INFLATION REPORT

FOURTH Quarter 2011

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 4.0 percent with a tolerance interval of ± 1.0 percentage point for 2011. The inflation target range for 2011, therefore, is 3.0-5.0 percent. For the medium term, the BSP shifted to a fixed inflation target of 4.0 percent ± 1.0 percentage point for 2012-2014.

The report is published on a quarterly basis, presenting a survey of the various factors affecting inflation. These include recent price and cost developments, prospects for aggregate demand and output, labor market conditions, monetary and financial market conditions, fiscal developments, and the international environment. A section is devoted to a discussion of monetary policy developments in the most recent, as well as a comprehensive analysis of the BSP's view of the inflation outlook for the policy horizon. This issue also features a box article on the rebasing of the consumer price index for the Philippines using 2006 as the new base year.

The Monetary Board approved this Inflation Report at its meeting on 26 January 2012.

AMANDO M. TETANGCO, JR.
Governor

3 February 2012

List of Acronyms, Abbreviations, and Symbols

AE	Advanced economy
AFF	Agriculture, Fishery, and Forestry
AP	Asia Pacific
AL	Auto Loans
BAS	Bureau of Agricultural Statistics
BES	Business Expectations Survey
BIR	Bureau of Internal Revenue
BIS	Bank for International Settlements
BOC	Bureau of Customs
BPO	Business Process Outsourcing
BTr	Bureau of the Treasury
CAMPI	Chamber of Automotive Manufacturers of the Philippines, Inc.
CAR	Capital Adequacy Ratio
CBD	Central Business District
CCRs	Credit Card Receivables
CES	Consumer Expectations Survey
CDS	Credit Default Swaps
CI	Confidence Index
CPI	Consumer Price Index
DBCC	Development Budget Coordination Committee
DOF	Department of Finance
EIA	Energy Information Administration
EM	Emerging Market
EMBI	JP Morgan Emerging Market Bond Index
ERC	Energy Regulatory Commission
EU	European Union
FAO	Food and Agriculture Organization
GDP	Gross Domestic Product
GNI	Gross National Income
GRAM	Generation Rate Adjustment Mechanism
ICERA	Incremental Currency Exchange Rate Adjustment
IEA	International Energy Agency
IMF	International Monetary Fund
IPP	Independent Power Producer
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
NCCP	National Council for Commuters' Protection
NDA	Net Domestic Assets
NEDA	National Economic and Development Authority

NEER	Nominal Effective Exchange Rate
NFA	Net Foreign Assets; National Food Authority
NFIA	Net Factor Income from Abroad
NG	National Government
NPC	National Power Corporation
NPI	Net Primary Income
NPLs	Non-performing loans
NSO	National Statistics Office
OPEC	Organization of the Petroleum Exporting Countries
PBR	Performance-Based Rate
PCE	Personal Consumption Expenditure
PMI	Purchasing Managers' Index
PSEi	Philippine Stock Exchange Composite Index
PSIC	Philippine Standard Industrial Classification
RB	Rural Banks
REER	Real Effective Exchange Rate
ROP	Republic of the Philippines
RP	Repurchase
RREL	Residential and Real Estate Loans
RRP	Reverse Repurchase
SEM	Single-Equation Model
SMS	Short Message Service
SDA	Special Deposit Account
TCS	Transportation, Communications, and Storage
U/KBs	Universal/commercial banks
WEO	World Economic Outlook
WESM	Wholesale Electricity Spot Market

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) encouraging/discouraging deposits in the special deposit account (SDA) facility by banks and trust entities of BSP-supervised financial institutions; (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)[1] in consultation with the BSP. On 9 July 2010, the BSP announced its shift to a fixed inflation target for the medium term of 4.0 percent ± 1.0 percentage point for 2012-2014.

BSP's Explanation Clauses

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

[1] The 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 Department of Budget and Management (DBM), National Economic and Development Authority (NEDA), and the Department of Finance (DOF). The BSP sits as a resource agency.

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. Starting in 2012, the Monetary Board will hold eight (8) monetary policy meetings in a year to review and decide on the stance of monetary policy. Prior to 2012, monetary policy meetings were held every six weeks while prior to July 2006, meetings were held every four weeks during the 2002 – July 2006 period.

Chairman Amando M. Tetangco, Jr.

Members Cesar V. Purisima

Alfredo C. Antonio

Ignacio R. Bunye

Peter B. Favila

Felipe M. Medalla

Armando L. Suratos

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 will meet eight times a year (beginning in January 2012) but may also meet between regular meetings, whenever it is deemed necessary.

Chairman Amando M. Tetangco, Jr.
Governor

Members[2] Diwa C. Guinigundo
Deputy Governor
Monetary Stability Sector

Nestor A. Espenilla, Jr.
Deputy Governor
Supervision and Examination Sector

Ma. Cyd N. Tuaño-Amador
Assistant Governor
Monetary Policy Sub-Sector

Ma. Ramona GDT Santiago
Assistant Governor
Treasury Department

[2] The Advisory Committee is supported by a Technical Secretariat composed of officers and staff from the Department of Economic Research, Center for Monetary and Financial Policy, and the Treasury Department.

2012 SCHEDULE OF MONETARY POLICY MEETINGS, INFLATION REPORT PRESS CONFERENCE AND PUBLICATION OF MB HIGHLIGHTS					
Period		Advisory Committee (AC) Meeting	Monetary Board (MB) Meeting	MB Highlights Publication	Inflation Report (IR) Press Conference
2012	Jan	13 (Fri) (AC Meeting No. 1)	19 (Thu) (MB Meeting No. 1)		
	Feb	24 (Fri) (AC Meeting No. 2)		16 (Thu) (19 Jan 2012 MB)	3 (Fri) (Q4 2011 IR)
	Mar		1 (Thu) (MB Meeting No. 2)	29 (Thu) (1 Mar 2012 MB)	
	Apr	13 (Fri) (AC Meeting No. 3)	19 (Thu) (MB Meeting No. 3)		
	May			17 (Thu) (19 Apr 2012 MB)	4 (Fri) (Q1 2012 IR)
	Jun	8 (Fri) (AC Meeting No. 4)	14 (Thu) (MB Meeting No. 4)		
	Jul	20 (Fri) (AC Meeting No. 5)	26 (Thu) (MB Meeting No. 5)	12 (Thu) (14 Jun 2012 MB)	
	Aug			23 (Thu) (26 Jul 2012 MB)	10 (Fri) (Q2 2012 IR)
	Sep	7 (Fri) (AC Meeting No. 6)	13 (Thu) (MB Meeting No. 6)		
	Oct	19 (Fri) (AC Meeting No. 7)	25 (Thu) (MB Meeting No. 7)	11 (Thu) (13 Sep 2012 MB)	
	Nov			22 Nov (Thu) (25 Oct 2012 MB)	9 (Fri) (Q3 2012 IR)
	Dec	7 (Fri) (AC Meeting No. 8)	13 (Thu) (MB Meeting No. 8)	10 Jan 2013 (Thu) (13 Dec 2012 MB)	

CONTENTS

OVERVIEW[3]

Average headline inflation for 2011 is within government target. Headline inflation in 2011 averaged 4.4 percent and 4.8 percent using the 2000-based Consumer Price Index (CPI) series and 2006-based CPI series, respectively, both well within the Government's announced target range of 3-5 percent for the year. In Q4 2011, average inflation accelerated to 4.7 percent from the quarter-ago and year-ago rates of 4.4 percent and 3.0 percent, respectively, using the 2000-based CPI series. This was due mainly to higher inflation outturns for most food items, notably vegetables and fish, which reflected the agricultural damage wrought by typhoons Pedring and Quiel that visited the country in September and October 2011. Non-food inflation, on the other hand, decreased on account of slower price increases for fuel, and transportation and communication services. The official core inflation measure released by the National Statistics Office (NSO) was slightly higher at 3.7 percent during the review quarter as the decrease in food core inflation was offset in part by the increase in non-food core inflation. Nonetheless, the number and weight of CPI components showing inflation rates above the 5.0 percent threshold continued to edge higher, with more food items above the threshold.

Private consumption remains resilient. While the Philippine economy grew at a modest pace of 3.2 percent in Q3 2011 due to strong external headwinds and lower-than-programmed fiscal spending, household consumption continued to advance robustly on the back of steady overseas remittance flows, benign inflation, and improving employment conditions. Capital formation, buoyed by strong inventory build-up, also boosted output growth. Other indicators also pointed to moderate improvements in domestic demand, supported by generally upbeat business and consumer sentiment along with strong credit growth. Vehicle sales rebounded in the first two months of Q4 2011 declining in the preceding two quarters, while energy sales grew slightly on the back of reconstruction activities in the aftermath of typhoon Pedring. The manufacturing capacity utilization index remained above the 80 percent mark during the review quarter. Real estate activity has also remained strong, reflecting still growing demand from the offshoring and outsourcing (O&O) sector. There are limited signs of an asset price bubble thus far, although some segments of the residential property sector could be at risk of an oversupply. While damage from the recent typhoons had somewhat dampened consumer sentiment for the current quarter, consumers remained optimistic for the year ahead on expectations of income gains and better job prospects. Going forward, however, the balance of risks to domestic output conditions leans toward a slower pace of economic activity given persistent uncertainty and weaknesses in the global economy.

Heightened uncertainty and rising financial market stresses dampen global growth prospects. The crisis in the euro area represents the biggest threat to the global economy. Fiscal problems coupled with vulnerabilities in the banking system are expected to further dampen business and consumer sentiment in the region. Moreover, a potential disorderly debt default by Greece could trigger a contagion which could spread to the rest of Europe, as well as adversely affect global financial markets. Meanwhile, the US economy appears to be showing gradual improvements in manufacturing activity, consumer sentiment and employment conditions. Nonetheless, the US economy remains susceptible to financial market tensions amid the failure of Congress to settle on a long-term debt reduction plan. Looking ahead, the overall balance of global economic activity appears to be tipping towards a further slowdown. Structural headwinds in advanced economies (AEs) relating to the continued need to repair public and private sector balance sheets along with stalled recoveries of labor and housing markets will likely continue to hold back global economic growth over the medium term.[4] The inflation environment in most AEs remains generally manageable given still sizeable spare capacity in these economies. By contrast, underlying inflationary pressures persist in many emerging economies despite the modest decline in inflation outturns in these economies over recent months. The recent growth slowdown in emerging economies should help ease overheating pressures in these economies.

Persistent uncertainty over the European debt crisis and global economic prospects weigh down on local and global financial markets. Results of the October European summit on measures to resolve the debt crisis

[3] The analyses in this report are based on information as of 31 December 2011.
[4] ECB Monthly Bulletin, December 2011.

resulted initially in growing market optimism. However, the failure of European leaders to reach a definitive consensus led to contagion fears, increasing risk aversion across major financial markets in the world. Standard and Poor's (S&P) decision to put 15 European countries on watch for potential downgrades further dampened market sentiment. On the local front, the change in S&P's credit outlook for the Philippines from stable to positive, the decline in the country's unemployment rate, and the continued strength of the external payments position helped bolster investor confidence. Nonetheless, the local stock trading turned bearish during the quarter while both the EMBI+ Philippine spread and the Philippine credit default spread swap (CDS) spread widened relative to their previous quarter levels, reflecting heightened global risk aversion. The peso likewise depreciated—despite sustained foreign exchange inflows from overseas remittances and portfolio inflows—due to persistent concerns over the sovereign debt problem in Europe. Nevertheless, auctions for government securities during the quarter were generally oversubscribed while the yield curve has continued to shift downward on the back of ample market liquidity and investors' expectations that the BSP will continue to hold policy rates steady in the near term. The growth in domestic liquidity was steady, supported by brisk credit activity, thus providing support to the domestic economy amid more subdued prospects for the global economy. This is in line with the results of the Q4 2011 BSP Senior Bank Loan Officers' Survey indicating a sustained increase in demand for loans from enterprises and households.

Inflation expectations continue to be in line with the Government target. Based on the results of the BSP's survey of private economists, the mean inflation forecast for 2012 and 2013 eased to 4.2 percent and 4.1 percent, respectively, in the December 2011 survey round. Analysts noted that the continuing weak global economic growth would help temper domestic inflationary pressures, particularly the transitory pressure on food prices due to the damages wrought by Typhoon Sendong. Results of the December 2011 Asia Pacific consensus forecasts for the country also showed lower and within-target range forecasts for 2011 and 2012.

The BSP keeps policy interest rates steady during the quarter. During its 20 October and 1 December 2011 monetary policy meetings, the Monetary Board (MB) decided to maintain policy interest rates at their current levels as latest baseline projections indicated a within-target inflation outlook, supported by firmly anchored inflation expectations. The MB noted the relatively subdued pace of economic activity in Q3 2011, along with the downside tilt of the balance of risks to the inflation outlook as weaker global economic growth is expected to hold back inflation pressures. Reserve requirement ratios were likewise maintained at their current rates as liquidity in the financial system remained in line with the economy's growth trajectory.

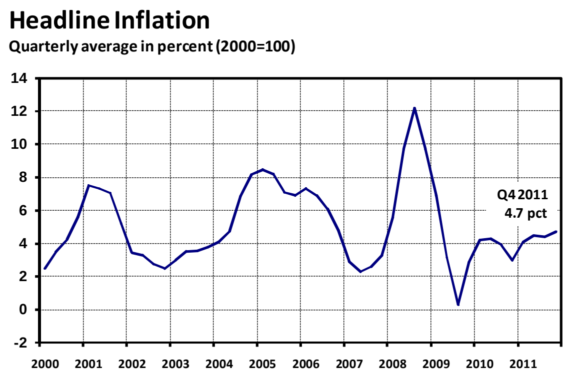
Abating inflation pressures provide scope for monetary policy to support domestic economic activity. The baseline inflation forecasts reflect a decelerating path, with average headline inflation rates for 2012-2013 projected to settle within the 3-5 percent inflation target. In its overall assessment in January 2012, the MB was of the view that inflation pressures were likely to remain subdued given increasingly weaker global conditions. The US is showing signs of a more solid recovery while the euro area economy is growing notably weaker amid continued uncertainties on how the debt crisis would be resolved. Nevertheless, upside risks to the inflation outlook remain, with the main risks associated with sustained heavy capital inflows and the consequent rapid growth in domestic liquidity, potential spikes in global oil prices due to renewed geopolitical tensions in the Middle East and North African (MENA) region, and possible increases in utility tariffs. The major challenge for policymakers at this point is to head off the risks associated with the global economic slowdown and keep the economy on a steady course. While the Philippines can rely on the strength of domestic demand to drive growth, it remains a considerable challenge for domestic consumption to fully compensate for the weaknesses in external demand. Given the uncertainty regarding the duration and depth of the ongoing debt crisis in Europe, supportive monetary policy settings can help to underpin and sustain domestic demand. A more accommodative monetary stance given benign inflation pressures can likewise bolster overall confidence in the resilience of the economy. Going forward, therefore, the BSP will remain committed to achieving its price stability objectives while allowing room for the economy to grow.

[On 19 January 2012, the MB decided to reduce key policy rates by 25 basis points to 4.25 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.25 percent for the overnight lending or repurchase (RP) facility.]

I. INFLATION AND REAL SECTOR DEVELOPMENTS

Prices

Inflation accelerates.



Year-on-year (y-o-y) headline inflation accelerated to 4.7 percent in Q4 2011 compared to the quarter-ago and year-ago levels of 4.4 percent and 3.0 percent, respectively, using the 2000-based CPI series. Meanwhile, the new 2006-based CPI series released by the NSO—which was derived using an updated consumer basket of goods and services—showed a stable y-o-y headline inflation for Q4 2011 at 4.8 percent.

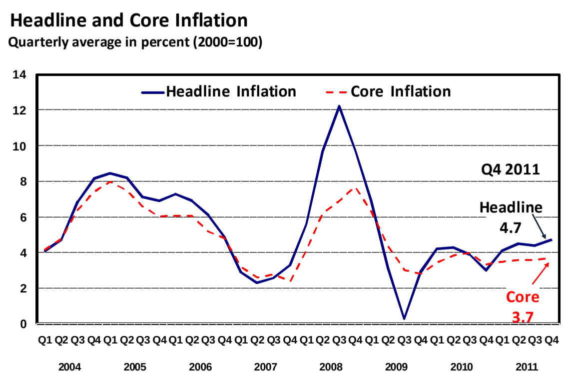
Based on the 2000-based CPI series, the rise in headline inflation was due mainly to higher prices of most food items, notably vegetables and fish, which reflected the agricultural damages wrought by typhoons Pedring and Quiel.

Likewise, core inflation, which excludes some food and energy items to measure generalized price pressures, was slightly higher at 3.7 percent in Q4 2011 from the previous quarter's level.

Y-o-y headline inflation for the whole year of 2011 averaged 4.4 percent and 4.8 percent using the 2000-based CPI series and 2006-based CPI series, respectively, well within the Government's target range of 3-5 percent for the year.

Headline and Core Inflation

Headline inflation rises on account of higher food inflation.



The increase of headline inflation to 4.7 percent was due to the higher inflation outturn for food. Food inflation went up as most commodity groups posted higher prices due to supply constraints brought about by weather disturbances. Non-food inflation, on the other hand, decreased on account of lower prices of fuel, and transportation and communication services.

