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INFLATION REPORT
1st Quarter 2016

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 2015-2018 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 14 April 2016.

AMANDO M. TETANGCO, JR.
Governor

The Monetary Policy of the Bangko Sentral ng Pilipinas

The BSP Mandate

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

Monetary Policy Instruments

The BSP's primary monetary policy instrument is its overnight reverse repurchase (RRP) or borrowing rate. Other instruments to implement the desired monetary policy stance to achieve the inflation target include (a) increasing/decreasing the reserve requirement; (b) accepting deposits in the special deposit account (SDA) facility by banks and trust entities of BSP-supervised financial institutions; (c) adjusting the rediscount rate on loans extended to banking institutions on a short-term basis against eligible collateral of banks' borrowers; and (d) outright sales/purchases of the BSP's holdings of government securities.

Policy Target

The BSP's target for monetary policy uses the Consumer Price Index (CPI) or headline inflation rate, which is compiled and released to the public by the National Statistics Office (NSO). The policy target is set by the Development Budget Coordination Committee (DBCC)[1] in consultation with the BSP. The inflation target for 2015-2018 is 3.0 percent ± 1.0 ppt.[2]

BSP's Explanation Clauses

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

[1] The DBCC, created under Executive Order (E.O.) No. 232 dated 14 May 1970, is an inter-agency committee tasked primarily to formulate the National Government's fiscal program. It is composed of the 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.

[2] The inflation range target for 2015-2018 was announced thru DBCC Resolution No.2015-1 dated 27 January 2015. The decision to maintain the inflation range target for 2016-2018 was announced thru DBCC Resolution No.2015-7 dated 29 December 2015.

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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Amando M. Tetangco, Jr.

Members
Cesar V. Purisima
Alfredo C. Antonio
Felipe M. Medalla
Armando L. Suratos
Juan D. De Zuñiga, Jr.
Valentin A. Araneta

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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2016 Schedule of Monetary Policy Meetings, Inflation Report Press Conferences and Publication of MB Highlights

2016	Advisory Committee Meeting	Monetary Board Meeting	Publication of MB Highlights	Inflation Report Press Conference
Jan			14 (Thu) (17 Dec 2015 MB)	22 (Fri) (Q4 2015 IR)
Feb	5 (Fri)	11 (Thu)		
Mar	18 (Fri)	23 (Wed)	10 (Thu) (11 Feb 2016 MB)	
Apr			21 (Thu) (23 Mar 2016 MB)	22 (Fri) (Q1 2016 IR)
May	6 (Fri)	12 (Thu)		
Jun	17 (Fri)	23 (Thu)	9 (Thu) (12 May 2016 MB)	
Jul			21 (Thu) (23 Jun 2016 MB)	22 (Fri) (Q2 2016 IR)
Aug	5 (Fri)	11 (Thu)		
Sep	16 (Fri)	22 (Thu)	8 (Thu) (11 Aug 2016 MB)	
Oct			20 (Thu) (22 Sep 2016 MB)	21 (Fri) (Q3 2016 IR)
Nov	4 (Fri)	10 (Thu)		
Dec	16 (Fri)	22 (Thu)	8 (Thu) (10 Nov 2016 MB)	

List of Acronyms, Abbreviations, and Symbols

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

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Overview

Headline inflation edged up but remains subdued. Headline inflation inched higher to 1.1 percent in Q1 2016 but remained below the low end of the government's announced annual target of 3.0 percent ± 1.0 percentage point for 2016-2018. This was slightly higher than the previous quarter's 1.0 percent but lower than the year-ago level of 2.5 percent. Modest upticks in selected food items contributed to the slightly higher inflation reading. Meanwhile, non-food inflation remained steady as easing utility rates were counterbalanced by price increases in other items such as transport fares. In contrast, core inflation eased to 1.6 percent from 1.8 percent in the previous quarter. Two out of the three alternative measures of core inflation, i.e., measures using trimmed mean and net of volatile items, were lower. There were 22 CPI items with inflation rates greater than the upper end of the 2016 inflation target, comprising 11.3 percent of the CPI basket.

Inflation expectations are generally lower. Results of the BSP's survey of private sector economists for March 2016 showed lower mean inflation forecasts for 2016 of 1.9 percent from 2.5 percent in December 2015. Analysts attributed their lower inflation expectations to continued low global oil prices, slower global economic growth, and lower domestic electricity rates which are seen to outweigh upside risks brought by the El Niño phenomenon, increased government expenditures from the upcoming election, pending power rate adjustments, rebound in oil prices, base effects in the CPI data, the possible occurrence of La Niña in the latter part of 2016, and expectations of higher US interest rates. Similarly, results of the March 2016 Consensus Economics survey also showed a lower mean inflation forecast for 2016 at 2.2 percent from 2.5 percent in December 2015. Meanwhile, mean inflation forecast for 2017 was at 3.1 percent.

Domestic demand remains intact. The domestic economy expanded in Q4 2015 by 6.3 percent from the previous quarter's 6.1 percent although this was slightly lower than the previous year's increase of 6.6 percent. This brought the full-year 2015 growth to 5.8 percent. Growth for the quarter in review was fueled by accelerated consumer spending and increased fixed capital investments, particularly in durable equipment and public construction. Meanwhile, the services and industry sectors continued to be the main drivers of growth on the production side. Likewise, trends in higher-frequency demand indicators point to optimistic prospects in the near term. Vehicle sales sustained its double-digit growth, supported by rising household incomes coupled with attractive car financing terms offered by industry players while the composite Purchasing Managers' Index remained firmly above the 50-point expansion threshold.

Inflation edges higher amid firm domestic prospects but remains benign

At the same time, business and consumer confidence continue to improve, consistent with the assessment that underlying domestic demand continues to be firm against a backdrop of sustained credit growth and notable improvements in employment conditions.

Global economic activity softens in early 2016. Economic activity in advanced economies remains subdued as growth in the US, euro area and Japan continued to regain momentum. In contrast, downturns were noted in major emerging markets such as India and China. The subdued economic outlook for emerging markets dampened global growth prospects to which several central banks responded by easing monetary policy settings in order to stave off deflationary pressures.
In addition, in order to achieve their price stability targets, the Bank of Japan introduced quantitative and qualitative monetary easing with negative interest rate while the European Central Bank expanded its asset purchase program.

Domestic financial market remains solid despite external headwinds. The domestic financial system remained stable, supported by strong macroeconomic fundamentals. However, uncertainty on the external front stemming from continuing worries over global growth, China's bumpy transition and deepening monetary policy divergence buffeted emerging market assets.
On the domestic front, the Philippine equities market saw dampened activity as cautious investor sentiment reined in gains. Increased risk perception was likewise reflected in the country's bond spreads and risk premiums. Nevertheless, sovereign CDS remained lower compared to the Philippines' Asian neighbors. Moreover, investor

appetite for local currency government securities remained healthy, affirmed by the continued oversubscription in the scheduled GS auctions. Amid all these external developments, the Philippine banking system remained sound and resilient, marked by a continued increase in assets, lending, and deposits, and with capital adequacy ratios comfortably above the BSP's and Bank for International Settlements' prescribed levels. In addition, bank lending standards for both loans to enterprises and households were also broadly unchanged during the quarter, indicating that banks continue to be prudent in managing their risks.

The BSP maintains monetary policy settings during the quarter. The BSP decided to maintain its key policy interest rates at 4.0 percent for the overnight borrowing or RRP facility and 6.0 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also kept steady. The reserve requirement ratios were left unchanged as well. The BSP's assessment of a manageable inflation outlook and robust growth conditions continue to support keeping monetary policy settings steady, particularly with inflation expectations firmly anchored within the inflation target band over the policy horizon.

Current monetary policy settings remain appropriate. Latest baseline inflation forecasts extending to 2017 show that annual average inflation is likely to settle within the target range while inflation expectations remain well-anchored. The continued buoyancy of domestic demand, including fiscal policy which is already starting to provide additional boost to demand, suggests that prospects for growth remain firm despite indications that the global economy is growing at a slightly slower pace than previously expected. Thus, although inflation pressures remain largely subdued, the relatively strong and positive indicators of domestic activity serve to allay concerns on potential deflationary pressures. In addition, liquidity and credit continue to grow at a reasonable pace, suggesting that the economy may not require further monetary stimulus at the moment.

The BSP is of the view that current monetary policy settings are appropriate

Equally important, there continues to be ample room for fiscal policy to provide an additional boost to domestic demand by raising infrastructure and social spending through improved budget execution. Over the period ahead, the BSP has scope to further assess whether weaker external conditions and heightened financial market volatility would require an appropriate policy response.

On balance, the BSP is of the view that current monetary policy settings remain appropriately calibrated. Going forward, the BSP will continue to monitor domestic and external developments to ensure that the monetary policy stance remains consistent with its price and financial stability objectives.

I. Inflation and Real Sector Developments

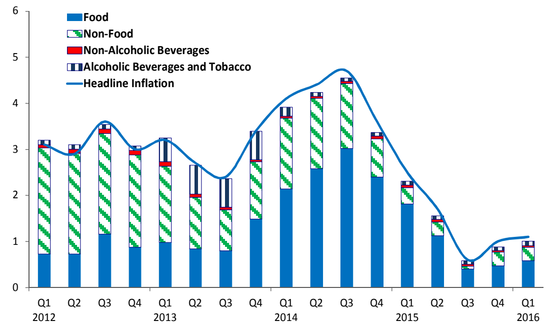
Prices

Headline Inflation. Headline inflation inched up in the first quarter of 2016 on the back of higher prices of selected food items.

Inflation dynamics remain driven by supply-side factors

Inflation increased to 1.1 percent from 1.0 percent in the previous quarter but remained below the low end of the government's announced target of 3.0 percent ± 1.0 percentage point for 2016-2018.

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



Source: Philippine Statistical Authority (PSA), BSP

Core Inflation. On the other hand, core inflation (which excludes certain volatile food and energy items) eased to 1.6 percent from 1.8 percent in the previous quarter. Similarly, two out of the three alternative measures of core inflation computed by the BSP were lower in Q1 2016. Both trimmed mean and net of volatile items edged down to 1.2 percent (from 1.3 percent) and 1.3 percent (from 1.5 percent), respectively. Meanwhile, the weighted median measure was steady at 1.3 percent.

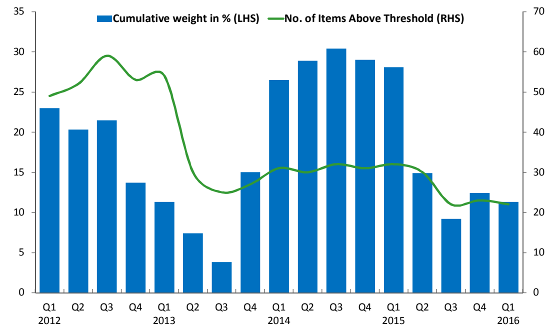
The number of items with inflation rates greater than the threshold of 4.0 percent (which is the upper end of the 2016 inflation target) was slightly lower at 22 items in Q1 2016 from 23 items in the previous quarter. These items accounted for 11.3 percent of the CPI basket, lower than the quarter-ago share of 12.4 percent.

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

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

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

Chart 2. CPI Items with Inflation Rates Above Threshold



Source: PSA, BSP staff estimates

Food Inflation. Food inflation increased to 1.6 percent in Q1 2016 from 1.3 percent in the previous quarter. The slightly higher food inflation can be traced mainly to price increases in certain key food items namely, meat, vegetables, sugar as well as oils and fats.

Meanwhile, rice prices continued to decline compared to year-ago levels as the arrival of additional rice importation and onset of the main harvest season in the previous quarter ensured sufficient supply during the start of the year. Rice accounts for 8.9 percent of total CPI basket.

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

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

Source of Basic Data: PSA, BSP

Non-Food Inflation. On the other hand, non-food inflation remained steady in Q1 2016 at 0.5 percent. Inflation for housing, water, electricity, gas, and other fuels remained in the negative territory as utility rates declined. Electricity rates decreased during the quarter on lower generation charge. Water rates also declined in Q1 2016.

Nonetheless, these developments were counterbalanced by higher price increases of certain non-food items like health, recreation and culture as well as restaurants and miscellaneous goods and services. Similarly, transport fares for air and ships increased due to higher demand for provincial trips during the Lenten season. By contrast, transport services eased during the quarter as previous rollbacks of domestic petroleum products (i.e., gasoline, kerosene, diesel, and LPG) led to transport fare reductions in Q1 2016.

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

Commodity	2015				2016
	Q1	Q2	Q3	Q4	Q1
Non-Food	0.6	0.5	0.1	0.5	0.5
Clothing and Footwear	3.1	2.6	2.3	2.3	1.9
Housing, Water, Electricity, Gas and Other Fuels	-1.1	-1.1	-1.7	-1.2	-1.0
Electricty, Gas, and Other Fuels	-8.7	-8.2	-9.8	-8.8	-6.9
Furnishings, Household Equipment & Routine Maintenance of the House	2.2	2.1	1.7	1.6	1.5
Health	2.7	2.3	1.7	1.8	1.9
Transport	-0.7	0.0	-0.5	0.9	0.3
Transport Services	2.6	2.9	2.5	3.3	1.2
Communication	-0.1	-0.1	0.0	0.0	0.1
Recreation and Culture	1.1	1.1	1.0	1.0	1.1
Education	5.1	4.7	3.6	3.6	3.6
Restaurant and Miscellaneous Goods and Services	1.6	1.2	1.2	1.3	1.6

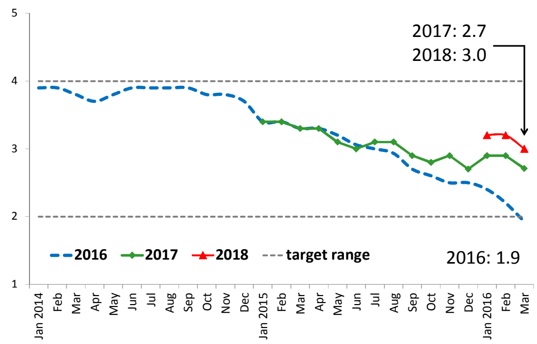
Source of Basic Data: PSA, BSP

Private Sector Economists' Inflation Forecasts. Results of the BSP's survey of private sector economists for March 2016 yielded lower mean inflation forecast for 2016 relative to the results in December 2015.[3]

Mean inflation forecasts for 2016 are lower

In particular, the mean inflation forecast for 2016 declined to 1.9 percent from 2.5 percent in December 2015. By contrast, the average annual inflation forecast for 2017 was unchanged at 2.7 percent from the December 2015 survey results. Meanwhile, mean inflation forecast for 2018 was at 3.0 percent.

Chart 3. BSP Private Sector Economists' Survey
mean forecast for full year; in percent



Source: BSP

Analysts attributed their lower inflation expectations to continued low global oil prices, slower global economic growth, and lower domestic electricity rates. These are likely to outweigh the upside risks brought by the El Niño phenomenon, increased government expenditures from the upcoming election, pending power rate adjustments, rebound in oil prices, base effects in the CPI data, possible occurrence of La Niña in the latter part of 2016, and prospects of rising US interest rates.

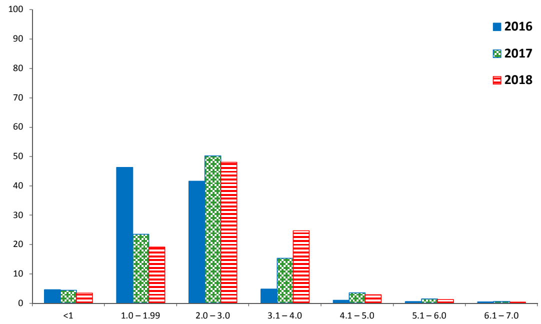
Based on the probability distribution on the forecasts provided by 23 out of 28 respondents, there is a 46.3-percent chance that average inflation for 2016 will settle between the 1.0-1.99 percent range. Meanwhile, there is a 46.4-percent chance that 2016 inflation rate will fall within the 2-4 percent target range.

[3] There were 28 respondents in the BSP's survey of private sector economists in March 2016. The survey was conducted between 8-28 March 2016.

For 2017, the respondents assigned a 65.5-percent chance that inflation will fall within the 2-4 percent target range.

