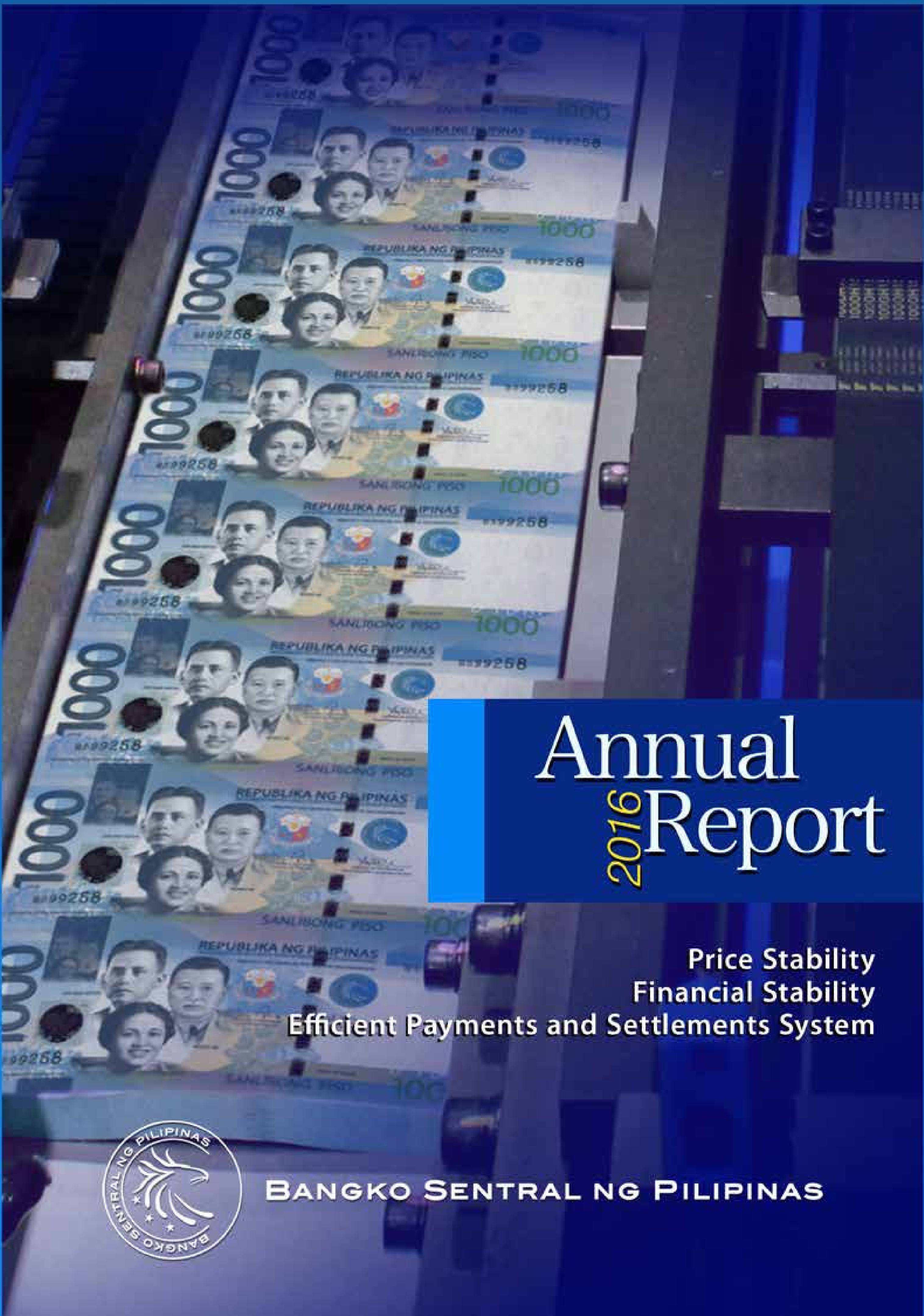


Annual Report 2016

Price Stability
Financial Stability
Efficient Payments and Settlements System

BANGKO SENTRAL NG PILIPINAS

About the Cover

Resilience and dynamism. In 2016, the demonetization of the New Design Series paved the way for the full circulation of the New Generation Currency (NGC) series of the Philippine peso in the economy. The NGC is a symbol of strength and progress. Its stronger security features and world-class design promote the integrity of the currency system. Along with other policy reforms and programs, the adoption of the NGC represents the BSP's proactive and continued support for the growth and resilience of the Philippine economy.

Contents

How We Performed in 2016: Operations, Advocacies, and Financial Results

Statistical Annexes

Governor's Foreword

"Resilience Amidst Global Uncertainty"

AMANDO M. TETANGCO, JR.
Governor

2016 proved to be a year of significant transitions and tough surprises. The global economy continued to be gripped by sluggish growth brought about by weak external trade, instability in international oil prices, slowdown in some key emerging economies, and the fragile recovery in advanced economies. With this backdrop, monetary policies continued to diverge and risk sentiment remained fickle.

While these issues have affected the global economy for the last five years, new developments in 2016 further intensified the environment of uncertainty. These included the geopolitical tensions in the Middle East, the historic decision of the British people to leave the European Union, and the result of the recent US presidential elections. These events astonished the markets and brought with it bouts of volatility and shifts in capital flows.

Against this difficult background, the Philippine economy demonstrated strength and resilience. Growth momentum was sustained with GDP advancing by 6.8 percent in 2016 from 5.9 percent in 2015. At this level, the Philippines emerged as one of Asia's fastest growing economies.

Growth was more balanced, supported by robust private consumption, public and private investment and, recently, by the resurgence of manufacturing and construction. This diversification added a pillar of strength to the economy while generating employment for more Filipinos.

The series of policy and structural reforms, disciplined macroeconomic management, and governance reforms over the years supported improvements in output and productivity growth. Clearly, the way forward is to continue to build on these gains to secure a better future for all Filipinos.

In 2016, monetary and financial policies of the Bangko Sentral ng Pilipinas (BSP) stayed the course of promoting stability and confidence in the Philippine economy.

In the midst of robust economic growth, low and stable prices prevailed with 2016 inflation settling at 1.8 percent. The monetary policy stance for the year remained attuned to domestic conditions and kept inflation expectations firmly anchored.

The BSP decided to maintain its monetary policy settings despite inflation hovering below the target, as domestic price movements continued to be driven mainly by transitory supply-side factors outside the influence of monetary policy. Indeed, indicators of domestic demand stayed firm, supported by adequate liquidity and credit conditions as well as buoyant business and consumer sentiments. While the full-year inflation stood below the inflation target range of 2.0 – 4.0 percent, the inflation environment was expected to gradually return to a target-consistent path over the policy horizon.

2016 marked the BSP's formal shift in its monetary operations to an interest rate corridor (IRC) system. With the introduction of new facilities and the refinement of existing operations, the BSP has developed an active and more dynamic policy toolkit that is expected to improve its influence on market interest rates and ultimately enhance monetary policy transmission in the economy.

Meanwhile, continuing reforms and enhancements in governance and risk management practices kept the Philippine banking system vibrant, stable and profitable in 2016. The banking system's non-performing assets continued to trend downward to low single digit levels, while its capital adequacy ratio of 15.6 percent remained comfortably above the minimum prescribed by the BSP and by the Bank for International Settlements. The BSP's regulatory reform agenda which was instituted over the years enabled the banking system not only to prudently position itself against global and domestic headwinds but also to receive positive international reviews for its overall strength and competitiveness.

The Philippine Payments and Settlements System (PhilPaSS) operated by the BSP continued to provide safe, sound, and efficient payment and settlement of financial transactions in real time. The number of transactions processed and settled in PhilPaSS increased by 14.1 percent to 1.6 million in 2016, reflecting higher volumes of financial market trading and interbank transactions while aggregate value of transactions surged to 67.9 percent to ₱469.5 trillion. Both the number and the value of transactions reached all-time high levels in 2016.

On the external front, the impact of global headwinds was reflected in lower current account surplus of US$601 million in 2016 – 91.7 percent lower than the 2015 US$7.3 billion surplus – and the overall balance of payments position which yielded a deficit of US$420 million in 2016, a reversal of the US$2.6 billion surplus in 2015.

Nevertheless, the economy was able to lower its external debt to 24.6 percent of GDP in 2016, from 26.5 percent in 2015. The end-2016 gross international reserves (GIR) of US$80.69 billion, largely unchanged from 2015, remained well above the standard adequacy metrics as it can cover 8.9 months' worth of imports of goods and payments of services and primary income. This is also equivalent to 5.6 times the country's short-term external debt based on original maturity and 4.0 times based on residual maturity.

Indeed, strong macroeconomic fundamentals gained from decades-long structural reforms shielded our economy from the full impact of global shocks and helped us cope with uncertainties that cloud our way forward. Thus, we can be optimistic that our economy will remain resilient and sustain broad-based growth.

Nevertheless, there are risks that compel us to remain vigilant. First, the tentative growth prospects abroad are threatened by a developing trend to retreat from multilateralism and cooperation. Such inward-looking policies could weaken external trade in both goods and services and potentially affect the business process outsourcing (BPO) sector as well as the deployment and the remittances of overseas Filipinos (OFs). Consequently, these could moderate domestic income and consumption. Another factor to watch out for in the near term is the impact of the ongoing rebalancing of the Chinese economy.

Second, the divergence of monetary policies will continue to influence conditions in global financial markets. The uncertainty in the pace and level of the next adjustments of the US Fed's policy rates along with the ensuing volatility from this divergence may put pressure on the exchange rate as well as the balance sheets of economic agents. Finally, risks emanating from the domestic front such as political dynamics and adverse weather disturbances may affect the pace of growth.

In the face of these challenges, the BSP remains steadfast in pursuing its mandate of maintaining price and financial stability in the Philippine economy. We will consistently upgrade our surveillance, diligently improve our policy toolkit, and meticulously work on our structural reform agenda. Our policymaking will be calibrated to boost productivity and to enhance the efficiency of financial intermediation to underpin sustained growth of the Philippine economy.

We will continue to review and align our regulations and policies with international standards to improve risk management as well as to ensure the competitiveness of our banks in the light of the Association of Southeast Asian Nations (ASEAN) integration, guard against the build-up of vulnerabilities in the system and ensure orderly financial market adjustments.

And we will continue to work with Congress on the proposed amendments to the 24-year old BSP charter in the light of global and local changes in the economy, the financial landscape, technology applications and risks, and regulatory framework. The amendments will strengthen the BSP's functions related to monetary stability, financial stability, prudential supervision and financial viability.

Moreover, we will intensify our efforts to help bring the fruits of economic development to all Filipinos through the implementation of the National Strategy for Financial Inclusion (NSFI) with other government agencies and the development of an inclusive financial system that supports inclusive growth.

Looking ahead, I am confident that our homegrown sources of strength, policy flexibility and effective collaboration with our partners in government, the banking industry, the private sector, multilateral institutions, NGOs and the academe will enable the BSP to continue to contribute significantly to the sustained growth of our economy in 2017 and in the years to come. n

Who we are

Our Vision

The BSP aims to be a world-class monetary authority and a catalyst for a globally competitive economy and financial system that delivers a high quality of life for all Filipinos.

Our Mission

The BSP is committed to promote and maintain price stability and provide pro-active leadership in bringing about a strong financial system conducive to a balanced and sustainable growth of the economy. Towards this end, it shall conduct sound monetary policy and effective supervision over financial institutions under its jurisdiction.

Our Core Values

Integrity
Excellence
Patriotism
Dynamism
Solidarity

About the Bangko Sentral ng Pilipinas

The Congress shall establish an independent central monetary authority... (which) shall provide policy direction in the areas of money, banking and credit. It shall have supervision over the operations of banks and exercise such regulatory powers as may be provided by law over the operations of finance companies and other institutions performing similar functions.

- Section 20, Article XII, 1987 Philippine Constitution

The State shall maintain a central monetary authority that shall function and operate as an independent and accountable body corporate in the discharge of its mandated responsibilities concerning money, banking and credit. In line with this policy, and considering its unique functions and responsibilities, the central monetary authority established under this Act, while being a government-owned corporation, shall enjoy fiscal and administrative autonomy.

- Section 1, Article 1, Chapter 1
Republic Act No. 7653 (The New Central Bank Act)

The BSP's Legal Mandate

The BSP is the central bank of the Republic of the Philippines. It was established on 3 July 1993 as the country's independent central monetary authority, pursuant to the Constitution and Republic Act No. 7653 or the New Central Bank Act. The BSP replaced the old Central Bank of the Philippines, which was established on 3 January 1949.

As the Philippines' central monetary authority, the BSP is responsible, among other things, for:

- Maintaining price stability conducive to a balanced and sustainable growth of the economy;
- Maintaining financial stability by ensuring that the banking system is sound and stable; and
- Ensuring the safe, timely, and accurate payment and settlement of financial transactions.

Powers and Functions

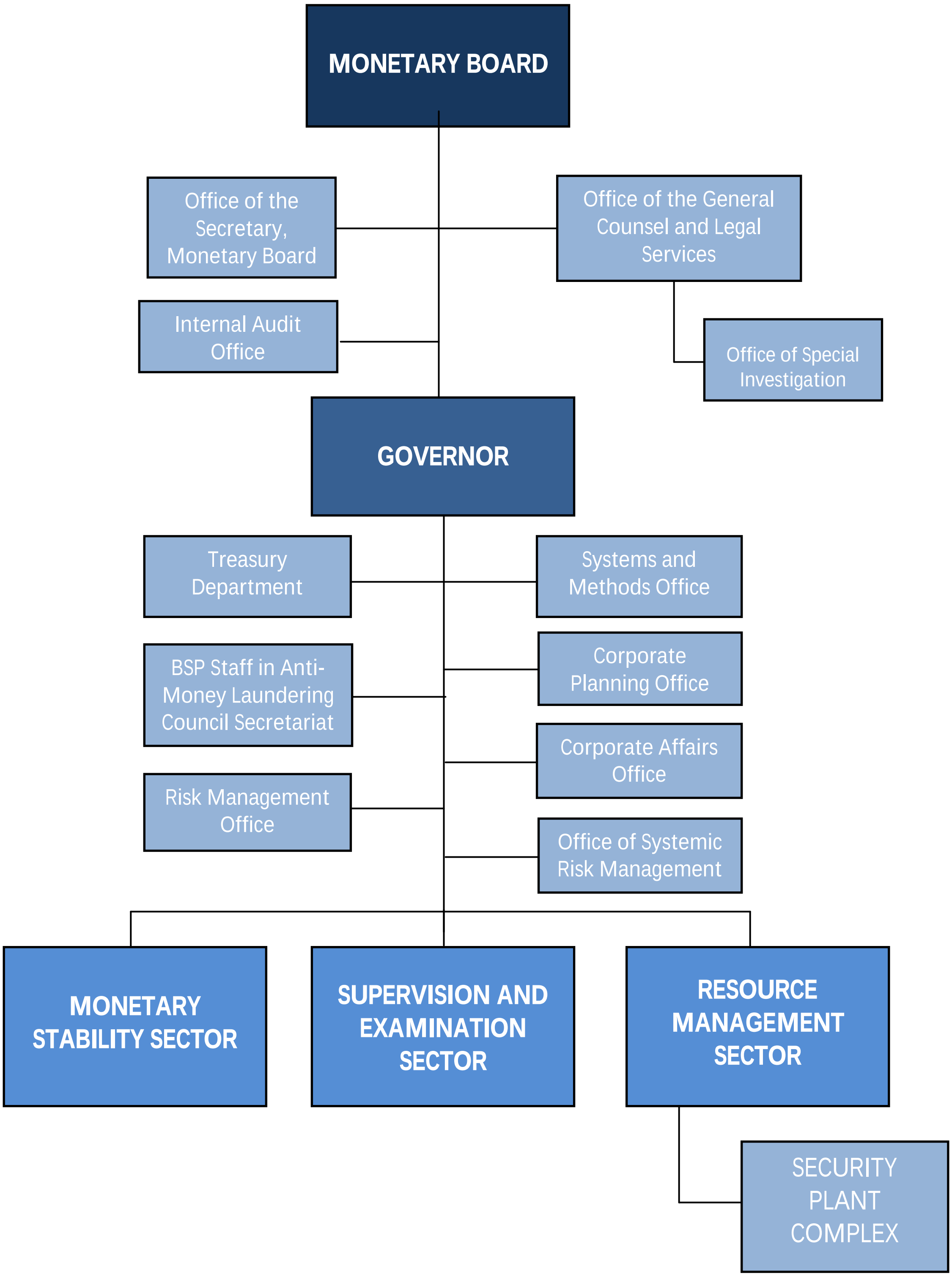
The BSP charter also designates the BSP to perform the following functions:

- *Liquidity management*. The BSP formulates and implements monetary policy aimed at influencing money supply consistent with its primary objective of maintaining price stability.
- *Currency issue.* The BSP has the exclusive power to issue the national currency. All notes and coins issued by the BSP are fully guaranteed by the government and are considered legal tender for all private and public debts.
- *Lender of last resort.* The BSP extends discounts, loans, and advances to banking institutions for liquidity purposes.
- *Financial supervision.* The BSP supervises banks and exercises regulatory powers over non-bank institutions performing quasi-banking functions.
- *Management of foreign currency reserves*. The BSP seeks to maintain sufficient international reserves to meet any foreseeable net demands for foreign currencies to preserve the international stability and convertibility of the Philippine peso.
- *Determination of exchange rate policy.* The BSP determines the exchange rate policy of the Philippines. Currently, it adheres to a market-oriented foreign exchange rate policy such that its role is principally to ensure orderly conditions in the market.
- *Other activities.* The BSP functions as the banker, financial advisor, and official depository of the Government, its political subdivisions and instrumentalities, and government-owned and -controlled corporations.

The New Central Bank Act imposes limitations and other conditions on the exercise of such powers by the BSP. Among others, the charter limits the circumstances under which the BSP may extend credit to the government and prohibits it from engaging in development banking or financing.

Organizational Structure

As of 31 December 2016



The **Monetary Board** issues rules and regulations necessary for the effective discharge of the responsibilities and exercise of the powers vested upon the BSP. Its chairman is the BSP Governor, with five full-time members from the private sector and one member from the Cabinet.

The **Governor,** as the chief executive officer of the BSP, directs and supervises the operations and internal administration of the BSP.

The BSP is organized into the following functional groupings:

- **Offices under the Monetary Board and the Governor,** which render various administrative support to the Monetary Board or to the Governor and provide support in the formulation and application of the BSP's strategic plans, practices, and procedures. These offices are collectively referred to as the Executive Management Services;
- **Monetary Stability Sector,** which takes charge of the formulation and implementation of the BSP's monetary and macroeconomic stabilization policies;
- **Supervision and Examination Sector**, which enforces and monitors compliance with banking laws and regulations to promote a sound and healthy financial system;
- **Resource Management Sector,** which serves the human, financial, and physical resource needs of the BSP; and
- **Security Plant Complex,** which produces Philippine currency, security documents, and commemorative medals and medallions.

Governance

The Monetary Board

Chairman & Governor
Amando M. Tetangco, Jr.

Members
Carlos G. Dominguez III
Alfredo C. Antonio
Felipe M. Medalla
Armando L. Suratos
Juan D. De Zuñiga, Jr.
Valentin A. Araneta

Executive Management Services

Ma. Ramona Gertrudes D.T. Santiago
Assistant Governor

Elmore O. Capule
Assistant Governor and General Counsel

Johnny Noe E. Ravalo
Assistant Governor

Edna C. Villa
Assistant Governor

Julia C. Bacay-Abad
Executive Director II

Monetary Stability Sector

Diwa C. Guinigundo
Deputy Governor

Wilhelmina C. Mañalac
Managing Director

Iluminada T. Sicat
Managing Director

Augusto C. Lopez-Dee
Managing Director

Francisco G. Dakila, Jr.
Managing Director

Carlyn A. Pangilinan
Managing Director

Supervision and Examination Sector

Nestor A. Espenilla, Jr.
Deputy Governor

Leny I. Silvestre
Managing Director

Chuchi G. Fonacier
Managing Director

Restituto C. Cruz
Managing Director

Resource Management Sector and Security Plant Complex

Vicente S. Aquino
Deputy Governor

Dahlia D. Luna
Assistant Governor

Eduardo G. Bobier
Managing Director

Elvira E. Ditching-Lorico
Managing Director

Paterson L. Encabo
Managing Director

Silvina Q. Mamaril-Roxas
Managing Director

Gerardo K. Galvey
Managing Director

Enrique C. Domingo
Executive Director II

How the Philippine Economy Performed in 2016

Global Economic Growth Remains Sluggish

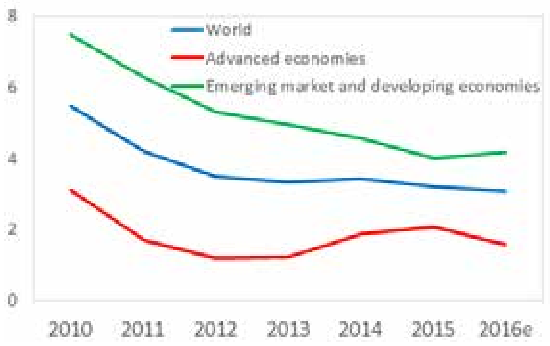
The Philippine economy continued to tread a difficult global operating environment, which was characterized by sluggish recovery and fragile growth prospects.

Global growth in 2016 remained slow and more diverse among different country groups. Advanced economies (AEs) recorded growth, which was supported by improvements in manufacturing output, employment and consumer demand. The US led the recovery among AEs, recording higher GDP growth compared to 2015 and rising consumer prices while labor market conditions returned to pre-crisis levels. In Europe, third quarter growth was stronger than expected in the United Kingdom (UK), Germany and Spain while output remained below market potential for some economies in the euro area. In Japan, estimates suggest that growth was stronger than previously estimated.[1]

Growth for most EMDEs weakens

Meanwhile, growth momentum for most of emerging markets and developing economies (EMDEs) weakened while becoming more uneven in 2016. Growth among Latin American countries such as Brazil and Mexico was marked down amid tightening financial conditions. For ASEAN-5, growth was also downgraded with Indonesia's weak private investments and Thailand's slowdown in consumption and investment. China, on the other hand, showed recovery, albeit marginal, as fiscal stimulus supported economic activity during the year.

Chart 1.1 World GDP Growth
At constant prices, y-o-y percent change



Source: IMF World Economic Outlook (WEO), January 2017 update

The sluggish recovery of the global economy was further affected by the occurrence of multiple non-economic tail events which dampened investor sentiment and led to occasional bouts of volatility in global financial markets. In particular, on 24 June 2016, the UK voted to leave the European Union (EU) – referred to as Brexit – unleashing huge uncertainty on the economic prospects of UK and EU. The outcome of the US elections in November 2016 likewise surprised markets, as the campaign for protectionist and anti-immigration policies created new uncertainties for the global economy. There were also geopolitical tensions and terrorist attacks that heightened market anxiety.

The divergence of monetary policies among AEs and its impact on domestic financial conditions

[1]Growth estimates were based on the IMF World Economic Update, January 2017.

persisted during the year-in-review. The spillovers from the expected monetary policy normalization in the US and the uncertainty over the Brexit outcomes affected the pickup of EMDE's growth.

These factors constituted an environment of radical uncertainty in the global economy.[2] It has resulted in generally weaker risk sentiment and bouts of volatility as markets were often surprised by increased frequency of shocks.

In the medium term, while most Asian countries may benefit from better global growth, they will continue to be exposed to higher interest rates and weaker currencies especially countries with substantial debt overhang. Moreover, the growing political uncertainty such as protectionist or inward-looking policies in the US expose countries in Asia to a potential rise in trade barriers and reduction in policy buffers that could increase financial and economic stress of export-dependent economies.

Against such economic landscape, authorities have become keener on limiting the build-up of vulnerabilities. Economic policies have been geared toward strengthening fundamentals and building resilience. Volatilities might be inevitable in the current uncertain environment but stronger fundamentals and a healthier banking system can play a role to keep the economy's balance. To this end, monetary authorities will remain steadfast in macroeconomic surveillance and in adhering to sound monetary policymaking. Reforms to further strengthen the financial system will be pursued and policies that support a stronger external position will be employed.

[2] Radical uncertainty refers to uncertainty so profound it is impossible to represent the future in terms of knowable and exhaustive list of outcomes to which we can attach probabilities (King, Mervyn (2016). The End of Alchemy: Money, Banking and the Future of the Global Economy)

Box Article 1

Brexit: Does the Philippines Need to Worry?

Brexit into Uncertainty

UK's decision to leave the EU on 23 June 2016, widely known as Brexit, can be considered as one of the "black swan" events of 2016.[3,4] To many pundits, this event marked an end of an epoch and ushered in a new era of radical uncertainty.[5] According to the International Monetary Fund (IMF) (2016), Brexit and the uncertainty associated with Britain and Europe's future economic relationship imply substantial increase in economic, political, and institutional risks.[6] These risks are projected to have significant macroeconomic and financial consequences, not only for Britain and Europe, but also for the rest of the world. This article discusses the potential economic impact of Brexit on the Philippine economy.

Brexit in Context

Brexit basically means that the UK is withdrawing its membership from the EU – a political and economic union of 28 member-states which are primarily located in Europe. It is a single market where people, goods, services, and capital can freely move among member countries. In exchange, member countries pay a certain amount in the form of fiscal transfers.

With the vote to leave, UK can no longer enjoy unfettered access in the EU market bloc. In other words, movement of goods, persons, services, and capital between UK and EU members will now be subject to new restrictions or regulations. The exact nature of these agreements will be decided through series of negotiations once Article 50 is triggered.[7]

Life after Brexit: an Amicable Separation or Painful Divorce

Negotiations under Article 50 would involve matters relating to immigration and laws where UK has ceded sovereignty to EU, among others. Nonetheless, policymakers and observers would agree that trade will be one of the most contentious issues in the negotiations that would ensue. Studies have identified the following potential scenarios how the UK and EU economic relationship would evolve post Brexit (Dhingra and Sampson, 2016):

1. **The Norwegian Model**. One option is 'doing a Norway' and joining the European Economic Area. This would minimize the trade cost of Brexit, but it would mean paying about 83.0 percent as much into the EU budget as the UK currently does. It would also require keeping current EU regulations (without having a seat at the table when the rules are decided).

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[3]A "black swan" is an event or occurrence that is unexpected, seemingly irrational and difficult to predict. The term was popularized by Nassim Taleb.
[4]The "black swan" events of 2016 included the unexpected outcome of the UK referendum on EU and the upset in the close race in the US presidential elections in November.
[5]As noted in the main text of the Report, radical uncertainty refers to uncertainty so profound it is impossible to represent the future in terms of a knowable and exhaustive list of outcomes to which we can attach probabilities. King (2016)
[6]IMF(2016)
[7]Article 50 of the Treaty of Lisbon contains the rules of exit from EU. It will be triggered by the exiting country to formalize the process and will normally be followed by a 2-year negotiation. If no agreement is finalized, withdrawal becomes effective, unless there is consensus to extend negotiations. (www.telegraph.uk).

2. **The Swiss Model**. Another option is 'doing a Switzerland' and negotiating bilateral deals with the EU. Switzerland still faces regulation without representation and pays about 40.0 percent as much as the UK to be part of the single market in goods. But Switzerland has no agreement with the EU on free trade in services, an area where the UK is a major exporter of.

3. **World Trade Organization.** A further option is doing it alone as a member of the World Trade Organization. This would give the UK more sovereignty at the price of less trade and a bigger fall in income, even if the UK were to abolish tariffs completely.

Based on these scenarios, the London School of Economics' (LSE) Centre for Economic Performance (CEP) conducted an analysis on the impact of Brexit on the UK economy (Dhingra et al., 2016). The study assumes the following:

1. an 'optimistic scenario' of a Norwegian or Switzerland type of agreement resulting in small increases in trade costs between the UK and the EU; and,

2. a 'pessimistic scenario' where no favorable trade agreement is arranged thereby leading to larger increases in trade costs.

In the optimistic case, Brexit reduces UK income by 1.1 percent of GDP. In the pessimistic case, UK income falls by 3.1 percent (£50 billion per year).[8]

In the long run, reduced trade may lead to slower productivity growth. Factoring in these effects could easily more than double the costs of Brexit and lead to a loss in the pessimistic case comparable to the decline in UK GDP during the global financial crisis (GFC) of 2008-09.[9]

Mapping the Brexit Channel: Impact on the Philippines

Assessing the magnitude of the impact of Brexit is difficult given that the Brexit is just unfolding. Nonetheless, the likely impact of Brexit on the Philippines can be felt via two channels: 1) trade or real channel; and 2) financial sector channels. Data suggest that the Brexit's impact on the Philippines via these two channels appear to be muted and manageable.

Trade channel

In terms of the trade channel, linkage with UK remains important but limited, suggesting dampened first round effects (Table 1). For the period January-October 2016, Philippine exports to UK only account for 0.9 percent of the country's total exports. Meanwhile, imports from UK only amount to 0.6 percent of our total imports.

For the same period, gross placement of foreign direct investments (FDI) from the UK represented about 0.8 percent of FDI in the Philippines. Gross placement of foreign portfolio investments (FPI), however, accounts for

[8] The scenarios are based on the type of trade agreement between UK and EU will be reached following the Brexit.
[9] Meanwhile, a study by Her Majesty's (HM) Treasury point to two scenarios: "shock" and "severe shock," where the negative impact reaches 3.6 and 6.0 percentage points of GDP respectively over two years, which would bring the British economy into a recession.

29.5 percent of total FPI in the Philippines for 2016. This is larger than the share of foreign portfolio placement of EU (sans UK) of 15.3 percent during the same period. Lastly, remittances from OFs in the UK only represented 5.3 percent of the country's total remittances for the period January-December 2016.

Table 1. Philippine Bilateral Relations with UK	
Indicators	**UK**
% of Total Exports (Jan-Oct 2016)	0.9
% of Total Imports (Jan-Oct 2016)	0.6
% of Total Gross FDI (Jan-Oct 2016)	0.8
% of Total Gross Placement of FPI (Jan-Dec 2016)	29.5
% of Total Remittances (Jan-Dec 2016)	5.3

Source: BSP

Financial channel

The impact of Brexit could also be felt via the financial markets through heightened global risk aversion. A day after Brexit, Philippine financial markets' kneejerk reaction was marked with turbulence and volatility. However, it can be noted that markets recovered quickly.

On 24 June 2016, the local equities market ended negative as the PSEi declined by 1.3 percent in line with most Asian equities. As of 21 July however, the PSEi recovered as the index increased by 6.2 percent from its 24 June 2016 level (Figures 1 and 2).

Figure 1

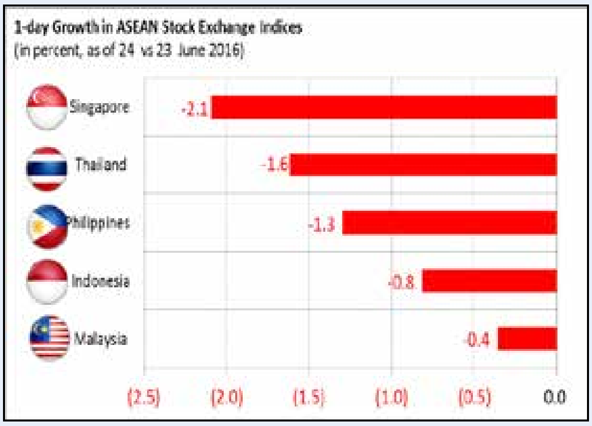
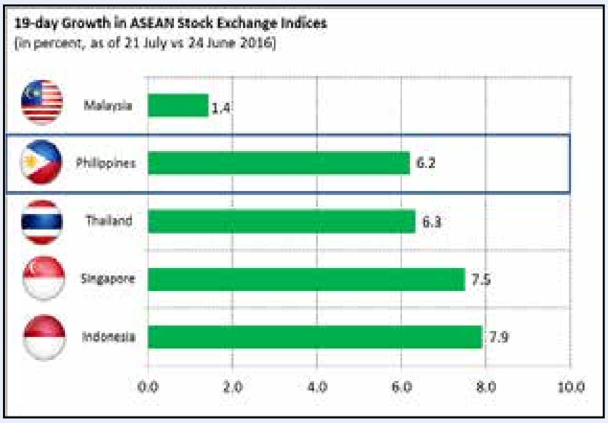


Figure 2



Meanwhile, the peso depreciated against the US dollar following the voting results by 0.9 percent on 24 June 2016 (Figures 3 and 4). This was in tandem with most Asian currencies which depreciated against the dollar except for the Japanese yen, which was considered as a safe-haven asset. As of 21 July, the peso continued to depreciate but at a lesser extent while most Asian currencies have rebounded against the US dollar.

Figure 3

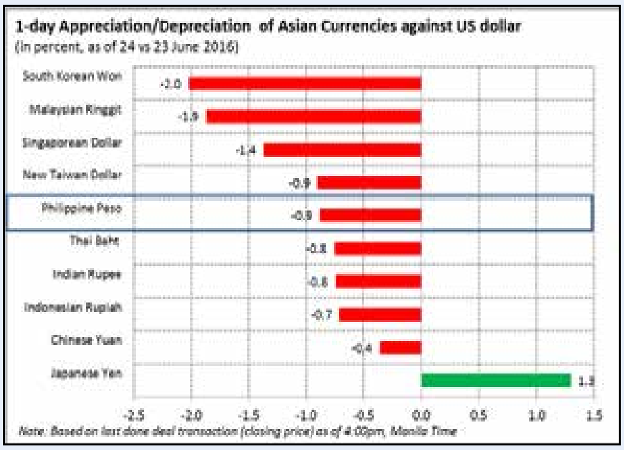
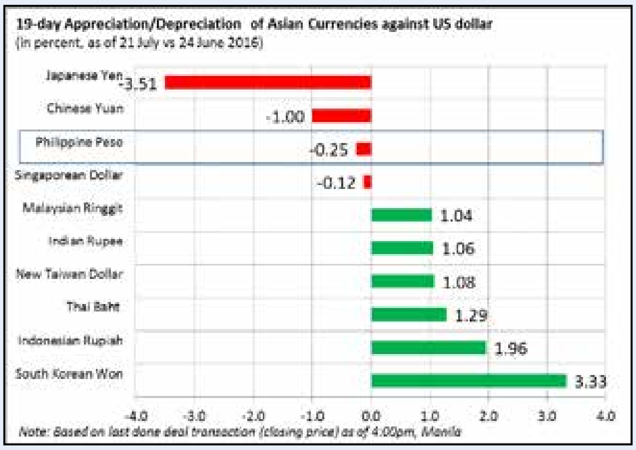


Figure 4



Crunching the Numbers

The BSP's Department of Economic Research's (DER) model-based assessments also find Brexit's impact on the Philippines to be subdued. To assess Brexit's impact on key Philippine macroeconomic variables, a simulation exercise was conducted under an adverse and a limited scenario similar to that conducted by the London School of Economics (LSE). Adverse scenario is similar to UK reverting to WTO agreements while the limited scenario is similar to the Norway agreement.[10]

Overall, Brexit was estimated to have a limited impact on the Philippine output and inflation in both adverse and limited scenarios. Results suggest that the one-year impact on GDP is almost nil, while the reduction in GDP over a two-year horizon is less than half a percentage point in both scenarios. At the same time, inflation is expected to rise slightly but will remain within the Government's announced inflation target range over the policy horizon even with the impact of Brexit.

Impact on Financial Markets

Brexit's spillover effects on key Philippine financial markets were also measured using the DER's Financial Market Spillovers Indices. These provide measures of volatility of returns spillovers using variance decompositions obtained from generalized vector autoregressive (VAR) model.[11]

Figures 5 and 6 indicate that on the day the referendum results were announced (24 June 2016), the Philippine Equities Volatility Spillover Index and the Peso Volatility Spillover Index increased from 26.4 percent to 77.4 percent and 35.9 percent to 64.3 percent, respectively. While the changes are significant, the increases in the indices were lower than the GFC levels. It can also be observed that the indices normalized relatively faster after the Brexit vote.

[10]The limited scenario refers to a more optimistic European Economic Area (EEA)-type regime similar to Norway. In this scenario, households and firms are relatively confident about the new long run. Hence, uncertainty dissipates relatively quickly. On the other hand, adverse scenario refers to a pessimistic regime where UK reverts to WTO rules.

[11]Details on the methodology are provided in a study by Allon, J., Delloro V., Fernandez J.R, A. "Measuring Philippine Financial Market Spillovers: A Variance Decomposition Approach."

Figure 5

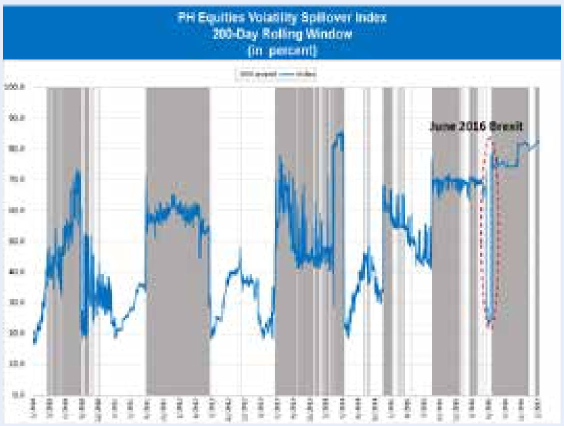
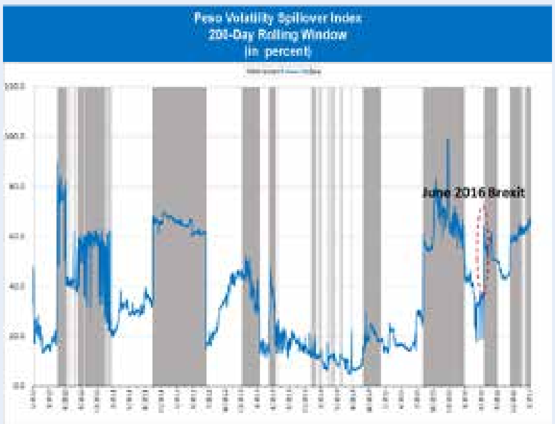


Figure 6



Source: BSP staff estimates

Conclusion

Initial assessments suggest that the Philippines need not worry about the potential spillover impact of Brexit. However, developments from Brexit are just unfolding and risks, depending on how the terms of engagement with EU would be handled, could potentially escalate and lead to significant second round effects.

However, the BSP stands ready if the situation worsens. The BSP has an ample menu of policy options to mitigate the impact from Brexit, including dollar and peso liquidity measures and the tapping of regional firewalls such as Bilateral Swap Agreements (BSA) with Japan, among others.

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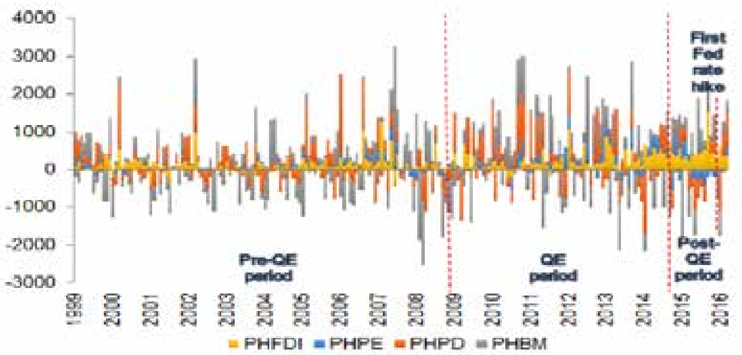
Box Article 2

Fed Normalization and Implications for the Philippines: A Capital Flow Perspective[12]

Introduction

The GFC, which started in mid-2007, prompted the US Federal Reserve (US Fed) to use unconventional monetary policy tools (i.e., setting its interest rate to zero lower-bound and conducting quantitative easing or QE measures) aimed at reviving the growth of the US economy.[13] Throughout this period, surges in capital flows have been observed in emerging market economies (EMEs). In the Philippines, surges in capital flows became apparent starting in 2010 (Figure 1).

Figure 1: Gross Private Capital Inflows into the Philippines (in million US$, Jan 1999-Mar 2016)



Source: Bangko Sentral ng Pilipinas (BSP) 2016
Note: Data from 1999-2004 are compiled using the Balance of Payments Manual Five (BPM5) framework while data from 2005-present are compiled using the Balance of Payments Manual Six (BPM6) framework. PHFDI, PHPE, PHPD, and PHBM mean foreign direct investment, portfolio equity, portfolio debt securities, and bank and money market inflows, respectively. The data are derived from the Balance of Payments Statistics.

However, reversals of greater magnitude have since been observed in the EMEs, including the Philippines, during the following episodes: (1) the announcement by former US Fed Chairman Ben Bernanke of the possibility of tapering the Fed's bond purchases in May 2013; (2) the announcement of the US Fed that it would start the tapering process in December 2013, continuing after the end of QE in October 2014; and (3) the pronouncement of the US Fed of its first rate hike in December 2015. Extreme movements in capital flows in response to the US monetary policy actions have important implications on domestic capital management measures. In particular, with the resumption of the Fed rate hike as US macroeconomic conditions strengthen, EMEs would have to come up with policy imperatives to counter extreme capital flow volatilities and at the same time build cushions to ensure resilience.

[12]Excerpt from Sabuga, I. and Rico Shirakawa, J.B. (2016).
[13]From November 2008 to March 2010, the US Fed implemented its first QE and purchased US$1.75 trillion in long-term Treasuries, including debt issued by Fannie Mae and Freddie Mac, and fixed-rate mortgage-backed securities (MBS) guaranteed by those agencies (Haltom and Wolman, 2012). Similarly, another tranche of QE was implemented from November 2010 through June 2011 where the US Fed purchased US$600 billion worth of long-term Treasuries. In September 2012, the US Fed again announced that it would purchase US$40 billion in agency-backed MBS per month, also known as QE3, until US economic conditions improve substantially.

While studies have shown that previous episodes of EME currency crises (i.e., Latin America in 1982, Mexico in 1994, and Asia in 1997) were characterized by surges in capital flows that were subsequently followed by reversals or “sudden stops”, some recent studies have narrowed down the effects of the US unconventional monetary policy and its normalization on the behavior of specific capital flows. These studies stress that different types of capital flows could be more sensitive to changes in monetary policy and that some capital flows may have different implications for financial stability of recipient countries.[14]

This article explores the case of the Philippines as an example of a small-open economy. In particular, it seeks to: (1) determine the impact of the US unconventional monetary policy and its normalization on the dynamics of capital inflows into the Philippines, particularly the relatively volatile flows namely: portfolio equity; portfolio debt securities; and other investments (mostly composed of bank and money market flows); and (2) present policy imperatives for the Philippines in dealing with capital flow volatility. The analysis measures the magnitude and persistence of the US monetary policy shocks (i.e., QE and US policy normalization) on specific types of capital inflows, using both “push” and “pull” factors in a structural vector autoregression (SVAR) model.

In investigating the impact of US unconventional monetary policy and its normalization as global push factor. The box article considers the following volatile flows: portfolio equity, portfolio debt securities, and bank and money market. The Philippine capital flows are represented by the following variables of interest:

- Philippine portfolio equity inflows scaled as a percentage of nominal GDP;
- Philippine portfolio debt securities inflows scaled as a percentage of nominal GDP; and
- Philippine bank and money market inflows scaled as a percentage of nominal GDP.

The US unconventional monetary policy and its normalization can impact capital inflows of a small open economy through three main channels, namely: (1) portfolio balance channel - suggests that the purchase made through QE reduces the supply of US assets to private investors and therefore demand for substitute assets (i.e., EMEs assets) increases as investors adopt riskier behavior in search of higher yields (Chen et al., 2013);(2) signaling channel - underscores the importance of the US Fed actions as a way of providing information on the current state of the US economy, which consequently influences the appetite of investors as reflected in their investment decisions (Bauer and Rudebusch, 2013); and (3) liquidity channel - indicates that QE could improve market functioning and decrease liquidity premia. This, in turn, encourages investors away from US bonds to non-US bonds (Fratzscher et al., 2013).

Testing the impact of global or “push” factors and their corresponding channel made use of the following:[15]

- A variable representing the US unconventional monetary policy or level of liquidity (QE) in the US as proxied by M2 or broad money in the US. This variable captures the liquidity and portfolio balance channels;
- Variables representing US policy normalization: (1) expected US policy rate path as proxied by Fed funds futures rate to capture the change in expectations, part of the signaling channel; and (2) a dummy variable captures surprise changes in the US monetary policy through announcement (i.e., taper tantrum, start of

[14]See Suh and Koo (2016), Lim, et. al (2014), De Gregorio (2014) and Sun(2015)
[15]Similar variables, except USSIG, are also used in previous studies such as Culha (2006), Korap (2010), Dahlhaus and Vasishtha (2014), Lim et al. (2014), Koepke (2015), and Suh and Koo (2016).

QE tapering, end of QE, and first Fed rate hike). The study examines the impact of a surprise change on the timing of the implementation of the policy normalization. However, there is no consensus yet among empirical studies about the impact of the timing. Koepke (2015) shows that the effect of monetary policy on EMEs' capital inflows may also be due to the element of surprise. On the other hand, Lim et al. (2014) show that regardless of whether normalization occurs gradually or rapidly, on average, gross capital flows-to-GDP increase by 0.08 percent during QE and decrease by 0.6 percent when policy normalization continues until the end of 2016.