The official NSO core inflation measure inched up in Q4 2011 as the decrease in food core inflation was offset in part by the increase in non-food core inflation. Likewise, the Q4 2011 core inflation was higher compared to the 3.4 percent recorded in the same quarter a year ago.

Official core inflation is slightly higher.

Meanwhile, two out of three alternative measures of core inflation estimated by the BSP fell in Q4 2011 relative to the rates registered in the previous quarter. In particular, the weighted median and net of volatile items measures slowed down to

Alternative Core Inflation Measures
Quarterly averages of year-on-year change

Quarter	Official Core Inflation	Trimmed Mean 1/	Weighted Median 2/	Net of Volatile Items 3/ *
2010	**3.7**	**3.0r**	**2.6**	**4.9**
Q1	3.4	3.4	3.2	5.0
Q2	3.9	3.2	2.9	5.6
Q3	4.0	2.8	2.4	4.8
Q4	3.4	2.5r	1.8r	4.1
2011	**3.6**	**3.5**	**2.4**	**4.7**
Q1	3.5	3.2	2.2	4.4
Q2	3.6	3.7	2.6	5.0
Q3	3.6	3.4	2.5	4.8
Q4	3.7	3.6	2.3	4.6

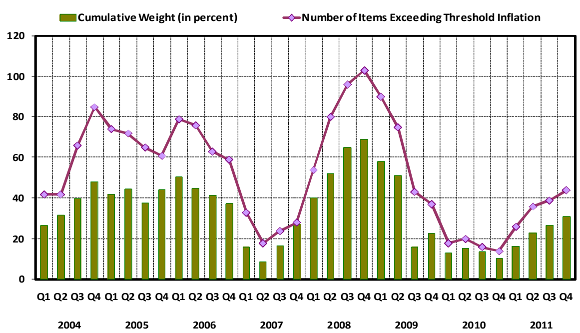
1/ The trimmed mean represents the average inflation rate of the (weighted) middle 70 percent in a lowest to-highest ranking of year-on-year inflation rates for all CPI components.
2/ The weighted median represents the middle inflation rate (corresponding to a cumulative CPI weight of 50 percent) in a lowest-to-highest ranking of year-on-year inflation rates.
3/ The net of volatile items method excludes the following items: educational services, fruits and vegetables, personal services, rentals, recreational services, rice, and corn.
r/ Revised.
** The series has been recomputed using a new methodology that is aligned with NSO'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: NSO, BSP estimates

Contribution to Quarterly Inflation
in percent (2000=100)

Item	Weight in Headline CPI	Percentage Contribution to Year-on-Year Headline Inflation		
		Q4 2010	Q3 2011	Q4 2011
Core Inflation	***81.6***	**2.9**	**3.1**	**3.2**
Non-core Items	*18.4*	0.1	1.3	1.5
Rice	9.4	0.1	0.2	0.2
Corn	0.9	0.0	0.1	0.1
Fruits and Vegetables	5.3	-0.3	0.4	0.7
Gas, LPG	1.3	0.1	0.3	0.1
Kerosene	0.3	0.0	0.0	0.0
Oil, Gasoline and Diesel	1.3	0.2	0.4	0.3
Headline Inflation	***100.00***	***3.0***	***4.4***	***4.7***

Source of Basic Data: NSO, BSP

CPI Items with Inflation Rates Above Threshold



2.3 percent and 4.6 percent from the previous quarter's 2.5 percent and 4.8 percent, respectively. The trimmed mean measure, on the other hand, went up to 3.6 percent from the quarter-ago level of 3.4 percent.

Core inflation contributed 3.2 percentage points (ppt) to headline inflation in Q4 2011, slightly higher than the 3.1-ppt contribution in the previous quarter and the 2.9-ppt contribution in the same quarter a year ago. Meanwhile, non-core CPI items contributed 1.5 ppts to headline inflation, reflecting an increase from the 1.3-ppt contribution in the previous quarter and 0.1 ppt a year ago.

The proportion of CPI components showing inflation rates above a given threshold provides an indication as to whether pressures on consumer prices are becoming generalized over time. In Q4 2011, the number of items with inflation rates greater than the threshold of 5.0 percent (the upper end of the 2011 inflation target) increased to 44 from 39 in the previous quarter and 14 in Q4 2010. Accordingly, these items accounted for a greater proportion of the CPI basket at 31.0 percent compared to the quarter- and year-ago shares of 26.5 percent and 10.5 percent, respectively.

Grouping the CPI basket into food and non-food components showed that more food items were above the threshold. In particular, there were 30 food items with inflation rates above the threshold from 28 items in the previous quarter. Meanwhile, there were 14 non-food items with inflation rates higher than the threshold in Q4 2011, compared to the previous quarter's 11 items.

Higher prices of vegetables and fish drive up food inflation.

Food Inflation

Food, beverage, and tobacco inflation rose to 4.5 percent during the review quarter compared to the quarter-ago and year-ago rates of 3.8 percent and 1.9 percent, respectively. Reflecting tight supply conditions triggered by unfavorable weather conditions, prices picked up for most food products, including vegetables and fish.

Inflation Rates for Selected Food Items
Quarterly averages in percent (2000=100)

Commodity	2010		2011	
	Q3	Q4	Q3	Q4
Food, Beverage and Tobacco	***3.3***	***1.9***	***3.8***	***4.5***
Food	3.4	2.0	3.8	4.5
Cereal & Cereal Products	1.4	1.4	3.4	3.9
o/w Rice	0.9	1.0	1.8	2.3
Corn	0.1	-0.6	12.0	14.3
Dairy Products	1.5	1.5	2.6	2.7
Eggs	2.9	2.8	2.0	2.3
Fish	2.4	2.3	7.3	8.1
Fruits & Vegetables	2.3	-5.8	6.7	13.9
Meat	4.3	1.3	1.7	2.0
Miscellaneous Food	7.2	7.3	3.2	1.3
Beverages	1.7	1.8	2.8	2.8
Tobacco	2.7	2.5	7.8	7.4

Source of Basic Data: NSO, BSP

Inflation Rates for Selected Non-Food Items
Quarterly averages in percent (2000=100)

Commodity	2010 Q3	2010 Q4	2011 Q3	2011 Q4
Non-Food Items	***4.4***	***3.9***	***5.0***	***4.9***
Clothing	1.9	1.8	2.9	2.7
Housing & Repairs	1.7	1.9	2.3	1.8
Fuel, Light & Water	14.1	10.8	9.1	10.3
Fuel	7.6	6.4	16.7	9.6
Light	21.3	15.6	3.4	10.8
Water	7.3	7.6	10.2	10.2
Services	3.5	3.7	6.8	6.1
Transpo & Comm.	3.4	3.9	9.9	8.5
Miscellaneous	1.3	1.2	1.4	1.7

Source of Basic Data: NSO, BSP

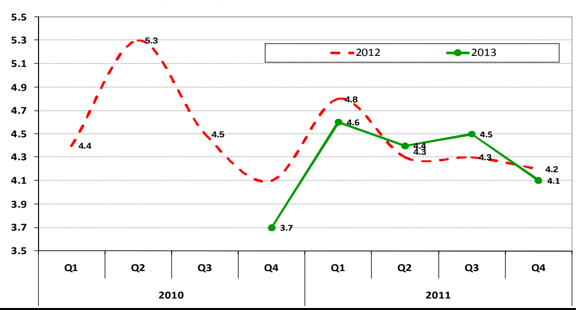
Non-food inflation

Non-food inflation decelerated to 4.9 percent in Q4 2011 from 5.0 percent in the previous quarter, but was higher than the 3.9 percent posted a year ago. Lower inflation for fuel, and transportation and communications services accounted for the lower non-food inflation in Q4 2011. In particular, from 16.7 percent in Q3 2011, fuel inflation declined to 9.6 percent in Q4 2011. Likewise, transportation and communication services inflation slowed down to 8.5 percent from 9.9 percent in the previous quarter. Meanwhile, light inflation edged up to 10.8 percent from the quarter-ago level of 3.4 percent, reflecting the upward adjustment in electricity rates.

Private Sector Economists' Inflation Forecasts

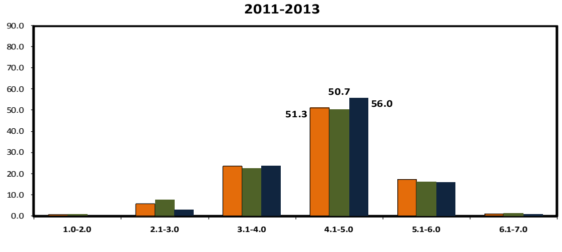
Mean inflation forecasts for 2012 and 2013 ease.

BSP Private Sector Economists' Survey
Mean Forecast for Full-year, in percent



Private Sector Forecasts for Inflation, Dec 2011 *Annual Percent Change*	2012 Q1	2012 Q2	2012 Full year	2013 Full year	2014 Full year
1) ASIA ING	4.70	4.60	4.40	4.30	4.00
2) ATR KimEng	3.90	4.20	4.30	4.80	5.00
3) Banco De Oro	4.70	4.65	4.50	4.70	4.60
4) Bank of China	4.90	5.10	5.20	4.80	4.60
5) Bank of Commerce	4.80	4.80	4.80	-	-
6) Deutsche Bank	-	-	3.80	4.00	-
7) Goldman Sachs	3.80	3.70	3.70	4.00	-
8) IDEA	3.92	3.22	3.32	3.11	3.18
9) Metrobank	-	-	4.20	4.10	3.90
10) MIB	4.40	4.20	4.00	3.50	-
11) RCBC	3.5-3.9	3.1-3.6	3.5-4.1	3.0-4.0	3.0-4.0
Median Forecast	4.4	4.2	4.2	4.1	4.0
Mean Forecast	**4.3**	**4.2**	**4.2**	**4.1**	**4.1**
High	4.9	5.1	5.2	4.8	5.0
Low	3.7	3.2	3.3	3.1	3.2
Number of observations	9	9	11	10	7
Memo Item:					
Government Target			**4.0±1.0**	**4.0±1.0**	**4.0±1.0**

Probability Distribution For Analysts' Inflation Forecasts*
2011-2013



*Probability distributions were averages of those provided by 8 respondents.

Based on the results of the BSP's survey of private economists for December 2011, inflation is expected to be within the 3-5 percent target range for both 2012 and 2013. The mean inflation forecasts for 2012 and 2013 eased to 4.2 percent and 4.1 percent in the fourth quarter, respectively, compared to 4.3 percent and 4.5 percent in the previous quarter.[5]

Analysts noted that the early part of 2012 could lead to increased inflation pressures due to agricultural constraints as a result of the damage wrought by Typhoon Sendong. Nonetheless, the continuing weak global economic growth could help temper domestic inflationary pressures.

Based on the probability distribution on the forecasts provided by 8 out of 11 respondents, there is a 50.7 percent chance that average inflation for 2012 could settle within 4.1-5.0 percent, still within the 4.0 percent ± 1.0 percentage point target range for 2012.

Meanwhile, results of the December 2011 Asia Pacific consensus forecasts for the country also showed lower forecasts for 2011 and 2012 relative to September 2011. In particular, respondents expect inflation to average at 4.6 percent (from 4.7 percent) for 2011 and 4.0 percent (4.3 percent) for 2012.

[5] For Q1 and Q2 2012, inflation is estimated to be at 4.3 percent and 4.2 percent, respectively.

Results of the BES for Q4 2011 indicate that the majority of respondents anticipating inflation to move up in the current and next survey quarters decreased.

Relative to the previous survey, a smaller majority of respondents expect inflation to rise over the survey quarter (from a diffusion index of 32.1 percent to 28.3 percent) as well as in the next quarter (from 29.2 percent to 18.2 percent), which is consistent with the expected easing of global commodity price pressures on account of the slower global economic growth.

Meanwhile, results of the CES for Q4 2011 show that consumers expect a higher inflation over the next 12 months.

Consumers expect inflation to rise over the next 12 months relative to the previous survey round, given pending petitions for higher electricity rates and the possibility of increased domestic prices. In particular, over the next 12 months, respondents anticipate inflation to reach 9.6 percent from 8.5 percent in the previous survey round. Respondents expect significantly higher inflation for the following items: fruits and vegetables (from 12.8 percent to 16.5 percent); education (from 8.6 percent to 11.0 percent); fish and seafood (from 10.1 percent to 11.7 percent); water (from 6.4 percent to 8.0 percent); clothing (from 7.4 percent to 8.9 percent); and fuel (from 7.4 percent to 8.8 percent).

Box Article: Rebasing of the Consumer Price Index for the Philippines

The consumer price index (CPI) is an indicator of the average price of a fixed basket of goods and services commonly purchased by households relative to a base year. The practice of rebasing the CPI series every five years[6] is done to ensure that the market basket surveyed continues to capture current goods and services consumed by households and, thus, ascertains that the reviewed expenditure patterns are up to date. The period 2006 was chosen as the new base period[7] since it coincided with the Family Income and Expenditure Survey (FIES) and the Census of Philippine Business and Industry (IOSPBI),[8] which were conducted in the same year (2006).

This is the 9th revision for the CPI series[9] and is also in accordance with the National Statistical Coordination Board (NSCB) Resolution Number 2, Series of 2009, which approves the synchronized rebasing of the price indices to base year 2006.

Classification

A new classification system has been introduced in the 2006-based CPI basket, taking into consideration the United Nations' (UN) recommendations in the grouping of commodities in the market basket. The NSO adopted the UN Classification of the Individual Consumption According to Purpose (COICOP) in grouping the items in the CPI basket in order to bring the Philippine CPI series closer in line with international standards and improve its comparability with data in other countries. The following are some of the countries in Asia using COICOP: (1) Thailand; (2) Korea; (3) Indonesia; (4) Singapore; and (5) Malaysia.

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6 In accordance with Statistical Advisory Board Resolution No. 4, Series of 1985 and further reiterated in National Statistical Coordination Board Resolution No. 6, Series of 1991.

7 The base period is the period, usually a given year, for which the index number is set to 100. The base year serves as the reference point of the index number series.

8 FIES and IOSPBI are conducted every three to six years.

9 Previous base years used are as follows: 1941, 1961, 1966, 1972, 1978, 1988, 1994, and 2000.

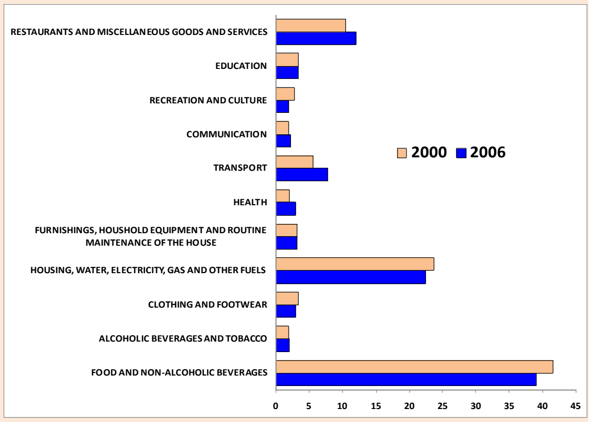
Prior to the 2006-based CPI series, the NSO used the Philippine Standard Commodity Classification (PSCC), which was derived from the Standard International Trade Classification (SITC). In using the PSCC, the CPI is classified into six major groups[10] while under UN COICOP, there are 11 major groups.[11] One of the most important developments under the new classification system is the reclassification of items under miscellaneous items under more specific sub-categories.

Weights

Weights for the 2006-based CPI were based on the results of the 2006 FIES. The FIES has been used as the basis for national CPI weights since 1982 (1978=100 CPI series) until the present. Figure 1 presents a comparison of the national weighting patterns for the 2000-based and 2006-based CPI series.

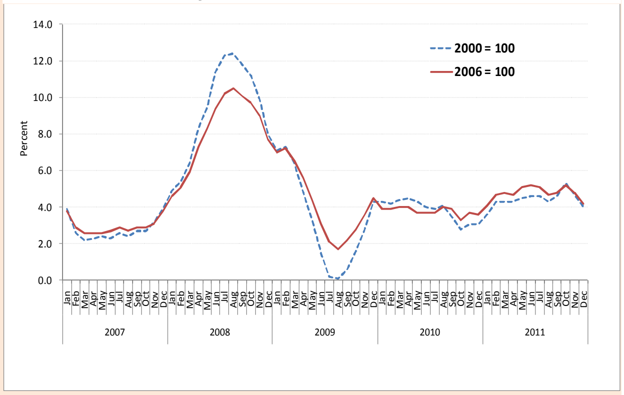
As with the 2000-based CPI basket, food and non-alcoholic beverages has the highest weight among the major groups at 39.0 percent in the 2006-based CPI. This, however, has decreased from its share of 41.5 percent in 2000 as the weights of most food groups went down, except for milk, cheese and eggs, and food products not elsewhere classified. In particular, the weight of rice declined to 8.9 percent from 9.4 percent.

Figure 1. Comparison of 2000 and 2006 Weights *Nationwide*



Likewise, the share of housing, water, electricity, gas and other fuel, the second highest group, dropped slightly to 22.5 percent in 2006 from 23.7 percent in 2000 as the weights for rentals and materials for the maintenance and minor repair of dwelling were lower, offsetting the higher weights for water and electricity.

