

ISSN 1655-5104

INFLATION REPORT

Q2 2019



BANGKO SENTRAL NG PILIPINAS

Foreword

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

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

The government's target for annual headline inflation under the inflation targeting framework has been set at 3.0 percent \pm 1.0 percentage point (ppt) for 2019-2022 by the Development Budget Coordination Committee (DBCC). This is consistent with the desired disinflation path over the medium term, favorable trends in inflation dynamics, and expected higher capacity of the economy for growth under a low inflation environment.

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

The Monetary Board approved this Inflation Report at its meeting on 11 July 2019.



BENJAMIN E. DIOKNO
Governor



The Monetary Policy of the Bangko Sentral ng Pilipinas

The BSP Mandate

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

Monetary Policy Instruments

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

Policy Target

The BSP's target for monetary policy uses the Consumer Price Index (CPI) or headline inflation rate, which is compiled and released to the public by the Philippine Statistical Authority (PSA). The policy target is set by the Development Budget Coordination Committee (DBCC)² in consultation with the BSP. The inflation target for 2018-2020 is 3.0 percent \pm 1.0 ppt.³

BSP's Explanation Clauses

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

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

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

³ The DBCC, in coordination with the BSP, through DBCC Resolution No. 2019-1 dated 26 February 2019, decided to keep the inflation target at 3.0 percent \pm 1.0 percentage point for 2019 – 2020 and to set the inflation target at 3.0 percent \pm 1.0 percentage point for 2021 – 2022.

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 (MB), which has seven members appointed by the President of the Philippines. The Monetary Board holds eight (8) monetary policy meetings in a year to review and decide on the stance of monetary policy.

Chairman & Governor

Benjamin E. Diokno

Members

Carlos G. Dominguez III

Felipe M. Medalla

Juan D. De Zuñiga, Jr.

Peter B. Favila

Antonio S. Abacan, Jr.

V. Bruce J. Tolentino

The Advisory Committee

The Advisory Committee was established as an integral part of the institutional setting for inflation targeting. It is tasked to deliberate, discuss, and make recommendations on monetary policy to the Monetary Board. Like the Monetary Board, the Committee meets eight times a year but may also meet between regular meetings, whenever deemed necessary.

Chairman

Benjamin E. Diokno

Governor

Members

Diwa C. Guinigundo

Deputy Governor

Monetary and Economics Sector

Ma. Cyd Tuaño-Amador

Deputy Governor

Corporate Services Sector

Chuchi G. Fonacier

Deputy Governor

Financial Supervision Sector

Ma. Ramona GDT Santiago

Senior Assistant Governor

Financial Market Operations Sub-Sector

Johnny Noe E. Ravalo

Assistant Governor

Office of Systemic Risk Management

Francisco G. Dakila, Jr.

Assistant Governor

Monetary Policy Sub-sector

Technical Staff

Chairman

Dennis D. Lapid

Director, Department of Economic Research

Members

Mary Jane T. Chiong

Managing Director, Office of the Governor

Lyn I. Javier

Managing Director, Financial Supervision Research and Consumer Protection Sub-sector

Veronica B. Bayangos

Director, Office of the Supervisory Policy and Research Department

Lorelei S. Fernandez

Senior Director, Financial Market Operations Sub-Sector

Redentor Paolo M. Alegre, Jr.

Director, Department of Economic Statistics

Lara Romina E. Ganapin

Acting Deputy Director, Department of Economic Research

Dennis M. Bautista

Deputy Director, Department of Economic Research

Ma. Mediatríz M. Boelsch

Assistant Chief Dealer, Financial Market Operations Sub-Sector

Thea Josefina Natalia W. Santos

Deputy Director, Financial Supervision Sub-Sector 1

Cherrie F. Ramos

Bank Officer V, Department of Economic Research

Jasmin E. Dacio

Bank Officer V, Department of Economic Research

Gabrielle Roanne L. Moral

Bank Officer V, Department of Economic Research

Eduard Joseph D. Robleza

Bank Officer V, Department of Economic Research

Jan Christopher G. Ocampo

Bank Officer V, Department of Economic Research

Marites B. Oliva

Bank Officer V, Center for Monetary and Financial Policy

Alvin Joshua P. Fama

Acting Bank Officer V, Office of Systemic Risk Management

Sol Elizah T. Roxas

Bank Officer VI, Provident Fund Office

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

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

List of Acronyms, Abbreviations, and Symbols

ADB	Asian Development Bank	NBQBs	Non-Banks with Quasi-Banking Function
AHFF	Agriculture, Hunting, Forestry and Fishing	NCR	National Capital Region
AONCR	Areas Outside the National Capital Region	NEDA	National Economic and Development Authority
BAP	Bankers Association of the Philippines	NEER	Nominal Effective Exchange Rate
BES	Business Expectations Survey	NFA	Net Foreign Asset; National Food Authority
BI	Bank of Indonesia	NG	National Government
BIR	Bureau of Internal Revenue	NGCP	National Grid Corporation of the Philippines
BNM	Bank Negara Malaysia	NIA	National Income Accounts
BOC	Bureau of Customs	NNPL	Net Non-Performing Loans
BOE	Bank of England	NPC	National Power Corporation
BOJ	Bank of Japan	NSFR	Net Stable Funding Requirement
BOT	Bank of Thailand	ODF	Overnight Deposit Facility
bp	Basis Point	OP	Office of the President
BPO	Business Process Outsourcing	OPEC	Organization of the Petroleum Exporting Countries
BTr	Bureau of the Treasury	OPR	Overnight Policy Rate
CALABARZON	Cavite, Laguna, Batangas, Rizal and Quezon	PAGASA	Philippine Atmospheric, Geophysical and Astronomical Services Administration
CAMPI	Chamber of Automotive Manufacturers of the Philippines, Inc.	PBOC	People's Bank of China
CAR	Capital Adequacy Ratio	PCE	Personal Consumption Expenditure
CBD	Central Business District	PISM	Philippine Institute for Supply Management
CDS	Credit Default Swap	PMI	Purchasing Managers' Index
CES	Consumer Expectations Survey	ppt	Percentage Point
CI	Confidence Index	PSA	Philippine Statistics Authority; Power Supply Agreement
CPI	Consumer Price Index	PSALM	Power Sector Assets and Liabilities Management
DBCC	Development Budget Coordination Committee	PSEi	Philippine Stock Exchange Composite Index
DBM	Department of Budget and Management	QBs	Quasi-Banks
DepED	Department of Education	q-o-q	Quarter-on-Quarter
DI	Diffusion Index	RBI	Reserve Bank of India
DILG	Department of Interior and Local Government	RBNZ	Reserve Bank of New Zealand
DOE	Department of Energy	RBs	Rural Banks
DOF	Department of Finance	REER	Real Effective Exchange Rate
ECB	European Central Bank	RP	Repurchase
EIA	Energy Information Administration	RR	Reserve Requirement
EMBIG	Emerging Market Bond Index Global	RREL	Residential Real Estate Loan
ERC	Energy Regulatory Commission	RREPI	Residential Real Estate Price Index
FCD	Foreign Currency Deposit	RRP	Reverse Repurchase
FDI	Foreign Direct Investment	RRR	Reserve Requirement Ratio
GDP	Gross Domestic Product	SBL	Substandard or Below Loan
GIR	Gross International Reserve	SDA	Special Deposit Account
GNI	Gross National Income	SEC	Securities and Exchange Commission
GNPL	Gross Non-Performing Loan	SLOS	Senior Bank Loan Officers' Survey
GOUR	Generation Over/Under Recovery	SLOUR	System Loss Over/Under Recovery
GS	Government Securities	SME	Small and Medium Enterprise
IEA	International Energy Agency	S&P	Standard and Poor
IMD	International Institute for Management Development	TAFPPC	True-up Adjustments of Fuel and Purchased Power Cost
IMF	International Monetary Fund	TAFxA	True-up Adjustments of Foreign Exchange Related Costs
IMTS	International Merchandise Trade Statistics	TBs	Thrift Banks
IPP	Independent Power Producer	TDF	Term Deposit Facility
JGS	JG Summit Holdings, Inc.	TLP	Total Loan Portfolio
kWh	Kilowatt Hour	TOUR	Transmission Over/Under Recovery
LEM	Loans Especially Mentioned	TPI	Trading Partner Index
LFS	Labor Force Survey	TPI-A	Trading Partner Index in Advanced Countries
LSOUR	Lifeline Subsidy Over/Under Recovery	TPI-D	Trading Partner Index in Developing Countries
MB	Monetary Board	U/KBs	Universal and Commercial Banks
mb/d	Million Barrels per Day	VaPI	Value of Production Index
MERALCO	Manila Electric Company	VoPI	Volume of Production Index
MISSI	Monthly Integrated Survey of Selected Industries	WB	World Bank
MSCI	Morgan Stanley Capital International	WEO	World Economic Outlook
MTP	Major Trading Partner	WESM	Wholesale Electricity Spot Market
		y-o-y	Year-on-Year
		y-t-d	Year-to-Date

Contents

Overview	viii
I. Inflation and Real Sector Developments	1
Prices.....	1
Private Sector Economists' Inflation Forecasts.....	2
Energy prices.	4
Aggregate Demand and Supply	5
Aggregate Demand.....	6
Other Demand Indicators.	7
Aggregate Supply.....	15
Labor Market Conditions	16
II. Monetary and Financial Market Conditions.....	18
Domestic Liquidity	18
Monetary Operations	19
Credit Conditions	19
Interest Rates.....	21
Financial Market Conditions	24
Banking System.....	26
Exchange Rate.....	28
III. Fiscal Developments.....	30
IV. External Developments	31
V. Monetary Policy Developments.....	34
VI. Inflation Outlook.....	35
BSP Inflation Forecasts.....	35
Risks to the Inflation Outlook	36
Implications for the Monetary Policy Stance.....	38
Summary of Monetary Policy Decisions	39

Overview

Headline inflation returns to mid-point of the target. Headline inflation rate fell to the midpoint of the inflation target at 3.0 percent in Q2 2019 from 3.8 percent in the previous quarter. This brought the first half average to about 3.4 percent year-on-year (y-o-y) in 2019, which is within the National Government's (NG) announced target range of 3.0 percent \pm 1.0 percentage point (ppt) for the year.

Overall inflation in Q2 2019 falls to midpoint of the target

Likewise, core inflation—which excludes selected volatile food and energy items to measure underlying price pressures—also slowed down to 3.4 percent y-o-y in Q2 2019 from 3.9 percent in Q1 2019. Meanwhile, BSP-computed alternative core inflation measures also eased in Q2 2019 relative to the previous quarter. Consistent with the downtrend in overall inflation, the number of CPI items with inflation rates higher than the threshold of 4.0 percent (the upper end of the 2018 inflation target) also fell to 65 items in Q2 2019 from 79 items in the previous quarter. Collectively, these items accounted for almost a quarter (23.5 percent) of total CPI basket, lower than the 43.3 percent share in Q1 2019.

Inflation expectations for 2019 to 2021 are lower.

Results of the BSP's survey of private sector economists in June 2019 showed lower mean inflation forecasts for 2019 to 2021 relative to the results in March 2019. In particular, the mean inflation forecast for 2019 decreased to 2.9 percent from 3.3 percent in the March 2019 survey. Similarly, the mean inflation forecasts for 2020 and 2021 declined to 3.2 percent and 3.1 percent, respectively, from 3.4 percent during the same review period.

Analysts expect inflation to remain manageable and within the government's target range, with risks to the inflation outlook likely to be broadly balanced. The key upside risks to inflation are seen to emanate from the adverse effect of weather conditions, brought about by weak El Niño condition, on domestic food supply; volatile global crude oil prices; higher domestic demand, particularly in Q4 2019 due to the Christmas season; weaker peso against the US dollar; higher government spending on infrastructure; and the

potential impact of African swine fever on local pork prices. Meanwhile, possible downside risk to inflation are base effects; the continued implementation of non-monetary policy actions to increase domestic food supply and stabilize prices, such as the rice tariffication law, rice importations, and the mitigating measures put in place by the Department of Agriculture against El Niño; and easing global crude oil prices

Real Gross Domestic Product (GDP) growth eases.

The Philippine economy grew by 5.6 percent in Q1 2019. This is lower than the 6.3-percent and 6.5-percent expansion in Q4 2018 and Q1 2018, respectively. On the expenditure side, growth in Q1 2019 was driven by household consumption (6.3 percent), investments (6.8 percent), and government spending (7.4 percent). On the production side, the services sector remained resilient at 7.0 percent in Q1 2019, lower than the 6.6-percent growth recorded in Q4 2018.

Real GDP growth is lower in Q1 2019

High-frequency real sector indicators present mixed signals. The composite Purchasing Managers' Index (PMI) in May 2019 remained above the 50-point expansion threshold at 51.5, lower than the April PMI at 53.8. This is the lowest recorded level since 2011. The overall decline of the index was due to the slower rate of expansion of all the sectors in review. The drop in PMI contrasts with the increase in the average capacity utilization rate of the manufacturing sector to 84.4 percent in May 2019, which is slightly higher than the month-ago level at 84.3 percent; the acceleration in energy sales of Meralco by 10.6 percent y-o-y in April 2019, which is faster compared to the 3.6-percent growth in the same period a year-ago; and increase in sales of new vehicles from the Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI) members by 1.1 percent y-o-y in the first two months of Q2 2019, a reversal from the 12.9-percent contraction recorded in the same period a year ago. In terms of sentiments, business outlook on the economy improved for the second quarter of 2019, with the overall confidence index (CI) of the Business Expectations Survey (BES) rising to 40.5 percent from 35.2 percent in the

previous quarter while consumer outlook was broadly steady for Q2 2019.

Economic growth experience of other countries

varied. In the US, real GDP expanded by 3.1 percent on a seasonally adjusted quarter-on-quarter (q-o-q) basis in Q1 2019, faster than the 2.2-percent growth rate in Q4 2018. Real GDP growth in the euro area rose to 0.4 percent in Q1 2019 from 0.2 percent in Q4 2018 while Japan's real GDP grew by 0.6 percent in Q1 2019 from 0.5 percent (revised) expansion in Q4 2018. In China, GDP growth was unchanged at 6.4 percent y-o-y in Q1 2019. In Southeast Asia, manufacturing output growth accelerated in Myanmar and Vietnam, but slowed down in the Philippines, Thailand, and Indonesia. Meanwhile, Malaysia and Singapore remained in the contraction territory.

The domestic financial system remained stable, supported by firm macroeconomic fundamentals.

As of 28 June 2019, the extra yield investors demanded to own Philippine sovereign debt over U.S. Treasuries or the Emerging Market Bond Index Global (EMBIG) Philippines spread stood at 79 bps from the end-March level of 90 bps. Similarly, the country's 5-year sovereign credit default swap (CDS) decreased to 47 bps from its end-March level of 59 bps. The Philippine banking system continued to lend support to the country's long-term economic growth and stable financial condition. During the second quarter of 2019, banks' balance sheets exhibited sustained growth in assets and deposits. Furthermore, asset quality indicators remained healthy while capital adequacy ratios continued to be above international standards. The peso averaged at ₱52.07/US\$1 in Q2 2019, appreciating by 0.57 percent from the previous quarter's average of ₱52.37/US\$1. Credit rating upgrade and prospects of improving macroeconomic conditions contributed to the appreciation of the peso. Preliminary results of the Q2 2019 Senior Bank Loan Officers' Survey (SLOS) showed that most of the respondent banks continued to maintain their credit standards for loans to both enterprises and households during the quarter based on the modal approach. This is the 41st consecutive quarter since Q2 2009 that the majority of respondent banks reported broadly unchanged credit standards.

The BSP eases monetary policy settings in

Q2 2019. Given easing price pressures during the second quarter, the BSP deemed it appropriate to reduce the policy rate by 25 basis points (bps) on 9 May 2019. At the same time, the Monetary Board recognized that the downtrend in domestic inflation over the past few months provided scope for a phased reduction in reserve requirements for banks and non-bank financial institutions with quasi-banking functions (NBQBs), with the initial cut taking effect on the reserve week beginning 31 May 2019.

Subsequently, at its meeting on 20 June 2019, the Monetary Board decided to maintain the BSP's monetary policy settings to allow prior monetary adjustments to work their way through the traditional channels of monetary policy. Latest baseline inflation forecasts continue to indicate a within-target trajectory in 2019 and 2020, with broadly balanced risks to the inflation outlook over the policy horizon. Inflation expectations have likewise moderated further amid declining inflation readings. Domestic growth momentum has also remained firm, supported by a projected recovery in household spending and the continued implementation of the government's infrastructure spending program.

With a manageable inflation outlook and firm prospects for domestic economic growth, a prudent pause allows the BSP to observe and assess the impact of its monetary adjustments during the second quarter. In particular, the phased reduction in reserve requirements, is expected to help temper the impact of tighter domestic liquidity conditions at the start of the year and thereby support real sector activity in the coming months. Meanwhile, increased uncertainty over global macroeconomic prospects also offer scope for the BSP to hold its policy settings steady for the time being. These developments require the BSP to remain vigilant to ensure that monetary policy settings remain in line with its price stability objective while being supportive of economic growth.

I. Inflation and Real Sector Developments

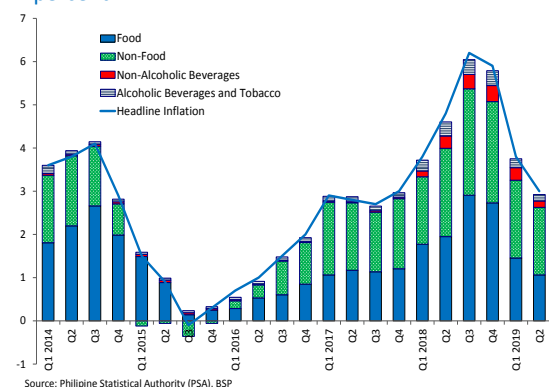
Prices

Headline inflation. Headline inflation rate fell to the midpoint of the inflation target at 3.0 percent in Q2 2019 from 3.8 percent in the previous quarter.

Overall inflation in Q2 2019 falls to midpoint of target range

This brought the first half average to about 3.4 percent y-o-y in 2019, which is within the NG’s announced target range of 3.0 percent ± 1.0 ppt for the year.

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



Core Inflation. Likewise, core inflation—which excludes selected volatile food and energy items to measure underlying price pressures—also slowed down to 3.4 percent y-o-y in Q2 2019 from 3.9 percent in Q1 2019.

Official core inflation likewise slows down in Q2 2019

Meanwhile, BSP-computed alternative core inflation measures also eased in Q2 2019 relative to the previous quarter.

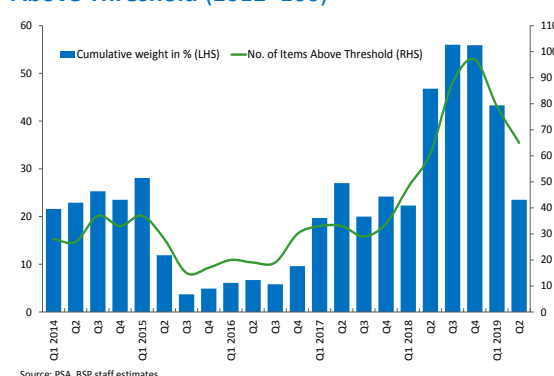
Table 1. Alternative Core Inflation Measures
quarterly averages of year-on-year change

Quarter	Official Headline Inflation	Official Core Inflation	Trimmed Mean ¹	Weighted Median ²	Net of Volatile Items ³
2014	3.6	2.6	3.3	2.8	2.8
Q1	3.6	2.8	3.0	2.4	2.4
Q2	3.8	2.6	3.4	3.0	2.6
Q3	4.1	2.7	3.6	3.2	3.0
Q4	2.9	2.1	3.1	2.6	3.0
2015	0.7	1.0	1.5	1.7	2.2
Q1	1.5	1.3	2.6	2.7	2.9
Q2	0.9	1.3	1.7	1.7	2.4
Q3	-0.1	0.8	0.9	1.3	1.8
Q4	0.3	0.8	0.9	1.2	1.8
2016	1.3	1.6	1.2	1.3	1.9
Q1	0.7	1.0	0.8	1.0	1.5
Q2	1.0	1.2	1.1	1.4	1.8
Q3	1.5	1.7	1.4	1.3	2.0
Q4	2.0	2.2	1.6	1.5	2.3
2017	2.9	2.4	2.2	1.8	2.7
Q1	2.9	2.7	2.1	1.9	2.6
Q2	2.8	2.5	2.3	1.7	2.8
Q3	2.7	2.3	2.1	1.6	2.7
Q4	3.0	2.4	2.3	1.7	2.7
2018	5.2	4.2	4.2	4.1	4.5
Q1	3.8	3.0	2.9	2.8	3.8
Q2	4.8	3.8	3.6	3.8	4.3
Q3	6.2	4.7	5.0	4.6	4.7
Q4	5.9	4.9	5.2	5.2	4.9
2019					
Q1	3.8	3.9	3.8	3.4	3.7
Q2	3.0	3.4	2.9	3.0	3.0

¹The 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.
²The 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.
³The net of volatile items method excludes the following items: bread and cereals, vegetables sugar, jam, honey, chocolate, and confectionery, electricity, gas, fuel and lubricants for personal transport equipment, and passenger transport by road, which represents 29.5 percent of all items.
 Source: PSA, BSP estimates

Consistent with the downtrend in overall inflation, the number of CPI items with inflation rates higher than the threshold of 4.0 percent (the upper end of the 2019 inflation target) also fell to 65 items in Q2 2019 from 79 items in the previous quarter.

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



Collectively, these items accounted for almost a quarter (23.5 percent) of total CPI basket, lower than the 43.3 percent share in Q1 2019.

Food Inflation. Sufficient domestic food supply conditions continued to support easing food prices in Q2 2019. Food inflation rate slowed down significantly to 3.0 percent y-o-y in Q2 2019 after exceeding the upper end of the target of 4.0 percent for five consecutive quarters.

Food inflation slows down in Q2 2019

Rice prices decreased with the summer harvest season and continued arrival of rice imports. Likewise, corn prices fell during the quarter relative to year-ago levels. Slower price increases of other large-weighted food items such as meat, fish, as well as milk, cheese, and eggs also contributed to the slowdown in food inflation. Year-on-year inflation rate for non-alcoholic beverages decelerated to 5.1 percent in Q2 2019 after posting double-digit rates in the previous three quarters. Similarly, inflation rate for alcoholic beverages and tobacco in Q2 2019 at 9.5 percent, was lower relative to quarter- and year-ago levels.