Chart 4. Probability Distribution for Analysts' Inflation Forecasts*

2016-2018



*Probability distributions were averages of those provided by 23 out of 28 respondents.
Source: BSP Survey

Results for the March 2016 Consensus Economics survey showed lower mean inflation forecast for 2016 at 2.2 percent (from 2.5 percent in December 2015). Meanwhile, mean inflation forecast for 2017 was at 3.1 percent.[4]

Table 4. Private Sector Forecasts for Inflation, March 2016

annual percentage change

	2016			2017	2018
	Q2	Q3	FY	FY	FY
1) Al-Amanah Islamic Bank	1.10	1.30	1.30	2.00	2.00
2) Asia ING	1.40	2.30	1.90	3.00	3.20
3) Banco de Oro	2.24	2.85	2.50	3.00	3.50
4) Bangkok Bank	2.00	2.25	2.20	2.50	2.75
5) Bank of Commerce	1.45	1.87	1.62	-	-
6) Bank of China	1.30	1.80	2.10	3.00	3.00
7) Bank of the Philippine Islands	2.10	2.70	2.30	-	-
8) Barclays	1.80	2.60	2.20	2.70	-
9) Chinabank	2.10	2.40	2.00	2.30	2.50
10) Citibank, N.A.	1.20	1.50	1.70	2.60	3.50
11) CTBC Bank	1.10	1.50	1.50	3.00	4.00
12) Deutsche Bank	-	-	2.60	3.10	-
13) Eastwest Bank	1.00	1.20	1.35	1.75	2.00
14) Global Source	1.60	2.70	2.20	3.50	-
15) IDEA	1.01	1.74	1.45	2.93	3.43
16) Land Bank of the Philippines	1.30-1.60	1.50-1.80	2.10-2.40	2.70-3.00	2.70-3.00
17) Maybank	2.10	2.50	2.33	3.00	3.00
18) Maybank-ATR KimEng	1.80	2.40	2.10	-	-
19) Metrobank	-	-	1.40	2.70	3.80
20) Multinat'l Inv. Banc	1.75	2.00	1.74	3.00	-
21) Mizuho	1.20	1.50	1.30	1.50	2.00
22) Nomura	2.10	3.10	2.40	3.50	-
23) Phil. Equity Partners	1.50	2.00	2.20	3.10	-
24) RCBC	1.50-2.00	2.00-2.50	1.80-2.30	3.00-3.50	2.80-3.30
25) Robinsons Bank	1.50-2.00	2.00-2.50	1.50-2.50	2.00-4.00	2.00-4.00
26) Standard Chartered	2.00	2.60	2.20	2.90	3.30
27) UBS	2.00	2.50	2.00	2.30	-
28) Union Bank	1.51	1.55	1.42	1.96	2.27
Median Forecast	1.7	2.3	2.0	2.9	3.0
Mean Forecast	**1.6**	**2.1**	**1.9**	**2.7**	**3.0**
High	2.2	3.1	2.6	3.5	4.0
Low	1.0	1.2	1.3	1.5	2.0
Number of Observations	26	26	28	25	18
Government Target	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**

Source: BSP

Similarly, based on the BSP Business Expectations Survey (BES), majority of firms in Q1 2016 expect inflation to increase, albeit modestly, in the current quarter relative to the previous quarter (from a diffusion index of 18.2 percent to 25.2 percent).

Inflation expectations remain subdued

The number of firms that expect inflation to increase slightly in the next quarter went up from 21.4 percent to 32.7 percent. Meanwhile, results of the Q1 2016 BSP Consumer Expectations Survey (CES) show that respondents anticipate inflation to decline to 3.3 percent from 4.2 percent in the previous quarter.

Energy prices. The average price of Dubai crude oil dropped further in the first quarter of 2016. International oil prices declined by 25.3 percent in Q1 2016 due largely to persistent oversupply and inventory buildup.[5]

Global oil price continues to drop on oversupply and inventory buildup

In January 2016, oil prices continued its downtrend as inventory accumulated alongside increased production from Iran after oil-related sanctions were lifted on 16 January. Furthermore, Indonesia's re-entry after a 7-year hiatus was also anticipated to further exacerbate the global supply glut.

At the same time, the US crude stockpiles remained elevated at around 534.8 million barrels (excluding Strategic Petroleum Reserve) for the week ending 25 March 2016; this was higher by 13.4 percent relative to 2015.[6]

Oil prices increased slightly in the following months (from February-March 2016), driven by reports of potential plans between Russia and selected Organization of the Petroleum Exporting Countries (OPEC) member countries (i.e., Saudi Arabia, Venezuela, and Qatar) to freeze oil output.

[4] There were 18 respondents in the Consensus Economics' survey in March 2016.

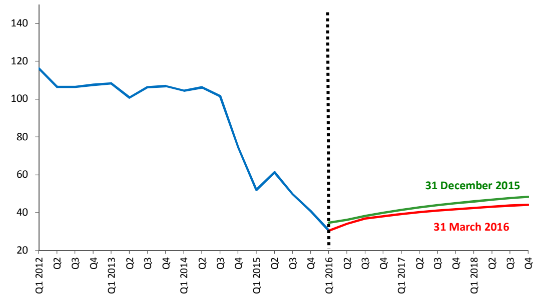
[5] Global inventory was estimated to have climbed by 1 billion barrels in 2014-15. Source: January 2016 Oil Market Report from the International Energy Agency. https://www.iea.org/oilmarketreport/reports/2016/0116/

[6] Based on Weekly Petroleum Status Report (March 2016). https://www.eia.gov/petroleum/supply/weekly/

However, this was not enough to offset the consecutive decreases since 2015.

Meanwhile, the estimated futures prices of Dubai crude oil in Q1 2016 showed a lower path for 2016 to 2018 compared to the estimates in the previous quarter.[7]

Chart 5. Spot and Estimated Prices of Dubai Crude Oil



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

Global oil supply is projected to outstrip demand for the next two years but could narrow in 2H 2017. In its latest report, the US Energy Information Administration (EIA) revised both supply and demand forecasts downward though production will continue to exceed consumption for 2016-2017. Production is expected to decline in the coming months due largely to lower non-OPEC output particularly, the US tight oil production, which is regarded to be one of the most price-sensitive.

Similarly, projections on oil consumption were lower as downside risks to global demand increased with the possible slowdown in economic growth of major consumers namely, China, Japan, and OECD Europe. In March 2016, the US EIA adjusted December 2015 supply estimates for 2016 downward to 1.1 million barrels per day (mb/d) from 1.4 mb/d. Meanwhile, supply forecasts for 2016 from both the IEA and OPEC remained steady at 1.2 mb/d and 1.25 mb/d, respectively.

Meanwhile, prices of domestic petroleum products showed mixed trends compared to the previous quarter. Gasoline, kerosene and diesel posted an increase relative to end-Q4 2015. By contrast, LPG decreased by ₱4.45 per liter. Nonetheless, domestic retail pump prices remained lower than year-ago levels.

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

QUARTER	GASOLINE	KEROSENE	DIESEL	LPG
2014 Q1	53.75	50.87	44.25	41.73
Q2	54.95	51.51	43.70	40.27
Q3	52.15	47.99	40.70	38.74
Q4	41.20	37.39	30.05	33.87
2015 Q1	42.60	35.59	28.85	31.19
Q2	45.90	37.49	29.65	30.18
Q3	42.25	33.44	26.80	28.00
Q4	38.10	29.07	22.60	32.14
2016 Q1	39.00	30.32	22.80	27.69
QUARTER-ON-QUARTER CHANGE				
2016 Q1	0.90	1.25	0.20	(4.45)
YEAR-ON-YEAR CHANGE				
2016 Q1	(3.60)	(5.27)	(6.05)	(3.50)

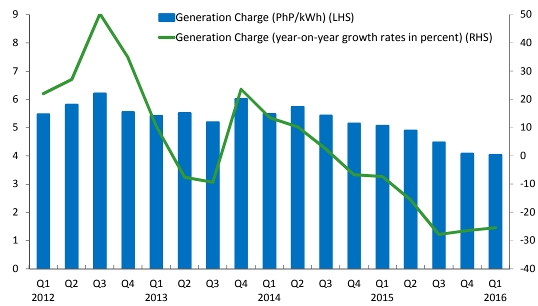
*Average Metro Manila retail pump prices for the big three oil companies: Caltex, Petron and Shell
Source: Department of Energy (DOE)

Power. Overall electricity rates went down slightly in Q1 2016 due to lower generation costs.

Lower generation charges lead to decreased retail electricity prices

For Q1 2016, the average generation charge dropped by ₱0.04 per kilowatt hour (kWh) to ₱4.03 per kWh from ₱4.07 per kWh in Q4 2015. The marginal decline in the average electricity rates during the quarter was driven mainly by the lower generation cost from the Power Supply Agreements (PSAs) in January and March 2016, which offset the increase recorded in February 2016. The lower generation charge in the quarter were attributed to the higher dispatch of the power plants, reduction of capacity fees, and to some extent, the reduction in fuel cost.

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



Source: Meralco

[7] Future prices derived using Brent crude futures data.

Meanwhile, 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's (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.

Water. Effective 1 January 2016, the all-in-water rates of Manila Water Company, Inc. (MWCI) and Maynilad Water Services, Inc (MWSI) went down by ₱0.34/cu.m. (from ₱34.00/cu.m to ₱33.66/cu.m.) and ₱0.26 /cu.m. (from ₱45.87/cu.m. to ₱45.61/cu.m.), respectively.

MWSS adjusts rates for concessionaires due to FCDA

The decrease in the all-in-tariff rate of MWCI was attributed mainly to the downward adjustment of basic water charges as the MWSS Board of Trustees (MWSS-BOT) approved and confirmed MWSS-RO Resolution No. 2015-14-CA, ordering a ₱0.36/cu.m. reduction in MWCI basic water charge while reflecting an increase of ₱0.20/cu.m., taking expected inflation into account. The lower foreign currency differential adjustment (FCDA) for Q1 2016 brought down further MWCI's all-in-water tariff rate by ₱0.05/cu.m.

Meanwhile, the reduction in all-in-tariff rate of MWSI was due to the decrease in FCDA by ₱0.46/cu.m. for Q1 2016 which offset the inflation-adjusted increase in the basic water charge of ₱0.27/cu.m.

Aggregate Demand and Supply

The Philippines' real gross domestic product (GDP) grew by 6.3 percent in Q4 2015, higher than the 6.1 percent growth in the previous quarter but lower than the 6.6 percent growth in the same period last year. This brought the full-year 2015 growth to 5.8 percent.

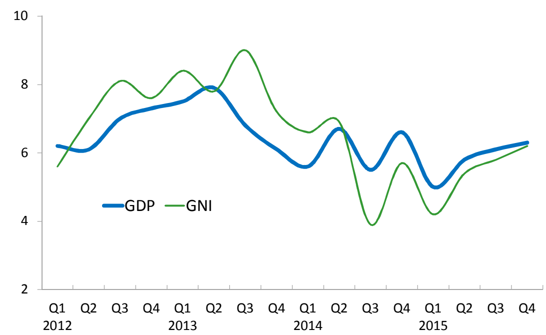
The Philippine economy sustains momentum in Q4

The fourth quarter growth was fueled by accelerated consumer spending and increasing fixed capital investments, particularly in durable equipment and public construction. Meanwhile, the services and industry sectors continued to be the main drivers of growth on the production side.

On a seasonally-adjusted basis, quarter-on-quarter GDP growth accelerated to 2 percent in Q4 2015 from 1.4 percent in Q3 2015.

Gross national income (GNI) growth increased to 6.2 percent in Q4 2015 from the previous quarter's growth of 5.8 percent. Likewise, net primary income accelerated to 5.4 percent in Q4 2015 (from 4.7 percent in Q3 2015) which was driven mainly by the positive growth in compensation inflow and the decline in property expense.

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



Source: PSA

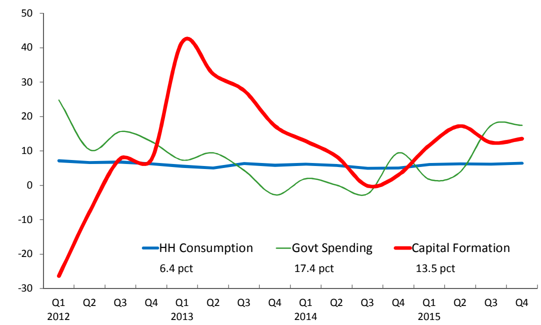
Aggregate Demand. On the expenditure side, household and government spending as well as fixed capital investments led to the accelerated growth of the economy (with contribution to GDP growth of 4.7 percentage points, 1.4 percentage points, and 4.9 percentage points, respectively), offsetting the negative contribution of net exports (-3.1 percentage points), which was due mainly to the slowdown of growth in exports of goods and the higher expansion in imports of services.

Household consumption find boost in benign inflation

Household consumption, which accounted for nearly three-fourths of the country's output at 72.5 percent, rose by 6.4 percent in Q4 2015, higher compared to the 6.1-percent growth in the previous quarter. The slower pace of increase in prices of consumer goods and services available to households boosted household spending during the quarter. The top contributors to growth of household final consumption expenditure were food and non-alcoholic beverages (2.8 percentage points) and miscellaneous goods and services (1.3 percentage points).

Chart 8. Gross Domestic Product by Expenditure Shares

at constant prices



Source: PSA

Growth in investments in capital formation accelerated to 13.5 percent in Q4 2015 from 12.4 percent in Q3 2015, as growth in fixed capital investments increased to 22.5 percent in Q4 2015 from 13.3 percent in Q3 2015. The expansion in fixed capital investments can be attributed mainly to the following:

(a) surge in growth of private investments in durable equipment (40.2 percent in Q4 2015 from 19.1 percent a quarter ago) as investments in road vehicles increased by 57.2 percent from 42.4 percent in the previous quarter, coinciding with the higher growth in car sales[8] reported in Q4 2015 at 38.9 percent (compared to the previous quarter's 33.0 percent); and

(b) higher growth in public construction (51.0 percent from 41.5 percent in the previous quarter).

Government expenditures growth remained steady at 17.4 percent in Q4 2015 owing to the continued increase in disbursements under maintenance and other operating expenses (MOOE) for the implementation of projects and social protection programs.

Overall exports growth picked up in Q4 2015, registering an expansion of 7.1 percent from the quarter-ago growth rate of 6.5 percent. The slowdown in exports of goods growth compared to a quarter ago (from 5.4 percent to 1.7 percent) was offset by the appreciable growth in exports of services (from 12.5 percent to 30.2 percent). The growth in exports of services was due mainly to the increase in miscellaneous services, such as maintenance and repair services, charges for the use of intellectual property, and telecommunications, computer, and information services (which contributed 17.8 percentage points) and travel services (which contributed 10 percentage points). Meanwhile, the growth in exports of goods decelerated, driven by the higher contraction in exports of articles of apparel and clothing accessories and others (e.g., transport equipment/parts), which contributed -1.8 percentage points and -5.3 percentage points, respectively.

Table 6. Economic Performance

at constant 2000 prices; growth rate in percent

BY EXPENDITURE ITEM	2014	2015			
	Q4	Q1	Q2	Q3	Q4
Household Consumption	5.0	6.0	6.2	6.1	6.4
Government Consumption	9.4	1.7	3.9	17.4	17.4
Capital Formation	3.0	11.6	17.2	12.4	13.5
Fixed Capital Formation	8.0	10.0	8.9	13.3	22.5
Exports	12.8	6.4	2.1	6.5	7.1
Imports	9.9	8.7	10.4	14.9	13.3

Source: PSA

Overall imports posted 13.3 percent growth for the quarter, lower than the quarter-ago increase of 14.9 percent, owing to the slowdown in the growth of imports of goods compared to a quarter

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

ago (13.1 percent from 15.9 percent). The contraction in imports of mineral fuels and artificial resins contributed negatively to the fourth quarter's growth of imports of goods (-0.9 percentage point and -0.6 percentage point, respectively). Meanwhile, imports of services increased by 13.6 percent (from 10.3 percent a quarter ago) due largely to the 24.3 percent growth in imports of transportation (which contributed 3.6 percentage points) and the 30.5 percent growth in imports of miscellaneous services, such as construction services and personal, cultural and recreational services (which contributed 7.3 percentage points).

