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INFLATION REPORT

Q2 2018

BANGKO SENTRAL NG PILIPINAS

Foreword

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

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

The government's target for annual headline inflation under the inflation targeting framework has been set at 3.0 percent ± 1.0 percentage point (ppt) for 2018-2020 by the Development Budget Coordination Committee (DBCC). This is consistent with the desired disinflation path over the medium term, favorable trends in inflation dynamics, and expected higher capacity of the economy for growth under a low inflation environment.

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

The Monetary Board approved this Inflation Report at its meeting on 12 July 2018.

NESTOR A. ESPENILLA, JR.
Governor

The Monetary Policy of the Bangko Sentral ng Pilipinas

The BSP Mandate

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

Monetary Policy Instruments

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

Policy Target

The BSP's target for monetary policy uses the Consumer Price Index (CPI) or headline inflation rate, which is compiled and released to the public by the National Statistics Office (NSO). The policy target is set by the Development Budget Coordination Committee (DBCC)[2] in consultation with the BSP. The inflation target for 2018-2020 is 3.0 percent ± 1.0 ppt.[3]

BSP's Explanation Clauses

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

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

The Monetary Board

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

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The Advisory Committee

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

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Bank Officer VI, Provident Fund Office

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

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

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

List of Acronyms, Abbreviations, and Symbols

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

Contents

Overview

Headline inflation increases further. Headline inflation in Q2 2018 rose to 4.8 percent from the quarter- and year-ago rates of 3.8 percent and 2.8 percent, respectively, using the 2012-based Consumer Price Index (CPI) series. This brought the year-to-date average inflation to 4.3 percent, higher than the upper end of the National Government's (NG) announced target range of 3.0 percent ± 1.0 percentage point for the year. Inflation pressures in Q2 came from both food and non-food items. Food inflation registered an uptick of 5.5 percent as food commodities such as corn, vegetables, sugar, jam, honey, chocolate, and confectionery posted higher prices. Likewise, inflation for non-food items was at 3.4 percent as prices for domestic petroleum products remained elevated. Similarly, core inflation increased to 3.8 percent in Q2, higher than the quarter- and year-ago rates of 3.0 percent and 2.5 percent, respectively. The BSP's alternative measures for the weighted median, trimmed mean, and net of volatile items measures were also higher at 3.0 percent (from 2.4 percent), 3.4 percent (from 2.5 percent), and 3.7 percent (from 2.8 percent), respectively. The number of CPI items with inflation rates greater than the threshold of 4.0 percent (the upper end of the 2018 inflation target) rose further to 61 items in Q2 from 48 items in the previous quarter. Collectively, these items accounted for 46.8 percent of the CPI basket, higher than 22.3 percent in the previous quarter.

Inflation expectations rise. The BSP's survey of private sector economists for June 2018 showed that mean inflation forecasts for 2018-2020 were higher relative to the results in March 2018. Private sector economists' average inflation forecast for 2018 was at 4.5 percent, a rise from 4.1 percent in the previous survey. Mean inflation forecasts for 2019 and 2020 likewise increased as both were estimated at 3.8 percent from 3.7 percent and 3.6 percent, respectively, in the previous survey round. Analysts noted that key upside risks to inflation in 2018 include higher and volatile global oil prices, weakening peso, effects of the implementation of the TRAIN law on prices of domestic goods; and rising global inflation, among others. Similarly, results of the June 2018 Consensus Economics inflation forecast survey showed that respondents expect 2018 average inflation to increase to 4.4 percent from 4.0 percent in the March 2018 survey. Mean inflation forecast for 2019 was also higher at 3.7 percent from 3.5 percent in the previous month's survey.

Domestic economy grows firmly. Real GDP expanded by 6.8 percent in Q1 2018, higher than 6.5 percent registered a quarter- and year-ago. The Q1 growth rate tracked closely the lower end of the NG's growth target of 7.0 - 8.0 percent for 2018. On the expenditure side, domestic activity was stronger on account of the expansion in capital formation and household consumption. On the production side, output was supported by the strong performance in the services and industry sectors.

Q2 headline inflation rises above the high end of target range

In addition, high-frequency real sector indicators suggested continued firm growth prospects in the near term. The composite Purchasing Managers' Index as of April 2018 remained above the 50-point expansion threshold, indicating upbeat prospects in the months ahead. Similarly, consumer sentiment improved while business confidence remained positive for the current and next quarter. In contrast, vehicle sales contracted as the imposition of higher excise taxes on automobiles induced buyers toward earlier acquisition of units.

Global economy continues to improve. The JP Morgan Global All-Industry Output Index continued to suggest strong economic improvement in the months ahead, owing to faster rates of expansion in key economies. In the US, Q1 2018 real GDP grew at a higher rate of 2.8 percent. Consequently, inflation increased slightly due mainly to higher inflation for energy and shelter. Similarly, manufacturing PMI indicated faster expansion amid robust demand. In the euro area, Q1 2018 growth remained broadly steady as inflation rose on price increases in services, energy and food. The euro composite PMI also remained steady in the expansion territory. In China, growth remained robust in Q1 2018, driven mainly by the services industry and manufacturing, as inflation remained unchanged. At the same time, the seasonally adjusted manufacturing PMI was broadly unchanged. In contrast, Japan's real GDP grew at a slower rate in Q1 2018, attributed to the lower growth in both private and public demand. Inflation increased marginally. Nevertheless, the seasonally adjusted manufacturing PMI remained firmly in the expansion territory.

Domestic financial system remains resilient amid uncertainty. Uncertainty in the external environment coming from the continuing policy normalization in the US, trade tensions between key economies, as well as in the domestic front such as the current account deficit, higher inflation and a depreciating peso contributed to pressure on the resilience of the Philippine financial system despite the strong Q1 GDP outturn. The Philippine Stock Exchange index retreated by 11.1 percent, quarter-on-quarter, to average 7,623.21 index points during the review quarter. Similarly, sovereign debt spreads widened mainly on external developments as the peso continued to depreciate, averaging ₱52.45/US$1 during the review quarter. Nevertheless, investor demand for government securities remained healthy as evidenced by oversubscriptions to the Bureau of the Treasury's regular auctions of T-bills and T-bonds, and issuance of the Retail Treasury Bonds. In addition, the banking system saw continued increases in total assets, lending, and deposits, while capital adequacy ratios remained comfortably above the BSP's prescribed levels and international norms. Meanwhile, based on the latest round of the BSP survey on senior bank loan officers, bank lending standards for loans to both enterprises and households were broadly unchanged in Q2 2018, indicating a stable supply of credit.

The BSP raises key policy rates in Q2 2018. At its monetary policy meeting on 10 May, the BSP raised its policy rate by 25 basis points to 3.25 percent for the overnight reverse repurchase or RRP facility. In the 20 June meeting, the BSP decided to hike the policy rate by another 25 basis points to 3.50 percent as a follow-through action.

In deciding to raise the key policy interest rate twice during the review quarter, the BSP noted that inflation expectations remained elevated for 2018 and that the risk of possible second-round effects from ongoing price pressures argued for follow-through monetary policy action.

Although inflation expectations remain within the target range for 2019, elevated expectations for 2018 highlight the risk posed by sustained price pressures on future wage and price outcomes.

Increased inflation expectations, risk of second-hand effects call for monetary policy response

The sum of new information during the quarter suggests appropriateness of monetary policy response. Latest baseline forecasts using the 2012-based CPI series show that inflation could average above the target range for 2018 and revert back to the target range by 2019. Risks to the inflation outlook remain on the upside. Additional wage adjustments and transport fare hikes due to higher excise taxes on petroleum products and other key commodities, and faster-than-expected monetary policy normalization in the US are among the main upside risks to future inflation. Meanwhile, slower global economic growth and the proposed reform in the rice industry are the main downside risks to inflation.

With higher baseline inflation projections and the balance of risks skewing to the upside, an increase in policy rates was seen to be appropriate. Policy rate actions also serve to stem the build-up in inflation expectations and possible second-round effects from ongoing cost-push price pressures.

Nevertheless, there is also increased optimism on the passage of the proposed rice tariffication bill which should result in downward pressure on food prices and help curb inflation expectations in the near-term. Meanwhile, prospects for aggregate demand are expected to remain solid, suggesting that the economy as a whole will be able to sustain its momentum. Social mitigating measures by the National Government could also likely provide a stabilizing influence on inflation expectations in the near term while allowing sufficient time for the economy to adjust to the recent monetary actions. The BSP continues to emphasize its vigilance and readiness for follow-through action as necessary to safeguard the BSP's inflation objective.

I. Inflation and Real Sector Developments

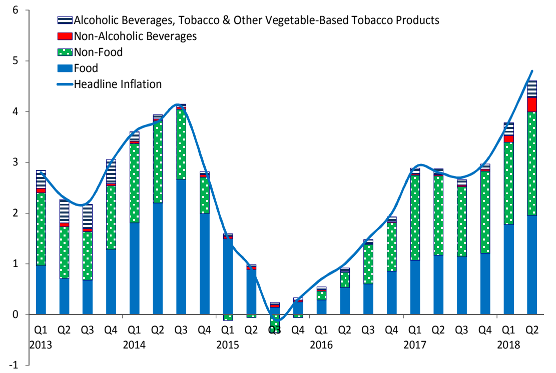
Prices

Headline inflation rises. Headline inflation in Q2 2018 was at 4.8 percent, higher from quarter-ago and year-ago rates of 3.8 percent and 2.8 percent, respectively, using the 2012-based Consumer Price Index (CPI) series.

Q2 headline inflation is higher at 4.8 percent

This brought the year-to-date (ytd) average inflation to 4.3 percent which is above the high end of the National Government's (NG) announced target range of 3.0 percent ± 1.0 percentage point (ppt) for the year.

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



Source: Philipine Statistical Authority (PSA), BSP

Food inflation was at 5.5 percent in Q2 2018, higher compared to the previous quarter as faster price increases for commodities such as vegetables and sugar, jam, honey, chocolate, and confectionery more than offset the decline for meat, fish, milk, cheese, and eggs prices. Likewise, non-food inflation rose to 3.4 percent in Q2 2018 as most non-food groups, registered higher prices during the quarter.

Core Inflation. Core inflation - which measures generalized pressures by excluding volatile items such as food and energy – also increased to 3.8 percent in Q2 2018, higher than 3.0 percent in Q1 2018 and 2.5 percent in Q2 2017, using the 2012-based CPI series. In terms of the BSP-computed alternative measures for core inflation, the weighted median, trimmed mean, and net of volatile items measures of core inflation were higher at 3.0 percent (from 2.4 percent), 3.4 percent (from 2.5 percent), and 3.7 percent (from 2.8 percent), respectively.

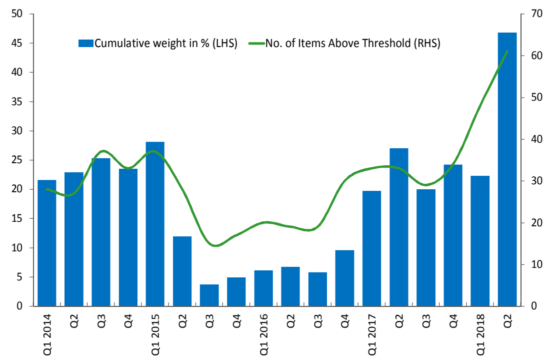
Table 1. Alternative Core Inflation Measures
quarterly averages of year-on-year change

Quarter	Official Headline Inflation	Official Core Inflation	Trimmed Mean [1]	Weighted Median [2]	Net of Volatile Items [3]
2014	**3.6**	**2.6**	**1.5**	**1.9**	**-0.6**
Q1	3.6	2.8	2.5	2.5	0.6
Q2	3.8	2.6	2.2	2.4	-0.3
Q3	4.1	2.7	1.4	1.8	-0.8
Q4	2.9	2.1	0.1	0.9	-1.8
2015	**0.7**	**1.0**	**1.5**	**1.7**	**1.2**
Q1	1.5	1.3	2.4	2.6	1.5
Q2	0.9	1.3	1.6	1.7	1.3
Q3	-0.1	0.8	1.0	1.3	1.0
Q4	0.3	0.8	1.0	1.1	1.2
2016	**1.3**	**1.6**	**1.2**	**1.1**	**1.5**
Q1	0.7	1.0	0.9	1.0	1.2
Q2	1.0	1.2	1.1	1.0	1.4
Q3	1.5	1.7	1.3	1.0	1.6
Q4	2.0	2.2	1.3	1.2	1.7
2017	**2.9**	**2.4**	**1.6**	**1.5**	**2.1**
Q1	2.9	2.7	1.6	1.5	2.2
Q2	2.8	2.5	1.5	1.4	1.9
Q3	2.7	2.3	1.6	1.5	2.0
Q4	3.0	2.4	1.8	1.5	2.1
2018					
Q1	3.8	3.0	2.5	2.4	2.8
Q2	**4.8**	**3.8**	**3.4**	**3.0**	**3.7**

[1] The trimmed mean represents the average inflation rate of the (weighted) middle 70 percent in a lowest-to-highest ranking of year-on-year inflation rates for all CPI components.
[2] The weighted median represents the middle inflation rate (corresponding to a cumulative CPI weight of 50 percent) in a lowest-to-highest ranking of year-on-year inflation rates.
[3] The net of volatile items method excludes the following items: bread and cereals, vegetables sugar, jam, honey, chocolate, and confectionery, electricity, gas, fuels and lubricants for personal transport equipment, and passenger transport by road, which represents 29.5 percent of all items.
Source: PSA, BSP estimates

The number of CPI items with inflation rates greater than the threshold of 4.0 percent (the upper end of the 2018 inflation target) rose further to 61 items in Q2 2018 from 48 items in the previous quarter, using the 2012-based CPI series. Majority of these items were food commodities. Collectively, these items accounted for 46.8 percent of the CPI basket, larger than the quarter-ago share of 22.3 percent.

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



Source: PSA, BSP staff estimates

Food Inflation. Food inflation (2012=100) registered an uptick at 5.5 percent in Q2 2018 compared to 5.0 percent in Q1 2018 and 3.3 percent in Q2 2017. Food commodities such as corn, vegetables, sugar, jam, honey, chocolate, and confectionery, and food products not elsewhere classified posted elevated prices during the quarter. Similarly, rice prices went up in Q2 2018 due to some tightness in domestic supply amid lower inventory levels.

Food inflation registers an uptick

At the same time, non-alcoholic beverages increased to 9.9 percent (from 4.6 percent) while alcoholic beverages and tobacco items (ABT) continued to post double-digit growth of 20.5 percent (from 15.9 percent in the previous quarter) due to effects of higher excise tax on sugar-sweetened beverages and tobacco products.

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

Commodity	2017				2018	
	Q1	Q2	Q3	Q4	Q1	Q2
Food and Non-Alcoholic Beverages	**2.9**	**3.1**	**2.9**	**3.3**	**5.0**	**5.9**
Food	3.0	3.3	3.2	3.4	5.0	5.5
Bread and Cereals	0.9	1.1	1.0	1.1	2.8	4.2
Rice	1.0	1.1	0.9	0.9	2.6	4.4
Corn	-3.4	-4.6	-2.2	4.2	9.7	13.7
Meat	2.4	4.9	4.6	5.6	6.4	5.0
Fish and Seafood	5.0	7.7	8.3	8.9	12.2	11.7
Milk, Cheese and Eggs	2.3	2.4	2.2	2.1	2.1	2.0
Oils and Fats	4.6	4.9	4.5	4.3	4.0	3.2
Fruit	8.3	7.0	4.8	3.3	6.1	5.8
Vegetables	10.2	3.3	2.6	2.1	3.9	7.4
Sugar, Jam, Honey, Chocolate and Confectionery	1.1	-0.4	-1.2	-1.9	-1.4	1.4
Food Products, N.E.C.	0.7	0.0	0.5	0.9	2.0	3.2
Non-Alcoholic Beverages	0.9	0.9	1.1	1.2	4.6	9.9
Alcoholic Beverages, Tobacco and Other Vegetable-Based Tobacco Products	7.0	7.2	6.8	6.5	15.9	20.5

Source of Basic Data: PSA, BSP

Non-Food Inflation. Likewise, Q2 2018 inflation for non-food (2012=100) items was at 3.4 percent from 2.7 percent in the previous quarter.

Non-food inflation increases

Heavily-weighted CPI commodities specifically, actual rentals for housing and catering services contributed positively to the higher Q2 2018 inflation. Moreover, prices for domestic petroleum products remained elevated during the quarter, reflecting rising international crude oil prices. Other non-food commodity groups such as clothing and footwear, furnishing, household equipment, and routine household maintenance, health, communication, and education likewise posted faster price increases during the quarter.

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

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

Source of Basic Data: PSA, BSP

Private Sector Economists' Inflation Forecasts. Results of the BSP's survey of private sector economists for June 2018 showed that mean inflation forecasts for 2018-2020 were higher relative to the results in March 2018.

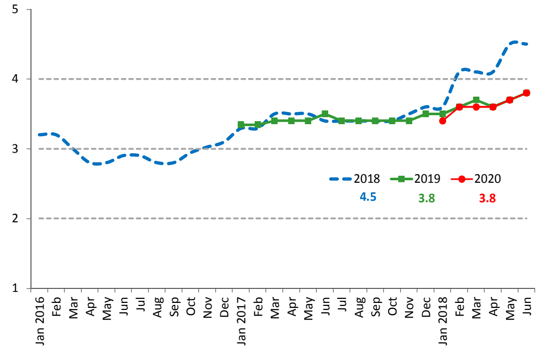
Private sector economists' mean inflation forecasts for 2018 – 2020 are higher

The survey on private sector economists for June 2018 showed that the mean inflation forecast for 2018 rose to 4.5 percent from 4.1 percent in the March 2018 survey.[4] Likewise, mean inflation forecasts for 2019 and 2020 both increased to 3.8 percent (from 3.7 percent and 3.6 percent, respectively in the previous survey round).

[4] There were 24 respondents in the BSP's survey of private sector economists in June 2018. The survey was conducted from 13 to 18 June 2018.

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 2018 (2012=100)



*Based on forecasts provided by 24 out of 30 respondents.
Source: BSP

Analysts noted that risks to inflation in 2018 remain tilted to the upside. Possible upside risks to inflation are the higher and volatile global oil prices; weakening peso; effects of the implementation of R.A. 10963 or the Tax Reform for Acceleration and Inclusion (TRAIN) law on the prices of domestic goods; higher government spending on infrastructure; potential rise in wages; adverse weather conditions; higher utility rates; and the rising global inflation. The key downside risk to inflation was seen to emanate from the removal of quantitative restrictions on rice importation which could reduce domestic rice prices.

Table 4. Private Sector Forecasts for Inflation

annual percentage change; June 2018 (2012=100)

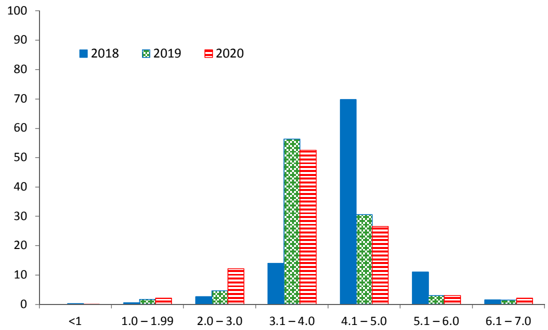
	2018			2019	2020
	Q3	Q4	FY	FY	FY
1) Al-Amanah Islamic Bank	4.50	4.30	4.20	4.00	3.50
2) Asia ING	4.20	4.10	4.30	3.80	3.60
3) Banco de Oro	4.80	4.10	4.50	3.80	-
4) Bangkok Bank	4.70	4.80	4.60	4.80	5.00
5) Bank of Commerce	4.86	4.50	4.46	-	-
6) Bank of China Ltd.	4.70	4.80	4.60	4.50	4.40
7) Barclays	4.50	4.30	4.30	3.80	-
8) Citibank	5.30	4.80	4.70	3.10	3.10
9) Chinabank	4.60	4.20	4.20	3.80	3.80
10) CTBC Bank	4.50	4.30	4.30	4.00	3.80
11) Credit Suisse	4.80	4.60	4.50	3.70	3.60
12) Deutsche Bank	-	-	4.70	4.20	-
13) Korea Exchange Bank	4.13	4.13	4.03	3.83	3.83
14) Maybank	4.63	4.50	4.40	4.05	4.20
15) Maybank-ATR KimEng	4.50	4.10	4.20	3.80	3.10
16) Metrobank	-	-	4.50	3.40	-
17) Mizuho	4.30	4.00	4.30	-	-
18) Nomura	5.10	4.70	4.60	3.50	-
19) Robinsons Bank	4.70	4.40	4.40	3.50	2.80
20) Philippine Equity Partners	5.10	4.90	4.60	3.40	-
21) Security Bank	5.30	5.10	4.70	3.30	3.40
22) Standard Chartered	5.10	6.00	5.20	4.90	4.20
23) Union Bank of the Phils.	4.90	4.70	4.80	3.60	4.00
24) UBS	4.90	4.70	4.60	3.80	-
Median Forecast	4.7	4.5	4.5	3.8	3.8
Mean Forecast	**4.7**	**4.5**	**4.5**	**3.8**	**3.8**
High	5.3	6.0	5.2	4.9	5.0
Low	4.1	4.0	4.0	3.1	2.8
Number of Observations	22	22	24	22	15
Government Target	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**

Source: BSP

Meanwhile, inflation is anticipated to moderate, stabilize, and settle within the 2-4 percent target range in 2019 to 2020 as TRAIN's inflationary impact tapers off.