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

Commodity	2018				2019	
	Q1	Q2	Q3	Q4	Q1	Q2
Food and Non-Alcoholic Beverages	5.0	5.9	8.5	8.0	4.6	3.0
Food	5.0	5.5	8.2	7.7	4.1	3.0
Bread and Cereals	2.8	4.2	6.6	7.1	3.0	0.2
Rice	2.6	4.4	7.5	8.2	3.0	-0.8
Corn	9.7	13.7	11.3	4.9	-0.7	-3.3
Meat	6.4	5.0	7.3	6.4	4.4	3.6
Fish	12.2	11.7	12.4	12.0	6.8	3.8
Milk, Cheese and Eggs	2.1	2.1	2.7	2.9	2.6	2.5
Oils and Fats	4.0	3.2	3.8	4.8	4.1	3.1
Fruit	6.1	5.8	5.6	4.0	1.9	4.1
Vegetables	3.9	7.4	18.8	11.7	4.8	9.9
Sugar, Jam, Honey, Chocolate and Confectionery	-1.4	1.4	8.9	10.4	7.9	4.6
Food Products, N.E.C.	2.0	3.2	4.3	5.4	4.3	6.5
Non-Alcoholic Beverages	4.6	9.9	11.5	12.9	10.0	5.1
Alcoholic Beverages and Tobacco	15.9	20.5	21.7	21.7	13.0	9.5

Source of Basic Data: PSA, BSP

Non-Food Inflation. Non-food inflation also moderated in Q2 2019 to 2.6 percent y-o-y from 3.0 percent in the previous quarter. Inflation for utilities such as water supply and electricity were lower during the quarter while health-related components, namely, medical products and hospital services also posted slower y-o-y inflation rate in Q2 2019 compared to the previous quarter.

Non-food inflation also slows down

At the same time, education inflation rate remained at negative territory in Q2 2019, which still reflected the implementation of the government's free-tuition program for public tertiary education. Inflation rate for restaurants and miscellaneous goods and services also decelerated further in Q2 2019 to 3.3 percent from 3.9 percent in the previous quarter.

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

Commodity	2018				2019	
	Q1	Q2	Q3	Q4	Q1	Q2
Non-Food	2.6	3.4	4.1	3.9	3.0	2.6
Clothing and Footwear	2.0	2.2	2.4	2.6	2.4	2.4
Housing, Water, Electricity, Gas and Other Fuels	2.7	3.5	5.2	4.3	3.7	3.2
Electricity, Gas, and Other Fuels	4.3	6.2	10.6	6.8	4.9	3.0
Furnishings, Household Equipment & Routine Household Maintenance	2.4	2.9	3.5	3.8	3.7	3.2
Health	2.2	2.7	4.0	4.5	4.1	3.6
Transport	4.9	6.0	7.9	7.2	2.3	3.0
Communication	0.2	0.3	0.4	0.4	0.4	0.4
Recreation and Culture	1.4	1.4	2.1	3.2	3.1	3.1
Education	1.8	2.5	-3.8	-3.8	-3.8	-4.0
Restaurant and Miscellaneous Goods and Services	2.6	3.6	3.9	4.4	3.9	3.3

Source of Basic Data: PSA, BSP

Private Sector Economists' Inflation Forecasts.

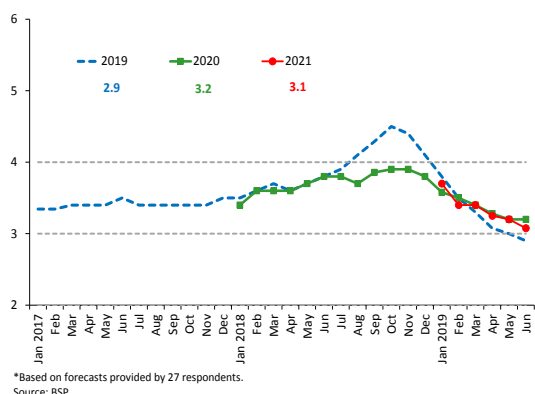
Results of the BSP's survey of private sector economists in June 2019 showed lower mean inflation forecasts for 2019 to 2021 relative to the results in March 2019.

Private sector economists' mean inflation forecasts for 2019 to 2021 are lower

In particular, the mean inflation forecast for 2019 decreased to 2.9 percent from 3.3 percent in the March 2019 survey.⁴ Similarly, the mean inflation forecasts for 2020 and 2021 declined to 3.2 percent and 3.1 percent, respectively, from 3.4 percent during the same review period.

⁴ There were 27 respondents in the BSP's survey of private sector economists in June 2019. The survey was conducted from 7 to 17 June 2019.

Chart 3. BSP Private Sector Economists' Survey*
mean forecast for full year; in percent
January 2016 to February 2018 (2006=100)
March 2018 to June 2019 (2012=100)



Analysts expect inflation to remain manageable and within the government's target range, with risks to the inflation outlook likely to be broadly balanced. The key upside risks to inflation are seen to emanate from the adverse effect of weather conditions, brought about by weak El Niño condition, on domestic food supply; volatile global crude oil prices; higher domestic demand, particularly in Q4 2019 due to the Christmas season; weaker peso against the US dollar; higher government spending on infrastructure; and the potential impact of African swine fever on local pork prices. Meanwhile, possible downside risk to inflation are base effects; the continued implementation of non-monetary policy actions to increase domestic food supply and stabilize prices, such as the rice tariffication law, rice importations, and the mitigating measures put in place by the Department of Agriculture against El Niño; and easing global crude oil prices.

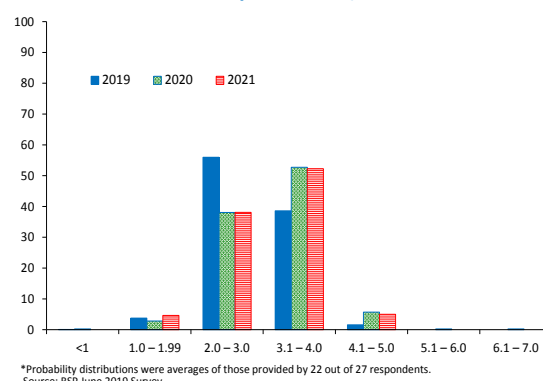
Table 4. Private Sector Forecasts for Inflation
annual percentage change; June 2019 (2012=100)

	2019			2020	2021
	Q3	Q4	FY	FY	FY
1) Al-Amanah Islamic Bank	3.20	3.50	3.50	3.50	3.50
2) Asia ING	3.00	3.30	3.20	3.10	3.00
3) Banco de Oro	3.00	3.20	3.20	3.30	3.20
4) Bangkok Bank	2.90	3.00	3.00	3.20	3.20
5) Bank of Commerce	1.89	1.77	2.63	-	-
6) Bank of China Ltd.	3.10	3.00	3.00	3.00	3.00
7) Bank of the Philippine Islands	1.90	1.70	2.70	3.40	3.00
8) Barclays	2.40	2.60	3.00	3.50	-
9) Citibank	3.00	1.40	2.80	3.00	-
10) Chinabank	3.30	3.30	3.40	3.30	3.30
11) CTBC Bank	3.50	3.50	3.50	3.50	3.50
12) Deutsche Bank	-	-	2.30	2.50	-
13) Eastwest bank	2.10	1.70	2.70	2.60	2.90
14) Global Source	2.00	1.90	2.70	3.00	3.00
15) Korea Exchange Bank	3.20	3.20	3.10	3.00	3.00
16) Land Bank of the Phils.	1.70	2.10	2.60	3.00	3.40
17) Maybank	3.30	4.00	3.80	3.30	3.50
18) Maybank-ATR KimEng	2.20	2.30	3.00	2.80	2.80
19) Metrobank	-	-	3.00	2.50 - 3.50	2.50 - 3.50
20) Mizuho	2.10	2.00	2.70	2.70	-
21) RCBC	1.60 - 1.80	1.30 - 1.80	2.40 - 2.60	3.00 - 3.50	3.50 - 4.00
22) Robinsons Bank	2.40	2.70	3.00	3.20	3.00
23) Philippine Equity Partners	2.10	2.10	2.80	3.20	-
24) Security Bank	2.30	2.30	3.00	3.00	2.00
25) Standard Chartered	3.00	1.90	2.70	4.20	4.00
26) Union Bank of the Phils.	2.90	2.80	3.20	3.00	2.80
27) UBS	1.80	1.80	2.60	3.40	-
Median Forecast	2.4	2.3	3.0	3.2	3.0
Mean Forecast	2.6	2.5	2.9	3.2	3.1
High	3.5	4.0	3.8	4.2	4.0
Low	1.7	1.4	2.3	2.5	2.0
Number of Observations	25	25	27	26	20
Government Target	3.0±1.00	3.0±1.00	3.0±1.00	3.0±1.00	3.0±1.00

Source: BSP

Based on the probability distribution of the forecasts provided by 22 out of 27 respondents, there is a 94.6-percent probability that average inflation for 2019 will settle between the 2-4 percent range. For 2020, the respondents assigned a 90.8-percent probability that inflation will fall within the 2-4 percent target range.

Chart 4. Probability Distribution for Analysts' Inflation Forecasts* (2019-2021)



*Probability distributions were averages of those provided by 22 out of 27 respondents.
Source: BSP June 2019 Survey

Survey-based inflation expectations are within target

Based on the Q2 2019 BSP Business Expectations Survey (BES), a smaller number of respondents expect inflation to decline in the current quarter (i.e., the diffusion index increased from -9.8 percent to -5.5 percent).

By contrast, more respondents anticipate higher inflation in the next quarter (i.e., the diffusion index increased from -0.8 percent to 2.7 percent). Firms generally expect the rate of increase in consumer prices to remain within but at the upper bound of the government's 2 to 4 percent inflation target range at 3.9 percent in Q2 2019 and 4 percent in Q3 2019 (from 5 percent and 4.9 percent, respectively, in the previous quarter's survey results).

Consumer Expectations Survey (CES) results for Q2 2019 indicated that consumers expect inflation to decrease over the next 12 months to an average of 4 percent from 4.7 percent in the Q1 2019 survey. Nonetheless, respondents expect inflation to stay within the government's target range of 2-4 percent in 2019. Consumers expect lower inflation for the following items: rice (3.4 percent); bread and cereals (4.8 percent); meat (4 percent); fish and seafood (5.4 percent); fruits (4.6 percent); vegetables (5.7 percent); milk, cheese, and eggs (4.4 percent); non-alcoholic beverages (4.9 percent); alcoholic beverages (6.3 percent); clothing (2.3 percent); house rent (2.6 percent); light (6.2 percent); fuel (3.6 percent); medical care (3 percent); transportation (6.5 percent); communication (1.7 percent); education (3.8 percent); personal care (4.1 percent); and restaurants and cafes (3.2 percent).

Energy prices. Dubai crude oil prices, on average, went up by 6.1 percent in Q2 2019 relative to the previous quarter's level due to concerns of tighter oil supply.

Energy prices rise in Q2 2019 amid tighter supply concerns

This was brought about by several developments including the strong compliance of the Organization of the Petroleum Exporting Countries (OPEC) and selected non-OPEC countries to their agreement to reduce supply.⁵

⁵ Based on data from the International Energy Agency (IEA), OPEC and non-OPEC compliance reached 133 percent and 169

Further contributing to the price increase during the quarter is the United States' decision in late April to not extend the waivers issued to countries importing oil from Iran as well as production disruptions in Russia from the Druzhba pipeline contamination.

Meanwhile, demand concerns remain a key downside risk to the oil price path given trade tensions between the United States and China, which escalated in the second quarter.

Estimated futures prices of Dubai crude oil as of end-June 2019,⁶ which are based on movements of Brent crude oil, showed a lower path for 2019 - 2023 compared to the estimates in the previous quarter.⁷

Chart 5. Spot and Estimated Prices of Dubai Crude Oil



In the June 2019 US Energy Information Administration (EIA) report, world oil supply is expected to reach 100.85 million barrels per day (mb/d) in 2019, which is slightly lower than the projected world oil demand of 101.14 mb/d. Meanwhile, world oil supply was revised slightly downward for 2020 to 102.82 mb/d (from 103.03 mb/d in the May report) but remains higher than the expected consumption of 102.56 mb/d.⁸

On a cumulative basis, net price adjustments of domestic petroleum products⁹ as of 26 June 2019 remained positive for the first half of 2019. Prices

percent, respectively, in May 2019. IEA Oil Market Report (June 2019) published on 14 June 2019.

<https://www.iea.org/oilmarketreport/reports/>

⁶ Future prices using Brent crude futures data. Taken as of 28 June 2019.

⁷ Future prices derived using Brent crude futures data. Taken as of 29 March 2019 Sources: BSP-staff calculations, Bloomberg L.P.

⁸ Source: US EIA Short-Term Energy Outlook (June 2019). <https://www.eia.gov/outlooks/steo/>

⁹ Based on year-to-date net adjustments reported by the Department of Energy (DOE). Source: DOE oil monitor as of 26 June 2019.

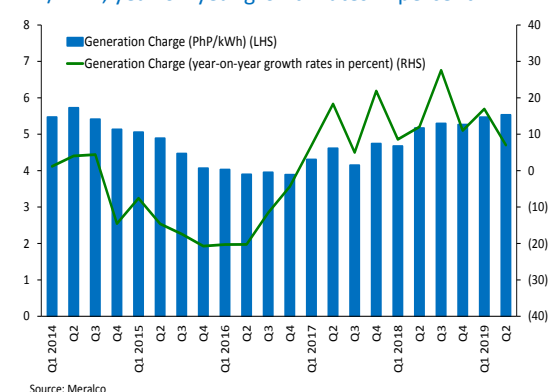
of gasoline, kerosene, and diesel went up on a net basis by ₱3.70 per liter, ₱1.10 per liter, and ₱2.75 per liter, respectively.

Power. For Q2 2019, the overall electricity rate in the Manila Electric Company (Meralco)-franchised area decreased by around ₱0.07 per kilowatt hour (kWh) to ₱10.31 per kWh (from ₱10.24 per kWh in Q1 2019).

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

The downward adjustment was attributed mainly to the average decrease in the generation cost by ₱0.07 per kWh to about ₱5.53 per kWh (from ₱5.47 per kWh in Q1 2019). In turn, the lower generation cost in Q2 2019 was primarily due to registered decreases in generation charges from Independent Power Producers (IPPs) and Power Supply Agreements (PSAs) due to strengthening of the peso against the US dollar and lower fuel prices (for coal and Malampaya natural gas) as well as from the Wholesale Electricity Spot Market (WESM) despite continued tightness of supply conditions in the Luzon grid.

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



There are potential sources of upside pressures on electricity charges. Meralco has existing petitions for rate increases with the Energy Regulatory Commission (ERC) which include the petition to implement the Maximum Average Price for 2012, 2013, 2014, and 2015, amended application for a rate increase in the January 2014 billing (consisting of incremental fuel costs and deferred generation cost to be collected monthly for six months); and petitions for the refund of generation over/under recovery (GOUR),

transmission over/under recovery (TOUR), system loss over/under recovery (SLOUR), and lifeline subsidy over/under recovery (LSOUR) for the period January-December 2011. In addition, the Power Sector Assets and Liabilities Management (PSALM) has several pending petitions with ERC for the recovery of True-Up Adjustments of Fuel and Purchased Power Costs (TAFPPC), Foreign Exchange Related Costs (TAFxA) and Purchased Power Costs and Foreign Exchange Related Costs by the National Power Corporation (NPC), and NPC's Stranded Debt portion of the universal charge. Likewise, the National Grid Corporation of the Philippines (NGCP) also filed several petitions to recover connection charges and residual sub-transmission charges for 2011-2013 and the costs of repair on damages caused by force majeure events such as earthquake, flooding, landslides, and lightning incidents in 2011-2012.

Aggregate Demand and Supply¹⁰

The Philippine economy grew by 5.6 percent in Q1 2019. This is lower than the 6.3-percent and 6.5-percent expansion in Q4 2018 and Q1 2018, respectively.

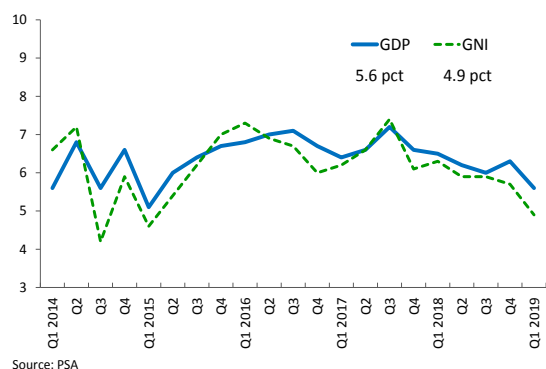
Real GDP is lower in Q1 2019

On the expenditure side, growth in Q1 2019 was driven by household consumption at 6.3 percent (from 5.3 percent in Q4 2018) and capital formation (investments) at 6.8 percent (from 4.9 percent in Q4 2018). Government spending expanded at 7.4 percent, lower than the 12.6-percent growth in Q4 2018. On the production side, the services sector remained resilient at 7.0 percent in Q1 2019, lower than the 6.6-percent growth recorded in Q4 2018. Meanwhile, the industry sector and the agriculture, hunting, forestry and fishing (AHFF) sector grew by 4.4 percent and 0.8 percent, respectively, lower than the 6.6-percent and 1.8-percent growth in Q4 2018.

¹⁰ Based on revised National Income Accounts (NIA) released as of 9 May 2019.

Gross national income (GNI) growth also moderated at 4.9 percent in Q1 2019 compared to the 5.7- and 6.3-percent growth in Q4 2018 and Q1 2018, respectively. Likewise, net primary income decelerated to 1.9 percent from the 2.7- and 4.9-percent growth in Q4 2018 and Q1 2018.

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



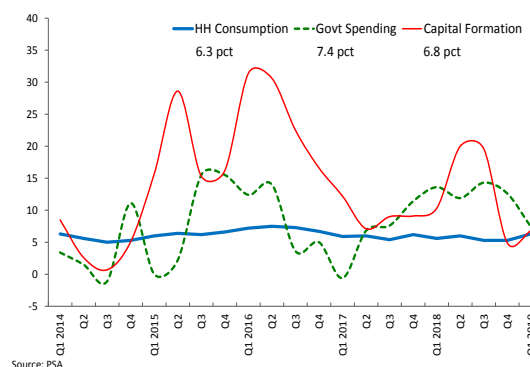
Aggregate Demand. On the expenditure side, household spending, investments (or capital formation), and government spending contributed 4.3 ppts, 2.2 ppts, and 0.8 ppts, respectively, to the total GDP growth in Q1 2019, offsetting the negative contribution of net exports at -2.6 ppt.

Household spending is key growth driver in Q1 2019

Household expenditure, which accounted for 69.5 percent of the country's total output in Q1 2019, grew by 6.3 percent, higher than the quarter- and year-ago growth of 5.3 percent and 5.6 percent, respectively. Household spending was propped up by easing inflation (at 3.8 percent in Q1 2019 from 5.9 percent in Q4 2018) and improving consumer sentiment (at -0.5 percent in Q1 2019 from -22.5 percent in Q4 2018). Higher spending on food and non-alcoholic beverages, largely due to lower food inflation, contributed to the boost in private consumption. Household expenditures on transport, housing, water, electricity, gas and other fuels, communication, restaurants and hotels, recreation and culture, health, and clothing and footwear were also higher in Q1 2019 relative to the previous quarter. However, expenditures on furnishings, household equipment and routine household maintenance,

education, miscellaneous goods and services were lower for the same period.

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



Government expenditures grew by 7.4 percent in Q1 2019, after registering double-digit growth for the past five years. The lower growth in government spending was due mainly to the delayed passage of the 2019 National Budget. Specifically, growth in government disbursements for personnel services slowed significantly to 5.6 percent in Q1 2019 from 21.5 percent and 22.6 percent in Q4 2018 and Q1 2018, respectively. The slowdown may be attributed to the postponed release of the last tranche of the Salary Standardization Law and the second tranche of adjustment for military and uniformed personnel, and the inability to hire for newly-created positions within the government. Moreover, the reenacted budget resulted in lower growth in maintenance and other operating expenditures due to the lag in the implementation of programs and projects.

Capital formation accelerated to 6.8 percent in Q1 2019 from 4.9 percent in Q4 2018. The higher growth may be traced to higher investments in durable equipment (5.7 percent) and positive changes in inventories (32.3 percent). Public construction contracted by 8.6 percent in Q1 2019 from an 11.8-percent expansion in Q4 2018. Government operation on a reenacted budget has affected several capital outlay projects, such as the Department of Interior and Local Government's (DILG) construction of police stations and purchase of new equipment and the Department of Education's (DepED) repair and rehabilitation of schoolbuildings. Slower growth was also observed in private construction, intellectual property products, and breeding stock and orchard development.

Table 5. Gross Domestic Product by Expenditure Shares
at constant 2000 prices; growth rate in percent

BY EXPENDITURE ITEM	2018				2019
	Q1	Q2	Q3	Q4	Q1
Household Consumption	5.6	6.0	5.3	5.3	6.3
Government Consumption	13.6	11.9	14.3	12.6	7.4
Capital Formation	10.3	20.0	19.6	4.9	6.8
Fixed Capital Formation	8.2	19.3	16.6	8.5	5.7
Exports	10.3	14.7	14.2	14.4	5.8
Imports	11.3	21.0	19.1	12.4	8.3

Source: PSA

Overall exports decelerated to 5.8 percent in Q1 2019 from 14.4 percent in Q4 2018. The 6.1-percent decline in exports of goods was due to the continued slowdown in semiconductor sales, following the weaker performance of the global semiconductor industry amid the US-China trade dispute. Moreover, agricultural exports weakened due to the sluggish sales of bananas (particularly to China, Japan and South Korea), coconut products, copra oil cake or meal, mangoes and pineapple. Likewise, exports of services decelerated to 4.9 percent in Q1 2019 (from 7.4 percent in Q4 2018) as the bulk of exports in miscellaneous services reported lower growth of 1.4 percent (from 7.2 percent in Q4 2018). Exports in insurance services continued to decline for the fourth consecutive quarter at -5.5 percent. However, exports in travel services recorded a double-digit growth of 15.7 percent in Q1 2019 (from 5.5 percent in Q4 2018) with the influx of foreign tourists in the country.

In the same manner, overall imports decelerated to 8.3 percent in Q1 2019 from 12.4 percent in Q4 2018. The 8.6-percent decline in the imports of goods in Q1 2019 (from 12.8 percent in Q4 2018) may be traced to the lower growth of electronics and cereals, which offset the higher growth of transport equipment. Likewise, imports of services recorded a 6.8-percent growth (from 10.8 percent in Q4 2018) due to the slowdown in imports of travel and transportation services.