Other Demand Indicators. High-frequency demand indicators continued to report positive signals in the first quarter of the year. The property sector continues to grow at a manageable pace, vehicle sales sustains its double-digit growth while the composite Purchasing Managers' Index remains firmly above the 50-point expansion threshold in January, indicating continued firm domestic demand. Moreover, business and consumer confidence for the current quarter continue to improve and turn bullish for the next quarter.

Property Prices

Land Values, Metro Manila. Data from Colliers International indicated that implied land values[9] in the Makati CBD and Ortigas Center appreciated in Q4 2015 from quarter- and year-ago levels.

Implied land values trend higher but still below 1997 levels in real terms

Implied land values in the Makati CBD reached ₱500,000/sq.m. in Q4 2015, higher by 8.7 percent and 13.6 percent relative to the levels recorded in Q3 2015 and Q4 2014, respectively. Similarly, implied land values in the Ortigas Center rose by 4.1 percent quarter-on-quarter and 13.2 percent year-on-year to ₱179,500/sq.m.

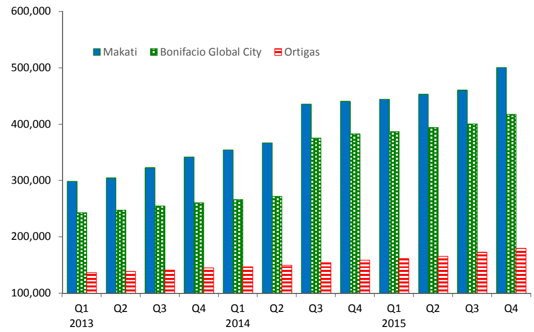
[9] In the absence of reported closed transactions, implied land values based on trends are used by Colliers International to monitor prices.

Land values in the Makati CBD were above their 1997 levels in nominal terms, but just about half of their 1997 levels in real terms.

Continued demand for office space keeps vacancy rates low

Meanwhile, land values in the Ortigas Center were about 92.1 percent of their 1997 level in nominal terms and 40.1 percent in real terms.

Chart 9. Land Values
average price per square meter



Source: Colliers International Philippines

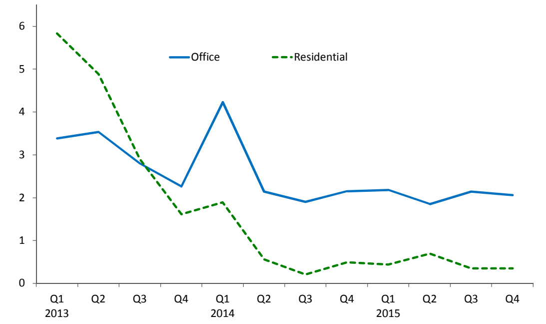
Vacancy Rates, Metro Manila. The office vacancy rate in the Makati CBD remained steady at 2.1 percent in Q4 2015 relative to quarter-ago level but slightly lower than the year-ago level of 2.2 percent. The continued strong office demand in the Makati CBD has kept office vacancy rates at low single-digit levels. However, Colliers anticipates office vacancy to rise to 2.3 percent in Q4 2016 with the scheduled completion of office buildings that would surpass projected demand.

Similarly, the residential vacancy rate in the Makati CBD increased to 8.9 percent in Q4 2015 from 8.3 percent in the previous quarter.

Higher residential vacancy rates due to completion of new residential buildings

The residential vacancy rate in Q4 2015 was also higher than the year-ago level of 8.1 percent due to recent residential building completions. The delivery of new residential condominium units within the next 12 months is expected to increase vacancy rates by 9.0 percent by Q4 2016.

Chart 10. Vacancy Rates (Makati Central Business District)
in percent



Source: Colliers International Philippines

Rental Values, Metro Manila.[10] Monthly Grade A office[11] rents in the Makati CBD reached ₱910/sq.m. in Q4 2015, representing an increase of 0.6 percent from the previous quarter. Similarly, monthly Grade A office rents in the Makati CBD were higher by 7.1 percent relative to Q4 2014.

Office rental values show slight increase

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

Monthly rents for luxury three-bedroom condominium units in the Makati CBD rose to ₱883/sq.m. in Q4 2015 or a 0.9 percent growth from the previous quarter. Likewise, monthly rents for the 3-bedroom segment were higher by 5.4 percent compared to the year-ago levels.

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

[11] In terms of location, Grade A office are located within the CBD and have good access from the main and secondary avenues. In terms of general finish, Grade A office units have high quality presentation and maintenance.

Residential rental values rise slightly

Residential rental values for luxury three-bedroom high-rise units were above their 1997 levels in nominal terms but were only about 81.0 percent of their 1997 levels in real terms.

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

Source: Colliers International Philippines

Capital Values, Metro Manila. Capital values[12] for office buildings in the Makati CBD in Q4 2015 were higher in nominal terms than their quarter- and year-ago levels. Grade A office capital values in the Makati CBD rose to ₱108,850/sq.m., higher by 4.2 percent and by 11.1 percent compared to the quarter- and year-ago levels, respectively.

Capital values for office and residential buildings are higher

Grade A office capital values were also higher than the 1997 levels in nominal terms. Nevertheless, in real terms, office capital values were about 59.7 percent of the comparable levels in 1997.

Capital values for luxury residential buildings[13] in Makati CBD in Q4 2015 rose to ₱151,350/sq.m. from their quarter- and year-ago levels. Average

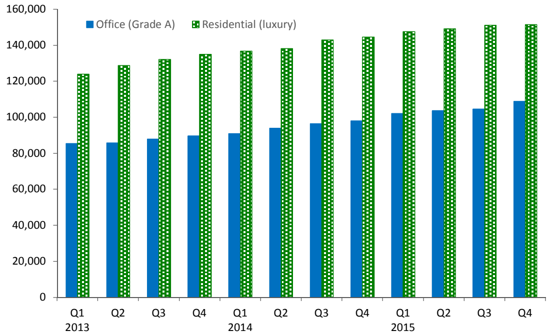
[12] Capital value is defined as the probable price that the property would have fetched if sold on the date of the valuation. The valuation includes imputed land and building value.

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

prices for three-bedroom luxury residential condominium units increased by 0.2 percent quarter-on-quarter and 4.7 percent year-on-year.

Capital values for luxury residential buildings were above their 1997 levels in nominal terms. In real terms, residential capital values were about 67.7 percent of the comparable levels in 1997.

Chart 12. Capital Values (Makati Central Business District)
price per square meter



Source: Colliers International Philippines

Vehicle Sales. Sales of new vehicles[14] grew by 24.5 percent y-o-y in the first two months of Q1 2016 from a 21.1-percent growth recorded in the same period a year ago. The Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI) attributed the continued growth in car sales to rising household incomes coupled with attractive car financing terms of industry players.

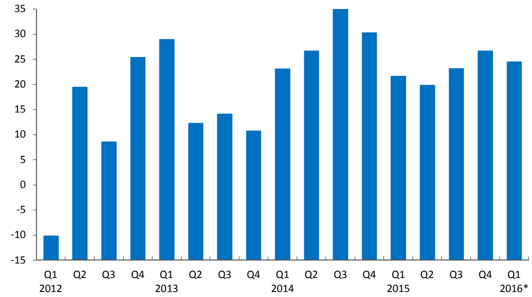
Sales of new vehicles continue to be robust

Passenger car sales from CAMPI members grew by 20.2 percent y-o-y in January-February 2016, accruing to a total of 18,451 units from 15,349 units sold in the same period in 2015. Similarly, commercial vehicles, which account for about 61.0 percent of total vehicle sales, expanded by 27.2 percent in the first two months of Q1 2016.

[14] 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.

Commercial vehicles sold during the quarter reached 30,507 units from 23,976 units in the same period in 2015.

Chart 13. Vehicle Sales
number of units



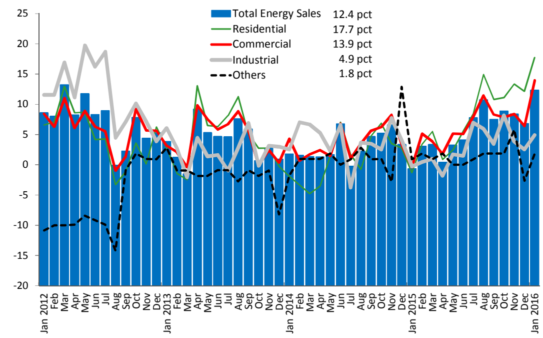
* January-February 2016
Source: Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI)

Energy Sales. Total energy sales of Meralco increased by 12.4 percent year-on-year in January 2016, a turnaround after a 0.6-percent decline a year-ago.

Energy sales increase in January

Residential Energy Sales (RSALES), Commercial Energy Sales (CSALES), and Industrial Sales (ISALES) rose by 17.7 percent, 13.9 percent and 4.9 percent to 903.6 kWh, 1,162.5 kWh and 790.7 kWh year-on-year, respectively, in January 2016.

Chart 14. Energy Sales
year-on-year growth in percent



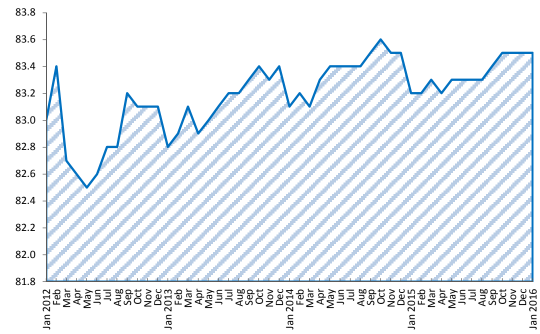
Source: Meralco, BSP calculations

Capacity Utilization. The average capacity utilization rate of the manufacturing sector was unchanged at 83.5 percent in January 2016 from the month-ago level based on the Philippine Statistics Authority's Monthly Integrated Survey of Selected Industries (MISSI).

Capacity utilization in manufacturing remains above 80 percent

Of the 581 respondent-establishments, 60.5 percent operated at least at 80.0 percent capacity in January 2016. Data show that manufacturing companies have been operating above the 80.0-percent capacity since 2010.

Chart 15. Monthly Average of Capacity Utilization for Manufacturing
in percent



Source: PSA

Volume and Value of Production. Preliminary results of the MISSI showed that the volume of production index (VoPI) grew at a significantly faster pace in January 2016 by 34.3 percent year-on-year from 5.0 percent (revised) in December 2015. This is the highest since January 2010 when the VoPI rose by 36.2 percent.

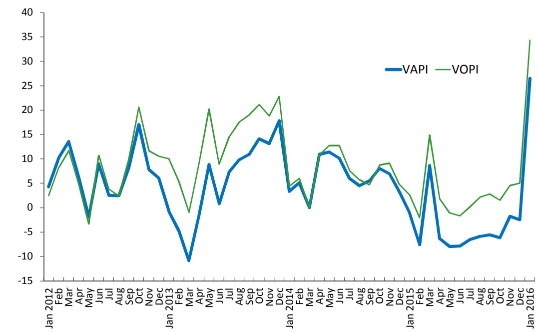
Manufacturing output rises

The January growth was led by the triple-digit increment in the production of chemical products, followed by tobacco products (49.4 percent), machinery except electrical (23.6 percent), food (20.2 percent), electrical machinery (19.2 percent), and beverages (10.1 percent).

Factory output—as measured by the VoPI—increased in January 2016 following a moderate growth in 2015, which was a result of weak global demand and adverse weather conditions, the National Economic and Development Authority (NEDA) said in a press statement dated 10 March 2016. The expansion of the manufacturing sector will likely be sustained for the year ahead given the anticipated increase in spending for election-related activities and infrastructure projects. Also, stronger domestic demand during the summer will provide support to the sector's growth.

Similarly, the value of production index (VaPI) grew in January 2016 by 26.5 percent, from a contraction of 2.5 percent (revised) in the previous month. The uptick in VaPI was led by the expansions in the following sub-sectors: chemical products (309.6 percent), tobacco products (49.6 percent), food (19.1 percent), and beverages (11.7 percent). The rise in the VaPI of chemical products was driven mainly by the drugs and medicines sub-sector, which grew ten times year-on-year.

Chart 16. Volume and Value Indices of Manufacturing Production
year-on-year in percent



Source: PSA

Business Expectations. Business optimism on the economy remained positive albeit lower for Q1 2016,[15] with the overall confidence index (CI)[16] declining to 41.9 percent from 51.3 percent for Q4 2015. This indicates that the number of optimists declined but continued to be greater than the number of pessimists during the quarter.

[15] The Q1 2016 BES was conducted during the period 5 January-17 February 2016 among 1,539 firms surveyed nationwide. Respondents were drawn from the combined list of the Securities and Exchange Commission's Top 7,000 Corporations in 2010 and Business World's Top 1000 Corporations in 2014, consisting of 588 companies in NCR and 951 firms in AONCR, covering all 18 regions nationwide. The survey response rate for this quarter was lower at 82.6 percent (from 83.6 percent in the previous quarter). The response rates were lower both for NCR at 80.3 percent (from 81.5 percent in the previous quarter) and for AONCR at 84 percent (from 85 percent in Q4 2015).

[16] The CI is computed as the percentage of firms that answered in the affirmative less the percentage of firms that answered in the negative with respect to their views on a given indicator. A positive CI indicates a favorable view, except for the inflation rate and the peso-borrowing rate, where a positive CI indicates the opposite.

Business sentiment optimistic in Q1 and more bullish in the next quarter

According to respondents, their less upbeat quarter-on-quarter outlook was due to the following factors: (a) usual slowdown in business activity and moderation of consumer demand after the holiday season; (b) decline in global oil prices and other commodities; (c) growing concerns about the outlook for global growth amid continued weakness in China; (d) wait-and-see attitude of businesses with regard to the outcome of the 2016 national and local elections; (e) adverse effects of El Niño on crop production and businesses; (f) strong market competition; and, (g) bearish trend of the Philippine stock market. The sentiment of businesses in the Philippines mirrored the less sanguine business outlook in the United Kingdom, Germany, China, and Korea, but was in contrast to the more buoyant views of those in the United States, Canada, France, Netherlands, and Russia. Meanwhile, a more pessimistic outlook was registered by businesses in Hong Kong SAR and Singapore.

Table 7. Business Expectations Survey

BUSINESS OUTLOOK INDEX	2014	2015				2016
	Q4	Q1	Q2	Q3	Q4	Q1
Current Quarter	48.3	45.2	49.2	41.4	51.3	41.9
Next Quarter	43.1	58.2	47.3	53.1	43.9	49.6

Source: BSP

For the next quarter (Q2 2016), business outlook turned more optimistic, with the CI rising to 49.6 percent from 43.9 percent in the last quarter's survey. The next quarter CI suggests that economic growth could be higher for the next quarter. Respondents cited the following factors as reasons behind their more bullish outlook: (a) election-related spending in the run-up to the elections in May 2016; (b) sustained increase in orders and projects leading to higher volume of production; (c) anticipated increase in demand during summer with the expected influx of both local and foreign tourists and enrollment periods; (d) introduction of new and enhanced business strategies and processes; and, (e) expansion of businesses and new product lines.

Consumer Expectations. Consumers' outlook continued to improve for Q1 2016[17], with the overall CI[18] rising to -5.7 percent from -8.1 percent for Q4 2015. The current quarter CI matched the all-time high recorded for Q2 2013 since the nationwide survey started in Q1 2007. The higher (but still negative) CI for Q1 2016 means that the number of households with optimistic views increased but continued to be less than those who think otherwise.

Consumer confidence improves in Q1 and turns optimistic in the next quarter

According to respondents, their more favorable outlook during the current quarter was due to the following reasons: (a) availability of more jobs; (b) stable prices of commodities; and (c) more investors in the country. The other factors cited by respondents that helped boost their confidence for the current quarter were oil price rollback, assistance from government such as the Pantawid Pamilyang Pilipino Program (4Ps), perception of less corruption in the government, and anticipated election of new government officials. The outlook of consumers in the Philippines for Q1 2016 mirrored the improved sentiment of consumers in Canada, China, and Taiwan, but was in contrast to the less optimistic views of those in the Euro Area, Indonesia, Japan, South Korea, Thailand, United Kingdom, and the United States.