- A variable representing change in market sentiments (i.e., business or household) represented by the US Chicago Board Options Exchange volatility index to capture the confidence channel effects, which is also part of the signaling channel.

To control for the potential domestic factors affecting capital flows, the following domestic or "pull" factors are added in the SVAR model:[16]

- Philippine short-term interest rate;
- Philippine real effective exchange rate; and
- Philippine industrial production index.

The study uses publicly available monthly data from January 2008 to March 2016.[17]

Empirical Results and Discussion

Table 1: Summary of Results on the Impact of the US Unconventional Monetary Policy and Its Normalization on Capital Inflows into the Philippines[18]

Variable of Interest	Magnitude (in percent)	Persistence
	Shock to USLIQ	
SPHPE	0.01(M1); 0.01(M2); 0.06(M3)	M3
SPHPD	-0.22(M1); 0.24(M2);-0.34(M3)	M3
SPHBM	0.23(M1); 0.14(M2); 0.34(M3)	M3
	Shock to USSIG	
SPHPE	-0.03(M1); 0.16(M2)	M2
SPHPD	-0.26(M1); -0.28(M2)	M2
SPHBM	-0.22(M1); -0.54(M2)	M2
	Shock to USFUT	
SPHPE	-0.16(M1)	M1
SPHPD	-0.25(M1); -0.63(M2); -0.13(M2)	M3
SPHBM	-0.16(M1); -0.60(M2); -0.34(M3); -0.14(M4); -0.06(M5);-0.03(M6)	M6

Notes: The confidence intervals estimated for some variables are large, hence, it is necessary to consider some margins of uncertainty in interpreting the results. Once the plus and minus one standard error bands are added, we can see how significant these effects are. From the results, it shows that only the impact of a shock to *USLIQ* on *SPHBM* in period three; *USSIG* on *SPHPE* in period two and *SPHBM* in period three; and *USFUT* on *SPHPE* in period one, *SPHPD* in period two, and *SPHBM* beginning period two (i.e., M2) are significant at +/- 1 S.E.

[16] The same variables are also used in previous studies such as Culha (2006), Korap (2010), Lim et al. (2014), and Suh and Koo (2016).
[17] This time period is selected for the analysis to cover the year when QE measure was first implemented until the period of the latest available data. Kindly note that no significant change is observed in the results when the time period considered starts in November 2008 (i.e., the actual implementation of QE1). First log-difference transformations are applied to all variables, except USSIG, PHSTR, SPHPE, SPHPD, and SPHBM.
[18] Results show the impact of a one-standard deviation increase in the variables of interest (USLIQ,USSIG,USFUT).The variable names "SPHPE", "SPHPD", and "SPHBM" refer to Philippine portfolio equity inflows scaled as a percentage of nominal GDP, Philippine portfolio debt securities inflows scaled as a percentage of nominal GDP, and Philippine bank and money market inflows scaled as a percentage of nominal GDP, respectively. Meanwhile, the variable names "USLIQ", "USSIG", and "USFUT" refer to broad money in the US, dummy variable for surprise changes in US monetary policy, and US Fed funds futures rate, respectively. "M1", "M2", "M3", and "M6" pertain to the persistence of the corresponding variable (at the one-, two-, three-, and six-month lags, respectively).

The findings of this study show that among the different types of capital flows, bank and money market as well as portfolio debt securities flows face higher risks with QE and US policy normalization compared to portfolio equity. This is shown by the contrast between the large magnitudes in the response of bank and money market as well as portfolio debt securities flows to an impulse from US policy actions on the one hand and the relatively small impact of US policy actions on portfolio equity on the other hand. In general, these results are consistent with the findings of Suh and Koo (2016) as well as Dahlhaus and Vasishtha (2014), which observed that portfolio debt, and bank and money market inflows are more vulnerable to US monetary policy shocks compared to portfolio equity. Similarly, the said empirical results highlight the findings of De Gregorio (2014), which notes the important role of portfolio and banking flows during the GFC, more specifically the retrenchment of debt flows which was observed to be more severe. The findings that bank and money market and portfolio debt securities face outflow risks as a result of policy normalization imply that monetary authorities in the Philippines need to be vigilant, particularly on the possible reversals that can be triggered among portfolio debt, and bank and money market capital flows.

In addition, the impact does not last very long. The results of the impulse response functions show that the impact of shock from US monetary policy does not exhibit long periods of persistence. Shocks dissipate at most after the sixth month (see column 4 in Table1). Although the empirical findings show that the magnitude of the effect is relatively small and fleeting, capital reversals particularly those triggered by US policy normalization could affect the economy adversely if the exposure is large. The results likewise show that sudden reversals brought by US policy normalization is more pronounced than surges brought by QE.

Conclusion and Policy Implications

This study presents an empirical analysis on the impact of the US unconventional monetary policy and its normalization on the dynamics of the relatively volatile capital inflows (i.e., portfolio equity, portfolio debt securities, and bank and money market) into the Philippines using an SVAR model. Overall results suggest that of the three volatile capital inflows, the impact is more pronounced on portfolio debt securities as well as on bank and money market inflows. In other words, the impact on portfolio equity inflows is very small. Although the results also show that the effects of the US unconventional monetary and its normalization on the aforementioned volatile capital inflows are minimal when scaled in terms of GDP, there is a need to examine sources of vulnerability to capital surges and their subsequent reversals. In relation to this, the results show that the impact of US monetary policy normalization as measured by capital outflows is larger in magnitude compared to the effects of unconventional monetary policy in terms of capital inflows. Hence, capital reversals particularly those triggered by US policy normalization could adversely affect a small open economy if the exposure is large.

There are several implications of this analysis for the Philippines. First, a larger magnitude of capital inflows into the country as a result of QE could imply that a much larger capital outflow is expected during the succeeding US monetary policy normalization. Based on the empirical results, the most vulnerable capital flows could be traced from portfolio debt securities, and bank and money market (i.e., other investments) inflows. The results also highlight that prudent supervision of portfolio debt securities, and bank and money market flows are imperative in the case of the Philippines. Reforms that could enhance the stability of the banking system (i.e., ensure strong capitalization) and strengthen the monitoring of debt securities, especially external debt exposures, could help a small open economy like the Philippines cope with capital flow volatility.

Second, while global factors are the main drivers of the movements of capital flows, strong country fundamentals could mitigate the impact of adverse effects of shocks to capital flows such as that brought about by the impact of the US monetary policy. Healthy domestic macroeconomic fundamentals (i.e., robust economic growth, stable inflation, sound banking and financial system) could act as buffer to deal with capital surges and "sudden stops". Third, reforms implemented by the Philippines, particularly in enhancing the monetary and financial policy processes as well as the imposition of macroprudential measures have helped in managing the impact of capital flow volatility. While capital flow volatility is inevitable and is a permanent feature of a small open economy like the Philippines, empirical results show that the country's exposure to surges and sudden reversal is relatively small. In recent years, much more stable FDI flows drive majority of the composition of gross private capital inflows into the country. Therefore, continued efforts to promote the viability of the country as destination for FDIs are imperative to mitigate the impact of capital flow volatility.

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The Philippine Economy: Domestic Demand Remains Firm

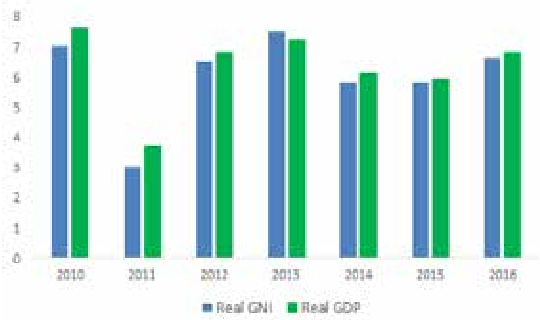
Aggregate output and demand. The Philippine economy registered solid growth in 2016 as real GDP expanded 6.8 percent, near the upper end of the 6.0 - 7.0 percent growth target of the national government (NG) for the year. On the demand side, the sustained strong performance of household consumption and investments contributed to output growth. On the supply side, growth impetus came from the steady firm numbers of both services and industry sectors. Growth in the services sector during the year was driven particularly by the real estate, renting and business activities, and financial intermediation. Meanwhile, the industry sector was boosted mainly by the sustained double-digit expansion posted by the construction subsector as well as the steady performance of the manufacturing subsector.

Philippine economy achieves upper end of growth target

Overall, internal sources of growth have kept the economy on high ground in 2016 despite growing global uncertainties. The expansion from domestic sources, which reached 11.5 percentage points (ppts), tempered the negative GDP growth contribution of 4.7 ppts by exports.

By industrial origin, the services sector continued to account for the bulk of the 2016 output growth as it contributed 4.3 ppts to the 6.8 percent GDP growth during the year. The 7.5 percent growth of the services sector was fuelled by the sustained expansion in retail estate, renting and business activities (9.1 percent); financial intermediation (7.7 percent); and trade and repair of motor vehicles, motorcycles, personal and household goods (7.3 percent). These services were supported by the sustained robust performance of the business process outsourcing (BPO) sector.

Chart 1.2. Real GNI and Real GDP
Annual growth, in percent



Source: Philippine Statistics Authority (PSA)

The Philippines is a top destination for information technology (IT)-BPO services and is considered a market leader. The IT-BPO sector has been growing by double-digit rates for the past ten years, supported by its voice sub-sector, which continues to be number one in the world in terms of market share; and by the growing non-voice sub-sector. In the non-voice sub-sector, healthcare information management, and animation and game development, in particular, grew by 26.8 percent and 29.4 percent in 2016, respectively.[19]

Another key pillar of the strong 2016 GDP outturn was the performance of the industry sector. The industry sector posted the strongest growth among the three sectors in 2016 at 8.0 percent, and contributed 2.7 ppts to the 2016 growth during the year. The sector has been growing by more than 7.0 percent over the past four quarters, boosted by the sustained double-digit growth of the construction subsector and the emergence of manufacturing as a key growth driver of the industry sector. The manufacturing sector expanded by 7.0 percent in 2016, backed by the five fastest growing manufacturing industries during the year, namely: office, accounting and computing machinery (44.0 percent), basic metal

[19] The Philippine IT-BPM Sector Roadmap 2022.

industries (39.1 percent), machinery and equipment except electrical (25.5 percent), transport equipment (25.0 percent), and rubber and plastic products (24.4 percent). Meanwhile, the 12.6-percent expansion of the construction subsector reflected the progress exhibited by both public and private construction. Public construction has been posting double-digit growth for the past seven consecutive quarters at an average of greater than 30 percent. This is due to the aggressive push of the government for the implementation of various critical infrastructure projects. Private construction continued to be bullish driven largely by the aggressive expansion of residential and commercial buildings amid continued strong demand for living, office and retail spaces as reflected in the reported strong 9.1-percent growth of the real estate, renting and other business activities, and ownership of dwellings subsector.

The agriculture, hunting, forestry, and fishing (AHFF) sector, which accounted for 8.8 percent of the country's full- year GDP, registered a contraction of 1.3 percent in 2016, slipping further from a meager growth of 0.1 percent the year before. This outturn in the AHFF sector slightly tempered real GDP growth by 0.1 ppt. The sector continued to reel from the effects of extreme weather disturbances such as the El Niño in the first two quarters, which reduced harvest areas and cut *palay* and corn production by 8.1 percent and 16.4 percent, respectively. The AHFF sector recovered in the third quarter with 2.9 percent growth, attributed mainly to the movement of *palay* and corn harvest to the third quarter due to late plantings in some areas heavily affected by the dry spell/drought. However, it returned to negative territory in the fourth quarter with the onslaught of six typhoons/tropical storms reflecting La Niña-like conditions, namely, "Igme" (1-3 October), "Julian" (4-6 October), "Karen" (12-16 October), "Lawin" (17-21 October), "Marce" (23-28 November), and "Nina" (22-27 December). These rains affected largely the main harvest season for rice, with the October-December 2016 *palay* production falling by 3.6 percent from the output for the same period in 2015.

By subsector, more than half of the 1.3 percent contraction in AHFF due to the decline in fishing gross value added (GVA) by 3.0 percent. The volume of fisheries production had also been affected by the hot sea surface temperatures brought about by the El Niño phenomenon. Major fruits such as banana and mango likewise recorded 2.0 percent and 10.1 percent declines in GVA, respectively, during the year. For bananas, the lower output could be attributed to smaller bunches harvested in some areas and the decrease in bearing hills due to the previous year's typhoons. Meanwhile, the negative output in mango production was mainly accounted for by lower yields in some areas affected by the dry spell such as Batangas, and North and South Cotabato.

On the demand side, the key drivers of the 2016 real GDP growth were the sustained strong performance of household consumption and capital formation. One key development during the year was that investments had overtaken household spending in both growth and contribution to the overall output growth. Investments, which grew by 20.8 percent, contributed 4.9 ppts to growth. Investments benefitted in part from the policies laid out and budget allocation provided by the government which focused on accelerating the implementation of critical infrastructure projects in the country.

Household spending remained a key pillar of domestic economic growth as it posted a 6.9 percent expansion and contributed 4.8 ppts to output growth. Household consumption during the year was buttressed by the benign inflation environment, low interest rates, as well as improving labor market conditions. Notably, the five top growing consumption items during the year were the following: transport (10.5 percent), communication, and restaurants and hotels (both 8.0 percent); health (7.4 percent), and education (7.0 percent). This trend could be an indication of an expanding middle class in the country, consistent with the results of a study which reported that the middle class spending behavior is generally toward increased human-capital-development-related expenditures.[20]

On the other hand, the improving savings rate[21] in the country in recent years provided room for greater investments and consumption. Latest available data show that the average savings rate in the country had been roughly constant for the period 2008-2015 at around 30.0 percent. A key challenge attributed to having high national savings is how to channel corporate savings to financing productive activities and how to direct household savings toward greater consumption to boost domestic demand.[22] Ultimately, the goal is to achieve sustainable and inclusive growth for the Philippine economy moving forward.

Medium-term developments and outlook

The Philippine economy expanded continuously over the past 10 years, with brisk growth after the global financial crisis (GFC) in 2008-2009. For the period 2007- 2016, the Philippine economy grew at an average of 5.6 percent. In the latter half of this period (2012-2016), growth averaged 6.6 percent.

The services sector (e.g., trade, real estate and renting activities, and financial intermediation) remained the key driver of growth of the Philippine economy. Nonetheless, the share of industry output (e.g., manufacturing and construction) has been expanding in recent years. The emergence of the manufacturing sector as a key contributor to output expansion has been a welcome transformation. It is the job-creating engine of the economy that has anchored its path to sustainable inclusive growth.

On the demand side, growth has historically been buoyed up by robust private consumption and, recently, by capital investments as well. It is worthy to note that in 2016, the contribution of investments to overall GDP growth outpaced that of private consumption. The continued solid performance of private consumption has been supported, in part, by sustained remittances from OFs.

Behind the country's economic achievements is a long history of purposeful and sometimes painful structural reforms, disciplined macroeconomic management, and improvements in governance. These include the full implementation of risk-based bank supervision (2007), privatization of the National Transmission Corporation (TransCo) and National Power Corporation's (NPC) assets (2009), adoption of phased-in migration to Basel III (2011), implementation of the revised excise tax rates on alcohol and tobacco (2013), liberalization of foreign bank entry in the Philippines (2014), passage of the Philippine Competition Act (2015), and further liberalization of foreign exchange regulations and implementation of the interest rate corridor system by the BSP (2016). These reforms contributed to the expansion of the role of market forces in key sectors of the economy, encouraging investments, ensuring fiscal sustainability, strengthening the banking system, promoting innovation and competition, and encouraging stronger private sector participation.

Meanwhile, the successful liberalization of key industries allowed the Philippine economy to

[20] Albert, Jose Ramon G., Gaspar, Raymond E.,and Raymundo, Martin Joseph M. (2015). "Why we should pay attention to the middle class." *Philippine Institute for Development Studies (PIDS) Policy Notes* No. 2015-13 (July 2015)

[21] Gross savings (net national savings plus depreciation) in percent of GNI at current prices; per PSA. Depreciation is now termed as consumption of fixed capital.

[22] Jha, Shikha, Prasad, Eswar, and Terada-Hagiwara, Akiko. (2009). "Saving in Asia and Issues for Rebalancing Growth," Asian Development Bank (ADB) Economics Working Paper Series No. 162, May 2009.

achieve higher potential growth and establish production efficiencies. Production efficiency has been improving through the years, as seen in the declining incremental capital-output ratio (ICOR) from 4.2 during 2002-2009 to 3.5 during the period 2010-Q3 2016 (Box Article 3).[23] In addition, potential output growth has been steadily rising alongside marked improvement in total factor productivity (TFP) growth. This is consistent with a declining ICOR as well as the observed structural shift in employment and production that requires higher levels of skills and knowledge. Lending support to this is the country's favorable labor dynamics as evident in the rise in the share of labor working under the wage and salary segment and the increase in the number of high school and college graduates, which implies an increase in potential trainable workforce.

Moving forward, the Philippine economy is expected to continue to perform strongly. The Philippine economy is poised to make headway in achieving its goals, particularly its 2017 growth target of 6.5 percent – 7.5 percent and medium-term target of 7.0 percent – 8.0 percent (2018-2022). Growth impulses are expected to come from homegrown sources of resilience – macroeconomic stability (improving growth, manageable inflation dynamics, and firmly anchored inflation expectations); comfortable domestic and external financial cushions; sound banking system (supported by sound and prudent supervisory and regulatory frameworks that limit excessive risk-taking without preventing the development of the domestic financial sector); and solid domestic demand base (supported by a young and economically active population).

[23] ICOR is a metric that assesses the amount of capital necessary to generate a unit of production.

Box Article 3

Does the Recent Philippine Growth Pattern Reflect Improvement in Productive Capacity?[24]

The series of structural and policy reforms in the last two decades, disciplined macroeconomic management, and governance reforms, along with the renewed commitment to further enhance the macroeconomic environment and social equity, have brought about an economic growth renaissance that could potentially become the norm for the Philippines. A key policy issue is whether these growth patterns translate into structural changes and the expansion in the economy's productive capacity.

Domestic demand expansion that is supported by a strong upturn in productive investment endogenously generates improvement in productive capacity, thereby allowing increase in both demand and potential output over the medium term. Monitoring and assessment of potential output growth is an essential element in the policymakers' analytical toolkit for medium-term macroeconomic forecasting and the determination of the stance of fiscal and monetary policies. It facilitates understanding of how the economy is "overworking or underworking its resources" and hence, provides an important gauge of the inflation dynamics in the economy (Jahan & Mahmud, 2013).

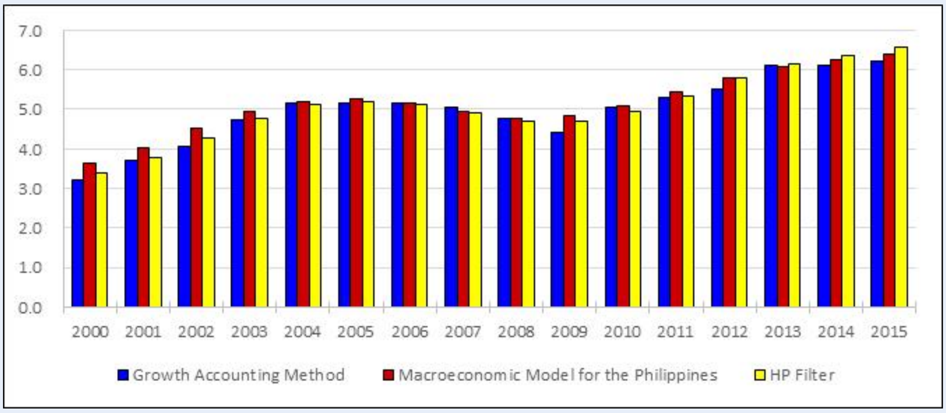
Policymakers look at various estimates of potential output growth, recognizing that these estimates will change over time with data revisions and new information. Empirical methods for extracting the unobservable trend component encompass statistical filters, multivariate filters, and structural approach. For the structural approach, the growth accounting method with Cobb-Douglas production function is standard in the literature.[25] In this approach, total factor productivity (TFP) growth is an important "unobservable" component that is analyzed alongside the growth of the factors of production, i.e., labor and capital. It also measures how the factors of production, including technological progress, are efficiently used. Considering the natural limits to input growth expansion, sustaining higher potential output growth would necessitate higher productivity growth.

[24] Technical details and complete analysis are found in the 2015 BS Review article entitled "Decomposing Potential Output Growth in the Philippines."
[25] Some of the studies that have Cobb-Douglas production function in their methodologies include those conducted by economists and researchers at the International Monetary Fund (Anand et al., 2014); Asian Development Bank (Jungsoo Park, 2010); Asian Productivity Organization (2012); European Commission (D'Auria et al., 2010); World Bank (Ghosh, 2010); and Philippine Institute for Development Studies (Cororaton, 2002; Llanto, 2012), among others.

Analytical Results

Estimates from various methods indicate that there has been a general improvement in potential output growth over time (Figure 1).

Figure 1. Historical estimates of different measures of potential output growth (in percent)



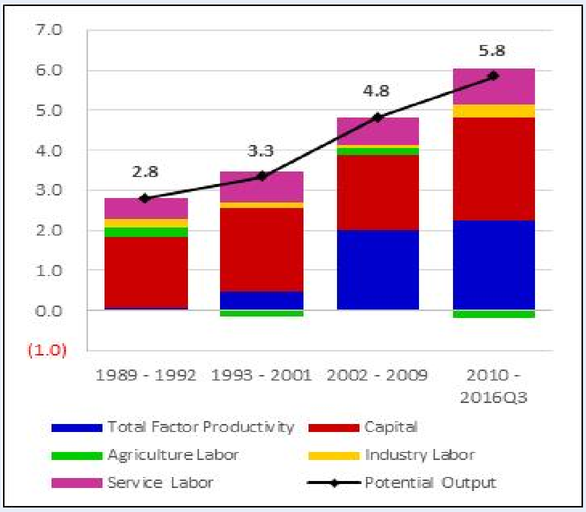
BSP staff estimates as of 16 January 2017
Note: The Hodrick Prescott (HP) filter is a univariate filter that relies on own history of the data and uses a smoothing parameter to extract the trend component. The Macroeconomic Model for the Philippines uses multivariate Kalman filter, which treats the filtering problem as a small system, where the estimates of potential output, inflation, and other parameters of the dynamic model are determined simultaneously.

The production function approach provides a useful framework for decomposing proximate sources of potential output growth and in analyzing both historical and future changes (Anand et al., 2014). BSP staff estimates (Figure 2) indicate that capital has the highest contribution to growth with the share of TFP rising over time, a finding consistent with the earlier study of Cororaton (2002) and more recent work of Anand et al. (2014). This is also in sync with the declining estimates of incremental capital output ratio or ICOR (Figure 3).

In terms of sectoral labor contribution to potential output growth, the services sector accounts for the biggest share. Agricultural labor contributed least to growth. Industrial labor likewise showed a declining contribution to potential output growth, although a reversal is seen in the post-global financial crisis period. This trend may have reflected inadequate diversification of growth across industries. Efforts to reverse the uneven industrial policy have gained ground through the implementation of the Comprehensive National Industrial Strategy (CNIS). The CNIS, which has been in effect since 2012, is designed to generate higher quality jobs and enable domestic industries to become competitive both in the local and global markets through enabling policies and support measures.[26]

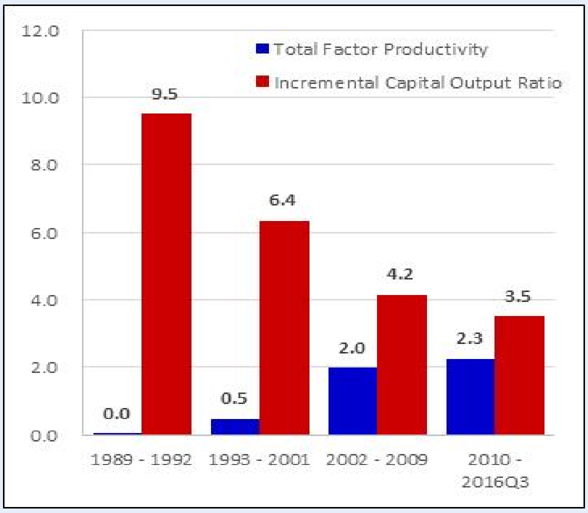
[26] http://industry.gov.ph/comprehensive-national-industrial-strategy (accessed on 17 January 2017).

Figure 2.Decomposition of potential output growth using growth accounting method



BSP staff estimates as of 16 January 2017

Figure 3.TFP using growth accounting method and incremental capital-output ratio



BSP staff estimates as of 16 January 2017

Policy Implications

The gains from previous reforms and the continued adoption of an inclusive socioeconomic agenda by the government bode well for the economy's potential growth prospects. With rising potential output growth, the scope for sustained productivity growth improvement has to be supported by, at least, steady macroeconomic, institutional and social reform momentum. For instance, the planned massive spending on infrastructure and social investment that are to be bankrolled by wide-ranging tax reforms could significantly transform the country's growth trajectory.

Prospectively, the structural policy imperatives include, among others, well-designed and growth-critical infrastructure development programs; institutional reforms that facilitate business development; greater diversification into higher value-added products and services; agricultural value chain development to improve agricultural productivity; generation of adequate and better-quality jobs; educational reforms and continuous upgrading of skills-development programs designed to develop a deeper and stronger talent pool with higher quality skills needed by industries; encouraging technological innovations; and livelihood and skills training intervention programs for those who cannot afford to have tertiary education. On its part, the BSP's disciplined approach to the fulfillment of its price stability mandate would, to use Poole and Wheelock's argument (2008), "reduce fluctuations in real economic activity and allow better management of financial and liquidity crises." Thus, the strategic pursuit of financial sector reforms and financial inclusion policies need not be constrained by the price stability objective.

To better improve the decomposition of potential output growth, areas of future research include estimating the human capital development component of labor and identifying the determinants of TFP. The generation of official aggregate capital stock series and micro-based estimates of capital stock and depreciation rates for sectoral productivity analysis would represent a significant stride in understanding the development of productivity growth and potential output growth in the Philippines.

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Box Article 4

Analyzing the Trends and Developments in the Household Sector's Economic Behavior

Introduction[27]

The household sector's economic behavior is a key variable in the development of economic models to craft responsive policy interventions.[28] In the Philippines, which is a consumption-driven economy, household final consumption expenditure (HFCE) constitutes the bulk of GDP and gross national income (GNI) with an average share of 73.1 percent and 60.6 percent, respectively, from 2010 to 2015. [29,30] This is significantly higher than the 50 percent average share of HFCE to GDP recorded in the East Asia and Pacific Region.[31] Meanwhile, the average shares or contributions of households' savings to GDP and to gross national savings (GNS) are substantially low at 0.8 percent and 2.9 percent, respectively.

Although this trend could generally be viewed as normal and a positive consequence of favorable macroeconomic developments in the country, it could also raise concerns about its implications on the country's long term economic performance. While consumption induces interim and short-term effect on economic output, sustainable and long-run economic development could depend on the amount of savings and investment in the economy. This article provides a reference scenario in understanding the household sector's economic behavior, through the lens of marginal propensities to consume (MPC) and to save (MPS) as well as other related indicators, covering the period 2011-2015.[32, 33]

Household Sector's Economic Trends and Behavior

The HFCE has been a steady driver of the country's strong economic performance, with real growth rate averaging 4.9 percent during the past 15 years.[34] The average growth in consumption expenditure was at 4.3 percent for the past decade (2000-2010). For the last five years (2011-2015), average growth increased to 5.9 percent. The higher growth in consumption spending during the period was made possible by a low and stable inflation[35] and the steady rise in household disposable income (HDI).[36] A low and stable inflation environment mitigates the erosion in household income's purchasing power and at the same time enables households to better plan their spending. The increase in HDI is on account of the decrease in unemployment, sustained inflows of OFs remittances, and the series of minimum wage hikes during the period.[37,38]

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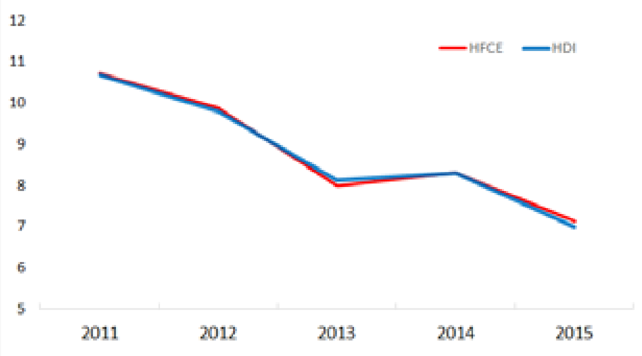
[27]The data used in the discussion are sourced from the Philippine Statistics Authority's (PSA) National Accounts, Consolidated Accounts: Household Sector's Income and Outlay Series, and The World Bank statistics.
[28]Household sector, as defined in this article, refers to all resident households in the Philippines.
[29]HFCE, as defined in the 2008 System of National Accounts (SNA), consists of expenditures incurred by resident households on consumption goods or services.
[30]On average, only about 20 percent and 16.9 percent of GDP and GNI, respectively, constitutes investment spending. While the share of investment spending is low, this has been increasing in recent years. In 2016, the contribution of capital formation to GDP was 26.9 percent.
[31]Source: The World Bank
[32]Due to the unavailability of a longer time-series data on household sector's net savings, the periods considered in this article cover 2010-2015 only.
[33]MPC refers to the additional consumption for every extra peso of income received, while MPS pertains to the fraction of an extra peso of income that goes to extra savings. MPC is calculated as change in household final consumption expenditure over a change in household disposable income ($(HFCE_t - HFCE_{t-1})/(HDI_t - HDI_{t-1})$). MPS is simply 1- MPC.
[34]Real growth rate at constant 2000 prices
[35]Average annual inflation rate for 2011-2015 is 3.3 percent.
[36]HDI, in this article, is computed as households' personal income less property expenses, taxes on income and wealth, compulsory fees, social security contributions and current transfers' payments. HDI grew at an average rate of 8.8 percent during the period under review.
[37]Average annual unemployment rate for 2010-2015 is 6.9 percent, with a marked decline from 7.4 percent in 2010 to 6.3 percent in 2015 (without Leyte).
[38]Minimum wage rates, in real terms, for non-agricultural in NCR and areas outside NCR (AONCR) rose from ₱244.11 and ₱192.08 in 2010 to ₱363.84 and ₱257.82, respectively, in 2015. For agricultural real wage rates, NCR rates increased from ₱221.75 to ₱335.85, while for AONCR real wage rates reached

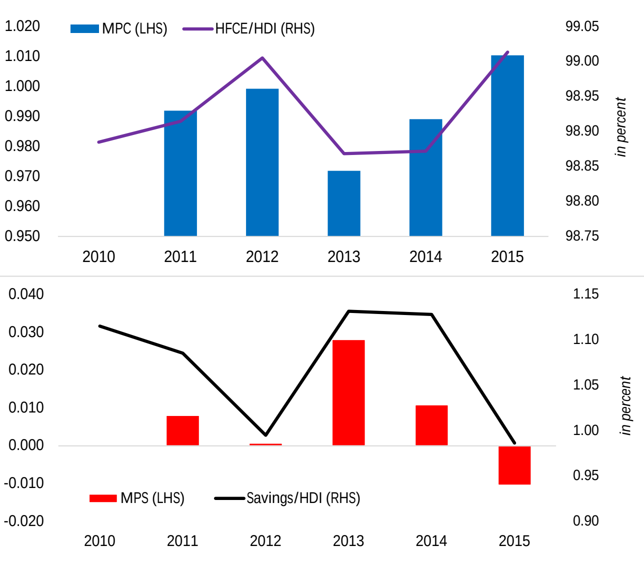
During the period under review, the increase in income was steadily matched by a corresponding increase in household spending, with the latter consistently outpacing the expansion in HDI (Figure 1). Calculating for the MPC reveals that, on average, Filipino households increase consumption by 99 centavos for every additional peso increase in income earned (Figure 2). In addition, HFCE accounted for an average of 98.9 percent of HDI from 2010-2015. These trends and developments support existing literature and official survey results (i.e., 2014 BSP Consumer Finance Survey (CFS) and 2015 BSP National Baseline Survey on Financial Inclusion (NBSFI)) which show that most Filipino households only have minimal deposits/savings.[39]

Figure 1: Household Disposable Income and Expenditure Growth
in percent



Source: Phippine Statistics Authority

Figure 2: Household MPC and MPS and Other Selected HH Indicators



Source: Phippine Statistics Authority

In 2013, the 8.1 percent expansion in HDI exceeded the 8 percent increase in spending. As a result, the MPC dropped to 0.972 and the households' propensity to save peaked at 0.028. Household savings improved by 23.0 percent from 0.6 percent in 2012. This ensued, in part, from the confluence of positive macroeconomic factors, including—benign inflation condition and sustained inflows of OF remittances.[40] The remittance-augmented HDI allowed the sector to earmark a higher portion of their income for savings.[41] The prudent shift in the households' saving behavior may also be reflective of precautionary motives following the series of crises in advanced economies and the fragile global economic recovery.[42]

₱240.04 and ₱229.45 from ₱177.07 and ₱157.26, for plantation and non-plantation, respectively.

[39]Also see Terada-Hagiwara's (November 2009) paper on Explaining Filipino Households' Declining Saving Rate, as well as Bersales and Mapa's (2008) research on Population Dynamics and Household Savings: Evidence from the Philippines

[40]Headline inflation was lower at 3.0 percent in 2013 vis-à-vis 3.8 percent and 3.2 percent in 2010 and 2012, respectively. OF remittances posted an 8.6 percent increase year-on-year. Meanwhile, the rate of growth in the household final consumption expenditure also declined by 1.9 percentage points to 8.0 percent in 2013 from the 9.9 percent in 2012.

[41]Bersales and Mapa (2008) employed data from the Family Income and Expenditure Survey (FIES) covering the years 1985-2003 to analyze the role of population dynamics in aggregate household savings in the Philippines and find that remittance is a significant source of aggregate household savings.

[42]Terada-Hagiwara's (November 2009) study, which covered the years 1994-2006, finds that precautionary saving motive is a significant factor in influencing the saving behavior of Filipino households. The NBSFI also identified saving money for emergencies as the principal purpose of Filipino households that are saving.

However, households' saving behavior reverted in succeeding years, with the MPS sliding down to 0.011 in 2014 and dipping further into negative territory at -0.010 in 2015. This is partly explained by the deceleration in the growth rate of compensation of employees to 4.8 percent in 2015 from 9.0 percent in 2014. Such deceleration, led to a corresponding slowdown in the growth of personal income to 5.6 percent in 2015 from 8.2 percent in 2014.[43]

The negative slope in the sector's saving function indicates that households consumed more for every peso of additional income earned in 2015, as growth in consumption outstripped that of disposable income (net) at 7.0 percent and 7.1 percent, respectively.[44] This resulted in a decline in the aggregate nominal saving for the household sector recorded during the year, but not dissaving. However, should the increase in consumption expenditure continue to outpace the expansion in household disposable income, especially on a larger scale, households would start drawing down from savings generated in prior periods (i.e., dissaving) or borrowing against future income to finance consumption outlays (i.e., credit availment).

Given these observations, there is a need to further look into the empirical evidence on the means by which Filipino households manage funds to match their spending behavior. Meanwhile, the statistics on MPS should be supplemented with empirical evidence to identify the drivers of households' inclination to save (e.g., favorable macroeconomic conditions, personal judgment, and geographical distance to financial institutions).

Policy Implications

The decisions of the household sector to consume or save have important consequences on aggregate demand given the sector's substantial share and contribution to GDP. Their behavior inevitably influences the longer term prospects of the Philippine economy. To achieve a structural improvement in GDP growth in the medium term, a good mix of household demand and savings is needed since the Philippines requires investment growth to supplement the consumption-driven economy. Meanwhile, strong domestic consumption (together with low local interest rates) may trigger faster consumer credit growth and thus raise financial stability concerns. Household income growth should keep pace with loan growth to prevent overleveraging.

Given the low household savings (0.7 percent of GDP in 2015) in the Philippines, there is wide scope for targeted policy intermediation that can significantly boost private savings. These measures include:

- Tax reforms. The package of reform measures being proposed by the government that includes modifying personal tax rates and income brackets and simplifying tax processes is expected to help increase household savings by enhancing households' disposable income. The rationalization of the value-added tax (i.e., consumption tax) is also seen to help increase personal income.
- Capital market development. Further development of the capital markets could help provide households with more savings/investment opportunities amid low nominal savings rate. Meanwhile, measures to promote awareness and understanding of investment instruments/products among the general

[43] Household personal income is household income net of property expenses.
[44] Source: Philippine Statistics Authority's (PSA) Household Sector's Income and Outlay Series

population would make saving a more established household practice and priority.[45] The passage into law of the Personal Equity and Retirement Act was not meant only to provide a supplementary retirement benefit for the working population, but also to mobilize savings toward low-risk investments and to help develop the capital market.[46]

- Government socio-economic programs. Higher and well-targeted social spending by the government to promote more inclusive growth (i.e., to support education and skills development programs, health care, socialized housing and resettlement, as well as enhanced targeting and implementation mechanisms of the conditional cash transfer program, and the expanded coverage (i.e., encompassing employment status)) and the affordability of retirement insurance/programs could help support the households' financial security and allow households to save a greater portion of their income.

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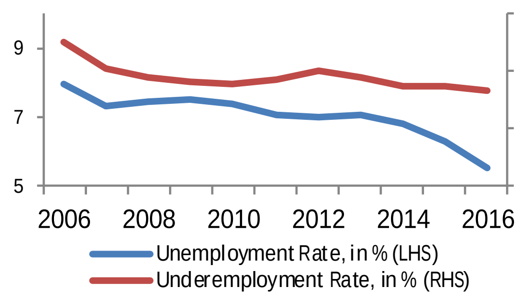
[45] According to a BSP survey, two-thirds of saving households have a bank account, while one quarter keep their savings at home, and 11 percent place their money in cooperatives, paluwagan (an informal saving scheme with rotating beneficiaries) and other credit/loan associations, as well as in government nonfinancial institutions, such as the Social Security System, the Home Development Mutual Fund and PhilHealth.(Source: Philippines: Selected Issues, IMF Country Report No. 14/246, IMF, August 2014).

[46] Eric M. Mechavez, The Personal Equity and Retirement Account Act: Finally a viable option, BusinessOnline, 3 August 2016

Employment. Labor conditions showed marked improvements in 2016. The number of jobless Filipinos eased to 2.4 million (from 2.6 million in 2015), as the unemployment rate dropped to an 11-year low of 5.5 percent. This represents a decline of 0.8 percentage point from its year-ago level of 6.3 percent. Most of the unemployed were men (63 percent), 15-24 years of age (48 percent), and with high school education (43 percent).

Chart 1.3. Labor Market Indicators
In percent



Source: PSA

While the labor force participation rate slightly declined to 63.4 percent (from 63.7 percent in 2015), employment growth accelerated to 5.4 percent in 2016 from 0.2 percent in 2015. This brought the number of employed persons to 40.8 million.

The services sector continued to be the highest employer, accounting for 55.7 percent of the total employed persons, with 1.6 million additional employed persons in 2016. The key driver for the robust expansion in employment in the services sector was wholesale and retail trade, repair of motor vehicles and motorcycles. Both contributed a combined 714,000 additional employed persons in the services sector.

The industry sector also supported employment, as its share to total climbed to 17.5 percent with additional employment of 865,000 persons in 2016. This was attributed to the vibrant construction subsector, the employment of which grew by 25.0 percent in 2016 (equivalent to 675,000 additional employed persons).

Meanwhile, employment in the agriculture sector contracted by 2.9 percent in 2016 (a reduction of 332,000 employed persons), albeit at a slower pace, compared to the decline of 4.3 percent in 2015. This was due mainly to the prolonged El Niño episode recorded since 2015.

While more Filipinos gained jobs in 2016, the rate of underemployment[47] remains relatively high at 18.3 percent, albeit slightly lower than the 18.5 percent level in 2015. The volume of underemployed persons reached 7.5 million in 2016, an increase of 298,000. Of the total underemployed, 43.9 percent (3.3 million) were in the services sector, 38.0 percent (2.8 million) in the agriculture sector, and 18.1 percent (1.4 million) in the industry sector.

Vulnerable employment[48] decreased to 34.9 percent in 2016 from 37.6 percent in 2015 as the number of unpaid family workers contracted by 15.0 percent. Meanwhile, wage and salary workers posted a 9.9 percent growth (2.3 million persons) and accounted for 61.8 percent of total employment. Much of the expansion came from the private sector with 2.0 million additional employed persons.

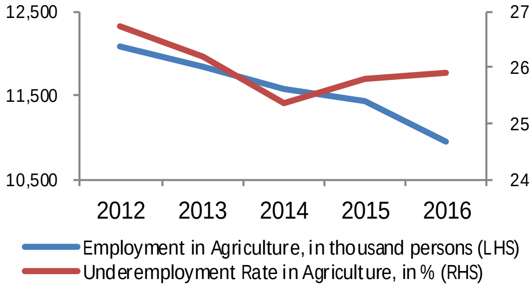
Services sector drives strong employment growth in 2016

Measured in terms of labor turnover rates or the percent difference between the rates of accession (additions) and separation (losses), employment growth in large enterprises based in Metro Manila

[47]Underemployment covers employed persons who express the desire to have additional hours of work in their present job or an additional job, or to have a new job with longer working hours.
[48]Vulnerable employment is defined as the proportion of self-employed and unpaid family workers in total employment.

accelerated to 2.3 percent in Q2 2016, almost double the 1.2 percent registered in Q2 2015. Despite the country's economic growth, a key challenge has been translating growth into gains in employment. The unemployment rate has declined rapidly in recent years as job creation became the government's priority while underemployment has stagnated. This highlights the need to create quality employment that would match the skill level of Filipinos.

Chart 1.4 Labor Market Indicators (Agriculture)
In percent



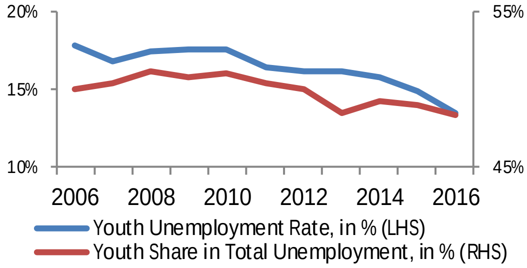
Note: Effective January 2012, the Labor Force Survey (LFS) adopted industry codes following the 2009 Philippine Standard Industrial Classification (PSIC). Prior to this, codes used the 1994 PSIC.

Source: PSA

Another challenge has been carving inclusive and equitable gains in employment. Similar to underemployment, the decline in vulnerable employment has been sluggish. There have been large employment contractions in the agriculture sector over the past four years. It is beset with 25.9 percent underemployment – much higher than the national figure of 18.3 percent. More lucrative employment opportunities in urban areas may have led to the decrease in the supply of workers in the agriculture sector.

Youth unemployment has also been a persistent challenge, as those aged between 15 to 24 years old have comprised around 50.0 percent of the total unemployed in the past 10 years. While the youth make up 20.3 percent of the labor force, they comprise only 18.0 percent of total employment. To facilitate the absorption of the youth into the labor force, skills-training mismatch as well as insufficient employment generation to accommodate new graduates would need to be addressed.

Chart 1.5 Youth unemployment
In percent



Source: PSA

Box Article 5

Toward an Employment-Oriented Philippine Economy

Overview

Recent developments indicate that the country's strong economic performance has produced positive gains for the domestic labor market. For one, unemployment in 2016 showed a significant decline, indicating the availability of more jobs for Filipino workers. The domestic labor market, however, continues to be challenged by the need to fully optimize the potential benefits from the country's robust growth. The issues which confront the domestic labor market include the persistence of high underemployment, continuing mismatch between job demand and available skills and education, and labor market rigidities brought about by complex legal and institutional frameworks. Going forward, the thrust of the NG to prohibit the labor-only contracting scheme (i.e. "endo" or the 5-5-5 work scheme) is expected to have some repercussions on the labor market. These labor market concerns need to be addressed because they have significant implications on the welfare of workers and households in the country. For growth to be inclusive, the economy should undertake a structural transformation into one that is more investment-led and employment-oriented.

Recent developments in the Philippine economy and labor market

Sustained macroeconomic policies and structural reforms have helped the Philippine economy maintain its growth momentum for 72 consecutive quarters since 1999. Over the last two years, the average growth of the Philippine economy (i.e., 6.4 percent) exceeded that of all other economies in the region, except China and India. While the country experienced strong growth, employment grew at a relatively slow pace. Between 2004 and 2015, the country's economy expanded at an average rate of 5.5 percent while employment grew at an average rate of only 2.1 percent.[49]

An underlying reason for the observed disconnect between output growth and employment growth is the disparity in the sectoral structures of output and employment. For example, over the last three years (i.e., 2014 – 2016), the agriculture, hunting, forestry and fishing sector, which is the second largest sector employer (i.e., 29 percent), had the smallest share to domestic output at 9.4 percent. By contrast, the industry sector, which accounted for almost 33.0 percent of GDP, accounted for only 17.0 percent of the country's total employment. The service sector comprised the largest shares in both output and employment at 57.1 percent and 54.7 percent, respectively.