Other Demand Indicators. High-frequency real sector indicators present mixed signals. The composite Purchasing Managers' Index (PMI) in May 2019 remained above the 50-point expansion threshold at 51.5, albeit lower than the April PMI at 53.8. This is the lowest recorded level since 2011. The overall decline of the index was due to the slower rate of expansion of all the sectors in review. However, the average capacity utilization rate of the manufacturing sector stood at 84.4 percent in May 2019, slightly higher than the month-ago level at 84.3 percent. In addition,

energy sales of Meralco increased by 10.6 percent y-o-y in April 2019, faster compared to the 3.6-percent growth in the same period a year-ago while sales of new vehicles from CAMPI members increased by 1.1 percent y-o-y in the first two months of Q2 2019, a reversal from the 12.9-percent contraction recorded in the same period a year ago. Business outlook on the economy improved for the second quarter of 2019, with the overall confidence index (CI) of the Business Expectations Survey (BES) rising to 40.5 percent from 35.2 percent in the previous quarter while consumer outlook was broadly steady for Q2 2019.

Property Prices

Capital Values. Capital values¹¹ for Grade A office buildings in Makati CBD in Q1 2019 were higher in nominal terms than their quarter- and year-ago levels.

Capital values for office and residential buildings increase

Grade A office capital values in Makati CBD rose to ₱229,250/sq.m., higher by 2.9 percent and 12.3 percent compared to the quarter- and year-ago levels, respectively. Grade A office capital values exceeded the 1997 levels in nominal terms. In real terms, office capital values were higher by 13.0 percent than the comparable levels in 1997.

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



Source: Colliers International Philippines

¹¹ Probable price that the property would have fetched if sold on the date of the valuation. The valuation includes imputed land and building value.

Likewise, capital values for luxury residential buildings¹² in Makati CBD in Q1 2019 increased to ₱244,850/sq.m. from their quarter- and year-ago levels. Average prices for three-bedroom luxury residential condominium units in Makati CBD grew by 6.5 percent quarter-on-quarter and 19.4 percent year-on-year. Capital values for luxury residential buildings in nominal terms were more than twice the 1997 levels. In real terms, residential capital values were about 98.4 percent of the comparable levels in 1997.

Rental Values. Monthly Grade A office¹³ rents in the Makati CBD reached ₱1,110/sq.m. in Q1 2019, an increase of 2.3 percent from the previous quarter. Similarly, monthly Grade A office rents in Makati CBD were higher by 7.8 percent relative to Q1 2018.

Office rental values above 1997 levels in nominal terms

The appreciation in office rental rates was due to the sustained demand from business process outsourcing (BPO) and offshore gaming firms. Office rental values for Grade A offices were above their 1997 levels in nominal terms. In real terms, office rental values were about 58.6 percent of the comparable levels in 1997.

Monthly rent for luxury three-bedroom condominium units in the Makati CBD was recorded at ₱830/sq.m. in Q1 2019, a slight increase of 0.6 percent from the previous quarter.

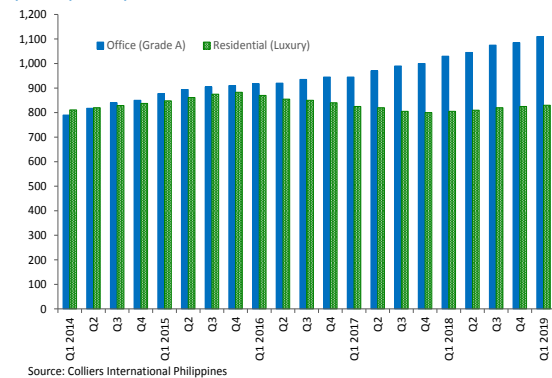
Luxury rental values rise

Likewise, monthly rents for the 3-bedroom segment in Makati CBD were higher by 3.1 percent compared to the year-ago levels.

¹² In terms of location, luxury residential units are located within the CBD core and have quality access to/from and have superior visibility from the main avenue. Meanwhile, in terms of general finish, luxury residential units have premium presentation and maintenance.

¹³ Grade A office refers to office units that are located within the CBD but not in the core area and have quality access to and from the secondary or main avenues. Meanwhile, in terms of general finish, Grade A office buildings have high quality presentation and maintenance.

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



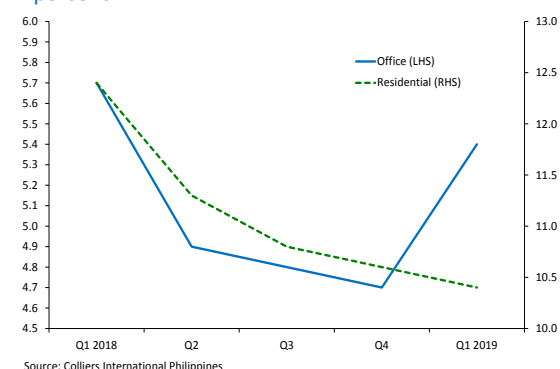
The increase in rents in Makati CBD in Q1 2019 could be attributed to the strong take-up of newly-completed condominium units. Residential rental values for luxury three-bedroom high-rise units were above their 1997 levels in nominal terms, but were only about 60.4 percent of their 1997 levels in real terms.

Vacancy Rates. The overall office vacancy rate in Metro Manila increased to 5.4 percent in Q1 2019 from 4.7 percent in the Q4 2018 due to the completion of additional office spaces and the transfer of firms to newer office buildings.

Office vacancy rates increase

Office vacancy rates in Makati CBD (1.2 percent from 2.1 percent), Ortigas Center (1.9 percent from 2.7 percent), and Manila Bay Area (0.5 percent from 0.7 percent) decreased in Q1 2019 compared to the previous quarter. Meanwhile, the office vacancy rate in Fort Bonifacio in Q1 2019 was higher at 6.3 percent from 4.5 percent in Q4 2018. The overall office vacancy rate in Metro Manila is projected to rise at about 6.0 percent in 2019 amid projected additional supply and property stakeholders' risk averse appetite before the 2022 national elections. Colliers International Philippines noted that an active office leasing market would temper the increase in vacancy rates.

Chart 11. Vacancy Rates (Metro Manila)
in percent



Meanwhile, the overall residential vacancy rate in Metro Manila declined to 10.4 percent in Q1 2019 from 10.6 percent in Q4 2018 due to the strong take-up of newly completed condominium units especially in the established business districts. In particular, residential vacancy rates across all major CBDs in Metro Manila were lower in Q1 2019 from their respective quarter-ago levels, namely: Makati CBD (10.6 percent from 10.8 percent), Fort Bonifacio (14.4 percent from 14.6 percent), Rockwell Center (9.5 percent from 9.7 percent), Ortigas Center (4.6 percent from 4.8 percent), Eastwood City (4.1 percent from 4.3 percent), and Manila Bay area (11.9 percent from 12.1 percent). Colliers foresees residential vacancy rate to marginally increase to 10.5 percent in 2019 due to the delivery of new residential units.

BSP Residential Real Estate Price Index (RREPI).¹⁴

Residential real estate prices rose by 3.1 percent y-o-y in Q1 2019 as the RREPI increased to 119.9 from 116.3 for the same quarter a year ago.

Residential real estate prices rise in Q1 2019

Y-o-y prices of townhouses and condominium units grew by 10.9 percent and 9.6 percent, respectively. Meanwhile, prices of single detached

¹⁴ The RREPI measures the average changes in prices of different types of housing units over a period of time across different geographical regions where the growth rate of the index measures house inflation. It is computed as a weighted chain-linked index based on the average appraised value per square meter weighted by the share of floor area of new housing units.

housing units and duplex units¹⁵ declined by 1.7 percent and 8.0 percent, respectively, compared to year-ago levels. Quarter-on-quarter, the RREPI went up by 1.6 percent in Q1 2019, a further increase from the 1.3-percent q-o-q expansion posted in Q4 2018.

Table 6. Residential Real Estate Price Index By Housing Type
Q1 2014=100; growth rate in percent

Quarter	Residential Real Estate Price Index ¹ (By Housing Type)				
	Overall ²	Single Detached/Attached	Duplex ³	Townhouse	Condominium Unit
2016 Q1	106.9	98.9	114.7	107.3	123.2
Q2	111.7	105.8	98.5	109.3	123.9
Q3	109.6	102.6	96.7	100.5	126.4
Q4	111.1	104.9	87.5	107.7	125.5
2017 Q1	113.9	108.0	91.2	107.6	128.3
Q2	111.8	103.6	103.6	112.7	129.3
Q3	111.6	103.4	88.4	107.8	131.0
Q4	117.4	104.6	102.6	116.4	143.3
2018 Q1	116.3	107.4	131.5	122.4	130.9
Q2	117.2	104.4	99.0	127.7	141.1
Q3	116.5	103.6	115.5	127.5	138.6
Q4	118.0	102.6	98.8	129.7	144.2
2019 Q1	119.9	105.6	121.0	134.2	145.2
Year-on-Year Growth Rates					
2016 Q1	1.3	-0.9	10.4	4.0	8.7
Q2	5.9	8.1	0.6	12.9	3.3
Q3	3.8	5.4	-5.1	2.9	3.5
Q4	3.3	4.3	-12.3	6.4	3.6
2017 Q1	6.5	9.2	-20.5	0.3	4.1
Q2	0.1	-2.1	5.2	3.1	4.4
Q3	1.8	0.8	-8.6	7.3	3.6
Q4	5.7	-0.3	17.3	8.1	14.2
2018 Q1	2.1	-0.6	44.2	13.8	2.0
Q2	4.8	0.8	-4.4	13.3	9.1
Q3	4.4	0.2	30.7	18.3	5.8
Q4	0.5	-1.9	-3.7	11.4	0.6
2019 Q1	3.1	-1.7	-8.0	9.6	10.9
Quarter-on-Quarter Growth Rates					
2016 Q1	-0.7	-1.7	14.9	6.0	1.7
Q2	4.5	7.0	-14.1	1.9	0.6
Q3	-1.9	-3.0	-1.8	-8.1	2.0
Q4	1.4	2.2	-9.5	7.2	-0.7
2017 Q1	2.5	3.0	4.2	-0.1	2.2
Q2	-1.8	-4.1	13.6	4.7	0.8
Q3	-0.2	-0.2	-14.7	-4.3	1.3
Q4	5.2	1.2	16.1	8.0	9.4
2018 Q1	-0.9	2.7	28.2	5.2	-8.7
Q2	0.8	-2.8	-24.7	4.3	7.8
Q3	-0.6	-0.8	16.7	-0.2	-1.8
Q4	1.3	-1.0	-14.5	1.7	4.0
2019 Q1	1.6	2.9	22.5	3.5	0.7

¹ Based on bank reports on residential real estate loans granted per BSP Circular No. 892 dated 16 November 2015.
² No index generated for apartments due to very few observations.
³ Indices for duplex exhibit more volatility due to relatively small number of reported real estate loans.
Source: BSP

The average residential property prices increased in both National Capital Region (NCR) and the Areas Outside the NCR (AONCR) by 8.7 percent and 0.4 percent y-o-y, respectively. In NCR, the rise in prices of single detached houses, townhouses, and condominium units more than offset the decline in prices of duplexes. In AONCR, all types of housing units registered price increases, except for single detached houses.

¹⁵ Duplex units account for only 0.5 percent of total new housing units reported during the quarter.

Residential property prices rise in the NCR and AONCR

For Q1 2019, about 74 percent of residential real estate loans (RREs) were for the acquisition of new housing units. By type of housing unit, 46.2 percent of residential property loans were for the purchase of single detached units, followed by condominium units (44.5 percent), and townhouses (8.6 percent).

Table 7. Residential Real Estate Price Index By Area

Q1 2014=100; growth rate in percent

Quarter	Residential Real Estate Price Index ¹ (By Area)		
	Overall	NCR	AONCR
2016 Q1	106.9	113.4	103.3
Q2	111.7	116.1	109.3
Q3	109.6	115.7	106.2
Q4	111.1	117.3	107.9
2017 Q1	113.9	118.4	111.6
Q2	111.8	120.4	107.5
Q3	111.6	118.2	108.1
Q4	117.4	127.6	111.1
2018 Q1	116.3	121.6	112.6
Q2	117.2	126.5	111.9
Q3	116.5	126.2	110.5
Q4	118.0	129.6	110.2
2019 Q1	119.9	132.2	113.1
Year-on-Year Growth Rates			
2016 Q1	1.3	3.5	1.8
Q2	5.9	1.9	9.6
Q3	3.8	0.2	6.9
Q4	3.3	0.6	6.0
2017 Q1	6.5	4.4	8.0
Q2	0.1	3.7	-1.6
Q3	1.8	2.2	1.8
Q4	5.7	8.8	3.0
2018 Q1	2.1	2.7	0.9
Q2	4.8	5.1	4.1
Q3	4.4	6.8	2.2
Q4	0.5	1.6	-0.8
2019 Q1	3.1	8.7	0.4
Quarter-on-Quarter Growth Rates			
2016 Q1	-0.7	-2.7	1.5
Q2	4.5	2.4	5.8
Q3	-1.9	-0.3	-2.8
Q4	1.4	1.4	1.6
2017 Q1	2.5	0.9	3.4
Q2	-1.8	1.7	-3.7
Q3	-0.2	-1.8	0.6
Q4	5.2	8.0	2.8
2018 Q1	-0.9	-4.7	1.4
Q2	0.8	4.0	-0.6
Q3	-0.6	-0.2	-1.3
Q4	1.3	2.7	-0.3
2019 Q1	1.6	2.0	2.6

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

Source: BSP

By area, most of the RREs granted in the NCR were for the purchase of condominium units, while RREs granted in AONCR were for single detached houses. By region, NCR accounted for

42.5 percent of the total number of RREs granted during the quarter, followed by CALABARZON (28.5 percent), Central Luzon (9.1 percent), Central Visayas (6.5 percent), Western Visayas (4.4 percent), Davao Region (2.6 percent), and Northern Mindanao (2.0 percent). Together, NCR and the six other regions accounted for 95.6 percent of total housing loans granted by banks.

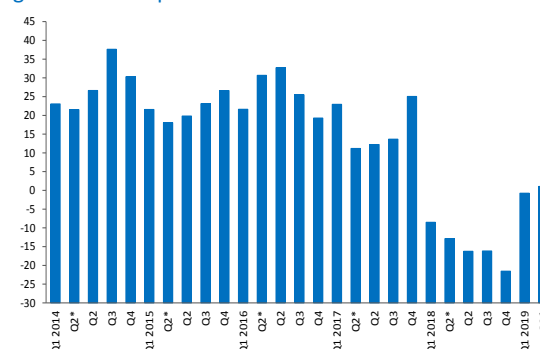
Vehicle Sales. Sales of new vehicles from CAMPI¹⁶ members increased by 1.1 percent y-o-y in the first two months of Q2 2019, a reversal from the 12.9-percent contraction recorded in the same period a year ago, due mainly to higher sales of commercial vehicles during the period.

Sales of new vehicles increase

Sales of passenger cars declined by 13.4 percent y-o-y in April-May 2019, a further drop from the 10.4-percent reduction in the same period in 2018. New passenger car sales accrued to a total of 16,714 in the first two months of Q2 2019 units from 19,311 units in the same period a year ago.

Chart 10. Vehicle Sales

growth rate in percent



* April - May

Source: Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI)

¹⁶ Vehicle sales data is gathered on a monthly basis by the Chamber of Automotive Manufacturers of the Philippines (CAMPI). CAMPI represents the local assemblers and manufacturers of vehicle units in the Philippine automotive industry. The following are the active members of CAMPI: (1) Asian Carmakers Corp., (2) CATS Motors, Inc., (3) Columbian Autocar Corp., (4) Honda Cars Philippines, Inc., (5) Isuzu Philippines Corp., (6) Mitsubishi Motors Philippines Corp., (7) Nissan Motor Philippines Corp., (8) Suzuki Philippines Inc., (9) Toyota Motor Philippines Corp. and (10) Universal Motors Corp.

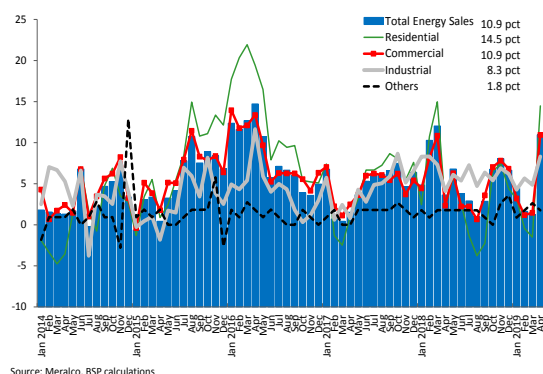
By contrast, commercial vehicle sales, which account for about 70.6 percent of total vehicle sales, rose by 8.6 percent y-o-y in the first two months of Q2 2019 from the 14.1-percent decline in the same period of 2018. Commercial vehicles sold during the period reached 40,083 units from 36,892 units in April-May 2018.

Energy Sales. Energy sales of Meralco increased by 10.6 percent y-o-y in April 2019, faster compared to the 3.6-percent growth in the same period a year-ago.

Energy sales accelerate

Energy sales from the residential sector, commercial sector, and industrial sector increased by 14.5 percent, 10.9 percent, and 8.3 percent, respectively.

Chart 11. Energy Sales
year-on-year growth in percent



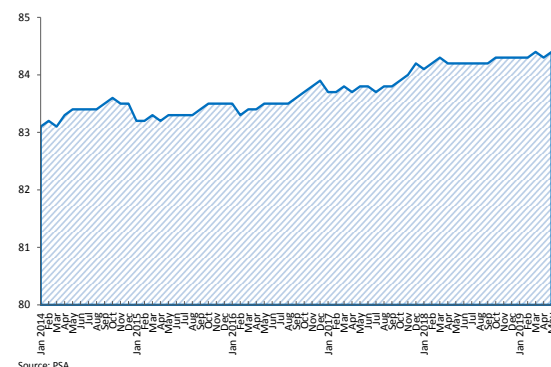
Capacity Utilization. The average capacity utilization rate of the manufacturing sector stood at 84.4 percent in May 2019, slightly higher than the month-ago level at 84.3 percent based on the Philippine Statistics Authority's Monthly Integrated Survey of Selected Industries (MISSI).

Capacity utilization in manufacturing remains above 80 percent

Of the 683 respondent-establishments, 60.1 percent of which operated at least at 80.0 percent capacity in May 2019. Data showed that most of the manufacturing companies have

been operating above the 80.0 percent capacity since 2010.

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



More than half of the 20 major industries in the sector operated above the 80.0 percent capacity level that include: petroleum products (89.5 percent); basic metals (88.8 percent); non-metallic mineral products (86.4 percent); machinery except electrical (86.4 percent); food manufacturing (85.3 percent); chemical products (85.2 percent); electrical machinery (85.1 percent); paper and paper products (83.9 percent); rubber and plastic products (83.3 percent); wood and wood products (82 percent); and textiles (80.4 percent).

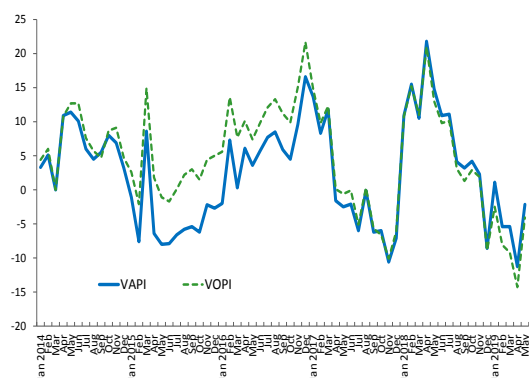
Volume and Value of Production. Preliminary results of the MISSI showed that volume of production index (VoPI) contracted by 4 percent year-on-year in May 2019, an improvement from the 14.3-percent (revised) decline in the previous month. Of the 20 major industries, only six posted contractions namely, food manufacturing (-14 percent), furniture and fixtures (-35 percent), basic metals (-5.9 percent), non-metallic mineral products (-7.1 percent), miscellaneous manufactures (-8.5 percent), and leather products (-6.4 percent).

Manufacturing output declines

Factory output – as measured by the VoPI – declined due mainly to lower production of food and selected export-oriented products. NEDA recognized the positive development of the manufacturing sector and noted that a stronger push for policies and programs that would improve food production and public spending is

needed to help boost the sector's growth. Declines in the domestic prices of rice and oil, as well as the downward adjustment in electricity rates, are expected to keep inflation at manageable level, which should bode well with producers of manufactured goods. According to NEDA, the growth of food manufacturing is also important as it accounts for the largest share among the manufacturing sub-sectors. At the same time, the enactment of Republic Act No. 11032 or the Ease of Doing Business and Efficient Government Service Delivery Act of 2018 would help improve the efficiency of local government units in processing business applications, among others.

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



Source: PSA

Likewise, the value of production index (VaPI) posted a 2.1-percent slump in May, better than the 11.3-percent contraction a month-ago. This was attributed to the following sub-sectors: food manufacturing (-17.7 percent), basic metals (-13.5 percent), miscellaneous manufactures (-15.6 percent), leather products (-18.3 percent), textiles (-2.0 percent), furniture and fixtures (-3.9 percent), and chemical products (-0.4 percent).

Business Expectations. Business outlook on the economy improved for the second quarter of 2019, with the overall confidence index (CI)¹⁷ of the BES¹⁸ rising to 40.5 percent from 35.2 percent

¹⁷ The CI is computed as the percentage of firms that answered in the affirmative less the percentage of firms that answered in the negative with respect to their views on a given indicator. A positive CI indicates an optimistic outlook while a negative CI indicates a pessimistic outlook.

¹⁸ The BES is a quarterly survey of a random sample drawn from the combined list of firms from the Securities and Exchange Commission's (SEC) Top 7,000 Corporations in 2010 and BusinessWorld's Top 1,000 Corporations in 2017. The Q2 2019 BES was conducted during the period 1 April - 28 May 2019.

in the previous quarter. This means that the number of optimists increased and continued to be greater than the number of pessimists during the quarter.

Business outlook improves in Q2 2019

Respondents attributed their more upbeat sentiment during Q2 2019 to the following factors: (a) usual uptick in demand during summer (e.g., foreseen increase in the number of local and foreign tourists), enrollment, and harvest periods; (b) election-related spending in the run up to the May 2019 elections; (c) sustained increase in orders and projects (e.g., alcoholic beverages, automotive parts, business process outsourcing, and computer equipment and supplies) leading to higher volume of production; (d) expansion of businesses and new product lines; and (e) continued roll-out of government infrastructure and development projects with the approval of the 2019 national budget in April 2019. They were also optimistic that their business operations would benefit from the favorable macroeconomic conditions in the country, particularly the easing of inflation in 2019.

The sentiment of businesses in the Philippines mirrored the more positive business outlook in Canada, France, Greece, Hungary, Israel, and South Korea. However, business sentiments in Brazil, Chile, Euro Area, the Netherlands, and the United States were less buoyant.