[17] The Q1 2016 CES was conducted during the period 21-30 January 2016 among 5,805 households nationwide. Respondents were drawn from the Philippine Statistics Authority (PSA) 2003 Master Sample List of Households. Of the sample size, 5,673 households responded to the survey, equivalent to a response rate of 97.7 percent (from 97.1 percent in the last quarter's survey). The respondents consist of 2,850 households in NCR (with 98.7 percent response rate) and 2,823 households in AONCR (with 96.7 percent response rate). Nearly half of the respondents (47.7 percent) were from the low-income group, 38.2 percent from the middle-income group, and 14 percent from the high-income group.

[18] The CI is computed as the percentage of households that answered in the affirmative less the percentage of households that answered in the negative with respect to their views on a given indicator. A positive CI indicates a favorable view, except for the inflation rate, the peso-borrowing rate, unemployment and change in prices, where a positive CI indicates the opposite. The overall consumer CI measures the average direction of change in three indicators - overall condition of the economy, household finances, and household income.

Table 8. Consumer Expectations Survey

CONSUMER OUTLOOK INDEX	2014	2015				2016
	Q4	Q1	Q2	Q3	Q4	Q1
Current Quarter	-21.8	-10.0	-16.2	-11.6	-8.1	-5.7
Next 3 Months	0.7	4.4	-0.4	5.8	5.7	9.1
Next 12 Months	9.6	17.3	16.4	15.8	18.0	25.4

Source: BSP

For the next quarter (Q2 2016), consumer sentiment continued to be more favorable as the next quarter CI increased and remained in the positive territory at 9.1 percent (from 5.7 percent in the previous quarter's survey), while the year ahead CI rose to 25.4 percent (from 18 percent for Q4 2015). This indicates that the number of consumers with favorable views increased and exceeded those with unfavorable views. Consumers were of the view that good governance and improvements in infrastructure and peace and order would continue over the next 12 months. They also anticipated lesser household expenses as well as an increase in household income and savings which could translate to growth in real income and higher purchasing power of the household.

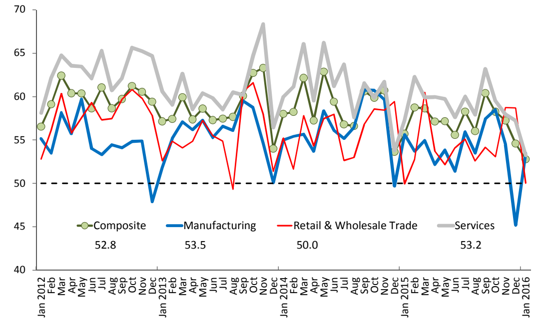
Purchasing Managers' Index.[19] The composite PMI remained firmly above the 50-point expansion threshold[20] at 52.8 in January 2016. However, this was lower than the composite PMI at 54.6 in the previous month.

PMI remains firmly above the 50-point expansion threshold

The decline was due mainly to the slower rate of expansion of the services and retail/wholesale sectors.

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

Chart 17. Purchasing Managers' Index



Source: Philippine Institute of Supply Management (PISM)

The manufacturing PMI in January 2016 accelerated by 8.3 index points to 53.5 from 45.2 in December 2015. In December, manufacturers adjusted their capacity build-up due to the severe lead time and delivery conditions during the month that brought the index to its record low. Also, shutdown and maintenance work in manufacturing plants also contributed to the deceleration of the sector in December. In January 2016, the manufacturing PMI showed a significant reversal as three of the five sub-indices expanded at a faster rate. Manufacturing companies reported that stronger demand, higher overall production, and increased level of stockpiles contributed to the expansion of the sector. All the manufacturing subsectors accelerated in January 2016, except for food and beverages and publishing and printing.
The services PMI declined by 4.0 index points to 53.2 in January 2016 from 57.2 in the previous month. This was attributed to the easing of demand in January. Slower expansions were noted in four out of the six indices during the month due to lower number of new services contracted, fewer task orders in progress, lower price charges on services rendered, and lower amount paid for materials and services. All the sub-indices remained well above the 50-point expansion threshold, except for business activity sub-index which showed a faster contraction.

Likewise, the retail and wholesale PMI decreased by 8.7 percentage points to 50.0 in January 2016 from 58.7 a month ago due to the anticipated post-holiday slackening in retail/wholesale business. Three of the five sub-indices showed contraction that include the Sales Revenue Index, Employment Index, and Inventories Index. The retail subsector PMI decreased by 8.3 index points to 51.0 in January 2016 from 59.3 in December 2015. Similarly, the wholesale subsector PMI declined to 47.6 from 57.1 in the same review period.

External Demand

Exports. Exports of goods remained in negative growth territory in Q4 2015. Exports dropped by 5.0 percent from a decline of 8.1 percent in the previous quarter as foreign shipments across all export commodities decreased.

Export performance remains negative

The decline in exports can be attributed to lower demand from the country's Asian trading partners[21], which account for the bulk of the country's exports.

Table 9. Exports of Goods
growth rate in percent

COMMODITY GROUP	2014	2015	
	Q4	Q3	Q4
Coconut Products	9.0	-29.7	-13.9
Sugar and Products	-95.0	-87.8	-75.0
Fruits and Vegetables	-2.1	-27.3	-28.3
Other Agro-Based Products	14.3	-22.3	-34.2
Forest Products	9.9	-57.2	-77.8
Mineral Products	-1.5	-43.7	-33.3
Petroleum Products	-25.5	1.0	-42.6
Manufactures	6.5	-3.8	-1.1
Special Transactions	173.0	130.7	-35.1
Total Exports	**5.7**	**-8.1**	**-5.0**

Source: BSP staff computations based on data from the PSA

Imports. Imports of goods increased marginally by 0.5 percent in Q4 2015, from a 12.1-percent growth a quarter ago.

Imports of goods slow down

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

Table 10. Imports of Goods
growth rate in percent

COMMODITY GROUP	2014	2015	
	Q4	Q3	Q4
Capital Goods	-9.8	28.5	30.7
Raw Materials and Intermediate Goods	21.4	29.7	-4.9
Mineral Fuels and Lubricants Lubricants	-17.6	-49.9	-32.2
Consumer Goods	26.1	33.6	-2.2
Special Transactions	-25.8	8.9	-9.3
Total Imports	**4.5**	**12.1**	**0.5**

Source: BSP staff computations based on data from the PSA

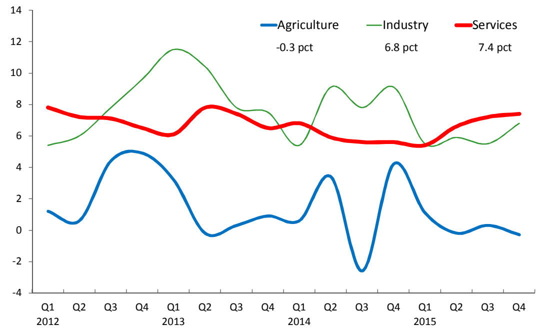
Aggregate Supply. On the production side, the fourth quarter growth was mainly driven by the services sector (contributing 4.1 percentage points) and the industry sector (contributing 2.3 percentage points). Meanwhile, agriculture contributed -0.03 percentage point.

Services sector remains the main driver of output growth on the production side

The services sector expanded by 7.4 percent in Q4 2015, slightly higher than the 7.2-percent growth in Q3 2015. Major contributors to the sector's growth were trade and repair of motor vehicles, motorcycles, personal and household goods (2.2 percentage points), real estate, renting and business activities (1.5 percentage points) and other services (1.4 percentage points). The increase in output of trade and repair of motor vehicles, motorcycles, personal and household goods sector can be attributed mainly to output of retail trade (4.9 percentage points). Meanwhile, growth of real estate, renting and business activities improved slightly to 7.9 percent from 7.8 percent in the previous quarter, on account of the higher growth of renting and other business activities at 11.8 percent from 11.5 percent a quarter ago. Also, the growth in other services was due primarily to the accelerated increase from a quarter ago of services in recreational, cultural and sporting activities (13.5 percent from 7 percent) and hotels and restaurants services (10.9 percent from 10.7 percent).

[21] East Asia (includes China, Hong Kong, Japan, Macau, Mongolia, North Korea, South Korea and Taiwan) and ASEAN (includes Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Singapore, Thailand and Vietnam)

Chart 18. Gross Domestic Product by Industrial Origin (at constant prices)
year-on-year growth in percent



Source: PSA

The industry sector grew by 6.8 percent in Q4 2015, higher compared to 5.5 percent in Q3 2015. This was due mainly to the acceleration in manufacturing (which posted a growth of 6.6 percent from 5.5 percent a quarter ago) and construction activities (which grew by 8.4 percent from 5.4 percent in the previous quarter). Growth in manufacturing came mainly from chemical and chemical products (2.5 percentage points), food manufactures (1.9 percentage points), and radio, television and communication equipment and apparatus (1.5 percentage points). Moreover, appreciable growths in manufacturing of wood, bamboo, cane and rattan articles (35.7 percent from 12.7 percent) and basic metal industries (35.6 percent from -24 percent) were noted compared to that a quarter ago. However, negative growths were recorded primarily in beverage industries, petroleum and other fuel products, and furniture and fixtures. Meanwhile, growth in construction was due to the robust growth of public construction. Growth in all sub-sectors of the industry sector accelerated compared to a quarter ago, except for electricity, gas and water supply (4.8 percent from 6.6 percent).

Agriculture, hunting, forestry and fishery (AHFF) sector's growth reverted to negative territory at -0.3 percent in Q4 2015 from 0.3 percent a quarter ago. The contraction mainly came from the negative growth of palay and corn production and fishing (particularly in the production of milkfish, tiger prawn, skipjack, and yellowfin tuna). The sector's performance was negatively affected by the long dry spell and damages caused by Typhoon "Lando".

Table 11. Economic Performance
at constant 2000 prices; growth rate in percent

BY INDUSTRIAL ORIGIN	2014	2015			
	Q4	Q1	Q2	Q3	Q4
Agri., Hunting, Forestry and Fishing	4.2	1.1	-0.2	0.3	-0.3
Agriculture and Forestry	4.3	1.9	-0.3	0.2	0.7
Fishing	4.2	-2.9	-0.1	1.1	-4.5
Industry Sector	9.1	5.5	5.9	5.5	6.8
Mining and Quarrying	5.9	-3.1	-7.1	3.6	7.8
Manufacturing	7.7	6.0	4.7	5.5	6.6
Construction	17.9	5.4	15.3	5.4	8.4
Electricity, Gas and Water Supply	5.1	5.1	2.7	6.6	4.8
Service Sector	5.6	5.4	6.6	7.2	7.4
Transport, Storage and Communication	4.5	8.3	6.4	8.1	8.9
Trade and Repair of Motor Vehicles, Motorcycles, Personal and Household Goods	3.4	5.5	6.6	8.3	7.0
Financial Intermediation	8.9	4.3	5.8	5.4	7.4
Real Estate, Renting and Business Activities	9.7	6.3	7.0	7.8	7.9
Public Administration and Defense; Compulsory Social Security	11.4	-3.5	-0.3	3.1	3.2
Other Services	1.8	6.6	10.0	7.2	8.1

Source: PSA

Labor Market Conditions

In January 2016, the Philippine labor market[22] posted the second lowest unemployment rate in the past 10 years,[23] although its underemployment rate deteriorated compared to the same period in 2015.

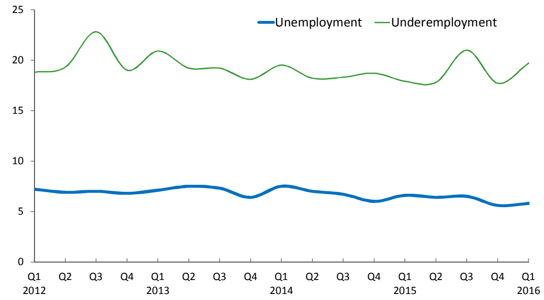
Unemployment rate improves notably

The country's unemployment rate settled at 5.8 percent, still below 6 percent and much lower than the 6.6 percent unemployment rate in January 2015.[24] This is equivalent to a 279,000 decline in unemployment level to 2.4 million, resulting from a 2.0-percent growth in employment that outpaced the 1.1-percent growth in the labor force. The unemployment rate

[22] The data used in the analysis are estimates based on January 2016 data that excludes the province of Leyte, to be comparable with the January 2015 Labor Force Survey (LFS), which did not cover the province of Leyte. The Philippine Statistics Authority also released preliminary estimates with Leyte.
[23] Since 2005, the country posted the lowest unemployment rate in October 2015 at 5.7 percent. Starting April 2005, the new unemployment definition based on international standard was adopted per NSCB Resolution No. 15 series of 2004.
[24] Including Leyte, the resulting unemployment rate is the same at 5.8 percent.

among the youth (15-24 years old) also improved to 14.4 percent from 14.9 percent in the same period last year, although this is still more than double the rate at the national level.[25]

Chart 19. Unemployment and Underemployment
in percent



Source: PSA

The 752,000 increase in total employment to 39.2 million came mainly from the 5.6-percent and 8.4-percent growth in employment in services and industry sectors, respectively, which offset the 8.1-percent decline in employment in agriculture sector. The 1.2 million employment generated in services sector (the country's primary employment contributor) was driven primarily by other services activities (12.9 percent), public administration and defense (10.6 percent), and transportation and storage (4.9 percent) sub-sectors. The 508,000 additional employment in industry sector was contributed mainly by a double-digit employment growth in construction (18.0 percent)[26] and a continued increase in employment in manufacturing (2.1 percent) sub-sector. Meanwhile, the 935,000 employment loss in agriculture sector was due to adverse effects of El Niño on agriculture production.

However, the underemployment rate worsened to 19.7 percent from 17.9 percent in January 2015[27] due to increase in invisible[28] (43.1 percent) underemployment. Nevertheless, the higher share of full-time employment to total employment (67.4 percent from 61.6 percent a year ago) resulted in an increase in the country's overall mean hours of work (hours per week) to 42.5 from 40.3, which could indicate a higher level of economic activities in the first quarter of 2016.

[25] The youth comprises 48.3 percent of the unemployed in January 2016. There was a slight decline in labor force participation rate among the youth (from 43.9 percent to 41.3 percent) partly due to their decision to attend school and become full-time students (Source: NEDA (2016), "Unemployment Down, More Jobs created in January 2016," NEDA Media Release, 11 March).

[26] This gained primarily from increased public infrastructure spending.

[27] Majority of the underemployed were wage and salary workers in private establishments.

[28] This refers to underemployed full-time workers or those who work 40 hours or more per week but still wanted more work.

II. Monetary and Financial Market Conditions

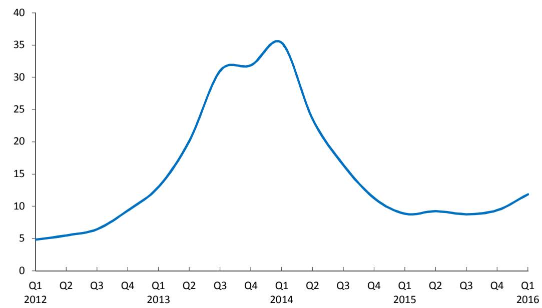
Domestic Liquidity and Credit Conditions

Domestic liquidity or M3 grew by 11.8 percent year-on-year in February 2016 from 9.4 percent in end-Q4 2015.

Domestic liquidity remains ample

Money supply continued to expand due mainly to robust demand for credit.

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



Source: BSP

Domestic claims rose by 16.7 percent in February, faster than the 11.4-percent increase at end-Q4 2015 on sustained bank lending growth. Meanwhile, net public sector credit grew by 29.4 percent in February from 12.9 percent at the end of the previous quarter.

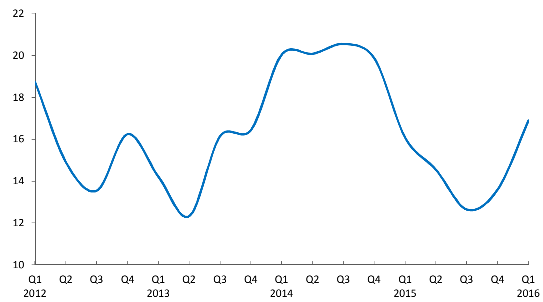
The growth in net foreign assets (NFA) was faster at 9.3 percent y-o-y in February from 6.6 percent in end-Q4 2015. The BSP's NFA position continued to expand on the back of robust foreign exchange inflows coming mainly from overseas Filipinos' remittances and business process outsourcing receipts. The NFA of banks likewise rose, driven largely by the increase in banks' foreign assets resulting from investments in marketable debt securities.

