2018 Annual Report

Navigating the Future

About the Cover

The Bangko Sentral ng Pilipinas celebrated its 25th year in 2018, continuing to be the country's vanguard of monetary and financial stability while remaining relevant as it navigates the digital frontier through the power of its workforce. This year's cover features an artistic rendition of the BSP's 25th anniversary logo—a maze-like, stylized number 25—to symbolize the BSP's journey through the years and into the future.

Contents

Statistical Annexes

Governor's Foreword

by Nestor A. Espenilla, Jr.

Navigating the Future

NESTOR A. ESPENILLA, JR.
Governor

By many accounts, 2018 was not entirely a walk in the park for the Philippine economy. The country had to successfully surmount some serious challenges from both external and domestic fronts. While the global economy started the year on an upbeat note coming from a rapid upswing in 2017, it quickly lost steam. Global economic activity slowed down mainly on account of the escalation of trade tensions among the world's key economies and the associated rise in policy uncertainty, bouts of financial market volatility, and slowing investment and trade. Such global developments, including higher oil prices and the U.S. Federal Reserve's continued interest rate hikes, exposed emerging markets to capital flow reversals, exchange rate volatility and inflationary pressures.

Domestically, the economy hurdled with bouts of price pressures for most of the year. The 2018 average inflation of 5.2 percent was higher than the National Government (NG)'s target range of 3 ± 1 percent for the year. This was driven largely by supply-side factors related to rising global oil prices, higher excise taxes, and weather-related disruptions that affected the price of key services and commodities. There was also some demand impulse, as the economy sustained its strong growth. In response, the BSP raised its policy interest rate by a cumulative 175 basis points beginning in May 2018 to rein in inflation expectations and prevent sustained supply-side pressures from giving rise to second-round effects. This was also supported by the implementation of non-monetary measures by the government to alleviate inflation, such as streamlining of import procedures and processes for agricultural products, as well as the swift passage of the bill lifting the quantitative restrictions on rice, among others.

Meanwhile, the movements of the peso have largely reflected both key external and domestic events which affect market sentiment, with the long-term trend still being driven by the country's macroeconomic fundamentals. Strong demand for imports of capital goods, raw materials and intermediate products in support of the growing economy; increasing direct and portfolio investments abroad; and debt repayment and pre-payments by the NG and private corporations were the primary domestic factors that contributed to the peso's depreciation during most of 2018. Nonetheless, the trend towards the end of the year was marked by renewed optimism on slowing domestic inflation data and strong remittance inflows.

Amid these challenges, the Philippine economy remains in a position of strength, characterized by broadening growth drivers and anchored on robust potential capacity. Built upon purposeful structural reforms and sound macroeconomic management, the Philippine economy has achieved solid and steady growth for 20 years to date and has emerged as one of the fastest-growing economies in Asia.

While the full-year 2018 GDP growth of 6.2 percent was below the revised national government target of 6.5-6.9 percent for the year, it marked the 7th consecutive year where the domestic economy registered growth of above 6.0 percent. This performance provides additional boost to the government's ability to achieve its growth target of 7.0-8.0 percent for 2019. Continued positive alignment between growth and inflation, ample domestic liquidity and credit, manageable external payments position, sound and safe banking system, sustained commitment to structural reforms, and positive investor sentiment are all expected to sustain favorable growth prospects for the Philippine economy.

Nonetheless, even as the Philippine economy appears resilient and its growth momentum sustained, now is definitely not the time to be complacent. The global economic landscape is driven by overarching and widely-scoped forces that alter the way we do things, the way governments craft policies, and the way businesses operate. Such forces extend from the rebalancing of the world economy, changes in demographics, rapid urbanization, climate change, the rise of disruptive technologies, and adoption of protectionist policies, to name a few.

Looking ahead, as the economy gears up for a higher growth trajectory, it is not enough that we are able to withstand these challenges, we must stand ready for the future – institute more game-changing reforms, integrate innovation and inclusiveness in government policies, and leapfrog to a dynamic yet robust, far-reaching and broad-based growth of the economy. For both the government and private sectors, navigating the currents of rapid changes and disruptive forces must keep us on our toes so that we are never satisfied with what is and continue to explore what can be. We need to find our way, masterfully steer our ship, watch out for headwinds, proactively manage threats and danger, and sail towards our destination of sustainable and inclusive growth.

The government's strong commitment toward the implementation of its massive infrastructure agenda, coupled with fiscal reforms, and strengthening the investment climate all lead to increased productivity, more jobs, higher incomes, and ultimately to sustained inclusive growth. On the part of the Bangko Sentral ng Pilipinas (BSP), its primary contribution to support the country's growth trajectory lies in the effective discharge of its mandates and policy thrusts. Maintaining price and financial stability, and ensuring a safe and efficient payments and settlements system will help foster an enabling macroenvironment that is conducive to accelerating economic growth and help expand further its absorptive capacity.

The BSP carries with it lessons and experiences from its 25 years of existence, and an amended charter (Republic Act No. 11211) that strengthens its capability and regulatory powers to adapt to a fast-evolving market landscape. All these, and the BSP's steadfast commitment to its mandate will enable it to navigate a charted path to sustainable economic growth and better quality of life for all Filipinos.

Price Stability. In line with the inflation targeting approach to the conduct of monetary policy, the Development Budget Coordination Committee (DBCC) in coordination with the BSP, decided to keep the current inflation target at 3.0 percent ± 1.0 percentage point for 2019 – 2020 and adopt the same inflation target for 2021 – 2022. The inflation target continues to be an appropriate quantitative representation of the medium-term goal of price stability that is optimal for the Philippines given the current structure of the economy and outlook of macroeconomic conditions over the next few years. Improved productive capacity of the economy, fueled by higher infrastructure investments by the NG, supports achieving robust economic growth amid a low and stable inflation environment.

The BSP introduced further refinements to the interest rate corridor framework to encourage active and dynamic liquidity management by banks and provide the BSP with greater operational flexibility. These enhancements will continue to afford the BSP scope to reduce over the medium term its reliance on reserve requirements for managing liquidity in the financial system, which would help reduce intermediation cost and free up resources to finance productive endeavors.

Financial Stability. The Philippine financial system continues to be among the economy's homegrown sources of strength and stability. In 2018, the banking industry maintained its growth momentum in terms of assets, loan portfolio, and deposits. Banks remain sufficiently capitalized and past due ratios have also consistently declined over the years, contributing to greater ability to intermediate funds, manage risks, and increase profitability.

In 2018, the BSP introduced a number of micro and macroprudential measures, and pursued proactive and strategic policy reforms aimed at (i) strengthening risk governance and forward-looking surveillance; (ii) leveraging on technology in finance and the use of artificial intelligence; (iii) achieving greater and broader access to financial services; (iv) upholding the integrity of financial system and safeguarding the interest of the public; and (v) accelerating capital markets reforms, including liberalizing foreign exchange rules and pursuing improvements in the governance framework of the the foreign exchange trading market. The BSP likewise carried out initiatives and advocacy programs to advance financial education and consumer protection.

Efficient Payments and Settlements System. The BSP has made significant strides in raising the efficiency of the payments system. 2018 saw the enactment of the National Payment Systems Act (Republic Act No. 11127), which fosters the efficiency of domestic financial transactions, and promotes safe, efficient, and reliable operation of payment systems which are crucial part of the country's financial infrastructure. The BSP also launched InstaPay in 2018, the latest automated clearing house under the National Retail Payment System Framework.

Looking ahead, amid the risks and challenges in the horizon, the BSP remains committed to stay the course through the effective discharge of its mandates and policy thrusts. It stays firmly committed to maintain price and financial stability to help minimize systemic risks and fortify resilience against adverse shocks. The BSP will continue to monitor closely price developments and ensure that the monetary policy stance remains appropriate in keeping inflation within target. The BSP will continue to pursue intensified surveillance of bank lending activity and reinforcement of financial sector regulatory reforms that would help in maintaining a safe and resilient financial system while ensuring the availability of credit to support economic growth.

Lastly, the BSP is also ardent in pursuing reforms to foster a more enabling environment for economic activities to prosper. Regulators like the BSP need to foster a supportive ecosystem where responsible innovations are encouraged to thrive, and lead the way in reshaping the financial system and regulatory framework into one that is fully responsive to the needs of the domestic economy.

Governor's Message

by Benjamin E. Diokno

Navigating the Future with the Wisdom of the Past

The successful navigation of the future will not be possible without the wisdom of the past. It has been an eventful year for the Bangko Sentral ng Pilipinas (BSP)—it is from these junctures that we learn to traverse the years ahead, more equipped and more agile than before.

BENJAMIN E. DIOKNO
Governor

2018 marked another challenging yet fruitful year for the BSP in its efforts to strongly commit to price stability and financial sector soundness amid a volatile and risk-laden environment. During the year, oil and food price shocks saw domestic prices churn an annual average of 5.2 percent, exceeding the National Government's inflation target of 2-4 percent. To ensure that second-round effects would not upset inflation expectations, the BSP tightened its policy interest rate by a total of 175 basis points.

Together with other targeted policies and measures, these efforts have yielded results as inflation edged lower toward the end of the year, credit and liquidity levels remained supportive of domestic needs, financial market conditions stood firm amid economic uncertainties, and the banking system exhibited strong positive performance. Accordingly, these developments helped immensely in sustaining the Philippine economy's positive growth streak, fortifying its place as one of the best performing economies in Asia.

As I take the helm as the new BSP Governor, I am both humbled and empowered by the legacy of my predecessor, Governor Nestor A. Espenilla, Jr., who built a career spanning 38 years in the BSP. As such, I know that I am coming into an institution strengthened by his vision centered on financial inclusion, financial learning, consumer protection, and financial market development, alongside a deep commitment to achieving the BSP's core mandates. It is my privilege to continue pursuing such and agenda for the Filipino people.

With the BSP's solid foundation rooted on an active pursuit of reforms over the past 25 years and the enhanced legal and regulatory framework that strengthens our stability objectives and institutional independence, I know I am joining an institution that is better equipped and agile more than ever.

The landmark passage of Republic Act No. 11211 or The New Central Bank Act strengthens policy framework for promoting price stability, enhances the framework for prudential regulation and systemic risk management to foster financial stability, and empowers the BSP to oversee payment and settlement systems.

All these, including better data access, increased capitalization and ability to set up reserves against sharp foreign exchange fluctuations, and other key provisions, place the BSP at a stronger position to pursue its mandates with vigor. Ultimately, in the attainment of its objectives, the BSP promotes broad and convenient access to high quality services and consider the interest of the general public.

Internally, I know I am joining one of the best central bank workforces in the world. With the guidance of the BSP Strategy Map 2018-2023, the BSP's complement of competent officers and staff continue to execute the Bank's primary objectives.

Key components of the BSP's strategic goals over the medium term include promoting Dynamic Stakeholder Engagement to constantly seek ways to improve delivery of mandates; Organizational Agility amid a changing operating environment; and Organizational Capability by constantly developing agile, collaborative, motivated, and skilled BSP workforce.

As I set sail into the future, I cannot help but appreciate all the challenges, experiences, and milestones that the BSP has encountered along the way. This brings me great confidence as embark on this new journey as the fifth BSP Governor.

Rest assured that I will run a tight ship and pursue nothing less than the pursuit of sustaining the BSP's status as a globally recognized monetary authority and primary financial system supervisor that supports a strong economy and promotes a high quality of life for all Filipinos.

Who we are

Our Vision

The BSP aims to be recognized globally as the monetary authority and primary financial system supervisor that supports a strong economy and promotes a high quality of life for all Filipinos.

Our Mission

To promote and maintain price stability, a strong financial system, and a safe and efficient payments and settlements system conducive to a sustainable and inclusive growth of the economy.

Our Core Values

Excellence
Patriotism
Integrity
Solidarity
Accountability

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

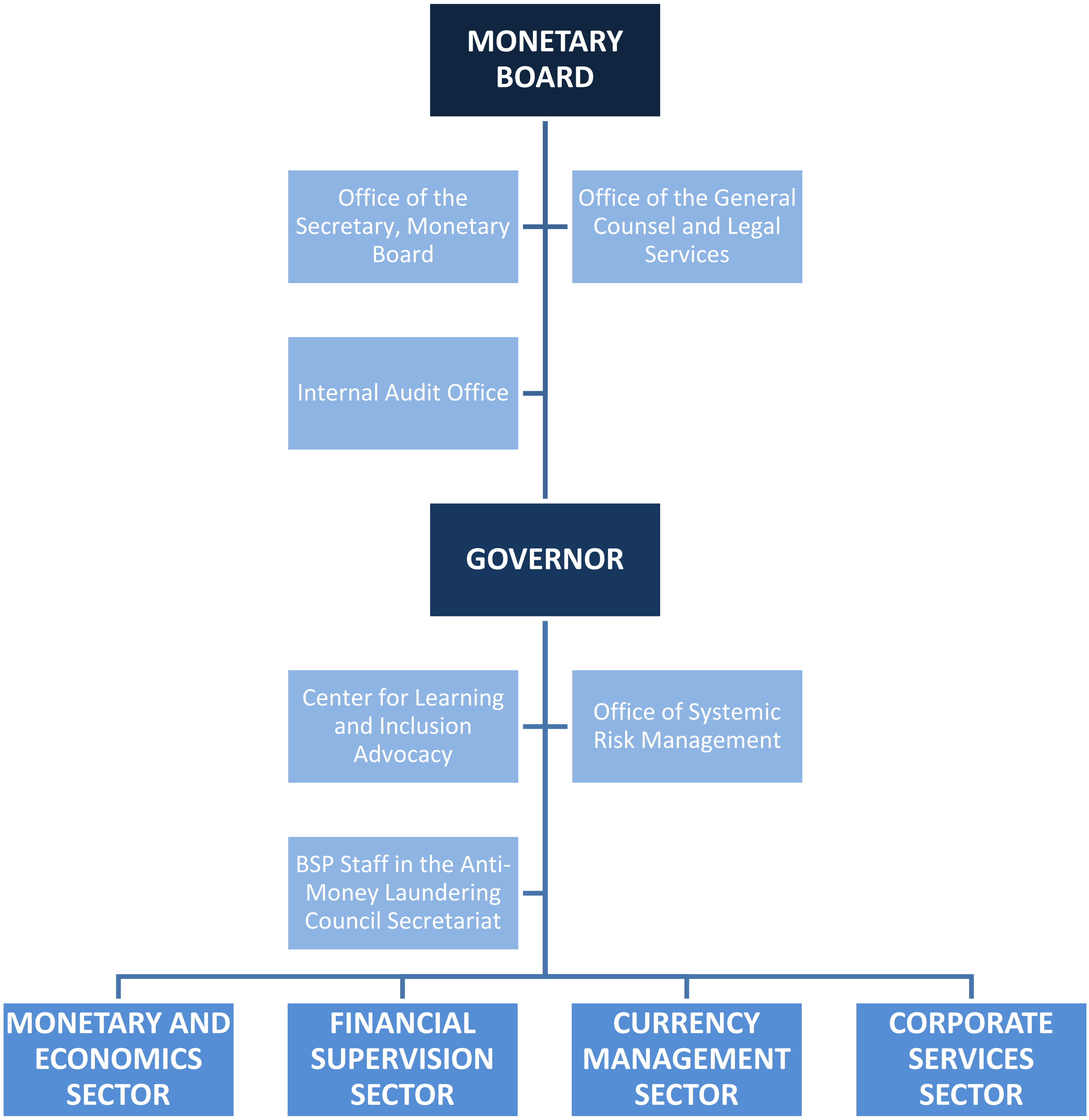
The BSP charter also designates the BSP to perform the following functions:

- *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 2018



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 and technical support to the Monetary Board or the Governor in the areas of legal, internal controls, system risks, and advocacies
- **Monetary and Economics Sector,** which is mainly responsible for the operations/activities related to monetary policy formulation, implementation and assessment
- **Financial Supervision Sector,** which is mainly responsible for the regulation of banks and other BSP-supervised financial institutions, as well as the oversight and supervision of financial technology and payment systems
- **Currency Management Sector,** which is mainly responsible for the forecasting, production, distribution, and retirement of Philippine currency, and the production of security documents, commemorative medals, and medallions
- **Corporate Services Sector,** which is mainly responsible for the effective management of corporate strategy, communications, and risks, as well as the BSP's human, financial, technological, and physical resources to support BSP's core functions

Governance

The Monetary Board

Chairman & Governor
Nestor A. Espenilla, Jr.

Members
Antonio S. Abacan, Jr.
Carlos G. Dominguez III
Peter B. Favila
Felipe M. Medalla
V. Bruce J. Tolentino
Juan D. De Zuñiga, Jr.

Offices under the Monetary Board and Governor

Elmore O. Capule
Assistant Governor and General Counsel

Edna C. Villa
Assistant Governor

Prudence Angelita A. Kasala
Managing Director

Mel Georgie B. Racela
Executive Director II

Johnny Noe E. Ravalo
Assistant Governor

Mary Jane T. Chiong
Managing Director

Pia Bernadette R. Tayag
Managing Director

Antonio Z. Pio de Roda
Technical Advisor III

Monetary and Economics Sector

Diwa C. Guinigundo
Deputy Governor

Ma. Ramona Gertrudes D.T. Santiago
Senior Assistant Governor

Francisco G. Dakila, Jr.
Assistant Governor

Wilhelmina C. Mañalac
Assistant Governor

Financial Supervision Sector

Chuchi G. Fonacier
Deputy Governor

Restituto C. Cruz
Assistant Governor

Arifa A. Ala
Managing Director

Rosalinda S. Dumaliang
Managing Director

Lyn I. Javier
Managing Director

Vicente T. De Villa III
Officer-in-Charge

Currency Management Sector

Dahlia D. Luna
Senior Assistant Governor

Iluminada T. Sicat
Assistant Governor

Josefa Elvira E. Ditching-Lorico
Managing Director

Ma. Cecilia D. Santos
Managing Director

Corporate Services Sector

Maria Almasara Cyd N. Tuaño-Amador
Deputy Governor

Gerardo K. Galvey
Assistant Governor

Eduardo G. Bobier
Managing Director

Gerardo A. Butardo
Managing Director

Silvina Q. Mamaril-Roxas
Managing Director

Carlos L. Panes
Managing Director

Bella S. Santos
Managing Director

Enrique C. Domingo
Executive Director II

Vincent Z. Bolivar
Senior Deputy General Counsel

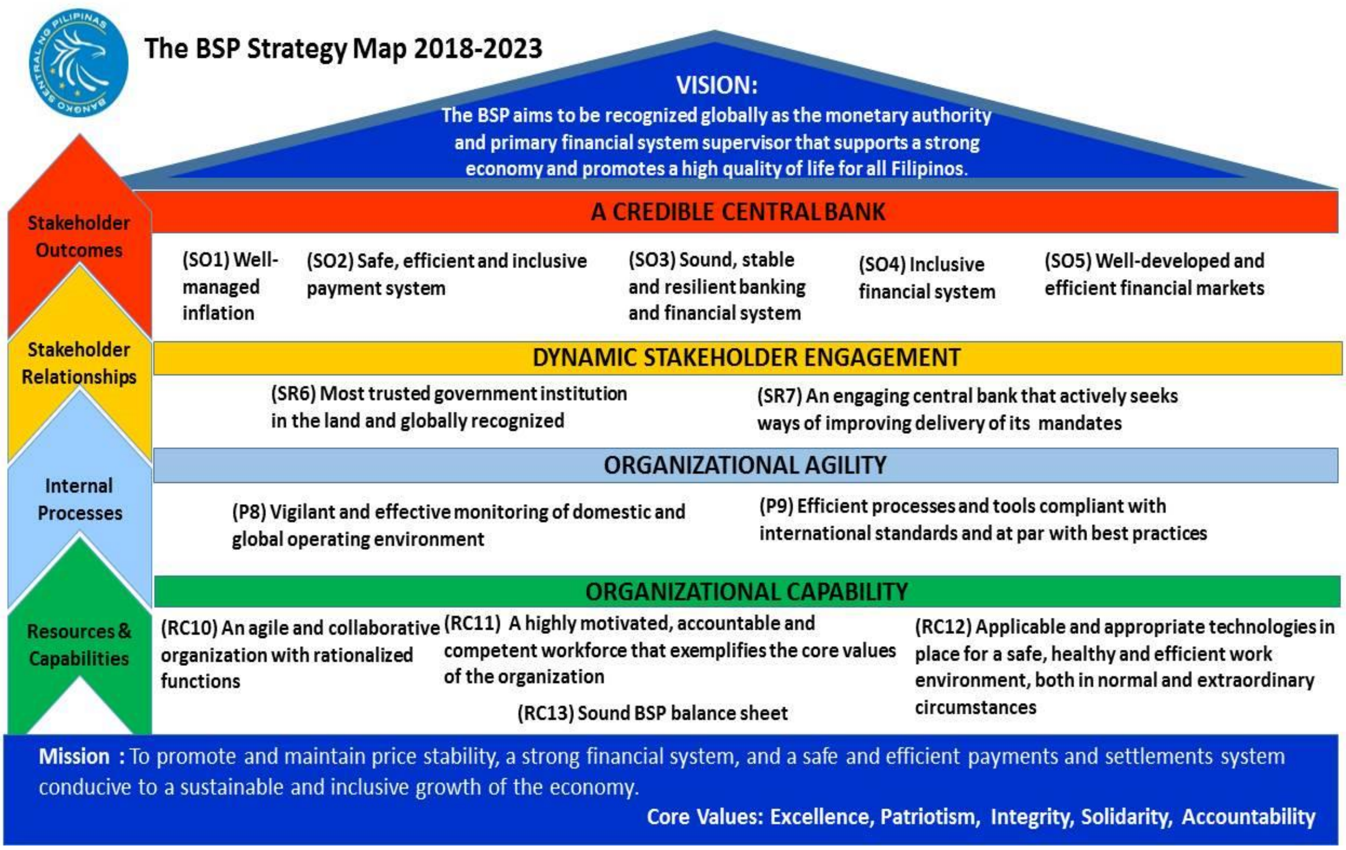
The BSP Strategy Map

2018 was witness to the birth of the new BSP Strategy Map for 2018-2023. The Monetary Board (MB) approved the strategy map that covers four themes: A Credible Central Bank, Dynamic Stakeholder Engagement, Organizational Agility and Organizational Capability. The MB also approved the new vision and mission statements in both English and Filipino versions.

The vision, mission, and core values of an organization serve as its foundation. It is from which all the goals and activities of an organization and accordingly, its employees emanate – the North Star of an organization.

In the same way that travellers rely on the North Star for guidance, the vision, mission, and values are the standards against which the organization's decisions and actions are weighed. Albeit often overlooked, this analogy also underscores a vital lesson about direction-setting. The North Star changes with time. Before our current North Star, the Polaris, were the Thuban and Kochab. In the future, Errai and Alderamin will become our north pole star. Like the North Star that it is, the vision, mission, and values of an organization change as the circumstances dictate.

As to its core values, BSP retains Excellence, Patriotism, Integrity and Solidarity. The previous core value of Dynamism was subsumed as a component of Excellence and was replaced with Accountability. The new emphasis on Accountability is consistent with the overall direction of the Bank toward good governance. BSP employees are expected to take responsibility not only for their own but also for the group's actions.

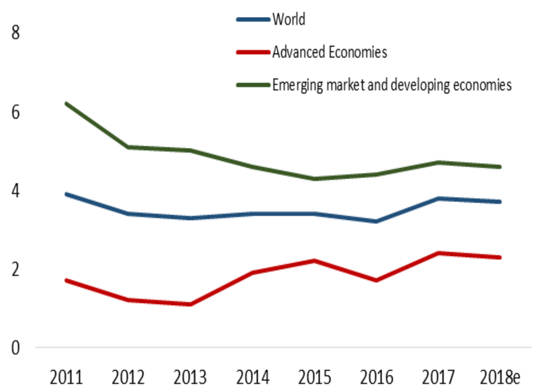


How We Were in 2018: Global and Domestic Macroeconomic Landscape

Global Economic Activity slows down in 2018

Global economic growth decelerated in 2018 as trade tensions among some major advanced and emerging economies dampened trade and manufacturing activity.

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



Source: IMF World Economic Outlook (WEO), January 2018 Update

Economic activity among advanced economies diverged during the latter part of the year. The US economy continued to recover, driven largely by stronger-than-expected domestic demand due to a strong labor market and procyclical fiscal stimulus. Meanwhile, growth in the euro area slowed as exports remained subdued due to the stronger euro and weaker external demand. Prolonged uncertainty on the Brexit outcome continued to cloud the growth prospects for the euro area. Economic growth in Japan also eased, reflecting the output contraction during the first three quarters of the year due to the impact of unfavorable weather conditions and natural disasters.

Given the slower growth momentum during the second half of 2018, the International Monetary Fund (IMF) forecasted global growth for 2019 and 2020 at 3.5 percent and 3.6 percent, respectively, slower than the projected 3.7 percent growth for 2018. Projections of slower growth reflect weakening financial market sentiment, deeper-than-expected contraction in some major emerging economies, and the negative impact of trade tensions between the US and China. The IMF considers the signing of the US-Mexico-Canada free trade agreement (USMCA) to replace NAFTA, the December 2018 US-China announcement of a 90-day “truce” on tariff hikes, and the announced reduction in Chinese tariffs on US car imports as positive developments toward reducing trade frictions. However, a further escalation of trade tensions remains a source of risk to the outlook.[1] Amid a backdrop of softer international trade and investment, heightened trade uncertainty, and substantial financial market pressures among countries with elevated current account deficits, growth across emerging markets and developing economies (EMDEs) lost momentum in 2018.

Growth in EMDEs loses momentum amid a challenging external environment

EMDEs faced a more challenging external environment, characterized by the negative spillovers of trade tensions, rising US interest rates, dollar appreciation, capital outflows, and

[1] IMF World Economic Outlook (WEO) Update, January 2019.

volatile oil prices. The increased tariffs on certain goods such as US steel imports were associated with large and negative effects on some small, producer EMDEs. However, in the short term, some EMDEs may benefit from trade diversion as the higher tariffs increase the cost of specific goods in the US and China.

Across EMDEs in the East Asia and Pacific (EAP) region, economic growth also slowed down in 2018, reflecting diminishing support from exports amid deteriorating external conditions, as well as financial stress in some large EMDEs. Growth in commodity-importing economies (excluding China) eased, with slower economic activity seen in the Philippines due to the faster rise in inflation, capacity constraints, and currency pressures. The pace of recovery of Thailand moderated owing to tighter fiscal policies and weaker export growth.

These external challenges were accompanied by renewed market attention to country-specific vulnerabilities and financial stress as evident in some large economies such as Argentina and Turkey.[2] Domestic demand generally declined across EMDEs, reflecting tighter domestic borrowing conditions, weaker confidence, and policy tightening in some economies to arrest domestic price and capital outflow pressures. While China has been easing monetary and fiscal policies in anticipation of slower export growth, several EAP countries such as Indonesia sought to stem capital outflows through monetary policy tightening. Inflation also generally increased due partly to higher energy prices and positive output gaps, prompting a shift to less accommodative monetary policies.

Weak global economic landscape dampens growth prospects across EMDEs

Prospects for economic growth across EMDEs may be constrained by the persistently weak global economic landscape due to a projected slowdown in advanced economies, weakening trade and investment, tighter financing conditions, geopolitical risks, and continued trade policy uncertainty. Although unlikely to materialize in the near term, the simultaneous occurrence of a severe US economic downturn and a sharper-than-expected slowdown in the Chinese economy would trigger a significant decline in global activity. This could be exacerbated by the potential impact of escalating tensions on cross-border trade and investment as well as weakening market confidence in global trading policies, which could limit growth opportunities for trade-oriented EMDEs.

The ongoing monetary policy normalization in advanced economies may also pose challenges for EMDEs by constraining the room for monetary policy maneuvering of many central banks, while higher borrowing costs may weaken leverage and liquidity for some sovereigns and corporates and consequently undermine financial stability. Policy uncertainty and geopolitical risks remain elevated and may continue to erode market sentiment and investment, with the potential to spill over globally. Contagion across countries could also arise from heightened investor risk aversion and shifts in portfolio allocations. Meanwhile, broadly stable commodity prices in the next two years, moderating global demand and trade, and a gradual tightening of global financing conditions is expected to result in moderate growth across EAP economies. Resilient domestic demand is expected to offset the possible continued slowdown in exports.

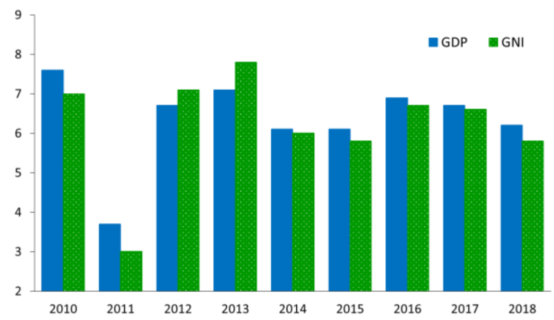
[2] World Bank Global Economic Prospects, January 2019.

The Philippine economy remains in a position of strength

The Philippine economy continued to be on a steady growth track despite presence of domestic and external challenges with real gross domestic product (GDP) rising by 6.2 percent in 2018. While this rate was lower than the 6.7 percent growth recorded in 2017 and falls 0.3 percentage points (ppts) short of achieving the lower end of the national government's (NG) growth target of 6.5 percent to 6.9 percent for 2018, it marked the seventh consecutive year of above 6.0 percent growth for the Philippine economy (2012-2018).

The GDP outturn in 2018 continued to be generally broad-based with major sectors contributing positively to growth. On the supply side, GDP growth was fuelled by the industry and services sectors particularly driven by the manufacturing and construction sub-sectors and retail trade and related services. On the demand side, growth was buttressed by the firm numbers coming from government spending, providing additional boost to the continued robust performance of household spending and investments. Region-wise, the 2018 growth performance of the Philippine economy stood out as it continued to outpace its ASEAN peers and is recognized as one of the fastest-growing economies in Asia.

Chart 1.2. Real GNI and Real GDP
annual growth rate in percent; at constant 2000 prices



Source: Philippine Statistics Authority (PSA)

Aggregate Output and Demand

Supply side. The agriculture, hunting, forestry, and fishing (AHFF) sector grew by 0.8 percent in 2018, a significant slowdown from the 4.0 percent expansion in 2017. Nonetheless, this enabled the sector to add 0.1 ppt to the overall GDP growth in 2018. The weak performance of the sector can be attributed to the contraction registered in most of the agriculture crops during the year amid the nineteen (19) typhoons that hit the country in 2018. In particular, typhoon Ompong caused considerable damage in Northern Luzon, which is the country's major rice-producing area. Palay, which is the sector's major crop accounting for 26.4 percent of the total agriculture output in 2018, contracted by 1.0 percent, a significant turnaround from the 9.4 percent growth it posted in 2017. Corn, which accounted for 6.7 percent of the total agriculture production in 2018 also contracted by 1.7 percent from posting a 9.8 percent growth in the previous year. Fishing, which accounted for 15.3 percent of the sector's total output continued to post a contraction of 0.3 percent from 0.9 percent. Sugarcane production (1.9 percent share) also contracted by 16.6 percent from registering a 30.2 percent expansion in 2017 while banana (which accounted for 9.2 percent), decelerated to a growth of 2.1 percent from 2.9 percent in the previous year. On the contrary, lending support to the overall positive performance of the agriculture sector were the improvements in livestock (which accounted for 16.4 percent of the total agriculture sector output), which rose by 1.9 percent from 1.1 percent in 2017, as well as poultry (8.6 percent share), which increased by 5.8 percent from 4.5 percent in 2017.

Given these latest developments in the agriculture sector, the government is looking at five priority projects to help improve the sector's performance. These include the construction of more farm-to-market roads (FMR), setting up of small water irrigation systems, installation of post-harvest, logistics and transport facilities, as well as provision of easy credit access to farmers and fishermen.

The industry sector continued to catch up with the services sector in terms of growth and contribution to the overall GDP output. The sector expanded by 6.8 percent in 2018, lower than its 7.2 percent growth in 2017. This could be partly explained by the notable deceleration of the manufacturing sub-sector during the year. Manufacturing posted a 4.9 percent expansion in 2018, which is the lowest growth posted by the sub-sector since 2011, and represented an almost 50 percent reduction relative to its 8.4 percent growth in 2017. At this growth pace, the manufacturing sub-sector managed to contribute 1.1 ppts to the 2.3 percent growth of the industry sector in 2018, lower than its 1.9 ppts contribution to industry growth in 2017.

The notable slowdown in manufacturing can be linked to the weak performance of a number of the sub-sector's major products. Food manufacture, which accounted for almost half of the total manufactured products in 2018, slowed to a growth of 4.1 percent in 2018 from 4.9 percent in 2017. Chemical and chemical products and radio, television and communication equipment and apparatus, which accounted for 11 percent of total manufacturing output in 2018, respectively, both performed poorly in 2018. Chemical products contracted by 4.9 percent from a growth of 7.9 percent in 2017 while the radio, television equipment and apparatus grew by 11.3 percent from 13.0 percent in 2017. Other manufactured goods that performed poorly in 2018 include basic metal industries (which contracted by 3.4 percent from a 22.5 percent growth in 2017), fabricated metal products (which grew by 7.4 percent from 50.2 percent), transport equipment (which grew by 0.9 percent from 12.0 percent), furniture and fixtures (which decelerated by 4.5 percent from 16.8 percent), and tobacco (which contracted further to 18.2 percent from a 7.9 percent decline in 2017).

Offsetting the slowdown in manufacturing was the strong comeback of the construction sub-sector in 2018 as it posted a 15.9 percent growth, thrice its growth rate of 5.3 percent in 2017 and the highest rate of expansion for the sub-sector since 2013. This enabled the construction sub-sector to contribute 1.0 ppt to the total GDP growth in 2018 from a 0.3 ppts contribution to the 2017 GDP outturn. The uptick in construction activities was registered in both the public and private sectors, indicating some "crowding in" of investments by the latter in line with the government's sustained efforts to pursue its massive infrastructure agenda. Public construction continued to grow at a double-digit rate in 2018 at 21.2 percent from 12.7 percent in 2017 while private construction more than tripled its growth by 12.9 percent from 3.7 percent in the previous year.

The services sector continued to be the primary growth engine of the Philippine economy on the production side. The sector expanded by 6.6 percent in 2018, slightly lower than its 6.8 percent growth in the previous year. Despite this, it continued to account for more than half of the 6.2 percent GDP growth in 2018 as the sector contributed 3.8 ppts. The slowdown can be partly explained by the slower growth posted by some of its major accounts such as the retail trade, financial intermediation, and real estate, renting and business activities.

Trade and repair of motor vehicles, motorcycles, personal and household goods rose by 5.9 percent in 2018 from 7.3 percent in 2017; financial intermediation by 7.1 percent from 7.6 percent and real estate and related activities grew by 4.8 percent from 7.4 percent in the previous year. These developments could partly be attributed to a number of challenges faced by the domestic economy in 2018 including the inflation uptick, implementation excise tax on fuels amid enactment of the TRAIN law, as well as the subdued performance of the business process outsourcing (BPO) industry during the year. Nonetheless, the sector's overall performance during the year was buoyed by the solid performance of public administration and defense and compulsory social security, which almost doubled its growth to 14.6 percent from 7.8 percent in the previous year and transportation, storage and communication by 5.1 percent from 4.0 percent in 2017.

Demand side. On the demand side, the robust GDP performance in 2018 can be traced to the strong performance of investments as it has once again overtaken household spending as the key contributor to the GDP growth during the year. Along with this, the strong performance of government spending as reflected in its double-digit growth during the year, lent support to growth amid continued weak net exports performance in 2018. Capital formation posted a 13.9 percent growth in 2018, an improvement from the 9.4 percent growth it posted during the previous year. This enabled investments to account for 4.0 ppts of the total 6.2 percent GDP growth in 2018. This is mainly on the back of the double-digit growth of both construction and durable equipment, which grew by 15.1 percent and 13.4 percent, respectively. This enabled construction to pitch in 1.5 ppts to the overall GDP outturn in 2018 and durable equipment by an even higher 2.2 ppts contribution.

Household spending continued with its role of being a steady and stable growth driver for the Philippine economy in 2018 as it grew by 5.6 percent, albeit lower than the 5.9 percent growth it posted in 2017. The slowdown in household spending can be associated with the modest growth posted by some major items during the year relative to the previous year. Food and non-alcoholic beverages, which accounted for more than 40 percent of the total household spending in 2018, decelerated by 4.9 percent from 5.5 percent, transport (11 percent share) expanded by 1.5 percent from 4.8 percent in 2017, restaurant and hotels by 6.7 percent from 10.4 percent, furnishings, household equipment and routine household maintenance by 5.8 percent from 7.0 percent, and health by 3.7 percent from 6.8 percent. Higher inflation recorded during the year could have partly contributed to the easing of household spending in 2018.

A notable development observed in 2018 was the accelerated growth of government spending to 12.8 percent. This is a remarkable performance following an average growth of 3.5 percent for the past five years and reflective of the government's efforts to address existing bottlenecks in spending including imposing greater fiscal discipline on major national government agencies in terms of implementing critical programs and projects as scheduled. Increased government spending was also a signal of the government's commitment to ensure that the priority soft and hard infrastructure reform measures of the administration will be implemented to ensure sustainability of the economy's growth moving forward.

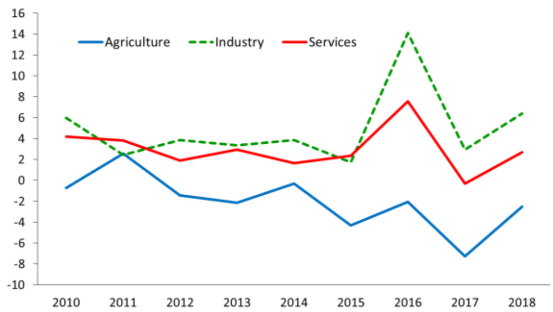
The sustained resilient domestic demand of the Philippine economy in 2018 enabled the economy to grow by more than 6 percent despite the 2.9 ppts taken out by net exports from the overall GDP output for 2018. Imports continued to outgrow exports in 2018 as it grew by 14.5 percent while exports grew by 11.5 percent. Nonetheless, increase in imports were deemed reflective of the current uptrend in construction activities which necessitated additional inputs of imported capital goods and other construction-related materials.

By regional and global trends, the 2018 performance of the Philippine economy remained one of the highest. On an annual basis as well, the year 2018 marked the 7th consecutive year where the domestic economy registered growth of above

6.0 percent, providing additional boost to the national government's ability to achieve its growth target of 7.0 percent to 8.0 percent for 2019. Lending support to this sustained optimism are the domestic sustainability factors which include, among others, continued positive alignment between growth and inflation, ample domestic liquidity and credit, resilient external payments position, sound and safe banking system, sustained commitment to structural reforms, and positive investor sentiment supporting favorable growth prospects for the Philippine economy.

Employment. The country's employment rate in 2018 was registered at 94.7 percent, 0.4 percentage points (ppts) higher than the previous year's 94.3 percent, based on the Philippine Statistics Authority's (PSA) preliminary results of the Annual Labor and Employment Estimates for 2018.[3]

Chart 1.3. Employment by Sector
Year-on-year growth rates; in percent



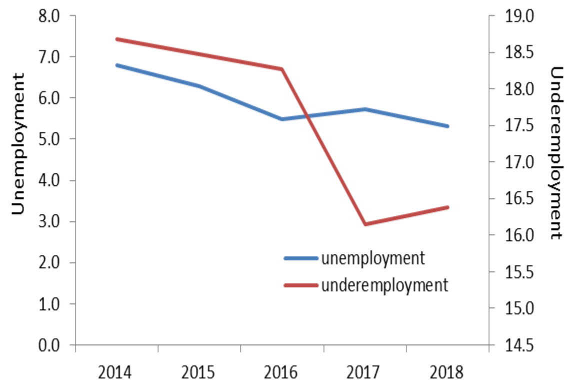
Source: PSA

In 2018, the total number of employed persons increased by 2.1 percent to reach 41.2 million from 40.3 million a year ago. Of the three (3) major employment sectors, the services sector accounted for more than half of the total employed persons with a share of 56.6 percent. The agriculture sector comprised 24.3 percent of the total employment while the industry sector took a 19.1 percent share of the total.

[3] Data is based on the average of four (4) Labor Force Survey (LFS) rounds: January, April, July, and October 2018.

Correspondingly, the number of jobless Filipinos decreased to 2.3 million in 2018 from 2.4 million in 2017, which brought down the unemployment rate to 5.3 percent from 5.7 percent in 2017. Most of the unemployed persons in 2018 were men (63.2 percent), between 15-24 years of age (44.6 percent), and have completed junior high school education (29.0 percent).

Chart 1.4. Unemployment/Underemployment Rate
In percent



Source: PSA

The labor force participation rate in 2018 is at 60.9 percent, 0.3 ppts lower than the 61.2 percent in 2017. This could be attributed to the faster growth in the working age population of 15 years old and over as against the decreasing number of persons in the labor force.[4]

In terms of class of workers, the number of wage and salary workers rose by 4.2 percent, due mainly to the increase in the number of workers who worked with pay in own family-operated farm or business (9.1 percent). Meanwhile, vulnerable employment (i.e., the proportion of self-employed and unpaid family workers to total employment) decreased as the number of unpaid family workers contracted by 4.8 percent.

[4] Based on the Institute of Labor Studies' Labor Force Survey Report, majority of those who are not in the labor force (economically inactive) cited household family duties, school participation, being too young or too old or retired or with a permanent disability, and temporary illness or disability.

The underemployment rate[5] in 2018 increased to 16.4 percent from 16.1 percent in the previous year. According to the Institute of Labor Studies, the increase in underemployment suggests that workers have been experiencing low-paying jobs or job mismatch, or do not have access to regular full-time jobs. Of the total underemployed, 45.5 percent were engaged in the services sector, 34.6 percent in the agriculture sector, and 19.9 percent in the industry sector.

The Q3 2018 labor turnover rate (LTR)[6] in the National Capital Region (NCR) dropped to 0.9 percent, lower by 0.2 ppts than the 1.1 percent registered in Q3 2017 LTR. In Q3 2018, the accession rate of 9.5 percent exceeded the separation rate of 8.6 percent, which means that 95 workers per 1,000 employed were hired due to business expansion or replacement of separated workers; while 86 workers per 1,000 employed were laid off or voluntarily left their jobs. Of the three (3) employment sectors, only the services sector registered an increased LTR at 1.3 percent, with an accession rate of 8.9 percent and a separation rate of 7.5 percent. On the other hand, the agriculture and industry sectors posted negative LTRs at 0.4 percent and 0.1 percent, respectively.

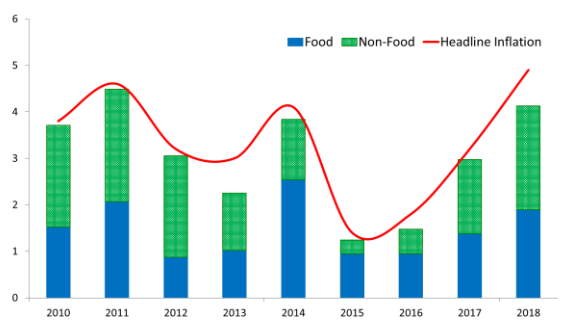
Prices. Year-on-year (y-o-y) headline inflation averaged 5.2 percent in 2018, higher than the 2.9 percent average in the previous year. This was also above the Government's 2018 inflation target range of 3.0 percent ± 1.0 percentage point. Headline inflation increased markedly in 2018 due to supply-side factors namely, increase in both food and energy prices alongside the implementation of tax reform measures.

[5] 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.
[6] Based on the preliminary results of PSA's Labor Turnover Survey (LTS) for Q3 2018, which was released in 31 January 2019. The labor turnover rate is the percent difference between the rates of accession (additions) and separation (losses).

Inflation for 2018 is above the Government's target

Food inflation rose to 6.6 percent in 2018 from 3.2 percent in the previous year as prices of key food items like rice, fish, meat, and vegetables increased due to supply bottlenecks caused by adverse weather conditions.

Chart 1.5. Headline Inflation (2006=100)
In percent



Source: PSA, BSP

Likewise, non-food inflation also rose in 2018 due largely to rising international oil prices. The oil price increase was driven largely by geopolitical tensions and decision of major producers to limit production. This also resulted in higher transport inflation as minimum fares for jeepney and bus were adjusted upwards during the year.

At the same time, the direct and indirect impact of the tax reform implementation also affected prices of sugar-sweetened drinks, gaming tickets, and domestic petroleum products.

On a geographical basis, headline inflation in both the National Capital Region (NCR) and in areas outside the NCR (AONCR) rose to 5.5 percent and 5.1 percent, respectively. These were significantly higher than the average inflation of 3.7 percent in NCR and 2.7 percent in AONCR recorded in the previous year.

Core inflation—which excludes certain volatile food and energy items to measure underlying price pressures—rose to 4.2 percent in 2018 from 2.4 percent a year ago. Likewise, alternative measures of core inflation estimated by the BSP also increased relative to the rates registered in the preceding year (Table 1.1).

Table 1.1. Measures of Core Inflation (2012=100) in percent

	2017	2018
Core Inflation	2.4	4.2
Trimmed Mean[1]	2.2	4.2
Weighted Median[2]	1.8	4.1
Net of Volatile Items[3]	2.7	4.5

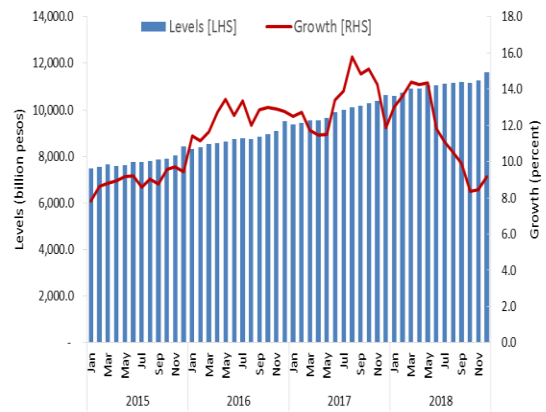
[1] The trimmed mean represents the average inflation rate of the (weighted) middle 70 percent in a lowest-to-highest ranking of year-on-year inflation rates for all CPI components.
[2] The weighted median represents the middle inflation rate (corresponding to a cumulative CPI weight of 50 percent) in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

Monetary Aggregates. Domestic liquidity or M3 increased by 9.2 percent y-o-y as of end-December 2018 following an 11.9-percent expansion recorded at end-2017.

Overall domestic liquidity conditions remain supportive of the country's requirements

The growth in domestic liquidity was due mainly to the continued expansion in domestic claims or credits to the domestic economy. Domestic claims grew by 14.6 percent y-o-y, supported by the sustained increase in claims on the private sector (14.8 percent), reflecting the steady growth in bank lending. Meanwhile, net claims on the central government rose by 16.4 percent.

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



Source: BSP

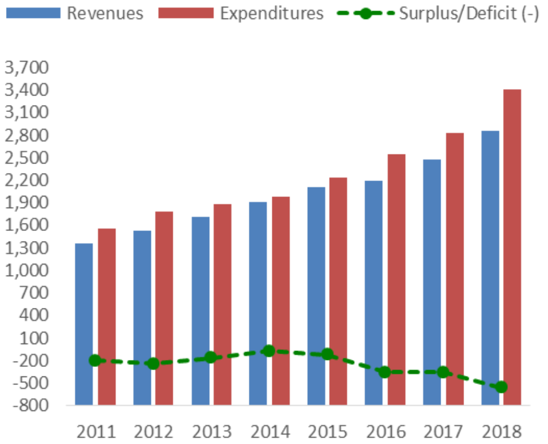
Net foreign assets (NFA) in peso terms rose by 1.3 percent y-o-y in December 2018. The BSP's NFA position held firm on the back of robust foreign exchange inflows composed mainly of Overseas Filipinos' (OF) remittances, business process outsourcing receipts, and foreign portfolio investments. Meanwhile, the NFA of banks contracted in December 2018, even as banks' foreign assets increased as a result of higher loans and investments in marketable debt securities.

Operations of the NG. The NG recorded a higher budget deficit for 2018 of ₱558.3 billion from ₱350.6 billion in 2017. This level of fiscal deficit was above the ₱523.7 billion programmed deficit for full year 2018, which is equivalent to 3.2 percent of GDP.