Based on the probability distribution of the forecasts provided by 20 out of 24 respondents, there is a 16.6-percent probability that average inflation for 2018 will settle between the 2-4 percent range, while there was an 82.8-percent chance that inflation will rise beyond 4 percent. For 2019, the respondents assigned a 60.8-percent probability that inflation will fall within the 2-4 percent target range.

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



*Probability distributions were averages of those provided by 20 out of 24 respondents.
Source: BSP June 2018 Survey

Results of the June 2018 Consensus Economics inflation forecast survey for the Philippines showed that respondents expect 2018 inflation to increase to 4.4 percent from 4 percent in the March 2018 survey.[5] Similarly, mean inflation forecast for 2019 was higher at 3.7 percent from 3.5 percent in the previous month's survey.

Based on the Q2 2018 BSP Business Expectations Survey (BES), a higher number of respondents expected inflation to increase in the current quarter relative to the previous quarter (from a diffusion index of 61.3 percent to 63.5 percent).

Businesses expect within-target inflation; consumers expect a breach in the upper end of target range

[5] There were 16 respondents in the Consensus Economics' survey in June 2018.

By contrast, the number of respondents that expect inflation to increase in the next quarter went down (from 49.2 percent to 47.1 percent). Businesses expect the rate of increase in consumer prices to stay within the 2 to 4 percent BSP inflation target range in Q2 and Q3 2018 both at 3.8 percent.

Meanwhile, results of the Consumer Expectations Survey (CES) for Q2 2018 indicated that consumers expect inflation to breach the upper end of the governments's target range of 2-4 percent in the next 12 months at 4.2 percent. This is lower than the 4.7 percent expected inflation rate in the Q1 2018 survey.

Energy prices. The average spot price of Dubai crude oil rose by 12.9 percent in Q2 2018 compared to the previous quarter over geopolitical risks concerning Iran and Venezuela.

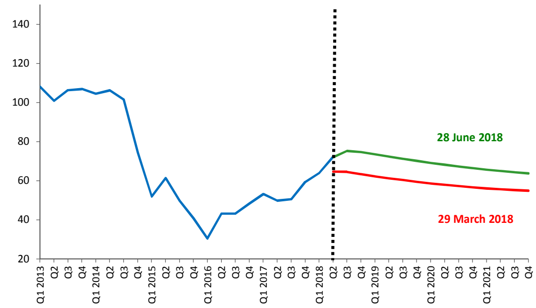
Oil prices remain elevated on geopolitical tensions

Dubai crude oil prices increased significantly in Q2 2018 due to geopolitical tensions between the United States and selected key oil producers namely, Iran and Venezuela. In May 2018, the US announced its withdrawal from the Joint Comprehensive Plan of Action (JCPOA) and sanctioned companies doing business with Iran. At the same time, declining oil production from Venezuela also contributed to the price increase.

Nevertheless, there are other factors exerting downward pressure on oil prices namely, announcements from major producers like Saudi Arabia and Russia that it would evaluate possibly increasing production given output declines from Venezuela and uncertatinty surrounding Iran production. In late June 2018, the Organization of the Petroleum Exporting Countries (OPEC) and non-OPEC Ministerial Meeting reaffirmed their commitment to the required level of conformity and agreed to voluntarily adjust its compliance to 100 percent for the second half of 2018. This is in light of the 147-percent compliance rate in May 2018 based on OPEC data.[6]

Rising US crude oil production is also a downside risk to oil prices as US Energy Information Administration (EIA) expects US output to exceed 10 million barrels per day (mb/d) in 2018-2019.[7] Likewise, demand concerns stemming from possible trade war between the US and China has also led to price declines during the quarter.

Chart 5. Spot and Estimated Prices of Dubai Crude Oil



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

Estimated futures prices of Dubai crude oil as of end-June 2018,[8] which are based on movements of Brent crude oil, showed a higher path for 2018 to 2021 compared to the estimates in the previous quarter.[9]

In terms of supply-demand outlook[10], the US EIA expects demand to outstrip supply in 2018 before reverting to surplus in 2019. Projections for global oil production was adjusted downwards for both 2018 and 2019 due largely to OPEC while demand forecast was unchanged relative to the previous month's (May 2018) report.[11]

[6] Source: "The 4th OPEC and non-OPEC Ministerial Meeting concludes" Press Release No 14/2018, 23 June 2018, URL: http://www.opec.org/opec_web/en/press_room/5081.htm

[7] US EIA Short-Term Energy Outlook (June 2018), URL: https://www.eia.gov/outlooks/steo/pdf/steo_text.pdf

[8] Future prices using Brent crude futures data. Taken as of 28 June 2018.

[9] Future prices derived using Brent crude futures data. Taken as of 29 March 2018. Source: BSP-staff calculations, Bloomberg.

[10] Using US EIA forecast of International Petroleum and Other Liquids Balance, Short-Term Energy Outlook (June 2018)

[11] Source: US EIA Short-Term Energy Outlook (June 2018). Forecast Comparisons: International Crude Oil and Liquid Fuels. https://www.eia.gov/outlooks/steo/pdf/ compare.pdf

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

Domestic Oil Products	Year-to-Date (June 2018)					
	Increase		Decrease		Net Adjustments	
	Number	Amount (₱/liter)	Number	Amount (₱/liter)	Number	Amount (₱/liter)
Gasoline	13	17.27	12	-11.37	1	5.90
Kerosene	17	15.55	8	-6.89	9	8.66
Diesel	15	21.30	10	-13.85	5	7.45
LPG	4	3.74	3	-2.90	1	0.84

Source: Department of Energy (DOE)

On a cumulative basis, net adjustments of domestic petroleum prices remained positive in the first half of 2018. Net adjustment of gasoline, kerosene, and diesel went up by ₱5.90 per liter, ₱8.66 per liter, and ₱7.45 per liter, respectively. Likewise, LPG prices increased slightly by ₱0.84 per liter in end-June compared to the end-2017 level.

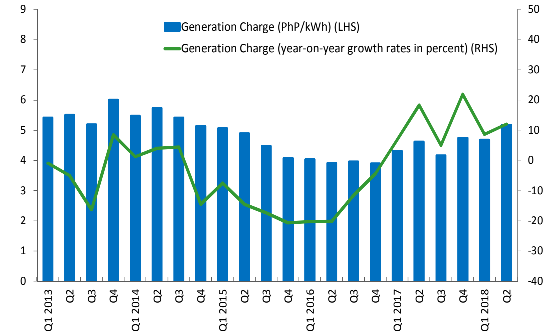
Power. For Q2 2018, the overall electricity rate in the Meralco franchised area increased by around ₱0.64 per kilowatt hour (kWh) to ₱10.14 per kWh (from ₱9.50 per kWh in Q1 2017). The upward adjustment was due mainly to increases in generation charge.

Electricity prices increase on upward adjustment in generation charge

The adjustment in the generation cost in Q2 2018, on average, increased by ₱0.49 per kWh to ₱5.17 per kWh (from ₱4.68 per kWh in Q1 2018). The upward adjustment in the generation cost in Q2 2018 was primarily due to higher generation charge from the Wholesale Electricity Spot Market (WESM). The higher charge from the WESM was due to tighter supply conditions in the Luzon grid. With warmer temperature, demand for power in the Luzon grid increased by about 357 megawatts (MW) and 239 MW in April and June, respectively.

Chart 6. Meralco's Generation Charge

Ph₱/kWh; year-on-year growth rates in percent



Source: Meralco

There are potential sources of upside pressures on electricity charges. Meralco has existing petitions for rate increases with ERC which include the petition to implement the Maximum Average Price for 2012, 2013, 2014, and 2015, amended application for a rate increase in the January 2014 billing (consisting of incremental fuel costs and deferred generation cost to be collected monthly for six months); and petitions for the refund of generation over/under recovery (GOUR), transmission over/under recovery (TOUR), system loss over/under recovery (SLOUR), and lifeline subsidy over/under recovery (LSOUR) for the period January-December 2011.

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

Box Article 1: Updated Core Inflation Measure for the Philippines Based on the 2012-Based CPI

I. Background

Core inflation, a widely used measure of the underlying trend in the average consumer prices, is a measure of inflation that aims to capture the permanent component of the inflationary process that can be influenced by monetary policy. It is often used as a complementary indicator to what is known as "headline" or consumer price index (CPI) inflation. While the headline inflation measures the rate of change in the CPI, a measure of the average price of a standard "basket" of goods and services consumed by a typical family, core inflation measures the change in average consumer prices after excluding from the CPI certain items with volatile price movements. By stripping out the volatile components of the CPI, core inflation allows us to see the broad underlying trend in consumer prices. Core inflation is often used as an indicator of the long-term inflation trend and as an indicator of future inflation.

The Philippine Statistics Authority (PSA) started releasing the consumer price index (CPI) series with 2012 as the new base year starting on 6 March 2018. The release of the rebased CPI series prompted a review of the official core inflation measure for the Philippines, pursuant to PSA Board Resolution No. 01, Series of 2017-096.[12] The said PSA Board Resolution (previously referred to as National Statistical Coordination Board Resolution No. 6 Series of 2003) approved the use of exclusion method for the computation of the official definition of core inflation in the Philippines.

The exclusion method simply excludes a fixed, pre-specified list of volatile CPI components (typically food and energy items) whose short-term behavior tends to diverge from that of the underlying price trend. Based on the description of the exclusion method, core inflation for the Philippines is officially defined as the year-on-year rate of change of the monthly headline CPI after excluding food and energy items. The list of excluded items from the official core inflation measure is a result of discussions among members of the Interagency Committee on Price Statistics (IACPS).[13]

Following the approval by the PSA Board of the list of excluded items from the core inflation using 2012-based CPI series during its meeting on 9 May 2018, the PSA has started publishing the official core inflation series with 2012 as base year on 5 June 2018, alongside the release of the monthly headline CPI.

II. Updated Core Inflation using 2012-based CPI Series

Consistent with previous practice in the review of official core inflation measure (whenever the CPI is rebased), the list of excluded items from the 2012-based official core inflation measure was a result of interagency technical discussions among the members of the IACPS during its meeting on 30 April 2018.[14] Subsequently, the said list of excluded items was presented to and approved by the PSA Board on 9 May 2018.

The determination of items to exclude from the 2012-based CPI data followed the same methodology used in coming up with a list of excluded items for the 2006-based official core inflation series. The process involved selecting food and energy-related items that are significantly volatile (based on historical monthly CPI data) using CPI data from the 3-digit to 5-digit level of disaggregation.

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[12]The official definition and methodology for the computation of core inflation were approved in 2003 by the National Statistical Coordination Board (NSCB) as contained in the NSCB Resolution No. 6 Series of 2003. The said resolution likewise stated that the list of excluded items shall be reviewed by the then NSCB Board and the Technical Committee on Price Statistics whenever the CPI data is rebased (Annex BR-6-2003-1). The said NSCB Board Resolution was ratified by the PSA in 2017 under PSA Board Resolution No. 01, Series of 2017-096.

[13]In the previous updating, the IACPS used to be the Technical Committee on Price Statistics (TCPS).

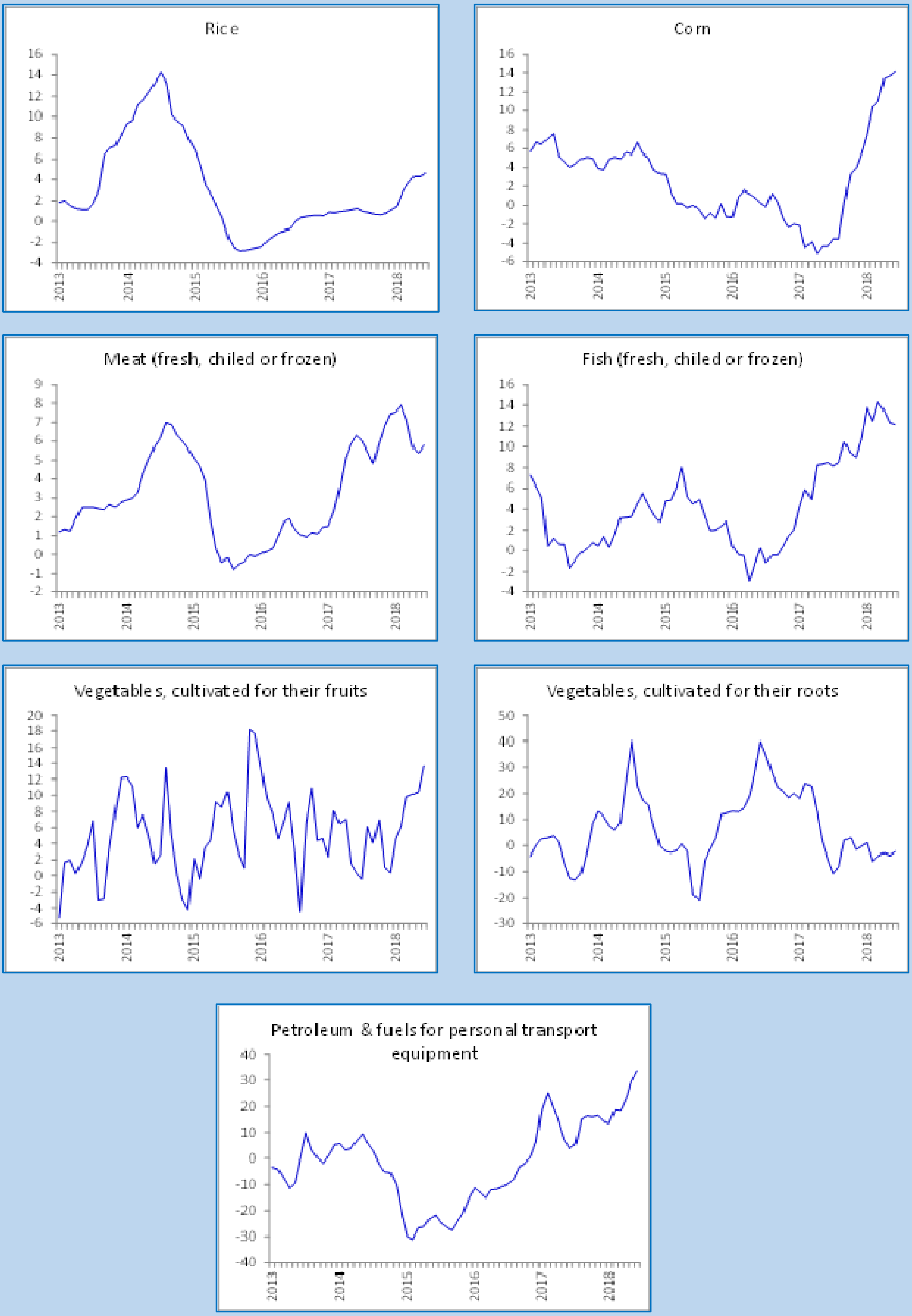
[14]The list of excluded items from the 2006-based official core inflation measure was the result of inter-agency technical discussions in 2012 among the National Statistics Office (NSO), the National Statistical Coordination Board (NSCB), the National Economic and Development Authority (NEDA), the Statistical Research and Training Center (SRTC), the National Wage and Productivity Commission (NWPC), the Department of Trade and Industry (DTI), and the Bangko Sentral ng Pilipinas (BSP).

The list of excluded items for the 2012-based official core inflation series is composed of mostly the same set of food- and energy-related items excluded from the CPI series with 2006 as base year, with the exception of fruits and natural gas and the addition of fish, as shown in *Table 1*. The total weight of excluded items will reach 22.8 percent of the CPI basket, which is 2.8-ppt higher than the total weight of excluded items from the 2006-based CPI basket at 20.0 percent. Meanwhile, the historical plots of inflation rates for each of the items excluded from the 2012-based official core inflation series are shown in *Figure 1*.

Table 1. Excluded Items from the 2006- and 2012-Based Official Core Inflation Measure

2006=100		2012=100	
CPI Item	**Weight**	**CPI Item**	**Weight**
Rice	8.9	Rice	9.6
Corn	0.7	Corn	0.6
Meat, Fresh, Chilled or Frozen	4.9	Meat, Fresh, Chilled or Frozen	4.8
Fruit, Fresh	1.5	Fish, Fresh, Chilled or Frozen	4.3
Vegetables Cultivated for their Fruit, Fresh or Dried	1.2	Vegetables Cultivated for their Fruit	0.9
Vegetables Cultivated for their Roots, Fresh or Dried	0.6	Vegetables Cultivated for their Roots	0.6
Natural Gas, Liquefied or in the Gaseous State	1.5	Petroleum and Fuels for Personal	2.0
Gas Oils for Motor Vehicles	0.7		
Total Excluded Weight	**20.0**	**Total Excluded Weight**	**22.8**
Source of Basic Data: Philippine Statistics Authority (PSA)			

Figure 1. Historical Inflation of Excluded Items, January 2013 - June 2018



Source of Basic Data: PSA

2012-based Core Inflation vs. 2006-based Core Inflation

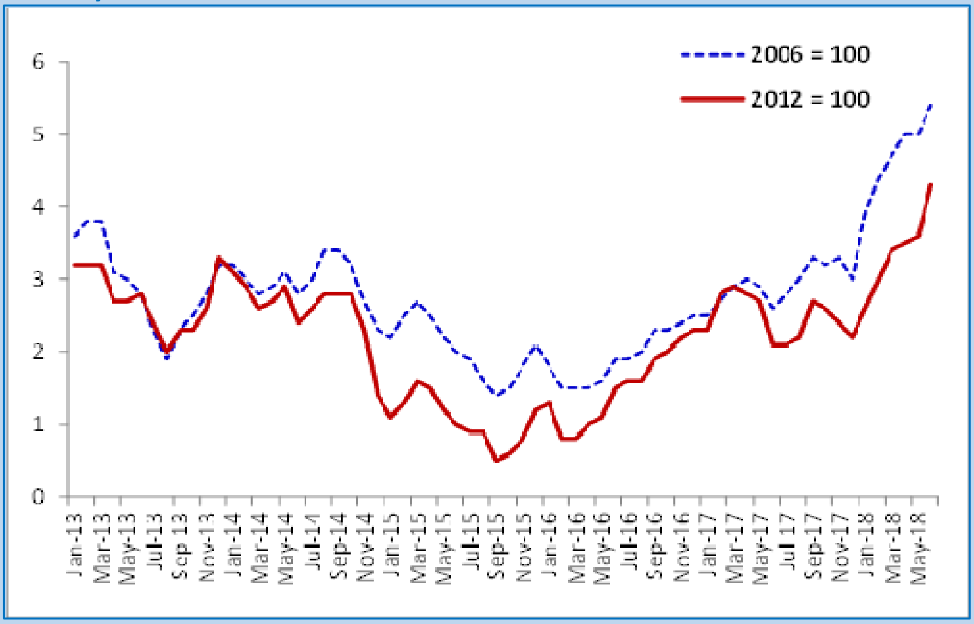
On average, the 2012-based official core inflation is lower compared with the 2006-based core inflation, consistent with the trend observed for the headline inflation series for the two base years *(Table 2)*. Meanwhile, the coefficient of variation (CV) points to a slightly more volatile 2012-based core inflation compared with the 2006-based series although formal statistical test indicated that the difference in variability of the two series is not statistically significant. A comparison of the historical plots of the 2006-based and proposed 2012-based official core inflation series are shown in *Figure 2*.