Table 8. Business Expectations Survey

BUSINESS OUTLOOK INDEX	Current Quarter	Next Quarter
2016 Q1	41.9	49.6
Q2	48.7	45.3
Q3	45.4	56.8
Q4	39.8	34.5
2017 Q1	39.4	47.2
Q2	43.0	42.7
Q3	37.9	51.3
Q4	43.3	39.7
2018 Q1	39.5	47.8
Q2	39.3	40.4
Q3	30.1	42.6
Q4	27.2	29.4
2019 Q1	35.2	52.0
Q2	40.5	47.6

Source: BSP

For the quarter ahead (Q3 2019), business outlook was less positive as the CI declined to 47.6 percent from 52.0 percent in the previous quarter. Business optimism was dampened on the back of expectations of interruptions of business activities during the rainy season and stiffer competition.

Consumer Expectations. Consumer outlook was broadly steady for Q2 2019 as the overall confidence index (CI)¹⁹ of the Consumer Expectations Survey (CES)²⁰ remained negative, but showed a marginal decline to -1.3 percent from -0.5 percent in Q1 2019. This indicates that the pessimists continued to outnumber the optimists, but the margin, while increasing slightly, remained narrow from the previous quarter.

Consumer confidence is broadly steady in Q2 2019

The slightly weakened consumer outlook for Q2 2019 was attributed to expectations of higher prices of goods and household expenses. Consumers cited that concerns on poor health and high medical expenses as well as the water crisis may have also contributed to their pessimistic sentiment. Their negative sentiments were, however, counterbalanced by the following expectations: (a) improvement in peace and order; (b) additional income; (c) availability of more jobs; (d) good governance; and (e) additional working family members.

¹⁹ The CI is computed as the percentage of households that answered in the affirmative less the percentage of households that answered in the negative with respect to their views on a given indicator. A positive CI indicates an optimistic outlook while a negative CI indicates a pessimistic outlook.

²⁰ The CES is a quarterly survey of a random sample of around 5,000 households in the Philippines. The Q2 2019 CES was conducted during the period 1 - 13 April 2019.

Table 9. Consumer Expectations Survey

CONSUMER OUTLOOK INDEX		Current Quarter	Next 3 Months	Next 12 Months
2016	Q1	-5.7	9.1	25.4
	Q2	-6.4	5.6	26.6
	Q3	2.5	27.3	43.8
	Q4	9.2	18.8	33.4
2017	Q1	8.7	16.5	31.7
	Q2	13.1	13.6	34.3
	Q3	10.2	17.8	33.7
	Q4	9.5	17.5	32.0
2018	Q1	1.7	8.8	24.0
	Q2	3.8	8.7	23.1
	Q3	-7.1	3.8	13.0
	Q4	-22.5	-0.8	10.7
2019	Q1	-0.5	10.7	28.4
	Q2	-1.3	9.7	25.2

Source: BSP

The sentiment of consumers in the Philippines for the second quarter of 2019 mirrored the unchanged confidence of those in France, Germany, the United Kingdom, and the Netherlands. Meanwhile, consumers in Euro Area, Japan, Switzerland, and Thailand registered more pessimistic sentiment, while those in Australia, Indonesia, South Korea, and the United States reported more favorable views.

For the next quarter (Q3 2019) and the year ahead, consumers felt less optimistic as the CIs declined, but remained positive at 9.7 percent (from 10.7 percent a quarter ago) and 25.2 percent (from 28.4 percent in the previous quarter's survey results), respectively.

Furthermore, the consumer outlook was less upbeat for the next quarter and the year ahead due mainly to concerns on higher prices of goods as well as expectations on the increase in household and educational expenses with the start of the school opening for the school year 2019-2020.

Purchasing Managers' Index.²¹ The composite PMI in May 2019 remained above the 50-point expansion threshold²² at 51.5, albeit lower than the April PMI at 53.8. This is the lowest recorded level since 2011. The overall decline of the index was due to the slower rate of expansion of all the sectors in review.

PMI remains firmly above the 50-point expansion threshold

Chart 14. Purchasing Managers' Index



Source: Philippine Institute of Supply Management (PISM)

The manufacturing PMI decreased by 2.0 index points to 50.6 in May 2019 from 52.6 in March brought about by slowdown in business activities amid the election ban on government projects and delayed budget approval. The sector's continued deceleration was evident in the lower PMIs of all the indices in review, except the Supplier Deliveries Index, with the Production Index and Employment Index posting the largest fall. Detailed reports on inventories suggest that the sector's lackluster performance was due to delays in the delivery of raw materials and work-in-process output. By export category, firms with export volume of up to 25 percent of their total revenues posted faster expansion during the month, which was offset by the slowdown of non-exporting firms and those with export volume of at least 26 percent of total revenues. On a per sector basis, five subsectors grew at a faster pace namely paper (64.8), basic metals (54.3), fabricated metals (54.8), communication and medical equipment (55.8), and motor

²¹ Data based on the monthly purchasing managers' index report of the Philippine Institute for Supply Management (PISM).

²² The actual formula used to calculate the PMI assigns weights to each common element and then multiplies them by 1.0 for improvement, 0.5 for no change, and 0 for deterioration. As a result, an index above 50 indicates economic expansion, and an index below 50 implies a contraction. PMI surveys are conducted on the last week of the month.

vehicles (51). Fuel, rubber and plastic, and food and beverages decelerated, while the following posted a contraction: publishing, non-metallic minerals, and machinery. Prospects are less favorable for the manufacturing sector in the month ahead.

Similarly, the services PMI declined by 2.4 index points to 52 from 54.5 due mainly to weaker demand. This is contrary to business managers' expectations of an acceleration for the month. All the variables in review, except for Employment Index, went down led by the significant drop of the Outstanding Business Index to 51.2 from 55.7. On a per sector basis, five of the 12 subsectors expanded faster in May (construction; renting of goods and equipment; postal and telecommunications; electricity, gas, and water; and miscellaneous business activities). Four subsectors expanded at a slower rate (education; transportation, including travel agency; real estate; and banking and financial intermediation), while the other three subsectors posted contraction (health and social work, hotels and restaurants, and business and knowledge processing). Survey respondents expect the sector to slowdown further in June 2019.

The retail and wholesale PMI also went down by 1.9 index points to 50.7 in May 2019 from 52.6 in the previous month, which is consistent with managers' expectations of a deceleration. The significant drop of the Sales Revenue Index, Employment Index, and Inventories Index more than offset the increase in the PMIs of the Purchases Index and Supplier Deliveries Index. Meanwhile, the PMI of the retail subsector declined by 4.1 index point to 50.8 in May 2019 from 54.8 in April. By contrast, the PMI of the wholesale subsector increased by 3.3 index points to 53.1 in May from 49.8 in the previous month. Managers are anticipating a turnaround next month.

External Demand²³

Exports. Exports of goods fell by 3.2 percent y-o-y in Q1 2019, lower than the 1.2-percent contraction in Q4 2018 and the 1.1-percent expansion in Q1 2018.

Exports of goods decrease

²³ International Merchandise Trade Statistics (IMTS) concept

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

Table 10. Exports of Goods
growth rate in percent

COMMODITY GROUP	2018		2019
	Q1	Q4	Q1
Coconut Products	-26.2	-15.4	-34.7
Sugar and Products	26.0	-97.1	-55.1
Fruits and Vegetables	6.2	37.9	42.9
Other Agro-Based Products	8.4	-11.9	-7.3
Forest Products	111.9	3.9	55.2
Mineral Products	28.4	-29.0	4.9
Petroleum Products	30.8	-14.6	-26.7
Manufactures	0.3	0.3	-4.2
Special Transactions	-11.2	21.3	7.7
Total Exports	1.1	-1.2	-3.2

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

Imports. The growth of imports in Q1 2019 slowed down to 4.7 percent y-o-y from 9.8 percent in Q4 2018 and 9.4 percent in Q1 2018 as the contraction in inward shipments of raw materials and intermediate goods, and mineral fuels and lubricant eclipsed the growth performance in imports of capital goods and consumer goods.

Imports of goods also decline

Table 6. Imports of Goods
growth rate in percent

COMMODITY GROUP	2018		2019
	Q1	Q4	Q1
Capital Goods	7.4	5.5	11.6
Raw Materials and Intermediate Goods	12.0	14.3	-0.9
Mineral Fuels and Lubricants	11.2	22.5	-5.2
Consumer Goods	5.1	-0.3	11.6
Special Transactions	30.5	20.2	31.3
Total Imports	9.4	9.8	4.7

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

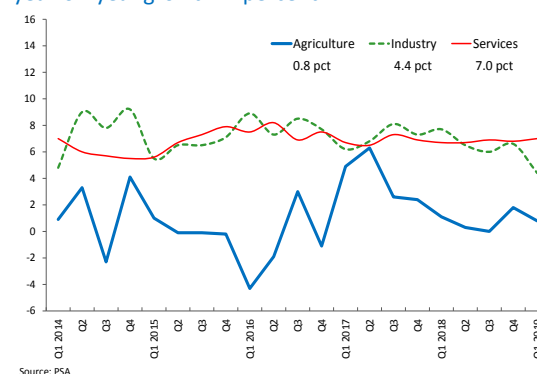
Aggregate Supply. On the production side, growth was due largely to the services sector, which accounted for 4.0 ppts of GDP growth. The industry sector and the AHFF sector contributed 1.5 ppts and 0.1 ppt, respectively.

Services sector supports supply-side growth

The services sector posted a 7.0-percent expansion in Q1 2019 (highest since Q4 2017), due mainly to the growth in the transport, storage and communication, wholesale and retail trade, and financial intermediation sub-sectors. Meanwhile, the public administration and defense, and other services sub-sectors were lower in Q1 2019 relative to the previous quarter while the real estate, renting and business activities sub-sector was unchanged.

The industry sector decelerated to 4.4 percent in Q1 2019 from 6.6 percent in Q4 2018, due mainly to the 3.9-percent slowdown in construction after registering double-digit growth rates for the past four quarters. This was the result of the reduction in public construction output due to the delay in the passage of the 2019 National Budget. Furthermore, private construction recorded softer growth, which may be associated with the minimal increases in total floor area based on the number of building permits issued in January to February 2019 and supply of office spaces and residential units in Metro Manila.

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



Source: PSA

Likewise, the mining and quarrying sub-sector and utilities sub-sector fell to 5.3 percent and 3.1 percent, respectively in Q1 2019 (from 8.1 percent and 6.7 percent in Q4 2018). Lower growth in the mining and quarrying sub-sector was due to the decline in the output of other non-metallic mining, and stone quarrying, clay and sandpits. However, the production of crude oil, natural gas and condensate, and nickel and copper mining registered faster growth, with nickel mining reverting to positive growth in Q1 2019. Meanwhile, the slowdown in the utilities sub-sector was the result of the water supply shortage in Metro Manila and nearby provinces, and power interruptions by Meralco as part of its maintenance operations.

After a slowdown in the last five quarters, manufacturing output improved slightly to 4.6 percent in Q1 2019 from 3.2 percent in Q4 2018, on account of higher growth in food manufactures and a reversal of negative growth to positive growth in basic metal industries and chemical and chemical products. This was also reflected in the more upbeat business sentiment in Q1 2019, driven by brisker business activities due to election-related spending and increased consumption with inflation easing. However, manufacturing growth was moderated by the decline in the production of furniture and fixtures, office, accounting and computing machinery, and machinery and equipment except electrical.

Table 7. Gross Domestic Product by Industrial Origin
at constant 2000 prices; growth rate in percent

BY INDUSTRIAL ORIGIN	2018				2019
	Q1	Q2	Q3	Q4	Q1
Agri., Hunting, Forestry and Fishing	1.1	0.3	0.0	1.8	0.8
Agriculture and Forestry	2.0	0.3	0.2	1.7	0.7
Fishing	-3.6	0.4	-0.9	2.5	1.5
Industry Sector	7.7	6.5	6.0	6.6	4.4
Mining and Quarrying	7.4	-5.4	-1.3	8.1	5.3
Manufacturing	7.3	5.7	3.8	3.2	4.6
Construction	10.2	13.0	15.2	20.0	3.9
Electricity, Gas and Water Supply	6.4	4.1	5.0	6.7	3.1
Service Sector	6.7	6.7	6.9	6.8	7.0
Transport, Storage and Communication	6.6	6.0	5.4	3.7	8.1
Trade and Repair of Motor Vehicles, Motorcycles, Personal and Household Goods	6.1	6.0	5.1	6.7	7.4
Financial Intermediation	7.8	7.6	7.2	6.3	9.8
Real Estate, Renting and Business Activities	4.6	4.5	5.7	4.1	4.1
Public Administration and Defense; Compulsory Social Security	13.2	15.0	17.8	14.7	9.7
Other Services	7.0	6.8	7.9	9.4	5.7

Source: PSA

The AHFF sector grew flat at 0.8 percent in Q1 2019 from 1.8 percent in Q4 2018, due to the decline in palay production (at -4.5 percent

in Q1 2019 from -2.2 percent in Q4 2018), reduction in corn output, and slowdown in livestock, poultry, and fishing activities. Agriculture was also adversely affected by the onset of the weak El Niño phenomenon during the latter part of 2018.

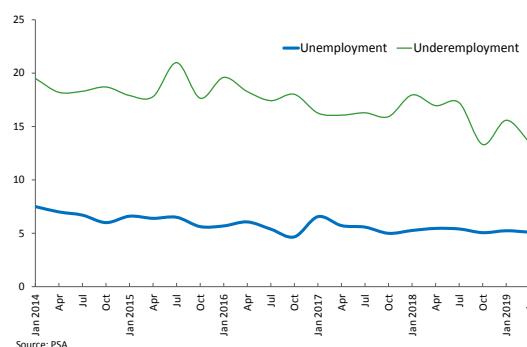
Labor Market Conditions

The Philippine labor market posted a good performance in the second quarter of 2019 as major indicators for both quantity and quality of employment improved.

Labor market shows improvement

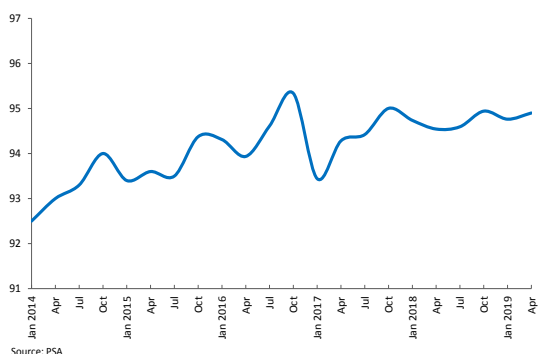
Compared to April 2018 survey round, the results of the April 2019 round of the labor force survey (LFS) showed that the country's employment rate slightly increased to 94.9 percent from 94.5 percent while the rates of unemployment, underemployment, and youth unemployment declined to 5.1 percent from 5.5 percent, 13.5 percent from 17.0 percent, and 12.9 percent from 13.8 percent, respectively. In terms of level of employment, the survey indicated an employment gain of 1.3 million.

Chart 16. Unemployment and Underemployment in percent



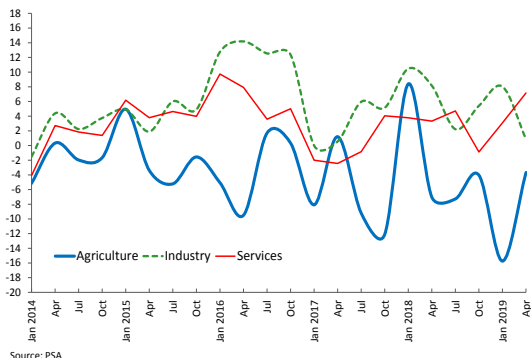
The slightly higher employment rate of 94.9 percent in April 2019 is equivalent to 42.2 million employed individuals. This is higher by 1.3 million compared to 40.9 million employed persons in the same survey round a year ago.

Chart 17. Employment Rate in percent



Employment gain in the services sector tempered the deceleration in employment growth in industry and the employment loss in agriculture sector. Employment in the services sector increased by 7.2 percent to 24.7 million, partly due to wholesale and retail trade. This may be attributed to increased business activities in line with the campaign period for the country’s national election.²⁴ Employment growth in the industry sector was recorded at 0.9 percent due to contraction in manufacturing and deceleration in construction subsectors. The weak employment in manufacturing subsector was partly due to slower global trade while that in construction subsector was due to budget delays. Meanwhile, employment in agriculture subsector continued to decline since the second quarter of 2018. While this trend has been partly attributed to the rising cost of inputs amidst low profit, limited access to credit, poor infrastructure, and vulnerability to environmental risks,²⁵ the sector also experienced losses caused by weak El Nino.

Chart 18. Employment by Sector in percent



²⁴ NEDA (2019a), “PH Labor Market ‘Upbeat’ But Gains Need to be Sustained-NEDA,” NEDA Media Release, 6 June.

²⁵ NEDA (2019b), “Sustainable Agricultural Policies Vital to Improving Employment Situation,” NEDA Media Release, 7 March.

Meanwhile, the unemployment level declined by 3.2 percent, equivalent to 74 thousand lesser unemployed individuals. The latest unemployment rate is also the lowest recorded by the country for all surveys conducted in the April rounds since 2006. However, in terms of highest grade completed, majority of the unemployed are still the junior high school graduates (26.4 percent share) and college graduates (23.8 percent). In terms of age, the bulk belongs to the 15-24 age group or the youth (43.8 percent), followed by 25-34 years old (30.9 percent), although the number of unemployed youth declined by 7.4 percent during the period. The country’s latest youth unemployment rate was the lowest recorded for all surveys conducted in the April rounds since 2006, although it is still more than twice the unemployment rate at the national level.

Aside from lower number of unemployed, the quality of employment slightly improved, with the reduction in underemployment rate from 17.0 percent to 13.5 percent. This is equivalent to 1.2 million reduction in the number of employed individuals who wanted more work compared to April 2018. Similar to unemployment rate, this underemployment rate in April 2019 is the lowest achieved by the country for all surveys conducted in the April rounds since 2006. However, other aspects of quality of employment did not improve during the period. This is evidenced by lower share of remunerative work or wage and salary workers (63.3 percent in April 2019 from 63.8 percent a year ago) and the decline in overall mean hours of work (hours per week) from 42.0 in April 2018 to 41.7 in April 2019, which could indicate a slowdown in economic activity in the second quarter of 2019.

To further improve the employment condition in the country, the government recognizes the need to address both quality and quantity of employment. While employment opportunities have increased, it is also crucial to improve the knowledge and skills of the country’s workforce through training and education. The government also emphasizes the need for more comprehensive income protection program through a more vigilant enforcement of work safety regulations, aggressive employment facilitation, and unemployment insurance to protect workers from unsafe working conditions and economic disruptions.²⁶

²⁶ NEDA (2019a).

II. Monetary and Financial Market Conditions

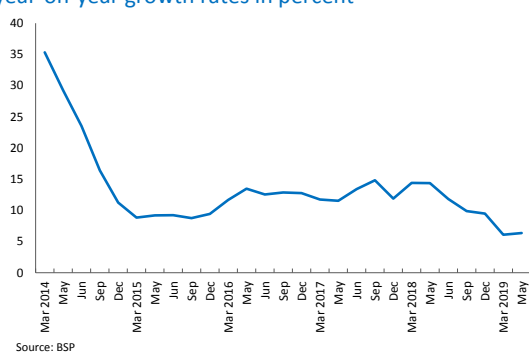
Domestic Liquidity

Domestic liquidity (M3) grew by 6.4 percent y-o-y in May 2019 to ₱11.7 trillion, faster than the 6.1-percent (revised) expansion as of end-Q1 2019.

Domestic liquidity increases...

Money supply continued to increase due mainly to sustained demand for credit. Domestic claims grew, albeit slower, by 6.8 percent in May from the 9.2-percent (revised) expansion in end-Q1 2019 due to the sustained growth in credit to the private sector. Meanwhile, net claims on the central government contracted by 6.4 percent in May, a reversal from the 0.2-percent (revised) growth in end-Q1 2019.

Chart 19. Domestic Liquidity
year-on-year growth rates in percent



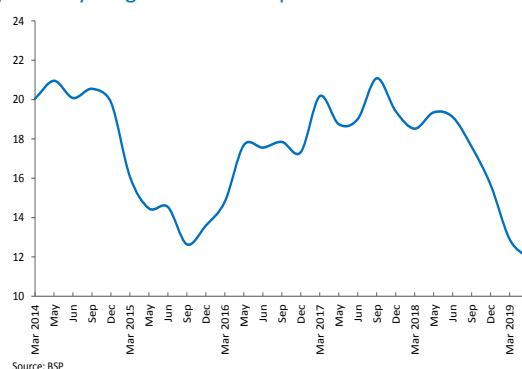
Net foreign assets (NFA) in peso terms grew by 4.4 percent y-o-y in May from a growth of 2.1 percent (revised) in end-Q1 2019 as the BSP's NFA position improved during the month. The BSP's NFA position continued to expand in May, supported by foreign exchange inflows coming mainly from overseas Filipinos' remittances and business process outsourcing receipts. By contrast, the NFA of banks decreased as their foreign liabilities rose due to increased placements and deposits made by foreign banks with their local branches and other banks.

Outstanding loans of commercial banks, net of RRP placements with the BSP, grew at a slightly slower rate of 11.9 percent y-o-y as of May 2019, slower than the 12.9-percent and 19.1-percent growth rates posted at end-Q1 2019 and end-Q2 2018, respectively.

...as lending growth decelerates

The sustained increase in bank lending was largely due to loans for production activities, which expanded by 11.5 percent y-o-y in May 2019 from 12.8-percent growth in end-Q1 2019 and 19.2-percent rise in end-Q2 2018. The expansion in production loans was driven primarily by increased lending to the following sectors: real estate activities; financial insurance activities; manufacturing; electricity, gas, steam and air conditioning supply; construction; and, wholesale and retail trade, repair of motor vehicles and motorcycles.

Chart 20. Loans Outstanding of Commercial Banks
year-on-year growth rates in percent



Meanwhile, loans for household consumption grew by 14.6 percent as of May 2019, lower than the 15.1-percent growth and 17.8-percent expansion in end-Q1 2019 and end-Q2 2018, respectively.

Monetary Operations

As of end-Q2 2019, majority of the BSP's liquidity-absorbing monetary operations had been through the overnight RRP facility, comprising about 81.4 percent of total outstanding amount of liquidity absorbed in BSP liquidity facilities. Meanwhile, the combined placements in the overnight deposit facility (ODF) and the term deposit facility (TDF) made up the remaining 18.6 percent.