Fiscal deficit widens

For 2018, revenues increased by 15.0 percent y-o-y to reach ₱2,850.2 billion, supported by higher collections by the Bureau of Internal Revenue (BIR) and Bureau of Customs (BOC) by 10.1 percent and 29.4 percent respectively. The increase in total tax collections was also due to the 27.8 percent y-o-y increase in non-tax revenues, buoyed by the 14.3 percent y-o-y increase in the income of the Bureau of the Treasury.

Chart 1.7. Cash Operations of the National Government
In billion pesos



Source: Bureau of the Treasury (BTr)

Disbursements for the review period significantly outpaced the expansion in revenues as it reached ₱3,408.4 billion, 20.7 percent more than the outturn in 2017. Based on the latest Department of Budget and Management (DBM) data available for the period January to December 2018,[7] the upbeat spending performance was driven mainly by large double-digit growth rates in infrastructure spending and personal services.

Spending on infrastructure and other capital outlays (CO) surged by 41.3 percent to reach ₱234.9 billion as of December 2018.[8] Apart from the deliberate increase in allocation to pursue massive infrastructure build-up throughout the country, increases in personal services amounted to ₱178.8 billion due to higher pay of government workforce and faster rate of filling of positions by various agencies.

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 the debt-to-GDP ratios over the last seven years. The National Government's outstanding debt-to-GDP ratio declined from 51.0 percent in 2011 to 41.9 percent in 2018, 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 Firm amid Risks

Foreign Exchange Market. The peso averaged ₱52.68/US$1 for the period 3 January to 28 December 2018, depreciating by 4.32 percent from the ₱50.40/US$1 average in 2017.[9] The depreciaton of the peso against the US dollar during the year was due mainly to the series of interest rate hikes by the US Fed and concerns over the rising trade tension between the US and its major trading partners, including China. Meanwhile, these depreciation pressures were partly offset by market optimism on slowing domestic inflation data and strong remittance inflow towards the end of the year. In addition, the series of policy rate hikes by the BSP during the year provided support to the peso.

[7] DBM Report on National Government Disbursement Performance, As of December 2018.
[8] Ibid.

[9] Dollar rates or the reciprocal of the peso-dollar rates (based on reference rates data) were used to compute for the percentage change.

Peso weakens due to Fed rate hike prospects and lingering trade conflict between US and China

As of end-December 2018, the peso closed at ₱52.85/US$1, depreciating by 5.04 percent from its closing rate of ₱49.93/US$1 a year ago.[10] The peso depreciated in tandem with most regional currencies except the Japanese yen and Thai baht.

Table 1.2. 2018 Coefficient of variation of selected currencies

In percent

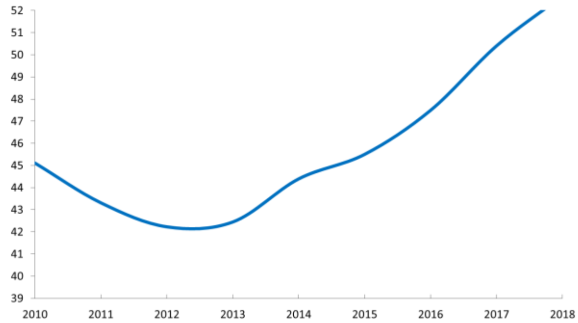
IDR	3.88	**THB**	2.26
CNY	3.87	**JPY**	2.10
MYR	2.61	**PHP**	1.97
KRW	2.44	**SGD**	1.88

Source of basic data: Bloomberg

Nonetheless, the sustained inflows of foreign exchange from overseas Filipinos' remittances, foreign direct investments, and BPO receipts, as well as the ample level of the country's gross international reserves and robust economic growth, continued to provide support to the peso.[11]

Chart 1.8. Philippine Peso – US Dollar Exchange Rate

PHp/US$



Source: Reference Exchange Rate Bulletin, Treasury Department, BSP

Meanwhile, the volatility of the peso (as measured by the coefficient of variation) stood at 1.97 percent (year-to-date) on 28 December 2018. This was relatively lower than the volatility of most currencies in the region except for the Singapore dollar which registered a volatility of 1.88 percent during the same period.[12]

On a real trade-weighted basis, the peso gained external price competitiveness against the basket of currencies of all trading partners (TPI) and trading partners in advanced (TPI-A) and developing countries (TPI-D) in 2018 due mainly to the peso's nominal depreciation. The real effective exchange rate (REER) index of the peso decrease year-on-year against the TPI, TPI-A, and TPI-D by 2.71 percent, 2.70 percent, and 2.72 percent, respectively.[13]

Equities Market. The Philippine stock market started 2018 on a high note as the Philippine Stock

[10] Last trading day for the Philippines for 2018 and 2017 is 28 and 29 December, respectively.

[11] As of end-December 2018, the country's gross international reserves (GIR) stood at US$79.2 billion (revised). This can cover 7.0 months' worth of imports of goods and payments of services and primary income. It is also equivalent to 6.0 times the country's short-term external debt based on original maturity and 4.1 times based on residual maturity. Foreign direct investments (FDI) remained positive and registered a net inflow of US$8.5 billion as of end-October 2018. Remittances from OF workers likewise continue to flow in from various geographical locations globally totaling US$26.1 billion as of the November 2018. As of end-September 2018, business process outsourcing (BPO) and tourism receipts reached US$16.4 billion and US$5.5 billion, respectively.

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

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

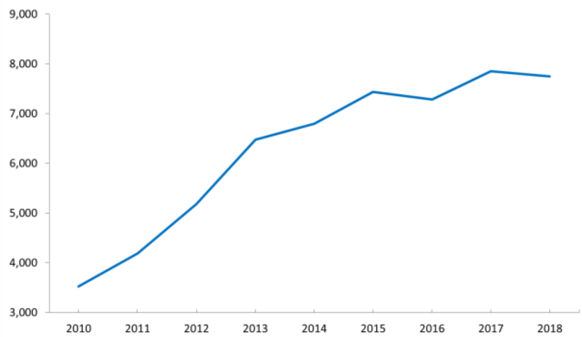
Exchange index (PSEi) peaked at 9,058.62 index points on 29 January 2018.

Philippine stock market declines but recovers

Boosting the benchmark index higher were investors' bullish outlook on the Philippine economy following the passage of the Tax Reform for Acceleration and Inclusion (TRAIN) law, anticipation of higher government infrastructure spending and the possible entry of a third player in the telecommunications industry.

Starting February, the market trended downwards until July of the same year. Domestic and external factors, weighed on the main index, namely: rising domestic inflation and interest rates; moderating outlook for the Philippine economy; expectations of the delayed approval of Philippine Government's budget; slowing global growth due to fresh geopolitical tensions; and normalizing US Fed monetary policy.

Chart 1.9. Annual Average Philippine Stock Exchange Index (PSEi)
(in index points)



Source: Philippine Stock Exchange, BSP

- ***Rising domestic inflation and interest rates.*** After domestic inflation rose beyond the national government's target rate of 2-4 percent since March 2018, investor sentiments were dampened as concerns rose on prospects of continued interest rate hikes to counter inflation. The BSP raised policy rates by a total of 175 basis points from hikes implemented in May, June, August, and September. However, tamer inflation expectations in November and December partly boosted trading in the local bourse in the last month of 2018.

- ***Deceleration in the Philippine economic outlook.*** The bullish outlook on the Philippine economy boosted the financial market in the first month of 2018 on the back of the TRAIN law passage, expectations of higher government infrastructure spending and the possible entry of a third player in the telecommunications industry. However, after the country's robust 6.8 percent growth in first quarter of 2018, the deceleration in the Philippine economy's growth in Q2 and Q3 contributed to some retreat in investor confidence.

- ***Delayed approval of Philippine government budget.*** In the last month of 2018, the delayed enactment of the 2019 proposed ₱3.757 trillion national budget and the expected ban on public works ahead of the May mid-term elections in 2019, dampened trading sentiments.

- ***Fresh geopolitical tensions.*** Protracted trade tension between the US and China[14] and fresh geopolitical tensions between the US and several other counties like Iran, North Korea, and Syria weighed on the bourse throughout most of the year amid fears of slowing global growth. In December, however, rising optimism over possibly warmer trade

[14] Trade relations are wworsening between the US on the one hand and China, the European Union and other nations, on the other. In retaliation against the Trump administration's tariff hikes on steel and aluminum, Beijing has vowed to impose its own tariffs on US soybeans and other farm products. The European Union, meanwhile, was set to slap tariffs on $3.4 billion worth of American products, from whiskey and motorcycles to peanuts and cranberries. Moreover, India and Turkey have already raised import duties on US products, ranging from rice to autos and sunscreen.

relations between the US and China[15] provided a boost to the local stock market in the last month of the year.

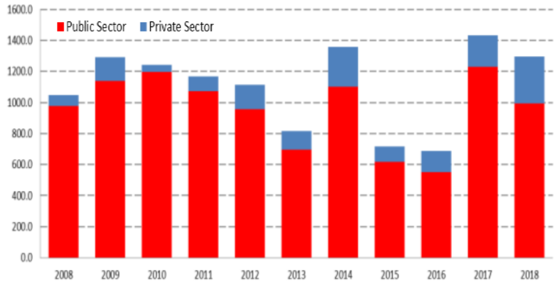
- ***Normalizing US Fed monetary policy.*** In December 2015, the Federal Reserve Board (FRB) initiated the process of "normalization," with the objective of gradually raising the federal funds rate back to "normal". Amid a strengthening US labor market and economic activity, the US Fed continued, albeit gradually, to raise policy rates (four times) by a total of 100 basis points in 2018. This resulted in the volatility in global financial markets during the year.

Hence, from the registered peak of 9,058.62 index points on 29 January, the benchmark index finally closed at 7,466.02 index points on 28 December 2018. The closing level in December was about 17.6 percent below the peak and 12.8 percent lower year-to-date. The bourse entered bear market territory[16] due to the aforementioned negative factors several times during the year. [17]

Amid negative global sentiments and local stocks high valuation of listed stocks, foreign investors posted net sales of ₽60.49[18] billion during the year. This was a turnaround from the net purchases of ₽56.20 billion posted in 2017. Hence, the price-earnings ratio fell slightly from an average of 21.6x in 2017 to an average of 19.8x in 2018. Moreover, total market capitalization was lower at ₽16.15 trillion by 8.2 percent y-o-y from the ₽17.58 trillion in the previous year, as the sell down by foreign funds pared the valuation of large-cap stocks. Mirroring the retreat in the PSEi, the average daily value turnover shrank by 12.7 percent from ₽8.2 billion in 2017 to ₽7.2 billion in 2018.

Bond Market. The Philippine bond market continued to be dominated by government securities. Although the size of the Philippine corporate bond market grew over the past 3 years, it is still relatively small compared to government bonds. During the year, private issuances of local currency bonds were mostly from the real estate, financial corporations and holding firms.

Chart 1.10. Local Currency Bond Issuances
In billion pesos



Meanwhile, the NG continued to favor domestic sources, which were estimated to account for about 80 percent of the borrowings while the remaining 20 percent was sourced from foreign sources. This limited the country's exposure to foreign exchange risks.

In terms of investor preference for shorter or longer-dated debt paper instruments, preference remained in the shorter end of the curve, as it is easier to discount information and formulate strategies in the immediate term.

[15] During the G20 Summit, US and China decided to suspend the imposition of new tariffs until January 2019. This and positive comments made by President Trump about reaching a trade deal with China improved investor sentiments. Officials from the US and China were to resume meeting in Beijing on 7 January 2019 to discuss the next steps in their trade talks before their 90-day truce expires on 1 March 2019.

[16] A bear market is a condition in which securities' prices fall and widespread pessimism causes the stock market's downward spiral to be self-sustaining. Although figures vary, a downturn of 20 percent or more from the previous peak is typically an entry into a bear market.

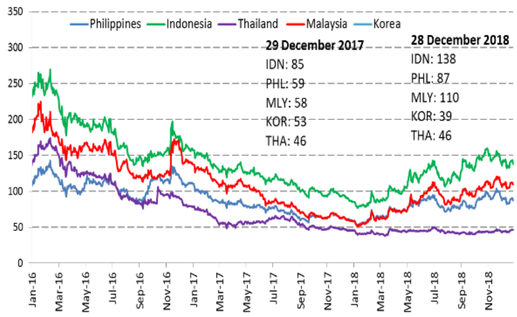
[17] The local bourse entered the bear market for 12 days from June to July; and for 34 days from September to November.

[18] Please note that the amount is attached table based on revised actual figures from January to November 2018, while the initial figures from December remain unchanged. However, table recently sourced from the PSE show that net foreign selling totaled ₽61.01 billion in 2018.

In the secondary market, the degree of trading activity was highly sensitive to external and domestic developments. The external and domestic developments resulted in a challenging and volatile operating environment that affected investors' risk sentiment. Major external developments included mainly the protracted uncertainty over the US Fed's policy normalization and the continued prospect of more inward-looking or protectionist policies in major economies. Domestically, investor confidence was challenged by high inflation and slower-than-expected growth.

Chart 1.11. Five-Year CDS Spreads of Selected Asian Countries

In basis points



The immediate spillover from rising global interest rates was manifested in the higher cost of raising funds from external funding 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 year-on-year. As of end-December 2018, the Philippines' 5-year sovereign CDS stood at 87 bps. This is lower than Malaysia's 110 bps and Indonesia's 138 bps but higher than Korea's 39 bps and Thailand's 46 bps.

Credit Risk Assessment. In the first semester of 2018, the China Lianhe Credit Rating Co., Ltd., a major Chinese credit rating agency has given the Philippines' planned issue of RMB 1.46 billion-worth of "Panda bonds" its highest rating of 'AAA' with a stable outlook.

Meanwhile, Standard & Poor's (S&P) raised its outlook on the Philippines' credit rating from "stable to "positive". Japan Credit Rating Agency, Ltd. (JCR) kept the country's rating of "BBB+" with a stable outlook on account of the economy's robust growth, resilience against major headwinds, and the government's comparatively sound fiscal position.

In the second semester, Fitch Ratings kept the Philippines' investment grade of "BBB" on strong growth prospects and assigned a "stable" outlook in July and December. Moody's Investors Service on the other hand, affirmed the Philippines' "Baa2" rating with a stable outlook in July while Korea-based NICE (National Information & Credit Evaluation) Investors Service maintained the Philippines' investment grade rating of "BBB" in November.

Box Article 1

Constructing a Commercial Property Price Index (CPPI) for the Philippines

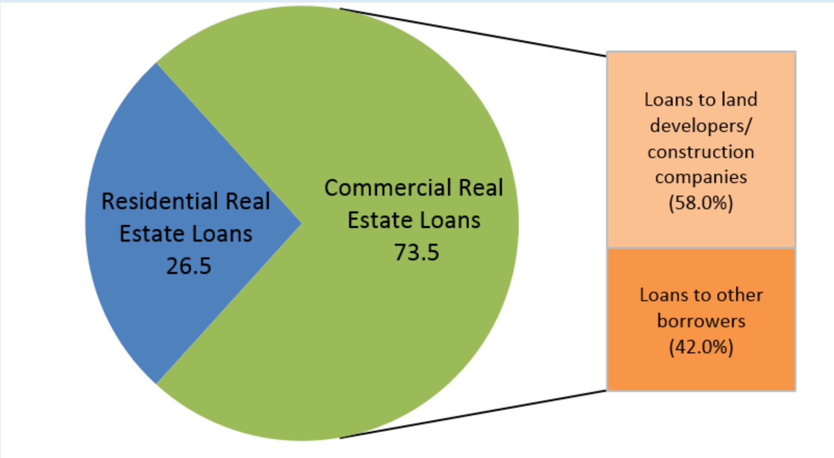
The 2008 Global Financial Crisis (GFC) underscored the important role that the real estate sector plays in the real economy, financial stability and monetary transmission process. In response to the information gaps revealed by the crisis, the Bangko Sentral ng Pilipinas (BSP) institutionalized the quarterly Residential Real Estate Price index (RREPI) in 2016. To have a more comprehensive measure of real property prices, the BSP in 2017, began the development of the Commercial Property Price Index (CPPI) to augment the RREPI.

Given the link of commercial property prices with economic growth and its impact on investment decisions and financial conditions of firms, the CPPI is useful to the BSP in terms of monetary policy making and inflation targeting. Furthermore, the CPPI as a measure of banks' risk exposure is important in maintaining financial stability.

An Overview of the Commercial Real Estate Sector in the Philippines

In the Philippines, banks' exposure to the commercial real estate sector is substantial, owing to the growing demand for residential real estate in the country. Commercial property encompasses office spaces, retail/shopping malls, industrial/logistical buildings, hotels and restaurants, and residential properties that are being developed for lease or sale, among others.

Figure 1. Universal/Commercial Banks' Outstanding Loans to the Real Estate Sector As of June 2018



Source: BSP

Data reported by banks as of end-June 2018 showed that almost three-fourths (or 73.5 percent) of the total outstanding loans to the real estate sector were for commercial real estate projects, amounting to ₽1.12 trillion, 8.8 percent higher than the ₽1.03 trillion loans recorded during the same period in 2017. Majority of these loans were extended to land developers and construction firms (at 58 percent). This increased by 10.8 percent to ₽651 billion as of end-June 2018 from ₽87 billion in end-June 2017. Out of this amount ₽233 billion was allotted for building residential units, while construction for office buildings and condominiums, retail/wholesale, and manufacturing totaled ₽57 billion. Loans to other borrowers (at 42 percent) also increased by 6.1 percent to ₱472 billion from ₱445 billion during the same period a year ago (see Figure 1).

Capturing Trends in Commercial Property Prices

The construction of the CPPI is a first in the Philippines, and as a complement to the RREPI, it is expected to provide a broader perspective on the overall health of the real estate sector. Specifically, the CPPI is designed to a) monitor asset price movements as a macroeconomic indicator; b) measure risk exposure as a financial stability or soundness indicator; and c) provide inputs in the formulation of monetary policy.

The CPPI will provide a measure on the average changes in prices of commercial properties over a period of time across different geographical regions, where the growth rate of the index measures commercial property price inflation. The main source of data will be the reports submitted by universal/commercial banks (UBs/KBs) and thrift banks (TBs) on commercial properties appraised during the reference quarter, classified as commercial, industrial, and special use, which is based on the highest and best use (HABU)[1] concept. Data from banks' appraisal reports would cover the National Capital Region (NCR) and areas outside the NCR.

The CPPI will be computed as a weighted chain-linked index based on the average appraised value per square meter weighted by the share of floor area of the condominium space or lot area of the commercial property. In addition to the overall CPPI, sub-indices may also be constructed by commercial property type (i.e., condominium space, land only, or land with improvement) and geographical area (i.e., NCR or AONCR).

The BSP's Role in Developing the CPPI

This project, which is still in its inception stage, will be jointly undertaken by the Center for Monetary and Financial Policy (CMFP) and the Department of Economic Statistics (DES) of the BSP. In order to make an initial evaluation on the available information from banks' appraisal reports, a survey dry run for the CPPI is being conducted in Q1 2019 with the following objectives: a) assess the availability and volume of commercial property data from banks, b) generate preliminary CPPI data, and c) determine possible challenges/issues related to the submission of quarterly bank appraisal reports.

To determine the availability and volume of commercial property data, for each appraised commercial property, respondent banks will be required to provide the following information: a) month of appraisal; b) location of property; c) HABU classification of property (i.e., commercial, industrial, or special use); d) actual use of property (e.g., shopping center/mall, office, etc.); e) type of property (i.e., condominium space, land only, and land with improvement); f) type of commercial condominium space (i.e., new, pre-owned, and foreclosed); g) appraised value of condominium space or land per square meter; h) total floor area of condominium space or land area per square meter; and i) total appraised value of land or condominium space.

[1] Highest and Best Use (HABU) refers to the most probable use of a property which is physically possible, appropriately justified, legally permissible, financially feasible, and which results to the highest value of the property being valued.

Philippine Banking System Financially and Operationally Sound and Stable

The Philippine banking system maintains its growth momentum, ending 2018 with sustained growth in assets, loans, deposits and capital. This is supported by proactive implementation of prudential reforms designed to raise the bar on corporate governance standards and risk management culture, stronger BSP supervised financial institutions (BSFIs), and greater access to financial services.

With stronger balance sheets, leaner and stronger outreach, active pursuit of financial innovations and committed partnerships with stakeholders, the banking system's positive performance is expected to continue in 2019, ready to adapt and respond to the evolving financial landscape and client expectations.

Banks remain stable and focused on technology-enabled asset growth

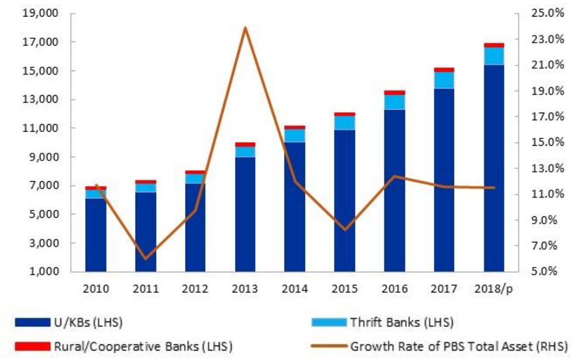
Banks ended 2018 on a positive note with sustained growth in key balance sheet accounts and remained profitable, despite lingering vulnerabilities in the domestic and international macroeconomic landscape.

As of end-December 2018, the total resources of the banking system grew by 11.5 percent to ₱16,911.4 billion from the same period in 2017. The banks' total assets accounted for over 97 percent of the country's annual gross domestic product (GDP) in nominal terms.

Universal and commercial banks (U/KBs) continue to hold the bulk of the banking system's assets at ₱15,421.2 billion (91.2 percent), while the thrift banks (TBs) and rural banks and cooperatives (RCBs), whose assets stood at ₱1,244.7 billion and ₱245.6 billion, constitute 7.4 percent and 1.5 percent of the total resources of the banking system, respectively.

Chart 1.12. Resources of the Banking System

in billion pesos, growth rate in percent

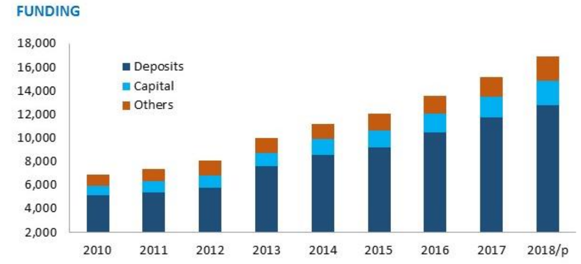


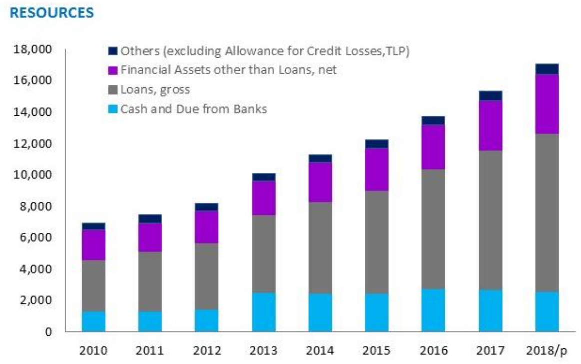
Source: BSP

The increase in resources was supported by the expansion in the banks' funding base mostly through deposits which registered a y-o-y growth of 8.8 percent to ₱12,760.9 billion as of end-December 2018. Peso and foreign-currency deposits increased by 9.1 percent and 7.3 percent, respectively. Deposits, which are equivalent to 75.5 percent of banks' total assets as of end-December 2018, are composed mainly of savings accounts (with a share of 47.1 percent), as well as time deposits (28.1 percent) and demand deposits (22.9 percent). Around 78.7 percent of these deposits are sourced from resident individuals and private corporations, providing stability as a funding source.

Chart 1.13. Sources and Uses of Funds

in billion pesos

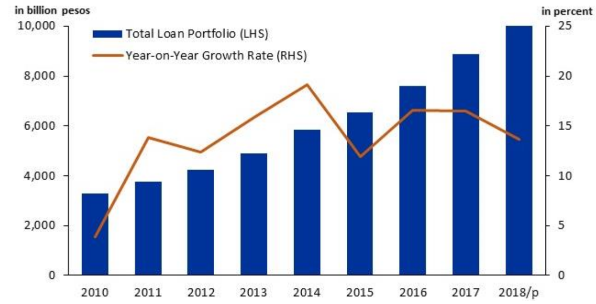




Source: BSP

Chart 1.14. Total Loan Portfolio

in billion pesos, growth rate in percent



Source: BSP

Sustained growth in bank deposits spurs expansion in bank loans and investments

The industry's total loan portfolio (TLP), on a gross basis, grew by 13.6 percent y-o-y to ₱10,075.6 billion as of end-December 2018. Loans for production activities which held nearly 79 percent of banks' aggregate loan portfolio continued to be driven by increased lending to key production sectors such as wholesale and retail trade (14.7 percent), manufacturing (12.7 percent), real estate (10.6 percent), and loans for household consumption (10.1 percent). The double-digit y-o-y growth rates of loans to these sectors were due to the positive prospects for the sectors and for the overall economy.

The banking system's lending to the real estate sector which accounted for the largest share of TLP at 16.9 percent, reached ₱1,705.9 billion as of end-December 2018, up from ₱1,542.1 billion the previous year.

In the same manner, the banking system's portfolio investments rose to ₱3,462.6 billion, 18.8 percent higher than a year ago. The bulk of these investments are held-to-maturity (HTM) financial assets at nearly 70 percent or ₱2,414.5 billion. As data indicate, available for sale (AFS) securities which stood at ₱816.1 billion also constitute a sizeable share equivalent to 23.7 percent.

Beginning end-June 2015, the share of HTM to total portfolio investment of banks was higher at 43.3 percent compared to 42.3 percent share of the AFS. Subsequently, the average proportion of HTM picked up to more than 50.0 percent. This insulates banks from mark-to-market (MTM) losses brought by fluctuations in interest rates and protects their overall bottom line.

Real estate loans exhibit modest growth

Banks' real estate exposures (REEs) continues to expand but at a slower pace. These REEs are composed mainly of commercial real estate loans (RELs) with 85.9 percent share and real estate investments (REIs). These generally posted double-digit y-o-y growth rates but starting 2017, growth rates have slowed down following BSP's implementation of prudential reforms on credit risk management[20] and real estate stress test.

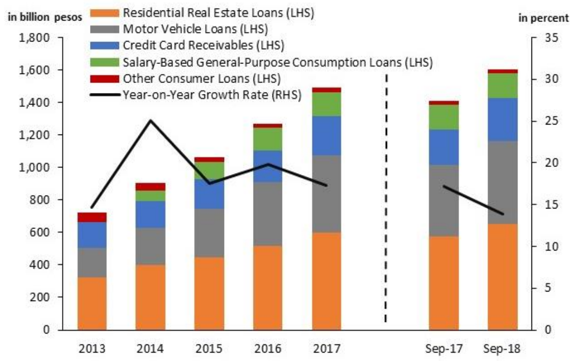
Data show that the REEs of U/KBs and TBs on a consolidated basis increased by 11.2 percent y-o-y to ₱2,139.4 billion as of period ended-June 2018. This was notably slower than the 18.6 percent y-o-y growth rate posted in June 2017. Total RELs went up by only 11.7 percent to ₱1,836.9 billion, with the slowdown in the y-o-y growth rates of both commercial RELs and residential RELs as of end-June 2018. Commercial RELs, which accounted for about two-thirds of total RELs, mainly drive the growth in REEs while growth of residential RELs has been relatively stable since 2016.

Meanwhile, the non-performing REL ratio remains low at 1.8 percent which broadly indicates that banks have been prudent in their risk-taking activities.

To ensure that banks' exposure to RELs remains manageable, prudential measures for REEs have been adopted. These measures included (1) the REL limit of 20 percent of TLP (with exclusions), net of interbank loans, for U/KBs,[21] (2) heightened surveillance of banks' real estate and project finance exposures, and (3) the real estate stress test (REST) thresholds for U/KBs and TBs.[22]

The U/KB industry has been compliant with the REL limit since 2008, registering a 13.0 percent ratio as of end-June 2018. Meanwhile, the REST results as of end-June 2018 indicated that the stressed capital adequacy ratio (CAR) and common equity tier 1 (CET1) ratio of the U/KB industry registered above the minimum requirements on solo and consolidated bases.

Chart 1.15. Components of Consumer Loans (Solo Basis) Universal, Commercial and Thrift Banks
in billion pesos, growth rate in percent



Source: BSP

Meanwhile, the growth of consumer loans decelerated to 13.9 percent in end-September 2018 from 17.2 percent the previous year due to the slower expansion in motor vehicle loans, as well as the continued decline in salary-based general purpose consumption loans and other types of household loans during the period.

Banks' asset quality remains satisfactory with adequate provisioning for loan losses

Amid continued loan growth, the banking system's loan quality remained satisfactory. Banks continue

[20] Refers to Circular No. 855 dated 29 October 2014

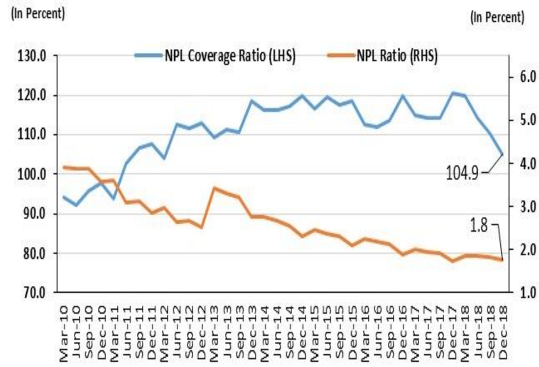
[21] For purposes of computing the 20 percent limit as detailed in Circular No. 600 dated 4 February 2008, RELs of U/KBs exclude the following: (1) loans to individual households for housing units and acquisition of land to be occupied by the borrower; (2) loans to developers/construction companies for socialized and low-cost residential properties for government housing programs; (3) loans guaranteed by the Home Guaranty Corporation; and (4) loans collateralized by non-risk assets.

[22] Under Circular No. 839 dated 27 June 2014, the REST limit combines a macroprudential overlay of a severe stress test scenario, the principle of loss absorbency through minimum capital ratio thresholds, and heightened supervisory response.

to adhere to sound credit underwriting standards as shown by the satisfactory loan quality of the banking system's loan portfolio. The non-performing loan (NPL) ratio remained low at only 1.8 percent as of end-December 2018. The banking system's NPL ratio has been on a downward trend for the past five years. Banks continued to set aside adequate provisioning for credit losses, with the NPL coverage ratio still above 100 percent, i.e., at 104.9 percent as of end-December 2018.

Chart 1.16. Philippine Banking System NPL Ratio and NPL Coverage Ratio

As of End-Periods Indicated

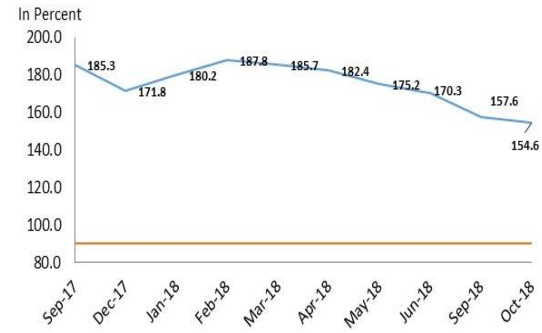


Source: BSP

The BSP's onsite examination and offsite supervision maintain that banks in general continue to adhere to sound credit underwriting standards and at the same time enhance their credit risk management practices. This is implemented through improvements in credit underwriting standards and loan loss methodologies, periodic review and calibration of credit scoring models, and use of credit risk mitigants, among others. Moreover, the BSP Financial Supervision Sector (FSS) continues to improve its financial surveillance tools. The FSS is also vigilantly monitoring actions taken by banks to effectively manage exposures to specific sectors for which NPLs may rise, such as real estate lending and consumer loans, to mitigate signs of overheating that could lead to the deterioration of loan quality.

Based on a study by Cachuela (2018), [23] Philippine banks are shown to be generally prudent and risk-sensitive in their lending decisions as the quality of loans remains relatively stable. In particular, the study shows that banks not just lent more, but lent to capable borrowers as well. Moreover, based on the panel vector autoregression (VAR) simulations, it was also found that an increase in monetary policy rate has no substantial impact on NPL growth even after the occurrence of a shock.

Chart 1.17. Universal and Commercial Banks LCR Trend and Gap against Minimum Requirement



Source: BSP

Meanwhile, the banking system continues to maintain sufficient buffers to meet liquidity and funding requirements. As of end-October 2018, the liquidity coverage ratio (LCR) of the U/KB industry registered at 154.6 percent on solo basis. This is above the BSP's current regulatory threshold of 90.0 percent. [24] Since the implementation of the LCR, banks were consistently above the regulatory minimum. This indicates that banks hold sufficient High Quality Liquid Assets (HQLAs) that can be easily converted into cash to service liquidity requirements over a 30-day stress period. Moreover, the 96.3 percent of HQLAs held by U/KBs are Level 1 assets. Of these assets, 41.8 percent is comprised of reserves with the BSP while 43.7 percent is made up of securities issued or guaranteed by the Philippine national government.

[23] Cachuela, R. (2018). "Does Expansion of Bank Lending Lead to Weakening of Loan Quality in the Philippines?", A Report on the Philippine Financial System-First Semester of 2018. Bangko Sentral ng Pilipinas.

[24] Raised to 100 percent starting 1 January 2019.

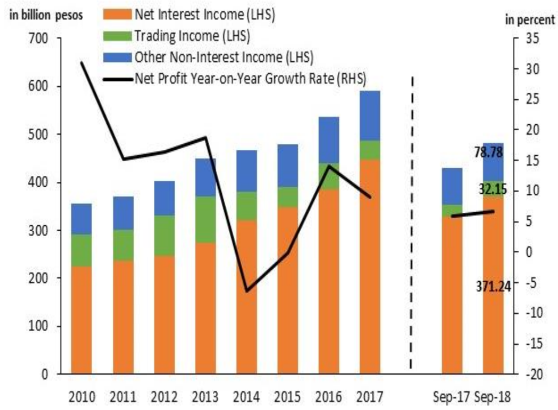
Domestic banks generally maintain most of their Level 1 HQLAs in the form of eligible securities and reserves to the BSP. Similarly, subsidiaries and branches of foreign banks in general, hold Level 1 HQLAs in the form of eligible securities and deposits with the BSP.

Strong core earnings boost bank profits

As of end-December 2018, the Philippine banking system posted a positive bottom line as net profit grew to ₱178.8 billion which was 6.4 percent higher than the level a year ago. The overall profitability was buoyed by the 13.9 percent increase in net interest income to ₱509.7 billion primarily from lending activities. On the expenditure side, majority of the banking system's interest expense of ₱190.0 billion was represented by interest paid on deposits (81.0 percent share or ₱154.7 billion).

Chart 1.18. Sources of Revenue Philippine Banking System

in billion pesos, growth rate in percent



Source: BSP

As of end-December 2018, almost 77.2 percent of banks' operating income came from net interest earned. Proceeds from other revenue sources such as trading and other non-interest bearing activities contributed 6.3 percent and 16.5 percent respectively to the industry earnings for the period. Overall, the banking system remains reliant on interest income, which are considerably more stable and less risky revenue sources. Meanwhile, annual return on assets (ROA) and return on equity (ROE) stood at 1.1 percent and 9.4 percent, respectively, lower than the ROA and ROE ratios recorded in 2017 of 1.2 percent and 10.2 percent, respectively. The dip in annual ROE and ROA stemmed from the faster growth recorded in capital accounts and total assets of the banking system.

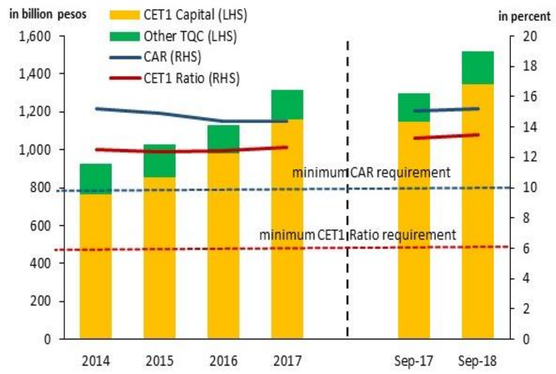
Banks continue to be well-capitalized with adequate funds to support risk-taking activities

Banks' risk-taking activities are adequately supported by capital, which is mainly composed of common equity and retained earnings. Capital adequacy ratios (CARs) of U/KBs on solo and consolidated bases slightly increased as of end-September 2018 to 15.2 percent and 15.8 percent, respectively from 15.0 percent and 15.7 percent, respectively a year ago. The increase is due to the capital build-up being undertaken by the industry in view of the ongoing Basel reforms and in anticipation of further expansion of the loan portfolio. The Common Equity Tier 1 (CET 1) ratio of U/KBs stood at 13.5 percent and 14.1 percent on solo and consolidated bases, respectively. The CAR and CET1 ratios were still well-above the 10.0 percent and 6.0 percent minimum requirements, respectively, indicating that U/KBs are generally well-prepared to withstand shocks to their balance sheets.

These developments suggest that banks have become risk sensitive. The findings from a recent study by Layaoen and Domantay-Mailig (forthcoming 2019) provide empirical evidence that, in general, U/KBs and their subsidiary TBs tend to adjust their regulatory capital ratios in the short- and medium-term, and those with lower capital are likely to quickly adjust their capital ratios parallel to their peers.[25] This finding in effect implies that banks maintain adequate capital and liquidity solely to support the expansion of their lending and deposit-taking operations.

Chart 1.19. Composition of Capital (Solo Basis) Universal and Commercial Banks

As of end-period indicated, in billion pesos, ratios in percent

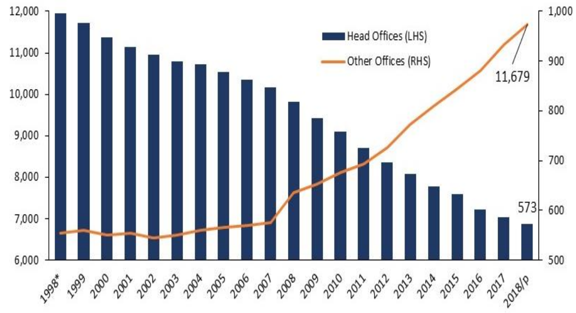


Source of data: BSP

Leaner and stronger banking landscape backs industry performance

The increase in bank assets is accompanied by an expansion in the banks' physical network. From 11,793 in 2017, preliminary data show that bank offices grew to 12,252 as of end-December 2018 on account of the new "other offices" established. Overall, the banking system has a network of 573 head offices and 11,679 other offices, most of which are regular branches and branch-lite units which serve as cost-effective, dressed-down distribution modes catering to small depositors and low-income groups. Opening of branch-lite units is aligned with the BSP's strategic direction to democratize access to transaction accounts to promote financial inclusion. Banks are encouraged to widen their presence and broaden their geographical and digital footprints thru the establishment of branch-lite units, other offices and digital access points to bring more innovative and efficient financial services to the countryside, particularly the hard to reach financially unserved and underserved areas.

Chart 1.20. Philippine Banking System Total Banking Units



Source of data: BSP
/p - preliminary

** BSP's merger and consolidation policy amended and rationalized in 1998 with the issuance of Circular No. 172 dated 3 September 1998.*

Moreover, in light of the BSP's thrust to promote greater competitiveness and liberalization in the banking sector, the Monetary Board (MB) has approved 12 foreign bank applications since the implementation of Republic Act (R.A.) 10641 in 2014.

This is also in line with the BSP's Consolidation Program for Rural Banks (CPRB)[26] which was re-launched in 2017, to promote greater consolidation in order to further strengthen the financial condition and governance of the industry, particularly the rural bank sector. To ensure the stable and smooth functioning of the banking system, the BSP has closed down a total of 12 regulated entities with unviable and unsustainable operations.

[25] C. Layaoen and V. Domantay-Mailig (Forthcoming 2019), "Do Capital Regulation Influence Banks Holding of "Excess" Capital?" A preliminary version of the study was included as a box article in the BSP Second Semester 2017 Report on the Philippine Financial System.

[26] Initially launched in August 2015, the CPRB is a progressive incentive program by the BSP, PDIC and LBP to encourage mergers and consolidations among rural banks (RBs). It aims to strengthen the rural banking industry, in recognition of the major role that the RBs play in financial inclusion, and to bring about a less fragmented banking system by enabling them to improve financial strength, enhance viability, strengthen management and governance, and expand market reach, among others.

The ongoing industry consolidation and streamlining of the banking structure is made all the more inclusive and efficient with the sustained improvements in electronic banking (e-banking), which is being encouraged as an alternative service delivery channel to the conventional brick-and-mortar physical presence of bank branches.

The total number of automated teller machines (ATM), currently the most iconic e-banking outlet/form, reached 21,098 units as of end-September 2018 or an additional 1,354 units from the previous year's 19,744 units. Improvements in e-banking are expected to continue as more ATM consortiums evolve and transition into more sophisticated financial innovations and digital products/ facilities.

All in all, the Philippine banking system demonstrates resilience amid risks in the global and domestic environment. Through its sound and steady performance, the banking system provides stability in the financial system and has been one of the anchors of sustained robust performance of the domestic economy. The year 2018 also saw banks breaking new frontiers in terms of delivery of financial services and financial innovation following breakthroughs in financial technology (FinTech) and digital services. Acknowledging that these new technologies provide both challenges and opportunities, the Philippine banking system still has a cornucopia of things that needs to be done and braces itself for the tasks that lie ahead.

The Philippine Non-Bank Sector[27]

The non-bank sector continues to evolve as alternative service provider of inclusive finance

The non-bank sector, comprised of quasi banks, non-stock savings and loan associations, pawnshops, money services business units and other non-bank financial institutions such as trust corporations, continues to play an important role in promoting financial inclusion through their wide network of branches and registered corollary business units located nationwide. These alternative, technology-enabled service delivery channels extend banking services to more Filipinos in hard-to-reach places not catered by banks and other bigger financial institutions.

Non-Bank Financial Institutions with Quasi-Banking Functions (NBQBs)

NBQB network remains stable

There were nine operating NBFIs with quasi-banking functions (NBQBs)[28] in the country consisting of three investment houses (IHs), five financing companies (FCs), and one other NBQB as of end-December 2018. The industry has a total physical network of 120 offices, composed of nine head offices and 111 other offices.

---

[27] Consists of BSP supervised non-bank financial institutions (NBFIs) such as quasi-banks, non-stock savings and loan associations, pawnshops and other NBFIs such as investment Houses (w/o quasi-banking (QB) function), financing companies (w/o QB function), investment company (w/o QB function), securities dealer/broker, lending investor, venture capital corporation, credit card company, government NBFIs, Electronic Money Issuer (EMI) - Others, AAB Forex Corporations, remittance agent, credit granting entities (CGEs) and trust corporations.

[28] The NBQBs are non-bank financial institutions (NBFIs) authorized by the BSP to borrow funds from 20 or more lenders for their own account through issuances, endorsement or assignment with recourse or acceptance of deposit substitutes for purposes of re-lending or purchasing receivables and other obligations. NBQBs are subject to BSP supervision.

Loan growth drives asset expansion

As of end-December 2018, the total resources of the NBQBs grew by 8.2 percent y-o-y to ₱282.2 billion. This was mainly attributed to increased lending activities of NBQBs. Total loans rose by 15.7 percent y-o-y to ₱189.9 billion. Meanwhile, net investments declined by 9.4 percent from ₱44.3 billion in December 2017 to ₱40.2 billion in December 2018. This broadly reflects NBQBs' rebalancing of their portfolio to manage the rising interest rate environment. Despite sustained loan growth, the asset quality of NBQBs remained manageable as the NPL and NPA ratios were recorded at 3.9 percent and 2.9 percent, respectively. To adequately provide against potential credit losses, the industry raised the NPA and NPL coverage ratios to 82.3 percent (from 57.8 percent, end-December 2017) and 89.2 percent (from 62.6 percent as of end-December 2017), respectively.

Chart 1.21. Total Resources of NBQBs

As of end-period indicated, in billion pesos

Source: BSP

Bills payable propels fund build-up

The asset expansion was largely funded by bills payable which reached ₱191.0 billion, up by 7.6 percent y-o-y from ₱177.6 billion last year. Moreover, total capital went up at the same pace (7.6 percent), further strengthening the industry's capital position to P54.8 billion from P51.0 billion last year. The expansion in capital was on account of the increases in capital stock, surplus, surplus reserves and undivided profits. Meanwhile, capital-to-asset ratio remained at 19.4 percent. In turn, the industry posted a net income of ₱8.1 billion mainly from net-interest income which held 79.5 percent of the total operating income of the NBQBs. Earnings from leasing activities boosted the overall income of the industry for the period. Meanwhile, the NBQBs remained profitable with annual return on assets (ROA) and return on equity (ROE) of 3.0 percent and 15.2 percent, respectively.

Trust Operations

As of 30 September 2018, the assets under management (AUM) of trust entities amounted to ₱3,313.8 billion, representing 1.2 percent growth y-o-y. The trust industry is dominated by the trust departments of banks, which accounted for 75 percent of the total AUM.

Trust industry modestly expands

Trust and agency arrangements accounted for almost equal shares in the industry's AUM, at 43 and 42 percent, respectively. Majority of the accounts in trust arrangements are concentrated on unit investment trust funds (UITFs) at 49 percent while managed institutional and individual accounts took the remaining 35 and 16 percent, respectively. The institutional accounts are mostly employee-benefit trusts while the individual accounts are mostly personal trusts. Agency arrangements are mostly in individual and institutional accounts-others, which respectively take 43 percent and 57 percent of the portfolio.

Meanwhile, these UITFs reached ₱673.8 billion, 68 percent of which were in money market while 23 percent were in equity funds. There were around 250 approved funds as of 31 October 2018. As of end-December 2018, there were 38 BSP-supervised financial institutions with trust licenses, two of which are currently inactive.

Trust corporations gear up for further reforms

There are three trust corporations (TCs) operating in the country as of end-December 2018. Two of the three TCs are former trust departments of the BSP-supervised financial institutions (BSFIs), which spun-off their operations in 2016. The third TC is a wholly-owned subsidiary of an insurance company, which started operations in the latter part of 2017. Meanwhile, another entity is awaiting the issuance of its Certificate of Authority to operate before it fully engages in the trust business.

Total assets under management (AUM) of the TCs reached ₱796.5 billion as of 30 September 2018.[29] This is equivalent to 23.9 percent of the total AUM of the trust industry of ₱3.3 trillion. Of the total AUM of TCs, 25 percent are in UITFs. There are around 57 approved funds of TCs as of 31 October 2018.

The BSP is currently drafting guidelines on the marketing and distribution of UITFs by TCs. The regulation is designed to level the playing field among trust industry players by enabling TCs to provide greater access to their UITF products to different market segments. In particular, the guidelines are expected to provide opportunities for TCs to distribute UITFs through various third-party channels. This initiative will help increase the share of TCs in the total AUM of the industry, as well as promote a more financially inclusive financial sector.

[29] Latest available data

Non-Stock Savings and Loans Associations (NSSLAs)

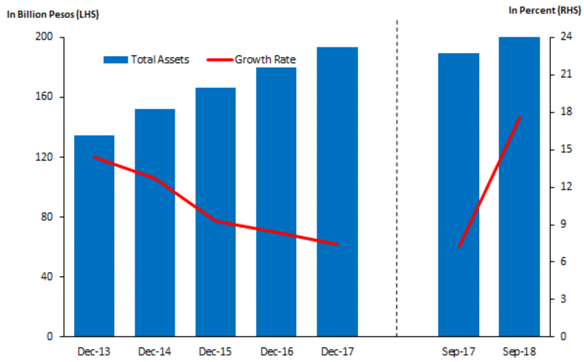
As of end-December 2018, there are 63 operating NSSLAs in the Philippines. These were slightly lower than the 65 NSSLAs reported as of end-December 2017 due to industry consolidation.

The BSP defines NSSLAs as non-stock, non-profit corporations engaged in the business of accumulating the savings of its members for lending as well as providing long-term financing for home development and personal finance. These NSSLAs are typically formed by employees and officers in one country, or employees of government agencies including member-retirees.

NSSLAs network drop as the industry consolidates

The NSSLA industry posted a 17.6 percent increase in total resources from ₱189.1 billion in 2017 to ₱222.3 billion as of end-September 2018, mainly due to the 33.2 percent y-o-y increase in loans. Loans, which accounted for 79.7 percent of total resources, climbed during the period in review by ₱44.1 billion to reach ₱177.2 billion.