As of February 2016, outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, grew by 16.9 percent y-o-y relative to the 13.6 percent and 16.1 percent growth posted at end-Q4 2015 and end-Q1 2015, respectively.

...while bank lending sustains growth

The sustained expansion of bank lending was driven largely by loans for production activities, which expanded by 17.4 percent y-o-y in February 2016, higher than the 13.7 percent and 15.9 percent growth recorded at end-Q4 2015 and end-Q1 2015, respectively.

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



Source: BSP

The expansion in production loans was driven primarily by increased lending to the following sectors: real estate activities; electricity, gas, steam and airconditioning supply; wholesale and retail trade, repair of motor vehicles and motorcycles; manufacturing; and information and communication. Meanwhile, loans for household consumption grew by 15.7 percent y-o-y as of February 2016, higher than the 15.1 percent growth registered in end Q4-2015 but lower than the 19.8 percent expansion in end-Q1 2015.

Credit Standards. Results of the Q1 2016 Senior Bank Loan Officers' Survey (SLOS)[29] showed that most of the respondent banks maintained their credit standards for loans to both enterprises and households during the quarter based on the modal approach.[30] This is the 28th consecutive quarter since Q2 2009 that the majority of banks reported broadly unchanged credit standards.

Meanwhile, the diffusion index (DI) approach[31,32] pointed to a net tightening of overall credit standards for loans extended to businesses while overall credit standards for loans extended to households were unchanged. In the previous quarter, credit standards for both corporate lending and household loans eased slightly based on the DI approach.

Lending to Enterprises. Most banks (86.7 percent of banks that responded to the question) indicated that credit standards for loans to enterprises remained unchanged during the quarter using the modal approach. Meanwhile, a net tightening was observed using the DI approach as the number of respondents indicating tighter overall credit standards outnumbered those that indicated the opposite.

Most respondent banks maintain credit standards for loans to enterprises

The net tightening of overall credit standards was attributed by respondent banks to their reduced tolerance for risk, perception of stricter financial system regulations, and more uncertain outlook on certain industries and firms. In terms of specific credit standards, the net tightening of overall credit standards for business loans reflected stricter collateral requirements and loan covenants.[33]

Table 12. General Credit Standards for Loans to Enterprises (Overall)

	2014	2015				2016
	Q4	Q1	Q2	Q3	Q4	Q1
Tightened Considerably	0.0	3.4	0.0	0.0	3.2	3.3
Tightened Somewhat	3.2	13.8	3.2	6.3	0.0	6.7
Remained Basically Unchanged	**93.5**	**79.3**	**93.5**	**87.5**	**90.3**	**86.7**
Eased Somewhat	3.2	3.4	3.2	6.3	6.5	3.3
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**	**13.8**	**0.0**	**0.0**	**-3.2**	**6.7**
Weighted Diffusion Index for Credit Standards	**0.0**	**8.6**	**0.0**	**0.0**	**0.0**	**5.0**
Mean	3.0	2.8	3.0	3.0	3.0	2.9
Number of Banks Responding	**31**	**29**	**31**	**32**	**31**	**30**

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

In terms of borrower firm size, overall credit standards tightened across all firm sizes, except for small and medium enterprises (SMEs) for which overall credit standards were unchanged based on the DI approach.

Most of the respondent banks foresee maintaining their overall credit standards for loans to businesses over the next quarter. However, the percentage of banks expecting a slight easing of overall credit standards for enterprises was higher compared to those expecting the opposite. Respondent banks cited expectations of improvement in the profitability of banks' portfolio and more aggressive competition from banks and non-bank lenders as among the reasons for the expected net easing of credit standards.

Lending to Households. The survey results likewise showed that most of the respondent banks (81.0 percent) continued to report unchanged overall credit standards for loans extended to households. At the same time, the DI approach showed basically unchanged overall

[29] The survey consists of questions on loan officers' perceptions relating to the overall credit standards of universal/commercial banks (U/KBs) in the Philippines, as well as to factors affecting the supply of and demand for loans by both enterprises and households. Survey questionnaires were sent to 35 U/KBs, of which, 32 banks responded to the current survey representing a response rate of 91.4 percent. As of end-December 2015, U/KB loans accounted for about 84.2 percent of the banking system's total outstanding loans.

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

[31] 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").

[32] 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.

[33] 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) 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.

credit standards for household loans in Q1 2016 with equal percentages of banks reporting tighter and easier credit standards for the quarter.

Most respondent banks report unchanged credit standards for loans to households

Respondent banks attributed the steady credit standards to banks' unchanged tolerance for risk and profile of borrowers, among others. In particular, banks' responses indicated overall unchanged loan margins and maturities. Respondent banks likewise maintained collateral requirements and loan covenants, particularly for auto loans and personal/salary loans during the quarter.

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

	2014	2015				2016
	Q4	Q1	Q2	Q3	Q4	Q1
Tightened Considerably	0.0	0.0	0.0	0.0	0.0	0.0
Tightened Somewhat	14.3	10.5	9.5	4.2	4.5	9.5
Remained Basically Unchanged	**85.7**	**84.2**	**81.0**	**87.5**	**81.8**	**81.0**
Eased Somewhat	0.0	5.3	9.5	8.3	13.6	9.5
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	**14.3**	**5.3**	**0.0**	**-4.2**	**-9.1**	**0.0**
Weighted Diffusion Index for Credit Standards	**7.1**	**2.6**	**0.0**	**-2.1**	**-4.5**	**0.0**
Mean	2.9	2.9	3.0	3.0	3.1	3.0
Number of Banks Responding	**21**	**19**	**21**	**24**	**22**	**21**

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

Looking ahead, most of the respondent banks expect their overall credit standards for household loans to remain unchanged. However, some banks anticipate overall credit standards to ease slightly on expectations of higher risk tolerance, improvement in borrowers' profile, and more aggressive competition from banks and non-bank lenders, along with banks' more favorable outlook on the economy.

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.

Loan demand from both enterprises and households is unchanged

Using the DI approach, however, results showed a net increase in loan demand[34] across all firm sizes, except micro enterprises, and all household loans, except credit cards and auto loans. The net increase in loan demand of firms[35] was attributed by banks largely to higher working capital and accounts receivable financing needs of borrower firms. Meanwhile, the net increase in demand for household loans reflected higher household consumption and banks' more attractive financing terms, among others.

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

Real Estate Loans. Most of the respondent banks (95.2) also indicated unchanged credit standards for commercial real estate loans in Q1 2016. The DI approach, however, indicated a net tightening of overall credit standards for the said type of loan after being unchanged in the previous quarter.

[34] 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.

[35] In particular, top corporations, large middle-market enterprises, and SMEs.

Credit standards for real estate loans remain steady

The tighter overall credit standards for commercial real estate loans reflected respondent banks' reduced tolerance for risk, deterioration in the profile of borrowers, and perception of stricter financial system regulations. In terms of specific credit standards for commercial real estate loans, banks' responses showed wider loan margins, reduced credit line sizes, stricter collateral requirements, and increased use of interest rate floors.

Demand for commercial real estate loans was also unchanged in Q1 2016 based on the modal approach. A number of banks, however, indicated increased demand for the said type of loan on the back of clients' improved economic outlook and increased working capital and inventory financing needs of customers, among others. 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 increase further.

Similarly, in the case of housing loans extended to households, most of the respondent banks (82.4 percent) reported unchanged credit standards. Using the DI approach, however, a slight easing of credit standards for housing loans was noted in Q1 2016. The net easing of credit standards for housing loans was attributed by respondent banks largely to improvement in borrower's profile and higher risk tolerance of banks for the said type of loan. Over the next quarter, although most respondent banks foresee maintaining their credit standards for housing loans, a number of banks expect credit standards to tighten slightly on expectations of lower tolerance for risk. At the same time, results continued to show increased demand for housing loans in Q1 2016 as well as expectations of a continued increase in demand for the said type of loan in the next quarter.

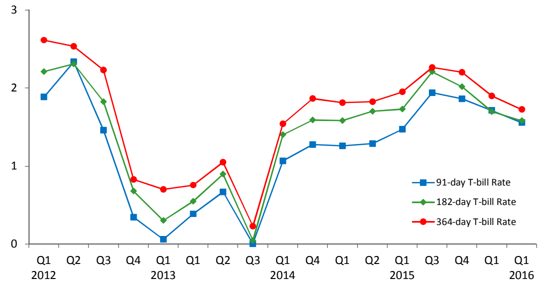
Interest Rates

Primary Interest Rates. In Q1 2016, the average 91-day, 182-day, and 364-day T-bill rates in the primary market decreased to 1.555 percent, 1.580 percent, and 1.723 percent from 1.710 percent, 1.697 percent, and 1.897 percent, respectively, in Q4 2015.

T-bill rates in the primary market decline

The decline in T-bill rates reflected strong investor preference for short-dated tenors amid concerns over slowing economic growth in Asia.

Chart 22. Treasury Bill Rates
in percent



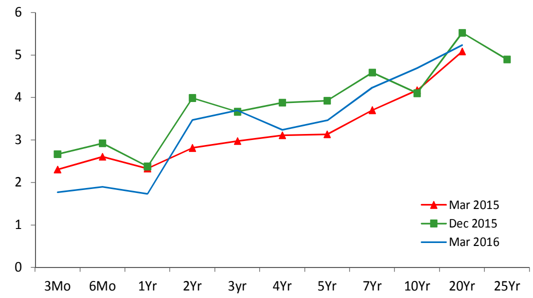
Source: Bureau of the Treasury (BTr)

Yield Curve. The secondary market yield for government securities (GS) fell generally, except for the 3-year and 10-year GS, as of end-March 2016 relative to the end-December 2015 levels, amid strong buying interest as market players invested their excess liquidity and serviced their clients' requirements as well as supply concerns due to lack of long-dated securities in the Q2 2016 schedule of the NG's Treasury bond offering.

The yield curve declines

Debt paper yields were lower by a range of 29.0 bps (20-year GS) to 102.3 bps (6-month GS) compared to end-December 2015 levels. By contrast, the interest rates for the 3-year and 10-year GS rose by 2.8 bps and 59.0 bps, respectively.

Chart 23. Yields of Government Securities in the Secondary Market
in percent



Source: Bloomberg

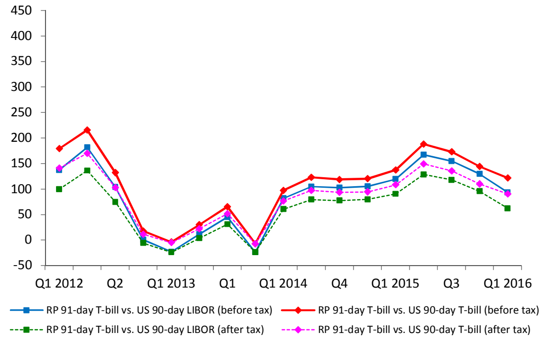
Relative to year-ago levels, the secondary market yields of GS increased generally by a range of 12.6 bps for the 4-year GS to 71.5 bps for the 3-year GS except for the shorter-dated maturities which declined by -53.9 bps (3-month), 71.1 bps (6-month) and 59.5 bps (1-year).

Interest Rate Differentials. The average differentials between domestic and US interest rates, gross and net of tax, narrowed further in Q1 2016 relative to the previous quarter.

Interest rate differentials narrow further

The average 91-day RP T-bill rate declined q-o-q by 14.5 bps to 1.555 percent in Q1 2016 from 1.700 percent in Q4 2015. Meanwhile, the average US 90-day LIBOR and US 90-day T-bill rate increased by 21.6 bps and 7.9 bps, respectively, to 0.625 percent and 0.341 percent in Q1 2016. Foreign interest rates rose on investor optimism following the release of better-than-expected US economic data on manufacturing activity, non-farm payrolls, and consumer and construction spending during the quarter.

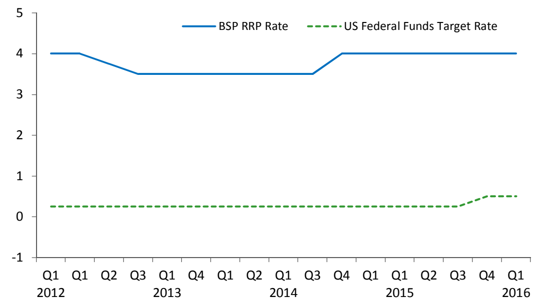
Chart 24. Interest rate Differentials
quarterly averages; in basis points



Source: Bloomberg, BTr and BSP

The positive differential between the BSP's overnight borrowing or RRP rate and the US Fed funds target rate remained unchanged at 350-375 bps in Q1 2016, as the policy settings for both central banks were kept steady.

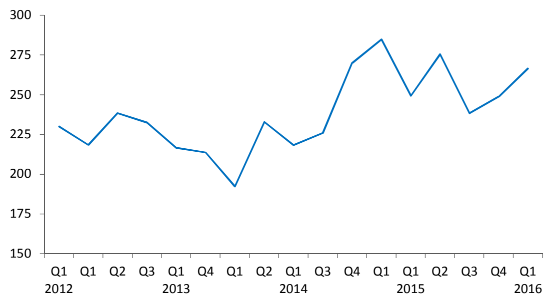
Chart 25. BSP RRP Rate and US Federal Funds Target Rate
in percent



Source: Bloomberg and BSP

Meanwhile, the interest rate differential between the BSP's overnight RRP rate and the US Fed funds target rate adjusted for risk[36] widened further to 266 bps as of end-March 2016 from 249 bps in end-December 2015 due to lower risk premium.

Chart 26. Risk-Adjusted Differentials
in basis points



Source: Bloomberg and BSP

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

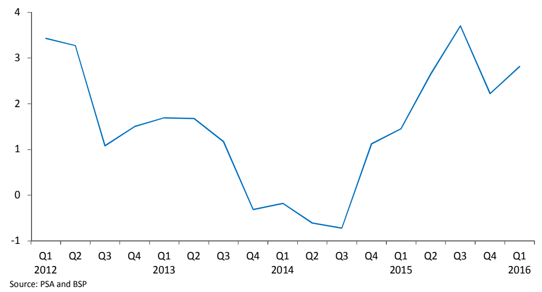
The decline in the risk premium could be attributed to the larger decrease in the 10-year ROP yield, relative to the decrease in the 10-year US Note, to 2.61 percent and 1.77 percent, respectively. ROP bond yield fell, reflecting the risk-on sentiment in Asian credit markets while the 10-year US note declined due to demand for safe-haven assets following the release of weaker-than-expected US data on consumer sentiment, employment, industrial production, and retail sales, as well as the continued decline in global oil prices and subdued global economic growth prospects during the review quarter.

Meanwhile, the real lending rate[37] increased to 2.8 percent in March 2016 from 2.2 percent in December 2015. This was due to the 40-bp decline in inflation to 1.1 percent in March 2016 from 1.5 percent in December 2015 combined with the 20-bp rise in the actual bank lending rate[38] to 3.9 percent.

Real lending rate increases

The Philippines' higher real lending rate placed fifth in a sample of 10 Asian countries, with Indonesia recording the highest real lending rate at 7.5 percent. Meanwhile, Malaysia and Taiwan posted the lowest at 0.4 percent.

Chart 27. Philippines' Real Lending Rate
in percent



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

Financial Market Conditions

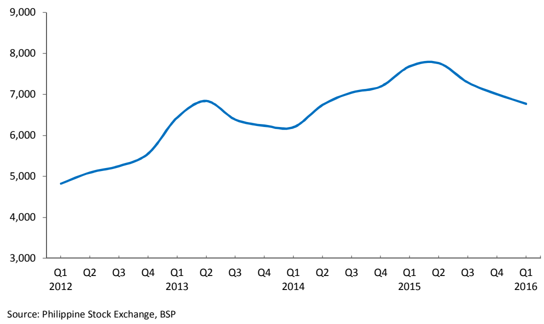
The domestic financial system remained stable, supported by strong macroeconomic fundamentals during the review quarter.

Domestic financial market conditions reflect external uncertainties

However, uncertainty in the external front stemming from continuing worries over global growth, China's bumpy transition and deepening monetary policy divergence buffeted emerging market assets. Nonetheless, the performance of the domestic financial market remained favorable compared to other countries in the region.

