ISSN 1655-5104

INFLATION REPORT
1st QUARTER 2017

BANGKO SENTRAL NG PILIPINAS

Foreword

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

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

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

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

The Monetary Board approved this Inflation Report at its meeting on 11 April 2017.

AMANDO M. TETANGCO, JR.
Governor

The Monetary Policy of the Bangko Sentral ng Pilipinas

The BSP Mandate

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

Monetary Policy Instruments

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

Policy Target

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

BSP's Explanation Clauses

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

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

The Monetary Board

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

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

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

List of Acronyms, Abbreviations, and Symbols

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

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Overview

Headline inflation rises. The average headline inflation for Q1 2017 was higher at 3.2 percent compared to the quarter- and year-ago rates of 2.5 percent and 1.1 percent, respectively. Nevertheless, inflation remained within the National Government's announced target range of 3.0 percent ± 1.0 percentage point for 2017. The rise in average inflation during the review quarter could be attributed to some tightness in domestic food supply and upward adjustments in petroleum prices and electricity rates. Similarly, core inflation was higher at 2.7 percent in Q1 2017 from the quarter- and year-ago rates of 2.5 percent and 1.6 percent, respectively. Two out of the three alternative measures of core inflation estimated by the BSP increased during the review quarter. Specifically, the trimmed mean and net of volatile items measures were both higher at 2.2 percent, from 1.8 percent and 2.0 percent, respectively, a quarter ago. Meanwhile, the weighted median measure was unchanged from the previous quarter's rate of 1.9 percent. The number of items with inflation rates greater than the threshold of 4.0 percent (which is the upper end of the 2017 inflation target) increased to 31 items in Q1 2017 from 21 items in the previous quarter which collectively comprised 21.3 percent of the CPI basket.

Inflation expectations increase though within the range target. The BSP's survey of private sector economists for March 2017 reported higher mean inflation forecasts for the full year 2017 and 2018. Average annual inflation forecasts for 2017 and 2018 rose to 3.4 percent and 3.5 percent, respectively, from 3.0 percent and 3.1 percent in the December 2016 survey. The higher inflation expectations were attributed to a weaker peso, high global oil prices, implementation of the tax reform, rise in electricity rates due to higher oil prices and maintenance shutdown of some power plants, and higher government spending on infrastructure as well as the possible occurrence of El Niño in the latter part of 2017. These were seen to outweigh the downside risks from the slowdown in the Chinese economy and the yuan devaluation, as well as the risk of recession and deflation in Japan and the Eurozone. Similarly, results of the March 2017 Consensus Economics inflation forecast survey showed higher mean inflation forecast for 2017 at 3.2 percent compared to the previous survey's 2.9 percent. Meanwhile, average mean inflation forecast for 2018 remained broadly steady at 3.3 percent.

Domestic economic activity remains strong. The Philippine economy grew by 6.6 percent in Q4 2016, lower than the quarter- and year-ago acceleration of 7.1 percent and 6.7 percent, respectively. For the full year, real GDP expanded by 6.9 percent, at the high end of the National Government's 2016 growth target of 6.0-7.0 percent. On the expenditure side, the acceleration of growth in government spending and exports of goods were weighed down partially by the slowdown in consumer spending and fixed capital investments. On the production side, the faster expansion of the services sector was moderated by the contraction in agriculture, hunting, forestry and fishing as well as the lower growth in the industry sector. In addition, other indicators continued to point to firm demand prospects in the near term. Vehicle sales sustained its double-digit growth in the first two months of 2017, supported by continued demand for commercial vehicles. Similarly, energy sales continued to increase.

Inflation in Q1 higher but well within the 2017 range target

Outlook for the domestic economy remained strong. Preliminary composite Purchasing Managers' Index indicated sustained strong expansion in the period ahead. In addition, business and consumer expectations surveys reported broadly steady optimism for the next quarter. These indicators support the view that the country's underlying domestic demand remains firm. At the same time, data on the manufacturing sector's utilization rate point to the economy's capacity to absorb further expansion to productivity.

Global economy remains steady with broadly positive outlook. For Q4 2016, the US economy continued to grow, supported by personal consumption, investments and state spending. Inflation also rose in February on price upticks in food, shelter and recreation. Similarly, Japan's real GDP accelerated due mainly to a pickup in exports amid a weak yen as inflation eased in February. China's economy likewise improved from the previous quarter as several sectors reported positive outturns. Meanwhile, inflation decelerated in February as food prices declined. In contrast, real GDP in the euro area slowed in Q4 although inflation picked up marginally in February driven mainly by the price increases in fuels for transport, vegetables, and heating oil. India likewise reported a slightly lower GDP while inflation rose in February. Outlook for these economies were generally optimistic while that for the ASEAN region remained unchanged owing to the slower rates of expansion in both output and total new orders.

Domestic financial system shows strength amid uncertainty. Volatility coming mainly from the external environment, such as concerns over the shift in US policy including the Fed's anticipated March rate hike, implications of the Brexit process being moved forward and worries over China's declining foreign exchange reserves spilled over into the country's financial markets. The peso remained weak during the review quarter due mainly to higher demand for the US dollar amid continued improvement in the US economy. Nevertheless, the equities market rose in Q1, closing at 7,258.3 index points, as the sustained strong GDP growth in the last quarter of 2016 supported positive sentiment. Debt spreads narrowed as the favorable investor appetite for Philippine securities kept the premium on sovereign debt low. Similarly, investor demand for local currency government securities remained healthy as indicated by oversubscriptions during the regular auctions by the Bureau of the Treasury. Moreover, the banking system saw a continued increase in assets, lending, and deposits, as capital adequacy ratios remained comfortably above the BSP's prescribed levels and international norms. In addition, based on the latest round of the survey on senior bank loan officers, bank lending standards for loans to both enterprises and households were broadly unchanged in Q1 2017, indicating a generally stable supply of credit.

Monetary policy settings were kept steady in Q1 2017. The BSP decided to maintain the key policy interest rate for its overnight reverse repurchase or RRP facility at the February and March monetary policy meetings. The reserve requirement ratios were likewise left unchanged. The BSP's decision to keep the policy rate steady was based on the assessment that while headline inflation has risen due to recent upticks in food and oil prices, inflation dynamics remained manageable.

The latest baseline forecasts of the BSP indicate that inflation could settle slightly above the midpoint of the target range in 2017 and approach the midpoint in 2018. Inflation is projected to rise near the high end of the 2017 target range, driven by a weaker exchange rate and the continued strength in domestic economic activity but will revert back and approach the midpoint of the target range in 2018.

The risks to future inflation remain tilted toward the upside. The expected impact of the government's broad fiscal reform program along with possible adjustments in electricity rates and transportation fares are the main upside risks to inflation. Meanwhile, the lingering uncertainty over the prospects of the global economy, due in part to possible shifts in macroeconomic policies in advanced economies, continues to pose as the key downside risk to the inflation outlook.

Prevailing monetary policy stance remains appropriate

The prevailing monetary policy settings remain appropriate. In summary, prevailing monetary policy settings are deemed to remain appropriate, given that inflation dynamics remain manageable, as reflected in well-contained inflation expectations over the policy horizon; domestic economic activity continues to expand within expectations as latest indicators of domestic demand broadly point to firm growth prospects; and strong credit demand and ample liquidity conditions continue to provide sufficient stimulus to real sector activity. Meanwhile, the BSP's open market operations have remained generally oversubscribed since January, suggesting continued favorable conditions for short-term funding and monetary policy implementation.

Nevertheless, the balance of risks to the inflation outlook remains tilted toward the upside, which supports the case for maintaining vigilance in setting the stance of monetary policy. Going forward, the BSP will need to watch closely for indications of increasing underlying inflationary pressures and the realization of the upside risks to inflation.

I. Inflation and Real Sector Developments

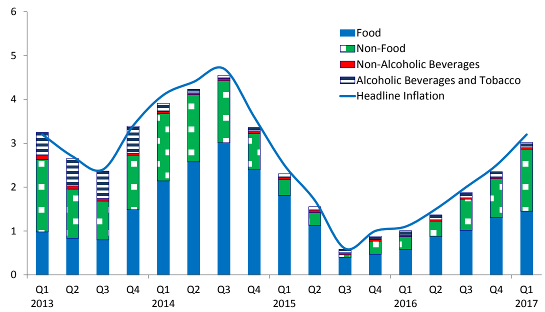
Prices

Headline Inflation Headline inflation continued to increase in Q1 2017 to 3.2 percent compared to quarter- and year-ago rates of 2.5 percent and 1.1 percent, respectively, which is well within the National Government's (NG) announced target range of 3.0 percent ± 1.0 percentage point (ppt) for 2017.

> Q1 2017 inflation pressures came mostly from food, electricity rates and fuel prices

The higher headline inflation during the review quarter was due to an increase in both food and non-food inflation. Food inflation rose to 4.0 percent in Q1 2017 owing to some tightness in the domestic supply conditions, while the higher non-food inflation of 2.4 percent could be attributed to upward adjustments in electricity rates and domestic petroleum prices.

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



Source: Philipine Statistical Authority (PSA), BSP

Core Inflation. Similarly, core inflation, which excludes certain volatile food and energy items to measure generalized price pressures, rose to 2.7 percent in Q1 2017, higher than 2.5 percent in the previous quarter and 1.6 percent a year ago. Two out of the three alternative measures of core inflation estimated by the BSP increased in Q1 2017 relative to the rates registered in the previous quarter. In particular, the trimmed mean and net of volatile items measures were both higher at 2.2 percent (Table 1). Meanwhile, the weighted median measure was unchanged from the previous quarter's rate of 1.9 percent.

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

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

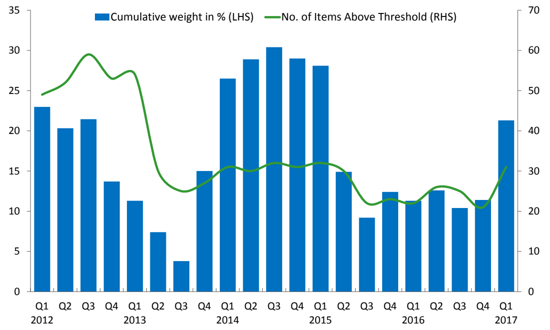
[1] The trimmed mean represents the average inflation rate of the (weighted) middle 70 percent in a lowest-to-highest ranking of year-on-year inflation rates for all CPI components.
[2] The weighted median represents the middle inflation rate (corresponding to a cumulative CPI weight of 50 percent) in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

The number of items with inflation rates greater than the threshold of 4.0 percent (which is the upper end of the 2017 inflation target) went up to 31 items in Q1 2017 from 21 items in the previous quarter. Majority of these items were food commodities. Collectively, these items accounted for 21.3 percent of the CPI basket, slightly higher than the quarter-ago share of 11.4 percent.

Alternatively, CPI items with inflation below 2 percent (the low end of the 2017 inflation target) increased to 138 items in Q1 2017 from 132 items in the previous quarter although the equivalent weight of these items accounted for a smaller portion of CPI basket at 43.2 percent (from 63.0 percent in the previous quarter).

Meanwhile, CPI items within the target range of 2-4 percent declined to 64 items (from 80 items) in Q1 2017 but accounted for a larger share of the total CPI basket at 35.6 percent from 25.5 percent.

Chart 2. CPI Items with Inflation Rates Above Threshold



Source: Philippine Statistics Authority, BSP staff estimates

Food Inflation. Food inflation accelerated in Q1 2017 on higher prices of key food items like meat, fish, oils and fats, as well as milk, cheese, and eggs. Similarly, rice prices also increased due partly to the end of the main harvest season. Inflation rates of fruit, vegetables, and sugar remained elevated during the quarter albeit posting lower inflation readings compared to the previous quarter.

Some tightness in domestic supply pushes food inflation in Q1 2017

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

Commodity	2015				2016				2017
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Food and Non-Alcoholic Beverages	**4.8**	**3.0**	**1.1**	**1.3**	**1.6**	**2.3**	**2.7**	**3.5**	**3.8**
Food	5.0	3.1	1.1	1.3	1.6	2.4	2.8	3.6	4.0
Bread and Cereals	5.7	2.6	-0.5	-1.6	-1.2	-0.2	0.9	1.5	1.8
Rice	7.2	3.3	-0.9	-2.5	-2.0	-0.9	0.5	1.4	2.0
Corn	2.4	0.2	-0.6	-0.4	1.7	2.6	2.5	1.9	0.7
Meat	4.2	1.3	0.4	0.8	1.0	2.2	2.0	1.6	2.4
Fish	5.1	5.3	3.2	3.7	2.8	2.7	4.3	4.9	6.9
Milk, Cheese and Eggs	4.4	3.3	1.9	1.3	1.2	1.5	2.0	2.2	2.4
Oils and Fats	2.7	0.9	-0.3	-0.2	0.3	2.1	3.9	4.6	6.1
Fruit	11.4	9.6	4.9	3.5	3.3	4.4	7.0	9.2	7.9
Vegetables	1.1	0.4	0.2	9.0	10.3	12.9	9.9	11.7	10.6
Sugar, Jam, Honey	3.8	4.2	2.9	3.9	6.4	5.0	3.4	3.0	1.1
Food Products, N.E.C.	4.8	4.6	3.8	2.7	3.1	-1.0	-2.4	-0.1	1.2
Non-Alcoholic Beverages	2.1	2.2	1.8	1.4	1.2	1.2	1.2	1.3	1.2
Alcoholic Beverages and Tobacco	4.0	3.8	3.7	3.9	4.9	5.5	6.0	6.3	6.0

Source of Basic Data: PSA, BSP

Non-Food Inflation. Elevated prices of international crude oil were reflected in the higher inflation outturns for oil-related CPI items namely, transport services, gas, and other fuels. Inflation for transport services rose during the quarter due to approved fare hikes in February 2017,[4] influenced by upward adjustments in the domestic prices of petroleum products during the quarter. At the same time, electricity rates went up as a result of the maintenance shutdown of the *Malampaya* natural gas facility.

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

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

Commodity	2015				2016				2017
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Non-Food	**0.6**	**0.5**	**0.1**	**0.5**	**0.5**	**0.6**	**1.2**	**1.5**	**2.4**
Clothing and Footwear	3.1	2.6	2.3	2.3	1.9	2.3	2.6	2.6	2.8
Housing, Water, Electricity, Gas and Other Fuels	-1.1	-1.1	-1.7	-1.2	-1.0	-1.0	0.2	1.2	2.9
Electricty, Gas, and Other Fuels	-8.7	-8.2	-9.8	-8.8	-7.0	-6.8	-3.2	-0.2	6.0
Furnishings, Household Equipment & Routine Maintenance of the House	2.2	2.1	1.7	1.6	1.5	1.6	2.1	2.4	2.3
Health	2.7	2.3	1.7	1.8	1.9	2.4	2.7	2.6	2.6
Transport	-0.7	0.0	-0.5	0.9	0.3	0.0	0.0	0.9	2.7
Transport Services	2.6	2.9	2.5	3.3	1.2	0.7	0.3	0.7	1.5
Communication	-0.1	-0.1	0.0	0.0	0.1	0.2	0.1	0.1	0.2
Recreation and Culture	1.1	1.1	1.0	1.0	1.1	1.6	1.7	1.7	1.8
Education	5.1	4.7	3.6	3.6	3.6	3.0	1.8	1.8	1.8
Restaurant and Miscellaneous Goods and Services	1.6	1.2	1.2	1.3	1.6	2.2	2.4	2.2	2.1

Source of Basic Data: PSA, BSP

Private Sector Economists' Inflation Forecasts. Results of the BSP's survey of private sector economists for March 2017 showed that the mean inflation forecasts for the full year 2017 and 2018 were higher relative to the results in December 2016.[5]

Mean inflation forecasts for 2017 and 2018 are higher

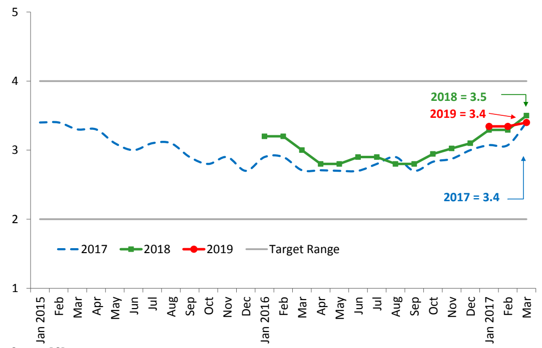
In particular, the mean inflation forecast for 2017 rose to 3.4 percent from 3.0 percent. The average annual inflation forecast for 2018 also went up to 3.5 percent from 3.1 percent.

[4] The Land Transportation Franchising and Regulatory Board (LTFRB) approved the fare petitions of taxi and PUJ transport groups in February 2017. This effectively raised the minimum fare for PUJ's by ₽1.00 in NCR, Region III, and IV. Likewise, taxi flagdown rates were also raised by ₽ 10 to ₽40.

[5] There were 30 respondents in the BSP's survey of private sector economists in March 2017. The survey was conducted between 7 to 31 March 2017.