Figure 2. Headline Inflation Rates for 2006- and 2000-based CPI, *January 2007 – December 2011*



Weights of two other major groups (clothing and footwear, and recreation and culture) were also lower compared to their 2000 weights.

The other major groups, however, increased their shares in the 2006 CPI basket. The weight for transport saw the biggest increase at 2.2 ppts (7.8 percent from 5.6 percent), driven by a higher expenditure share for passenger transport by road. The weight for restaurant and miscellaneous goods and services, which has been reclassified outside food in the 2006-based CPI series, went up by 1.5 ppts (12.0 percent from 10.5 percent). The increase reflected higher weights for meals, snacks, drinks and refreshment purchased outside the home and that of personal care items.

[10] The six major groups are as follows: (1) food, beverages, and tobacco, (2) clothing, (3) housing and repair, (4) fuel, light, and water, (5) services and (6) miscellaneous.

[11] 11 major groups for the new based CPI series are as follows: (1) Food and Non-Alcoholic Beverages, (2) Alcoholic Beverages and Tobacco, (3) Clothing and Footwear, (4) Housing, Water, Electricity, (5) Gas and Other Fuels, (6) Furnishings, Household Equipment and Routing Maintenance of the house, Health, Transport, Communication, Recreation and Culture, Education, Restaurants and Miscellaneous Goods and Services

Analysis of the 2006-based CPI Series

As shown in Fig. 2, the inflation rate using 2006 as base year follows closely the movement of inflation using 2000 as base year. However, the 2006-based inflation is generally less volatile than the 2000-based series. This could be due to the smaller weight of food CPI in the 2006 basket. The 2006-based CPI series has a lower standard deviation (2.2 ppts) compared to the 2000-based series (2.9 ppts).

Table 1. Summary Statistics for the Monthly Inflation Rate Series Using Base Years 2006 and 2000

Base year	2006 = 100	2000 = 100
Average	4.78	4.73
Standard Deviation	2.19	2.90
Coefficient of Variation	0.46	0.61
Sample	Jan 2007 - Dec 2011	Jan 2007 - Dec 2011

There have been initial concerns that the new series has an upward bias relative to the old series, prompted largely by the higher inflation rates reported shortly after the 2006-based series was introduced. However, based on an initial analysis of the headline inflation from 2007-present, there appears to be no upward bias in the new CPI series. The average monthly inflation rate for the 2006-based series is marginally higher (0.05 percentage point) than the 2000-based series over the sample period January 2007 – December 2011 (Table 1). However, statistical test indicated that the difference in the average inflation rates of the two series over the sample period is not statistically significant.

Going forward, the challenge for the BSP is to reconfigure its forecasting models to use the new series, which will require a sufficient length of historical time series. Prior to the release of the 2006-based CPI series, the BSP's inflation forecasting models were estimated using 2000-based data going back 1985.

The rebasing of the CPI series will also be accompanied by a review of the definition of core inflation measure. As specified in the NSCB Resolution No. 6 Series of 2003, the list of excluded items shall be reviewed by the NSCB Board and the inter-agency Technical Committee on Price Statistics (TCPS) whenever the CPI data is rebased. The review is necessary to determine whether the excluded items, which consist of historically volatile food- and energy-related components in the 2000-based CPI basket, are still consistent with the new CPI series.

References:

National Statistics Office. (2011). *The 2006-Based Consumer Price Index (*Special Release No. 621). Retrieved from http://www.census.gov.ph/data/sectordata/cpi2006basetx.html.

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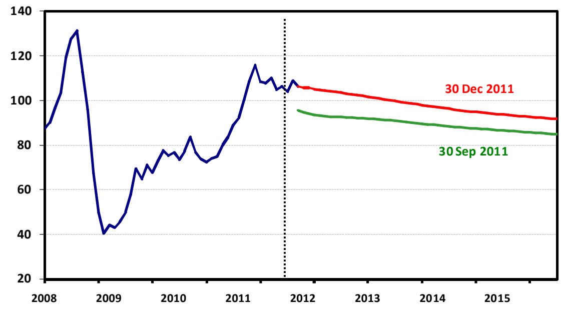
International Monetary Fund. Special Data Dissemination Standards (IMF-SDDS).

Energy Prices

International oil prices dip q-o-q amid demand concerns.

The international price of Dubai crude oil dipped further by 0.60 percent quarter-on-quarter (q-o-q) in Q4 2011 amid concerns that demand would falter as the global economy remained weak, with Europe struggling to contain its debt crisis while growth in Asia is slowing down. During the quarter, Fitch Ratings lowered France's outlook and placed Spain and Italy under review for possible credit downgrade. Oil prices also decreased following the

Spot and Estimated Future Prices of Dubai Crude Oil*
Price in US dollars per barrel



*Futures prices derived using Brent crude futures data.

Organization of Petroleum Exporting Countries' (OPEC) decision to raise its production ceiling to 30 million barrels a day, the first adjustment in three years, amid Europe's continuing economic woes. The death of North Korean leader Kim Jong Il, which prompted investors to sell equities and commodities, and the contraction in Chinese manufacturing,[12] which signaled a modest deterioration in business conditions, also brought down oil prices down.

Meanwhile, the estimated futures prices of Dubai crude oil in Q4 2011, which are based on movements in Brent crude oil futures, suggest a higher path for 2012 onwards compared to the estimates in the previous quarter.

Forecasts for the 2012 global oil demand decrease.

Global energy authorities have revised downward their 2012 forecasts for global oil demand as of December relative to their September projections. The downward adjustments mainly took into account the continued weakening of the global economic outlook, particularly in the euro area. The International Energy Agency (IEA),[13] the OPEC,[14] and the Energy Information Agency (EIA)[15] projected global demand to increase by 1.3 million barrels per day (mmbd) [from 1.4 mmbd], 1.1 mmbd [from 1.3 mmbd], and 1.39 mmbd [from 1.4 mmbd], respectively. The bulk of the increase in 2012 world oil consumption is expected to come from non-OECD[16] regions, especially China, Brazil, and the Middle East.

Local gasoline pump prices, except diesel, decrease.

Domestic Retail Pump Prices (peso/liter)*
End-quarter prices

Quarter	Gasoline**	Kerosene	Diesel	LPG
2010				
Q1	44.25	41.37	33.75	32.66
Q2	44.00	42.12	34.75	31.72
Q3	41.50	40.12	33.00	31.41
Q4	48.50	45.62	38.00	38.92
2011				
Q1	54.60	53.11	47.10	37.27
Q2	54.65	49.77	44.20	39.22
Q3	56.45	49.51	44.05	38.46
Q4	53.83	49.43	44.89	37.68
Q-o-Q	-2.62	-0.08	0.84	-0.78
Y-o-Y	5.33	3.81	6.89	-1.24

* *Average retail pump price for the Big Three oil companies—Caltex, Petron, and Shell, Metro Manila prices only.*
** *Average price for unleaded gasoline*
Source: Department of Energy (DOE)

Tracking global oil price movements, domestic prices of gasoline, kerosene, and LPG decreased by ₱2.62 per liter, ₱0.08 per liter, and ₱0.78 per liter in Q4 2011, respectively, relative to end-Q3 2011 levels. By contrast, the price of diesel went up by ₱0.84 per liter.

Meanwhile, compared to end-Q4 2010 levels, domestic petroleum prices, except LPG, were all higher during the review quarter. In particular, the prices of unleaded gasoline, kerosene, and diesel increased by ₱5.33 per liter, ₱3.81 per liter, and ₱6.89 per liter, respectively. By contrast, the price of LPG went down by ₱1.24 per liter.

[12] The HSBC Purchasing Managers' Index, a composite indicator designed to give a single-figure snapshot of operating conditions in the manufacturing economy, contracted for the second consecutive month in December at 48.7 (from 47.7 in November). A reading below 50 indicates a contraction.
[13] IEA, December 2011 Oil Market Report, www.iea.org.
[14] OPEC December 2011 Monthly Oil Market Report, www.opec.org.
[15] Energy Information Agency, December 2011 Short-Term Energy Outlook, www.eia.doe.gov.
[16] Organization for Economic Cooperation and Development.

Power

Power rates accelerate due to higher generation costs.

Power rates rose in Q4 2011 as Meralco passed on higher generation costs to consumers. The increase in generation costs was driven mainly by the higher prices at the Wholesale Electricity Spot Market (WESM), due, in turn, to a generation supply constraint brought about by the maintenance shutdown of the Malampaya natural gas pipeline from 20-26 October. The Independent Power Producers' (IPP) overall generation cost also increased as a result of the natural gas restriction of Malampaya, which led to the use of the more expensive liquid fuel.[17]

Meanwhile, the Energy Regulatory Commission (ERC) has approved the petition of the National Power Corporation (NPC) to recover actual and incremental fuel, IPP and foreign exchange rate fluctuation costs in off-grid or missionary areas amounting to ₱4.1 billion, or equivalent to ₱1.43 per kwh for every user, over the next four years.[18]

The approval of the rate increase will enable the NPC to recover ₱3.6 billion under the 4th, 5th and 6th installments of the Generation Rate Adjustment Mechanism (GRAM) and ₱0.5 billion under the same installments of the Incremental Currency Exchange Rate Adjustment (ICERA).[19] The NPC will start collecting these additional costs, which will appear as a separate item in consumers' electricity bill, starting in the January 2012 billing period.

Potential sources of upside pressures on electricity charges remain, stemming from pending petitions with the ERC. These include: (1) the Power Sector Assets and Liabilities Management (PSALM) Corporation's petition to recover stranded debt and contract costs through an increase in the universal charge; (2) the NPC's petition to recover actual and incremental fuel, IPPs, and foreign exchange rate fluctuation costs under the 13th to 17th GRAM and the 15th to 16th ICERA; and (3) the National Grid Corporation of the Philippines' (NGCP) petition to recover the costs of repair of damages caused by tropical storms Ondoy and Pepeng in 2009 as well as the bombings in Lanao del Norte in 2008.

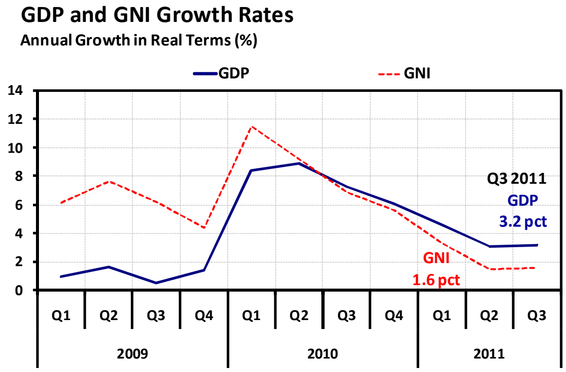
[17] http://www.meralco.com.ph

[18] The NPC previously petitioned to recover ₱7.3 billion for GRAM and ₱1.0 billion for ICERA but only half were approved for collection through the universal charge-missionary electrification of consumers in the small power utilities group (SPUG) areas.

[19] GRAM is a mechanism which allows utilities like NPC to recover costs associated with fuel and purchased power, while ICERA allows them to recover foreign exchange-related costs.

Aggregate Demand and Supply

The Philippine economy grows at a modest pace.

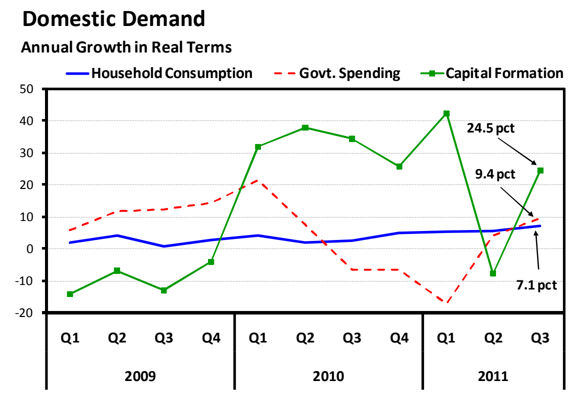


Gross Domestic Product (GDP) grew at an annual rate of 3.2 percent in Q3 2011, significantly slower compared to the 7.3 percent growth recorded in the same quarter in 2010 but slightly higher compared to the 3.1 percent growth (revised) in Q2 2011. On the expenditure side, expansion was led by household expenditure, which contributed 4.7 ppts to GDP growth. On the production side, GDP growth was due largely to services, which contributed 3.0 ppts to GDP growth. The seasonally-adjusted estimate of GDP showed a 0.3 percent q-o-q growth in Q3 2011 from 0.5 percent in Q2 2011.

Gross National Income (GNI) also grew at a slower pace of 1.6 percent in Q3 2011 from 6.9 percent in the same period last year, but expanded slightly faster compared to the 1.5 percent growth posted in the previous quarter. The growth of GNI slowed down as the net primary income (NPI) contracted by 3.4 percent.

Aggregate Demand

Private consumption continues to advance strongly despite strong external headwinds.



Economic Performance

At constant 2000 prices

Growth rate (in percent)

Sector	2010	2011	
	Q3	Q2	Q3
By expenditure item			
Household consumption	2.4	5.5	7.1
Government consumption	-6.5	4.3	9.4
Capital formation	34.5	-7.7	24.5
Fixed capital formation	15.4	-9.9	0.5
Exports	23.1	1.4	-13.1
Imports	22.1	0.4	0.5

Source: NSCB

Household consumption, accounting for 69.4 percent of GDP, continued to boost GDP growth with a 7.1 percent expansion in Q3 2011. All major expenditure items posted increases, particularly food, education, restaurants and hotels, miscellaneous goods and services, as well as furnishings, household equipment, and routine household maintenance.

Government consumption accelerated in Q3 2011 on account of the higher spending for social protection programs such as the Pantawid Pamilyang Pilipino Program as well as the pension program for indigent older persons. Government final consumption expenditure rebounded by 9.4 percent from the 6.5 percent contraction in Q3 2010 and 4.3 percent growth in Q2 2011.

Similarly, capital formation grew at a faster pace of 24.5 percent from its quarter-ago decline of 7.7 percent, but was slower than the 34.5 percent growth registered in the same quarter a year ago. Capital formation was supported by the build-up of inventories, which contributed 4.2 ppts to GDP growth. However, construction activities fell sharply by 10.6 percent due, in turn, to the decline in both public (-21.3 percent) and private construction activities (-7.8 percent).

Meanwhile, the spillovers from the adverse developments in the global front are quite evident in the performance of merchandise exports, which have contracted quite sharply. Total exports decreased by 13.1 percent in Q3 2011 due to the decline in exports of goods and services. Merchandise exports contracted due mainly to the decline in exports of electronic components, which accounted for 73 percent of total merchandise exports.

Other Demand Indicators

Other demand indicators point to resilient private consumption.

Other indicators pointed to moderate improvements in domestic demand. Vehicle sales rebounded in the first two months of Q4 2011 after contracting for two consecutive quarters, while energy sales grew slightly on the back of reconstruction activities following typhoon Pedring. Real estate activity likewise had remained strong, reflecting still growing demand from the O&O sector. There are limited signs of an asset price bubble thus far, although some segments of the residential property sector could be at risk of an oversupply going forward. The capacity utilization index continued to be above the 80 percent mark during the review quarter. Survey-based indices showed mixed trend as business confidence sustained its uptrend while consumer sentiment declined for the current quarter but indicated improving outlook for 2012.

Property Prices

Land Values, Metro Manila

Implied land values continue to trend higher.

Data from Colliers International indicated that implied land values[20] in the Makati CBD and Ortigas Center increased in Q3 2011 from the quarter- and year-ago levels. Implied land values in the Makati CBD reached ₱274,141/sq.m. in Q3 2011, higher by 1.9 percent and 2.8 percent relative to the levels recorded in Q2 2011 and Q3 2010, respectively. Similarly, implied land values in the Ortigas Center rose by 0.9 percent q-o-q and 4.2 percent y-o-y to ₱126,350/sq.m. Land values are presently at about 64-65 percent of their 1997 levels in nominal terms, but only about 30-31 percent of their 1997 levels in real terms.

[20] In the absence of reported closed transactions, implied land values based on trends are used by Colliers International to monitor prices.

Vacancy Rates, Metro Manila

Office vacancy rates decline on strong demand for office space.

The monthly office vacancy rate in the Makati CBD of 3.8 percent in Q3 2011 represented a decline from the previous quarter and year-ago levels. Compared to the Q2 2011 rate of 4.2 percent, vacancy rates in the Makati CBD decreased in Q3 2011 on the back of strong demand amid limited availability of office space. Office vacancy rates in the Makati CBD are expected to remain stable as Makati continues to be a preferred business location.

Overall residential vacancy rates rise in the non-premium segments.

Meanwhile, the residential vacancy rate at 10.4 percent during the quarter was higher compared with both the Q3 2010 and Q2 2011 levels. Vacancy rates in the residential buildings rose further, driven by the higher vacancy rates for Grades A and B residential buildings. According to Colliers, the increase in vacancy rates in the Makati CBD is expected to continue due to potential increases in supply over the next 12 months. Likewise, the high-rise residential segment continued to post strong growth in the number of licenses to sell issued by the Housing and Land Use Regulatory Board (HLURB) on the back of new approved high-rise projects in the previous quarters, despite the downtrend in other market segments. These factors point to a risk of an oversupply in the residential property market going forward.

Rental Values, Metro Manila[21]

Office rental values increase due to strong demand from O&O sector.