Chart 1.22. Non-Stock Savings and Loan Associations (NSSLAs)
Asset Growth
As of end-period indicated



Source of Data: BSP

NSSLAs resources rise as loans expand

As of end-September 2018, there was modest improvement in the NSSLA industry's loan and asset quality as the aggregate NPL ratio declined by 1.7 percentage points from 9.9 percent in end-September 2017 to 8.2 percent as of end-September 2018. Moreover, the NPA ratio, consisting of NPL and real and others properties acquired (ROPA), also improved to 6.7 percent as of end-September 2018 from 7.2 percent a year ago. This shows that the credit underwriting standards remained sound despite the industry's increased lending activities.

Members' deposits remain a major funding source

The total liabilities of NSSLAs grew mainly on account of the expansion in the members' deposits which collectively contributed 66.6 percent of total liabilities. This is accompanied by the sustained increase in capital, which continued to be the industry's major funding source with 67.4 percent share to aggregate funds as of end-September 2018. The total capital inched up due to the sustained expansion in paid-in capital from the members and retained earnings.

To further protect the funds of NSSLA members, the BSP approved Circular Nos. 993 and 994 which set the guidelines on: (1) the establishment of the true identity and eligibility of persons to become NSSLA members, and (2) the determination of the propriety of NSSLAs' fund investments in January 2018. In particular, Circular No. 993, the Know-Your-Member (KYM) guidelines set a clear expectation on the responsibilities of the Board of Trustees and Management of NSSLAs to establish and implement effective risk management system and risk control mechanisms. This is to prevent the use of NSSLAs, by unscrupulous persons, as a means to profit or to take advantage of their nature and operations.

Similarly, the NSSLA members are also protected through the approval of rules and regulations covering the NSSLAs' investments using their unused or excess funds. Said guidelines clearly define the allowable investments and limit of such investments that NSSLAs can enter into. These investments, which must not exceed 10 percent of the NSSLA's total assets, unless otherwise approved by the BSP-Monetary Board, must be safe, readily marketable, high grade and locally-issued.

In October 2018, the BSP issued Circular No. 1013 amending certain provisions in the existing rules governing prejudicial acts, practices or omissions in regulating and supervising the NSSLAs. The new guidelines aim to impose the minimum requirements and standards to ensure the judicious utilization of credit, and the sound, stable and efficient operations of NSSLAs that would allow for the provision or establishment of additional savings and credit facilities in a fair manner to NSSLA members; and curtail or prevent acts, practices or omissions of NSSLAs which are prejudicial to their members' interests.
At the same time, the BSP also approved Circular No. 1016 requiring NSSLAs to designate a compliance risk management and appoint a chief compliance officer (COO) to ensure the safety and soundness of its operations and activities.

Pawnshops

There were a total of 1,013 pawnshops with 11,094 branches nationwide as of end-December 2018.

Pawnshops have one of the largest office network among NBFIs

The wide network of pawnshops helped extend credit to the unbanked or underserved segments of the population particularly those belonging to the low-to-middle income class, which is consistent with the BSP's financial inclusion advocacy.

In terms of geographical distribution, pawnshops are heavily concentrated in the Luzon Area comprising 53 percent of the total network nationwide while Visayas and Mindanao have 25 percent and 22 percent share in the network, respectively. The regions with most number of registered pawnshops are the National Capital Region (29 percent), CALABARZON (24 percent) and Central Luzon (21 percent). Meanwhile, the size of the pawnshops' network paved the way for the BSP's strategic shift to a network-based supervision and regulation of the pawnshops and their corollary businesses (i.e., remittance and/or money changing/foreign exchange dealing operations).

Pawnshops as multiservice providers

The pawnshop industry has evolved beyond traditional operations as a number of industry players started offering corollary/money service business (MSB) activities such as remittances and money changing, and other kinds of cross-selling activities such as distribution of micro-insurance. With the evolving business models of the pawnshops, these regulations are also being calibrated to handle these developments.

Among others, different license classifications, taking into account the level of complexity of the pawnshops have been introduced and implemented as follows: [30]

Type	Description
"A"	Basic pawnshop business with not more than 10 offices.
"B"	Basic pawnshop business with more than ten (10) offices and with or without BSP-registered corollary business activities excluding remittances.
"C"	Basic pawnshop business with more than ten (10) offices and with BSP-registered corollary business activities including remittance operations.
"D"	Virtual pawnshop operators or those engaged in pawnshop business through electronic pawning (e-pawning) which refer to systems and processes that enable customers to pawn their personal property through electronic channels.

Following the signing in the latter part of 2017 of the Memorandum of Agreement (MOA) between the BSP and the Chamber of Pawnbrokers of the Philippines, Inc. (CPPI), partnership with the pawnshop industry continues to be strengthened. The MOA aims to:

(1) Enhance the collaboration and cooperation between BSP and CPPI;
(2) Strengthen the supervision and regulatory oversight of BSP; and
(3) Encourage active participation of CPPI in BSP's advocacies on financial inclusion and education, as well as consumer welfare.

Money Service Businesses (MSBs)

The BSP issued Circular No. 942 dated 20 January 2017 to strengthen its regulatory oversight over MSBs.

[30] Circular No. 938 dated 23 December 2016.

Pawnshops lead MSB operations

The Circular aims to streamline the supervisory oversight of the BSP over MSBs and to ensure a level playing field conducive to the growth of the parallel and formal banking market. Remittance and Transfer Companies (RTC) refers to an entity that provides Money or Value Transfer Services and one of the financial institutions introduced in the Circular. Other MSBs include Remittance Agents (RAs), Remittance Platform Providers (RPPs), and E-money Issuers (EMI). The Circular also strengthened the regulation and supervision of the BSP over MSBs through the adoption of network approach wherein the entity that operates a remittance business shall be held responsible for the operation of its remittance network and accreditation of its Remittance Sub-Agents (RSAs).

The Circular requires MSBs to re-register with the BSP and secure a Certificate of Registration (COR) to operate a remittance and transfer company (RTC) and/or money changing/ foreign exchange dealing (MC/FXD) business. MSBs with more than one (1) branch are required to register, through their head office, with the BSP while branch office/s and single RSAs shall be subject to notification requirements.

As expected, the geographical distribution of MSBs is similar to that of the pawnshop industry since most of the registered pawnshop offices have registered corollary businesses. MSBs are mostly located in Luzon which comprise 59 percent of the total network nationwide while Visayas and Mindanao have 23 percent and 18 percent share in the network, respectively. The regions with the most number of registered entities in Luzon Area are the National Capital Region (34 percent), CALABARZON (23 percent) and Central Luzon (20 percent).

Based on the registration requirement under Circular No. 942, there were 950 MSBs with 14,428 branches broken down as follows[31]:

	As of 31 December 2018		
	Head Office	**Branch**	**Total**
A. Pawnshop with MSB	*190*	*9,705*	*9,895*
Pawnshop with RTC	53	2,297	2,350
Pawnshop with FXD/MC	40	89	129
Pawnshop with RTC/FXD/MC	97	7,319	7,416
B. Standalone MSB	*760*	*4,723*	*5,483*
RTC	89	2,185	2,274
FXD/MC	507	272	779
RTC/FXD/MC	164	2,266	2,430
Total MSBs	***950***	***14,428***	***15,378***

Electronic Money Issuers (EMIs)

Since the issuance of Circular No. 649 in 2009 which provides the guidelines for e-money operations and issuance, the e-money product has expanded with the increase in usage and adoption in the Philippine market.

E-money shows greater usage

The amount and number of inflow and outflow transactions in the e-money system, including the outstanding balances, exhibits stable growth from 2010 to 2017. The increasing number of licensed EMIs and e-money agents enabled access to financial services to remote and far-flung areas where banks/financial institutions' presence is fairly limited. As of end-December 2018, EMI licenses are spread out across banks (30 EMI-banks), NBFIs (two EMI-NBFIs) and Others (nine EMI-Others).

[31] Preliminary data as of end-December 2018

Box Article 2

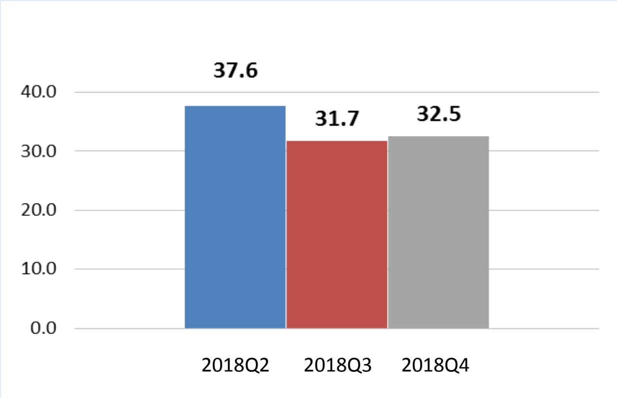
Household Debt Situation in the Philippines: Trends in the Consumer Expectations Survey (CES)

The CES is a household-based survey on consumer sentiment in the Philippines. About 5,000 sample households are covered in the quarterly CES, almost equally allocated between the NCR and areas outside NCR (AONCR). In Q2 2018, the CES was expanded to include key debt indicators, as approved by MB Resolution No. 1802 dated 26 October 2017. The generation of data on household debt provides present/advance information on the current-, near-term and year ahead, along with consumer tendencies on debt-related behavior/intentions of households to avail loans and their experience in paying their debt.

Overview

The results of the Q2 2018[1] CES showed that more than one-third of the total number of households (37.6 percent) or 2,010 households have outstanding loans[2] during the survey period. The percentage of households with outstanding loans fell to 31.7 percent in Q3 2018[3] but increased to 32.5 percent in Q4 2018[4] (see Figure 1).

Figure 1: Percentage of Respondents and/or Spouse with Outstanding Loan



Source: BSP

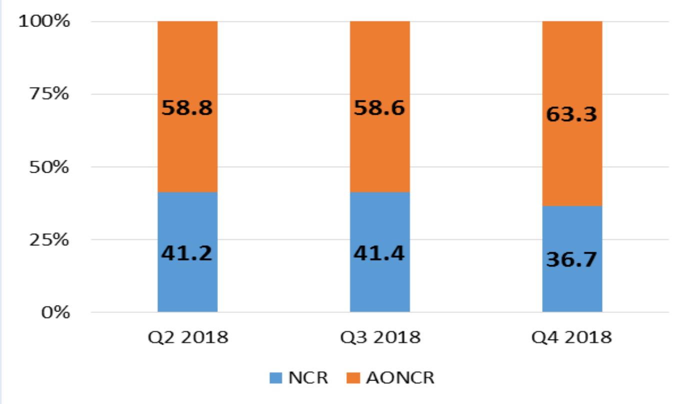
Drivers of Household Debt

A breakdown of the survey results by area and by income group showed more detailed information on the drivers of household debt. In Q2 2018, more respondents in the AONCR (58.8 percent) reported having outstanding loans compared to those in the NCR (41.2 percent). This percent share was almost the same in Q3 2018. In Q4 2018, the quarter-on-quarter trends reversed when compared to Q2 and Q3 2018, as the share of respondents with outstanding loans in AONCR increased to 63.3 percent while the share of NCR respondents decreased to 36.7 percent (see Figure 2).

---

[1] The Q2 2018 CES was conducted on 2 – 14 April 2018.
[2] Outstanding debt/loan pertains to the unpaid balance of loans by households (i.e., respondent and/or his/her spouse/partner) that was reported active at the time of the interview.
[3] The Q3 2018 CES was conducted on 1 – 14 July 2018.
[4] The Q4 2018 CES was conducted on 1 – 13 October 2018.

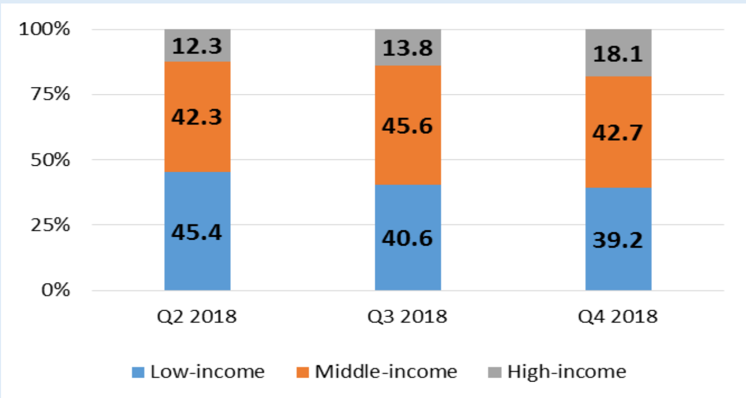
Figure 2: Percentage of Respondents and/or Spouse with Outstanding Loan by Area



Source: BSP

By income group, most of the households with outstanding loans in Q2 2018 belonged to the low-income group[5] at 45.4 percent, while 42.3 percent and 12.3 percent belonged to the middle-income group[6] and the high-income group[7], respectively. However, beginning Q3 2018, the bulk of households with outstanding loans shifted to the middle-income group. While this remained true in Q4 2018, the increase in the percentage of respondents with outstanding loans from the high-income group was notable. Meanwhile, there was a decreasing trend in the share of respondents with outstanding loans from the low-income group from Q2 to Q4 2018 (see Figure 3).

Figure 3: Percentage of Respondents and/or Spouse with Outstanding Loan by Income Group



Source: BSP

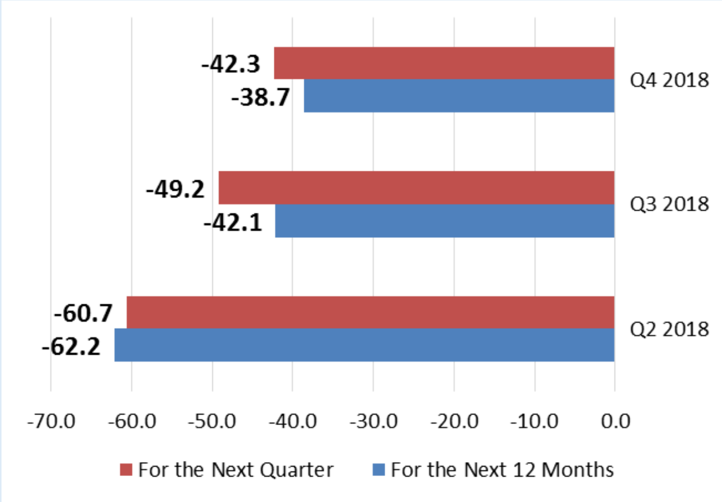
Consumer Outlook on Debt

Other aspects of household indebtedness captured by the expanded CES are consumers' perceptions on their loan situation[8] for the next quarter and the year ahead as well as their experience in paying their debt.[9]

[5] Low-income refers to households with monthly family income of less than ₽10,000.
[6] Middle-income refers to households with monthly family income between ₽10,000-₽29,999.
[7] High-income refers to households with monthly family income of more than ₽30,000.
[8] A positive CI indicates that more households expect that their outstanding loan will increase, while a negative CI indicates that more households expect that their outstanding loan will decrease.
[9] A positive CI indicates that more households have an easy experience in paying their debt, while a negative CI indicates that more households find it difficult to pay their debt.

According to respondents, they expected their outstanding loans to decline for the next quarter and the next 12 months, but the number that said so was lower in Q4 2018 compared to both Q2 and Q3 2018 survey results (see Figure 4).

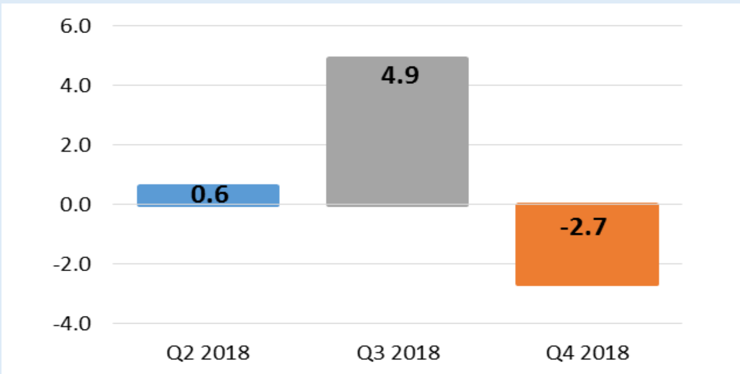
Figure 4: Debt Situation Outlook



Source: BSP

Both Q2 and Q3 2018 survey results showed that respondents viewed their overall experience in paying household debt in the last 12 months to be easy at 0.6 percent and 4.9 percent, respectively. However, the index on debt payment experience turned negative at -2.7 percent in Q4 2018. This means that more respondents found it difficult to pay for their debts, compared to those who said easy, due to the following factors: (a) not enough income/budget deficit/have no capacity to pay; (b) unstable job; (c) prioritized other household expenses; (d) high interest rate; and, (e) business is down.

Figure 5: Debt Payment Experience



Source: BSP

External Sector

Balance of Payments

BOP position for full-year 2018 registers higher deficit

The BOP position for full-year 2018 posted a deficit of US$2.3 billion, significantly higher than the US$863 million deficit recorded a year ago.

Balance of Payments (in million US$)	Jan-Dec	
	2017	2018
Current Account	-2143	-7879
Capital Account	69	65
Financial Account	-2798	-7832
Net Unclassified Items	-1588	-2324
Overall BOP	**-863**	**-2306**

This development was brought about by the rise in the current account deficit as the trade-in-goods deficit continued to widen. Meanwhile, the financial account net inflows were markedly higher during the year, boosted by the reversal of the other investment account to net inflows from net outflows in 2017, along with the reduced net outflows of portfolio investments. This positive outcome more than offset the lower net inflows of direct investments.

The current account posts a higher deficit

The current account (CA) yielded a deficit of US$7.9 billion (2.4 percent of GDP) in 2018, higher than the US$2.1 billion deficit (0.7 percent of GDP) registered in 2017. This developed as the widening deficit in the trade-in-goods account more than offset the higher net receipts posted in the trade-in-services, as well as in the primary and secondary income accounts.

- The trade-in-goods deficit for full-year 2018 rose by 21.9 percent to US$49 billion, reflective of the 9.4 percent expansion in imports of goods and the 0.3 percent decline in exports of goods. Exports of goods dropped to US$51.7 billion in 2018 from US$51.8 billion in the previous year owing mainly to lower export shipments of coconut and mineral products. The 26.1 percent decline in export shipments of coconut products followed the fall in coconut oil price in the world market price even as export volume increased. Exports of mineral products dropped by 5.9 percent on account of the decreased exports of gold. Lower exports of sugar and products, and other agro-based products were also recorded during the year. These declines more than negated the higher exports of manufactures, and fruits and vegetables.

- Imports of goods expanded to US$100.7 billion in 2018 from US$92 billion in 2017. The 9.4 percent increase was attributed to higher imports across all major commodity groups, notably raw materials and intermediate goods, indicating increased domestic production activity. Imports of raw materials and intermediate goods grew by 16.7 percent to reach US$37.6 billion, supported by increased importation of manufactured goods (20.4 percent) and higher purchases of materials and accessories for the manufacture of electronic products (60 percent). Imports of mineral fuels and lubricants, capital goods, and consumer goods expanded by 21.3 percent, 5 percent, and 7.6 percent, respectively.

- Net receipts in the trade-in-services account aggregated to US$10.5 billion in 2018, 20.7 percent higher than the US$8.7 billion net receipts posted in 2017. This developed on account largely of increased net receipts in technical, trade-related and other business services;[41] manufacturing services; and telecommunications services, combined with lower net payments in travel services. The gains registered in these service categories more than offset the higher net payments in government goods and services, charges for use of intellectual property, and the reversal of the personal, cultural, and recreational services to net payments from net receipts in 2017.

- The primary income account posted net receipts of US$3.8 billion in 2018, 19.2 percent higher than the US$3.2 billion net receipts in 2017. The growth was attributed to the 4.6 percent increase in net compensation inflows amounting to US$8.1 billion from US$7.8 billion in 2017. Another growth driver was the 5.7 percent decline in net payments of investment income, arising from decreased interest payments on other investments (by 99.3 percent) and portfolio investments (by 7.9 percent). Similarly, net payments of dividends to portfolio investors abroad were lower during the year (by 8.1 percent). Moreover, the 28 percent improvement in interest receipts on reserve assets (US$1.2 billion in 2018 from US$949 million in 2017) also contributed to the overall growth of the primary income account.

- Net receipts in the secondary income account grew by 2.6 percent growth in 2018 to reach US$26.8 billion. The improvement was attributed largely to the 2.8 percent increase in remittances of non-resident OF workers amounting to US$24.8 billion during the year.

[41] Estimated earnings from BPO services grew by 2.9 percent in 2018 to reach US$21.2 billion.

The CA balance mirrors the saving and investment behavior of the economy. The rise in investments and infrastructure spending over the last three years has resulted in the narrowing of the savings-investment (S-I) gap. Nonetheless, the CA deficit remains financeable, with continued robust inflows from structural sources of foreign exchange – foreign direct investments (FDI), overseas Filipinos' remittances, business process outsourcing revenues, as well as tourism receipts. These accounts continue to provide a buffer for the domestic economy despite external headwinds. The country's external debt metrics have also steadily improved along with an adequate level of gross international reserves (GIR) to meet any unforeseeable demand for the country's immediate obligations – imports and short-term debt.

The economy also has enough policy space to ward off the potential adverse effects of external shocks. For example, the BSP can deploy liquidity-enhancing measures similar to those adopted during the height of the Global Financial Crisis when there was severe liquidity tightening globally.

At the same time, while the country is able to rely on sufficient buffers in the external sector, the National Government has been pursuing strategies to boost our exports and competitiveness, especially amid increasing risks from the rise of trade protectionism which can dampen global growth prospects. The continued adoption of policies to further improve the country's export competitiveness remains essential over the medium term. Over time, as competitiveness issues and infrastructure gaps are addressed, this would lead to the expansion of the economy's productive capacity and to increased FDIs, lending support to sustainable economic growth. This could then result in a subsequent rise in goods exports, eventually alleviating the current account deficit.

Capital account registers lower net receipts

The capital account recorded lower net receipts of US$65 million in 2018. This resulted from the reversal to gross acquisition of non-produced non-financial assets of US$10 million from gross disposal of US$1 million a year ago.

The financial account doubles net inflows

The financial account continued to register net inflows of US$7.8 billion in 2018, more than double the US$2.8 net inflows recorded in 2017. This resulted from the reversal of the other investment account to net inflows from net outflows in 2017, and lower net outflows of portfolio investments during the year. These more than compensated for the lower net inflows of direct investments.

Direct investment account. Net inflows of direct investments amounted to US$5.9 billion in 2018, lower by 15.8 percent than the US$7 billion net inflows recorded in 2017. This was due mainly to the 4.4 percent decline in FDI brought about by the drop in non-residents' net equity placements by 33.3 percent to US$2.3 billion in 2018. Capital infusions during the year were channeled to the manufacturing, financial and insurance, real estate, electricity, gas, steam and air conditioning supply, and arts, entertainment, and recreation industries. These were sourced mostly from Singapore, United States, Hong Kong, Japan, and China. Net investments in debt instrument totaled US$6.7 billion during the year from US$6 billion in 2017.

Meanwhile, residents' net investments abroad rose to US$3.9 billion in 2018, up by 19.5 percent from its level in 2017. This was due to the surge in residents' net placements in debt instruments issued by foreign affiliates, which more than doubled to reach US$3 billion in 2018 from US$1.4 billion in 2017.

Portfolio investment account. Net outflows of portfolio investments in 2018 amounted to US$858 million, 65 percent lower than the US$2.5 billion net outflows posted in 2017. This stemmed mainly from the reversal of FPI to net inflows of US$3.4 billion from net outflows of US$796 million in 2017. In particular, non-residents' net placements in debt securities issued by local banks and the NG amounted to US$1.5 billion and US$3.1 billion in 2018, respectively. Meanwhile, residents' investments abroad rose to US$4.2 billion in 2018 from US$1.7 billion in 2017 as investments in foreign debt securities expanded to US$4.4 billion (from US$915 million).

Other investment account. The other investment account posted net inflows of US$2.8 billion in 2018, a turnaround from US$1.8 billion net outflows posted in 2017. This developed on account of residents' net disposal of financial assets which amounted to US$669 million (from net acquisition of US$2.3 billion) and increase in residents' net incurrence of liabilities to US$2.1 billion in 2018 (from US$508 million). In particular, residents' net withdrawal of currency and deposits abroad amounted to US$1.3 billion from net placements of US$1.5 billion in 2017. Net loan availment by residents from foreign creditors reached US$3.1 billion in 2018 from the US$676 million net repayments in 2017.

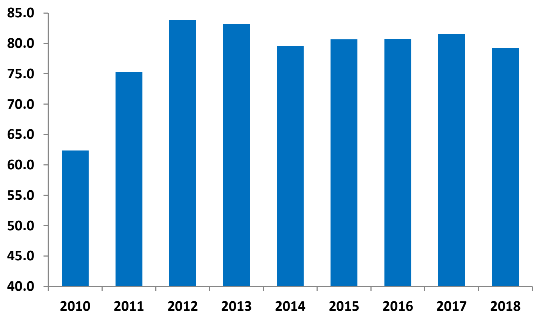
Financial derivatives. Trading in financial derivatives resulted in a higher net gain of US$53 million in 2018 from US$51 million in the previous year.

International Reserves. The country's gross international reserves (GIR) amounted to US$79.2 billion as of end-December 2018, lower compared to the recorded level of US$81.6 billion in the previous year. At this level, the GIR nonetheless remains adequate as it can cover 7 months' worth of imports of goods and payments of services and primary income. Equivalent to 6 times the country's short-term external debt based on original maturity and 4.1 times based on residual maturity.

International reserves remain more than adequate

The y-o-y decrease in reserves was due mainly to lower inflows from the BSP's foreign exchange operations, revaluation adjustments on its gold holdings resulting from the decrease in the price of gold in the international market and lower BSP holdings of Special Drawing Rights (SDRs) in the International Monetary Fund (IMF). This was partially offset by increased inflows from BSP's investments abroad, and higher BSP reserve position in the IMF.

Chart 1.23. Gross International Reserves
in billion US dollar

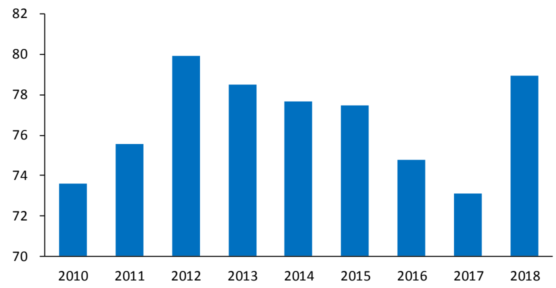


Bulk of the country's reserves or 84.3 percent of the total reserves was held in foreign investments. Meanwhile, 10.3 percent were in gold and the remaining 5.4 percent were in holdings of SDRs, the BSP's reserve position in the IMF, as well as in foreign exchange.

Net international reserves (NIR), which refer to the difference between the BSP's GIR and total short-term liabilities, amounted to US$79.2 billion as of end-2018, a decrease of US$2.4 million from its level a year ago.

External Debt. The Philippines' outstanding external debt stood at US$79.0 billion as of end-2018, up by US$5.9 billion (or 8.0 percent) from the US$73.1 billion level as of end-2017.

Chart 1.24. External Debt
in billion US dollar



Source: International Operations Department (IOD)-BSP

The country's level of external debt has exhibited a general downward trend from end-2012 (US$79.9 billion) to end-2017 (US$73.1 billion). However, as of end-December 2018, the debt stock grew to US$79.0 billion (or by 8.0 percent from the end-2017 level) due largely to net availments by both public (US$3.5 billion) and private sectors (US$3.2 billion). Specifically, this is attributed to the National Government (NG)'s increased financing for its infrastructure development and social spending programs, private banks' preparation for the increase in the Liquidity Coverage Ratio (LCR) threshold under the Basel 3 liquidity rule and to source funding for purchases of RP bills while other private firms decided to increase working capital, expand funding base, and extend term liabilities. Prior periods' adjustments (US$594 million) further increased the debt levels. However, the increase in resident holdings of Philippine debt papers issued offshore (US$1.2 billion) and negative FX revaluation adjustments (US$125 million) partially tempered the sharp increase in the debt stock during the year.

As of year-end, the maturity profile of the country's external debt remained predominantly medium- to long-term (MLT) in nature [i.e., those with original maturities longer than one (1) year], with share to total at 79.7 percent (US$62.9 billion), lower than 80.5 percent (US$58.8 billion) a year ago. Nonetheless, FX requirements for debt payments are well spread out and, thus, more manageable. Short-term (ST) loans [or those with original maturities of up to one year] stood at US$16.1 billion by the close of 2018 and accounted for the 20.3 percent balance of the debt stock.

External debt remains resilient

Private sector foreign borrowings substantially increased to US$39.3 billion during the year despite declining in recent years (from US$39.2 billion in 2015 to US$35.6 billion as of end-2017) in view of: a) commercial banks' issuance of bills and notes offshore to diversify sources of liquidity and extend term liabilities; b) to comply with the increase in the LCR threshold as specified by the Basel 3 liquidity rule; and c) to fund purchases of RP bills, among others. Likewise, public sector external debt grew by US$2.2 billion (from US$37.5 billion in 2017 to US$39.7 billion in 2018), which is reflective of the sizeable increase in foreign borrowings by the NG to fund its infrastructure and social spending programs.

The key external debt indicators remained at comfortable levels during the period in review. The debt service ratio, which relates principal and interest payments to exports of goods and receipts from services and primary income, was recorded at 6.3 percent for January to December 2018 from 6.2 percent recorded for the same period a year ago due to larger payments made during the 12-month period (January 2018 – December 2018). The DSR has also 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 external debt expressed as a percentage of Gross National Income (GNI), slightly increased to 19.9 percent from 19.4 percent a year ago due to the higher debt stock. The same trend was observed using GDP. Despite the significant increase in the level of external debt during the year, the Philippines' sustained positive economic growth resulted only in a slight increase in the external debt to GDP ratio from 23.3 percent as of end-2017 to 23.9 percent as of end-2018. This indicates the country's sustained capacity to service maturing foreign obligations.

What We Did in 2018: Three Pillars of Philippine Central Banking

Price Stability: Monetary Policy Stance Remains Supportive of Economic Growth

Monetary Policy. During its policy meetings on 10 May, 20 June, 9 August, 27 September, and 15 November 2018, the BSP decided to raise its key policy rate by 25 basis points (bps), 25 bps, 50 bps, 50 bps, and 25 bps, respectively, bringing the rate for the overnight reverse repurchase or RRP facility to 4.75 percent. The interest rates on the overnight lending and deposit facilities were likewise raised accordingly. This brought the cumulative policy rate increase to 175 bps during the year.

The BSP raises policy rates five consecutive times

Amid persistent signs of sustained and broadening price pressures as well as elevated inflation expectations in 2018, the BSP decided to raise the BSP policy interest rate five consecutive times to anchor inflation expectations and to safeguard the inflation target over the policy horizon. Given the baseline forecasts indicated that future inflation path was higher for 2018-2019, BSP believed that a tighter monetary policy stance would help steer inflation towards a target-consistent path over the medium term by reducing further risks to the inflation outlook, including those emanating from the continued uncertainty in the external environment amid tighter global financial conditions, trade tensions among major economies, and the normalization of monetary policy in advanced economies.

Equally important, the BSP believed that prospects for the domestic economy remained generally favorable and allowed some scope for calibrated adjustments in the policy rate to rein in inflation expectations and preempt further second-round effects. The BSP likewise reiterated its support for carefully coordinated efforts with other government agencies in implementing non-monetary measures to mitigate the impact of supply-side factors on inflation.

Meanwhile, during the last monetary policy meeting on 13 December 2018, the BSP decided to maintain its monetary policy settings. The BSP noted that the latest inflation forecasts show a lower path over the policy horizon, with inflation settling within the target band of 3.0 percent ± 1.0 percentage point for 2019-2020. Recent headline inflation readings indicated signs of receding price pressures as constraints on food supply continue to ease with the implementation of various non-monetary measures.

Inflation expectations have also steadied given the decline in international crude oil prices and the stabilization of the peso.

The risks to the inflation outlook have become more evenly balanced for 2019 and leans toward the downside for 2020 amid a more uncertain global economic environment, which could temper inflation pressures from commodity prices in the near term.

Given these considerations, the BSP deemed it prudent for the time being to keep monetary policy settings steady and allow previous monetary responses to continue to work their way through the economy. The BSP reiterated that it remains vigilant against developments that could affect the outlook for inflation.

The BSP emphasized its strong commitment to take further policy action as appropriate to safeguard its price stability mandate.

Loans and Credit. ***The BSP ensured the effective delivery of discounts, loans and advances to banks with temporary liquidity needs consistent with its price stability objective.*** In 2018, the BSP intensified its loan collection efforts; maximized the full potential of technology in delivering loans and advances with the use of the Electronic Rediscounting System (eRS) and Loans and Credit Management Information System (LCMIS) platforms; implemented refinements on existing policies and regulations on its credit facilities; and enhanced the provision of credit through the Credit Surety Fund (CSF).

Total loan availments in 2018 reached ₱71,831.2 million. Majority of loan releases pertain to availments under the BSP's rediscounting facility, of which ₱69,830.4 million went to universal and commercial banks (UKBs), ₱1,642.2 million to thrift banks (TBs), and ₱51.1 million to rural banks (RBs). With rediscounting, banks were able to increase asset growth and expand their loan portfolio by submitting the credit instruments of their borrowers from transactions related to working capital and other service activities, and support importation and trading activities. As such, about 75.0 percent of the loans released went to Other Credits mainly composed of Capital Expenditure, Other Services, and Permanent Working Capital. The remaining 25.0 percent of the loans released went to Commercial Credits composed of Imports and Trading. Meanwhile, loans granted to PDIC amounted to ₱307.5 million during the year.

Temporary rediscounting relief measures were granted to banks in calamity-affected areas in 2018. In addition to regulatory relief, the BSP also granted temporary rediscounting relief to banks affected by Tropical Cyclone "Josie" in Q3 2018. The temporary relief provided a 60-day grace period to settle outstanding rediscounting obligations with the BSP to all rediscounting banks with operations or end-user borrowers in affected areas. The measure also allowed rediscounting banks to restructure with the BSP the outstanding rediscounted loans of their end-user borrowers affected by Tropical Cyclone "Josie" on a case-to-case basis and subject to the terms and conditions stated in the implementing guidelines.

Targets related to the provision of loans and credits were surpassed in 2018. Total gross income from lending operations reached ₱2,561.8 million, significantly exceeding the projected level of ₱1,362.0 million, due to the growth in peso rediscounting and its efficient collection. Loan collections increased to ₱18,090.4 million in 2018 from ₱905.6 million in the previous year, which can be attributed to the capability of the eRS to automatically debit the demand deposit account of borrower banks as the loan falls due. Likewise, the over-all composite past due ratio (PDR) of loans improved to 3.2 percent in 2018 from 4.5 percent in the previous year due to the BSP's heightened efforts to collect loans and implementation of the Monetary Board-approved write-off of uncollectible accounts after all reasonable collection efforts have been exhausted. Furthermore, the credit risks on rediscounting loans were proactively managed through off-site analysis, on-site credit verifications and the conduct of semestral reviews on borrower banks.

The BSP continues to improve the delivery of credit. Projects and policies to enhance the delivery of credit to all productive sectors of the economy were implemented. Among the accomplishments in 2018 were:

- ***Process improvement through eRS and LCMIS.*** Technical assistance programs were provided by the BSP's Department of Loans and Credit (DLC) to banks, covering an in-depth discussion of the BSP's rediscounting facility, documentary requirements for each loan type, and key features of the eRS. The BSP likewise proactively and timely addressed all concerns reported by eRS users during the year. Meanwhile, the BSP continued in developing the LCMIS which started production in 2017. The LCMIS primarily aims to provide immediate delivery of credit, streamline the operations, and centralize and integrate databases of transactions. The Loan Management and Financial Service Modules of the LCMIS were successfully deployed in September 2018. The LCMIS project is expected to be completed by the end of 2019.

- ***Policies.*** On 14 June 2018, the BSP issued Circular 1008 on the Amendments to Pertinent Regulations on Rediscounting Availments and Emergency Loans or Advances to Banking Institutions. In this Circular, the BSP removed the ₱3.0 billion cap per bank on rediscountable National Food Authority papers and established the acceptability of syndicated loans and loans with underlying real estate collaterals under Mortgage Trust Indentures to secure rediscounting and emergency loans. The BSP also issued Circular 1017 on 10 October 2018 which contains the implementing guidelines on the restructuring scheme covering the rediscounting obligations with the BSP of rediscounting banks in areas affected by calamities. The BSP continues to review and undertake studies on credit policies to align with international standards and best practices and to respond to the needs of the changing economic environment.

- ***Expansion of Credit Surety Fund (CSF).*** The CSFs are now under the regulation of the Cooperative Development Authority (CDA) due to the passage of Republic Act No. 10744 or the *Credit Surety Fund Cooperative Act of 2015*. As mandated in the CSF Act, the BSP will continue to promote and organize CSFs nationwide and provide technical assistance such as trainings and seminars in coordination with other public or private stakeholders. In 2018, the coordination efforts between BSP and CDA commenced to implement the provisions of the said law.

Asset Management. The BSP continued to properly administer and dispose its acquired real assets. The BSP is continuously taking measures to expedite the disposal of BSP-acquired properties and management of receivables. Among the initiatives done by the BSP in 2018 to hasten the disposal of properties is the conduct of monthly public auctions, weekly updating of the list of properties available for sale, utilization of social media for the advertisement of BSP-acquired assets for sale, and procurement of appraisal services necessary for the timely pricing of properties.

The total book value of acquired assets stood at ₱14.7 billion as of 31 December 2018, lower by about ₱1.4 billion or 8.6 percent than the previous year's level of ₱16.0 billion.

Through the various asset disposal schemes, the BSP Committee on Disposal of Real Properties auctioned off 1,758 properties with a total net book value of ₱1.2 billion for an aggregate selling price of ₱2.1 billion. This generated an estimated net income of ₱836.3 million, inclusive of interest income of ₱50.4 million that is estimated to be generated over the term of the contracts for installment sales.

The total collections of ₱938.1 million of sales contract receivables which represented 98.1 percent of the total installments due were higher than the target collection rate of 88.0 percent for the year. Interest income earned from the total collections amounted to ₱394.3 million. In addition, the BSP earned a total miscellaneous income of ₱534.7 million, a significant portion of which pertains to realized profit from assets sold on installment basis.

Notes and Securities Printing. The BSP has produced a total of 2.035 billion pieces of banknotes, 2.736 million pieces of judicial title forms, and 76,200 pieces of expense checks, International Operations Department forms, official receipts, and statement of accounts. Meanwhile, a total of 3.704 billion pieces were delivered, consisting of 2.032 billion pieces from in-house produced banknotes, 888.75 million pieces of outsourced finished banknotes, 547.62 million pieces advance deliveries, and

235.45 million pieces existing inventory at the start of the year.

The final acceptance of the Banknote Printing and Finishing Equipment Lines 3 and 4 was completed during the year, with both lines becoming fully operational as of 22 June 2018. The installation and commissioning of the in-line cutting interface with the Automatic Single Notes Inspection System, the Banknote Sheet Inspection Machine, and the Ultrasonic Cleaning Machine was also completed in 2018.

Mint and Refinery. A total of 2.461 billion pieces of coins; 83 pieces of Presidential Medals; 31 pieces of State Decorations; 112,083 pieces of commemorative coins; and 162 pieces of commemorative medals were produced and delivered by the BSP in 2018. At the same time, 11,008.755 troy ounces of panned gold deliveries (with 10,663.181 fine troy ounces of gold) were received from the gold buying stations of the BSP Quezon City and Regional Operations Sub-sector.

Currency Issuance and Retirement. The BSP has continued to provide adequate and timely supply of good quality currency to meet the requirements of the economy. The Metro Manila Currency Operations Sub-sector (MMCOSs) serviced currency requirements of banks in Metro Manila amounting to 2.36 billion pieces of banknotes (equivalent to ₱921 billion) and 1.74 billion pieces of coins (equivalent to ₱3.8 billion). Meanwhile, the Regional Operations Sub-sector (ROSs) shipped banknotes and coins to the regions amounting to ₱508.16 billion and ₱1.88 billion, respectively.

To ensure sufficient supply of banknotes and coins, the BSP introduced improvements in core processes to address backlog in banknote verification, released the New Generation Currency (NGC) coin series, and soft launched the Integrated Currency Management System. In addition, the BSP Regional Offices and Branches located in different parts of the country undertook the following activities: (a) regular assessments of forecasts of currency requirements in the region; (b) strategic scheduling and adoption of more efficient modes of currency shipments; (c) provision of ample buffer stock for unexpected spikes in currency demand or potential delay in currency delivery to the regions; (d) accelerating the verification process to maximize vault space utilization while allowing for quicker turnaround of banks' access to their deposits; (e) servicing bank withdrawals with new and fit banknotes and coins in accordance with their denominational requests; (f) retiring unfit banknotes for immediate replacement with new/fit currency to promote Clean Note and Coin Policy; (g) review/update of currency operation procedures/processes/ practices with the view to improve operational efficiency and internal controls; and (h) ensure access and availability of BSP services across the country by facilitating evaluation of various properties offered for sale for prospective BSP site and possible relocation of existing BSP branches based on the approved criteria set by the Monetary Board for the acquisition of lot.

International Operations. The BSP, through the International Operations Department (IOD), continuously reviews the FX regulatory framework to ensure it remains appropriate to the needs of a dynamic and expanding economy. The recent reforms to the FX regulatory framework of the country are intended to promote vibrant domestic business activities, broaden the financing options and promote portfolio and risk diversification by investors, and support greater integration with regional and global markets.

The current policy thrust of the BSP remains geared towards the liberalization of the FX regulatory framework, facilitating access to the banking system's FX resources for legitimate transactions, and further streamlining of procedures and documentary requirements for FX transactions. The liberalization is being undertaken in a well-calibrated manner, giving due consideration to prevailing market conditions, while ensuring that prudential regulations and safeguard measures (e.g., documentary/

reportorial requirements, registration, monitoring) remain in place.

To date, there have been a total of 10 waves of FX reforms, the most recent of which was implemented through the issuance of BSP Circular No. 984 on 22 December 2017, which became effective on 15 January 2018. The liberalization of FX rules under the Circular focused on foreign loan transactions. The reforms included:

a. Removal of the prior BSP approval requirement for purely private sector foreign loans/ borrowings such that these loans now only need to be registered with the BSP to allow use of banking system resources for loan repayments;

b. Removal of the requirement for BSP registration for certain foreign loans/borrowings of the private sector, provided these are duly reported to the BSP;

c. Further streamlining of procedures and substantial reduction in the documentary requirements to support applications for approval and/or registration of certain foreign loans; and

d. Removal of the US$60,000 daily limit on FX sale by depository banks for the balance of peso deposit accounts of non-residents.

These measures helped mobilize FX resources to finance the development requirements of the economy, facilitated trade in goods and services as well as non-trade transactions, and facilitated increased inflows of foreign portfolio investments.

The BSP also opened a temporary window for six (6) months (from 15 January to 15 July 2018) for foreign loan registration to accommodate foreign loans that previously were not qualified for registration. This initiative helped firms to timely service their foreign loans, enabled the BSP to improve its database and statistics on foreign loans, and allowed analysis of loan transactions on a wider perspective.

The BSP also completed the review of the rules on foreign investments. The draft Circular aims to: (a) further facilitate access to FX resources of the banking system for investments; (b) expand the coverage of investments that can be registered with the BSP; (c) expand the definition of banks allowed to register foreign portfolio investments; and (d) align the concept of foreign investments with the 6th edition of the IMF's Balance of Payments and International Investment Position Manual (BPM6), which presents revised and updated international standards for concepts, definition and classifications for international accounts statistics. The BSP continued engaging with stakeholders in drafting the policy reforms to ensure that the evolving market needs are appropriately considered.

The BSP also completed the preparatory work on the proposed revisions to the Inter-Agency Memorandum of Agreement (MOA) for the effective implementation of the FX rules on physical cross-border transfer of currencies and other monetary instruments, consistent with the BSP's thrust to enhance the dissemination and implementation of these rules.

The BSP continued to adopt a consultative approach in providing FX policy advisory services through telephone inquiries, email and letter exchanges, and meetings. The responses are aimed at promoting greater compliance by stakeholders, particularly banks and their subsidiary/affiliate forex corporations as well as the private corporates/entities, with the FX rules.

The Manual of Regulations on Foreign Exchange Transactions (FX Manual), as amended, which serves as a valuable reference material for the general public, is likewise regularly updated to include the latest amendments to the FX policies so as to provide regular and updated advisory service to the public. Regular updates on the "Frequently Asked Questions" are based on various queries received from clients and other stakeholders for better understanding of existing procedures and rules on FX transactions.

In pursuit of its mandates and thrust to deliver quality service to the public, the BSP also undertakes the following initiatives:

a. Currency Exchange Facility (CEF) Program. The BSP has in place a program for displaced/affected OFs returning from countries experiencing emergencies/unforeseen problems. The CEF provides immediate liquidity assistance by allowing conversion to pesos of returnees' holdings of third currencies with the BSP Head Office and branches as well as banks. The BSP has continued to work closely with the Department of Foreign Affairs (DFA) regarding this Program and in 2018, facilitated the settlement of accounts by the DFA for the third currencies it acquired from the BSP.

b. Amendment of rules on conversion/transfer of foreign currency loans to peso loans. The BSP, under Circular No. 1006 dated 1 June 2018, amended the guidelines on the conversion and transfer of foreign currency loans and real and other properties acquired (ROPA) in the books of the foreign currency deposit unit (FCDU)/expanded FCDU (EFCDU) to peso loans and ROPA in the books of the RBU. The Circular liberalizes the guidelines for the redenomination of FCDU loans by allowing banks, under less stringent conditions, to convert their FCDU/EFCDU loans to peso loans without prior BSP approval, given the current US dollar-Peso exchange rate conditions.

c. Currency Rate Risk Protection Program (CRPP). The BSP, through the issuance of Circular Nos. 1014 and 1015, issued on 24 September 2018 and 5 October 2018, respectively, updated the CRPP in order to help ease the demand pressures in the FX market. The CRPP is a non-deliverable forward (NDF) hedging facility between the BSP and a universal/commercial bank (UB/KB) in response to the request of bank clients desiring to hedge their eligible foreign currency obligations against FX fluctuations.

To increase the public's awareness on BSP's FX regulations and the country's external debt, BSP intensified its information campaign through the following mechanisms:

a. Infographics. The BSP released public advisories in the form of infographics regarding policies on FX transactions and external debt statistics which were posted at the BSP website and the BSP's official social media accounts. The infographics are made in an easy-to-understand manner for clarity and ease of comprehension, and cover topics on FX rules on cross-border transfer of currencies and private sector foreign loans, and on external debt statistics.

b. Export Forum/Exhibits. Similar to previous years, the BSP has participated in the Export Enablers Exhibit at the National Export Congress (NEC) of the Export Marketing Bureau (formerly Bureau of Export Trade Promotion) of the Department of Trade and Industry which seeks to promote the development of the export industry. This year's exhibit was held on 7 December 2018 at the Philippine International Convention Center with the theme "SPICE Up to Scale Up", which stands for Stimulate, Permeate, Innovate, Connect, Export.

c. Study Visits from other Central Banks. The BSP hosted a study visit for the Central Bank of Myanmar (CBM) and the State Bank of Vietnam (SBV) on Foreign Exchange Management on 15-16 October 2018, which is one of the capacity-building initiatives of the ASEAN-5 central banks in support of the financial integration process of the ASEAN member states.

Economic Research and Information Dissemination Activities

Regular reports. The BSP continued to publish regular reports to provide the public information on the macroeconomic and external factors behind its monetary policy actions and to guide expectations on the future path of the BSP monetary policy stance. Among the published regular reports in 2018 were the quarterly Inflation Report, the quarterly Report on Economic and Financial Developments, and the Report on Regional Economic Developments. The BSP likewise published relevant statistical reports on the Balance of Payments (BOP), International Investment Position (IIP), Philippine Flow of Funds (FOF), Selected Economic and Financial Indicators (SEFI), Selected Philippine Economic Indicators (SPEI), and Statistical Bulletin.