Chart 3. BSP Private Sector Economists' Survey

mean forecast for full year; in percent



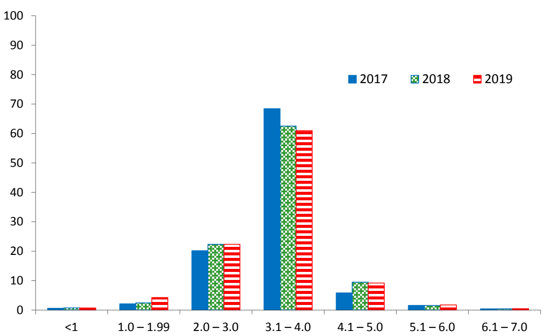
Source: BSP

Analysts attributed their higher inflation expectations to a weaker peso, persistently high global oil prices, the implementation of tax reform (i.e., fuel and vehicle excise taxes), rise in electricity rates due to higher oil prices and maintenance shutdown of some power plants, and higher government spending on infrastructure. The increase in the mean inflation forecast also accounted for the possible occurrence of El Niño in the latter part of 2017 as well as transport fare hike as a result of higher oil prices. These were seen to outweigh the downside risks brought by a possible return to low global oil prices, the slowdown of the Chinese economy and the yuan devaluation, as well as the risk of recession and deflation in Japan and the Eurozone.

Based on the probability distribution of the forecasts provided by 23 out of 30 respondents, there was an 88.6 percent probability that average inflation for 2017 will settle between the 2-4 percent range. For 2018, the respondents assigned an 84.9 percent probability that inflation will fall within the 2-4 percent target range.

Chart 4. Probability Distribution for Analysts' Inflation Forecasts*

2016-2018



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

Results of the March 2017 Consensus Economics inflation forecast survey for the Philippines showed a higher mean inflation forecast for 2017. Respondents expect 2017 inflation to settle at 3.2 percent, higher than the December 2016 mean forecast at 2.9 percent.[6] Meanwhile, respondents' mean inflation forecast for 2018 was broadly steady at 3.3 percent.

Table 4. Private Sector Forecasts for Inflation, March 2017

annual percentage change

	2017			2018	2019
	Q2	Q3	FY	FY	FY
1) Al-Amanah Islamic Bank	3.50	3.60	4.00	4.00	3.00
2) ANZ	3.30	3.30	3.20	3.70	-
3) Asia ING	3.40	3.60	3.40	3.30	3.50
4) Banco De Oro	3.51	3.71	3.30	3.70	3.20
5) Bangkok Bank	3.50	3.70	3.60	4.00	4.00
6) Bank of Commerce	3.54	3.80	3.58	-	-
7) Bank of China	3.40	3.30	3.50	3.60	3.70
8) Bank of the Philippine Islands	3.60	3.80	3.70	3.30	-
9) Barclays	3.40	3.50	3.30	3.00	-
10) Chinabank	3.00	3.00	3.00	3.10	3.20
11) Citibank	3.40	3.60	3.30	3.50	-
12) CTBC Bank	2.90	3.10	3.50	3.60	3.75
13) Deutsche Bank	-	-	3.30	3.10	-
14) Eastwest Bank	3.10	3.20	3.40	3.50	3.75
15) Global Source	3.57	3.95	3.63	-	-
16) IDEA	3.70	4.00	3.80	4.10	4.10
17) Land Bank of the Philippines	3.20-3.50	3.30-3.60	3.30-3.60	3.00-3.30	3.00-3.30
18) Maybank	3.35	3.40	3.28	3.23	3.35
19) Maybank-ATR KimEng	3.00	3.00	3.00	3.30	-
20) Metrobank	-	-	3.10	3.60	-
21) Multinat'l Inv. Banc	3.40	3.50	3.40	3.50	-
22) Mizuho	3.40	3.20	3.30	3.20	-
23) Nomura	3.20	3.30	3.30	3.70	-
24) Phil. Equity Partners	3.45	3.71	3.52	3.67	-
25) RCBC	3.20-3.60	3.30-3.80	3.10-3.60	3.10-3.60	3.00-3.50
26) Robinsons Bank	3.50	3.60	3.40	3.00	2.00
27) Security Bank	3.00	3.10	3.10	3.40	3.40
28) Standard Chartered	2.90	3.40	3.00	3.30	3.30
29) UBS	3.20	3.50	3.30	3.90	-
30) Union Bank	3.00	3.20	3.50	4.00	4.20
Median Forecast	3.4	3.5	3.4	3.5	3.4
Mean Forecast	**3.3**	**3.5**	**3.4**	**3.5**	**3.4**
High	3.7	4.0	4.0	4.1	4.2
Low	2.9	3.0	3.0	3.0	2.0
Number of Observations	28	28	30	28	16
Government Target	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**

Source: BSP

Based on the Q1 2017 BSP Business Expectations Survey (BES), majority of firms expect inflation to increase in the current quarter relative to the previous quarter (from a diffusion index of 49.4 percent to 51.0 percent).

Inflation expectations trend higher

[6] There were 20 respondents in the Consensus Economics' survey in March 2017.

There were more firms that expect inflation to increase in the next quarter (from a diffusion index of 35.5 percent to 38.6 percent).

Similarly, results of the CES for Q1 2017 indicated that consumers expect inflation to increase over the next 12 months to 3.1 percent from 2.7 percent in the Q4 2016 survey. The number of respondents who anticipate higher inflation also increased compared to the previous quarter, reflecting stronger inflationary expectations.

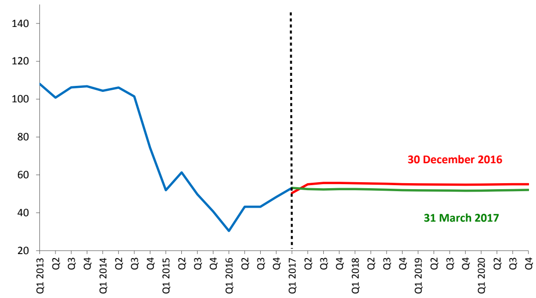
Energy prices. The average price of Dubai crude oil increased further in Q1 2017 by 10.0 percent compared to the previous quarter. Dubai crude prices continued to rally for the most of the review quarter due to strong adherence of members of the Organization of the Petroleum Exporting Countries (OPEC) to their output targets with Saudi Arabia leading OPEC's efforts in reducing output. According to International Energy Agency (IEA) statements, the estimated compliance rate for OPEC and the 11 non-OPEC countries were around 98 percent and 37 percent, respectively, from January-February 2017.[7]

Oil prices increase amid OPEC-led production cuts

Nonetheless, the upward momentum of oil prices was tempered slightly in March 2017 following official reports from the US Energy Information Administration (EIA) which showed that US commercial crude stockpiles remained elevated despite the lower supply from OPEC. Based on weekly data published by the US EIA, US commercial crude stockpiles[8] have reached 534 million barrels for the week ending 24 March 2017, 30.2 percent higher than the 503.8 million barrels in the same period a year ago. At the same time, data from Baker Hughes as of 31 March 2017 showed that active oil and gas rigs in the US have now reached 824 rigs, higher by 374 compared to the same period in 2016.[9]

On the other hand, estimated futures prices of Dubai crude oil as of end-March, which are based on movements of Brent crude oil, showed a lower path for 2017 to 2020 compared to the estimates in the previous quarter.[10]

Chart 5. Spot and Estimated Prices of Dubai Crude Oil



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

In March 2017, the US EIA report suggests that the oil market is "showing signs of closer balance in early 2017."[11] However, latest projections show supply would continue to slightly outstrip demand for the next two years. The expected surplus was due partly to higher US production, which could be attributed to an improved forecast methodology regarding rig efficiency as well as expectations of a rapid rise in drilling in the near-term. Non-OPEC production was estimated to produce 58.71 mb/d in 2017 and 59.70 mb/d in 2018. By contrast, US EIA revised downward its 2017 forecast for OPEC supply by 200,000 per barrel to 39.53 mb/d compared to the previous forecast—in line with the continued high degree of compliance among OPEC members.

Meanwhile, both the IEA[12] and OPEC[13] in its March 2017 report, projected global oil demand for 2017 to increase by 1.4 mb/d and 1.26 mb/d, higher relative to the December 2016 estimates estimates of 1.3 mb/d and 1.15 mb/d, respectively. Meanwhile, the US EIA maintained its global demand projection for 2017 to increase by 1.6 mb/d.

Prices of domestic petroleum products were mixed during the quarter. In particular, gasoline, kerosene, and diesel fell by ₱2.58 per liter, ₱1.40 per liter, and ₱0.10 per liter, in end-March 2017 compared to end-December 2016. By contrast, LPG prices increased by ₱5.09 per liter.

[7] "Oil Market Report" (International Energy Agency (IEA), March 15, 2017), https://www.iea.org/media/omrreports/fullissues/2017-03-15.pdf.
[8] Excluding Strategic Petroleum Reserve (SPR). Source: US EIA, Weekly Petroleum Status Report, 29 March 2017.
[9] Source: Baker Hughes Rig Count Overview and Summary Count. http://phx.corporate-ir.net/phoenix.zhtml?c=79687&p=irol-rigcountsoverview

[10] Future prices derived using Brent crude futures data. Data as of 31 March 2017 Source: BSP-staff calculations, Bloomberg
[11] Source: US EIA, Short-Term Energy Outlook (March 2017)
[12] IEA, March 2017 Oil Market Report, www.iea.org
[13] OPEC, March 2017 Monthly Oil Market Report, www.opec.org

Relative to year-ago levels, however, prices of all monitored domestic petroleum products recorded an upward adjustment as shown in the table below.

Table 5. Domestic Retail Pump Prices
peso/liter; end-quarter prices

Quarter	Gasoline	Kerosene	Diesel	LPG
2014 Q1	53.75	50.87	44.25	41.73
Q2	54.95	51.51	43.70	40.27
Q3	52.15	47.99	40.70	38.74
Q4	41.20	37.39	30.05	33.87
2015 Q1	42.60	35.59	28.85	31.19
Q2	45.90	37.49	29.65	30.18
Q3	42.25	33.44	26.80	28.00
Q4	38.10	29.07	22.60	32.14
2016 Q1	39.00	30.32	22.80	27.69
Q2	41.15	33.53	27.95	29.12
Q3	41.60	32.71	26.50	28.03
Q4	45.98	36.81	30.30	31.49
2017 Q1	43.40	35.41	30.20	36.58
Quarter-on-Quarter Change				
2016 Q4	4.38	4.10	3.80	3.46
2017 Q1	(2.58)	(1.40)	(0.10)	5.09
Year-on-Year Change				
2016 Q4	7.88	7.74	7.70	(0.65)
2017 Q1	4.40	5.09	7.40	8.89

*Average Metro Manila retail pump prices for the big three oil companies: Caltex, Petron and Shell
Source: Department of Energy (DOE)

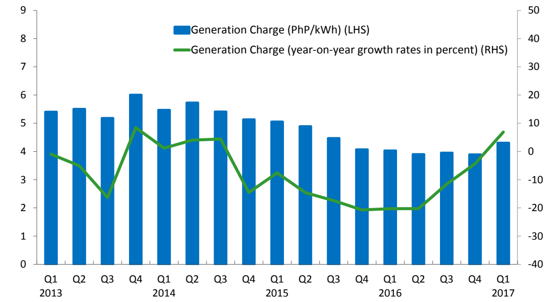
Power. Overall electricity rates in the Meralco franchise area increased in Q1 2017 due to higher generation costs. For Q1 2017, the average generation charge went up by ₱0.32 per kilowatt hour (kWh) to ₱4.31 per kWh from ₱3.89 per kWh in Q4 2016.

Higher generation costs lead to upward adjustment in retail electricity prices

The upward adjustment in the average electricity rates during the review quarter was due largely to the normalization of levels in capacity fees of Pagbilao and Ilijan power plants in February.[14] At the same time, the increase reflected the "pass on" charge approved by the Energy Regulatory Commission (ERC) which arose from the Malampaya maintenance shutdown on 28 January to 16 February 2017.

[14] The reduction in capacity fees in January 2017 was due to the annual reconciliation of outage allowances that is done at the end of each year under the contracts approved by the Energy Regulatory Commission (ERC). Source: Meralco

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



Source: Meralco

On 6 March 2017, the ERC approved Meralco's petition for staggered recovery and payment of the differential generation charge for the February 2017 supply month. A recovery of ₱1.75 billion will be spread over three months, translating to an upward adjustment of ₱0.22 per kWh per month per household starting in the March billing.

Meanwhile, there are potential sources of upside pressures on electricity charges. Meralco has existing petitions for rate increases with ERC which include the implemention of the Maximum Average Price, refund for generation recovery, system loss and lifeline subsidy. The Power Sector Assets and Liabilities Management (PSALM) likewise has several pending petitions with ERC for the recovery of foreign exchange related costs as well as the National Power Corporation's stranded debt portion of the universal charge. Similarly, the National Grid Corporation of the Philippines filed several petitions to recover connection charges and residual sub-transmission charges.

Aggregate Demand and Supply

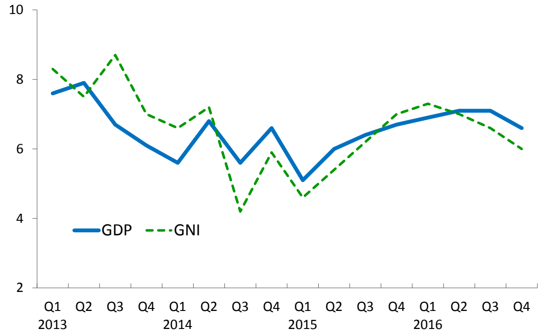
The Philippine economy grew by 6.6 percent in Q4 2016, lower than the quarter- and year-ago acceleration of 7.1 percent and 6.7 percent, respectively.

Real GDP sustains strong growth

On the expenditure side, the slower pace of GDP growth was mainly attributed to the slowdown in consumer spending and fixed capital investments, weighing down the acceleration of growth of government spending and exports of goods and services. Similarly, on the production side, the slowdown in the economy could be attributed to the contraction in agriculture, hunting, forestry and fishing and the lower growth in the industry sector. Meanwhile, the faster expansion of the services sector helped to temper the slowdown in the economy. On a seasonally-adjusted basis, quarter-on-quarter (q-o-q) GDP growth accelerated to 1.7 percent in Q4 2016 from 1.5 percent in Q3 2016.

Gross national income (GNI) growth decelerated to 6.0 percent in Q4 2016 from the quarter- and year-ago growth of 6.6 percent and 7.0 percent, respectively. Meanwhile, net primary income declined by 3.3 percent in Q4 2016, lower than the 4.1-percent and 8.5-percent growth in Q3 2016 and Q4 2015, respectively.

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



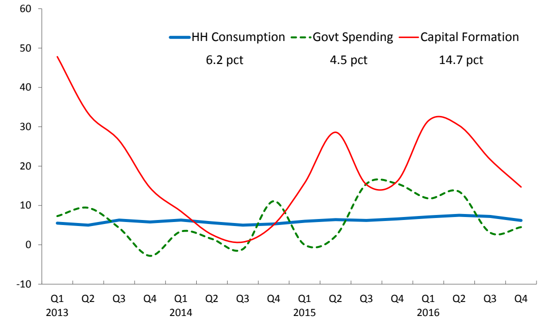
Source: PSA

Aggregate Demand. Household and government spending as well as fixed capital investments contributed 4.5 ppts, 0.4 ppt, and 4.7 ppts, respectively, to total GDP growth, offsetting the negative contribution of net exports (-2.2 ppts), which was due mainly to the accelerated growth of imports of goods.

Household spending on food and beverages supports demand-side expansion

Household spending, which accounted for nearly three-fourths of the country's output at 72.4 percent, grew by 6.2 percent in Q4 2016, albeit lower than the 7.2-percent growth in the previous quarter. The slower growth in household spending was attributed to the decelerated growth of consumption in food and non-alcoholic beverages (5.6 percent from 8.4 percent), alcoholic beverages and tobacco (4.2 percent from 6.9 percent), health (6.2 percent from 7.4 percent), transport (12.4 percent from 12.7 percent), recreation and culture (3.2 percent from 4.8 percent), and education (7.7 percent from 8 percent). Meanwhile, growth in expenditures on clothing and footwear, housing, water, electricity, gas and other fuels, furnishings, household equipment and routing household maintenance, communication, and restaurants and hotels improved compared to a quarter ago. Miscellaneous goods and services expanded at a steady rate of 8.0 percent.

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



Source: PSA

Growth in investments in capital formation slowed down to 14.7 percent in Q4 2016 from 21.7 percent in Q3 2016 due to the deceleration of fixed capital growth (to 18.5 percent in Q4 2016 from 25.4 percent in Q3 2016).

This can be attributed mainly to the lower growth in investments in durable equipment (26.3 percent in Q4 2016 from 31.7 percent a quarter ago) as investments in road vehicles grew by 27.8 percent from 41.5 percent in the previous quarter, which could be due to the decelerated growth in car sales[15] reported in Q4 2016 at 19.8 percent (from the previous quarter's 25.9 percent).

In addition, construction growth slowed down to 9.3 percent compared to 18.8 percent in the previous quarter due to the deceleration in the growth of both private (6.9 percent from 18.5 percent) and public construction (19.2 percent from 20 percent). Meanwhile, growth in breeding stock and orchard development and intellectual property products expanded compared to a quarter ago.

[15] Data based on the Chamber of Automotive Manufacturers of the Philippines (CAMPI) and Association of Vehicle Importers and Distributors (AVID).

Government expenditures improved by 4.5 percent in Q4 2016 from 3.1 percent in Q3 2016 due to the double-digit growth in spending on personnel services following the implementation of Executive Order No. 201 s2016 that upgraded the salary and granted additional benefits to government employees, as well as the release of retirement and terminal leave benefits in some agencies and the ₱2,000 bonus granted to a number of contracts of service, job order and project-based workers in the government during the period.