Monthly office rents in the Makati CBD reached ₱665/sq.m. in Q3 2011, higher by 0.6 percent and 6.4 percent than the quarter- and year-ago levels.[22] The outlook for office rental rates remains on the uptrend over the next 12 months amid strong demand for O&O office space. Office rental values in Q3 2011 remained below the 1997 levels for premium grade offices. In real terms, office rental values were about 38.9 percent of the comparable levels in 1997.

Likewise, residential rental values remain on an uptrend.

Monthly rents for 3-bedroom condominium units in the Makati CBD rose to ₱616/sq.m. in Q3 2011, representing an 8.3 percent growth from the

[21] Actual rentals for housing comprise 13.8 percent of the 2006-based CPI basket. The NSO only surveys rentals ranging from around ₱300-₱10,000/month to compute rent inflation. However, the rental values discussed in this section pertain to high-end rented properties, which may be considered as indicators of wealth and demand.

[22] This was computed as the average of the rental values for the Premium, Grade A and Grade B segments. Premium refers to office space with capital values of ₱75,000/sq.m. and above; Grade A, between ₱65,000 and ₱75,000/sq.m.; and Grade B, ₱65,000/sq.m. and below.

previous quarter. Similarly, monthly rents for the 3-bedroom segment were higher by 12.6 percent relative to the levels in the previous year. According to Colliers, the significant increase in rents, along with the continued improvement in occupancy rates, indicated that landowners are confident of a positive turnout in the luxury residential market over the long term. Residential rental values were above their 1997 levels in nominal terms but were only about 61.9 percent of their 1997 levels in real terms.

Jones Lang LaSalle estimates showed that average Grade A office rentals in the Makati CBD and Bonifacio Global City (BGC) reached ₱9,064/sq.m. per annum in Q3 2011, higher by 7.4 percent compared to the previous quarter and by 20.9 percent compared to the same quarter in the previous year.[23] Office rental values continued to rise due to the growing demand for office space in newer buildings in BGC. Building owners also raised rents to secure a stream of income in anticipation of a large volume of future office stock that could cause a reduction in rental values. Despite the expected increase in new office supply over the next quarters, demand for office space is expected to be sustained by the O&O sector. Jones Lang LaSalle noted that while the office sector currently remains generally unaffected by global market woes, the persistence of said factors is a threat to the sector and could contribute to its slowdown over the coming months.

Capital Values, Metro Manila

Capital values for office buildings increase in line with the rise in rental values.

Capital values[24] for office buildings in the Makati CBD were higher in nominal terms than their quarter- and year-ago levels. Consistent with the uptrend in office rental values in Q3 2011, Grade A office capital values in the Makati CBD rose to ₱80,319/sq.m., higher by 0.4 percent and by 5.5 percent compared to the quarter- and year-ago levels, respectively. Office capital values in Q3 2011 were higher than the 1997 levels for grade A offices in nominal terms. Nevertheless, in real terms, office capital values were about 48.2 percent of the comparable levels in 1997.

[23] Jones Lang La Salle is one of the world's leading real estate services and money management firms, with approximately 160 offices worldwide and has over 45 years of experience in Asia Pacific.

[24] Refers to the probable price that the property would have fetched if sold on the date of the valuation, which includes imputed land and building value.

Capital values for luxury residential buildings in Makati CBD were also higher than their quarter- and year-ago levels. Average prices for residential condominium units increased by 1.0 percent q-o-q and 5.5 percent y-o-y in Q3 2011. Residential capital values in Q3 2011 were above their 1997 levels in nominal terms but represented about 52.5 percent of comparable levels in 1997 in real terms.

Vehicle Sales[25]

Vehicle sales post solid recovery.

Domestic vehicle sales continued to rebound in the first two months of Q4 2011 at 5.6 percent (y-o-y) after contracting for two consecutive quarters. Aggregate vehicle sales reached 25,579 units from 24,222 units in the same period a year ago. Despite the supply constraints caused by the natural disasters in Thailand, domestic vehicle sales pulled through due to the stabilizing supply situation in Japan early in Q4.

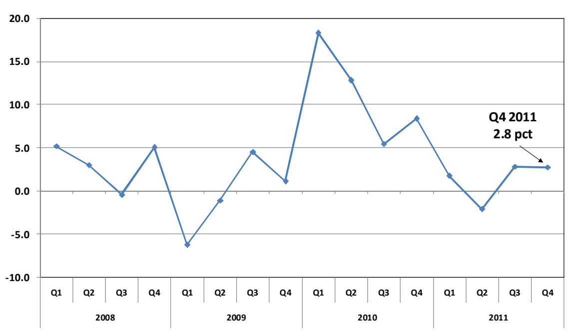
- Passenger car sales declined by 20.3 percent in Q4 2011 (October-November), a reversal of the 0.2 percent growth in the previous quarter.

- Meanwhile, sales of commercial vehicles[26] recovered, recording double-digit growth of 18.2 percent from the 15.9 percent contraction recorded in the previous quarter.

Energy Sales

Energy sales growth remains steady.

Quarterly Power Meralco Sales
Year-on-year change in percent



Y-o-y growth of Meralco sales during the first two months of Q4 2011 was steady at 2.8 percent relative to previous quarter. Energy sales grew by 8.4 percent in the same period a year ago. Meanwhile, q-o-q growth of energy sales declined in the first two months of Q4 2011, a reversal of the 3.9 percent growth posted in the previous quarter. Meralco power sales sustained its y-o-y growth as consumption resumed pace due to reconstruction efforts in the aftermath of typhoon Pedring in November following the power outages caused by storms experienced in October.

Capacity Utilization

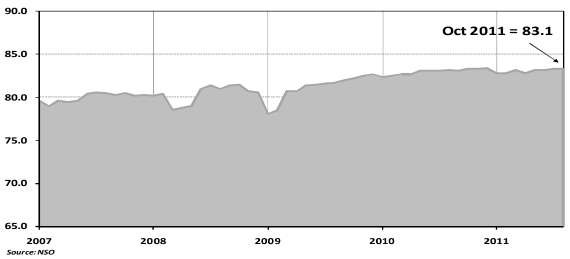
Capacity utilization in manufacturing remains above 80 percent.

Based on the NSO's Monthly Integrated Survey of Selected Industries (MISSI), the average capacity

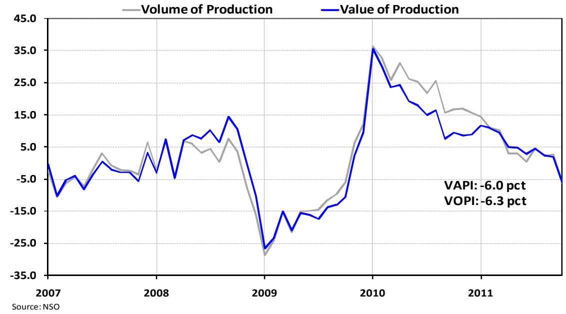
[25] Vehicle sales starting 2011 were adjusted to exclude the sales of four (4) members which left CAMPI, namely, Hyundai, Volvo, Chevrolet, and Chana.

[26] Commercial vehicles include Asian utility vehicles (AUVs), sports utility vehicles (SUVs), light commercial vehicles (LCVs), light trucks, heavy-duty trucks, and buses.

Monthly Average Capacity Utilization for Manufacturing
In percent



Volume and Value Indices of Manufacturing Production
In percent



utilization rate in the manufacturing sector was generally stable at 83.1 percent in October from 83.2 percent (revised) in the previous month. The largest proportion of the establishments surveyed continued to operate above 80 percent.

Volume and Value of Production

MISSI data for industrial production in October 2011 declined. The value of production index (VAPI) declined by 6.0 percent, a reversal of the month- and year-ago growth of 1.9 percent and 9.5 percent, respectively. The decline was due mainly to six major sectors that posted double-digit contractions, in particular, basic metals, food manufacturing, electrical machinery, machinery except electrical, footwear and wearing apparel and fabricated metal products. Likewise, volume of production index decreased by 6.3 percent in October, pulled down by lower production output from five major sectors (similar to VAPI, except for fabricated metal products).

Business Expectations Survey (BES)

Business outlook improves on robust domestic demand and sound macroeconomic fundamentals.

Business Expectations Survey

Index	**2010**	**2011**			
	Q4	**Q1**	**Q2**	**Q3**	**Q4**
Business Outlook Index					
Current Quarter	50.6	47.5	31.8	34.1	38.7
Next Quarter	51.0	59.4	33.0	53.9	36.1

Source: BSP

Preliminary results of the Q4 2011 BES showed a sustained uptrend in business confidence for the current quarter. Overall confidence index (CI) rose by 4.6 index points to 38.7 percent from 34.1 percent in the previous quarter. Business confidence in areas outside NCR was more buoyant compared to sentiments in the NCR. Respondents attributed the bullish business outlook for the current quarter to the following factors: (a) heightened consumer demand during the Christmas and harvest seasons; (b) implementation of government projects, including, Public-Private Partnership (PPP); (c) sound domestic macroeconomic fundamentals; (d) business expansion due to steady investment flows; (e) introduction of new and improved business strategies; and (f) sustained inflow of OF remittances. This prevailing sentiment mirrored the optimistic views of businesses in Korea and India. By contrast, a weaker outlook prevailed in the more developed economies, such as the United States, Germany, Singapore, Hong Kong and New Zealand, wherein the sentiment was marred generally by the slowdown in the US economy along with the debt crisis in the euro area.

Meanwhile, the business sentiment for the next quarter (Q1 2012) outlook, while remaining relatively high, dropped to 36.1 percent from the

53.9 percent posted in the previous quarter. Businesses were less optimistic for the next quarter (Q1 2012) in view of the expected slowdown of business activity after the Christmas season. External factors particularly, the weak global economic prospects also weighed down on the Q1 2012 business outlook.

Consumer Expectations Survey

Meanwhile, damages from recent typhoons dampen consumer sentiment.

Consumer Expectations Survey

Index	2010	2011			
	Q4	Q1	Q2	Q3	Q4
Current Quarter	-8.5	-23.1	-24.1	-18.7	-20.6
Next 3 months	11.9	-6.2	-7.8	1.5	2.8
Next 12 months	25.9	1.2	4.4	11.7	14.6

Source: BSP

Overall consumer CI for the current quarter turned more negative in Q4 2011 at -20.6 percent from -18.7 percent in Q2 2011. The negative CI means that consumers with an optimistic outlook were outnumbered by those with opposite views. Majority of the respondents cited damages to crops and businesses caused by typhoons Pedring and Quiel along with higher prices of basic commodities and unemployment as factors that contributed to the lower CI. Less optimistic sentiments were also noted in other Asian countries, specifically, China, Thailand, India and Singapore for Q4 2011.

Looking ahead, consumers were more optimistic for the quarter- and year-ahead periods due to favorable job and income prospects, increased investments, along with stable prices of goods and services. This was reflected in a higher CI index for the quarter ahead at 2.8 percent from 1.5 percent a quarter ago. Likewise, consumers' outlook turned more bullish in the year ahead, which continued to post a double-digit CI of 14.6 percent (from 11.7 percent a quarter ago).

External Demand

Exports

Merchandise exports and imports decline.

Exports of Goods (BOP data)
Growth rate (in percent)

Commodity Group	2010	2011	
	Q3	Q2	Q3
Coconut products	77.2	27.9	-0.5
Sugar and Products	-37.5	570.0	820.0
Fruits and Vegetables	3.9	92.5	49.2
Other Agro-based products	18.6	22.7	24.9
Forest products	-40.0	22.2	150.0
Mineral products	55.4	81.2	37.2
Petroleum products	40.4	409.6	47.5
Manufactures	41.5	-7.1	-20.9
Special transactions	-18.6	-3.1	33.9
Total Exports, as per NSO Foreign Trade Statistics	40.3	1.0	-14.9
Conceptual and coverage adjustments	27.1	-3.0	-43.8
Total Exports, BPM5	**41.6**	**1.0**	**-15.5**

Source: BSP

Merchandise exports in Q3 2011 decreased by 15.5 percent y-o-y, a reversal of the quarter- and year-ago growth rates of 1.0 percent and 41.6 percent, respectively. The decline in exports was due mainly to lower outward shipments of manufactures, particularly electronics, which represents about half of overall exports. Under electronics, semiconductors declined by 40.2 percent in Q3 2011 as both volume and price fell, consistent with the downward trend in the book-to-bill ratio. According to the Semiconductor Industry Association (SIA), worldwide sales of semiconductors dropped due to waning demand from AEs, specifically the US, Europe and Japan. In addition, exports of coconut products, led by coconut oil, declined. Tight supply of raw materials contributed largely to the fall in coconut oil exports. Furthermore, the elevated price of coconut oil prompted consumers to shift to alternative products such as palm kernel oil.

Imports

Similarly, imports of goods fell by 2.2 percent y-o-y from a growth of 2.4 percent in the previous quarter and 31.8 percent in the same quarter a year ago. The contraction can be traced to lower inward shipments of raw materials and intermediate goods. The import of semi-processed raw materials also dropped, particularly accessories for the manufacture of electrical equipment. This was reflected partly in the continued weak exports of electronic products, which indicated the sluggish global demand for electronics. The significant contraction was offset partly by the growth in imports of mineral fuels and lubricants, led by petroleum crude, as both volume and price increased due to elevated international oil prices. Imports of capital and consumer goods also recorded positive increments during the quarter.

Imports of Goods (BOP data)

Growth rate (in percent)

Commodity Group	2010	2011	
	Q3	Q2	Q3
Capital Goods	9.0	-3.5	22.9
Raw Materials & Intermediate Goods	41.8	0.0	-21.0
Mineral Fuels & Lubricants	8.7	18.6	51.8
Consumer Goods	40.1	-2.9	2.9
Special Transactions	58.9	-8.4	8.4
Total Imports[1/]	31.1	2.2	-2.2
Conceptual and coverage adjustments	246.3	61.8	2.9
Total Imports, BPM5	**31.8**	**2.4**	**-2.2**

[1/] Include valuation adjustments to NSO data

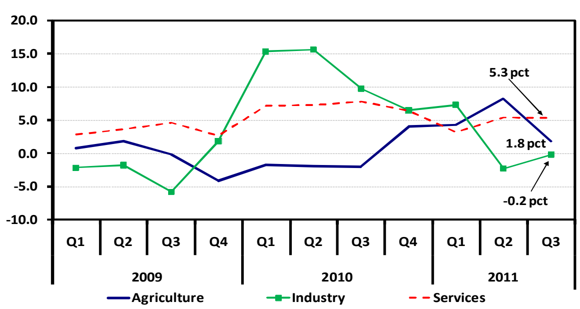
Source: BSP

Aggregate Supply

Output growth in the services sector underpins expansion on the production side.

Agriculture, Industry and Services Sectors

Annual Growth in Real Terms



The services sector, which comprised 58.0 percent of GDP, expanded by 5.3 percent in Q3 2011 from 5.4 percent in the previous quarter. The growth in services was driven by the expansion in the following sub-sectors: real estate, renting and other business activities, trade and repair of motor vehicles, motorcycles, personal and household goods, and other services.

Despite the impact of adverse weather conditions in the third quarter, the agriculture sector posted a 1.8 percent growth from a decline of 2.0 percent in the same period in 2010. The major contributors were *palay*, poultry, and livestock. The recovery of sugarcane, *palay*, and corn production from the severe dry spell in 2010 also bolstered agriculture output sector. Fishing, however, was severely affected by the series of typhoons that hit the country as fishing output declined by 6.1 percent in Q3 2011 from a growth of 2.8 percent in Q3 2010.

Meanwhile, the industry sector contracted for the second consecutive quarter as construction continued to decline at a double-digit rate. Industrial output was also pulled down by the contraction in electricity, gas, and water supply industries, coupled with a slower growth in manufacturing and mining and quarrying industries during the quarter.

Economic Performance

At constant 2000 prices

Growth rate (in percent)

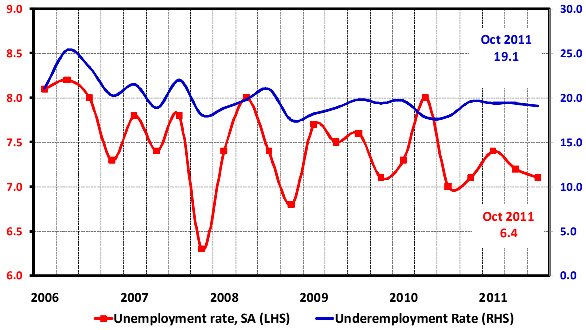
Sector	2010	2011	
	Q3	Q2	Q3
By industrial origin			
Agri, Hunting, Forestry & Fishing	**-2.0**	**8.2**	**1.8**
Agriculture and Forestry	-3.1	11.5	3.7
Fishing	2.8	-2.4	-6.1
Industry	**9.8**	**-2.3**	**-0.2**
Mining and quarrying	6.8	3.0	1.1
Manufacturing	8.4	4.7	3.1
Construction	15.6	-23.3	-12.2
Electricity, gas and water supply	10.1	-3.4	-1.0
Services	**7.8**	**5.4**	**5.3**
Transport., Storage, & Comm.	3.0	4.2	4.9
Trade	11.0	1.9	3.8
Finance	13.1	11.6	3.6
Real estate, Rent, & Bus. Act.	6.6	6.9	7.6
Government services	6.5	5.4	5.4
Other services	4.4	5.9	7.0

Source: NSCB

Labor Market Conditions

Unemployment rate decreases from previous quarter.