Table 2. Summary Statistics for Headline and Core Inflation Measures*
January 2013 - June 2018

Inflation Measure	Base Year	Min	Max	Mean	Standard Deviation	Coefficient of Variation
Core	2012	0.5	4.3	2.2	0.9	0.4
	2006	1.4	5.4	2.8	0.9	0.3
Headline	2012	-0.4	5.2	2.4	1.3	0.5
	2006	0.4	5.7	2.9	1.3	0.4

*Based on BSP staff computations
Source of Basic Data: PSA

Figure 2. Core Inflation: 2006-based vs 2012-based
January 2013 - June 2018

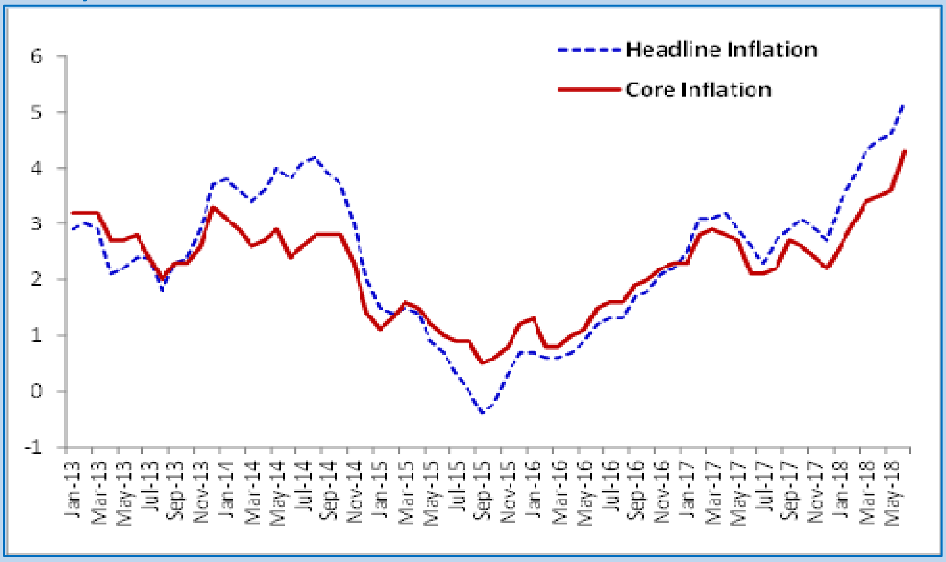


Source of Basic Data: PSA

2012-based Core Inflation vs. Headline Inflation

Figure 3 shows a comparison of the historical plots of the 2012-based official core inflation series and 2012-based headline inflation series. Based on the summary statistics computed in Table 2, the average core inflation at 2.2 percent is lower than the 2.4-percent average headline inflation rate for the period January 2012 - June 2018. At the same time, core inflation series exhibits less volatility compared to headline inflation series because of the exclusion of the historically volatile items from the CPI basket in the computation of the core inflation. This is also confirmed by formal statistical test on the difference between the variances of the two inflation series. Nonetheless, the two series generally tracks each other as shown in *Figure 3* and as evidenced by the computed positive correlation coefficient of 0.9 percent.

Figure 3. Core Inflation vs. Headline Inflation (2012=100)
January 2013 - June 2018



Source of Basic Data: PSA

Summary

The release of the 2012-based CPI series prompted a review of the list of items excluded from the official measure of core inflation pursuant to PSA Board Resolution No. 01, Series of 2017-096. The said resolution, which approved the use of exclusion method for the computation of the official definition of core inflation in the Philippines, also required a review of the list of excluded items from the core inflation every time the CPI is rebased. The PSA started releasing the 2012-based core inflation series beginning on 5 June 2018, alongside the release of the monthly headline CPI.

The list of excluded items from the official core inflation measure is a result of discussions among members of the Interagency Committee on Price Statistics. Employing the same methodology used in coming up with a list of excluded items for 2006-based core inflation series, the excluded items for the 2012-based series is composed of mostly the same set of food- and energy-related items excluded from the CPI series with 2006 as base year, with the exception of fruits and natural gas and the addition of fish. The total weight of excluded items comprises 22.8 percent of the CPI basket, which is 2.8-percentage point higher than the weight of excluded items from the 2006-based CPI basket at 20.0 percent.

The 2012-based core inflation measure generally follows the trend of the 2006-based official core inflation measure, although the 2012-based core inflation series is lower on average compared to the 2006-based official core inflation series. Meanwhile, the 2012-based core inflation series generally follows the trend of the 2012-based headline inflation series although core inflation appears to be lower than the headline inflation, on average. Core inflation series also exhibits less volatility compared to headline inflation series due to the exclusion of the historically volatile items from the CPI basket in the computation of the core inflation.

Aggregate Demand and Supply[15]

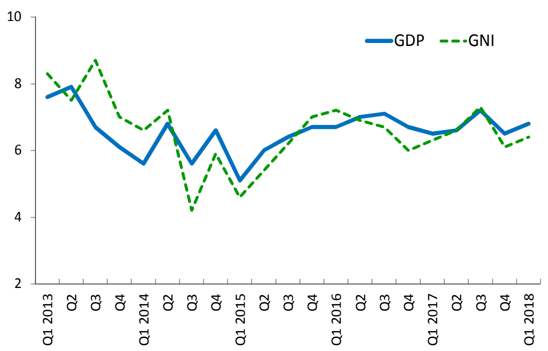
The Philippine economy grew by 6.8 percent in Q1 2018. This is higher than the 6.5-percent expansion a quarter- and year-ago.

Real GDP sustains growth in Q1 2018

On the expenditure side, the higher Q1 2018 growth was on account of the expansion in capital formation and household consumption. On the production side, the higher GDP growth for the quarter was due to the services and industry sector, while the agriculture, hunting, forestry and fishing sector contributed marginally to growth.

Gross national income (GNI) growth was also higher at 6.4 percent in Q1 2018 compared to the previous quarter's growth of 6.1 percent and the Q1 2017 growth of 6.3 percent. Likewise, net primary income posted growth of 4.3 percent in Q1 2018, higher than the 3.7-percent growth in the previous quarter but lower than the 5.5 percent growth in the same period in 2017.

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



Source: PSA

Aggregate Demand. On the expenditure side, household spending and investments (or capital formation) each contributed 3.9 ppts, and government spending contributed 1.4 percentage points to total GDP growth, offsetting the -2.9 ppts contribution of net exports.

[15] Based on National Income Accounts released as of 10 May 2018

Household spending remains a key growth driver

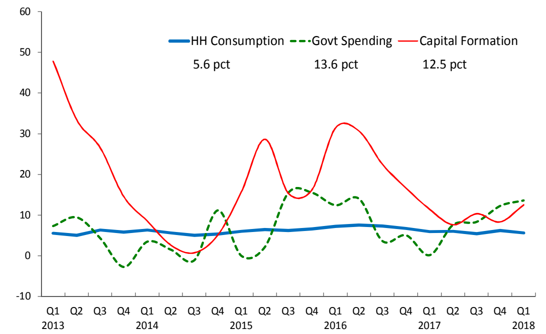
Household expenditure, which accounted for 68.8 percent of the country's output, grew at 5.6 percent in Q1 2018 slower than the 6.2-percent expansion a quarter ago and 5.9 percent growth in Q1 2017.

The slowdown in the growth of household expenditure in Q1 2018 was accounted for by the deceleration in the consumption of food and non-alcoholic beverages, housing, water, electricity, gas and other fuels, furnishings, household equipment and routine, transport, and restaurants and hotels. The contraction in the consumption of alcoholic beverages and tobacco detracted from household expenditure.

The lower consumption on food and non-alcoholic beverages from a quarter ago may be attributed to higher prices of rice, fish, and meat, which have been persistently high since February 2017. Likewise, the increase in the prices of fuel and electricity, which may have contributed to the slowdown in the spending on utilities, was brought about by the rise in crude oil prices in the world market and the enactment of the TRAIN law.

Conversely, consumption of clothing and footwear items, health and communication products, recreation and culture, and education services as well as miscellaneous goods and services continued to grow at a stronger pace in Q1 2018 vis-à-vis Q4 2017. Expenditures in these items during the review quarter were boosted by the increase in the following factors: (1) remittances from Overseas Filipino (OF) workers; (2) the weakening of the peso against the US dollar; and (3) employment growth (6.1 percent) in January 2018 from -0.3 percent in October 2017.

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



Source: PSA

Capital formation accelerated to 12.5 percent in Q1 2018 from 8.3 percent in Q4 2017 with the higher growth in public and private construction spending, breeding stock and orchard development, and inventory build-up. However, investments in durable equipment and intellectual property products slowed.

The increased investment in public sector construction stemmed from the government's commitment to expedite infrastructure development. Likewise, acceleration in the growth of private construction reflected the increased number of building permits approved in Q1 2018.

However, in Q1 2018, fixed investments in durable equipment and intellectual property products slowed to 8.4 percent and 12.7 percent, respectively, from 11.2 percent and 24.0 percent in Q4 2017. Investments in durable equipment dropped following the weak demand for specialized machinery for particular industries, transport equipment and miscellaneous equipment and as the business confidence weakened in Q1 2018. Meanwhile, the drop in the intellectual property products may be attributed to the slower pace of investment in computer software and databases.

Government expenditures continued to grow at a faster rate of 13.6 percent in Q1 2018 from 12.2 percent in Q4 2017. The expansion in subsidies was on account of continued cash assistance to Conditional Cash Transfer (CCT) beneficiary households as well as health insurance premiums for senior citizens under the National Health Program of the Philippine Health Insurance Corporation (PHIC). This also includes releases to Government-Owned and Controlled Corporations (GOCCs), such as those intended for the irrigation projects of National Irrigation Administration (NIA), rice importation program of National Food Authority (NFA), and power subsidy to the Subic Bay Metropolitan Authority (SBMA). Moreover, expenditures on personnel services grew as a result of higher salaries and the release of bonuses, which also contributed to the acceleration in government expenditures.

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

BY EXPENDITURE ITEM	2017				2018
	Q1	Q2	Q3	Q4	Q1
Household Consumption	5.9	6.0	5.4	6.2	5.6
Government Consumption	0.1	7.6	8.3	12.2	13.6
Capital Formation	11.4	7.6	10.3	8.3	12.5
Fixed Capital Formation	13.8	7.0	7.8	9.4	8.9
Exports	17.4	21.4	18.8	20.6	6.2
Imports	18.7	18.6	17.2	18.1	9.3

Source: PSA

Overall exports grew by 6.2 percent in Q1 2018, notably lower than the 20.6 percent growth in Q4 2017. This may be attributed to the significant slowdown in the growth of goods exports, i.e., 2.9 percent in Q1 2018 vs. 22.2 percent in Q4 2017, due to a contraction in semiconductor exports and a slowdown in exports of electronic data processing and metal components. Despite this, overall exports were boosted by the grown in services exports, i.e., 17.9 percent in Q1 2018 vs. 14.5 percent in Q4 2017.

Overall imports increased by 9.3 percent in Q1 2018, lower than 18.1 percent in Q4 2017. This deceleration was due to the slowdown in the imports of both goods and services. In Q1 2018, goods imports rose by only 9.3 percent, lower than 18.1 percent in Q4 2017, due to the deceleration in growth of principal import goods, including contractions in growth of mineral fuels and transport equipment. Similarly, growth of services imports in Q1 2018 was at 9.6 percent, lower than the 17.8 percent growth in Q4 2017. The main driver for the deceleration in the growth of imports of services was the lower growth imports on miscellaneous services, particularly the other business service activities (i.e., professional engineering and other business services).

Other Demand Indicators. High-frequency indicators of domestic activity continued to point to firm growth prospects in the near term. The composite Purchasing Managers' Index (PMI) remains firmly above the 50-point mark, pointing to sustained expansion across all sectors. Capacity utilization for the manufacturing sector also suggests that more than half of major manufacturing sectors operate at above 80.0 percent. Moreover, despite a contraction in vehicle sales, business and consumer sentiments remain optimistic for the current and next quarter.

Property Prices

Vacancy Rates. The overall office vacancy rate in Metro Manila increased slightly at 5.8 percent in Q1 2018 from about 5.3 percent in the previous quarter due to the completion of additional office supply.

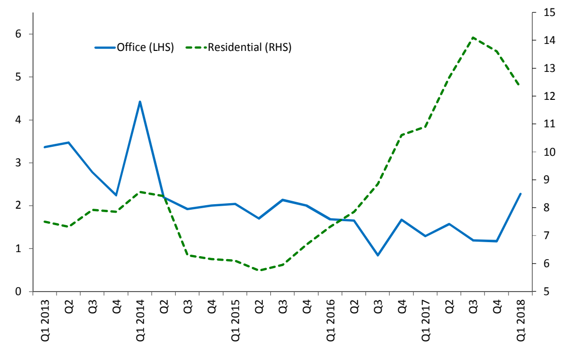
Office vacancy rates increase slightly

Office vacancy rates in Makati CBD and Ortigas Center for Q1 2018 increased relative to their quarter-ago levels of 2.3 percent (from 1.2 percent in Q4 2017) and 6.0 percent (from 3.6 percent in Q4 2017), respectively. Meanwhile, office vacancy rates in Fort Bonifacio and Manila Bay Area decreased in Q1 2018 to 4.4 percent (from 6.1 percent in Q4 2017) and 2.4 percent (from 4.3 percent in Q4 2017), respectively. With the sizeable upcoming supply, Colliers expects overall vacancy rates in Metro Manila to reach about 6-9 percent in the next two to three years.

Meanwhile, the overall residential vacancy rate in Metro Manila decreased slightly to 12.4 percent in Q1 2018 from 12.6 percent in Q1 2018 due to the strong demand from a growing Chinese community in the Manila Bay Area and Makati CBD as well as sustained demand from employees of KPO and multinational firms in Fort Bonifacio. In particular, Q1 2018 vacancy rates eased in the Makati CBD (12.3 percent from 13.6 percent), Manila Bay Area (14.7 percent from 19.0 percent), Eastwood City (5.9 percent from 6.1 percent) and Ortigas Center (6.2 percent from 6.4 percent) compared to their quarter-ago levels. On the other hand, vacancy rates in Fort Bonifacio and Rockwell Center rose compared to the previous quarter.

Colliers foresees that residential vacancy rates will range to about 12-16 percent in the next two to three years.

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



Source: Colliers International Philippines

Rental Values. Monthly Grade A office[16] rents in the Makati CBD reached ₱1,030/sq.m. in Q1 2018, representing an increase of 3.2 percent from the previous quarter. Similarly, monthly Grade A office rents in the Makati CBD were higher by 8.6 percent relative to Q1 2017.

Office rental values above 1997 levels in nominal terms

Office rental rates continued to increase amid strong demand from a diversified tenant mix from the following sectors: online gaming; traditional companies, i.e., logistics companies, construction firms, online shopping firms, and government agencies; and, business process outsourcing (BPO) firms. Colliers noted the increased leasing demand of knowledge process outsourcing (KPO) firms in Q1 2018 in spite of concerns on the reduction in fiscal incentives for BPO companies under the proposed Tax Reform for Acceleration and inclusion package 2 (TRAIN 2).

Office rental values for Grade A offices were above their 1997 levels in nominal terms. In real terms, office rental values were about 53.5 percent of the comparable levels in 1997.

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

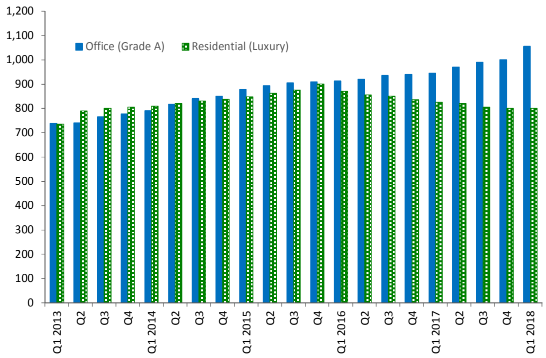
Monthly rent for luxury three-bedroom condominium units in the Makati CBD was at ₱800/sq.m. as of Q1 2018, declining by 0.4 percent from the previous quarter.

Luxury rental values decline

Likewise, the monthly rent for the 3-bedroom units was lower by 2.9 percent compared to year-ago levels. Residential rental rates in the Makati CBD as well as in Rockwell Center and Fort Bonifacio continued to drop as the rental market became more competitive due to the ample supply of residential units across CBDs. However, Colliers expect rents to increase by 1-3 percent in 2019 to 2020.

Residential rental values for luxury three-bedroom high-rise units were above their 1997 levels in nominal terms but were only about 67.9 percent of their 1997 levels in real terms.

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



Source: Colliers International Philippines

Capital Values. Capital values[17] for Grade A office buildings in the Makati CBD in Q1 2018 were higher in nominal terms than their quarter- and year-ago levels. Grade A office capital values in the Makati CBD rose to ₱204,100/sq.m., higher by 4.0 percent and by 21.2 percent compared to the quarter- and year-ago levels, respectively.

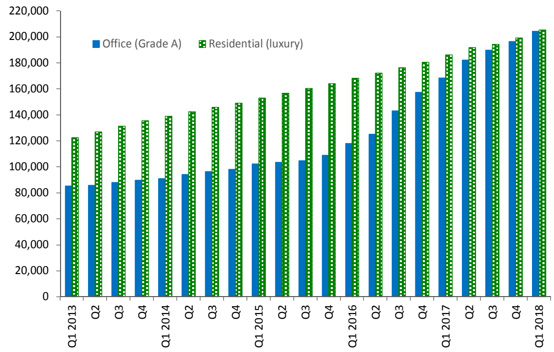
Grade A office capital values were more than two times higher than the 1997 levels in nominal terms. In real terms, office capital values were about slightly higher than the comparable levels in 1997.

Capital values for office and residential buildings rise

Likewise, capital values for luxury residential buildings[18] in Makati CBD in Q1 2018 increased to ₱205,100/sq.m. from their quarter- and year-ago levels. Average prices for three-bedroom luxury residential condominium units grew by 3.0 percent quarter-on-quarter and 10.2 percent y-o-y.

Capital values for luxury residential buildings doubled from their levels in 1997. In real terms, residential capital values were about 84.8 percent of the comparable levels in 1997.

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



Source: Colliers International Philippines

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

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

BSP Residential Real Estate Price Index.[19]

Residential real estate prices increased by 2.1 percent y-o-y in Q1 2018 as the Residential Real Estate Price Index (RREPI) rose to 116.3 from 113.9 for the same quarter a year ago.

Residential real estate prices higher in Q1 2018

Year-on-year, prices of townhouses and condominium units grew by 13.8 percent and 2 percent, respectively. Meanwhile, prices of single detached housing units declined slightly by 0.6 percent. Quarter-on-quarter, the RREPI declined marginally by 0.9 percent. The RREPI measures the average change in prices of various types of housing units comprising of single detached/attached house, duplex, townhouse, and condominium unit based on data from housing loans granted by universal, commercial, and thrift banks.

The average residential property prices in both NCR and AONCR rose by 2.7 percent and 0.9 percent compared to year-ago prices, respectively.

Residential property prices increase in NCR and AONCR

In NCR, the higher growth in prices of condominium units, townhouses, and duplexes offset the decline in prices of single detached houses. Meanwhile, the higher increase in prices of townhouses and duplexes in AONCR, outweighed the decrease in prices of single detached houses and condominium units.

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

Table 7. Residential Real Estate Price Index By Area

Q1 2014=100; growth rate in percent

Quarter	Residential Real Estate Price Index [1] (By Area)		
	Overall [2]	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
	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
	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

[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; Indices for duplex exhibit more volatility due to relatively small number of reported real estate loans.
Source: BSP

For Q1 2018, about seven in ten (73.5 percent) residential real estate loans were for the purchase of new housing units. By type of housing unit, 48.9 percent of residential property loans were for the acquisition of condominium units, followed by single detached units (43.2 percent) and townhouses (7.6 percent). By area, condominium units were the most common house purchases in NCR, while single detached houses were prevalent in AONCR. By region, NCR accounted for 48.3 percent of the total number of residential real estate loans granted during the quarter, followed by AONCR - CALABARZON (25.5 percent), Central Luzon (7.1 percent), Central Visayas (5.5 percent), Western Visayas (4.3 percent), Davao Region (3.2 percent) and Northern Mindanao (1.8 percent). Together, these seven regions accounted for 95.7 percent of total housing loans granted by banks.

Table 8. Residential Real Estate Price Index By Housing Type

Q1 2014=100; growth rate in percent

Quarter		Residential Real Estate Price Index [1] (By Housing Type)				
		Overall [2]	Single Detached/ Attached	Duplex [3]	Townhouse	Condominium Unit
2016	Q1	106.9	98.9	114.7	107.3	123.2
	Q2	111.7	105.8	98.5	109.3	123.9
	Q3	109.6	102.6	96.7	100.5	126.4
	Q4	111.1	104.9	87.5	107.7	125.5
2017	Q1	113.9	108.0	91.2	107.6	128.3
	Q2	111.8	103.6	103.6	112.7	129.3
	Q3	111.6	103.4	88.4	107.8	131.0
	Q4	117.4	104.6	102.6	116.4	143.3
2018	Q1	116.3	107.4	131.5	122.4	130.9
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
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

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

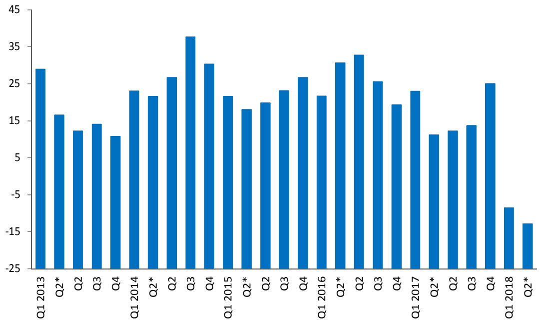
Vehicle Sales. The growth in the sales of new vehicles from CAMPI[20] members contracted by 12.9 percent y-o-y in the first two months of Q2 2018 from the 11.2-percent growth recorded in the same period a year ago as sales of both passenger cars and commercial vehicles declined as some people bought new cars in 2017 ahead of the imposition of the higher excise tax on automobiles.