Press releases, livestreams and social media. The publication of press communications, in addition to the regular reports, helped the BSP enhance its transparency and accountability mechanisms to the public. Apart from the publication of the highlights of the monetary policy meetings, the BSP published press releases on its monetary policy decisions as well as press releases on money supply, bank lending, and inflation. Press releases on the gross international reserves (GIR), BOP position, foreign direct investments and OF remittances, as well as the results of the quarterly Residential Real Estate Price Index were also published by the BSP.

In 2018, the BSP started to live-stream its monetary policy announcements and briefings on Inflation Report and BOP position via social media (Facebook Live) to expand Filipinos' understanding of monetary policy. The BSP has also enhanced its presence in social media to have direct communication to its stakeholders.

Surveys. The BSP conducted regular surveys in 2018 to supplement information from data releases in aid of better policy-making. Among these surveys were the monthly Private Sector Economists' Survey 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) which monitors residents' holdings of foreign-issued equities and long- and short-term debt securities; the annual and quarterly Coordinated Direct Investment Survey (CDIS), which accounted for the financial transactions and stock of equity and debt between resident companies and their immediate foreign direct investors, direct investment enterprise abroad, and fellow enterprises abroad; and, the quarterly Business Expectations Survey (BES) and Consumer Expectations Survey (CES), which capture the business sentiment and general consumer outlook on future economic conditions. The BSP also conducted the monthly Cross-Border Transactions Survey (CBTS) which covers intercompany accounts for transactions settled through accounts abroad.

In response to the measurement challenges posed by the rapid spread of digital technologies and its accompanying effects on the exchange of goods and services, the BSP introduced in 2018 the quarterly Survey on International Mobile Money Transfer Services (IMMTS).[88]

In line with the BSP's goal in expanding the scope of its macroeconomic and financial surveillance activities, the Department of Economic Research conducted the Corporate Financial Trends Survey (CFTS) in Q3 2018. The survey is designed to collect financial data from the non-financial corporations (NFCs). Prior to the conduct of the survey, a series of information sessions was held in Q3 2018, which served as a venue for consultation and feedback gathering on the survey template. The CFTS was deployed in Q3-Q4 2018 and is expected to provide a more granular analysis of

[88] The said survey monitors information on resident companies' transactions with non-residents involving cross-border remittances and trade-in-goods and services through mobile money platforms. The survey of IMMTS is envisioned to be part of the regular surveys being conducted by the BSP to capture information for the compilation of the BOP and IIP statistics.

corporate finance that could help policymakers understand better the corporate sector and its linkage to the financial system and to the other sectors of the real economy.

Research initiatives. In an effort to continuously improve its economic modeling and forecasting capability, the BSP reviewed and refined its in-house models for inflation and participated in international network meetings on model development and forecasting. Research activities on timely issues and developments affecting the conduct of monetary policy have also been conducted by the BSP in 2018. These included studies on the assessment of monetary policy transmission channels; estimation of neutral real interest rate (NRR); enhancement of the interest rate corridor (IRC), disaggregated 3-digit level CPI, household sector dynamics and monetary policy in the Philippines; review of the potential output and output gap estimation models of the BSP, the flattening of the Phillips curve in the Philippines: the role of the global output gap, foreign exchange interventions, capital flows, and financial vulnerabilities on selected Asian emerging economies, exchange rate dynamics using traditional regression models and support vector machine algorithm; preliminary assessment of the drivers of Philippine foreign exchange market liquidity, contagion risk analysis of cross-border exposure, and dynamics of international reserves under globalized finance; and re-assessment of the sovereign credit ratings of the Philippines.

Information dissemination activities. Aiming to augment public awareness and broaden the discourse on timely issues affecting its operating environment, the BSP organized events such as the annual Exporters' Forum held in March 2018; two rounds of "Conference on Gearing Up for External Competitiveness"(CGUEC) for users of foreign exchange; four Public Information Campaigns (PIC) on inflation developments and outlook; five rounds of PICs relative to the guidelines in securing MB opinion on government domestic borrowings and two Environmental Scanning Exercises (ESE). 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: Tax Reform for Acceleration and Inclusion (TRAIN) law, rebasing of the CPI to 2012, poverty and unemployment trends in the regions, digital payments, and policy principle for Fintech, among others.

The BSP held the 7th Bangko Sentral ng Pilipinas International Research Conference on "Expanding the Boundaries of Central Banking in an Environment of Globalized Finance" in Q3 2018. The BSP also co-hosted the 4th Annual Public Policy Conference on Harnessing the Fourth Industrial Revolution: Creating Our Future Today in Q3 2018 for the celebration of the Development Policy Research Month (DPRM).

To reinforce its close working ties with the academe, the BSP continued to organize the BSP-University of the Philippines (UP) Professorial Chair Lectures. Research studies and lectures covered in the said conference include nowcasting inflation rate, measuring market risk, cryptocurrency, big data, corporate governance issues, and incomplete contracts and regulation that govern the provision of water and wastewater services in Manila.

Inter-agency and multilateral committees. The BSP continued to work towards enhanced relationships with the public and private sectors as it actively participated in local and international committees and working groups. As a resource institution of the Development Budget Coordination Committee (DBCC), the BSP engaged in discussions regarding economic policy and macroeconomic assumptions serving as basis for the preparation of the National Government's (NG's) annual budget and fiscal program. The BSP likewise acted as resource institution in various legislative hearings including BSP Charter-related issues, National Payments Systems Act, NG budget, Rice tariffication bill, TRAIN 2: Tax Reform for Attracting Better and High-quality Opportunities (TRABAHO) bill, TRAIN 2+: sin tax for alcoholic beverages and tobacco products, tax amnesty (general and estate), tax reforms in the sale of gold to the BSP by small-scale miners, inflation update and inflation outlook, impact of suspension of excise tax on oil, and institution of legal framework for the conduct of Islamic banking in the Philippines.

The BSP participated actively in other inter-agency committees, including the National Food Authority Council, Food Security Committee on Rice, Committee on Tariff and Other Related Matters, Financial Stability Coordination Council, and Bureau of Treasury Auction Committee. The BSP is also an active member of statistical committees and working groups involved in the compilation of various macroeconomic, monetary and financial statistics and in the enhancement of statistical standards.

Recognizing the importance of international cooperation and dialogue, the BSP also hosted and chaired the 23rd Executives' Meeting of Asia Pacific (EMEAP) Central Bank Governors and 7th Informal Meeting of EMEAP Governors and Heads of Supervisory Authorities in Q3 2018. The BSP also joined the EMEAP Monetary and Financial Stability Committee (MFSC), Bank for International Settlements (BIS) Research Conference, South East Asian Central Banks (SEACEN) Directors of Monetary Policy/Research, and SEACEN Research Week.

To give recognition to the BSP's government and private stakeholders, the BSP hosted the 15th Awards Ceremony and Appreciation Lunch for Stakeholders in Q3 2018 with the theme "Reinforcing Partnerships, Defying New Challenges", in which 164 awards were given to 38 awardees from the NCR and 126 awardees from AONCR. In Q4 2018, the BSP also hosted the 2018 BSP-DepEd Annual Oratorical Contest with the theme "Exploring Philippine Wonders in Numbers" wherein 16 school divisions from the NCR have participated.

In fulfilling its role as the government's financial advisor on official credit operations, the BSP evaluated a total of 378 requests for MB opinion on proposed borrowings by the NG, local government units (LGUs), government-owned and controlled corporations (GOCCs), local water districts (LWDs), and state university/colleges (SUCs).

Trainings, workshops and technical assistance projects. The BSP conducted in Q2 2018 training/workshop on the production of Consumer and Business Confidence Indices for the Ministry of Economy and Finance of the Kingdom of Cambodia. In Q3 2018, the BSP received technical assistance from the International Monetary Fund (IMF) and the Deutsche Bundesbank by conducting a workshop on Global Integrated Monetary and Fiscal (GIMF) and a training course on Liquidity Forecasting and Market Operations, respectively. The BSP also hosted the SEACEN Course on Financial Cycles and Crises and Intermediate Course on Analytics of Macroeconomics and Monetary Policy Management in Q4 2018 in coordination with the SEACEN Centre.

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 April-June 2018. The VRE completed a research paper entitled "Foreign Exchange Interventions, Capital Flows, and Financial Vulnerabilities in Selected Asian Emerging Economies".

Program and Process Initiatives. The BSP has introduced several refinements to the IRC framework to ensure effective implementation as the size of the Term Deposit Facility (TDF) auctions was gradually scaled up. On 14 February 2018, the BSP started offering a 14-day tenor in its TDF in response to the strong interest of various counterparties for a tenor longer than 7 days but shorter than 28 days following a series of BSP consultations.

The BSP continued to develop the Commercial Property Price Index (CPPI) to have a more comprehensive measure of real property prices. A survey dry run was conducted in order to assess and identify available information from banks' appraisal reports that would provide useful information in the generation of the CPPI.

To enhance the monetary and financial statistics compiled and disseminated by the BSP, the BSP hosted the IMF technical assistance mission to review the progress and improve the quality of statistics collected in the Other Financial Corporations Survey (OFCS). The OFCS, together with the Depository Corporation Survey (DCS), will complete the monetary statistics framework, thus providing a more comprehensive measure of the claims (by debtor sector) and liabilities (by creditor sector) of the entire financial system.

The BSP completed the 2010 Philippine Financial Social Accounting Matrix (PFSAM) which connects the multi-industrial relationships in production to multi-sectoral distribution of income, consumption, investment in fixed assets, non-produced assets and financial instruments in the economy as well as its interaction with the rest of the world.

To complement its survey initiatives, the BSP launched the BSP E-Survey Portal which features an online questionnaire, a database and an application for data maintenance and consolidation system. In 2018, the portal's registered users increased to 1706 representing 1335 institutional respondents to the CBTS Survey. This is a considerable increase from 2017 registered users of 860 which constituted at least 400 institutional respondents.

To fully harness the potential of big data in policy-making at the BSP, the DER has established the Macroeconomic Big Data Lab and Analytics Hub (Lab and Hub) as a venue for exploration of methods and solutions for processing and extracting data that may be a source of useful information/insights on the BSP's various research and operations (such as monetary policy analysis and assessment, economic modeling, and generation of statistics/indices). The Lab and Hub will also serve as a sandbox or testing site for new indicators that will be generated before they can be used as complementary or supplementary variables in aid of monetary policy formulation/assessment.

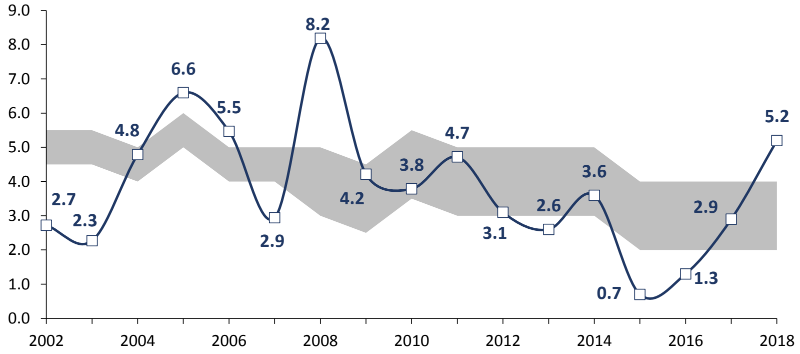
Box Article 3

Monetary Policy Amid Supply-Side Challenges: The Philippine Experience in 2018

Philippine inflation has been low and stable in recent years, even falling below the set target in 2015 and 2016. Hence, the surge in inflation rate for most of 2018 became all the more significant and palpable, raising concerns that prolonged inflation can raise public's expectations for future inflation.

The BSP is responsible for maintaining price stability, which operationally translates to ensuring that headline inflation remains within the government-announced target range (**Figure 1**).[1] To achieve its goal of low and stable inflation, the BSP conducts monetary policy, particularly, by adjusting its policy rate (the overnight reverse repurchase rate) to influence market interest rate and in so doing affect household and firm demand. However, this process becomes more complicated when supply-side forces are driving price increases. For this reason, one of the most important aspects of monetary policy is assessing the dynamics and determinants of inflation.

Figure 1. Headline Inflation (2012=100)
year-on-year in percent



Sources: Philippine Statistics Authority (PSA) and BSP

Dynamics of Philippine Inflation in 2018

Annual headline inflation rose sharply in 2018, driven largely by supply-side factors, including rising global oil prices, weather-related supply disruptions, and higher excise taxes. International crude oil prices have been on a steady uptrend especially during the start of the year driven by geopolitical tensions and major oil producer policies to curb output. Global crude oil prices (Dubai crude oil) averaged around US$69.13 per barrel[2] in 2018, higher by 30.1 percent compared to the previous year. As a net oil importer, the Philippines is highly sensitive to energy price movements, which are mostly influenced by external developments.

Food prices also started to increase as adverse weather conditions and typhoons resulted in supply disruptions. The impact of these supply shocks are particularly strong especially when the share of food in the Philippine CPI basket is large.[3] Food inflation increased significantly in 2018 to 6.6 percent from 3.2 percent in the previous year.

---

[1] The target-setting process is coordinated between government economic agencies under the Development Budget Coordinating Committee (DBCC). The National Government, through the DBCC, sets the inflation target two years ahead in consultation with the BSP.

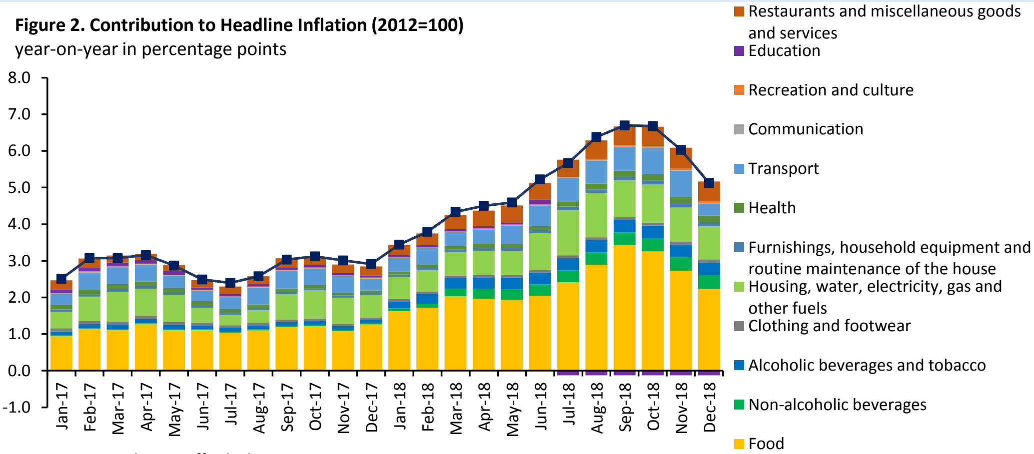
[2] Using crude oil (petroleum), Dubai Fateh 32 API. Source: International Monetary Fund (IMF) Commodity Prices, https://www.imf.org/en/Research/commodity-prices

[3] Food commodity in the Philippines accounts for around 35.5 percent of the total CPI basket.

The implementation of the tax reform measures in 2018 also exerted upward pressures on inflation. The excise tax on sugar-sweetened beverages and domestic petroleum products (i.e., gasoline, diesel, and liquefied petroleum gas) contributed to the increase in food and non-food inflation during the year.

As a result of these price developments, signs of second-round effects have emerged. Transport groups petitioned for minimum fare hikes while labor groups across the country also lobbied for upward adjustments in minimum wages with the end of the 12-month cycle. In sum, a combination of both domestic and external factors pushed actual inflation in 2018 beyond the government's 2-4 percent target range.

Figure 2. Contribution to Headline Inflation (2012=100)
year-on-year in percentage points



Sources: PSA and BSP staff calculations

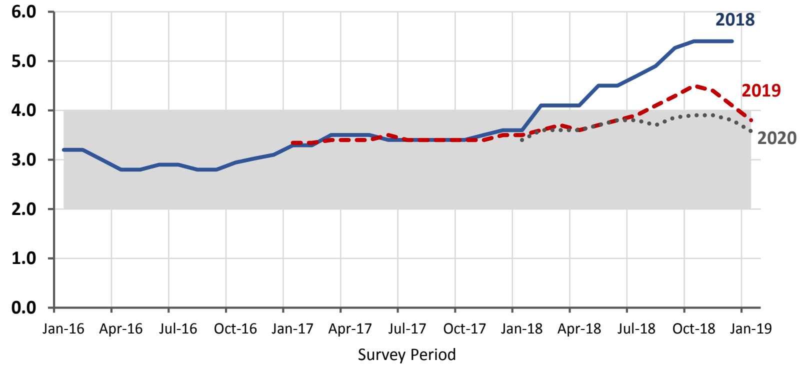
Monetary Policy Response to Supply Shocks

Consistent with the standard approach among central banks in responding to supply-side shocks, the BSP decided to maintain its policy rate in Q1 2018. In a supply shock episode, central banks typically look through first round effects because experience has repeatedly shown that these forces tend to be transitory in nature. Acknowledging the limitations of monetary policy to directly fight supply-side inflation, there are circumstances wherein inflation targeting central banks can justify deviations from the inflation target. For the BSP, the following conditions were included in the explanation clauses under which the target may not be achieved: (1) volatility in commodity prices (agricultural products and oil), (2) natural calamities or events that affect a major part of the economy, and (3) significant reforms in government policies, such as changes in the tax structure, incentives, and subsidies.

Given that price pressures were mainly supply-side in origin, which cannot be effectively addressed by monetary policy, the BSP articulated its support for non-monetary measures by the National Government to directly address temporary price pressures while keeping a close watch on potential second-round effects of high prices. The BSP also carefully communicated its inflation outlook to ensure that the public's inflation expectations do not become disanchored while remaining vigilant and attentive to the risks with the view of charting the appropriate policy course.

However, information beginning in Q2 2018 suggested the emergence of second-round effects along with a sustained rise in inflation expectations. The BSP was of the view that sustained high inflation can unseat inflation expectations and potentially feed into wage- and price- setting behavior. At the time, inflation expectations[4] have been steadily rising, with the mean inflation forecast increasing to about 5.4 percent for 2018 and 4.5 percent for 2019 as of October 2018 survey period. **Figure 3** shows the uptrend in both 2018 and the hump-shaped path for both 2019 and 2020. For these reasons, the BSP believed that more decisive monetary actions were necessary and thus, raised its policy interest rate by a cumulative 175 basis points from May to November 2018.

Figure 3. BSP Private Sector Economists' Survey
Mean forecast for full year, in percent



Source: BSP-DER

The series of policy rate adjustments was intended to rein in the public's elevated inflation expectations and to prevent sustained supply-side pressures from giving rise to further second-round effects, as well as to reduce exchange rate volatility arising from the continued uncertainty in the external environment. The buoyancy of domestic demand suggests room for a calibrated policy response. Equally important to anti-inflation efforts by the BSP was the decisive action of the National Government to implement various non-monetary measures such as, liberalizing rice importation, streamlining administrative processes on importation of key food commodities, and intensified price monitoring of selected food items.

The concerted monetary and non-monetary measures brought expected and positive outcomes. Headline inflation started dissipating in the fourth quarter of 2018 with the last two consecutive months of 2018 recording negative month-on-month inflation. Inflation expectations also began to stabilize, consistent with the BSP's inflation outlook of within-target inflation by 2019 and 2020. The BSP believes that the series of monetary tightening measures in 2018 will help steer inflation toward its desired path over the policy horizon.

[4] Based on BSP's monthly survey of private sector economists.

Box Article 4

Corporate Financial Condition: Some Landscape and Policy Considerations

The rise in leverage among emerging market economies (EMEs) after the GFC in 2007-2009 has been driven mainly by low interest rates and increased access to global capital markets. Studies on the topic show that global drivers of corporate debt in EMEs have included low interest rates in advanced economies (AEs) and search for yield among investors in AEs.[1] In the years following the GFC, particularly as central banks in AEs implemented quantitative easing, corporate issuers took advantage of favorable financial conditions to refinance their debt, with consequent impact on overall leverage.

The landscape

In the case of the Philippines, non-financial corporations (NFCs) have tapped both the banking system and the debt securities markets as sources of funds. In 2016, data from a sample of firms in the Philippines showed debt-to-equity (D/E) ratio at 80.8 percent, which was a decline from 2015's 84.8 percent.[2] On an industry basis, leveraging activities in the electricity, gas, steam and air conditioning supply sector was one of the highest with D/E ratio at 172.4 percent followed by information and communication sector and transportation and storage sector at 146.1 percent and 136.4 percent, respectively (Figure 1). The interplay of push (ample global liquidity, prolonged low global interest rates) and pull factors (robust growth of the Philippine economy) supported the borrowing activities of corporates.

Figure 1. Debt-to-Equity (in percent)

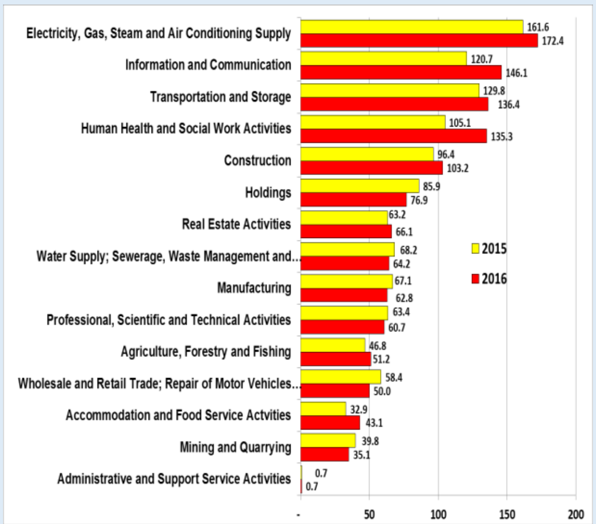
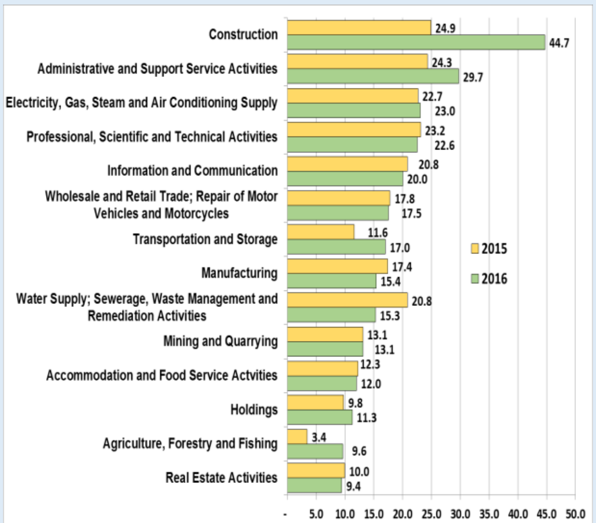


Figure 2. Return-on-Equity (in percent)

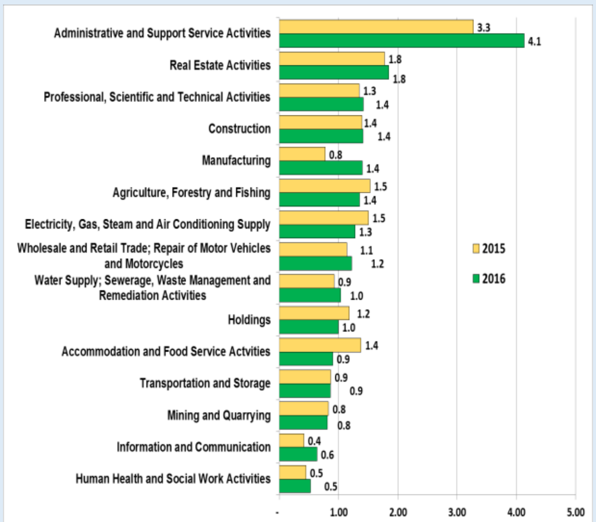


Source: 2016 Audited Consolidated Financial Statements, Staff calculation
Note: D/E ratio is measured as the ratio of total debt and total equity (Figure 1). ROE is measured as the ratio of net income and total equity (Figure 2).

---

[1] S. Elekdag, et al. (2015), Chapter 3: "Corporate leverage in emerging markets- a concern?" IMF Global Financial Stability Report, October 2015.
[2] Ratios are computed based from the 2016 Audited Consolidated Financial Statements of sample firms based on a stratified sampling of BusinessWorld's Top 1,000 corporations representing 15 pre-identified industries based from the 2009 Philippine Standard Industrial Classification or PSIC.

Figure 3. Current Ratio (in percent)



Source: 2016 Audited Consolidated Financial Statements, Staff calculation.
Note: Current ratio is measured as the ratio of current assets and current liabilities.

As borrowing activities among NFCs have increased, firms continued to stay profitable with return-on-equity (ROE) ratios ranging between 9.4 to 44.7 percent in 2016 (Figure 2). In terms of short-term solvency, most sectors remained adequately covered in servicing short-term debt. Firms maintained a reasonable level of current assets to strike a balance between profitability and debt servicing. Current assets as of 2016 were more than cover the short-term debt of firms in most industries (Figure 3).

Data as of 2017 on the country's top holding firms' debt profile indicate that most of their borrowings were largely peso-denominated and contracted at fixed interest rates. This would imply a relatively manageable debt exposure of Philippine NFCs to FX and interest rate risks. Disclosures in the financial statements of sample NFCs also suggested that firms use a combination of natural hedges and derivative hedging to manage FX exposures.[3]

In terms of the refinancing needs of the country's top holding firms, maturities of the combined bank loans and bond issuances were examined. Considering both currency and interest types, 42.5 percent of these firm exposures were denominated in Philippine peso and carried fixed interest rates while 14.1 percent were denominated in foreign currency and had floating interest rates (Figure 4). Data show that, as of end-2017, a larger portion of the bank loans (53.8 percent) of these holding companies was set to mature in less than one year (assumed to have matured in 2018) while 28.2 percent and 18.0 percent had maturities of (i) one to three years; and (ii) more than three years, respectively. During the year, total bonds and corporate issuances had maturities of one to three years (39.2 percent) and more than three years (41.8 percent) (Figure 5).

For the top holding firms under study, the bulk of corporate debt was contracted at fixed interest rates and denominated in Philippine peso. This is a welcome development given that floating interest rate and exchange rate risks are thus limited with respect to this bulk of corporate debt. However, additional funds (for the remaining small portion of top holding firms' debt) may be needed for a certain portion of debt to account for interest rate repricing and foreign exchange movements.

[3] The discussion on holding firms uses data from 2017 Audited Consolidated Financial Statements of the country's top holding companies.

Figure 4. Top Holding Firms' Debt by Currency and by Interest Type (in percent) as of end-2017

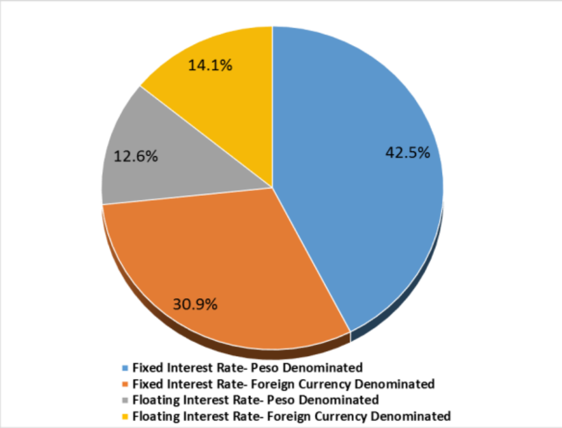
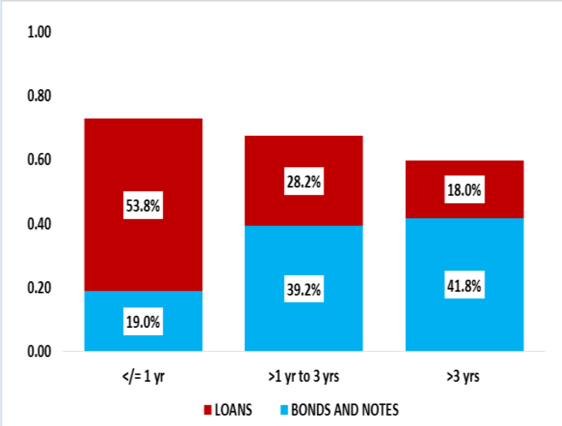


Figure 5. Top Holding Firms' Debt by type and by maturity (in percent) as of end-2017



Source: Audited 2017 Financial Statements

Policy Considerations and Steps Forward

The above analysis partly illustrates how the use of non-financial corporate sector data can potentially enrich the policy-making process. Detailed corporate debt data can, for example, enable a deeper analysis of the impact on corporate balance sheet of policy adjustments with some granularity (i.e. at the firm level). Such data can also allow authorities to more closely examine the linkages between changes in macro-financial conditions and the real economy.

At the same time, data availability remains a key issue in analyzing the corporate sector. Notice that the data presented were not current, with the latest using only 2016-2017 audited financial statements. The currently available information on NFCs is not sufficient to allow the granularity and frequency of information needed to fully quantify the effects of policy decisions or adjustments on the real sector. Hence, development of surveillance metrics will require authorities to address information and analytical gaps. Once necessary inputs and data become available, corporate sector surveillance tools can be utilized with the application of models and empirical methods for both macroeconomic and financial stability analysis.

Prudential Reforms for a Stable Banking System[1]

In 2018, the BSP set its strategic policy objectives aimed at (i) strengthening risk governance and forward-looking surveillance; (ii) leveraging on technology in finance and the use of artificial intelligence; (iii) achieving greater and broader access to financial services; (iv) upholding the integrity of the financial system and safeguarding the interest of the public; and (v) accelerating capital markets reforms, including foreign exchange initiatives. The following are the recent policy issuances and initiatives undertaken by the BSP aimed at achieving these objectives.

Strengthening risk governance and forward-looking surveillance.

In strengthening risk governance, the BSP is guided by the concept of proportionality towards achieving (a) enhanced risk management systems, and (b) sound capital position of supervised financial institutions. These objectives are complemented by the deployment of prompt and calibrated enforcement actions as well as dynamic and forward-looking assessment framework.

Enhanced risk management systems. In an effort to further strengthen corporate governance and promote effective risk management across supervised financial institutions, the BSP has instituted various strategic policy reforms. These reforms aim to plug in the gap with international standards and to provide overarching principles and expectations. Moreover, these aim to raise the bar on risk management, particularly in the areas of liquidity, information technology and cyber security.

- *Liquidity reforms.* To further bolster the liquidity position of the banking system, the BSP embarked on a four-phased program. The liquidity requirements were aimed at ensuring that supervised financial institutions function smoothly not only during normal times but also under stress.

The *first phase* covers the enhancement of the liquidity risk management guidelines which were originally issued in 2006. Since that time, significant local and international events and developments have highlighted the importance of banks' effective management of liquidity risk. The revised liquidity risk management guidelines (Circular No. 981 dated 3 November 2017) are primarily anchored on the Principles for Sound Liquidity Risk Management and Supervision issued by the Basel Committee. The guidelines emphasized the responsibility of the board of directors to clearly define the tolerance for liquidity risk in a manner that can easily be communicated and understood by personnel. The senior management is responsible for the development of funding strategies that are aligned with the set risk tolerance.

The *second phase* is the amendment to the Basel III liquidity coverage ratio (LCR) and the introduction of a minimum liquidity ratio (MLR) requirement for stand-alone TBs, RCBs and quasi-banks (QBs) (Circular No. 996 dated 8 February 2018). The scope of application of the LCR framework was expanded to include not only U/KBs but also their subsidiary banks and QBs which shall be subject to a minimum LCR of 100 percent beginning 1 January 2019. Meanwhile, the stand-alone TBs, RCBs and QBs shall be subject to a separate MLR of 20 percent by 1 January 2019. The MLR is expressed as a percentage of a covered institution's eligible stock of liquid assets to its qualifying liabilities.

The *third phase* covers the adoption of the Basel III Standards on Net Stable Funding Ratio (NSFR) of 100 percent starting 1 January

[1] For the period 1 January – 31 December 2018.

2019. This shall be applicable to U/KBs and their subsidiary banks as well as QBs.

The *fourth phase* will cover the intraday liquidity reporting guidelines. The intraday liquidity monitoring tools aim to enable banking supervisors to better monitor a bank's management of intraday liquidity risk and its ability to meet payment and settlement obligations on a timely basis under both normal and stressed conditions.

- *Risk governance.* The BSP Circular No. 989 dated 4 January 2018 provides guidelines on the conduct of stress testing exercises. This regulation outlines the overarching governance standards and risk management expectations on stress testing practices in the banking industry.

- *Technology and cyber-risk reporting and notification requirements.* In line with increased reliance on and adoption of technology by BSFIs, along with growing concerns on cyber-security, Circular No. 1019 dated 31 October 2018 requires BSFIs to submit regular and event-driven reports covering technology-related information as well as incidence of major cyber-attacks and operational disruptions. The Circular enables the BSP to have an enhanced visibility on the changing IT risk landscape and to proactively ensure that the impact and risks arising from cyber-related incidents and operational disruptions are minimized and contained to avert potential systemic risks to the financial system.

Sound capital position (BASEL III reforms). The Philippines has made significant strides in adopting the Basel III reform package. The pace and sequencing of the reforms have taken into account local market conditions. The Basel III capital and liquidity standards issued by Basel Committee on Banking Supervision (BCBS) that have been adopted by the BSP are as follows:

- *Leverage ratio framework including disclosure requirements.* Circular No. 990 dated 22 January 2018 covers the adoption of a minimum leverage ratio of not lower than five (5) percent as a requirement for universal banks (UBs), commercial banks (KBs) and their subsidiary banks and quasi-banks (QBs) effective 1 July 2018. The Circular allows covered financial institutions until 30 June 2018 to assess their compliance with the said framework and implement measures to meet the requirement. Upon effectivity of the leverage ratio framework, covered banks and QBs must submit the Basel III Leverage Ratio Report along with the Basel III CAR Report quarterly on both solo and consolidated bases. In addition, said financial institutions are required to disclose their leverage ratio in their published balance sheets and annual reports.

Enhanced reporting of banking sector developments and risks. The FSS consistently provided timely and insightful reports to keep management and relevant stakeholders well-informed. In 2018, the FSS continued to brush up the following reports:

- *Enhanced Report on the Philippine Financial System.* It is a semestral report required to be submitted by the BSP Governor to the President of the Philippines and both Houses of Congress. It contains a comprehensive assessment of major developments in the Philippine financial system during the semester. The semestral report was enhanced to reflect featured articles on analytical researches conducted by FSS staff as well as the inclusion of a comprehensive analysis of the Financial Soundness of the Banking System.

- *Banking Stability Risk Analysis (BSRA).* This semestral internal report is now prepared more frequently on a quarterly basis to apprise Management of the holistic assessment of the condition and performance of the banking system. The comprehensive report also highlights key emerging vulnerabilities and risks confronting the banking sector and their potential impact on the system's overall safety and soundness. The BSRA was enhanced to employ technical analyses on a quarter-on-quarter and year-on-year bases in support of the emerging risks identified. The BSRA also contains the supervisory actions taken by the Sector and mitigating measures undertaken by banks concerned to address specific risk exposure. The BSRA also recommends policy measures that will address emerging risks and vulnerabilities.

- *Bank Deposit Interest Rates Report.* It is a quarterly report on bank deposit interest rates for purposes of determining market median rates on deposits and monitoring banks that rely excessively on wholesale, high-cost or volatile deposits/borrowings.

- *Banking Sector Outlook Survey (BSOS).* The BSOS gathers the sentiments of the Presidents/Chief Executive Officers/Country Managers of banks in the country related to their growth outlook and risk assessments, business performance strategies, and insights on regulation and supervision within a two-year horizon. It is also part of the BSP's surveillance toolkit to promote the sustained resilience of the banking system. Moreover, it aims to provide supervisory information and market perspectives on emerging issues and trends for timely and relevant prudential reporting and related analysis. The BSOS was initially rolled-out in June 2018 with the intention to conduct the survey bi-annual in the succeeding years. The maiden report is published in the BSP Website.

Heightened surveillance and research. The FSS remains committed to enhance the quality of policy decisions and strengthen the institution's analytical capacity through the conduct of an empirical research, publications and proactive surveillance of the domestic, regional and global economies as well as updates in international standards to foster an integrated policy response to risks.

Towards strengthening its research function to support supervisory policy initiatives, the FSS has endeavored in preparing empirical research. These include:

- *Do Capital Regulations Influence Banks' Holding of "Excess" Capital?* This study examines universal and commercial banks' (U/KBs'), and their subsidiary thrift banks' (TBs') motives in managing their capital and risks amid the adoption of Pillar 1 and of the Basel III framework on minimum capital requirement as well as estimate the speed at which they adjust their capital.

- *Have Domestic Prudential Policies Been Efficient: Insights from Bank-level Property Loan Data.* This study examines the effectiveness of domestic macro and micro prudential policies in restraining growth of real bank loan commitments and in preserving the quality of bank loans using panel bank data regression from the first quarter of 2014 to the fourth quarter of 2017.

- *Does Expansion of Bank Lending Lead to Weakening of Loan Quality in the Philippines?* This study analyzes whether the expansion of bank lending in the Philippines leads to a deterioration of loan quality given that Basel reforms have been implemented.

- *What is Driving the Behavior of Deposit Interest Rate in the Philippines?* This study analyzes the factors that influence the behavior of deposit interest rates. In addition, the results of the study intends to provide empirical support to some of the widely held assumptions associated with determinants of deposit interest rate such as financial access and expanded banking network, wages and better economic conditions.

- *A Vulnerability Index for the Cross-Border Exposures of Philippine Banks.* This study analyzes vulnerability indicators in cross-border exposures of the Philippine banking system and constructs a composite vulnerability index. The index will in turn help the BSP in determining any incipient risks to banking stability due to possible excessive risk-taking activities in channeling domestic funds across different regions and vice versa.

Achieving greater and broader access to financial services.

The BSP's pursuit of a broader goal on financial inclusion began with the effort to develop a sustainable microfinance in the country through the issuance of regulations on microfinance starting 2001. Over the years, positive developments in the financial inclusion agenda became evident as seen in the following factors:

More financial access points. The overall banks' network of branch and other offices continued to expand as supported by the rationalization of branching guidelines which allowed banks to expand their physical network to strategic locations. Banks were given more flexibility to reach the underserved or unbanked areas with the establishment of branch-lite units.

- *Wider range of products.* Aside from the range of microfinance products (e.g. micro-loans, micro-deposits, and micro-insurance) and agricultural value chain financing, banks are now given more flexibility to expand the range of products and services offered through their branch-lite units. Moreover, the BSP issued Circular No. 992 dated 1 February 2018 setting out the framework for banks to offer a basic deposit account (BDA) to promote account ownership among the unbanked. The minimum key features of the BDA include simplified KYC requirements, an opening amount of less than ₱100, no minimum maintaining balance, no dormancy charges, and maximum balance of ₱50,000.

Adoption of the national retail payment system (NRPS) framework. As the BSP's flagship program to transform the payment system, the NRPS intends to attain the increase in e-payments to at least 20 percent of total retail payments by year 2020. The implementation of the NRPS intends to create a seamless retail payment ecosystem with interoperable systems and processes. Under the NRPS, the BSP is working closely with its supervised institutions for the development of payment schemes that will allow users to conveniently and securely transfer funds from one account to another, in the same or different BSFIs. The two priority Automated Clearing Houses (ACH) are the Philippine EFT System and Operations Network or PESONet (batch fund transfers) and InstaPay (real time, low value transfers). The PESONet was launched on 8 November 2017 while Instapay was launched on 23 April 2018 (Circular No. 1000). These payment schemes and the financial products built over them can promote e-commerce, facilitate operational efficiency of MSMEs, and enable even small merchants to accept electronic payments through mobile P2P (peer to peer) transactions.

- *Availability of InstaPay and PESONet in all existing electronic delivery channels.* The BSP Memorandum No. M-2018-026 dated 4 September 2018 requires all BSFIs with authority to offer electronic financial and payment services (EFPS), such as electronic banking, to make fund transfer via PESONet and/or InstaPay available through its e-channels (i.e. internet and mobile) by 30 November 2018. Further, the fund transfer confirmation of the BSFI to its client-sender will clearly indicate whether the fund transfer is made via PESONet or InstaPay to set proper expectation on the availability of funds to the beneficiaries.

Implementation of the national ID law. The BSP is working closely with the lead government agencies (i.e., Philippine Statistics Authority and Department of Finance) for the implementation of the National ID law. On 6 August 2018, the President signed into law Republic Act (RA) No. 11055, or the Philippine Identification Systems Act, which aims to establish a single national ID system to serve as the core identity platform for a wide range of digital-enabled services that can make transacting with the government and financial service providers significantly more seamless, efficient and convenient. This is aligned with the foundational approach for national ID adopted by other countries. The digital ID platform can facilitate ease and cost of account opening and lending, making the low-income clients a viable target market for both niche and mainstream financial service providers.

Other recent initiatives. The BSP issued Circular No. 1001 dated 30 April 2018 (Credit Limits for Project Finance Exposures) to support the government's 'Build, Build, Build' initiative. A separate single borrower's limit (SBL) is allowed for Special Purpose Entities (SPEs) or companies doing stand-alone projects under the government program. The BSP has issued Circular No. 1003 dated 16 May 2018 implementing the Philippine Credit Card Industry Regulation Law (Republic Act No. 10870). The law and its Implementing Rules and Regulations (IRR) aim to make consumer credit readily available under conditions of safe, sound, efficient, and fair business conduct aligned with global best practices.

Meanwhile, Circular No. 1009 dated 18 July 2018 provides the revised rules and regulations governing the mandatory credit allocation for agriculture and agrarian reform credit to implement the amendments to the Implementing Rules and Regulations of Republic Act (R.A.) No. 10000, The Agri-Agra Reform Credit Act of 2009. Specifically, the amendments to the IRR of R.A. No. 10000 aim to further promote compliance with the mandatory agri-agra credit requirement by rationalizing the modes of alternative agri-agra compliance, subject to prudential controls.

Leveraging on technology in finance and the use of artificial intelligence.

The BSP remains proactive in its approach to the rapid expansion and reach of financial technology (FinTech) innovation considering its potential to promote financial inclusion and improve efficiency in banking operations. The BSP's "test-and-learn" approach, which is currently referred to as the "regulatory sandbox," is underpinned by the three core principles of proportionate regulation, multi-stakeholder collaboration and consumer protection.

In 2017, several regulations were issued aimed at allowing the use of technology to streamline the conduct of banking activities and ensuring that technology-related risks, including anti-money laundering (AML) and other concerns with respect to FinTech, are properly addressed and/or are mitigated.

Thus, in the year of reckoning (2018), pertinent guidelines were implemented such as the use of third party cash agents, virtual currency (VC) exchanges framework, social media risk, risk-based know-your-customer (KYC) rules, and business continuity management, among others.

Upholding the integrity of the financial system and safeguarding the interest of the public.

Part and parcel of the BSP's objective to maintain financial stability is to uphold the integrity of the financial system considering the areas of prudential reporting, disclosure requirements and compliance to the provisions of Anti-Money Laundering (AML) Act of 2001.

Philippine Financial Reporting Standard (PFRS) 9 – financial instruments. Circular No. 1011 dated 14 August 2018 is a local adoption of the International Financial Reporting Standards (IFRS) 9, where the IFRS 9 replaced the International

Accounting Standards (IAS) 39 effective for the annual period beginning 1 January 2018. The amendment is in response to the criticisms that IAS 39 is too complex and inconsistent with the way entities manage their business risk and defers the recognition of credit losses in loans and receivables in the credit cycle. The BSP issued more principle-based guidelines adopting the IFRS 9/ Philippine Financial Reporting Standards (PFRS) 9. The Circular sets out the supervisory expectations in classifying and measuring financial instruments and in recognizing impairment to promote prudence and transparency in financial reporting.

Marking-to-market of financial instruments. Circular No. 1021 dated 15 November 2018 enhances the guidelines on marking-to-market of financial instruments to align BSP regulations with international accounting standards and in response to the adoption of a valuation methodology for peso denominated government securities (GS) by a benchmark administrator authorized by the Securities and Exchange Commission (SEC). The new policy aims to ensure consistency of fair value measurements and comparability of financial reports in the financial system.

Accelerating capital market reforms, including foreign exchange initiatives.

The BSP continues to develop policies that contribute to capital market development which serves as a counter-balance to bank lending for purposes of supporting long-term financing requirements of the government and corporates. Parallel to this, the BSP has issued regulations that are aligned with the overarching strategy of expanding the depth and breadth of capital market transactions in an environment where market participants observe proper governance over their market activities.

Streamlined requirements for the issuance of bonds and commercial papers. Circular No. 1010 dated 9 August 2018 was issued to address the concern on investor protection, price discovery and transparency for the issuance of debt security and to align with the Securities Regulations Code. It is intended to relax the requirements for the issuance of bonds and of commercial paper to banks/quasi-banks (QBs) which demonstrate the capacity to undertake their funding strategy.

Currency rate risk protection program (CRPP Facility). Circular No. 1014 dated 24 September 2018 enhances the guidelines on the Currency Rate Risk Protection Program (CRPP) aimed at easing the demand pressures in the foreign exchange spot market. To facilitate the transactions under the CRPP facility, the BSP provides various regulatory reliefs such as exclusion from the NDF position limits. Moreover, reduced market risk capital charges shall be applied for net open positions for NDFs under this facility. UBs/KBs also do not need additional derivatives authority since transactions under the CRPP are considered generally authorized derivatives activities.

Meanwhile, Circular No. 1015 dated 5 October 2018 amends the implementing guidelines for the CRPP Facility in terms of mechanics and pricing, among others. The availment process was also rationalized to facilitate easier access.

Establishment of a local renminbi (RMB) trading market. Last 30 October 2018, the BSP witnessed the landmark signing of the Memorandum of Agreement (MoA) establishing a local RMB trading market. The move signals the start of a non-discriminatory and well-functioning trading community. It diversifies currency options for the economy and strengthens the FX market governance framework. The MoA signing also builds trust and investor protection mechanisms, supports product innovation and market development.

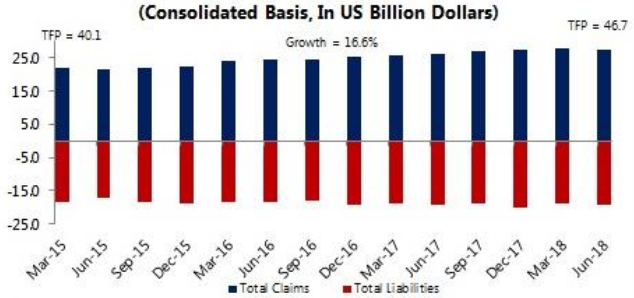
Box Article 5

A Vulnerability Index for Cross-Border Risks[1]

1. The context

In many empirical studies, inter-linkages in the global economy, including those channeled through banks[2] in the form of cross-border financial flows, contributed to the spreading of the Global Financial Crisis (GFC) in 2007 to 2008. Financial integration offer many benefits such as facilitating financial flows for efficient capital allocation, yet may also subject a bank to vulnerabilities as negative shocks can be easily transmitted across countries. The goal of each recipient jurisdiction is to reap these benefits from cross-border capital flows but at the same time ensure that strategies are in place to mitigate against risks brought about by such financial flows. Hence, regular surveillance by the supervising institution of each jurisdiction to enhance understanding of any emerging risk is essential to preserve domestic and global financial stability.

Figure 1. Total Financial Posiiton of U/KBs and its Subsidiary TBs*
(Consolidated Basis, In US Billion Dollars)



*Total Financial Position = sum of cross-border financial claims and cross-border financial liabilities; U/KBs = Universal and Commercial Banks; TBs = Thirfft Banks
Source of Data: Supervisory Data Center

The BSP required banks to report its cross-border financial positions in September 2014[3] and since then, gross financial position[4] has grown by 26.9 percent to US$46.7 billion as of end-June 2018 (from US$36.8 billion as of end-September 2014). The Philippine banking system remains a net cross-border lender with a net cross-border financial asset position of US$8.3 billion as of end-June 2018. Meanwhile, year-on-year (YoY) growth averaged at 6.6 percent. Apparently, these exposures are minimal relative to total banking assets, representing 9.3 percent as of end-June 2018[5]. However, the inherent risks from these exposures warrant regular surveillance to prevent recurrence of past global bank disruptions.