Unemployment and Underemployment Rates
in percent



Based on the preliminary results of the October Labor Force Survey (LFS), the unemployment rate in October 2011 was estimated at 6.4 percent, lower than the 7.1 percent posted in both the October 2010 and July 2011 LFS. Meanwhile, the proportion of underemployed to total employed persons was unchanged at 19.1 percent in October 2011 relative to the July 2011 level, but was lower compared to the 19.6 percent recorded in October 2010.[27]

Employment increased by 5.6 percent y-o-y in October 2011 to 38.5 million, driven largely by the growth in the services sector. Employment in the services sector was higher by 1.2 million, translating into a 6.5 percent growth. The services sector accounted for 52.1 percent of the total employed persons, while the agriculture and industry sectors employed 33.4 percent and 14.5 percent, respectively.

In terms of major occupation groups, the y-o-y increase in the employment level could be traced to the higher growth of service workers, officials of government and special interest organizations, laborers, technicians, special occupations workers, clerks, professionals, and workers in trades and plants. However, the decline in the employment of farmers pulled down employment growth during the period.

[27] Underemployed persons include all employed persons who express the desire to have additional hours of work in their present job or an additional job, or to have a new job with longer working hours. Visibly underemployed persons are those who work for less than 40 hours during the reference period and want additional hours of work.

II. MONETARY AND FINANCIAL MARKET CONDITIONS

Domestic Liquidity and Credit Conditions

Domestic liquidity continues to grow as NFA expands further….

M3 continued to grow in November 2011, although at a slightly slower pace of 7.2 percent from the end-Q3 2011 expansion of 7.4 percent. The growth of domestic liquidity continued to be fueled by the expansion in net foreign assets (NFA), particularly in the BSP's NFA position, as foreign exchange inflows from overseas Filipinos' remittances and portfolio investments continued to increase. Meanwhile, the NFA of banks decreased further owing to the continued increase in their foreign liabilities coupled with a decline in foreign assets. On the one hand, banks' foreign liabilities rose with higher placements made by foreign banks, including that of the head offices/other branches of foreign banks, with local banks. On the other hand, the contraction in banks' foreign assets was due in part to the decrease in loan receivables from foreign banks.

…while NDA contracts at a slower pace.

Meanwhile, net domestic assets (NDA) contracted at a slower pace of 7.1 percent compared to end-Q3 2011 as the slower expansion of the net other items account (which includes, among other things, revaluation and capital and reserve accounts as well as SDA placements of trust entities) was combined with a larger increase in net domestic credits. Net domestic credits rose with the sustained increase in credits extended to the private sector, in line with the continued growth of bank lending to businesses and households. Similarly, credits extended to the public sector increased, following two quarters of contraction, due largely to the faster expansion in credits extended to the local government and other public entities.

Bank lending growth accelerates further.

Bank lending of U/KBs continued to expand, providing support to the domestic economy amid more subdued prospects for the global economy. As of November 2011, bank lending growth, net of banks' reverse repurchase (RRP) placements with the BSP, rose to 22.5 percent y-o-y from a growth of 21.7 percent at end-Q3 2011 and 8.9 percent at end-Q4 2010. The faster growth of bank lending was driven largely by lending to the following productive sectors: wholesale and retail trade; real estate, renting and business services; electricity, gas and water; manufacturing; financial intermediation; and transportation, storage and communication. Meanwhile, consumer loans registered a growth of

18.1 percent as of November 2011, faster than the 17.9 percent growth at end-Q3 2011 and the 8.9 percent growth at end-Q4 2010.

Meanwhile, overall credit standards remain generally unchanged.

Results of the Q4 2011 Senior Bank Loan Officers' Survey[28] showed overall unchanged credit standards for loans to enterprises, based on the diffusion index approach,[29,30] given the equal number of banks that indicated tightening and easing of lending standards during the quarter. This followed the slight net tightening observed in the previous two quarters. Meanwhile, all banks indicated unchanged credit standards for loans to households in Q4 2011 after two consecutive quarters of slight net easing.[31]

Lending to Enterprises

The overall unchanged credit standards for loans to enterprises reflected the banks' steady outlook on the general economy and certain industries amid more uncertain global economic prospects, stable asset portfolio, and unchanged tolerance for risk.

General Credit Standards to Enterprises (Overall)

	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011	Q2 2011	Q3 2011	Q4 2011
Tightened considerably	5.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tightened somewhat	10.5	4.5	9.5	15.0	0.0	5.6	7.1	5.0
Remained basically unchanged	**84.2**	**95.5**	**90.5**	**80.0**	**100.0**	**94.4**	**92.9**	**90.0**
Eased somewhat	0.0	0.0	0.0	5.0	0.0	0.0	0.0	5.0
Eased considerably	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*
Diffusion Index for Credit Standards	***15.8***	***4.5***	***9.5***	***10.0***	***0.0***	***5.6***	***7.1***	***0.0***
Weighted Diffusion Index for Credit S	***10.5***	***2.3***	***4.8***	***5.0***	***0.0***	***2.8***	***3.6***	***0.0***
Mean	*2.8*	*3.0*	*2.9*	*2.9*	*3.0*	*2.9*	*2.9*	*3.0*
Number of banks responding	***19.0***	***22.0***	***21.0***	***20.0***	***19.0***	***18.0***	***14.0***	***20.0***

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").

With regard to firm size, the results of the survey showed mixed results as credit standards for top corporations and micro enterprises indicated a slight net tightening while banks' responses showed a slight net easing in standards for large middle-market firms and small and medium-sized enterprises in Q4 2011.

In terms of specific credit standards,[32] survey results for Q4 2011 continued to show narrower loan margins along with increased credit lines for the fourth consecutive quarter, particularly for top corporations and large middle-market enterprises. Survey results have also been showing a net narrowing of loan margins since Q4 2010 on the back of a generally stable interest rate environment,

[28] Survey questions were sent to 34 commercial banks, with 24 banks responding, or a response rate of 70.6 percent. As of March 2011, commercial banks' loans accounted for around 85.5 percent of the banking system's total outstanding loans. Meanwhile, the banks that responded to the Q4 2011 survey accounted for 63.3 percent of the total universal and commercial bank loans for November 2011.

[29] A positive diffusion index indicates that more banks have tightened their credit standards compared to those that eased ("net tightening"), whereas a negative diffusion index indicates that more banks have eased their credit standards compared to those that tightened ("net easing").

[30] Prior to the Q1 2010 survey, the BSP looked only at the mode of responses in interpreting the results of the survey, i.e., the number of banks that tightened, loosened, or maintained credit standards. Since Q1 2010, the BSP started analyzing the results of the survey by looking at the percentage difference ("diffusion index") between banks reporting that credit standards have been tightened and those reporting that they have been eased.

[31] Meanwhile, most banks indicated generally unchanged bank credit standards for the tenth consecutive quarter starting Q2 2009, based on the percentage of responding banks indicating whether they tightened, loosened, or maintained their credit standards.

[32] The survey questionnaire identified five specific credit standards: (1) loan margins (price-based); (2) collateral requirements; (3) loan covenants; (4) size of credit lines; and (5) length of loan maturities.

while the size of credit lines has been increasing since Q2 2010. Banks' standards on collateral requirements were unchanged since Q3 2011 while standards on loan covenants showed a slight net tightening in the fourth quarter after being unchanged in the previous quarter. Loan maturities appeared to have lengthened for top corporations but slightly shortened for large middle-market and small and medium enterprises. Meanwhile, banks' responses indicated an overall slight tightening in terms of the use of interest rate floors for loans to businesses, specifically for top corporations and large middle-market enterprises.

Moving forward, respondent banks expect a slight net tightening over the next quarter of overall credit standards, particularly for top corporations and large middle-market enterprises. This was confirmed by some banks already indicating somewhat tightening of credit standards for top corporations and micro enterprises in Q4 2011.

Lending to Households

The survey results indicated unchanged credit standards across all types of loans to households, following an overall net easing observed in the past two quarters.[33] The unchanged view of respondent banks on the economy, stable asset portfolio of banks and unchanged tolerance for risk and profile of borrowers contributed to the unchanged credit standards for loans to households during the quarter.

General Credit Standards to Households (Overall)

	Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011	Q2 2011	Q3 2011	Q4 2011
Tightened considerably	11.1	0.0	0.0	0.0	8.3	0.0	0.0	0.0
Tightened somewhat	11.1	23.1	8.3	0.0	0.0	0.0	0.0	0.0
Remained basically unchanged	**66.7**	**69.2**	**83.3**	**100.0**	**91.7**	**88.9**	**91.7**	**100.0**
Eased somewhat	11.1	7.7	8.3	0.0	0.0	11.1	8.3	0.0
Eased considerably	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*	*100.0*
Diffusion Index for Credit Standards	***11.1***	***15.4***	***0.0***	***0.0***	***8.3***	***-11.1***	***-8.3***	***0.0***
Weighted Diffusion Index for Credit	***11.1***	***7.7***	***0.0***	***0.0***	***8.3***	***-5.6***	***-4.2***	***0.0***
Mean	*2.8*	*2.8*	*3.0*	*3.0*	*2.8*	*3.1*	*3.1*	*3.0*
Number of banks responding	***9.0***	***13.0***	***12.0***	***10.0***	***12.0***	***9.0***	***12.0***	***14.0***

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").

In terms of specific credit standards for loans to households, survey responses indicated unchanged standards on collateral requirements, loan covenants, and loan maturities across all types of household loans. Meanwhile, banks' responses showed a slight widening of loan margins for housing loans, increase in credit lines for housing and auto loans, and less use of interest rate floors for personal/salary loans.

Over the next quarter, banks indicated that credit standards would likely remain unchanged for credit card and auto loans while those for housing and personal/salary loans would likely ease somewhat in the near term.

[33] Loans extended to households include: (1) housing loans; (2) credit card loans; (3) auto loans; and (4) personal/salary loans.

Loan demand

The survey results also pointed to a sustained increase in demand[34] for loans from enterprises (except micro enterprises) and households (except auto loans). For loans to businesses, the net increase in demand for loans was attributed by banks to increased customers' inventory and accounts receivable financing needs as well as the relatively low interest rates. On the other hand, the attractive terms of financing offered by banks, the relatively low interest rates, as well as higher housing investment of households contributed to the increase in demand for household loans during the review quarter.

The overall positive net change in demand for corporate and household loans was consistent with the strong bank lending growth during the first two months of Q4 2011 for which data are available.

Looking ahead, respondent banks expect demand for credit from both businesses and households to continue to increase in the next quarter.

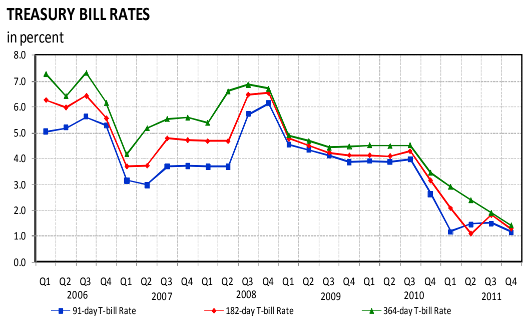
Special Questions on Commercial Real Estate Loans

All respondent banks reported unchanged overall credit standards for commercial real estate loans in Q4 2011 relative to Q3 2011. In terms of specific credit standards, banks' responses indicated a slight net tightening of standards on the size of credit lines, collateral requirements, and use of interest rate floors. Meanwhile, standards on loan covenants have been unchanged while loan maturities were longer. Among the important reasons cited for the unchanged credit standards for commercial real estate loans were the banks' stable economic outlook along with the stable asset portfolio of banks and unchanged tolerance for risk. Respondent banks' loan-to-value ratios were steady during the quarter. Banks also reported increased demand for commercial real estate loans in Q4 2011 given clients' steady outlook on the economy and relatively stable interest rate environment.

[34] "Diffusion index (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.

Interest Rates

T-bill rates end higher relative to previous quarter.



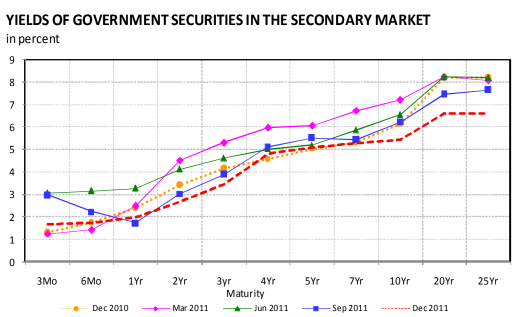
Primary Interest Rates

During Q4 2011, the average 91-day, 182-day, and 364-day T-bill rates declined to 1.15 percent, 1.25 percent, and 1.42 percent from 1.49 percent, 1.81 percent, and 1.83 percent in Q3 2011, respectively. However, the end-of-period T-bill rates in the fourth quarter were higher for the 91-day and 182-day than those of end-Q3 2011 on the back of cautious market sentiment amid the continuing debt crisis in the euro area. The rising T-bill rates also reflected investors' preference for longer-dated government papers given expectations of a manageable inflation outlook over the policy horizon. T-bill rates have started to normalize earlier in the quarter after rates fell below 1.0 percent towards the latter part of the third quarter.

Meanwhile, on an annual basis, the average interest rates for the 91-day, 182-day, and 364-day T-bills for 2011 were significantly lower at 1.37 percent, 1.69 percent, and 2.30 percent compared to the rates in 2010 at 3.73 percent, 3.97 percent, and 4.26 percent, respectively.

Yield Curve

The yield curve continues to shift downward.



Secondary market yields were generally lower across all tenors (except for the 1-year instrument) as of end-December 2011 relative to the end September-2011 levels, amid ample market liquidity and investors' expectations that the BSP will continue to hold policy rates steady to help spur economic activity. Debt paper yields were lower by a range of 18.7 basis points (bps) (7-year GS) to 130.5 bps (3-month GS) compared to end-September 2011 levels.

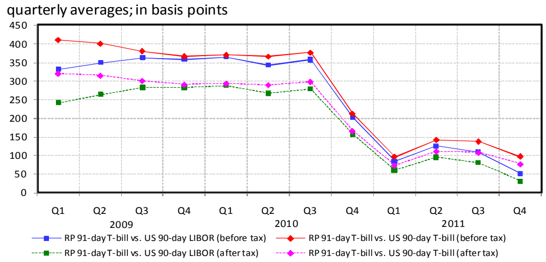
Relative to the 29 December 2010 levels, secondary market yields of government securities (GS) declined generally except for the 3-month, 6-month, 4-year and 5-year maturities which rose ranging from 1.2 bps (6-month GS) to 34.3 bps (3-month GS). The yield curve flattened as investors' preference shifted to longer-dated papers on expectations of a manageable inflation environment.

Interest Rate Differentials

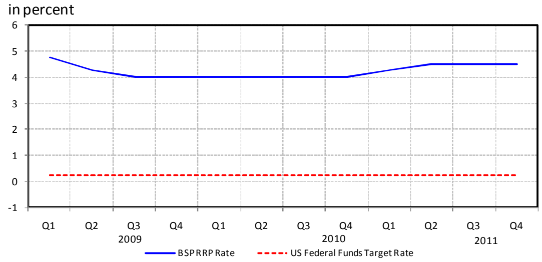
Interest rate differentials continue to narrow.

The average positive differentials between domestic and US interest rates, net of tax, narrowed in Q4 2011 relative to the previous quarter, following the

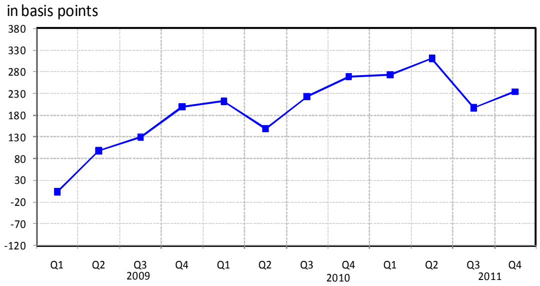
INTEREST RATE DIFFERENTIALS
quarterly averages; in basis points



BSP RRP RATE AND US FEDERAL FUNDS TARGET RATE
in percent



RISK-ADJUSTED DIFFERENTIALS
in basis points

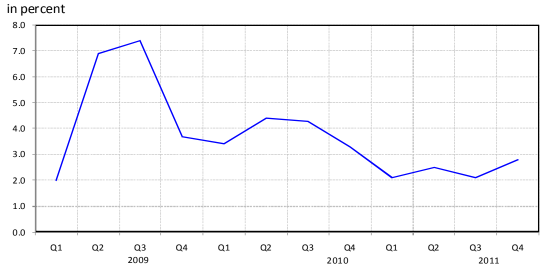


decline in the average RP 91-day T-bill rate to 0.99 percent from 1.44 percent in Q3 2011 and in the average US 90-day T-bill rate to 0.02 percent from 0.07 percent. Meanwhile, the rise in the average US 90-day LIBOR was offset by the fall in the Philippine T-bill rate.