Growth in sales of new vehicles contracts

Sales of passenger cars declined by 10.4 percent y-o-y in April-May 2018 from the 3.6-percent growth in the same period in 2017. New passenger car sales accrued to a total of 19,311 in the first two months of Q2 2018 units from 21,552 units in the same period a year ago.

Chart 12. Vehicle Sales

number of units



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

Commercial vehicle sales, which account for about 68.3 percent of total vehicle sales, dropped by 14.1 percent y-o-y in the first two months of Q2 2018 relative to 15.5-percent growth in the same period of 2017. Commercial vehicles sold during the quarter reached 36,892 units from 42,995 units in April-May 2017.

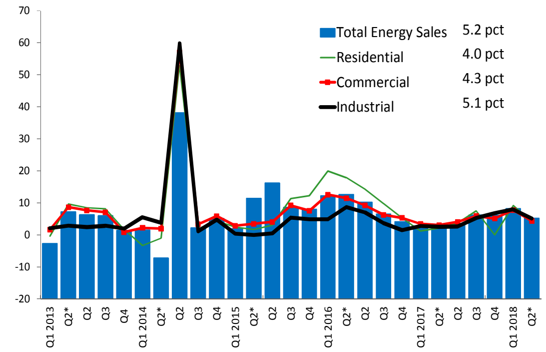
Energy Sales. Meralco's energy sales for Q2 2018 (April-May) grew by 5.2 percent, faster than the 2.6-percent growth reported in the same period a year ago.

Energy sales increase

Energy sales from the residential sector, commercial sector, and industrial sector increased by 4.0 percent, 4.3 percent, and 5.1 percent, respectively.

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

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



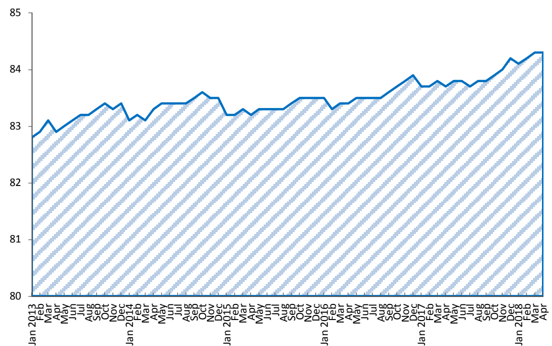
*April-May
Source: Meralco, BSP calculations

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

Capacity utilization in manufacturing remains above 80 percent

Of the 706 respondent-establishments, 61.5 percent of which operated at least at 80.0 percent capacity in April 2018. Data showed that most of the manufacturing companies have been operating above the 80.0 percent capacity since 2010.

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



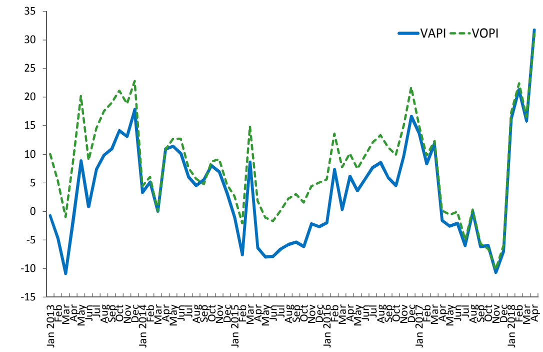
Source: PSA

Volume and Value of Production. Preliminary results of the MISSI showed that volume of production index (VoPI) grew by 31.1 percent year-on-year in April 2018 from a 16.5-percent (revised) growth in the previous month.

Manufacturing sustains growth

The rise in VoPI was due to the expansion in the production of printing (182.8 percent), petroleum products (79.2 percent), food manufacturing (31.4 percent), electrical machinery (26.8 percent), machinery except electrical (34 percent), chemical products (23.4 percent), beverages (31.7 percent), non-metallic mineral products (24.6 percent), miscellaneous manufactures (34.5 percent), textiles (32.1 percent), rubber and plastic products (21 percent), tobacco products (10 percent), fabricated metal products (12.9 percent), wood and wood products (11.7 percent), and leather products (22.2 percent).

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



Source: PSA

The value of production index (VaPI) also grew by 31.7 percent in April 2018 from a 15.8-percent growth a month ago. This was attributed to the significant expansion of the following sub-sectors: printing (166.7 percent), petroleum products (104.9 percent), electrical machinery and food manufacturing (both at 29.6 percent), machinery except electrical (38.1 percent), beverages (47.2 percent), chemical products (20.9 percent), tobacco products (65 percent), non-metallic mineral products (29.2 percent), and miscellaneous manufactures (39 percent).

Business Expectations. Business optimism on the economy was broadly steady for Q2 2018, with the overall confidence index (CI)[21] of the Business Expectations Survey[22] declining slightly to 39.3 percent from 39.5 percent for Q1 2018. This indicates that the optimists continued to outnumber the pessimists but the margin was almost unchanged from that of a quarter ago.

Business outlook broadly steady

Respondents with steady outlook noted that sustained demand and ongoing market adjustments as a result of the recently enacted TRAIN Law were to be expected for Q2 2018. Outlook remained optimistic due to the (a) usual higher demand during summer given the expected arrival of local and foreign tourists, and enrolment and harvest periods, (b) increase in orders and volume of production, (c) ongoing rollout of government infrastructure projects with the "Build, Build, Build" strategy of the administration, (d) positive view on the TRAIN Law as its revenue is expected to support infrastructure projects of the government, which may attract new investments, (e) expansion of businesses and new product lines, and (f) sound macroeconomic conditions. However, there was a slight dent in optimism caused by expectations of higher consumer prices, partly due to oil price hikes, and peso depreciation.

Table 9. Business Expectations Survey

BUSINESS OUTLOOK INDEX		Current Quarter	Next Quarter
2015	Q1	45.2	58.2
	Q2	49.2	47.3
	Q3	41.4	53.1
	Q4	51.3	43.9
2016	Q1	41.9	49.6
	Q2	48.7	45.3
	Q3	45.4	56.8
	Q4	39.8	34.5
2017	Q1	39.4	47.2
	Q2	43.0	42.7
	Q3	37.9	51.3
	Q4	43.3	39.7
2018	Q1	39.5	47.8
	Q2	39.3	40.4

Source: BSP

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

For the quarter ahead (Q3 2018), business outlook fell but remained positive. The next quarter CI, at 40.4 percent, was lower than the 47.8 percent in the previous quarter's survey. Respondents cited the following factors as reasons behind their lower business confidence: (a) interruption of business activities during the rainy season, (b) lower consumer demand as households prioritized enrolment expenses, and (c) expectations of higher commodity prices.

Consumer Expectations. Consumer confidence was more optimistic for Q2 2018, with the overall confidence index (CI)[23] of the Consumer Expectations Survey[24] increasing to 3.8 percent from 1.7 percent for Q1 2018. The higher CI indicates that the optimists increased and continued to outnumber the pessimists.

[21] 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 a favorable view.

[22] The BES is a quarterly survey of firms drawn at random from the combined list of the Securities and Exchange Commission's Top 7,000 Corporations in 2010 and Business World's Top 1,000 Corporations in 2016. The Q2 2018 BES was conducted during the period 2 April-22 May 2018.

[23] 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 a favorable view.

[24] The CES is a quarterly survey of a random sample of about 5,000 households in the Philippines. The Q2 2018 BES was conducted during the period 2-14 April 2018.

Consumer confidence weakens but remains positive

According to respondents, their positive outlook for Q2 2018 was mainly brought about by their expectations of: (a) improvement in peace and order situation, (b) additional income, (c) availability of more jobs, (d) effective government policies, and (e) increase in family savings.

Table 10. Consumer Expectations Survey

CONSUMER OUTLOOK INDEX		Current Quarter	Next 3 Months	Next 12 Months
2015	Q1	-10.0	4.4	17.3
	Q2	-16.2	-0.4	16.4
	Q3	-11.6	5.8	15.8
	Q4	-8.1	5.7	18.0
2016	Q1	-5.7	9.1	25.4
	Q2	-6.4	5.6	26.6
	Q3	2.5	27.3	43.8
	Q4	9.2	18.8	33.4
2017	Q1	8.7	16.5	31.7
	Q2	13.1	13.6	34.3
	Q3	10.2	17.8	33.7
	Q4	9.5	17.5	32.0
2018	Q1	1.7	8.8	24.0
	Q2	3.8	8.7	23.1

Source: BSP

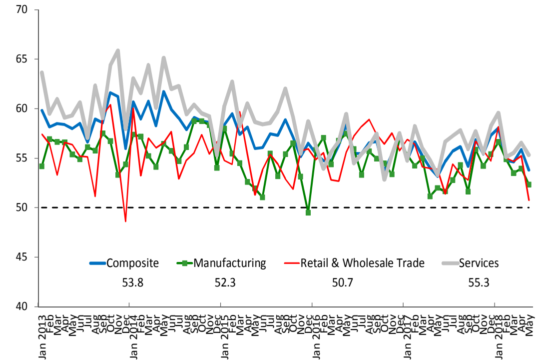
The positive current quarter outlook of consumers in the Philippines mirrored the improved confidence of consumers in Australia, Euro Area, France, Indonesia, Thailand, and the United States but was in contrast to the weakened views of those in Japan, South Korea, Switzerland, Taiwan, and United Kingdom for Q2 2018.

Consumers' optimism remained generally steady for the next quarter (Q3 2018) and the year ahead, as the CIs showed a fractional decline from previous quarter's survey at 8.7 percent from 8.8 percent and at 23.1 percent from 24 percent, respectively. The relatively steady outlook in the near-term stemmed from the counterbalancing of the number of respondents that reported more positive views on the economy, in anticipation of more jobs and additional income, versus those with negative views due to expectations of higher prices of goods.

Purchasing Managers' Index (PMI).[25] The composite PMI in May 2018 remained firmly above the 50-point expansion threshold at 53.8,[26] albeit lower than the composite PMI of 55.9 in April 2018. This was due to the slower rate of expansion of all sectors.

PMI remains firmly above the 50-point expansion threshold

Chart 16. Purchasing Managers' Index



Source: Philippine Institute of Supply Management (PISM)

The manufacturing PMI decreased by 1.6 index points to 52.3 in May from 53.9 in April 2018. This is a contrary to managers' expectation for the month as demand was weaker-than-expected with lower number of new orders. In turn, production volume decreased which resulted in the contraction of the Inventories Index. Meanwhile, the slack in demand kept the Supplier Deliveries Index stable at a PMI of 53.8. In terms of the sector's performance by export category, firms generally posted month-on-month deceleration, especially firms with export volume of up to 25 percent of total revenues, which recorded a contraction in May. By contrast, non-exporting companies expanded from month-ago level. On a per sector basis, lower PMIs were noted in five of 12 manufacturing subsectors, which more than offset the increases observed in seven other subsectors. In particular, three subsectors decelerated namely communication and medical equipment (with a PMI of 56.2),

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

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

non-metallic minerals (55), and textiles and clothing (50.8), while two others posted contraction which were motor vehicles (49.8) and publishing (47.2). Meanwhile, survey respondents expect the sector to further slowdown in June. Similarly, the services PMI went down marginally by 1.2 index points to 55.3 in May from 56.5 in the previous month. Five of six indices declined, with the Employment Index posting the biggest drop (50.7). Despite firms' limited business activities during the month to contain their operating cost, the Price Charge Index (which measures the average price charged to all services) increased. This was attributed mainly to the implementation of the TRAIN Law which was believed to have inevitably pushed prices up.

Meanwhile, five of the 13 subsectors showed faster expansion in May (transportation including travel agency; real estate; renting of goods and equipment; miscellaneous business activities; and education), five subsectors expanded at slower rate (electricity, gas, and water; construction; hotels and restaurants; postal and telecommunications; provident and insurance), while the other three subsectors posted contraction (banking and financial intermediation; health and social work; and business and knowledge). Prospects are favorable for the sector in the month ahead.

The retail and wholesale PMI also decreased by 4.5 index points to 50.7 in May from 55.2 a month ago. Firms also attributed the sector's performance to weak demand as evident in the slower expansion of all the indices, with the Inventories Index posting a contraction (45.8). Meanwhile, the PMI of the retail subsector decreased to 52.5 in May from 55.8 in April. The PMI of the wholesale subsector contracted to 48.4 in May from 56.0 a month ago. Managers are expecting the sector to accelerate in June.

External Demand[27]

Exports. Exports of goods decreased by 5.5 percent in Q1 2018, a reversal from the growth rates of 13.4-percent and 25.5 percent in Q4 2017 and Q1 2017, respectively.

Exports of goods decrease

[27] International Merchandise Trade Statistics (IMTS) concept

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

Table 11. Exports of Goods
growth rate in percent

COMMODITY GROUP	2017		2018
	Q1	Q4	Q1
Coconut Products	150.5	-8.9	-36.2
Sugar and Products	-67.2	961.8	4.5
Fruits and Vegetables	11.5	-16.5	-22.3
Other Agro-Based Products	25.3	2.2	-11.0
Forest Products	184.9	595.2	135.3
Mineral Products	67.8	70.4	29.0
Petroleum Products	17.4	69.8	-16.6
Manufactures	20.4	9.4	-4.8
Special Transactions	113.1	112.9	-34.2
Total Exports	**25.5**	**13.4**	**-5.5**

Source: BSP

Imports. Imports grew by 6.9 percent in Q1 2018 from 21.1 percent and 19.3 percent in Q4 2017 and Q1 2017, respectively, due to the sustained albeit slower expansion in the importation of capital goods, raw materials and intermediate goods, mineral fuels and lubricants, and consumer goods.

Imports of goods decline

Table 12. Imports of Goods
growth rate in percent

COMMODITY GROUP	2017		2018
	Q1	Q4	Q1
Capital Goods	10.0	14.2	11.5
Raw Materials and Intermediate Goods	20.3	23.2	5.5
Mineral Fuels and Lubricants	58.4	47.6	6.1
Consumer Goods	15.4	16.9	1.8
Special Transactions	22.7	1.5	0.9
Total Imports	**19.3**	**21.1**	**6.9**

Source: BSP

Aggregate Supply. On the production side, growth was largely due to the services sector (7.0 percent in Q1 2018 from 6.9 percent in Q4 2017), which accounted for 4.0 ppts of the 6.8 percent growth in GDP. The industry sector was the fastest growing sector at 7.9 percent from 7.0 percent in Q4 2017, contributing 2.7 ppts to the growth of the economy. Lastly, the agriculture, hunting, forestry and fishing sector growth slowed down to 1.5 percent in Q1 2018 from 2.4 percent in Q4 2017, contributing marginally at 0.1 ppt to overall GDP growth.

Services sector continues to support supply-side growth

Except for trade and repair of motor vehicles, motorcycles, personal and household goods and real estate, renting and business activities sub-sector, all other services sub-sectors recorded gains that were higher than that of Q4 2017, namely: (1) financial intermediation (7.6 percent from 5.2 percent); (2) transport, storage and communication (6.4 percent from 4.9 percent); (3) public administration and defense; compulsory social security (13.2 percent from 8.5 percent); and (4) other services (8.8 percent from 6.3 percent). However, the sub-sectors on trade and repair of motor vehicles, motorcycles, personal and household goods (6.1 percent from 8.7 percent) and real estate, renting and business activities (4.7 percent from 6.6 percent) posted growths lower than Q4 2017.

The acceleration in the transport, storage and communication was due to the higher increase in land transport and communication services.

Meanwhile, the increase in the number of transactions in banking institutions and non-bank financial intermediation drove the faster growth in the financial intermediation.

The double-digit growth in the public administration and defense was due to the upward adjustments in the compensation for civilian and military and uniformed government personnel, along with the release of 2016 performance-based bonus to qualified employees of the Department of Education (DepEd) and the transfer of funds to the Development Bank of the Philippines (DBP) for salaries and allowances of poll watchers for the 2018 SK and barangay elections. Moreover, payments made by the social services sub-sector and other operating requirements of the government also contributed to the acceleration of the public administration and defense.

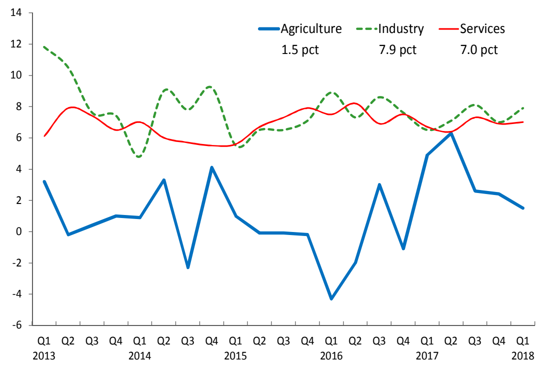
The higher growth in the other services sub-sector was driven by the activities in the social-related sub-sectors, such as education, health and social work. Education in Q1 2018 can be partially attributed to the enrollment season in relatively larger schools, such as University of the Philippines and Ateneo de Manila University. Meanwhile, recreation, cultural and sporting activities continued to grow given the increase in the number of tourist arrivals during the first quarter of 2018.

The slower growth in the trade and repair of motor vehicles, motorcycles, personal and household goods sub-sector may be due to the less optimistic consumer sentiment in Q1 2018. As such, lower household spending may have constrained retail and wholesale trade activities.

Real estate, renting and business activities grew at slower rates vs. Q4 2017. The slower growth in the real estate and renting (5.7 percent in Q1 2018 vs. 8.1 percent in Q4 2017) and other business activities (5.3 percent in Q1 2018 vs. 8.0 percent in Q4 2017) may be attributed to the faster y-o-y increase on real estate prices.[28] While the slide in the value added growth of renting and other business activities may be an effect of the policy uncertainties in the United States with regard to the business process outsourcing (BPO) industry. This was reflected in the drop in foreign direct investments in the month of January 2018, specifically in the information and communication and administrative and support service activities classification, where BPO services are categorized.

[28] http://www.bsp.gov.ph/statistics/keystat/rrepi.htm: Real estate prices grew by 5.7 percent (Y-o-Y) in Q4 2017.

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



Source: PSA

The acceleration of the industry sector may be attributed to the faster growth in construction (9.3 percent in Q1 2018 from 4.3 percent in Q4 2017), manufacturing (8.0 percent in Q1 2018 from 7.9 percent in Q4 2017), and electricity, gas and water supply (6.0 percent in Q1 2018 from 5.5 percent in Q4 2017). Meanwhile, the mining and quarrying growth slowed down to 4.5 percent in Q1 2018 from 5.4 percent in Q4 2017. The acceleration in construction was caused mainly by the substantial increase in the government's disbursement performance resulting to double digit growth rates in infrastructure and other capital outlays and capital transfers to Local Government Units (LGUs), which is in line with the government's thrust of accelerating infrastructure development under the Build, Build, Build program.

Manufacturing sub-sector's expansion may be attributed to the acceleration in the food manufacturing, publishing and printing, petroleum and other fuel products, non-metallic mineral products, machinery and equipment except electrical, office, accounting and computing machinery, electrical machinery and apparatus, radio, television and communication equipment and apparatus.

The utilities sub-sector grew by 6.0 percent in Q1 2018 from the 5.5 percent in Q4 2017. This was due to higher electricity output growth, based on the MERALCO sales for the first quarter of 2018. However, this was tempered by the lower growth of water production and negative growth of steam production.

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

BY INDUSTRIAL ORIGIN	2017				2018
	Q1	Q2	Q3	Q4	Q1
Agri., Hunting, Forestry and Fishing	4.9	6.3	2.6	2.4	1.5
Agriculture and Forestry	5.6	8.1	3.7	3.0	2.4
Fishing	1.2	-2.7	-2.1	-0.1	-3.7
Industry Sector	6.5	7.1	8.1	7.0	7.9
Mining and Quarrying	-17.8	19.2	7.9	5.4	4.5
Manufacturing	7.7	8.0	10.1	7.9	8.0
Construction	9.7	4.3	4.0	4.3	9.3
Electricity, Gas and Water Supply	1.7	3.0	3.4	5.5	6.0
Service Sector	6.7	6.4	7.3	6.9	7.0
Transport, Storage and Communication	4.2	3.3	3.6	4.9	6.4
Trade and Repair of Motor Vehicles, Motorcycles, Personal and Household Goods	7.3	5.8	7.3	8.7	6.1
Financial Intermediation	7.0	9.4	8.9	5.2	7.6
Real Estate, Renting and Business Activities	7.0	8.1	7.8	6.6	4.7
Public Administration and Defense; Compulsory Social Security	5.5	8.4	8.2	8.5	13.2
Other Services	7.3	4.9	7.5	6.3	8.8

Source: PSA

The growth of the agriculture, hunting, forestry and fishery (AHFF) sector decelerated in Q1 2018 to 1.5 percent from 2.4 percent in Q4 2017. The slower growth of AHFF for the quarter was due to the slowdown in agriculture and a further contraction in fishing.