Stock Market. In the first three months of 2016, the Philippine Stock Exchange index (PSEi) fell 3.4 percent lower, quarter-on-quarter, to average 6,766.4 index points during the period-in-review. This developed as persistent anxiety over global growth, exacerbated by China's bumpy transition, the threat of plunging oil prices and deepening monetary policy divergence weigh on demand for emerging market equities.

Chart 28. Quarterly Average PSEi
In basis points



Despite the quarter-on-quarter decline, the index trended upwards month-on-month after hitting the bear territory in the first month of the year. The PSEi posted its lowest in 23 months at 6,084.28 index points on 21 January[39] amid concerns over the outlook for global growth, the fiasco over China's circuit breaker mechanism,

[39] The PSEi jumped to bear territory on 11 January, as it closed at 6,288.26 index points, about 22.6 percent below the peak posted in April 2015 of 8,127.48 index point.

rising geopolitical tensions between Saudi Arabia and Iran, as well as the nuclear testing by North Korea helped trigger a global sell-off. However, the US Fed's decision to hold-off an interest rate hike during its two-day meeting in January and the release of a robust Philippine GDP growth in Q4 2015 tempered partly the decline and helped move the index past bear territory by 27 January. The PSEi averaged 6,469.8 index points in January, lower by 6.2 percent than the previous month's level.

The PSEi continued to show some recovery in February on optimism that the US Fed will continue to defer further interest rates hikes and on hopes of more stimulus across major central banks. The Saudi Arabia–Russia agreement reached on 16 February to freeze oil production output to levels registered in January 2016 in efforts to stem the global supply glut also helped improve investors' risk appetite.

External headwinds dampen stock trading in Q1 2016

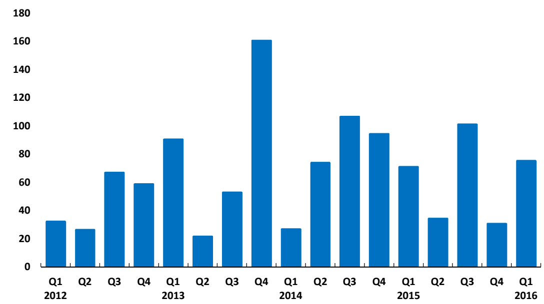
Nevertheless, these were offset by lingering concerns about global growth amid disappointing GDP outturn from Japan and trade data from China. The PSEi averaged 3.7 percent higher at 6,771.8 index points in February.

In March, the PSEi breached the 7,000 mark, boosted by the PBoC's decision to cut reserve requirements by 50 bps, the ECB's aggressive stimulus program and the US Fed's dovish guidance on interest rates. Reports of positive earnings by domestic firms also helped encourage the return of foreign investors in the local bourse. The main index averaged 6.0 percent higher at 7,117.7 index points in March.

Other stock indicators registered positive turnouts during the review period. Total market capitalization reached ₽13.9 trillion in end-March, higher by 3.2 percent than the ₽13.5 trillion posted in end-December 2015. Foreign investors' return in the local bourse in March resulted in net purchases of ₽3.4 billion in Q1 as opposed to the net sales of ₽15.2 billion registered in the previous quarter. Meanwhile, data from Bloomberg indicated that the price-earnings ratio of local issues was virtually unchanged at 20.8x in end-March 2016. Philippine shares remained the second most expensive in the ASEAN5 region, next to Indonesia's 24.9x.

Government Securities. The Bureau of the Treasury (BTr) decided to award in full bids for all tenors in auctions held during Q1 2016 (January – March 2016). With total subscription amounting to ₽135.5 billion, about 2.3 times higher than the ₽60.0 billion total offered amount, results of the T-bill auctions conducted during the review quarter continued to show firm demand for government securities amid concerns over slowing economic growth in Asia. The oversubscription for the quarter at ₽75.5 billion was lower than the ₽30.7 billion oversubscription in the previous quarter.

Chart 29. Total Oversubscription of T-bill Auctions



Source: Bureau of the Treasury

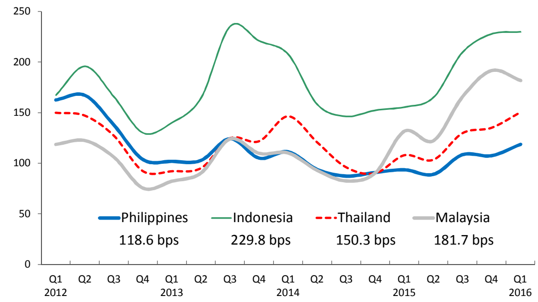
Sovereign Bond and CDS Spreads. The cost of insuring Philippine sovereign debt increased in the first quarter of 2016. The country's 5-year sovereign credit default swap (CDS) spreads averaged 118.6 basis points (bps) in Q1 2016, up from Q4 2015 average of 107.4 bps.

Debt spreads widen due to uncertainties on the external front

Against those of neighboring economies, the Philippine CDS traded lower than Indonesia's average of 229.8 bps, Malaysia's 181.7 bps and Thailand's 150.3 bps.

Chart 30. Quarterly Philippine Sovereign 5-Year CDS Spreads

in basis points

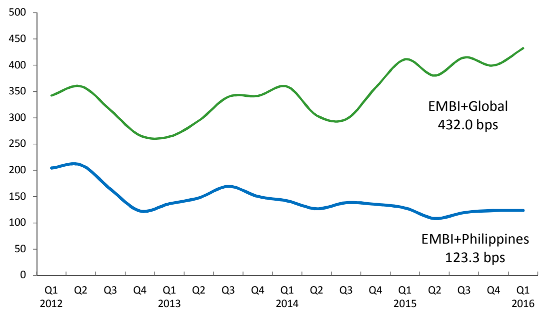


Source: Bloomberg

Meanwhile, the risk premium from holding a Philippine sovereign bond over a similarly tenured US Treasury bond climbed to an average of 123.3 bps, marginally higher than the previous quarter's 123.1 bps as indicated by the wider EMBIG Philippine spreads.

Chart 31. Quarterly JPMorgan EMBI+ Sovereign Bond Spreads

in basis points



Source: Bloomberg

In January 2016, debt spreads took a negative turnaround, widening to levels last seen during the taper tantrum in 2013. Investors traded on a safe-haven mode which pushed yields of US Treasury bonds lower while raising yields of the relatively risky emerging market bonds higher (including the Philippines) thereby resulting in a wider debt spreads. The rout in China's financial market sapped investors' risk appetite away from higher-yielding emerging market assets, which wiped out gains from most of Asia's equities market and weakened their currencies against the US dollar. Investors were also surprised as the Bank of Japan adopted a negative interest rate strategy.

In February 2016, debt spreads further widened as concerns over China and the continued drop in oil prices spurred market jitters. China's foreign exchange reserves shrank by US$99.5 billion in January to US$3.23 trillion, the lowest level since 2012. Meanwhile, talks between Venezuela and Saudi Arabia failed to mitigate oil supply issues. In March, debt spreads narrowed as the global economic and financial environment remained calm. Yields continued to decrease as investors stay cautious and away from high risk assets.

By 31 March, the Philippines' 5-year sovereign CDS stood at 104 bps, lower than the 109 bps in end-Q4 and has remained lower than Indonesia's 197 bps, Malaysia's 153 bps and Thailand's 130 bps. The EMBIG Philippines also ended the quarter narrower at 107 bps compared to the previous quarter's closing of 124 bps.

Banking System

The Philippine banking system maintains its strong position as it continues to support long-term economic growth. Banks' balance sheets were marked by a sustained growth in assets and deposits.

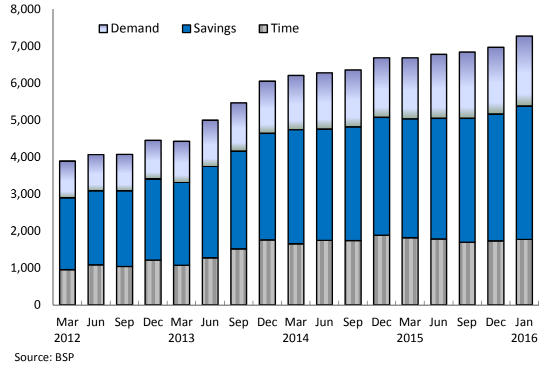
The Philippine banking system remains robust

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

Savings Mobilization. Savings and demand deposits were the primary sources of funds for the banking system. Banks' total deposits[40] as of end-January 2016 amounted to ₱7.3 trillion, 11.3 percent or ₱0.7 trillion higher than the year-ago level. The growth in deposits outpaced the 8.9-percent growth posted in the previous quarter. Demand, savings, and time deposits expanded by 17.4 percent, 13.7 percent, and 1.5 percent respectively.[41] Also, foreign currency deposits owned by residents (FCD-Residents) grew by 12.5 percent, y-o-y, to ₱1.5 trillion.[42]

[40] This refers to the total peso-denominated deposits of the banking system.
[41] Along with the savings, time and demand deposits, M3 includes currency in circulation and deposit substitutes.
[42] M4 is the sum of M3 and FCD-Residents. Along with savings, time and demand deposits, M3 includes currency in circulation and deposit substitutes.

Chart 32. Deposit Liabilities of Banks
in billion pesos

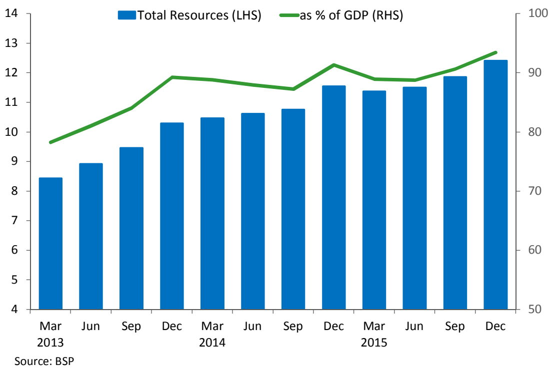


Institutional Developments. The total resources of the banking system grew by 7.6 percent to ₱12.4 trillion as of end-December 2015 from the year-ago level of ₱11.5 trillion.

Total resources of the banking system continue to rise

As a percent of GDP, total resources stood at 93.4 percent.

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



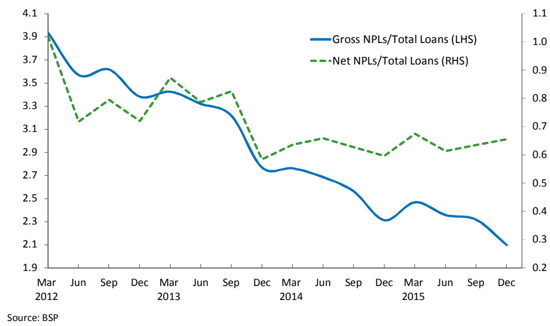
The number of banking institutions (head offices) fell to 632 as of end-December 2015 from the year- and quarter-ago levels of 648 and 635, respectively, indicating continued consolidation of banks as well as the exit of weaker players in the banking system. By banking classification, banks (head offices) consisted of 40 universal and commercial banks (U/KBs), 68 thrift banks (TBs), and 524 rural banks (RBs). Meanwhile, the operating network (head offices and branches/agencies) of the banking system expanded to 10,756 offices in Q4 2015 from 10,361 offices during the same period in the previous year and 10,615 offices in Q3 2015, 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 at 2.1 percent, as of end-December 2015, was an improvement relative to the 2.3 percent posted a year- and a quarter-ago.

Asset quality of Philippine banks continues to improve

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[43]. The improvement reflected the combined effect of the GNPL decrease of ₱2.8 billion, from ₱139.7 billion in Q3 2015 down to ₱136.9 billion in Q4 2015, and the banking system's TLP expansion of ₱495.6 billion, from ₱6.0 trillion in Q3 2015 to ₱6.5 trillion. Similarly, the net non-performing loan (NNPL) ratio increased, though mildly, to 0.7 percent relative to the 0.6 percent posted a year- and a quarter-ago. In computing for the NNPLs, specific allowances for credit losses[44] on TLP are deducted from the GNPLs. The said allowances decreased to ₱94.2 billion in end-December 2015 from the ₱101.4 billion posted a quarter ago.

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



[43] The 3.5 percent NPL ratio was based on the pre-2013 definition.
[44] 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.

The Philippine banking system's GNPL ratio of 2.1 percent was higher relative to South Korea (1.7 percent) and Malaysia (1.2 percent), but lower when compared with Thailand (2.6 percent) and Indonesia (2.3 percent).[45]

The loan exposures of banks remained adequately covered as the banking system registered an NPL coverage ratio of 117.8 percent. The Q4 2015 coverage ratio was lower than the 119.8 percent registered a year-ago but slightly higher than the 117.6 percent posted in end-September 2015. The ratio is indicative of banks' continued compliance with the loan-loss provisioning requirements of the BSP to ensure adequate buffers against potential credit losses.

Compliance with the BSP capital framework for U/KBs under the Basel III framework[46] took effect on 1 January 2014. The new Basel III regime incorporates adjustments to the treatment of bank capital in ways that enhance the use of the CAR as a prudential measure. The capital adequacy ratio (CAR) of universal and commercial banks (U/KBs) stood at 15.55 percent on solo basis and 16.40 percent on consolidated basis at the end of the third quarter in 2015. These figures are well-above the BSP regulatory threshold of 10.0 percent and international minimum of 8.0 percent. The banks' latest CAR on solo basis rose quarter-on-quarter from the 15.48 percent posted at end-June last year. On the other hand, U/KBs' CAR on consolidated basis at end-September last year slightly declined from the 16.42 posted a quarter earlier.

Banks remain well-capitalized amid tighter capital requirements

The industry's capitalization remains predominantly composed of Common Equity Tier 1 (CET 1), the highest quality among instruments eligible as bank capital. The CET 1 of U/KBs increased quarter-on-quarter to 12.99 percent and 13.92 percent of risk weighted assets (RWA) from 12.87 percent and 13.89 percent last quarter on both solo and consolidated bases, respectively. Their Tier 1 ratio also grew to 13.18 percent and 14.08 percent from 13.06 percent and 14.05 percent last quarter on both solo and consolidated bases, respectively. Tier 1 is composed of common equity and qualified capital instruments. Both CET 1 and Tier 1 ratios of U/KBs were also above the BSP thresholds of 6.0 percent and 7.5 percent, respectively. Said capital ratios increased amid the U/KBs' profitable operations and issuance of new shares as well as the infusion of foreign bank capital.

The CAR of U/KBs on a consolidated basis at 16.4 percent was higher than those of Malaysia (16.1 percent) and South Korea (13.9 percent), but lower compared to those of Indonesia (20.6 percent) and Thailand (17.4 percent).[47]

[45] Sources: Various central bank websites, IMF and financial stability reports, Indonesia (Banks' Nonperforming Loans, Q1 2015); Malaysia (Banking System's Net Impaired Loans, Q4 2015); Thailand (Total Financial Institutions' Gross NPLs, Q4 2015); and South Korea (Domestic Banks' Substandard or Below Loans [SBLs], Q4 2015).

[46] Basel III no longer counts towards "bank capital" those Basel II-compliant capital instruments that do not have the feature of loss absorbency. Loss absorbency refers to the ability of bank-eligible capital instruments other than common equity to behave and act in the same way as common equity shares at the point where the bank takes losses and becomes non-viable. In addition, Basel III now deducts from capital the investments of banks in non-allied undertakings, defined benefit pension fund assets, goodwill and other intangible assets.

[47] Sources: Various central bank websites, IMF and financial stability reports, Indonesia (Commercial Banks, Q3 2015); Thailand (Commercial Banks' Capital Funds Percentage of Risk Assets, Jan. 2016); Malaysia (Banking System's Total Capital Ratio, Q4 2015); and South Korea (Domestic Banks' Capital Ratio, Q4 2015).

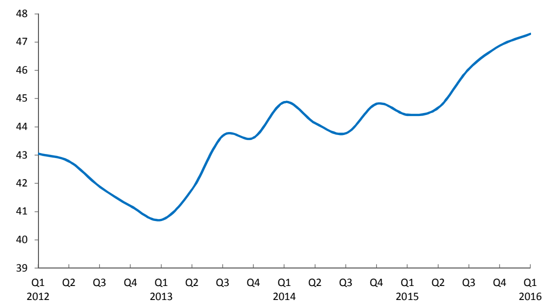
Exchange Rate

The peso depreciated against the US dollar in the first quarter of 2016. On a quarter-on-quarter basis, the peso weakened by 0.9 percent to average ₱47.30/US$1 from the previous quarter's average of ₱46.87/US$1.