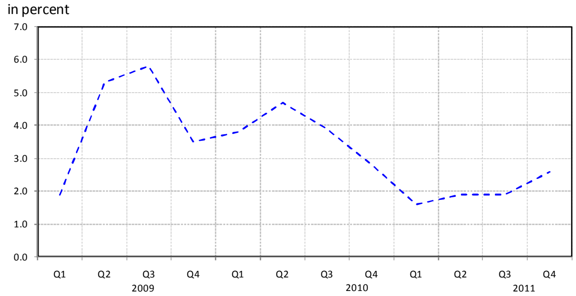
The positive differential between the BSP's policy interest rate (overnight borrowing or RRP rate) and the US federal funds target rate remained unchanged at 425 bps in Q4 2011. Adjusted for the risk premium,[35] the average spread between the BSP's policy rate and the US federal funds target rate fell to 242 bps from 253 bps in Q3 2011. This development could be traced to the 11-bp rise in the risk premium given the larger decline in the 10-year US yield compared to the 10-year RP yield. The higher risk premium reflects both the change in the riskiness of the asset and in investors' risk appetite.

Real lending rate rises.

PHILIPPINES' REAL LENDING RATE (2000-BASED CPI SERIES)
in percent



PHILIPPINES' REAL LENDING RATE (2006-BASED CPI SERIES)
in percent



The real lending rate—measured as the difference between the average bank lending rate and inflation—rose to 2.8 percent in December 2011 from 2.1 percent in September as the inflation rate (2000-based CPI series) dropped to 4.0 percent in December 2011 from 4.6 percent in the September.

Using the 2006-based CPI inflation series, the real lending rate also rose to 2.6 percent in December 2011 from 1.9 percent in September, as the inflation rate declined to 4.2 percent in December from 4.8 percent in September.

Based on the 2000-based CPI series, the real lending rate of the Philippines at 2.8 percent in December 2011 remained the fourth highest in a sample of 10 Asian countries, with Indonesia recording the highest real lending rate at 8.2 percent. Based on the 2006-CPI series, the Philippines' real lending rate at 2.6 percent was likewise ranked the fourth highest in December for the same sample.

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

Financial Market Conditions

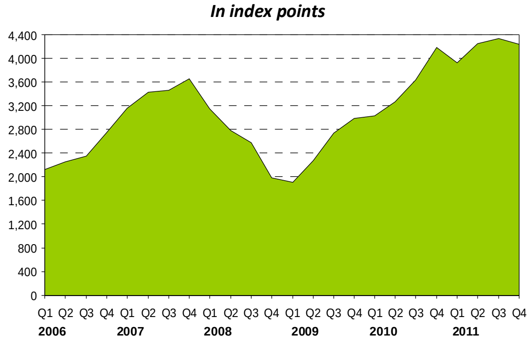
Persistent uncertainties over the European debt crisis and global economic prospects weigh down on local and global financial markets.

Results of the October European summit on measures to resolve the debt crisis resulted initially to growing market optimism. However, the failure of European leaders to reach a definitive consensus led to contagion fears, increasing risk aversion across major financial markets in the world. S&P's decision to put 15 European countries on watch for potential downgrades further dampened market sentiment. On the local front, the change in S&P's credit outlook for the Philippines from stable to positive, the reported decline in the country's unemployment rate, and the continued strength of the external payments position helped bolster investor confidence. Nonetheless, the local stock trading turned bearish during the quarter while both the EMBI+ Philippine spread and the Philippine CDS spread widened relative to their previous quarter levels, reflecting heightened global risk aversion. The peso likewise depreciated—despite sustained foreign exchange inflows from overseas remittances and portfolio inflows—due to persistent concerns over the sovereign debt problem in Europe.

Stock Market

The local stock index dips over concerns about the worsening European debt crisis.

Average PSEi
In index points



The Philippine Stock Exchange index (PSEi) declined in the last quarter of 2011, weakened primarily by concerns about Europe's struggle to resolve its debt crisis and fears about its likely impact on global economic prospects. The slower growth of the Philippine economy in the third quarter also helped dampen sentiments and kept investors trading cautiously. The deterioration in investor risk appetite saw the local composite index dip by 2.2 percent from 4,334.36 index points in the third quarter to 4,239.22 index points in the last three months of 2011. Relative to the average posted a year ago, however, this quarter's level rose by 1.4 percent.

Month-on-month (m-o-m), trends in the local bourse were mixed.

- The PSEi closed at 4,333.72 index points In October, 8.4 percent higher than the previous month's closing index as worries about Europe's struggle to resolve the debt crisis were offset by the higher-than-expected Q3 2011 growth of the US, initial optimism over the agreements reached at the 26 October European summit on measures to contain the debt crisis, and the

National Telecommunication Commission's approval of PLDT's acquisition of DIGITEL.

- In November, the PSEi was pushed 2.8 percent lower to close at 4,211.04 index points due to heightened concerns on the possible contagion from the European debt crisis, rising bond yields in Italy and other euro-member states, a ratings downgrade for Hungary and Belgium, and Germany's failure to find buyers for 35 percent of its bond auction. The sharp decline in Philippine exports in September and the lower-than-expected real GDP growth in Q3 also helped push the index lower than the month-ago level, notwithstanding the rise in global stocks, following the US Thanksgiving weekend retail sales boom.

- In December, the local index climbed 3.8 percent higher m-o-m to close at 4,371.96 index points. Investor sentiment was boosted by signs that the US economy was picking up and the coordinated move of six central banks[36] to renew the dollar swap lines with the US Fed at lower rates. However, market confidence was partly dampened by S&P's decision to put 15 European nations on watch for potential downgrades. As the year drew to a close, the negative market tone was defused by the reported slowdown in domestic inflation, news of S&P raising its outlook for the Philippines to positive from stable, the decline in the country's unemployment rate, the better-than-expected external payments surplus in the first 11 months of the year, and the award of the government's first PPP project.

Foreign investors turn net buyers.

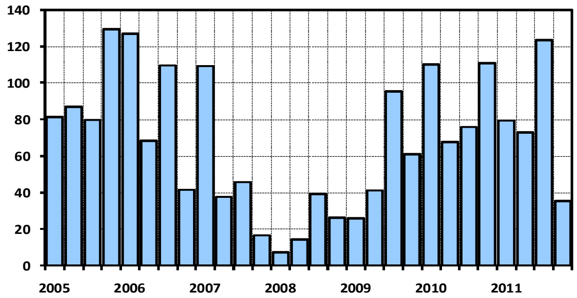
Notwithstanding the q-o-q decline in the PSEi, stock market capitalization rose by 6.1 percent to ₽8.7 trillion in end-December from ₽8.2 trillion in end-September. Foreign investors also posted substantial net purchases amounting to ₽40.9 billion during the quarter-in-review, a sharp reversal from the ₽5.6 billion net selling recorded in the previous quarter, reflecting their strong support of several local IPOs and block sales held in November and December.

Government Securities

For most of the auctions during the review quarter, the Auction Committee made partial awards of the

[36] Specifically, the US Fed, ECB, Bank of England, Bank of Canada, Bank of Japan and Swiss National Bank.

Oversubscription of T-bill Auctions
In billion pesos

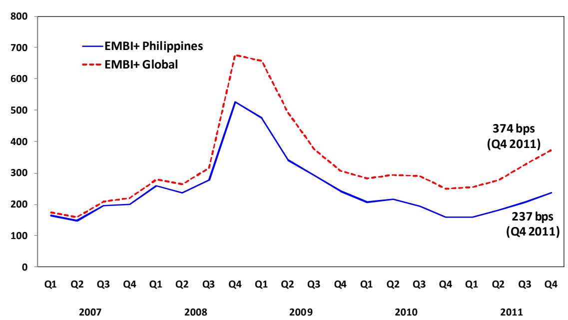


programmed amount as investors posted bids that were deemed too high by the Committee and given the NG's comfortable cash position. The only time the Auction Committee made a full award of the programmed amount was during the 2 November auction. On the other hand, all bids during the 3 October and 28 November were rejected as bids posted were deemed unreasonably high. The 3 October 2011 auction was also undersubscribed as investors waited for new developments that would show clearer signals of where interest rates were heading. Nonetheless, the auctions were mostly oversubscribed in Q4 2011, with oversubscription amounting to ₱35.4 billion (compared to ₱123.4 billion of the previous quarter).

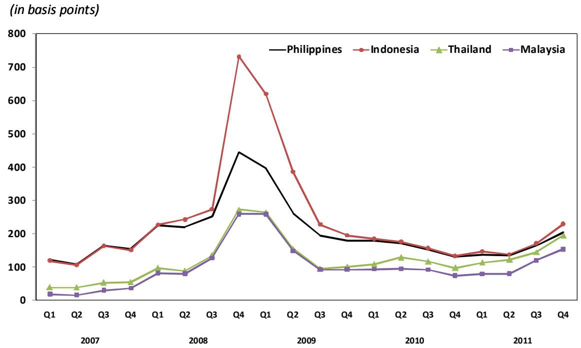
Sovereign Bond and CDS Spreads

Debt spreads continue to widen.

Quarterly JP Morgan EMBI+Sovereign Bond Spreads
(in basis points)



Quarterly Philippine Senior 5-year CDS Spreads
(in basis points)



Debt spreads widened significantly in the fourth quarter on contagion fears over the euro area debt and financial crisis. The EMBI+ Philippine spreads, or the extra yield investors demand to hold Philippine debt securities over US Treasuries, averaged 237 bps during the review period, wider than the third quarter's average of 208 bps. Similarly, the CDS spread, or the cost of insuring the country's 5-year sovereign bonds against default, rose to 203 bps from 163 bps in Q3 2011. Against neighboring economies, the Philippine CDS traded narrower than Indonesia's 229 bps but wider than Malaysia's 153 bps and Thailand's 194 bps.

After widening to the year's peak in the first week of October, debt spreads tightened towards the rest of October as conditions in the global markets stabilized on growing optimism that the results of the EU summit would lead to comprehensive measures that would help resolve the crisis. The favorable deal reached among European heads of state and the IMF to impose a 50 percent haircut on Greek debt and the increase in the bailout fund provided investors relief, prompting them to demand lower premium on debt instruments. On the domestic front, the announcement of a ₱72 billion stimulus package to cushion the economy and improvements in the country's macroeconomic data also contributed to the easing of the country's debt spreads.

However, in November, investors grew skeptical about the adequacy of the measures taken so that debt spreads widened anew. Contagion fears increased as markets priced-in the possibility of the euro area's crisis affecting even generally stable economies. The turmoil spread across Europe's major economies as yields on bonds issued by Italy, France, Netherlands, and Austria soared to historic highs. This, in turn, pushed debt spreads of Asian emerging market assets to reach their second widest level in 2011. S&P's warning of potential downgrades among European nations likewise contributed to the widening of debt spreads.

Meanwhile, efforts of key central banks to extend financial assistance to banks in the euro area's in December and signs of steady pick-up in the US economy have somehow calmed investors in the latter part of the quarter, tempering the further widening of spreads. The change in S&P's credit outlook for the Philippines from stable to positive,[37] the decline in the country's unemployment rate, and the greater-than-expected external payments surplus also mitigated debt spreads' widening trend.

Banking System

Key performance indicators show sustained resiliency of the banking system.

The Philippine banking system remained sound during the last quarter of the year marked by growing resource base, improving non-performing loans (NPL) ratio, which is now close to its pre-Asian crisis level, and higher loan-loss provisioning ratios. The system's capital adequacy ratios of over 15 percent remained comfortably above the BSP's and the Bank for International Settlements' (BIS) minimum requirements.

Saving Mobilization

Savings and time deposits remained the primary sources of funds for banks. Banks' total deposits[38] as of end-November 2011 amounted to ₱3.9 trillion, 7.3 percent higher than the year-ago level of ₱3.6 trillion. The continued growth in deposits reflected depositors' sustained confidence in the banking system. Savings deposits registered an 8.6 percent growth and continued to account for nearly half of the funding base. Meanwhile, demand and time deposits expanded y-o-y by 12.3 percent and 1.0 percent, respectively, from its level posted a year ago.

Institutional Developments

The total resources of the banking system rose by 7.7 percent to ₱7.3 trillion as of end-October. The

[37] S&P adjusted Philippines credit outlook on 16 December 2011.
[38] Total peso-denominated deposits.

increase could be traced to the growth in currency and deposits, indicative of the public's continued trust in the banking sector. Universal and commercial banks (U/KBs) accounted for almost 90 percent of the total resources of the banking system.

The number of banking institutions (head offices) fell further to 739 as of end-June 2011 from the quarter- and year-ago levels of 746 and 773, respectively, denoting the continued consolidation of banks as well as the exit of weaker players in the banking system. By banking classification, banks (head offices) consisted of 38 U/KBs, 72 thrift banks (TBs), and 629 rural banks (RBs). Meanwhile, the operating network (including branches) of the banking system increased to 8,915 in Q2 2011 from 8,870 in Q1 2011 and 8,685 during the same period last year, due mainly to the increase in the branches/agencies of commercial and rural banks.

Asset quality of the Philippine banking system improves further.

The banking system's asset quality continued to improve as the NPL ratio sustained its downtrend, easing to 3.2 percent as of end-October 2011 from the 3.9 percent registered a year ago. Banks' initiatives to improve asset quality along with prudent lending regulations helped bring back the NPL ratio to pre-Asian crisis levels. The low NPL ratio reflected the 7.0 percent decline in the level of NPLs combined with the 14.3 percent expansion in the industry's total loan portfolio (TLP). The NPL level dropped to ₱111.4 billion at end-October 2011 from ₱119.7 billion during the same period in 2010, while TLP expanded to ₱3.5 trillion from ₱3.1 trillion during the same period last year.

Meanwhile, the NPL ratio of U/KBs declined further to 2.5 percent as of end-October 2011 from the 3.2 percent posted in the same period in 2010, but was generally unchanged relative to the ratio posted at end-September 2011.

Nonetheless, the Philippine banking system's NPL ratio of 3.2 percent was higher compared to some of its neighbors like Indonesia's 2.7 percent, Malaysia's 1.9 percent, South Korea's 1.0 percent and Thailand's 2.8 percent.[39] The lower NPL ratios of Malaysia and South Korea could be attributed to the creation of publicly-owned asset management companies (AMCs), which purchased the bulk of

[39] Sources: Various central bank websites and financial stability reports, Indonesia (commercial banks, October 2011); Malaysia (banking system, November 2011); Thailand (commercial banks, September 2011); and Korea (banking system, June 2011).

their NPLs, a practice not implemented in the Philippines.

The loan exposure of banks remained adequately covered as the banking system's NPL coverage ratio improved to 99.9 percent as of end-October 2011 from 97.4 percent in the preceding year. The ratio was indicative of banks' continued compliance with the loan-loss provisioning requirements of the BSP to ensure adequate buffers against unexpected losses.

Banks remain adequately capitalized, exceeding prescribed levels set by the BSP and BIS.

Meanwhile, the CARs of the Philippine banking system remained robust despite concerns over the possible impact of the sovereign risk problem in Europe on the availability of foreign funding for local banks. The banking system registered average CARs of 16.5 percent on solo basis and 17.4 percent on consolidated basis as of end-March 2011, which were higher than the CARs posted as of end-December 2010. The sustained strength of the banking system's CARs resulted from the higher growth rate of qualifying capital vis-à-vis that of risk weighted assets. The industry's CAR continued to exceed both the statutory level set by the BSP at 10.0 percent and the BIS international standard at 8.0 percent.

The Philippine banking system's CAR on consolidated basis at 17.4 percent was comparatively higher than those of Indonesia (17.2 percent), Thailand (16.2 percent), Malaysia (14.8 percent) and South Korea (14.5 percent).[40]

Meanwhile, placements in the special deposit account (SDA) facility of the BSP increased by about 32.5 percent y-o-y to reach ₱1,640.0 billion as of end-December 2011 from the ₱1,238.0 billion posted during the same period a year ago. Similarly, placements under the BSP RRP window went up to ₱295.9 billion from the ₱285.1 billion.

Exchange Rate

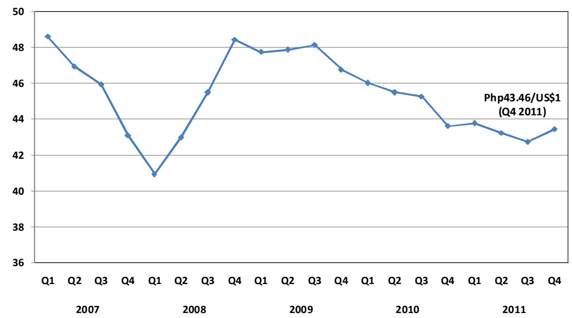
Peso depreciates on euro area crisis concerns.

The peso weakened as the global economic environment continued to navigate through uncertainties in the fourth quarter of 2011. The peso averaged weaker at ₱43.46/US$1, depreciating by 1.6 percent from the ₱42.75/US$1 average in the third quarter of 2011. [41] Nonetheless, on a y-o-y

[40] Sources: Various central bank websites and financial stability reports, Indonesia (commercial banks, October 2011); Thailand (average full branch, September 2011); Malaysia (banking system, November 2011); and Korea (commercial banks, June 2011).

[41] Dollar rates or the reciprocal of the peso-dollar rates were used to compute for the percentage change.