Moreover, a strong increase in cross-border banking is expected in the region following the adoption of the Association of Southeast Asian Nations (ASEAN) Banking Integration Framework (ABIF), which aims to achieve free flows of financial services within the ASEAN regional banking market. While there are efficiency gains in cross-border banking, periodic surveillance is necessary as exposures are sensitive to changes in interest rates, exchange rates and other developments.

This study intends to analyze risks indicators in cross-border exposures of the Philippine banking system and to construct a composite index. The index will serve as a comprehensive measure of the behavior of cross-border exposures of Philippine banks, not a tool for estimation of the likelihood of a crisis. The index will in turn help the Bangko Sentral ng Pilipinas (BSP) in determining any incipient risks to banking stability due to possible excessive risk-taking activities in the channelling of domestic funds across different regions and vice versa.

---

[1] Prepared by Jessica P. Hutalla and Ryan Louise M. Briones, Supervisory Policy and Research Department (SPRD). We are grateful for the comments from Dr. Veronica B. Bayangos (Director, SPRD), Patrick Joseph M. Sadornas (SPRD), Cherry Wyle G. Layaoen (SPRD), Rodenel L. Fallarco (SDC) and Christian D. Mina (DES). The views expressed in this study are those of the authors and do not necessarily represent those of the BSP or the BSP policy.
[2] For instance, Brunnermeier et al (2012) confirmed that the vast bulk of cross-border debt is intermediated through the domestic banking system based on the Bank for International Settlements (BIS) data.
[3] Circular No. 850 dated 8 September 2014 - Phase 1 implementation required universal and commercial banks, as well as thrift banks that are subsidiaries of U/KBs to report their cross border financial claims and liabilities to the BSP.
[4] Gross financial position is the sum of total claims and liabilities. The best way for management to obtain a picture of an international bank's overall exposure to foreign borrowers outside a bank's own organisation is by measuring country exposure on a consolidated basis.
[5] Total assets of the banking system grew by 50.7 percent in June 2018 relative to September 2014 partly due to entry of new foreign banks.

The rest of this study is organized as follows: Section 2 presents the empirical methodology in constructing the index on cross-border exposures and main results; while Sections 3 and 4 discuss the results and implications for banking supervision.

The analysis in this paper is based on the value and composition (that is, by country, account, currency and by sectoral counter-party) of a bank's position of financial claims on, and liabilities to, the rest of the world. In particular, cross-border position refers to the asset and liability position vis-à-vis banks and non-banks located in a country other than the country of residence of the reporting banking office, which in this case, the Philippine banks. This definition is consistent with the definition of the Bank for International Settlements (BIS) in its international banking statistics.

2. Empirical Methodology

2.1 Cross-Border Risk Profiling

The survey of empirical literature has identified significant areas of risk that arise from banks' cross-border exposures. These include country/sovereign risk, risk to exposures from advanced economies and emerging market economies, interest rate risk, funding disruptions, risk transfer, currency/exchange rate risk and risk of concentration. The selection of indicators for the identified risk areas is based on the analysis of the details of the claims and liabilities of the banking system from the cross-border balance sheet accounts.

The BIS, in its 1982 paper, defined country risk as the possibility that sovereign borrowers of a particular country may be unable or unwilling to fulfil their foreign obligations. The same paper recommended 'diversification' of country exposures in order to spread the risks in the same way when a bank tries to avoid excessive concentrations of risks in any of its areas of business. To measure the country risk in cross-border exposures, this paper utilizes the latest sovereign credit ratings of Standard and Poor's (S&P)[6]. As of end-June 2018, the total banking system's jurisdictional counterparties with Investment-Grade status made up 93.1 percent of claims and 94.6 percent of liabilities.

Meanwhile, exposures from emerging markets and advanced economies capture varied investment opportunities due to relatively higher economic growth rate, higher returns and diversification benefits. However, the downsides are the risks that come with the rewards, such as foreign exchange rate risk, political risk, among others. As of end-June 2018, the Philippine banks' cross-border claims to advanced economies and emerging markets accounted for 66.5 percent and 33.8 percent of total claims, respectively.

Interest rate risk arises when the interest rate of a counterparty that issued a security increases. When the security's coupon rate is higher than the market rate, the security can be priced at a premium. However, if the security's coupon rate is lower than the market rate, the security can be priced at a discount. This study has identified the following accounts which are subject for marked-to-market valuation - Available for Sales (AFS) Securities, Financial Assets Designated at Fair Value (FADFV) and Held-for-Trading (HFT)[7] Securities.

Funding disruptions during a crisis depend on the bank's underlying funding model. Banks' model that relies on short-term wholesale funding represents greater risk, regardless of whether these banks are domestically-owned or branches/subsidiaries of foreign banks (Brunnermeier et al, 2012). This is because counterparties may reverse quickly when financial conditions deteriorate. Bayangos (2011) estimated a model using Generalized Method of Moments (GMM) and concluded that supply factors mainly drove international claims and cross-border bank lending during the GFC. This means that the stress experienced by major internationally-active banks have reduced the supply of international claims and cross-border lending to the Philippines.

[6] For countries with no credit ratings under S&P, the ratings were substituted from Fitch and Moody's.
[7] A held-for-trading security refers to debt and equity investments that are purchased with the intent of selling them within a short period of time, usually less than one year.

Risk transfers refer to conditional claims, which materialize when an immediate borrower cannot service its outstanding debts. Aldasoro and Ehlers (2017) included parent and third-party guarantees, credit derivatives (protection purchased) and collateral.

Currency risk is the risk that foreign exchange rates or the implied volatility will change, which affects, for example, the value of an asset held in that currency or valuation impact of currency movement. With the greater integration in the global financial system, the financial channel of exchange rates has become more important. As of end-June 2018, majority of total claims and liabilities were denominated in US Dollars (USD). By counterparties, not all USD were transacted with the United States (US), only USD claims were mainly coming from the US, but for liabilities, USD funding was sourced from Singapore.

Concentration risk denotes the overall spread of a bank's outstanding exposure over the number of borrowers. These concentrated exposures may threaten the health of a financial institution or investment portfolio. Indicators of concentration risk refer to percentage of cross-border claims to total bank assets and concentration risk by country.

2.2 Panel Principal Component Analysis

In this section the specific risk areas and the indicators identified in Section 2 are used to construct the bank-level and overall vulnerability indices of banks' cross border exposures. In particular, it may be recalled that the risk areas identified in Section 2 include country risk, risk to exposures from advanced economies and emerging market economies, interest rate risk, funding disruptions, exchange rate risk and risk of concentration.

A Principal Component Analysis (PCA) using panel (bank-level) data has been carried out in this study. This technique basically condenses an original set of variables into a smaller number of linear varieties by identifying patterns in high-dimensional data and revealing the underlying factors (principal factors) that best describe variations in the data through identification and clustering of variables that measure the same theme (Kaźmierczak and Cavan, 2011). The intention of such an exercise is to appropriately capture the information from a large group of variables. This methodology has been used in different empirical studies in constructing specific index.

3. Empirical Results

3.1 Overall Index. The absolute values of the eigenvectors/loadings are further re-scaled to arrive at weights of the eight indicators with a total of 100.0 percent. The single composite index was obtained by taking the sum of the products of the indicator weights and the average indicator amount across banks and across periods, as shown in the following equation:

$$V_t = \sum_{j=1}^{K} F_j * X_{j,t} \qquad \textbf{\textit{(Equation 1)}}$$

Where:

V_t is the risk index at time t
F_j is the weight for indicator j
$X_{j,t}$ is the value of the indicator j at time t for the all 42 banks[8]
k is the total number of indicators

[8] There were 43 banks under study as some banks were removed due to incomplete data sets.

3.2 Interpretation. A rising index is driven by the variability of each indicator, hence, a reflective of the risk that each indicator is representing. In general, the overall index of Philippine banks' cross border exposure from end-March 2015 to end-June 2018 captures risks such as country risk, risk to exposures from advanced economies and emerging market economies, interest rate risk, funding disruptions, currency or exchange rate risk and risk of concentration. The three indicators with the highest weights are Liabilities to China, Bills Payable and liabilities denominated in USD. This finding indicates that the index captures to a large extent risks such as concentration risk, funding disruption (average bills payable) and currency/exchange rate risk (average liabilities denominated in USD). These identified indicators with the highest weights are both related to the funding side of the banking system.

Table 1. Factor Loadings and Corresponding Weights

Indicators	Loadings	Weights (Share to Total Loadings)
AdvClaims	0.422304	0.10050
NFSClaims	0.416230	0.09905
USDClaims	0.439398	0.10456
BillsP	0.689477	0.16407
DebtSec	0.339004	0.08067
EMClaims	0.383094	0.09116
LiabChina	0.945831	0.22508
USDLiab	0.566878	0.13490
Total	**4.202216**	**1.00000**

Source: OSPD estimates as of 17 August 2018.

The overall index from end-March 2015 to end-June 2018 reveals that risks had peaked around end-December 2017 relative to banks' exposure as of end-March 2015 (base year). This sudden spike relative to previous quarters can be attributed to the increase of these banks' funding in the form of bills payable and its liabilities in US dollar-denominated currencies. The risks from these exposures relative to the funding side may impact negatively on its net income through interest rate expense[9] given further peso depreciation against US dollar. These two indicators are among the top three with the highest weights, thus the sudden spike. As stated in the previous section, dollar-denominated liabilities may pose risk to financial systems in the event of a large and sudden exchange rate depreciation.

However, as of end-June 2018, banks have significantly decreased its exposures in debt securities that are subject for marked-to-market valuation, followed by reduction in claims from advance economies and reduction of bills payable.

4. Conclusion

A quarterly overall vulnerability index for cross-border risk exposures of the Philippine banking system was constructed from end-March 2015 to end-June 2018. These banks' cross-border exposures represented 9.3 percent of the total banking system assets as of end-June 2018.

The results revealed that the overall index has risen since end-March 2015 to end-June 2018. A rising vulnerability index represents susceptibility of these banks to external risks that may directly affect its exposures or which affect the economic conditions of its counterpart jurisdictions, in particular, shocks affecting the funding side of the balance sheet. However, compared with previous quarters, the index has decreased since end-December 2017. This means that banks' vulnerability to external risks has waned.

[9] Interest expense as of end-December 2017 grew by 36.9 percent Q-o-Q at US$126.9 Billion from US$92.7 Billion as of end-September 2017.

These findings indicate that the overall index is a relevant measure of overall risks of banks' cross-border exposures particularly in a globalized finance. As mentioned in Section 1, the index can serve as a comprehensive measure of Philippine banks' cross-border exposures, not a tool for estimation of the likelihood of a crisis. There is scope to continue the analysis on a regular basis. In the future, the predictive power of the index and consequent threshold analysis can be used to analyze in greater detail the behavior of each bank's cross-border exposures.

References

Ahuja, A., Syed, M. and Wiseman, K. (2017). **Assessing Country Risk – Selected Approaches – Reference Note**, *International Monetary Fund Technical Notes and Manual, June.*

Aldasoro, I. and Ehlers, T. (2017). **Risk Transfers in International Banking**, *Bank for International Settlements Quarterly Review, December.*

Avdjiev, S., Koch, C. and Shin, H.S. (2017). **The Dollar Exchange Rate as a Global Risk Factor: Evidence from Investment**. *Paper prepared for the IMF 18th Jacques Polak Annual Research Conference, October.*

Bayangos, V. (2011). **Was it Supply? International Claims and Cross-Border Lending to the Philippines During the Global Financial Crisis,** *Economic Newsletter, BSP. November – December.*

Brunnermeier, M., De Gregorio, J., Eichengreen, B., El-Erian, M., Fraga, A., Ito, T., Lane, P., Ferry, J., Prasad, E., Rajan, R., Ramos, M., Rey, H., Rodrik, D., Rogoff, K., Song Shin, H., Velasco, A., di Mauro, B., and Y. Yu (2012). **Banks and Cross-Border Capital Flows: Policy Challenges and Regulatory Responses,** *Committee on International Economic Policy and Reform, September.*

Catao, L. and Terrones, M. (2016). **Dollar Dependence**. *Finance & Development, September.*

Dabrowski, M. (2016). **Are Advanced Economies at Risk of Falling Into Debt Traps?** *The Bruegel Newsletter, Policy Contribution, Issue No. 21, November.*

Hahm, J.-H., Shin, H. S. and Shin, K. (2012). **Noncore Bank Liabilities and Financial Vulnerability. Journal of Money, Credit and Banking,** *45: 3–36. doi:10.1111/jmcb.12035, September.*

Koch, C. and Remolona, E. (2018). **Common Lenders in Emerging Asia: Their Changing Roles in Three Crises.** *Bank for International Settlements Quarterly Review, March.*

Management of Banks' International Lending (Country Risk Analysis and Country Exposure Measurement and Control), *Bank for International Settlements Working paper No. BCBS122, March.*

Reinhardt, D. and Riddiough, S. (2014). **The two faces of cross-border banking flows: an investigation into the links between global risk, arms-length funding and internal capital markets,** *Bank of England Working Paper No. 498, April.*

Box Article 6

What is Driving Bank Profitability?[1]

A. The context

Significant developments in the Philippine banking industry have been observed over time as banks evolve and innovate to keep in step with the rapidly changing operating environment. Apart from the traditional banking operations of deposit taking and lending, banks have also engaged in other income generating activities such as trading and asset management. The evolving operating environment for Philippine banks has also been driven by factors beyond the country's borders. For instance, investors in search of higher yield turned to emerging market economies with more upbeat growth prospects as central banks in advanced economies lowered their policy rates in response to the Global Financial Crisis in 2008. Moreover, the Basel III framework introduced by the Bank of International Settlements (BIS) after the crisis has also affected the day-to-day operations of banks across jurisdictions.

Amidst these major developments in both the global and domestic financial system, Philippine banks, at its core, are still business entities with the primary goal of earning a profit. From the perspective of supervisors, bank profitability may be viewed as a manifestation of effective performance by the bank's board of directors and senior management. Consequently, poor profitability may signal increased vulnerability as it weakens a bank's ability to absorb shocks.

This study identifies key determinants of profitability for 123 Philippine banks from end-March 2013 to end-June 2018 using Dynamic Panel Generalized Method of Moments (GMM). The sample consists of all universal, commercial (U/KBs) and thrift banks (TBs) as well as the top 25 rural and cooperative banks (R/CBs) in terms of their loan portfolio as of end-March 2018.

While there are several studies that have analyzed the determinants of bank profitability, most of the literature has focused on advanced economies (eg Staikouras and Wood (2004), Albertazzi and Gambacorta (2009), Bolt et al (2010), Petria, Capraru and Ihnatov (2015), Borio et al (2015)) and on emerging market economies (eg Kohlscheen et al (2018). By contrast, this study focuses on country-specific factors that drive the growth of bank profitability during the last decade using a comprehensive set of banks. Moreover, this study also highlights the relative importance of key factors that may support profitability and banking stability in the Philippines using a wider and more recent set of database. By and large, our results are in line with those of Kohlscheen et al (2018). This suggests that banks in the Philippines are relatively similar to their emerging market economies counterparts which typically operate in less sophisticated financial markets.

The results of the study show that the profitability of 123 Philippine banks is affected by both macro-financial and bank-specific factors. Following diagnostics and robustness checks, the study reveals that loan growth, particularly for commercial loans, is a key determinant of profitability for Philippine banks compared to real Gross Domestic Product (GDP) growth. This indicates that banks with higher rates of loan growth are more profitable, suggesting that the credit cycle is key for bank profitability compared to the business cycle.

A contribution of this study to empirical literature is the finding that portfolio investments relative to total assets is a better predictor of bank profitability. This finding may imply that banks which also sell, trade or hold portfolio investments are more profitable than those who solely rely on their lending operations for income. For both banks and regulators, this finding highlights the importance of understanding the relationship between asset mix and profitability in order to make well-informed policy decisions. Another finding worth emphasizing is that banks with higher capital ratios are generally more profitable. This result confirms Islam and Nishiyama (2016) finding that better capitalized banks can effectively transform their creditworthiness into lower funding cost, which in turn may be used to acquire riskier yet higher yielding assets.

---

[1] This article was prepared by Mr. Ryan Louise M. Briones and Ms. Veronica B. Bayangos, Supervisory Policy and Research Department. The results of this study are preliminary. The usual institutional disclaimer applies.

The remainder of this article discusses data and empirical methodology in Section B. The empirical results in detail are presented in Section C while Section D concludes.

B. Empirical Methodology

Following the specifications of Kolscheen et al (2018), this study uses the equation below to determine the factors affecting bank profitability:

$$ROA_{i,t} = c + \rho_1 ROA_{i,t-1} + \alpha_1 Comm\_Loan_{i,t} + \alpha_2 Cons\_Loan_{i,t} + \alpha_3 CAR_{i,t} + \alpha_4 Investments_{i,t} + \alpha_5 Dep\_Corp_{i,t} + \alpha_6 Dep\_Indiv_{i,t} + \alpha_7 Cost_{i,t} + \beta_1 Inflation_t + \beta_2 Real\_GDP_t + \beta_3 RRP_t + \beta_4 Bond\_Yield_t + \beta_5 FX\_Rate_t + \beta_6 CDS_t + \beta_7 PSE_t + \varepsilon_{i,t} ,$$

where $ROA_{i,t}$ represents the Return on Assets of bank *i* at time *t*. Similarly, $X_{i,t}$ refers to an explanatory variable for bank i at time t while $\varepsilon_{i,t}$ is the error term.

The Return on Assets (ROA) is the profitability measure used in the study. It reflects a bank's capability to generate profits using its asset base. It is expressed as the ratio between a bank's annualized net profit/loss and its average assets. One advantage of using ROA is that the numerator represents an aggregate measure of profitability which captures interest and non-interest income and expenses[2]. In the earlier regression exercise, the study considered Return on Equity and Net Interest Income as measures of profitability. However, the exercise did not produce reasonable estimates.

The Philippine banking system registered an average ROA of 1.21 percent from end-March 2014 to end-June 2018, after averaging 1.86 percent in 2013. Among ASEAN-5 economies[3], the Philippines registered the second lowest ROA as of end-March 2018.

Quarterly bank-specific data as well as balance sheet, income statement and macro-financial data were compiled during the period. Meanwhile, the explanatory variables are listed in Table 1, along with a brief description of each:

Table 1: Explanatory Variables used in the Estimation

Variable Name	Description
Cons_Loan[4]	Annual growth rate of consumer loans. The consumer loan portfolio consists of the following loans: (1) Motor Vehicle Loans, (2) Credit Card Receivables, (3) Salary Based General Purpose Consumption Loans, (4) Residential Real Estate Loans and (5) Other Consumer Loans.
Comm_Loan	Annual growth rate of commercial loans. The commercial loan portfolio of banks is estimated as Total Loan Portfolio (exclusive of interbank loans and total reverse repurchase) less Consumer Loans.
Investments	Share of a bank's portfolio investments to its total assets
CAR	Capital Adequacy Ratio
Dep_Indiv	Annual growth rate of deposit liabilities to individuals
Dep_Corp	Annual growth rate of deposit liabilities to corporates. The corporate deposit base is estimated as Total Deposit Liabilities less Deposits Liabilities to Individuals.
Cost	Ratio between annualized non-interest expenses and annualized total operating income
Inflation	Annual growth rate of the Consumer Price Index
Real_GDP	Annual growth rate of real Gross Domestic Product
RRP	Overnight Reverse Repurchase Rate set by the BSP. This is a proxy measure for short-term interest rate.
Bond_Yield	Yield-to-Maturity of the 10 Year Philippine Government Security. This is a proxy measure for long-term interest rate.
FX_Rate	The exchange rate between the US Dollar and the Philippine Peso
CDS	Credit Default Swap spread. This is a proxy measure for country credit risk.
PSE	Philippine Stock Exchange Composite Index

Source of data: Supervisory Data Center, Bloomberg

[2] As of end-September 2018, profitability of the Philippine banking system is mainly driven by net interest income (at 76.9 percent of total operating income). Non-interest income, which captures about 23.1 percent of total operating income, is mainly from fees and commission income as well as trading income (at 58.9 percent and 28.7 percent of total non-interest income, respectively), while non-interest expenses are mostly for compensation/fringe benefits and other administrative expenses.

[3] ASEAN-5 is composed of the following countries: Philippines, Singapore, Indonesia, Malaysia and Thailand.

[4] Consumer Loan data (and the derived commercial loan data) for RCBs were excluded from the dataset used.

Residual tests show that standard errors of regression are robust while the Arellano-Bond Serial Correlation test result shows that the residuals do not have second-order serial correlation.

C. Empirical Results

Following diagnostics and robustness checks, the results of the study show that commercial loan growth drives bank profitability, which is expected given that most banks rely on loans to generate income. Moreover, commercial loan growth is a better predictor of bank profitability compared to consumer loan growth and to real GDP growth. The credit cycle thus appears to predict bank profitability better than the business cycle[5].

Meanwhile, the results also imply that growth in deposit liabilities can translate into higher earnings as banks with higher deposit bases can potentially issue more loans and invest in higher yielding assets. Retail deposits are also a better predictor of bank profitability than corporate deposits as these are generally considered stable and deposit interest rates in the Philippines have been relatively low over the past few years.[6]

In terms of asset mix, it is interesting to note that portfolio investments relative to total assets pushes bank profitability. More importantly, the results of estimations using both the portfolio investments to total assets ratio and the total loans to total assets ratio show that the former is a better predictor of bank profitability than the latter. This may imply that banks which also sell, trade or hold portfolio investments are more profitable than those who solely rely on their lending operations for income. While this finding may incentivize banks to increase their portfolio investments, they must still strike the proper balance between investments and loans (Bechtel 2014).

Another finding worth emphasizing is that banks with higher capital ratios are generally more profitable. This is consistent with earlier research findings by Sufian and Chong (2008) regarding Philippine commercial bank profitability from 1990-2005. Islam and Nishiyama (2016) argue that better capitalized banks can effectively transform their creditworthiness into lower funding cost, which in turn may be used to acquire riskier yet higher yielding assets. Consequently, Van den Heuvel (2003) reveals that when equity is sufficiently low, because of loan losses or some other adverse shock, the bank will reduce lending because of the capital requirement and the cost of issuing new equity. Even when the capital requirement is not currently binding, his model showed that a low-capital bank may optimally forgo profitable lending opportunities now in order to lower the risk of future capital inadequacy. More efficient banks also tend to be more profitable, consistent with the findings of Goddard et al (2010).

In the case of the Philippines, the above finding is consistent with the finding by Layaoen and Domantay-Mailig (Forthcoming 2018) that, in general, U/KBs and their subsidiary TBs adjust their regulatory capital ratios through changes in the level of capital (i.e., capital stock, additional paid-in capital, retained earnings and undivided profits). In addition, U/KBs and their subsidiary TBs have lesser pressure to adjust their risk-weighted exposures but are more inclined to maintain a reasonable balance between changes in the size of assets and capital.

With regards to macroeconomic variables, the results show that high inflation can translate into higher profitability. Perry (1992) states that the effect of inflation on bank profitability is dependent on whether inflation is anticipated or not. If inflation is anticipated, banks can adjust their interest rates accordingly and their profits will be affected positively.

However, the results also show that short-term interest rates reduce bank profitability. According to Borio et al (2015), higher interest rates could erode bank profitability if the demand for loans is more responsive to interest rates compared to the demand for deposits. Data for Philippine banks show that the

[5] The study also finds that loan growth Granger causes ROA for up 4 quarter lags. Moreover, bi-directional Granger causality between bank credit growth and ROA was found at 2 quarter lags.
[6] Data derived from the Branch Regional Information System (BRIS) and an earlier survey conducted by the BSP suggest that from 2013 to the third quarter of 2016, the median rates for regular peso savings deposits of U/KBs have been stable at 0.25 percent. Meanwhile, banks opted to offer higher interest rates on their large-value, longer-tenured deposit products (time deposit accounts with maturities of more than one year, amounting to one million and above), to secure funding for credit expansion following the recent round of policy rate hikes and adjustments in the reserve requirement in 2018.

overnight RRP rate Granger causes commercial loan growth at 2, 3 and 4 quarter lags while no Granger causality was found between overnight RRP rate and deposit growth[7]. Meanwhile, the effects of the remaining macroeconomic variables are either marginal (CDS, PSE) or not significant (real GDP, exchange rate, 10-year bond yield) in our regression results.

The coefficients estimated for each variable are presented in Table 2. The variables highlighted in gray are not found to be significant at 10% confidence level.

Table 2: Estimation Results

Variable	Equation 1		Equation 2	
	Coefficient	P-value[8]	Coefficient	P-value
ROA(-1)	0.1487	0.000	0.1430	0.0000
COMM_LOAN	0.0051	0.000	0.0048	0.0000
CONS_LOAN	-0.0001	0.000	-0.0001	0.0006
CAR	0.1685	0.000	0.1657	0.0000
INVESTMENTS	0.0475	0.000	0.0451	0.0000
DEP_CORP	0.0005	0.000	0.0005	0.0000
DEP_INDIV	0.0018	0.000	0.0017	0.0254
COST	-0.0194	0.000	-0.0214	0.0000
INFLATION	0.0491	0.000	0.0526	0.0024
REAL_GDP			-0.0387	0.1126
RRP	-0.0558	0.000	-0.0879	0.0154
BOND_YIELD			-0.0164	0.5841
FX_RATE			1.28E-05	0.8887
CDS	-4.28E-05	0.000	-5.07E-05	0.0000
PSE	-1.77E-06	0.000	-1.51E-06	0.0001
Mean dependent var	-0.0002		-0.0002	
S.E. of regression	0.0168		0.0166	
J-statistic	69.3174		66.7919	
Prob(J-statistic)	0.3992		0.3813	

Source: Authors' estimates

D. Conclusion

The study shows that loan growth, particularly for commercial loans, is a key driver of profitability for 123 Philippine banks. Moreover, the credit cycle is a better predictor of Philippine bank profitability compared to the business cycle, consistent with the findings of Kolscheen et al (2018) for emerging market economies. In addition, the estimation results also imply that banks holding investment securities in addition to their loan portfolio are generally more profitable than those solely reliant on lending operations. For both banks and regulators, these findings highlight the importance of understanding the relationship between asset mix and profitability in order to make well-informed policy decisions.

An important takeaway from the study is that better capitalized banks are generally more profitable due to lower funding costs and the ability to take on higher risks. By contrast, lower or under capitalized banks may temporarily sacrifice profit taking opportunities in favor of capital build up to avoid further deterioration. From a policymaker's perspective, this implies that bank stability and profitability are not mutually exclusive but rather reinforcing.

The results of the study also imply that Philippine banks are able to translate relatively higher inflation into higher earnings, especially if inflation is anticipated. It is worth noting though that the same results show short-term interest rates reducing bank profitability. Further insights regarding the links between

[7] At 10% confidence level however, RRP Granger causes the outstanding amount of corporate deposits at 3 and 4 quarter lags.
[8] P-values denoted as "0.000" are rounded off and not exactly equal to the value "0".

inflation, interest rates and bank profitability will be beneficial for an inflation targeting country such as the Philippines.

References

Albertazzi, U. & Gambacorta, L. (2006). **Bank Profitability and the Business Cycle**. *Banca D' Italia Temi di discussion (Working Papers) No. 601*.

Bechtel, A. (2014). **Loan Mix Characteristics on Bank Profitability**. *The Park Place Economist, 22 (1) p. 30-38.*

Bolt, W., de Haan, L., Hoeberichts, M., van Oordt, M. & Swank, J. (2010). **Bank Profitability during Recessions.** *DNB Working Paper No. 251*

Borio, C., Gambacrota, L. & Hoffman, B. (2015). **The influence of monetary policy on bank profitability**. *BIS Working Papers No. 514*

Goddard, J. Liu, H., Molyneux, P. & Wilson, J. (2010). **Do Bank Profits Converge?** *Bangor Business School Working Paper.*

Islam, M.S. & Nishiyama, S.I. (2016). **The Determinants of Bank Profitability: Dynamic Panel Evidence from South Asian Countries**. *Journal of Applied Finance & Banking 6(3), pp. 77-97*

Kolscheen, E., Murcia, A. & Contreras, J. (2018). **Determinants of Bank Profitability in Emerging Markets**. *BIS Working Papers No. 686*

Layaoen, C. and V. Domantay-Mailig (Forthcoming 2019). **Do Regulations Influence Banks' Holding of 'Excess' Capital,** *BSP Working Paper Series*.

Perry, P. (1992). **Do banks gain or lose from inflation?** *Journal of Retail Banking, 14 (2), p. 25-30.*

Petria, N., Capraru, B. & Ihnatov, I. (2015). **Determinants of banks' profitability: evidence from 27 EU banking system.** *Procedia Economics and Finance 20(2015), pp. 518-524*

Staikouras, C. & Wood, G. (2004). **The Determinants of European Banking Profitability**. *International Business and Economics Research Journal 3(6), pp. 57-68*

Sufian, F. & Chong, R.R. (2008). **Determinants of Bank Profitability in a Developing Economy: Empirical Evidence from the Philippines.** *Asian Academy of Management Journal of Account and Finance 4(2), p. 91-112*

Van den Heuvel S.J. (2003). **Does Bank Capital Matter for Monetary Transmission?** *Federal Reserve Bank of New York, Economic Policy Review, May, p. 258-265.*

Efficient and Reliable Payments and Settlements System

The BSP, through Payment System Oversight Department (PSOD), made great strides in reforming the Philippine payments landscape in 2018. In line with its mandate of strengthening the third pillar (i.e., an efficient payment system) of central banking in the country, this Department initiated revolutionary changes to address the need for safe, convenient, and efficient means of moving funds which are vital in the pursuit of productive activities that fuel economic growth.

Being the Bangko Sentral's arm looking after payment systems, the PSOD is on the frontline, developing policies, licensing payment service providers, promoting electronic payments, monitoring compliance with the payment standards, and dealing with the various stakeholders in the payments ecosystem. The authority of the BSP to oversee payment systems has explicit legal support with the recently-enacted Republic Act 11127 which is known as the National Payment Systems Act (NPSA). The NPSA provides the Bangko Sentral with a suite of powers, enabling it to effectively carry out oversight over payment systems. In particular, the NPSA empowers the Bangko Sentral to exercise the following key functions:

i. Rule-making;
ii. Imposition of administrative sanctions;
iii. Determination of payment systems to be designated as systemically important;
iv. Supervision over operators of designated payment systems;
v. Accreditation of a PSMB comprised of participants of designated payment systems; and
vi. Setting of rules for finality of settlement and elimination of the zero-hour rule through the provisions on netting

In 2018, the PSOD was instrumental in the establishment of InstaPay – a fast and secure electronic funds transfer service which is available anytime and anywhere for urgent and low-value payment requirements. With 24 participating institutions as of year-end 2018, InstaPay consistently showed exponential growth in terms of both volume and value, zooming upward shortly after its launch in April 2018. InstaPay is the second automated clearing house launched in the country, coming after PESONet which is a batched electronic funds transfer service. The PESONet serves as a better alternative to the paper-based check system. Unlike a check, the PESONet allows receipt of funds on the same banking day the sender initiates the payment within a certain cut-off time. The PESONet has been gaining traction in the payments industry since it went live in November 2017. The volume started to take off in July 2018 and increased further in the last quarter of 2018 given the intensified marketing efforts of the payment service providers. As of end-December 2018, there were forty-seven (47) payment service providers, i.e, banks and non-banks, participating in the PESONet as of year-end 2018.

To stir the growth of digital payments and at the same time safeguard the interest of the payment service providers while ensuring the protection of consumers, the PSOD also has developed the following regulations in 2018:

- Circular No. 1000 dated 23 April 2018– **Guidelines on the Settlement of Instant Retail Payments**

This Circular requires that the net clearing obligations of the InstaPay ACH participants be prefunded through a Demand Deposit Account maintained with the BSP. This regulation serves as a credit-risk mitigating measure for the benefit of participating-institutions.

- Memorandum to All BSFIs No. 2018-012 dated 23 March 2018 - **Guidelines on the NRPS Key Principles and the Specific Rules Applicable Thereto**

This Memorandum provides more detailed guidelines on the implementation of the NRPS principles such as the prohibition of bilateral clearing arrangements, the immediate crediting of funds to the account of recipients, the availability of e-payment services in all electronic delivery channels, etc.

- Memorandum to All BSFIs No. 2018-013 dated 28 March 2018 – **Disclosure of Fees on Electronic Payments**

This Memorandum requires BSFIs to report the fees they charge for e-payment services, for posting to the BSP website. This regulation enables the public to make informed decision when choosing the institution(s) through which they can make payments or transfer funds.

- Memorandum to All BSFIs No. 2018-021 dated 12 July 2018 - **FAQ on AML-related concerns on the adoption of the NRPS Framework**

This Memorandum clarifies compliance with the Anti-money laundering (AML) rules relative to the NRPS framework.

- Memorandum to All BSFIs No. 2018-026 dated 4 September 2018 - **Availability of InstaPay and PESONet in all Existing Electronic Delivery Channels**

This Memorandum requires BSFIs offering funds transfer services to make InstaPay and PESONet available in all their electronic delivery channels (e.g., mobile, online, etc.) within a certain deadline.

In line with the Bangko Sentral's reform agenda of promoting digital innovations and increasing the availability of safer and more efficient channels for delivering banking, payment, remittance, investment, and other financial services, the PSOD also proposed a policy[1] to the Monetary Board, streamlining the licensing requirements for BSP-supervised financial institutions (BSFIs) that intend to offer electronic payment and financial services (EPFS). Moreover, to expedite public awareness campaigns aimed at boosting e-transactions or reversely, reducing paper-based payments, the Department pushed for the issuance of a Memorandum[2] requiring payment service providers to educate their personnel on NRPS and post InstaPay and PESONet materials on their premises and websites.

As a strategic partner for transformative developments in the payments field, the PSOD fostered collaboration with internal and external stakeholders, ensuring a smoothly-sailing journey towards the shared vision of the industry and the Bangko Sentral of increasing the payments' velocity in support of the brisk pace of economic activities. On 23 November 2018, the BSP hosted and facilitated a workshop on enabling electronic bills payment under the NRPS framework, with the government as the pilot biller. This workshop paved the way for the formation of a Technical Working Group (TWG) tasked to carry out the operationalization of the government bills payment service. In addition, the BSP has been closely coordinating with the Philippine Payments Management Inc., an industry-led governing body which ensures that the Payment Service Providers (PSPs) uphold the payment principles spoused by the Bangko Sentral.

The Bangko Sentral has been recognized as thought leader in the payments industry. This is mainly due to its top caliber human resource in the PSOD. The Bangko Sentral serves as the co-chair in the Association of South East Asian Nations (ASEAN) Working Committee on Payment and Settlement Systems (WC-PSS). The Bangko Sentral is also a member of the Digital Financial Services Working Group of the Alliance for Financial Inclusion and the Working Group on Financial Market Infrastructure of the Executives' Meeting of East Asia and the Pacific (EMEAP)

[1] This policy was issued as Circular No. 1033 dated 22 February 2019.

[2] While this Memorandum was elevated to the Deputy Governor, Financial Supervision Sector, in 2018, it was issued on 3 January 2019 as Memorandum No. M-2019-001.

Central Banks. Moreover, the Bangko Sentral, through the PSOD officers, has been a resource institution in various international gatherings of central banks and industry practitioners.

The BSP continues to broaden the range of digital services available to individuals, businesses, and the government. The Bangko Sentral has been closely tracking the adoption of the Quick-Response (QR) Code by the PSPs. The QR Code will be instrumental in accelerating electronic payments since almost every entity including a market vendor, cab driver, or variety store owner can possibly operate with the use of a QR code as mode for accepting payments. Currently, the country is at the infancy stage as regards QR code adoption, with only few institutions promoting the use of this code. Thus, the Bangko Sentral pursues a National QR Code Standard that will enable interoperability of QR Code-based payment facilities.

The Bangko Sentral also directs banks and non-bank EMIs to make the "direct debit" service a useful piece of their electronic funds transfer facility. With this e-payment service, payers will save much time and effort in settling their recurring and periodic expenses such as utility bills, taxes, government licenses, permits, and fees.

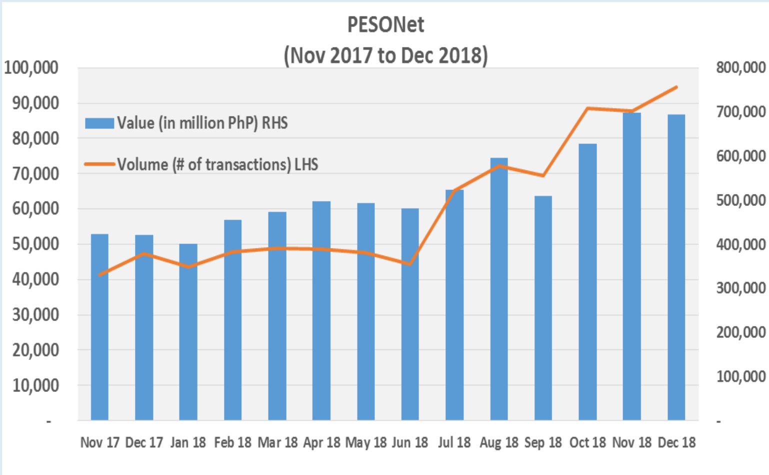
The Bangko Sentral anticipates other meaningful initiatives to crop up as the payments ecosystem continues to evolve. By setting a strategic direction that is in sync with industry trends and consistently focused on addressing any brewing treat to the payment system, the Bangko Sentral displays its firm commitment to its mandate of sustaining a safe, efficient, and reliable payment system that is supportive of the country's inclusive growth objective.

Box Article 7

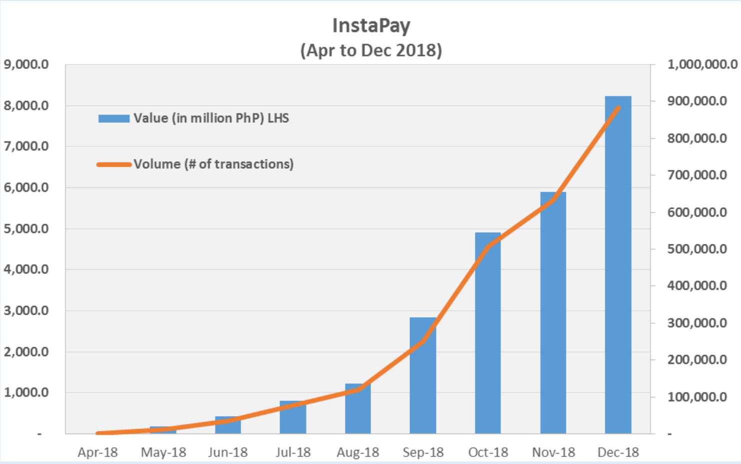
PESONet and InstaPay, on the Rise

PESONet and InstaPay are the buzzwords in the payments space these days. No wonder, these funds transfer services have ended the long waiting time for a safe, efficient, and reliable means to move money from one transaction account to another.

The PESONet and the InstaPay have stemmed from the National Retail Payment System (NRPS) reform initiative of the Bangko Sentral. The NRPS is a policy and regulatory framework which promotes interoperability among payment service providers (PSPs), banks and non-bank electronic money issuers (EMIs) alike. This framework requires the PSPs to collaborate through multilateral clearing and settlement agreements which are called automated clearing houses (ACHs) to enable individuals, businesses, and even government institutions to transfer funds from their PSPs to other PSPs.



The PESONet is a batched inter-institution funds transfer service which is highly suitable for remittances or payments that should reach the payees on the same banking day the payment transactions are made. While the same-day credit to the recipients' accounts is subject to the cut-off time adopted by the PSPs, the PESONet apparently is a better alternative to the paper-based check system where payments are made available to the payees after a day or two. Being a safe and efficient payment option that generally imposes no transaction limit, the PESONet addresses the payment service requirements of those making business-to-business fund transfers, payroll and loan disbursements, as well as dividend payouts. The numbers show that PESONet has been gaining traction in the payments ecosystem, registering a total payments value of ₱86.77 billion in December 2018. This amount is equivalent to a 64.0 percent increase in value since PESONet went live in November 2017. In terms of volume, PESONet began to take off in June 2018 and in general continued to grow in the succeeding months after certain issues on the PSPs' compliance with the laws and regulations on anti-money laundering and terrorist financing were threshed out. In a span of 13 months from its launch up to December 2018, the PESONet recorded a payments volume of 129.0 percent higher than the initial volume of 329,906. As of the end of 2018, forty-seven (47) BSFIs were participating in the PESONet ACH.



The InstaPay is another priority retail payments solution that forms part of the NRPS digitalization agenda. InstaPay is meant to speed up urgent and low-value payments such as those made for the settlement of hospital bills, school fees, small loans, etc. InstaPay allows instant or immediate crediting of payments to the recipients' accounts, hence, the name InstaPay. Given its massive importance as a fast and easy facility for transferring funds straight from a transaction account (i.e., bank or electronic money account) to another account, InstaPay shows exponential growth in terms of volume and value. Both of these metrics have been steeply moving upward starting June 2018 shortly after the launch of InstaPay in April 2018. Although each InstaPay transaction is capped at ₱50,000, a payer can transfer funds as many times as he needs to anytime, all year round. As of 31 December 2018, payers could use InstaPay through twenty four (24) participating BSFIs. Moreover, there were already thirty six (36) BSFIs allowing their accountholders to receive funds via InstaPay.

Aside from offering convenience, safety, and efficiency, the PESONet and the InstaPay promote transparency by providing adequate disclosure of transaction fees to clients. Given that the fees are charged only to the payers (i.e., no fee borne by payees or recipients), these funds transfer services are increasingly becoming more attractive to financial consumers. In an effort to enable these consumers to make informed decision when choosing a PESONet- or InstaPay-participating PSP, the Bangko Sentral publishes the fees charged by each of these PSPs on its website.

The journey towards transformative digitalization of payments has just begun. As the payments industry continues to evolve, the Bangko Sentral has more impactful initiatives that are attuned to financial technology trends and at the same time responsive to emerging risks. The country can expect a broader suite of digital services with more exciting features coming up in the short to medium term. The following NRPS initiatives are in progress:

- Adoption of a National Quick-Response (QR) Code Standard. The QR Code standard will be instrumental in accelerating electronic payments growth since almost every entity including a market vendor, cab driver, or variety store owner can possibly operate with the use of a QR code as mode for accepting payments.
- Availability of electronic bills and government payment facility. This facility will bring about considerable amount of savings both for payers and billers including the government. Payers can avoid the cost of physically moving money from their accounts to the billers' accounts as they can pay for their utilities and government obligations such as licenses, permits, and taxes within the comforts of their homes or places of work. On the part of the billers, the facility will significantly lessen human intervention in the bill collection process, contributing to minimization of fraud or corrupt practices.

The Bangko Sentral is optimistic that with NRPS, the country will be able to achieve a desirable level of efficiency in the flow of funds within the economy, supporting productive activities that boost economic growth.

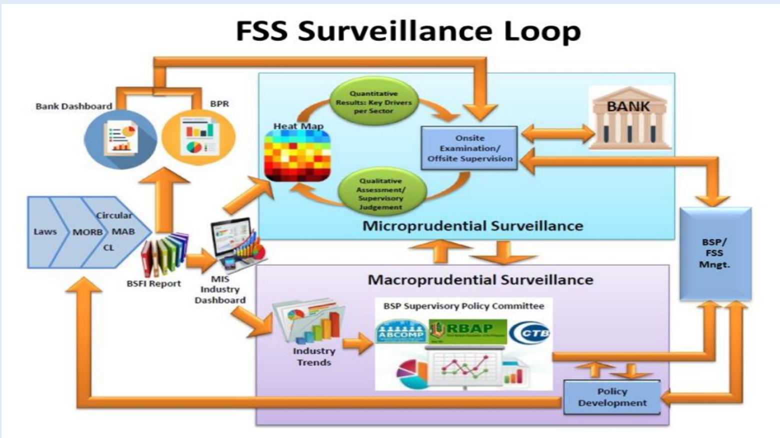
Box Article 8

The Evolving Financial Surveillance Tools

The year 2018 has been the advent of major developments in terms of financial surveillance for the Bangko Sentral ng Pilipinas (BSP) over BSP-Supervised Financial Institutions. These were brought about primarily through the BSP's continued efforts in exploring and harnessing various technological advances as the financial system embraces the age of digitization. As the regulator of the financial system, the BSP through the Financial Supervision Sector (FSS), fortified its surveillance with the FSS Surveillance Loop ("The Loop").

FSS Surveillance Loop

The Loop is a surveillance framework that highlights the constant dialogue and interaction of the BSP (through its supervisory departments and working groups such as the BSP Supervisory Policy Committee) with the various institutions that make up the financial ecosystem e.g. BSP-Supervised Financial Institutions (BSFIs), other Financial Sector Regulators such as the Securities and Exchange Commission (SEC), Philippine Deposit Insurance Commission (PDIC) and Insurance Commission (IC), other government agencies and stakeholders. The consistent and rigorous interplay of these institutions reveals true market conditions which becomes the basis in crafting policies and introducing initiatives that will be able to maximize opportunities or address potential areas of concern. It provides a strong, data-driven and empirical basis for decision-making by BSP management.



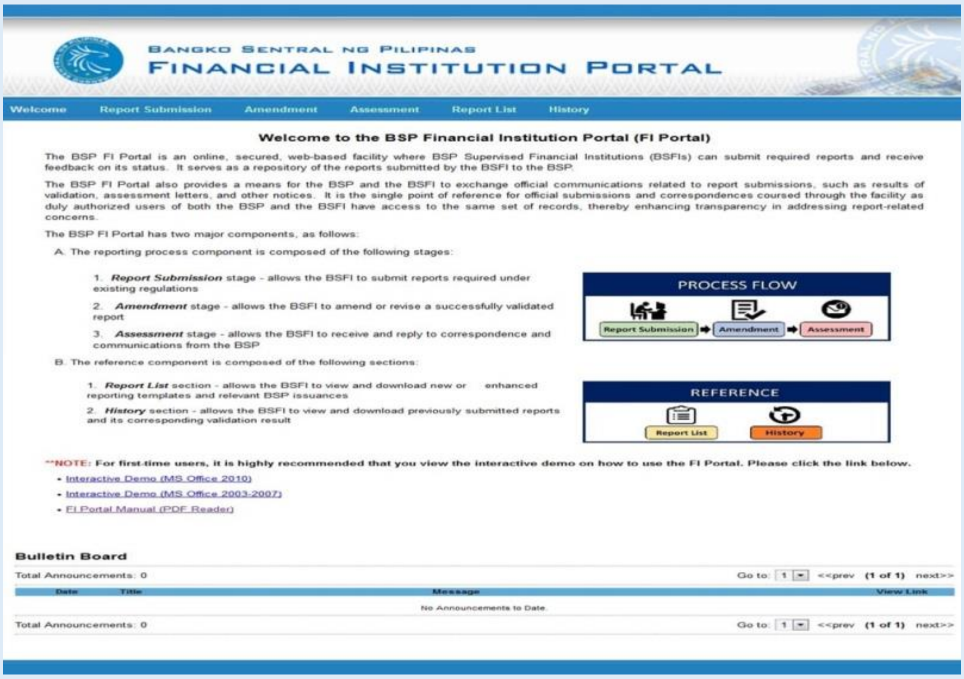
The Loop crystallizes and clarifies the existing core practices of different units in the BSP in determining ongoing developments in the financial and banking sector to highlight areas of emerging interests or potential concern through analysing statistical trends and behavior that are emanating and sourced from prescribed reports submitted by BSFIs. These observed trends are then verified as to whether it is a peculiar behavior of a limited segment of supervised institutions or a system-wide phenomenon. This process entails assessing the condition of specific BSFIs through internal consultation with key officials of FSS departments and conducting informative dialogues with the different industry associations[1] in gaining better market perspective. The information gathered through these processes becomes the basis of specific directives or implementation of certain policies that may affect individual banks or the banking industry as a whole or its major sub-industries.

[1] Bankers Association of the Philippines (BAP), Association of Bank Compliance Officers (ABCOMP), Chamber of Thrift Banks (CTB), Rural Bankers Association of the Philippines (RBAP).