Consistent with the BSP's assessment of prevailing liquidity conditions and taking into account higher NG deposits with the BSP coming from NG debt issuances and tax remittances, the average weekly total offer volumes for the TDF auctions was lower at about ₱35.4 billion in Q2 2019 relative to the ₱47.7 billion average weekly volume offered in the previous quarter. The average bid-to-cover ratios for the 7-day, 14-day, and 28-day tenors were recorded at 1.4, 1.5, and 0.8 compared to 1.5, 1.3, and 1.3, respectively, in the previous quarter. Meanwhile, the average bid-to-cover ratio for the daily RRP offerings was lower at about 0.9 during the quarter from 1.0 in Q1 2019.

Credit Conditions

Credit Standards. Results of the Q2 2019 Senior Bank Loan Officers' Survey (SLOS) showed that most of the respondent banks²⁷ continued to maintain their credit standards for loans to both enterprises and households during the quarter based on the modal approach.²⁸

Majority of banks keep credit standards steady

This is the 41st consecutive quarter since Q2 2009 that the majority of respondent banks reported broadly unchanged credit standards.

²⁷ For the Q1 2009 - Q2 2018 survey rounds, the survey covered only universal and commercial banks. Starting in the Q3 2018 survey round, the BSP expanded the coverage of the SLOS to include new foreign commercial banks and top thrift banks. Survey questions were sent to a total of 66 banks (42 universal and commercial banks, and 24 thrift banks) for the Q2 2019 survey round, 45 of whom sent their responses representing a response rate of 68.2 percent.

²⁸ In the modal approach, the results of the survey are analyzed by looking at the option with the highest share of responses.

Meanwhile, the diffusion index (DI) approach^{29,30} continued to indicate a net tightening of credit standards for both loans to enterprises and households. In the previous quarter, credit standards for loans to enterprises and households also showed a net tightening based on the DI approach.

Lending to Enterprises. Most banks in the survey (81.0 percent of banks that responded to the question) indicated that they maintained their credit standards for loans to enterprises during the quarter using the modal approach.

Table 8. General Credit Standards for Loans to Enterprises (Overall)

	2017				2018				2019	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Tightened Considerably	0.0	0.0	0.0	0.0	0.0	3.6	2.3	6.7	2.1	4.8
Tightened Somewhat	6.7	10.0	7.4	3.7	3.7	10.7	18.6	20.0	22.9	11.9
Remained Basically Unchanged	93.3	90.0	88.9	88.9	92.6	82.1	76.7	71.1	72.9	81.0
Eased Somewhat	0.0	0.0	3.7	7.4	3.7	3.6	0.0	0.0	0.0	0.0
Eased Considerably	0.0	0.0	0.0	0.0	0.0	0.0	2.3	2.2	2.1	2.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Diffusion Index for Credit Standards	6.7	10.0	3.7	-3.7	0.0	10.7	18.6	24.4	22.9	14.3
Number of Banks Responding	30	30	27	27	27	28	43	45	48	42

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

Source: BSP

Meanwhile, results based on the DI approach pointed to a net tightening of credit standards for business loans during the quarter, which was attributed by respondent banks to their perception of stricter financial system regulations and deterioration in profile of borrowers. In terms of specific credit standards,³¹ DI-based results pointed to wider loan margins, stricter collateral requirements and loan covenants as well as increased use of interest rate floors.

²⁹ In the DI approach, a positive DI for credit standards indicates that the proportion of banks that have tightened their credit standards exceeds those that eased ("net tightening"), whereas a negative DI for credit standards indicates that more banks have eased their credit standards compared to those that tightened ("net easing").

³⁰ During the Q1 2010 to Q4 2012 survey rounds, the BSP used the diffusion index (DI) approach in the analysis of survey results. Beginning in Q1 2013, the BSP used both the modal and diffusion index (DI) approaches in assessing the results of the survey.

³¹ The survey questionnaire asks banks to describe changes in six specific credit standards: (1) loan margins (price-based); (2) collateral requirements; (3) loan covenants; (4) size of credit lines; (5) length of loan maturities; and (6) use of interest rate floors. A loan covenant is an agreement or stipulation laid down in loan contracts, particularly contracts with enterprises, under which the borrower pledges either to take certain action (an affirmative covenant), or to refrain from taking certain action (a negative covenant); this is consequently part of the terms and conditions of the loan. Meanwhile, an interest rate floor refers to a minimum interest rate for loans. Greater use of interest rate floor implies tightening while less use indicates otherwise.

Banks' responses likewise highlighted a net tightening of credit standards across all borrower firm sizes, namely, top corporations, large middle-market enterprises, small and medium enterprises (SMEs) and micro enterprises based on the DI approach.

Over the next quarter, results based on the modal approach showed that most of the respondent banks expect credit standards to remain unchanged. Meanwhile, results based on the DI approach showed that more respondent banks expect overall credit standards for business loans to tighten over the next quarter compared to those that expect the opposite, on the back of respondent banks' expectations of stricter financial system regulations, reduced tolerance for risk, deterioration in borrower's profile, and less favorable economic outlook, among other factors.

Lending to Households. The results of the survey likewise indicated that most respondent banks (88.0 percent) kept their overall credit standards unchanged for loans extended to households during the quarter based on the modal approach. Meanwhile, results based on the DI approach reflected a net tightening of credit standards for household loans, particularly for housing, auto, and personal/salary loans.

Table 9. General Credit Standards for Loans to Households (Overall)

	2017				2018				2019	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Tightened Considerably	0.0	0.0	0.0	0.0	0.0	0.0	6.3	10.7	3.3	4.0
Tightened Somewhat	0.0	9.1	5.0	0.0	15.8	5.9	12.5	7.1	16.7	8.0
Remained Basically Unchanged	100.0	81.8	90.0	90.5	78.9	94.1	75.0	78.6	73.3	88.0
Eased Somewhat	0.0	9.1	5.0	9.5	5.3	0.0	6.3	3.6	3.3	0.0
Eased Considerably	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.3	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Diffusion Index for Credit Standards	0.0	0.0	0.0	-9.5	10.5	5.9	12.5	14.3	13.3	12.0
Number of Banks Responding	21	22	20	21	19	17	32	28	30	25

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

Source: BSP

The overall net tightening of credit standards for household loans reflected stricter collateral requirements and loan covenants, shortened loan maturities, and increased use of interest rate floors. Respondent banks attributed the tightening of overall credit standards for household loans largely to deterioration in the profile of borrowers.

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

banks anticipate lower tolerance for risk and stricter financial system regulations along with deterioration in borrower's profile and profitability of banks' portfolios.

Loan demand. Responses to the survey question on loan demand indicated that the majority of respondent banks continued to see stable overall demand for loans from both enterprises and households during the quarter.

Demand for loans from firms and households remains stable

Using the DI approach, however, results showed a net increase in overall demand³² for both business and household loans. The overall net increase in loan demand from firms was attributed by banks largely to their customers' higher working capital requirements. Meanwhile, respondent banks attributed the overall net increase in household loan demand to higher household consumption, lower interest rates, and banks' more attractive financing terms.

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

Real Estate Loans. Most of the respondent banks (86.7 percent) reported that credit standards for commercial real estate loans were maintained in Q2 2019.

³² The "DI for loan demand" refers to the percentage difference between banks reporting an increase in loan demand and banks reporting a decrease. A positive DI for loan demand indicates that more banks reported an increase in loan demand compared to those stating the opposite, whereas a negative DI for loan demand implies that more banks reported a decrease in loan demand compared to those reporting an increase.

Majority of banks maintain credit standards for real estate loans

The DI approach, however, continued to point to a net tightening of overall credit standards for commercial real estate loans for the 14th consecutive quarter which was attributed by respondent banks to a less favorable economic outlook and a perceived deterioration in the profile of borrowers, among other factors. The net tightening of overall credit standards for commercial real estate loans reflected respondent banks' wider loan margins, reduced credit line sizes, stricter collateral requirements and loan covenants, shortened loan maturities, and increased use of interest rate floors. Over the next quarter, while most of the respondent banks anticipate maintaining their credit standards for commercial real estate loans, DI-based results point to expectations of continued net tightening of credit standards for the said type of loan.

Demand for commercial real estate loans was also unchanged in Q2 2019 based on the modal approach. Meanwhile, DI-based results showed a net decrease in demand for commercial real estate loans, which respondent banks attributed largely to higher interest rates. Over the next quarter, although most of the respondent banks anticipate generally steady loan demand, more banks expect demand for commercial real estate loans to increase compared to those expecting the opposite.

For housing loans extended to households, results based on the modal approach pointed to unchanged credit standards while DI-based results indicated a net tightening of credit standards for housing loans. Respondent banks attributed the tighter credit standards for housing loans to their perception of stricter financial system regulations and deterioration in the profitability and liquidity of banks' portfolios as well as in the profile of housing loan borrowers. Over the next quarter, results based on the modal approach showed that respondent banks expect credit standards for housing loans to remain unchanged. However, using the DI approach, survey results suggested expectations of a net tightening of credit standards for housing loans in Q3 2019 as respondent banks anticipate lower risk tolerance, stricter financial system regulations, and a deterioration in profile of borrowers for the said type of loan.

Most banks reported unchanged demand for housing loans in Q2 2019 based on the modal approach while DI-based results pointed to a net increase in demand for housing loans, which was attributed by respondent banks to higher household consumption, lower interest rates, and more attractive financing terms offered by banks. Furthermore, banks' responses indicated expectations of a net increase in demand for housing loans over the next quarter supported by expectations of higher household consumption and higher housing investment, among other factors.

Interest Rates

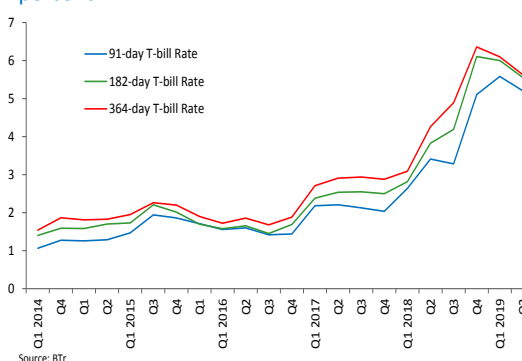
Primary Interest Rates

In Q2 2019, the average interest rates for the 91-, 182- and 364-day T-bills in the primary market decreased to 5.204 percent, 5.552 percent, and 5.627 percent from 5.583 percent, 6.000 percent, and 6.098 percent, respectively.

T-bill rates decrease further

The results of the auctions during the quarter reflected market players' strong demand for government securities amid expectations of policy rate cuts from the BSP within the year. The appetite for government notes was driven as well by the three-phased 200-bp reduction in reserve requirement (i.e., 100 bps on 31 May, 50 bps on 28 June and 50 bps on 26 July).

Chart 21. Treasury Bill Rates
in percent

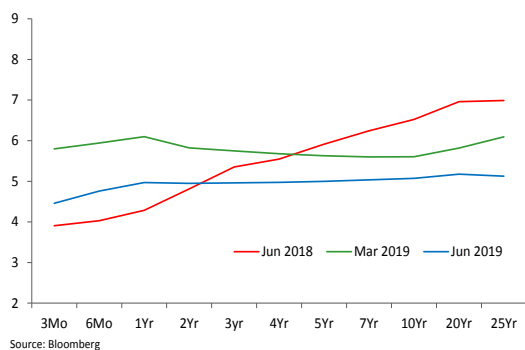


Yield Curve.³³ As of end-June 2019, the secondary market yield for government securities (GS) for all maturities declined relative to the end-March 2019 levels, as market players invested their excess liquidity and serviced their clients' requirements following the sovereign credit rating upgrade from S&P Global Ratings and the 25-bp reduction in the BSP's key policy interest rates.

Yields for GS decline across all maturities

Debt paper yields were lower by a range of 53.3 bps for the 10-year GS to 133.9 bps for the 3-month GS compared to end-March 2019 levels.

Chart 22. Yields of Government Securities in the Secondary Market
in percent



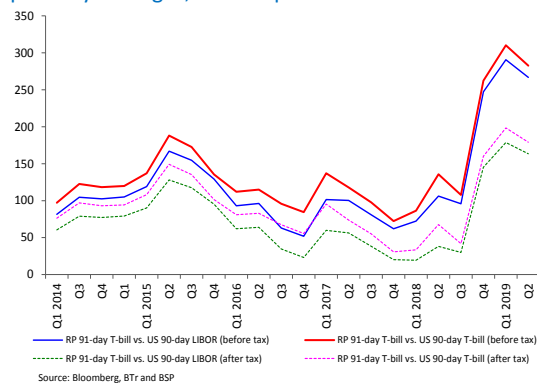
Relative to year-ago levels, the secondary market yields for GS with maturities of 3 years to 25 years decreased by a range of 39.4 bps (for the 3-year GS) to 186.4 bps (for the 25-year GS) while the secondary market yields for GS with maturities of 3 months to 2 years rose by a range of 13.7 bps (for the 2-year GS) to 73.1 bps (for the 6-month GS).

Interest Rate Differentials. The average differentials between domestic and US interest rates, gross and net of tax, narrowed in Q2 2019 relative to the previous quarter.

Interest rate differentials narrow in Q2 2019

The average 91-day RP T-bill rate declined q-o-q by 42.1 bps to 5.170 percent in Q2 2019 from 5.591 percent in Q1 2019. Likewise, the average US 90-day LIBOR and the US 90-day T-bill rate declined by 18.4 bps and 14.4 bps, respectively to 2.502 percent and 2.345 percent in Q2 2019. These developments led to narrower positive gross and net of tax differentials between the 91-day RP T-bill rate and US interest rates. Domestic interest rates fell following the reductions in the BSP's key policy interest rates and the reserve requirement ratios of universal and commercial banks (U/KBs), non-banks with quasi-banking functions (NBQBs), thrift banks (TBs), and rural banks (RBs) during the quarter.

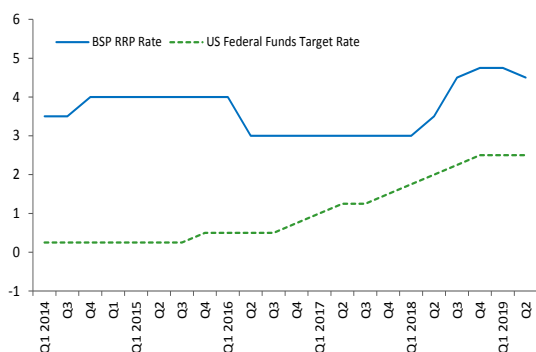
Chart 23. Interest Rate Differentials
quarterly averages; in basis points



³³ On 29 October 2018, the Bankers Association of the Philippines (BAP) replaced the PDST Reference Rates and launched the PHP BVAL Reference Rates which will be used as the Philippine Peso GS benchmark. The PHP BVAL Reference Rates are calculated by Bloomberg Finance Singapore L.P. and/or its affiliates in an agreement with the BAP.

The positive differential between the BSP's overnight borrowing or RRP rate and the US Fed funds target rate narrowed to a range of 200-225 bps in Q2 2019, reflecting the impact of the 25-bp decline in the BSP's overnight RRP rate to 4.50 percent on 9 May 2019.

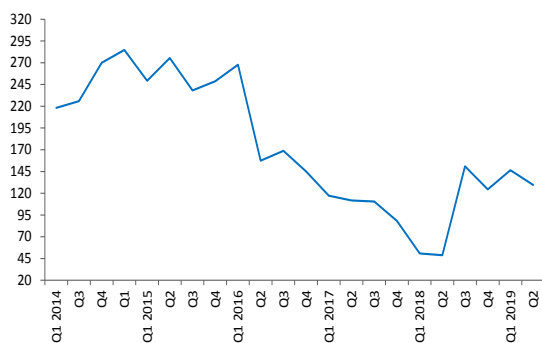
Chart 24. BSP RRP Rate and US Federal Funds Target Rate
in percent



Source: Bloomberg and BSP

Similarly, the interest rate differential between the BSP's overnight RRP rate and the US Fed funds target rate adjusted for risk³⁴ narrowed to 130 bps as of end-June 2019 from 147 bps in end-March 2019.

Chart 25. Risk-Adjusted Differentials
in basis points



Source: Bloomberg and BSP

This development could be traced to the 25-bp decline in the interest rate differential between the BSP's overnight RRP rate and the US federal funds rate and the 8-bp decline in the risk premium, following the 54.0-bp and 46.0-bp decline in the interest rates for the 10-year ROP note and the 10-year US Treasury note, respectively. The 10-year ROP and US Treasury note rates fell amid strong demand for safe-haven government bonds due to the continued trade conflict between the US and China, geopolitical

³⁴ The difference between the 10-year ROP note and the 10-year US Treasury note is used as proxy for the risk premium.

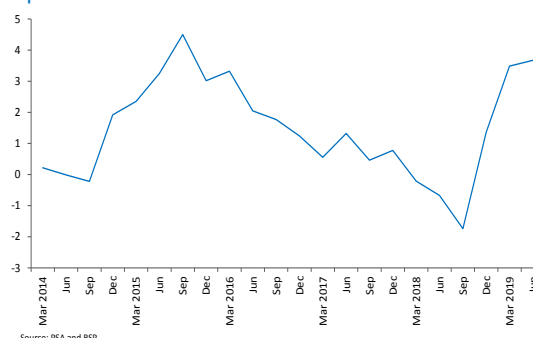
tensions in Hong Kong, between the US and Iran, and sustained growing concerns over a possible global economic slowdown following the release of weaker-than-expected US data on new home sales, employment, manufacturing activity, industrial output and retail sales.

Domestic real lending rate³⁵ rose to 3.7 percent in June 2019 from 3.5 percent in March 2019.

Real lending rate increases

The increase in domestic real lending rate was due to the 60.0-bp and 40.0-bp decline in inflation and actual bank lending rate³⁶, to 2.7 percent and 6.4 percent, respectively in June 2019.

Chart 26. Philippines' Real Lending Rate
in percent



Source: PSA and BSP

The Philippines' real lending rate at 3.7 percent in June 2019 is the fifth lowest in a sample of 10 Asian countries for the second consecutive quarter, with Indonesia recording the highest real lending rate at 7.0 percent followed by India at 6.1 percent while Japan posted the lowest at 0.3 percent.

³⁵ Real lending rate is measured as the difference between actual bank lending rate and inflation.

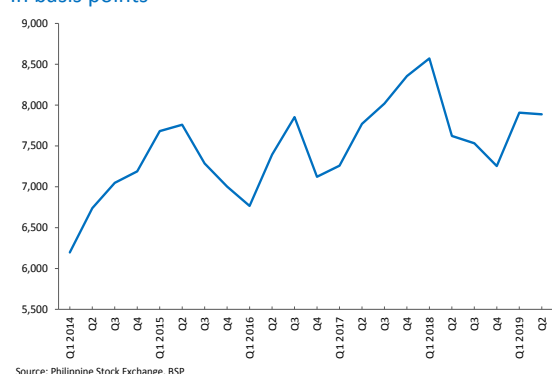
³⁶ The actual bank lending rate for the Philippines is the weighted average interest rate charged by reporting commercial banks on loans and discounts granted during the period.

Financial Market Conditions

The domestic financial system in Q2 2019 reflected the volatility coming primarily from the external environment. Nevertheless, sound banking system and firm economic growth prospects supported investor appetite for domestic assets.

Stock Market. In the second quarter of 2019, the Philippine Stock Exchange index (PSEi) declined by a slight 0.2 percent, q-o-q, to average 7,882.95 index points.

Chart 27. Quarterly Average PSEi
In basis points



The benchmark index traded sideways due to concerns over the moderation of global and domestic economic growth; lingering trade tensions between the US and China; and heightened geopolitical tensions. These developments offset the positive impact on the local bourse of Standard and Poor Global Ratings' (S&P) upgrade of the country's sovereign rating, Fitch Rating's affirmation of the country's credit rating, and the BSP's easing monetary policy stance amid a manageable inflation outlook.

In April, a slower-than-expected domestic inflation outturn helped lift the index past the 8,000-index point mark. However, this was followed by some declines as concerns over a slowing global economy³⁷ and the cut in the Philippine 2019 growth forecast by the World Bank (WB), Asian Development Bank (ADB), and the International Monetary Fund (IMF) weighed on the local bourse.

³⁷ Reinforcing concerns over a slowing global economy were the inversion of the US yield curve, which is usually associated with an upcoming recession; the contraction of the Eurozone Manufacturing Purchasing Managers' Index; and the lowering of the IMF's global growth forecast for 2019.

The benchmark index returned to the 8,000-index point mark at the beginning of May as investors reacted positively to S&P's upgrade of the country's sovereign rating to "BBB+" in end-April and the announcement of the continued decline in the headline inflation for April. However, market pressures arose anew on lower-than-expected Philippine GDP growth in the first quarter and the escalating trade tensions between the US and China,³⁸ which triggered a global sell off. Towards the end of May, the phased 200-bp reduction in universal and commercial banks' reserve requirements, following the BSP's decision to cut policy rates by 25 bps, tempered the decline. Moreover, Morgan Stanley Capital International's (MSCI's) quarterly rebalancing effective on 3 June,³⁹ the Philippines' better competitiveness ranking by the International Institute for Management Development (IMD);⁴⁰ and Fitch Ratings' affirmation of the country's "BBB" credit rating in end-May saw investors reposition their portfolios.

In June, the effectivity of the BSP's phased RRR cut on 31 May and the BSP's decision to keep rates unchanged after the May inflation stayed within target⁴¹ gave the main index a boost. In addition, reports that US President Trump postponed the implementation of a 5-percent tax on all Mexican

³⁸ In a tweet on early 6 May, President Donald Trump raised pressure on China with a threat to hike tariffs on \$200 billion worth of Chinese goods. On 10 May, the US delivered on Trump's threat and increased import tariffs on \$200 billion worth of Chinese goods to 25 percent from 10 percent. In retaliation, China announced it will raise tariffs up to 25 percent on \$60 billion worth of US goods starting on 1 June. On 15 May, President Trump slapped Chinese technology firm Huawei Technologies Co. Ltd with a US export ban, barring American companies from selling components and software to Huawei to restrict their access to American technology (without first obtaining a license). The US Commerce Department also issued a rule prohibiting US companies from purchasing equipment from Huawei. Meanwhile, China also raised tariffs on imports of US rare earth metal ores from 10 percent to 25 percent.

³⁹ MSCI announced that effective 3 June, it will trim the index weight of some local firms, including SM Prime Holdings, Inc. (0.17 percent), Ayala Land, Inc. (0.15 percent), BDO Unibank, Inc. (0.12 percent), SM Investments Corp. (0.10 percent), and JG Summit Holdings (JGS), Inc. (0.08 percent). On the other hand, MSCI will increase the weight of Ayala Corp. by 0.82 percent and International Container Terminal Services, Inc. by 0.36 percent.