Nonetheless, in 2016, indicators point to an improvement in labor market conditions. Preliminary results of the Annual Labor and Employment Estimates for 2016 from the PSA show the employment rate at 94.5 percent. The services sector continued to employ more than half (55.6 percent) of the total employed persons, of which 19.6 percent were engaged in wholesale and retail trade or in the repair of motor vehicles and

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[49] It should be noted that, in the January 2014 Labor Force Survey (LFS), Region VIII was excluded while the survey rounds for April, July and October 2014 and for January and April 2015 did not include the Province of Leyte.

motorcycles. Meanwhile, the agriculture and industry sectors accounted for 26.9 percent and 17.5 percent of total employment, respectively. The unemployment rate registered at 5.5 percent.[50]

Challenges and policy initiatives

While the domestic labor market has been making headway in terms of increased job creation, there remain significant challenges that need to be addressed to ensure that the country's strong economic growth translates into quality and decent jobs for Filipino workers. One of these is persistently high underemployment. Underemployment in the country has remained at double-digit levels and its magnitude is almost thrice that of unemployment (Figure 1). It is estimated that one out of five employed workers is underemployed, so that about 20.0 percent of workers are not satisfied with their work or income levels and are looking for more work to meet their living requirements. Moreover, underemployment is highly correlated with poverty given that it occurs more in the agriculture and service sectors. In 2016, 38.0 percent of agricultural workers and 43.9 percent of service sector workers said that they were underemployed. Recognizing the need to rein in underemployment, the current administration set an indicative target of lower underemployment by 2022 from its current average level of 18.3 percent.

One positive development in this area is the increasing share of wage and salary workers among the total employed. Between 2006 and 2015, the proportion of wage and salary workers to total employed increased from 51.1 percent to 59.2 percent (Figure 2). In 2016, it stood at 61.9 percent. Almost 45 percent of the wage and salary workers are employed in the private sector. This is in keeping with the observation that during times of economic expansion workers in the informal sector (e.g., self-employed workers) are enticed to move towards formal employment which gives a more stable income stream and better health benefits and insurance coverage. With more workers settling in jobs with greater financial stability, this is expected to alleviate the problem of underemployment in the country.

Another concern is the high structural unemployment in the Philippines.[51] Structural unemployment in the country is linked to the continuing mismatch between job demand and available skills and education of the current work force.[52] The mismatch in the skills and competency of the current workforce and job demand is given as a major reason why job vacancies in the Philippines are hard to fill. Based on the 2013/2014 Integrated Survey on Labor and Employment (ISLE), 29.9 percent of employers cited the applicants' lack of needed competency and skill as their main reason for being unable to fill up vacancies.

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[50] Developments in the labor market, particularly the unemployment rate, are important to the conduct of monetary policy. It has been shown theoretically and empirically that a short-run tradeoff exists between inflation and unemployment. Nonetheless, there is a level of unemployment that is consistent with the long-run potential growth of an economy and thus does not exert any upward or downward pressure on inflation. This level of unemployment is known as the Non-Accelerating Inflation Rate of Unemployment or NAIRU. Macroeconomic theory posits that inflation will tend to rise if the unemployment rate falls below the natural rate and inflation tends to fall when unemployment rises above the natural rate. Preliminary estimate of NAIRU for the Philippines for the period 2005Q2 – 2015Q4 puts it at 6.0 - 6.5 percent. An understanding of the NAIRU and the factors that affect it can help policymakers determine the extent of the policy interventions that they will undertake.

[51] Structural unemployment is a form of unemployment caused by a mismatch between the skills of workers in the economy and the skills demanded of workers by employers (also known as the skills gap). It is a longer lasting form of unemployment and one that is affected by the fundamentals of the economy, including technology, demographics, and policies. Structural unemployment is a complex concept and it is difficult to measure. Thus far, there is no conclusive estimate of structural unemployment in the Philippines. However, an indicative estimate that can be used to determine structural unemployment is the NAIRU. The NAIRU is the sum of frictional unemployment (i.e. search unemployment) and structural unemployment. As previously mentioned, preliminary estimates put the NAIRU in the Philippines at 6.0 to 6.5 percent.

[52] A stark example of this is the observed trend in the employment of science and engineering graduates. The World Bank (2013) estimates that only around 10 percent of science graduates and postgraduates find jobs in the manufacturing sector, while almost half end up working in trade, real estate, and other services subsectors that are less related to their fields of study. A similar trend is observed among engineering majors. There are a large number of workers that end up in the retail trade, which has become some sort of a catch basin for workers who cannot find gainful employment.

Figure 1. Unemployment and underemployment rates (in percent)

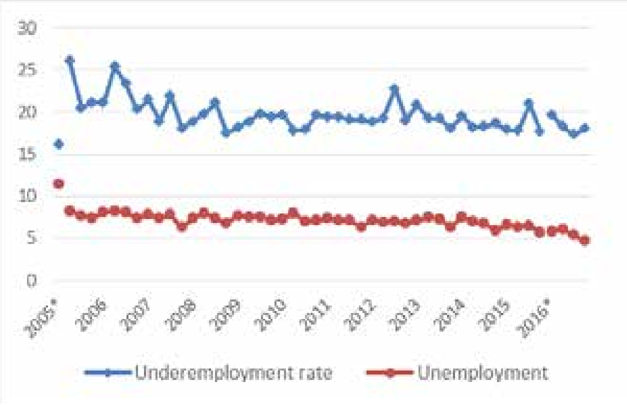
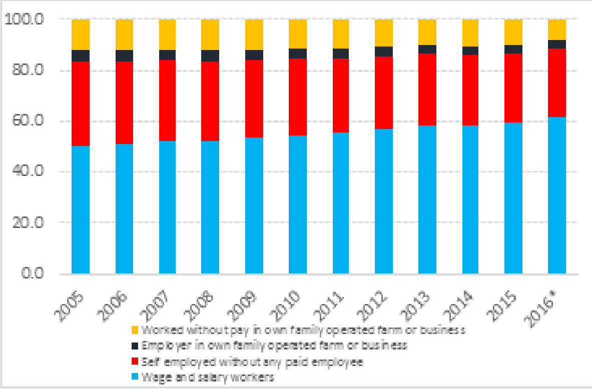


Figure 2. Proportion of different classes of workers (% to total employment)



* A new definition of unemployed was adopted starting April 2005 per National Statistical Coordination Board Resolution No. 15 dated October 20, 2004.As previously noted, there is a break in the series in the LFS starting in the April 2016 rounds due to the adoption of the 2013 Master Sample Design as well as the population projections based on the 2010 Census of Population and Housing. Thus, LFS results starting April 2016 rounds are not comparable with previous survey rounds.
Source: Philippine Statistics Authority (PSA)

As a means to address the issue of skills mismatch, the NG, through the Technical Education and Skills Development Authority (TESDA), has implemented modular and ladderized training programs (e.g. Technical Vocational Education and Training) to further enhance the skills of Filipino workers. Human capital development has become a lynchpin for government programs for the agriculture, industry and services sectors.[53]

Enhancing the skills of employed Filipinos is not only vital in addressing the skills mismatch in the domestic labor market but also in improving the country's labor productivity. From a negative growth rate of 1.7 percent in 2009, labor productivity improved to 5.4 percent in 2015. The agriculture sector posted the highest growth in labor productivity in 2015 at 5.2 percent followed by the services and industry sectors at 3.9 percent and 3.1 percent, respectively. These are significant improvements from their year-ago growth rates of 0.3 percent (agriculture), 2.1 percent (services) and 2.6 percent (industry). Improving labor productivity can help in alleviating the problem of structural unemployment.

Going forward, an issue that could have strong repercussions on the domestic labor market is the prohibition of the practice of "endo" or end of contract. The main reason given for the end to "endo" is to assure workers' security of tenure and stability at work. Although this is a laudable aim, an end to this policy could have repercussions on a segment of the country's labor market.[54] The Department of Labor and Employment (DOLE) recognizes the potential negative consequence of ending "endo" and thus, has recommended the

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[53]The strengthening of industry-academe linkages is an initiative that is being eyed to meet labor market needs, reduce future job-skill mismatches and bring down unemployment and underemployment.

[54]Using data from the PSA, a study of the Institute for Labor Studies (2015) noted that there were 489,315 agency-hired workers employed in various business establishments in 2012. The top three sectors that engaged the services of contractual workers in the said year were: (a) manufacturing (31.2 percent); (b) wholesale and retail trade (19.9 percent); and (c) real estate, renting and business activities (11.1 percent). Moreover, the latest statistics on non-regular workers of PSA indicate that as of 30 June 2014, half of the non-regular workers were contractual/project-based, with 50.5 percent share or 672,279 workers. The total number of non-regular workers reached 1.3 million during the period, which comprised more than a quarter (29.9 percent) of total establishment workforce of 4.5 million.

earmarking of substantial funds to serve as safety net protection for displaced workers by providing job facilitation services, training and retraining programs, livelihood assistance, and scholarships for dependents.

While initiatives and programs have been undertaken to facilitate employment generation in the country, rigidities that could hamper the growth of the labor market remain. Complex legal framework, high minimum wages, and restrictions on the use of flexible contracts have led to the closure of many labor-intensive firms or have hindered their expansion, leaving many Filipinos with much fewer job options. These are areas which need to be looked at and assessed carefully.

Sustaining the gains: toward an employment-oriented economy

Successive years of strong growth have gradually generated employment gains for the labor sector. Unemployment has been declining in recent quarters indicating that more jobs are being created in the economy. However, there are still a number of persistent issues that need to be addressed in the labor market including high underemployment, skills mismatch, labor market rigidities and, potentially, the prohibition of labor-only contracting. Policy initiatives and programs have already been implemented to alleviate these concerns but there is much left to be done. The economy's potential to create more jobs will be boosted by engaging in human capital development (e.g., upgrading of the assessment and certification procedure for graduates of technical vocational education and training in TESDA, specialized trainings and staff improvement provided by BPO service-providers, stronger linkages between industries and the academe) and by undertaking physical infrastructure projects that could further enhance the different sectors of the economy. Moreover, the strengthening of livelihood programs/small and medium enterprises (SMEs) and microfinance activities can generate employment opportunities, particularly in the rural areas. Indeed, for growth to be inclusive, the economy needs to undertake a structural transformation to being more investment-led and employment-oriented.

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Prices. Year-on-year (y-o-y) headline inflation averaged at 1.8 percent in 2016, higher than the 1.4 percent average in the previous year, but remained below the Government's 2016 inflation target range of 3.0 percent ± 1.0 percentage point (Statistical Annex - Table 3). Inflation was on an uptrend throughout the year due to tighter food supply caused by weather-related shortfalls. This was coupled with rising domestic pump prices triggered by increasing international oil prices.

PH inflation rises in 2016 but remains below target

Food inflation was unchanged at 2.6 percent in 2016 compared to the previous year as price increases of key food items such as vegetables, sugar, oils and fats were offset by moderate price increases in fish, fruit, milk, cheese, and eggs. Rice inflation also declined further in 2016, entering negative territory as supply remained adequate due partly to arrival of rice imports. Meanwhile, typhoons and the adverse impact of the El Niño phenomenon continued to push prices of selected agricultural products higher, particularly in the second half of 2016.

Meanwhile, non-food inflation rose to 0.9 percent in 2016 from 0.5 percent in the previous year as inflation rates for most commodities registered an uptick during the year. Key items, such as transport services along with restaurants and miscellaneous goods and services, rose during the year. Inflation for transport went up partly due to higher air and sea travel fares especially during the holiday season, while rising international crude prices also triggered upward adjustments in domestic pump prices.

By contrast, core inflation—which excludes certain volatile food and energy items to measure underlying price pressures—eased further to 1.9 percent in 2016 from 2.1 percent a year ago. Similarly, alternative measures of core inflation estimated by the BSP dropped relative to the rates registered in the preceding year.

Table 1.1 Measures of Core Inflation
In percent

	2015	2016
Core Inflation	2.1	1.9
Trimmed Mean[1]	1.9	1.6
Weighted Median[2]	1.9	1.8
Net of Volatile Items[3]	1.8	1.6

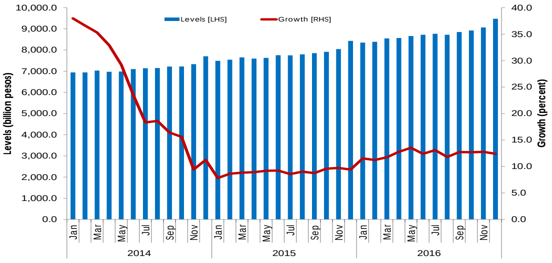
[1] The trimmed mean represents the average inflation rate of the (weighted) middle 70 percent in a lowest-to-highest ranking of year-on-year inflation rates for all CPI components.
[2] The weighted median represents the middle inflation rate (corresponding to a cumulative CPI weight of 50 percent) in a lowest-to-highest ranking of year-on-year inflation rates.
[3] The net of volatile items method excludes the following items: bread and cereals, meat, fish, fruit, vegetables, gas, solid fuels, fuels and lubricants for personal transport equipment, and passenger transport by road, which represent 39.0 percent of the CPI basket.
Sources of basic data: PSA, BSP

Monetary Aggregates. Domestic liquidity or M3 increased by 12.7 percent y-o-y at the end of 2016 following a 9.4-percent expansion recorded at end-2015. The observed increase in money supply remains consistent with the robust expansion in domestic demand.

Domestic liquidity remains adequate to support economic growth

The growth in domestic liquidity was due mainly to the sustained expansion in domestic claims or credits to the domestic economy. Domestic claims rose by 17.0 percent y-o-y, buoyed by the continued increase in claims on the private sector (by 16.4 percent), reflecting the steady growth in bank lending. Meanwhile, net claims on the central government rose by 27.4 percent.

Chart 1.6 Domestic Liquidity (M3)
Levels in billion pesos; Y-o-y Growth in percent



Source: BSP

Net foreign assets (NFA) in peso terms rose by 7.8 percent y-o-y in December 2016. The BSP's NFA position continued to expand on the back of robust foreign exchange inflows comprised mainly of overseas Filipinos' remittances and business process outsourcing receipts. Meanwhile, the NFA of banks expanded, driven largely by the growth in banks' foreign assets resulting from higher interbank loans, deposits with other banks, and investments in marketable debt securities.

Operations of the NG. The NG recorded a higher budget deficit for 2016 of ₱353.4 billion from ₱121.7 billion in 2015. The fiscal deficit remained within the ₱388.9 billion programmed deficit for the full year, which is equivalent to 2.7 percent of GDP.

Fiscal deficit significantly higher as spending picks up pace

For 2016, revenues increased by 4.1 percent y-o-y to reach ₱2,195.9 billion, supported by higher collections by the Bureau of Internal Revenue (BIR) and Bureau of Customs (BOC) by 9.3 percent and 7.8 percent respectively. The increase in tax collections was partly tempered by the 26.6 percent y-o-y contraction in non-tax revenues, particularly the income of the Bureau of the Treasury and privatization proceeds, sans the one-time transfer to the NG of the Coco Levy assets in 2015.

Disbursements for the review period significantly outpaced the expansion in revenues as it reached ₱2,549.3 billion, 14.3 percent more than the outturn during in 2015. Based on the latest DBM data available for the period January to November 2016,[55] the upbeat spending performance was driven mainly by large double-digit growth rates in infrastructure spending, subsidies to government-owned and –controlled corporations (GOCCs) and transfers to local government units (LGUs), as well as increased maintenance expenditures and higher outlays for personnel services.

Spending on infrastructure and other capital outlays (CO) surged by 46.3 percent to reach ₱426.3 billion as of November 2016,[56] more than twice the 22.8 percent pace of growth in the comparable period last year. Apart from the deliberate increase in allocation to pursue massive infrastructure build-up throughout the country, the faster expansion in capital spending can also be attributed to the facilitative measures implemented by the government, such as 24/7 construction work and early procurement policy.[57]

Higher disbursements for personnel services was due mainly to the creation and filling up of positions in various government agencies, as well as funding of the benefits of government employees. Meanwhile, increased subsidies to GOCCs correspond to payments for completed housing programs of the National Housing Authority (NHA), irrigation projects of the National Irrigation Administration (NIA) as well as the additional beneficiaries under the National Health

[55] DBM Report on National Government Disbursement Performance, As of November 2016.
[56] Ibid.
[57] The DBM describes the early procurement policy as allowing agencies to proceed with procurement activities, short of award, for the projects slated for the following budget year, provided that the President has approved the National Expenditure Program.

Insurance Program (NHIP) of the Philippine Health Insurance Corporation (PHIC).

The deficit for the period was financed mainly from domestic sources, which covered about 80 percent of the gross financing requirement of the NG, reflecting the government's bias toward domestic borrowings in order to minimize the impact of fluctuations in the foreign exchange. The country's favorable fiscal position and sustained economic growth, coupled with proactive liability management, resulted in narrowing debt-to-GDP ratios over the last seven years. The National Government's outstanding debt-to-GDP ratio declined from 52.4 percent in 2010 to 42.1 percent in 2016, with the share of domestic debt at around two-thirds of the total outstanding debt. This provides sufficient elbow room for fiscal authorities to further boost public spending, especially on infrastructure, education, health and targeted social protection programs that are not only there to provide additional growth impetus, but would likewise improve human capital and enhance the country's competitiveness.

Financial Market Conditions Reflect External Uncertainty

In 2016, financial markets experienced a cycle of ups and downs. Investors oscillated between being risk-averse and risk-takers in response to market jitters and rebounds. This kind of volatility persisted the entire year amidst the uncertainties in the global external environment and some domestic factors brought about by perceptions of heightened political risks, diplomatic issues, and possible portfolio rebalancing.

Volatility affects financial markets

Episodes of extreme price swings were evident in the first few months of 2016. The average 30-day volatility of the Philippine Stock Exchange index (PSEi) reached about 30 percent for the year. This set the tone for a challenging year for the equities market. Meanwhile, the 1-month currency options volatility index for the Philippine foreign exchange market experienced about 4 to 5 percent volatility for the year.

Markets are roiled by periods of deep sell-offs

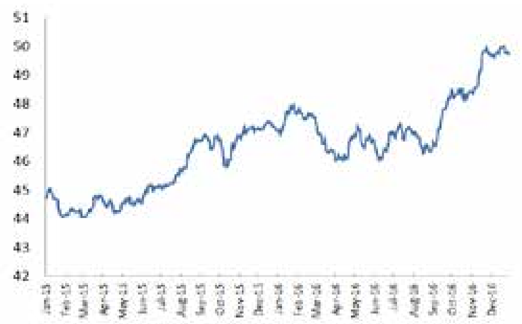
Chart 1.7 Philippine Stock Exchange index (PSEi)
In index points

Source: Philippine Stock Exchange (PSE)/Bloomberg

Large price swings affected both the equities and foreign exchange markets. The year started with the PSEi declining to its lowest index price level since the "Black Monday",[58] falling sharply by 287.17 points or 4.4 percent to 6,288.26 on 11 January 2016. The stock market ended the year in the negative territory. Similarly, the peso started to weaken in September 2016 and closed the year at ₱49.72/US$1, a 5.4 percent depreciation relative to the closing rate of ₱47.06/US$1 as of end-December 2015. Currency markets reacted frequently to external developments which partly and temporarily affected market sentiments despite the country's sustained sound macroeconomic fundamentals.

[58]August 24, 2015 is considered "Black Monday," in the Philippines when the Philippine stock market plunged 6.7 percent or 487.97 points down, wiping out the year's record gains over concerns of a weakening Chinese economy.

Chart 1.8 Peso dollar exchange rate



Source: Philippine Dealing and Exchange Corp (PDEX)/ Bloomberg

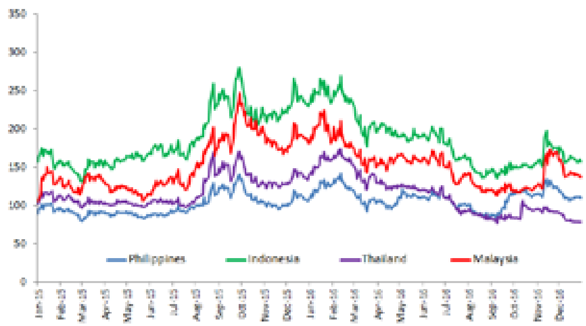
Yet it was not all downward plunges, there were times of trend recovery. Subsequent to the low of 6,084.28 index points in 21 January 2016, the PSEi rallied and peaked at 8,102.3 index points on 21 July 2016 due to the optimism over the inauguration of the Duterte administration and the successful maiden initial public offerings (IPOs) conducted during the period. Meanwhile, the peso regained strength in the months of March and April following the aggressive stimulus measures from the European Central Bank (ECB) and the dovish US Federal Reserve statements on the outlook for interest rates.

In August, the peso exhibited signs of appreciation due to the recovery in oil prices and weak retail sales data in the US, which renewed views of a delay in the timing of the US policy rate hike. There were the periodic bouts of appreciation before the weakening trend closed the year.

External financial conditions spill over to the local economy

External developments resulted in a challenging and volatile operating environment that affected investors' risk sentiment. The immediate spillover was manifested in the higher cost of raising funds from the external market and the higher yield demanded for owning Philippine debt papers. The Philippine 5-year sovereign credit default swap (CDS) increased, albeit lower than other ASEAN countries, beginning mid-August or following the Chinese yuan devaluation.

Chart 1.9 Five-Year CDS Spreads
In basis points



Source: Bloomberg

Meanwhile, the emerging bond index global (EMBIG) spread for the Philippines similarly increased around November. This was lower than the spreads for neighboring economies, namely, Indonesia and Malaysia.

Heightened risk aversion sparks capital outflows and portfolio rebalancing

The heightened risk aversion sparked bouts of volatility due to portfolio rebalancing and search-for-yield behavior. This was confirmed by some episodes of portfolio investment outflows in both bonds and equities. The combination of a stronger US dollar and the rise in US interest rates encouraged a return of investors to the US markets and retrenchment from emerging economies, including the Philippines. However, for the months of June to August, the country seemed to be a recipient of investor rebalancing and served as a destination for investors in search for higher yields as evidenced by an apparent surge in placements in equity investments and debt securities. Bond yields fell to about 3.8 percent while inflows were recorded at about US$1.5 million. Meanwhile, long-term government bond yields went as high as 5.5 percent (20-Year Bond) reflecting lower demand by investors as the year ended.

Investors prefer shorter-dated bonds

While volatilities climbed across financial markets, investors were also demanding higher risk premium from holding longer-dated debt securities. The yield differential between the 3-month Philippine Treasury bill (T-bill) against 20-year Treasury bond (T-bond) in the secondary market increased during the same periods of bearish episodes in the equities market and the weakening of the peso. The widening gap suggests that investors preferred to hold shorter-dated bonds to avoid losses from holding longer-dated bonds given the risks and uncertainties in the global environment.

Medium-term developments and outlook

Equities market. The Philippine stock market has undergone a number of reforms and development over the past decades that elevated the local stock market to international standards. Among the reforms, major structural changes include: the unification of two stock exchanges; the demutualization of the Philippine Stock Exchange (PSE) that converted it from a member-organization into a stock corporation; the enactment of the Securities Regulation Code (SRC); and corporate governance reforms that changed the PSE's board structure and composition in compliance with the SRC, enabling it to be more profitable and solve potential conflicts of interest. Technology also played a great role in the transformation of the stock market in the Philippines. Among others, trading in the PSE was improved by the implementation of a fully computerized match trading system, purchase of the Clearing and Settlement System and the launch of a new trading system provided by the NYSE Euronext Technology. In addition to the improvement in the trading platform, the PSE also launched the mobile trading application that provided investors easier access to the disclosures of issuers and thus improved the transparency of the PSE.

As a result of these structural reforms, the Philippine stock market experienced a phenomenal growth over the past decade.

Philippine stock market records remarkable growth

The benchmark stock index is expected to revisit the 8,000 mark in 2017-2018 as the Philippine growth story remains intact despite risks of the impact of protectionist policies from the US on the country's thriving BPO industry.

Over the short-term, the government's tax reform program could offer a positive catalyst to the stock market. Over the longer-term, the administration's promised massive infrastructure spending during its six-year term could provide an even greater catalyst for the local bourse as it promotes greater growth and demand for fund mobilization through corporate listing. Moreover, the merger of the country's equity and fixed-income exchanges that is scheduled to push through in 2017[59] is expected to have a net benefit effect not just for the Philippine Stock Exchange (PSE) but for the capital market as a whole. The PSE has noted that daily value turnover is seen to reach ₱8 billion to ₱8.2 billion in 2017 from the average daily value turnover of about ₱7.8 billion in 2016.

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[59]The PSE, which has a 20.98 percent stake in Philippine Dealing System (PDS), has long pushed for the integration between the PSE and the PDS so as to align with other Southeast Asian exchanges that facilitate the trading of both equities and fixed-income securities.

The risk, however, could come from the possibility that yield-seeking funds would stay out of emerging markets for a longer time, particularly if US interest rates rise faster than expected.

Absent concerns about a strengthening US dollar and potential fall-out from increasing protectionist trade policies, investors may likely continue to adopt a wait-and-see attitude on whether the Philippine government will be able to execute the much needed reform program and expansion in infrastructure spending.

Foreign exchange market. The country's exchange rate policy has supported a freely floating exchange rate system whereby the BSP leaves the determination of the exchange rate to market forces. But the BSP on some occasions of excessive volatilities in the exchange rate enters the market mainly to maintain order and stability in the foreign exchange market. This policy ensures the role of the exchange rate as automatic stabilizer that promotes economic flexibility and reduces economic distortions.

Peso is expected to remain broadly stable

The BSP has combined foreign exchange intervention and monetary measures with market-based foreign exchange regulations to prevent major exchange rate volatility. During episodes of strong foreign exchange inflows, the BSP pursued liberalization of the country's existing foreign exchange regulatory framework, particularly those pertaining to outward investments, foreign exchange swaps, capital movements as well as banks' foreign exchange positions. The reforms allowed individuals and businesses greater access to foreign exchange for outward investment and over-the-counter transactions. By making the FX environment more open, some of the pressure on the exchange rate was alleviated.

While market sentiment stemming from external developments continues to affect the foreign exchange market, the peso is expected to remain broadly stable on account of the country's strong macroeconomic fundamentals—including robust GDP growth, low and stable inflation, favorable external payments position, strong and resilient banking system, and prudent fiscal position. Likewise, the ample level of international reserves,[60] the sustained structural inflows of foreign exchange from overseas Filipino remittances, BPO and tourism receipts, foreign direct investments, and recovery of exports could continue to support the peso. The credit rating upgrades that have been earned over the last few years are expected to support market confidence towards the Philippine financial markets.

Bond Market. For the past decade, milestones were made that were central to capital market reform such as the Securitization Law, the Special Purpose Vehicle (SPV) Law and the elimination of documentary stamp tax in secondary trading. There are remaining measures in the legislative agenda that need to be pursued: the amendment of the BSP Charter, passage of the Payment Systems Act and the Islamic Banking Framework, to name a few.

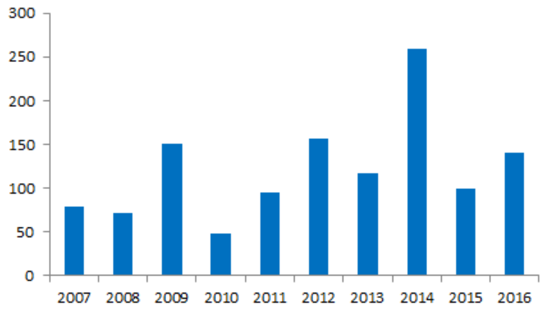
The capital market reforms have translated to the continued development of the Philippine debt market. At present, government papers dominate the local capital market. The corporate bond market, although a small and nascent market, has been growing rapidly over the past years.

The government is expected to issue more local currency bonds to finance the projected higher

[60] Data showed that the country's GIR stood at US$80.69 billion as of end-December 2016 (revised). Meanwhile, personal remittances from overseas Filipinos (OFs) totaled US$2.45 billion in November 2016, decreasing by 18.4 percent year-on-year. On a cumulative basis, personal remittances in the first ten months of 2016 reached US$26.9 billion, higher by 5.1 percent than the level recorded in the same period last year. Lastly, foreign direct investments (FDI) posted net inflows in September 2016 amounting to US$342 million, a decrease by 14.3 percent from the US$399 million recorded in the same period last year.

deficit in 2017. The government will continue to favor domestic sources which are estimated to account for 80 percent of the borrowings while the remaining 20 percent will come from foreign sources. This will reduce the country's exposure to foreign exchange risks. Meanwhile, the public sector is still expected to dominate the bond market while the private sector will continue to tap the bond market to fund capital requirements and to refinance maturing obligations for the year.

Chart 1.10 Private Corporation Bond Issuances
In billion US dollars



Source: PDEX/Bloomberg

Investor preference for shorter or longer-dated debt paper instruments as well as the degree of trading activity in the secondary market, can remain highly sensitive and dependent on external and domestic developments. Investor preference is expected to remain in the shorter end of the curve, as it is easier to discount information and formulate strategies in the immediate term, and in expectation also of potential increases in rates as the US Fed continues with its interest rate normalization.

Meanwhile, the 364-day T-bill rate for 2017 is projected to be at 2.5 to 4.0 percent. [61]

For the BSP's part, capital market reforms will continue through close coordination with the private sector. Planned reforms include the development of the interbank repo, single price convention, overnight index swap, financial benchmarks as well as the PSE-PDS merger.

[61] Approved by the DBCC on 26 December 2016.

Credit Risk Assessment. Major third-party credit watchers continued to acknowledge the Philippine economy's strong fundamentals and robust growth prospects, leading to favorable sovereign rating actions in 2016.

Fitch Ratings, Standard & Poor's and Moody's Investors Service affirmed their respective investment grade sovereign credit rating for the Philippines, recognizing the country's economic strength and low vulnerability to external shocks. Credit rating agencies also noted the gains from sound macroeconomic policies, as well as the country's favorable demographics and rising investments as anchors of a robust growth outlook.

Table 1.2 Philippine Sovereign Credit Ratings
As of end-December 2016

Rating Agency	Local Currency (LT/ST)	Foreign Currency (LT/ST)	Outlook
S & P	BBB/A-2	BBB/A-2	Stable
Moody's	Baa2/n.a.	Baa2/n.a.	Stable
Fitch	BBB/n.a.	BBB-/B	Positive
JCRA	BBB+/n.a.	BBB+/n.a.	Stable
NICE	BBB+/n.a.	BBB/n.a.	Stable
R&I	n.a	BBB/a-2	Stable

Source: Investor Relations Office (IRO), Report of Credit Rating Agencies

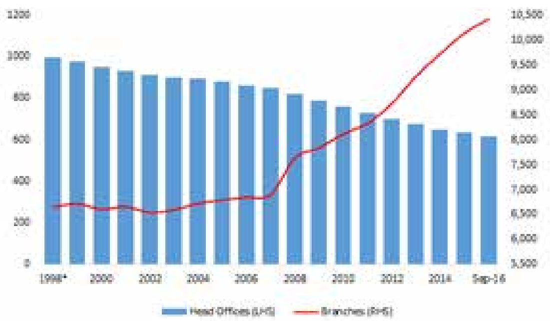
The Philippines also earned one positive rating action from NICE Ratings in January 2016 which upgraded the sovereign's credit to BBB/stable from BBB-/positive. A Japanese credit rating, JCR, on the other hand, rates the Philippines at BBB+, the highest rating ever achieved by the country, which is a notch lower than the A category. Another Japanese credit rating agency, R&I, rates the Philippines at BBB with a stable outlook.

Banking Sector Prudently Positioned Against Headwinds

The Philippine banking system expanded its footprint beyond brick and mortar as well as withstood challenges to its operating environment. In the past 10 years, the banking system prudently positioned itself against local and global headwinds but remained accommodative to differentiated needs of its stakeholders. Taken altogether, the banking system exhibited better asset quality, ample liquidity position, rising income, and strong capitalization.

Banks streamlined further but with wider physical reach. As of end-September 2016, there were 613 operating banks (from 847 in 2007) with a network of 10,411 branches/other offices (from 6,897 branches/other offices in 2007). This distribution network is 1.5 times wider than the level recorded in 2007 and 1.6 times higher than that in 1998. Part of the streamlining can be attributed to 100 recorded cases of mergers and consolidations since September 1998.

Chart 1.11 Total Banking Units



Source: BSP

Policy reforms which allowed the establishment of alternative financial access points such as microfinance-oriented banks/branches, extension offices (EOs), other banking offices (OBOs), and micro-banking offices (MBOs) enabled banks to expand their physical reach, particularly in underbanked or unbanked areas in an efficient and cost-effective manner. After the implementation of said guidelines in 2011, the number of EOs, OBOs and MBOs grew in number totaling to 225, 436, and 651, respectively, as of end-September 2016. Further, the number of unbanked areas declined to 591 cities and municipalities as of end-September 2016 from 609 in 2011.

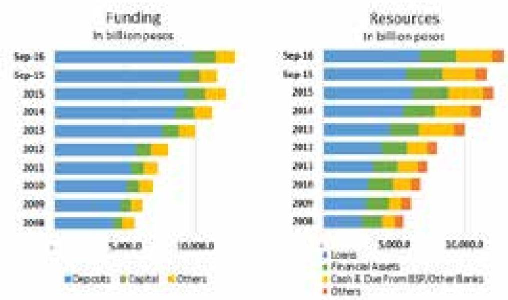
Complementing the banks' wider distribution network was the sustained investment in electronic banking bringing the number of banks with e-banking facilities to 121 as of end-September 2016 from 96 in 2008. All these helped boost banks' deposit generation and lending activities. Retail[62] deposits from residents[63] remained to be the primary funding source of banks. Total deposits grew annually by 12.0 percent[64] as of end-September 2008 to ₱9,819.7 billion.

The changes in the banks' physical structure are broadly aligned with the BSP's policy thrust of promoting streamlined banking structure but with wider financial access point.

On the back of higher deposits, resources of the banking system expanded by 11.4 percent to ₱12,799.2 billion as of end-September 2016 due to increased lending[65] and investment activities[66].

[62] As of end-September 2016 at ₱4,766.9 billion or a share of 48.5 percent to total deposits. In addition, the types of deposit accounts were mostly savings deposits with a share of 49.6 percent while demand deposits registered a 22.8 percent share of total deposits.
[63] Resident deposit liabilities as of end-September 2016 was at ₱9,717.0 billion, accounting for 99.0 percent to total deposits.
[64] Compounded Annual Growth Rate (CAGR)
[65] Total loan portfolio (net of allowance for credit losses) grew annually (CAGR) by 12.7 percent since end-September 2008 to ₱6,847.8 billion as of end-September 2016.
[66] Financial assets (net of allowance for credit losses) rose by 9.6 percent (CAGR) since end-September 2008 to ₱2,590.1 billion as of end-September 2016.

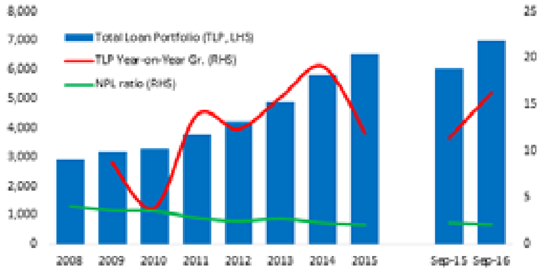
Chart 1.12 Source and Use of Funds



Source: BSP

Chart 1.13 Lending and Loan Quality Trend

Level in billion pesos; growth rate, ratio in percent



Source: BSP

Banks' lending behavior was generally on an upward trend in line with the country's growth fundamentals. To ensure quality of banks' lending, BSP supplemented existing rules on credit limits (e.g., SBL, DOSRI and concentration limits) with the adoption of Credit Risk Management (CRM) principles. The CRM guidelines emphasized the critical role of the board of directors and senior management in promoting a prudent and sound credit environment commensurate to the bank's size, scale and complexity of operations. The guidelines also require compliance with sound credit underwriting and administration practices as well as utilization of cash flow analysis in determining a borrower's capacity to pay or creditworthiness.

Asset quality improved amid increased bank lending. Gross non-performing loans (NPLs) remained low at 2.1 percent of the total loan portfolio (TLP) as of end-September 2016, considerably better than as of end-December 2008 when NPL ratio was 4.1 percent with NPL coverage ratio remained above 100 percent. Real and other properties acquired (ROPA) similarly declined by 6.0 percent annually since end-September 2008 to ₱112.5 billion as of end-September 2016. This resulted in a lower non-performing asset (NPA) ratio further easing to 2.0 percent as of end-September 2016 from 5.1 percent as of end-December 2008. Moreover, the NPA coverage ratio rose to 77.3 percent from 44.9 percent.

While lending has generally been diverse across economic sectors, increasing concentration in the real estate sector has been noted starting 2009.[67] As a pre-emptive measure, the BSP adopted Real Estate Stress Test (REST) Limits[68] to ensure that banks would have sufficient buffer to withstand a crisis. The limits combine a macro-prudential overlay of a stress scenario which is a 25 percent write-off rate, recognizing the principle of loss absorbency through the use of capital thresholds.

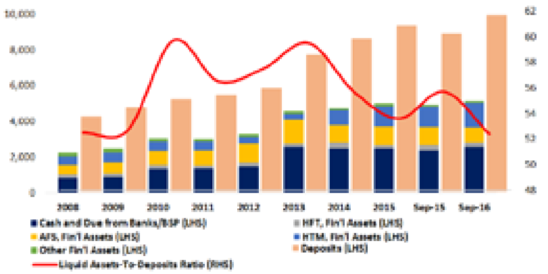
With the continued uptrend in consumer loans, significant growth was observed in the motor vehicle loans[69], mainly auto loans, due to increased market demand for private transport coupled with attractive marketing strategies and flexible financing options. To facilitate intensified financial surveillance, the BSP amended reportorial requirements of banks to allow a more granular submission of data on motor vehicles.

Liquidity is also a source of strength of the banking system with Philippine banks reporting liquidity ratios that are at par with counterparts in the

[67]Lending to real estate activities reached ₱1,240.8 billion as of end-September 2016.
[68]REST limits are equivalent to 10 percent CAR and 6 percent CET 1/Tier ratio after adjusting for stress test scenario of a 25 percent write-off rate on real estate exposures (REE) and Real and Other Properties Acquired.
[69]MVLs of UKBs and TBs increased by 28.5 percent to ₱364.3 billion as of end-September 2016.

region.[70] Liquid assets such as cash and investment securities were proportionately more than 50.0 percent relative to total deposits and 37.8 percent[71] to total assets.

Chart 1.14 Liquid Assets and Deposits
Level in billion pesos; ratio in percent

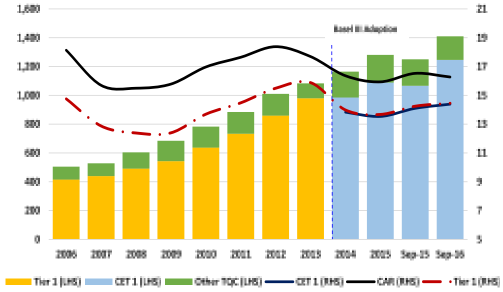


Source: BSP

Banks continue to maintain a healthy buffer to be able to service deposit withdrawals. Based on initial results of compliance with the Basel III Liquidity Coverage Ratio (LCR)[72], banks are able to provide for withdrawals under an assumed 30-day stress scenario. The adoption of the LCR will be complemented by the Basel III Net Stable Funding Ratio (NSFR) to promote funding stability.

Bank capitalization, on the other hand, continued to be on an uptrend in support of banks' risk-taking activities. Capital grew annually by 12.7 percent for the past 8 years to ₱1,552.4 billion as of end-September 2016. After 15 years, the minimum capital requirement for big banks was adjusted in 29 October 2014 to ensure that banks maintain a capital base that can support viable operation and service clients effectively.

Chart 1.15 Bank's Core Capital Supports Risk Taking Activities (on consolidated basis)
Level in billion pesos; ratio in percent



Source: BSP

The shift to the Basel III capital adequacy framework effective 1 January 2014 resulted in some decline in banks' capital adequacy ratio (CAR) owing to the tightening of the components of risk-based total qualifying capital to align with international standards. However, banks continued their capital build-up to support expansion in lending and investing operations.

Banks continue their capital build-up

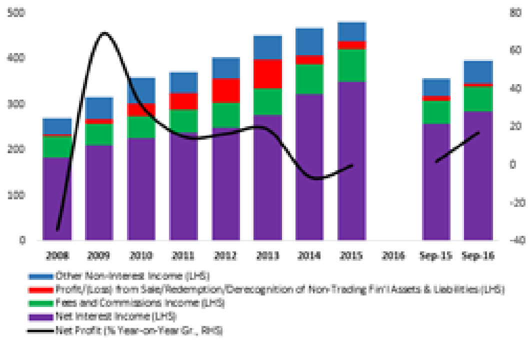
Universal and commercial banking group registered Basel III-CAR of 16.1 percent on consolidated basis and 15.4 percent on a solo basis as of end-September 2016 that remained above the BSP and BIS prescribed thresholds. The capital of the banking system is mainly comprised of common equity tier 1 (CET1) capital, which is considered the highest quality among the instruments eligible as regulatory capital, enabling banks to withstand unexpected losses in times of market stress. CET1 ratios were recorded at 14.2 percent and 13.4 percent on consolidated and solo bases as of end-September 2016.

The Fitch Ratings, in its April 2016 Asia Pacific (APAC) Banks Regulatory Compendium Report, cited that Philippine banks' minimum CET1 ratios of 10.0 to 11.0 percent (without a countercyclical buffer) were second highest after Hong Kong, SAR

[70]Most recent data on liquid assets ratio of the International Monetary Fund (IMF) showed that the Philippines was among the strongest across its ASEAN-5 counterparts. Singapore was at 69.4 percent followed by the Philippines at 34.1 percent, Malaysia at 22.1 percent (as of end-June 2016), Indonesia at 21.8 percent, and Thailand at 18.9 percent (as of end-June 2016).
[71]IMF Financial Soundness Indicator (FSI), accessed on 16 January 2017.
[72] In March 2016, the BSP announced its implementation of the Basel III LCR standards under a transitional/ phased-in arrangement.

which has been leading the way in the APAC region at CET1 10.0 percent to 12.0 percent range for larger banks.

Chart 1.16 Key Sources of Revenue
Level in billion pesos; growth in percent



Source: BSP

To further strengthen the system's capital base, the BSP adopted capital standards on systemically important banks and leverage ratio. The framework for Domestic Systemically Important Banks (DSIBs) increases banks' minimum CET1 ratio by 1.5 to 3.5 percentage points depending on the classification of the bank, as well as subjects DSIBs to more intensive supervisory approach. This is in addition to the existing minimum CET1 ratio of 6.0 percent and the capital conservation buffer of 2.5 percent. DSIBs whose capital ratio falls below their corresponding regulatory minimum will be subject to restriction in the distribution of their income. The Basel III leverage ratio, on the other hand, acts as a non-risk sensitive backstop to the CAR and is designed to restrict excessive leverage in the industry. This is currently implemented on a monitoring basis.

Resulting banks' core profitability improved through September 2016 with sustained increase in interest income from loans providing cushion against thinning revenues from treasury activities beginning 2014. Profitability indicators such as return on assets (ROA) and return on equity (ROE) stood at 1.2 percent and 10.0 percent, respectively, for the period ended September 2016.

In terms of cross-border activities, Philippine banks remain domestically oriented. Cross-border financial position of banks is minimal and diversified but may be exposed to contagion risks from linkages and spillovers from the US (major foreign counterparty) and Asia Pacific countries (biggest regional financial partner). Cross-border exposures, however, appear to be limited to certain channels, primarily capital market participation and loans and borrowings from banks[73] which are mainly denominated in US dollar.

Philippine banks remain domestically oriented

The BSP requires banks that have cross-border credit risk exposures to have adequate risk management systems to identify, measure, monitor and control country and transfer risks in its international lending and investment activities. Complementary to this, the BSP institutionalized the periodic collection of cross-border financial position of banks to serve as surveillance tool in analyzing potential financial risks emanating from foreign counterparties of Philippine banks.

Going forward, the BSP maintains a positive outlook for the Philippine banking system given its solid financial position and strong economic fundamentals of the Philippines. Moreover, the regulatory reforms strategically instituted over the years have prepared the banking system well for the challenges ahead. The BSP shall continue to invest in sound regulatory policies to achieve a more financially inclusive and stable banking system.

[73]Banks include central bank/official monetary authority, related entities and foreign offices.

External Sector Buoyed Up by Structural Flows

BOP position for full year 2016 reverses to deficit

The BOP position for full year 2016 yielded a deficit of US$420 million, a reversal of the US$2.6 billion surplus registered in 2015. This development was underpinned by the decline in the current account surplus as a result mainly of the increase in trade-in-goods deficit which more than offset the upturn in net receipts of secondary income, trade-in-services and primary income. Meanwhile, the financial account recorded lower net outflows attributed mainly to the marked increase in net inflows of direct investments along with reduced net outflows in portfolio investments. This positive development tempered the reversal of the other investment account to net outflows from net inflows in 2015.

The current account surplus declines

The current account recorded a surplus of US$601 million (0.2 percent of GDP) in 2016, 91.7 percent lower than the US$7.3 billion surplus (2.5 percent of GDP) in 2015. The decline in the current account surplus was due primarily to the widening deficit in the trade-in-goods account.