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

BY EXPENDITURE ITEM	2015				2016			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Household Consumption	6.0	6.4	6.2	6.6	7.1	7.5	7.2	6.2
Government Consumption	0.0	2.2	15.5	15.5	11.8	13.5	3.1	4.5
Capital Formation	15.7	28.6	15.3	16.2	31.5	30.3	21.7	14.7
Fixed Capital Formation	13.8	13.2	16.5	23.0	28.3	30.3	25.4	18.5
Exports	10.8	3.3	9.3	11.3	10.2	10.6	9.0	13.4
Imports	12.7	13.3	14.4	18.0	21.1	25.4	13.3	15.4

Source: PSA

Overall exports growth accelerated in Q4 2016 to 13.4 percent from the quarter-ago growth rate of 9 percent. The expansion in exports of goods (12.8 percent from 8.1 percent) and in exports of services (15.7 percent from 14 percent a quarter ago) boosted overall exports. Growth in exports of goods was driven mainly by higher exports of semiconductors (3.8 percent from 2.1 percent), consumer electronics (35.5 percent from a decline of 46.6 percent), control instrumentation (288.7 percent from 126.5 percent), metal components (37.6 percent from 6.8 percent) and other goods (25 percent from 11.1 percent). Meanwhile, the improved growth in exports of services was primarily due to higher exports of services in insurance (8.5 percent from 7.1 percent) and lower decline in transportation (-4.8 percent from -11 percent).

Overall imports posted 15.4 percent expansion for the quarter, higher than the quarter-ago increase of 13.3 percent, owing to the accelerated growth in imports of goods. The expansion in imports of semiconductors (8.6 percent from -2.1 percent), machinery and mechanical appliances (37.8 percent from 20.8 percent), transport equipment (70.5 percent from 48.9 percent) and other goods (5.5 percent from -2.2 percent) mainly contributed to the 20.6 percent growth of imports of goods for the quarter from 14.1 percent a quarter ago. Meanwhile, growth of imports of services decreased to 0.5 percent (from 9.8 percent a quarter ago) largely due to the lower growth in imports of transportation (0.9 percent from 45.1 percent) and the contraction of miscellaneous services (e.g., technical, trade-related, and other business services and computer services) by 7.1 percent from a positive growth of 1.6 percent a quarter ago.

Other Demand Indicators. Higher-frequency demand indicators continued to support the view of firm economic activity. The property sector continued to exhibit strong demand due mainly to the BPO sector, vehicle sales sustained its double-digit growth while the composite Purchasing Managers' Index remained firmly above the 50-point expansion threshold. Similarly, business and consumer confidence remained optimistic for the current and next quarter.

Property Prices

Vacancy Rates, Makati CBD. The office vacancy rate in the Makati CBD in Q4 2016 was lower at 1.6 percent relative to the year-ago rate of 2.0 percent but was higher than 0.8 percent in the previous quarter.

> Lower office vacancy rates due to demand from BPO and traditional offices as well as offshore gaming companies

According to Colliers, office vacancy rates have remained low for the quarter due to sustained demand from both BPO and traditional office locators and increasing take-up by offshore gaming companies amid limited office supply. Meanwhile, the lower-than-expected office supply was due to delayed office building completions amid the dearth of skilled construction laborers. Colliers expects office vacancy to tighten further to below one-percent level (0.6 percent) in the next twelve months due mainly to strong pre-leasing demand.

Meanwhile, the residential vacancy rate in the Makati CBD increased further to 13.3 percent in Q4 2016 from 11.5 percent in the previous quarter.

Makati CBD residential vacancy rate higher on take-up slowdown

The residential vacancy rate in Q4 2016 was also higher than the year-ago level of 8.9 percent due to a slowdown in take-up in the Makati CBD amid preference for newer residential buildings offering significantly lower rents in the fringe areas. In the next twelve months, Colliers foresees that vacancy rates will rise to about 16.6 percent due to considerable increase in projected residential supply.

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

Source: Colliers International Philippines

Rental Values, Makati CBD. Monthly Grade A office[16] rents in the Makati CBD reached ₱925/sq.m. in Q4 2016, representing an increase of 0.5 percent from the previous quarter.

Office rental values increase in nominal terms

Similarly, monthly Grade A office rents in the Makati CBD were higher by 1.6 percent relative to Q4 2015. Office rental values for Grade A offices were above their 1997 levels in nominal terms. In real terms, office rental values were about half of the comparable levels in 1997.

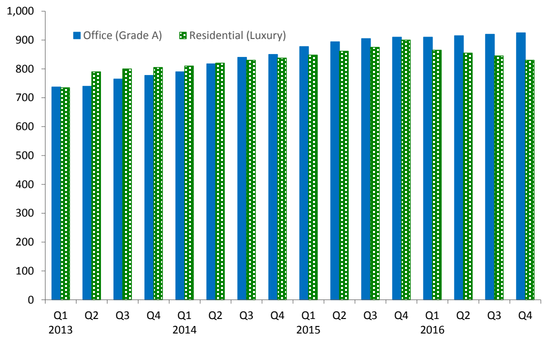
[16] Grade A office refers to office units that are located within the CBD but not in the core area and have quality access to and from the secondary or main avenues. Meanwhile, in terms of general finish, Grade A office buildings have high quality presentation and maintenance.

Monthly rents for luxury three-bedroom condominium units in the Makati CBD was at ₱830/sq.m. in Q4 2016, declining by 1.8 percent from the previous quarter.

Luxury rental values decline

Likewise, monthly rents for the 3-bedroom segment were lower by 7.8 percent compared to the year-ago levels. Residential rental rates in the Makati CBD declined due to slower take-up as tenants increasingly preferred renting in newly-built and lower-priced residential buildings in the fringe areas. Residential rental values for luxury three-bedroom high-rise units were above their 1997 levels in nominal terms but were only about 74.5 percent of their 1997 levels in real terms.

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



Source: Colliers International Philippines

Capital Values, Makati CBD. Capital values[17] for office buildings in the Makati CBD in Q4 2016 were higher in nominal terms than their quarter- and year-ago levels.

Capital values for office and residential buildings rise

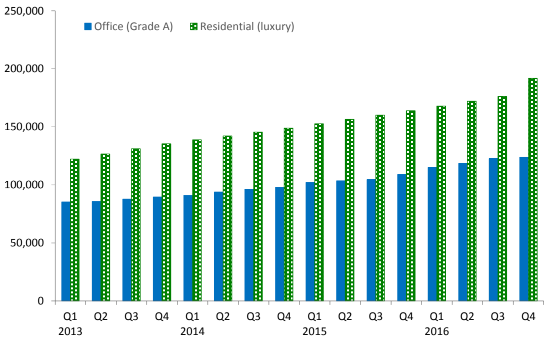
Grade A office capital values in the Makati CBD rose to ₱123,800/sq.m., higher by 1.0 percent and by 13.7 percent compared to the quarter- and year-ago levels, respectively. Grade A office capital

[17] Capital values reflect the probable price that the property would have fetched if sold on the date of the valuation. The valuation includes imputed land and building value.

values were also higher than 1997 levels in nominal terms. Nevertheless, in real terms, office capital values were about 66.4 percent of the comparable levels in 1997.

Likewise, capital values for luxury residential buildings[18] in Makati CBD in Q4 2016 increased to ₱191,800/sq.m. from their quarter- and year-ago levels. Average prices for three-bedroom luxury residential condominium units grew by 8.9 percent q-o-q and 17.0 percent year-on-year (y-o-y). Residential capital values have expanded due to strong sales in the pre-selling market. According to Colliers, the favorable low interest rate environment has continued to encourage buyers to purchase condominium units. Capital values for luxury residential buildings were above their 1997 levels in nominal terms. In real terms, residential capital values were about 83.8 percent of the comparable levels in 1997.

Chart 9. Capital Values
(Makati Central Business District)
price per square meter



Source: Colliers International Philippines

[18] In terms of location, luxury residential units are located within the CBD core and have quality access to/from and have superior visibility from the main avenue. Meanwhile, in terms of general finish, luxury residential units have premium presentation and maintenance.

BSP Residential Real Estate Price Index (RREPI).[19] Residential real estate prices grew by 0.3 percent in Q4 2016 from 2.2 percent in the previous quarter and 5.2 percent in the same quarter of 2015.[20]

Residential property prices increase marginally in Q4 2016

The growth in RREPI, which is a composite index of the residential price indices in the NCR and AONCR, was due to the increase in the average residential prices in AONCR in Q4 2016, outweighing the decline in prices in NCR. Residential real estate prices in the AONCR grew by 1.7 percent y-o-y in from 4.9 percent in the Q3 2016, while that of NCR declined further by 1.1 percent y-o-y from 0.2-percent contraction in the previous quarter.

The marginal growth in residential real estate prices in Q4 2016 is also reflected in the slowdown in the price of condominium units as well as the contraction in the price of single detached/attached house units, offsetting the increase in the price of townhouse units. The price of townhouse units rose faster at 6.2 percent y-o-y from 4.9 percent in the previous quarter. The price of condominium units also increased albeit at a slower rate of 1.8 percent y-o-y from 3.1 percent in Q3 2016. Meanwhile, the price of single detached/attached units fell by 1.0 percent, a reversal from the 2.4-percent growth in the previous quarter. The price of duplex units also declined by 12.3 percent in Q4 2016.[21]

[19] The RREPI measures the average changes in prices of different types of housing units over a period of time across different geographical regions where the growth rate of the index measures house inflation. It is computed as a weighted chain-linked index based on the average appraised value per square meter weighted by the share of floor area of housing units.
[20] For Q4 2016, about seven in ten real estate loans were for the purchase of new housing units (70.5 percent). By type of housing unit, 48.1 percent of residential property loans were for condominium units, followed by single detached units (43.9 percent) and townhouses (7.6 percent). By region, NCR accounted for 51.6 percent of the total number of residential real estate loans granted during the quarter, followed by CALABARZON (25.6 percent), Central Luzon (5.8 percent), Central Visayas (4.7 percent), Western Visayas (3.9 percent), Davao Region (3.8 percent) and Northern Mindanao (1.5 percent). Together, these seven regions accounted for 96.9 percent of total housing loans granted by banks.
[21] Price indices for duplex units exhibit more volatility due to relatively small number of reported real estate loans.

Table 7. Residential Real Estate Price Index

Q1 2014=100; growth rate in percent

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

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

Vehicle Sales. Sales of new vehicles from CAMPI[22] members grew by 17.4 percent y-o-y in the first two months of Q1 2017, albeit slower than the 24.5-percent growth recorded in the same period a year ago, due mainly to the slowdown in the growth in sales of passenger cars.

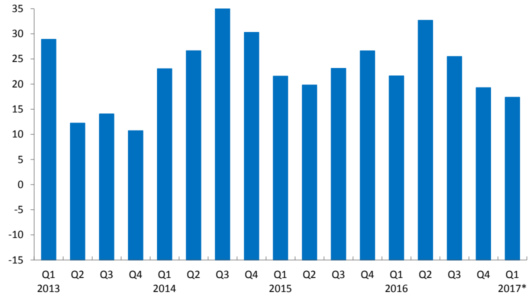
Sales of new vehicles remain at double-digit rate

Sales of passenger cars expanded at a lower rate of 8.9 percent y-o-y in January-February 2017 compared to the 20.2-percent growth in the same period in 2016. New passenger car sales accrued to a total of 20,098 units in the first two months of Q1 2017 from 18,451 units in the same period a year ago.

[22] 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 10. Vehicle Sales

number of units



* January-February 2017
Source: Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI)

The growth of commercial vehicle sales, which account for about 65.0 percent of total vehicle sales, also slowed down to 22.5 percent y-o-y in the first two months of Q1 2017 relative to 27.2-percent growth in the same period in 2016. Commercial vehicles sold during the quarter reached 37,367 units from 30,507 units in January-February 2016.

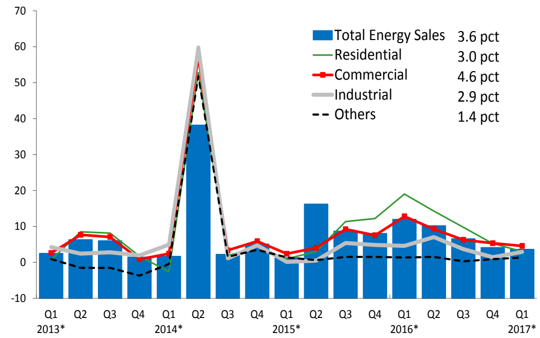
Energy Sales. Meralco's energy sales for Q1 2017 (January-February) grew by 3.6 percent, significantly slower than the 12.0-percent growth reported in the same period a year ago.

Energy sales increase at slower pace

Energy sales from the residential sector, commercial sector and industrial sector grew by 3.0 percent, 4.6 percent, and 2.9 percent, respectively.

Chart 11. Energy Sales

year-on-year growth in percent



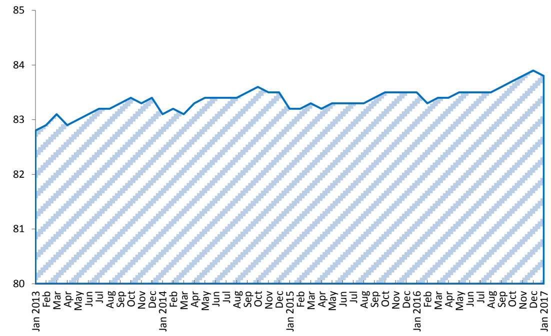
*January-February 2017
Source: Meralco, BSP calculations

Capacity Utilization. Based on the Philippine Statistics Authority's Monthly Integrated Survey of Selected Industries (MISSI), the average capacity utilization rate of the manufacturing sector declined slightly to 83.8 percent in January 2017 from 83.9 percent a month ago.

Capacity utilization in manufacturing remains above 80 percent

Of the 607 respondent-establishments, 56.5 percent operated at least at 80.0 percent capacity in January 2017. Data showed that the manufacturing companies have been operating above the 80.0 percent capacity since 2010.

Chart 12. Monthly Average of Capacity Utilization for Manufacturing
in percent



Source: PSA

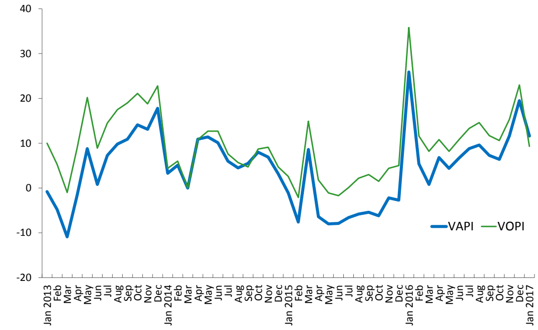
Volume and Value of Production. Preliminary results of the MISSI showed that volume of production index (VoPI) grew by 9.3 percent y-o-y in January 2017, albeit lower than the month-ago rate of 23 percent (revised).

Manufacturing output sustains growth

The continued expansion in VoPI was led by double-digit increments in the production of food (28.6 percent), petroleum products (45.3 percent), basic metals (59.2 percent), transport equipment (46.6 percent), footwear and wearing apparel (50.1 percent), machinery except electrical (14.7 percent), fabricated metal products (21.1 percent), and textiles (14.4 percent).

Production of wood and wood products posted a significant three-digit growth of 116.7 percent in January from 27.5 percent (revised) a month ago.

Chart 13. Volume and Value Indices of Manufacturing Production
year-on-year in percent



Source: PSA

Similarly, the value of production index (VaPI) also grew by 11.6 percent in January 2017. However, this was lower than the month-ago level of 19.5 percent. The increase was supported by the double-digit increments in the VaPI of the following sub-sectors: petroleum products (87.2 percent), food manufacturing (28.6 percent), basic metals (54.5 percent), machinery except electrical (20.9 percent), transport equipment (45.5 percent), footwear and wearing apparel (44.8 percent), wood and wood products (118.5 percent), miscellaneous manufactures (19.3 percent), fabricated metal products (22.3 percent).

Business Expectations. The business sector's optimistic economic outlook remained broadly unchanged for Q1 2017, with the overall confidence index (CI) of the latest Business Expectations Survey (BES)[23] declining slightly at 39.4 percent from 39.8 percent for Q4 2016. This means that the optimists continued to outnumber the pessimists but the margin was almost unchanged from that of a quarter ago.

[23] The Q1 2017 BES was conducted during the period 5 January - 15 February 2017. Respondents, which were drawn from the combined list of the Securities and Exchange Commission's Top 7,000 Corporations in 2010 and Business World's Top 1,000 Corporations in 2015, consisted of 588 companies in NCR and 906 firms in AONCR and covered all 17 regions nationwide. The survey response rate for Q1 2017 was higher at 82.9 percent from 80.7 percent in the previous quarter. The response rate was slightly lower for NCR at 80.1 percent (from 80.2 percent in the previous quarter) and higher for AONCR at 84.8 percent (from 81.0 percent in Q4 2016).

Business confidence broadly steady in Q1 2017 but more upbeat in the next quarter

The current quarter's relatively steady outlook stemmed from the counterbalancing of the number of respondents that reported more positive views on the economy with those that indicated that they were negatively affected by the (a) usual slowdown in business activity and moderation of consumer demand after the holiday and harvest seasons, (b) start of implementation of new business strategies for the year, (c) rising oil prices and higher cost of raw materials, and (d) wait-and-see attitude of investors with regard to the economic policy of the Trump administration, which could affect companies involved in business process outsourcing (BPOs). Likewise, the optimistic sentiment of firms was tempered by expectations of a peso depreciation (which increases costs of imports) and relatively higher inflation and interest rates.

The sentiment of businesses in the Philippines mirrored the steady business outlook in France and the Euro Area. Meanwhile, a less optimistic outlook was registered by businesses in China, Hong Kong SAR, Thailand, Canada and Germany while more buoyant views were reported by those in the US, UK, South Korea and Netherlands.