In the agriculture sub-sector, the deceleration can be traced to the decline in production of sugarcane, mango, and cassava. However, the higher growth of palay production (from 4.4 percent in Q4 2017 to 4.6 percent in Q1 2018), coconut including copra (from 3.7 percent in Q4 2017 to 8.5 percent in Q1 2018), livestock (from 1.8 percent in Q4 2017 to 2.1 percent in Q1 2018) and poultry (from 4.7 percent in Q4 2017 to 5.2 percent in Q1 2018) as well as the recovery in the production of corn (from -5.6 percent in Q4 2017 to 4.7 percent in Q1 2018), moderated the slowdown in the agriculture sub-sector.

Meanwhile, fishing continued to contract in Q1 2018 at -3.7 percent from -0.1 percent in Q4 2017. There was a reduction of output for milkfish, tilapia, tiger prawn, roundscad, yellowfin tuna and other fish varieties due to delayed stocking caused by the typhoons (i.e., Vinta, Agaton, Basyang, and Caloy).

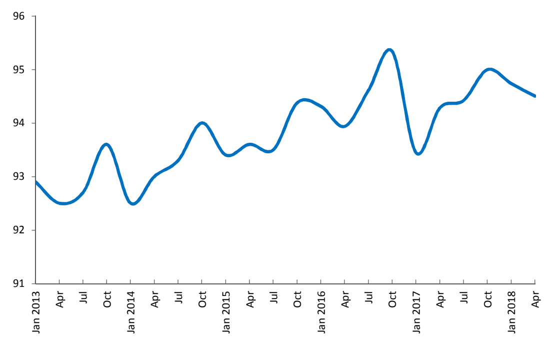
Labor Market Conditions

Similar to the results of the January 2018 round of the labor force survey (LFS), the Philippine labor market improved in terms of quantity but slightly deteriorated in terms of quality in the April 2018 round of the LFS. The country's employment rate, overall unemployment rate and youth unemployment rate all improved compared to the same period a year ago while the overall underemployment rate increased anew.

Labor market shows improvement

During the period, the employment rate rose to 94.5 percent, the unemployment rate declined to 5.5 percent and the youth unemployment rate dropped to 13.8 percent, not only better compared to respective rates in April 2017 but also the highest in terms of employment rate and the lowest in terms of overall and youth unemployment rates in all of the previous April rounds of the LFS since 2005.[29] These brought the country closer to the targets of the government of reducing the overall unemployment rate to 3 to 5 percent and the youth unemployment rate to 8 percent by 2022. However, the government also needs to take more actions to improve the quality of employment as underemployment rate in the country went up again to 17.0 percent level, after settling at 16.1 percent in the second quarter of 2017.

Chart 18. Employment Rate
in percent

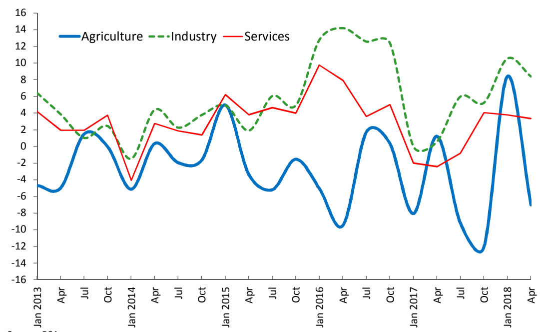


Source: PSA

The improvement in employment rate in April 2018 is equivalent to 625 thousand more employed people compared to the level a year ago, which brings the total of employed individuals to 40.9 million. The main employment contributor continued to be the services sector, with net employment gain of 743 thousand or 3.3 percent growth, coming mainly from public administration and defense with 11.5 percent growth. This was followed by the industry sector, with net employment gain of 605 thousand or 8.1 percent growth partly due to strong employment in construction and manufacturing subsectors that expanded by 13.1 percent and 3.1 percent, respectively. Employment in agriculture sector, however, declined again with net employment loss of 723 thousand or 6.9 percent contraction. This appears to be consistent with the rice and corn situation outlook of the government that there may be a decline in production of both rice and corn in the second quarter of 2018 due to the contraction in harvest area caused by early planting in the previous quarter, conversion of some areas to commercial and industrial establishments, and inadequate water supply.[30]

Meanwhile, it is worth noting that among the country's major sub-sectors, construction posted the highest contribution to employment growth in April 2018 and this is mainly attributed to the increased infrastructure spending of the National Government (NG) under the Build, Build, Build program.[31]

Chart 19. Employment by Sector
in percent



Source: PSA

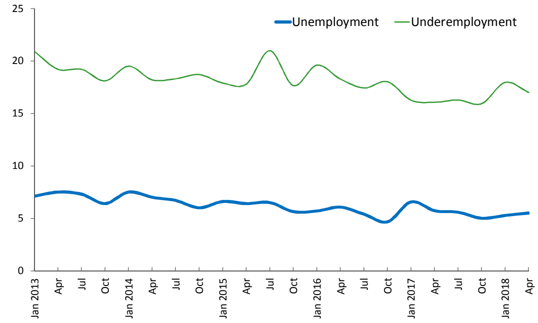
The 5.5 percent unemployment rate in April 2018 is equivalent to 2.4 million unemployed individuals. These are the lowest unemployment rate and level that were recorded by the country for the second quarter since 2005. However,

[29] Starting April 2005, the Philippine Statistics Authority has adopted the new unemployment definition based on international standard per NSCB Resolution No. 15 series of 2004.

[30] Philippine Statistics Authority (2018), "Rice and Corn Situation and Outlook, April 2018 Round," Special Release 2017-129, 15 May.
[31] NEDA (2018), "Infra Boosts Employment for 2018," 5 June.

this latest unemployment rate also implies a year-to-date (y-t-d) unemployment rate of 5.4 percent, which is higher than the 4.7 to 5.3 percent target of the NG for 2018. Among the youth (15-24 age group), the unemployment rate dropped from 14.9 percent in April 2017 to 13.8 percent in April 2018, but as before, this youth unemployment rate remains more than twice of the country's national rate. Also, majority of the unemployed are still the junior high school graduates (28.9 percent share) and college graduates (19.6 percent) of the country's labor force.

Chart 20. Unemployment and Underemployment
in percent



Source: PSA

Meanwhile, the 17.0 percent underemployment rate in April 2018 is equivalent to 6.9 million underemployed individuals, majority of which are visible (52.5 percent) and are employed in the services (47.1 percent share) and agriculture (32.4 percent share) sectors. On a positive note, however, other aspects of quality of employment improved during the period as evidenced by higher share of remunerative work or wage and salary workers (63.8 percent in April 2018 from 61.3 percent a year ago) and the increase in overall mean hours of work (hours per week) (42.0 in April 2018 from 40.3 in April 2017), which could imply that economic activity increased in the second quarter of 2018.

II. Monetary and Financial Market Conditions

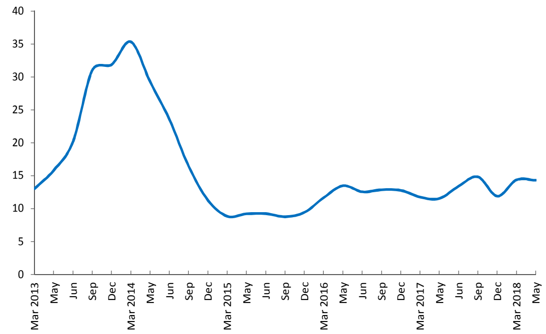
Domestic Liquidity

Domestic liquidity (M3) grew by 14.3 percent y-o-y in May to ₱11.0 trillion, slightly slower than the 14.4-percent expansion as of end-Q1 2018.

Domestic liquidity continues to grow

Money supply continued to increase due mainly to sustained demand for credit. Domestic claims grew by 16.8 percent in May from the 14.5-percent expansion in end-Q1 2018 as growth in credit to the private sector continued. On the other hand, net claims on the central government expanded by 17.3 percent in May from 7.0 percent in end-Q1 2018, reflecting the continued borrowings by the National Government.

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



Source: BSP

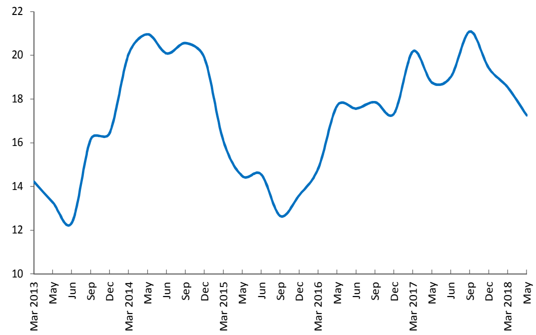
Meanwhile, growth in net foreign assets (NFA) slowed slightly to 5.4 percent y-o-y in May from 5.6 percent in end-Q1 2018. The BSP's NFA position grew slightly during the review period on the back of steady foreign exchange inflows coming mainly from overseas Filipinos' remittances and business process outsourcing receipts. The NFA of banks also expanded due largely to the faster growth in banks' foreign assets resulting from higher loans and investments in marketable debt securities.

Preliminary data as of May 2018 show that outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, increased at a faster rate of 19.4 percent y-o-y relative to the 18.5-percent and 19.0-percent growths posted at end-Q1 2018 and end-Q2 2017, respectively.

...as lending sustains growth due to production activities

The sustained increase in bank lending was due largely to loans for production activities, which expanded by 19.3 percent y-o-y in May 2018 from 18.2-percent growth in end-Q1 2018 and 17.9-percent rise in end-Q2 2017.

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



Source: BSP

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

Meanwhile, loans for household consumption grew by 18.4 percent as of end-May 2018, lower than the 19.8-percent and 22.5-percent growth recorded in end-Q1 2018 and end-Q2 2017, respectively.

Box Article 2: Operational Refinements to the IRC System: Further Enhancing Monetary Policy

The BSP adopted the interest rate corridor (IRC) system as framework for conducting its monetary operations with the primary objective of enhancing monetary policy transmission.[32] The main features of the BSP's IRC system are as follows: (i) a symmetric and narrow corridor at 100 bps around the policy rate compared to the pre-IRC period of an asymmetric and wide de facto corridor of 350 bps; (ii) an active monetary operations through the conduct of term deposit auctions; and (iii) a more accessible reverse repurchase (RRP) facility through a system of prorated allocation.

The IRC system aims to guide short-term market interest rates toward the middle of the corridor which is the BSP's policy rate (RRP) by conducting monetary operations at a rate that is close to the policy rate (plus an appropriate term premium). The main liquidity absorption tool under the IRC is the term deposit facility (TDF) with the RRP as a fine-tuning tool that would ensure that short-term market rates move close to the RRP rate (which is the BSP's policy rate). Meanwhile, the interest rates for the two standing facilities form the upper and lower bounds of the corridor – overnight lending facility (OLF) and overnight deposit facility (ODF), respectively – and are set at ± 50 basis points around the policy rate.

Table 1: BSP's IRC System: Structure and Instruments

OLD CORRIDOR STRUCTURE		NEW IRC STRUCTURE
Term Repurchase Facility O/N Repurchase Facility	Ceiling	O/N Lending Facility
		Term Deposit Facility
Reverse Repurchase Facility (O/N & Term)	**Policy rate**	**O/N Reverse Repurchase Facility**
Special Deposit Account	Floor	O/N Deposit Facility

Since formally adopting the IRC in June 2016, the BSP has continued to review the features of the IRC system to ensure efficient implementation. The key operational refinements, thus far, are the following:

1. Conduct of RRP moved to later time of the day

Starting 17 April 2017, the conduct of the daily RRP offering was moved from 2:00PM to around 4:30PM. The BSP conducted a survey to understand counterparties' strategies on liquidity management. Based on the results of the survey, the check-clearing process, which is at 4:30PM, is an important consideration in banks' daily liquidity management. Banks would prefer to hold sizeable liquidity balances, as reflected in their large ODF balances, as a precaution for check-clearing needs rather than maximize RRP and TDF placements.

In response to feedback and discussions with counterparties, the BSP moved the conduct of the daily RRP auction to around 4:30PM. In this way, banks would have information on their check-clearing results when submitting bids to the RRP offering, and can therefore make a decision to maximize their placements in the TDF and RRP facilities and leave only a residual amount in the ODF.

2. Announcing of TDF offer volumes one week before auction date

Beginning with the TDF auction on 3 May 2017, details on the offer volumes per tenor are posted on the BSP website one week before the scheduled auction instead of a two-week lead time which was the practice when the IRC system started. The aim of this refinement is to increase flexibility in determining the volume of offerings in the TDF, in order to accommodate changing market conditions.

[32] It is important to note that the shift to the IRC system in June 2016 did not represent a change in the BSP's stance of monetary policy. The IRC reforms were primarily operational in nature and were not intended to materially affect prevailing monetary policy settings.

3. Introduction of a 14-day TDF tenor

On 14 February 2018, the BSP started offering a 14-day tenor in its TDF in response to the strong interest of various counterparties for a tenor longer than 7 days but shorter than 28 days following a series of BSP consultations.

Focusing on shorter-tenored term deposits is in line with international central banking practice of using term deposits as an ideal short-term sterilization tool. Central banks with corridor systems usually lever the very short-end of the yield curve, from overnight to two weeks of maturity with an intention to steer the market interest rates until the end of the reserve maintenance period, usually coinciding with a central bank's monetary policy meetings.[33]

4. Varying auction offer volumes in the TDF

Following the migration of funds from the special deposit account (SDA) in the pre-IRC period to the TDF and ODF in the second half of 2017, the BSP started to actively adjust weekly offer volumes in the TDF, consistent with the liquidity forecasts instead of the earlier practice of announcing fixed offer amounts. Varying the weekly TDF offer volumes affords the BSP with sufficient operational flexibility in taking into account recent developments in the money market when conducting monetary operations. Moreover, it would encourage active and dynamic liquidity management as banks will have to consider a broader range of volume and make more calibrated decisions on their bids.

Moving forward, the BSP is considering the following additional operational refinements:

1. Introduce scope to re-allocate total volume offer across the different tenors of the TDF;
2. Increase the TDF auction frequency from the current one auction per week;
3. Further shorten the lead time in announcing of TDF offer volumes;
4. Lengthen the reserve maintenance period from the current one week cycle; and
5. Transform the RRP facility from a fixed-rate, fixed-volume auction to a variable-rate, variable-volume auction.

The continuous efforts of the BSP to refine its monetary operations are meant to enhance its capacity to guide short-term market interest rates to move closely with the BSP policy rate, and in the process, strengthen the transmission of changes in the monetary policy stance to the rest of the economy.

[33] Gray and Talbot, "Handbooks in Central Banking No. 24 Monetary Operations." Centre for Central Banking Studies, Bank of England. 2006.

Monetary Operations

For Q2 2018, majority of the BSP's monetary operations had been through the reverse repurchase (RRP) facility, comprising about 61.5 percent of total. Meanwhile, the BSP's deposit facilities – namely, the term deposit facility (TDF) and the overnight deposit facility (ODF), made up the remaining 38.5 percent.

Market demand for the TDF remained generally strong during the review quarter. The average bid-to-cover ratios for the 7-day, 14-day and 28-day tenors were at 1.3, 1.1, and 1.0, respectively, from 2.0, 1.3, and 1.5 in the previous quarter.[34] On the other hand, the average bid-to-cover ratio for the daily RRP facility was at about 1.0 from 1.5 in the previous quarter.

Liquidity conditions during the quarter were affected by holidays (such as Holy Week in April), barangay elections in May, as well as the ₱121.8-billion Retail Treasury Bonds issuance by the NG in early June. In view of these, offer volumes for the various tenors of the TDF were reviewed and adjusted accordingly, based on the BSP's assessment of prevailing liquidity conditions. The TDF auctions are conducted every Wednesday while the RRP auction is a daily fine-tuning operation.

Credit Conditions

Credit Standards. Results of the Q2 2018 Senior Bank Loan Officers' Survey (SLOS) showed that most of the respondent banks continued to maintain their credit standards for loans to both enterprises and households during the quarter based on the modal approach.[35]

Majority of banks keep credit standards steady

This is the 37th consecutive quarter since Q2 2009 that the majority of respondent banks reported broadly unchanged credit standards.

[34] The BSP started offering the 14-day tenor on 14 February 2018 while the 28-day tenor was reoffered starting 7 February 2018.
[35] 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[36,37] showed a net tightening of credit standards for both loans to enterprises and households. In the previous quarter, credit standards for loans to enterprises were unchanged while those for loans to households showed a net tightening based on the DI approach.

Lending to Enterprises. Most banks (82.1 percent of banks that responded to the question) indicated that credit standards for loans to enterprises were maintained during the quarter using the modal approach.

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

	2017				2018	
	Q1	Q2	Q3	Q4	Q1	Q2
Tightened Considerably	0.0	0.0	0.0	0.0	0.0	3.6
Tightened Somewhat	6.7	10.0	7.4	3.7	3.7	10.7
Remained Basically Unchanged	**93.3**	**90.0**	**88.9**	**88.9**	**92.6**	**82.1**
Eased Somewhat	0.0	0.0	3.7	7.4	3.7	3.6
Eased Considerably	0.0	0.0	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0
Diffusion Index for Credit Standards	**6.7**	**10.0**	**3.7**	**-3.7**	**0.0**	**10.7**
Weighted Diffusion Index for Credit Standards	**3.3**	**5.0**	**1.9**	**-1.9**	**0.0**	**7.1**
Mean	2.9	2.9	3.0	3.0	3.0	2.9
Number of Banks Responding	**30**	**30**	**27**	**27**	**27**	**28**

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

Meanwhile, results based on the DI approach pointed to a net tightening of credit standards for the quarter, which was largely attributed by respondent banks to their perception of stricter financial system regulations, and deterioration of the profile of corporate borrowers. DI-based results in terms of specific credit standards[38]

[36] In the diffusion index approach, a positive diffusion index (DI) for credit standards indicates that the proportion of banks that have tightened their credit standards are greater compared to those that eased ("net tightening"), whereas a negative DI for credit standards indicates that more banks have eased their credit standards compared to those that tightened ("net easing").
[37] From Q1 2010 to Q4 2012 survey rounds, the BSP used largely the DI approach in the analysis of survey results. Beginning in Q1 2013, the BSP used both the modal and DI approaches in assessing the results of the survey.
[38] 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.

pointed to stricter collateral requirements, shorter loan maturity periods, and increased use of interest rate floors, reflecting the net tightening of overall credit standards for corporate loans.

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

For the next quarter, results based on the modal approach showed that most of the respondent banks anticipate unchanged credit standards. Meanwhile, the DI approach showed that more respondent banks expect overall credit standards for business loans to tighten over the next quarter compared to those that expect the opposite, largely on account of banks' perception of stricter financial system regulations and expectations of a decline in deposit base of banks and deterioration of the profile of their corporate borrowers.

Lending to Households. The results of the survey also showed that most respondent banks (94.1 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. In particular, credit standards for credit card and personal/salary loans tightened due mainly to respondent banks' reduced tolerance for risk.

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

	2017				2018	
	Q1	Q2	Q3	Q4	Q1	Q2
Tightened Considerably	0.0	0.0	0.0	0.0	0.0	0.0
Tightened Somewhat	0.0	9.1	5.0	0.0	15.8	5.9
Remained Basically Unchanged	**100.0**	**81.8**	**90.0**	**90.5**	**78.9**	**94.1**
Eased Somewhat	0.0	9.1	5.0	9.5	5.3	0.0
Eased Considerably	0.0	0.0	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0
Diffusion Index for Credit Standards	**0.0**	**0.0**	**0.0**	**-9.5**	**10.5**	**5.9**
Weighted Diffusion Index for Credit Standards	**0.0**	**0.0**	**0.0**	**-4.8**	**5.3**	**2.9**
Mean	3.0	3.0	3.0	3.1	2.9	2.9
Number of Banks Responding	**21**	**22**	**20**	**21**	**19**	**17**

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

In terms of respondent banks' outlook for the next quarter, results based on the modal approach indicated that the majority of the respondent banks anticipate maintaining their overall credit standards. Meanwhile, DI-based results pointed expectations of a slight net easing of credit standards for household loans as respondent banks anticipate an improvement in the profitability and liquidity of their portfolio, among others.