- The trade-in-goods deficit for full year 2016 widened to US$34.1 billion. This was 46.2 percent higher than the US$23.3 billion deficit in 2015. Imports recorded double-digit growth (at 16.6 percent) while exports grew marginally by 0.6 percent. Exports of goods totaled US$43.4 billion, a modest increase from the US$43.2 billion recorded in 2015. This developed as the decline in shipments of manufactured goods and mineral products negated the growth in exports of sugar products, fruits and vegetables and coconut products. Exports of manufactured goods declined by 7.1 percent due largely to lower shipments of machinery and transport equipment, non-consigned electronics (including other electronics), and garments due to the continued sluggish demand from the country's major trading partners. Exports of mineral products and other agro-based products fell by 18.8 percent and 2 percent, respectively.

- Imports of goods increased to US$77.5 billion in 2016 from the year-ago level of US$66.5 billion. The expansion in total imports was driven mainly by increases in purchases of capital goods (by 41.6 percent) and raw materials and intermediate goods (by 16.8 percent). These accounted for 15.5 percentage points of the 16.6 percent aggregate growth in imports, pointing to the continued expansion in the domestic economy's capital formation and production. Growth in imports of capital goods was boosted by increased importation of power generating and specialized machines, and telecommunication equipment and electrical machines. The increase in imports of raw materials and intermediate goods was driven primarily by purchases of manufactured goods (by 25 percent), particularly iron and steel, non-metallic mineral manufactures, and textile, yarn, fabrics and made-up articles. Meanwhile, imports of consumer goods rose by 26 percent to US$14.4 billion on account mainly of higher importation of durable goods, notably passenger cars and motorized cycles[74] (by 63.3 percent). By contrast, imports of mineral fuel and lubricants declined by 15.2 percent due mainly to the 29.6 percent contraction in imports of petroleum crude as

[74] US$4.2 billion or 86.6 percent of which are completely built-up vehicles.

world market prices of crude oil dropped in 2016.

- Net receipts in the trade-in-services account grew by 30.6 percent to US$7.1 billion in 2016, compared to the US$5.5 billion net receipts recorded in 2015. Higher net receipts were posted in computer, and technical, trade-related and other business services,[75] which more than offset the higher net payments for insurance and pension, transport, financial, and government goods and services. The reversal of telecommunication services as well as personal, cultural and recreational services to net receipts from net payments also supported the improvement in the trade-in-services account.

- The primary income account registered net receipts of US$2.6 billion, higher than the US$1.9 billion net receipts posted in 2015. The 39.7 percent increment stemmed from reduced net payments of investment income (by 17.8 percent), notably dividend payments to foreign direct and portfolio investors on their equity and investment fund shares in resident enterprises (by 15.6 percent and 12.6 percent, respectively). Residents' interest payments on foreign portfolio investments also declined, particularly on bonds held by non-residents which were issued by the local corporates (by 23.2 percent) and the NG (by 7.7 percent). Interest receipts on reserve assets which rose by 21.5 percent, also contributed to the upturn in primary income net receipts. These gains, more than offset the 3.9 percent contraction in net compensation income from resident OF workers amounting to US$7.4 billion in 2016 due to lower remittances from sea-based workers.

[75] Export earnings in business process outsourcing services amounted to US$20.2 billion in 2016, higher by 12.8 percent than the US$17.9 billion recorded in 2015.

- Net receipts in the secondary income account rose by 7.3 percent to US$25 billion, boosted mainly by the 7.6 percent increase in remittances by non-resident OF workers amounting to US$23.2 billion.

Capital account yields higher net receipts

Cumulative net receipts in the capital account reached US$102 million in 2016. This was 21.4 percent higher than the US$84 million posted in 2015 due to the increase in capital transfers to financial and nonfinancial corporations, households, NPISHs and the NG.

The financial account continues to post net outflows

The financial account registered net outflows (or net lending by residents to the rest of the world) of US$949 million in 2016, a decline of 58.8 percent from the US$2.3 billion net outflows in 2015. This was on account of lower net outflows of portfolio investments and higher net inflows of direct investments during the year. These more than compensated for the reversal of other investments account to net outflows from net inflows in the previous year.

Direct investment account. Net inflows of direct investments increased markedly to US$4.2 billion in 2016 from US$100 million in 2015. The higher FDI, coupled with lower net acquisition of financial assets by residents, contributed to higher net inflows during the period. In particular, net FDI posted a 40.7 percent growth to reach US$7.9 billion, buoyed by the 68.6 percent rise in non-residents' placements in debt instruments issued by local subsidiaries/affiliates (or intercompany borrowing), which amounted to US$5.2 billion.

Similarly, net investments in equity capital grew by 12.1 percent to US$2 billion, with gross placements coming mostly from Japan, Singapore, US, and Taiwan. These capital placements were channeled to the following sectors: financial and insurance; arts, entertainment and recreation; manufacturing; and construction. Meanwhile, residents' net acquisition of financial assets went down by 33.2 percent to US$3.7 billion given the drop in net placements in debt instruments and equity capital of foreign subsidiaries/affiliates by 34.7 percent and 29.1 percent, respectively.

Portfolio investment account. The portfolio investment account yielded net outflows of US$1.4 billion in 2016, significantly lower than US$5.5 billion in the previous year. This was brought about by the 66.5 percent decline in residents' net acquisition of financial assets (to US$1.1 billion) combined with the 87.6 percent decline in their net repayment of liabilities (to US$264 million). Residents' net acquisition of financial assets which were largely in the form of net placements in debt securities issued by non-residents decreased to US$915 million from US$2.8 billion in 2015. Meanwhile, residents' net repayment of liabilities was mainly from the local corporates' net redemption of long-term bonds held by non-residents amounting to US$608 million.

Financial derivatives. Trading in financial derivatives resulted in net gain of US$32 million in 2016 from a net loss of US$6 million a year ago.

Other investment account. The other investment account recorded US$3.8 billion net outflows in 2016, a reversal of the US$3.1 billion net inflows in 2015. Residents' net acquisition of financial assets during the year amounted to US$2.9 billion, comprised mainly of non-residents' net availment of loans from local banks (US$1.5 billion) and residents' placements of currency and deposits in banks abroad (US$1.3 billion). Meanwhile, residents' net repayment of liabilities reached US$886 million, with net outflows stemming largely from repayment of loans availed by local corporates from non-resident creditors (US$1.5 billion).

Table 1.3 Balance of Payments
In million dollars

	Jan-Dec	
	2015 r	2016
Current Account	7266	601
Capital Account	84	102
Financial Account	2301	949
Net Unclassified Items	-2433	-175
Overal BOP*	**2616**	**-420**

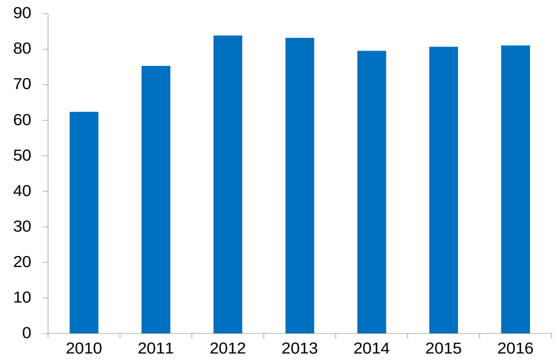
*Details may not add up due to rounding.
r Revised

International Reserves. The country's GIR amounted to US$80.7 billion (revised) as of end December 2016, largely unchanged compared to its level in the previous year. This was due mainly to inflows from the BSP's income from investments abroad and revaluation adjustments on the BSP's gold holdings and foreign currency-denominated reserves. These were partially offset by payments made by the National Government (NG) for its maturing foreign exchange obligations and the BSP's foreign exchange operations.

Reserves remain adequate

The end-2016 GIR level remains well above the standard adequacy metrics as it can cover 8.9 months' worth of imports of goods and payment of services and primary income. It is also equivalent to 5.6 times the country's short-term external debt based on original maturity and 4.0 times based on residual maturity.

Chart 1.17 Gross International Reserves
In billion US dollars



Source: BSP

Bulk of the country's reserves, at 84.6 percent, was held in foreign investments. Meanwhile, 9.0 percent were in gold and the remaining 6.4 percent were in the combined holdings of SDRs, the BSP's reserve position in the IMF, and foreign exchange.

Net international reserves (NIR), which refer to the difference between the GIR and the BSP's total short-term liabilities, amounted to US$80.7 billion as of end-2016, similar to its level a year ago.

External Debt. Outstanding Philippine external debt stood at US$74.8 billion as of end-2016, reflecting a decline of US$2.7 billion from the US$77.5 billion level in 2015. The decrease was due to: (a) net principal repayments by both the public and private sectors (US$3.4 billion); (b) previous periods' audit adjustments (negative US$168 million) due to late reporting; and (c) negative (downward) foreign exchange revaluation adjustments (US$36 million). However, the full downward impact of these factors on debt stock was partly offset by an increase in non-residents investments in Philippine debt papers issued offshore (US$846 million).

As of year-end, the maturity profile of the country's external debt continued to be largely medium- to long-term (MLT) in nature [i.e., those with original maturities longer than one (1) year], with a share to total of 80.6 percent (US$60.2 billion). This means that FX requirements for debt payments are well spread out and, thus, more manageable. The weighted average maturity for all MLT loans stood at 16.9 years at the close of 2016, slightly better than the 16.5 years recorded a year ago. Short-term (ST) loans [or those with original maturities of up to one (1) year] stood at US$14.5 billion by the close of 2016, accounting for 19.4 percent of the total debt stock. These loan accounts consisted of: (a) bank liabilities; (b) trade credits; and (c) other non-bank liabilities.

External debt remains manageable

At the end of 2016, public sector borrowings were down to US$37.5 billion from US$38.3 billion in end-2015. The share of public sector debt to total external debt, however, rose to 50.1 percent from 49.4 percent in 2015 due to the larger decrease in private sector accounts. The decline in public sector debt was due largely to net principal repayments (US$1.5 billion), which were partly offset by the increase in non-residents' investments in public sector debt papers (US$616 million) and upward FX revaluation adjustments (US$32 million).

Private sector debt likewise declined by 4.9 percent from US$39.2 billion in 2015 to US$37.3 billion in 2016, with share to total correspondingly declining from 50.6 percent to 49.9 percent. In 2016, the following were noted for private sector accounts: (a) net repayments (US$1.9 billion); (b) increase in non-residents' investments in private sector debt papers (US$231 million); (c) prior periods' audit adjustments (negative US$191 million); and (d) downward FX revaluation adjustments (US$67 million).

The key external debt indicators remained at comfortable levels at the close of 2016. The debt service ratio (DSR), which relates principal and interest payments (debt service burden or DSB) to exports of goods and receipts from services and primary income, is a measure of adequacy of the country's FX earnings to meet maturing obligations. As of end-2016, the ratio increased to 6.9 percent due largely to the increase in payments (from US$5.6 billion in 2015 to US$7.1 billion). Large principal payments in 2016 included the full redemption of bonds at maturity by the following: a) PSALM (US$638 million); b) NG (EUR500 million or about US$557 million); and c) two (2) universal banks (aggregating US$425 million). Nevertheless, the DSR has consistently remained well below the international benchmark range of 20.0 to 25.0 percent.

The external debt ratio (a solvency indicator), or total outstanding debt (EDT) expressed as a percentage of annual aggregate output or gross national income(GNI), continued to improve by year-end to 20.4 percent from 21.9 percent in 2015. The same trend was observed using GDP as denominator.

Medium-term developments and outlook

Balance of Payments. In stark contrast to the decade of the 1970s and 1980s when the Philippine economy experienced BOP crises, the previous decade has seen the transformation of the external sector as a pillar of strength for the economy.

Amid lingering global economic and financial uncertainties, the country's BOP position remained in surplus for the past years, except in 2014 and 2016.[76] The resilience is underpinned by the favorable performance of the current account, which has posted surpluses since 2003.

Providing a great push to the current account is the sustained growth in OFs remittances, BPO revenues, as well as tourism receipts.

OF remittances has been one of the largest contributors to FX earnings of the country. For the past decade, it has been growing at an average annual growth rate of around 8.0 percent, reaching US$25.6 billion in 2015. Its resilience and robust performance could be attributed to the continued demand for Filipino workers (from a million deployed OF workers in 2007 to almost 2 million in 2015), diversification of geographical location[77] and shift to a higher-skilled job.[78]

All of these contributed to the build-up of the BSP's FX assets which currently is more than enough to meet the country's FX liquidity requirements.

The overall BOP position is seen to post a surplus in 2017 to reflect an expected surplus in the current account.

External Debt. During the period 2007 to end-December 2016, total outstanding Philippine external debt grew by 12.4 percent, from US$66.5 billion to US$74.8 billion as private sector obligations increased from US$28.5 billion as of end-2007 to US$37.3 billion as of end-December 2016 or by 30.8 percent. The growth in private sector borrowings may be attributed to the country's favorable credit ratings, robust economic

[76]Among the main reasons for the reversal of the overall BOP position to a deficit in 2014 and 2016 were the US Fed tapering and policy normalization, respectively.

[77]While Middle East countries such as Saudi Arabia, United Arab Emirates and Qatar, continue to be major OF destinations as they host around 53 percent of total deployed OFs in 2015, other countries have been able to make it among the top OF destinations. These include Singapore (9.8 percent share to total), Hong Kong (6.0 percent), Taiwan (4.4 percent), and Malaysia (1.8 percent). *Source: Philippine Overseas Employment Administration (POEA)*

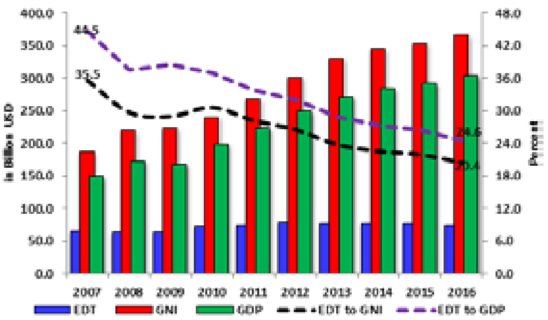
[78]The number of professionals, technical and related workers increased by 23.3 percent in 2014 compared to their number in 2007. The number of administrative and managerial workers deployed in 2014 likewise increased significantly from their 2007 levels.

growth and sound macro-economic fundamentals which boosted business operations.

While total outstanding Philippine external debt showed an upward trend, key debt indicators (i.e., ratio of external debt to aggregate output, debt service ratio and ratio of gross international reserves to short-term debt) continued to improve and consistently outperformed international benchmarks. Highlights of developments in external debt ratios from end-2007 to end- 2016 are as follows:

a. The continued positive growth rate in GNI and GDP offset the increase in the debt stock, resulting in improved debt to GDP/GNI ratios. The ratios indicate the country's sustained strong position to service foreign obligations in the medium-term.

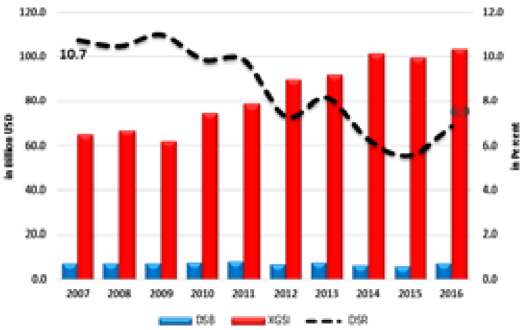
Chart 1.18 Total External Debt versus GNI and GDP
Levels in billion US dollars, ratios in percent



Source: BSP

b. The DSR likewise continued to improve, declining to single digit level starting 2010, signaling that requirements for debt payments are much lower relative to foreign exchange receipts. The historical DSR series shows figures way below the international critical benchmark range of 20.0 to 25.0 percent.

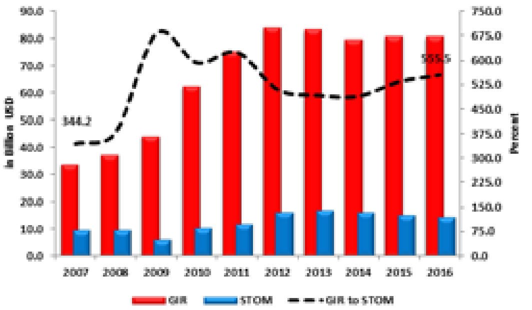
Chart 1.19 External Debt Ratio
Levels in billion US dollars, ratio in percent



Source: BSP

c. The trend in the ratio of GIR to short-term debt based on original maturity concept (STOM, which is a liquidity indicator capacity to pay obligations maturing within one year), likewise showed sustained improvement.

Chart 1.20 GIR vs Short-term Debt
Levels in billion US dollars, ratio in percent



Source: BSP

The BSP expects that the country's external debt ratio will continue to remain within prudent levels, indicating a manageable and sustainable external debt position.

Box Article 6

The Dynamics of Current Account in the Philippines: What Causes Its Fluctuation?[79]

Introduction

From the large and persistent deficit before the Asian Financial Crisis (AFC) to a sustained surplus a few years after the AFC, current account movements especially in EMDEs like the Philippines have drawn the interest of many. A persistent current account deficit is a serious cause of concern for many economies as it signals that a country could be on a path to insolvency, building up excessive net foreign debt, and raising the prospects of default or a sharp reversal in capital flows, which could trigger abrupt adjustment costs. Large deficits and rising indebtedness could also leave a country more vulnerable to adverse external shocks. This is a concern for policymakers as they need to ensure that a country moves toward a sustainable position in which the size of a current account deficit is not so large that it will lead to excessive build-up in foreign indebtedness. Furthermore, country-specific considerations are very important while introducing policy response, as the factors that can make the country relatively resilient to external shocks could be the same as those that help attract foreign capital and vice versa.

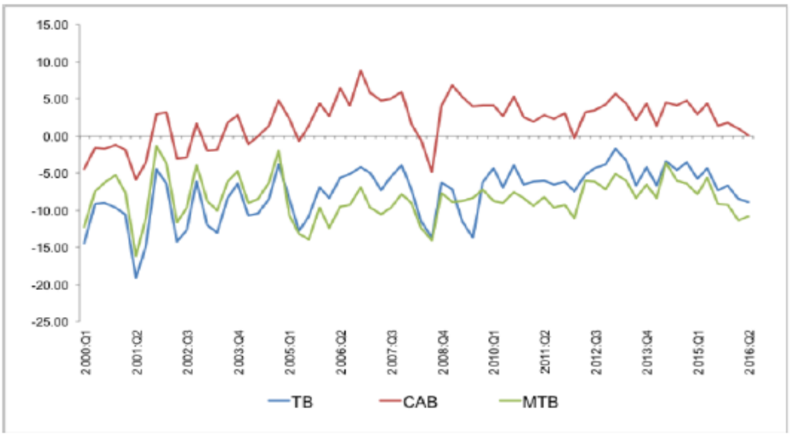
While the Philippine annual current account balance has remained in surplus since year 2003, a declining trend has been observed recently. From 8.8 percent in Q4 2006, the current account-to-GDP ratio went down to 0.1 percent in Q2 2016. This trend forms the basis of this study for finding out the determinants of the country's current account movements. Empirical work on the determinants of current account movements has been very limited especially for the Philippines. Hence, to fill the gap in the literature, this study intends to investigate the sources of the country's current account fluctuations. A structural VAR approach replicating the model applied in Nikolaychuk and Shapovalenko (2013) in analysing a small-open economy is used in this study.[80]

Trends in the Philippines' Current Account[81]

The movements of the current account and its main components, namely the external trade balance (which includes both the merchandise trade and services trade), using quarterly data from 2001 Q1 and 2016 Q2 is shown in Figure 1. Other important components of the current account include remittances to the Philippines and income on capital as shown in Table 1.

[79] Excerpt from Sabuga, I. and Rico Shirakawa, J.B. (2016).
[80] This is done by estimating the effects of the following shocks: supply, demand, nominal, and terms-of-trade shocks imposing sign restrictions on the impulse response functions as determined on the basis of macroeconomic theory and results of the previous studies on related topics. Both historical decomposition of the current account and forecast error variance decomposition are also generated to determine which of the factors in the SVAR system influenced the most current account fluctuation.
[81] Source: Bangko Sentral ng Pilipinas (2016)

Figure 1: Current Account (CAB), Trade Account Balance (TB), and Merchandise Trade Account Balance (MTB) (as percent of GDP, 2000 Q1 – 2016 Q2)



Source: Bangko Sentral ng Pilipinas (BSP) 2016
Note: Data from 2000 Q1-2004 Q4 are compiled using the Balance of Payments Manual Five (BPM5) framework while data from 2005 Q1- 2016 Q2 are compiled using the Balance of Payments Manual Six (BPM6) framework. CAB, TB, and MTB mean current account balance, trade account balance, and merchandise trade account balance, respectively.

Table 1: Composition of Current Account in the Philippines (in million US$, 2000-June 2016)

	2000	2005	2010	2015	Jan-Jun 2016
Merchandise Trade					
Exports	37,347	25,162	36,772	43,197	20,671
Imports	-43,318	-37,307	-53,631	-66,506	-37,065
Balance	-5,971	-12,146	-16,859	-23,309	-16,394
Services Trade					
Exports	3,377	8,611	17,782	29,322	15,992
Imports	-5,247	-6,463	-12,017	-23,681	-12,415
Balance	-1,870	2,148	5,765	5,641	3,577
Primary Income					
Receipts	3,336	4,741	6,688	9,505	4,742
Payments	-3,366	-4,387	-6,010	-7,649	-3,333
Net	-30	354	677	1,856	1,409
Secondary Income					
Receipts	5,909	11,816	17,970	24,334	12,546
Payments	-266	-181	-374	-827	-359
Net	5,643	11,634	17,596	23,506	12,186
Current Account					
Current Account Balance	-2,228	1,990	7,179	7,694	778

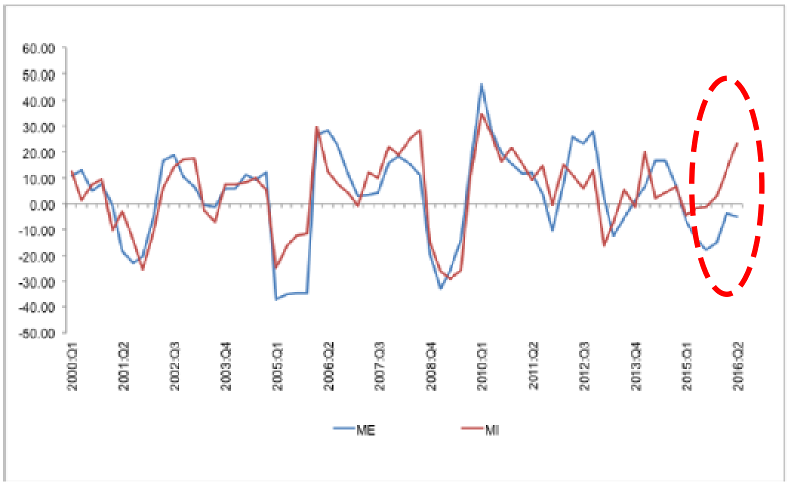
Source: Bangko Sentral ng Pilipinas

As shown in Figure 1, the Philippines' current account-to-GDP ratio registered deficits in Q1 2000 to Q3 2001 due mainly to deficits in merchandise and services trade accounts prior to the growth of the BPO industry. Meanwhile, in Q4 2001 to Q1 2002, the current account-to-GDP ratio exhibited a temporary surplus due mainly to lower goods imports driven by the decrease in petroleum crude prices and lower imports for electronic inputs associated with the slowdown of the US economy in the aftermath of the 9/11 attack.[82] From Q3 2005 to early 2007, the current account-to-GDP trend returned to a surplus as services exports began to

[82]Growth of the US economy declined to 0.2 percent year-on-year in Q4 2001 right after the 9/11 attacks from 2.9 percent in Q4 2000 (US BEA, 2016).

strengthen driven by the surging BPO industry and the rise in OF remittances (bulk of which is recorded in the secondary income account). Meanwhile, the adverse effects of the global financial crisis in mid-2007 led the current account-to-GDP to again post a deficit. Since then, the current account-to-GDP ratio exhibited a surplus driven by the continued strength of both the BPO sector and OF remittances. Recently, however, the share of current account-to-GDP has been on a declining trend even with the continued inflows of both BPO receipts and OF remittances. As shown in Figure 2, a decoupling of merchandise exports and imports has been observed since Q1 2015.

Figure 2: Merchandise Exports and Imports (percent change year-on-year, 2000 Q1-2016 Q2



Source: Bangko Sentral ng Pilipinas (BSP) 2016
Note: Data from 2000 Q1-2004 Q4 are compiled using the Balance of Payments Manual Five (BPM5) framework while data from 2005 Q1- 2016 Q2 are compiled using the Balance of Payments Manual Six (BPM6) framework. ME and MI mean merchandise exports and merchandise imports, respectively.

The widening of the trade deficit was driven mainly by the weak demand in emerging economies compounded by falling commodity prices. Meanwhile, the country's merchandise imports continued to rise consistent with the robust expansion of the domestic economy. The recent trend of the current account-to-GDP seems to follow Uz's (2010) conjecture saying that a declining current account balance could arise when a country tries to foster non-industrial production without enough industrial development, which could result in higher imports than exports.

Analytical Framework[83]

The trend in the country's current account could also be analyzed in terms of national savings vis-à-vis national investment. In theory, current account equals the country's savings minus investments. The declining trend in the current account could imply that a country's investments have been growing rapidly compared to its

[83]Following Uz (2010), this could be represented by $Y_t + C_t + I_t + G_t + (X_t - M_t)$. Rearranging the variables, $(X_t - M_t) = Y_t - C_t - I_t - G_t$. Then, $(X_t - M_t) = S_t - I_t$, where national savings is represented by $S_t = Y_t - C_t - G_t$ or external account has to be equal to the difference of national savings and investment. Dividing national savings into public and private savings implies the following equation: $(X_t - M_t) = (Y_t - T_t - C_t) + (T_t - G_t) - I_t = S_t^p + S_t^g - I_t$. Inserting the real variables to the model implies: $\frac{TB_t}{P_t} = \left(Y_t - \frac{NT_t}{P_t} - \frac{P_{Ct}}{P_t} C_t\right) + \left(\frac{NT_t}{P_t} - G_t\right) - \left(\frac{P_{It}}{P_t} I_t\right)$, where $\frac{TB_t}{P_t}$ is the nominal trade balance, P_t is the GDP deflator, NT_t is the taxes net of transfers, P_{Ct} is the price of final consumption goods that are purchased, and P_{It} is the price of final investment goods. So, the real trade balance is the sum of real private and public saving minus real investment, then external account and public budget are twinned.

savings. This could reflect the impact of policies on either supporting investments or reducing consumption. The current account could also be described in terms of the sum of private and public savings minus investment. If private savings is approximately equal to investments then current account deficit and public budget are interrelated. If this is true, then following Mundell-Fleming's approach, the external account and fiscal balance have to move in the same direction. The increase in the budget deficit causes an increase in interest rates. This then results in an increase in capital inflows and an appreciation of domestic currency thereby causing a current account deficit.

Current account imbalances have also been extensively studied over the past decade. For most of these studies, the finding is that current account imbalances are caused by demand and terms-of-trade shocks.

Empirical Results and Discussion[84]

The results of this study are consistent with the predictions of a wide set of open-economy models. Results show that the current account balance in the Philippines is mostly driven by demand[85] and terms-of-trade[86] shocks based on forecast error variance decomposition. With demand shock as one of the main drivers of the current account, this means that greater attention should be paid to the soundness of fiscal policy. In addition, the monetary policy can contribute in reducing the external mismatches by putting greater stress on aggregate demand management.

Table 2: Summary of Results on the Impact of Specific Shock to the Current Account

Shock	Sign Restrictions	Magnitude (in percent)	Persistence
		Model with REER	
Terms-of-Trade	+	1.02(Q1)	Q1
Supply	+	0.67(Q1)	Q1
Demand	−	−0.57(Q1); 0.79(Q2)	Q2
Nominal	+	0.54(Q1); −0.85(Q2)	Q2
		Model with NEER	
Terms-of-Trade	+	0.89(Q1)	Q1
Supply	+	0.52(Q1)	Q1
Demand	−	−0.60(Q1); 0.70(Q2)	Q2
Nominal	+	0.52(Q1); −0.66(Q2)	Q2
		Model with CPI	
Terms-of-Trade	+	0.80(Q1)	Q1
Supply	+	0.61(Q1)	Q1
Demand	−	−0.57(Q1); 0.57(Q2)	Q2
Nominal	+	0.54(Q1); −0.49(Q2)	Q2

Notes: Results presented are significant at +/- two standard deviations. Shock means the individual shock imposed in the SVAR system with the benchmark model (with REER), and alternative model (with NEER or CPI). Sign restriction is the assumption imposed on the individual shock on first period (i.e., Q1). The magnitude of shock presented means a one-standard deviation shock results in an increase/decrease of current account-to-GDP. Meanwhile, persistence means how the shock would last (e.g., Q2 means until the second quarter) until it goes back to its stable path.

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[84]The study uses an SVAR approach with sign restrictions following that of Nikolaychuk, S. and Shapovalneko, N. (2013) to analyse the determinants of current account fluctuation in the Philippines using publicly available data of four-variable SVAR for the period 2001 Q1 to 2016 Q2. The variables include terms-of-trade (TOT) or the ratio of exports and imports deflator; relative output (RO) or ratio of Philippine real GDP and trade-weighted real GDP of foreign trade partners; current account-to-GDP (CAB); and real effective exchange rate (REER). Alternative models are also presented substituting REER with consumer price index (CPI) or nominal effective exchange rate (NEER). While results generated are widely consistent with previous studies, persistence of each shock seems not to show in the Philippine data. This could be a subject for further investigation.
[85]Obtains the same findings as that of Hoffmaister, A. and Roldos, J. (1997); Garcia-Solanes, J., Lopez, J. and Torres, J. (2011); Barnett, A. ans Straub, R.(2008) which states that most important determinants of current account fluctuation are domestic ones (i.e., fiscal shocks; private absorption shocks). An increase in real domestic shock could result in the deterioration of current account.
[86]This is consistent with the findings of Otto (2003) on the existence of Harberger-Laursen-Metzler effect which states that the temporary improvement in the terms of trade leads to a trade balance improvement.

The positive terms-of-trade shock has an effect on output and real exchange rate. However, the response of CA to the said shock is short-lived as it dissipates in the next quarter, implying that terms-of-trade effect on current account has no persistence. In terms of supply shock, a permanent increase in output, which can be explained by an increase in productivity, leads to an appreciation of the real exchange rate. The changes in terms of trade are negative following a relative fall in domestic prices due to supply factors. Together, these factors lead to a positive effect on the current account balance, reflecting mainly higher supply of tradables. The same with the terms-of-trade shock, no persistence is observed in the results. Meanwhile, in terms of demand shock, an expansion shock (caused, for example, by a looser fiscal policy) leads to an initial hike in output, causing a deterioration of current account-to-GDP. Domestic prices also react to such changes, surging relative to foreign prices. As a result, the change in price competitiveness diminishes the first positive effect on relative output. The nominal shock was constructed as devaluation of the national currency in real terms. It seems that a nominal shock (or devaluation of the national currency) results in an increase in domestic demand and current account. Growth of domestic demand in response to the nominal shock has a maximum effect of three quarters, which result in a diminishing positive effect on the current account balance. Moreover, the positive response of the current balance to a nominal devaluation is not immediate. There is clear evidence that at least the J-curve effect cannot be rejected in the Philippines.[87]

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[87] J-Curve effect can be observed when a country's current account balance initially worsens following a depreciation of the domestic currency. This is based on the assumption that when domestic currency depreciates, imports are more expensive and that volume of imports and exports do not adjust automatically. After some time, volume of exports may start to rise given the domestic country's price competitiveness relative to the foreign country, causing a surplus in CA.

What We Did in 2016: Three Pillars of Philippine Central Banking

Price Stability: Monetary Policy Stance Is Well-Attuned to Demand Conditions

Monetary Policy. In 2016, the Monetary Board (MB) held 8 monetary policy meetings and decided to maintain interest rate on the BSP's overnight reverse repurchase (RRP) facility at 3.0 percent. The corresponding interest rates on the overnight lending and deposit facilities were also kept steady. The reserve requirement ratios were likewise left unchanged.

> The BSP maintains monetary policy settings in 2016 but implements operational adjustments in monetary operations

The policy decisions of the MB were based on the BSP's assessment of the dynamics and risks in the inflation environment over the policy horizon. Despite inflation hovering below the NG's inflation target range, the BSP made clear in its policy communications to the public that domestic price movements in 2016 continued to be driven mainly by supply-side factors that were outside the influence of monetary policy. Moreover, the BSP's inflation forecasts during the year showed inflation returning to the target by 2017. At the same time, the BSP observed that expectations of the public on future inflation remained aligned with the NG's inflation target over the 2017-2018 policy horizon. Equally important, the BSP noted that while global economic conditions remained subdued, domestic economic growth remained firm and did not appear to require additional monetary stimulus owing to robust private household consumption and investment. Business and consumer sentiment also stayed buoyant. In addition, robust domestic expansion has proceeded against a backdrop of ample domestic liquidity (M3) and strong credit activity. These considerations supported the BSP's decision to keep its monetary policy settings steady during the year.

In its policy pronouncements, the BSP also emphasized that it would continue to monitor emerging price and output conditions to ensure price and financial stability conducive to sustainable economic growth.

On 3 June 2016, the BSP made a formal shift in its monetary operations to an IRC system. The system for monetary operations was modified to consist of the following: overnight liquidity facilities, namely, the overnight lending facility (OLF) and the overnight deposit facility (ODF); the overnight RRP facility; and a term deposit facility (TDF). The interest rates for these facilities were also recalibrated as follows:

- 3.5 percent in the overnight lending facility (a reduction in the upper bound of the corridor from the overnight RP rate of 6.0 percent);
- 3.0 percent in the overnight RRP rate (an adjustment from 4.0 percent); and
- 2.5 percent in the overnight deposit facility (no change from the SDA rate).

> The BSP makes a formal shift in its monetary operations to an IRC system

The key benefit of the adoption of the IRC system is the strengthening of monetary policy transmission by ensuring that money market interest rates move within a reasonable range around the BSP's policy rate. The adjustments in the BSP's key interest rates under the IRC reform were primarily operational in nature and were not expected to materially affect prevailing monetary policy settings.

Medium-term developments and outlook

While domestic economic expansion has remained strong in the Philippines, there are risks that could impact the country's growth prospects moving forward. In particular, stagnant global trade, subdued investment, and heightened policy uncertainty continue to weigh down on the world economy. Nevertheless, with domestic economic growth expected to continue in 2017 - 2018, the BSP's monetary policy remains focused on achieving the inflation target. Inflation is projected to steadily increase and settle within the government target range driven by higher oil prices, weaker exchange rate, and continued strength in domestic economic activity. The Government has also approved the inflation target of 3.0 percent ± 1.0 percentage point for 2019–2020.

Meanwhile, the normalization of monetary policy in advanced economies particularly in the US, is seen to trigger portfolio rebalancing away from emerging economies, including the Philippines, resulting in potentially tighter financial market conditions and exchange rate pressures. The BSP recognizes the potential risks to financial stability that may arise from increased financial market volatility. Nonetheless, the key is for monetary authorities to remain on the lookout for evolving economic developments and ensure that the BSP's monetary policy tools are appropriately calibrated to guard against such risks.

Box Article 7

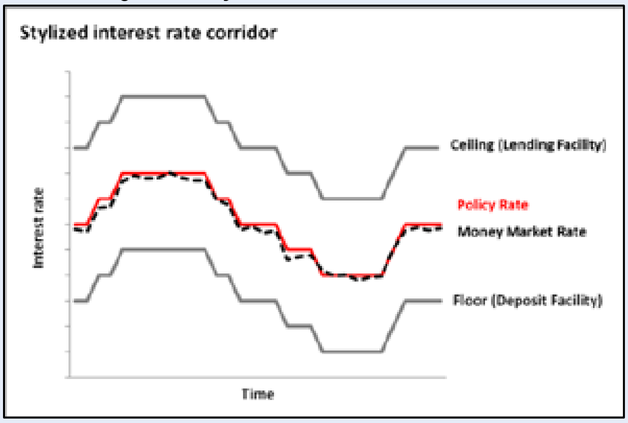
Implementation of Interest Rate Corridor (IRC) in the Philippines

The Philippines is one of the countries that saw a surge in foreign exchange inflows resulting from the QE policies pursued by advanced economies following the GFC. This resulted to a liquidity surplus in the domestic financial system which has placed pressure on the BSP's monetary policy implementation with short-term market interest rates diverging from the BSP's policy rate. To address this concern, the BSP embarked on a full-scale reform of its operational framework through the implementation of the IRC system. The shift to the IRC framework remains in line with the BSP's primary mandate of price stability as it improves the effectiveness of monetary policy actions. Moreover, it transformed the BSP's monetary operations from a generally passive set of instruments into an active and more dynamic policy toolkit that enhances monetary policy transmission whether during normal or extraordinary times.

On 30 September 2015, the BSP announced in a press release the shift to the IRC system by the second quarter of 2016 with the aim of establishing the needed infrastructure to enable active monetary operations in the Philippines in support of the announced policy stance, committing to a smooth and orderly transition. Consequently, on 3 June 2016, the IRC system went live with the launch of the BSP liquidity facilities.

An IRC is a system for guiding short-term market interest rates towards the central bank (CB) target/policy rate. It consists of a rate at which the CB lends to banks (typically an overnight lending rate) and a rate at which it takes deposits from them (deposit rate). In a standard corridor, the lending rate will be above the CB target/policy rate (thereby forming an upper bound for short-term market rates), and the deposit rate will be below the CB rate, thereby forming the lower bound (Figure 1).

Figure 1. Stylized interest rate corridor



Objectives

The key benefit of the adoption of the IRC system is the strengthening of monetary policy transmission by ensuring that money market interest rates move within a reasonable range around the BSP's policy rate. By helping ensure close relationship between the policy rate and market interest rates through the IRC system, the BSP would be able to generate a more effective policy signal as market rates closely track the policy target rate, thereby, impact the real economy.

In addition, the IRC system is also seen to confer important benefits to the Philippine financial system over time.

§ It is expected to promote greater interbank market activity by encouraging banks to undertake their day-to-day liquidity management more actively as BSP monetary operations gradually exert a stronger influence on short-term liquidity conditions.

- § Moreover, the offering of the term deposit facility (TDF) is expected to promote the establishment of benchmarks for short-term interest rates.
- § Increased activity and better pricing in money market rates, in turn, are seen to help add depth to money markets and help develop the domestic capital market.
- § Over time, the implementation of the IRC system will also allow possible adjustments in reserve requirements in line with international norms.

IRC Structure

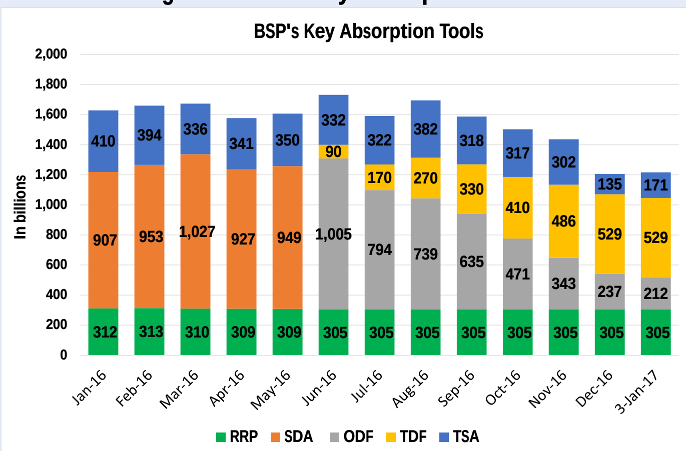
The modification of the operational toolkit includes BSP liquidity facilities transformed into overnight standing facilities. The standing facilities, namely the overnight lending facility and overnight deposit facility, replaced the repurchase (RP) facility and Special Deposit Account (SDA), and formed the ceiling and floor, respectively, of the corridor. Meanwhile, the RRP facility, which continued to serve as the key policy interest rate of the BSP, sits in the middle of the two standing facilities. In order to reflect the desired mid-corridor structure of the IRC, the interest rates for the overnight facilities were technically recalibrated.

- § A reduction in the upper bound of the corridor from the overnight RP rate of 6.0 percent to 3.5 percent in the overnight lending facility.
- § An adjustment from 4.0 percent to 3.0 percent in the overnight RRP rate.
- § No change from the SDA rate of 2.5 percent in the overnight deposit facility.

Early Developments

Since the start of the IRC implementation in June, market reception to the IRC system has been positive. Market participants have adjusted relatively quickly to the new framework for the monetary operations of the BSP. According to market players, the implementation of the IRC went smoothly with minimal market volatility. Moreover, banks and trust institutions are participating actively in the open market operations, specifically, in the TDF auctions (Figure 2).

Figure 2. BSP's Key Absorption Tools



Auctions for both the 7-day and 28-day term deposits have been oversubscribed, reflecting the sustained ample liquidity in the financial system. However, in the latter part of 2016, placements of market participants have decreased, resulting to an undersubscription. The reduction of placements could be mainly attributed to seasonality, that is, banks holding on to cash in response to higher demand for the holiday season. Following the holiday season, bid-to-cover ratios in the TDF and RRP facilities increased which could be indicative of the normalization of liquidity as seasonal effects may already be dissipating.

Meanwhile, the relatively small size of initial offerings of the TDF auction amid ample liquidity in the system resulted in the average accepted TDF bid rates that were close to the ODF.[88] After several months of operations, market interest rates have adjusted gradually as participants became more accustomed to the new operational framework.

The transition to the IRC system was deliberately done in a gradual manner to avoid unnecessary volatility in market interest rates. Over time, the BSP expects to achieve a convergence of market interest rates to the policy rate and thereby strengthen both interbank activity and the monetary policy transmission process. In the long run, the IRC system will support capital market development by encouraging more interbank transactions as well as facilitating price discovery and providing benchmarks for short-term interest rates. These developments in turn can also serve to improve the overall market conditions for funding by the corporate sector.

[88] The 7-day TDF auction offered volume is currently at ₱30 billion from an initial volume at ₱10 billion, while the 28-day TDF auction volume began at a ₱20-billion offering with additional new offers of ₱20 billion every 4 weeks, resulting to a volume offered of ₱150 billion at present.

Loans and Credit. The BSP ensured effective delivery of credit through its rediscounting facility. The BSP provided assistance to banks with temporary liquidity needs. During the year, the BSP focused on intensifying its loan collection effort, enhancing delivery of credit through the Credit Surety Fund (CSF), and maximizing the full potential of technology with the use of the Electronic Rediscounting System.

In line with the implementation of the BSP's IRC system effective 3 June 2016, the subsequent adoption of overnight lending rate on Rediscounting Window (RW) I with term premia took effect on 25 July 2016. From a base rate of 6.0 percent, the rate was reduced to 3.5 percent. The overnight RRP rate to which the rate for RW II is aligned, was also reduced from 4.0 percent to 3.0 percent.

The BSP also granted temporary rediscounting reliefs, in addition to regulatory reliefs to banks affected by typhoon *Lawin* in Q4 2016 per Monetary Board Resolution (MBR) No. 2018 dated 11 November 2016. The temporary relief granted a 60-day grace period to settle outstanding rediscounting obligations to all banks with operations or end-user borrowers in affected areas. The measure also allowed rediscounting banks to restructure with the BSP, on a case-to-case basis, the outstanding rediscounted loans of their end-user borrowers affected by the calamities, subject to the terms and conditions stated in the implementing guidelines.

Total loan availments in 2016 amounted to ₱79,602.1 million. Grant to the NG in the amount of ₱68,352.1 million accounted for the greater part of the total loan releases. This represents the participation of the government to IMF quota subscription[89].The remaining ₱11,250.0 million pertain to availments under the rediscounting facility, of which ₱9,749.0 million went to universal banks, ₱1,445.9 million to thrift banks, and ₱55.1 million to rural banks. Meanwhile, loan collections applied to principal reached ₱14,183.2 million, majority of which pertains to Peso Rediscounting amounting to ₱11,262.0 million.

The total outstanding loan portfolio of the BSP as of 31 December 2016 increased by ₱64,843.6 million or 93.18 percent to ₱134,430.6 million from the previous year's level of ₱69,587.0 million, largely due to the increase of Philippines' quota subscription in the IMF. Under the peso rediscounting facility, the total loans outstanding fell to ₱402.8 million as of end-2016 from ₱605.2 million in end-2015. Of the outstanding peso loans, thrift banks (TBs) and rural banks (RBs) accounted for ₱75.2 million (11.2 percent) and ₱327.6 million (88.8 percent), respectively.

Targets related to the provision of loans and credit were met in 2016. Total gross income from lending operations reached ₱1,830.4 million exceeding the projected level of ₱1,829.6 million mainly on the back of higher-than-expected income from regular rediscounting loan, emergency and restructured programs as well as miscellaneous income. Moreover, targeted collection levels in 2016 were exceeded, achieving a 100 percent collection rate on loans to PDIC, 98.4 percent for rediscounting loans, 61.1 percent for emergency loans and 84.9 percent for other loans.