Table 8. Business Expectations Survey

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

Source: BSP

Business outlook improved for the next quarter (Q2 2017) with the CI rising to 47.2 percent from 34.5 percent in the last quarter's survey, suggesting that economic growth could accelerate for the next quarter. Respondents cited the following factors as reasons behind their more optimistic outlook: (a) anticipated increase in demand during summer season due to the expected influx of a greater number of local and foreign tourists, enrollment and harvest periods, (b) sustained increase in orders and projects leading to higher volume of production, (c) expansion of businesses and new product lines (d) introduction of new and enhanced business strategies and processes, (e) continued infrastructure projects and government spending, and (f) confidence in the administration.

Consumer Expectations. Results of the latest Consumer Expectations Survey (CES)[24] show that consumer outlook was broadly steady for Q1 2017, with the overall confidence index (CI) decreasing slightly to 8.7 percent from 9.2 percent in Q4 2016. Despite the modest decline in the CI, consumer confidence remained positive, registering the second highest reading since the start of the nationwide survey in Q1 2007.

Consumer outlook for the current and next quarter remain optimistic

This indicates that the optimists continued to outnumber the pessimists, but the margin was almost unchanged from that of a quarter ago. The current quarter's relatively steady outlook stemmed from the counterbalancing of the number of respondents that reported more positive views on the economy versus those with negative views. Respondents with a pessimistic outlook cited the following factors: (a) higher prices of goods and household expenditures, (b) poor harvest, and (c) unfavorable weather conditions. Meanwhile, respondents with positive views cited the following reasons:
(a) improvements in the peace and order situation, (b) additional family income due to higher salary and stronger business activity, (c) availability of more jobs and increase in the number of employed family members, and (d) effective government policies.

The outlook of consumers in the Philippines mirrored the steady sentiment of consumers in

[24] The Q1 2017 CES was conducted during the period 19 - 31 January 2017. The CES samples, which were drawn from the Philippine Statistics Authority (PSA) Master Sample List of Households, were generated using a stratified multi-stage probability sampling scheme. It has a sample size of 5,574 households, of which 2,838 (50.9 percent) were from NCR and 2,736 (49.1 percent) from AONCR.

France. Meanwhile, a less favorable sentiment was registered by consumers in Australia, Euro Area, Indonesia, Japan, and United Kingdom while the improved views were reported by those in Canada, China, South Korea, Switzerland, Taiwan, Thailand, and the United States for Q1 2017.

For the next quarter (Q2 2017) and the year ahead, consumer confidence was less optimistic as the CIs declined but remained positive at 16.5 percent (from 18.8 percent a quarter ago) and 31.7 percent (from 33.4 percent in the previous quarter's survey results), respectively. This indicates that the number of households with positive outlook decreased but continued to exceed those with negative views. Respondents' less favorable outlook for the next quarter and the year ahead emanated from households' concerns about (a) higher prices of goods, (b) depreciation of the peso, (c) poor harvest due to bad weather conditions, and (d) slowdown in business activity.

Table 9. Consumer Expectations Survey

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

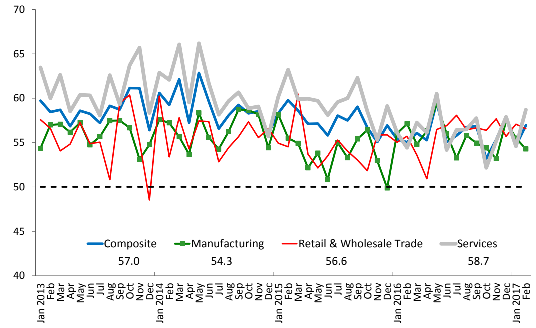
Source: BSP

For the next quarter (Q2 2017) and the year ahead, consumers' views on the economic condition of the country and family financial situation turned less optimistic but was broadly steady on family income when compared to their expectations in the previous quarter's survey. According to respondents, their less positive outlook was due mainly to their expectations of higher prices of goods, problems on peace and order situation, poor weather conditions, and higher excise tax on fuel and cars.

Purchasing Managers' Index.[25] The composite PMI remained firmly above the 50-point expansion threshold[26] at 57.0 in February 2017, higher than the composite PMI of 54.7 in the previous month. The improvement of the composite PMI was due mainly to the faster rate of expansion of the services sector, while the manufacturing and wholesale and retail sectors expanded at a slower rate.

PMI remains above the 50-point expansion threshold

Chart 14. Purchasing Managers' Index



Source: Philippine Institute of Supply Management (PISM)

The manufacturing PMI declined by 1.2 index points to 54.3 in February 2017 from 55.5 in January 2017. The number of respondent-establishments that experienced reduced business activity in February slightly pulled down the sector's performance. These firms reported a decline in sales and new orders that led to marginally lower production and inventories, as well as lower number of hires in February compared to month-ago. Some respondents also cited competition as one of the reasons for the sector's slower rate of expansion. Nonetheless, all the manufacturing indices remained firmly above the 50-point threshold. On a per sector basis, ten of the twelve manufacturing subsectors expanded compared to the month-ago levels led by rubber and plastic (with PMI of 65.6), communication and medical equipment (62.5), and publishing (53.3). The food and beverages, as well as the textiles subsector indicated a contraction with PMIs of 49.96 and 41.8, respectively. Meanwhile, survey respondents expect the sector to rebound in March 2017.

Likewise, the retail and wholesale PMI declined slightly by 0.5 index point to 56.6 in February 2017

[25] Data based on the monthly purchasing managers' index report of the Philippine Institute for Supply Management.
[26] 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.

from 57.1 a month ago. The slower expansion of the Sales Revenues Index, Supplier Deliveries Index, and Inventories Index marginally outweighed the others. The shorter lead time in February, as measured by the Supplier Deliveries Index, was attributed to weak demand despite improvement in traffic. Nonetheless, all the indices expanded well above the 50-point threshold with the most notable growth recorded by the Employment Index with a PMI of 61.1. Meanwhile, the PMI of the retail subsector rose month-on-month by 2.9 index points to 60.2 in February from 57.3. However, the contraction of the wholesale subsector offset the acceleration of the retail subsector. The wholesale subsector PMI declined by 4.8 index points to 49.0 from 53.8 in the same review period. Despite that, firms expect a turnaround for the sector as demand will likely pick up in the first quarter after the holiday peak in the fourth quarter in 2016.

By contrast, the services PMI increased by 4.3 index points to 58.7 in February 2017 from 54.6 in the previous month. All the indices expanded at a faster rate, with the New Orders Index and Average Operating Cost Index breaching the 60-point mark at 60.9 and 61.7 PMIs, respectively. Companies attributed the sector's expansion to robust demand that led to increases in sales, orders, customers, and production, while marketing and promotional efforts provided some additional support. Consequently, all firms by export categories remained firmly above the 50-point threshold. Firms with export volume between 26 percent and 50 percent of total revenues reported a PMI of 72.5 from a steady level of 50. Meanwhile, 9 out of 13 services subsectors expanded in February (i.e., electricity, gas, and water; construction; hotels and restaurants; transportation including travel agency; postal and telecommunications; provident and insurance; real estate; renting of goods and equipment; miscellaneous business activities; and education), while three subsectors posted contraction (i.e., banking and financial intermediation; health and social work; and business and knowledge).

External Demand

Exports. Exports of goods grew by 1.8 percent in Q4 2016, a turn-around from the 3.9-percent and 5.0-percent contractions posted in Q3 2016 and Q4 2015, respectively.

Exports of goods rise

The double-digit growth in outward shipments of coconut products, sugar and products, fruits and vegetables, other agro-based products, and mineral products outweighed the decline in exports of petroleum products and manufactures.

Table 10. Exports of Goods
growth rate in percent

COMMODITY GROUP	2015	2016	
	Q4	Q3	Q4
Coconut Products	-14.0	10.2	71.3
Sugar and Products	-75.9	-68.6	35.6
Fruits and Vegetables	-28.6	1.6	35.3
Other Agro-Based Products	-33.0	4.0	34.0
Forest Products	-78.3	-28.2	65.8
Mineral Products	-33.5	0.6	24.8
Petroleum Products	-42.8	-59.6	-4.9
Manufactures	-1.1	-3.9	-1.6
Special Transactions	-35.4	-29.2	-23.2
Total Exports	**-5.0**	**-3.9**	**1.8**

Source: BSP staff computations based on data from the PSA

Imports. Imports of goods grew by 13.0 percent in Q4 2016, faster than the 7.7-percent growth a quarter ago but slightly slower than the 13.7 percent expansion in the same quarter a year ago.

Imports of goods increase

The growth in imports was due to the expansion in inward shipments of capital goods, consumer goods and raw materials and intermediate goods, offsetting the contraction in the import bill of mineral fuels and lubricants.

Table 11. Imports of Goods
growth rate in percent

COMMODITY GROUP	2015	2016	
	Q4	Q3	Q4
Capital Goods	34.9	23.7	26.1
Raw Materials and Intermediate Goods	10.8	-6.8	3.8
Mineral Fuels and Lubricants	-19.3	-12.1	-1.4
Consumer Goods	19.6	35.7	19.9
Special Transactions	-4.0	29.2	20.8
Total Imports	**13.7**	**7.7**	**13.0**

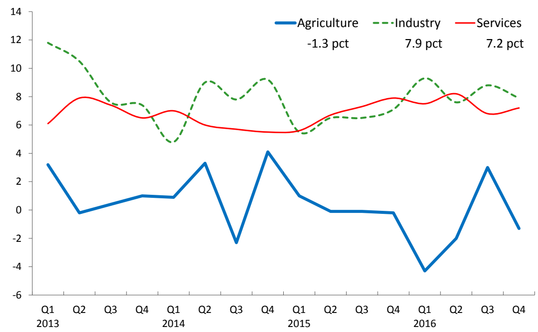
Source: BSP staff computations based on data from the PSA

Aggregate Supply. Growth was driven mainly by the services sector (contributing 4.0 ppts) and the industry sector (accounting for 2.7 ppts). Meanwhile, agriculture contributed -0.1 ppt.

Services sector continues to support supply-side growth

The services sector expanded by 7.2 percent in Q4 2016, higher than the 6.8-percent growth in Q3 2016. Major contributors to the sector's growth were trade and repair of motor vehicles, motorcycles, personal and household goods (2 ppts), real estate, renting and business activities (1.7 ppts), and other services (1 ppt). Trade and repair of motor vehicles, motorcycles, personal, and household goods increased by 6.5 percent from the quarter ago growth of 6.3 percent, largely due to the higher growth of retail trade (5.7 percent from 5.2 percent). Meanwhile, the growth in real estate, renting and business activities was higher at 9.1 percent from 8.9 percent in the previous quarter, on account of the increase in renting and other business activities (14.4 percent from 13.1 percent a quarter ago) and the slightly higher growth in ownership of dwellings (2.9 percent from 2.8 percent). Growth in transport, storage and communication and public administration and defense and compulsory social security increased as well compared to the previous quarter while growth in financial intermediation and other services declined from a quarter ago.

Chart 15. Gross Domestic Product by Industrial Origin (at constant prices)
year-on-year growth in percent



Source: PSA

The industry sector grew by 7.9 percent in Q4 2016, although lower compared to 8.8 percent in Q3 2016. This was due to the slowdown in the growth of construction (10.7 percent from 17.2 percent) and electricity, gas and water supply (EGW) (9.2 percent from 9.6 percent). The deceleration in the growth of construction was due to the lower growth of both public and private construction. Likewise, the slowdown in the growth of EGW stemmed from the lower growth of steam and water supply. Meanwhile, growth of manufacturing increased to 7 percent from 6.8 percent a quarter ago. This can be mainly attributed to the growth of petroleum and other fuel products (60.3 percent from 4.8 percent), and transport equipment (31.3 percent from 28.5 percent). Mining and quarrying posted 10.8-percent expansion compared to a contraction of 2 percent a quarter ago.

The agriculture, hunting, forestry and fishery (AHFF) sector contracted by 1.3 percent from a growth of 3 percent a quarter ago. The negative growth for the quarter mainly came from the contraction in the growth of palay (-3.6 percent from 16.3 percent) and corn (-0.1 percent from 10.5 percent) production, and fishing (-3.8 percent from -2.6 percent) as well as the slowdown in the growth of livestock (3.4 percent from 4 percent), poultry (1 percent from 2.5 percent) and agricultural activities and services (1.9 percent from 4.1 percent). The sector's performance was negatively affected by typhoons "Karen" and "Lawin."

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

BY INDUSTRIAL ORIGIN	2015				2016			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Agri., Hunting, Forestry and Fishing	1.0	-0.1	-0.1	-0.2	-4.3	-2.0	3.0	-1.3
Agriculture and Forestry	1.7	-0.1	-0.1	0.5	-4.0	-1.3	4.3	-0.7
Fishing	-2.9	0.0	0.0	-3.5	-5.9	-5.2	-2.6	-3.8
Industry Sector	5.5	6.5	6.5	7.1	9.3	7.6	8.8	7.9
Mining and Quarrying	-2.5	-8.6	0.5	14.0	11.4	-4.0	-2.0	10.8
Manufacturing	6.0	4.7	5.8	6.1	8.0	6.2	6.8	7.0
Construction	5.1	18.8	9.6	11.6	14.2	13.5	17.2	10.7
Electricity, Gas and Water Supply	5.8	4.4	7.7	4.5	10.2	10.3	9.6	9.2
Service Sector	5.6	6.7	7.3	7.9	7.5	8.2	6.8	7.2
Transport, Storage and Communication	8.4	6.6	8.0	9.1	5.3	7.0	4.6	6.4
Trade and Repair of Motor Vehicles, Motorcycles, Personal and Household Goods	5.9	6.7	8.4	7.3	7.5	8.9	6.3	6.5
Financial Intermediation	4.3	5.8	5.4	8.7	9.7	6.9	8.5	5.5
Real Estate, Renting and Business Activities	6.3	6.5	7.8	7.7	8.7	8.8	8.9	9.1
Public Administration and Defense; Compulsory Social Security	-4.0	-0.7	2.6	7.3	5.2	6.4	3.7	13.3
Other Services	6.9	11.1	7.3	7.7	7.3	9.0	6.8	6.0

Source: PSA

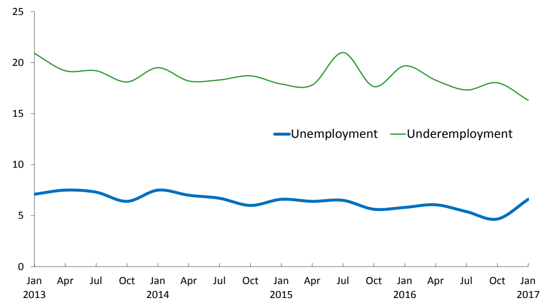
Labor Market Conditions

The Philippine labor market reported a relatively weak performance in January 2017 as both unemployment and youth unemployment[27] rates increased compared to their levels a year ago.[28] The unemployment rate went up to 6.6 percent in January 2017 from 5.7 percent in January 2016 while youth unemployment rate rose to 15.6 percent from 14.4 percent for the same period, respectively.

Philippine labor market weakens in Q1 2017

On a positive side, however, the country's underemployment rate improved in January 2017 as it declined to 16.3 percent from 19.6 percent in the same period in 2016. In the recently approved Philippine Development Plan 2017-2022, the target of the government is to reduce the country's unemployment rate to 3 to 5 percent, the youth unemployment rate to 8 percent and the underemployment rate in areas outside the NCR to between 16 and 18 percent in 2022.[29]

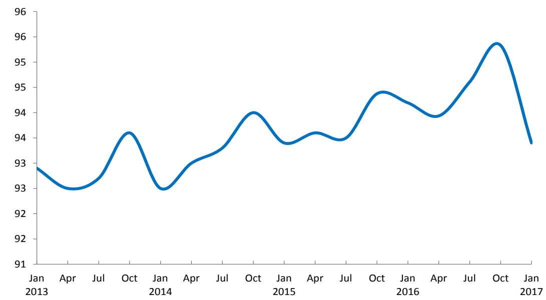
Chart 16. Unemployment and Underemployment
in percent



Source: PSA

The country's employment rate declined to 93.4 percent in January 2017 from 94.3 percent in January 2016 due mainly to typhoons Nina and Auring that hit the country in December 2016 and January 2017, respectively and the effect of dissipated election-related employment.[30] The latter was also observed in January 2011, following the 2010 elections.[31] The employment level settled at 39.3 million in January 2017, which is 1.3 million or 3.3 percent lower than the 40.7 million level a year ago. Employment in the country's three major sectors did not show improvement as this declined by 8.1 percent and 2.0 percent in the agriculture and services sectors, respectively, while that in the industry sector was nil.

Chart 17. Employment Rate
in percent



Source: PSA

The bulk of the country's employment continued to be in the services sector (57.1 percent share), albeit the sector provided a negative contribution to employment growth (-2.0 percent growth rate). Increase in employment in wholesale and retail trade (3.1 percent) and administrative and support service activities[32] (15.9 percent) were more than offset by declines in employment in other services activities (-15.4 percent), education (-11.8 percent), and accommodation and food service activities (-7.8 percent). These declines could be attributed in part to the end of election campaign activities and stricter enforcement of contractual arrangements. The agriculture sector continued to provide the second highest source of employment in the country, accounting for 25.5 percent. However, the 8.1-percent decline in employment in the sector was the main drag to the total employment growth caused primarily by adverse impact of weather disturbances. Meanwhile, employment in the industry sector (which accounted for 17.4 percent) was broadly steady as the increase in employment in construction (4.1 percent) was offset by reduction in employment in manufacturing (-3.1 percent) and mining and quarrying (-16.5 percent) sub-sectors. Nonetheless, most of the employed

[27] Refers to the unemployment rate of workers who are 15 to 24 years old.
[28] In comparing January 2017 with January 2016 figures, caution should be taken since starting April 2016, the Philippine Statistics Authority (PSA) adopted the 2013 Master Sample Design (MS Design), the 2010 Census of Population and Housing (CPH)-based population projections and the 2012 Philippine Standard Occupation Classification (PSOC).
[29] In future labor force survey (LFS) releases, the PSA will include official underemployment rate data outside NCR as this will be monitored against the PDP target.