The FSS Surveillance Loop has a high reliance on the quality of information that the BSP receives from BSFIs in the form of periodic reports as a starting point of analysis. Complete, accurate, consistent, reliable and timely information are necessary for the BSP to conduct its supervision effectively. This led to the issuance of a framework for adherence to the BSP reporting standards through BSP Circular No. 963 or Bank Responsibility for the Generation and Timely Submission of Required Reports to the Bangko Sentral.

While demanding a high level of reporting standards, the BSP also sought ways to partner with banks and international organizations in capitalizing on leading information technology to streamline the reporting submission process. These initiatives aim to utilize advancements in information technology in order to make the reporting process more secure, transparent, and efficient. This is currently being done primarily through two ongoing projects: the Financial Institution Portal (FI Portal), Regtech for Regulator-API Submission. Alongside this initiative of gaining better perspective through improvements in the formal reporting process, the BSP also embarked on a Chatbot project that is intended to obtain fresh sentiments from financial consumers. Together, these initiatives are expected to improve the overall surveillance capability of the BSP by partnering with banks and keeping a close ear to the needs of financial consumers.

Financial Institution Portal (FI Portal)



The BSP FI Portal is an online, secured, web-based facility for the submission of required reports by BSFIs. The portal is also designed to automate the process of monitoring the report submissions and to post, in real-time, the validation results of these submitted reports. It is envisioned to serve as the repository of all reports submitted to the BSP. The FI Portal also serves as a platform that will facilitate the exchange of official communications related to report submissions, such as results of validation, assessment letters, and other notices. It will be the single point of reference to all official submissions and correspondences coursed through the facility as duly authorized users of both the BSP and the BSFI have access to the same set of records.

The use of FI Portal eliminates the tedious and cumbersome process of report submission through email. It standardized the reporting process and eliminated numerous potential errors that are endemic to an email-based submission process. This is expected to reduce the time it would take for a report to be considered compliant with the BSP reporting standards, with the added benefit of minimizing penalties on BSFIs for non-compliance. The web-based channel also provides a more secure and transparent environment for the BSFI and the BSP. Official records of report submission and validation are automatically maintained in a secure manner that are available to both parties in case there is a need to review them.

The FI Portal is envisioned to exist side-by-side with the API-based submission within the next couple of years, as BSFIs mature in their technological capability to eventually migrate to more efficient and secure modes of submission such as the API as described below.

Application Programing Interface (API)

The BSP participates in the RegTech for Regulators Accelerator (R2A), a pioneering project that provides technical assistance for selected financial regulators in developing cutting-edge digital tools (referred as regtech solutions) to improve the speed, quality and comprehensiveness of information for risk-based supervision and evidence-based policymaking. Regtech solutions also have potential to reduce the cost of compliance for financial institutions, and increase consumer trust in the financial system. The R2A is being funded by several International organizations and is being managed by the consulting firm BFA Global with Rockefeller Philanthropy Advisors as fiscal sponsor.

As an R2A partner, the BSP has opportunity to pioneer the next generation of tools and techniques for market supervision and policy analysis in order to better monitor and understand financial marketplaces that are increasingly complex and innovative. Under this partnership, the BSP is piloting two regtech solutions: an API for supervisory reporting and a chatbot for complaints handling.

The API project involves the development of a program that will allow machine-to-machine reporting by banks to the BSP, thereby fully eliminating manual intervention in the reporting process. It utilizes the more current and advanced Extensible Markup Language (XML) reporting format in lieu of the existing reporting formats (Excel and CSV) which aligns the BSP with international practices in reporting standards. The use of the XML format also makes possible the restructuring of several reports into a single rationalized structure. Report validation is also kept to a minimum as inclusion of unnecessary data (i.e., generated totals or duplicate entries) are minimized. This in turn allows for a much faster generation of statistics that are used in various financial surveillance tools.

Phase 1 of the R2A project involved two pilot banks primarily as proof of concept, with a successful turnover done in June 2018. Phase 1.5 covers the development of analytical outputs that will complete and enhance the existing financial surveillance process. It will also expand the scope of the project to at least 20 additional pilot banks in preparation for live implementation within 2019.

Chatbot for Complaints Handling

A prototype chatbot and processing utility solution to handle customer complaints is also being developed under the R2A project. This will provide accessible, automated, and more convenient channels for consumers to file complaints with the BSP. This project uses social media messenger apps and text messages alongside the existing Consumer Assistance Mechanism currently being facilitated through emails, phone calls, and face-to-face interactions. This in return, strengthens BSP's ability to gather intelligence on customer experiences which is beneficial for consumer protection risk assessment and policymaking.

The chatbot, through the use of natural language processing, can either accept, classify, and send complaints to BSP consumer specialist who in return feeds possible responses or send the complaint to dedicated email address of concerned BSP supervised financial institutions (BSFIs). The technology will also weed out or screen complaints that are not even related to institutions under BSP's jurisdiction.

With the data gathered by the chatbot, the BSP will be able to use trend recognition and predictive analytics to better understand and address consumer protection challenges. The chatbot, and its attendant dashboard alerts and reporting tools, enable supervisors to minimize complaint processing time, and focus more on analytics as input to policymaking and financial system supervision. A digital solution like the chatbot, captures more data, has a wider reach, offers a faster turnaround time, and more cost-effective. The impact is far-reaching. Combined with advanced machine learning techniques, the platform can be used to detect anomalies and possibly uncover systematic market misconduct. An enhanced and improved user experience through the chatbot can lead to a improved system for analyzing complaints, enhanced consumer protection, and better engagement with consumers.

The FI Portal and API-based initiatives for BSFI reporting and the Chatbot for Complaints Handling clearly manifest the BSP's willingness to embrace digital transformation in the financial system and clearly reflect BSP's adaptability and resilience in the ever-changing financial ecosystem as it applies the FSS Surveillance Loop towards the fulfilment of its mandate. This also paves the way for the development of advance analytics that utilizes Big Data, Machine Learning, Text Mining, and similar technologies.

Financial Stability

In the pursuit of a stable financial system, the BSP is committed to identify, monitor, analyze and mitigate the build-up of systemic risks. The BSP through the Office of Systemic Risk Management (OSRM) implemented the following:

Formulated appropriate and timely interventions/policies that mitigate the build-up of systemic risks. Policy work was focused on addressing fundamental issues in 2018, namely, credit growth, financial market repricing and macro risks. Reform initiatives in 2018 were defined to address vulnerabilities that build over time. To this end, the policy framework on the Countercyclical Capital Buffer (CCyB) has been published.[1] It is designed to provide a steadying hand to counter the common occurrence of boom-and-bust periods within the financial cycle.

Other than the CCyB, the OSRM likewise recommended the re-implementation of the Currency Rate Risk Protection Program (CRPP) in response to growing demand pressures in the foreign exchange spot market in September 2018. The CRPP Facility allows clients of universal/commercial banks to hedge their foreign currency borrowings.

Meanwhile, in the pipeline are the Debt-to-Earnings of Borrowers Test (DEBT) and the Borrowers' Interconnectedness Index (BII) which were already exposed to relevant stakeholders for comments. The DEBT requires banks and enables the BSP to monitor the debt service capacity of top borrowers under stressed conditions. On the other hand, BII extends the risk analysis of DEBT to the borrowers' level of interconnectedness in terms of the magnitude and extent of its debt from the banking system.

Institutionalized a new Financial Stability Report. The Financial Stability Report (FSR) was released to the public for the first time, a milestone for the BSP. The FSR presents cross-cutting risks in an integrated manner rather than per industry where the primary audience are the market players to guide them on their business decisions that may impact financial stability (FS) in the Philippines. To mainstream FS, the BSP through the Messaging Unit has organized and executed pre-event and post-event social media activities for the launch thru its social media accounts with FB, Twitter and Instagram.

Developed a Macrofinancial Framework. A framework that establishes the nexus between the financial market and the real economy in the Philippines was crafted, making use of several behavioral equations. Coming from a small open economy perspective, the influence of the global environment on the domestic market was taken into account. Price signals and general market movements were also differentiated including investor sentiments and risk perceptions. In detail, the drivers of foreign exchange rate were looked into using the Currency Value-at-Risk Model and the relationships between and among the policy rate, market rates, lending rates, and the exchange rate were identified. More importantly, how the intricacies in the financial market impact real economy variables such as inflation and GDP was looked into.

Developed a framework for the monitoring of the repo market. In order to closely monitor the activity and developments in the repo market and ensure that liquidity and financial stability risks are sufficiently addressed, a monitoring framework based on the Financial Stability Board methodology was developed which supports the Government Securities Repo Program launched in November 2017 in its effort to develop and deepen the domestic financial market. The monitoring framework was approved by Management.

Formulated Financial Stability Indicators. Gauging the comovement of firms' asset returns and its potential adverse effect to the entire system, OSRM adopted the following measures of systemic

[1] Circular No. 1024 dated 06 December 2018

risk – Conditional Value at Risk (CoVaR), Delta Conditional Value at Risk (Delta CoVaR) and Marginal Expected Shortfall (MES), SRISK and Network Analysis. Both CoVaR and Delta CoVaR measure what happens to the profitability of the system when one firm encounters difficulties. As an enhancement to the model, the Forward Delta CoVaR considers individual firm-level characteristics such as the firm's size, leverage, maturity mismatch, and market-to-book value. MES measures the loss in capital of an institution when the system as a whole is already at the critical point of systemic dislocation. SRISK estimates the amount of capital that a firm would need to raise in order to function normally if a financial crisis occurs. Meanwhile, Network Analysis measures the risk arising from linkages in a financial system, where a failure in a single entity causes a cascading failure which could potentially bring down the entire project.

Conducted a quarterly systemic risk assessment.
Pursuant to its mandate of monitoring the financial institutions and the environment in which they operate in order to identify financial stability issues arising from local and cross-border developments, a quarterly systemic risk report is submitted to the members of the Financial Stability Coordination Council (FSCC).

Crafted a communication strategy.
The communication framework and communication program for financial stability through the FSCC was also developed. Said framework handles the challenges specifically identified by the BIS and other FS entities. It is a three-stage Communication Framework to consolidate the proactive efforts of FSCC members in mainstreaming FS and in communicating the Council's actions during normal and crisis situations. It is reinforced by an organized Communication Plan with levels of approaches (awareness, understanding, proficiency, and action) that will enable the Council to deliver core messages to its stakeholders as well as respond to financial stability issues brewing in the market more effectively using various information-education-communication tools. The layering of the communication approach recognizes the need to calibrate the messages that need to be conveyed keeping in mind the requirements of specific stakeholders. The Communication Plan also emphasizes the FSCC's approach in providing thought leadership in the new era of prudential oversight of financial stability.

Designed and implemented an intra-ASEAN survey on cross-border exposures for the surveillance of the Region's integration efforts.
Pursuant to the targets and milestones of the AEC 2025 Strategic Action Plans (SAP) for Financial Integration from 2016-2025, an intra-ASEAN survey on cross-border exposures was developed for the surveillance of the Region's integration efforts. The purpose of which was to provide baseline data on cross-border exposures prior to integration and to determine whether banking integration has been effective in increasing cross-border transactions.

Box Article 9

Towards a more dynamic Bangko Sentral: The BSP Charter as Amended

A major change in the central bank law is often a response to various factors (economic, political and historical) at play. Economic and financial developments may identify the need for additional authority, enhanced powers or greater flexibility in the conduct of its operations to achieve policy objectives. The growth in the size of the economy it services as a macroeconomic regulator as well as the increase in the scale and sophistication of the banking system over which it exercises oversight and regulatory powers further generate demands for revisions to the central bank law to ensure that it will continue to attain statutory objectives. In essence, the amendments to the law allow the central bank to retain and enhance its credibility as a policy and regulatory institution.

For the case of the Bangko Sentral ng Pilipinas, the motives for amending its organic law were to (1) strengthen its monetary stability functions; (2) enhance its financial stability and prudential supervision functions; and (3) reinforce its corporate and financial viability. To strengthen its monetary stability functions, it sought the restoration of its authority to obtain information from the non-bank private sector as well as to issue its own debt securities.[1] It further asked for the removal of thresholds in the growth of money supply and credit as guiding principles in the conduct of monetary management. To enhance the BSP's financial stability and prudential supervision functions, it requested for the formal recognition of financial stability as a shared objective with other regulators as well as for oversight of the country's payments systems. The BSP's supervisory authority was also expanded to cover money service businesses, credit granting businesses, and payment system operators. Authority to regulate the transfers and acquisition of large blocks of bank and non-bank equity as well as to raise penalties to enhance enforcement powers was also obtained. More importantly, full flexibility to conduct risk-based supervision of financial institutions and to improve the resolution mechanisms to deal with failing financial institutions was incorporated into the law. Lastly, legal protection, at par with other regulators, for BSP officers and staff in the conduct of the duties was also provided for in the revised law. Finally, to reinforce the corporate and financial viability of the BSP, its authorized capitalization was increased to P200 billion and tax exemption privileges were instituted for revenue generated under its governmental functions.

With respect to strengthening the central bank's monetary stability function, the amendments are very significant. The restoration of the authority to obtain information from the non-bank private sector is particularly important since current BSP authority is limited while the conduct of monetary policy has become more information-intensive over the years. It should be noted that the quality of monetary policy is dependent on the relevance, reliability, timeliness and comprehensiveness of the information used. It also empowers the BSP to be more proactive such that it can address potential risks and challenges to the economy. The restoration of the BSP's authority to issue its own securities as part of standard monetary operations provides the BSP with additional instruments for liquidity management thereby allowing greater flexibility in managing structural liquidity and in ensuring macroeconomic stability. Lastly, the removal of reporting thresholds for the growth of money supply and credit brings these accountability requirements into the context of modern central banking wherein the focus of the decision making process on money supply has declined over the years and has increasingly shifted instead to inflation.

[1] The latter is done through the deletion of a condition that the issuance by the BSP of its own securities can only be made in cases of extraordinary movements in price levels.

The amendments to enhance the financial stability and prudential supervision powers of the BSP are also noteworthy. An explicit mandate of financial stability as a shared responsibility with other regulators allows the BSP to work closely with other relevant bodies[2] to promote financial stability and complements BSP's role in promoting price stability, which rests on a bedrock of a robust and stable financial system. Similarly, the express mandate to oversee the country's payments systems, including financial market infrastructures, goes hand in hand with the promotion of monetary and financial stability.[3] On the other hand, the expansion of coverage of supervised entities would address regulatory gaps. Separately, the authority to regulate the transfers and acquisition of large blocks of bank and non-bank equity[4] will ensure that controlling interests are pre-qualified before actual control of supervised institutions is effected. The provision will also discourage practice of non-disclosure of equity transfers to avoid pre-qualification of transferee. Violations of this and other regulations will also face larger penalties which aim to reflect economic realities as the original penalties no longer serve as deterrent against violations of banking laws, rules, regulations as well as orders and instructions from the regulator. In a separate vein, the amendments also provide for full conduct of risk-based supervision of financial institutions consistent with internationally-accepted principles and standards.[5] Subsequently, for troubled supervised entities, the enhanced resolution mechanism authorizes the Monetary Board to direct the Philippine Deposit Insurance Corporation, as receiver for banks, to proceed with the liquidation of the closed bank and includes Non-Stock Savings and Loan Associations (NSSLAs) among those that may be placed under receivership.[6] Lastly, legal protection for BSP personnel performing official duties mitigates legal risks faced by BSP staff acting in good faith in the discharge of their functions; aligns legal protection for bank regulators with international best practices; and places BSP supervisory and regulatory staff on equal footing with other regulators (e.g., personnel of the Philippine Deposit Insurance Corporation).

Importantly, the reinforcement of the financial and corporate viability of the BSP promotes its financial independence and enhances its policy credibility. The increase in the authorized capitalization of the BSP will enable the BSP to meet the needs of an expanding economy and growing complexity and sophistication of the financial system. The capital infusion will be funded via declared dividends of the BSP which are earmarked under the law for its capital build-up. In so doing, the larger capitalization will be attained under an appropriate degree of financial autonomy which supports its pursuit of policy objectives without being constrained by concerns over its financial position. Lastly, the tax exemption privileges for revenue generated in the conduct of its governmental functions (e.g., extensions of credit as lender of last resort) recognizes that these operations are conducted using public funds to attain societal objectives assigned to the BSP by law and which should not be constrained by tax expenditures to recover costs and limit losses taken because of policy (i.e., not profit) considerations.

Most importantly, the BSP Charter, as amended, provides for a primary mandate of price stability conducive to a balanced and sustainable growth of the economy and employment. The additional phrase "and employment" affirms the current practice of flexible inflation targeting and prohibits a zero weight on output or, more specifically, employment in the conduct of central bank policy setting.

---

[2] These would include the Securities and Exchange Commission, the Insurance Commission, the Philippine Deposit Insurance Commission and other agencies of the National Government.
[3] It should be noted that failure in the payments system can result in (1) inefficient use of financial resources; (2) inequitable risk sharing among agents; (3) financial losses for market participants; and (4) loss of confidence in the financial system and in the use of money.
[4] Specifically, the amendment covers the transfer or acquisition of at least 10 percent of the voting shares in the bank or quasi-bank. Henceforth, the same shall require prior approval from the BSP.
[5] Under the Basel Core Principles for Effective Banking Supervision, examining financial institutions take into consideration the risk profile of the entity. For example, banks or quasi-banks which are determined to be very low-risk may be subjected to examination on a less frequent basis while banks or quasi-banks determined to be high-risk shall be subjected to examination as often as may be allowed by law.
[6] It is further provided that the receiver, defined as any person of recognized competence in banking, credit or finance, may be designated by the BSP.

How We Performed in 2018: Operations, Advocacies, Initiatives and Financial Results

Monetary Operations

In 2018, total placements in the BSP's monetary facilities declined to ₱428.59 billion from ₱491.3 billion in 2017. The decline may be attributed to the lower level of liquidity in the system due to the BSP's foreign exchange operations. A majority of banks' placements or around 69.4 percent went to the overnight reverse repurchase (RRP) facility while 13.5 percent and 16.0 percent went to overnight deposit facility (ODF) and term deposit facilities (TDFs), respectively. Banks also borrowed more actively from the BSP's overnight lending facility (OLF), especially after the BSP's efforts to communicate to the market that said facility is available for the daily liquidity management to provide counterparties a means to adjust their end-of-day liquidity requirements. The total volume of OLF borrowings amounted to ₱1,103.7 billion, higher than the ₱237.0 billion total availment in 2017.

In light of the BSP's 175-bp cumulative policy interest rate hikes in 2018, market interest rates consistently rose during the year. For the TDF, market participants aligned their bids with the BSP's higher policy rates. Similarly, the average cost of overnight funds in the interbank call loan (IBCL) market rose to 3.8 percent in 2018 from 2.7 percent in the previous year as banks priced in the BSP's 175-bps aggregate rate hike and the lower level of peso liquidity in the system.

Maintenance of peso stability

The BSP registered net US dollar sales for the year as the BSP tempered the pressures on the peso amid rising US interest rates, concerns over the country's widening trade and current account deficit, and accelerating inflation.

For the year, the peso depreciated by 5.04 percent to ₱52.58 on 28 December 2018 from ₱49.93 on 29 December 2017, tracking the movement of most regional currencies as the dollar strengthened amid rising US interest rates. Nonetheless, the BSP's market presence and its decision to hike policy rates five times in 2018 to contain inflation limited the peso's volatility, enabling the peso to rank as the least volatile among regional currencies. In 2018, the peso ranked as the third most depreciated currency among its peers, and the least depreciated currency among those with current account deficits (India, Indonesia and Philippines).
To further cushion the impact of the sharp peso movements, the BSP has also reactivated the Currency Rate Risk Protection (CRRP) facility in October 2018.

Currency Operations

The BSP, through the Metro Manila Currency Operations Sub-Sector (MMCOSs), carried out various initiatives to strengthen the implementation of the BSP Clean Note and Coin Policy, such as the standardization of banknote fitness level, reaching out to social media users through Coin-Ed videos and infographics, conceptualization and implementation of the CMS Front-liners Addressing Currency Issues Empowerment (FACE) Seminar, development and distribution to the regional offices of Standard Know Your Money (KYM) Training Kit, launch of the Clean Money Society Project, and strengthening of existing partnerships with various stakeholders to advance currency-related advocacies.

Meanwhile, the BSP Regional Offices and Branches (ROBs) also helped in promoting BSP advocacies, intensified and widened the reach of its public information campaigns particularly to those residing in far off and remote rural areas, and sustained the conduct of economic and financial surveillance. Topics covered in the public information campaigns included economic and financial literacy, counterfeit currency detection, coin recirculation, and clean note and coin policy, among others. Moreover, the regional Economic and Financial Learning Center (EFLC) units, in partnership with the EFLC and other departments/offices in the BSP head office, continued the rollout of the BSP Knowledge Resource Network, by establishing more Knowledge Resource Corners (KRCs) in various public and private partner libraries across the country. For 2018, the ROBs established 78 KRCs, in addition to the 93 KRCs established in 2017.

International Reserves Management

In 2018, the BSP realigned its investment strategies to strengthen the function of the GIR as liquidity support in times of volatility in the exchange rate and BOP. The new strategies also placed emphasis on the capital preservation of the reserves and the enhancement of returns. During the year, the BSP was also able to earn investment income and outperform the benchmarks even amid an environment marked by vulnerable financial assets, changing landscape in global trade and uncertainties in the monetary policy direction of developed markets.

For Internally-Managed Portfolio (IMP), under the stewardship of the Investment Management Committee (IMC), the BSP has implemented portfolio strategies to generate returns from international assets within the parameters and limits set in the operational guidelines approved by the IMC. In response to the developments and challenges in the global financial markets that surfaced in 2018, the BSP has rebalanced portfolios to support domestic operations. Furthermore, it continued to strengthen the framework for managing its reserve portfolios through the review of its Strategic Asset Allocation (SAA), which led to the creation of the working capital tranche, which will be implemented in 2019.

Furthermore, the BSP has expanded its credit risk appetite by lowering the credit rating threshold up to the investment grade for all its counterparties in the IMP.

The BSP also continued to implement measures aimed at ensuring the safety and diversification of the Bank's international assets. Key strategies and measures were employed during the year that facilitated the active management of the IMP. Investments in new markets (i.e., onshore Chinese government bonds and gilts) were also undertaken. The Investment and Liquidity Portfolios both outperformed their respective benchmarks during the year.

For Externally-Managed Portfolio (EMP), a portfolio that is predominantly composed of government bonds generated positive absolute returns in 2018, mostly due to income from interest accruals on bond holdings. The EMP also benefitted from the decline in Japanese and

German government bond yields amid increased demand for safety brought about by global trade tensions and political headlines in Europe.

The framework for managing gold reserves was also strengthened as it continued to manage the BSP's gold reserves in compliance with existing management guidelines. By the second half of the year, it implemented the strategies outlined in the new gold reserve management framework, with the adoption of investment policies and operational guidelines that govern the Bank's gold transactions, both in the international and domestic fronts, which was approved by the MB under Resolution No. 969 dated 14 June 2018. The new framework adopted a passive strategy for BSP's gold reserves consistent with the rationale of holding gold for insurance and security.

Thus, it involves naturally accumulating existing gold holdings from domestic purchases with Philippine pesos regardless of the gold-to-GIR ratio. The trading of BSP's strategic gold holdings may be allowed, but for limited purposes only, such as to cover the holdings cost.

Total gold reserves of the Bank as of end-2018 stood at AU6.36 million fine troy ounces (FTO), which is slightly higher than the AU6.31 million FTO registered as of end-2017.

Meanwhile, the framework for non-gold reserve management was revisited that led to the adoption of the following major changes:
(1) reserve tranching;
(2) currency composition;
(3) strategic asset allocation and benchmarks; and
(4) the setting of budget for active risk using the tracking error concept.

International Economic Cooperation

The BSP continued to strengthen monetary and financial cooperation and integration in the international, regional and bilateral fronts in 2018. To reap the benefits of collaborative engagement, the BSP remained an active participant in various regional and international cooperation programs, forums, conferences, workshops and technical meetings. Important initiatives were implemented and progress on critical agreements were advanced in the areas of regional economic integration, financial arrangement, economic surveillance, policy dialogue and capacity building.

Among the highlights of the year is the BSP's hosting and Chairship of the 23rd Executives' Meeting of East Asia-Pacific (EMEAP) Central Bank Governors and 7th Informal Meeting of EMEAP Governors and Heads of Supervisory Authorities on 3-5 August 2018. Both meetings set the stage for governors and heads of monetary authorities to discuss issues of mutual interest, such as developments in financial technology (fintech), credit and financial cycle identification and their impact to central banking, and globalization and its monetary implications on EMEAP central banks.

Participation in regional and international cooperation and integration agenda remains an important mechanism by which the BSP gathers important inputs to monetary and financial policy formulation, especially in its vision to become a world-class monetary authority.

Economic Surveillance and Policy Dialogue

Economic Surveillance. The BSP facilitated the conduct of regular surveillance activities in line with the International Monetary Fund's (IMF) Article IV Consultation Mission, which was held on 11-25 July 2018. The IMF Mission Team met with senior officials of national government agencies including the BSP, Department of Finance (DOF), Department of Budget and Management (DBM), and the National Economic and Development Authority (NEDA), officials from financial institutions and the private sector to discuss global developments and identify possible sources of risks to growth and financial stability. During the mission, the IMF team led by Mr. Luis E. Breuer noted the BSP's strategy of maintaining policy continuity, while adapting to emerging challenges, and taking advantage of the strong economy to implement reforms to improve inclusive growth and job creation. The IMF Staff Report, which was published on 27 September 2018, provided a glowing assessment of the Philippine economy and indicated ample policy space to deal with emerging risks.

Similar to the engagement with the IMF in terms of economic surveillance, the BSP likewise facilitated the conduct of the ASEAN+3 Macroeconomic Research Office (AMRO) Staff Consultation Visit held on 15-24 October 2018. This annual undertaking allows a mission team from AMRO to assess the country's macroeconomic conditions, as well as the emerging risks, policy challenges and responses. This year's discussions with country authorities and representatives of international financial institutions with offices in the Philippines as well as the private sector focused on the growth outturns and prospects amid rising inflation and a challenging external environment.

Likewise, the BSP contributed to the surveillance initiatives of EMEAP through quarterly financial market monitoring which tracked quick-moving financial market developments in the currencies, equities, and credit default swap (CDS) markets, as well as policy rate movements among EMEAP member economies and selected advanced and emerging market economies. The data template/ chart pack, which is transmitted to the Deputies of the EMEAP members on a quarterly basis, serves as a quick reference on the financial market developments in the region.

In addition, the BSP continued to contribute technical inputs in the preparation of various regional economic monitoring reports, such as the Association of Southeast Asian Nations (ASEAN) Financial Integration Monitoring Report (AFIMR), ASEAN Capital Account Liberalization Policy Dialogue Report, and the EMEAP Macro Monitoring Report.

Policy Dialogue. The BSP demonstrated thought leadership in various international forums, such as the Asia-Pacific Economic Cooperation (APEC), ASEAN, ASEAN+3, Bank for International Settlements (BIS), EMEAP, IMF, and the Southeast Asian Central Banks (SEACEN) Research and Training Centre through consultations, discussions and exchange of views on relevant monetary, economic and financial cooperation issues.

APEC. Under the APEC Finance Ministers' Process (FMP) led by the DOF, the BSP continued its active engagement by participating in meetings to safeguard and elevate its positions on various proposals and concerns, and providing technical inputs to various important APEC reports and statements, particularly those under its purview such as financial inclusion and the implementation of the Cebu Action Plan (CAP). These issues remain priorities under the chairship of Papua New Guinea of the APEC process.

ASEAN. During the 4th ASEAN Finance Ministers and Central Bank Governors Joint Meeting on 3-6 April 2018 in Singapore, the BSP participated in the ASEAN policy dialogue with the IMF, ADB, AMRO, and World Bank (WB) on the regional and global economic developments and outlook, as well as on issues on regional economic integration in ASEAN. The BSP presented the accomplishment report of the ASEAN Senior Level Committee on

Financial Integration under the Co-Chairship of BSP and Bank Indonesia (2016-2018) highlighting the following key achievements: (a) facilitated the publication of the Strategic Action Plan (SAP) for financial integration; (b) coordinated the development of Key Performance Indicators; (c) developed and implemented the Risk Monitoring Template and Heatmap; (d) facilitated the amendment of Annex 1 of the ASEAN Charter to include the central bank process; (e) encouraged engagement with the private sector; and (f) ensured the continued support of the ADB for capacity-building initiatives. The BSP also actively participated in the negotiation of the ASEAN Trade in Services Agreement (ATISA) Annex on Financial Services, the ASEAN-Hong Kong Free Trade Agreement, and ASEAN-Hong Kong Investment Agreement, to ensure that key disciplines and commitments affecting banking services are consistent with existing banking laws and regulations.

ASEAN+3. The BSP continued to play an active role in the various regional cooperation initiatives of the ASEAN+3 process through its sustained participation in the Taskforce, Deputies and Ministers and Governors' meetings. The BSP delegation consistently elevated its positions on matters related to the regional financial safety net, Chiang Mai Initiative Multilateralization (CMIM) which, in 2018, had undergone an intensive periodic review to ensure that the CMIM Agreement remains relevant and can be smoothly operationalized when the need arises. Another important element of the ASEAN+3 process is the continued capacity-building of AMRO as an international organization aiming to be a trusted advisor of the ASEAN+3 member countries. The BSP provided technical inputs to AMRO policy papers and proposals as well as transmitted comments on institutional reports to ensure that these reflect the views of the members. In a similar way, the BSP was also active in the meetings of the Asian Bond Markets Initiative (ABMI), another key aspect of the ASEAN+3 process, aimed at deepening regional capital markets by increasing the supply and demand of bond issuances, among others.

BIS. On the preservation of financial stability and enacting regulatory reforms in the financial and banking sectors, the BSP participated in the regular bi-monthly meetings and Annual General Meeting of the BIS. For 2018, the six (6) BIS bi-monthly meetings were conducted to discuss pressing issues among small open economies such as: post-crisis changes to monetary policy frameworks; spillovers from US economic policies; evolution of central banks' role in financial stability work; central bank communication policies; and housing markets and monetary policy. The BIS Governors also discussed emerging issues in the central banking community including: Basel III finalization; macroprudential measures and the housing market; artificial intelligence and machine learning in financial service industries; banknote counterfeiting risk and procurement; and the legal entity identifier and its future. The BSP Governor, as Chair of the EMEAP Governors' Meeting, served as a Member of the Financial Stability Institute (FSI) Advisory Board, which provides strategic guidance to the FSI of the BIS in promoting sound supervisory standards and practices. The BSP Governor also participated in the meeting of the Central Bank Governance Group (CBGG), which is the main venue for Governors to exchange views on the governance and organizational arrangements of central banks.

EMEAP. The BSP hosted the 23rd EMEAP Governors' Meeting and 7th Informal Governors and Heads of Supervisory Authorities (GHOS) Meeting on 4-5 August 2018 in Manila.

The meetings, which were chaired by Governor Nestor A. Espenilla, Jr., were attended by eleven (11) EMEAP central banks and monetary authorities[111] and by four (4) supervisory authorities, respectively. The EMEAP Governors' Meeting discussed the increased interdependence in the global economy and its impact on the conduct of monetary policy; as well as the post-global financial crisis (GFC) lessons to the current economic landscape and the remaining challenges for Asia-Pacific economies. Resource speakers were invited from the Federal Reserve Bank of New York (FRBNY), BIS, Asian Development Bank, and the IMF to share their views on the said topics.

Meanwhile, the 7th Informal GHOS Meeting looked into how financial technology changes the financial market landscape and discussed the current challenges to monetary and macroprudential policies. Experts from the Monetary Authority of Singapore, Dartmouth College, BIS, and the IMF led the discussions. The BSP also actively participated in the regular meetings of the EMEAP Deputies, EMEAP Monetary and Financial Stability Committee, EMEAP Asian Bond Fund (ABF) Oversight Committee, and the Pan Asian Index Fund Supervisory Committee and various EMEAP Working Groups (Banking Supervision, Financial Markets, Payments and Market and Information Technology Directors' Meeting).

IMF. At the IMF South East Asia Voting Group Constituency Office, the Philippines is represented by an Alternate Executive Director,[112] which allowed the Philippines, through the BSP, to further advance its interests and positions on key policy discussions in the IMF.

The BSP also participated in the Fund's regular meetings (including the IMF-World Bank Annual Meetings), provided comments and the BSP's 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. In particular, Deputy Governor Diwa C. Guinigundo served as a panelist for the panel discussion on emerging market policy responses to recent developments during the Joint Bank Indonesia–Federal Reserve Bank of New York Central Banking Forum on 10 October 2018. DG Guinigundo also served as panelist during the postcard series on Modernizing Monetary Policy Frameworks in ASEAN countries on 12 October 2018 where he shared the BSP's experiences and challenges in modernizing its monetary policy framework and highlighted measures taken, including peer knowledge sharing with the IMF and international experts.

The BSP also participated in the "High-Level Policy Dialogue on Regional Cooperation to Support Innovation, Inclusion, and Stability in Asia" on 11 October during the 2018 IMF-WB Annual Meetings in Bali, Indonesia. This underscored the importance of a region-wide approach to harness full potential of the new financial technologies for inclusive growth. During the dialogue, the panel welcomed the IMF/WB Group Bali Fintech Agenda that lays out key issues to consider in formulating policy approaches to capture the benefits from technological change and safeguard against its risks to financial stability, integrity, and consumer protection.

In addition, to facilitate policy dialogue and provide the platform for the Fund to disseminate its research work on some of the urgent issues affecting the global economy, the BSP organized six (6) outreach programs which were held in Manila, on the following topics:

Topic	Date
World Economic Outlook	19 April 2018
Asia Pacific Regional Economic Outlook	18 May 2018

[111] Reserve Bank of Australia, People's Bank of China, Hong Kong Monetary Authority, Bank Indonesia, Bank of Japan, Bank of Korea, Bank Negara Malaysia, Reserve Bank of New Zealand, BSP, Monetary Authority of Singapore, and Bank of Thailand.

[112] Ms. Edna C. Villa served as the Alternate Executive Director from 1 June 2017 to 31 October 2018 and was succeeded by Mr. Zeno R. Abenoja as Senior Advisor effective November 2018.

Topic	Date
Distribution Impact of the Tax Reform for Acceleration and Inclusion	20 July 2018
International Trade and Corruption Analysis: Using a Big Data Approach	18 October 2018
Global Financial Stability Report	26 October 2018
Financial Inclusion Seminar	22 November 2018

The lectures were attended by participants from the BSP and other government agencies (e.g., Bureau of the Treasury, DBM, DOF, and NEDA). The discussions were informative and useful in fostering understanding of the global and regional developments that may have an impact on domestic development and policy-making.

SEACEN. The BSP participated in the high-level governance meetings of the SEACEN Centre which includes the Deputy Governor-level Executive Committee Meeting and the Board of Governors' Meeting to discuss policy directions in the areas of research, training and capacity-building of the twenty (20) SEACEN member central banks, as well as critical internal, strategic issues. Aligned with the BSP's thought leadership thrust, the BSP also served as resource speaker in the following conferences and high-level seminars held in 2018:

Topic	Date/Venue
20th SEACEN-FSI Conference of the Directors of Supervision of Asia Pacific Economies on the topic "Nonperforming Assets (NPA) Identification and Measurement"	27 June 2018, Hong Kong SAR
SEACEN Conference of Directors of Payment and Settlement Systems on the topic "Payments and Settlement Systems in the ASEAN: Developments and General Lessons"	5 July 2018, Bali, Indonesia
2nd SEACEN Strategic Human Capital Conference "Attracting, Retaining and Engaging Talent with Pacing and Emerging Competencies in the Age of Digital Disruption"	27 August 2018, Sasana Kijang, Malaysia
The SEACEN-BIS High-Level Seminar on the topic "The Prospects for a Central Bank-Issued Cryptocurrency in the Asia-Pacific Region"	15 September 2018, Bangkok, Thailand

Bilateral Meetings. The BSP hosted a bilateral meeting with Bank Indonesia on 3-4 March 2018 in Taguig City where both central banks exchanged updates on recent economic, financial sector and fintech developments and explored the possibility of a Memorandum of Understanding (MOU) on Anti-Money Laundering and Combating the Financing of Terrorism in the area of payment system. The BSP also served as host to the Joint Working Group (JWG) Meeting on Bilateral Financial Cooperation between the Philippines and Japan on 21 May 2018 that discussed issues of mutual interest such as those faced by Japanese banks in the Philippines, financial markets and capital market reforms, progress of ASEAN financial integration, disaster risk financing and insurance, and updates on regulations on fintech and virtual currency. The JWG Meeting was also participated in by officials from the BTr, DOF, Securities and Exchange Commission, Insurance Commission and by officials from the Japanese Embassy, Ministry of Finance, Japan International Cooperation Agency and Financial Services Agency. In addition, the BSP participated in the Philippines-Japan Economic Partnership Agreement (PJEPA) Joint Committee Meeting on 28-30 May 2018 to review the provisions of and discuss possible enhancements to the commitments of the Philippines and Japan under the PJEPA.

Continued participation in global and regional financial arrangements as safety buffers in the BSP's policy toolkit against risks to tightening of global financial conditions

The existence of bilateral, regional and global financial safety nets demonstrates international cooperation efforts that enabled central banks to guard against possible financial market strain, credit crunch and liquidity squeeze. In 2018, the BSP maintained and renewed financial arrangements as part of its policy toolkit.

Global Arrangements. The BSP and the IMF have an outstanding Note Purchase Agreement (NPA), where the former committed to provide the latter with up to US$1 billion in resources to finance arrangements for countries with balance of payments difficulties.

The agreement was a renewal of an earlier agreement that was entered into by the BSP with the consent of the President of the Republic of the Philippines. Said facility is a testament to the country's sound macroeconomic fundamentals and strong external position. The agreement is effective until 31 December 2019 and may be renewed for another year, subject to the agreement of both parties. Participation in the said bilateral borrowing agreement will contribute towards boosting confidence in the adequacy of the Fund's resources to restore global economic and financial stability. As of end-2018, the IMF has not made any drawdown under the facility.

The Philippines, through the BSP, is a participant to the Fund's Financial Transactions Plan (FTP), which is the currency exchange arrangement between the Fund and selected members to facilitate IMF financing operations. The participation in the FTP is based on the strength of the member's balance of payments and reserve position, including developments in exchange and financial markets and the adequacy of the member's international reserve assets, recent and prospective current account balances, external competitiveness, and external debt indicators, among others. The Philippines is an FTP participant since August 2010.

In addition, the BSP continues to provide resources to the IMF under the New Arrangements to Borrow (NAB) facility. Said facility is a credit arrangement where the BSP provides resources to the IMF, up to a maximum amount of SDR370 million (about US$500 million). The Fund has made drawdowns from the BSP's NAB commitment to finance extended arrangements for Greece, Portugal, Tunisia, Cyprus, Ukraine, and Jamaica. The BSP receives interest income from its participation in the NAB based on the SDR interest rate.

Regional Arrangements. As another important layer of the financial safety nets available to and reliant on the cooperation and commitment of member economies, the CMIM facility continued to be reinforced in 2018 to ensure its readiness through the completion of the periodic review of the fundamental agreement, further enhancements to the Economic Review and Policy Dialogue matrix framework, and conduct of test runs. In all these, the BSP maintained active engagement and participation, not only to ensure the operationalization of the CMIM, but also to safeguard the country's interests and express its continued commitment in the regional financing arrangement.

Furthermore, the existing ASEAN Swap Agreement (ASA) which was renewed on 17 November 2017 remains in effect until 16 November 2019. The ASA involves the provision of short-term foreign exchange liquidity support for ASEAN Member Countries that experience balance of payments difficulties.

Bilateral Arrangements. To strengthen cooperation and information exchange in the areas of banking development and supervision, anti-money laundering, and capacity building programs on areas of mutual interest, the BSP forged a partnership with the signing of a Memorandum of Understanding (MOU) with Bank Indonesia on 4 August 2018 in Manila and the Czech National Bank on 12 October 2018 in Czech Republic. The BSP also signed an MOU with the People's Bank of China on Renminbi Clearing Arrangement during the State Visit of President Xi Jinping of China to the Philippines on 20 November 2018. The MOU was envisioned to act as a mechanism to facilitate the clearing of financial transactions denominated in RMB between market participants such as banks and non-bank financial institutions in the Philippines and China.

Moreover, the BSP's existing Bilateral Swap Arrangement (BSA) with Bank of Japan is effective until 5 October 2020.[113]

Renewed worries on escalating global trade tension and uncertainty in the timing of policy normalization in major advanced economies warrant stronger regional economic cooperation to build harmonized regulatory standards and surveillance systems

Risks to the global outlook remain tilted to the downside, with developments in international trade policy continuing to be a key source of uncertainty. This, in turn may impact the country through various channels, such as on trade, investment, and remittances. Noting the great potential of deeper regional trade and economic integration as a key growth driver for the region and the country, the BSP continued proactive participation in regional financial cooperation and integration initiatives.

ASEAN Financial Integration, Financial Inclusion, and Financial Stability. The BSP continued its active participation in the implementation of the ASEAN Economic Community (AEC) Blueprint 2025. In support of the ASEAN Financial Integration process, the BSP assumed the co-chairship of the Working Committee on Capital Account Liberalization (WC-CAL), Working Committee on Financial Inclusion (WC-FINC) and Working Committee on Payment and Settlement Systems (WC-PSS) for the period 2018-2020.

Inclusive Regional Integration. The BSP has actively engaged in the ongoing negotiations of the Regional Comprehensive Economic Partnership Agreement and also contributed to the conclusion of the Eighth Round of Negotiations on Financial Services Liberalization under the ASEAN Framework Agreement on Services (AFAS). Furthermore, the BSP supported the establishment of the National Connectivity Coordinating Committee of the Philippines (NCCC-PH) under the ASEAN Matters Technical Board (AMTB). The NCCC-PH will be responsible for coordinating and overseeing the implementation of priority projects and key actions of the Master Plan on ASEAN Connectivity (MPAC) 2025 which aims to provide physical, institutional and people-to-people connectivity in the ASEAN.

Capital Market Development. Sustaining its support to the development of the regional bond markets, the BSP participated in the discussions of the ABMI task forces focusing on promoting the issuance and demand of local currency-denominated bonds, and improving regulatory and related infrastructure for bond markets. The BSP participated in the 16th Cross-Border Settlement Infrastructure Forum (CSIF) organized by the ADB, contributing to the discussions on central securities depository and the real-time gross settlement (CSD-RTGS) linkages.

Capacity-Building Initiatives. The Philippines continues to benefit from considerable assistance of the IMF's capacity development resources such as technical assistance in the areas of fiscal management and financial market development and government finance statistics. During the year, the IMF provided the following technical assistance to the BSP:

IMF Department	Technical Assistance	Date of Mission
Statistics Department	TA Mission on Monetary and Financial Statistics	30 April - 11 May 2018
Institute for Capacity Development	TA Mission on Economics Structured Curriculum	15-16 October 2018

[113] The BSP and Bank of Japan signed the Restatement Agreement of the 3rd BSA (restated BSA) effective 6 October 2017, enabling the Philippines to swap its local currency against Japanese yen in addition to US dollars with the facility size of up to US$12 billion equivalent for the Philippines and US$500 million for Japan.

Meanwhile, the BSP, as co-chair of the WC-FINC, contributed in the completion of 24 capacity-building programs on financial inclusion topics. Some of these programs were conducted with the support of partners such as the ADB and the United Nations Capital Development Fund (UNCDF). The BSP also supported the ASEAN Steering Committee on Capacity Building (SCCB) by providing capacity building programs. In 2018, the SCCB was able to conduct 243 capacity-building courses under three (3) pillars[114] which benefited 644 participants from the CLMV[115] member states. The BSP aims to continue supporting the capacity building programs for CLMV under the various capacity-building pillars of the SCCB.

The BSP, with technical support from the Daiwa Institute of Research, commenced Phase VI of the Technical Assistance Coordination Team's (TACT) Bond Market Development Program aimed at developing safety measures in capturing data on the Philippine repo market, and identifying other safety measures or additional reporting requirements that will complement the data monitoring system that are currently in place, as well as the necessary enhancements within the system. The technical assistance is expected to be completed in one year.

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 forums throughout the year, including a briefing on ASEAN Banking Integration on 20 April 2018 conducted for the Capital Market Development Council (CMDC). In addition, the BSP served as a subject matter expert on the topic CAL Heatmap during the Capacity Building Course on "Capital Flow and Crisis Management" held on 5-6 November 2018 in Siem Reap, Cambodia co-organized by the Asian Development Bank and National Bank of Cambodia.

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 the region, in general and the country, in particular; and (c) to strengthen ties with other central banks and financial authorities by performing a leadership role in various bodies:

Conference/Workshop/ Meeting	Date and Venue	Extent of BSP Participation
Bilateral Meeting with the Bank Indonesia	3-4 March 2018, Taguig City	Host
Official Monetary and Financial Institutions Forum (OMFIF)-BSP Roundtable on Capital Market Development in the Context of Growing Asian and Financial Integration	2 May 2018, Manila	Host
4th Joint AMRO-IMF-BSP Seminar on Asia's Emergence in the New World Order: Growth, Integration, and Resilience	3 May 2018, Pasig	Co-Host
23rd EMEAP Governors' Meeting and 7th Informal Governors and Heads of Supervisory Authorities (GHOS) Meeting	4-5 August 2018, Manila	Chair
Joint Working Group (JWG) Meeting on Bilateral Financial Cooperation between the Philippines and Japan	21 May 2018, Manila	Co-Chair

[114] Pillar A comprises of courses organized in Cambodia, Laos, Myanmar and Vietnam (CLMV) countries with the support of ASEAN WCs; Pillar B comprises the ASEAN Financial Integration Framework (AFIF) customized courses as done in the previous phase; and Pillar C comprises bilateral learning programs which are supplied by the ASEAN-5 and demanded by BCLMV.
[115] Cambodia, Lao PDR, Myanmar, and Vietnam.

Box Article 10

Status of Regional Integration Efforts in ASEAN

ASEAN is a political and economic organization aimed primarily at promoting economic growth, active collaboration, mutual assistance, and regional peace and stability among its members.[1] The ASEAN Economic Community (AEC) Blueprint 2025, adopted on 22 November 2015, sets the general master plan for 2016-2025 towards an integrated ASEAN region.[2] To support the objectives of regional economic integration, the AEC Blueprint 2025 recognizes the importance of ensuring that the financial sector is inclusive and stable. The integration of the financial sector encompasses three strategic objectives: strengthening of financial integration; promoting financial inclusion; and ensuring financial stability.[3]

The financial integration aspect of the AEC will be pursued through sectoral initiatives which will be implemented by dedicated Working Committees. Each Working Committee involved in the ASEAN integration effort has prepared its work plan in the form of a Strategic Action Plan (SAP), which maps out the specific activities, quantifiable targets, and milestones in key sectors.

Status and Next Steps

The key accomplishments and initiatives moving forward in various areas of financial integration are as follows:

Financial Integration Area	Key Accomplishments/Status
Capital Account Liberalization (CAL) ASEAN aims to achieve freer flow of capital by gradually removing restrictions on foreign exchange transactions such as those in the current account (CA), foreign direct investments (FDIs), portfolio investments (PIs) and other flows (OFs), while imposing adequate safeguards.	• Adopted Article VIII of the International Monetary Fund, except Myanmar • Developed a CAL Heatmap, and an Enhanced Policy Dialogue Mechanism on Safeguards for CAL. The CAL Heatmap reflects objective scoring of the actual levels of development of the ASEAN Member States' (AMS) capital account regime, among others. Based on recent scoring, most members have already liberalized current account and direct investment flows.
Capital Market Development (CMD) ASEAN focuses on developing, interlinking and deepening the region's capital markets by building capacity and laying the long-term infrastructure to achieve integration of capital markets in ASEAN. This will be implemented through harmonization of domestic laws and regulations and linkage of market infrastructure.	• Established mutual recognition framework for Collective Investment Scheme (CIS) and harmonization of disclosure standards • Supported bond market development through the development of Bond Market Development Scorecard and ASEAN Capital Market Infrastructure Blueprint • Agreed to pursue initiatives to support green finance and infrastructure financing
Payment and Settlement Systems (PSS) Development ASEAN aims to establish an ASEAN payment system that is safe, innovative, efficient and more interconnected. It will be achieved through the adoption of international standards in domestic payment systems, development of domestic retail payment system and more efficient remittance mechanism, sound consumer protection and adequate risk management, among others.	• Agreed to adopt the ISO20022 standards to prepare domestic payment systems for bilateral/multilateral linkages within ASEAN • Promoted the implementation of chip-based cards for increased safety in using payment card • Developing a multilateral ASEAN Payments Policy Framework specifically covering cross-border real-time retail payments (RT-RPs) as well as a roadmap to facilitate such type of payments within the region
Financial Services Liberalization (FSL) The gradual removal of restrictions on ASEAN banks, insurance companies and investment companies in providing financial services in other	• Concluded eight (8) rounds of negotiations of FSL commitments under the ASEAN Framework Agreement on Services (AFAS) • Finalized the Annex on Financial Services under the ASEAN Trade in Services Agreement

---

[1] https://asean.org/asean/about-asean/. ASEAN is currently composed of ten (10) member states: Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam.