The past due ratio (PDR) improved to 4.7 percent in 2016 compared to 10.0 percent in the previous year.[90] Credit risks on current rediscounting loans were proactively managed through off-site analysis and on-site credit verifications. The decline in PDR was also due to the focused improvement on loan collection. This involved personal delivery of demand letter to individual bank borrowers, offering available BSP settlement schemes, intensifying foreclosure of collateral properties, and the implementation of the MB

[89]Provided for under IMF Resolution No. 66-2 and as required under the Articles of Agreement of the IMF and as authorized under Section 2 (a) of Republic Act No. 2052, as amended, and MBR No. 1752 dated 9 December 2010.

[90]The composite PDR ratio will be reduced to 2.4 percent if the matured PDIC loan amounting to ₱3,020.9 million for the account of the Philippine National Bank, referred to Department of Justice for interpretation of contested provisions of the Loan Agreement, will be excluded.

approved write-off of accounts per MBR No. 13 dated 07 January 2016.

The BSP continues to improve the delivery of credit. Various projects to enhance the delivery of credit to all productive sectors of the economy were implemented. Among the accomplishments were:

Credit Surety Fund (CSF) Program.[91] A total of ₱903.804 million loan releases from lender banks benefited 1,047 entrepreneurs under the CSF Program for 2016. Outstanding loan balance as of 31 December 2016 was ₱913.539 million of which ₱743.651 million was covered by the CSF. As of year-end 2016, the accumulated approved loans from date of inception in 2008 stood at ₱3.253 billion. To date, a total of 45 CSFs have been established in 30 provinces and 15 cities nationwide since 2008.

Systems Management Functions

Electronic Rediscounting System (eRS). Technical assistance was given to banks covering an in-depth discussion of BSP's rediscounting facility, documentary requirements for each loan type, and key features of the eRS.

Loans and Credit Management Information System (LCMIS). The LCMIS will streamline and fully computerize operations, from loan approval to recovery, including report generation and interface with other BSP systems. This will ensure real-time delivery of credit and other services, and seamless recording and updating of transactions in the Department of Loans and Credit databases and other BSP systems to which it is integrated. The Business Architecture (BA) documentation of LCMIS has been completed and the procurement process of LCMIS is nearing its completion.

[91]The CSF Program is a credit enhancement that allows micro, small and medium enterprises (MSMEs), which are members of cooperatives, to borrow form banks using the CSF surety cover as security for the loan in lieu of conventional collateral. Loans granted by banks under the CSF Program are eligible for rediscounting with the BSP through the Department of Loans and Credit.

Asset Management. As of 31 December 2016, the total book value of acquired assets stood at ₱15.945 billion,[92] lower by ₱0.237 billion or 1.5 percent than the previous year's level of ₱16.182 billion.

Through the various asset disposal schemes, the BSP Committee on Disposal of Real Properties disposed of an aggregate 914 titles with a total net book value of ₱263.255 million for a total contract price of ₱602.192 million. This generated an estimated net income of ₱357.958 million for the BSP, inclusive of interest income estimated at ₱82.043 million that will be generated over the term of the contracts for installment sales.

The total collections of ₱588.531 million of sales contract receivables which represent 90.31 percent of the total installments due were higher than the target collection rate of 88 percent for the year. Interest income earned from the total collections amounted to ₱277.153 million. In addition, the BSP earned a total miscellaneous income of ₱329.629 million.

The BSP is continuously taking measures to intensify its collection efforts through the timely sending of notices to delinquent buyers and lessees. Contracts to sell are cancelled for failure of the buyers to settle their delinquent installments after the first and second notices.

Notes and Securities Printing. A total of 1.8 billion pieces of banknotes were delivered for the 2016 order. The delivery comprised of 0.8 billion pieces outsourced finished banknotes (OFB) and 1.0 billion pieces produced in-house finished bank notes (IFB). With the recently acquired Laser Engraving Machine (LEM) which was commissioned on 28 September 2016, altos[93] can now be produced in 14 days, compared to the three (3)-month timeline for outsourced ones.

[92] Subject to adjustments
[93]Alto or Nickel Alto is a master plate with a configuration of four (4) across and eight (8) down or (32 outs layout) and five (5) across and 10 down or (50 outs layout) that produce a printing plate for Intaglio machine.

As of 4 November 2016, a total of 2,766,195 passport booklets or 99.24 percent of the total 2016 requirement were delivered to the Department of Foreign Affairs (DFA). The DFA authorized BSP to formally close the order and free BSP from any liability. The BSP was also able to deliver 4,500,000 pieces of judicial title forms (JTF) or 100 percent of the total 2016 requirement, to the Land Registration Authority. For other BSP securities documents, such as demand deposit check, expense check, official receipt, sales invoice, and statement of account, a total of 244,430 pieces or 100 percent of the target were produced and delivered to customers.

Mint and Refinery. The 2016 reassessed coin order of 1.5 billion pieces were delivered to the Currency Issue and Integrity Office (CIIO) in 2016. An additional 1.0 billion pieces, which is part of the 2017 requirement, were also delivered. The ending inventory stood at 0.2 billion pieces.

Apart from the production and delivery of circulation coins, the BSP produced refined gold consisting of 35 "Good Delivery Bars" (GDBs). The mint also produced and delivered 114 pieces of Presidential Medals, 86 pieces of State Decorations, 108,078 pieces of commemorative coins, and 40,737 pieces of commemorative medals.

Currency Issuance and Retirement. The demand for currency has been rising steadily consistent with the growing economy. Total currency in circulation (CIC) as of end-2016 increased to ₱1.1 trillion, up by 11.8 percent from the level recorded in the previous year.

The BSP also continued to provide timely, good-quality, and adequate currency to meet the requirements of the economy. Efforts included strengthening its methodology for forecasting denominational currency requirements; maximization of vault space and expansion of vault capacity; continuing improvements in the operations of Enhanced Cash Management (ECM) services; facilitating efficient verification of banknote and coin deposits; expediting the retirement of unfit notes through the use of Cash Disintegrator System and high-speed Automated Banknote Processing Machines (ABPMs); purchasing foreign currencies from banks as part of the BSP's service to banks; and facilitating shipment of foreign currencies to correspondent banks abroad.

At the same time, to preserve currency integrity, the BSP continued to conduct public information campaigns on various currency-related programs and policies of the BSP, such as counterfeit detection, Clean Note and Coin Policy (CNCP), and Coin Recirculation Program, among others; examined mutilated/doubtful currencies and negotiable instruments; strengthened the anti-counterfeiting drive; and calibrated the ABPMs for accuracy in counterfeit detection and in support of CNCP.

International Operations. The BSP, through the International Operations Department (IOD), continues to further amend existing foreign exchange (FX) regulations to keep the country's FX regulatory framework attuned with prevailing market conditions and responsive to the needs of our expanding and dynamic economy. The BSP has implemented nine waves of FX reforms since 2007, primarily aimed at rationalizing and facilitating stakeholders' access to FX resources of the banking system for legitimate FX transactions to support business activities that could contribute to economic growth and development. In 2016, the IOD issued five circulars further amending the Manual of Regulations on Foreign Exchange Transactions (FX Manual).

The FX liberalization initiatives for the year included the lifting of the prohibition on the notarization of documents covering foreign loans, deferred payment and other foreign or foreign currency denominated obligations of the private sector. The change in policy covers purely private sector accounts (that is, those without guarantee or foreign exchange exposure on the part of the government financial institutions and/or government owned/controlled entities) that are submitted to the BSP for approval and/or registration. It will, thus, provide the private sector greater flexibility with respect to documentation of their financing agreements to meet specific requirements of creditors and/or foreign laws that may govern such transactions.

The BSP likewise provided a final one-year grace period (from 1 September 2016 to 1 September 2017) within which application for registration of FDIs that are existing and already recorded in the books of the investee firm may be filed with the BSP, regardless of the date when funding for the investment was made via inward remittance of FX or transfer of assets to the Philippines. This measure is part of the BSP's efforts to further improve capture of data on FDIs and facilitate the use of FX resources of the banking system for legitimate purposes, including outward remittance in the FX equivalent of peso divestment proceeds from, and income on, registered FDIs.

Meanwhile, in line with the thrust to simplify regulations, the MB approved the lifting of the prior BSP approval and registration requirements for loans to be obtained by non-banks with quasi-banking functions (NBQBs) from offshore sources, offshore banking units (OBUs) and foreign currency deposit units (FCDUs) of banks. The new policy will facilitate the borrowing transactions of NBQBs to fund their operations and projects and help accelerate economic activity. These accounts, however, shall continue to be covered by the BSP's reportorial requirements as well as documentary requirements to support the purchase of FX from the banking system to service these loans.

Further FX liberalization reforms involving major amendments to the FX regulatory framework were also implemented in the third quarter of the year in consultation with relevant stakeholders. The reforms are part of BSP's continuing efforts to keep regulations appropriate for the changing needs of the economy, support greater international integration, promote portfolio/risk diversification by investors, facilitate access to the FX resources of the banking system for legitimate FX transactions, provide stakeholders greater flexibility in managing their cash flows, and encourage shift of FX transactions to the formal channel. These reforms include:

- Increased from ₱10,000 to ₱50,000 the amount of legal tender Philippine currency that may be brought into/out of the country;
- Raised the amount of FX that Philippine residents may purchase from the banking system without supporting documentation for non-trade current account transactions from US$120,000 to US$500,000 (for individuals) and US$1 million (for corporates/other entities);
- Allowed the sale of FX to residents up to US$500,000 (for individuals) and US$1 million (for corporates/other entities) without documentation for settlement of import obligations to non-residents (except intercompany netting arrangements);
- Allowed residents to deposit FX purchased from banks for certain underlying transactions (such as for payment of certain obligations to non-residents) into their Foreign Currency Deposit Unit (FCDU) accounts, prior to remittance to the intended beneficiaries;
- Lifted the prohibition on the sale of FX by banks and their forex corporations for resident-to-resident FX transactions;
- Lifted the prior BSP approval and registration requirements for private sector loans to be obtained from banks operating in the Philippines; and
- Aligned the pertinent sections of FX Manual with R.A. No. 10641 (An Act Allowing the Full Entry of Foreign Banks in the Philippines, Amending for the Purpose R.A. No. 7721) and the implementing BSP Circular (Circular No. 858).

To ensure proper understanding and appreciation of BSP rules governing FX transactions, the BSP regularly conducts information dissemination activities. For 2016, five briefings were held in various BSP regional branches. To help exporters better manage their FX risks, a presentation on basic hedging tools was included in the briefings which were also attended by exporters. After the issuance of the latest set of FX reforms (9th wave of reforms) in the third quarter of 2016, two briefings were held at the BSP Head Office in 2016 for bank compliance officers and industry association representatives to provide a venue for soliciting feedback on the new policies.

Aside from issuing press releases for its policy issuances, the BSP likewise updates its "Frequently Asked Questions on FX rules" which is posted at the BSP website for easy reference.

Economic Research and Information Dissemination Activities

Regular reports. In 2016, the BSP continued to publish regular reports to provide the public information on the factors behind its monetary policy actions and guide expectations on the future path of the BSP monetary policy stance. The publication of its regular reports likewise helped the BSP enhance its transparency and accountability mechanisms. In addition to publishing the highlights of the monetary policy meetings, the BSP also continued the publication of the quarterly Inflation Report, the quarterly report on economic and financial developments, and the press release on BSP's monetary policy decision. The report on Regional Economic Developments in the Philippines supplemented the analysis of economic conditions by outlining major regional trends and developments. The BSP also issued press releases on money supply, bank lending, and inflation.

The BSP maintained its commitment to provide timely and relevant data and information to help guide economic decision-making. The statistical reports published by the BSP in 2016 included the Philippine Flow of Funds (FOF), Selected Economic and Financial Indicators (SEFI), Selected Philippine Economic Indicators (SPEI), and Statistical Bulletin. The BSP also compiled and released data on the BOP and International Investment Position (IIP). Press releases on the GIR, foreign direct investments and OF remittances, as well as data series on bank-reported interest rates and household indebtedness, were also reported by the BSP. The BSP also released the results of the Quarterly Residential Real Estate Price Index (RREPI).[94]

Surveys. Regular surveys were conducted by the BSP to supplement information from data releases in aid of better policy-making. Among these surveys were the monthly Inflation Expectations Survey (IES) and the quarterly Senior Loan Officers' Survey (SLOS), which assessed the private sector's views on emerging inflation and current bank lending conditions; the semi-annual Coordinated Portfolio Investment Survey (CPIS) and the annual and quarterly Coordinated Direct Investment Survey (CDIS), which collected statistics on residents' holdings of non-resident investments; and the quarterly Business Expectations Survey (BES) and Consumer Expectations Survey (CES), which captured the business sentiment and general consumer outlook on future economic conditions. The BSP also conducted the monthly Cross-Border Transactions Survey (CBTS) to address the data gaps in the bank monitoring system for BOP compilation.[95]

The BSP completed the 2014 Consumer Finance Survey (CFS), a quadrennial nationwide survey on consumer finances among Filipino households with a sample size of 18,000 households. The 2014 CFS is the second survey on consumer finances following the 2009 inaugural CFS. The BSP also undertook the activities for the compilation of the Other Financial Corporation Survey (OFCS).[96]

[94]RREPI forms part of the financial soundness indicators (FSIs) for the Philippines and serves as a valuable tool in assessing the real estate and credit market conditions in the Philippines.
[95]The CBTS covers intercompany accounts for transactions settled through accounts abroad.
[96]The OFCS is an analytical survey that will provide comprehensive measure of the claims (or assets) and liabilities of OFCs in the Philippines.

Research initiatives. As an effort to continuously improve its economic modelling and forecasting capacity, the BSP reviewed and refined its in-house macroeconomic models such as the nowcasting model for GDP, liquidity and inflation, and participated in international network meetings on model development and forecasting. Research studies were also conducted by the BSP to analyze key economic and financial issues as inputs to the setting of monetary policy. These included studies on monetary policy transmission, the IRC system, macroeconomic modelling and forecasting, drivers of FDIs, the inclusion of Chinese Renminbi (RMB) as an international reserve eligible currency, investment of Philippine banks in capital market instruments in mainland China and Hong Kong, impact of foreign exchange liberalization reforms on the Philippine economy, impact of OF remittances from the Gulf Cooperation Council (GCC) countries on consumption, factors affecting consumption spending, financial conditions, financial market spillovers, global value chains, early warning systems, capital flows, impact of federalism to central banking, and local government debt.

Information dissemination activities. To promote public awareness, the BSP continued to provide venues for discussion on crucial economic and financial issues. These included the quarterly Inflation Report Press Conferences, IRC Briefings, Conferences on Gearing Up for External Competitiveness, Environmental Scanning Exercises, and the Exporters' Forum. Ten brownbag seminars were also held in an effort to deliver timely, relevant, and high-quality information to the BSP community, and covered the following topics: household income dynamics in small open economies under banking and mutual fund regimes, robust inference in panel predictive regressions with unknown persistence, the effects of monetary policy announcements at zero lower bound, interest rate corridor implementation in the Philippines, economic implications of Brexit, and integration of emerging market economies into global capital markets, among others.

To reinforce its close working ties with the academe, the BSP continued to organize the BSP-University of the Philippines (UP) Professorial Chair Lectures.[97] Lecture presentations covered the following economic, financial and social issues: credit risk, regulation of public pension funds, poverty statistics, competition mechanisms in the banking industry, effect of private placements on minority stockholders, global liquidity and financial vulnerability, financial reporting practices of government-owned and -controlled corporations, and big data analytics in the banking sector. Special lecture presentations on *"Determinants of the Use of Formal Financial Services: Insights from the 2015 National Baseline Survey on Financial Inclusion"* and *"Surprises in US Monetary Policy and Their Impact on Currencies in Asia"* were also held at the BSP.

Inter-agency and multilateral committees. The BSP continued to work towards enhanced relationships with the public and private sector as it actively participated in inter-agency committees and collaborated with various local and international organizations.

The BSP, as a resource institution of the Development Budget Coordination Committee (DBCC), participated actively in economic policy discussions and in setting macroeconomic assumptions needed for the preparation of the annual budget and policies and programs of the NG.

The BSP also participated actively in statistical working groups and committees on balance of payments, trade, investment, OF workers, remittances, statistical standards and other monetary and financial statistics.

The BSP hosted the 2016 Awards Ceremony and Appreciation Lunch for Stakeholders, with the theme *"12 Sustained Partnership, Sustained*

[97] The BSP-UP Professorial Chair Lectures provide opportunities for chairholders to present and discuss their research with participants from and outside the BSP.

Economic Growth". Awards were given to 88 outstanding institutional partners nationwide.

In fulfilling its role in the debt-financing process of other agencies in the government, the BSP received a total of 187 requests for MB opinion on proposed borrowings by the NG, government-owned and controlled corporations (GOCCs), local water districts (LWDs), state universities and colleges (SUCs), and local government units (LGUs).

Trainings, workshops and technical assistance projects. In Q1 2016, the BSP partnered with the Asian Development Bank (ADB) in conducting the ADB Capacity-Building Program for Cambodia, Laos, Myanmar, and Vietnam (CLMV); and co-organized with the Department of Foreign Affairs the BSP-Foreign Service Institute (FSI) Course on Fundamentals of Central Banking. The BSP also collaborated with the ADB in the conduct of workshops on "Macro-Financial Challenges and Vulnerabilities" and "Debt Sustainability and Early Warning System" in Q1 2016 and a course on "Contingent Claim Analysis and Macro-Financial Risk" in Q2 2016. The BSP also organized the 6th Bangko Sentral ng Pilipinas International Research Conference "Revisiting the Macro-Financial Linkages: Looking Back and Looking Ahead" in Q3 2016. The BSP also co-hosted with the Philippine Institute for Development Studies (PIDS) the 2nd Annual Public Policy Conference on "Risks, Shocks, Building Resilience" in Q3 2016. In Q4 2016, the BSP, in coordination with the South East Asian Central Banks (SEACEN) Centre, hosted the SEACEN-IMF Course on Monetary Policy Strategies and Monetary Policy Operation for selected ASEAN countries. The BSP also conducted in-house training on real and external sector economics, where topics on domestic government borrowings, projections of the Philippine balance of payments including merchandise trade, and developments in the Philippine rice market were discussed.

The BSP also participated in the secondment programme for BIS member central banks in the Asia-Pacific region hosted by the BIS Representative for Asia and the Pacific in Hong Kong by sending a Visiting Research Economist (VRE) for the period January-March 2016. The VRE completed a research paper entitled "The Effectiveness of Cyclical Capital Flows ad Macro Prudential Policies: Wither Asian Emerging Economies – Some Preliminary Results".

Meanwhile, various technical collaborations with the United States Department of the Treasury-Office of Technical Assistance (USDT-OTA) were continued in 2016. One of these projects that were continued in 2016 is the development of a Financial Computable General Equilibrium (FCGE) Model suited to the economic environment of the Philippines. The FCGE model shall equip the BSP with the facility to study in depth the relationship between the financial and real sectors of the economy. Other projects in the areas of financial stability and operational efficiency through modernization of information technology systems were also continued.

The USDT-OTA also helped in the development of the Residential Real Estate Price Index (RREPI). The RREPI serves as valuable tool in assessing the real estate and credit market conditions in the Philippines. The BSP released the Quarterly RREPI from Q2 2015 to Q1 2016 in June 2016 and the updates for the Q2 and Q3 2016 subsequently a quarter after the reference period.

Program and Process Initiatives. To facilitate smooth transition to the IRC system, the BSP conducted a series of public briefings and trainings for its market counterparties (consisting of banks and trust entities) in Q1-Q2 2016 (See Box Article 7 on IRC). As part of the implementation of the IRC system, the BSP developed the Monetary Operations System (MOS) and Liquidity Forecasting System (LFS). The MOS provides an online platform for the BSP to conduct its auction-based monetary operations. Counterparties access the MOS to participate in the auctions of the RRP facility and the TDFs. Meanwhile, the LFS facilitates the liquidity forecasting process which helps guide the active monetary operations of the BSP. Enhancements are on-going to expand the scope and functionalities of the MOS and LFS, in response to the efficiency requirements of the IRC.

The Corporate Leverage Workstream of the Financial Stability Coordination Council (FSCC), which is chaired by the BSP, developed the corporate leverage framework that served as reference for the database and its further improvement into the proposed Corporate Financial Trends Survey (CFTS). The proposed CFTS is an initiative to establish a database for corporations, which is essential to the formulation of sound, responsive and well-informed monetary, financial and economic policies. It aims to collect information on the sources and uses of funds (financial position), details of debt and other interest-bearing liabilities, and details of revenue of respondent corporations. The conduct of the CFTS will cover 2014 and 2015.[98]

The BSP intends to expand the coverage of RREPI to include Commercial Real Property Prices. The next phase is the development and institutionalization of the generation of data and estimation of commercial real estate price indices (CREPI) from commercial real estate loans granted by banks.

The BSP is also currently developing an electronic survey system that includes an online questionnaire, a database, and an application for data maintenance and consolidation system for the regular surveys conducted by the BSP. The electronic survey system is initially targeted for Cross Border Transactions Survey (CBTS), to be followed by the automation of the BSP-Senior Loan Officers' Survey (SLOS), Business Expectation Survey (BES) and Consumer Expectation Survey (CES). The project will be implemented in three phases to be completed in July 2017. The first and second phases of the project will cover the development of the data gathering modules of all CBTS surveys and the third phase will be on the customizability and report generation functionalities of the electronic CBTS system.

[98]Compilation and analysis of results for the 2014-2015 data are targeted to be completed by April 2017. Release of the 2015-2016 data will be in May 2017.

The BSP has also completed the initial estimates of sequence of accounts for different institutional sectors of the 2010 Philippine Financial Social Accounting Matrix (PFSAM). Ongoing revisions of the supply and use tables are currently being undertaken in order to be consistent with the sequence of accounts.[99]

Financial Stability: Supervision and regulation strengthen banks' resilience

In maintaining a stable and sound banking system, the BSP continued to strengthen its regulatory and supervisory framework as well as pursue financial inclusion and consumer protection initiatives. These were achieved by proactively engaging stakeholders, adhering to international best practices and standards, and championing capacity building of bank supervisors.

Strengthening Regulatory Framework. Significant policy reforms were instituted in 2016. In particular, 42 circulars, 25 memoranda and 107 circular letters were issued as a continuing and sequenced effort to uphold good governance, align regulations and risk management practices with international standards, and promote financial inclusion and consumer protection.

The prudential reforms were focused on:

- *Promoting deeper culture of good governance*. The outsourcing guidelines were revised in 2016 to emphasize the responsibility of board of directors and senior management in ensuring that outsourced activities shall be conducted in a safe and sound manner and in

[99]Institutional sectors include the following: Rest of the World, Non-Financial, Financial (Central Bank, Depository Corporations, Insurance and Pension, Other Financial Services), Government (National and Local Government, Social Securities) and Households.

compliance with applicable laws, rules, and regulations. For instance, key risk areas should be evaluated before entering into outsourcing contracts.

- *Enhancing risk governance*. Equally-important risk management guidelines in the areas of operational risk and information technology were adopted to complement the governance standards and align with international standards and evolving trends in the global financial system. The BSP also introduced the Liquidity Coverage Ratio (LCR) standard, a key component of the Basel reforms.

- *Strengthening bank's capital*. Minimum standards for domestic systemically important banks (DSIBs) in formulating their respective recovery plans were laid down. This further strengthened the implementation of the DSIBs framework as part of the BSP's efforts to ensure that banks are able to withstand shocks thereby promoting greater stability in the financial system.

- *Instituting financial stability mechanisms*. Proactive macro-prudential measures and macro-financial surveillance were institutionalized to timely identify and mitigate the build-up of system-wide risks. These include: (1) the Financial Surveillance Dashboard ("Dashboard") which is a compilation of key economic, financial market, and banking indicators that serves as a quick reference for BSP management and other users; (2) the new prudential reporting requirement on repurchase transactions; and (3) the cross-border liquidity arrangement between the Bank of Japan (BOJ) and BSP which can be utilized as a liquidity buffer during emergency situations.

- *Promoting market competition*. The moratorium on the establishment of new domestic banks was lifted and branching guidelines were rationalized. Banks were provided with more flexibility to expand their branching network to strategic areas and foster market competition.

- *Streamlining banking structure*. As part of the structural reform process, the BSP continued to promote industry consolidation to create stronger, better-managed and well-capitalized banks. The BSP issued clarificatory guidelines informing merging/consolidating banks of the menu of regulatory incentives that they can avail of, as long as these are responsive to their specific needs and reasonable given the attendant circumstances, subject to BSP evaluation and approval. Further, various notifications were published in 2016 informing the industry of mergers/consolidations and closures of banks.

- *Promoting financial integrity*. Banks were reminded to ensure the soundness and adequacy of their risk management policies and practices in dealing with foreign exchange dealers, money changers and remittance agents (FXDs, MCs and RAs) as well as to exercise caution and conduct customer due diligence procedures. These include the establishment of the legitimacy and/or validity of the source of funds based on the risk posed by a customer, consistent with regulations on Anti-Money Laundering and Terrorist Financing. These issuances were also timely, given concerns on de-risking by global banks.

- *Improving financial transparency*. BSP regulations were continuously aligned with International Accounting Standards (IAS). Disclosures in the annual reports of banks were also enhanced to uphold market discipline and confidence of the public in the financial system.

- *Promoting financial inclusion and consumer education*. Cooling-off provisions pertaining to customers' rights with respect to investment contracts entered into with a bank and revised guidelines governing fees on dormant deposit accounts and other retail bank products and services were introduced during the year to serve and protect consumer welfare. The BSP likewise released the guidelines on agricultural value chain financing, allowed the conversion of microfinance-oriented banks/branches to regular banks/branches, and expanded the allowable services of micro-banking offices.

- *Enabling environment for digital banking*. The National Retail Payment System (NRPS), BSP's flagship program for digital finance, was launched in December 2015. It is seen to guide the banking industry towards the establishment of a more safe, efficient and reliable payments and settlement systems. Electronic clearing of checks via electronic presentment through the Check Image Clearing System (CICS) of the Philippine Clearing House Corporation was similarly adopted to enhance efficiency of domestic payment system.

Usage and dependence on innovation and digital transformation, however, have given rise to risks. Guidelines on the adoption of the Europay, Mastercard, and Visa (EMV) technology were issued in response to risks arising from card fraud and skimming. The BSP is continuously enhancing its supervisory framework for technology risk management to ensure that public trust and confidence are preserved amidst the rapidly evolving technological landscape and increased bank participation in digital space.

Conducting Risk-Based Supervision. The smooth implementation of the risk-based approach to supervision was carried out by the on-site and off-site supervisory units of the BSP. On-site examination conducted in 2016 covered 506 banks and 43 non-banks. The BSP, likewise, inspected 7,232 entities comprised of pawnshops, money service businesses (MSBs), non-stock and savings loan associations (NSSLAs) and other non-bank financial institutions (NBFIs). A network-based approach was implemented by the BSP in supervising pawnshops.

During the year, the off-site supervisory arm processed almost 1,000 licensing requests as well as confirmed more than 500 elected directors and appointed officers.

With respect to the establishment of new banks, the BSP approved the entry of 3 foreign banks and the establishment of one rural bank, three of which have already commenced their banking operations in 2016. A number of banks from Taiwan, China, Korea, Japan and Indonesia have also signified interest to enter the Philippine banking system through the establishment of a branch/representative office or partnership with domestic banks.

Engaging Stakeholders. The BSP has taken an active role in coordinating with other domestic financial regulators through the Financial Sector Forum (FSF) and Financial Stability Coordination Council (FSCC) as well as in engaging industry associations through the Bank Supervision Policy Committee (BSPC) meetings to pursue policy reforms and achieve financial stability objectives.

The FSF-member agencies, comprised of the BSP, Securities and Exchange Commission (SEC), Insurance Commission (IC) and Philippine Deposit Insurance Corporation (PDIC), embarked on significant initiatives in promoting consumer protection and education as well as expanded its target audience in partnership with government agencies and institutions and the private sector. The FSF closed the year on a high note with the launching of the Personal Equity and Retirement Account (PERA) last 16 December 2016. PERA products provide an alternative vehicle for Filipinos to save and invest, and in turn, improve their lives.

The FSCC with members from the BSP, IC, PDIC, SEC, and the Department of Finance (DOF), signed a Memorandum of Agreement with the Housing and Land Use Regulatory Board (HLURB) on 30 September 2016 to facilitate information sharing among the agencies to better understand the interconnectedness and to mitigate the buildup of systemic risks in the financial system.

Meanwhile, the BSPC held 36 coordination meetings with 16 financial industry associations and expanded coverage of stakeholder engagement to enhance collaborative stance on cyber-security risk concerns.

The BSP, on the other hand, also attended Senate and Congress Committee Meetings and deliberations of various Senate and House Bills affecting the financial system and NG budget hearings for the timely passage of critical financial sector reform legislation. Position papers were also provided to both Houses of Congress on several bills affecting the banking system, which include, among others, amendments to the BSP Charter, Secrecy of Bank Deposits Law, Anti-Money Laundering, Al-Amanah Islamic Investment Bank, National Payments System Act, Lifting of Foreign Ownership Restrictions, Consumer Protection Act, and Credit Card Bill.
Close collaboration on various initiatives was carried out with other government offices and agencies such as the Bureau of the Treasury, National Economic and Development Authority (NEDA), and Department of Labor and Employment (DOLE).

Championing Capacity Building. The BSP continued to champion the capacity building of its supervisors through the in-house Professional Excellence Program for Bank Supervisors (PEPS) as well as their participation in both local and foreign trainings. PEPS, a progressive learning program of the Supervision and Examination Sector for supervisors, is categorized into 5 levels with a total of 22 learning programs. In 2016, a total of 89 courses were offered by the BSP Institute.

Bank supervisors have evolved into thought leaders contributing their insights in various local and international trainings or fora hosted by the Association of South East Asian Nations (ASEAN), South East Asian Central Banks (SEACEN), Executives' Meeting of East Asia Pacific Central Banks (EMEAP), Asia Pacific Economic Cooperation-Financial Regulators Training Initiative (APEC-FRTI), Bankers Institute of the Philippines, Inc. (BAIPHIL) as well as in study visits of 11 foreign regulators.

The BSP's strategic regulatory reform agenda underpinned by the implementation of a risk-based supervisory framework and collaboration between regulators and supervised entities, taken as a whole, contribute to the stability and soundness of the banking system. The Philippine banking system in 2016 posted improved asset quality, ample liquidity, strong capitalization and sustained profitability as it continues to expand its distribution network to deliver broader banking products and services. These key financial indicators reflected the overall strength of the banking industry amidst a challenging operating environment.

Box Article 8

Liberalization of the Banking System

Leveraging on good corporate governance and enhanced risk management practices in banks coupled with advancements in the BSP's risk-based approach to supervision, the BSP has gradually lifted regulatory barriers with the end goal of promoting growth and competitiveness of the Philippine banking system in the midst of an evolving global financial landscape. Further liberalization of the entry of foreign banks in the country was accompanied by the lifting of the moratorium on the grant of new banking licenses and rationalization of the branching guidelines.

Foreign Banks Liberalization. The Philippine banking system was opened to foreign banks in July 1994 through the enactment of R.A. No. 7721[100] allowing them to (i) own up to 60 percent of the voting stock of an existing domestic bank, (ii) establish a new banking subsidiary incorporated in the Philippines, or (iii) open a branch with full banking authority. The last mode of entry was made available by the Law for only 5 years to 10 qualified foreign banks, in addition to the 4 original foreign bank branches already operating in the Philippines prior to the passage of R.A. No. 7721.

To facilitate the entry of more foreign investments and to enhance competition as the industry gears up for the forthcoming regional integration, the 20-year old Law was amended by R.A. No. 10641[101] in July 2014. Under the new Law, the ownership ceiling of foreign banks in the voting stock of an existing domestic bank or a new banking subsidiary was increased from 60 percent to 100 percent. The new Law also opened the "branch" mode on a perpetual basis to qualified foreign banks and allowed them to establish 5 sub-branches in locations of their choice. Meanwhile the minimum capital requirements applicable to foreign bank branches (FBBs) were tightened by removing the "Net Due To" inter-office account which was deemed to be less permanent in nature, as a component of FBBs' regulatory capital. As a result, FBBs strengthened their capital position. Foreign banks were also given the right to participate in foreclosure proceedings and take possession of the mortgaged property similar to domestic banks. They have, however, a maximum period of 5 years within which to transfer the said property to qualified Philippine nationals.

While foreign banks were granted liberalized entry, the BSP retained the authority to adopt necessary measures to ensure that 60 percent of the Philippine banking system resources is controlled by domestic banks. As of end-September 2016, there were 23 foreign banks[102] operating in the Philippines accounting for 8.3 percent of the total assets of the banking system[103]. Since the implementation of R.A. No. 10641 in 2014, the BSP has approved 9 foreign bank applications, 8 of which are already operational[104].

[100]An Act Liberalizing The Entry And Scope Of Operations Of Foreign Banks In The Philippines And For Other Purposes
[101]An Act Allowing The Full Entry of Foreign Banks In The Philippines, Amending For The Purpose R.A. No. 7721. The BSP issued the corresponding implementing rules and regulations under Circular No. 858 dated 21 November 2014.
[102]The count does not include 2 foreign banks which became operational in the last quarter of 2016.
[103]The total assets of foreign banks and the banking system posted ₱1,063.4 billion and ₱12,799.2 billion, respectively, as of end-September 2016. The foreign banks' aggregate share excludes 1 foreign bank, which only started its operation on 16 December 2016.
[104]This includes Korean banks (Shinhan Bank, Industrial Bank of Korea, and Woori Bank), Taiwanese banks (Cathay United Bank, Yuanta Commercial Bank Co. Ltd., and First Commercial Bank), Japanese bank (Sumitomo Mitsui Banking Corporation), and Singaporean bank (United Overseas Bank).

The enactment of R.A. No. 10641 is expected to contribute to the promotion of a competitive banking environment for the benefit of the investing or depositing public. The Law provides the banking public with expanded opportunities through a wider array of financial services and products at competitive rates. Banks, on the other hand, can gain from operational synergies on account of (i) adoption of new technology; (ii) enhancement of human capital skills; and (iii) improvements in corporate governance and management practices.

Phased Lifting of Moratorium on Domestic Banks. With increased foreign competition, the BSP deemed it proper to review the continued relevance of the moratorium on the grant of new banking license or establishment of new banks. The moratorium, which was implemented in September 1999, was intended to prevent the proliferation of small banks that are not strong enough to weather economic volatilities. Lifting of the moratorium would then level the playing field among banks. The BSP adopted a phased-in approach in removing the moratorium. During the initial phase, existing thrift banks may apply for a license to convert into a universal or commercial bank, subject to compliance with minimum capital and other pre-qualification requirements as provided under existing regulations until end-2017. Starting 1 January 2018, the moratorium shall be fully lifted and locational restrictions shall be fully liberalized for all banks. Given this liberalization, the BSP still preserves its basic thrust of encouraging mergers and consolidations in the banking industry.

Branching Liberalization. Complementary to the liberalization of the establishment of new banks, the BSP also pushed for the establishment of alternative access points for the effective delivery of banking services in support of the BSP's microfinance and financial inclusion advocacy. The series of rules and regulations which were subsequently issued allowed banks to establish extension offices (EOs), other banking offices (OBOs) and micro-banking offices (MBOs) as well as loan collection and disbursement points (LCDPs), in the case of microfinance-oriented banks. The objective was to enable banks to expand their physical reach in an efficient and cost-effective manner (e.g., reduced manpower, lower infrastructure cost) thereby increasing access to financial services in areas where it may not be economically feasible to establish a regular branch. As of end-September 2016, there were 225 EOs, 436 OBOs, and 651 MBOs. Since 2011, the number of EOs and MBOs has continuously increased while the number of OBOs was maintained at a steady level.

To further boost the competitiveness of domestic banks, the BSP implemented a two-phased branch liberalization reform policy in 2011. The first phase allowed universal, commercial and thrift banks with limited branch network in "restricted areas" or in the cities of Makati, Mandaluyong, Manila, Parañaque, Pasay, Pasig, Quezon and San Juan, to establish new branches in these "restricted areas" before the door was fully opened to all banks starting 1 July 2014. Establishment of new branches in those strategic areas was, however, subject to a special licensing fee.

Moreover, the BSP recently allowed the conversion of microfinance-oriented banks/branches to regular banks/branches and rationalized the guidelines on the establishment of branches to provide banks with more flexibility in expanding their branching network in strategic areas. This further complements the BSP's policy of letting market competition drive the establishment of branches in all areas within the Philippines. Smaller banks now have the option to establish branches in Metro Manila to serve important niche markets with their own unique needs, subject to higher capitalization and special licensing fee.

Guided by their overall business model and strategic direction, banks are provided an enabling environment in making sound business decisions in pursuing opportunities that shall allow them to deliver high quality financial products and services to banking customers.

Box Article 9

Fintech and Cybersecurity: Opportunities and Challenges

Among the most popular buzzwords of the year are "fintech" and "cybersecurity". The BSP, as part of its mandate to ensure financial stability and the efficiency and safety of payment systems, continuously keeps abreast of these concepts to understand how they affect BSP supervised financial institutions (BSFIs) as well as financial consumers.

Fintech

Fintech (financial technology) refers to the integration of finance and technology in a manner that drives the transformation or disruption of the traditional processes in financial service delivery. Like most central banks, the BSP is keenly interested in Fintech because of its potential application in the delivery of digital financial services as well as its possible impact to the financial system.

Fintech companies leverage on technology as a primary driver to deliver solutions with speed, convenience and efficiency via multiple channels at a very competitive cost. These entities are venturing in spaces traditionally dominated by banks and are disrupting traditional banking models. According to a report by Citi Global Perspectives & Solutions[105], Fintechs are focusing primarily on the following areas:

Payments	Personal/SME Banking	Client Onboarding
• Alipay • Applepay	• Lending club • Crowd-funding	• Kenya • India

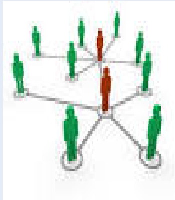
Fintech companies can play a very significant role in promoting financial inclusion. When unbanked consumers are provided with convenient digital platforms that are connected to the formal financial system, they become familiar with the procedures and begin to gain trust in the system. This is expected to build their confidence in the formal systems and eventually access more value-adding financial products and services such as savings, loans, insurance, and even investments.

[105] Citi Global Perspectives & Solutions (March 2016). *Digital Disruption: How FinTech is Forcing Banks to a Tipping Point.*

Among the major innovations in the fintech space are as follows:

Virtual currencies

Digital representation of currencies that can be digitally traded and can function as a medium of exchange, store of value or unit of account



Peer to Peer lending /Crowdfunding

Peer-to-peer lending matches individual borrowers directly with investors. Crowd-funding raises small amounts of money, obtained from a large number of individuals/organizations, to fund certain project or needs, through an online web-based platform.

Opportunities

Presents huge opportunities for efficient and cost-effective payments, remittances and transfers.

Challenges

Money laundering and terrorist financing risks may arise due to the degree of anonymity offered, transaction speed, and ability to facilitate cross-border transactions.

Issues on consumer protection may crop up such as possible lack of understanding as to how virtual currencies work, lack of financial backing or guarantee and exposure to excessive volatility.

Opportunities

Enables fund raising by entities that otherwise would not have access to financing through more traditional channels like banks and financial markets.

Challenges

Risks include risk of default, operational risks from utilizing the web-based platform, consumer protection risks, and investor protection risks.

The incremental amounts of funding as well as the growing number of investors and recipients heighten the overall risks which may potentially cascade to the financial system.

An example of a fintech company in the Philippines is the *Mynt*, which is Globe's newest mobile financial services provider that oversees its GCash operations. GCash is a micropayment service that transforms the mobile phone into a virtual wallet for secure, fast, and convenient money transfer and payment transactions. GCash can be used to buy prepaid load, pay bills, send money, make donations, shop online, and purchase goods.

BSP's Policy Direction: Balanced approach towards innovation

Regulators in many parts of the world, including the BSP, recognize the need to enable an environment that allows technological innovations to increase efficiency and effectiveness of financial institutions in delivering their products and services. At the same time, regulators must also ensure that these innovations are reliable, safe and that the risks involved are effectively managed. The BSP continuously monitors developments in Fintech in order to develop a balanced regulatory approach which is anchored on three pillars: (1) risk-based and proportionate regulation; (2) active multi-stakeholder collaboration; and (3) consumer protection.

Cybersecurity

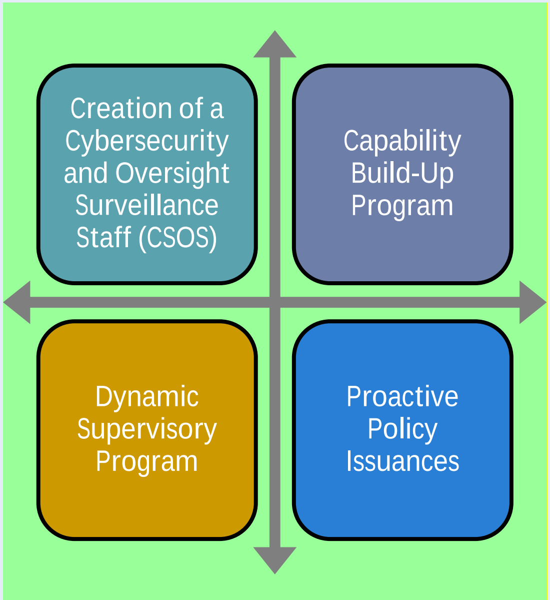
Rapid developments in technology and its increased application in the delivery of financial services necessitate the implementation of security measures to preserve the integrity of the financial system and confidence of financial consumers. This is due to the risks brought about by fast-evolving threats in cyberspace. Cyber-attacks continue to confront the global as well as local financial communities. If left unmanaged, these can cause financial instability and the erosion of trust and confidence in the financial system, both of which can have significant economic repercussions.

From secure to resilient

On 22 August 2013, the BSP issued Circular No. 808, which provides enhanced guidelines on information technology risk management. The guidelines likewise provide practical plans to address risks associated with emerging trends in technology and growing concerns on information security, including cybersecurity. While the Philippine financial services industry is not entirely defenseless against cyber-threats and attacks, it is no longer enough to be just secure and the industry needs to move toward resilience so that it can recover well from any incident.

Advancing BSP's approach to cybersecurity

The BSP is continuously enhancing its supervisory framework through the issuance of necessary guidelines, public advisories, and memoranda as well as the adoption of a robust and dynamic supervisory program. To ensure that public trust and confidence is preserved amid technology implementation by BSFIs, the BSP has been undertaking the following:



- Create the CSOS, a unit dedicated to study cybersecurity threats with the aim of enhancing regulatory policy framework and institutionalizing cybersecurity due diligence within the financial industry
- Conduct specialized trainings on cybersecurity and obtain security-specific certifications for supervisors
- Require BSFIs to adopt risk-based cybersecurity controls, processes and tools.
- Issue the following regulations on technology and cybersecurity:
    - Guidelines on business continuity management
    - Cybersecurity Risk Management Framework
    - Adoption of Multi-Factor Authentication Techniques for High Risk Transactions and/or Sensitive Communications
    - Guidelines on Social Media Risks

Conclusion

Fintech enables new opportunities in expanding financial services to a greater number of consumers, the development of which can be adversely affected by the increasing evolving cyberthreats. The BSP needs to keep a healthy balance in facilitating innovative developments through Fintech while ensuring that public trust and confidence is upheld amid such technological innovations. Through BSP's active surveillance of the cyber-environment, as well as continuous engagement with industry stakeholders, the twin objectives of financial stability and system efficiency may be achieved. More than just buzz words, Fintech and Cybersecurity shall continue to be a part of BSP's key regulatory and supervisory agenda.

Box Article 10
Demystifying De-Risking

The De-risking Phenomenon. De-risking is often referred to as the withdrawal of globally active banks from specific jurisdictions, activities or customer groups by terminating correspondent banking relationships (CBRs) or restricting financial services extended to their clients. CBRs play an important role in fostering international trade, facilitating remittances and promoting financial inclusion. In the aftermath of the GFC and the resultant complex operating environment, the risk appetite of banks have started to wane – leading to a general trend of de-risking which became apparent in 2014.

Drivers and Impact of De-risking. Banks "de-risk" to avoid business and reputational risks from customers where continuing relationships with them could expose the bank to higher money laundering/terrorist financing (ML/TF) risk and compliance costs. The risk avoidance is generally done on a wholesale basis and not on a case-by-case analysis of the risks associated with individual customers or a country. Financial institutions which initiated actions to terminate/restrict accounts or relationships were generally based in the US, UK,EU, Switzerland, and Canada.

For countries with high volume of remittances, such as the Philippines, this occurrence will potentially result in increased cost for clients which may eventually lead to financial exclusion. This affects a wide range of customers from small and medium entities such as banks, money transfer operators, remittance companies, exporters and overseas workers.

Actions Taken. In the past two or three years, there have been several local and international initiatives that aim to understand the de-risking phenomenon and identify lasting solutions. The Philippines has actively participated in various international meetings that discuss de-risking, such as the High-Level Meetings on Correspondent Banking by the Financial Stability Board, the International Monetary Fund, and the World Bank. In the recently concluded 11th Meeting of the Financial Stability Board Regional Consultative Group for Asia, the BSP was among the lead discussants on de-risking and correspondent banking, raising awareness on the issue and contributing to discussions on how this issue can be resolved.