⁴⁰ The Philippines climbed four notches in the 2019 World Competitiveness Ranking of the Swiss business school International Institute for Management Development. The Philippines is now ranked 46th out of 63 countries surveyed, an improvement from the 50th spot in 2018.

⁴¹ The Philippine Statistics Authority reported on 5 June that inflation accelerated to 3.2 percent in May, higher than April's 3 percent. This was within the BSP Department of Economic Research's 2.8-3.6 percent estimate range and also within the government's 2-4 percent target for the year.

goods⁴² combined with increased expectations that the US Fed will cut policy rates later this year also provided investors some buying impetus. The PSEi closed the quarter at 7,999.71 index points, higher by 1.0 percent than the closing index in Q1 2019 and by 7.1 percent year-to-date (y-t-d).

Mirroring the closing index's q-o-q rally, total market capitalization similarly rose by 0.1 percent to close at ₱17.3 trillion on 28 June from ₱17.2 trillion in end-March. The rise in four of the seven sectoral indices led the increase in market capitalization: services sector; property sector; industrials sector; and, the SME sector. Meanwhile, foreign investors withdrew and reverted to being net sellers of ₱11.4 billion in Q2 from being net buyers of ₱32.6 billion in the preceding quarter. This withdrawal contributed significantly to the average decline in the benchmark index during the review period. In addition, the price-earnings ratio for listed firms also dipped slightly from 19.59x in end-March to 19.38x in end-June.

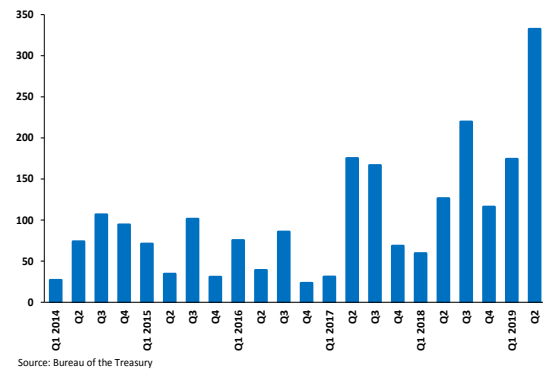
Government Securities. Results of the T-bill auctions conducted in April – June 2019 continued to show robust demand for short-term government securities with total subscription for the quarter amounting to about ₱527.5 billion or about 2.7 times the ₱195.0-billion aggregate offered amount.

Demand for T-bills remains strong

The oversubscription for Q2 2019, at ₱332.5 billion, was higher than the ₱177.5-billion oversubscription in the previous quarter. The Bureau of the Treasury (BTr) awarded in full the ₱4.0-billion, ₱5.0-billion and ₱6.0-billion offered amounts for the 91-, 182- and 364-day T-bills in 9 out of 13 auctions but made partial awards for the other scheduled auctions (8 April, 15 April, 22 April and 29 April) during the quarter.

⁴² In May, President Trump threatened to impose a 5 percent import tariff on all Mexican goods starting 10 June. However, on 7 June 2019, the US and Mexico reached a deal to avert the imposition of tariffs on Mexican goods: While the US indefinitely suspended tariffs on all Mexican goods, Mexico agreed to rapidly expand an asylum program (which sends people seeking asylum in the US to wait in Mexico as their cases are processed) and deploy security forces to stem the flow of Central American migrants to the US border.

Chart 28. Total Oversubscription of T-bill Auctions



Results of the T-bond auctions during the quarter likewise showed strong demand for T-bonds on the back of easing inflation expectations.

Sovereign Bond and Credit Default Swap (CDS) Spreads. In April, debt spreads narrowed due to positive external developments that included the fresh trade talks between US and China. Locally, domestic pressures on interest rates eased as inflation continued to slowdown.

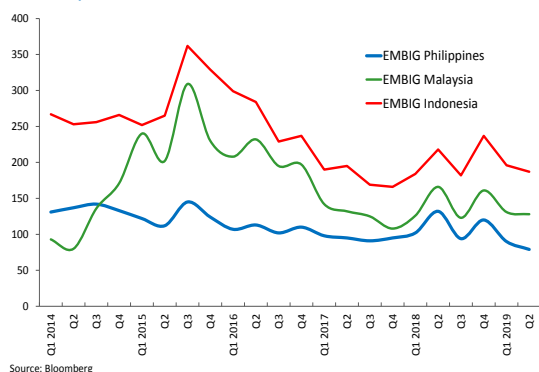
Debt spreads narrow on positive external developments

In May, debt spreads took a negative turnaround as the trade talks between the US and China failed to reach a truce. For instance, the US banned Huawei from its domestic supply chain while China cut pork orders from the US. In the domestic front, the lower-than-expected Q1 2019 Philippine GDP growth dampened investor sentiment.

In June, debt spreads slightly narrowed as global risks remained muted.

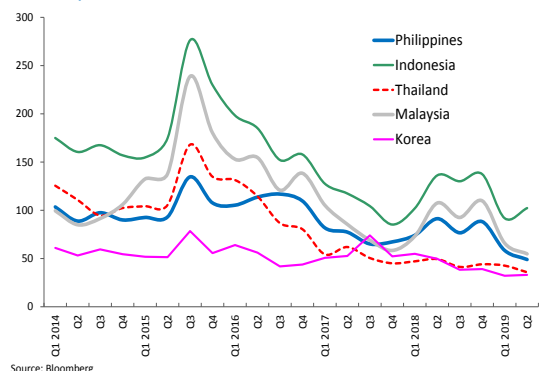
As of 28 June 2019, the extra yield investors demanded to own Philippine sovereign debt over U.S. Treasuries or the Emerging Market Bond Index Global (EMBIG) Philippines spread stood at 79 bps from the end-March level of 90 bps.

Chart 29. EMBIG Spreads of Selected ASEAN Countries
in basis points



Similarly, the country's 5-year sovereign CDS decreased to 47 bps from its end-March level of 59 bps. Against other neighboring economies, the Philippine CDS traded closely with Malaysia's 53 bps, but narrower than Indonesia's 90 bps and wider than Thailand's 33-bps and Korea's 32-bps spreads.

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



Banking System

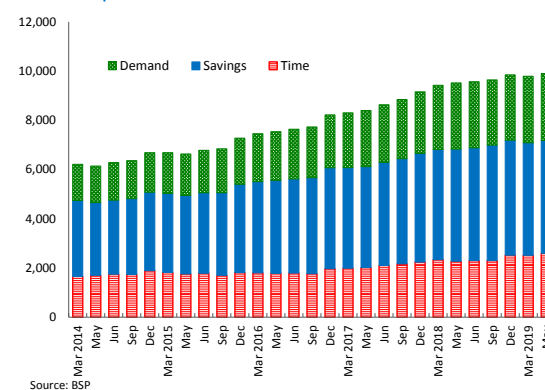
The Philippine banking system continued to lend support to the country's long-term economic growth and stable financial condition. During the second quarter of 2019, banks' balance sheets exhibited sustained growth in assets and deposits.

Philippine banking system exhibits stable growth in assets and deposits

Furthermore, asset quality indicators remained healthy while capital adequacy ratios continued to be above international standards, even with the implementation of the tighter Basel III framework.⁴³

Savings Mobilization. Savings deposits remained the primary sources of funds for the banking system. Banks' total deposits as of end-May 2019 amounted to ₱9.9 trillion, 4.0 percent higher than the year-ago level.⁴⁴ Relative to the end-March 2019 level, total deposits increased slightly by 1.1 percent.

Chart 31. Deposit Liabilities of Banks
in billion pesos



Meanwhile, foreign currency deposits owned by residents (FCD-Residents) reached ₱2.0 trillion as of end-May 2019, posting a y-o-y growth of 4.5 percent. With respect to the end-March 2019 level, FCD-Residents was generally steady.⁴⁵

Institutional Developments. The total resources of the banking system grew by 9.6 percent to reach ₱17.5 trillion as of end-May 2019 from ₱15.9 trillion a year ago. Relative to the

⁴³ Beginning 1 July 2018, covered institutions (universal banks [UBs], commercial banks [KBs] and their subsidiary banks and quasi-banks [QBs]) must maintain a leverage ratio of no lower than five (5) percent. The leverage ratio is a non-risk based measure, which serves as a backstop to the Capital Adequacy Ratio. It is designed to constrain the potential build-up of leverage in the banking industry and to promote stability of the financial system. Also, the BSP sets an observation period of six months (from 1 July 2018 to 31 December 2018) for the Net Stable Funding Requirement (NSFR). This is to ensure a smooth transition to the new prudential standard and to allow prompt assessment and calibration of the components of the NSFR. Beginning 1 January 2019, however, the covered institutions (U/KBs) shall maintain an NSFR of 100.0 percent on both solo and consolidated bases.

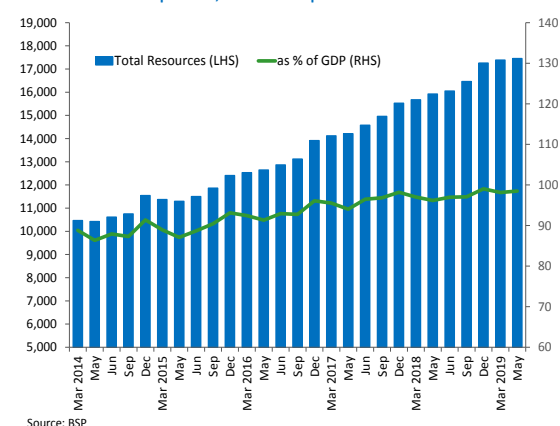
⁴⁴ This refers to the total peso-denominated deposits of the banking system.

⁴⁵ FCD-Residents, along with M3, forms part of a money supply measure called M4. Meanwhile, M3 consists of savings deposits, time deposits, demand deposits, currency in circulation, and deposit substitutes.

end-March 2019 level, total resources of the banking system increased slightly by 0.4 percent. As a percent of GDP, total resources stood at 98.5 percent.⁴⁶

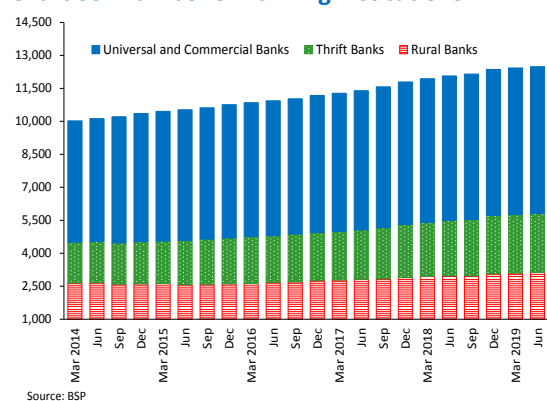
Total resources of the banking system continue to grow

Chart 32. Total Resources of the Banking System
levels in billion pesos; share in percent



The number of banking institutions (head offices) as of end-June 2019 has decreased to 554 offices from 581 a year ago and 569 a quarter ago. The banks' head offices are comprised of 46 U/KBs, 51 TBs, and 457 RBs.

Chart 33. Number of Banking Institutions



During the same period, the operating network (head offices and branches/agencies) of the banking system expanded to 12,487 offices from 12,066 offices a year ago and 12,427 offices a quarter ago. The expansion was due mainly to the increase in the branches/agencies led by RBs and followed by TBs and U/KBs.

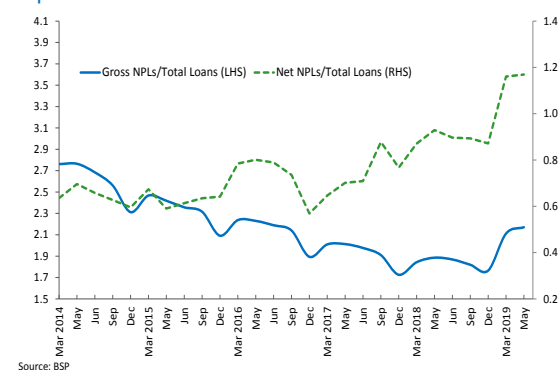
⁴⁶ GDP as of the first quarter of 2019.

The Philippine banking system's gross non-performing loan (GNPL) ratio increased slightly to 2.2 percent as of end-May 2019 relative to the 1.9 percent registered a year ago and 2.1 percent as of end-March 2019.

Asset quality of Philippine banks remains healthy

Banks' initiatives to improve their asset quality along with prudent lending regulations helped maintain the GNPL ratio below its pre-Asian crisis level of 3.5 percent.⁴⁷ Similarly, net non-performing loan (NNPL) ratio grew moderately to reach 1.2 percent as of end-May 2019 from the previous year's ratio of 0.9 percent and the end-March 2019 ratio of 1.1 percent. In computing for the NNPLs, specific allowances for credit losses on Total Loan Portfolio (TLP) are deducted from the GNPLs. Said allowances increased slightly to ₱101.0 billion in May 2019 from ₱99.1 billion posted as of end-March 2019.⁴⁸

Chart 34. Ratios of Gross Non-Performing Loans and Net Non-Performing Loans to Total Loans
in percent



The Philippine banking system's GNPL ratio of 2.2 percent was higher with respect to that of Malaysia (1.0 percent) and South Korea (1.0 percent) but lower than that of Indonesia (2.4 percent) and Thailand (3.0 percent).⁴⁹

⁴⁷ The 3.5 percent non-performing loans (NPL) ratio was based on the pre-2013 definition.

⁴⁸ This type of provisioning applies to loan accounts classified under loans especially mentioned (LEM), substandard-secured loans, substandard-unsecured loans, doubtful accounts and loans considered as loss accounts.

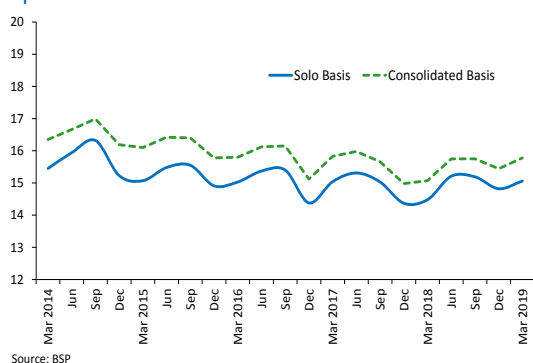
⁴⁹ Sources: Malaysia (Banking System's Ratio of net impaired loans to net total loans, May 2019); South Korea (Domestic Banks' Substandard or Below Loans [SBLs] ratio, March 2019); Indonesia, IMF and financial stability report (Banks' Nonperforming Loans to Gross Loans Ratio, March 2019); and

The loan exposures of banks remained adequately covered with the banking system's NPL coverage ratio of 91.4 percent as of end-May 2019. This was, however, lower than the previous year's and quarter's ratio of 115.5 percent and 95.7 percent, respectively.

U/KBs' CAR remains above international and regulatory standards

The capital adequacy ratio (CAR) of U/KBs at end-March 2019 increased marginally on solo basis to 15.1 percent from 14.8 percent during the previous quarter. Similarly, on a consolidated basis, CAR of U/KBs increased to 15.8 percent from 15.4 percent registered a quarter ago. These figures remained well above the BSP's regulatory threshold of 10.0 percent and international standard of 8.0 percent.

Chart 35. Capital Adequacy Ratio of Universal and Commercial Banks in percent



The CAR of Philippine U/KBs, on a consolidated basis was higher than that of South Korea (15.4 percent) but lower than those of Malaysia (17.5 percent), Thailand (18.5 percent) and Indonesia (23.3 percent).⁵⁰

Thailand (Total Financial Institutions' Gross NPLs ratio, March 2019).

⁵⁰ Sources: South Korea (Capital Ratios of Banks and Bank Holding Companies, March 2019); Malaysia (Banking System's Total Capital Ratio, May 2019); Thailand (Commercial Banks' Capital Funds Percentage of Risk Assets, April 2019); and Indonesia, IMF and financial stability report (Commercial Banks, Regulatory Capital to Risk-Weighted Assets Ratio, March 2019).

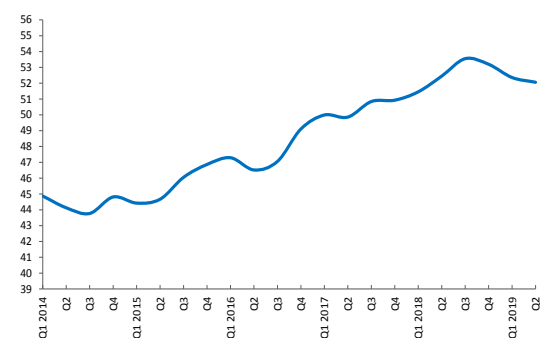
Exchange Rate

The peso averaged at ₱52.07/US\$1 in Q2 2019, appreciating by 0.57 percent from the previous quarter's average of ₱52.37/US\$1.

Peso appreciates against the US dollar in Q2 2019

The peso's appreciation was due mainly to improving market sentiment over the trade negotiations between the US and China and the generally dovish stance of the US Federal Reserve. Credit ratings upgrade and prospects of improving macroeconomic conditions likewise contributed to the appreciation of the peso. On a y-o-y basis, the peso likewise appreciated by 0.70 percent relative to the ₱52.43/US\$1 average in Q2 2018.⁵¹

Chart 36. Quarterly Peso-Dollar Rate PHp/US\$; average per quarter



In April, the peso appreciated to an average of ₱52.11/US\$1, 0.58 percent higher than the ₱52.41/US\$1 average in March. The peso's appreciation was due mainly to (i) the seasonal increase in remittances in time for the Holy Week break; (ii) the release of the narrower-than-expected Philippine trade deficit for February 2019; (iii) relative softness of the US dollar following the release of dovish minutes of the FMO meeting on 19-20 March 2019; and (iv) increased risk appetite amid positive market expectations on the ongoing US-China trade negotiations.

Meanwhile, in May 2019, the peso depreciated by 0.29 percent to an average of ₱52.26/US\$1 from the average in April. The peso depreciated on the back of (i) slower-than-expected economic growth

⁵¹ Dollar rates (per peso) or the reciprocal of the peso-dollar rates were used to compute for the percentage change.

for Q1 2019; (ii) lower-than-expected Philippine trade balance data for March 2019; (iii) risk-off sentiment amid uncertainty over the trade negotiations between the US and China; and (iv) the recent reduction in reserve requirement ratio (RRR) of commercial and universal banks.

In June 2019, the peso recovered to an average of ₱51.80/US\$1, appreciating by 0.89 percent from the average in May. The peso's appreciation was due mainly to (i) risk-on sentiment as tensions between the US and Mexico eased following a deal on immigration policies; (ii) continued market expectation of a dovish US Federal Reserve and anticipation of possible cut in US policy rates later this year; (iii) the release of slower-than-expected employment growth in the US; and (iv) market optimism ahead of the trade negotiations between the US and China on the sidelines of G20 Summit on 28 and 29 June 2019 in Osaka, Japan.

On a y-t-d basis, the peso appreciated against the US dollar by 2.62 percent to close at ₱51.24/US\$1 on 28 June 2019 from the end-December 2018 closing rate of ₱52.58/US\$1.⁵²

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

Meanwhile, the volatility of the peso's daily closing rates (as measured by the coefficient of variation) stood at 0.61 percent during the review quarter. This was slightly higher than the 0.55 percent registered in the previous quarter.⁵³ The volatility of the peso during the second quarter of 2019 was lower than the volatility of most currencies in the region.

On a real trade-weighted basis, the peso lost external price competitiveness in Q2 2019 against the basket of currencies of all trading partners (TPI) and trading partners in developing (TPI-D) countries relative to Q1 2019. This was indicated by the increase in the real effective exchange rate (REER) index of the peso by 0.72 percent and 1.73 percent against the TPI and TPI-D baskets, respectively. Meanwhile, against the basket of currencies of trading partners in advanced (TPI-A)

countries, the REER index of the peso decreased slightly by 1.08 percent.^{54,55}

Relative to Q2 2018, the peso likewise lost external price competitiveness in Q2 2019 across currency baskets. This developed following the nominal appreciation of the peso and the widening inflation differential, resulting in the increase in the REER index of the peso by 5.66 percent, 4.65 percent and 6.23 percent against the TPI, TPI-A, and TPI-D baskets, respectively.

⁵² Based on the last done deal transaction in the afternoon.

⁵³ The coefficient of variation is computed as the standard deviation of the daily closing exchange rate divided by the average exchange rates for the period.

⁵⁴ The TPI measures the nominal and real effective exchange rates of the peso across the currencies of 14 major trading partners (MTP) of the Philippines, which includes US, Euro Area, Japan, Australia, China, Singapore, South Korea, Hong Kong, Malaysia, Taiwan, Indonesia, Saudi Arabia, United Arab Emirates, and Thailand. The TPI-A measures the effective exchange rates of the peso across currencies of trading partners in advanced countries comprising of the US, Japan, Euro Area, and Australia. The TPI-D measures the effective exchange rates of the peso across 10 currencies of partner developing countries which includes China, Singapore, South Korea, Hong Kong, Malaysia, Taiwan, Indonesia, Saudi Arabia, United Arab Emirates, and Thailand.

⁵⁵ The REER index represents the Nominal Effective Exchange Rate (NEER) index of the peso, adjusted for inflation rate differentials with the countries whose currencies comprise the NEER index basket. A decrease in the REER index indicates some gain in the external price competitiveness of the peso, while a significant increase indicates the opposite. The NEER index, meanwhile, represents the weighted average exchange rate of the peso vis-à-vis a basket of foreign currencies.

III. Fiscal Developments

The NG recorded a fiscal deficit of ₱0.8 billion for the first five months of 2019, far lower than the ₱138.7 billion budget gap recorded in the same period last year, mainly caused by the delay in the approval of the 2019 budget.

Expenditures for the period in review amounted to ₱1,314.5 billion, 0.8 percent lower than the expenditures in January-May 2018. Excluding interest payments, expenditures went down by 1.7 percent to ₱1,163.5 billion. Meanwhile, interest payment was 6.7 percent higher compared to its year-ago level, reaching ₱151.0 billion in January-May 2019.

NG recorded a fiscal deficit for January-May 2019

Netting out the interest payments in NG expenditures, the primary surplus amounted to ₱150.2 billion, which is higher from the ₱2.7 billion surplus recorded in January-May 2018.

Table 10. National Government Fiscal Performance

in billion pesos

	2018		2019		Growth Rate (in percent)	
	May	Jan-May	May	Jan-May	May	Jan-May
Surplus/(Deficit)	-32.9	-138.7	2.6	-0.8	-107.8	-99.4
Revenues	259.0	1,186.3	317.2	1,313.7	22.5	10.7
Expenditures	291.9	1,325.1	314.7	1,314.5	7.8	-0.8

* Totals may not add up due to rounding

Source: Bureau of the Treasury (BTr)

Revenues increased by 10.7 percent to ₱1,313.7 billion in January-May 2019 compared to ₱1,186.3 billion in the same period last year. The Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC) contributed ₱908.5 billion and ₱251.7 billion, respectively. Revenue collections by the BIR and BOC were both higher by 9.8 percent. Meanwhile, income from BTr increased by 31.9 percent to ₱77.0 billion attributed to higher dividends on shares of stocks.