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

Demand for loans from firms and households remain stable

Using the DI approach, however, results showed a net increase in loan demand[39] across all firm sizes and all types of household loans (except personal/salary loans). The net increase in loan demand for firms was attributed by banks to their customers' higher working capital requirements and improvement in corporate customers' outlook during the quarter. Meanwhile, respondent banks attributed the net increase in loan demand from households to low interest rates and more attractive financing terms offered by banks, as well as increased household consumption.

Over the next quarter, most of the respondent banks expect unchanged loan demand from both firms and households. However, a larger proportion of respondents expect overall demand for corporate and household loans to increase in the next quarter relative to those who indicated the opposite. Respondent banks cited expectations of higher investment in plant or equipment and increased working capital needs as the key factors behind the expected increase in demand for business loans. Meanwhile, the anticipated net increase in household loan demand was attributed by respondent banks to low interest rates along with higher household consumption.

[39] 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.

Real Estate Loans. Most of the respondent banks (90.5 percent) indicated unchanged credit standards for commercial real estate loans in Q2 2018.

Majority of banks maintain credit standards for real estate loans

The DI approach, however, continued to indicate a net tightening of overall credit standards for commercial real estate loans for the tenth consecutive quarter. The tighter overall credit standards for commercial real estate loans reflected respondent banks' wider loan margins, reduced credit line sizes, stricter collateral requirements and loan covenants, and increased use of interest rate floors. Over the next quarter, while majority of the respondent banks foresee maintaining their credit standards for commercial real estate loans, DI-based results point to expectations of continued net tightening of credit standards for the said type of loan.

Demand for commercial real estate loans was also unchanged in Q2 2018 based on the modal approach. A number of banks, however, indicated increased demand for the said type of loan on the back of increased investment in plant and equipment, higher working capital needs, banks' more attractive financing terms and low interest rates. Over the next quarter, although most of the respondent banks anticipate generally steady loan demand, a number of banks expect demand for commercial real estate loans to continue to increase.

Meanwhile, credit standards for housing loans extended to households were unchanged based on both modal and DI approaches reflecting respondent banks' unchanged tolerance for risk and steady profile of borrowers. Over the next quarter, results based on both the modal and diffusion index approaches likewise showed that respondent banks foresee unchanged overall credit standards for housing loans on the back of their unchanged tolerance for risk, steady profile of housing loan borrowers and respondent banks' stable economic outlook. Most banks reported unchanged housing loan demand in Q2 2018 based on the modal approach while DI-based results pointed to a net increase in demand for housing loans during the quarter. Banks' responses likewise indicated expectations of sustained net increase in demand for housing loans over the next quarter.

Interest Rates

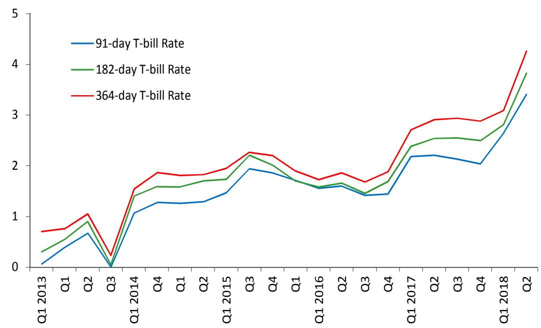
Primary Interest Rates

In Q2 2018, the average rates for the 91-day, 182-day, and 364-day T-bills in the primary market increased to 3.408 percent, 3.829 percent, and 4.262 percent from 2.637 percent, 2.813 percent, and 3.088 percent, respectively, in the previous quarter.

T-bill rates in the primary market increase

The results of the auction reflected strong market preference for the shorter-tenored notes following the May and June interest rate hikes by the BSP and the US Federal Reserve.

Chart 23. Treasury Bill Rates
in percent



Source: BTr

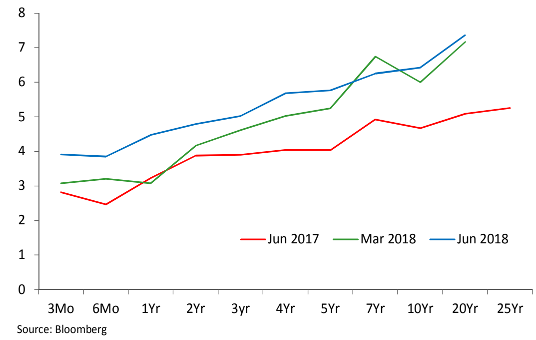
Yield Curve. As of end-June 2018, the secondary market yield for government securities (GS) for all tenors rose generally except for the 7-year GS relative to the end-March 2018 levels as general sentiment continued to be cautious ahead of the release of the June 2018 inflation data.

Yield curve rose in end-June 2018

Debt paper yields were higher by a range of 48.9 bps (7-year GS) to 139.9 bps (1-year GS) compared to end-March 2018 levels.

Chart 24. Yields of Government Securities in the Secondary Market

in percent



Relative to year-ago levels, the secondary market yields of GS for all maturities likewise increased by a range of 91.2 bps for the 2-year GS to 227.6 bps for the 20-year GS.

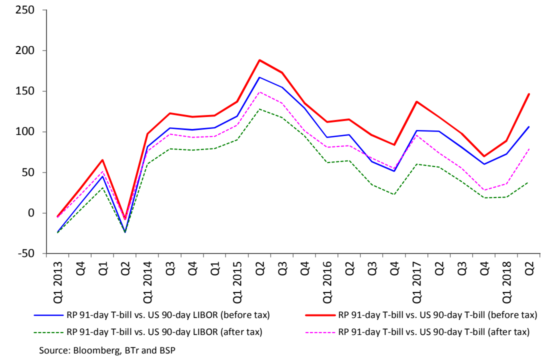
Interest Rate Differentials. The average differentials between domestic and US interest rates, gross and net of tax, widened further in Q2 2018 relative to the previous quarter.

Interest rate differentials widen further

The average 91-day RP T-bill rate rose q-o-q by 74.9 bps to 3.401 percent in Q2 2018 from 2.652 percent in Q1 2018. Likewise, the average US 90-day LIBOR and the US 90-day T-bill rate increased by 41.1 bps and 17.2 bps, respectively, to 2.338 percent and 1.935 percent in Q2 2018. These developments led to wider positive gross and net of tax differentials between the 91-day RP T-bill rate and US interest rates. Domestic and foreign interest rates rose during the quarter following the BSP's 50-bp and the US Fed's quarter point policy rate hikes.

Chart 25. Interest Rate Differentials

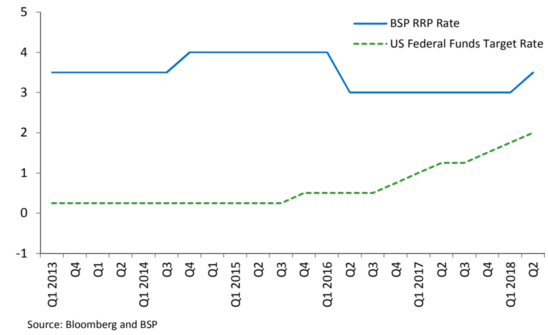
quarterly averages; in basis points



The positive differential between the BSP's overnight borrowing or RRP rate and the US Fed funds target rate widened to a range of 150-175 bps in Q2 2018 from 125-150 bps in Q1 2018, reflecting the impact of the 50-bp increases in the BSP's RRP rate to 3.25 percent on 10 May and 3.50 percent on 20 June as well as the 25-bp increase in the US Fed funds target rate to 1.75-2.00 percent on 14 June 2018.

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

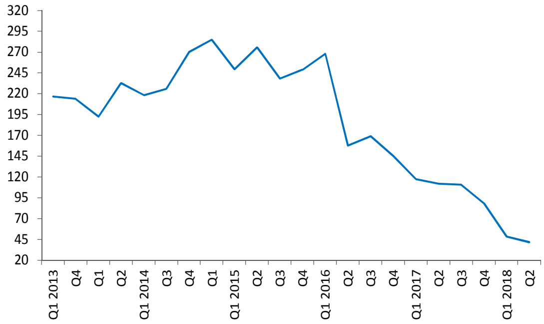
in percent



Meanwhile, the interest rate differential between the BSP's overnight RRP rate and the US Fed funds target rate adjusted for risk[40] narrowed further to 41 bps as of end-June 2018 from 48 bps in end-March 2018. This development could be traced to the 25-bp rise in the positive interest rate differential between the BSP's RRP rate and the US Fed funds target rate combined with a higher risk premium following the 39-bp and 8-bp increases in the 10-year ROP note and 10-year US note to 3.94 percent and 2.86 percent, respectively.

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

Chart 27. Risk-Adjusted Differentials
in basis points



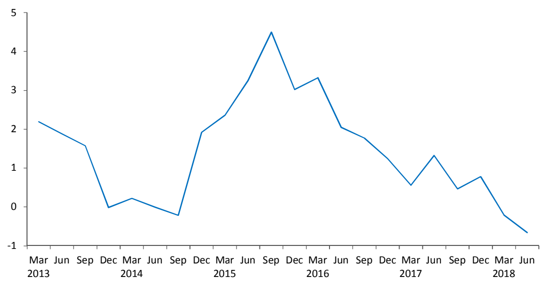
Source: Bloomberg and BSP

The 10-year ROP and US notes rose on renewed investor demand for risky assets as trade tensions between the US and China eased; geopolitical concerns between the US and Syria moderated; and an aggressive monetary policy tightening by the US Fed amid rising inflation expectations due to higher oil and steel prices; and the release of stronger-than-expected US data on retail sales, home sales, manufacturing and non-farm payrolls, lower unemployment and higher wages.

Domestic real lending rate[41] decreased further to -0.7 percent in June 2018 from -0.2 percent in March 2018. This was due to the 90-bp rise in inflation to 5.2 percent (2012=100) combined with the 40-bp increase in actual bank lending rate[42] to 4.5 percent in June 2018.

Real lending rate decreases further

Chart 28. Philippines' Real Lending Rate
in percent



Source: PSA and BSP

[41] Real lending rate is measured as the difference between actual bank lending rate and inflation.
[42] 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.

The Philippines' real lending rate at -0.7 percent in June 2018 remained the lowest for the fourth consecutive month in a sample of 10 Asian countries, with Indonesia recording the highest real lending rate at 7.2 percent followed by Singapore at 4.9 percent while Japan posted second to the lowest at 0.3 percent.

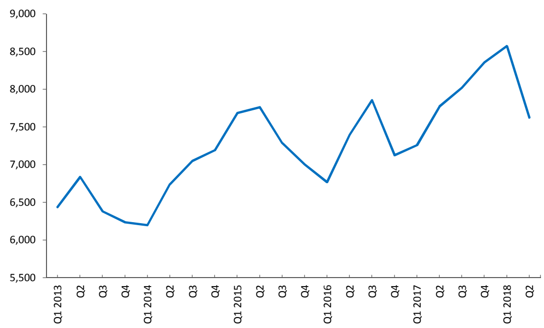
Financial Market Conditions

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

Domestic financial market conditions reflect external uncertainty

Stock Market. In Q2 2018, the Philippine Stock Exchange index (PSEi) retreated by 11.1 percent, q-o-q, to average 7,618.99 index points during the review period.

Chart 29. Quarterly Average PSEi
In basis points



Source: Philippine Stock Exchange, BSP

During the quarter, a combination of factors pushed the benchmark index lower month-on-month (m-o-m). Concerns over developments overseas, such as the looming trade war between the US and China, geopolitical concerns involving the US, Syria, North Korea, Iran and Italy and rising US Treasury yields, weighed down the main index. On the local front, the country's higher-than-expected domestic inflation, widening merchandise trade deficit and the peso weakening to a 12-year low also helped push the PSEi lower. Partly tempering the decline were reports of the robust Q1 GDP growth, the BSP's decision to cut reserve requirements for the second time this year effective June 1 and its policy rate hikes in May and June to curb rising inflation. In June, local equities entered bear market territory[43] amid worsening trade tensions between the US and some of its major trading partners[44] and the continued depreciation of the peso.

External headwinds and inflation concerns weakened the local bourse in Q2 2018

Mirroring the index's decline, total market capitalization declined 7.9 percent q-o-q to close at ₽15.79 trillion in June 2018. Foreign investors also continued to post net sales amounting to ₽31.78 billlion during the period, albeit slightly less than the ₽34.0 billion net sales posted in the preceding quarter. Meanwhile, the price-earnings ratio for listed issues also dropped from 20.65x on 30 March to 18.37x as of end-June 2018.

Government Securities. Results of the T-bill auctions conducted in Q2 2018 (April - June) continued to show robust demand for T-bills with total subscription for the quarter amounting to ₽321.4 billion, about 1.7 times the ₽195.0-billion total offered amount. The oversubscription for Q2 2018, at ₽126.4 billion, was higher than the ₽59.2 billion oversubscription in the previous quarter.

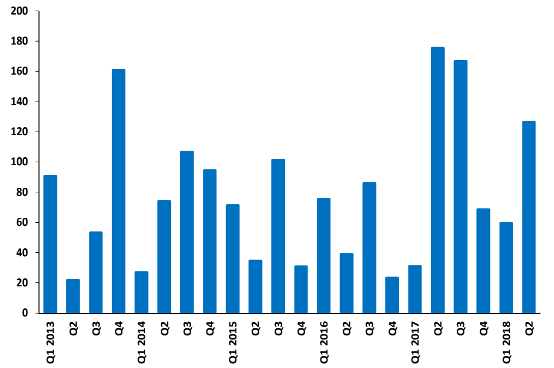
[43] On 21 June, the PSEi closed at 7,098.15 index points, more than 21 percent lower than the peak posted on 29 January of 9,058.62 index points.

[44] Trade tensions widened between the United States on the one hand and China, the European Union and lately India on the other. In retaliation against the Trump administration's tariff hikes on steel and aluminum, Beijing has vowed to impose its own tariffs on US soybeans and other farm products, while the European Union is set to slap tariffs on $3.4 billion in Moreover, India and Turkey have already raised import duties on US products, ranging from rice to autos to sunscreen.

Demand for local GS remains robust

The Bureau of Treasury (BTr) awarded in full all the ₱5.0-billion offered amount for the 91-day T-bills during the quarter, except for the auction on 2 April and 25 June wherein the BTr only made a partial award. Meanwhile, for the 18-June auction, the BTr rejected all bids tendered. For the 182-day T-bills, the BTr partially awarded bids for the 16-Aprill, 23-April, 30-April and 25-June auctions vis-à-vis the ₱4.0-billion offered amount, while it rejected in full all bids for the 2-April and 10-April auctions. Moreover, for the 364-day T-bills, the BTr awarded in full the ₱6.0-billion offered amount during the 25-May auction. Meanwhile, the BTr rejected all bids for the 2-April, 10-April, 30-April and 7-May auctions, and made partial awards for the other auction schedules during the quarter.

Chart 30. Total Oversubscription of T-bill Auctions



Source: Bureau of the Treasury

Sovereign Bond and CDS Spreads. In April, debt spreads widened as China retaliated against US trade tariffs by imposing tariffs on US food exports. This negative development spooked investors as the possibility of a full blown trade war between the two countries increased.

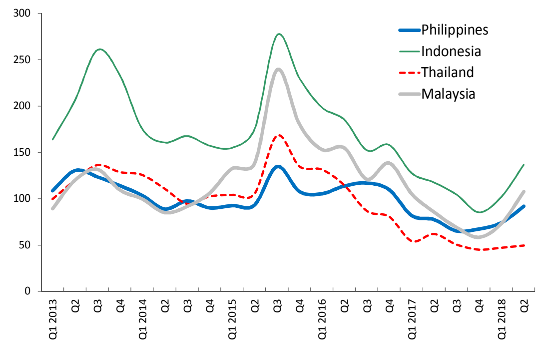
Debt spreads wider due to external developments

In May, debt spreads widened further as investors seemed to have rebalanced their portfolio away from emerging economies due to the strengthening US dollar and higher long-term treasury yields indicating a stronger US economy. Moreover, other advanced economies such as the European Union (EU) have indicated that their stimulus programs will not be extended when these expire, indicating a stronger outlook in advanced economies.

In June, debt spreads continued to widen due to the worsening trade tensions between the US and some of its trading partners such as the EU, Turkey and India. These countries have raised import duties on certain US products. On the domestic front, the country's higher-than-expected domestic inflation, widening merchandise trade deficit and depreciating peso to a 12-year low may have caused market jitters. However, the negative sentiment was partly tempered by the robust Q1 GDP growth figures and the BSP's policy actions to curb inflation.

As of end-June, the Philippines' 5-year sovereign credit default swaps (CDS) stood at 91 bps, higher than the 74 bps in end-1Q 2018. It has remained lower than Indonesia's 136 bps and Malaysia's 107 bps but higher than and Korea's 49 bps and Thailand's 48 bps in the current quarter.

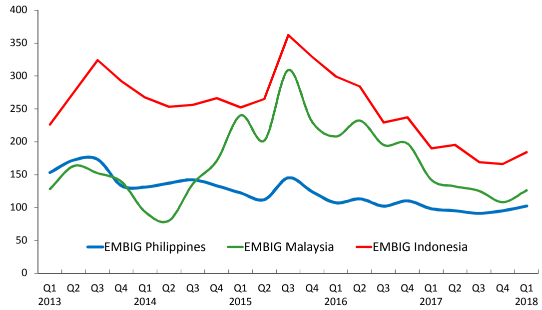
Chart 31. 5-Year CDS Spreads of Selected ASEAN Countries
in basis points



Source: Bloomberg

Meanwhile, the EMBIG Philippines ended the quarter wider at 132 bps when compared to the previous quarter's closing of 102 bps.

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



Source: Bloomberg

Banking System

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

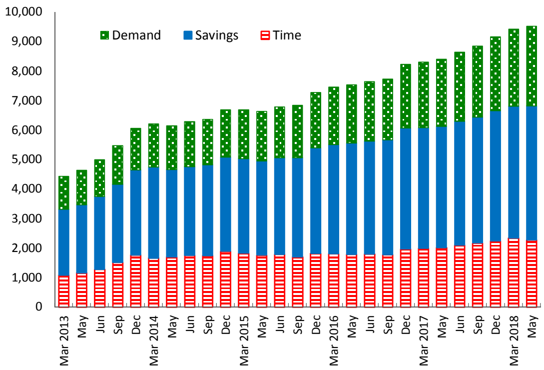
Philippine banking system exhibits steady growth in assets and deposits

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

Savings Mobilization. Savings deposits remained the primary sources of funds for the banking system. Banks' total deposits as of end-May 2018 amounted to ₱9.5 trillion, 13.3 percent or ₱1.1 trillion higher than the year-ago level.[45] Relative to the end-March 2018 level, total deposits grew marginally by 1.0 percent. Meanwhile, foreign currency deposits owned by residents (FCD-Residents) reached ₱1.9 trillion during the same period, posting a year-on-year growth of 7.8 percent. With respect to the end-March 2018 level, FCD-Residents grew by 1.1 percent.[46]

[45] This refers to the total peso-denominated deposits of the banking system.
[46] FCD-Residents, along with M3, forms part of a money supply measure called M4. Meanwhile, M3 consists of savings deposits, time deposits, demand deposits, currency in circulation, and deposit substitutes.

Chart 33. Deposit Liabilities of Banks
in billion pesos

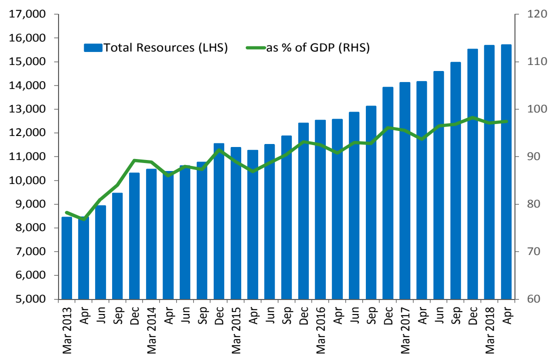


Source: BSP

Institutional Developments. The total resources of the banking system grew by 10.9 percent to reach ₱15.7 trillion as of end-April 2018 from ₱14.2 trillion a year ago. Relative to the March 2018 level, total resources remained unchanged. As a percent of GDP, total resources stood at 97.2 percent.[47]

Total resources of the banking system continue to rise

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

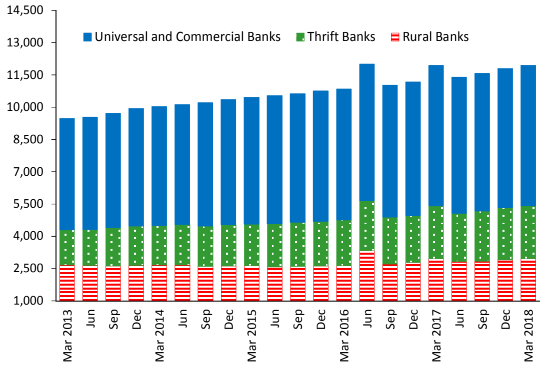


Source: BSP

The number of banking institutions (head offices) as of end-March 2018 of 585 offices were unchanged from a year ago but has decreased from a quarter ago's number of 587 offices. The banks' head offices are comprised of 43 universal and commercial banks (U/KBs), 55 thrift banks (TBs), and 487 rural banks (RBs). This indicated continued consolidation of banks as well as the exit of weaker players in the banking system.