Quarterly Peso-Dollar Rate
Q1 2007 - Q4 2011



basis, the peso appreciated by 0.4 percent from the ₱43.63/US$1 average in the fourth quarter of 2010 as the sustained inflow of OF remittances tempered the peso's further decline.[42]

The peso was generally on a downtrend during the quarter in review as the sovereign debt situation in Europe appeared to have taken a turn for the worse. In October 2011, the peso depreciated to ₱43.39/US$1 compared to the previous month's average of ₱43.09/US$1 as concerns over the euro area crisis stirred caution among investors. This caused them to sell risky assets, including emerging Asian currencies, and seek safe-haven US dollar denominated assets. The peso was also weighed down by the sharp drop in the country's exports.[43] The peso, however, partly regained its losses in November, as it averaged slightly stronger at ₱43.32/US$1, tracking the rally of Asian stocks following the ECB decision to cut its policy rates during the month to avoid a possible recession in the region.[44] The peso's strength was not sustained as the peso depreciated to an average of ₱43.66/US$1 in December 2011. This was due partly to persistent worries over the sovereign debt crisis in Europe and the risk of contagion, as well as the weak growth prospects of the global economy.[45] The peso also came under pressure after the International Monetary Fund (IMF) revised downward its growth forecast for the Philippine economy.[46] Likewise, the sluggish performance of the export sector in October 2011 weighed down on the peso's strength.[47]

On 29 December 2011, the peso closed at the same level relative to the closing price on 31 December 2010 at ₱43.84/US$1. Meanwhile, the rest of the Asian currencies depreciated against the US dollar except for the Japanese yen and the Chinese yuan which have appreciated vis-à-vis the US dollar by 4.41 percent and 4.57 percent, respectively.[48]

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[42] Cumulative remittances for January – October 2011 reached US$16.5 billion, registering a y-o-y expansion of 7.0 percent.

[43] According to the NSO, exports in August fell by 15.1 percent from a year earlier, the steepest drop since September 2009 due to weakening demand for the country's main electronics and semiconductors products as the global economy slows.

[44] On 3 November 2011, the ECB cut its benchmark interest rates by 25 basis points to 1.25 percent.

[45] On 6 December 2011, S&P's warned it may carry out an unprecedented mass downgrade of euro area countries if EU leaders fail to deliver a convincing agreement on how to solve the region's debt crisis.

[46] On 12 December 2011, the IMF reduced its growth forecasts for the Philippine economy this year and the next to 3.7 percent and 4.2 percent, after weak public investment and exports in the first nine months of 2011.

[47] Based on NSO data, total exports declined by 14.6 percent y-o-y in October 2011.

[48] Based on the last done deal in the afternoon.

Changes in Selected Dollar Rates

	Year-to-date Appr./(Depr.), in percent	
	30 Sep*	**29 Dec****
Philippine peso	**0.3**	**0.0**
Thai baht (onshore)	-3.5	-5.2
Chinese yuan	3.5	4.6
Malaysian ringgit	-3.9	-3.6
South Korean won	-4.6	-2.4
Singaporean dollar	-1.0	-1.4
New Taiwan dollar	-4.4	-3.8
Indonesian rupiah	1.9	-1.6
Japanese yen	5.8	4.4
Indian Rupee	-8.6	-16.1

Source: Bloomberg, Reuters and PDEX
* As of 4:00 p.m., 30 September 2011
** As of 4:00 p.m., 29 December 2011

Meanwhile, volatility, as measured by the coefficient of variation of the daily average exchange rates declined to 0.007 percent in the fourth quarter of 2011 compared with 0.011 percent in the previous quarter.

On a real, trade-weighted basis, the peso gained external price competitiveness against the basket of currencies of major trading partners (MTPs) in the fourth quarter of 2011.[49] This reflects mainly the combined effects of the nominal depreciation of the peso and the narrowing inflation differential relative to those of major competitor countries, which led to a decrease in the real effective exchange rate (REER) index of the peso by 0.29 percent.[50] Meanwhile, the peso lost external price competitiveness on competitor countries in both the broad and narrow series as the nominal appreciation of the peso more than offset the narrowing inflation differential relative to these baskets of competitor countries, leading to a 1.0 percent real appreciation of the peso in both currency baskets.

On a y-o-y basis, the peso lost external price competitiveness against the basket of currencies of MTPs and competitor countries in both the broad and narrow series as the peso appreciated in real terms by 1.7 percent, 1.3 percent, and 1.9 percent, respectively. This developed due to the widening inflation differential, along with the nominal appreciation of the peso against the competitor baskets of currencies.

[49] The basket of the major trading partners is composed of the currencies of US, Japan, the Euro area and the United Kingdom. The broad basket of competitor countries comprises the currencies of Singapore, South Korea, Taiwan, Malaysia, Thailand, Indonesia and Hong Kong while the narrow basket is composed of the currencies of Indonesia, Malaysia and Thailand only.
[50] 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 an 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

Fiscal balance continues to improve.

National Government Fiscal Performance

In billion pesos

	January-November		Growth	% to Q1-Q4 2011
	2010	2011	(%)	2011 Program
Surplus/(Deficit)	-269.8	-96.3	-64.3	32.1
Revenues	1,104.8	1,249.8	13.1	88.6
Expenditures	1,374.6	1,346.0	-2.1	78.7

**Totals may not add up due to rounding*

Source: BTR

The fiscal deficit in January to November 2011 reached ₽96.3 billion, 64.3 percent lower than the ₽269.8 billion deficit incurred during the same period last year. This represented 32.1 percent of the ₽300.0 billion full year programmed deficit for 2011. Meanwhile, netting out the interest payments in the expenditures, the primary surplus during the period January-November 2011 amounted to ₽155.3 billion, 2,912.6 percent higher than the level recorded in the same period last year.

Revenue collections increased by 13.1 percent to ₽1,249.8 billion in January-November 2011 compared to the year-ago level, and accounted for 88.6 percent of the full year 2011 program of ₽1,411.3 billion. The Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC) contributed ₽849.5 billion and ₽243.0 billion, respectively, to total revenues, increasing by 12.8 percent and 4.1 percent, respectively, compared to their contributions in the same period last year. Likewise, the collections by the Bureau of Treasury (BTr) rose to ₽75.0 billion from ₽50.5 billion in the same period in 2010. Revenues from other offices also increased by 22.0 percent to ₽82.3 billion.

Expenditures during the period January-November 2011 amounted to ₽1,346.0 billion, 2.1 percent lower than the disbursements in the same period in 2010, representing 78.7 percent of the Q1-Q4 2011 programmed amount. Excluding interest payments, total disbursements declined by 0.5 percent to ₽1,094.5 billion. Interest payments also went down by 8.5 percent to ₽251.6 billion.

IV. External Developments

The global economic environment has become more challenging amid renewed uncertainties.

Increased risk aversion due largely to the failure of European leaders to reach an agreement on how to address the region's fiscal and banking crises continues to dampen business sentiment worldwide. The JP Morgan Global All-Industry Output Index rose slightly to 52.0 in November from 51.3 in October as service sector activity picked up, while output in manufacturing slowed down amid a continuing decline in new orders. Output growth in the US and Russia continued to accelerate. However, with output indices falling in Japan, China, and the euro area, the overall balance of economic activity appears to be tipping towards a further slowdown going forward.[51]

Business and consumer sentiment in the US improves in light of positive economic data.

Real GDP grew by 1.8 percent q-o-q in Q3 2011, higher than the 1.3 percent in the previous quarter.[52] The acceleration reflected the growth in personal consumption expenditure and non-residential fixed investment as well as a smaller decline in state and local government spending.

The PMI rose markedly to 53.9 in December from 52.7 in November as manufacturing activity picked up on the back of an increase in new orders. Producers are becoming more optimistic amid lower costs of raw materials, although concerns about European financial conditions and the domestic economic environment remain.[53]

Consumer sentiment also improved considerably. From 40.9 in October, the Conference Board Consumer Confidence Index rose to 55.2 in November and to 64.5 in December as consumers' apprehension over near-term employment and income prospects eased.[54] Thomson Reuters and the University of Michigan reported that the index of consumer sentiment improved steadily from 60.9 in October to 64.1 in November and 69.9 in December.[55]

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[51] JP Morgan Global Manufacturing & Services PMI, http://www.markiteconomics.com/MarkitFiles/Pages/ViewPressRelease.aspx?ID=8909

[52] Second estimate by the Bureau of Economic Analysis (BEA). In October, the BEA issued an "advance" growth estimate of 2.5 percent for the same period.

[53] Institute for Supply Management, "November 2011 Manufacturing ISM *Report On Business*", 1 December 2011, http://www.ism.ws/ISMReport/MfgROB.cfm.

[54] "The Conference Board Consumer Confidence Index® Improves". 29 November 2011. http://www.conference-board.org/data/consumerconfidence.cfm

[55] "Political Deadlock and Consumer Spending". 23 November 2011. http://thomsonreuters.com/content/financial/pdf/i_and_a/438965/political_deadlock_and_consumer_spending

Lower unemployment and inflation also contributed to more upbeat sentiment. Unemployment fell to 8.6 percent in November from 9.0 percent in October. Similarly, inflation eased to 3.4 percent in November from 3.5 in October and 3.9 percent in September on the back of a decline in the indices for energy and food.

Pessimism persists in Europe amid elevated fiscal and financial risks.

European leaders have yet to reach a definitive consensus on how to address the region's ongoing fiscal and banking crises. During the European Summit on 9 December 2011, 26 of the 27 European Union (EU) member states agreed to support a fiscal treaty to tighten the implementation of budget rules in the euro area. However, with Britain opposing the treaty, doubts over its enforceability remain and continue to weigh heavily on the region's growth prospects.[56] Eurostat's estimates showed that real GDP grew by only 0.2 percent on a quarterly basis in Q3 2011, the same rate recorded in the previous quarter.[57]

Survey indicators also confirmed growing pessimism. While the composite PMI for the euro area rose slightly to 47.0 in November from 46.5 in October, the inflow of new business continued to slow down amid rising uncertainty and a more subdued global outlook. The European Commission's Economic Sentiment Indicator for the euro area also fell from 94.8 in October to 93.7 in November amid deteriorating business and consumer sentiment.

Unemployment remained elevated in the euro area at 10.3 in October, up slightly from 10.2 percent in September 2011 and 10.1 in October 2010.[58] Meanwhile, inflation in November was estimated at 3.0 percent, the same rate as in October.[59]

Economic activity in Japan picks up slightly.

In Q3 2011, real GDP grew by 1.5 percent q-o-q after contracting by 0.3 percent in the previous quarter. Continuing efforts to restore disaster-stricken facilities drove business and public investment, while the restocking of inventories abroad boosted exports and industrial production.

However, the Bank of Japan (BOJ) warned that the slowdown in the global economy could dampen the country's growth in the near-term. The widespread

[56] "New euro zone fiscal treaty will be enforceable". 13 December 2011. http://www.reuters.com/article/2011/12/13/us-eu-treaty-enforcement-newspro-idUSTRE7BC1C620111213
[57] Second estimate. Eurostat news release 179/2011 dated 6 December 2011.
[58] Eurostat news release 176/2011 dated 30 November 2011.
[59] Flash estimate; no detailed breakdown available. Eurostat news release 175/2011 dated 30 November 2011.

flooding in Thailand, weaker demand from China, and the persistent strength of the yen are likely to contribute to flat export growth moving forward.[60] The seasonally adjusted manufacturing PMI reflected these developments, as it fell to 49.1 in November from 50.6 in October due to fewer new businesses and export orders.

Meanwhile, inflation remained low at 0.2 percent in September from the same rate in August owing to stable international commodity prices. Hence, the BOJ made no adjustments to its monetary policy settings during its last meeting on 30 November.

Output growth appears to ease in China and India.

China's manufacturing output contracted in November as the increase in overseas orders failed to offset the significant reduction in new domestic orders. From 51.0 in October, the seasonally adjusted PMI fell to 47.7 in November. Headline inflation also eased considerably in November to 4.2 percent from 5.5 percent in October.

Meanwhile, India's real GDP growth fell to 6.9 percent in the second quarter (July to September) of the 2011-2012 fiscal year from 7.7 percent in the previous quarter (April to June) due to the contraction of mining and quarrying and the marked deceleration of manufacturing. Inflation also eased to 9.1 percent in November from 9.7 percent in October due to slower growth in food prices.

Subdued global growth prospects and lower inflation outcomes widen the scope for easing monetary policy settings in a number of economies.

The Bank of Thailand reduced its policy rate by 25 basis points (bps) on 30 November, citing the need to ensure adequate liquidity to support restoration efforts due to the severe impact of the floods on agriculture and manufacturing.

Following its rate cut last November, the Reserve Bank of Australia reduced its cash rate by another 25 bps on 6 December. Abating inflationary pressures and muted credit growth were among the main considerations behind the decision.

Finally, the European Central Bank (ECB) cut its policy rates by 25 bps on 8 December following the 25 bps cut on 10 November as financial market troubles intensified and further dampened economic activity across the region. Aimed at boosting liquidity, the rate cut followed the

[60] Bank of Japan. "Monthly Report of Recent Economic and Financial Developments—November 2011". 18 November 2011. http://www.boj.or.jp/en/mopo/gp_2011/gp1111b.pdf

coordinated move of five central banks (i.e., the ECB, Bank of Japan, Bank of England, Bank of Canada, and the Swiss National Bank) on 30 November to renew dollar swap lines with the US Fed. The ECB also reduced the reserve requirement by 100 bps to 1 percent effective 18 January 2012.

With both output growth and inflation on a steady decline, the People's Bank of China reduced the RMB required reserve ratio for deposit-taking institutions by 50 bps effective 5 December.

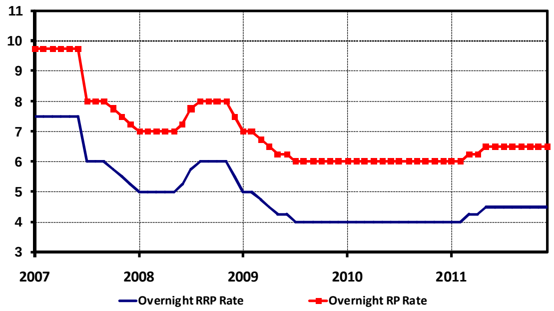
Meanwhile, the US Fed decided to keep its policy rate target at 0 to 0.25 percent during its 13 December policy meeting as the US economy posted modest growth in Q3 2011 amid stable inflation.

Citing abating price pressures and dampened business sentiment in their respective economies, the central banks of Canada, New Zealand, Indonesia, and South Korea also maintained their policy rates in December.

V. MONETARY POLICY DEVELOPMENTS

The Monetary Board decides to keep policy rates steady during the quarter.

BSP Policy Interest Rates
In percent



During its 20 October and 1 December 2011 monetary policy meetings, the MB decided to maintain policy interest rates at 4.5 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.5 percent for the overnight lending or repurchase (RP) facility during the review quarter. 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 outlook remained manageable, indicating that policy settings during the quarter continues to be appropriate. Latest baseline forecasts showed inflation settling within the target range of 3-5 percent for 2011-2013 while inflation expectations remained firmly anchored. The MB also took into account the data showing subdued domestic economic activity in Q3 2011, due to weather-related slowdown in the expansion of the agricultural sector and spillovers emanating from the uncertainty over the strength of the global economy and concerns over Europe's sovereign and banking sectors.

At the same time, risks to the inflation outlook remain tilted to the downside.

The Board noted that risks to the inflation outlook remained tilted to the downside. Weak global economic recovery is likely to be reflected in easing global demand and commodity price pressures. Nonetheless, the MB is of the view that upside risks to prices remained, including continued strong capital inflows that can fuel domestic liquidity and credit growth, pending petitions for electricity rate adjustments, and the possibility of higher domestic rice prices.

Meanwhile, the Monetary Board undertakes a review of the policy on reserve requirements.

Reserve requirement ratios were also maintained at their current rates as liquidity in the financial system remained in line with the economy's growth trajectory. Nonetheless, the BSP announced an ongoing review of its reserve requirement policy on 23 November 2011, which is aimed at operationally strengthening the reserve requirement as a liquidity management tool. The rationalization of the reserve requirement is intended to enable the BSP to have a better handle on the liquidity circulating in the financial system, with the view to enhancing the transmission of monetary policy actions on the economy. In addition, the review is expected to simplify implementation and enhance the BSP's monitoring of banks' compliance with reserve requirements.

VI. INFLATION OUTLOOK

BSP Inflation Forecasts

Emerging baseline forecasts indicate that inflation could settle within the announced target ranges over the policy horizon.

The emerging baseline forecasts point to average inflation settling within the government-announced target ranges for 2011-2013 of 4.0 percent ± 1.0 percentage point.[61]

Compared to the previous quarter, the upward adjustment in the forecast path in Q4 2011 may be attributed to higher-than-projected inflation outturn in October and the increase in oil prices in both the international and domestic market. However, the outlook for inflation remained manageable in the fourth quarter which prompted the MB to keep the BSP's key policy rates and the reserve requirement ratio unchanged.

The weakening global economy brought about by the continuing European sovereign debt crisis has prompted the IMF to revise downwards its global growth projection for 2011-2012. This slowdown in global economic activity represents a key downside risk to inflation via its impact on the commodity prices, particularly on oil. At the same time, the peso maintained its relative strength during the quarter, providing a stabilizing impact on costs of imported commodities.

Meanwhile, upside risks to inflation could come from the volatility in oil prices, large foreign capital inflows, petitions for electricity rate adjustments, and possible increase in food prices as they remain sensitive to supply shocks.