Peso weakens on uncertainties related to the US interest rate hike

On a year-on-year basis, the peso depreciated by 6.1 percent relative to the ₱44.42/US$1 average in the first quarter of 2015.[48] The weakness of the peso during the review quarter was due to the risk aversion towards emerging market assets arising from concerns on the Chinese economy and declining oil prices.

Chart 35. Quarterly Peso-Dollar Rate
PHp/US$



Source: Reference Exchange Rate Bulletin, Treasury Department, BSP.

In January 2016, the peso weakened to average ₱47.51/US$1 relative to the ₱47.23/US$1 average in December 2015 on continued risk aversion towards emerging market assets over concerns on global growth, declining oil prices, and worries on the Chinese economy. In February, the peso depreciated further to an average of ₱47.64/US$1 on safe-haven buying following the contraction in China's manufacturing sector.[49] Meanwhile, the Bank of Japan's move to introduce a negative interest rate policy rendered support for Asian currencies, tempering the depreciation of the peso. In March, the trend reversed as the peso appreciated to average ₱46.76/US$1 on improved risk appetite towards emerging market assets, following aggressive stimulus measures from the European Central Bank and dovish statement on the outlook for interest rates by the US Federal Reserve. Overall, the sustained inflows of foreign exchange from overseas Filipino remittances, foreign direct investments, BPO and tourism receipts, as well as the healthy level of gross international reserves and the country's robust economic growth provided stability to the peso.[50]

On a year-to-date basis, the peso appreciated against the US dollar by 2.1 percent on 31 March 2016 as it closed at ₱46.07/US$1, moving in tandem with most Asian currencies except the Indian rupee which depreciated against the US dollar.[51]

Table 14. Year-to-Date Changes in Selected Dollar Rates
appreciation/(-depreciation); in percent

	2012	2013	2014	2015	2016*
Singaporean Dollar	6.1	-2.7	-4.5	-6.0	5.2
Chinese Yuan	1.0	2.6	-2.7	-4.3	0.4
Thai Baht (Onshore)	3.0	-4.6	-0.7	-8.9	2.3
Philippine Peso	**6.8**	**-7.0**	**-0.7**	**-5.0**	**2.1**
Japanese Yen	-10.9	-16.3	-12.5	-0.5	6.9
New Taiwan Dollar	4.3	-1.9	-6.2	-3.6	2.0
Malaysian Ringgit	3.5	-5.5	-6.3	-18.6	9.6
Korean Won	7.7	1.1	-4.3	-6.6	3.0
Indonesian Rupiah	-5.9	-19.1	-2.1	-9.8	3.9
Indian Rupee	-3.1	-11.4	-2.9	-4.9	-0.1

Notes:
- Negative value represents depreciation of the currency against the US dollar.
- Cum means cumulative sum of year-to-date changes of selected Asian currencies.
- YTD changes are computed as the percent change between the closing prices for the year indicated versus the closing prices for the preceding year (i.e., closing prices are based on Bloomberg data as of 31 December except for the Philippine peso which used closing price for the last trading day of the year).
*Based on Bloomberg data as of 4:00 p.m., 31 March 2016

Meanwhile, volatility as measured by the coefficient of variation (COV) of the peso's daily closing rates stood at 1.15 percent during the first quarter of 2016, slightly higher compared with the 0.93 percent in the previous quarter.[52]
On a real trade-weighted basis, the peso lost external price competitiveness, for the period January to February 2016, against the basket of currencies of all trading partners (TPI), trading partners in advanced (TPI-A) and developing countries (TPI-D) as the real effective exchange rate (REER) index of the peso increased by 2.6 percent, 2.7 percent, and 2.5 percent, respectively, relative to the fourth quarter of 2015. These developed mainly on account of widening

[48] Dollar rates or the reciprocal of the peso-dollar rates were used to compute for the percentage change.
[49] Official manufacturing purchasing managers' index fell to 49.4 in January from 49.7 in December, marking the lowest level since August 2012 and the sixth straight month of contraction. A reading below 50 indicates a contraction. (Source: National Bureau of Statistics of China)
[50] GIR stood at US$81.9 billion as of end-February 2016 (revised).
[51] Based on the last done deal transaction in the afternoon.
[52] 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.

inflation differential which more than offset the nominal depreciation of the peso against these currency baskets.[53,54]

Relative to the first quarter of 2015, the peso gained external price competitiveness against the TPI, TPI-A, and TPI-D baskets for the period January to February 2016. These developed as the nominal depreciation of the peso which offset the impact of widening inflation differential led to the decrease in the REER index of the peso by 2.7 percent, 5.1 percent, and 0.9 percent against the TPI, TPI-A, and TPI-D baskets, respectively.

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

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

III. Fiscal developments

The National Government (NG) recorded a deficit of ₱121.7 billion in 2015, 66.0 percent higher than what was incurred in 2014. Nevertheless, the NG's 2015 shortfall was 57.0 percent lower than the programmed deficit of ₱283.7 billion for the year.

NG posts higher deficit in 2015

Consequently, the lower expenditure propped up the primary surplus, which is net of interest payments, to reach ₱187.7 billion or 140.0 percent higher than the target.

Table 15. National Government Fiscal Performance
in billion pesos

	2014	2015	Growth Rate
	Jan-Dec	Jan-Dec	(in percent)
Surplus/(Deficit)	-73.1	-121.7	66
Revenues	1,908.5	2,109.0	11
Expenditures	1,981.6	2,230.6	13

* Totals may not add up due to rounding
Source: BTr

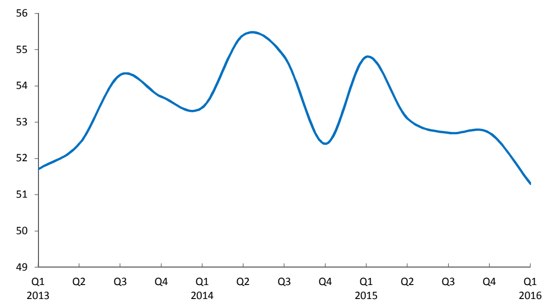
Revenues increased by 11.0 percent to ₱2,109.0 billion in 2015 compared to ₱1,908.5 billion in 2014, due largely to higher revenues from other offices. This was however 7.0 percent below the 2015 target. The Bureau of Internal Revenue continued to be the primary revenue collecting agency of the NG, contributing ₱1,433.3 billion, which was 7 percent higher than a year ago, but fell short of its target by 14.0 percent. Income from other offices, which include the Coco Levy Fund and the Cavite-Laguna Expressway Project, grew by 78.0 percent to reach ₱198.1 billion which is 90.0 percent higher than target. Similarly, the Bureau of the Treasury contributed ₱110.0 billion representing an 18.0 percent increase compared to its level a year ago, and surpassed the target by 81.0 percent. Meanwhile, income from the Bureau of Customs fell slightly by 0.5 percent to ₱367.5 billion, falling short of the program by 14.0 percent.

Expenditures for 2015 amounted to ₱2,230.6 billion, 13.0 percent higher than the total spending recorded in 2014. However, this was 13.0 percent lower than the disbursement program for the year. Excluding interest payments, expenditures went up by 16.0 percent from the year-ago level to P1,921.3 billion, which is 13.0 percent lower than programmed. Meanwhile, interest payments reached ₱309.4 billion in 2015, ₱11.8 billion lower compared to its year-ago level. This was 14.0 percent lower than the target.

IV. External Developments

The JP Morgan Global All-Industry Output Index fell to 50.6 in February from 52.6 in January owing to a broad-based slowdown in activity and new business across manufacturing and services. Output in the US stagnated as a contraction in the service sector offset the expansion in the manufacturing sector. Meanwhile, output in the euro area continued to expand, although signs of a slowdown were also noted in Germany, Italy, Spain, and France. Growth in Japan, Russia, and India was modest. The pace of production decelerated in China, while economic activity in Brazil remained in a severe downturn.[55]

Chart 36. JP Morgan Global All-Industry Output Index
index points



Source: Markit Economics

USA. Real GDP increased by 1.4 percent on a seasonally adjusted q-o-q basis in Q4 2015 after expanding by 2.0 percent in the previous quarter. On a y-o-y basis, real output growth was slightly slower at 2.0 percent in Q4 2015 compared to 2.1 percent in Q3 2015.

Growth in the US economy holds firm

The slower expansion during the review quarter reflected a deceleration in personal consumption expenditures and downturns in nonresidential fixed investment, state and local government spending, and exports.[56]

Meanwhile, the manufacturing PMI rose to 49.5 in February from 48.2 in January as production expanded at a somewhat faster pace.[57] Panel respondents likewise indicated a more positive view of demand than in the previous month, given favorable trends in new domestic orders. Inflation on a y-o-y basis eased to 1.0 percent in February from 1.4 percent in January as the decrease in the energy index more than offset the increase in the food index. Meanwhile, unemployment remained steady at 4.9 percent in February, the same rate as in January. Total nonfarm payroll employment increased by 242,000 during the month, with gains noted in health care and social assistance, retail trade, food services and drinking places, and private educational services. Job losses continued in mining.

Consumer confidence improved slightly in March as volatility in financial markets abated. The Conference Board Consumer Confidence Index rose to 96.2 in March from 94.0 in February,[58] while the Thomson-Reuters/University of Michigan Index of Consumer Sentiment eased to 91.7 in February from 92.0 in the previous month.[59]

On a q-o-q basis, real GDP grew by 0.3 percent in Q4 2015, the same pace as in the previous quarter. On a y-o-y basis, real GDP growth was solid at 1.6 percent in both Q4 and Q3 2015.[60]

Euro Area. On a q-o-q basis, real GDP grew by 0.3 percent in Q4 2015, the same pace as in the previous quarter. On a y-o-y basis, real GDP growth was solid at 1.6 percent in both Q4 and Q3 2015.[61]

[55] JP Morgan Global Manufacturing & Services PMI, http://www.markiteconomics.com/

[56] US Bureau of Economic Analysis, "National Income and Product Accounts Gross Domestic Product: Fourth Quarter 2015 (Third Estimate)," news release, 25 March 2016. http://www.bea.gov/newsreleases/national/gdp/2016/pdf/gdp4q15_3rd.pdf

[57] Institute for Supply Management, "February Manufacturing ISM *Report On Business*", 1 March 2016, https://www.instituteforsupplymanagement.org

[58] The Conference Board, "The Conference Board Consumer Confidence Index improved in March." 29 March 2016. http://www.conference-board.org/

[59] University of Michigan Survey of Consumers, "Inflationary psychology: friend or foe?" 26 February 2016. http://www.sca.isr.umich.edu/

[60] Eurostat news release 46/2016 dated 8 March 2016.

[61] Eurostat news release 46/2016 dated 8 March 2016.

Economic activity in the euro area regains some momentum

Meanwhile, the composite PMI for the euro area rose to 53.7 in March from 53.0 in February as new orders in both the manufacturing and service sectors increased marginally.[62]

The seasonally adjusted unemployment rate declined from 10.4 percent in December 2015 to 10.3 percent in January 2016, the lowest since August 2011.[63] Meanwhile, inflation declined to -0.2 percent in February from 0.3 percent in January, as the energy index decreased further during the month.[64]

The European Commission's Economic Sentiment Indicator for the euro area declined to 103.0 in March from 103.9 in the previous month owing to weaker confidence among managers in the services and construction sectors. Consumer confidence likewise dipped on households' less favorable assessment of general economic conditions.[65]

Japan. On a q-o-q basis, real GDP decreased by 0.3 percent in Q4 2015 after increasing by 0.3 percent in the previous quarter.

Manufacturing activity in Japan slows down

Meanwhile, real GDP expanded by 0.7 percent y-o-y in Q4 2015 following the 1.7-percent increase in Q3 2015.[66] The y-o-y expansion reflects the modest recovery of the Japanese economy, although exports and production have been tempered by the slowdown in emerging economies. Meanwhile, the seasonally adjusted manufacturing PMI fell to 49.1 in March from 50.1 in the previous month. Production growth decelerated due to a drop in total new orders, reflecting the decline in international orders particularly from China and Taiwan.[67]

Inflation rose to 0.3 percent in February from nil in January, while the seasonally adjusted unemployment rate increased slightly to 3.3 percent in February 2016 from 3.2 percent a month earlier.

China. Real GDP grew by 6.8 percent y-o-y in Q4 2015, bringing full-year average growth to 6.9 percent. Agricultural production showed steady growth, while investment in fixed assets slowed down.

The seasonally adjusted manufacturing PMI rose to 49.7 in March from 48.0 a month earlier, indicating a slight improvement in manufacturing output as new domestic orders increased marginally.[68]

Indicators continue to point to subdued Chinese economic activity

Inflation rose to 2.3 percent in February from 1.8 percent a month earlier. The prices of food, particularly fresh vegetables and pork, drove inflation.

India. Real GDP increased by 7.3 percent y-o-y in Q4 2015, slower than the 7.7-percent expansion in the previous quarter, with mining, utilities, and construction posting slower growths during the quarter compared to the same period a year ago.[69]

Output growth in India softens

Meanwhile, the composite PMI decreased to 51.2 in February from 53.3 in January, reflecting a slower intake of new business in both the manufacturing and service sectors.

[62] Markit Flash Eurozone PMI, http://www.markiteconomics.com/
[63] Eurostat news release 41/2016 dated 1 March 2016.
[64] Eurostat news release 40/2016 dated 29 February 2016.
[65] European Commission. http://ec.europa.eu/
[66] Department of National Accounts, Economic and Social Research Institute, Cabinet Office. http://www.esri.cao.go.jp/
[67] Nikkei Japan Manufacturing PMI, http://www.markiteconomics.com/
[68] Caixin China General Manufacturing PMI, http://www.markiteconomics.com/
[69] Central Statistics Office of India. http://mospi.nic.in/Mospi_New/Site/home.aspx

Inflation based on the consumer price index (CPI) decreased to 5.2 percent in February from 5.7 percent in January.

Policy Actions by Central Banks. Bank Indonesia reduced its BI rate by 25 bps each in January, February, and March in line with its previous moves to ease macroprudential policy and lower primary reserves in rupiah to further support the domestic economy amid a more benign inflation environment. In addition, following the reduction in reserve requirements in December 2015, Bank Indonesia lowered primary reserve requirements anew by 100 bps in March.

In February, Bank Negara Malaysia cut its statutory reserve requirement (SRR) ratio by 50 bps from 4.0 percent to 3.5 percent to ensure sufficient liquidity in the domestic financial system and to support the banking system amid net external outflows. Meanwhile, the Bank of Japan introduced a program of "quantitative and qualitative monetary easing (QQE) with negative interest rate" in order to achieve its price stability target of 2 percent.

A number of central banks ease their monetary policy settings

In March, the Reserve Bank of New Zealand cut its official cash rate by 25 bps, citing evidence of a material decline in long-run inflation expectations. Similarly, the Central Bank of the Republic of China (Taiwan) reduced its key policy rates by 12.5 bps to promote financial stability as well as to stimulate the domestic economy.

The European Central Bank (ECB) decided to ease further its policy settings by reducing ECB interest rates, expanding its asset purchase programme, and implementing other measures to stem the increasing risks to ECB's price stability mandate. Interest rates on the main refinancing operations and marginal lending facility were lowered by 5 bps each, while the interest rate on the deposit facility was reduced further into negative territory with another 10 bps cut.

Meanwhile, the People's Bank of China decided to cut its reserve requirement ratio by 50 bps to 17 percent, in line with its efforts to stabilize growth and manage capital outflows.

V. Monetary Policy Developments

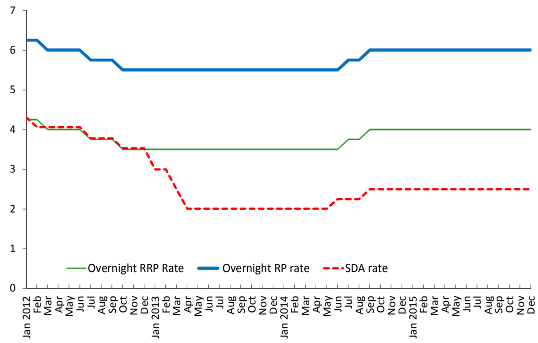
During its monetary policy meetings on 11 February and 23 March, the BSP decided to maintain its key policy interest rates at 4.0 percent for the overnight borrowing or RRP facility and 6.0 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also kept steady. Similarly, the reserve requirement ratios were left unchanged.