IV. External Developments

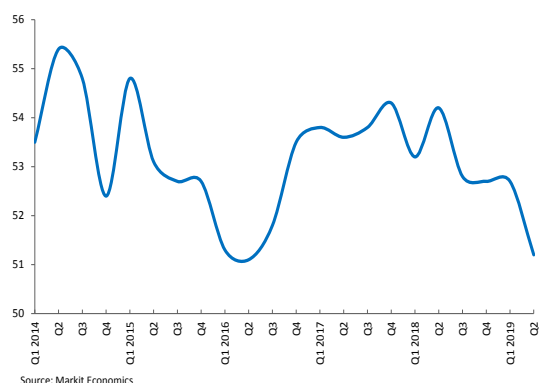
The JP Morgan Global All-Industry Output Index was 51.2 in June, unchanged from the record in May as service sector output expanded while output performances of the manufacturing sub-sectors were mixed. New orders remained weak in June amid the ongoing downturn in international trade flows.

Global economic activity steadies in June

During the month, output growth was above the global average in the US, the euro area, and Australia. Meanwhile, growth was below the benchmark in China, Japan, and India. The UK, Brazil, and Russia all posted contractions.⁵⁶

Chart 37. JP Morgan Global All-Industry Output Index

index points



US. Real GDP expanded by 3.1 percent on a seasonally adjusted q-o-q basis in Q1 2019, faster than the 2.2-percent growth rate in Q4 2018. On a y-o-y basis, real output grew by 3.2 percent in Q1 2019 from the 3.0-percent expansion in the previous quarter. The increase in real GDP in the first quarter reflected positive contributions from personal consumption expenditures (PCE), private inventory investment, exports, state and local government spending, and nonresidential fixed investment. These movements were partly offset by a decrease in residential investment.⁵⁷

⁵⁶ JP Morgan Global Manufacturing & Services PMI, <http://www.markiteconomics.com/>

⁵⁷ US Bureau of Economic Analysis, "Gross Domestic Product: First Quarter 2019 (Third Estimate)," news release, 27 June

US economy expands in Q1 2019

Meanwhile, the manufacturing PMI decreased to 51.7 percent in June from 52.1 in May as new export orders remained weak.⁵⁸

The unemployment rate rose to 3.7 percent in June from 3.6 percent in May. Total nonfarm payroll employment increased by 224,000 during the month, with employment gains in professional and business services, health care, and transportation and warehousing. Meanwhile, on a y-o-y basis, inflation was lower at 1.8 percent in May from 2.0 percent in April. The slower inflation was due mainly to the decline in the energy price index.

The Conference Board Consumer Confidence Index fell to 121.5 in June from 131.3 in May.⁵⁹ Consumers' assessment of current business and labor market conditions and their expectations regarding the short-term outlook were less favorable in June, due partly to the escalation in trade and tariff tensions. Similarly, the Thomson-Reuters/University of Michigan Index of Consumer Sentiment decreased to 97.9 in June from 100.0 in May.⁶⁰ Consumer sentiment weakened due to expected tariffs on Mexican imports and on nearly half of all Chinese imports, as well as slowing gains in employment.

Euro Area. On a q-o-q basis, real GDP growth in the euro area rose to 0.4 percent in Q1 2019 from 0.2 percent in Q4 2018. On a y-o-y basis, real GDP expanded by 1.2 percent in Q1 2019, the same rate posted in Q4 2018.⁶¹ Meanwhile, the composite PMI for the euro area increased to 52.2 in June from 51.8 in May due mainly to a solid rise in service sector activity.⁶²

Inflation in the euro area is expected to be at 1.2 percent in June, unchanged from the record in May due to slight increase in inflation for food,

2019. https://www.bea.gov/system/files/2019-06/gdp1q19_3rd_1.pdf

⁵⁸ Institute for Supply Management,

<https://www.instituteforsupplymanagement.org>

⁵⁹ The Conference Board, <http://www.conference-board.org/>

⁶⁰ University of Michigan Survey of Consumers,

<http://www.sca.isr.umich.edu/>

⁶¹ Eurostat news release 93/2019 dated 6 June 2019

⁶² Markit Eurozone PMI, <http://www.markiteconomics.com/>

alcohol, and tobacco as well as services.⁶³ The seasonally adjusted unemployment rate decreased to 7.5 percent in May from 7.6 percent in April.

The European Commission's Economic Sentiment Indicator in the euro area decreased to 103.3 in June from 105.2 in May due to weaker confidence in the industry sector and, to a lesser extent, in the services sector and among consumers.

Japan. On a q-o-q basis, real GDP grew by 0.6 percent in Q1 2019 from 0.5 percent (revised) expansion in Q4 2018. Similarly, on a y-o-y basis, real GDP expanded by 0.9 percent in Q1 2019 from a 0.3-percent (revised) growth in the previous quarter as private demand grew faster while public demand returned to expansion.⁶⁴

Manufacturing in Japan and China eases

Meanwhile, the seasonally adjusted manufacturing PMI decreased to 49.3 in June from 49.8 in May as total new orders, especially from overseas, declined amid a slowdown in global trade.⁶⁵

Inflation fell to 0.7 percent in May from 0.9 percent in April due mainly to the decline in the prices of clothes and footwear, culture and recreation, as well as fuel, light, and water charges. The seasonally adjusted unemployment rate eased to 2.4 percent in April from 2.5 percent in March.

China. Real GDP in China expanded by 6.4 percent y-o-y in Q1 2019, unchanged from the growth rate posted in Q4 2018. The expansion in Q1 2019 was supported mainly by strong manufacturing production and greater spending by Chinese consumers.

Meanwhile, the seasonally adjusted manufacturing PMI fell to 49.4 in June from 50.2 in May as total new business and international sales declined amid reports of trade tensions.⁶⁶

⁶³ Flash estimate. Eurostat news release 104/2019 dated 28 June 2019

⁶⁴ Second Preliminary Estimate. Department of National Accounts, Economic and Social Research Institute, Cabinet Office. <http://www/esri.cao.go.jp/>

⁶⁵ Nikkei Japan Manufacturing PMI, <http://www.markiteconomics.com/>

⁶⁶ Caixin China General Manufacturing PMI, <http://www.markiteconomics.com/>

Inflation went up to 2.7 percent in May from 2.5 percent in April due mainly to higher prices of food, tobacco, and liquor.

India. Real GDP in India expanded by 5.8 percent y-o-y in Q1 2019 from 6.6 percent in the previous quarter. Albeit slower, the latest GDP expansion was driven mainly by growth in public administration, defense, and other services; construction; financial, real estate, and professional services; and electricity, gas, water supply, and other utility services.⁶⁷

Economic activity in India expands at a weaker pace

Meanwhile, the composite PMI fell to 50.8 in June from 51.7 in May due to a softer upturn in factory output and a decline in services activity.

Inflation rose to 3.1 percent in May from 3.0 percent (revised) in the previous month. The uptick in the latest inflation reading was due mainly to higher inflation for food and beverages.

ASEAN Region. The Nikkei ASEAN Manufacturing PMI fell to 49.7 in June from 50.6 in May due to declining employment trends and weak output expansion.

Overall manufacturing conditions in the ASEAN region weaken

Manufacturing output growth accelerated in Myanmar and Vietnam, but slowed down in the Philippines, Thailand, and Indonesia. Meanwhile, Malaysia and Singapore remained in the contraction territory.⁶⁸

⁶⁷ Ministry of Statistics and Programme Implementation. <http://mospi.nic.in/>

⁶⁸ Nikkei ASEAN Manufacturing PMI, <http://www.markiteconomics.com/>

Policy Actions by Central Banks. On 6 June 2019, the Reserve Bank of India (RBI) decided to reduce the policy repo rate under the liquidity adjustment facility by 25 bps to 5.75 percent. The Monetary Policy Committee of the RBI noted that growth impulses have weakened significantly amid a widening output gap. At the same time, the inflation path remained below the RBI's target, even after accounting for the impact of the two previous policy rate cuts this year, including a 25-bps cut in April.

Central banks in the region have eased their monetary policy settings

Similarly, on 4 June 2019, the Reserve Bank of Australia decided to lower the cash rate by 25 bps to 1.25 percent to support employment growth and bring inflation closer towards the medium-term target. The recent inflation outcomes in Australia have been lower than expected and suggest subdued inflationary pressures.

On 8 May 2019, the Reserve Bank of New Zealand (RBNZ) reduced the official cash rate (OCR) by 25 bps to 1.5 percent to support the outlook for employment and inflation. Based on the RBNZ's assessment, further monetary stimulus may be necessary given the recent easing of domestic spending and projected ongoing headwinds to growth and employment.

Similarly, during its 7 May 2019 policy meeting, Bank Negara Malaysia (BNM) decided to lower the Overnight Policy Rate (OPR) by 25 bps to 3.0 percent to preserve the degree of monetary accommodativeness amid some signs of tightening financial conditions, even as domestic monetary and financial conditions remain supportive of the Malaysian economy.

Meanwhile, aside from the BSP, the Reserve Bank of New Zealand, Bank of Thailand (BOT), the Central Bank of the Republic of China (Taiwan), Bank Indonesia (BI), Bank of England (BOE), the US Federal Reserve, Bank of Japan (BOJ), and the European Central Bank (ECB) kept their respective policy rates unchanged in June.

The People's Bank of China (PBOC) did not announce any adjustment in its benchmark one-year lending rate during the quarter. However, on 6 May 2019, the PBOC announced that it would reduce the reserve requirement ratio (RRR) for about 1,000 small- and medium-sized banks to 8.0 percent from the current 10 to 11.5 percent to help lower funding costs for small and micro firms. The adjustment in the RRR is expected to release about 280 billion yuan (US\$41 billion) and will be implemented in three phases, effective on 15 May, 17 June, and 15 July this year. Since early 2018, the PBOC has already delivered five RRR cuts, reducing the ratio to 13.5 percent for big banks and 11.5 percent for small- to medium-sized lenders.

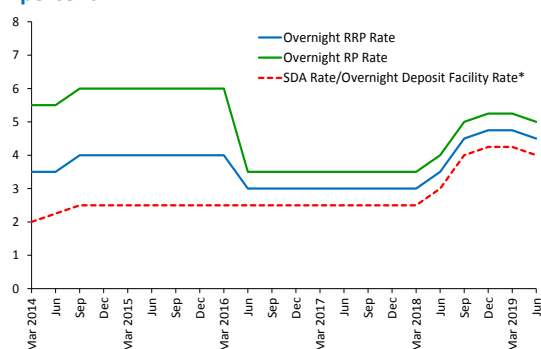
V. Monetary Policy Developments

At its monetary policy meeting on 9 May 2019, the BSP reduced the key policy rate by 25 bps to 4.50 percent for the overnight reverse repurchase or RRP facility. The interest rates on the overnight lending and deposit facilities were likewise raised accordingly.

The BSP reduces the key policy rate early in the quarter...

The BSP's decision was based on its assessment that the inflation outlook continues to be manageable, with easing price pressures owing to the decline in food prices amid improved supply conditions. Latest baseline forecasts indicate that inflation remains likely to settle within the target range of 3.0 percent \pm 1.0 percentage point for both 2019 and 2020, while inflation expectations have moderated further.

Chart 38. BSP Policy Rates in percent



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

In deciding on the stance of monetary policy, the BSP noted the impact of the budget delays on near-term economic activity, but took the view that the prospects for domestic demand remain firm, to be supported by a projected recovery in household spending and the continued implementation of the government's infrastructure program. In addition, the BSP observed that the global economic growth momentum has slowed down in 2019. Meanwhile, indications of slower growth in domestic liquidity and credit require careful monitoring.

Equally important, the BSP also noted that the risks to the inflation outlook remain broadly balanced for 2019 amid risks of a prolonged El Niño episode and higher-than-expected increases in global oil prices. For 2020, the risks continue to lean toward the downside as weaker global economic activity could temper commodity price pressures.

...and thereafter maintains its monetary policy stance

Meanwhile, in deciding to maintain the BSP's monetary policy settings at its monetary policy meeting on 20 June 2019, the BSP noted that the latest baseline forecasts indicate that inflation remains likely to settle within the target range of 3.0 percent \pm 1.0 percentage point for both 2019 and 2020, while inflation expectations have moderated further. The BSP also noted that while real sector activity moderated in the first quarter of the year, overall domestic economic activity is likely to remain firm, supported by a projected recovery in household spending and the continued implementation of the government's infrastructure program.

At the same time, the BSP observed that the risks to the inflation outlook are broadly balanced for 2019 and 2020. Weaker global economic prospects amid a possible easing in global demand and increased trade tensions continue to temper the inflation outlook. The potential adverse effects of a prolonged El Niño episode remain a key upside risk to inflation.

On balance, therefore, the BSP believed that the manageable inflation outlook and firm domestic growth prospects support keeping monetary policy settings steady for the time being. A prudent pause allows the BSP to observe and assess the impact of prior monetary adjustments including the phased reduction in the reserve requirements to be completed by the end of July.

The BSP reiterated that, looking ahead, it will continue to monitor emerging price and output conditions to ensure that monetary policy remains in line with the BSP's price stability objective while being supportive of economic growth.

VI. Inflation Outlook

BSP Inflation Forecasts

The latest baseline forecasts indicate that inflation will continue to ease and is expected to settle within the 3.0 percent \pm 1.0 percentage point target range for 2019 and 2020. Inflation is projected to decelerate close to the low-end of the target range in Q3 2019 before settling close to the midpoint of the target over the medium term.

The decline in the forecast path compared to the previous report can be attributed primarily to easing food prices which contributed to the lower-than-expected inflation outturns in Q2 2019.

The risks to the inflation outlook are broadly balanced for 2019 and 2020. Higher electricity rates, transport fare adjustments, proposed adjustments in the excise taxes on alcoholic beverages and cigarettes, and a prolonged *El Niño* episode are the main upside risks to inflation.

Meanwhile, slower global economic growth due to protectionist policies between the US and China as well as geopolitical tensions continue to be the main downside risks to inflation.

Inflation will continue to ease and is projected to settle within the target range in 2019 – 2020

Demand Conditions. Domestic growth prospects continue to be firm despite the slight deceleration in Q1 2019. Domestic economic activity slowed down to 5.6 percent in Q1 2019 from the 6.3 percent growth in Q4 2018 and 6.5 percent expansion in Q1 2018. On the expenditure side, growth was driven by acceleration in household consumption and increased investments growth. On the production side, the industry and services sectors continue to be the primary drivers of the expansion.

Economic activity in Q2 2019 could be boosted by the midterm national elections as well as the rebound in the tourism-related sectors. However, the delay in the implementation of the 2019 national budget could lower public construction and expenditures. The government is expected to

catch up with the implementation of its social programs and infrastructure projects by H2 2019.

Looking ahead, prospects for the domestic economy remains solid. Domestic growth could be supported by the services sector and public construction. Private demand is expected to remain robust, aided mainly by sustained remittance inflows and lower inflation. Private capital formation should likewise contribute to economic growth with construction and investments in durable equipment likely to remain positive as the government's projects and other infrastructure programs get underway.

High-frequency real sector indicators also point to firm growth prospects in the near term. Capacity utilization for the manufacturing sector suggests that more than half of all major manufacturing sectors are operating at or above 80.0 percent. The composite PMI also remains above the 50-point mark as of May 2019, suggesting sustained expansion across all sectors. Moreover, results of the BSP expectations surveys indicated improved business sentiment and broadly steady consumer confidence in Q2 2019.

Supply Conditions. Food inflation could decline further over the near term due to the implementation of non-monetary measures to ease import requirements, such as the passage of the Rice Tariffication Law. Meanwhile, the volatility in the global crude oil market and the possibility of a prolonged *El Niño* episode could pose additional upside pressures on food prices.

Improved domestic food supply conditions have contributed to decelerating price pressures

The deceleration in global non-fuel prices is expected to continue over the medium term. Heightened trade tensions have affected global trade and investments thereby dampening global demand for commodities. Prices of agricultural commodities and metals could remain stable in the near term due to subdued demand conditions. Commodity prices started to decline in the H2 2018 with the trade barriers imposed by the US and China. Similarly, metal prices have fallen

following the effects of tariffs on consumer and capital goods.

In the domestic front, *palay* and corn production could decrease by 6.5 percent and 10.2 percent, respectively, in Q2 2019 based on standing crop estimates by the PSA. The projected drop in *palay* and corn production could be attributed to a decline in harvest areas from 2018 levels.⁶⁹

The reforms in rice importation could significantly lower food prices in 2019. With the implementation of the Rice Tariffication Law and the accelerated issuance of certifications for the private sector's out-quota rice importation by the NFA, domestic rice prices could decline to levels similar to major import sources of rice, such as Thailand and Vietnam.

Meanwhile, international crude oil prices increased during the start of the quarter due mainly to higher-than-announced production cuts by OPEC and selected non-OPEC countries, the implemented sanctions by the US against Iran and Venezuela, and supply disruptions in other major producers. However, global oil prices started to decline sharply in June 2019 as demand was weighed down by market concerns on global growth owing to the continuing trade dispute between the US and China. Uncertainties surrounding the oil market could further emanate from supply dynamics and extent of trade dispute between the US and China as well as the extension of the production cut by OPEC and other non-OPEC countries.

The latest futures prices indicate that global crude oil prices could remain subdued in 2019-2020. This is in line with projections of the EIA along with other international agencies for crude oil prices to remain broadly steady in the near term.

Domestic economic activity remains generally in line with potential growth

The balance of demand and supply conditions as captured by the output gap (or the difference between actual and potential output), provides an

⁶⁹ PSA, Updates on April-June 2019 Palay and Corn Estimates, May 2019, available online at <http://www.psa.gov.ph>

indication of potential inflationary pressures in the near term.⁷⁰

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

Key assumptions used to generate the BSP's inflation forecasts. The BSP's baseline inflation forecasts are based on the following assumptions:

- 1) BSP's overnight RRP rate at 4.50 percent from July 2019 to December 2020;
- 2) NG fiscal deficits for 2019 to 2020, which are consistent with the DBCC-approved estimates;
- 3) Dubai crude oil price assumptions consistent with the trend of futures prices of oil in the international market;
- 4) Increase in nominal wage in November 2019 and November 2020 consistent with historical wage increases;
- 5) Real GDP growth is endogenously determined; and
- 6) Foreign exchange rate is endogenously determined through the purchasing power parity and interest rate parity relationships.

Risks to the Inflation Outlook

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

Compared to the previous inflation report, the latest fan chart shows a downward shift in the inflation projections. The decline in the forecast path can be attributed primarily to easing food prices which contributed to the lower-than-expected inflation outturns in Q2 2019.

⁷⁰ Inflation tends to rise (fall) when demand for goods and services exert pressure on the economy's ability to produce goods and services, i.e., when the output gap is positive (negative).

⁷¹ Based on the seasonally-adjusted GDP growth

Lower projected inflation path is due to deceleration in food prices

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

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

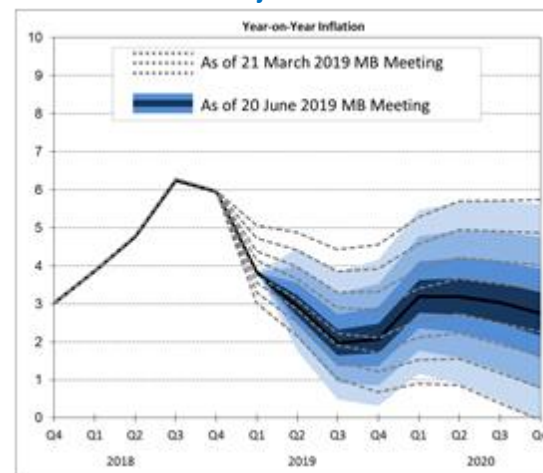
Higher excise taxes for cigarettes and alcoholic beverages likewise present an upside risk to inflation. The Senate approved S.B. 2233 on 3 June 2019 and was subsequently adopted by Congress to raise taxes on cigarettes and tobacco products (0.9 percent of the CPI basket) to fund the Universal Healthcare Act. Under the bill, the tax per pack of cigarettes will be raised on a staggered basis to ₱60.00 per pack in 2023 and subject to a 5.0 percent annual indexation onwards from the current level of ₱37.5 per pack.

The DOF has proposed to raise the sin taxes of alcoholic beverages (0.7 percent of the CPI basket). Under the proposed bill, the specific taxes of distilled spirits, wines, and fermented liquor indicated in the Sin Tax Reform Act of 2012 (Republic Act No. 10351) could be raised on top of the higher annual indexation of 7.0 percent from 4.0 percent previously.

A weak *El Niño* weather condition could present additional price pressures on food prices. A prolonged weak *El Niño* condition could affect domestic agricultural production. The latest assessment of the Philippine Atmospheric, Geophysical and Astronomical Services Administration (PAGASA) showed slightly warmer average temperatures to last until the end of 2019. Nonetheless, the projected rainfall conditions remain normal and could minimize damages from the warmer weather conditions.

The risks to the inflation outlook are broadly balanced in 2019 and 2020

Chart 39. Inflation Projection



Source: BSP estimates

The slower global economic outlook and the escalation of trade tensions remain as the primary downside risk to the outlook. The April 2019 World Economic Outlook (WEO) highlighted continued policy uncertainty such as the state of regulatory and fiscal policies in the US, spillovers from tighter global financial conditions, and geopolitical risks as the primary downside risks to global growth over the medium term. Meanwhile, the escalation of trade tensions between the US and China on global trade and investments could result in further downward adjustments to world growth. The imposition of additional trade barriers would raise consumer prices and the cost of capital goods, thereby dampening momentum from consumption and investment.

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

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

Implications for the Monetary Policy Stance

Given easing price pressures during the second quarter, the BSP deemed it appropriate to reduce the policy rate by 25 basis points (bps) on 9 May 2019. At the same time, the Monetary Board recognized that the downtrend in domestic inflation over the past few months provided scope for a phased reduction in reserve requirements for banks and NBQBs, with the initial cut taking effect on the reserve week beginning 31 May 2019.

Subsequently, at its meeting on 20 June 2019, the Monetary Board decided to maintain the BSP's monetary policy settings to allow prior monetary adjustments to work their way through the traditional channels of monetary policy. Latest baseline inflation forecasts continue to indicate a within-target trajectory in 2019 and 2020, with broadly balanced risks to the inflation outlook over the policy horizon. Inflation expectations have likewise moderated further amid declining inflation readings. Domestic growth momentum has also remained firm, supported by a projected recovery in household spending and the continued implementation of the government's infrastructure spending program.