On the domestic front, the Philippines is pursuing two-track initiatives to address the issue from a strategic standpoint. The BSP is working on the operationalization of a NRPS that would provide a more reliable and transparent platform for retail payments. This will be done through the issuance of a clear governance framework that would allow interoperability of all commercial electronic payment channels through appropriate clearing and settlement arrangements. It encourages participation in the formal financial system so that informal and unregulated channels are lessened. The end view is to make delivery of remittances safe, convenient and affordable. The Philippines has also completed the National Risk Assessment for money laundering/terrorist financing (ML/TF). This is a systematic process of evaluating the country's ML/TF vulnerabilities and preparing concrete action plans to address identified weaknesses and vulnerabilities across different sectors. The action plans, which have been identified as crucial for adoption include, among others, the strengthening of the anti-money laundering (AML)/combating the financing of terrorism (CFT) supervisory framework for banks and money service businesses (MSBs).

Initial Results. Taking off from the four-point agenda presented to the Heads of Group of 20 (G20) countries in November 2015, the Financial Stability Board (FSB) created a Correspondent Banking Coordination Group

(CBCG) in March 2016 to facilitate the implementation of the following action plan to assess and address the decline in correspondent banking[106]:

1. Further examining the dimensions and implications of the issue;
2. Clarifying regulatory expectations, as a matter of priority, including more guidance by the Financial Action Task Force (FATF);
3. Domestic capacity-building in jurisdictions that are home to affected respondent banks; and
4. Strengthening tools for due diligence by correspondent banks.

Since the establishment of the CBCG, significant progress has been made in the global arena on the implementation of the FSB's action plan. This included the publication of various reports on correspondent banking[107], conduct of survey on the impact of de-risking, and identification of areas for potential clarification and guidance by the FATF and Basel Committee on Banking Supervision. The CBCG also assisted in capacity-building efforts to support affected jurisdictions.

Following these, certain jurisdictions and standard-setting bodies have issued statements clarifying expectations on correspondent banking, supervision of MSBs, and risk-based application of AML/CFT standards. Examples of these are:

1. The Joint Fact Sheet of the U.S. Department of Treasury and the Federal Banking Agencies on correspondent banking (August 2016); and
2. The FATF Guidance on Correspondent Banking Services (October 2016).

Locally, the BSP issued a memorandum (M-2016-004) reminding banks on the customer due diligence required for their MSB customers. Also, the BSP is poised to issue enhanced regulatory framework for MSBs, with improved registration process, capital requirements, and other measures aimed to strengthen AML/CFT framework for MSBs.

The Road Ahead. The road to full resolution of the issue is long, but we believe efforts that have been initiated represent progress. We have raised awareness of this issue at an international level, prompting high level discussions and creation of working groups aimed at understanding the issue and identifying solutions. Standard setting bodies and regulators appreciate the depth of the issue and are working on addressing the concern. For our part, the BSP and the financial institutions concerned must continue to work together. An integral part of the solution to de-risking is enhancement of the AML/CFT legal and supervisory framework, as well as commitment of financial institutions to improve their internal AML/CFT processes. This way, the Philippines, can assure our international partners that the domestic AML/CFT infrastructure is robust and processes and systems can be relied on.

[106]Financial Stability Board (2016). Progress report to G20 on the FSB action plan to assess and address the decline in correspondent banking. http://www.fsb.org/wp-content/uploads/Progress-report-to-G20-on-the-FSB-action-plan-to-assess-and-address-the-decline-in-correspondent-banking.pdf
[107]This includes the *Committee on Payments and Market Infrastructures (CPMI) report on Correspondent Banking (July 2016) and the International Monetary Fund (IMF) Staff Discussion Note on The Withdrawal of Corresponding Banking Relationships: A Case for Policy Action (June 2016).*

Payments and Settlements System: *PhilPaSS* remains safe and reliable

The BSP as operator of the Philippine Payments and Settlements System (*PhilPaSS*) continued to provide safe, sound, and efficient payments and settlements of financial transactions in real time.

Table 2.1 Volume and Value of PhilPaSS Transactions
2016 vs 2015

	2016	2015	Growth Rate (%)
Volume (in thousand)	1,605.0	1,406.8	14.1%
Value (in trillion pesos)	469.5	279.6	67.9%
Transaction Fees (in million pesos)	141.7	134.0	5.7%

Source: Payments and Settlements Office (PSO)/ BSP

In 2016, the number of transactions processed and settled in *PhilPaSS* increased to 1.61 million, or by 14.1 percent, relative to the previous year. The higher volume of transactions was due mainly to the uptick in reverse repurchase and term deposit placements/maturities (98.6 percent); OF remittances coursed through the REMIT system (20.1 percent); regional banks' cash withdrawals (15.1 percent); and interbank transactions (14.7 percent).

Similarly, the value of transactions grew by 67.9 percent to ₱469.5 trillion amid the surge in the following: reverse repurchase and term deposit placements/maturities (130.1 percent); availments in BSP's e-rediscounting facility (69.98 percent); and interbank transactions (38.7 percent).

As a result of the higher volume of transactions, PhilPaSS' total transaction revenue in 2016 reached ₱141.7 million or 5.7 percent higher than a year-ago level. The increase mainly reflects higher fees from settled debit instructions and third-party transactions.

The BSP, through the Payments and Settlements Office, has also actively engaged in various projects, activities, and initiatives in 2016 to enhance the efficiency of the existing payments system, which included the following:

- Conducted research and study on the possibility of *PhilPaSS* weekend operations;

- Organized (i) six One-Stop-Shop fora aimed to encourage more banks to participate in *PhilPaSS*; (ii) two *PhilPaSS* fora focused on updating participants on the developments and trends in *PhilPaSS* settlement operations; (iii) six *PhilPaSS* symposia geared toward informing participant banks' personnel on the existence/benefits of *PhilPaSS* as an online, real-time payment facility for settlement of their clients' large value interbank financial transactions; (iv) three PhilPaSS REMIT consultative meetings; and (v) annual Client Satisfaction Survey[108];

- Participated in various domestic, regional, and global fora, including the development of: (i) an attachment program for Central Bank of Myanmar, Royal Monetary Authority of Bhutan and Central Bank of Uzbekistan; and (ii) guidelines and standards on pre-departure orientation program for ASEAN migrant workers; and

- Collaborated with various BSP departments on: (i) the establishment of an operational framework for the implementation of the Personal Equity Retirement Account (PERA) Act; (ii) securing approval of the Payment Systems Bill; and (iii) the planned electronic amortization payment system for the clients of the Asset Management Department.

Medium-term developments

Since its acquisition and implementation in 2002, several enhancements have been made and will continue to be made with *PhilPaSS* to ensure that its operations conform to global standards.

[108] The PhilPaSS received an overall rating of 4.6 on the scale of 5.0 from PhilPaSS stakeholders.

Among the significant strides undertaken by BSP are the following:

In August 2007, the BSP and the Philippine Dealing System (PDS) Holdings entered into a Memorandum of Agreement (MOA) for the interconnection of the PDS Settlement Highway with *PhilPaSS* to allow eDvP settlements through direct transmission to *PhilPaSS* of all the payment instructions done through the PDS and effect settlement in the demand deposit accounts (DDAs) of the counterparties. The transactions include foreign currency trading, interbank and interdealer repo, and public market trade of government securities. The eDvP system standardized the settlement mode for all market participants and for all types of securities transactions to eliminate the principal component of settlement risk, thus, limiting the exposure of counterparties only to pre-settlement risk or market price risk.

Moreover, the *PhilPaSS* REMIT System was developed as part of the BSP's advocacy to bring the OF remittances into the formal channel via banks to ensure that the welfare of OFs are properly safeguarded from remittance fraud and mishandling. In 2010, a MOA was entered into among the BSP, Association of Bank Remittance Officers, Inc. (ABROI), Bankers Association of the Philippines (BAP), Chamber of Thrift Banks (CTB) and the Rural Bankers Association of the Philippines (RBAP) that established the *PhilPaSS* REMIT System as the new settlement arm for OF remittances that will ensure the safe and immediate transfer and settlement of OF remittance funds into beneficiary accounts maintained with other banks. REMIT standardized and reduced the back-end processing fees to ₱50.00 per transaction that Beneficiary banks can charge against the amount of remittances received. This ensures that OF beneficiaries get more from proceeds of remittances, which previously were charged by participating banks between ₱100-₱550.00 per transaction.

While the aggregate value of OF remittances coursed through *PhilPaSS* REMIT comprise only about 1.6 percent of the Philippines' total inward remittances, the existence of the system (REMIT) has resulted in the following:

a. Influenced the non-bank remittance companies' lowering of their remittance fees;
b. Lowered the cost for the sending/remitting bank to transfer funds to beneficiaries' account with other banks;
c. Faster settlement of OF remittances as beneficiary banks are required to credit the OF's beneficiary accounts on the same day or at the latest the next day in cases where further validation of beneficiary accounts will be needed. This feature ensures that the OF's hard earned monies are properly safeguarded from remittance fraud, handling risks and undue delay; and
d. Encourages the unbanked OF beneficiary to open/maintain a bank account to facilitate the posting of remittance proceeds sent by the OF to his beneficiary/family. This facilitates financial literacy and empowering family members towards access to electronic financial services.

In October 2010, the BSP spearheaded the conduct of a study on the feasibility and applicability of Check Truncation Technology (CTT) in the Philippines through the creation of an Inter-Agency Committee (IAC) composed of representatives from BSP, PCHC, BAP, CTB and RBAP. After six years of study/research the IAC has completed the study giving rise to the Check Imaging Clearing System (CICS). In September 2016, the BSP informed banks of its approval of the adoption of the clearing of checks via electronic presentment through the CICS beginning 20 January 2017. Among the benefits to the bank customer include the following:

a. Shorter clearing cycle enables faster crediting of funds to your account the next banking day, compared to 3-5 banking in a non-CICS setup;
b. Quicker feedback if check is funded or not—regardless of location of the paying bank/branch;

c. Improved security against losing checks in transit as CICS eliminates the physical transport of checks; and
d. CICS-compliant checks with new design standards are more secure, reducing the chances of fraud.

Meanwhile, the signing of the MOA between BSP and Bancnet in 2011, for the *PhilPaSS* Settlement of Bancnet's ATM Network funds, improved the efficiency and security of the existing payment and settlement system.[109] The settlement of ATM transactions via *PhilPaSS* reduced the systemic and settlement risks for the ATM consortia's member-banks by settling in central bank money through the participating banks' DDAs maintained with BSP and eliminating the float days/period involved in charge slip/check processing and clearing.

[109]BancNet is an electronic banking consortia wholly owned by its member banks. Prior to their respective agreements with BSP, charge slips were used to provide the medium for inter-bank settlement across the network and with other networks. The charge slips are treated similarly as check items sent to the Philippine Clearing House Corporation (PCHC) for processing and consolidation, and are subject to reglementary clearing period or number of clearing days before considering final settlement depending on the origin of the check(s) being processed.

Box Article 11
Future Policy Direction of the Payments and Settlement System

The BSP will continue to pursue policy efforts to support the advancement of the country's payments and settlement system in the near to medium term. This is in response to recent developments in the payment systems environment, including the rapid expansion in innovative payment terminal services, coupled with the formulation of a new regulatory framework driven by the implementation of global financial standards. This is also in line with the broad objective of ensuring the safety, efficiency and reliability of the country's payments and settlement systems so as to contribute to monetary and financial stability.

Strengthening BSP's Oversight on Payment Systems

To control systemic risk and ensure the safety, efficiency and reliability of payment systems operations, the BSP filed a Payments Bill with the Houses of Senate and Congress last 30 June and 24 August 2016, respectively. The Bill was already approved in the Congress Committee Level and has gone through its first hearing in the Senate Committee level last 4 October 2016. Once enacted, it will strengthen the payments and settlement system oversight role of the BSP since it can already oversee non-financial payment provider companies which are not under its supervisory and regulatory powers. In addition, the Bill also requires, when deemed necessary, a payment system management body to be organized by the payment system participants for the purpose of self-regulation.

Implementation of the Check Image Clearing System

In September 2016, the BSP issued Memorandum No. 2016-012, informing banks about the Monetary Board approval for the adoption of the clearing of checks via electronic presentment through the Philippine Clearing House Corporation Check Image and Clearing System (CICS) beginning 20 January 2017. Under the CICS, physical delivery of checks will no longer be needed since the system only requires transmittal of the digital images of checks and their electronic payment information to the paying bank. With the CICS, the new check clearing process is expected to fast-track the crediting of funds to the depositors' account from the current 3-5 banking days to 1-2 banking days.

Migration to ISO 20022 Messaging Standard

In response to the Financial Integration objective of the ASEAN Economic Community (AEC) Blueprint 2025 (adopted by the ASEAN Leaders at the 27th ASEAN Summit on 22 November 2015, in Kuala Lumpur, Malaysia), the ASEAN member-countries of the Working Committee on Payment and Settlement Systems (WC-PSS), committed to adopt ISO 20022 standard as its platform for financial integration. To pursue this initiative, the BSP, as one of the members of the WC-PSS, has engaged in a project that will migrate the existing *PhilPaSS* infrastructure to ISO 20022 standard. As a start, a task force that will lead in the development of a road map for BSP's compliance to the new standard was created. Per recommendation of the task force, the BSP is now securing the services of a third-party consultant that will conduct an impact assessment on ISO 20022 to be able to capture the business requirements of BSP and its *PhilPaSS* participants and provide an implementation roadmap for ISO 20022 migration.

Participate in the Development of the National Retail Payment System (NRPS)

With the Filipino consumer in mind, the BSP aims to make the country's payment systems more efficient and reliable and is also paving the way for digital finance innovations to thrive in the country. Digital innovations – as an enabler of cost-efficiency – will allow more Filipinos to have a transaction account and do electronic payments, including the financially-excluded. This spells cheaper and better product choices for consumer and a bigger market for financial service providers.

Promoting digital finance is part of the BSP's flagship program, the NRPS, a policy and regulatory framework for retail payment systems in the Philippines. Under the NRPS, Filipinos will be able to make electronic payments to any transaction account (i.e., a bank or a mobile money account) from any transaction account in a convenient, affordable and secure manner using inter-operable payment network that financially links the country on a 24/7 basis.[110]

To jump-start the operationalization of the NRPS by 2017, the BSP is currently coordinating with the industry and other stakeholders for the creation of an industry self-governing body, the Payment System Management Body (PSMB), which shall be composed of representatives from commercial banks, thrift and rural banks, and non-bank and e-money issuers. The PSMB shall be responsible for setting clearing rules that will bind all payment system participants.

Enhancement of the *PhilPaSS* REMIT System

Since its implementation in 2010, *PhilPaSS* REMIT has played a pivotal role in ensuring the safe and efficient settlement of OFW remittances for their beneficiaries that are for credit to other banks. For the past 6 years, the value of transactions sent and settled through the system increased remarkably from ₱4.0 million in 2010 to ₱21.0 million in 2015 or by 426 percent; its corresponding volume likewise rose from 112,636 in 2010 to 492,984 in 2015 or by 338 percent. The Payment and Settlements Office will enhance the *PhilPaSS'* "REMIT" to further expand the recipient base of OFW remittances; promote electronic payments, and encourage domestic funds transfers to the accounts of RBs and TBs with BSP via *PhilPaSS* Participant Browser (PPB).

The banks' use of the PPB in initiating and sending payments (gross or batch via file upload) will simplify the banks' process of preparing the transaction files instead of using the existing file structures (input files, beneficiary file, reply file, feedback file). The lower cost of secure connectivity to *PhilPaSS* through the use of smart cards, compared to securing an institutional IP static address, will encourage RBs to actively participate in electronic payments, whether large-value or retail (OFs and funds transfers). Consequently, the introduction of electronic banking services/products/transactions could persuade more depositors to transact with RBs (thus increase their depositor base to even include the unbanked population in their respective areas). Overall, these improvements could help simplify the use and access of the current *PhilPaSS* REMIT system by more interested bank-participants and broaden the industry support toward the BSP's advocacy for financial inclusion.

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[110] Since its launch in December 2015, the NRPS Team of the BSP has been actively engaging the industry players and strategic retail payments users to align efforts towards the goal of the NRPS. These engagements have resulted in the following key outcomes: (1) secured the commitment of the key industry players to establish two priority retail payment schemes (i.e., the Batch Electronic Fund Transfer (EFT) Credit which is an interbank account-to-account fund transfer system and the pillar of electronic retail payments; and InstaPHay which is a new EFT service where banks and non-bank EMIs can participate to provide real-time low-value payment transactions); and (2) secured the support of key government agencies to promote digitization of government collections and disbursements.

Strengthening International Cooperation

The BSP will step up cooperation with countries in the Asia-Pacific region concerning issues related to cross-border payments, through regional central bank forums such as the EMEAP-WGPSS, ASEAN-WCPSS, and SEACEN. It will also continue to participate in the discussion among ASEAN+3 countries on the issues related to the statutes and policies of each country and harmonization of technical standards in support of efforts to bring about possible linkage of payment and settlement infrastructures.

How We Performed in 2016: Operations, Advocacies, and Financial Results

Currency Operations

Demonetization of New Design Series (NDS) Banknotes. In line with the efforts to continue to preserve the integrity of the Philippine bank notes, the BSP launched the New Generation Currency (NGC) in 2010. The NGC series contains new design and security features for all the denominations of the bank notes. Alongside the introduction of the NGC, the BSP set a timeline for the denomination of the old bank note series (NDS). The provisions of Section 57 of the R.A. No. 7653 (or the Central Bank Act) authorize the BSP to replace or demonetize banknotes that are more than five years old.[111] The old banknotes have been in circulation for more than three decades.

NDS Demonetization timeline. Under the original timeline,[112] all NDS banknotes will no longer be acceptable as payment for any transaction by 1 January 2016 but could be exchanged at face value, free of charge, at any authorized agent bank (AAB), the BSP-Cash Department, or any of the BSP's regional offices (ROs) and branches until 31 December 2016.

To give the general public ample time to exchange the old banknote series and to ensure the orderly transition to the NGC banknote series, the deadline was extended to 31 March 2017. After 31 March 2017, all NDS banknotes shall cease to be the liability of the BSP and therefore shall be subject for demonetization.

[111] Demonetization is the process of removing the monetary value of the legal tender currency by the issuing authority.
[112] BSP Circular No. 863, pursuant to BSP Circular No. 935 dated 28 December 2016, was issued on 29 December 2014 which contains the provisions on the replacement and demonetization of NDS banknotes.

Online registration of NDS holdings of OFs, Filipino immigrants and non-residents. The Online Registration of NDS Banknotes System (ORBS)[113] was operationalized starting 1 October 2016. The registered NDS banknotes shall be submitted for exchange with NGC banknotes within one (1) year from date of registration at any of the BSP Offices. In the case of OFs who are located in countries experiencing geopolitical crisis during the registration period (i.e., 1 October 2016 to 31 December 2016), they can avail of the BSP exchange facility for OFs until 31 December 2017 and need not register.

As of 31 December 2016, a total of 2,318 OFs, Filipino immigrants and non-residents registered their NDS holdings in the ORBS amounting to ₱26.3 million.

BSP Communication Program on currency-related advocacies. The BSP utilized various communication platforms in conducting a nationwide information campaign on the NDS demonetization and other currency-related advocacies. In 2016, the Composite Team accomplished the following:

- *Printed Materials and Promotional Items* – Various posters, primers, brochures and other promotional items were distributed by the BSP.

- *Internet and Social Media* – A dedicated webpage/portal on the NDS demonetization and NGC banknotes was integrated in the BSP

[113] Pursuant to BSP Circular No. 910, dated 22 April 2016, and Monetary Board Resolution No. 1967 dated 3 November 2016 on the online registration for OFs working living/abroad, Filipino immigrants and non-residents.

website, which include posters in various languages and dialects (English, Filipino, Ilocano, Cebuano and Bicolano), the NDS demonetization schedule, FAQs, and an interactive NGC brochure.

- *Face-to-Face Engagements* – A total of 9,582 Public information campaigns (PICs) were conducted nationwide, educating 521,314 participants. PICs conducted by the BSP from 2015 to 2016 covered 100 percent of cities and 95 percent of municipalities nationwide.

- *Pro-Active Presence in Mass Media* – At the same time, 39 media interviews were provided by BSP senior officials in Metro Manila. Likewise, 495 media interviews in print, radio, TV and other media outlets were provided by the Regional Office and Branch heads on the NDS demonetization in 2016. In addition, 124 articles appeared on print and online media in 2016, supplemented by 264 radio and TV features on the NDS demonetization.

Status of NDS banknotes in circulation. As of 31 December 2016, 7.6 percent [291.5 million pieces (mpcs)] of the 3.8 billion pieces of banknotes in circulation (BIC) were NDS banknotes. In value terms, this represented 2 percent (₱22 billion) of the ₱1,094 billion BIC. This reflects an improvement from the end-December 2014 figures which showed that 21 percent (711.7 mpcs) of the BIC were NDS banknotes. In value terms, the NDS accounted for 20.4 percent of BIC (₱184.3 billion).[114]

[114]Approximately 420.2 mpcs or 59 percent of the 711.7 mpcs were withdrawn from the system from January 2015 to end-December 2016. In value terms, these NDS banknotes surrendered/deposited to the BSP amounted to ₱162.3 billion, which is 88 percent of the ₱184.3 billion worth of NDS banknotes in circulation in end-December 2014.

International Reserves Management

The BSP remained vigilant in the face of world developments that may impact the GIR and continued to search for opportunities that will increase the return and diversify the risk of the reserves. In 2016, the BSP, under the stewardship of its Investment Management Committee (IMC), implemented portfolio strategies to generate returns from international assets while observing guidelines approved by the MB. The BSP continued to implement measures aimed at ensuring the safety and diversification of the BSP's international assets.

Key strategies and measures during the year include the continued investment for the hold-to-maturity portfolio and the use of futures contracts. The challenging market environment in 2016, however, led to the flat performance of the internally- and externally-managed portfolios (IMP and EMP) relative to their benchmark.

The BSP continued to manage the country's gold reserves in compliance with existing management guidelines. While there were no spot gold transactions during the year, the BSP continued to generate premium collections from gold call and put options trading.

Key policies and strategies adopted in the past decade. With the GIR increasing since the AFC in 1997, the BSP saw the need for changes in the way it manages the reserves. The growing reserves level required increased focus on governance, risk management, and yield enhancement, especially as the domestic economic conditions improved after 2005. Thus, as early as 2006, the BSP had already embarked on various projects to strengthen its reserve management. The BSP moved towards evaluating the performance of the internally-managed portion of the GIR through a benchmark.

The BSP also adopted the relevant provisions of the IAS to improve the transparency and quality of the BSP's financial statements. In particular, the adoption of IAS39 resulted in the reclassification of most securities held by the BSP as Available for Sale, which have to be reported at market or fair values instead of amortized cost.[115] In addition, the BSP started a project to implement a risk management system that would allow for a more efficient management of the GIR through systematic risk identification, measurement, monitoring and control. Further, the BSP has taken advantage of the opportunities to reduce interest expense following the prepayment of its IMF debt as early as 2006. Such payment has sent a clear signal to the international community that the structural reform process and macroeconomic prudence in the Philippines have firmly taken root to allow reduced dependence on external financing.

Since then, the BSP has continued to improve the governance structure for reserve management, strengthen risk management, and seek ways to improve profitability.

The improvements in the governance structure reflected the recognition by the BSP of the need to adapt to the changing market environment on a timely basis. In 2008, the internally-managed portion of the GIR was divided into tranches so that investment management could be aligned better with the various objectives of reserve management, i.e., ensuring the availability of sufficient foreign exchange liquidity for day-to-day operations; and generating income over the medium-term while maintaining acceptable risk exposures. Also, in 2008, the MB approved the creation of the IMC, which includes top management officials, to provide strategic guidance in the management of the reserve portfolio. The IMC is tasked, among others, to review the benchmarks and investment guidelines, and recommend necessary changes to the MB. In addition, the BSP formed a compliance unit in 2008 that was tasked to check on a daily basis if the reserve managers are observing the investment guidelines approved by the MB.

As the GIR level continued to increase, the need to have a stronger organizational focus on reserve management became imminent. Thus, in 2011, the MB approved the reorganization of the Treasury Department (TD), the department responsible for both reserve management and domestic market operations. The reorganization allowed TD to have, among others, a dedicated group that focuses on reserve management, and another group that focuses on market research, risk management, performance analysis, and compliance reporting.

International Economic Cooperation

In 2016, the BSP continued to proactively engage with its partners and counterparts in strengthening monetary and financial cooperation and integration in the international, regional and bilateral fronts.

The BSP demonstrated thought leadership in various central banking topics and participated in international cooperation initiatives. In particular, the BSP engaged with its international counterparts in the conduct of economic surveillance and policy dialogue; participated in financial arrangements and contributions; immersed in regional financial cooperation and integration, and contributed in capacity-building initiatives. The BSP likewise participated in high-level and technical meetings and hosted international conferences/workshops.

[115] IAS39 - Financial Instruments: Recognition and Measurement

In response to the establishment of the ASEAN Economic Community (AEC) in December 2015 and in preparation for the Philippines' hosting of the ASEAN meetings in 2017, the BSP intensified its efforts in 2016 in the domestic front to improve awareness and appreciation of the ASEAN process.

Economic Surveillance and Policy Dialogue

Economic Surveillance. The BSP, as the Philippine representative in the IMF, facilitated the conduct of regular surveillance activities in the country through the IMF Article IV Consultation Mission, which was held on 29 June -12 July 2016. The IMF Mission Team met with the new economic managers to discuss global developments that may have an impact on domestic economic policy-making. The IMF Staff Report noted that the Philippine economy has performed well in recent years with rising potential growth and strong macroeconomic fundamentals and that the outlook remains favorable despite external headwinds. The IMF Staff Report also noted that the Philippine authorities are well-equipped to respond as needed with suitable policies should any risks materialize, particularly given the strong fundamentals and ample policy space.

For the first time since the BSP joined the Southeast Asia Voting Group (SEAVG) Constituency in 2008, it held the position of Alternate Executive Director in the Constituency Office beginning November 2016 until October 2018.[116] The high-level representation accorded to the Philippines will enable it to further advance its interests and positions in the IMF. The BSP also participated in the Fund's regular meetings, provided comments and BSP stance on IMF policy papers, and likewise received visiting delegations of IMF senior officials at the BSP Manila Head Office, to share information and exchange views on international monetary and financial matters.

The BSP likewise facilitated the conduct of the ASEAN+3 Macroeconomic Research Office (AMRO) Staff Consultation Visit held on 15-19 August 2016. Said surveillance mission assessed the country's macroeconomic conditions, as well as the emerging risks, policy challenges and macroeconomic outlook of the economy. The BSP also participated in the further development of the Economic Review and Policy Dialogue (ERPD) Matrix facilitated by AMRO which consisted of economic indicators of all ASEAN+3 members that are intended to serve as tool for the assessment of members' qualification for the Chiang Mai Initiative Multilateralization's (CMIM[117]) crisis prevention facility. The ERPD Matrix covers monitoring of fiscal policy, external position and market access, financial sector soundness, and monetary policy indicators.

Similarly, the BSP contributed to the surveillance initiatives of the EMEAP through monthly financial market monitoring which tracked quick-moving financial market movements in the currencies, equities, and credit default swap (CDS) markets, as well as policy rate movements among EMEAP member economies and selected AEs and EMEs. In addition, the BSP contributed technical inputs to the preparation of various regional economic monitoring reports, such as the ASEAN Financial Integration Monitoring Report (AFIMR), ASEAN Capital Account Liberalization Policy Dialogue Report, ASEAN+3 Self-Assessment Report on Local Currency Bond Market Development, ASEAN+3 Regional Economic Monitoring (AREM) monthly

[116] The Constituency Office is instrumental in representing the interests of emerging markets such as the Philippines in the 24-member IMF Executive Board.

[117] The CMIM is a US$240 billion multilateral arrangement among the finance ministries and central banks of the ASEAN (Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam) + 3 member countries (China, Japan and Korea) and the Hong Kong Monetary. CMIM is a pooled fund within the Asian region which aims to address balance of payments and short-term liquidity difficulties in the region, and to supplement the existing financial arrangements by providing financial support through currency swap transactions among CMIM participants.

and quarterly reports, and IMF Staff Report, among others.

Policy Dialogue. The BSP advocated thought leadership in various international forums, such as the IMF, Bank for International Settlements (BIS), EMEAP, Asia-Pacific Economic Cooperation (APEC), ASEAN, ASEAN+3, and the Southeast Asian Central Banks (SEACEN) Research and Training Centre to discuss relevant monetary, economic and financial cooperation issues. During the year, the BSP also engaged in bilateral meetings with central bank counterparts to share common experiences, discuss economic developments, and exchange views on emerging policy challenges relevant to both institutions.

BIS. On the preservation of financial stability and enacting regulatory reforms in the financial and banking sectors, the BSP participated in various regular and extraordinary meetings of the BIS. During the year, the Governor continued to chair the meeting of Central Bank Governors from small open economies (SOE), which meet regularly at the sidelines of the BIS bi-monthly meetings. As Chair, the BSP takes the lead in identifying issues for discussion during the Group's meetings focusing on issues that are particularly relevant to SOEs such as: managing global downside risks and implications for financial markets; global financial conditions and currency depreciations; scope for independent monetary policy; liquidity management tools given uncertainty in the global market; deficiencies in the international monetary and financial system from the perspective of SOEs; and economic resilience of SOEs.

Likewise, the BSP participated actively in the meetings of the Asian Consultative Council (ACC). The ACC provides a vehicle for communication between the Asia and Pacific members of the BIS and its Board and Management on matters of interest to the central bank community in the region. The BSP has been representing the Philippines in the ACC meetings since 2003 and the Governor of the BSP served as the Chair of the ACC for two (2) years from April 2014 until March 2016.[118] The BSP steered the discussions related to researches on monetary and financial stability, and recent BIS banking activity in Asia, among others. The BSP also hosted the following BIS-related meetings: (1) Financial Stability Institute-SEACEN Regional Seminar on the Regulation and Supervision of Liquidity Risk on 26-28 April 2016 in Manila; and (2) Conference on Financial Inclusion and Central Banks on 2-4 June 2016 in Cebu.

IMF. To facilitate policy dialogue and provide the platform for the IMF's outreach activities, the BSP organized four (4) seminars/workshops, which were all held in Manila, on the following topics: (1) World Economic Outlook and analytical chapters on capital flows to emerging markets (18 April 2016); (2) Review of Fund-supported programs (6 May 2016); (3) United States Article IV Staff Report (19 August 2016); and (4) World Economic Outlook and analytical chapters on global trade, global disinflation, and spillovers from China (10 October 2016). The seminars/workshops were attended by participants from the BSP and other government agencies and the discussions were very informative and insightful in fostering understanding of the Fund's latest assessment of global developments that may likely have an impact on the Philippines.

SEACEN. The BSP continued to be a driving force in policy dialogue and exchange of views to promote financial stability. This came to the fore with the BSP's successful hosting of the BIS-SEACEN High-level Seminar back-to-back with the 15th Meeting of the SEACEN Executive Committee (EXCO) 26-27 September 2016 in Pasay City. As Chair of the SEACEN Board of Governors and EXCO for 2015/2016, the BSP selected the theme/topics for

[118] The ACC includes the central bank Governors of Australia, China, Hong Kong, India, Indonesia, Japan, Korea, Malaysia, New Zealand, Philippines, Singapore and Thailand.

the high-level seminar and invited speakers together with the BIS and The SEACEN Centre. The BSP likewise facilitated the institutional changes at the SEACEN Centre aimed at enhancing the conduct of research, training and capacity building on financial, monetary, banking, and economic development issues that are of particular relevance to its members.

ASEAN. During the ASEAN Central Bank Governors Meeting on 4 April 2016 in Vientiane, Lao PDR, the BSP participated in the ASEAN policy dialogue with the IMF on "Spillovers from China to ASEAN economies through trade channels" and with the ADB on "How ASEAN can work together to build greater financial resilience and attain inclusive and sustainable economic growth: Role of the central bank." The BSP assumed the co-chairmanship of the Senior Level Committee (SLC) on Financial Integration with Bank Indonesia early in 2016. One of the major reforms undertaken was the enhancement of the roles and functions of the SLC to include surveillance of macroeconomic and financial stability risks among the various ASEAN committees to drive the financial integration process forward while ensuring financial stability in the region.

ASEAN+3. Moreover, the BSP engaged in a high-level policy discussion with counterparts under the ASEAN+3 Finance Ministers and Central Bank Governors' and ASEAN+3 Finance and Central Bank Deputies' (AFCDM+3) processes. The BSP also advocated for the increase in the quick-disbursing portion of the CMIM from 30 percent to 40 percent in view of the increasing downside risks to global growth and financial stability. The BSP also played a key role in the organizational capacity-building of the AMRO in terms of developing its medium-term strategies including enhancing its governance structure; and on ensuring its smooth transition to an international organization.

EMEAP. The BSP also participated in high-level and technical-level EMEAP meetings to exchange views on: (a) global and regional financial and economic developments, as well as policy implications for EMEAP economies; (b) impact of ongoing international regulatory reforms; and (c) research studies in the areas of financial markets, banking supervision, payment and settlement systems, and other monetary and financial stability-related topics. The BSP likewise provided support for the timely identification of emerging risks and monitoring of developments in the region. It participated in the EMEAP Monetary and Financial Stability Committee (MFSC) teleconference call among Deputy Governors, which is organized on a need basis to facilitate discussions on recent economic and financial issues that have regional implications, as well as individual member policy actions. The BSP also actively participated in regular meetings of the EMEAP Asian Bond Fund (ABF) Oversight Committee and the Pan Asian Index Fund Supervisory Committee to monitor the performance of the ABF and discuss enhancements to ABF governance, marketing strategies, and single market funds monitoring.

Asia Pacific Economic Co-operation (APEC). The BSP provided active support to the activities and initiatives under the APEC Finance Ministers' Process (FMP) spearheaded by the Department of Finance (DOF). Under Peru's chairmanship of the APEC process, the BSP provided relevant technical inputs to various important APEC documents and statements under various initiatives such as the draft chapters for the proposed Free Trade Area of the Asia-Pacific (FTAAP), APEC Connectivity Blueprint, the Boracay Action Agenda, and the APEC Strategy for Strengthening Quality Growth, and the APEC Services Competitiveness Roadmap. At the same time, the BSP provided comments and views to critical APEC documents and statements, which reflected the general sentiment of high-level APEC officials and leaders, such as the joint ministerial statements of the APEC Finance

Ministers, Structural Reform Ministers, Ministers Responsible for Trade, and the APEC Leaders' Declaration.

Bilateral Meetings. The BSP likewise engaged in high-level bilateral meetings with Bank Indonesia on 17 September 2016 in Yogyakarta, Indonesia and with Bank of Thailand on 19 November 2016 in Chiang Mai, Thailand, to exchange information and experiences on monetary policy, banking supervision, and other central bank issues. Additionally, the BSP also hosted a web conference for the Joint Working Group (JWG) Meeting between the Philippines and Japan on 10 May 2016 that discussed issues of mutual interest such as those faced by Japanese banks in the Philippines, ASEAN financial integration, disaster risk financing, and capital market development in the Philippines.

Participation in Financial Arrangements and Contributions. The strong external and reserve position of the BSP enabled the institution to continue its contributions in various fund pooling arrangements in support of global and regional financial safety nets.

Global Arrangements. The BSP continued to facilitate contributions to various IMF facilities such as the Financial Transactions Plan[119] (FTP), New Arrangements to Borrow[120] (NAB), and the Bilateral Borrowing Facility to enhance global financial safety nets. As of 22 December 2016, nine countries (including Iraq, Romania, Ireland, Portugal, Greece, Moldova, Antigua and Barbuda, Ukraine, Tunisia) had drawn from funds exchanged by the BSP to the IMF's FTP amounting to SDR235.10 million (US$362.47 million). On the other hand, the Fund has made a total of SDR89.92 million (US$133.16 million) drawdowns from the BSP's NAB commitment to finance extended arrangements for Greece, Portugal, Tunisia, Cyprus, Ukraine, Jamaica, Jordan, and Pakistan. The BSP maintained its commitment of US$1 billion under the Note Purchase Agreement (NPA) with the IMF, in support of efforts to augment Fund resources for crisis prevention and resolution. While no drawdown has been made since the agreement was signed on 13 September 2013, it has helped boost confidence in the adequacy of the Fund's resources to restore global economic and financial stability. In this context, the BSP requested concurrence from the Office of the President to continue its participation in the Fund's bilateral borrowing facility until 2020.

Regional Arrangements. The BSP maintained active engagement in the strengthening of the CMIM as the ASEAN+3 regional financial arrangement, particularly on efforts to ensure operational readiness of the facility through the conduct of test runs and the development of mechanism to accurately detect potential crisis scenarios. The Philippines, through the BSP, has an outstanding contribution commitment of US$9.104 billion to the CMIM. The BSP may be able to borrow up to 2.5 times its contribution, i.e., US$22.76 billion from the CMIM. Under the facility, the management and custody of committed reserves remain with the central banks until a swap request has been approved.

Bilateral Arrangements. The BSP issued Circular No. 919 on 2 August 2016 to guide the implementation of the Cross-Border Liquidity Arrangement (CBLA) between the BSP and the Bank of Japan (BOJ). The Circular sets out the application procedures and terms for the provision of peso liquidity to banks operating in the Philippines against the Japanese yen during

[119] The FTP is the mechanism through which the Fund finances its lending and repayment operations in the General Resources Account. A member is selected for inclusion in the FTP plan based on a finding by the Executive Board that the member's balance of payments and reserve position are sufficiently strong.

[120] The NAB is a credit arrangement between the IMF and a group of members and institutions with the objective of providing supplementary resources to the IMF when these are needed to forestall or cope with an impairment of the international monetary system. The NAB is the first and principal recourse in circumstances in which the IMF needs to supplement its quota resources.

emergency situations. In addition, the BSP maintains swap arrangements including: (a) Bilateral Swap Arrangement (BSA) with BOJ, which would allow the BSP to swap up to US$12 billion; and (b) ASEAN Swap Arrangement (ASA) which would allow the Philippines to swap up to US$600 million in the event of a potential or an actual liquidity need.

Regional Financial Cooperation and Integration. The BSP continued its active participation in the implementation of the AEC Blueprint. Upon the declaration of the establishment of the AEC on 31 December 2015, the ASEAN Leaders also approved the AEC 2025 Blueprint, which provides broad directions through strategic measures for the AEC from 2016 to 2025. It will result in a more proactive ASEAN, having put in place the structure and frameworks to operate as an economic community, cultivating its collective identity and strength to engage with the world, responding to new developments, and seizing new opportunities. The new Blueprint will not only ensure that the ten (10) ASEAN Member States (AMS) are economically integrated, but are also sustainably and gainfully integrated in the global economy, thus contributing to the goal of shared prosperity. In 2016, the various ASEAN working committees formulated a consolidated Post-2015 Strategic Action Plan operationalizing the AEC 2025 Blueprint. This was approved by the ASEAN Finance Ministers and Central Bank Governors in April 2016.

The BSP likewise took on the co-chairmanship of the newly established Working Committee on ASEAN Banking Integration Framework (WC-ABIF) with the State Bank of Vietnam. The BSP hosted the WC-ABIF Meeting on 6 December 2016 in Manila to deliberate the committee's work program and structure, as well as to provide updates on compliance with Basel regulations and status of ABIF negotiations in respective jurisdictions.

In support of the ASEAN efforts for regional banking integration, the BSP continues to engage other ASEAN central banks/regulators to discuss possible bilateral arrangements to facilitate the entry of Qualified ASEAN Banks (QABs) as well as the implementation of other concessions on banking in accordance with the ABIF Guidelines. On 14 March 2016, the BSP and Bank Negara Malaysia signed a Heads of Agreement outlining the guidelines for the entry of QABs in the Philippines and Malaysia, with a key provision allowing up to three QABs from each jurisdiction to operate in the other country.

Under the Working Committee on Financial Services Liberalization (WC-FSL), the BSP continued to work with its regional counterparts in the drafting of the Annex on Financial Services under the proposed enhanced ASEAN Framework Agreement on Services (AFAS) or ASEAN Agreement on Trade in Services (ATISA). The BSP participated in the negotiations and conclusion of the AFAS 7th round of negotiations which will be implemented through the Protocol to Implement the 7th Package of Commitments on Financial Services under the AFAS signed on 23 June 2016. The BSP also actively engaged in the negotiations in the ASEAN-Japan Comprehensive Economic Partnership (AJCEP), ASEAN-Hong Kong Free Trade Agreement (AHKFTA), Regional Comprehensive Economic Partnership (RCEP), the PH-European Union (PH-EU) FTA, and the PH-European Free Trade Association (PH-EFTA) FTA. The enactment of R. A. No. 10641, which liberalizes foreign equity participation in banking, allows the BSP to engage with FTA partners for improved banking concessions and to support the progressive liberalization objectives of ASEAN.

Lending further support to the development of the regional bond markets, the BSP participated in the discussions of the ASEAN+3 Asian Bond Market Initiative (ABMI) task forces. It closely collaborated with the Securities and Exchange Commission (SEC) in the drafting of the ASEAN+3 Multicurrency Bond Issuance Framework (AMBIF) Guidelines for the Philippines under the ASEAN+3 Bond Market Forum (ABMF). The BSP continued to serve as co-chair of the ABMI Taskforce 4 which aims to improve the infrastructure for bond markets.

Capacity-Building Initiatives. The Philippines secured technical assistance (TA) from the IMF in the areas of fiscal management and financial sector development. A TA on medium-term budget framework, government cash management, formulation and drafting of the Public Financial Management (PFM) bill, and contingent liabilities management took place in 2014–2016. Meanwhile, several missions were conducted in 2015 and 2016 to assess the institutional needs for strengthening the framework for financial stability analysis and provide a road map for a comprehensive financial stability framework, focusing on the institutional setup, monitoring and tools, and crisis management.

The Steering Committee on Capacity Building (SCCB) was established by the SLC to work on matching capacity-building requirements and supply that will support AMS in the process of integration. Funding for these programs were sourced from various sponsors, such as the Asian Development Bank, SEACEN, and the ASEAN-Australia Development Cooperation Program II. The BSP fully supports capacity-building initiatives and believes that there must be an organized program of development assistance to help the country and other less-developed member states to prepare for the regional integration process. Aside from participating as subject matter expert for selected trainings/workshops, the BSP agreed to participate in the development of the ABIF Learning Roadmap, particularly, the five (5) learning modules for Layer 4 (Systemic Risk and Financial Stability) of the ABIF Learning Roadmap. In view of further developing the Philippine bond market, the BSP continued its close collaboration with the SEC, among others, in monitoring the progress of TA activities being facilitated by the Daiwa Institute of Research (DIR) for Phase V of the Philippines' TA program under the ABMI.

Meanwhile, on the domestic front, as part of the BSP's advocacy in increasing awareness on the benefits that the country may gain as part of the AEC, the BSP served as resource speaker on ASEAN financial integration initiatives in conferences and fora throughout the year. Of the eight speaking engagements, three presentations were held before the trainees of Development Bank of the Philippines' Management Associate Program in February, May and November 2016. The rest were presentations conducted before university students, local government officials, members of national finance and housing associations, and lawyers from the central bank.

Hosting of International Cooperation Events. The BSP hosted a number of conferences, workshops and meetings in line with the following objectives: (a) to sustain the discussion on issues relevant to emerging market economies; (b) to provide perspectives on critical issues affecting both the region and the country; and (c) to strengthen ties with other central banks and financial authorities by performing a leadership role in various bodies.

Conference/Workshop/Meeting. The BSP hosted the Third Meeting of the SEAVG Working Group (WG) on 13-14 July 2016 in Manila; and served as Chair during the SEACEN/BIS High-level Seminar and 15th Meeting of the SEACEN EXCO on 25-27 September 2016 in Manila.

Advocacy Programs

Microfinance and Financial Inclusion

The National Strategy for Financial Inclusion (NSFI) defines the national vision for financial inclusion and provides a platform for public and private sector coordination to ensure synergy of efforts in achieving shared objectives. Its implementation was spearheaded by the Financial Inclusion Steering Committee (FISC)[121], which was established under Executive Order No. 208 dated 2 June 2016. The BSP was designated as FISC Chair, and acts as FISC Secretariat.

The World Bank has lauded the Philippines ' efforts to develop a monitoring and evaluation system for the implementation of the NSFI, which defines a unique approach in gathering data on activities, inputs and indicators to enable collaborative reporting by various implementing agencies. The commitment to monitor progress and develop evidence-based programs and policies will ensure that efforts are indeed achieving the goal of expanding access to much needed financial services for the unserved and underserved sectors.

The BSP has successfully co-hosted a Joint Learning Program on the Philippine NSFI with the Alliance for Financial Inclusion on 17-21 October 2016 in view of the increasing interest to establish financial inclusion strategies. This program has provided a platform to share the Philippine experience in crafting, finalizing and implementing the NSFI.