The BSP maintains monetary policy settings in Q1 2016

The BSP's assessment of a manageable inflation outlook and robust growth conditions continue to support steady monetary policy settings. Latest forecasts indicate that average inflation is likely to settle within the target range of 3.0 percent ± 1 percentage point for 2016-2017, while inflation expectations continue to be firmly anchored within the inflation target band over the policy horizon. The BSP also noted that the risks surrounding the inflation outlook have shifted slightly to the downside. Downward price pressures could arise from slower-than-expected global economic activity and potential second-round effects from lower international oil prices. Meanwhile, upside risks to the inflation outlook persist, particularly those that could emanate from the impact of El Niño dry weather conditions on food prices and utility rates as well as pending petitions for power rate adjustments.

The BSP observed that domestic demand conditions are likely to stay firm, supported by solid private household and capital spending, buoyant business sentiment, and adequate credit and domestic liquidity. The BSP also recognized that uncertainty over economic growth prospects across the globe could continue to drive volatility in global financial markets.

Chart 37. BSP Policy Rates
in percent



Source: BSP

Given these considerations, the BSP affirmed the need to keep a watchful eye over domestic and external developments to ensure that the monetary policy stance remains in line with the BSP's price and financial stability objectives.

VI. Inflation Outlook

BSP Inflation Forecasts[70]

Inflation is expected to remain manageable over the policy horizon. The latest BSP baseline forecasts show that inflation could settle at the low-end of the government's target range of 3.0 percent ± 1.0 percentage point for 2016 and approach the midpoint of the target in 2017.

Inflation is expected to follow a manageable and target-consistent path over the policy horizon

The inflation projections for the current forecast round are lower compared to the previous quarter's forecast due mainly to the lower-than-projected inflation outturns in recent months, further decline in global crude oil prices as well as rollback in transport fares.

Demand Conditions. Key demand indicators support the view of continued vigor in domestic real sector activity. The domestic economy grew to post a 6.3-percent expansion in Q4 2015 from 6.1 percent in the previous quarter. The strong Q4 2015 economic performance was driven mainly by steady private consumption, sustained capital formation, and robust government spending. This brought the full-year output growth to 5.8 percent from 6.1 percent in 2014.

Looking ahead, prospects for the domestic economy continue to remain favorable. GDP expansion in the first half of 2016 could continue to pick up due to stronger growth in manufacturing and public sector construction. The government has identified expenditure measures to address the lag in disbursements and avoid underspending. The national and local elections could likewise provide a temporary boost to growth in 2016. Private demand is likewise expected to remain firm, aided mainly by sustained remittance inflows and low inflation. Private capital formation should also contribute to economic growth with construction and investments in durable equipment expected to remain solid, particularly as more Public-Private Partnership (PPP) projects get underway.

Other real sector indicators likewise point to firm growth prospect in the near term. Production indices for the manufacturing sector suggest continued expansion with more than half of all major manufacturing sectors operating above 80 percent of their capacity. The composite PMI also remains above the 50-point mark at 52.8 in January 2016. There have also been improvements in labor market conditions with the unemployment rate lower compared to a year ago, based on the results of the January 2016 Labor Force Survey (LFS).

The favorable economic outlook has also been reflected in the results of the BSP expectations surveys as sentiment of businesses and households appeared to be buoyant. In particular, households' and firms' expectations for Q2 2016 are upbeat, broadly in line with the expectation of brisker operations during the election period as well as anticipated pick-up in the economic activity during the summer season.

Supply Conditions. Commodity prices are likely to remain subdued, reflecting ample supply conditions. Food inflation is likely to remain benign over the near term given prospects of favorable harvest of key agricultural commodities.

Favorable supply prospects point to manageable inflation environment over the policy horizon

International oil prices are also likely to remain below 2015 levels as suggested by futures prices of oil and forecasts by multilateral agencies, with projected modest gains over the medium term.

Global agricultural prices are expected to decline in 2016 and could remain at moderate levels over

[70] The inflation forecast path in this report refers to the forecasts presented during the 17 December 2015 Monetary Policy Meeting. In the discussion, these forecasts are compared to the forecasts presented in the Q3 Inflation Report (or the forecasts during the 24 September 2015 Monetary Policy Meeting).

the medium term. Forecasts by the IMF and the World Bank suggest a continued decline in benchmark prices of key grains (wheat, maize, and rice) in 2016. Despite the ongoing El Niño weather phenomenon, ample global supply should keep food price pressures at bay. [71,72]

In the domestic front, first quarter *palay* and corn production could contract by 5.0 percent and 6.5 percent, respectively, due primarily to insufficient rainfall and dry spells brought about by the El Niño weather condition. By contrast, *palay* and corn production in Q2 2016 is expected to increase by 2.4 percent and 14.7 percent, respectively, based on farmers' planting intentions. [73]

The latest assessment of the Philippine Atmospheric, Geophysical and Astronomical Services Administration (PAGASA) showed that the ongoing El Niño phenomenon could last until 1H 2016. The slightly warmer average temperature and significant reduction in rainfall could result in moderate to severe drought conditions over the forecast horizon. Further intensification of El Niño conditions could provide upside pressures on the prices of agricultural commodities and utilities.

Table 16. Forecast Probabilities of El Niño Southern Oscillation (ENSO) Events
as of 10 March 2016

Season	La Niña	Neutral	El Niño
2016			
Feb-Apr	0%	1%	**99%**
Mar-May	0%	3%	**97%**
Apr-Jun	1%	25%	**74%**
May-Jul	9%	**51%**	40%
Jun-Aug	32%	**49%**	19%
Jul-Sep	43%	43%	14%
Aug-Oct	**50%**	38%	12%
Sep-Nov	**54%**	35%	11%
Oct-Dec	**57%**	33%	10%

Note: Optional cropping period and summer harvest are during Q1 and Q2, respectively.
Source: International Research Institute for Climate and Society and Climate Prediction Center

To help mitigate the impact of El Niño on agricultural production, the Department of Agriculture (DA) has activated its National El Niño Task Force to coordinate the various response measures. These programs include cloud seeding operations, installation of alterative irrigation systems, crop rotation, the use of hybrid crop varieties, and other government assistance for farmers. Furthermore, the national government has approved additional rice import for 2016 to ensure that existing inventory levels remain sufficient to meet national requirements.

Similarly, international oil prices fell further compared to the previous quarter's level. The decline in crude oil prices could be traced to a combination of ample supply and sluggish demand.

Forecast by the EIA suggests that Brent crude oil price could average at US$34.28 per barrel in 2016. Meanwhile, IMF and World Bank expect crude oil prices to average at US$34.75 per barrel and US$37.00 per barrel in 2016, respectively. However, there remains substantial uncertainty in the global oil price outlook. On the one hand, world oil supply could continue to outstrip demand in the near term given firm supply from OPEC countries, the impact of Iran's additional production with its re-entry in the global oil market, combined with weak demand growth. On the other hand, agreement between several OPEC and major non-OPEC producers, such as Russia, to freeze production levels and the accelerating pace in the reduction of US rig counts could support a recovery in global crude oil prices. [74,75]

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

1) BSP's overnight RRP rate at 4.00 percent from March 2016 to December 2017;

2) BSP's reserve requirement at 20.0 percent from March 2016 to December 2017;

3) NG fiscal deficits for 2016 to 2017, which are consistent with the DBCC-approved estimates;

4) Dubai crude oil price assumptions, the trend of which is consistent with the trend of futures prices of oil in the international market;

[71] IMF, *Commodity Price Outlook and Risks*, February 2016, available online at http://www.imf.org
[72] World Bank, *Commodity Markets Outlook*, January 2016, available online at http://www.worldbank.org
[73] PSA, *Rice and Corn Situation Outlook,* January 2016, available online at http://www.agstat.psa.gov.ph

[74] IMF, *Commodity Price Outlook and Risks*, 10 February 2016, available online at http://www.imf.org
[75] EIA, *Short-Term Energy Outlook*, 8 March 2016, available online at http://www.eia.gov

5) Increase in nominal wage in July 2016 and July 2017 based on historical wage increases;

6) Real GDP growth is endogenously determined in the BSP's MEM; and

7) Foreign exchange rate is endogenously determined in the BSP's MEM through the purchasing power parity and interest rate parity relationships.

Risks to the Inflation Outlook

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

Compared with the previous report, the latest projected inflation path is lower for 2016 and 2017

Compared to the previous inflation report, the latest fan chart presents a slight downward shift in the inflation projections for 2016 and 2017. The lower inflation projections for 2016 and 2017 reflected the continued decline in global crude oil prices, lower-than-projected inflation outturns in recent months, as well as the rollback in transport fares.

The BSP's review of current price trends suggests that the risks surrounding the inflation outlook appear to be on the downside. This assessment is depicted in the latest fan chart wherein the projection bands below the central projection are wider than the bands above it. Slower global economic activity and potential second-round effects emanating from the sustained decline in global oil prices pose downside risks. Meanwhile, pending petitions for adjustments in electricity rates and the impact on food and utility prices of stronger-than-expected El Niño conditions are the upside risks to inflation.

The possibility of a slower global economic growth could imply weaker demand-related price pressures as well as further uncertainties in the global oil market. The rebalancing in China, further decline in commodity prices, higher foreign currency exposure of corporate balance sheets, and capital flow reversals due to disruptive asset price shifts related to the normalization in US Fed policy rates are potential sources of downside risks to global growth prospects.[76]

The second-round effects of lower oil prices could come in the form of further reductions in transport fares and lower prices of basic commodities. Following the decline in diesel prices, the Land Transportation Franchising and Regulatory Board (LTFRB) approved the additional provisional rollback in the minimum jeepney fares by ₱0.50 for Metro Manila, Regions 2 to 7 in February 2016. Moreover, the LTFRB approved the permanent reduction in the flagdown taxi fares from ₱40.00 to ₱30.00 in March 2016. In addition, several bus operators in Metro Manila have volunteered to reduce by ₱1.00 the minimum fares for regular and air-conditioned buses. The continued decline in global and domestic oil prices could lead to reductions in transport fares in other regions. At the same time, the DTI has proposed for a rollback in the suggested retail prices (SRP) of basic goods due to lower transportation and distribution costs of manufacturers brought about by the decline in oil prices. This includes bread, canned sardines, milk, coffee, noodles, bottled water, processed meat, condiments, and batteries.

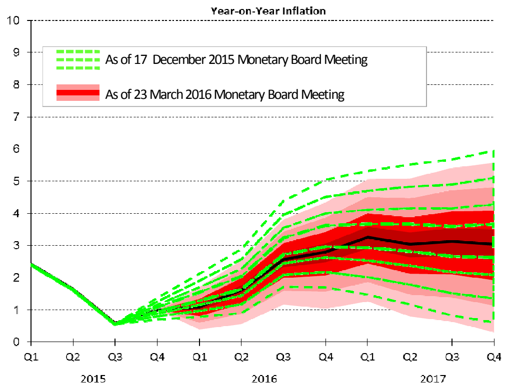
The risks to inflation outlook appear to be on the downside

Meanwhile, the intensification of the El Niño weather disturbance could adversely affect domestic food production as well as power and water supply. The said weather condition is expected to manifest as both drier-than-normal weather conditions and stronger-than-usual typhoons, which could impact negatively the agricultural production, ultimately posing a risk to food prices. Similarly, the El Niño weather phenomenon could lower the output of hydro-powered generation plants and consequently raise the cost of electricity and water.

[76] IMF, *World Economic Outlook*, January 2016, available online at http://www.imf.org

The pending petition of Meralco on the December 2013 rate adjustment, which is still under the temporary restraining order of the Supreme Court, also continues to pose an upside risk to the inflation outlook.

Chart 38. Inflation Projection



Source: BSP estimates

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 upper90 percent of the probability distribution. The bands widen (i.e., "fan out") as the time frame is extended, indicating increasing uncertainty about outcomes. The band in wire mesh depicts the inflation profile in the previous report.

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

VII. Implications for the Monetary Policy Stance

The latest baseline inflation forecasts show that inflation could move close to the 3.0 percent ± 1.0 ppt inflation target range for 2016-2017. The downward shift in the forecasted inflation path for 2016 is due mainly to lower global crude oil prices. Meanwhile, the slightly higher inflation forecast for 2017 reflected a weaker peso.

Average inflation is projected to return gradually to the inflation target range over the policy horizon

Potential adjustments in electricity rates given pending petitions and the impact of prolonged *El Niño* dry weather conditions are seen as the key upside risks to inflation. Meanwhile, the ongoing weakness in the global economy could provide downside risk to inflation.

Inflation expectations remain well-anchored over the policy horizon. Consistent with the BSP's inflation outlook, mean inflation forecasts based on December 2015 surveys of private sector economists have remained within the inflation target range in 2016-2017 while settling below the lower bound of the target range for 2015.

Headline inflation averaged higher in Q4 2015 at 1.0 percent from 0.6 percent in the previous quarter as prices of some food items went up due to decreasing supply caused by the recent typhoons that visited the country. Likewise, non-food inflation edged higher as prices of service-related CPI components accelerated during the quarter.

The Philippine economy grew by 6.0 percent in the third quarter, an improvement from the 5.8 percent growth in the previous quarter and from 5.5 percent in Q3 2014.

This brought year-to-date growth to 5.6 percent, albeit still below the government's growth target of 7-8 percent. Strong domestic demand fueled output growth, led by significant improvement in government spending, solid household consumption, and higher capital formation. On the supply side, growth was driven by the services sector while growth in the industry sector was supported by manufacturing.

Consistent with these developments, other indicators continue to point to positive growth momentum. Business outlook on the economy turned more upbeat for Q4 2015, with the overall confidence index (CI) rising to 51.3 percent—the highest in two years. Business outlook also remain positive for Q1 2016 at 43.9 percent albeit lower due to the typical slowdown in demand after the holiday season, concerns over the adverse effects of El Niño, and uncertainties in the global economy. Meanwhile, consumers' outlook improved for Q4 2015 as the overall confidence index (CI) turned less negative (from -11.6 percent to -8.1 percent) for Q3 2015. For the next quarter (Q1 2016), consumers' optimism was sustained as the CI was broadly steady while sentiment was more favorable for the next 12 months.

Growth in the US economy holds firm while economic activity in the euro area strengthen. However, downturn in key emerging markets, such as Brazil, China, and Russia, continues.

Domestic demand continues to be firm while external prospects remain uneven

Meanwhile, a number of central banks ease their monetary policy settings in Q4 2015 to support domestic economic activity and stave off delfationary pressures, while the US Fed decides to raise interest rates.

Notwithstanding below-target inflation for 2015, inflation dynamics are expected to gather some momentum in 2016 but will remain manageable given well-contained inflation expectations over the policy horizon.

Current monetary policy settings remain appropriate

Moreover, latest baseline inflation forecasts extending to 2017 show that annual average inflation is likely to settle within the target range. This outlook serves as the key argument for maintaining the BSP's monetary policy settings.

At the same time, firm demand-side conditions suggest that current monetary policy settings are appropriately calibrated with minimal deflationary risks. Thus, the economy does not need further monetary stimulus given the still ample liquidity in the system, sustained credit expansion and increased fiscal spending. Keeping a steady hand on policy levers remains prudent given the challenging global economic environment and to better gauge the impact of the US Fed normalization. Over the period ahead, emerging market economies (EMEs) could face the challenge of potential capital flow reversals and renewed volatility in financial markets. Keeping policy settings unchanged will allow authorities to consider further information on economic and financial conditions, and provide flexibility in responding to future monetary policy challenges resulting from the critical early stages of policy normalization in the US.

On balance, the BSP is of the view that current monetary policy settings remain appropriately calibrated. Going forward, the BSP will continue to monitor domestic and external developments to ensure that the monetary policy stance remains consistent with its price and financial stability objectives.

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
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.
23 Oct 2014 **11 Dec 2014**	4.00	6.00	The MB decided to maintain the BSP's key policy interest rates at 4.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and special deposit accounts were also kept steady. The reserve requirement ratios were left unchanged as well.

Summary of Monetary Policy Decisions

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

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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