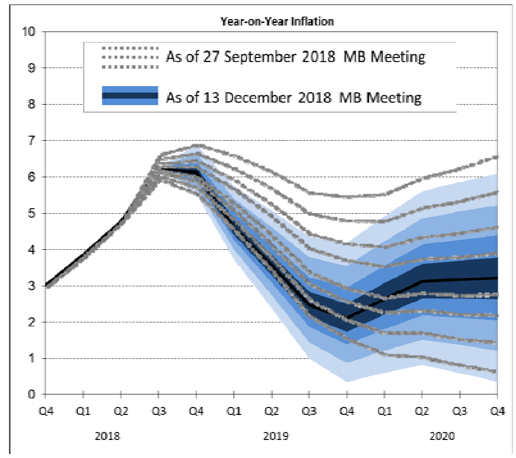
Faster-than-expected policy normalization in the US and other advanced economies could contribute to foreign exchange depreciation pressures and raise inflation. The sustained recovery in economic conditions in the US could warrant further rate hikes by the Federal Reserve. The baseline inflation outlook already assumes two rate hikes in 2019, consistent with latest market sentiment. However, faster-than-expected monetary policy normalization in the US and other advanced economies could lead to tighter global liquidity conditions and repricing of risks. Consequently, the higher federal funds rate could result in portfolio outflows and higher risk premia, leading to a weaker peso and higher inflation over the policy horizon.

Various petitions for rate adjustments by Meralco and PSALM are also considered as upside risks to inflation and have not yet been added to the baseline forecasts. Meralco's petitions include generation and transmission charges, system loss, lifeline subsidy, the December 2013 rate adjustment, which is the subject of Supreme Court temporary restraining order, and the ₱0.65/ kWh adjustment for the January 2014 billing period that is subject to the Energy Regulatory Commission's (ERC) approval. PSALM's petitions cover adjustments for fuel and foreign exchange costs.

Higher sin taxes for alcoholic beverages presents an additional upside risk to inflation. A draft bill proposes to raise the sin taxes of alcoholic beverages (0.7 percent of the CPI basket) as part of TRAIN Package 2 Plus. Under the proposed bill, the specific taxes of distilled spirits, wines, and fermented liquor specified in the Sin Tax Reform Act of 2012 (Republic Act No. 10351) were raised in addition to the higher annual indexation of 7.0 percent from 4.0 percent previously.

## The risks to the inflation outlook remains broadly balanced in 2019, but is tilted to the downside in 2020

**Chart 41. Inflation Projection**




Source: BSP estimates

The global economic outlook is also another source of downside risk to the inflation outlook. The continued policy uncertainty, spillovers from tighter global financial conditions, and geopolitical tensions could lead to slower global trade and economic activity on the whole, thereby leading to potential downward price pressures. Furthermore, the surge in protectionist measures among key economies remains a major risk to the global growth outlook and trade activity. Global demand could be undermined by heightened uncertainty in the trade policies especially between the US and China.

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.

## Implications for the Monetary Policy Stance

On the basis of new information in the fourth quarter, the BSP now has some latitude to allow the monetary policy adjustments throughout 2018, including the cumulative 75-basis-point hike in September and November, to work their way through the traditional channels of monetary policy. Latest baseline projections indicate a within-target inflation trajectory in 2019 and 2020, as inflation momentum continues to slow down owing to the decline in international crude oil prices, the normalization of food supply conditions, and the stabilization of the exchange rate. Inflation expectations also appear to have eased, supported by the recent policy actions of the BSP.

Given these developments, the BSP needs to gauge the impact of its monetary policy responses on domestic economic conditions, as monetary policy works with long and variable lags. At the same time, the implementation of non-monetary measures, including the provisions under the rice tariffication bill, are expected to continue to alleviate the impact of supply-side factors on inflation. Nonetheless, the BSP remains vigilant against developments that could affect the outlook for inflation and financial stability, including those emanating from external forces such as tighter global financial conditions and lingering geopolitical risks. Policy communications should also continue to be geared toward anchoring the public’s inflation expectations, with the message emphasizing authorities’ readiness to undertake further adjustments in the policy interest rate as necessary to safeguard price stability.