Further, the Philippines was cited as the most improved nation in terms of providing wider access to digital and financial services in the 2016 Brookings Report.[122] The Philippines has increased its 2016 overall score compared to its score in the 2015 report due to the (1) launch of the NSFI; (2) strong performance in terms of mobile capacity, as measured through smartphone penetration; and (3) highest rate of adoption of mobile money accounts among the Southeast Asian countries included in the report.[123] For the third year in a row (2014-2016), the Economist Intelligence Unit (EIU) ranked the Philippines as the top country in Asia and third in the world in terms of having a conducive environment for financial inclusion.

Financial Inclusion Regulations. In support of an inclusive financial system, the BSP continued to develop policies and regulations that are grounded on research and data, as well as responsive to the evolving needs of different stakeholders. In particular, the BSP broadened the products and services that can be delivered in unserved/underserved areas by micro-banking offices (MBOs). Moreover, to widen the market reach of microfinance-oriented banks/branches, the BSP has liberalized their operations by allowing them to convert into regular banks/branches. The BSP also issued the guidelines on Agricultural Value Chain Financing (AVCF) to address the associated credit risks with the agriculture and fisheries sector by shifting the focus of lending from individual farmers and fisher folks to the whole value chain.

Financial Inclusion Awareness. To further increase awareness on financial inclusion, the BSP – through the Inclusive Finance Advocacy Office – conducted the "Financial Inclusion Fridays" from August to November 2016. The BSP also hosted the Knowledge Exchange on Financial Inclusion on various dates with delegates coming from eight

[121] The FISC is composed of the BSP, DOF, DepEd, DTI, DSWD, DBM, NEDA, IC, CFO, SEC, PSA, PDIC, CDA, DAR and DOST.

[122] 2016 Financial and Digital Inclusion Project Report: Advancing Equitable Financial Ecosystem

[123] The Philippines has garnered the highest scores in Country Commitment (100) and Regulatory Commitment (100), also achieved a high score in Mobile Capacity (94) but a more modest one in Adoption (42).

countries. The discussions during these conventions covered agricultural and rural finance, microfinance, and financial inclusion.

Participation in Global Fora. The BSP actively participates in global discussions on financial inclusion. The BSP is a pioneer member of the Alliance for Financial Inclusion (AFI), committed to deepen financial inclusion in the Philippines as declared in the AFI Maya Declaration. It also co-chairs the Basel Consultative Group Workstream on Financial Inclusion which is tasked to develop and finalize the BCBS guidance paper on the application of core principles of supervision to financial institutions engaged in financial inclusion. The BSP is also an active member of various working groups on financial inclusion of the APEC, ASEAN, Better than Cash Alliance (BTCA), and Innovations for Poverty Action (IPA).

Financial Education and Consumer Protection

The World Bank has acknowledged that "there is an impressive focus on consumer protection in the banking sector in the Philippines" [124] as manifested in the wide range of laws and regulatory instruments issued by the BSP.

Over the years, the BSP has conscientiously sought ways to educate and protect financial consumers. The BSP has published the Financial Consumer Protection (FCP) Framework in December 2014. The Framework aims to develop among BSP-supervised financial institutions a culture of fair and responsible dealings with consumers to promote greater confidence in the financial system. They are, likewise, expected to adhere to consumer protection standards such as disclosure and transparency, fair treatment, respect of client's privacy, financial education and awareness, and effective recourse.

As part of the efforts to further strengthen the FCP, the BSP issued clarificatory guidelines on the implementation of the "cooling-off" provisions. Individual bank clients are given, as may be appropriate, a "cooling-off" period of at least two banking days, immediately following the signing of any agreement or contract. "Cooling-off" is a right of a client to cancel his investment contract during the period without penalty, except for collection of a reasonable amount of processing fees. The rules on dormant deposits and corresponding fees were streamlined. Under the revised rules, a monthly dormancy fee not exceeding ₱30.00 can only be imposed if the following conditions are met:

- No deposit or withdrawal from the account for five (5) years from the last activity;
- The deposit is below the minimum monthly average daily balance; and
- The depository bank has complied with the notification requirements.

To enable financial consumers to compare fees, the amended policy also requires banks to post their fees on retail deposit, remittance and loan products/services in their official website, and in conspicuous places in all banking units.

With the implementation of the FCP Framework, the BSP institutionalized a market conduct regulation approach toward consumer protection. This approach includes on-site assessment of banks' compliance with financial consumer laws and regulations. Implementation of the on-site assessment commenced in 2016 through the conduct of six on-site assessments focusing on the review of banks' policies and procedures which include, among others, a consumer protection risk management program, product approval,

[124] Republic of the Philippines: Diagnostic Review of Consumer Protection in the Banking Sector. 2014. http://responsiblefinance.worldbank.org/~/media/GIAWB/FL/Documents/Diagnostic-Reviews/Philippines-CP-DiagReview-Banking-Volume-I-FINAL.pdf

consumer assistance mechanism, and internal controls.

The BSP, through the Financial Consumer Protection Department (FCPD) handled a number of consumer complaints mostly about credit card, e-banking, loans and deposits-related transactions.

Several financial learning programs were also conducted aimed at empowering individuals to better manage their finances. These include the conduct of five Financial Education (Fin-Ed) Expos, a special Fin-Ed event for the members of the Banking Industry Tripartite Council (BITC), 12 Project Bro activities, and 21 Financial Empowerment seminars, as well as the issuance of public advisories on text scams, identity theft, and unauthorized company performing banking activities.

Further, in celebration of the Consumer Welfare Month in September 2016, the BSP, through the FCPD, hosted a two-day event wherein financial fraud, scams, cybercrime, and complaint-reporting procedures were discussed. Senator Grace Poe, as the invited keynote speaker, talked about the importance of financial education and the role of BSP consistent with the national policy on financial inclusion. More than 500 representatives from 80 different government agencies, the banking sector, academe, and consumer and industry groups participated in the said event.

Economic and Financial Learning Program (EFLP)

The EFLP serves as the umbrella program of the BSP that combines the relevant awareness and learning campaigns of various BSP departments and offices with the end objective of enabling the public acquire the knowledge and develop the skills needed to make well informed economic and financial choices and decisions. Programs under the EFLP directly handled by the Economic and Financial Learning Center (EFLC) of the BSP were the following:

- *"Be up to SPeed on BSP" Public Information Campaign (PIC) on the Role of the BSP in the Philippine Economy.* The PIC intends to enhance public awareness on the BSP as an institution, including its core functions and responsibilities and its role in the economy. It also aims to generate public understanding of policies and programs implemented by the BSP. In 2016, PICs were conducted in seven venues in different parts of the country attended by a total of 1,327 participants, largely composed of members of the academe. The campaigns were also attended by representatives from private and public offices.

- *"Paghahanda sa Kinabukasan" Financial Learning Campaign (FLC) for Overseas Filipinos (OFs) and their Beneficiaries*. The BSP's FLCs, organized in coordination with the OWWA, aim to educate participants on the importance of using remittances to build up savings and directing these into investments in financial products and business ventures. FLCs were conducted in seven venues attended by 724 participants, mainly family members and other beneficiaries of OFs.

- *"Users' Forum (UF) on BSP-Produced Statistics."* The forum aims to inform the public and enhance their appreciation of the various BSP-produced statistics and the relevance of these statistics in their individual undertakings. It covers topics on monetary, banking, financial, external sector statistics and expectation surveys. The UF was conducted as part of the BSP's celebration of the National Statistics Month (NSM) in October 2016 in BSP Manila and Kalibo, Aklan. This was attended by a total of 98 participants, mostly represented by members of the academe.

- *"Training for Trainers"*. The BSP participated in the four training of trainers (TOT) sessions of OWWA in September-October 2016 to discuss the BSP Saving Module to a total of 245 Overseas Workers Welfare Administration (OWWA) accredited Pre-Departure Orientation Seminar (PDOS) providers for sea-based OFs. In addition, the module was included in "PDOS Trainer's Handbook" labeled as "Module 7, Personal Finance Tips" which was released in 2016.[125] These trainers serve as additional channels of the BSP to bring financial education to departing OFWs.

In 2016, majority of the programs had participation rates of above 100 percent.[126] Meanwhile, these programs received ratings of above 4.0 (the target rating is 4-5) both on the learning gained and the overall conduct.

- *In-House Tours and Guided Group Discussion.* The BSP provides an introductory learning session featuring the work of the BSP and its role in the Philippine economy through an audio-visual presentation (AVP), lecture, open forum, and an optional walk-through of the library facilities. A total of 5,401 visitors, mostly students, have benefited from this initiative.

- *Mounting of Exhibits.* To enhance the learning experience of BSP visitors, quarterly exhibits were mounted at the BSP to serve as educational tool that provided them with updates on recent economic developments and additional knowledge on featured topics for the quarter.

- *Knowledge Resource Network*. A major initiative introduced to further advocate public awareness of essential economic and financial concepts is the establishment of the BSP Knowledge Resource Network (KRN) which was approved by the Monetary Board in December 2016. The BSP will put in place Knowledge Resource Collections (KRCs) that will feature the latest BSP publications and provide access to online publications and research assistance services with partner libraries of local government units (LGUs), national agencies, and academic institutions all over the country. These KRCs will be made available free of charge.

[125] The PDOS Trainer's Handbook was developed by OWWA in 2015 and was distributed and presented to PDOS trainers during the TOT sessions in 2016.

[126] The actual number of participants exceeded the total number of invited/expected attendees.

BSP Clean Note and Coin Policy

The BSP issued Circular No. 931, dated 9 December 2016, containing the guidelines on the Clean Note and Coin Policy (CNCP) and approval of the new service fees for banks' deposit and withdrawal transactions.

This recently issued BSP circular stipulates the requirement on banks' adoption of a CNCP which shall include the following: (a) bank-wide coverage of the policy; (b) criteria to determine when a note/coin is to be pulled out of circulation; (c) guidelines in ensuring that the life of currency is extended; and (d) deposit and/or exchange on a regular basis of unfit notes/coins with the BSP. BSP Circular No. 931 also lays down the important roles of compliance and internal audit functions of banks in assessing consistent adherence to the CNCP.

In line with the implementation of the BSP's Enhanced Cash Management (ECM) services to better serve the country's currency requirements, the BSP rationalized the service fee structure for banks' deposit and withdrawal transactions with the BSP, and amended some operational processes under the ECM services for greater efficiency. The fee on banks' withdrawals of banknotes was waived, among others, to encourage banks to withdraw new banknotes, thereby accelerating the replacement of unfit banknotes in circulation which is supportive of the BSP's Clean Note Policy.

Coin Recirculation

As part of the National Coin Recirculation Program, the BSP continuously conducts PICs to make all sectors of society realize fully the importance of coins and develop the habit of regularly using them in the payment of goods and services and in facilitating exact change in cash transactions. Effective recirculation of coins will lead to less minting cost on the part of the BSP, which may result in a potential increase in the amount of dividends that the BSP will be able to remit to the NG. Ultimately, this will allow the NG to allocate additional resources to build public infrastructures, particularly farm-to-market roads and school buildings, among others.

In various press interviews and discussions with stakeholders in 2016, the BSP reiterated that there is sufficient supply of coins. In fact, there were 26.35 billion pieces of coins in circulation valued at ₱29.63 billion as of end-December 2016, or an equivalent of 257 pieces per Filipino.

Of the 26.35 billion pieces of coins, about 56 percent are low-denomination coins (i.e., 1-, 5-, 10- and 25-sentimo). Hence, there is ample supply of low-denomination coins to support the implementation of R. A. No. 10909 or the No Shortchanging Act. The BSP was part of the Technical Working Group that drafted the Implementing Rules and Regulations (IRR) of the No Shortchanging Act and participated in the various public consultations held in Makati, Baguio, Davao and Cebu in October and November 2016. The said IRR was issued on 21 December 2016.

The BSP also continuously encourages the public to exchange their unfit coins with banks.[127] Unfit coins shall not be recirculated, but may be presented for exchange to or deposited with any bank pursuant to BSP Circular No. 829, Series of 2014.

Investor Relations

Amid the Philippines' impressive economic and governance gains, a major challenge for the Investor Relations Office (IRO) in 2016 was helping international stakeholders see through the political noise and maintain confidence in policy continuity, as well as on the country's sound economic fundamentals and sustainable growth path, given the transition of power in the middle of the year.

In response to this, the IRO helped promote and further improve awareness of the Philippine economy by engaging stakeholders through various initiatives such as organizing meetings and conference calls with Philippine economic officials, conducting economic briefings, maintaining a website and social media accounts, and producing and disseminating information collaterals. The IRO's outreach program seeks to ensure that stakeholder decisions benefit from a comprehensive understanding of the Philippines' sound economic fundamentals and policy agenda.

Key Results. The Philippines' proactive engagement of stakeholders such as debt watchers continues to reap results. Since clinching minimum investment grade (IG) rating from the biggest international credit rating agencies (CRA) in 2013, the Philippines earned further upgrades despite a volatile external environment and

[127] A currency coin shall be considered unfit for circulation when it is bent or twisted out of shape or defaced or show signs of corrosion, but its genuineness and/or denomination can still be readily and clearly determined/identified, or it has considerably reduced in weight by natural abrasion/wear and tear.

domestic challenges such as natural disasters. This has made the Philippines one of the most upgraded countries in the world in recent years.

The IRO also continued to engage other assessment institutions, whose reports are used as inputs by CRAs in assessing the Philippines' credit standing. One such third-party rater was Heritage Foundation. Continued engagement with Heritage Foundation has contributed to the 6-notch improvement of the Philippines' ranking to 70th in its January 2016 report from 76th in the previous year and from 97th in the 2013 report after the Philippines started to proactively engage Heritage Foundation in June 2013.

In 2016, the Philippines' investor relations program garnered 39 out of a maximum of 42 points in the Institute of International Finance's (IIF) monitoring and assessment of investor relations and data dissemination practices of most emerging markets and developing countries. The scores place the BSP-investor relation program in the top tier and in second place along with Peru, Brazil, Russian Federation, South Africa, Panama, and Poland. Currently, IIF rates 39 sovereigns.

Activities and initiatives. In fulfillment of its economic communications mandate, the IRO carried out these major activities.

Stakeholder meetings. The IRO arranged meetings and conference calls between stakeholders – including debt watchers, third-party observers, foreign portfolio investors and fund managers, etc. – and government economic officials. These engagements with our policymakers and economic managers allowed stakeholders to have a better grasp of developments in the Philippine economy and served as an important source of information for their country assessment and investment decisions.

Economic briefings and country presentations. The IRO helped organize economic briefings in New York and Washington D.C. in March and October 2016, respectively. It also organized the country presentation during the 11th Finance Ministers' Investors Seminar (AFMIS) in Jakarta, Indonesia in November which was attended by participants from the business community, diplomatic corps, banks, and Indonesia's Ministry of Finance. It likewise participated in the 3-leg US nondeal roadshow in March – New York, Boston, and San Francisco.

Investor meetings. A total of 88 investor meetings were arranged to provide macroeconomic updates and information on policy reforms, as well as the government's priority projects and programs, particularly on infrastructure.

Sideline meetings at the IMF/World Bank and third party raters. The IRO organized meetings between government talking heads and CRA officials at the sideline of the 2016 IMF Annual Meeting (i.e., meetings of BSP Governor, DOF, NEDA and DBM Secretaries with officials from Moody's, Fitch and S&P). It also engaged major third party raters by providing information and coordinating and consolidating inputs of concerned BSP departments for the Index of Economic Freedom. It likewise hosted the 2nd country review of the Economist Intelligence Unit (EIU). A total of six meetings were organized.

Investor conference call. A new initiative which aims to build relationship and maintain communication with the country's investors and other stakeholders through a teleconferencing facility, two conference calls were conducted in 2016 – on 1 September 2016 with 96 callers and on 6 December 2016 with two sessions having 113 callers from Asia, Europe, and North America.

EconomyPH Newsletter. This was launched early in 2016 with the aim of spreading good news about the Philippine economy to stakeholders. Three issues were released.

Infographics. Launched in 2015, this remains one of IRO's communication tools. Posted on and circulated through the IRO's Facebook and Twitter accounts, there are three types of infographics: (a) Quote of the Week (20 issued); (b) Ask EconomyPH (4 issues); and (c) EconomyPH 101 (13 issues). The IRO also produced an infographics on the 10-point socio-economic agenda of the Duterte Administration.

Media engagements. The IRO arranged international media engagements of the BSP Governor and other economic officials. Press releases were issued on IRO events and news on the Philippine economy, mainly those related to credit ratings and third-party assessment reports.

Communications and media relations assistance to the Philippine Competition Commission (PCC). The IRO provided the PCC, which was created in February 2016, with assistance in its communications and media relations needs from March to September 2016.

Sulong Pilipinas. The IRO provided assistance to this event, which was held on 20-21 June 2016 in Davao City. The event, which was primarily a workshop, gathered representatives of the business community, development partners, and other stakeholders to solicit their inputs on what economic policies, programs, and initiatives the Duterte administration should prioritize. The IRO helped in reporting about the event through real-time social media posts and consolidating inputs of the workshop participants.

Coordination with communication counterparts in other economic agencies and provision of investor materials to Philippine embassies and consulates. The IRO initiated engagements with communications personnel of other economic agencies to gather information on their initiatives, programs, and projects that may be included in economic promotional and information materials. Moreover, the IRO provided the Philippine Embassy in Washington DC and the Philippine Trade and Investment Center at the Philippine Embassy in London and other similar offices with investor collaterals for use in their investor outreach efforts.

Strengthening Governance

The year 2016 saw the completion of all the projects and action plans comprising the 2014-2016 BSP Governance Initiatives Roadmap, which addresses the identified gaps and areas for improvement resulting from the second System-wide Governance Assessment (SGA) in the BSP. It was in 2010 when the BSP adopted a principle-based governance framework. It was also during this time that the BSP committed to subject the level of adherence to good governance principles of its decision-making systems, processes and work ethics to an independent third party assessment.

The SGA, an internally-developed assessment methodology, determines the level of integration in the BSP operations to the five governance principles defined in the BSP governance framework (i.e., integrity, accountability and transparency, ownership and voice, responsiveness, and strategic direction). The Bank engaged the Development Academy of the Philippines (DAP), a recognized expert institution in the field of governance in the country, for the development of the methodology and the conduct of the SGA, first in 2010, and then in 2014. Based on the SGA results, DAP likewise assisted the BSP in the formulation of its first and second three-year Governance Initiatives Roadmap.

The 2014 SGA showed that the BSP has already achieved a "sustainable" level of integration in all of the five governance principles, way ahead of target. This level of integration indicates that BSP's governance supporting mechanisms have significantly improved and that the beneficial outcomes are positively perceived by the BSP employees. Among the accomplishments under the first Governance Initiatives Roadmap are the enhancements of the BSP Code of Ethics with the adoption of the No-Gift Policy; policy on disclosure of wrongdoing; enterprise communication policy; and formulation of strategic and operational planning guidelines, among others.

In 2015, the BSP was recognized as one of the institutions in the country to be awarded with the Islands of Good Governance (IGG) seal by the Institute for Solidarity in Asia together with the Institute of Corporate Directors and the National Competitiveness Council. The IGG lauded the BSP's contribution to strengthening Filipino institutions, communities, and individuals by ushering in greater financial inclusivity through policies and regulations that have reaped global recognition, as well as its practice of transformative and sustainable governance with integrity, courage, and perseverance.

For the year 2016, two notable accomplishments under the second Governance Initiatives Roadmap are the formulation of the BSP Employee's Charter and the Guidelines for the Conduct of Internal Customer Satisfaction Measurement (ICSM). Both of these initiatives are seen to strengthen and improve responsiveness and promote accountability and transparency to its stakeholders. They are reflective of the BSP's commitment to address stakeholders' needs in a proactive and timely manner, and to be accountable for the effective delivery of its mandated services.

Adopting the framework of the BSP Citizen's Charter of the Anti-Red Tape Act (ARTA), the BSP Employee's Charter similarly defines the committed service delivery period by departments/offices for services rendered to BSP employees. The BSP Employee's Charter provides a comprehensive guidebook on how to avail of the existing internal services offered in the Bank. It includes the following information: step-by-step procedure to obtain a particular service; the officer or employee responsible for each step; the maximum time to conclude the process; documents to be presented by the employee; and the amount of fees, when applicable.

The BSP Employee's Charter harmonized the existing policies, guidelines, rules and regulations in the BSP with the documented processes and quality standards in the approved Quality Management System (QMS) of servicing departments/offices. The Charter covers both services and employees from employment to retirement, including other available programs and privileges in the Bank.

To strengthen and improve stakeholder responsiveness, and to comply with the requirement on customer satisfaction measurement for ISO-certified quality management systems, the BSP instituted the Guidelines for the Conduct of Internal Customer Satisfaction Measurement (ICSM) in 2016. The guidelines provided the mechanism for BSP departments and offices to shift to survey tools that easily lend to bank-wide integration and consolidation to facilitate information analysis, comparability and problem-solving.

In the latter part of 2016, the BSP commenced the third round of its SGA which was again conducted by the DAP. The SGA will be completed in the first quarter of 2017 and the results shall guide the formulation of the third BSP Governance Initiatives Roadmap for the period 2017-2019. With the institutionalization of governance mechanisms in the Bank and the implementation of initiatives formulated under the governance roadmaps, the gains are expected to be sustained and governance efforts across the Bank are ensured to be in synergy and aligned with the BSP's governance ideals.

Institutional Capacity Building

The BSP ensures that its capacity as an institution is strategically built and anchored on organizational readiness that is carried out through the lens of the Human Capital Management Framework (HCMF) of the Bank. With this, BSP has again achieved various accomplishments in the areas of talent acquisition, talent succession, talent development, talent retention, and knowledge management.

Talent acquisition. Keeping in mind the objective to recruit, select, and place the right talent with the right skills at the right time, the BSP has been able to improve on its efficiency fill rate (EFR) from an average of 75 working days in 2014 and 37 working days in 2015 to only 29 working days in 2016. This dramatic change enabled the processing of a total of 3,897 appointments for this year alone. With the adoption of an accounts-based end-to-end approach from recruitment to appointment and with the use of LinkedIn as an additional sourcing strategy, the BSP expects its EFR to be reduced further in the years to come. Such efficiency has also been facilitated by encouraging departments and offices to accomplish their respective Annual Manpower Plans (AMPs). Guided by the BSP Merit Selection Plan (MSP) in carrying out this first objective, the understanding and compliance thereto has also been obtained. Thus, in 2016, the BSP was able to cascade completely to all departments and offices including the Regional Offices (ROs) and Branches the revised BSP MSP, as approved by the Civil Service Commission (CSC), and its implementing guidelines through a series of workshops with Administrative Officers and the conduct of briefings to sectors and sub-sectors.

Talent succession. The Bank has ascertained business continuity primarily through a viable leadership pipeline. The average turn-around-time of filling key and critical positions (KCPs) improved from four months in end-2015 to only two months at the end of 2016. This resulted in nine KCPs filled within three months from vacancy in 2016. Filling up KCPs has been more efficient by ensuring that at least three potential candidates for each KCP are willing, ready, and able. This has been realized at least through the implementation of the Management Development Program (MDP) Regular and Accelerated Tracks. In 2016, 49 potential successors to 22 KCPs have completed their MDP-Accelerated Track training while 212 officers are done with their MDP-Regular Track training. This training intervention for the Bank's future leaders is fortified with mentoring as a workplace development intervention (WDI). There have been 16 mentoring sessions conducted and participated in by 39 mentors and 151 mentees. Ninety-two percent of identified potential successors have completed other WDIs.

Talent development. To accelerate the development and enhancement of workforce capability and potential to achieve organizational goals, the BSP facilitated the 100 percent implementation of training programs identified in the employees' Individual Development Plans. To formalize and make the structure of training programs and WDIs for each job family more comprehensive, the Bank completed the development of competency-based curricula and model at 96 percent (24 out of 25 Job Families). The BSP also started gathering the baseline level of Bankwide competencies through online assessment across all sectors. By the end of 2016, 41 percent participation has been reached after rolling it out only in the first week of December of the same year. Full participation is expected in Q1 2017.

Talent retention. For the Bank's successfully placed and developed talents to be retained, BSP has put in place various mechanisms to engage and motivate them further to contribute more to the Bank. A new competitive and equitable compensation package was established through the 100 percent implementation of the new performance-based salary structure with an 11-level position classification hierarchy.

Alongside the monetary incentives to motivate employees, the Bank fostered a healthier working environment through the initiatives of the Health Services Office. In 2016, the BSP received the Red Orchid Hall of Fame Award for the 100 percent tobacco-free policy and advocacy and the Outstanding Healthy Lifestyle Award by the Department of Health in recognition of its efforts to look after the well-being of BSPers.[128]

Knowledge management. To familiarize employees with central banking regardless of their job family, the BSP has ensured that all significant information and knowledge assets are readily available. This objective was realized through the implementation of a knowledge management system that paves the way for knowledge sharing and access to accurate, updated, and timely information and enhanced operational efficiency. In 2016, the BSP fully operationalized the iKnow Portal. To ensure that knowledge sharing is embedded in the BSP culture, the Knowledge Management Group conducted 13 KM briefings, released 17 advisories, created four KM 'communities', conducted an assessment of the iKnow Portal's effectiveness, and continued enhancement of the iKnow Portal's "usability" (ease of use and availability).

Leadership and recognition. Towards the quest for thought leadership, these initiatives on institutional capacity building were shared with local and international counterparts and stakeholders. In 2016, the BSP hosted five (5) study visits by other central banks (Bhutan, Russia, Nepal, Sri Lanka, and Myanmar) to the BSP for their capacity development programs focused on BSP's performance of its functions/core operations – including human capital management, among others. Moreover, the BSP also engaged in benchmarking/information exchange with other government and private institutions such as CSC, DBM, DAP, and Philippine Rice Research Institute on various HR topics.

As an affirmation and recognition of the Bank's success in capacity building through the HCMF, the CSC has confirmed that the BSP's human capital management areas, i.e., Recruitment, Selection, and Placement; Performance Management; Learning and Development; and Rewards and Recognition have reached the top level of maturity in implementation as Centers of Excellence.

[128]The Red Orchid award is the highest honor given out by the DOH under its search for 100 percent tobacco-free provinces, municipalities, government offices and health facilities.

Box Article 12

Implementation of the Professional Excellence Program for Bank Supervisors (PEPS):
A Self-sustaining Capacity Building Program of the Supervisory and Examination Sector (SES)

The BSP's pursuit of excellence in risk-based supervision remains fully supported by the adoption of the SES competency framework that recognizes the unique skill set requirements of bank supervisors and entails targeted interventions to appropriately address gaps. The framework defines five SES competencies and identifies representative displayed behaviors that aid in competency assessments. This is complemented by a robust capacity-building program that supports the development of an individual's competencies.

The Professional Excellence Program for Bank Supervisors (PEPS) was launched in 2011[129], bringing closer the SES vision of being a highly respected supervisory authority noted for its integrity, competence, and leadership in guiding the financial system to thrive in an increasingly sophisticated and competitive global environment. PEPS is a progressive learning program that aims to provide professionals with the knowledge, skills, and on-the-job training to be fully effective bank supervisors. It currently has 22 courses ranging from entry to expert-level courses, as well as specialized courses. Each course targets specific competencies to be developed and subsequently demonstrated on the job. Embedded as well are online self-study modules of the FSI Connect, developed and maintained by the Financial Stability Institute of the BIS. The PEPS curriculum is likewise supported by on-the-job training and mentoring process. Finally, the PEPS supports a structured approach to career advancement, as completion of appropriate courses forms part of the indicative criteria for promotion, in addition to the objective assessment of demonstrated competencies.

The PEPS is fully functional and sustainable since it is internally developed, administered, and maintained by subject matter experts, through various course committees. Each committee is further guided by SES management sponsors who ensure that the courses are integrated, consistent, and responsive to changes in the regulatory and banking environment. The committees are supported by a pool of qualified resource persons[130], who undergo the train the trainers course included in the PEPS. Since 2011, the BSP has administered 442 PEPS course offerings, generating an average of 21 graduates each.

The capacity-building efforts of the BSP, through the PEPS, have further supported the strategic objective of promoting thought leadership through knowledge transfer. Specifically, the BSP has provided resource persons and course materials in various local and international events, seminars, and training programs. Indeed, the BSP has made substantial progress in building supervisory capacity, showing its commitment to effective supervision of financial institutions under its jurisdiction to protect the interest of the depositing public and other stakeholders and to preserve the overall stability of the financial system.

[129] Approved by the Monetary Board on 13 October 2011.
[130] Committee members also serve as resource persons.

Feedback Management System

During the year, the BSP Feedback Management System (FMS) was fully implemented using four (4) feedback channels: emoticon tablets in servicing departments/offices (SDOs), touchscreen kiosks in BSP entry points and lobbies of regional offices/branches (ROBs), FMS Weblink (Feedback Corner in the BSP website), and paper-based structured forms with scanning facility. The full implementation of the feedback channels provided real time external feedback to SDOs for timely resolution of stakeholders' concerns.

Launch of the Cosmetic Website. The BSP launched its revamped website on 24 October 2016. The cosmetic website offered a fresh look of the site with more helpful and user-friendly features. It featured the new BSP banner, easier navigation for both the mega menu and side panels, a searchable database for metadata, an interactive statistical database using PC Axis, and links to the social media accounts of the BSP.

BSP Financial Results

The BSP's Balance Sheet. The BSP's balance sheet as of end-December 2016 increased by ₱249.2 billion or 5.8 percent higher from the year-ago level of ₱4,309.9 billion. The balance sheet total as of end-December 2016 was ₱4,559.1 billion.

Table 3.1 Balance Sheet of the BSP
in billion pesos

Accounts	December	
	2016 p,u	2015r
Assets	4,559.1	4,309.9
Liabilities	4,500.7	4,268.7
Net Worth	58.4	41.2

p Based on the preliminary (pre-closing) BSP balance sheet as of end-December 2016 prepared by the Financial Accounting Department (FAD) of the BSP.
u Unaudited
r Based on restated BSP audited financial statements

The BSP's assets were composed largely of international reserves amounting to ₱3,998.0 billion (US$80.69 billion) as of end- December 2016, slightly higher than the year-ago balance of ₱3,782.4 billion (US$80.67 billion). The rise in the international reserves was brought by higher net foreign currency deposits and foreign exchange operations of the BSP. While there was no gold spot transaction during the review year, the BSP's gold holdings continued to generate premium collections from gold call and put options trading.

As of end-December 2016, the BSP's liabilities amounted to ₱4,500.7 billion, comprised mostly of deposits and currency issues. This amount was above the previous year level of ₱4,268.7 billion owing to the rise in the level of currency issuances during the year. The increase in BSP's liabilities was also driven by higher revaluation of international reserves and reserve deposits of other depository corporations (ODCs). However, the increase in reserve deposits was partially offset by the decrease in the Treasurer of the Philippines account and lower placements in overnight deposit facilities. As of 31 December 2016, there were about 3.85 billion pieces of notes valued at ₱1.09 trillion and 26.35 billion pieces of coins valued at ₱29.63 billion in circulation.

Operating Profit. The Bank's financial performance for the end-December 2016 greatly improved by gains on foreign exchange rate fluctuations and higher income on international reserves and further supported by lower interest expenses.

Table 3.2 Income Statement of the BSP
in billion pesos

Accounts	2016 [p,u]	2015[r]
Revenues	**69.207**	**56.665**
Expenses	**71.187**	**73.001**
Net Income/(Loss) Before Gain/(Loss) on FXR Fluctuations and	**(1.980)**	**(16.336)**
Gain/(Loss) on Foreign Exchange Rate Fluctuations	19.109	11.550
Income Tax Expense/(Benefit)	0.106	(0.333)
Net Worth	**17.023**	**(4.453)**

[p] Based on the preliminary (pre-closing) BSP balance sheet as of end-December 2016 prepared by the Financial Accounting Department (FAD) of the BSP.
[u] Unaudited
[r] Based on restated BSP audited financial statements

Total revenues for 2016 amounted to ₽ 69.2 billion, higher than the ₽56.7 billion posted last year. This was due mainly to the combined increase in interest income on international reserves and trading gains on foreign exchange securities.

Total expenditures amounted to ₽71.2 billion, slightly lower than the ₽73.0 billion posted last year. The y-o-y decrease in expenditures was due mainly to the drop in interest expense on overnight deposit facilities, national government deposits and reverse repurchase agreements. Net profit of ₽17.0 billion was composed mainly of realized gains on securities from foreign banks, matured swap transactions, and investments during the year.

Box Article 13

The Transformation of the BSP's Financial Management

Over the years, the accounting function has been viewed as a simple and mechanical process of recording the financial transactions of an entity. However, the accounting function has been transformed with the establishment of rules and international accounting principles and standards, as well as the heavy reliance of management on financial accounting reports for decision making. The upshot of these developments is that institutions are compelled to re-assess their long-established ways of doing things. At the BSP, the adoption of a modernized and improved financial management system has become imperative amid the evolution of accounting processes and changes in organizational structure, functions, strategies, operational methods, and technologies and culture. The BSP, through the Comptrollership Subsector (CoSS), is committed to ensure that BSP's financial management system, which encompasses the accounting system, is up-to-date and more responsive in addressing developments in the Philippine economy and the external environment with important impact on the country's financial system.

Evolution of the CoSS Financial Accounting and Reporting System

With the developments in the BSP's structure, functions and strategies, the CoSS financial accounting system has likewise evolved through the years, to take into account the requirements of governing statutes, the convergence and evolution of international accounting standards and the due diligence requirements set by international financial institutions.

Accounting framework. When BSP was established in 1949, its financial reporting framework was based mostly on principles developed by United States of America – the Generally Accepted Accounting Principles (US GAAP), and accounting practices were patterned from profit-oriented business practices. Starting 2005, the BSP adopted the applicable Philippine Financial Reporting Standards (PFRS), which is patterned after the International Financial Reporting Standards (IFRS) of the International Accounting Standards Board.[131]

Accounting system. From a manual process relying primarily on the use of paper-based accounting records and documents in recording and keeping financial information, an on-line system of computerization of accounting transactions was developed and put into operation in 1998. In 2002, the BSP operationalized its core Financial Accounting System (cFas), a custom-developed, web-based, on-line, real-time accounting system with central data base for general and subsidiary ledgers. The cFAS aims to address the accounting, management and financial reporting needs of BSP in an online real-time mode.

Organizational developments. In line with international accounting standards that focused on risk management and internal control, the then Comptrollership Department was renamed Comptrollership Subsector (CoSS) composed of three specialized offices/departments, ie., Budget Office, Accounting Department and Payments and Settlements Office.[132] The CoSS, through its Financial Accounting Department (FAD) and Budget Planning and Special Studies Group (BPSSG), is responsible for the accounting, budget planning and administration, and disbursement activities of the Bank. Among its functions are to:

[131] An independent and non-profit organization.
[132] The Payments and Settlements Office was eventually separated from CoSS in 2006.

1) Oversee and manage the overall financial accounting and budget administration functions of the BSP;
2) Recommend procedures and controls that would help ensure the protection of the Bank against fraud, financial negligence, violation of financial rules and principles, and losses of assets or funds; and
3) Maintain and control the demand deposit accounts of the Treasurer of the Philippines, banking institutions, government-owned and controlled corporations, and other government offices.

Essential to these functions is ensuring that reliable and relevant information, which is necessary in the (a) conduct of analysis of where and how organizational resources are being utilized and (b) assessment of the Bank's performance in carrying out its mandate, is easily accessible and available.[133] However, at present, the accounting systems in other departments/offices in BSP are not compatible and linked with the CoSS accounting system, making the acquisition and extraction of necessary information, as well as the timely submission of reports, more challenging.

Meanwhile, the CoSS Architecture Enterprise Board and Technical Working Group were constituted to review CoSS' enterprise architecture and to spearhead the development, implementation, administration and post-implementation assessment of the Integrated Financial and Management Information System (IFMIS). The IFMIS Phase 1 was formally launched on 15 August 2016.

Deployment of IFMIS

The BSP envisions to deploy a robust Integrated IFMIS to capture, monitor, and report timely and relevant financial information that will serve as guide for Management in decision-making. This is expected to achieve and promote operational efficiency and good governance in the organization, and provide flexibility to meet existing and evolving requirements in response to legal or institutional changes.

IFMIS is envisaged to support the automation and integration of BSP's financial management processes including planning; budget preparation, execution and administration; asset management, receipt and payments; accounting; financial and management reporting; tax accounting and compliance reporting. It is aimed at significantly improving the efficiency and effectiveness of BSP operations, as well as to promote participation, transparency and accountability.

IFMIS is viewed to address operational excellence and good governance, which are two of the four strategic themes in the BSP Strategy Map for 2012-2017. Operational excellence demands, among others, that the organization delivers its functions and services at an optimal cost level; while governance demands a culture of financial discipline and accountability. Advancements that will bring about the automation of processes must

[133] The bodies responsible for the governance of accounting and financial reporting in the BSP are as follows:
a. Seven-member Monetary Board - exercises the powers and functions of the BSP and approves the release of financial reports;
b. BSP Audit Committee - recommends approval of the financial reports;
c. BSP Budget Committee – conducts periodic review of budget status and submits report to the Monetary Board;
d. Comptrollership Sub-sector - prepares and analyzes the financial statements and reports and related management reports;
e. Internal Audit Office - undertakes the internal compliance review; and
f. Commission on Audit - takes charge of the financial and compliance audit of the BSP and all government agencies (Article IX-D of the Philippine Constitution; Presidential Decree No. 1445).

be embraced by all parties involved, as these developments are utilized to enhance BSP's financial and management information system and cope up with the needs of our stakeholders.

IFMIS Phase 1 is on-going and expected to be completed upon the official adoption of consultant's design and development of the IFMIS framework, target operating model, roadmap for implementation, and request for proposal (RFP) for IT solution. Meanwhile, *IFMIS Phase 2* (Implementation of the IT Solution) is targeted for completion by Q4 2018.

Statistical Annexes

List of Tables

1 GROSS NATIONAL INCOME (GNI) AND GROSS DOMESTIC PRODUCT (GDP) BY INDUSTRIAL ORIGIN

for periods indicated

in million pesos; at constant 2000 prices

				Percent Change		
	2014	2015	2016	2014	2015	2016
Agriculture, Hunting, Forestry and Fishing	718,778	719,748	710,590	1.7	0.1	-1.3
Industry Sector	2,391,188	2,535,796	2,738,320	7.8	6.0	8.0
Mining and Quarrying	81,695	80,500	80,258	12.1	-1.5	-0.3
Manufacturing	1,666,514	1,760,989	1,883,922	8.3	5.7	7.0
Construction	409,277	447,759	503,985	7.2	9.4	12.6
Electricity, Gas and Water Supply	233,702	246,548	270,155	3.6	5.5	9.6
Services Sector	4,060,319	4,338,284	4,664,261	6.2	6.8	7.5
Transport, Storage & Communication	538,044	581,289	615,706	6.5	8.0	5.9
Trade and Repair of Motor Vehicles, Motorcycles, Personal and Household Goods	1,185,810	1,270,526	1,362,690	5.8	7.1	7.3
Financial Intermediation	515,484	546,714	589,050	7.2	6.1	7.7
Real Estate, Renting & Business Activities	803,305	861,492	939,468	8.7	7.2	9.1
Public Administration & Defense: Compulsory Social Security	293,532	297,082	317,567	4.0	1.2	6.9
Other Services	724,144	781,181	839,779	4.0	7.9	7.5
Gross Domestic Product	**7,170,285**	**7,593,828**	**8,113,170**	**6.2**	**5.9**	**6.8**
Net Primary Income from the rest of the world	1,462,747	1,540,910	1,622,040	4.4	5.3	5.3
Gross National Income	**8,633,033**	**9,134,739**	**9,735,210**	**5.9**	**5.8**	**6.6**

Notes:

(1) The use of terminology Gross National Income (GNI) in place of Gross National Product (GNP) has been adopted in the revised/rebased Philippine System of National Accounts (PSNA) in accordance with the 1993/1998 System of National Accounts prescribed by the United Nations.

(2) Numbers may not add up to total due to rounding.

Source: Philippine Statistics Authority (PSA)

1a GROSS NATIONAL INCOME (GNI) AND GROSS DOMESTIC PRODUCT (GDP) BY EXPENDITURE SHARE

for periods indicated

in million pesos; at constant 2000 prices

Item	2014	2015	2016	Percent Change 2014	Percent Change 2015	Percent Change 2016
Household Final Consumption Expenditure	4,952,191	5,264,137	5,628,318	5.5	6.3	6.9
Government Final Consumption Expenditure	728,752	785,347	850,747	3.3	7.8	8.3
Capital Formation	1,568,363	1,805,281	2,180,842	5.2	15.1	20.8
Fixed Capital	1,525,606	1,757,296	2,169,885	6.2	15.2	23.5
Construction	632,219	688,493	781,910	8.5	8.9	13.6
Durable Equipment	749,703	913,204	1,211,236	4.4	21.8	32.6
Breeding Stocks and Orchard Development	97,295	99,286	102,928	-1.3	2.0	3.7
Intellectual Property Products	46,390	56,312	73,811	22.7	21.4	31.1
Changes in Inventories	42,757	47,985	10,957	-19.3	12.2	-77.2
Exports	3,377,986	3,681,166	4,016,105	11.7	9.0	9.1
Less: Imports	3,456,879	3,942,163	4,631,536	9.3	14.0	17.5
Statistical Discrepancy	-129	60	68,695			
Gross Domestic Product	**7,170,285**	**7,593,828**	**8,113,170**	**6.2**	**5.9**	**6.8**
Net Primary Income from the rest of the world	1,462,747	1,540,910	1,622,040	4.4	5.3	5.3
Gross National Income	**8,633,033**	**9,134,739**	**9,735,210**	**5.9**	**5.8**	**6.6**

Notes:

(1) The use of terminology Gross National Income (GNI) in place of Gross National Product (GNP) has been adopted in the revised/rebased Philippine System of National Accounts (PSNA) in accordance with the 1993/1998 System of National Accounts prescribed by the United Nations.

(2) Numbers may not add up to total due to rounding.