[30] NEDA (2017), "Agriculture Sector Loss Leads to Employment Decline in January 2017," NEDA Press Release, 14 March.
[31] NEDA (2017).
[32] Includes the business process outsourcing.

are still wage and salary workers (62.8 percent share) reflecting the strength of the Philippine economy. However, the share of vulnerable workers who are susceptible to external shocks and economic downturns (i.e., self-employed and unpaid family workers) remains high at 33.5 percent

The 6.6 percent unemployment rate in January 2017 is equivalent to 2.8 million unemployed individuals. As before, most of the unemployed are high school (31.1 percent share) and college (16.5 percent) graduates, although the growth in unemployment during the period came mainly from individuals with elementary and high school education.[33] The unemployment rate among the youth (18-24 age group) is more than double the national unemployment rate and more than thrice the unemployment rate of 25 to 54 age group (4.8 percent).

Meanwhile, most of the country's underemployed are in the services and agriculture sectors and more than half are visibly underemployed (60.0 percent share).[34,35] The country's overall mean hours of work (hours per week) also declined to 41.3 in January 2017 from 42.5 a year ago.

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[33] NEDA (2017).

[34] Visible underemployment refers to the proportion of employed individuals who are working for less than 40 hours and seeking additional hours of work. More than two-fifths (44.5 percent) of the visibly underemployed are in the agriculture sector.

[35] The invisible underemployment (underemployed full-time workers or those who work 40 hours or more per week but still wanted more work) has 40.0 percent share. Most (57.2 percent) of these are in services sector.

II. Monetary and Financial Market Conditions

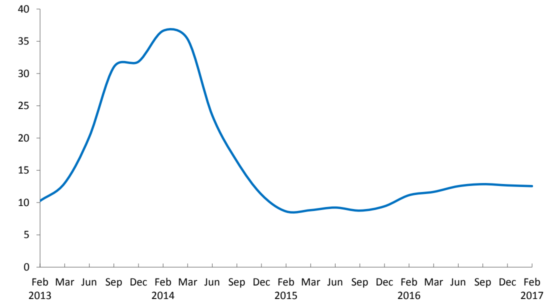
Domestic Liquidity

Domestic liquidity (M3) grew by 12.6 percent y-o-y in February to ₱9.4 trillion, broadly unchanged from the 12.7-percent pace of expansion recorded in end-Q4 2016.

Domestic liquidity continues to expand…

Money supply continued to increase due largely to sustained demand for credit. Domestic claims grew by 15.8 percent in February from 17.0 percent in end-Q4 2016 on sustained growth in credits to the private sector. Net claims on the central government also increased by 17.3 percent in February from 27.4 percent at the end of the previous quarter as a result of increased NG borrowings as part of its cash operations and the continued withdrawal by the NG of its deposits with the BSP.

Chart 20. Domestic Liquidity
year-on-year growth rates in percent



Source: BSP

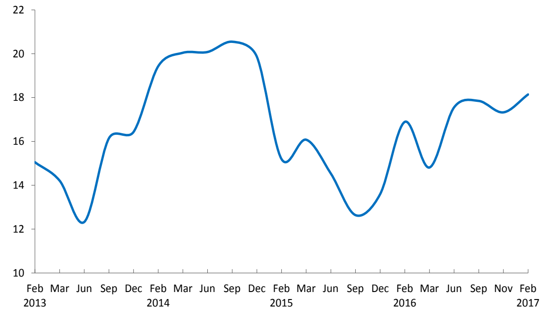
Meanwhile, the growth in net foreign assets (NFA) moderated to 7.2 percent y-o-y in February from 7.8 percent in end-Q4 2016. The BSP's NFA position expanded during the period on the back of robust foreign exchange inflows coming mainly from overseas Filipinos' remittances and business process outsourcing receipts. The NFA of banks likewise expanded due mainly to the growth in banks' foreign assets resulting from higher interbank loans and investments in marketable debt securities.

Preliminary data as of February 2017 show that outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, grew by 18.1 percent y-o-y relative to the 17.3 percent and 14.8 percent growth posted at end-Q4 2016 and end-Q1 2016, respectively.

…as lending sustains growth due to production activities

The sustained increase in bank lending was due largely to loans for production activities, which expanded by 17.6 percent y-o-y in February 2017 from a 16.9-percent growth in end-Q4 2016 and 15.0 percent rise in end-Q1 2016.

Chart 21. Loans Outstanding of Commercial Banks
year-on-year growth rates in percent



Source: BSP

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

Meanwhile, loans for household consumption grew by 24.6 percent y-o-y as of end-February 2017, higher than the 22.4 percent and 15.9 percent growth recorded in end-Q4 2016 and end-Q1 2016, respectively.

Monetary Operations

Market reception has been positive to the BSP's shift to the interest rate corridor (IRC) system since June 2016. Market participants have adjusted relatively quickly to the new framework of monetary operations of the BSP. The implementation of the IRC went smoothly with minimal market volatility. Moreover, banks and trust institutions are participating actively in the BSP's open market operations (OMO).

For Q1 2017, majority of the BSP's monetary operations had been through the term deposit facility (TDF). Market demand for the BSP's TDF remained strong, with average bid-to-cover ratios for the quarter at 1.5 and 1.2 for the 7-day and 28-day term deposits, respectively. Similarly, the average bid-to-cover ratio for the RRP facility was at 1.1 for the review quarter. The TDF auctions are conducted every Wednesday while the RRP auction is a daily fine-tuning operation.

Credit Conditions

Credit Standards. Results of the Q1 2017 Senior Bank Loan Officers' Survey (SLOS)[36] showed that most of the respondent banks continued to maintain their credit standards for loans to both enterprises and households during the quarter based on the modal approach.[37] This is the 32nd consecutive quarter since Q2 2009 that the majority of respondent banks reported broadly unchanged credit standards.

Banks generally maintain credit standards during the quarter

Meanwhile, the diffusion index (DI) approach[38,39] pointed to a net tightening of credit standards for loans extended to enterprises while those for households were unchanged. In the previous quarter, credit standards for both corporate lending and household loans showed net tightening based on the DI approach.

Lending to Enterprises. Most banks (93.3 percent of banks that responded to the question) indicated that credit standards for loans to enterprises remained unchanged during the quarter using the modal approach. However, results based on the DI approach indicated net tightening of credit standards for business loans, reflecting respondent banks' perception of stricter financial system regulations, less favorable economic outlook, and reduced tolerance for risk. In terms of specific credit standards, DI-based results indicated stricter loan covenants as well as increased use of interest rate floors despite narrower loan margins, increased credit line sizes, longer loan maturities, and unchanged collateral requirements.[40]

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

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

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

36 The survey consists of questions on loan officers' perceptions relating to the overall credit standards of universal/commercial banks (U/KBs) in the Philippines, as well as to factors affecting the supply of and demand for loans by both enterprises and households. Survey questionnaires were sent to 35 U/KBs, of which, 31 banks responded to the current survey representing a response rate of 88.6 percent. As of end-January 2017, U/KB loans accounted for about 87.4 percent of the banking system's gross total outstanding loans net of interbank loans and RRP agreements with BSP and other banks.

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

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

39 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.

40 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.

In terms of borrower firm size, banks' responses showed net tighter overall credit standards across firm sizes, except those for micro enterprises which showed net easing based on the DI approach.

Results based on the modal approach showed that most of the respondent banks anticipate unchanged credit standards over the next quarter. Meanwhile, the DI approach showed that some respondent banks expect credit standards to tighten over the next quarter largely on account of banks' expectations of stricter financial system regulations and lower tolerance for risk.

Lending to Households. The results of the survey also showed that all of the respondent banks (100.0 percent) kept their overall credit standards unchanged for loans extended to households during the quarter, using both the modal and DI approaches. The unchanged credit standards were attributed by respondent banks largely to their unchanged risk tolerance, steady profile of borrowers, and a stable economic outlook. In particular, banks' responses indicated unchanged overall credit standards for housing and personal/salary loans during the quarter. Meanwhile, overall credit standards for credit card loans and auto loans showed net tightening based on the DI approach. In terms of specific credit standards, results based on the DI approach indicated unchanged loan margins, collateral requirements, loan covenants, and loan maturities for loans extended to households.

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

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

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

Over the next quarter, results based on the modal approach indicated that majority of the respondent banks anticipate maintaining their overall credit standards. However, the DI approach showed expectations of net easing of overall credit standards across all types of household loans (except auto loans), as respondent banks expect higher tolerance for risk, improvement in the profitability of their portfolio as well as their borrowers' profiles, and expectations of less strict financial system regulations in Q2 2017.

Loan demand. Responses to the survey question on loan demand indicated that the majority of the respondent banks continued to see stable overall demand for loans from both enterprises and households. Using the DI approach, however, results showed a net increase in loan demand[41] across all firm sizes and all types of household loans (except credit card loans). The net increase in loan demand of firms was largely attributed by banks to higher requirements of borrower firms for working capital and accounts receivable financing. Meanwhile, the net increase in demand for household loans largely reflected higher household consumption along with banks' more attractive financing terms.

Demand for loans from both enterprises and households remain stable

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

Real Estate Loans. Most of the respondent banks (77.3 percent) also indicated unchanged credit standards for commercial real estate loans in Q1 2017. The DI approach, however, continued to indicate a net tightening of overall credit standards for commercial real estate loans for the fifth consecutive quarter. The tighter overall credit standards for commercial real estate loans

[41] 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.

reflected respondent banks' wider loan margins, reduced credit line sizes, and increased use of interest rate floors.

Credit standards for real estate loans remain steady

Demand for commercial real estate loans was also unchanged in Q1 2017 based on the modal approach. A number of banks, however, indicated increased demand for the said type of loan on the back of increased working capital and accounts receivable financing needs and higher investment in plant and equipment of borrowers, and clients' improved economic outlook. Over the next quarter, although most of the respondent banks anticipate generally steady loan demand, a number of banks expect demand for commercial real estate loans to continue to increase.

Meanwhile, in the case of housing loans extended to households, all of the respondent banks (100.0 percent) reported unchanged credit standards. The unchanged credit standards for housing loans was attributed by respondent banks largely to unchanged tolerance for risk and profile of borrowers as well as stable economic outlook. Over the next quarter, results based on the modal approach showed expectations of broadly unchanged overall credit standards for housing loans. However, results based on the DI approach indicated expectations of a net easing of credit standards for housing loans in Q2 2017 as respondent banks' anticipate an improvement in the profitability and liquidity in their portfolio and increase in their tolerance for risk as well as expectations of less strict financial system regulations. At the same time, results continued to show increased demand for housing loans in Q1 2017 as well as expectations of a continued increase in demand for the said type of loan in the next quarter.

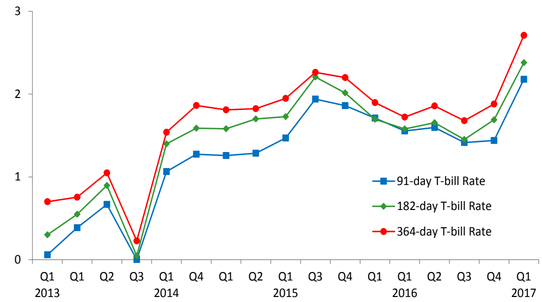
Interest Rates

Primary Interest Rates. In Q1 2017, the average 91-day, 182-day, and 364-day T-bill rates in the primary market increased to 2.179 percent, 2.380 percent, and 2.710 percent from 1.440 percent, 1.689 percent, and 1.880 percent, respectively, in Q4 2016.

T-bill rates in the primary market continue to increase

The results of the auction reflected mainly market players' strong demand for shorter-tenored government securities on cautious sentiment due to heightened uncertainty on the direction of US fiscal and monetary policy, as well as political moves in the Eurozone.

Chart 22. Treasury Bill Rates
in percent



Source: BTr

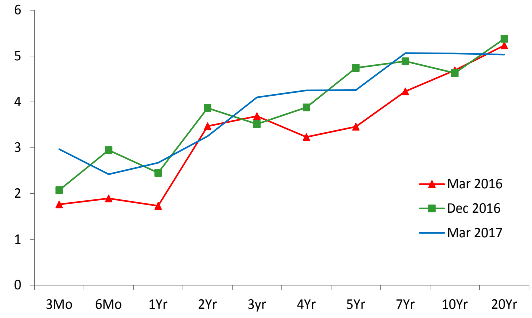
Yield Curve. As of end-March 2017, the secondary market yield for government securities (GS) rose generally except for the 6-month, 2-year, 5-year and 20-year GS relative to the end-December 2016 levels, after the US Fed hiked its policy rate in March 2017.

Yield curve rise generally in end-Mar 2017

Debt paper yields were higher by a range of 17.7 bps (7-year GS) to 89.4 bps (3-month GS) compared to end-December 2016 levels.

Chart 18. Yields of Government Securities in the Secondary Market

in percent



Source: Bloomberg

Relative to year-ago levels, the secondary market yields of GS likewise increased generally by a range of 36.5 bps for the 10-year GS to 120.5 bps for the 3-month GS except for the 2-year and 20-year tenors which declined by 22.0 bps and 20.2 bps, respectively.

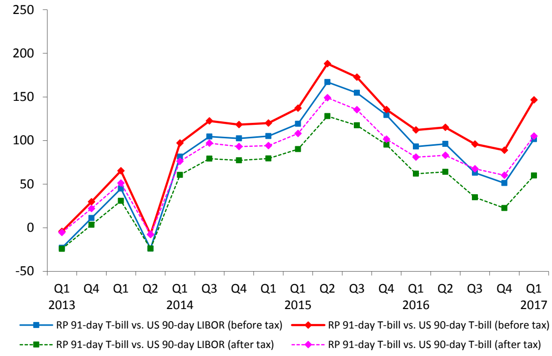
Interest Rate Differentials. The average differentials between domestic and US interest rates, gross and net of tax, widened in Q1 2017 relative to the previous quarter.

Interest rate differentials widen

The average 91-day RP T-bill rate rose q-o-q by 64.4 bps to 2.084 percent in Q1 2017 from 1.440 percent in Q4 2016. Likewise, the average US 90-day LIBOR and the US 90-day T-bill rate increased by 14.0 bps and 6.6 bps, respectively, to 1.068 percent and 0.617 percent in Q1 2017. 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 interest rates rose due mainly to investors' strong appetite for short-dated tenors amid ample liquidity in the financial system. Meanwhile, foreign interest rates rose during the quarter following the release of stronger-than-expected US data on personal spending, Q4 2016 GDP growth, orders for US manufactured durable goods, housing and retail sales, services sector growth and jobless claims vis a vis lower-than-expected US data on manufacturing activity, consumer sentiment and industrial output.

Chart 19. Interest Rate Differentials

quarterly averages; in basis points

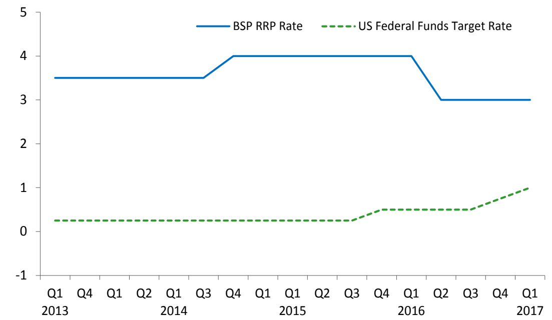


Source: Bloomberg, BTr and BSP

The positive differential between the BSP's overnight borrowing or RRP rate and the US Fed funds target rate narrowed to a range of 200-225 bps in Q1 2017 from 225-250 bps in Q4 2016, reflecting the impact of the 25-bp increase in the US Fed funds target rate to 0.75-1.00 percent on 16 March 2017.

Chart 20. BSP RRP Rate and US Federal Funds Target Rate

in percent

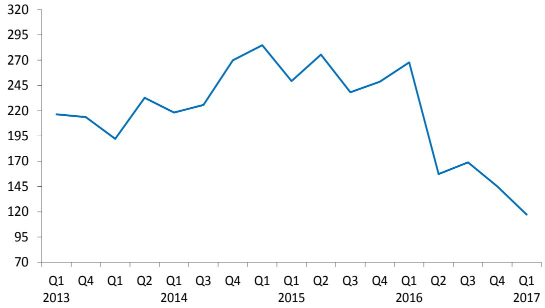


Source: Bloomberg and BSP

Similarly, the interest rate differential between the BSP's overnight RRP rate and the US Fed funds target rate adjusted for risk[42] narrowed further to 117 bps as of end-March 2017 from 145 bps in end-December 2016. This development could be traced to the decrease in the positive interest rate differential between the BSP's RRP rate and the US Fed funds target rate combined with a higher risk premium.