[2] https://asean.org/asean-economic-community/

[3] Financial integration will encompass strengthening of financial Integration to facilitate intra-ASEAN trade and investment through having more integrated banking, insurance and capital markets and a safe and cost-efficient financial market infrastructure; promoting financial inclusion through the delivery of financial products and services to a wider community; and ensuring financial stability through the continuous strengthening of regional infrastructure, particularly in times of regional stress.

Financial Integration Area	Key Accomplishments/Status
Member States will be implemented. Member States meet and negotiate on what financial services each country is willing to liberalize. The process of liberalization takes into consideration the readiness of the member economies, with an aim to have freer flow of financial services.	• Engaged Dialogue Partners to conclude free trade agreements (FTAs) with Australia, New Zealand, India, Japan, Korea, and Hong Kong • Initiated an FSL scoremap to provide a snapshot of ASEAN's progress in financial services liberalization
Banking Integration ASEAN targets to implement the ASEAN Banking Integration Framework (ABIF) by facilitating the entry and operation of qualified ASEAN banks (QABs)[4] in ASEAN jurisdictions to facilitate intra-ASEAN trade and investment. ASEAN also aims to achieve greater coherence of banking regulations for all AMS to support financial integration; and greater regional strength on the banking sector and market confidence.	• Approved on 31 December 2014 the ABIF Guidelines which set the parameters for the implementation of ABIF • Concluded the bilateral negotiations between the Bank Negara Malaysia (BNM) and Financial Services Authority of Indonesia [OJK] (2016), BNM and BSP (2017), and BNM and Bank of Thailand (BOT) (2017)
Financial Inclusion (FINC) ASEAN deliberates policy options, engages stakeholders and coordinates collective actions by member countries to enhance financial inclusion in ASEAN in the areas of financial intermediation and distribution channels, financial education, and consumer protection.	• Facilitated the significant reduction in financial exclusion levels in ASEAN from 58 percent in 2011 to 46 percent in 2017 based on the World Bank's FINDEX data • Completed the Guidance Notes (GN) on National Financial Inclusion Strategies and on Financial Education and Consumer Protection • Created an online portal that serves as repository of information and documents related to financial inclusion, financial education and consumer protection work in AMS, and also hosts the various guidance notes developed by WC-FINC
Capacity Building ASEAN recognizes the need to provide necessary capacity building and other initiatives to narrow the development gaps among ASEAN economies and bring all AMS to fully participate in the ongoing integration efforts.	• Initiated the development of Learning Roadmaps for each WC which provides a more holistic "hop on hop off" approach in learning • Conducted more than 243 capacity-building courses in 2018 under three (3) pillars[5] which benefited more than 644 participants from the CLMV[6] member states

BSP's Role in the ASEAN Financial Integration Process

Consistent with its mandate, the BSP has been supportive of the ASEAN financial integration process and has actively cooperated and collaborated with ASEAN central banks in advancing the financial integration objectives, through the following:

Responsive Regulations and Measures to Support Financial Integration. The BSP continues to undertake steps to strengthen the domestic financial system and the regulatory regime to ensure responsible risk taking. These include enhancing corporate governance and risk management; requiring capital build-up; encouraging mergers and consolidations; and opening up barriers to entry.[7] The BSP also lifted the moratorium on the granting of licenses for the establishment of new banks;[8] further liberalized the rules governing foreign exchange (FX) transactions;[9] implemented prudential reforms supportive of digital financial inclusion and financial technology (FinTech) innovations to promote micro, small and medium enterprises (MSMEs);[10] and established the National Retail Payments System (NRPS) including the new Automated Clearing Houses (PESO Net and InstaPay).[11]

---

[4] Refer to high quality banks that are strong and well managed and compliant with specific qualifications including the prudential requirements of host countries

[5] Pillar A comprises of courses organized in CLMV countries with the support of ASEAN WCs; Pillar B comprises the ASEAN Financial Integration Framework (AFIF) customized courses as done in the previous phase; and Pillar C comprises bilateral learning programs which are supplied by the ASEAN-5 and demanded by BCLMV.

[6] Cambodia, Lao PDR, Myanmar, and Vietnam

[7] Amando M. Tetangco, Jr. (2016, July 14). Speech on *ASEAN Integration, Change and Collaboration.* BSP website: http://www.bsp.gov.ph/publications/speeches.asp?id=533

[8] BSP Circular No. 902 (15 February 2016).

[9] BSP Circular No. 984 (22 December 2017); FAQs on Exchange Rate. BSP website: http://www.bsp.gov.ph/downloads/Publications/FAQs/exchange.pdf

[10] BSP Circular No. 855 (29 October 2014), BSP Circular No. 940 (20 January 2017), BSP Circular No. 944 (6 February 2017), BSP Circular No. 950 (15 March 2017), BSP Circular No. 987 (28 December 2017).

[11] BSP Media Release (2017, March 31). Banks and Non-Banks to Establish PESO Net and InstaPay. BSP website:

Thought Leadership in ASEAN. The BSP pro-actively contributes to the ASEAN financial integration agenda by consistent participation and taking of co-chairship roles in the ASEAN high-level and working committee-level processes.

The BSP Governor actively participates in the ASEAN Central Bank Governors' Meeting (ACGM) and the ASEAN Finance Ministers' and Central Bank Governors' Joint Meeting (AFMGM). At the Deputies-level, the BSP also participates in the ASEAN Central Bank Deputies' Meeting (ACDM) and the ASEAN Finance and Central Bank Deputies' Meeting (AFCDM). In 2017, the BSP assumed the chairship of the ACGM and ACDM and the co-chairship (with Department of Finance) of the AFMGM and AFCDM. Consistent with the Philippine agenda under the Philippines' 2017 ASEAN Chairmanship with the theme "Partnering for Change, Engaging the World", the BSP, as chair of the central bank process, emphasized on strengthening regional surveillance, enhancing safety nets, and continuing information exchange to ensure regional resiliency and financial stability.

The BSP[12] and the BNM co-chaired the ASEAN Senior Level Committee on Financial Integration (SLC) when it was established in 2011 until 2013. The SLC is a Deputy/Senior Official-level committee that provides guidance on ASEAN financial integration to achieve the goals set forth under the AEC Blueprint 2025. During this period, the following milestones have been achieved: (1) agreement on the broad thrusts of the ASEAN Financial Integration Framework (AFIF); (2) publication of the Summary Report of the "The Road to ASEAN Financial Integration – A Combined Study on Assessing the Financial Landscape and Formulating Milestones for Monetary and Financial Integration in ASEAN"; and (3) creation of the Task Force on ASEAN Banking Integration Framework (TF-ABIF) and the Steering Committee on Capacity-Building (SCCB).

The BSP has served as the Chair of the Working Committee on Capital Account Liberalization (WC-CAL) from 2009-2011 and as Co-Chair of the Committee, with Bank of Thailand from 2011-2013 and the State Bank of Vietnam from 2013-2016. The BSP has been recognized for its contributions and thought leadership in the various achievements towards progressive liberalization of capital flows in the region.

In 2016-2018, the BSP co-chaired the SLC for the second time with Bank Indonesia (BI), and successfully facilitated the publication of the SAP for financial integration; coordinated the development of Key Performance Indicators; developed and implemented the Risk Monitoring Template and Heatmap; facilitated the amendment of Annex 1 of the ASEAN Charter to include the central bank process; encouraged engagement with the private sector; and ensured the continued support of the Asian Development Bank for capacity-building initiatives.

At present, the BSP co-chairs three (3) Working Committees: WC-CAL, Working Committee on Financial Inclusion, and Working Committee on Payment and Settlement System for the period 2018-2020.

Public Awareness Campaigns. The BSP initiated outreach programs and continues to raise awareness on ASEAN and ASEAN integration, including the process and status of integration, benefits, and risks. The BSP conducts presentations in various symposiums and forums, provides inputs to news articles and publications, and participates in media interviews, on ASEAN financial integration issues.

---

http://www.bsp.gov.ph/publications/media.asp?id=4332&yr=2017.

[12] Represented by Deputy Governor Diwa C. Guinigundo, Monetary and Economics Sector

Advocacy Programs

Expansion of the Credit Surety Fund (CSF) Program

The CSF provides up to 80 percent surety cover for loans granted by banks to borrowers that would otherwise have difficulty assessing such credit facilities due to insufficient collateral, limited credit histories, and inadequate financial records, among other barriers. To date, there are currently 54 CSFs, with 791 members in 53 cities and provinces across the country. Loans released as of 30 September 2018 total an estimated ₱5.2 billion, reaching 17,400 beneficiaries. [128]

A total of ₱878.7 million were released from lender banks with 235 beneficiaries under the CSF Program from January to September 2018. Outstanding loan balance as of 30 September 2018 was about ₱1,255.0 million of which ₱1,017.0 million was covered by the CSF. As of said cut-off date, the accumulated approved loans from inception in 2008 stood at ₱5,499.0 million of which ₱5,195.0 million was released to 17,404 beneficiaries. Three CSFs were established in 2018, bringing the total to 54 CSFs established in 33 provinces and 21 cities nationwide since 2008. Further, the BSP continues to provide support to the Cooperative Development Authority (CDA) for the implementation of Credit Surety Fund (CSF) Cooperative Act of 2015 (RA No. 10744).

In 2018, the BSP intensified efforts to strengthen the foundations that are needed to achieve the envisioned scale, depth, and breadth of financial access. Key initiatives were geared toward the development of critical financial infrastructure, deepening financial literacy and promoting responsive products for the underserved markets. As with any high-impact objectives, strategic partnerships and collaborative efforts with various stakeholders played a key role in the success of these initiatives. [129] The National Strategy for Financial Inclusion (NSFI), shepherded by the interagency Financial Inclusion Steering Committee (FISC) chaired by the BSP, continues to serve as the primary platform for multi-stakeholder coordination and collaboration. The FISC identified digitalization and agriculture value chain finance as priority focal areas.

Key Initiatives/Achievements

Promotion of Responsive Products for the Underserved Market

Agriculture Value Chain Financing. BSP has been promoting the Agriculture Value Chain Financing (AVCF) as an innovative financing approach to support the agriculture sector. The BSP conducted the following initiatives to bolster knowledge and awareness on AVCF among key industry players and stakeholders:

- **Study on AVCF**. The BSP facilitated a study on AVCF with sponsorship from the Asian Development Bank. The study aims to provide better understanding of the challenges and opportunities of AVCF as a viable alternative financing approach in the country. It is also envisioned to serve as the basis for a national roadmap on innovative agriculture financing.

- **AVCF Forum**. The BSP and the Philippine Chamber of Agriculture and Food, Inc. (PCAFI) held a forum on 23 November 2018 to promote AVCF as a viable financing strategy and catalyze AVCF partnerships among major players toward improved access to finance by the agriculture sector. Over 100 participants, including bank senior executives, AVCF proponents, and industry practitioners attended the forum.

Basic Deposit Account. BSP issued Circular No. 992 dated 1 February 2018 to provide the framework

[128] Latest data sourced from the BSP Department of Loans and Credit.

[129] A detailed discussion of these initiatives is contained in the 2018 Financial Inclusion Initiatives report as part of the BSP's annual publication.

for a basic deposit account product designed to address barriers to account opening. The minimum key features of the account include the following: a) simplified know-your-customer (KYC) requirements; b) an opening amount requirement capped at PhP100; c) no minimum maintaining balance; and, d) no dormancy charges. These features meet the need of the unbanked for a low-cost, no-frills deposit account which they can open even if they do not have the standard identification documents.

Consumer Assistance Mechanism. Ensuring good market conduct and upholding consumer protection are crucial in building trust in the formal financial services. Toward this end, BSP provides, in addition to supervision and regulation, consumer assistance to facilitate resolution of the concerns and complaints of the public served by BSP-Supervised Financial Institutions (BSFIs).

- In the first semester of 2018, 94 percent of financial consumer complaints, inquiries, and requests (CIRs), were referred to BSFIs. A third of the total CIRs processed were resolved/closed during the same period.

- The BSP has undertaken a chatbot project as part of efforts to enhance consumer assistance. The chatbot uses state-of-the art neuro-linguistic programming (NLP), machine learning (ML), and artificial intelligence (AI) programs to facilitate multi-channel public interface with the BSP. Testing was completed in 2018, while the launch is targeted for 2019.

Legal Framework to Strengthen Financial Consumer Protection. The BSP continues to actively support the passage of a law providing a stand-alone statute governing Financial Consumer Protection, which will be carved out from Republic Act (RA) No. 7394 or the Consumer Act of the Philippines the provisions of Title IV (Consumer Credit Transaction). A proposed bill provides for, among others, the authority of financial regulators to exercise rulemaking, surveillance and inspection, market monitoring and enforcement powers over financial persons/entities.

Development of Critical Infrastructure

In 2018, the BSP worked closely with the national government to develop and realize the following critical legislative reforms:

- **National ID System**. A national digital ID system is a crucial public infrastructure with the ability to address persistent on-boarding issues, such as the lack of acceptable IDs and highly inefficient paper-based KYC processes. It enables all Filipinos, especially the unserved, to obtain a verifiable digital identity that they can use to open accounts, access financial services more efficiently, and participate in an increasingly digital economy.

  The BSP actively supported the passage of RA No. 11055 establishing the Philippine Identification System (PhilSys) signed into law by President Rodrigo Dutere on 6 August 2018. As a member of the interagency PhilSys Policy and Coordination Council (PSPCC), BSP was actively involved in the development of the Implementing Rules and Regulations (IRR) of RA No. 11055 published on 6 October 2018.

- **Secured Transactions Framework.** BSP actively supported the passage of the Personal Property Security Act (RA No. 11057) which was enacted into law on 17 August 2018. It provides the legal and institutional framework to facilitate the use of movable properties (e.g., bank accounts, industrial and agricultural equipment, durable consumer goods) as collateral for business and consumer credit. Through this law, underserved sectors such as agriculture and micro, small and medium enterprises (MSMEs) can use movable collaterals to gain access to finance from banks.

Financial Education and Consumer Protection

The BSP continued to provide 1) economic information learning programs; and 2) learning materials for various platforms (website, social media, print, face-to-face interactions during in-house and outreach learning sessions) in its pursuit to provide information services, programs, and materials to introduce the work of the BSP and its role in the Philippine economy and to promote greater understanding of essential economic concepts and issues.

- *Public Information Campaign (PIC) on the Role of the BSP in the Philippine Economy.* This 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. Three (3) learning programs were conducted in 2018 as follows:

    - 22 March, session for students attended by 205 students and faculty members from the University of Cagayan in BSP Manila.

    - 24 May, session for the workforce attended by 145 junior high school economics teachers from various schools in Manila under the Department of Education.

    - 8 November, special session for Philippine media broadcasters in support of Republic Act No. 10922 or the annual celebration of the Economic and Financial Literacy Week (EFLW).

- *PIC on BSP-Produced Statistics.* This activity 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. As part of the BSP's celebration of the National Statistics Month (NSM), one PIC session was conducted on 19 October at the BSP Head Office with 114 participants mostly from various government offices.

- *In-House Tours and Guided Group Discussions.* 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. During the year, 68 learning sessions were conducted attended by a total of 4,308 visitors, mostly students.

- *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.

- *Learning Materials.* Various materials were produced to explain economic concepts and various functions of the BSP as the country's monetary authority. These include two short videos on 1) monetary policy and inflation targeting; and 2) price level and inflation (revised). Meanwhile, the script to produce infographics about price level and inflation was already submitted to BSP management during the year.

- **Financial Education (Fin-Ed) Stakeholders Expo.** The first of its kind to be organized by the BSP, this two-day expo was attended by approximately 1,000 participants from public and private institutions, civil society, academe, and other relevant sectors.

- **Financial Empowerment Seminars (FES).** The BSP conducted 28 of these seminars across the country which was attended by over 3,400 participants.

- **Comprehensive Social Benefits Program (CSBP).** The BSP conducted 10 financial literacy sessions across the country with a total of 455 CSBP beneficiaries in attendance.

- **Memorandum of Agreement (MOA) on Financial Literacy Program for Schools.** This MOA with the Department of Education (DepEd) and BDO Foundation (BDOF) covers the development of teaching guides and financial literacy videos aimed at 700,000 DepEd teachers and personnel and 24 million students in over 47,000 public schools.

- **MOA on the Expansion of the Financing Ecosystem of Negosyo Centers.** This MOA is a partnership among the Department of Trade and Industry (DTI), Microfinance Council of the Philippines, Inc. (MCPI), and Alliance of Philippine Partners for Enterprise Development, Inc. (APPEND). The partnership formalizes linkages between financial institutions and Negosyo Centers nationwide and covers BSP's development of a financial education program for Negosyo Center business counsellors.

Knowledge Resource Network (KRN)

A major initiative introduced to further advocate public awareness of monetary policy and other essential economic and financial concepts is the establishment of the KRN (which was approved by the Monetary Board in December 2016). During 2018, the BSP launched KRN collections in 88 libraries of local government units, state universities/colleges and private academic institutions in National Capital Region (NCR) and 50 provinces in the country. These KRCs received various BSP publications such as books, annual reports, comics, guides and brochures and participated in the KRN's information resource sharing and reference assistance service for free during the year.

BSP Feedback Management System (FMS) for External Stakeholders

The BSP Feedback Management System (FMS) provides real time external feedback to BSP Servicing Departments/Offices (SDOs) through the four (4) feedback channels: emoticon tablets in 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.

In 2018, total feedback responses reached 25,336, of which 19,093 were emoticon responses (75.4%) and 6,243 were structured-form responses (24.6%). From the emoticon responses, 96.4 percent were "happy", while neutral and sad responses were only 2.2 percent and 1.3 percent, respectively. For the structured-form responses, the BSP received an overall rating of 4.9 (highest is 5).

Launch of the New Generation Currency Coin Series

The BSP released the New Generation Currency (NGC) Coin Series in circulation starting in March 2018, and presented the same to the President of the Philippines on 9 May 2018 in a ceremony at the Malacañan Palace. The NGC coins feature improved design and enhanced security features to prevent counterfeiting. The metallic composition and the use of the latest technology in minting contribute to improved wear and corrosion resistance capabilities of the new coins.

The BSP developed a series of Coin-Ed videos to serve as educational guide on the design and security features, and importance of the new Philippine coins, posted in the official account of the BSP in various social media platforms. The introductory video on the release of the NGC coins and the Coin-Ed videos reached approximately 2.5 million unique Facebook users.

BSP Clean Note and Coin Policy and Coin Recirculation Program

To strengthen the implementation of the BSP Clean Note and Coin Policy (CNCP), banknotes fitness level was rationalized which included the recalibration of machines, training of banks and signing of undertaking of compliance. The BSP's CMS also facilitated the conduct of the Front-liners Addressing Currency Issues Empowerment (FACE) Seminar, and developed and distributed to the regional offices a Standard Know Your Money (KYM) Training Kit. 3,309 KYM briefings were conducted nationwide to 209,620 participants. In addition, the BSP also strengthened partnerships with various stakeholders to advance currency-related advocacies, such as the CNCP and the Coin Recirculation Program.

For 2018, the BSP intensified its public information campaign on currency by proactively utilizing social media to widen the reach and effectively promote its currency-related policies and advocacies. The campaign is aimed at increasing awareness on the security features and pertinent laws against counterfeiting and mutilating banknotes, and reinforcing public engagement in the proper use of banknotes in day-to-day transactions. In posting advisories, infographics and videos online, the BSP reached more than 4 million unique social media users. An online, social media-focused dimension to the public information campaign is deemed relevant and timely to complement the structured face-to-face learning events for targeted audiences.

Regional Operations

In 2018, the BSP through the Regional Operations Sub-sector (ROSs) continued to provide adequate and timely supply of good quality currency to support economic development, and maintain confidence on and integrity of the Philippine peso in the areas under its jurisdiction. Specifically, the three (3) Regional Offices and 19 Branches located in the different parts of the country continued to service the currency requirements of stakeholders outside Metro Manila by:

i. Regular assessments of forecasts of currency requirements in the region;
ii. Strategic scheduling and adoption of more efficient modes of currency shipments;
iii. Provision of ample buffer stock for unexpected spikes in currency demand or potential delay in currency delivery to the regions;
iv. Accelerating the verification process to maximize vault space utilization while allowing quicker turn-around of banks' access of their deposits;
v. Servicing the withdrawals of banks with new and fit banknotes and coins, in accordance with their denominational requests;
vi. Retiring unfit bank notes for immediate replacement with new/fit currency thereby promote Clean Note and Coin Policy;
vii. Review/update of currency operations procedures/processes/practices with the view to improve operational efficiency and internal controls; and
viii. Ensure access and availability of BSP services across the country by evaluating the need for additional BSP presence in areas needed, including expansion through relocation of existing BSP branches to respond to the growing needs of the region where they operate.

The regional offices also helped promote BSP advocacies, intensified and widened the reach of its public information campaign, particularly in far off and remote rural areas as well as enhanced the conduct of economic and financial surveillance. Topics covered include economic and financial literacy, counterfeit currency detection, coin recirculation, clean note policy, *NDS* demonetization, and consumer protection, among others. In line with the objective to serve as springboard on BSP policies and programs, and as *thought-leader* on economic and financial issues in the countryside, the ROBs participated actively in a number of meetings of the regional development councils and other fora.

In addition to their regular mandate, the BSP's regional offices also provided other services. Specifically, it a) operated and maintained the BSP's four (4) gold buying stations located in Davao, Baguio, Naga and Zamboanga, b) purchased from banks foreign exchange and shipped them to the Head Office for consolidation, and c) provided logistical assistance to other BSP departments/units undertaking advocacy programs and other official-related activities. The gold and foreign exchange purchase operations, in turn, were aimed at providing support to the BSP's gross international reserves.

Investor Relations

In 2018, the Investor Relations Office (IRO)'s economic communications campaign focused on a targeted and message-driven communications program to spread the continued positive economic developments in the Philippines to a wider international investor audience and address concerns that the investing community may still have arising from the continued negative coverage in international media.

The economic communications initiatives, therefore, focused on economic briefings in key financial markets abroad and key regional centers in the Philippines, interviews with international media (sit down, written or phone), face-to-face meetings with investors here and abroad, investor conference call, credit rating analysts and officials here and abroad, and intensified social media campaign. These were undertaken in close coordination with economic agencies such as the Department of Finance, National Economic and Development Authority, Department of Budget and Management, Bureau of the Treasury and the key infrastructure agencies such as the Department of Public Works and Highways, Department of Transportation and Bases Conversion and Development Authority, among others. The said initiatives have contributed in helping international stakeholders to see through the noise and focus on the country's strong fundamentals, robust growth prospects and increasing investment opportunities.

As part of its targeted communications campaign for 2018, the IRO also actively engaged bank and think tank analysts, who also publish analytical reports on the Philippine economy for their clients. Some of these reports are also carried by the media. The IRO conducted two related activities: 1) economic briefing by the economic and infrastructure managers solely for analysts to directly engage them on the policies and plans of the Administration particularly for infrastructure development; and 2) a conference call with the BSP Governor to help directly communicate to these analysts the BSP's policies and outlook, particularly on inflation.

The Republic of the Philippines (ROP) received two (2) positive rating actions in 2018. Standard and Poor's raised its outlook on its BBB rating on the Philippines to positive in April 2018. The ROP's credit rating from the three (3) major global credit rating agencies (CRAs) are aligned at a notch above the minimum investment grade. ROP's credit rating was upgraded by RAM Ratings to BBB2 rating from BBB3. Meanwhile, Japan Credit Rating Agency rates the Philippines a notch away from the "A" category at BBB+, the highest rating ever achieved by the Republic. This brings to a total of 28 positive credit rating actions (17 upgrades and 11 positive outlooks) since July 2010.

The stronger credit profile of the Philippine government, which is used by investors as indication of the overall economic environment of a country, has also resulted in the increased attractiveness of the Philippines as investment destination. Total approved foreign investments for the first three quarters of 2018 reached ₱91.0 billion or an increase of 8.2 percent from ₱84.1 billion same period 2017. These reflect positive global investor sentiment on the country's economic fundamentals and improved investment environment, as a result of implementation of vital reforms such as easing doing business, among others.

Credit Rating Agency (CRA) Meetings. In line with its key mandate of helping the country maintain investment-grade credit ratings and favorable perception of the Philippines by the international financial community, the BSP Investor Relations Office (IRO) engaged seven (7) CRAs in 2018, namely: 1) Fitch Ratings; 2) Standard and Poor's; 3) Moody's Investor Service; 4) Japan Credit Rating Agency; 5) Ratings and Investment (R&I) Information, Inc.; 6) National Information and Credit Evaluation (NICE) Ratings; and 7) RAM Ratings. A total of 125 face-to-face meetings and conference calls were organized during the year to facilitate the review of the Philippines' credit profile by regional and international CRAs. In the said meetings, CRA analysts were provided with a better grasp of the strength of the Philippines' credit profile as well as clarification on various issues through comprehensive discussions with the country's economic officials and with representatives from the private sector, such as executives from various business chambers. While most meetings were held in Metro Manila, there were also meetings set up with economic zone locators outside Metro Manila where they shared with CRA analysts their first-hand experience in doing business in the Philippines.

The IRO also organized meetings between government talking heads and CRA officials at the sidelines of the 2018 IMF Annual Meeting in Bali, Indonesia on 12-14 October 2018.

Philippine Economic Briefings (PEBs) in Manila and in Regional Centers. The IRO conducted its flagship activity in Manila (September) as well as in key regional centers such as Davao (March and November), Cebu (April and November), Clark (April and November), and La Union (November). Audience count for each of the PEBs in 2018 reached between 150 and 500. The PEBs were done side-by-side with the launch of the Philippines' hosting of 2018 ADB Annual Meetings in Manila and the "Sulong Pilipinas" conferences. The briefings aimed to update the business community and other stakeholders on the performance of the economy and regions, outlook, investment opportunities and policy agenda of government. The country's top economic and infrastructure officials deliver presentations on various updates on the economy and the infrastructure sector before key stakeholders led by the investor community. As a departure from previous years briefings, the program for the 2018 PEB in Manila consisted of two (2) parts – economic briefing held at the BSP Head Office and an ocular visit to New Clark City the following day to showcase developments outside of Metro Manila. The ocular visit was attended by 36 analysts/members from media.

Non-Deal Roadshows and International Economic Briefings. The IRO organized Philippine Economic Briefings in Beijing (March), Tokyo (June), and London (September). These international economic briefings, participated in by the country's economic managers, were aimed to solidify the standing of the Philippines as a premier investment destination for both corporate businesses and financial portfolio investors. At the sidelines of these economic briefings were business roundtable discussions and one-on-one meetings with institutional investors. As part of the Bureau of the Treasury's investor outreach in preparation for sovereign bond issuances, the IRO provided investor collaterals, briefing notes for government officials, and logistical support in various legs of non-deal roadshows held in China-Singapore-Hong Kong (March), Tokyo (June), UK-Europe (September), and Hong-Kong-United States (October).

Investor meetings. A total of 74 investor meetings were arranged by the IRO in 2018 where analysts, economists, and/or clients of investment banks and asset management companies get updated about developments in the Philippine economy through discussions with officials from various economic agencies of the Philippine government. Among the investor meetings arranged were those for HSBC, Goldman Sachs, Morgan Stanley, JP Morgan, Barclays, Alliance Bernstein, Citibank, Franklin Templeton, and Bank of China Reverse Roadshow. Notable for the year was the ING Trip which the IRO helped organize for potential foreign direct investors. A total of 10 Chinese firms who are involved in various industries such as transportation, water, energy, etc. participated in the event. The IRO also coordinated for 5 investor meetings/conferences at the sidelines of the IMF Annual Meetings in Bali, Indonesia in October 2018. For these activities, the IRO provided investor collaterals, briefing kits for talking heads, technical support during meeting proper, and acted as resource persons on select topics.

Investor Conference Call. Consistent with the BSP's thrust to engage stakeholders and communicate principles behind its policies and initiatives, the IRO organized an investor conference call on 25 July 2018, with focus on promoting deeper understanding of the BSP's reform agenda, specifically with respect to reduction of the reserve requirement ratio, and the timing of monetary policy actions and their rationale. Around 42 research analysts from major financial institutions here and abroad whose commentaries are picked up by the media, as well as economists/analysts from CRAs participated in the conference call.

Media Interviews/Engagements. The IRO arranged interviews with economic officials at the sidelines of the Philippine Economic Briefings in Tokyo and London (sit down and live TV interviews), as well as during the IMF Annual Meetings through its International Economic Communications Consultant, Burson Marsteller. The IRO facilitated requests for interviews/speaking engagements with BSP officials on latest monetary policy decisions, as well as on questions on bank supervision and the macroeconomy.

Assistance in High-Profile Conferences. The IRO provided logistics- and communications-related assistance for various events hosted by the Philippine government. The Department of Finance tapped the IRO to handle the communications/media activities for the hosting of the 51st Asian Development Bank Annual Meetings in May 2018.

Social Media. The IRO continued to maintain its website (www.iro.ph) and social media accounts (#EconomyPH on Facebook and Twitter), which are vital in promoting awareness of strengths of the Philippine economy.

The IRO was able to increase its social media reach through posts of various economic updates, led by regular statistics and press releases issued by economic agencies, as well as of infographics and positive news about the Philippine economy that the IRO deemed interesting to readers. The IRO now has 1,471 followers on Twitter, up from the end-2017 figure of 1,325. Also, the IRO now has over 5,010 likers on Facebook, expanding from 4,653 by end-2017.

Press Releases. The IRO issued a total of 27 press releases during the year, mostly about developments in the country's credit ratings and on domestic and international economic briefings conducted by Philippine authorities. The press statements, released both to members of the local and international media, were aimed to highlight the gains from various investor engagements, help showcase the government's economic agenda, and promote the Philippines as a viable investment destination.

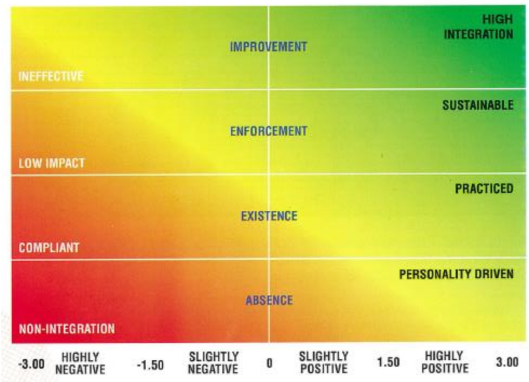
Investor Presentation and Other Collaterals. The IRO regularly updates its investor presentation which highlights recent economic developments, government's reform agenda and policy thrusts. These were either printed or saved in customized flash drives along with other reference materials on the Philippine economy, and were distributed to credit rating analysts, investors and other stakeholders during IR events. The IRO also prepared briefers for BSP officials and the economic managers for all IRO-arranged meetings.

Strengthening Governance

The context of good governance in the BSP was based on the concept that governance is a shared responsibility of everyone in the organization and not merely within the exclusive domain of top management and the Monetary Board. Specifically, strengthening good governance in the BSP came to the fore when it became one of the four (4) strategic themes in the 2011-2017 BSP Strategy Map. It started as a strategic initiative in 2009 which was undertaken in collaboration with the Development Academy of the Philippines (DAP) as the third party assessor on the state of governance in the BSP, specifically on five (5) governance principles namely, (1) integrity, (2) accountability and transparency, (3) ownership and voice, (4) strategic direction and (5) responsiveness. With the assistance of the DAP, a System-wide Governance Assessment (SGA) third party assessment tool was developed and administered in the BSP for three (3) rounds conducted in 2010, 2014, and 2017 to determine the level of integration of these governance principles in the BSP's operations.

The assessments focused on two (2) dimensions: one, the outcome and the other, the input dimension. The outcome dimension measured the perception of the internal stakeholders, while the input dimension measured the maturity of the policy and similar mechanisms that support the institutionalization of governance principles. The BSP's adherence to these governance principles was rated according to the grid below:

The Governance Performance Grid



While the BSP's initial target was to attain a "Sustainable" rating by 2017 for all the five (5) governance principles, the results of the second round of SGA in 2014 showed that the BSP already achieved the sustainable level of integration of all these principles in its operations, i.e., three (3) years in advance. The SGA third round results, on the other hand, showed that by the end of the term of Former Governor Tetangco in 2017, the BSP reached the highest level of integration for two (2) of the five (5) governance principles (i.e., accountability & transparency, and strategic direction). The other three (3) governance principles, on the other hand, were maintained at the "Sustainable" level. The results indicated significant progress in the integration of the principles in the areas of BSP's decision-making, systems and processes, and work ethics.

After each SGA, a three (3)-year Governance Initiatives Roadmap was formulated incorporating the key recommendations for each governance principle, including projects and programs for implementation of concerned BSP departments/offices. Among the institutional transformations in the first round were the adoption of a standard Project Management (PM) Methodology; installation of a PM Portal for project monitoring and control; and the enhancement of the BSP Code of Ethics which included a bank-wide No Gift Policy. For the second SGA in 2014, the BSP finalized and implemented the BSP Employee's Charter and the Integrated Customer Satisfaction Measurement tools; adopted a policy on disclosure of wrong-doing; developed guidelines for signature reduction program; and implemented a BSP Enterprise-Wide Communication (BSP-EWC) Plan.

For the third round of SGA, under the new set of Monetary Board headed by Governor Nestor A. Espenilla, Jr., the implementation of the 2017-2019 Governance Roadmap is regularly monitored and reported in the Quarterly Strategy Review Meetings under the Objective SR6 - Most trusted government institution in the land and globally recognized. As of end December 2018, most of the programmed governance initiatives were well in place. On a continuing implementation are the initiatives to increase the awareness of BSP employees on the Employees' Charter. The number of visits on the Employee's Charter page in the iKnow Portal as reflected in the Access Statistics is also being monitored through the iKnow Portal Dashboard. The continual update of the Citizen's Charter as supported by the Standard Processing Time of Requests (SPTRs) received from the public is also regularly monitored by the Systems and Methods Office (SMO).

Efforts to sustain BSP's commitment towards good governance is continually pursued by communicating the results of the governance assessment in various format such as briefings for BSP departments and offices on the SGA results, and reporting of the status of governance roadmap implementation to the BSP management. The 2017 Governance Report brochure was also disseminated to all BSP departments and offices, specifically to incumbents of Assistant Manager and up positions including the Monetary Board Members.

The BSP governance journey since 2009 has set for management and staff the pursuit for greater dedication to achieve the highest level of integration of the governance principles and ensure that good governance is an integral part of BSP's way of life.

Institutional Capacity Building

The advent of changes in leadership, strategies, tools, and processes in 2018 was welcomed openly by the BSP, and in such challenging fiscal year, the Bank has continued to build, strengthen, and reinforce its capabilities. With the launch of the new blueprint of strategies spanning the years 2018 to 2023, the BSP will continue to take on the role as a strategic partner and enabler.

Organizational Agility

Talent acquisition and succession. Under the Organizational Agility theme, it aims to ensure "efficient processes and tools compliant with international standards and on par with best practices." One of the initiatives under this objective is the enhancement of the recruitment process. The filling of vacancies has been maintained since 2017 at a 20-working day efficiency fill rate from the average of 75 in 2014, 37 in 2017, and 29 in 2016.[130] This is primarily due to the 100% ownership and support from departments and offices by submission of their respective Annual Manpower Plans (AMP), the institutionalization of the accounts-based approach of the Human Resource Management Department (HRMD), and the continued collaboration with administrative officers at the Main Complex, Security Plant Complex, and the Regional Offices and Branches. Meanwhile, the average of 21 days in processing of request for pre-employment test and interview was reduced to eight (8) days.

Through the years, the Bank has always put succession or placement of talents at a top priority. In 2018, a total of 1,028 positions were filled, 17 of which are key and critical positions (KCPs). The efficiency fill rate for KCPs was from

[130] Exclusive of freeze days

1.5 months or 45 calendar days in 2017 to 0.5 month or 15 calendar days in 2018.

The Talent Acquisition through Scholarship (TAS) program enables BSP to recruit more potential experts. The program covers non-BSP individuals pursuing bachelor's/master's/doctorate degrees in local of foreign academic institutions, in the fields of Economics, Finance, Statistics/Mathematics, Data Science, and Information Technology. The TAS program is part of the capacity-building strategies that aim to beef up the BSP's roster of central banking operations experts by requiring participants of the program to render service of obligation for a minimum period from six (6) months to two (2) years.

Organizational Capability

Index Development. Another theme—Organizational Capability—calls upon HR to take the lead in terms of achieving "an agile and collaborative organization with rationalized functions" and "a highly motivated, accountable, and competent workforce that exemplifies the BSP core values." The HRSs developed the indices through its People Information Management Group (PIMAG) serving as the Initiative Champion for Index Development. The indices determined the metrics and validators that contribute to measuring organizational agility and collaboration, and employee motivation, employee accountability, and employee competence. In 2018, the execution teams of the mentioned objectives, led by PIMAG, completed the identification, validation, standardization, and formulation of the indices based on end-2017 data.

Organizational Agility and Collaboration. Simultaneous with the mentioned index development have been high-impact initiatives such as those that indicate structural, people, and process dimensions of agility. The Bankwide reorganization in 2018 accomplished 18 structural changes including major ones such as the creation of a new sector that is the Currency Management Sector headed by a Senior Assistant Governor, the creation of the Payment System Oversight Department, and the creation of the Center for Learning and Inclusion Advocacy. The Human Resource Development Department (HRDD) made sure that such reorganizations would sooner have their corresponding process documentations with service level agreements through the Quality Management System within the purview of the Systems and Methods Office. The BSP Research Experts Panel was also created in 2018, which aims to strengthen the BSP's capability to conduct scholarly research in the areas of finance, economics, and other fields that have significant impact to the BSP. The main responsibility of the experts panel is to provide support to BSP departments/offices and guidance to BSP Management in advancing its research priorities. The first meeting of the REP, which was conducted in November 2018, focused on the initial presentation of research papers of BSP employees.

Organizational agility also meant some changes in the assignments of people across the different sectors of the Bank through the Talent Optimization Program (TOP) which commenced in January 2018, designed for managers and leaders, aimed at nurturing their holistic or multi-discipline capacities and managerial and leadership competencies by means of inter-sector job rotation. For HRDD's initial implementation, 19 officers were reassigned to various units in the BSP to expose them to other areas and enable them to see the bigger picture, have a broader appreciation of central banking, and understand how one function interacts with the other aspects of BSP operations. The second wave of reassignments involved 15 other officers in the BSP main office, and 12 officers in the BSP Regional Offices and Branches.

For potential successors and leaders of BSP, HRDD also spearheads vital programs such as the Mentoring Program (MP) and the Executive Coaching Program (ECP). 12 mentorships were successfully completed in 2018. To provide mentors and mentees an opportunity to get together and share their mentoring experiences, as well as to provide a venue to gather feedback on the BSP MP, the HRDD conducts a quarterly activity called *Quarterly Kumustahan*. A total of three (3) *Kumustahan* activities were held in 2018.

On the other hand, the ECP, which was conceived as a component leadership development initiative under the BSP Succession Management Program, was piloted in 2018, aimed to help participants to gain self-awareness, clarify goals, and achieve development plans through the guidance of a certified professional coach. For the pilot run, nine (9) BSP officers participated from 06 December 2017 to 20 April 2018.

Employee Motivation, Accountability, and Competence. The major initiatives to achieve employee motivation, accountability, and competence primarily included the procurement of an external service provider to jumpstart the Total Rewards Project (TRP) in 2019 to harmonize and enhance monetary and non-monetary incentives, the enhancement of the BSP Organizational Climate Survey (OCS) to capture the strategic metrics of the Bank in terms of employee motivation, and the fast-tracking of capacity building programs to address competency gaps.

The TRP is seen to consider factors that affect employee engagement, empowerment, commitment, and satisfaction. It will start with salary review to be followed by an evaluation of employee motivational factors. The latter information shall be extracted mainly from the enhanced OCS which shall be administered in the first quarter of 2019.

To continue to achieve this objective on employee motivation, accountability, and competence, we have ensured that certain HR areas are well performed, as follows:

a. *Performance Management*
The HRDD completed the design phase of the proposed revised Performance Management System (PMS), which incorporates enhancements to formalize the conduct of a mid-year performance review, redirect focus on major performance goals/final outputs, require the formulation and implementation of a performance improvement plan when an employee is at risk of a serious performance decline, and facilitate documentation through the Integrated HR Information System. The new PMS is intended to be rolled out beginning year 2020. The HRMD, meanwhile, sought the approval of the Management of certain enhancements to the performance-related across-the-board incentives for BSP employees.

b. *Talent Development*
Besides TOP, MP, and ECP for managers and leaders, HRSs also addresses the knowledge and skills of the entire workforce through the Bangko Sentral ng Pilipinas Institute (BSPI) to ensure that training requirements, as identified in Individual Development Plans and other developmental tools, have been 100% complied with. So that our employees are guided in their development journey, the Management approved 32 capacity building programs (integrated curricula with other learning interventions) for 25 technical-functional job families (JFs), one (1) leadership and management JF, one (1) Bankwide JF, and five (5) FSS JFs, of which implementation shall be monitored strictly starting in the first quarter of 2019.

In 2018, 30 BSP employees were approved to avail of the BSP Scholarship and Continuing Professional Education Program locally and abroad, while 11 employees were also approved to undertake Global Certification Programs.
The BSPI started in 2018 the second phase of competency assessment—on technical competencies. Competency assessments started

with the *Assessment of Bankwide Competencies* initiative from Q4 2016 to Q1 2017. The objective of the assessment of technical competencies is to enhance further the initial Capacity Building Programs developed for each BSP job family. Among those completed technical competency assessments in 2018 include the Information Technology and Currency Management.

The BSPI also launched during the BSP Anniversary 2018 the BSP*i*Learn and the Learning and Development (L&D) Dashboard as part of the continuing efforts to adopt the digital technology platform to further expand the learning opportunities that are available to BSP's personnel. The L&D Dashboard integrates data analytics into the L&D process to ensure consistent alignment of L&D strategies and activities with the knowledge and skills requirements of the Bank.

c. *Rewards and Recognition*

While the TRP is commencing in 2019, annually, the HRSs conducts the Program to Reward and Incentivize Service Excellence (PRAISE) and during the 16th BSP PRAISE Awarding Ceremony held on 04 September 2018, the BSP recognized 504 honorees in the six (6) award categories, i.e., Continuing Professional Achievement Award, Award for Perfect Attendance, Gawad Gantimpala, Suggestions Award, Model Employee Award, and Best Performing Department/Office Award.

d. *Talent Onboarding and Retention*

The HRSs makes sure that employees obtain satisfaction in their job with the presence of processes, systems, and tools that facilitate onboarding and efficient transactions and operations related to their employment. The HRSs with the help of the Information Technology Sub-sector and other departments, launched the BSP Onboarding Room for a visual glimpse of employee experience in BSP. The BSPI also facilitated Induction Courses and Values in Action Programs.

The HRMD initiated the implementation of the four-day workweek schedule in the BSP effective Y2019, and institutionalized Study Leave privileges for employees taking technical and vocational examinations.

e. *Data Governance, Management, and Analytics*

The fiscal year 2018 signaled the parallel run of HR transactions with the integrated HR Information System (iHRIS) prior to full transition to the latter. PIMAG piloted the iHRIS – Phase 1 modules[131] Bankwide starting 16 August 2018 until its full implementation targeted in March 2019. PIMAG also spearheaded the facilitation and coordination meetings with HR departments, Information Technology Sub-sector (ITSs), and Service Provider on the customizations and testing of the Phase 2 modules[132]. To facilitate better understanding of the system, PIMAG conducted a series of orientations to employees, managers, executives, and Administrative Officers in the BSP Main Office, Quezon City and Regional Offices on iHRIS. At the same time, PIMAG conducted a re-orientation for all HR data stewards (primary iHRIS users) on HR data governance together with KMG on data privacy last 30 October 2018. This is to reiterate to the data stewards their roles and accountabilities in managing data in the HR systems as well as the HR data governance principles.

PIMAG's continued operations are formalized under Office Order No. 4110, series of 2018 on the Implementation of the Integrated Human Resource Information System (iHRIS) Phase 1 approved by the Governor on 28

[131] Phase 1 modules are: Planning and Organizing, Records Management, Payroll, Attendance, Employee and Managerial Self Service, and Employee Relations

[132] Phase 2 modules are: Talent Acquisition, Benefits, Health and Wellness, Learning and Development, Analytics, Career and Performance

December 2018. Moreover, PIMAG generated reports to HR top management and other BSP departments on personnel statistics, diversity profile, intergenerational data, among others, being PIMAG as the centralized database management unit for HR data requirements.

f. *Knowledge Management*
To ensure that employees possess the sufficient knowledge of the Bank's processes, policies, and programs to aid them in the discharge of their duties and responsibilities, the Knowledge Management Group (KMG) carried out in 2018 initiatives in embedding the KM culture in the Bank and strengthening BSP's data governance activities.

KMG, being the manager of the BSP's intranet called *iKnow*, resolved 100% (144 out of 144) of all portal performance issues in 2018, addressing promptly users' needs. This paved the way for 17 functionality enhancements in the *iKnow* Portal effected with negligible interruption. Moreover, KMG strategically engaged the BSP to share and spread knowledge through various initiatives, namely, KM advisories/audio-visual presentations/FAQs/primers, KM Briefings in Regional Offices/Branches, I Know *iKnow* Well Quiz, I Got a Job Story Contest, and Q and A institutional memory story-telling by a retiree. The KMG also made possible the additional sections in the portal: among others, the Learning Sessions Materials, which contain the handouts used in BSP seminars/lectures conducted for the public; and the Capacity Building Program, which contains the learning and development track for each job family. The other additional sections are the Business Facilities Section featuring facilities for BSP functions and special events; the List of Retirees/Separated from the Service; and link to other systems like the iHRIS and BSP Vital. Information sessions and other promotional collaterals and communications on data privacy, Communities of Practice, records management, data classification, and KM operationalization as a whole have also been pursued at the Main Complex, Security Plant Complex, and the Regional Offices and Branches. With the KMG Head as the Lead Data Protection Officer (DPO), the group likewise conducted eight (8) meetings with BSP sectoral DPOs aside from the thirty-four (34) data privacy awareness sessions. The sessions reached more than 1,200 employees including outsourced personnel. The KMG also released a primer and a video advisory about data protection.

Leadership and Recognition

In line with the goal to share BSP's well-recognized HR policies and programs and become thought leaders for BSP's partner agencies and other stakeholders, the HRSs has served as a subject matter expert to various benchmarking institutions such as the 53 different cluster and individual government agencies and financial institutions in the Philippines and other local firms on talent acquisition, talent development, talent retention, knowledge management, and analytics. The HRSs through BSPI also facilitated learning requests on other central banking functions. In 2018, the BSP hosted five study visits from foreign central banks on the areas of general central banking, bank supervision, foreign exchange management, and economic surveillance.

The BSP has been unanimously nominated by the member countries of the South East Asian Central Banks (SEACEN) to chair the Special Advisory Group for the Leadership and Governance pillar. BSP was also nominated to chair the Technical Working Group (TWG) of Developing a SEACEN Competency Framework and a Member of the TWG on Human Capital Analytics and Dashboards.

Box Article 11

Managing Human Capital now a SEACEN Leadership and Governance Focus

Every central bank derives its success primarily from its people who are competent, motivated, and accountable. While the training programs of the SEACEN Research and Training Centre have successfully been delivered to enhance central banking acumen and core leadership skills amongst its member central banks, the times call for SEACEN's Leadership and Governance pillar to expand to include focus on strategic human capital management research and training activities.