With a manageable inflation outlook and firm prospects for domestic economic growth, a prudent pause allows the BSP to observe and assess the impact of its monetary adjustments during the second quarter. In particular, the phased reduction in reserve requirements, which will be completed by the end of July 2019, is expected to help temper the impact of tighter domestic liquidity conditions at the start of the year and thereby support real sector activity in the coming months. Meanwhile, increased uncertainty over global macroeconomic prospects also offer scope for the BSP to hold its policy settings steady for the time being. These developments require the BSP to remain vigilant to ensure that monetary policy settings remain in line with its price stability objective while being supportive of economic growth.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
2 0 0 8			
31 Jan 2008	5.00	7.00	The Monetary Board (MB) decided to reduce by 25 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 RRP, 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 \pm 1 percentage point target range in 2008 and the 3.5 \pm 1 percentage point target range in 2009.
13 Mar 2008 24 Apr 2008	5.00	7.00	The MB decided to keep the BSP's key policy interest rates at 5 percent for the overnight borrowing or RRP facility and 7 percent for the overnight lending or RP facility. The MB also decided to implement immediately the following refinements in the SDA facility: (1) the closure of existing windows for the two-, three-, and six-month tenors; and (2) the reduction of the interest rates on the remaining tenors. The interest rates on term RRP and RPs were also left unchanged.
5 Jun 2008	5.25	7.25	The MB decided to increase by 25 bps the BSP's key policy interest rates to 5.25 percent for the RRP facility and 7.25 percent for RP facility as emerging baseline forecasts indicate a likely breach of the inflation target for 2008 along with indications that supply-driven pressures are beginning to feed into demand. Given the early evidence of second-round effects, the MB recognized the need to act promptly to rein in inflationary expectations. The interest rates on term RRP, RPs, and SDAs were also increased accordingly.
17 Jul 2008	5.75	7.75	The MB increased by 50 bps the BSP's key policy interest rates to 5.75 percent for the overnight borrowing or RRP facility and 7.75 percent for the overnight lending or RP facility. The interest rates on term RRP, RPs, and SDAs were also increased accordingly.
28 Aug 2008	6.00	8.00	The MB increased by 25 bps the BSP's key policy interest rates to 6.0 percent for the overnight borrowing or RRP facility and 8.0 percent for the overnight lending or RP facility. The interest rates on term RRP, RPs, and SDAs were also increased accordingly.
6 Oct 2008 6 Nov 2008	6.00	8.00	The MB kept the BSP's key policy interest rates unchanged at 6.0 percent for RRP facility and 8.0 percent for the RP facility. The interest rates on term RRP, RPs, and SDAs were also left unchanged.
18 Dec 2008	5.50	7.50	The MB decided to reduce the BSP's key policy interest rates by 50 bps to 5.5 percent for the overnight borrowing or RRP facility and 7.5 percent for the overnight lending or RP facility. The interest rates on term RRP, RPs, and SDAs were also adjusted accordingly. Latest baseline forecasts showed a decelerating inflation path over the policy horizon, with inflation falling within target by 2010. This outlook is supported by the downward shift in the balance of risks, following the easing of commodity prices, the moderation in inflation expectations, and the expected slowdown in economic activity.
2 0 0 9			
29 Jan 2009	5.00	7.00	The MB decided to reduce the BSP's key policy interest rates by another 50 bps to 5 percent for the overnight borrowing or RRP facility and 7 percent for the overnight lending or RP facility. The interest rates on term RRP, RPs, and SDAs were also adjusted accordingly. Latest baseline forecasts showed a decelerating inflation path over the policy horizon, with inflation falling within target by 2010. The MB based its decision on the latest inflation outlook which shows inflation falling within the target range for 2009 and 2010. The Board noted that the balance of risks to inflation is tilted to the downside due to the softening prices of commodities, the slowdown in core inflation, significantly lower inflation expectations, and moderating demand.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
5 Mar 2009	4.75	6.75	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 4.75 percent for the overnight borrowing or RRP facility and 6.75 percent for the overnight lending or RP facility. The interest rates on term RRP, RP, and SDAs were also reduced accordingly. Given possible upside risks to inflation, notably the volatility in oil prices and in exchange rates, increases in utility rates, and potential price pressures coming from some agricultural commodities, the MB decided that a more measured adjustment of policy rates was needed.
16 Apr 2009	4.50	6.50	The MB reduced key policy rates by another 25 bps to 4.5 percent for the overnight borrowing or RRP facility and 6.5 percent for the overnight lending or RP facility, effective immediately. This rate cut brings the cumulative reduction in the BSP's key policy rates to 150 bps since December last year. The current RRP rate is the lowest since 15 May 1992. Meanwhile, the interest rates on term RRP, RP, and SDAs were also reduced accordingly. In its assessment of macroeconomic conditions, the MB noted that the latest baseline inflation forecasts indicated a lower inflation path over the policy horizon, with average inflation expected to settle within the target ranges in 2009 and 2010. In addition, the MB considered that the risks to inflation are skewed to the downside given expectations of weaker global and domestic demand conditions and a low probability of a significant near-term recovery in commodity prices.
28 May 2009	4.25	6.25	The MB decided to reduce the BSP's key policy interest rates by another 25 bps to 4.25 percent for the overnight borrowing or RRP facility and 6.25 percent for the overnight lending or RP facility. The interest rates on term RRP, RP, and SDAs were also reduced accordingly. Baseline forecasts indicated a lower inflation path over the policy horizon, with average inflation expected to settle within the target ranges in 2009 and 2010. In addition, the Monetary Board considered that, on balance, the risks to inflation are skewed to the downside given expectations of weaker global and domestic demand conditions and a low probability of a significant near-term recovery in commodity prices.
9 Jul 2009	4.00	6.00	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 4 percent for the overnight borrowing or RRP facility and 6 percent for the overnight lending or RP facility, effective immediately. The interest rates on term RRP, RP, and SDAs were reduced accordingly. This is the sixth time since December 2008 that the BSP has cut its policy interest rates.
20 Aug 2009 1 Oct 2009 5 Nov 2009 17 Dec 2009	4.00	6.00	The MB kept key policy rates unchanged at 4 percent for the RRP facility and 6 percent for the overnight lending RP facility. The decision to maintain the monetary policy stance comes after a series of policy rate cuts since December 2008 totaling 200 bps and other liquidity enhancing measures.
2010			
28 Jan 2010 11 Mar 2010 22 Apr 2010 3 Jun 2010 15 Jul 2010 26 Aug 2010 7 Oct 2010 18 Nov 2010 29 Dec 2010	4.00	6.00	The MB decided to keep the BSP's key policy interest rates steady at 4 percent for the RRP facility and 6 percent for the RP facility. The interest rates on term RRP, RP, and SDAs were also left unchanged.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
2 0 1 1			
10 Feb 2011	4.00	6.00	The MB decided to keep the BSP's key policy interest rates steady at 4 percent for the overnight borrowing or RRP facility and 6 percent for the overnight lending or RP facility. The interest rates on term RRP, RP, and SDAs were also left unchanged.
24 Mar 2011	4.25	6.25	The MB decided to increase by 25 bps the BSP's key policy interest rates to 4.25 percent for the overnight borrowing or RRP facility and 6.25 percent for the overnight lending or RP facility. The interest rates on term RRP, RP, and SDAs were also raised accordingly. The MB's decision was based on signs of stronger and broadening inflation pressures as well as a further upward shift in the balance of inflation risks. International food and oil prices have continued to escalate due to the combination of sustained strong global demand and supply disruptions and constraints.
5 May 2011	4.50	6.50	The MB decided to increase the BSP's key policy interest rates by another 25 bps to 4.5 percent for the overnight borrowing or RRP facility and 6.5 percent for the overnight lending or RP facility. The interest rates on term RRP, RP, and SDAs were also raised accordingly. Baseline inflation forecasts continue to suggest that the 3-5 percent inflation target for 2011 remains at risk, mainly as a result of expected pressures from oil prices.
16 Jun 2011	4.50	6.50	The MB decided to keep policy rates steady at 4.5 percent for the overnight borrowing or RRP facility and 6.5 percent for the overnight lending or RP facility. At the same time, the Board decided to raise the reserve requirement on deposits and deposit substitutes of all banks and non-banks with quasi-banking functions by one percentage point effective on Friday, 24 June 2011. The MB's decision to raise the reserve requirement is a preemptive move to counter any additional inflationary pressures from excess liquidity.
28 Jul 2011	4.50	6.50	The MB maintained the BSP's key policy interest rates at 4.5 percent for the overnight borrowing or RRP facility and 6.5 percent for the overnight lending or RP facility. At the same time, the Board increased anew the reserve requirement on deposits and deposit substitutes of all banks and non-banks with quasi-banking functions by one percentage point effective on 5 August 2011. The MB's decision to raise the reserve requirement anew is a forward-looking move to better manage liquidity.
8 Sep 2011 20 Oct 2011 1 Dec 2011	4.50	6.50	The MB decided to keep the overnight policy rates steady. At the same time, the reserve requirement ratios were kept unchanged.
2 0 1 2			
19 Jan 2012	4.25	6.25	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 4.25 percent for the overnight borrowing or RRP facility and 6.25 percent for the overnight lending or RP facility. The interest rates on term RRP, RP, and SDAs were also reduced accordingly. The MB's decision is based on its assessment that the inflation outlook remains comfortably within the target range, with expectations well-anchored and as such, allowed some scope for a reduction in policy rates to help boost economic activity and support market confidence.
1 Mar 2012	4.00	6.00	The MB decided to reduce the BSP's key policy interest rates by another 25 bps to 4.0 percent for the overnight borrowing or RRP facility and 6.0 percent for the overnight lending or RP facility. The interest rates on term RRP, RP, and SDAs were also reduced accordingly. The MB is of the view that the benign inflation outlook has allowed further scope for a measured reduction in policy rates to support economic activity and reinforce confidence.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
19 Apr 2012	4.00	6.00	The MB decided to keep the BSP's key policy interest rates steady at 4.0 percent for the overnight borrowing or RRP facility and 6.0 percent for the overnight lending or RP facility. The interest rates on term RRP, RP, and SDAs were also left unchanged.
14 Jun 2012	4.00	6.00	The MB decided to keep the BSP's key policy interest rates steady at 4.0 percent for the overnight borrowing or RRP facility and 6.0 percent for the overnight lending or RP facility. The interest rates on term RRP, RP, and SDAs were also left unchanged. The MB's decision was based on its assessment that the inflation environment remains manageable. Baseline forecasts continue to track the lower half of the 3-5 percent target range for 2012 and 2013, while inflation expectations remain firmly anchored. At the same time, domestic macroeconomic readings have improved significantly in Q1 2012.
26 Jul 2012	3.75	5.75	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 3.75 percent for the overnight borrowing or RRP facility and 5.75 percent for the overnight lending or RP facility. The interest rates on term RRP, RP, and SDAs were also reduced accordingly. This is the third time in 2012 that the BSP has cut its policy rates. The MB's decision was based on its assessment that price pressures have been receding, with risks to the inflation outlook slightly skewed to the downside. Baseline forecasts indicate that inflation is likely to settle within the lower half of the 3-5 percent target for 2012 and 2013, as pressures on global commodity prices are seen to continue to abate amid weaker global growth prospects. At the same time, the MB is of the view that prospects for global economic activity are likely to remain weak.
13 Sep 2012	3.75	5.75	The MB decided to keep the BSP's key policy interest rates steady at 3.75 percent for the overnight borrowing or RRP facility and 5.75 percent for the overnight lending or RP facility. The interest rates on term RRP, RP, and SDAs were also left unchanged. The MB's decision was based on its assessment that the inflation environment remains benign, with the risks to the inflation outlook appearing to be broadly balanced.
25 Oct 2012	3.50	5.50	The MB decided to reduce the BSP's key policy interest rates by 25 bps to 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRP, RP, and SDAs were also reduced accordingly. This is the fourth time in 2012 that the BSP has cut its policy rates. The MB's decision was based on its assessment that the inflation environment continued to be benign with latest baseline forecasts indicating that the future inflation path will remain within target for 2012-2014. A rate cut would also be consistent with a symmetric response to the risk of below-target inflation.
13 Dec 2012	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRP, RP, and SDAs were also left unchanged. The MB's decision was based on its assessment that current monetary settings remained appropriate, as the cumulative 100-basis-point reduction in policy rates in 2012 continued to work its way through the economy.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
2 0 1 3			
24 Jan 2013	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRP's and RPs were also maintained accordingly. The reserve requirement ratios were kept steady as well. At the same time, the MB decided to set the interest rates on the SDA facility at 3.00 percent regardless of tenor, effective immediately, consistent with the BSP's continuing efforts to fine-tune the operation of its monetary policy tools.
14 Mar 2013	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rate on the RRP was also set at 3.50 percent regardless of tenor. Following its previous decision to rationalize the SDA facility in January 2013, the MB further reduced the interest rates on the SDA facility by 50 bps to 2.50 percent across all tenors effective immediately.
25 Apr 2013	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rate on the RRP was also set at 3.50 percent regardless of tenor. Meanwhile, the SDA rate was further reduced by 50 basis points to 2.0 percent across all tenors.
13 Jun 2013 25 Jul 2013 12 Sep 2013 24 Oct 2013 12 Dec 2013	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRP's, RPs, and SDA were also maintained.
2 0 1 4			
6 Feb 2014	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRP's, RPs, and SDA were also maintained.
27 Mar 2014	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRP's, RPs, and SDA were also maintained. Meanwhile, the MB decided to increase the reserve requirement by one percentage point effective on 11 April 2014.
8 May 2014	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRP's, RPs, and SDA were also maintained. Meanwhile, the MB decided to increase the reserve requirements for U/KBs and TBs by a further one percentage point effective on 30 May 2014.
19 Jun 2014	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRP's and RPs were also maintained. The reserve requirement ratios were left unchanged as well. Meanwhile, the MB decided to raise the interest rate on the SDA facility by 25 basis points from 2.0 percent to 2.25 percent across all tenors effective immediately.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
31 Jul 2014	3.75	5.75	The MB decided to increase the BSP's key policy rates by 25 bps to 3.75 percent for the overnight borrowing or RRP facility and 5.75 percent for the overnight lending or RP facility. The interest rates on term RRP's and RPs were also raised accordingly. The rate on special deposit accounts (SDA) was left unchanged. Meanwhile, the reserve requirement ratios were also kept steady.
11 Sep 2014	4.00	6.00	The MB decided to increase the BSP's key policy rates by 25 bps to 4.0 percent for the overnight borrowing or RRP facility and 6.0 percent for the overnight lending or RP facility. The interest rates on term RRP's, RPs, and SDA were also raised accordingly. Meanwhile, the reserve requirement ratios were left unchanged.
23 Oct 2014 11 Dec 2014	4.00	6.00	The MB decided to maintain the BSP's key policy interest rates at 4.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRP's, RPs, and special deposit accounts were also kept steady. The reserve requirement ratios were left unchanged as well.
2015			
12 Feb 2015 26 Mar 2015 14 May 2015 25 Jun 2015 13 Aug 2015 24 Sep 2015 12 Nov 2015 17 Dec 2015	4.00	6.00	The MB decided to maintain the BSP's key policy interest rates at 4.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRP's, RPs, and special deposit accounts were also kept steady. The reserve requirement ratios were left unchanged as well.
2016			
11 Feb 2016 23 Mar 2016 12 May 2016	4.00	6.00	The MB decided to maintain the BSP's key policy interest rates at 4.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRP's, RPs, and special deposit accounts were also kept steady. The reserve requirement ratios were left unchanged as well.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)			Monetary Policy Decisions
	Overnight Reverse Repurchase Facility	Overnight Deposit Facility	Overnight Lending Facility	
2 0 1 6				
23 Jun 2016				<p>The BSP formally adopted an interest rate corridor (IRC) system as a framework for conducting its monetary operations. The shift to IRC is an operational adjustment and not a change in the monetary policy stance. The IRC is a system for guiding short-term market rates towards the BSP policy interest rate which is the overnight reverse repurchase (RRP) rate. The IRC system consists of the following instruments: standing liquidity facilities, namely, the overnight lending facility (OLF) and the overnight deposit facility (ODF); the overnight RRP facility; and a term deposit auction facility (TDF). The interest rates for the standing liquidity facilities form the upper and lower bound of the corridor while the overnight RRP rate is set at the middle of the corridor. The repurchase (RP) and Special Deposit Account (SDA) windows will be replaced by standing overnight lending and overnight deposit facilities, respectively. Meanwhile, the reverse repurchase (RRP) facility will be modified to a purely overnight RRP. In addition, the term deposit facility (TDF) will serve as the main tool for absorbing liquidity.</p> <p>The interest rates for these facilities will be set as follows starting 3 June 2016:</p> <ul style="list-style-type: none"> • 3.5 percent in the overnight lending facility (a reduction of the interest rate for the upper bound of the corridor from the current overnight RP rate of 6.0 percent); • 3.0 percent in the overnight RRP rate (an adjustment from the current 4.0 percent); and • 2.5 percent in the overnight deposit facility (no change from the current SDA rate).
11 Aug 2016				
22 Sep 2016	3.00	2.50	3.50	
10 Nov 2016				
22 Dec 2016				
2 0 1 7				
9 Feb 2017				<p>The MB decided to maintain the BSP's key policy interest rates at 3.0 percent for the overnight (RRP) facility, 3.5 percent for the overnight lending facility (OLF) and 2.5 percent for the overnight deposit facility (ODF). The reserve requirement ratios were left unchanged as well.</p>
23 Mar 2017				
11 May 2017				
22 Jun 2017	3.00	2.50	3.50	
10 Aug 2017				
21 Sep 2017				
9 Nov 2017				
14 Dec 2017				

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)			Monetary Policy Decisions
	Overnight Reverse Repurchase Facility	Overnight Deposit Facility	Overnight Lending Facility	
2 0 1 8				
8 Feb 2018	3.00	2.50	3.50	The MB decided to maintain the BSP's key policy interest rates at 3.0 percent for the overnight RRP facility, 3.5 percent for the OLF and 2.5 percent for the ODF.
15 Feb 2018				The reserve requirement ratio was reduced by one (1) percentage point as an operational adjustment to support the BSP's shift toward a more market-based implementation of monetary policy as well as its broad financial market reform agenda. The reduction will apply to the reservable liabilities of all banks and non-bank financial institutions with quasi-banking functions with reserve requirement at twenty (20) percent.
22 Mar 2018	3.00	2.50	3.50	The MB decided to maintain the BSP's key policy interest rates at 3.0 percent for the overnight RRP facility, 3.5 percent for the OLF and 2.5 percent for the ODF.
10 May 2018	3.25	2.75	3.75	The MB decided to increase the BSP's key policy interest rates by 25 basis points to 3.25 percent for the overnight RRP facility, 3.75 percent for the OLF and 2.75 percent for the ODF.
24 May 2018				The reserve requirement ratio was reduced by one (1) percentage point as part of its medium-term financial market reform agenda to promote a more efficient financial system by lowering intermediation costs. The reduction will apply to those reservable liabilities of all banks and non-bank financial institutions with quasi-banking functions that are currently subject to a reserve requirement of nineteen (19) percent.
20 Jun 2018	3.50	3.00	4.00	The MB decided to raise the BSP's key policy interest rates by 25 basis points to 3.50 percent for the overnight RRP facility, 4.00 percent for the OLF and 3.00 percent for the ODF.
9 Aug 2018	4.00	3.50	4.50	The MB decided to raise the BSP's key policy interest rates by 50 basis points to 4.00 percent for the overnight RRP facility, 4.50 percent for the OLF and 3.50 percent for the ODF.
27 Sep 2018	4.50	4.00	5.00	The MB decided to raise the BSP's key policy interest rates by 50 basis points to 4.50 percent for the overnight RRP facility, 5.00 percent for the OLF and 4.00 percent for the ODF.
15 Nov 2018	4.75	4.25	5.25	The MB decided to raise the BSP's key policy interest rates by 25 basis points to 4.75 percent for the overnight RRP facility, 5.25 percent for the OLF and 4.25 percent for the ODF.
13 Dec 2018	4.75	4.25	5.25	The MB decided to maintain the BSP's key policy interest rates at 4.75 percent for the overnight RRP facility, 5.25 percent for the OLF and 4.25 percent for the ODF.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)			Monetary Policy Decisions
	Overnight Reverse Repurchase Facility	Overnight Deposit Facility	Overnight Lending Facility	
2 0 1 9				
7 Feb 2019 21 Mar 2019	4.75	4.25	5.25	The MB decided to keep the BSP's key policy interest rates at 4.75 percent for the overnight RRP facility, 5.25 percent for the OLF and 4.25 percent for the ODF.
9 May 2019	4.50	4.00	5.00	The MB decided to reduce the BSP's key policy interest rates by 25 basis points to 4.50 percent for the overnight RRP facility, 5.00 percent for the OLF and 4.00 percent for the ODF.
16 May 2019				The MB decided to reduce the reserve requirements by 200 basis points (or 2 percentage points) which shall be implemented according to the following schedule: 100 basis points on 31 May 2019; 50 basis points on 28 Jun 2019; and 50 basis points on 26 Jul 2019. The reduction will apply to those reservable liabilities of universal and commercial banks (U/KBs) that are currently subject to a reserve requirement of eighteen (18) percent.
23 May 2019				The MB complemented the reduction in reserve requirements for universal and commercial banks (U/KBs) with a phased 200-basis-point reduction in the reserve requirements for thrift banks (TBs) and non-bank financial institutions with quasi-banking functions (NBQBs), as well as a 100-basis-point reduction for demand deposits and NOW accounts of rural and cooperative banks on 31 May 2019. Moreover, long-term negotiable certificates of time deposits issued by all banks and NBQBs will have reduced and uniform reserve requirement ratio of 4.0 percent. The reductions on reserve requirements will take effect for U/KBs, TBs, and NBQBs on the reserve weeks beginning 31 May 2019, 28 Jun 2019, and 26 Jul 2019. The lower ratios shall apply to all reservable liabilities except bonds and mortgage/chattel mortgage certificates as the BSP continues to assess the impact of a reduction in the reserve requirements on said instruments.
20 Jun 2019	4.50	4.00	5.00	The MB decided to maintain the BSP's key policy interest rates at 4.50 percent for the overnight RRP facility, 5.00 percent for the OLF and 4.00 percent for the ODF.

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



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.

The BSP also welcomes feedback from readers on the contents of the Inflation Report as well as suggestions on how to improve the presentation. Please send comments and suggestions to the following addresses:

By post: BSP Inflation Report
 c/o Department of Economic Research
 Bangko Sentral ng Pilipinas
 A. Mabini Street, Malate, Manila
 Philippines 1004

By e-mail: bspmail@bsp.gov.ph