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

Chart 21. Risk-Adjusted Differentials
in basis points



Source: Bloomberg and BSP

Meanwhile, the higher risk premium in end-March 2017 could be attributed to the 10-bp decrease in the 10-year US note to 2.33 percent and the 7-bp decrease in the 10-year ROP note to 3.16 percent. The 10-year US and 10-year ROP notes declined on heightened demand for safe-haven assets amid a sell-off in the equities market following the increasing political uncertainty in the US, over the policies of the Trump administration, and in Europe, ahead of the elections in France, Germany and the Netherlands; the US Fed's interest rate hike in March 2017; and improved investor appetite for riskier emerging market assets following the release of higher-than-expected consumer confidence index in the US for March 2017.

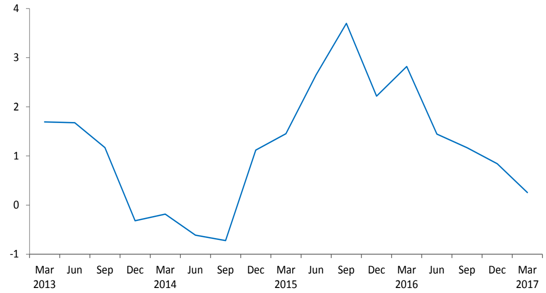
Domestic real lending rate[43] decreased further to 0.3 percent in March 2017 from 0.8 percent in December 2016. This was due to the 80-bp rise in inflation to 3.4 percent combined with the 30-bp rise in actual bank lending rate[44] to 3.7 percent in March 2017.

Real lending rate decreases further

The Philippines' real lending rate continued to be the second lowest in a sample of 10 Asian countries in March 2017, with Indonesia recording the highest real lending rate at 7.6 percent while Malaysia posted the lowest at 0.10 percent.

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

Chart 22. Philippines' Real Lending Rate
in percent



Source: PSA and BSP

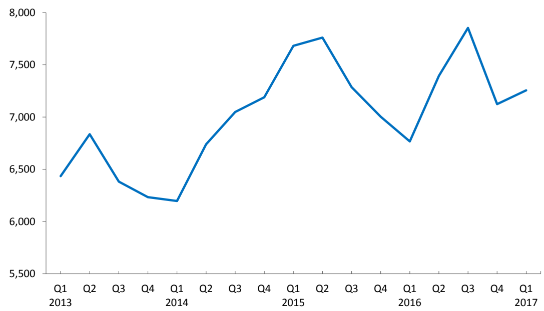
Financial Market Conditions

The domestic financial system during the review quarter reflected the uncertainty in the external environment. Volatility coming mainly from concerns over the shift in US policy including the Fed's anticipated March rate hike, implications of the Brexit process being moved forward and worries over China's declining foreign exchange reserves spilled over into the country's financial markets. Nevertheless, the domestic financial market remained resilient, supported by the sustained strong growth of the economy.

Domestic financial market conditions reflect external uncertainty

Stock Market. In the first three months of 2017, the Philippine Stock Exchange index (PSEi) rose by 1.9 percent, quarter-on-quarter, to average 7,258.3 index points during the review period.

Chart 23. Quarterly Average PSEi
In basis points



Source: Philippine Stock Exchange, BSP

The country's robust Q4 2016 Real GDP growth combined with the promised policies of newly-inaugurated US President Donald Trump to lift the US economy boosted investor sentiments and lifted the PSEi above the 7,300 level. However, growing uncertainty in the local mining industry, concerns over President Trump's ability to deliver on promised policies and heightened expectations of a US interest rate hike in March saw investors stay on the sidelines in the latter half of the period. As of 31 March 2017, the PSEi closed at 7,311.72 index points, higher year-to-date by 6.9 percent and year-on-year by 0.7 percent.

PSEi rallies in Q1 2017 on robust GDP growth

Month-on-month, the sotck market index showed a general uptick. In January, investors picked up bargains from the previous month's weak performance, spurred by President-elect Trump's promised tax cuts and increased infrastructure spending to boost US growth; the less hawkish tone of the US Fed in the recently-released FOMC December meeting minutes; and the visit of Japan Prime Minister Abe to the Philippines, which came with a ₱434-billion aid package and agreements on trade and infrastructure. The release of favorable Philippine growth numbers for Q4 also helped boost sentiments. Tempering the rally were concerns over Trump's protectionist policies[45] and the Brexit process moving forward. The PSEi averaged 7,243.95 index points in the first month of 2017, higher by 6.4 percent than the level in December 2016.

In February, the PSEi moved sideways amid Trump policy jitters, concerns over the continued decline in China's foreign exchange reserves; and the Philippine government's intensified mining crackdown.[46] However, strong OF remittances in December and the rally in the US stock market, over strong US manufacturing and services PMI data in January, prompted bargain hunting and lifted the PSEi. Toward the end of the month, however, gains were capped by increasing expectations for a March US interest rate hike. The PSEi averaged at 7,253.55 index points in February, 0.1 percent higher than the level posted in January.

In March, the PSEi continued to move sideways on risk-on, risk-off behavior. The optimistic and conciliatory tone of President Trump's first speech before US Congress partly boosted investor sentiments. However, the lack of details about his economic plans saw investors trade cautiously in the local bourse. Despite the Philippine's positive economic growth prospects for 2017/2018 which lifted investors demand for local shares, worries over higher domestic inflation and growing anxiety over Trump policies saw a retreat in local equities. In particular, the Trump administration's failure to repeal and replace Obamacare raised doubts over Trump's ability to deliver on promised comprehensive tax reforms, corporate deregulation and infrastructure spending boost that have propelled financial markets in recent months. However, the month ended higher amid window dressing; reports of Fitch Rating's affirmation of the country's investment grade credit rating; S&P's upward adjustment of its growth forecast for the Philippines; and the conduct of the first local IPO for 2017 (Wilcon Depot, Inc.). The PSEi averaged 7,277.43 during the month, higher by 0.3 percent relative to the average index in February.

Mirroring the rally in the PSEi, total market capitalization increased by 5.9 percent, q-o-q, to reach ₱15.3 trillion as of March 31. Most sectoral sub-indices rallied during the quarter, except for the mining and oil sub-index, which suffered from the announced closure of half of the mining firms. In contrast, data from Bloomberg reflected a deceleration in the domestic price-earnings ratio from the 19.7x average in Q1 2016 to 18.9x in the first three months of 2017. Meanwhile, preliminary data from the PSE also showed that foreign investors continued to post net sales of ₱18.3 billion during the review quarter from the net sales of ₱33.84 billion recorded in the preceding quarter.

[45] These included the US withdrawal from the Trans-Pacific Partnership and new travel ban issued against seven Muslim-dominated countries.

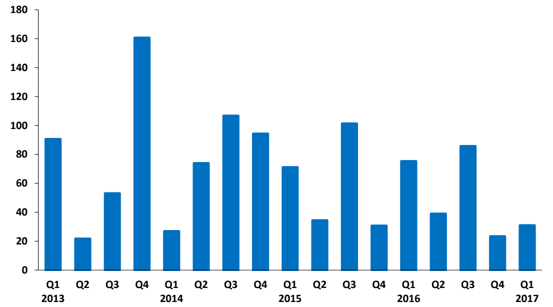
[46] In February 2017, the DENR Secretary ordered the shutdown of 23 mines and the suspension of 5 more of the country's 41 mines for various environmental violations. Later, this was followed by the cancellation of 75 mining contracts in pre-production stages (i.e., mineral production sharing agreements for mines that have yet to go into production) for being located in watershed zones.

Government Securities. Results of the T-bill auctions conducted in Q1 2017 (January-March) showed robust demand for T-bills with total subscription for the quarter amounting to ₱105.9 billion, about 1.4 times the ₱75.0-billion total offered amount. The oversubscription fo r the quarter, at ₱30.9 billion, was higher than the ₱23.4-billion oversubscription in the previous quarter.

Demand for local GS is robust

The Bureau of Treasury (BTr) decided to partially award T-bills in Q1 2017 as investors sought rates that were higher than what the government was willing to pay, despite the strong demand for T-bills. However, during the 13-March auction, BTr awarded in full all tenors as the interest rates fetched during the auction were in line with market expectations.

Chart 24. Total Oversubscription of T-bill Auctions



Source: Bureau of the Treasury

Sovereign Bond and CDS Spreads. In January, debt spreads narrowed as global financial conditions remained favorable despite the implementation of protectionist policies of the Trump administration such as the withdrawal of the US from the Trans-Pacific Partnership.[47] Domestically, investor confidence was boosted by the encouraging full-year GDP growth together with the positive growth outlook given by Standard and Poor (S&P) and World Bank (WB). S&P raised its growth forecast for the Philippines by 0.1 percent to 6.4 percent for 2017. WB gave a similar picture for the Philippines by increasing overall economic prospects by 0.7 percent to 6.9 percent for 2017.[48]

[47] A 12-nation deal that had been negotiated under former President Barack Obama that would have reduced tariffs for American imports and exports with the countries in the region.

[48] (Asia-Pacific Sovereign Rating Trends, Jan 2017) and (Global Economic Prospects, Jan 2017).

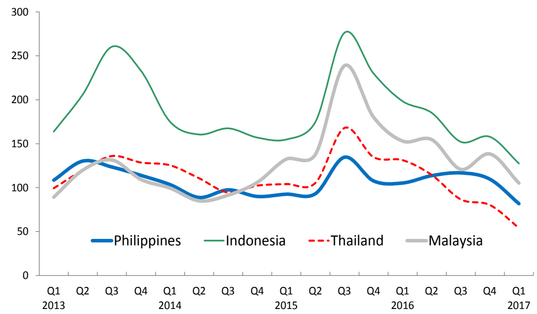
Debt spreads narrower on improved US economic data

In February, debt spreads further narrowed falling below the 90 basis points which was last seen in August 2016. The tighter debt spreads were due to the upbeat growth momentum that propelled investors to sustain their positive sentiment. Meanwhile, favorable investor appetite for Philippine debt has kept low the country's premium on sovereign debt. On the other part of the spread, the higher probability of a US Fed rate hike[49] pushed US interest rates higher, thereby narrowing the spreads between emerging market and the US interest rates.

In March, debt spreads continued to narrow amidst positive global developments such as the announcement of ECB to keep the massive monetary stimulus in the region. Meanwhile, investors' early anticipation and pricing-in of a US Fed rate hike in March minimized the corresponding immediate-term effects on global and domestic interest rates. The US Fed raised its policy rates on 15 March 2017 indicating that the US economy was nearing towards its employment and price-stability objectives.[50]

As of end-March 2017, the Philippines 5-year sovereign credit default swaps (CDS) stood at 82 bps, lower than the 111 bps in end-4Q 2016. It has remained lower than Indonesia's 128 bps and Malaysia's 108 bps in the current quarter.

Chart 30. 5-Year CDS Spreads of Selected ASEAN Countries
in basis points



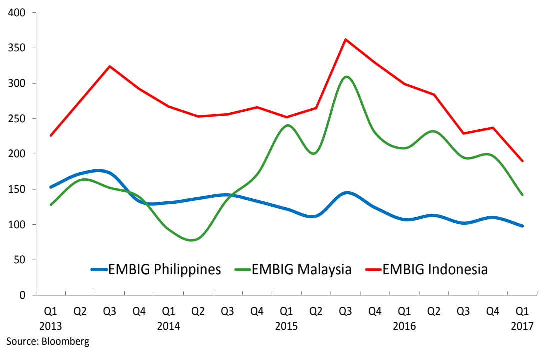
Source: Bloomberg

[49] Bloomberg estimates roughly about 86 percent probability of a fed rate hike as of 2 March 2017.

[50] The US Fed raised the target range for its federal funds by 25 bps 0.75-1.0 percent during its 14-15 March 2017 meeting.

Likewise, the EMBIG Philippines ended the quarter narrower at 98 bps when compared to the previous quarter's closing of 110 bps.

Chart 31. EMBIG Spreads of Selected ASEAN Countries
in basis points



Banking System

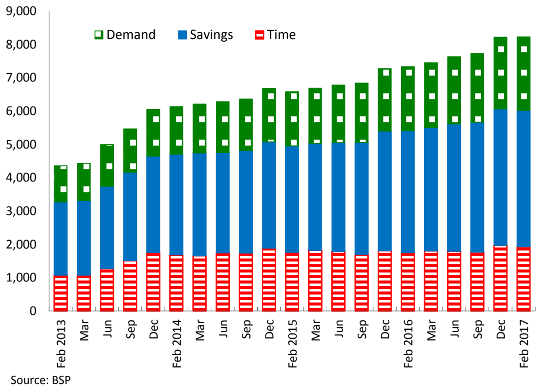
The Philippine banking system remained resilient in supporting long-term economic growth and stable financial condition. Based on latest data, banks' balance sheets exhibited steady growth in assets and deposits.

Philippine banking system posts steady growth in assets and deposits

Asset quality indicators continued to improve while capital adequacy ratios remained above international standards, even with the implementation of the tighter Basel III framework.

Savings Mobilization. Savings and demand deposits remained the primary sources of funds for the banking system. Banks' total deposits[51] as of end-February 2017 amounted to ₱8.2 trillion, 12.2 percent or ₱0.9 trillion higher than the year-ago level.

Chart 32. Deposit Liabilities of Banks
in billion pesos



Total deposits as of end-February 2017 grew by 0.2 percent from its level as of end-December 2016 as demand deposits increased by 2.7 percent while time and savings deposits contracted by 2.0 percent and 0.1 percent, respectively. Meanwhile, foreign currency deposits owned by residents (FCD-Residents) reached ₱1.73 trillion as of end-February, higher by 13.0 percent from the previous year and by 1.3 percent from the level as of end-December 2016.[52]

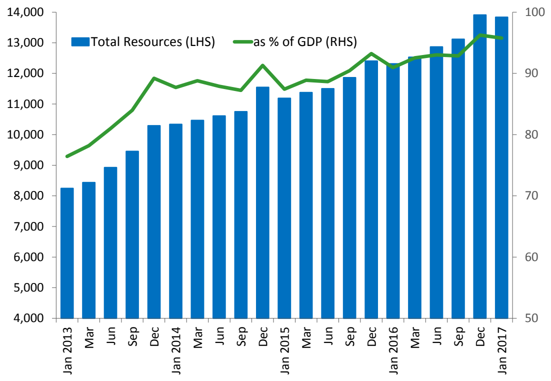
Institutional Developments. The total resources of the banking system as of end-January 2017 reached ₱13.8 trillion, higher by 12.4 percent from ₱12.3 trillion during the same period last year. In terms of its size to the economy, total resources stood at 95.8 percent of GDP.

Total resources of the banking system continue to rise

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

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

Chart 33. Total Resources of the Banking System
levels in billion pesos; share in percent



Source: BSP

The number of banking institutions (head offices) decreased to 613 offices as of end-September 2016 from 635 offices a year ago and 618 offices as of end-June 2016. This indicated continued consolidation of banks as well as the exit of weaker players in the banking system.

By banking classification, banks (head offices) consisted of 41 U/KBs, 64 thrift banks (TBs), and 508 rural banks (RBs). Meanwhile, the operating network (head offices and branches/agencies) of the banking system expanded to 11,024 offices in end-September 2016 from 10,615 offices during the same period in the previous year and 10,936 offices in end-June 2016, due mainly to the increase in the branches/agencies of U/KBs, TBs and RBs.

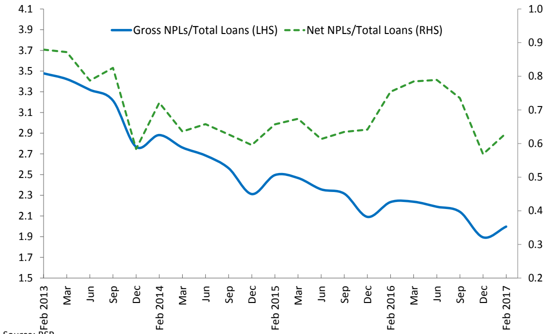
The Philippine banking system's gross non-performing loan (GNPL) ratio, net of interbank loans (IBL), improved to 2.04 percent as of end-February 2017 relative to 2.28 percent registered during the same period in the previous year but slightly increased from 1.95 as of end-December 2016.

Asset quality of Philippine banks remain healthy

Banks' initiatives to improve their asset quality along with prudent lending regulations helped maintain the GNPL ratio below its pre-Asian crisis level of 3.5 percent.[53]

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

Chart 25. Ratios of Gross Non-Performing Loans and Net Non-Performing Loans to Total Loans of the Banking System
in percent



Source: BSP

Similarly, the net non-performing loan (NNPL) ratio declined to 0.63 percent as of end-February 2017 relative to the previous year's ratio of 0.75 percent but increased slightly from 0.57 percent as of end-December 2016. In computing for the NNPLs, specific allowances for credit losses on TLP are deducted from the GNPLs, said allowances increased to ₱103.6 million in end-February 2017 from ₱100.9 million posted as of end-December 2016.[54]

The Philippine banking system's GNPL ratio of 2.04 percent was higher relative to that of Malaysia (1.20 percent) and South Korea (1.42 percent) but lower than that of Thailand (2.83 percent) and Indonesia (2.90 percent).[55]

The loan exposures of banks remained adequately covered as the banking system registered an NPL coverage ratio of 116.0 percent as of end-February 2017. This was higher than the previous year's ratio of 113.9 but marginally lower than the end-December 2016 ratio of 118.5 percent.

The capital adequacy ratio (CAR) of universal and commercial banks (U/KBs) at end-September 2016 improved slightly to 15.40 percent on solo basis, relative to the previous quarter ratio of 15.37 percent. Likewise, the CAR on a consolidated basis, increased slightly to 16.15 percent from the

[54] 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.