Source: Philippine Statistics Authority (PSA)

2 SELECTED LABOR, EMPLOYMENT AND WAGE INDICATORS
for periods indicated

	2013		2014			2015		2016[p]	Percent change (%) 2015	Percent change (%) 2016
	w/ Region VIII	w/o Region VIII	w/ Region VIII	w/o Region VIII	w/o Leyte[5]	w/ Leyte	w/o Leyte	w/ Leyte	w/ Leyte	w/ Leyte
Employment Status [1]										
Labor Force (In Thousands)	41,022	39,088		40,050	41,379		41,343	43,206		
Employed	38,118	36,286		37,310	38,651		38,741	40,837		
Unemployed	2,905	2,801		2,740	2,728		2,602	2,367		
Underemployed	7,371	6,912		6,870	7,118		7,180	7,478		
Labor Force Participation Rate (%)	63.9	63.9		64.4	64.6		63.7	63.4		
Employment Rate (%)	92.9	92.8		93.2	93.4		93.7	94.5		
Unemployment Rate (%)	7.1	7.2		6.8	6.6		6.3	5.5		
Underemployment Rate (%)	19.3	19.0		18.4	18.4		18.5	18.3		
Overseas Employment (Deployed, in thousand)[2]	1,836		1,833			1,844			0.6	
Land-Based	1,469		1,431			1,438			0.5	
Sea-Based	367		402			407			1.2	
Strikes										
Number of new strikes declared	1		2			5		15	150.0	200.0
Number of workers involved	400		51			730		3,106	1331.4	325.5
Legislated Wage Rates [3]										
In Nominal Terms										
Non-Agricultural										
National Capital Region (NCR)	466.00		466.00			481.00		491.00	3.2	2.1
Regions Outside NCR (ONCR)	349.50		362.50			362.50		378.50	0.0	4.4
Agricultural										
NCR										
Plantation	429.00		429.00			444.00		454.00	3.5	2.3
Non-Plantation	429.00		429.00			444.00		454.00	3.5	2.3
ONCR										
Plantation	324.50		337.50			337.50		353.50	0.0	4.7
Non-Plantation	309.00		322.00			335.00		335.00	4.0	0.0
In Real Terms (at 2006 prices) [4]										
Non-Agricultural										
National Capital Region (NCR)	362.36		356.54			363.84		361.56	2.0	-0.6
Regions Outside NCR (ONCR)	256.80		260.23			257.82		265.24	-0.9	2.9
Agricultural										
NCR										
Plantation	333.59		328.23			335.85		334.32	2.3	-0.5
Non-Plantation	333.59		328.23			335.85		334.32	2.3	-0.5
Regions Outside NCR (ONCR)										
Plantation	238.43		242.28			240.04		247.72	-0.9	3.2
Non-Plantation	224.08		224.70			229.45		223.48	2.1	-2.6

Notes:
1 Starting with January 2007 LFS round, the population projection based on the 2000 Census of Population was adopted to generate the labor force statistics per NSCB Resolution No. 1 Series of 2005.
2 Details may not add up to totals due to rounding.
3 Source of data for both nominal and real wage rates is the National Wages and Productivity Commission. Includes basic minimum wage and cost of living allowance (COLA). Starting 2006, annual average/total is as of December.
4 Starting 10 November 1990, adjustments in the minimum legislated wage rates are being determined by the Regional Tripartite Wages Productiviity Board. Starting 2010, real terms is computed using 2006 as base year.
5 Annual 2014 data refer to the average estimates for April, July and October survey rounds only excluding data of the province of Leyte.
p Preliminary

Sources: Philippine Overseas Employment Administration (POEA), National Wages and Productivity Commission (NWPC), and National Conciliation and Mediation Board (NCMB) and Philippine Statistics Authority (PSA)

3 CONSUMER PRICE INDEX (CPI) IN THE PHILIPPINES, METRO MANILA AND ALL AREAS OUTSIDE METRO MANILA

for periods indicated

2006=100

Commodity Group	Philippines				Metro Manila				All Areas Outside Metro Manila			
	CPI		Percent Change		CPI		Percent Change		CPI		Percent Change	
	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016
All Items	**141.5**	**144.0**	**1.4**	**1.8**	**131.8**	**133.4**	**1.0**	**1.2**	**144.6**	**147.4**	**1.5**	**1.9**
Food and Non-Alcoholic Beverages	157.3	161.2	2.5	2.5	148.1	153.5	2.2	3.6	159.2	162.9	2.6	2.3
Food	159.2	163.3	2.6	2.6	150.0	155.6	2.4	3.7	161.1	164.9	2.7	2.4
Alcoholic Beverages, Tobacco and Narcotics	182.4	192.8	3.8	5.7	156.0	162.1	2.2	3.9	187.7	198.9	4.1	6.0
Non-Food	129.8	131.0	0.5	0.9	124.7	124.6	0.4	-0.1	131.8	133.6	0.4	1.4
Clothing and Footware	136.3	139.5	2.6	2.3	141.5	145.0	3.0	2.5	134.5	137.7	2.4	2.4
Housing, Water, Electricity, Gas and Other Fuels	129.1	128.9	-1.3	-0.2	123.1	120.9	-1.5	-1.8	131.8	132.5	-1.1	0.5
Furnishing, Household Equipment and Routing Maintenance of the House	130.9	133.4	1.9	1.9	126.4	127.7	1.0	1.0	132.5	135.4	2.2	2.2
Health	139.3	142.6	2.1	2.4	146.2	148.1	3.1	1.3	137.4	141.1	1.8	2.7
Transport	127.6	128.0	-0.1	0.3	116.8	116.3	1.5	-0.4	130.9	131.6	-0.5	0.5
Communication	92.7	92.8	0.0	0.1	94.2	94.4	0.1	0.2	91.9	92.0	-0.2	0.1
Recreation and Culture	115.3	117.1	1.1	1.6	119.5	122.9	2.1	2.8	113.9	115.0	0.8	1.0
Education	155.8	159.8	4.2	2.6	159.5	165.5	5.6	3.8	154.7	158.1	3.8	2.2
Restaurants and Miscellaneous Goods and Services	130.2	132.9	1.3	2.1	123.5	124.8	0.7	1.1	133.1	136.4	1.6	2.5

Source: Philippine Statistics Authority (PSA)

4 CASH OPERATIONS OF THE NATIONAL GOVERNMENT

for periods indicated

in million pesos

	Actual		Annual Change
	2015	2016	(%)
Revenues	**2,108,956**	**2,195,914**	**4.1**
Tax Revenues	1,815,475	1,980,390	9.1
Bureau of Internal Revenue	1,433,302	1,567,214	9.3
Bureau of Customs	367,534	396,365	7.8
Other Offices	14,639	16,811	14.8
Non-tax Revenues	293,481	215,524	-26.6
of w/c: Bureau of the Treasury	110,035	101,737	-7.5
Expenditures	**2,230,645**	**2,549,336**	**14.3**
of which:			
Allotments to Local Government Units	387,559	449,776	16.1
Interest Payments	309,364	304,454	-1.6
Equity and Net Lending	10,463	26,979	157.9
Surplus/Deficit (-)	**-121,689**	**-353,422**	**-190.4**
Financing	**92,851**	**220,938**	**137.9**
External Borrowings (Net)	64,782	-24,113	-137.2
Domestic Borrowings (Net)	28,069	245,051	773.0
Total Change in Cash: Deposit/Withdrawal (-)	-1,580	-257,654	-16,207.2
Budgetary	-28,838	-132,484	-359.4
Non-Budgetary [1]	27,258	-125,170	-559.2

[1] Refer to accounts not included in the NG budget, e.g., sale, purchase or redemption of government securities, but included in the cash operations report to show the complete relationship in the movements of the cash accounts

Source: Bureau of the Treasury

5 DEPOSITORY CORPORATIONS SURVEY (SRF-based)*

as of period indicated
in million pesos

	LEVELS Dec-15	Dec-16 [p]	GROWTH RATES (%)
1. NET FOREIGN ASSETS	**3,998,783**	**4,308,975**	**7.8**
A. Monetary Authorities	3,762,845	3,946,439	4.9
Claims on non-residents	3,837,264	4,023,829	4.9
less: Liabilities to non-residents	74,419	77,390	4.0
B. Other Depository Corporation	235,938	362,536	53.7
Claims on non-residents	1,023,852	1,211,829	18.4
less: Liabilities to non-residents	787,913	849,293	7.8
2. DOMESTIC CLAIMS	**7,861,026**	**9,193,613**	**17.0**
A. Net Claims on Central Government	1,261,692	1,607,496	27.4
Claims on central government	1,992,572	2,101,500	5.5
less: Liabilities to central government	730,880	494,003	(32.4)
B. Claims on Other Sectors	6,599,334	7,586,117	15.0
Claims on other financial corporations	680,481	771,494	13.4
Claims on state and local government	76,635	82,848	8.1
Claims on public nonfinancial corporations	277,971	256,796	(7.6)
Claims on private sector	5,564,247	6,474,979	16.4
3. LIQUIDITY AGGREGATES			
M4 (M3 + 3.e)	**9,888,718**	**11,206,515**	**13.3**
M3 (M2 + 3.d) **	8,429,929	9,497,935	12.7
M2 (M1 + 3.c)	8,067,273	9,137,898	13.3
M1 (3.a + 3.b)	2,667,609	3,069,611	15.1
3.a Currency outside depository corporations (Currency in circulation)	791,431	921,162	16.4
3.b Transferable deposits included in broad money (Demand deposits)	1,876,179	2,148,448	14.5
3.c Other deposits included in broad money	5,399,663	6,068,287	12.4
Savings deposits	3,586,873	4,097,560	14.2
Time deposits	1,812,790	1,970,728	8.7
3.d Securities other than shares included in broad money (Deposit substitutes)	362,656	360,037	(0.7)
3.e Transferable and other deposits in foreign currency (FCDs-Residents)	1,458,789	1,708,581	17.1
4. LIABILITIES EXCLUDED FROM BROAD MONEY	**1,971,092**	**2,296,073**	**16.5**

* Based on the Standardized Report Forms (SRFs), a unified framework for reporting monetary and financial statistics to the International Monetary Fund (IMF).
[p] Preliminary
** May also be derived as Net Foreign Assets + Domestic Claims, net of Liabilities excluded from broad money and transferable and other deposits in foreign currency (FCDs-Residents).
Source: BSP

6 SELECTED DOMESTIC INTEREST RATES [1]

for periods indicated
in percent per annum

	Nominal Interest Rates			Real Interest Rates [7]		
	2014	2015	2016	2014	2015	2016
Borrowing Rates of Banks						
Interbank Call Loans	2.218	2.526	2.525	-1.882	1.126	0.725
Savings Deposits [2]	0.626	0.710	0.721	-3.474	-0.690	-1.079
Time Deposits [2]						
(All Maturities)	1.080	1.496	1.541	-3.020	0.096	-0.259
Lending Rates						
All Maturities [3]	5.525	5.580	5.639	1.425	4.180	3.839
High [4]	6.801	6.877	6.671	2.701	5.477	4.871
Low [5]	4.384	4.470	4.300	0.284	3.070	2.500
Bangko Sentral Rates[6]						
R/P (Overnight)	..	..	..	..	..	..
R/P (Term)	..	..	..	..	..	..
Overnight Lending Facility (OLF)	...	...	..	...	...	..
RR/P (Overnight)	3.770	4.000	3.417	-0.330	2.600	1.617
Overnight Deposit Facility (ODF)	...	...	2.500	...	...	0.700
Term Deposit Auction Facility (TDF)						
7-Day	...	...	2.661	...	...	0.861
28-Day	...	...	2.761	...	...	0.961
RR/P (Term)						
Rediscounting	3.724	4.079	3.839	-0.376	2.679	2.039
Rate on Government Securities						
Treasury Bills (All Maturities)	1.495	1.894	1.595	-2.605	0.494	-0.205
91-Day	1.244	1.772	1.500	-2.856	0.372	-0.300
182-Day	1.605	1.924	1.583	-2.495	0.524	-0.217
364-Day	1.788	2.077	1.761	-2.312	0.677	-0.039
Government Securities in the Secondary Market [8]						
3-Month	2.541	2.667	2.076	-0.159	1.167	-0.525
6-Month	2.643	2.918	2.946	-0.057	1.418	0.346
1-Year	2.696	2.371	2.452	-0.005	0.871	-0.148
2-Year	3.057	3.985	3.868	0.357	2.485	1.268
3-Year	3.450	3.663	3.517	0.750	2.163	0.917
4-Year	3.571	3.875	3.881	0.871	2.375	1.281
5-Year	3.680	3.925	4.743	0.980	2.425	2.143
7-Year	4.148	4.585	4.886	1.448	3.085	2.286
10-Year	4.371	4.100	4.628	1.671	2.600	2.028
20-Year	5.173	5.522	5.377	2.473	4.022	2.777
25-Year	4.950	4.892	..	2.250	3.392	..

[1] All figures are weighted average rates, unless stated otherwise
[2] Covers all commercial banks
[3] Ratio of all commercial banks' total interest incomes to their total outstanding peso-denominated loans
[4] Refers to the average of all highs quoted by reporting commercial banks
[5] Refers to the average of all lows quoted by reporting commercial banks
[6] Beginning 3 June 2016, the BSP shifted its monetary operations to an interest rate corridor (IRC) system. The repurchase (RP) and Special Deposit Account (SDA) windows were replaced by standing overnight lending and overnight deposit facilities, respectively. The reverse repurchase (RRP) facility was modified to a purely overnight RRP. In addition, the term deposit facility (TDF) will serve as the main tool for absorbing liquidity. Starting 3 June 2016, the interest rates for these facilities were set as follows: 3.5 percent in the OLF (a reduction from 6.0 percent); 3.0 percent in the overnight RRP rate (an adjustment from 4.0 percent); and 2.5 percent in the ODF (no change from the current SDA rate). The OLF and ODF will serve as upper and lower bound, respectively, of the IRC system.
[7] Nominal interest rate less inflation rate
[8] End-of-Period; beginning 2015, data refers to PDST-R2 while those for earlier periods refers to PDST-F.

.. No Transaction/No Quotation/No Issue
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Source: BSP

7 CROSS RATES OF THE PESO

period averages

pesos per unit of foreign currency

		US Dollar	Japanese Yen	Pound Sterling	Hongkong Dollar	Swiss Franc	Canadian Dollar	Singapore Dollar	Australian Dollar	Bahrain Dollar	Saudi Rial	Brunei Dollar	Indo Rupiah	Thai Baht	UAE Dirham	EURO
2014	**Ave**	**44.3952**	**0.4208**	**73.1731**	**5.7252**	**48.6018**	**40.2315**	**35.0648**	**40.0974**	**117.7596**	**11.8363**	**34.9268**	**0.0037**	**1.3672**	**12.0872**	**59.0432**
	Jan	44.9266	0.4321	74.0269	5.7920	49.7477	41.1783	35.3263	39.8717	119.1749	11.9795	35.1880	0.0037	1.3657	12.2323	61.2469
	Feb	44.8950	0.4397	74.3135	5.7867	50.1819	40.6097	35.4679	40.2635	119.0872	11.9711	35.3284	0.0038	1.3756	12.2238	61.3016
	Mar	44.7916	0.4381	74.4520	5.7711	50.8876	40.3382	35.3400	40.6363	118.8140	11.9437	35.2012	0.0039	1.3832	12.1953	61.9409
	Apr	44.6416	0.4351	74.6995	5.7572	50.5496	40.6009	35.5664	41.6028	118.4140	11.9035	35.4253	0.0039	1.3815	12.1542	61.6350
	May	43.9236	0.4314	73.9965	5.6660	49.4516	40.3407	35.1096	40.8495	116.5086	11.7116	34.9698	0.0038	1.3513	11.9588	60.3484
	Jun	43.8175	0.4293	74.0822	5.6528	48.9246	40.4681	35.0303	41.0022	116.2253	11.6829	34.8908	0.0037	1.3474	11.9300	59.5975
	Jul	43.4665	0.4276	74.2780	5.6085	48.4989	40.5584	34.9877	40.8363	115.2966	11.5901	34.8475	0.0037	1.3531	11.8342	58.9257
	Aug	43.7673	0.4258	73.2141	5.6473	48.1523	40.0898	35.0739	40.7390	116.0917	11.6701	34.9339	0.0038	1.3663	11.9160	58.3659
	Sep	44.0751	0.4119	71.9350	5.6860	47.1462	40.0966	34.9299	40.0406	116.9114	11.7517	34.7920	0.0037	1.3708	12.0001	56.9349
	Oct	44.7979	0.4156	72.0912	5.7746	47.0830	39.9746	35.1776	39.3383	118.8267	11.9421	35.0400	0.0037	1.3812	12.1967	56.8661
	Nov	44.9514	0.3875	70.9959	5.7970	46.6432	39.7096	34.7182	38.9172	119.2334	11.9815	34.5846	0.0037	1.3717	12.2384	56.1001
	Dec	44.6878	0.3755	69.9919	5.7632	45.9551	38.8130	34.0494	37.0710	118.5317	11.9074	33.9201	0.0036	1.3589	12.1666	55.2554
2015	**Ave**	**45.5028**	**0.3760**	**69.5888**	**5.8697**	**47.3197**	**35.6520**	**33.1266**	**34.2412**	**120.7585**	**12.1317**	**33.0064**	**0.0034**	**1.3308**	**12.3892**	**50.5291**
	Jan	44.6044	0.3764	67.5228	5.7531	47.2855	36.8376	33.3326	36.1260	118.3126	11.8776	33.2085	0.0035	1.3627	12.1439	51.8185
	Feb	44.2214	0.3728	67.7105	5.7028	47.3619	35.3451	32.6549	34.4404	117.2958	11.7850	32.5348	0.0035	1.3575	12.0397	50.2159
	Mar	44.4457	0.3695	66.6675	5.7290	45.4456	35.2817	32.3068	34.4120	117.8925	11.8512	32.1898	0.0034	1.3638	12.1011	48.2323
	Apr	44.4136	0.3717	66.4142	5.7303	46.1928	36.0270	32.9291	34.3952	117.8153	11.8431	32.8075	0.0034	1.3660	12.0921	47.9446
	May	44.6106	0.3697	68.9978	5.7545	47.8767	36.6623	33.4497	35.2446	118.3252	11.8964	33.3247	0.0034	1.3334	12.1456	49.8209
	Jun	44.9831	0.3635	70.0355	5.8023	48.3268	36.4134	33.4578	34.6977	119.3305	11.9957	33.3338	0.0034	1.3345	12.2476	50.4958
	Jul	45.2649	0.3674	70.4481	5.8396	47.5120	35.3235	33.2927	33.6277	120.1137	12.0702	33.1707	0.0034	1.3212	12.3242	49.8437
	Aug	46.1420	0.3746	71.9861	5.9513	47.6345	35.1180	33.0760	33.7471	122.3931	12.3033	32.9579	0.0034	1.3053	12.5633	51.3555
	Sep	46.7504	0.3891	71.7659	6.0323	48.1214	35.2777	33.0510	33.0060	124.1160	12.4684	32.9346	0.0033	1.2991	12.7301	52.5457
	Oct	46.3609	0.3860	71.0269	5.9821	47.8555	35.4449	33.0814	33.4019	123.1043	12.3660	32.9638	0.0034	1.2978	12.6235	52.0504
	Nov	47.0067	0.3844	71.5190	6.0650	46.7839	35.5067	33.3169	33.5722	124.9108	12.5325	33.1992	0.0034	1.3159	12.7995	50.6537
	Dec	47.2303	0.3874	70.9713	6.0936	47.4394	34.5859	33.5709	34.2240	125.4917	12.5910	33.4520	0.0034	1.3129	12.8606	51.3725
2016	**Ave**	**47.4925**	**0.4375**	**64.3793**	**6.1185**	**48.2201**	**35.8617**	**34.4082**	**35.3147**	**126.0707**	**12.6651**	**34.2839**	**0.0036**	**1.3461**	**12.9315**	**52.5568**
	Jan	47.5111	0.4021	68.4806	6.1066	47.2361	33.4223	33.1651	33.3269	126.2955	12.6654	33.0498	0.0034	1.3139	12.9370	51.6548
	Feb	47.6361	0.4141	68.3006	6.1201	47.9863	34.4956	33.9074	33.9669	126.5985	12.7053	33.7871	0.0035	1.3378	12.9705	52.9010
	Mar	46.7240	0.4135	66.5513	6.0204	47.5365	35.3036	34.0062	34.9329	124.1002	12.4619	33.8829	0.0036	1.3248	12.7224	51.9247
	Apr	46.2845	0.4215	66.2094	5.9679	48.0278	36.0560	34.2935	35.4511	122.8972	12.3449	34.1669	0.0035	1.3192	12.6025	52.4798
	May	46.8023	0.4300	68.0290	6.0285	47.8984	36.2220	34.1821	34.2659	124.1893	12.4809	34.0577	0.0035	1.3226	12.7435	52.9396
	Jun	46.4645	0.4396	66.2371	5.9861	47.9170	36.0387	34.3220	34.3588	123.3064	12.3922	34.1957	0.0035	1.3159	12.6515	52.2377
	Jul	47.0581	0.4514	61.9364	6.0671	47.9167	36.1158	34.8462	35.3963	124.7987	12.5482	34.7176	0.0036	1.3431	12.8131	52.0597
	Aug	46.6809	0.4611	61.2008	6.0190	48.1178	35.9240	34.6821	35.5976	123.8812	12.4492	34.5537	0.0035	1.3442	12.7105	52.3221
	Sep	47.4294	0.4657	62.3769	6.1151	48.7038	36.2356	34.9092	35.9735	125.8942	12.6480	34.7812	0.0036	1.3668	12.9144	53.1722
	Oct	48.3482	0.4666	59.8314	6.2329	49.0389	36.5784	34.9908	36.8331	128.3062	12.8925	34.8646	0.0037	1.3798	13.1645	53.3734
	Nov	49.1550	0.4546	61.1309	6.3375	49.3884	36.5828	34.8767	37.0383	130.4174	13.1085	34.7534	0.0037	1.3921	13.3840	53.0779
	Dec	49.8156	0.4300	62.2673	6.4203	48.8735	37.3655	34.7173	36.6355	132.1634	13.2843	34.5968	0.0037	1.3932	13.5645	52.5389

Source: BSP

8 STOCK MARKET TRANSACTIONS

for the periods indicated
volume in million shares, value in million pesos

	2014		2015		2016		Percent Change 2015		Percent Change 2016	
	Volume	Value	Volume	Value	Volume	Value	Volume	Value	Volume	Value
T o t a l	**815,193.1**	**2,130,120.9**	**493,261.9**	**2,151,411.1**	**442,270.5**	**1,929,499.2**	**-39.5**	**1.0**	**-10.3**	**-10.3**
Financial	4,981.2	278,292.2	4,094.6	273,521.9	5,109.0	275,527.6	-17.8	-1.7	24.8	0.7
Industrial	64,433.4	428,165.2	34,467.1	530,927.0	29,029.5	401,978.7	-46.5	24.0	-15.8	-24.3
Holding Firms	37,382.4	499,986.7	55,334.7	538,920.6	37,014.4	491,273.5	48.0	7.8	-33.1	-8.8
Property	70,184.2	360,390.5	45,161.7	361,165.6	55,205.3	347,679.4	-35.7	0.2	22.2	-3.7
Services	70,243.4	461,553.1	49,463.1	358,736.4	86,585.7	330,139.4	-29.6	-22.3	75.1	-8.0
Mining & Oil	566,348.1	89,916.5	303,635.6	75,723.9	227,142.4	65,175.4	-46.4	-15.8	-25.2	-13.9
SME	1,613.8	11,072.3	1,098.0	11,558.6	2,178.2	17,033.0	-32.0	4.4	98.4	47.4
ETF	6.6	744.4	7.1	857.1	5.9	692.2	6.5	15.1	-16.4	-19.2
Composite Index (PSEi)										
Average	**6,793.3**		**7,432.6**		**7,284.5**		**9.4**		**-2.0**	
End of Period	**7,230.6**		**6,952.1**		**6,840.6**		**-3.9**		**-1.6**	

Source: PSE

9 PHILIPPINES: BALANCE OF PAYMENTS
in million U.S. dollars

	2015 r	2016 p	Growth (%) 2016 p
Current Account	7266	601	-91.7
Export	105851	110006	3.9
Import	98585	109406	11.0
Goods, Services, and Primary Income	-15997	-24361	-52.3
Export	81765	84346	3.2
Import	97762	108707	11.2
Goods and Services	-17854	-26955	-51.0
Export	72262	74802	3.5
Import	90117	101757	12.9
Goods	-23309	-34079	-46.2
Credit: Exports	43197	43444	0.6
Debit: Imports	66506	77524	16.6
Services	5455	7125	30.6
Credit: Exports	29065	31357	7.9
Debit: Imports	23610	24233	2.6
Primary Income	1857	2594	39.7
Credit: Receipts	9503	9545	0.4
Debit: Payments	7646	6950	-9.1
Secondary Income	23263	24962	7.3
Credit: Receipts	24086	25660	6.5
Debit: Payments	823	699	-15.1
Capital Account	84	102	21.4
Credit: Receipts	99	117	17.7
Debit: Payments	15	15	-2.8
Financial Account	2301	949	-58.8
Net Acquisition of Financial Assets	6139	7063	15.1
Net Incurrence of Liabilities	3838	6114	59.3
Direct Investment	-100	-4235	-4149.6
Net Acquisition of Financial Assets	5540	3698	-33.2
Net Incurrence of Liabilities	5639	7933	40.7
Portfolio Investment	5471	1383	-74.7
Net Acquisition of Financial Assets	3343	1119	-66.5
Net Incurrence of Liabilities	-2128	-264	87.6
Financial Derivatives	6	-32	-673.4
Net Acquisition of Financial Assets	-531	-701	-32.0
Net Incurrence of Liabilities	-537	-669	-24.6
Other Investment	-3076	3832	224.6
Net Acquisition of Financial Assets	-2213	2946	233.1
Net Incurrence of Liabilities	864	-886	-202.6
NET UNCLASSIFIED ITEMS	-2433	-175	92.8
OVERALL BOP POSITION	2616	-420	-116.1
Debit: Change in Reserve Assets	2616	-420	-116.0
Credit: Change in Reserve Liabilities	.	.	6678.9

Details may not add up to total due to rounding.
p Preliminary
r Revised to reflect data updates from official data sources, updated estimates on OF remittances related data, and post-audit adjustments
. Rounds off to zero

Technical Notes:
1. Balance of Payments Statistics from 2005 onwards are based on the IMF's Balance of Payments and International Investment Position Manual, 6th Edition.
2. Financial Account, including Reserve Assets, is calculated as the sum of net acquisitions of financial assets less net incurrence of liabilities.
3. Balances in the current and capital accounts are derived by deducting debit entries from credit entries.
4. Balances in the financial account are derived by deducting net incurrence of liabilities from net acquisition of financial assets.
5. Negative values of Net Acquisition of Financial Assets indicate withdrawal/disposal of financial assets; negative values of Net Incurrence of Liabilities indicate repayment of liabilities.
6. Overall BOP position is calculated as the change in the country's net international reserves (NIR), less non-economic transactions (revaluation and gold monetization/demonetization). Alternatively, it can be derived by adding the current and capital account balances less financial account plus net unclassified items.
7. Net unclassified items is an offsetting account to the overstatement or understatement in either receipts or payments of the recorded BOP components vis-à-vis the overall BOP position.
8. Data on Deposit-taking corporations, except the central bank, consist of transactions of commercial and thrift banks and offshore banking units (OBUs).

10 GROSS INTERNATIONAL RESERVES

end-of-period

in million US dollars

		GIR (1=2 to 6)	Reserve Position in the Fund (2)	Gold (3)	SDRs (4)	Foreign Investments (5)	Foreign Exchange (6)	Import Cover [1] (7)	Short-Term External Debt Cover (in percent) [4] Original Maturity [2] (8)	Residual Maturity [3] (9)
2015	Jan	80,716.0	555.2	8,045.2	1,193.1	70,359.1	563.3	10.1	476.4	394.3
	Feb	80,837.0	554.3	7,632.4	1,191.1	70,938.9	520.2	10.1	485.8	402.5
	Mar	80,458.5	439.0	7,437.1	1,167.5	70,565.2	849.7	10.1	614.3	482.5
	Apr	80,850.1	447.9	7,404.2	1,191.0	71,547.1	260.0	10.2	611.1	475.4
	May	80,405.0	442.5	7,480.8	1,176.9	70,809.0	495.8	10.1	628.5	484.2
	Jun	80,644.3	444.8	7,377.8	1,190.3	70,646.8	984.6	10.1	610.5	473.2
	Jul	80,332.4	441.1	6,864.4	1,180.4	71,223.5	623.0	10.0	606.7	468.2
	Aug	80,255.4	446.2	7,150.9	1,188.2	70,614.4	855.7	10.0	606.0	467.2
	Sep	80,550.5	444.9	7,014.8	1,188.1	70,799.9	1,102.8	10.0	553.5	434.2
	Oct	81,097.8	442.7	7,178.7	1,182.3	71,362.5	931.6	10.0	556.8	424.4
	Nov	80,173.2	434.9	6,700.6	1,161.4	70,752.2	1,124.0	9.9	507.6	394.5
	Dec	80,666.9	438.6	6,702.9	1,172.9	71,739.4	613.0	9.9	534.3	409.7
2016	Jan	80,692.4	437.0	7,040.8	1,168.5	71,220.2	825.9	9.8	534.6	409.5
	Feb	81,877.6	417.8	7,815.6	1,169.2	71,032.0	1,443.0	10.0	541.6	412.4
	Mar	82,977.0	423.6	7,764.9	1,192.5	71,379.1	2,217.0	10.0	579.7	436.2
	Apr	83,736.3	424.3	8,152.8	1,199.7	71,711.5	2,247.9	10.0	595.1	450.7
	May	82,927.2	419.9	7,672.2	1,187.5	71,684.2	1,963.3	9.7	583.9	441.1
	June	85,284.3	449.2	8,336.1	1,184.1	73,295.2	2,019.8	9.9	586.6	445.5
	July	85,506.2	447.5	8,505.4	1,179.4	73,294.3	2,079.6	9.9	603.1	451.0
	Aug	85,792.0	447.9	8,261.3	1,180.3	73,930.0	1,972.4	9.8	616.6	449.8
	Sep	86,139.1	458.5	8,307.0	1,181.5	73,850.0	2,342.1	9.8	611.4	445.9
	Oct	85,105.8	452.5	8,129.0	1,166.2	71,630.9	3,727.2	9.6	606.9	448.5
	Nov	81,451.1	444.6	7,402.1	1,146.0	68,934.4	3,523.9	9.1	580.2	414.6
	Dec	80,691.8	441.6	7,259.1	1,138.0	68,290.0	3,563.1	8.9	555.5	403.1

[1] Number of months of average imports of goods and payment of services and primary income that can be financed by reserves. Starting 2005, figures were revised to reflect data based on BPM6 concept.

[2] Based on latest available outstanding short-term external debt.

[3] Refers to adequacy of reserves to cover outstanding short-term debt based on original maturity plus principal payments on medium-and long-term loans of the public and private sectors falling due in the next 12 months. Figures reflect data based on debt service schedule on debt as of 30 September 2016; outstanding external debt , debt service burden and outstanding short-term loan of non-banks as of 31 December 2016.

[4] Starting December 2005, annual outstanding annual short-term debt were revised to reflect the new reporting framework in line with international standards under the latest External Debt Statistics Guide and International Monetary Fund's Balance of Payments and International Investment Position Manual, 6th Edition.

Details may not add up to total due to rounding.

Source: BSP

11 TOTAL EXTERNAL DEBT [1]

as of periods indicated

in million US dollars

	31 December 2015				31 December 2016			
	Short-term		Medium & Long- Term	Total	Short-term		Medium & Long- Term	Total
	Trade	Non-Trade			Trade	Non-Trade		
Grand Total	2,203	12,896	62,375	77,474 [a]	2,087	12,440	60,237	74,763 [a]
Public Sector		899	37,374 [b]	38,273		801	36,669 [b]	37,470
Banks		899	3,206	4,105		801	3,119	3,921
Bangko Sentral ng Pilipinas			1,337 [c]	1,337			1,292 [c]	1,292
Others		899	1,870 [d]	2,768		801	1,828 [d]	2,629
Non-Banks			34,168	34,168			33,549	33,549
CB-BOL								
NG and Others			34,168	34,168			33,549	33,549
Private Sector	2,203	11,998	25,001	39,201	2,087	11,638	23,568	37,293
Banks		11,392	3,365	14,756		11,450	3,666	15,116
Foreign Bank Branches		4,542	270	4,812 [e]		4,012	166	4,178 [e]
Domestic Banks		6,850	3,095 [d]	9,944		7,438	3,500 [d]	10,938
Non-Banks	2,203	606	21,636 [f]	24,445	2,087	188	19,902 [f]	22,177

1 Covers debt owed to non-residents, with classification by borrower based on primary obligor per covering loan/rescheduling agreement/document.

Exclusions	31 December 2015	31 December 2016
a Residents' holdings of Philippine debt papers issued offshore;	17,376	16,529
Non-residents' holdings of peso-denominated debt securities	5,315	5,506
Inclusions		
b Cumulative foreign exchange revaluation on US$-denominated multi-currency loans from Asian Development Bank and World Bank	(52)	(43)
c Accumulated SDR allocations from the IMF	1,165	1,121
d Outstanding Hybrid Tier 1 capital of banks	82	
excludes: residents' holdings	43	
e "Due to Head Office/Branches Abroad" (DTHOBA) accounts of branches and offshore banking units of foreign banks operating in the Philippines which are considered by BSP as "quasi-equity"	3,550	3,123
f Loans without BSP approval/registration which cannot be serviced using foreign exchange from the banking system;	14,306	13,139
Obligations under capital lease arrangements	1,390	1,306

Source: Bangko Sentral ng Pilipinas

12 SELECTED FOREIGN DEBT SERVICE INDICATORS

for periods indicated
in million US dollars

	2015 [r]	2016 [p]
Debt Service Burden (DSB) [1]	5584	7143
Principal	2998	4592
Interest	2587	2551
Export Shipments (XS) [2]	43197	43444
Exports of Goods and Receipts from Services and Income (XGSI) [2, 3]	99563	103728
Current Account Receipts (CAR) [2]	105851	110006
External Debt	77474	74763
Gross Domestic Product (GDP)	292451	304257
Gross National Income (GNI)	353758	366187
Ratios (%) :		
DSB to XS	12.93	16.44
DSB to XGSI	5.61	6.89
DSB to CAR	5.28	6.49
DSB to GNI	1.58	1.95
External Debt to GDP	26.49	24.57
External Debt to GNI	21.90	20.42

[1] Debt service burden represents principal and interest payments after rescheduling. In accordance with the internationally-accepted concept, debt service burden consists of (a) Principal and interest payments on fixed MLT credits including IMF credits, loans covered by the Paris Club and Commercial Banks rescheduling, and New Money Facilities; and (b) Interest payments on fixed and revolving short-term liabilities of banks and non-banks but excludes (i) Prepayments of future years' maturities of foreign loans and (ii) Principal payments on fixed and revolving ST liabilities of banks and non-banks.

[2] Based on the accounting principle under the Balance of Payments and International Investment Position Manual, Sixth edition (BPM6)

[3] Includes cash remittances of overseas Filipino workers that were coursed through and reported by commercial banks which are reflected under Compensation of Employees in the Primary Income account and workers' remittances in the Secondary Income account.

[p] Preliminary

[r] Revised to reflect latest data adjustments

Source: BSP

13 BALANCE SHEET OF THE BANGKO SENTRAL NG PILIPINAS

As of the periods indicated

In million pesos

	2015 [r] Dec	2016 [p,u] Dec	Percent Change (%)
Assets	**4,309,872.3**	**4,559,098.3**	**5.8**
International Reserves	3,782,378.7	3,997,977.8	5.7
Domestic Securities	222,629.9	223,226.6	0.3
Loans and Advances	85,535.1	151,051.6	76.6
Revaluation of International Reserves	0.0	0.0	...
Bank Premises and Other Fixed Assets	18,325.8	18,061.3	-1.4
Derivative Instruments in a Gain/(Loss) Position	0.0	0.0	...
Other Assets	201,002.9	168,781.1	-16.0
Liabilities	**4,268,705.8**	**4,500,743.0**	**5.4**
Currency Issue	1,005,194.9	1,124,192.6	11.8
Deposits	2,788,890.4	2,679,033.8	-3.9
Reserve Deposits of Other Depository Corporations (ODCs)[1]	1,456,213.2	1,631,642.6	12.0
Reserve Deposits of Other Financial Corporations (OFCs)[2]	5,660.9	1,946.8	-65.6
Overnight Deposit Facility[3]	828,318.5	236,591.0	-71.4
Term Deposit Facility[3]	..	529,218.4	...
Treasurer of the Philippines[4]	426,847.0	136,869.5	-67.9
Foreign Financial Institutions	39,346.2	111,089.6	182.3
Other Foreign Currency Deposits	47.8	50.8	6.4
Other Deposits[5]	32,456.7	31,625.1	-2.6
Foreign Loans Payable	46.6	28.4	-39.1
Net Bonds Payable	23,564.7	24,891.2	5.6
Allocation of SDRs	54,717.7	56,084.9	2.5
Derivatives Liability	9.4	0.0	...
Derivative Instruments in a Loss Position	98.1	0.0	...
Revaluation of International Reserves	73,896.8	299,527.2	305.3
Reverse Repurchase Facility[3]	311,717.8	305,057.2	-2.1
Other Liabilities	10,569.4	11,927.7	12.9
Net Worth	41,166.6	58,355.4	41.8
Capital	50,000.0	50,000.0	0.0
Surplus/Reserves	-8,833.4	8,355.4	194.6

Note: Details may not add up to total due to rounding off.

[1] ODCs are deposit generating institutions other than the BSP such as universal and commercial banks (UB/KBs), specialized government banks (SGBs), thrift banks (TBs), rural banks (RBs) and non-banks with quasi-banking functions (NBQBs).

[2] OFCs are trust units of banks.

[3] Starting 3 June 2016, the Reverse Repurchase Agreement and Special Deposit Account have been replaced by the Reverse Repurchase Facility and Overnight Deposit Facility, respectively, and a Term Deposit Facility was introduced in line with the implementation of the Interest Rate Corridor (IRC) system. Includes accrued interest payables.

[4] Includes foreign currency deposits.

[5] Mostly GOCC deposits.

[p] Based on the preliminary (pre-closing) BSP balance sheet as of end-December 2016 prepared by the Financial Accounting Department (FAD) of the BSP.

[r] As restated based on the audited financial statements prepared by FAD of the BSP.

[u] Unaudited

[..] No transaction

[...] Blanks

14 INCOME POSITION OF THE BANGKO SENTRAL NG PILIPINAS

For the periods indicated

In billion pesos

	2015 [r] Dec	2016 [p,u] Dec	Percent Change (%)
Revenues	**56.665**	**69.207**	**22.1**
Interest Income	39.192	45.984	17.3
International Reserves	29.141	37.745	29.5
Domestic Securities	4.349	3.968	-8.8
Loans and Advances	1.697	0.906	-46.6
Others	4.005	3.365	-16.0
Miscellaneous Income	15.882	22.563	42.1
Net income from Branches	1.591	0.660	-58.5
Expenses	**73.001**	**71.187**	**-2.5**
Interest Expenses	48.789	43.620	-10.6
Reserve Deposits of ODCs and OFCs[1]	0.000	0.000	...
Overnight Deposit Facility[2]	24.330	19.951	-18.0
Term Deposit Facility[2]	..	4.688	...
National Government Deposits	10.014	6.122	-38.9
Reverse Repurchase Facility[2]	12.389	10.699	-13.6
Loans Payable	2.013	2.115	5.1
Other Foreign Currency Deposits	0.000	0.000	...
Other Liabilities	0.043	0.045	4.7
Cost of Minting	8.185	9.240	12.9
Other Expenses	16.027	18.327	14.4
Net Income/(Loss) Before Gain/(Loss) on FXR Fluctuations and Income Tax Expense/(Benefit)	**-16.336**	**-1.980**	**87.9**
Gain/(Loss) on FXR Fluctuations[3]	11.550	19.109	65.4
Income Tax Expense/(Benefit)	-0.333	0.106	131.8
Net Income/(Loss) After Tax	**-4.453**	**17.023**	**482.3**

Note: Details may not add up to total due to rounding off.

[1] ODCs are deposit generating institutions other than the BSP such as universal and commercial banks (UB/KBs), specialized government banks (SGBs), thrift banks (TBs), rural banks (RBs) and non-banks with quasi-banking functions (NBQBs) while OFCs are trust units of banks.

[2] Starting 3 June 2016, the Reverse Repurchase Agreement and Special Deposit Account have been replaced by the Reverse Repurchase Facility and Overnight Deposit Facility, respectively, and a Term Deposit Facility was introduced in line with the implementation of the Interest Rate Corridor (IRC) system.

[3] This represents realized gains or losses from fluctuations in FX rates arising from foreign currency-denominated transactions of the BSP, including: 1) rollover/re-investments of matured FX investments with foreign financial institutions and FX-denominated government securities; 2) servicing of matured FX obligations of the BSP; and 3) maturity of derivatives instruments.

[p] Based on the preliminary (pre-closing) BSP income statement as of end-December 2016 prepared by the Financial Accounting Department (FAD) of the BSP.

[r] As restated based on the audited financial statements prepared by FAD of the BSP.

[u] Unaudited

[..] No transaction

[...] Blanks

15 BSP: CONDENSED STATEMENT OF CONDITION
In thousand pesos

Assets	As at December 31	
	2016*	2015**
Foreign currency financial assets		
Deposits with foreign banks	898,320,913	651,004,362
Other cash balances	258,108	165,471
Investment securities	2,659,148,174	2,724,397,511
Foreign securities purchased under agreements to resell	18,370,207	33,557,775
Loan to IMF	3,943,509	2,154,847
Gold	361,277,662	315,828,397
International Monetary Fund special drawing rights	56,659,243	55,270,297
Gross international reserves	**3,997,977,816**	**3,782,378,660**
Other foreign currency receivables	87,859,512	120,700,013
Non-IR foreign currency	34,552	33,828
Total foreign currency financial assets	**4,085,871,880**	**3,903,112,501**
Local currency financial assets		
Investment securities	223,226,567	222,629,865
Loans and advances	151,051,555	85,535,081
Due from administrator of funds	29,961,114	29,955,171
Other receivables	18,309,021	15,169,499
Total local currency financial assets	**422,548,257**	**353,289,616**
Total financial assets	**4,508,420,137**	**4,256,402,117**
Acquired assets held for sale	68,976	709,232
Investment property	15,618,972	15,206,205
Bank premises, furniture, fixtures and equipment	18,061,250	18,325,751
Intangibles assets	269,183	267,878
Inventories	7,179,876	9,915,645
Property dividend to NG	285,214	285,214
Deferred tax assets	7,194,171	7,269,116
Miscellaneous assets	2,000,527	1,491,147
Total other assets	**50,678,169**	**53,470,188**
Total Assets	**4,559,098,306**	**4,309,872,305**

* *Pre-closing and unaudited*
** *Audited but subject to restatement*

Source: Financial Accounting Department

15 BSP: CONDENSED STATEMENT OF CONDITION

In thousand pesos
(continuation)

Liabilities and Capital	As at December 31	
	2016*	2015**
Foreign currency financial liabilities		
Short-term deposits	11,071,130	40,839,652
Loans payable	28,376	46,613
Bonds payable	24,891,234	23,564,740
Allocation of International Monetary Fund special drawing rights	56,084,887	54,717,655
Derivative instruments in gain/(loss) position	0	98,110
Other liabilities	2,888,225	2,067,790
Total foreign currency financial liabilities	**94,963,852**	**121,334,560**
Local currency financial liabilities		
Government deposits	127,644,201	388,650,024
Deposits of banks and quasi banks	1,663,419,422	1,491,735,999
Deposits of the International Monetary Fund and other FIs	111,089,598	39,346,194
Securities sold under agreements to repurchase	305,057,187	311,717,752
Special deposit accounts	0	828,318,544
Term deposit account	529,218,447	
Overnight deposit account	236,590,976	
Total local currency financial liabilities	**2,973,019,831**	**3,059,768,513**
Total financial liabilities	**3,067,983,683**	**3,181,103,073**
Other liabilities		
Currency in circulation	1,124,192,577	1,005,194,936
Retirement benefit obligations	2,499,889	2,374,945
Miscellaneous liabilities	6,081,491	5,680,630
Deferred tax liability	8,769	6,061
Dividends payable	449,345	449,345
Revaluation of foreign currency accounts	299,527,201	73,896,760
Total other liabilities	**1,432,759,272**	**1,087,602,677**
Total Liabilities	**4,500,742,955**	**4,268,705,750**
Capital accounts		
Capital	50,000,000	50,000,000
Surplus	(66,847,216)	(83,653,761)
Unrealized gains/(losses) on investments	-2,495,068	-2,975,701
Capital reserves	77,697,635	77,796,017
Total Capital accounts	**58,355,351**	**41,166,555**
Total Liabilities and Capital accounts	**4,559,098,306**	**4,309,872,305**

* *Preclosing and unaudited*

** *Audited but subject to restatement*

Source: Financial Accounting Department

16 BSP: CONDENSED STATEMENT OF INCOME AND EXPENSES with Budget Information

In thousand pesos

Period ended December 31	2016* Budget	2016** Actual	2015*** Actual
Operating Income:			
Income from foreign currency financial assets			
Interest income	38,792,660	40,839,220	32,946,811
Fees, miscellaneous foreign currency income & trading gains foreign	242,051	15,279,367	9,211,955
Total income from foreign currency financial assets	39,034,711	56,118,587	42,158,766
Expenses on foreign currency financial liabilities			
Interest expense	2,005,794	2,223,671	2,046,724
Other foreign currency expenses	1,004,021	919,038	843,528
Total expenses on foreign currency liabilities	3,009,814	3,142,709	2,890,253
Net income from foreign currency financial assets and liabilities	36,024,897	52,975,878	39,268,513
Income from local currency financial assets			
Interest income & trading gains local	5,721,788	5,146,948	6,247,268
Total Income from local currency financial assets	5,721,788	5,146,948	6,247,268
Expenses on local currency financial assets/liabilities			
Interest expense	58,901,129	41,396,329	46,742,828
Provision for probable losses	3,444	439,692	353,245
Final tax on interest income/discounts	768,433	793,461	869,721
Total expenses on local currency financial assets	59,673,006	42,629,482	47,965,794
Net loss from local currency financial assets and liabilities	(53,951,218)	(37,482,534)	(41,718,526)
Net income/(loss) from financial accounts	(17,926,321)	15,493,344	(2,450,013)
Other operating income	6,104,727	7,941,076	8,258,205
Currency printing and minting cost	21,182,755	9,239,503	8,184,662
Operating expenses:			
Personnel services, development and training	11,389,999	12,578,964	11,353,461
Traveling	374,726	322,654	305,298
Taxes and licenses	138,467	143,110	140,037
Currency and gold operations	323,800	318,892	316,068
Acquired Assets	417,163	247,515	183,586
Other services	3,447,875	2,600,479	2,748,147
Depreciation	690,097	769,810	688,467
Fidelity insurance	80,883	71,507	67,673
Light, fuel & water	263,844	290,413	283,217
Repairs & maintenance	821,338	470,002	491,259
Communication services	345,996	266,449	246,889
Supplies	85,368	50,574	52,616
Others	1,160,349	681,724	918,026
Bad Debts - PICC	0	9	117
Market decline of acquired assets	22,420	(36,356)	(1,086,687)
Total operating expenses	16,114,450	16,175,267	13,960,027
Net loss before FX rates fluctuation	(49,118,799)	(1,980,350)	(16,336,497)

* *Exluding PICCI budget*
** *Preclosing and unaudited*
*** *Audited but subject to restatement*

Source: Financial Accounting Department

16 BSP:CONDENSED STATEMENT OF INCOME AND EXPENSES with Budget Information[1]

In thousand pesos
(continuation)

Period ended December 31	2016* Budget	2016** Actual	2015*** Actual
Net realized gain on fX rates fluctuation	**0**	**19,109,390**	**11,550,015**
Loss before income tax	**(49,118,799)**	**17,129,040**	**(4,786,482)**
Income tax benefit	**0**	**106,503**	**(333,339)**
Income/(Loss) for the year	**(49,118,799)**	**17,022,537**	**(4,453,143)**

* *Exluding PICCI budget*
** *Preclosing and unaudited*
*** *Audited but subject to restatement*

Source: Financial Accounting Department