## Summary of Monetary Policy Decisions

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

## Summary of Monetary Policy Decisions

| Effectivity Date | Levels (in percent) | | Monetary Policy Decisions |
|---|---|---|---|
| | RRP Overnight | RP Overnight | |
| **6 Oct 2008** | 6.00 | 8.00 | The MB kept the BSP's key policy interest rates unchanged at 6.0 percent for RRP facility and 8.0 percent for the RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged. |
| **6 Nov 2008** | 6.00 | 8.00 | The MB decided to keep the BSP's key policy interest rates steady at 6 percent for the overnight borrowing or RRP facility and 8 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged. |
| **18 Dec 2008** | 5.50 | 7.50 | The MB decided to reduce the BSP's key policy interest rates by 50 bps to 5.5 percent for the overnight borrowing or RRP facility and 7.5 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also adjusted accordingly. Latest baseline forecasts showed a decelerating inflation path over the policy horizon, with inflation falling within target by 2010. This outlook is supported by the downward shift in the balance of risks, following the easing of commodity prices, the moderation in inflation expectations, and the expected slowdown in economic activity. |
| | | **2 0 0 9** | |
| **29 Jan 2009** | 5.00 | 7.00 | The MB decided to reduce the BSP's key policy interest rates by another 50 bps to 5 percent for the overnight borrowing or RRP facility and 7 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also adjusted accordingly. Latest baseline forecasts showed a decelerating inflation path over the policy horizon, with inflation falling within target by 2010. The MB based its decision on the latest inflation outlook which shows inflation falling within the target range for 2009 and 2010. The Board noted that the balance of risks to inflation is tilted to the downside due to the softening prices of commodities, the slowdown in core inflation, significantly lower inflation expectations, and moderating demand. |
| **5 Mar 2009** | 4.75 | 6.75 | The MB decided to reduce the BSP's key policy interest rates by 25 bps to 4.75 percent for the overnight borrowing or RRP facility and 6.75 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. Given possible upside risks to inflation, notably the volatility in oil prices and in exchange rates, increases in utility rates, and potential price pressures coming from some agricultural commodities, the MB decided that a more measured adjustment of policy rates was needed. |

## Summary of Monetary Policy Decisions

| Effectivity Date | Levels (in percent) RRP Overnight | Levels (in percent) RP Overnight | Monetary Policy Decisions |
|---|---|---|---|
| **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**<br>**1 Oct 2009**<br>**5 Nov 2009**<br>**17 Dec 2009** | 4.00 | 6.00 | The MB kept key policy rates unchanged at 4 percent for the RRP facility and 6 percent for the overnight lending RP facility. The decision to maintain the monetary policy stance comes after a series of policy rate cuts since December 2008 totaling 200 bps and other liquidity enhancing measures. |
| | | **2 0 1 0** | |
| **28 Jan 2010**<br>**11 Mar 2010**<br>**22 Apr 2010**<br>**3 Jun 2010**<br>**15 Jul 2010**<br>**26 Aug 2010**<br>**7 Oct 2010**<br>**18 Nov 2010**<br>**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**<br>**20 Oct 2011**<br>**1 Dec 2011** | 4.50 | 6.50 | The MB decided to keep the overnight policy rates steady. At the same time, the reserve requirement ratios were kept unchanged. |

## Summary of Monetary Policy Decisions

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

## Summary of Monetary Policy Decisions

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

## Summary of Monetary Policy Decisions

| Effectivity Date | Levels (in percent) | | Monetary Policy Decisions |
|---|---|---|---|
| | RRP Overnight | RP Overnight | |
| **13 Jun 2013**<br>**25 Jul 2013**<br>**12 Sep 2013**<br>**24 Oct 2013**<br>**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. |
| **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. |