[55] Sources: Malaysia – Bank Negara Malaysia, Quarterly Bulletin for Q4 2016 (Banking System's Impairment ratio, net of impairment provisions, Q4 2016); South Korea – Financial Supervisory Service (Domestic Banks' Substandard or Below Loans [SBLs] ratio, Q4 2016); Thailand – Bank of Thailand (Total Financial Institutions' Gross NPLs ratio, Q4 2016); and Indonesia – IMF: Financial Soundness Indicators website (Banks' Non-performing Loans to Gross Loans Ratio, Q4 2016).

quarter ago ratio of 16.12 percent. These figures were well above the BSP regulatory threshold of 10.0 percent and international minimum of 8.0 percent.

U/KBs maintain high levels of CAR

The CAR of Philippines' U/KBs on a consolidated basis at 16.15 percent was higher than that of South Korea (14.92 percent) but lower than that of Malaysia (16.50 percent), Thailand (18.04 percent) and Indonesia (20.62 percent).[56]

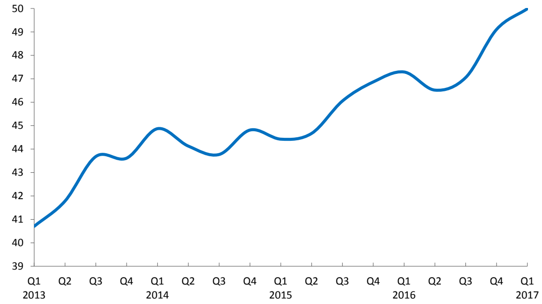
Exchange Rate

On a q-o-q basis, the peso weakened by 1.79 percent to average ₱50.00/US$1 from the previous quarter's average of ₱49.11/US$1. Likewise, on a y-o-y basis, the peso depreciated by 5.45 percent relative to the ₱47.28/US$1 average in Q1 2016.[57]

The peso depreciates against the US dollar

The weakening of the peso during the review quarter was due mainly to the following developments: (i) the US Fed rate hike in March 2017 and the expectation for more and faster rate increases in 2017; (ii) persisting political noise in Europe; and (iii) strong US dollar requirement by domestic corporates.

Chart 26. Quarterly Peso-Dollar Rate
PHp/US$



Source: Reference Exchange Rate Bulletin, Treasury Department, BSP

In January 2017, the peso strengthened against the US dollar by 0.16 percent to average ₱49.74/US$1 relative to the ₱49.82/US$1 average in December following: (i) the release of the Federal Open Market Committee (FOMC) minutes which bared a gradual increase in interest rates by the US Federal Reserve; (ii) lower-than-expected US GDP growth in Q4 2016;[58] (iii) Bank of Japan's move to keep policy rates unchanged;[59] and on the domestic side, (iv) the release of strong 2016 GDP data.[60]

In February, the trend reversed as the peso weakened against the US dollar by 0.45 percent to average ₱49.96/US$1 relative to the previous month. Markets turned cautious given the increased probability of an interest rate hike by the US Federal Reserve in March amid improvement in the US jobs market and as inflation showed signs of nearing the US Fed's two percent goal. In addition, strong corporate demand for US dollar ahead of the expected rate hike added pressure on the peso.

The depreciation of the peso continued as it averaged ₱50.28/US$1 in March, weakening by 0.62 percent from that in February. The peso's weak performance was due mainly to hawkish comments from a number of Fed officials prior to the 15 March 2017 FOMC meeting which bolstered expectation of a policy rate hike in the

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[56] Sources: South Korea - Financial Supervisory Service (Domestic Banks' Capital Ratio, Q4 2016); Malaysia – Bank Negara Malaysia, Quarterly Bulletin for Q4 2016 (Banking System's Total Capital Ratio, Q4 2016); Thailand – Bank of Thailand (Commercial Banks' Capital Funds Percentage of Risk Assets, Q4 2016); and Indonesia – IMF Financial Soundness Indicators website (Commercial Banks, Regulatory Capital to Risk-Weighted Assets Ratio Q4 2016).

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

[58] US economic growth slowed in the last quarter of 2016 to 1.9 percent from the 3.5 percent recorded in the third quarter. The fourth quarter's figure brought full-year GDP growth to 1.6 percent in 2016, its worst performance since 2011.

[59] The Bank of Japan (BoJ) kept monetary policy steady on 31 January 2017 and roughly maintained its upbeat price forecasts, signaling a steady economic recovery will help accelerate inflation towards its 2 perent target without additional stimulus. In a widely expected move, the BoJ maintained the 0.1 percent interest it charges on a portion of the excess reserves that financial institutions park with the central bank.

[60] On 26 January 2017, the PSA released the country's GDP growth for the fourth quarter of 2016 and for the entire 2016 of 6.6 percent and 6.8 percent, respectively.

US.[61] These were coupled by a surge in month-end demand for the US dollar and safe-haven buying on the back of persisting political noise in Europe.[62]

On a year-to-date basis, the peso depreciated against the US dollar by 0.9 percent on 31 March 2017 as it closed at ₱ ₱50.16/US$1. This is in contrast with the strengthening of most Asian currencies during the same period.[63]

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

appreciation/(-depreciation); in percent

	2013	2014	2015	2016	2017*
Korean Won	1.1	-4.3	-6.6	-2.6	7.9
Thai Baht (Onshore)	-4.6	-0.7	-8.9	0.1	4.0
Singaporean Dollar	-2.7	-4.5	-6.0	-2.0	3.6
Indian Rupee	-11.4	-2.9	-4.9	-2.9	4.8
Indonesian Rupiah	-19.1	-2.1	-9.8	2.3	1.1
Philippine Peso	**-7.0**	**-0.7**	**-5.0**	**-5.3**	**-0.9**
Japanese Yen	-16.3	-12.5	-0.5	3.3	4.6
Malaysian Ringgit	-5.5	-6.3	-18.6	-4.2	1.4
Chinese Yuan	2.6	-2.7	-4.3	-6.6	0.8
New Taiwan Dollar	-1.9	-6.2	-3.6	1.9	6.5

Notes:
- Negative value represents depreciation of the currency against the US dollar.
- YTD changes are computed as the percent change between the closing prices for the year indicated versus the closing prices for the preceding year.
* Data as of 4:00 p.m., 31 March 2017
Source: Treasury Department - BSP

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

Meanwhile, the volatility of the peso's daily closing rates (as measured by the coefficient of variation) stood at 0.54 percent during the review quarter, lower than 1.43 percent registered in the previous quarter.[65] Relative to other currencies in the region, the volatility of the peso was in the middle of the pack.[66]

On a real trade-weighted basis, the peso lost external price competitiveness in Q1 2017 against the basket of currencies of all trading partners (TPI), trading partners in advanced (TPI-A) and developing countries (TPI-D). Relative to Q4 2016, the real effective exchange rate (REER) index of the peso increased by 2.63 percent, 5.31 percent, and 0.72 percent, respectively, mainly on account of widening inflation differential.[67,68]

On the other hand, the peso gained external price competitiveness against the TPI, TPI-A, and TPI-D baskets, relative to Q1 2016. This developed as the nominal depreciation of the peso offset the impact of widening inflation differential against these currency baskets, resulting to a decrease in the REER index of the peso by 3.58 percent, 3.71 percent, and 3.49 percent against the TPI, TPI-A, and TPI-D baskets, respectively.

[61] San Francisco Federal Reserve President John Williams had said "there are no more reasons to further delay the US central bank's plan of hiking interest rates soon with the US economy now at full employment and with higher chances of inflation spiking on the back of potential tax cuts from US President Donald J. Trump." Similarly, New York Federal Reserve President William Dudley had said the case for tightening monetary policy "has become a lot more compelling." In addition, Federal Reserve Board Governor Lael Brainard, a known dove at the US central bank, said in an address at Harvard University that "after being an important constraint in the past few years, the external environment currently appears more benign than it has been for some time even though risks remain. Assuming continued progress, it will likely be appropriate soon to remove additional accommodation, continuing on a gradual path".

[62] Britain has formally begun its process of leaving the European Union (EU) which investors believe could trigger a period of political concerns with the country's partners in the EU and pose risk to Britain's economy.

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

[64] As of end-March 2017, country's gross international reserves (GIR) stood at US$80.87 billion (preliminary). This can cover 8.9 months' worth of imports of goods and payments of services and primary income and is equivalent to 5.2 times the country's short-term external debt based on original maturity and 3.9 times based on residual maturity. Foreign direct investments (FDI) net inflows rose by 13.2 percent to reach US$685 million in January 2017. Personal remittances from overseas Filipinos (OFs) rose by 8.5 percent year-on-year in January 2017 to reach US$2.4 billion. Tourism and BPO receipts reached US$5.14 billion and US$20.2 billion, respectively in 2016.

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

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

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

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

III. Fiscal Developments

The National Government (NG) achieved ₽2.2 billion in fiscal surplus for January 2017, a reversal of the ₽3.5-billion deficit posted in the previous year.

NG achieves fiscal surplus for January 2017

Netting out the interest payments in NG expenditures, the primary surplus amounted to ₽44.6 billion, 6 percent higher than the amount recorded in January 2016.

Table 16. National Government Fiscal Performance
in billion pesos

	2016	2017	Growth Rate (in percent)	2016 Program
	Jan			
Surplus/(Deficit)	-3.474	2.222	-162.9	-388.9
Revenues	182.226	200.314	9.9	2,256.7
Expenditures	185.700	198.092	6.7	2,645.6

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

Revenues increased by 9.9 percent to ₽200.3 billion in January 2017 compared to ₽182.2 billion in the same period in 2016. The Bureau of Internal Revenue (BIR) and the Bureau of Customs (BoC) contributed ₽147.4 billion and ₽35.9 billion, respectively. The revenues of the BIR and BOC were higher by 14 percent and 16 percent, respectively, compared to their levels a year ago. Meanwhile, income from Bureau of the Treasury (BTr) increased by 1 percent to ₽8.0 billion.

Expenditures for the period in review amounted to ₽198.1 billion, 6.7 percent higher than the expenditures in January 2017. Excluding interest payments, expenditures went up by 11 percent to ₽155.7 billion. Meanwhile, interest payment was ₽3.2 billion lower compared to its year-ago level, reaching ₽42.3 billion in January 2017.

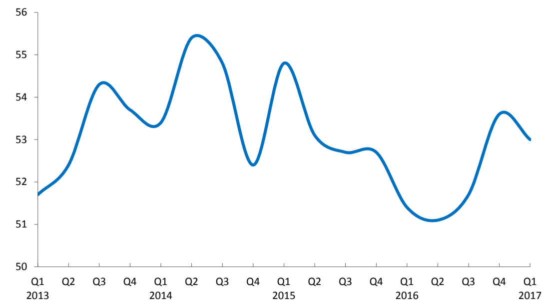
IV. External Developments

The JP Morgan Global All-Industry Output Index was unchanged at 53.0 in March from the same level in February, as the pace of growth in production and new orders held firm from February readings. Output growth accelerated in Germany, France, and Italy, while it slowed in South Korea and Brazil.[69]

Global economic activity remains steady

For 2017, the IMF expects inflation to accelerate but remain broadly manageable. The outlook considered the recent recovery of headline inflation for advanced economies due to the bottoming out of prices for commodities such as oil and metals and the mixed inflation developments across emerging market and developing economies (EMDEs).

Chart 27. JP Morgan Global All-Industry Output Index
index points



Source: Markit Economics

US. Real GDP grew by 2.0 percent on a seasonally adjusted y-o-y basis in Q4 2016 from 1.7 percent in Q3 2016. On a q-o-q basis, real output growth was at 2.1 percent in Q4 2016 from 3.5 percent in Q3 2016. The q-o-q deceleration in real GDP reflected a downturn in exports and federal government spending.[70] Meanwhile, the manufacturing PMI registered a reading of 57.2 in March, lower than the 57.7 record in February as new orders continued to grow, albeit at a slower rate.[71]

Economic growth in the US remains buoyant

On a y-o-y basis, inflation rose to 2.7 percent in February 2017 from 2.5 percent in January. The upward movements in the indexes for food, shelter, and recreation resulted in higher inflation during the month. The unemployment rate improved slightly to 4.7 percent in February from 4.8 percent in January. Total nonfarm payroll employment increased by 235,000 in February, with gains seen in construction, private educational services, manufacturing, health care, and mining.

The Thomson-Reuters/University of Michigan Index of Consumer Sentiment rose to 96.9 in March from 96.3 in the previous month.[72] Meanwhile, the Conference Board Consumer Confidence Index increased sharply to 125.6 in March from 116.1 in February[73] as consumers' assessment of current business and labor market conditions improved considerably.

Euro Area. On a q-o-q basis, real GDP in the euro area rose by 0.4 percent in Q4 2016, the same pace as in Q3 of the same year. On a y-o-y basis, real GDP growth was slower at 1.7 percent in Q4 2016 from the previous quarter. Meanwhile, the composite PMI for the euro area rose to 56.7 in March from 56.0 in February as growth accelerated in the service sector while manufacturing output eased marginally. By country, stronger output increases were seen in Germany and France.[74]

[69] JP Morgan Global Manufacturing & Services PMI, http://www.markiteconomics.com/
[70] US Bureau of Economic Analysis, "Gross Domestic Product: Fourth Quarter and Annual 2016 (Third Estimate)," news release, 30 March 2017.https://www.bea.gov/newsreleases/national/gdp/2017/pdf/gdp4q16_3rd.pdf
[71] Institute for Supply Management, https://www.instituteforsupplymanagement.org
[72] Final results for March. University of Michigan Survey of Consumers, http://www.sca.isr.umich.edu/
[73] The Conference Board, http://www.conference –board.org/
[74] Markit Flash Eurozone PMI (flash estimate), http://www.markiteconomics.com/

Economic activity in the euro area holds firm

The seasonally adjusted unemployment rate was 9.5 percent in February, lower than the 9.6 percent recorded in January.[75] Meanwhile, inflation in February is estimated at 2.0 percent from 1.8 percent in January, driven mainly by the price increases in fuels for transport, vegetables, and heating oil.[76]

The European Commission's Economic Sentiment Indicator in the euro area remained broadly unchanged in March at 107.9 from 108.0 in February as confidence levels in industry, retail trade and construction remained high. However, the more upbeat consumer confidence was offset by the weaker sentiment in the service sector.

Japan. On a q-o-q basis, real GDP expanded by 0.2 percent in Q4 2016, albeit slower than the 0.3 percent growth in Q3 2016. On a y-o-y basis, real GDP growth rose to 1.7 percent in Q4 2016 from 1.1 percent in the previous quarter.[77] The latest expansion in the Japanese economy was primarily supported by the pickup in exports amid a weak yen, while private consumption, which accounts for the largest share in the Japanese economy, remained flat.

Manufacturing activity in Japan improves further

The seasonally adjusted manufacturing PMI eased to 52.4 in March from 53.3 in February as new orders, output, and employment expanded at a slightly slower pace.[78]

Inflation declined slightly to 0.3 percent in February from 0.4 percent in January. The seasonally adjusted unemployment rate also eased slightly in February to 2.8 percent from 3.0 percent in the previous month.

[75] Eurostat news release 55/2017 dated 3 April 2017
[76] Eurostat news release 45/2017 dated 16 March 2017
[77] Department of National Accounts, Economic and Social Research Institute, Cabinet Office. http://www/esri.cao.go.jp/
[78] Nikkei Japan Manufacturing PMI, http://www.markiteconomics .com/

China. Real GDP grew by 6.8 percent y-o-y in Q4 2016, higher than the 6.7 percent GDP growth recorded in Q3 2016. The expansion in transport, storage, and post; real estate; accommodation and restaurants; and wholesale and retail trade supported the economy during the quarter.

Output growth in China is slightly faster in Q4 2016

Meanwhile, the seasonally adjusted manufacturing PMI fell to 51.2 in March from 51.7 in February as the softer increase in new export sales led to weaker growth in new orders.[79]

Inflation declined to 0.8 percent in February from 2.5 percent in January as food prices decreased by 4.3 percent.

India. Real GDP in India grew by 7.0 percent y-o-y in Q4 2016 from 7.4 percent in the previous quarter. The latest GDP growth was brought about by the expansion in manufacturing; trade, hotels, transport, communication, and services related to broadcasting; and agriculture, forestry, and fishing.[80]

Economic activity in India continues to expand, albeit at a slower pace

Meanwhile, the composite PMI increased for the third straight month in March to 52.5 from 50.7 in February due to solid growth in new orders and production amid strengthening demand conditions.

Inflation rose to 3.7 percent in February 2017 from 3.2 percent in January.

ASEAN Region. The Nikkei ASEAN Manufacturing PMI rose to 50.9 in March from 50.3 in February due to stronger expansions in both output and new orders.

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

Manufacturing output increases marginally in the ASEAN region

All ASEAN economies except Malaysia recorded improvements in their respective manufacturing sectors. Vietnam remained as the strongest performer, followed by the Philippines and Myanmar.[81]

Policy Actions by Central Banks. Central banks monitored by the BSP kept their policy rates unchanged during the month, with many citing improvements in global economic activity behind their respective monetary policy decisions.

Most central banks maintain their monetary policy settings, while the US Fed decides to raise interest rates

On 14-15 March, the FOMC decided to increase by 25 bps its target range for the federal funds rate to 0.75 – 1 percent. The decision was based largely on the current strengthening of the labor market and the moderate pace of expansion in economic activity.

Meanwhile, following the US Fed's policy rate hike, the People's Bank of China (PBOC) raised interest rates by 10 bps on both the medium-term lending facility and the open market operation reverse repurchase agreements on 16 March. The decision brought the rate on 6-month and 1-year MLF loans to 3.05 percent and 3.2 percent, respectively. The seven-day reverse repos were offered at 2.45 percent, 14-day reverse repos at 2.6 percent and 28-day reverse repos at 2.75 percent. This was the third time this year that the PBOC raised interest rates on its facilities, following similar adjustments on 24 January and 3 February 2017.