[47] GDP as of the first quarter of 2018.

Chart 35. Number of Banking Institutions



Source: BSP

Meanwhile, the operating network (head offices and branches/agencies) of the banking system expanded to 11,936 offices as of end-March 2018 from 11,793 offices a quarter ago, due mainly to the increase in the branches/agencies of U/KBs, TBs, and RBs.

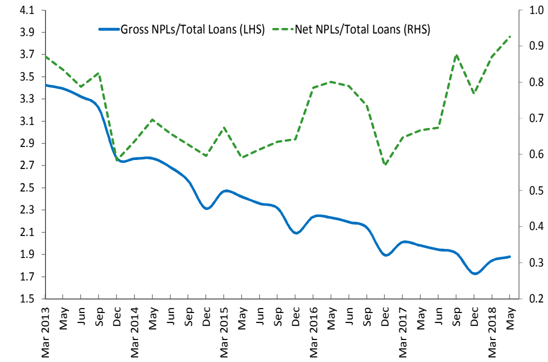
The Philippine banking system's gross non-performing loan (GNPL) ratio improved to 1.9 percent as of end-May 2018 relative to the 2.0 percent registered a year ago but slightly higher than the end-March 2018 ratio of 1.8 percent.

Asset quality of Philippine banks remain healthy

Banks' initiatives to improve their asset quality along with prudent lending regulations helped maintain the GNPL ratio below its pre-Asian crisis level of 3.5 percent.[48] Meanwhile, the net non-performing loan (NNPL) ratio increased slightly to 0.9 percent as of end-May 2018 relative to the previous year's ratio of 0.8 percent and remained unchanged relative to the end-March 2018 ratio. In computing for the NNPLs, specific allowances for credit losses on Total Loan Portfolio (TLP) are deducted from the GNPLs. Said allowances decreased marginally to ₱87.3 billion in end-May 2018 from ₱87.5 billion posted as of end-March 2018.[49]

[48] The 3.5 percent NPL ratio was based on the pre-2013 definition.
[49] 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.

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



Source: BSP

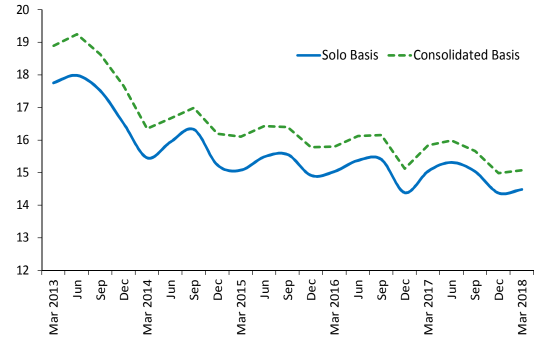
The Philippine banking system's GNPL ratio of 1.9 percent was higher with respect to that of Malaysia (1.1 percent) and South Korea (1.2 percent) but lower than that of Indonesia (2.6 percent) and Thailand (2.9 percent).[50]

The loan exposures of banks remained adequately covered as the banking system registered an NPL coverage ratio of 115.5 percent as of end-May 2018. This was higher than the previous year's ratio of 114.3 percent but lower than the end-March 2018 ratio of 119.7 percent.

U/KBs' CAR remains above international and regulatory standards

The capital adequacy ratio (CAR) of U/KBs at end-March 2018 increased slightly to 14.5 percent on solo basis, relative to the previous quarter's ratio of 14.4 percent. Similarly, CAR on a consolidated basis increased marginally to 15.1 percent from the quarter-ago ratio of 15.0 percent. Nonetheless, these figures remained well above the BSP regulatory threshold of 10.0 percent and international minimum of 8.0 percent.

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



Source: BSP

The CAR of Philippine U/KBs, on a consolidated basis, was lower than that of South Korea (15.4 percent), Malaysia (17.1 percent), Thailand (18.3 percent) and Indonesia (23.0 percent).[51]

Exchange Rate

The peso averaged ₱52.43/US$1 in Q2 2018, depreciating by 1.91 percent from the previous quarter's average of ₱51.43/US$1.

Peso depreciates against the US dollar in Q2 2018

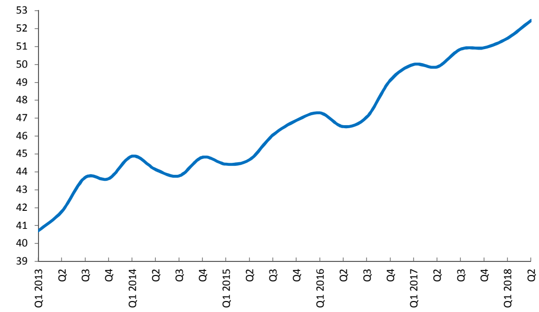
The peso's depreciation during the review period was due mainly to market expectations of faster-than-expected pace of US Fed rate hikes and concerns over the lingering trade tension between the US and its major trading partners, including China. On a year-on-year basis, the peso likewise depreciated by 4.91 percent relative to the ₱49.86/US$1 average in Q2 2017.[52]

[50] Sources: Malaysia (Banking System's Ratio of net impaired loans to net total loans, Q4 2017); South Korea (Domestic Banks' Substandard or Below Loans [SBLs] ratio, Q1 2018); Indonesia, IMF and financial stability reports (Banks' Nonperforming Loans to Gross Loans Ratio, Q4 2017); and Thailand (Total Financial Institutions' Gross NPLs ratio, Q1 2018).

[51] Sources: South Korea (Domestic Banks' Capital Ratio, Q1 2018); Malaysia (Banking System's Total Capital Ratio, May 2018); Thailand (Commercial Banks' Capital Funds Percentage of Risk Assets, April 2018); and Indonesia, IMF and financial stability reports (Commercial Banks, Regulatory Capital to Risk-Weighted Assets Ratio Q4 2017).

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

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



Source: Reference Exchange Rate Bulletin, Treasury Department, BSP

In April, the peso depreciated marginally by 0.06 percent to an average of ₱52.10/US$1 from the ₱52.07/US$1 average in March. The peso's depreciation was due mainly to: (1) rising tensions over a brewing trade war between the US and China[53]; (2) the general strengthening of the dollar on the back of rising US Treasury yields in March; and (3) optimistic US inflation outlook ahead of the US Fed policy meeting.[54]

The depreciation of the peso continued in May as it averaged ₱52.19/US$1, 0.18 percent more than its average in April. The peso's performance was amid safe haven buying following (i) release of minutes of the US Federal Reserve's May policy meeting which the market perceived as hawkish; (ii) the comments of US President Trump that he was not satisfied with the latest round of trade talks with China; (iii) geopolitical concerns involving the US, China, North Korea and Italy; and (iv) rising US Treasury yields, which boosted the US dollar.

In June, the peso averaged ₱53.05/US$1 depreciating further by 1.61 percent from the average in May. The peso's depreciation can be attributed to the second interest rate hike of the US Fed for the year and market expectations of two more rate hikes until end-2018. Concerns over the lingering trade tension between the US and China likewise continued to add pressure to the peso.

On a year-to-date basis, the peso depreciated against the US dollar by 6.39 percent to close at ₱53.34/US$1 on 29 June 2018 from the end-December 2017 closing rate of ₱49.93/US$1. The peso's performance is in line with the strengthening, during the period, of most Asian currencies except the Japanese yen and Malaysian ringgit.[55]

Nonetheless, the sustained inflows of foreign exchange from overseas Filipino remittances, foreign direct investments, BPO receipts, and recovery of exports; as well as the ample level of the country's gross international reserves and the country's robust economic growth, are expected to provide support to the peso.[56]

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

	2013	2014	2015	2016	2017	2018*
Korean Won	1.13	-4.34	-6.61	-2.63	13.16	-4.21
Thai Baht (Onshore)	-4.59	-0.68	-8.86	0.14	9.69	-1.71
Singaporean Dollar	-2.72	-4.52	-5.99	-1.99	8.23	-2.02
Indian Rupee	-11.40	-2.94	-4.93	-2.88	6.27	-6.75
Indonesian Rupiah	-19.07	-2.08	-9.81	2.32	-0.64	-5.28
Philippine Peso	**-7.02**	**-0.73**	**-4.97**	**-5.35**	**-0.42**	**-6.39**
Japanese Yen	-16.26	-12.46	-0.47	3.33	3.83	1.87
Malaysian Ringgit	-5.47	-6.30	-18.55	-4.21	10.69	0.26
Chinese Yuan	2.60	-2.70	-4.33	-6.62	6.68	-1.74
New Taiwan Dollar	-1.95	-6.16	-3.63	1.89	8.76	-2.44

Notes:
- Negative value represents depreciation of the currency against the US dollar.
- YTD changes are computed as the percent change between the closing prices for the year indicated versus the closing prices for the preceding year.
* Data as of 4:00 p.m., 29 June 2018
Source: Treasury Department - BSP

Meanwhile, the volatility of the peso's daily closing rates (as measured by the coefficient of variation) stood at 1.05 percent during the review quarter, lower than the 1.51 percent registered in the previous quarter.[57] The volatility of the peso was lower than most of the other currencies in the region.

On a real trade-weighted basis, the peso gained external price competitiveness in Q2 2018 against the basket of currencies of all trading partners (TPI) and trading partners in advanced (TPI-A) and

[53] US President Trump instructed its officials to consider slapping $100 billion worth of duties against China, following the latter's imposition of new tariffs on 128 US goods including frozen pork, wine and apples.
[54] The US consumer prices, as measured by the personal consumption expenditure (PCE) price index, jumped 2 percent in March compared with the same period last year. This followed the 1.7 percent rise in February and was the biggest gain since February 2017. Source: Reuters news, "U.S. core PCE price index hits 2 percent; spending slows", April 30, 2018.

[55] Based on the last done deal transaction in the afternoon.
[56] As of end-June 2018, the country's gross international reserves (GIR) stood at US$77.7 billion (preliminary). This can cover 7.5 months' worth of imports of goods and payments of services and primary income. It is also equivalent to 6.0 times the country's short-term external debt based on original maturity and 4.1 times based on residual maturity. Foreign direct investments (FDI) remained positive and registered a net inflow of US$2.2 billion as of end-March 2018. Remittances from OF workers continue to flow in from various geographical locations globally. As of end-April 2018, cash remittances from OFs amounted to US$9.4 billion. In 2017, exports of goods, and business process outsourcing (BPO) and tourism receipts reached US$48.2 billion, US$22.1 billion, and US$7.0 billion, respectively.
[57] 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.

developing (TPI-D) countries. Relative to Q1 2018, the real effective exchange rate (REER) index of the peso decreased by 0.70 percent, 1.74 percent and 0.06 percent against the TPI, TPI-A, and TPI-D baskets, respectively. The impact of widening inflation differential was offset by the nominal depreciation which resulted to the general decrease in the REER index.[58,59]
Relative to Q2 2017, the peso likewise gained external price competitiveness in Q1 2018 against the TPI, TPI-A, and TPI-D baskets. This developed as the nominal depreciation of the peso outweighed the impact of widening inflation differential against these currency baskets, resulting to a decrease in the REER index of the peso by 5.01 percent, 4.18 percent, and 5.53 percent against the TPI, TPI-A, and TPI-D baskets, respectively.

III. Fiscal Developments

The National Government (NG) recorded a ₱138.7-billion fiscal deficit for January-May 2018, two times higher than the deficit posted in the previous year.

NG recorded a fiscal deficit for January-May 2018

Netting out the interest payments in NG expenditures, the primary surplus amounted to ₱2.7 billion, twenty-three times lower than the amount recorded in the January-May 2017.

Table 17. National Government Fiscal Performance
in billion pesos

	2017		2018		Growth Rate (in percent)	
	May	Jan-May	May	Jan-May	May	Jan-May
Surplus/(Deficit)	-33.4	-63.6	-32.9	-138.7	-2.0	118.0
Revenues	228.3	996.5	259.0	1,186.3	13.0	19.0
Expenditures	261.7	1,060.1	291.9	1,325.1	12.0	25.0

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

Revenues increased by 19 percent to ₱1,186.3 billion in January-May 2018 compared to ₱996.5 billion in the same period last year. The Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC) contributed ₱827.7 billion and ₱229.3 billion, respectively. Revenue collections by the BIR and BOC were higher by 15 percent and 31 percent, respectively. The notable increase in BOC collections could be attributed to the combined effects of peso depreciation, higher oil prices, and higher import volumes. Meanwhile, income from Bureau of the Treasury (BTr) increased by 22 percent to ₱58.4 billion owing to higher dividends on shares of stocks held by the government and remittance of shares in PAGCOR and MIAA profits.

Expenditures for the period in review amounted to ₱1,325.1 billion, 25 percent higher than the expenditures in January-May 2018. Excluding interest payments, expenditures went up by 28 percent to ₱1,183.6 billion. Meanwhile, interest payment was ₱9.1 billion higher compared to its year-ago level, reaching ₱141.4 billion in end-May 2018.

[58] The TPI measures the nominal and real effective exchange rates of the peso across the currencies of 14 major trading partners of the Philippines, which includes US, Euro Area, Japan, Australia, China, Singapore, South Korea, Hong Kong, Malaysia, Taiwan, Indonesia, Saudi Arabia, United Arab Emirates, and Thailand. The TPI-Advanced measures the effective exchange rates of the peso across currencies of trading partners in advanced countries comprising of the US, Japan, Euro Area, and Australia. The TPI-Developing measures the effective exchange rates of the peso across 10 currencies of partner developing countries which includes China, Singapore, South Korea, Hong Kong, Malaysia, Taiwan, Indonesia, Saudi Arabia, United Arab Emirates, and Thailand.
[59] 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.

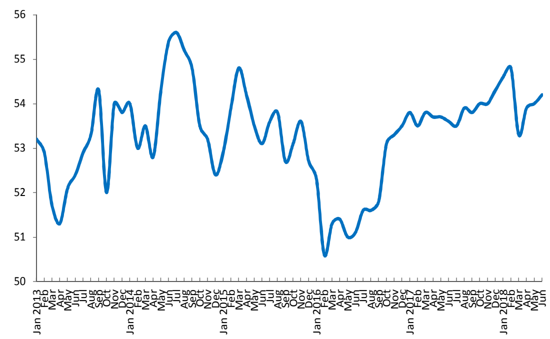
IV. External Developments

The JP Morgan Global All-Industry Output Index increased slightly to 54.2 in June from 54.0 in May as service sector business activity continued to expand faster.

Global economic activity improves in June

The rate of expansion in the US remained close to the record-high in May while economic activity accelerated in the euro area, China, and India. Meanwhile, slower growth was recorded in Russia, while economic activity in Brazil contracted further.[60]

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



Source: Markit Economics

US. Real GDP expanded by 2.0 percent on a seasonally adjusted q-o-q basis in Q1 2018, slower than the 2.9-percent growth rate in Q4 2017. On a y-o-y basis, real output grew by 2.8 percent, faster than the 2.6-percent expansion in the previous year. The slower q-o-q growth in real GDP reflected primarily the decelerations in personal consumption expenditures, exports, state and local government spending, and federal government spending, and a downturn in residential fixed investment.[61]

[60] JP Morgan Global Manufacturing & Services PMI, http://www.markiteconomics.com/
[61] US Bureau of Economic Analysis, "Gross Domestic Product: First Quarter 2018 (Third Estimate)," news release, 28 June 2018. https://www.bea.gov/newsreleases/national/gdp/2018/pdf/gdp1q18_3rd.pdf

Growth in the US economy holds firm

Meanwhile, the manufacturing PMI increased to 60.2 percent in June from 58.7 percent in May as new orders continued to expand amid robust demand.[62]

The unemployment rate increased to 4.0 percent in June from 3.8 percent in May. Total nonfarm payroll employment increased by 213,000 during the same month, with employment gains in professional and business services, manufacturing, and health care. Meanwhile, on a y-o-y basis, inflation was 2.9 percent in June from 2.8 percent in May due mainly to higher inflation for medical care services, food, and transportation services.

The Thomson-Reuters/University of Michigan Index of Consumer Sentiment increased to 98.2 in June from 98.0 in May.[63] Meanwhile, the Conference Board Consumer Confidence Index decreased to 126.4 in June from 128.8 in May.[64] Consumers' appraisal of current conditions was relatively unchanged in June while their optimism about the short-term outlook eased during the month. Consumers' outlook for the labor market was slightly more favorable.

Euro Area. On a q-o-q basis, real GDP growth in the euro area decreased to 0.4 percent in Q1 2018 from 0.7 percent in Q4 2017. On a y-o-y basis, real GDP expanded by 2.5 percent in Q1 2018 from 2.8 percent in Q4 2017.[65]

Output growth in the euro is broadly steady

Meanwhile, the composite PMI for the euro area rose to 54.8 in June from 54.1 in May due to improved service sector performance and inflows of new orders.[66]

[62] Institute for Supply Management, https://www.instituteforsupplymanagement.org
[63] University of Michigan Survey of Consumers, http://www.sca.isr.umich.edu/
[64] The Conference Board, http://www.conference–board.org/
[65] Eurostat news release 93/2018 dated 7 June 2018
[66] Flash estimate. Markit Eurozone PMI, http://www.markiteconomics.com/

Inflation in the euro area increased to 1.9 percent in May from 1.3 percent (revised) in April due to the increases in the price indices for services; energy; food, alcohol, and tobacco; and non-energy industrial goods.[67] The seasonally adjusted unemployment rate was 8.4 percent in May, the same rate posted in April.

The European Commission's Economic Sentiment Indicator in the euro area was generally steady at 112.3 in June from 112.5 in May as incrementally higher confidence in industry, services, and retail trade was offset by lower confidence in the construction sector and among consumers.

Japan. On a q-o-q basis, real GDP contracted by 0.2 percent in Q1 2018 from the 0.3 percent growth in Q4 2017. Meanwhile, on a y-o-y basis, real GDP grew by 1.1 percent, slower than the 1.9 percent expansion in the previous quarter.[68] The decline in the y-o-y real GDP growth was attributed to the lower growth in both private and public demand.

Manufacturing activity in Japan continues to expand

Meanwhile, the seasonally adjusted manufacturing PMI rose to 53.0 in June from 52.8 in May as new orders increased albeit at a slower rate.[69]

Inflation rose to 0.7 percent in May from 0.6 percent in April due to faster increases in the price indices of food; fuel, light, and water; medical care; transportation and communication; education; and clothes and footwear. The seasonally adjusted unemployment rate decreased to 2.2 percent in May from 2.5 percent in April.

China. Real GDP in China expanded by 6.8 percent y-o-y in Q1 2018, the same rate recorded in the previous quarter. The GDP expansion was driven mainly by the services industry and manufacturing.

Indicators point to steady Chinese economic activity

Meanwhile, the seasonally adjusted manufacturing PMI was broadly unchanged at 51.0 in June from 51.1 in May due to a sustained rise in new business.[70]

Inflation was 1.9 percent in June from 1.8 percent in May as both food and non-food prices increased during the month.

India. Real GDP in India expanded by 7.7 percent y-o-y in Q1 2018 from 7.0 percent (revised) in the previous quarter. The latest GDP growth was driven by the expansion in agriculture, forestry and fishing; mining and quarrying; manufacturing; electricity, gas, water supply and other utility services; construction; trade, hotels, transport, and communication; financial, real estate and professional services; and public administration, defense, and other services.[71]

Economic activity in India expands at a faster pace

Meanwhile, the composite PMI rose to 53.3 in June from 50.4 in May due to the increase in new business and new orders in the manufacturing and service sectors amid strong market demand.

Inflation rose to 4.9 percent in May from 4.6 percent in April as the respective price index of all commodity groups increased during the month.

ASEAN Region. The Nikkei ASEAN Manufacturing PMI decreased slightly to 51.0 in June from 51.4 in May due to weaker increases in both output and new orders.

[67] Eurostat news release 97/2018 dated 15 June 2018
[68] Second Preliminary Estimate. Department of National Accounts, Economic and Social Research Institute, Cabinet Office. http://www/esri.cao.go.jp/
[69] Nikkei Japan Manufacturing PMI, http://www.markiteconomics .com/
[70] Caixin China General Manufacturing PMI, http://www.markiteconomics.com/
[71] Preliminary. Ministry of Statistics and Programme Implementation. http://mospi.nic.in/

Manufacturing conditions in the ASEAN region remain broadly steady

Output expanded faster in Vietnam and Singapore while slower rates of expansion were recorded in the Philippines, Indonesia, and Thailand. Meanwhile, manufacturing conditions in Malaysia improved but remained in the contraction territory.[72]

Policy Actions by Central Banks. On 29 June 2018, the Board of Governors of Bank Indonesia (BI) decided to raise the BI 7-day reverse repo rate by 50 bps to 5.25 percent. The latest policy rate hike was considered by BI as a preemptive, front-loading, and ahead-of-the-curve move to maintain the domestic financial market's competitiveness against several countries' changing monetary policies and amid elevated global uncertainty. Previously, the BI also hiked the 7-day reverse repo rate by 25 bps each during the policy meetings held last 30 May and 17 May. The two consecutive policy rate hikes in May were regarded as preemptive measures to strengthen the country's economic stability and to protect the rupiah against the possible impact of a higher-than-expected Fed funds rate hike and escalating global financial market risk.