## Summary of Monetary Policy Decisions

| Effectivity Date | Levels (in percent) | | Monetary Policy Decisions |
|---|---|---|---|
| | RRP Overnight | RP Overnight | |
| **23 Oct 2014**<br>**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. |
| | | **2015** | |
| **12 Feb 2015**<br>**26 Mar 2015**<br>**14 May 2015**<br>**25 Jun 2015**<br>**13 Aug 2015**<br>**24 Sep 2015**<br>**12 Nov 2015**<br>**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**<br>**23 Mar 2016**<br>**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**<br>**11 Aug 2016**<br>**22 Sep 2016**<br>**10 Nov 2016**<br>**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.<br><br>The interest rates for these facilities will be set as follows starting 3 June 2016:<br><br>• 3.5 percent in the overnight lending facility (a reduction of the interest rate for the upper bound of the corridor from the |

## Summary of Monetary Policy Decisions

| Effectivity Date | Levels (in percent) RRP Overnight | Levels (in percent) RP Overnight | Monetary Policy Decisions |
|---|---|---|---|
| | | | current overnight RP rate of 6.0 percent);<br><br>• 3.0 percent in the overnight RRP rate (an adjustment from the current 4.0 percent); and<br><br>• 2.5 percent in the overnight deposit facility (no change from the current SDA rate). |
| **2 0 1 7** | | | |
| **9 Feb 2017<br>23 Mar 2017<br>11 May 2017<br>22 Jun 2017<br>10 Aug 2017<br>21 Sep 2017<br>9 Nov 2017<br>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. |
| **2 0 1 8** | | | |
| **8 Feb 2018** | 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). |
| **15 Feb 2018** | | | The reserve requirement ratio was reduced by one (1) percentage point as an operational adjustment to support the BSP's shift toward a more market-based implementation of monetary policy as well as its broad financial market reform agenda. The reduction will apply to the reservable liabilities of all banks and non-bank financial institutions with quasi-banking functions with reserve requirement at twenty (20) percent. |
| **22 Mar 2018** | 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). |
| **10 May 2018** | 3.25 | 3.75 | The MB decided to increase the BSP's key policy interest rates by 25 basis points to 3.25 percent for the overnight reverse repurchase (RRP) facility, 3.75 percent for the overnight lending facility (OLF) and 2.75 percent for the overnight deposit facility (ODF). |
| **24 May 2018** | | | The reserve requirement ratio was reduced by one (1) percentage point as part of its medium-term financial market reform agenda to promote a more efficient financial system by lowering intermediation costs. The reduction will apply to those reservable liabilities of all banks and non-bank financial institutions with quasi-banking functions that are currently subject to a reserve requirement of nineteen (19) percent. |

## Summary of Monetary Policy Decisions

| Effectivity Date | Levels (in percent) | | Monetary Policy Decisions |
|---|---|---|---|
| | RRP Overnight | RP Overnight | |
| **2018** | | | |
| **20 June 2018** | 3.50 | 4.00 | The MB decided to raise the BSP's key policy interest rates by 25 basis points to 3.50 percent for the overnight reverse repurchase (RRP) facility, 4.00 percent for the overnight lending facility (OLF) and 3.00 percent for the overnight deposit facility (ODF). |
| **9 August 2018** | 4.00 | 4.50 | The MB decided to raise the BSP's key policy interest rates by 50 basis points to 4.00 percent for the overnight reverse repurchase (RRP) facility, 4.50 percent for the overnight lending facility (OLF) and 3.50 percent for the overnight deposit facility (ODF). |
| **27 September 2018** | 4.50 | 5.00 | The MB decided to raise the BSP's key policy interest rates by 50 basis points to 4.50 percent for the overnight reverse repurchase (RRP) facility, 5.00 percent for the overnight lending facility (OLF) and 4.00 percent for the overnight deposit facility (ODF). |
| **15 November 2018** | 4.75 | 5.25 | The MB decided to raise the BSP's key policy interest rates by 25 basis points to 4.75 percent for the overnight reverse repurchase (RRP) facility, 5.25 percent for the overnight lending facility (OLF) and 4.25 percent for the overnight deposit facility (ODF). |
| **13 December 2018** | 4.75 | 5.25 | The MB decided to maintain the BSP's key policy interest rates at 4.75 percent for the overnight reverse repurchase (RRP) facility, 5.25 percent for the overnight lending facility (OLF) and 4.25 percent for the overnight deposit facility (ODF). |

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:

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