The PBOC also raised interest rates on its standing lending facility (SLF), effective March 16. It decided to increase the rates for its overnight SLF loans to 3.3 percent from 3.1 percent. It also hiked the rates for the seven-day SLF to 3.45 percent from 3.35 percent and the one-month SLF to 3.8 percent from 3.7 percent. The market viewed the moves as an attempt by the PBOC to help contain leverage in the financial system amid steady economic growth and rising inflation.

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

V. Monetary Policy Developments

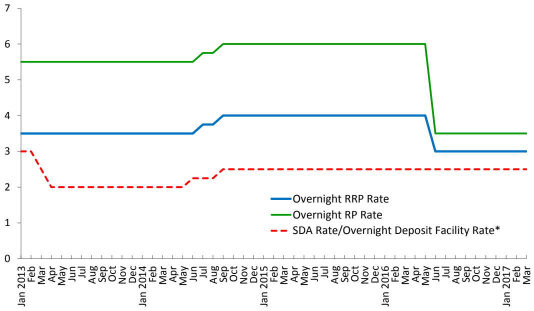
During the monetary policy meetings in 9 February and 23 March 2017, the BSP decided to maintain the key policy interest rate at 3.0 percent for the overnight reverse repurchase or RRP facility. The corresponding interest rates on the overnight lending and deposit facilities were also kept steady. The reserve requirement ratios were likewise left unchanged.

The BSP maintains monetary policy settings during the quarter

The BSP's decision to keep the policy rate steady is based on its assessment of inflation dynamics and the risks to the inflation outlook over the policy horizon. While headline inflation has risen due to the recent increases in food and oil prices as well as base effects, latest forecasts continue to show average inflation firmly settling within the target range of 3.0 percent ± 1 percentage point for 2017-2018. The overall balance of risks surrounding the inflation outlook also remains tilted to the upside, given possible adjustments in electricity rates and transportation fares as well as the transitory impact of the government's proposed fiscal reform program. Meanwhile, lingering uncertainty over the prospects of the global economy, due in part to possible shifts in macroeconomic policies in advanced economies, continues to pose a key downside risk to the inflation outlook. Nevertheless, inflation expectations remain anchored to the inflation target over the policy horizon.

Chart 28. BSP Policy Rates

in percent



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

The BSP also noted the beneficial effects on inflation of the removal of quantitative restrictions on rice importation. At the same time, the BSP stressed that while the global economic environment has become more challenging, domestic economic activity is expected to stay firm, supported by buoyant household consumption and private investment, increased fiscal spending, and ample credit and liquidity.

With these considerations, the Monetary Board believes that prevailing monetary policy settings remain appropriate. Going forward, the BSP will continue to monitor and assess evolving economic developments and will calibrate its policy tools as appropriate to ensure sustained price and financial stability.

VI. Inflation Outlook

BSP Inflation Forecasts

The BSP's latest forecasts[82] indicate that inflation could settle slightly above the midpoint of the target range in 2017 and approach the midpoint in 2018. Inflation is projected to rise close to the high-end of the target range in the second half of 2017, driven by the weaker exchange rate and the continued strength in domestic economic activity, before reverting back to the midpoint of the target range in 2018.

The risks to future inflation remain tilted toward the upside. The expected impact of the government's broad fiscal reform program along with possible adjustments in electricity rates and transportation fares are the main upside risks to inflation. Meanwhile, the lingering uncertainty over the prospects of the global economy, due in part to possible shifts in macroeconomic policies in advanced economies, continues to pose as the key downside risk to the inflation outlook.

Inflation is expected to fall slightly above the midpoint of the target range in 2017 and approach the midpoint in 2018

Demand Conditions. Key demand indicators support the view of robust domestic real sector activity. The country's real GDP expanded by 6.6 percent in Q4 2016 from 7.1 percent growth in the previous quarter, resulting in a full year growth of 6.9 percent.

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

High-frequency real sector indicators likewise point to favorable growth prospects in the near term. Production indices for the manufacturing sector suggest continued expansion with more than half of all major manufacturing sectors operating at above 80.0 percent capacity. The composite Purchasing Managers' Index (PMI) also remains firmly above the 50-point mark at 57.2 as of February 2017, indicating a sustained expansion across all sectors.

The optimistic economic outlook has also been reflected in the results of the BSP expectations surveys as business and consumer confidence indices remaining broadly steady for Q1 2017. This is in line with the generally favorable macroeconomic conditions.

Supply Conditions. Commodity prices are expected to remain manageable, reflecting ample supply conditions. Food inflation could remain benign over the near term given prospects of favorable domestic supply along with timely arrival of rice imports. Meanwhile, oil prices are projected to remain flat in the medium term as suggested by futures prices signaling that the world oil market is close to achieving balance between supply and demand.

Commodity prices are expected to remain manageable

Global agricultural prices are projected to settle at moderate levels over the medium term. Forecasts by the International Monetary Fund (IMF) and the World Bank suggest benchmark prices of key grains (wheat, maize, and rice) could have modest

[82] The inflation forecast path in this report refers to the forecasts presented during the 23 March 2017 monetary policy meeting. In the discussion, these forecasts are compared to the forecasts presented in the Q4 2016 Inflation Report which corresponds to forecasts on 22 December 2016 monetary policy meeting.

rise in 2017-2018 before normalizing over the medium term.[83,84]

In the domestic front, *palay* and corn production could increase in Q1 2017 by 15.2 percent and 25.0 percent, respectively, based on standing crop estimates, due to higher harvest areas and adequate water supply in key producing regions.[85]

International oil prices rose compared to the previous quarter's level with the start of the implementation of the production cut of Organization of the Petroleum Exporting Countries (OPEC) and several non-OPEC countries. Nonetheless, global crude oil prices eased anew to US$50.00 per barrel in March 2017 due to rising inventory levels after averaging close to US$55.00 per barrel in the first two months of 2017.

Forecasts by the Energy Information Adiministration (EIA), IMF, and World Bank suggest that global crude oil price could average close to US$55.00 per barrel in 2017. However, the outlook remains uncertain due to supply-side factors. Despite the relatively high compliance of OPEC members to their production targets, there is uncertainty on whether the member countries would renegotiate voluntary supply reductions in H2 2017. Moreover, higher production of shale oil from the United States could limit price pressures for the year. On the demand side, slower growth in China is expected to temper global demand in 2017.[86, 87,88]

Output gap remains positive

The balance of demand and supply conditions as captured by the output gap (or the difference between actual and potential output), provides an indication of potential inflationary pressures in the near term.[89]

Given the latest GDP data, estimates by the BSP show that the output gap remains slightly positive and is broadly stable relative to the previous quarter.[90]

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

1) BSP's overnight RRP rate at 3.0 percent from March 2017 to December 2018;

2) NG fiscal deficits for 2017 to 2018, which are consistent with the DBCC-approved estimates;

3) Dubai crude oil price assumptions, trends of which are consistent with the trend of futures prices of oil in the international market;

4) Increase in nominal wage in June 2017 and June 2018 consistent with labor productivity growth and historical wage increases;

5) Real GDP growth is endogenously determined; and

6) Foreign exchange rate is endogenously determined through the purchasing power parity and interest rate parity relationships.

Risks to the Inflation Outlook

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

Projected inflation path is slightly higher for 2017 and 2018

Compared to the previous inflation report, the latest fan chart presents a slight upward shift in the inflation projection for 2017 and 2018.

[83] IMF, Commodity Market Monthly, February 2017, available online at http://www.imf.org
[84] World Bank, Commodity Markets Outlook, January 2017, available online at http://www.worldbank.org
[85] PSA, Rice and Corn Situation Outlook, January 2017, available online at http://www.psa.gov.ph
[86] EIA, Short-Term Energy Outlook, March 2017, available online at http://www.eia.gov
[87] IMF, Commodity Markets Monthly, February 2017, available online at http://www.imf.org
[88] World Bank, Commodity Markets Outlook, January 2017, available online at http://www.worldbank.org
[89] 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).
[90] Based on the seasonally-adjusted GDP growth

The increase in the projected inflation path could be attributed mainly to the weaker domestic currency, higher electricity rates due to the *Malampaya* maintenance shutdown, which were partly offset by lower oil prices.

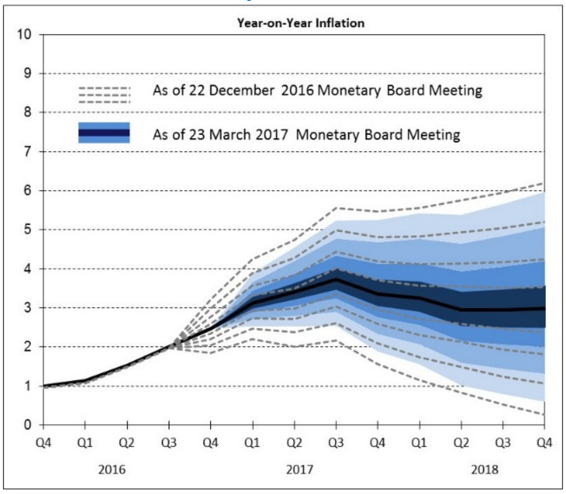
The BSP's review of current inflation dynamics suggests that the risks surrounding the inflation outlook remains tilted on the upside. This assessment is depicted in the latest fan chart wherein the projection bands above the central projection are greater than the bands below it. The projected impact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

The national government's proposed fiscal reform package represents an upside risk to inflation. The Department of Finance (DOF) has submitted to Congress the tax reform package under the Tax Reform for Acceleration and Inclusion (TRAIN) bill. It includes simplification of personal income tax (PIT) system, broadening of the value-added tax (VAT) system, staggered increase in excise tax on all petroleum products, excise tax on automobiles and reduction and restructuring of the estate and donor tax to a single rate of 6.0 percent. The expected net increase in revenue from these reforms, together with some tax administration measures are intended largely for funding the government's key infrastructure and social spending programs, which could boost domestic economic activity and raise the country's productive capacity.

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

Sustained increase in productive public investment and higher capital income from the gradual reduction in corporate income tax would have significant crowding-in effect on private investment, resulting in a beneficial cycle of higher investment and potential output. In terms of inflationary impact, higher consumption taxes, together with the demand stimulus from the fiscal reform program is expected to result in higher inflation.

Chart 29. Inflation Projection



Source: BSP estimates

The risks to inflation outlook remain tilted on the upside

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

By contrast, lingering uncertainty over the prospects of the global economy is the main downside risk to the inflation outlook. Heigthened economic uncertainty in the US due to possible expansionary fiscal policies leading to a higher and faster-than-expected federal funds rate hikes. At the same time, US President Trump's proposed restrictive trade policies, such as increase in tariffs to China, Mexico and other countries, the repeal of the North American Free Trade Agreement (NAFTA), and withdrawal from the Trans-Pacific Partnership (TPP) agreement, could lead to slower global trade activity and thereby lead to downward price pressures.

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

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

VII. Implications for the Monetary Policy Stance

The prevailing monetary policy settings remain appropriate. The latest BSP baseline forecasts show that inflation could approach the midpoint of the target range in 2017 and 2018. At the same time, the balance of risks to the inflation outlook remains tilted toward the upside which argues for maintaining vigilance in setting the stance of monetary policy going forward. The impact of the government's overall fiscal reform program, pending petitions for adjustments in electricity rates, and further transport fare hikes are seen as the main upside risks to the baseline forecast. Meanwhile, the lingering uncertainty in the global economic landscape poses as the main downside risk to inflation.

Nevertheless, inflation dynamics remain manageable given well-contained inflation expectations over the policy horizon. Inflation expectations—based on forecast surveys of private sector economists by the BSP and by Consensus Economics—also continue to be within target over 2017-2018. Inflation in Q1 2017 was at 3.2 percent.

Domestic demand continues to be firm

Domestic economic activity continued to expand within expectations, supporting the maintenance of present monetary policy settings. The economy grew by 6.6 percent in Q4 2016, bringing full year growth to 6.9 which is close to the high end of the government's growth target of 6-7 percent in 2016. Strong domestic demand fueled output growth, supported by household consumption and capital formation. On the supply side, growth was driven by the services sector while growth in the industry sector was supported by manufacturing.

Latest indicators of domestic demand continue to broadly point to firm growth prospects over the policy horizon. The Philippine composite PMI remained firmly above the 50-point expansion threshold at 57.0 in February 2017, albeit lower than in the previous month due to seasonal factors. Business optimism on the economy remained steady and positive for Q1 2017 and higher for the next quarter. Trends in other high-frequency demand indicators are also generally positive, with continued increases in sales volume of automobiles and electricity as well as production volume in the manufacturing sector. Strong NG expenditure growth resulting from the initiatives of the Duterte administration to ramp up public spending as evident in the second semester of 2016 is also expected to provide a boost to the economy.

Strong credit demand and ample liquidity conditions suggest that the present policy stance continues to provide sufficient stimulus to real sector activity. Domestic liquidity increased by 12.6 percent while bank lending grew by 18.1 percent in February 2017. Meanwhile, open market operations (OMO) by the BSP were generally oversubscribed since January with strong demand for TDF placements driving down the WAIR for 7-and 28-days tenors.

Data on economic activity and inflation in the global economy have improved in recent months. The pace of economic activity in the US, euro area, and Japan remained steady, while production improved in China and India. The sharp increase in energy prices led to higher inflation in the US and euro area while the uptick in the prices of food, tobacco, and liquor pushed up inflation in China. Stronger growth along with stronger inflationary pressures, including higher commodity prices, are seen to affect the future stance of monetary policy in advanced economies. On March 15, the US Federal Reserve raised the federal funds rate by 25 basis points to a range of 0.75-1.0 percent as was expected by the market, marking its third increase since the global financial crisis. Market analysts expect two possible further rate increases in 2017.

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent) RRP Overnight	Levels (in percent) RP Overnight	Monetary Policy Decisions
2 0 1 2			
19 Jan 2012	4.25	6.25	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 4.25 percent for the overnight borrowing or RRP facility and 6.25 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly The MB's decision is based on its assessment that the inflation outlook remains comfortably within the target range, with expectations well-anchored and as such, allowed some scope for a reduction in policy rates to help boost economic activity and support market confidence.
1 Mar 2012	4.00	6.00	The MB decided to reduce the BSP's key policy interest rates by another 25 bps to 4.0 percent for the overnight borrowing or RRP facility and 6.0 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. The MB is of the view that the benign inflation outlook has allowed further scope for a measured reduction in policy rates to support economic activity and reinforce confidence.
19 Apr 2012	4.00	6.00	The MB decided to keep the BSP’s key policy interest rates steady at 4 percent for the overnight borrowing or RRP facility and 6 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged.
14 Jun 2012	4.00	6.00	The MB decided to keep the BSP’s key policy interest rates steady at 4 percent for the overnight borrowing or RRP facility and 6 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged. The MB’s decision was based on its assessment that the inflation environment remains manageable. Baseline forecasts continue to track the lower half of the 3-5 percent target range for 2012 and 2013, while inflation expectations remain firmly anchored. At the same time, domestic macroeconomic readings have improved significantly in Q1 2012.
26 Jul 2012	3.75	5.75	The MB decided to reduce the BSP’s key policy interest rates by 25 bps to 3.75 percent for the overnight borrowing or RRP facility and 5.75 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also reduced accordingly. This is the third time in 2012 that the BSP has cut its policy rates. The MB’s decision was based on its assessment that price pressures have been receding, with risks to the inflation outlook slightly skewed to the downside. Baseline forecasts indicate that inflation is likely to settle within the lower half of the 3-5 percent target for 2012 and 2013, as pressures on global commodity prices are seen to continue to abate amid weaker global growth prospects. At the same time, the MB is of the view that prospects for global economic activity are likely to remain weak.
13 Sep 2012	3.75	5.75	The MB decided to keep the BSP’s key policy interest rates steady at 3.75 percent for the overnight borrowing or RRP facility and 5.75 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged. The MB’s decision was based on its assessment that the inflation environment remains benign,

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
2 0 1 4			
6 Feb 2014	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained.
27 Mar 2014	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained. Meanwhile, the MB decided to increase the reserve requirement by one percentage point effective on 11 April 2014.
8 May 2014	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained. Meanwhile, the MB decided to increase the reserve requirements for U/KBs and TBs by a further one percentage point effective on 30 May 2014.
19 Jun 2014	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs and RPs were also maintained. The reserve requirement ratios were left unchanged as well. Meanwhile, the MB decided to raise the interest rate on the SDA facility by 25 basis points from 2.0 percent to 2.25 percent across all tenors effective immediately.
31 Jul 2014	3.75	5.75	The MB decided to increase the BSP's key policy rates by 25 bps to 3.75 percent for the overnight borrowing or RRP facility and 5.75 percent for the overnight lending or RP facility. The interest rates on term RRPs and RPs were also raised accordingly. The rate on special deposit accounts (SDA) was left unchanged. Meanwhile, the reserve requirement ratios were also kept steady.
11 Sep 2014	4.00	6.00	The MB decided to increase the BSP's key policy rates by 25 bps to 4.0 percent for the overnight borrowing or RRP facility and 6.0 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also raised accordingly. Meanwhile, the reserve requirement ratios were left unchanged.
23 Oct 2014 **11 Dec 2014**	4.00	6.00	The MB decided to maintain the BSP's key policy interest rates at 4.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and special deposit accounts were also kept steady. The reserve requirement ratios were left unchanged as well.

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

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

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

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

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