Demand Conditions

The latest National Income Accounts (NIA) from the NSCB showed that the domestic economy continued to expand albeit below analysts' expectations. The risks to the country's economic performance are the continuing crisis in the Euro area and possible weakening of the global inventory cycle.

According to the results of the October 2011 MISSI, the VoPI showed a decline of 6.3 percent due mainly to the decrease in production of basic metals, machinery and food manufacturing. Capacity utilization also declined slightly in October but remained high at above the 80 percent mark.

[61] BSP models use the 2000-based CPI series to forecast inflation. Re-estimation of the models using the 2006-based CPI data is ongoing, the results of which will be presented in the Q1 Inflation Report for 2012.

Meanwhile, business and consumer confidence remained favorable as indicated by the BSP-conducted surveys. Replies from business respondents showed a significant improvement in business sentiment in Q4 2011 compared to Q3 2011. Strong investment inflows as well as the country's sound macroeconomic fundamentals, sustained stream of OF remittances, implementation of government projects and brisker business in the Christmas and harvest seasons are the reasons for the respondents' optimistic outlook in Q4 2011. On the other hand, household respondents remained positive based on the Q4 2011 survey but are more optimistic on the year ahead. Households' brighter year-ahead outlook was boosted by expectations of more jobs, increased investments, increased salaries and stable prices.

Supply Conditions

The agriculture, hunting, forestry and fishing (AHFF) continued to grow in Q3 2011, registering a 1.8 percent growth, which reverses the 2.0 percent contraction recorded in the same quarter last year. The strong growth of sugarcane, palay, cassava, poultry and rubber drove the recovery of the AHFF sector.

In the international market, the Food and Agriculture Organization (FAO) revised upward its outlook on cereal production in 2011-2012 due mainly to better than expected harvests at the start of the season. Global cereal production is expected to reach 2.3 billion tonnes, which is 3.7 percent higher than its year-ago level. Total cereal utilization is likely to increase in 2011/12 as food consumption is expected to keep pace with population growth. Meanwhile, cereal inventories are also projected to increase in 2012 due mainly to the expected build-up of world rice inventories, despite the flooding in the South East Asian countries this year. Notwithstanding the bright outlook on grains production, the FAO warns that uncertainties on world food security may become more prevalent because of worsening global economic conditions.

In the energy market, oil prices dropped to US$96.45 per barrel in October from the September average of US$106.31 per barrel, after news broke out that a financial crisis could develop again. Oil prices have thus far recovered, averaging US$106.50 per barrel in Q4 2011. Looking ahead, world oil demand is expected to ease, broadly in line with the pace of global economic activity. The projected decline in global demand as well as the faster-than-expected recovery of Libya's crude oil production could pose downside risks to oil prices. Nonetheless, supply-related factors continue to present risks to oil prices. In particular, geopolitical uncertainties would continue to be a key risk factor in the global oil market given price-inelastic supply and reports of decline in OECD inventories and OPEC spare capacity.

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. 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).

Positive output gap estimate widens.

Based on the latest GDP data, preliminary estimates yielded an output gap of 1.3 percent in Q3 2011, higher than the 0.7 (revised) percent reported in the previous quarter. The expansion in the output gap emerged as growth in actual output outpaced the growth in potential output. This also suggests that as actual output continues to grow above trend, stronger domestic demand conditions could lead to inflationary pressures over the short to medium term.

Key assumptions used to generate the BSP's inflation forecasts

The BSP's baseline inflation forecasts generated from the BSP's single equation model (SEM), and the multi-equation model (MEM) are based on the following assumptions:

(a) NG fiscal deficits for 2011 to 2013, which are consistent with the DBCC-approved estimates;
(b) BSP's overnight RRP rate at 4.5 percent from October 2011 to December 2013;
(c) Dubai crude oil price assumptions, which are consistent with the futures prices of oil in the international market;
(d) Annual increase in nominal wage of 4.2 percent for 2012 and 4.1 percent for 2013 ;
(e) Real GDP growth, which is endogenously-determined in the BSP's MEM; and
(f) Foreign exchange rate, which is endogenously-determined in the BSP's MEM through the purchasing power parity and interest rate parity relationships.

Risks to the Inflation Outlook

The latest fan chart suggests that inflation will gradually decline in 2012 and then stabilize near the low end of target in 2013.

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.

The current fan chart suggests that inflation will gradually decline until the fourth quarter of 2012 and then stabilize near the lower-end of the target range in 2013. Relative to the previous Report, the latest fan chart represents a slight upward shift in the 2012 inflation and an unchanged 2013 inflation path.

The higher 2012 inflation path generated during the quarter incorporates the impact of higher-than-projected inflation outturns for October 2011 due to temporary price shocks brought by typhoon *Pedring* during the month. Moreover, the increases in electricity rates and domestic oil prices in Q4 2011 resulted to an upward adjustment in the 2012 inflation path. Despite the slight upward shift of the projected inflation path in the fan chart for 2012, average inflation for 2012 and 2013 are still expected to settle at the low-end of the medium-term target range of 4.0 percent ± 1.0 percentage point.

The balance of risks to the inflation outlook remains tilted to the downside.

The latest fan chart also shows that there are uncertainties further out as shown by the widening bands of the chart over time.

The BSP's assessment of current price trends and risks to future inflation suggests that the balance of risks to the inflation outlook remains slightly tilted to the downside. This is reflected in the latest fan chart by the wider bands below the central projection than those above it.

The downside risks to future inflation emanate from concerns over the uncertainty in the global economy and its potential impact on domestic economic activity.

- The downside risks to global economic growth continue to persist. Concerns over deficit situation in the US and Europe's debt problem have significant repercussions on the global economic environment.

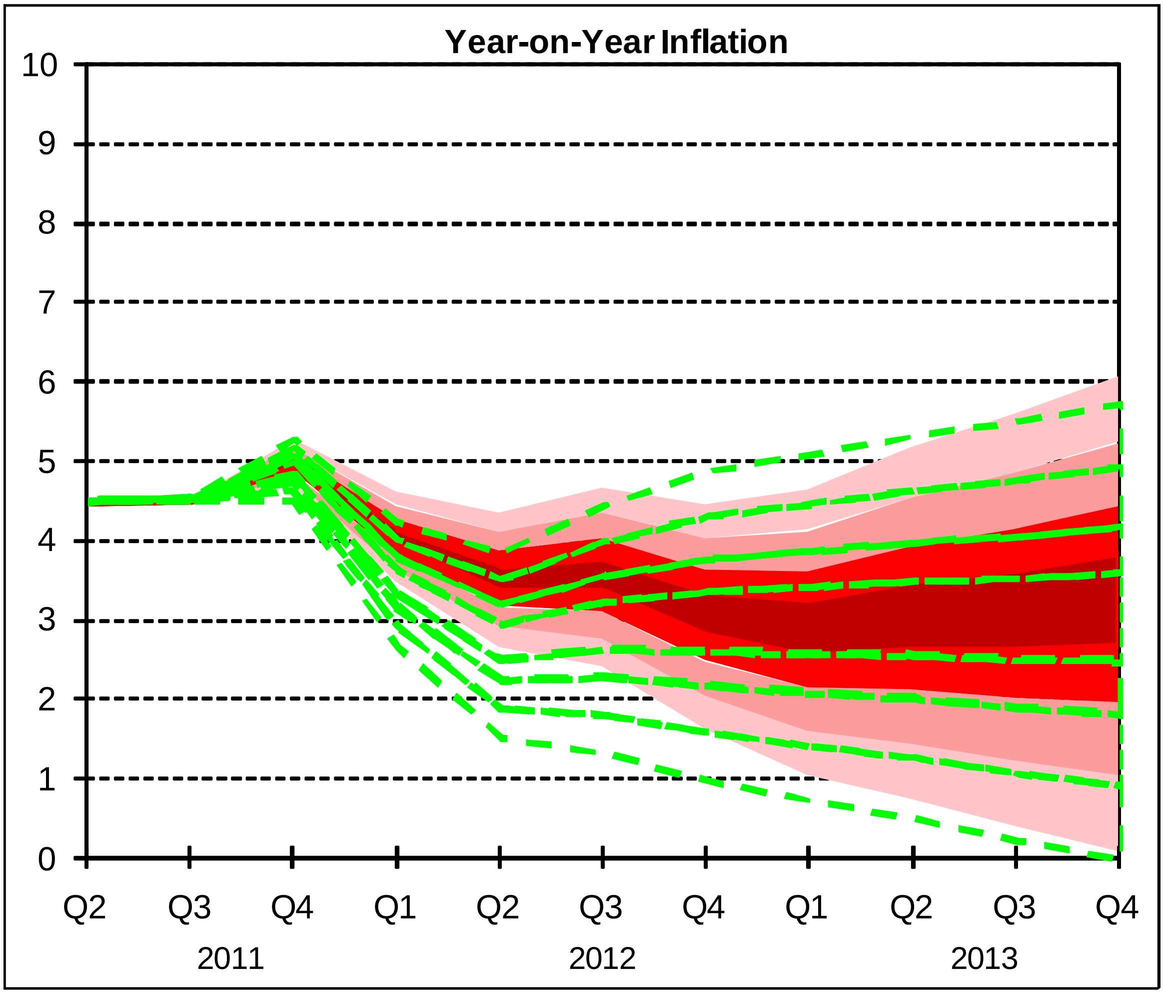
- Demand-side price pressures could weaken as developments in the external sector dampen international commodity prices and domestic economic activity. However, conditions in the oil market remains susceptible to geopolitical tensions in the major oil producing economies.

Nonetheless, upside risks to the inflation outlook remain.

Meanwhile, there are also upside risks to the inflation outlook. Additional petitions for electricity rate adjustments pose additional risks to inflation. Finally, supply shocks in key agricultural commodities due to weather-related disruptions could trigger potential spikes in food prices.

- Additional petitions for power rate adjustments for the recovery of stranded contract cost and debts, recovery of transmission line repairs resulting from typhoons and theft, an increase in the universal charges for missionary electrification, and recovery of fuel and foreign exchange costs represent additional risks to future inflation as these are not yet included in the baseline forecasts.

- Food prices remain an upside risk on inflation. Supply shocks in key agricultural commodities both in the domestic and global front are sources of uncertainty on food prices. The threat of continued weather disturbances could constrain supply and put transitory upward pressure on the prices of rice and other crops in the near-term.



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 as of Q3 2011.

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 inflation target remains comfortably achievable over the policy horizon.

The baseline inflation forecasts reflect a decelerating path, with average headline inflation rates for 2012-2013 projected to settle within the 3-5 percent inflation target. This inflation trajectory is in line with the latest BSP and private sector surveys, which reflected inflation expectations anchored towards the target over the policy horizon.

Inflation pressures are likely to remain manageable given increasingly weaker global conditions. Nevertheless, upside risks to the inflation outlook remain. The main risks are linked to sustained heavy capital inflows and the consequent rapid growth in M3 and possible increases in utility tariffs.

With inflation pressures abating, monetary policy has some scope to support domestic economic activity.

The global economic environment has become more challenging amid renewed uncertainties. Recent developments have been mixed. The US shows signs of a more solid recovery, although it remains susceptible to financial market volatilities amid the failure of Congress to settle on a long-term debt-reduction plan. In contrast, the euro area economy is notably weaker and it remained uncertain how the current situation would be resolved. With the resolution of the European sovereign debt crisis expected to be a drawn-out process, uncertainty and risk aversion are likely to weigh down on both the real sector and global financial markets. The overall balance of global economic activity appears to be tipping towards a further slowdown going forward.

External headwinds are expected to affect the domestic economy through the trade, remittance, investment, financial market, and confidence channels. So far, remittances are holding up and foreign portfolio investments continue to record net inflows. The impact on the merchandise trade sector, however, has been more pronounced, as reflected in the sharp drop in exports.

At the same time, as the global economy faces a period of weaker near-term growth prospects, domestic economic activity could weaken consequently as households and firms respond cautiously by holding back consumption and investment decisions.

The major challenge for policymakers is to head off the risks associated with the global slowdown, keeping the economy on a steady course.

While the Philippines can rely on the resilience of domestic demand to drive growth, it would still be a considerable challenge for domestic consumption to fully compensate for the fall in external demand. Given the uncertainty regarding the duration and depth of the ongoing debt crisis, supportive monetary policy settings can help to underpin and sustain domestic demand. However, an accommodative monetary policy, given benign inflation pressures, would be more effective if complemented with a fiscal stimulus package that would respond to prevailing risks to economic activity. Both monetary and fiscal policies should ensure a macroeconomic environment that will continue to broadly support consumer confidence and promote investment spending.

SUMMARY OF MONETARY POLICY DECISIONS, 2008 - 2011

2008 BSP KEY POLICY RATES

EFFECTIVITY DATE		LEVELS RRP OVERNIGHT	LEVELS RP OVERNIGHT	Monetary Policy Decision
2008	31-Jan	5.00	7.00	The 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	5.00	7.00	The MB decided to keep the BSP's key policy interest rates at 5 percent for the RRP facility and 7 percent for the 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. This will ensure that banks' loanable funds remain adequate to meet the requirements of the expanding economy.
	24-Apr	5.00	7.00	The MB maintained 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 interest rates on term RRPs and RPs were also left unchanged.
	5-Jun	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.
	17-Jul	5.75	7.75	The MB decided to raise by 50 bps the BSP's key policy interest rates to 5.75 percent for the RRP facility and 7.75 percent for the RP facility as BSP's baseline forecasts show the risk of inflation exceeding the inflation targets for 2008 and 2009. Price pressures have increased even as they are projected to ease starting late 2008. For this reason, authorities believe that more decisive monetary action is necessary.
	28-Aug	6.00	8.00	The MB increased by 25 bps the BSP's key policy interest rates to 6.0 percent for the RRP facility and 8.0 percent for the RP facility. In its assessment, the MB recognized that further measured tightening of monetary policy was necessary given the latest forecasts indicating above-target inflation for both 2008 and 2009.
	6-Oct	6.00	8.00	The MB kept the BSP's key policy interest rates unchanged at 6 percent for the RRP facility and 8 percent for the RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged.
	6-Nov	6.00	8.00	The MB decided to keep the BSP's key policy interest rates steady at 6 percent for the RRP facility and 8 percent for the RP facility. The interest rates on term RRPs, RPs, and SDAs were also left unchanged.
	18-Dec	5.50	7.50	The MB decided to reduce the BSP's key policy interest rates by 50 bps as 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.

2009-2010 BSP KEY POLICY RATES

EFFECTIVITY DATE		LEVELS		Monetary Policy Decision
		RRP OVERNIGHT	RP OVERNIGHT	
2009	29-Jan-09	5.00	7.00	The MB decided to reduce the BSP's key policy interest rates by another 50 bps. The MB based its decision on the latest inflation outlook which showed 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.
	05-Mar-09	4.75	6.75	The MB decided to reduce the BSP's key policy interest rates by 25 bps as baseline inflation forecasts continue to indicate within-target inflation in 2009 and 2010. The MB believed that the global financial strains are likely to persist and pose risks to economic activity. An accommodative monetary policy stance is expected to help ensure greater availability of credit and reinforce market confidence.
	16-Apr-09	4.50	6.50	The MB decided to reduce key policy rates by another 25 bps. In its assessment of macroeconomic conditions, the MB noted that the latest baseline inflation forecasts continue to indicate within-target inflation in 2009 and 2010. In addition, inflation expectations remain well anchored. The MB believed that the global financial strains are likely to persist and pose risks to economic activity.
	28-May-09	4.25	6.25	The MB decided to reduce the BSP's key policy interest rates by another 25 bps. 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.
	09-Jul-09	4.00	6.00	The MB decided to reduce the BSP's key policy interest rates by 25 bps. This is the sixth time since December 2008 that the BSP has cut its policy interest rates, bringing the cumulative reduction in the BSP's policy rate to 200 bps since December 2008. The MB decision was based on the latest baseline forecasts showing average inflation keeping within the target ranges for 2009 and 2010. Given prevailing downside pressures on prices and output due to the impact of weaker global economic activity on domestic demand, the reduction in policy rates will support economic activity as banks are expected to pass on the lower borrowing costs to clients.
	20-Aug-09 01-Oct-09 05-Nov-09 17-Dec-09	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 interest rates on term RRPs, RPs, and SDAs were also left unchanged.
2010	28-Jan 11-Mar 22-Apr 3-Jun 15-Jul 26-Aug 7-Oct 18-Nov 29-Dec	4.00	6.00	The Monetary Board 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.

2011 BSP KEY POLICY RATES

EFFECTIVITY DATE		LEVELS: RRP OVERNIGHT	LEVELS: RP OVERNIGHT	Monetary Policy Decision
2011	10-Feb	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 special deposit accounts (SDAs) were also left unchanged.
	24-Mar	4.25	6.25	The MB decided to increase by 25 bps the BSP's key policy interest rates. 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	4.50	6.50	The MB decided to increase by another 25 bps the BSP's key policy interest rates as 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	4.50	6.50	The MB decided to keep policy rates steady. 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	4.50	6.50	The MB maintained the BSP's key policy interest rates. 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 20-Oct 1-Dec	4.50	6.50	The MB decided to keep the BSP's key policy rates steady. At the same time, the reserve requirement ratios were kept unchanged.

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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