A number of central banks tighten their monetary policy settings

On 20 June 2018, the Monetary Board (MB) of the BSP raised the interest rate on the overnight repurchase facility by another 25 bps to 3.50 percent. The MB's decision was based on the assessment that inflation expectations remained elevated for 2018 and that the risk of possible second-round effects from ongoing price pressures argued for follow-through monetary policy action. Previously, during its 10 May 2018 monetary policy meeting, the BSP also hiked its key policy rate by 25 bps to 3.25 percent.

Similarly, on 13 June 2018, the Federal Open Market Committee (FOMC) decided to raise the federal funds target range by 25 bps to 1.75 to 2 percent in view of realized and expected labor market conditions and inflation. The FOMC expects that further gradual increases in the target range for the federal funds rate will be consistent with sustained economic activity expansion, strong labor market conditions, and inflation near the 2-percent objective over the medium term.

On 6 June 2018, the Reserve Bank of India raised the policy repo rate by 25 bps to 6.25 percent, taking into account higher CPI projections for 2018 to 2019 due to the sharp rise in April CPI inflation excluding food and fuel, the uptick in the price of Indian basket of crude and other global commodity prices, and recent global financial market developments.

Meanwhile, on 20 June 2018, the People's Bank of China (PBOC) decided to reduce the reserve requirement ratio (RRR) by 50 bps to support qualified debt-to-equity swap programs and boost the supply of credit to small and micro businesses. The cut in the reserve requirement ratio shall take effect on 5 July 2018. The PBOC expects the RRR reduction to release about 500 billion yuan (US$77 billion) for China's five large state banks and 12 national joint-stock commercial banks, and about 200 billion yuan in funding for mid-sized and small banks. An earlier reduction of 100 bps to the RRR took effect last 25 April 2018, in a move by the PBOC to encourage financial institutions to provide loans to small and micro companies and lower funding costs.

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

V. Monetary Policy Developments

At its monetary policy meeting in 10 May, the BSP raised the key policy rate by 25 bps to 3.25 percent for the overnight reverse repurchase or RRP facility. In the 20-June meeting, the BSP decided to hike the policy rate anew by another 25 bps to 3.50 percent. The interest rates on the overnight lending and deposit facilities were likewise raised accordingly.

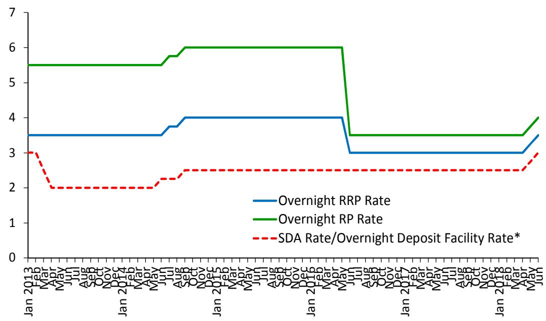
The BSP raises the key policy rate twice in Q2 2018

In deciding to raise the key policy interest rate twice during the review quarter, the BSP noted that inflation expectations remained elevated for 2018 and that the risk of possible second-round effects from ongoing price pressures argued for follow-through monetary policy action. Although inflation expectations remain within the target range for 2019, elevated expectations for 2018 highlight the risk posed by sustained price pressures on future wage and price outcomes. Equally important, while latest baseline forecasts have shifted lower for 2018-2019, upside risks continue to dominate the inflation outlook, even as various measures of core inflation continue to rise. Moreover, the impact of international oil and commodity price movements on overall inflation is expected to be stronger given prevailing robust aggregate demand conditions.

Given these considerations, the BSP believes that the subsequent policy actions enable the BSP to reinforce its signal on safeguarding macroeconomic stability in an environment of rising commodity prices and ongoing normalization of monetary policy in advanced economies. The BSP likewise reiterates its support for carefully coordinated efforts with other government agencies in implementing non-monetary measures to mitigate the impact of supply-side factors on inflation.

Chart 40. BSP Policy Rates

in percent



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

The BSP also emphasized its continued vigilance against financial developments, including excessive peso volatility, that could affect the outlook for inflation. The BSP is prepared to take further policy action as needed to achieve its price and financial stability objectives.

VI. Inflation Outlook

BSP Inflation Forecasts

The BSP's latest baseline forecasts using the 2012-based CPI series show that inflation could average above the target range for 2018 and revert to the target range by 2019.[73]

The risks to the inflation outlook remain on the upside. Additional wage adjustments and transport fare hikes due to higher excise taxes on petroleum products and other key commodities, pending petitions for adjustments in transport fares and electricity rates, and faster-than-expected monetary policy normalization in the US are the main upside risks to future inflation.

Meanwhile, slower global economic growth due to protectionist policies in advanced economies and geopolitical tensions along with the proposed reform in the rice industry involving the replacement of quantitative restrictions with tariffs and the deregulation of rice importation continue to be the main downside risks to inflation.

Inflation is expected to settle above the high-end of the target range in 2018 before settling slightly above the midpoint of the target range in 2019

Demand Conditions. Outturns for key demand indicators attest to the view of robust domestic real sector activity. The economy grew by 6.8 percent in Q1 2018, faster than the Q4 2017 growth of 6.5 percent. On the expenditure side, growth was driven by the acceleration in public consumption as well as stronger capital formation. On the production side, the industry and services sectors continue to be the primary drivers of growth.

Economic activity in the Q2 2018 is expected to remain firm, partly driven by the continued strength in public construction with the implementation of the government's infrastructure programs. However, this could be partly offset by the expected slowdown in the agriculture sector on account of lower production in *palay* and corn and deceleration in tourism due to the rehabilitation of Boracay.

Looking ahead, prospects for the domestic economy continue to remain favorable. GDP expansion could continue to pick up due to the robust growth in the services sector. Private demand is expected to remain firm, aided mainly by sustained remittance inflows. Private capital formation should likewise contribute to economic growth with construction and investments in durable equipment expected to remain solid as the government's projects and other infrastructure programs get underway amid ample liquidity conditions.

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

The optimistic economic outlook has also been reflected in the results of the BSP expectations surveys as consumer confidence turns more upbeat in Q2 2018. Similarly, business confidence is steady in Q2 2018.

Supply Conditions. Food inflation could remain elevated over the near term due to lower production of key agricultural products, such as rice and corn. Similarly, oil prices are expected to remain flat or slightly higher over the near term before gradually declining over the medium term as suggested by futures prices.

[73] On 22 February 2018, the Philippine Statistics Authority (PSA) announced the release of the 2012-based CPI series starting 6 March 2018. The 2006-based and 2012-based CPI series will be released simultaneously until June 2018. The official CPI data beginning July 2018 will use the 2012-based series. The initial release of the 2012-based CPI series covers data beginning 2012 onwards. The PSA plans to release to the public the historical 2012-based CPI series on September 2018.

Commodity prices continue to be elevated over the near term

Global non-oil prices could rise in the coming months before moderating over the medium term. Forecasts by the IMF and World Bank suggest that benchmark prices of key grains, particularly wheat and rice, are projected to rise slightly in 2018 before easing in the medium term. The IMF projects non-fuel commodities to rise by 5.6 percent in 2018 and 0.5 percent in 2019 due to buoyant global demand. The rise in non-oil commodity prices for 2018 can be attributed mainly to higher industrial (9.6 percent) and metal (13.0 percent) prices due to higher growth in both advanced and emerging economies.[74,75]

In the domestic front, *palay* and corn production could decline by 2.4 percent and 3.4 percent, respectively, in Q2 2018 based on standing crop estimates. The projected reduction in *palay* and corn production could be attributed to the shift in planting and harvest schedules in the previous quarters. Based on farmers' expectation, the decline in *palay* and corn output could carry over in Q3 2018.[76]

International crude oil prices rose significantly compared to the previous quarter's level owing mainly to geopolitical concerns as well as robust compliance to the production cut by the Organization of the Petroleum Exporting Countries (OPEC) and several non-OPEC producers. Meanwhile, uncertainties surrounding the oil market could emanate from supply dynamics and geopolitical concerns. Higher US production and the recent output increase from Saudi Arabia and Russia could exert downward pressure on oil prices. Meanwhile, US sanctions against Iran and lower output from Venezuela could pose upside risks to crude oil prices.

The latest futures prices indicate that global crude oil prices could remain elevated in 2018-2019 before gradually declining over the medium term. Similarly, the Energy Information Administration (EIA) along with other international agencies expect crude oil prices to remain relatively flat or decelerate in 2018-2019.[77,78]

Output gap remains slightly positive

The balance of demand and supply conditions as captured by the output gap (or the difference between actual and potential output), provides an indication of potential inflationary pressures in the near term.[79]

Given the latest GDP data, estimates by the BSP show that the output gap remains slightly positive and is broadly steady relative to the previous quarter.[80]

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

1) BSP's overnight RRP rate at 3.5 percent from July 2018 to December 2019;

2) NG fiscal deficits for 2018 to 2019, which are consistent with the DBCC-approved estimates;

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

4) Increase in nominal wage in October 2018 and October 2019 consistent with labor productivity growth and historical wage increases;

5) Real GDP growth is endogenously determined; and

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

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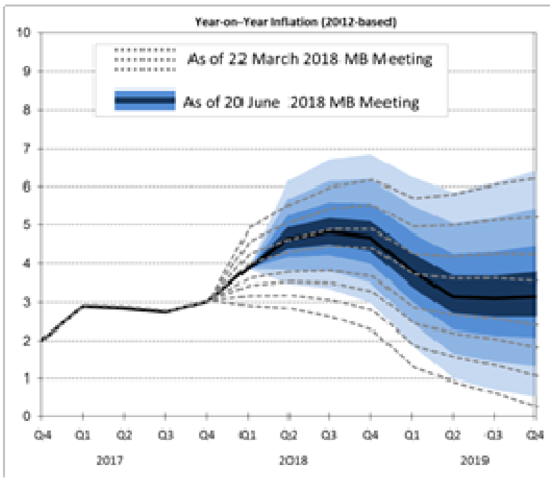
74 IMF, World Economic Outlook, April 2018, available online at http://www.imf.org
75 World Bank, Commodity Markets Outlook, 24 April 2018, available online at http://worldbank.org
76 PSA, Rice and Corn Situation Outlook, 15 May 2018, available online at http://www.psa.gov.ph
77 EIA, Short-Term Energy Outlook, June 2018, available online at http://www.eia.gov
78 IMF, World Economic Outlook, April 2018, available online at http://www.imf.org
79 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).
80 Based on the seasonally-adjusted GDP growth

Risks to the Inflation Outlook

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

Chart 41. Inflation Projection [81]



Source: BSP estimates

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

Projected inflation path is seen to peak in Q3 2018 before reverting to target in 2019

[81] 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.

Based on the latest 2012-based CPI series, the path of inflation is seen to peak in Q3 2018 before gradually decelerating to the midpoint of the target range in 2019.

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

Additional wage adjustments and potential increase in transport fares represent an upside risk to inflation. The higher excise taxes on key commodities could lead to higher-than-assumed minimum wage hikes. However, the planned unconditional cash transfers and other social welfare programs in the pipeline could temper demands for higher wage increases.

Several transport groups have submitted a petition to the Land Transportation Franchising and Regulatory Board (LTFRB) to raise the minimum jeepney, bus, and taxi fares. The transport groups have cited the significant rise in diesel prices due to the implementation of the Tax Reform for Acceleration and Inclusion (TRAIN) Act and the higher cost of spare parts due to the weaker peso for the proposed fare hike. Nevertheless, non-monetary measures such as institutional arrangements in setting transportation fares and minimum wages, unconditional cash transfers, as well as transport subsidies are expected to help mitigate these inflationary impulses.

Faster-than-expected policy normalization in the US and other advanced economies could contribute to foreign exchange depreciation pressures and raise inflation. The sustained recovery in economic conditions in the US could warrant further rate hikes by the Federal Reserve. The baseline inflation outlook already incorporates three rate hikes by the US Fed in 2018 and two rate hikes in 2019, consistent with latest market sentiment. However, faster-than-expected monetary policy normalization in the US and other advanced economies could lead to tighter global liquidity conditions and repricing of risks. Consequently, the higher federal funds rate could result in portfolio outflows and higher risk premia, leading to a weaker peso and higher inflation over the policy horizon.

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

The balance of risks to the inflation outlook remain tilted towards the upside

The proposed reforms in rice importation is the main downside risk to inflation. The House of Representatives and the Senate have accelerated discussions to liberalize the country's rice import policy by replacing quantitative restrictions (QR) on rice by reasonable tariff rates. As the Philippines remains the sole World Trade Organization (WTO) member that still has special treatment exemption, RA No. 8178 or the Agricultural Tariffication Act of 1996 (which maintains the rice QR) would continue to be in effect unless amended or repealed by Congress. Given the significant share of rice in the CPI basket and lower production costs from major import sources such as Thailand and Vietnam, the liberalization of rice importation policy could drive down domestic rice prices.

The global economic outlook is also another source of downside risk to the inflation outlook. The continued policy uncertainty, spillovers from tighter global financial conditions, the imposition of inward-looking policies, and geopolitical tensions could lead to slower global trade and economic activity on the whole, thereby leading to potential downward price pressures.

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

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

Implications for the Monetary Policy Stance

The sum of new information in Q2 calls for monetary policy response to rein inflation expectations and contain second-round effects. With higher baseline inflation projections and the balance of risks skewing to the upside, an increase in policy rates is appropriate. Policy rate actions also serve to arrest the build-up in inflation expectations and possible second-round effects from ongoing cost-push price pressures. Headline and core inflation readings have also been elevated in Q2 2018 amid broader inflation pressures. Nevertheless, there is increased optimism on the passage of the proposed rice tariffication bill which should result in downward pressure on food prices and help curb inflation expectations in the near-term. Meanwhile, prospects for aggregate demand are expected to remain solid, suggesting that the economy as a whole will be able to retain its momentum amid adjustments in policy interest rates. Social mitigating measures by the National Government could also likely provide a stabilizing influence on inflation expectations in the near term while allowing sufficient time for the economy to adjust. The BSP also remains vigilant and ready for follow-through action as necessary to safeguard the BSP's inflation objective.

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
13 Jun 2013 **25 Jul 2013** **12 Sep 2013** **24 Oct 2013** **12 Dec 2013**	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained.
2014			
6 Feb 2014	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained.
27 Mar 2014	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained. Meanwhile, the MB decided to increase the reserve requirement by one percentage point effective on 11 April 2014.
8 May 2014	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also maintained. Meanwhile, the MB decided to increase the reserve requirements for U/KBs and TBs by a further one percentage point effective on 30 May 2014.
19 Jun 2014	3.50	5.50	The MB decided to keep the BSP's key policy interest rates steady at 3.50 percent for the overnight borrowing or RRP facility and 5.50 percent for the overnight lending or RP facility. The interest rates on term RRPs and RPs were also maintained. The reserve requirement ratios were left unchanged as well. Meanwhile, the MB decided to raise the interest rate on the SDA facility by 25 basis points from 2.0 percent to 2.25 percent across all tenors effective immediately.
31 Jul 2014	3.75	5.75	The MB decided to increase the BSP's key policy rates by 25 bps to 3.75 percent for the overnight borrowing or RRP facility and 5.75 percent for the overnight lending or RP facility. The interest rates on term RRPs and RPs were also raised accordingly. The rate on special deposit accounts (SDA) was left unchanged. Meanwhile, the reserve requirement ratios were also kept steady.
11 Sep 2014	4.00	6.00	The MB decided to increase the BSP's key policy rates by 25 bps to 4.0 percent for the overnight borrowing or RRP facility and 6.0 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDA were also raised accordingly. Meanwhile, the reserve requirement ratios were left unchanged.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent) RRP Overnight	Levels (in percent) RP Overnight	Monetary Policy Decisions
23 Oct 2014 **11 Dec 2014**	4.00	6.00	The MB decided to maintain the BSP's key policy interest rates at 4.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and special deposit accounts were also kept steady. The reserve requirement ratios were left unchanged as well.
			2 0 1 5
12 Feb 2015 **26 Mar 2015** **14 May 2015** **25 Jun 2015** **13 Aug 2015** **24 Sep 2015** **12 Nov 2015** **17 Dec 2015**	4.00	6.00	The MB decided to maintain the BSP's key policy interest rates at 4.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and special deposit accounts were also kept steady. The reserve requirement ratios were left unchanged as well.
			2 0 1 6
11 Feb 2016 **23 Mar 2016** **12 May 2016**	4.00	6.00	The MB decided to maintain the BSP's key policy interest rates at 4.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and special deposit accounts were also kept steady. The reserve requirement ratios were left unchanged as well.
23 Jun 2016 **11 Aug 2016** **22 Sep 2016** **10 Nov 2016** **22 Dec 2016**	3.00	3.50	The BSP formally adopted an interest rate corridor (IRC) system as a framework for conducting its monetary operations. The shift to IRC is an operational adjustment and not a change in the monetary policy stance. The IRC is a system for guiding short-term market rates towards the BSP policy interest rate which is the overnight reverse repurchase (RRP) rate. The IRC system consists of the following instruments: standing liquidity facilities, namely, the overnight lending facility (OLF) and the overnight deposit facility (ODF); the overnight RRP facility; and a term deposit auction facility (TDF). The interest rates for the standing liquidity facilities form the upper and lower bound of the corridor while the overnight RRP rate is set at the middle of the corridor. The repurchase (RP) and Special Deposit Account (SDA) windows will be replaced by standing overnight lending and overnight deposit facilities, respectively. Meanwhile, the reverse repurchase (RRP) facility will be modified to a purely overnight RRP. In addition, the term deposit facility (TDF) will serve as the main tool for absorbing liquidity. The interest rates for these facilities will be set as follows starting 3 June 2016: • 3.5 percent in the overnight lending facility (a reduction of the interest rate for the upper bound of the corridor from the

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent) RRP Overnight	Levels (in percent) RP Overnight	Monetary Policy Decisions
			current overnight RP rate of 6.0 percent); • 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).
		2 0 1 7	
9 Feb 2017 **23 Mar 2017** **11 May 2017** **22 Jun 2017** **10 Aug 2017** **21 Sep 2017** **9 Nov 2017** **14 Dec 2017**	3.00	3.50	The MB decided to maintain the BSP's key policy interest rates at 3.0 percent for the overnight reverse repurchase (RRP) facility, 3.5 percent for the overnight lending facility (OLF) and 2.5 percent for the overnight deposit facility (ODF). The reserve requirement ratios were left unchanged as well.
		2 0 1 8	
8 Feb 2018	3.00	3.50	The MB decided to maintain the BSP's key policy interest rates at 3.0 percent for the overnight reverse repurchase (RRP) facility, 3.5 percent for the overnight lending facility (OLF) and 2.5 percent for the overnight deposit facility (ODF).
15 Feb 2018			The reserve requirement ratio was reduced by one (1) percentage point as an operational adjustment to support the BSP's shift toward a more market-based implementation of monetary policy as well as its broad financial market reform agenda. The reduction will apply to the reservable liabilities of all banks and non-bank financial institutions with quasi-banking functions with reserve requirement at twenty (20) percent.
22 Mar 2018	3.00	3.50	The MB decided to maintain the BSP's key policy interest rates at 3.0 percent for the overnight reverse repurchase (RRP) facility, 3.5 percent for the overnight lending facility (OLF) and 2.5 percent for the overnight deposit facility (ODF).
10 May 2018	3.25	3.75	The MB decided to increase the BSP's key policy interest rates by 25 basis points to 3.25 percent for the overnight reverse repurchase (RRP) facility, 3.75 percent for the overnight lending facility (OLF) and 2.75 percent for the overnight deposit facility (ODF).
24 May 2018			The reserve requirement ratio was reduced by one (1) percentage point as part of its medium-term financial market reform agenda to promote a more efficient financial system by lowering intermediation costs. The reduction will apply to those reservable liabilities of all banks and non-bank financial institutions with quasi-banking functions that are currently subject to a reserve requirement of nineteen (19) percent.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
2018			
20 June 2018	3.50	4.00	The MB decided to raise the BSP's key policy interest rates by 25 basis points to 3.50 percent for the overnight reverse repurchase (RRP) facility, 4.00 percent for the overnight lending facility (OLF) and 3.00 percent for the overnight deposit facility (ODF).

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

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

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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