The Bangko Sentral ng Pilipinas (BSP) has been largely instrumental in heeding this call, as such could spell a significant transformation in the area of capacity building. This will translate into equipping central bankers with future-ready skills amidst fast-paced technological advancement, digitalization, and integration. The BSP served as a host to the first Strategic Human Capital Management Conference of SEACEN and now chairs the Special Advisory Group for Leadership and Governance, and the Technical Working Group on Developing a SEACEN Competency Framework.

It can be recalled that it was only until 2016 that even the SEACEN intermediate and advanced leadership courses hardly focused on leaders or HR practitioners as strategic partners in people management and development. We have also observed that HR role in central banks is mostly regarded as a service provider and not as a strategic partner. It was noted that it is high time to spread the learning investment from core central banking functions to HR's pivotal role on human capital management that nurtures leadership and drives organizational readiness and resiliency. Global data highlights that Leadership/Managerial Skills, Human Capital (HC) Management and Analytics are identified as among the top valued organizational needs but with the least readiness or machinery in firms and industries across the globe, thereby negatively impacting employee engagement and motivation[1].

It will also be advantageous for SEACEN members to learn in a timely manner HR best practices from other central banks more than from local financial institutions. Whereas, HR officers in central banks in Latin America and the Caribbean take pride in their efficient exchange of information brought about by their annual or bi-annual conferences and seminars[2].

It was in the first quarter of 2016 that the SEACEN Centre partnered with Bangko Sentral ng Pilipinas (BSP) and Bank Negara Malaysia (BNM) to realize the inaugural Roundtable Forum on Strategic Human Capital Management which served as an avenue to share with other monetary authorities in the region BNM's and BSP's strategic practices and initiatives on human capital management as well as to benchmark with them on the same. At the macro level, this Forum paved the way for brainstorming on the future of the human capital of member central banks in view of the ASEAN economic integration.

Taking off from the Roundtable, in consultation with the SEACEN Centre, the BSP jointly proposed with BNM[3] for the Executive Director's consideration the mentioned Convention aimed at capability enhancement, alliance strengthening, and communication efficiency among HR practitioners of SEACEN. Specifically, the proposed Convention had the following objectives:

---

[1] *Global Human Capital Trends, 2017; Deloitte University Press DUPress*

[2] Based on testimonies from participants to the XII Meeting on Central Bank Human Resource Management organized by the Center for Latin America Monetary Studies on 20-22 April 2016, Santiago, Chile

[3] Based on the videoconference between BNM and BSP on 07 September 2016, following the discussions of BSP on the matter in Alotau, Papua New Guinea on 17-20 August 2016, as triggered by BSP's letter to the Executive Director on 11 August 2016.

1. Increase awareness among SEACEN members of the global human capital management trends and developments through sharing from international counterparts and key institutions;
2. Draw out from SEACEN members information on their respective HR systems, challenges, response to global HR practices, and moving-forward plans; and
3. Draft a strategy map or blueprint for SEACEN's human capital management strategies basing primarily on the outcome of the foregoing objectives.

The First SEACEN Strategic HR Conference

The Bangko Sentral ng Pilipinas (BSP) and the Bank Negara Malaysia (BNM), in coordination with the SEACEN Centre, hosted the inaugural Strategic HR Conference on 14-16 August 2017 in Manila, Philippines with the theme: *"The Strategic Role of HR in SEACEN."*

During the Conference, the BSP and BNM facilitated the Roundtable Forum participated by relevant high-level officers from SEACEN member central banks on 15 August 2017. Based on the various strategic learning sessions on 14 August 2017 and the roundtable sharing and internal assessment of SEACEN members' HR policies and practices, we have arrived at three major agreements:

1. There is a need to strengthen the capabilities of HR, especially on gaining a more global and integrated perspective of various talent management trends and developments through an exposure to human capital management and practices of SEACEN member central banks, select non-SEACEN member central banks and other relevant organizations. Therefore, the conduct of an annual SEACEN Strategic HR Conference among the SEACEN members, is highly encouraged by the participants. Conference outcomes may, amongst others, pave the way for the crafting of a policy or agreement that will provide the HR officers and staff of the different SEACEN members an avenue for them to undergo workplace development interventions such as secondment, job shadowing, cross-posting, or study visits for a certain period in other SEACEN members' HR units.

2. There is a need to have our own data collection mechanism for the development of a database on human resource matters in the central banking context. Therefore, the SEACEN Centre has to create a Dashboard for Human Capital Management and Analytics, and an active directory of key officers from SEACEN member central banks to facilitate a more efficient information exchange on HR. As the SEACEN Centre does not have the resident HR expertise, member central banks that have the requisite expertise can choose to send their HR resource experts for a specific duration to assist the SEACEN Centre in creating the Dashboard. Succeeding coordination meetings may be done via videoconferencing as practiced by other SEACEN Centre-led research or training teams.

3. There is a need to more particularly feature human capital management in a relevant knowledge block of the SEACEN Centre. There is a need for the SEACEN Centre to explore the synergistic linkage between HR-related studies and the strategic direction of SEACEN member central banks. Therefore, SEACEN member central banks need to recommend to the Executive Committee (ExCo) an expansion in the training and research activities under the pillar of leadership and governance to include matters relating to Human Capital Management.

These foregoing agreed proposals then earned the approval of the Board of Governors upon representation by the ExCo, paving the way for the conduct of the 2nd SEACEN Strategic Human Capital (formerly Human Resource) Conference in BNM in 2018, the creation of a Special Advisory Group (SAG) for the L&G pillar in the meantime that the Centre has yet to hire a Director, and the creation of an additional Senior Analyst position to manage the development of courses and coordinate the research and training activities on human capital under the supervision of the Executive Director.

BSP leads the way

The BSP was unanimously selected as the Chair of the SAG, tasked to provide the overall direction of research and training activities under the L&G pillar from 2018 onwards, with a special focus on human capital management. The SAG also formed two technical working groups to spearhead and facilitate HC priorities: one on Developing a SEACEN Dashboard for HC and Analytics, chaired by BNM, and the other one on Developing a SEACEN Competency Framework, chaired by BSP. Analytics and Competency are now the main foci for the HC area of L&G, anchored on the philosophy that human capital management in central banking has to be data-driven, strategic, and developmental.

BSP Financial Results

The BSP's Balance Sheet. The BSP's total assets as of end-December 2018 was ₱4,851.3 billion, higher by 3.9 percent than the audited level of ₱ 4,667.0 billion in the previous year (*Table 13*). The BSP's assets were composed mainly of international reserves amounting to ₱4,140.2 billion. Moreover, the international reserves were comprised largely of foreign deposits and investment securities at about 78.4 percent while gold holdings constituted 10.4 percent of the total reserves.

Table 1. Balance Sheet of the BSP
in billion pesos

	2018 Dec [p]	2017 Dec [a]
Assets	4,851.3	4,667.0
Liabilities	4,734.9	4,586.3
Net Worth	116.4	80.7

Note: Details may not add up to total due to rounding.
[p] Based on the preliminary and unaudited BSP balance sheet as of end-December 2018 prepared by the Financial Accounting Department (FAD) of the BSP.
[a] Audited but subject to restatement.

The BSP's liabilities have reached a total of ₱ 4,734.9 billion as of end-December 2018, higher by 3.2 percent than the previous year's level of ₱4,586.3 billion. The increase was driven by higher currency issue but partially offset by lower government deposits and placements in deposit facilities. Meanwhile, the combined share of deposits and currency issued of 80.1 percent made up the majority of the BSP's liabilities.

Operating Profit. Based on preliminary and unaudited data for the year 2018, the BSP registered a net income of ₱39.8 billion. The net profit for the review period increased by 69.5 percent as compared to the previous year's level of ₱23.5 billion, primarily on the account of higher gains from fluctuations in foreign exchange rates.[136]

Table 2. Income Statement of the BSP
in billion pesos

	2018 Dec [p]	2017 Dec [a]
Revenues	68.269	75.564
Less: Expenses	66.199	66.396
Net Income/(Loss) Before Gain/(Loss) on FXR Fluctuations and Income Tax Expense/(Benefit)	2.070	9.168
Gain/(Loss) on Foreign Exchange Rate Fluctuation:	53.133	15.478
Income Tax Expense/(Benefit)	15.354	1.140
Net Income/(Loss) After Tax	39.849	23.506

Note: Details may not add up to total due to rounding.
[p] Based on the preliminary and unaudited BSP balance sheet as of end-December 2018 prepared by the Financial Accounting Department (FAD) of the BSP.
[a] Audited but subject to restatement.

Total revenues for 2018 amounted to ₱68.3 billion, lower than the ₱75.6 billion posted in the previous year. The decline in total revenues was due to the reversal in miscellaneous income account. Total expenditures amounted to ₱66.2 billion, slightly lower than the P66.4 billion posted last year. The y-o-y decrease in expenditures was due primarily to decreased interest expense on term deposit facility.

[136] Arising from foreign-currency denominated transactions of the BSP.

Statistical Annexes

List of Tables

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

for periods indicated
at constant 2000 prices

Item	Levels (in Million Pesos)			Percent Change		
	2016	2017	2018	2016	2017	2018
Agriculture, Hunting, Forestry and Fishing	710,926	739,029	744,814	-1.2	4.0	0.8
Industry Sector	2,750,034	2,947,103	3,148,000	8.0	7.2	6.8
Mining and Quarrying	83,106	86,222	87,121	3.2	3.7	1.0
Manufacturing	1,885,514	2,043,118	2,142,456	7.1	8.4	4.9
Construction	512,113	539,267	625,228	12.1	5.3	15.9
Electricity, Gas and Water Supply	269,301	278,497	293,196	9.0	3.4	5.3
Services Sector	4,661,781	4,979,575	5,310,300	7.5	6.8	6.6
Transport, Storage & Communication	611,902	636,577	669,230	5.3	4.0	5.1
Trade and Repair of Motor Vehicles, Motorcycles, Personal and Household Goods	1,367,438	1,467,855	1,553,736	7.6	7.3	5.9
Financial Intermediation	590,112	635,064	679,922	7.9	7.6	7.1
Real Estate, Renting & Business Activities	930,685	999,493	1,047,219	8.9	7.4	4.8
Public Administration & Defense: Compulsory Social Security	318,540	343,251	393,474	7.1	7.8	14.6
Other Services	843,105	897,335	966,720	7.5	6.4	7.7
Gross Domestic Product	**8,122,741**	**8,665,708**	**9,203,113**	**6.9**	**6.7**	**6.2**
Net Primary Income from the rest of the world	1,632,345	1,729,139	1,793,182	5.8	5.9	3.7
Gross National Income	**9,755,087**	**10,394,846**	**10,996,296**	**6.7**	**6.6**	**5.8**

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
at constant 2000 prices

Item	Levels (in Million Pesos)			Percent Change		
	2016	2017	2018	2016	2017	2018
Household Final Consumption Expenditure	5,642,389	5,973,816	6,306,064	7.1	5.9	5.6
Government Final Consumption Expenditure	854,570	914,136	1,031,487	9.0	7.0	12.8
Capital Formation	2,289,675	2,504,502	2,852,306	24.5	9.4	13.9
Fixed Capital	2,270,587	2,485,451	2,834,197	26.1	9.5	14.0
Construction	793,470	839,967	966,394	13.1	5.9	15.1
Durable Equipment	1,292,959	1,431,518	1,623,083	37.7	10.7	13.4
Breeding Stocks and Orchard Development	102,845	106,262	111,313	3.6	3.3	4.8
Intellectual Property Products	81,313	107,704	133,406	33.9	32.5	23.9
Changes in Inventories	19,087	19,051	18,110	-49.6	-0.2	-4.9
Exports	4,124,942	4,930,584	5,495,712	11.6	19.5	11.5
Less: Imports	4,788,834	5,657,331	6,476,519	20.2	18.1	14.5
Statistical Discrepancy	0	0	-5,936			
Gross Domestic Product	**8,122,741**	**8,665,708**	**9,203,113**	**6.9**	**6.7**	**6.2**
Net Primary Income from the rest of the world	1,632,345	1,729,139	1,793,182	5.8	5.9	3.7
Gross National Income	**9,755,087**	**10,394,846**	**10,996,296**	**6.7**	**6.6**	**5.8**

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

	LEVELS				PERCENT CHANGE (in percent)		
	2016	2017		2018[p]	2016	2017	2018
Employment Status [1]							
Labor Force (In Thousands)	43,361	42,775		43,461		-1.4	1.6
Employed	40,998	40,334		41,160		-1.6	2.0
Unemployed	2,363	2,441		2,302		3.3	-5.7
Underemployed	7,513	6,506		6,735		-13.4	3.5
Labor Force Participation Rate (%)	63.5	61.2		60.9		-3.6	-0.5
Employment Rate (%)	94.6	94.3		94.7		-0.3	0.4
Unemployment Rate (%)	5.4	5.7		5.3		4.7	-7.2
Underemployment Rate (%)	18.3	16.1		16.4		-12.0	1.4
Overseas Employment (Deployed, in thousand)	2,112	1,993			14.5	-5.7	
Land-Based	1,670	1,615			16.1	-3.3	
Sea-Based	443	378			8.9	-14.6	
Strikes							
Number of New Strikes Declared	15	9		14	200.0	-40.0	55.6
Number of Workers Involved	3,106	1,479		8,102	325.5	-52.4	447.8
Legislated Wage Rates							
In Nominal Terms[2]							
Non-Agricultural							
National Capital Region (NCR)	491.00	512.00		537.00	2.1	4.3	4.9
Regions Outside NCR (ONCR)	378.50	380.00		400.00	4.4	0.4	5.3
Agricultural							
NCR							
Plantation	454.00	475.00		500.00	2.3	4.6	5.3
Non-Plantation	454.00	475.00		500.00	2.3	4.6	5.3
ONCR							
Plantation	353.50	353.50		370.00	4.7	0.0	4.7
Non-Plantation	335.00	348.00		368.00	0.0	3.9	5.7
In Real Terms[3]							
Non-Agricultural	2006-based		2012-based				
National Capital Region (NCR)	361.56	360.31	460.43	460.94	-0.6	-0.3	0.1
Regions Outside NCR (ONCR)	265.24	251.16	336.88	342.47	2.9	-5.3	1.7
Agricultural							
NCR							
Plantation	334.32	334.27	427.16	429.18	-0.5	0.0	0.5
Non-Plantation	334.32	334.27	427.16	429.18	-0.5	0.0	0.5
Regions Outside NCR (ONCR)							
Plantation	247.72	240.64	317.32	316.78	3.2	-2.9	-0.2
Non-Plantation	223.48	224.66	299.23	300.41	-2.6	0.5	0.4

Notes:

[1] Starting April 2016 round, the Labor Force Survey (LFS) adopted the 2013 Master Sample Design, with a sample size of approximately 44,000 households as well as the population projections based on the 2010 Census of Population and Housing (2010 CPH). Meanwhile, previous survey rounds were derived using 2000 CPH population projection. Starting January 2017 round, Computer Aided Personal Interviewing (CAPI) using Tablet was utilized in the LFS enumeration.

[2] Source of data for both nominal and real wage rates is the National Wages and Productivity Commission. It includes basic minimum wage and cost of living allowance (COLA). Starting 2006, annual figures reflects December data. Figures outside NCR represent the highest nominal regional rates in a given category and its corresponding value in real terms.

[3] Starting 10 November 1990, adjustments in the minimum legislated wage rates are being determined by the Regional Tripartite Wages Productiviity Board. Starting 2018, real terms is computed using 2012 as base year while previous data were computed using 2006 as base year.

[p] Preliminary

Details may not add up to totals due to rounding.

Sources: Philippine Overseas Employment Administration (POEA), National Wages and Productivity Commission (NWPC), 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

2012=100

Commodity Group	Philippines						Metro Manila						All Areas Outside Metro Manila					
	CPI			Percent Change			CPI			Percent Change			CPI			Percent Change		
	2016	2017	2018	2016	2017	2018	2016	2017	2018	2016	2017	2018	2016	2017	2018	2016	2017	2018
All Items	**108.4**	**111.5**	**117.3**	**1.3**	**2.9**	**5.2**	**105.1**	**109.0**	**115.0**	**0.7**	**3.7**	**5.5**	**109.3**	**112.2**	**117.9**	**1.4**	**2.7**	**5.1**
Food and Non-Alcoholic Beverages	112.3	115.7	123.6	1.6	3.0	6.8	113.3	119.5	127.7	2.8	5.5	6.9	112.1	114.9	122.8	1.4	2.5	6.9
Food	112.8	116.4	124.1	1.7	3.2	6.6	114.1	120.9	128.7	3.0	6.0	6.5	112.5	115.5	123.2	1.4	2.7	6.7
Alcoholic Beverages and Tobacco	146.5	156.6	187.9	4.6	6.9	20.0	135.6	147.4	179.0	3.7	8.7	21.4	148.8	158.5	189.7	4.9	6.5	19.7
Non-Food	104.9	107.6	111.3	1.0	2.6	3.4	101.2	104.1	108.8	-0.4	2.9	4.5	106.2	108.8	112.2	1.4	2.4	3.1
Clothing and Footware	111.8	114.5	117.2	2.1	2.4	2.4	113.0	115.8	118.5	1.6	2.5	2.3	111.5	114.2	116.8	2.3	2.4	2.3
Housing, Water, Electricity, Gas and Other Fuels	103.6	106.4	110.6	0.5	2.7	3.9	97.9	100.4	105.7	-1.9	2.6	5.3	105.9	108.9	112.6	1.2	2.8	3.4
Furnishing, Household Equipment and Routing Maintenance of the House	110.2	112.7	116.2	1.8	2.3	3.1	109.8	112.2	115.5	0.9	2.2	2.9	110.4	112.8	116.5	2.1	2.2	3.3
Health	109.5	112.4	116.1	2.1	2.6	3.3	110.5	113.6	117.8	1.0	2.8	3.7	109.3	112.1	115.8	2.4	2.6	3.3
Transport	93.8	98.5	105.0	-1.4	5.0	6.6	90.0	97.0	105.1	-2.6	7.8	8.4	95.0	98.9	104.9	-0.8	4.1	6.1
Communication	100.5	100.8	101.1	0.3	0.3	0.3	100.5	100.7	101.2	0.2	0.2	0.5	100.5	100.8	101.1	0.4	0.3	0.3
Recreation and Culture	109.1	110.4	112.6	0.9	1.2	2.0	108.3	109.8	111.7	1.2	1.4	1.7	109.3	110.5	112.9	0.7	1.1	2.2
Education	116.2	119.1	118.1	3.0	2.5	-0.8	117.7	120.3	122.6	3.3	2.2	1.9	115.7	118.7	116.6	2.9	2.6	-1.8
Restaurants and Miscellaneous Goods and Services	107.5	109.3	113.2	1.7	1.7	3.6	103.3	105.5	110.1	1.0	2.1	4.4	109.1	110.8	114.5	2.0	1.6	3.3

Source: Philippine Statistics Authority (PSA)

4 CASH OPERATIONS OF THE NATIONAL GOVERNMENT

for periods indicated

	Levels (in million pesos)			**Annual Change** (in percent)		
	2016	**2017**	**2018**	**2016**	**2017**	**2018**
Revenues	**2,195,914**	**2,473,132**	**2,850,184**	**4.1**	**12.6**	**15.2**
Tax Revenues	1,980,390	2,250,678	2,565,812	9.1	13.6	14.0
Bureau of Internal Revenue	1,567,214	1,772,321	1,951,850	9.3	13.1	10.1
Bureau of Customs	396,365	458,184	593,111	7.8	15.6	29.4
Other Offices	16,811	20,173	20,851	14.8	20.0	3.4
Non-tax Revenues	215,524	222,454	284,372	-26.6	3.2	27.8
of w/c: Bureau of the Treasury	101,737	99,905	114,199	-7.5	-1.8	14.3
Expenditures	**2,549,336**	**2,823,769**	**3,408,443**	**14.3**	**10.8**	**20.7**
of which:						
Allotments to Local Government Units	449,776	530,150	575,650	16.1	17.9	8.6
Interest Payments	304,454	310,541	349,215	-1.6	2.0	12.5
Equity and Net Lending	26,979	1,121	8,860	157.9	-95.8	690.4
Surplus/Deficit (-)	**-353,422**	**-350,637**	**-558,259**	**-190.4**	**0.8**	**-59.2**
Financing [1]	**220,938**	**663,929**	**783,277**	**137.9**	**200.5**	**18.0**
Foreign Borrowings (Net)	-24,113	27,569	191,752	**-137.2**	214.3	595.5
Domestic Borrowings (Net)	245,051	636,360	591,525	773.0	159.7	-7.0
Total Change in Cash: Deposit/Withdrawal (-)	**-257,654**	**255,403**	**-52,651**	**-16,207.2**	**199.1**	**-120.6**
Budgetary	-132,484	313,292	225,018	-359.4	336.5	-28.2
Non-Budgetary [2]	-125,170	-57,889	-277,669	-559.2	53.8	-379.7

[1] Starting 2018, the National Government Cash Operations Report follows the Government Finance Statistics Manual (GFSM) 2014 concept wherein reporting of debt amortization reflect the actual principal repayments to creditor including those serviced by the Bond Sinking Fund (BSF); while financing includes gross proceeds of liability management transactions such as bond exchanges.

[2] 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 (BTr)

5 DEPOSITORY CORPORATIONS SURVEY (SRF-based *)

as of end-periods indicated

	LEVELS (in million pesos)			GROWTH RATES (in percent)		
	Dec-16	Dec-17	Dec-18 p	Dec-16	Dec-17	Dec-18 p
1. NET FOREIGN ASSETS	**4,309,018**	**4,403,236**	**4,459,547**	**7.8**	**2.2**	**1.3**
A. Monetary Authorities	3,946,631	4,003,601	4,088,881	4.9	1.4	2.1
Claims on Non-Residents	4,023,829	4,084,708	4,172,381	4.9	1.5	2.1
less: Liabilities to Non-Residents	77,198	81,107	83,500	3.7	5.1	3.0
B. Other Depository Corporation	362,387	399,635	370,666	53.6	10.3	-7.2
Claims on Non-Residents	1,211,638	1,295,967	1,500,547	18.3	7.0	15.8
less: Liabilities to Non-Residents	849,251	896,332	1,129,881	7.8	5.5	26.1
2. DOMESTIC CLAIMS	**9,199,882**	**10,476,875**	**12,009,225**	**17.0**	**13.9**	**14.6**
A. Net Claims on Central Government	1,603,047	1,635,469	1,903,439	27.1	2.0	16.4
Claims on Central Government	2,097,032	2,400,240	2,683,437	5.2	14.5	11.8
less: Liabilities to Central Government	493,985	764,770	779,998	-32.4	54.8	2.0
B. Claims on Other Sectors	7,596,834	8,841,406	10,105,786	15.1	16.4	14.3
Claims on Other Financial Corporations	770,783	925,040	1,088,531	13.3	20.0	17.7
Claims on State and Local Government	82,833	81,064	87,465	8.1	-2.1	7.9
Claims on Public Nonfinancial Corporations	256,796	284,609	260,671	-7.6	10.8	-8.4
Claims on Private Sector	6,486,423	7,550,694	8,669,118	16.6	16.4	14.8
3. LIQUIDITY AGGREGATES						
M4 (M3 + 3.e)	**11,214,561**	**12,486,649**	**13,580,059**	**13.4**	**11.3**	**8.8**
M3 (M2 + 3.d) **	9,505,978	10,636,069	11,612,149	12.8	11.9	9.2
M2 (M1 + 3.c)	9,140,446	10,202,303	11,065,705	13.3	11.6	8.5
M1 (3.a + 3.b)	3,069,459	3,550,830	3,887,379	15.1	15.7	9.5
3.a Currency Outside Depository Corporations	920,954	1,047,576	1,233,503	**16.4**	**13.7**	**17.7**
3.b Transferable Deposits Included in Broad Money	2,148,505	2,503,254	2,653,876	14.5	16.5	6.0
3.c Other Deposits Included in Broad Money	6,070,987	6,651,473	7,178,325	12.4	9.6	7.9
Savings Deposits	4,100,820	4,409,286	4,665,756	14.3	7.5	5.8
Time Deposits	1,970,167	2,242,187	2,512,570	8.7	13.8	12.1
3.d Securities Other Than Shares Included in Broad Money (Deposit Substitutes)	365,532	433,766	546,444	0.8	18.7	26.0
3.e Transferable and Other Deposits in Foreign Currency (FCDs-Residents)	1,708,583	1,850,580	1,967,910	17.1	8.3	6.3
4. LIABILITIES EXCLUDED FROM BROAD MONEY	**2,294,339**	**2,393,462**	**2,888,713**	**16.4**	**4.3**	**20.7**

* 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]		
	2016	2017	2018	2016	2017	2018
Borrowing Rates of Banks						
Interbank Call Loans	2.525	2.730	3.734	1.225	-0.170	-1.466
Savings Deposits[2]	0.720	0.685	0.899	-0.580	-2.215	-4.301
Time Deposits[2]						
(All Maturities)	1.541	1.807	3.163	0.241	-1.093	-2.037
Lending Rates						
All Maturities[3]	5.642	5.630	6.139	4.342	2.730	0.939
High[4]	6.671	6.492	7.109	5.371	3.592	1.909
Low[5]	4.300	4.137	4.573	3.000	1.237	-0.628
Bangko Sentral Rates[6]						
Overnight Lending Facility (OLF)	.. r	3.500	4.323	.. r	0.600	-0.877
RR/P (Overnight)	3.417	3.000	3.729	2.117	0.100	-1.471
Overnight Deposit Facility (ODF)	2.500	2.500	3.229	1.200	-0.400	-1.971
Term Deposit Auction Facility (TDF)						
7-Day	2.661	3.234	3.840	1.361	0.334	-1.360
14 -Day	...	...	3.921	...	...	-1.279
28-Day	2.761	3.446	3.938	1.461	0.546	-1.262
Rediscounting	3.839	3.547	4.318	2.539	0.647	-0.883
Rate on Government Securities						
Treasury Bills (All Maturities)	1.595	2.449	4.389	0.295	-0.451	-0.811
91-Day	1.500	2.147	3.539	0.200	-0.753	-1.661
182-Day	1.583	2.502	4.489	0.283	-0.398	-0.711
364-Day	1.761	2.879	5.144	0.461	-0.021	-0.056
Government Securities in the Secondary Market[8]						
3-Month	2.076	2.432	5.776	-0.125	-0.468	0.676
6-Month	2.946	3.308	6.514	0.746	0.408	1.414
1-Year	2.452	3.032	6.783	0.252	0.132	1.683
2-Year	3.868	3.986	6.885	1.668	1.086	1.785
3-Year	3.517	4.298	6.976	1.317	1.398	1.876
4-Year	3.881	4.921	7.016	1.681	2.021	1.916
5-Year	4.743	4.744	7.037	2.543	1.844	1.937
7-Year	4.886	5.328	7.061	2.686	2.428	1.961
10-Year	4.628	5.699	7.065	2.428	2.799	1.965
20-Year	5.377	5.704	7.491	3.177	2.804	2.391
25-Year	..	..	7.528	..	..	2.428

[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. The Overnight Lending Facility (OLF) and Overnight Deposit Facility (ODF) will serve as upper and lower bound, respectively, of the IRC system.

[7] Nominal interest rate less inflation rate (2012=100)

[8] End-of-Period; beginning 29 October 2018, data refer to the Philippine Peso Bloomberg Valuation Service (PHP BVAL) Reference Rates while those for earlier periods refer to the Philippine Dealing System Treasury Reference Rates 2 (PDST-R2).

- Not Available

.. No Transaction/No Quotation/No Issue

... Blank

Source: Bangko Sentral ng Pilipinas (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 Dinar	Saudi Rial	Brunei Dollar	Indo Rupiah	Thai Baht	UAE Dirham	EURO
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
2017	**Ave**	**50.4037**	**0.4495**	**64.9706**	**6.4686**	**51.2195**	**38.8850**	**36.5254**	**38.6418**	**133.7434**	**13.4412**	**36.3935**	**0.0038**	**1.4866**	**13.7244**	**56.9491**
	Jan	49.7363	0.4328	61.3425	6.4125	49.3186	37.6357	34.8096	37.0610	131.9653	13.2644	34.6882	0.0037	1.4021	13.5425	52.8348
	Feb	49.9614	0.4422	62.4591	6.4388	49.9397	38.1566	35.3290	38.2766	132.5403	13.3243	35.2045	0.0037	1.4269	13.6044	53.2346
	Mar	50.2752	0.4454	62.0548	6.4745	50.1804	37.5815	35.7930	38.3291	133.4299	13.4083	35.6661	0.0038	1.4412	13.6901	53.7365
	Apr	49.8626	0.4527	62.9429	6.4150	49.8251	37.1648	35.6614	37.6260	132.3719	13.2969	35.5343	0.0037	1.4486	13.5768	53.4359
	May	49.8603	0.4441	64.4409	6.4036	50.5254	36.6670	35.7474	37.0608	132.3388	13.2961	35.6197	0.0037	1.4464	13.5763	55.0972
	Jun	49.8501	0.4496	63.8775	6.3929	51.5070	37.4536	36.0349	37.6132	132.3225	13.2932	35.9051	0.0037	1.4662	13.5737	56.0089
	Jul	50.6382	0.4504	65.7851	6.4850	52.7764	39.8179	36.9210	39.4279	134.4022	13.5038	36.7869	0.0038	1.4999	13.7876	58.3076
	Aug	50.8747	0.4630	66.0288	6.5053	52.6703	40.3404	37.3927	40.2627	135.0246	13.5665	37.2558	0.0038	1.5297	13.8522	60.1073
	Sep	51.0094	0.4605	67.9427	6.5280	53.0141	41.4972	37.7881	40.6448	135.3334	13.6023	37.6486	0.0038	1.5394	13.8886	60.7373
	Oct	51.3433	0.4546	67.7973	6.5774	52.3768	40.8459	37.7631	40.0215	136.2200	13.6911	37.6247	0.0038	1.5445	13.9800	60.4006
	Nov	51.0384	0.4523	67.4082	6.5395	51.4574	40.0288	37.6411	38.9300	135.2612	13.6096	37.5028	0.0038	1.5497	13.8972	59.8798
	Dec	50.3947	0.4464	67.5675	6.4511	51.0422	39.4311	37.4232	38.4483	133.7113	13.4382	37.2848	0.0037	1.5442	13.7234	59.6090
2018	**Ave**	**52.6614**	**0.4769**	**70.3179**	**6.7197**	**53.8692**	**40.6612**	**39.0471**	**39.3810**	**139.6538**	**14.0414**	**38.9028**	**0.0037**	**1.6302**	**14.3387**	**62.1943**
	Jan	50.5087	0.4554	69.7775	6.4597	52.5408	40.6329	38.2266	40.1687	134.0407	13.4684	38.0825	0.0038	1.5826	13.7533	61.6042
	Feb	51.7856	0.4793	72.3817	6.6208	55.4033	41.2191	39.2487	40.7824	137.4125	13.8093	39.1006	0.0038	1.6455	14.1008	63.9431
	Mar	52.0676	0.4911	72.6846	6.6418	55.0105	40.2891	39.5816	40.4661	138.1474	13.8843	39.4318	0.0038	1.6651	14.1775	64.2312
	Apr	52.0986	0.4847	73.3727	6.6385	53.8784	40.9351	39.6189	40.0608	138.2423	13.8928	39.4689	0.0038	1.6652	14.1857	64.0093
	May	52.1948	0.4755	70.2903	6.6502	52.3312	40.5726	38.9705	39.2764	138.4189	13.9179	38.8255	0.0037	1.6337	14.2113	61.6634
	Jun	53.0476	0.4823	70.4818	6.7604	53.6080	40.4078	39.3527	39.7350	140.3745	14.1454	39.2073	0.0038	1.6349	14.4437	61.9226
	Jul	53.4329	0.4797	70.4068	6.8090	53.7366	40.6812	39.2070	39.5527	141.2871	14.2479	39.0636	0.0037	1.6061	14.5484	62.4512
	Aug	53.2735	0.4796	68.6848	6.7871	53.8854	40.8721	38.9335	39.0671	141.2639	14.2051	38.7918	0.0037	1.6119	14.5050	61.5363
	Sep	53.9419	0.4821	70.4221	6.8817	55.7503	41.3693	39.3457	38.8373	143.1371	14.3829	39.2027	0.0036	1.6541	14.6873	62.9028
	Oct	54.0086	0.4787	70.3199	6.8920	54.4068	41.5496	39.1714	38.3872	143.3327	14.3990	39.0299	0.0036	1.6494	14.7057	62.0820
	Nov	52.8083	0.4659	68.1667	6.7454	52.7637	40.0078	38.4100	38.2395	140.1401	14.0774	38.2709	0.0036	1.6022	14.3782	60.0061
	Dec	52.7691	0.4680	66.8260	6.7503	53.1150	39.3983	38.4985	37.9983	140.0480	14.0668	38.3586	0.0036	1.6123	14.3680	59.9800

Source: Bangko Sentral ng Pilipinas (BSP)

7a EFFECTIVE EXCHANGE RATE INDICES OF THE PESO

period average

1980 = 100

	NOMINAL			REAL		
		Trading Partners			Trading Partners	
	Overall [1]	Advanced [2]	Developing [3]	Overall [1]	Advanced [2]	Developing [3]
2016	**15.00**	**12.15**	**24.03**	**86.98**	**82.15**	**114.06**
Jan	15.41	12.65	24.45	91.78	88.95	118.22
Feb	15.18	12.41	24.17	88.39	85.43	114.07
Mar	15.30	12.54	24.32	88.56	85.27	114.60
Apr	15.24	12.44	24.27	88.68	84.62	115.45
May	15.16	12.28	24.27	88.20	82.95	115.99
Jun	15.20	12.24	24.46	88.74	82.89	117.24
Jul	14.98	12.05	24.09	86.51	81.25	113.86
Aug	14.94	11.96	24.12	85.83	79.94	113.62
Sep	14.75	11.80	23.81	84.43	78.40	112.00
Oct	14.59	11.71	23.53	83.75	77.81	111.05
Nov	14.62	11.78	23.51	84.30	78.82	111.30
Dec	14.74	12.04	23.47	84.86	80.28	111.14
2017	**14.13**	**11.51**	**22.54**	**83.05**	**79.07**	**108.35**
Jan	14.70	11.99	23.43	88.03	85.16	113.72
Feb	14.48	11.83	23.08	85.70	82.74	110.85
Mar	14.37	11.75	22.87	84.54	81.32	109.62
Apr	14.41	11.73	23.01	85.30	81.20	111.30
May	14.39	11.73	22.96	84.90	80.57	111.00
Jun	14.29	11.61	22.83	84.34	79.81	110.46
Jul	14.04	11.41	22.44	81.93	77.91	106.97
Aug	13.82	11.17	22.17	80.28	75.61	105.43
Sep	13.73	11.15	21.96	79.81	75.22	104.77
Oct	13.75	11.20	21.94	80.30	75.96	105.19
Nov	13.78	11.28	21.92	80.71	76.72	105.41
Dec	13.89	11.41	22.07	81.09	77.16	105.84
2018	**13.30**	**10.83**	**21.22**	**80.84**	**77.01**	**105.44**
Jan	13.62	11.19	21.62	83.14	80.95	106.99
Feb	13.18	10.77	20.98	79.43	77.00	102.50
Mar	13.07	10.65	20.85	78.91	75.70	102.47
Apr	13.08	10.71	20.81	79.69	76.46	103.47
May	13.26	10.90	21.04	80.47	77.07	104.60
Jun	13.14	10.77	20.89	80.24	76.55	104.55
Jul	13.25	10.75	21.20	80.30	76.21	104.96
Aug	13.36	10.81	21.41	81.06	76.40	106.43
Sep	13.21	10.68	21.19	80.44	75.60	105.79
Oct	13.29	10.75	21.30	81.26	76.31	106.93
Nov	13.60	11.04	21.74	83.11	78.38	109.06
Dec	13.56	11.03	21.66	82.12	77.53	107.70

[1] Australia, Euro Area, U.S., Japan, Hong Kong, Taiwan, Thailand, Indonesia, Malaysia, Singapore, South Korea, China, Saudi Arabia, and U.A.E.

[2] U.S., Japan, Euro Area, and Australia

[3] Hong Kong, Taiwan, Thailand, Indonesia, Malaysia, Singapore, South Korea, China, Saudi Arabia, and U.A.E

Source: BSP

8 STOCK MARKET TRANSACTIONS

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

	2016		2017		2018		Percent Change 2017		Percent Change 2018	
	Volume	Value	Volume	Value	Volume	Value	Volume	Value	Volume	Value
T o t a l	**442,270.5**	**1,929,499.2**	**440,547.4**	**1,958,364.1**	**403,847.2**	**1,736,822.4**	**-0.4**	**1.5**	**-8.3**	**-11.3**
Financial	5,109.0	275,527.6	5,486.9	293,846.1	4,355.7	271,071.4	7.4	6.6	-20.6	-7.8
Industrial	29,029.5	401,978.7	40,960.8	487,105.4	28,560.4	355,193.8	41.1	21.2	-30.3	-27.1
Holding Firms	37,014.4	491,273.5	54,916.7	427,941.0	37,510.4	400,471.5	48.4	-12.9	-31.7	-6.4
Property	55,205.3	347,679.4	85,696.1	318,017.9	68,913.0	319,095.2	55.2	-8.5	-19.6	0.3
Services	86,585.7	330,139.4	79,183.7	349,965.2	64,474.4	332,909.9	-8.5	6.0	-18.6	-4.9
Mining & Oil	227,142.4	65,175.4	173,117.1	72,031.8	198,294.5	50,848.5	-23.8	10.5	14.5	-29.4
SME	2,178.2	17,033.0	1,182.0	8,953.4	1,733.2	6,559.1	-45.7	-47.4	46.6	-26.7
ETF	5.9	692.2	4.1	503.3	5.5	673.1	-30.7	-27.3	35.5	33.7
Composite Index (PSEi)										
Average	**7,284.5**		**7,850.5**		**7,745.0**		**7.8**		**-1.3**	
End of Period	**6,840.6**		**8,558.4**		**7,466.0**		**25.1**		**-12.8**	

Source: Philippine Stock Exchange (PSE)

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

	2017 r	2018 p	Growth (%) 2018 p
Current Account	-2143	-7879	-267.7
Export	124126	128818	3.8
Import	126269	136697	8.3
Goods, Services, and Primary Income	-28295	-34699	-22.6
Export	97229	101211	4.1
Import	125525	135910	8.3
Goods and Services	-31522	-38543	-22.3
Export	86646	89142	2.9
Import	118168	127686	8.1
Goods	-40215	-49036	-21.9
Credit: Exports	51814	51674	-0.3
Debit: Imports	92029	100710	9.4
Services	8693	10493	20.7
Credit: Exports	34832	37469	7.6
Debit: Imports	26139	26976	3.2
Primary Income	3226	3844	19.2
Credit: Receipts	10583	12068	14.0
Debit: Payments	7357	8224	11.8
Secondary Income	26153	26820	2.6
Credit: Receipts	26897	27607	2.6
Debit: Payments	745	787	5.7
Capital Account	69	65	-6.3
Credit: Receipts	103	103	.
Debit: Payments	34	38	12.9
Financial Account	-2798	-7832	-179.9
Net Acquisition of Financial Assets	6717	6038	-10.1
Net Incurrence of Liabilities	9515	13870	45.8
Direct Investment	-6952	-5854	15.8
Net Acquisition of Financial Assets	3305	3948	19.5
Net Incurrence of Liabilities	10256	9802	-4.4
Portfolio Investment	2454	858	-65.0
Net Acquisition of Financial Assets	1658	4224	154.8
Net Incurrence of Liabilities	-796	3366	522.7
Financial Derivatives	-51	-53	-5.4
Net Acquisition of Financial Assets	-503	-1466	-191.2
Net Incurrence of Liabilities	-453	-1413	-212.0
Other Investment	1750	-2783	-259.1
Net Acquisition of Financial Assets	2257	-669	-129.6
Net Incurrence of Liabilities	508	2114	316.4
NET UNCLASSIFIED ITEMS	-1588	-2324	-46.4
OVERALL BOP POSITION	-863	-2306	-167.2
Debit: Change in Reserve Assets	-862	-2305	-167.5
Credit: Change in Reserve Liabilities	1	1	-35.8

Details may not add up to total due to rounding.
r Revised to reflect data updates from official data sources and post-audit adjustments
p Preliminary

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 (GIR)

as of periods indicated, in million US dollars

	2016	2017	2018
Gross International Reserves	**80,692**	**81,570**	**79,193**
Reserve Position in the Fund	442	424	474
Gold	7,259	8,337	8,153
SDRs	1,138	1,211	1,184
Foreign Investments	68,290	65,815	66,733
Foreign Exchange	3,563	5,783	2,649
Import Cover[1]	8.8	7.8	7.0
Short-Term External Debt Cover (in percent)[2]			
Original Maturity[3]	555.5	571.4	492.9
Residual Maturity[4]	418.2	427.4	357.4
Net International Reserves	**80,689**	**81,567**	**79,189**

[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] Starting December 2005, outstanding annual external debt reflects the new reporting framework in line with international standards under the latest External Debt Statistics Guide and BPM6.

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

[4] This 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 outstanding short-term debt and debt service schedule on outstanding external debt as of 31 December 2018.

Details may not add up to total due to rounding

Source: Bangko Sentral ng Pilipinas

11 TOTAL EXTERNAL DEBT [1]
as of periods indicated
in million US dollars

	31 December 2017				31 December 2018			
	Short-term		Medium &	Total	Short-term		Medium &	Total
	Trade	Non-Trade	Long- Term		Trade	Non-Trade	Long- Term	
Grand Total	2,498	11,777	58,823	73,098 [a]	2,623	13,445	62,892	78,960 [a]
Public Sector		287	37,223 [b]	37,510		431	39,272 [b]	39,703
Banks		287	3,428	3,716		431	3,371	3,802
Bangko Sentral ng Pilipinas			1,347 [c]	1,347			1,319 [c]	1,319
Others		287	2,082	2,369		431	2,051	2,483
Non-Banks			33,794	33,794			35,901	35,901
CB-BOL								
NG and Others			33,794	33,794			35,901	35,901
Private Sector	2,498	11,489	21,601	35,588	2,623	13,014	23,620	39,256
Banks		11,297	4,131	15,428		12,605	6,265	18,870
Foreign Bank Branches		4,562	150	4,712 [d]		5,151	193	5,344 [d]
Domestic Banks		6,735	3,981	10,716		7,454	6,072	13,527
Non-Banks	2,498	192	17,469 [e]	20,160	2,623	408	17,355 [e]	20,386

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

Exclusions	31 December 2017	31 December 2018
a Residents' holdings of Philippine debt papers issued offshore;	15,936	17,185
Non-residents' holdings of peso-denominated debt securities	5,308	6,757
Inclusions		
b Cumulative foreign exchange revaluation on US$-denominated multi-currency loans from Asian Development Bank and World Bank	(29)	(22)
c Accumulated SDR allocations from the IMF	1,190	1,162
d "Due to Head Office/Branches Abroad" (DTHOBA) accounts of branches and offshore banking units of foreign banks operating in the Philippines	3,614	4,215
e Loans without BSP approval/registration which cannot be serviced using foreign exchange from the banking system;	12,342	6,497
Obligations under capital lease arrangements	1,170	1,195

Source: Bangko Sentral ng Pilipinas

12 SELECTED FOREIGN DEBT SERVICE INDICATORS
for periods indicated
in million US dollars

	2017 [r]	2018 [p]
Debt Service Burden (DSB) [1]	7309	7704
Principal	4768	4811
Interest	2541	2893
Export Shipments (XS) [2]	51814	51674
Exports of Goods and Receipts from Services and Income (XGSI) [2, 3]	117363	121866
Current Account Receipts (CAR) [2]	124126	128818
External Debt	73098	78960
Gross Domestic Product (GDP)	313595	330846
Gross National Income (GNI)	377089	396583
Ratios (%) :		
DSB to XS	14.11	14.91
DSB to XGSI	6.23	6.32
DSB to CAR	5.89	5.98
DSB to GNI	1.94	1.94
External Debt to GDP	23.31	23.87
External Debt to GNI	19.38	19.91

[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 end-periods indicated
in million pesos

	2017 [a] Dec	2018 [p] Dec	Growth Rates (in percent)
Assets	**4,666,958.0**	**4,851,291.4**	**3.9**
International Reserves [1]	4,056,596.1	4,140,162.7	2.1
Domestic Securities	224,616.1	223,298.8	-0.6
Loans and Advances	187,418.1	277,505.7	48.1
Bank Premises and Other Fixed Assets	23,065.0	23,725.0	2.9
Derivative Instruments in a Gain/(Loss) Position	100.0	52.6	-47.4
Other Assets	175,162.7	186,546.7	6.5
Liabilities	**4,586,269.4**	**4,734,857.0**	**3.2**
Currency Issue	1,267,482.3	1,490,240.3	17.6
Deposits	2,531,380.8	2,304,081.9	-9.0
Reserve Deposits of Other Depository Corporations (ODCs)[2]	1,867,228.1	1,843,831.7	-1.3
Reserve Deposits of Other Financial Corporations (OFCs)[3]	2,010.2	1,283.1	-36.2
Secured Settlement Account	..	2,681.6	….
Overnight Deposit Facility[4]	85,472.4	58,643.8	-31.4
Term Deposit Facility[4]	100,957.5	69,195.7	-31.5
Treasurer of the Philippines[5]	326,815.4	170,158.6	-47.9
Foreign Financial Institutions	115,052.8	122,832.9	6.8
Other Foreign Currency Deposits	1,012.5	1,053.1	3.9
Other Deposits[6]	32,831.9	34,401.4	4.8
Foreign Loans Payable	30.4	30.4	0.0
Net Bonds Payable	24,986.5	26,290.2	5.2
Allocation of SDRs	59,856.9	61,368.5	2.5
Derivatives Liability	98.3	0.0	….
Derivative Instruments in a Loss Position	4.5	0.0	….
Revaluation of Foreign Currency Accounts[7]	381,544.8	534,976.4	40.2
Reverse Repurchase Facility[4]	305,057.2	300,986.1	-1.3
Other Liabilities	15,827.7	16,883.1	6.7
Net Worth	**80,688.5**	**116,434.4**	**44.3**
Capital	50,000.0	50,000.0	0.0
Surplus/Reserves	30,688.5	66,434.4	116.5

Note: Details may not add up to total due to rounding.
[1] Excludes the reserve tranche position with the IMF
[2] 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).
[3] OFCs are trust units of banks.
[4] 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.
[5] Includes foreign currency deposits
[6] Mostly GOCC deposits
[7] Previously named Revaluation of International Reserves
[a] Audited but subject to restatement
[p] Based on the preliminary and unaudited BSP balance sheet as of end-December 2018 prepared by the Financial Accounting Department (FAD) of the BSP
.. No transaction
…. Not computed

Source: Bangko Sentral ng Pilipinas

14 INCOME POSITION OF THE BANGKO SENTRAL NG PILIPINAS

for periods indicated
in billion pesos

	2017 [a] Dec	2018 [p] Dec	Growth Rates (in percent)
Revenues	**75.564**	**68.269**	**-9.7**
Interest Income	58.270	78.157	34.1
International Reserves	47.789	64.155	34.2
Domestic Securities	5.134	7.517	46.4
Loans and Advances	1.681	2.675	59.1
Others	3.666	3.810	3.9
Miscellaneous Income[1]	17.055	-10.052	-158.9
Net income from Branches	0.239	0.164	-31.4
Expenses	**66.396**	**66.199**	**-0.3**
Interest Expenses	35.504	29.927	-15.7
Reserve Deposits of ODCs and OFCs[2]	0.000	0.000	....
Overnight Deposit Facility[3]	2.115	1.341	-36.6
Term Deposit Facility[3]	15.882	5.818	-63.4
National Government Deposits	6.768	9.412	39.1
Reverse Repurchase Facility[3]	8.075	10.113	25.2
Loans Payable	2.464	3.099	25.8
Other Foreign Currency Deposits	0.000	0.000	....
Other Liabilities	0.200	0.144	-28.0
Cost of Minting	8.061	11.260	39.7
Other Expenses	22.831	25.012	9.6
Net Income/(Loss) Before Gain/(Loss) on FXR Fluctuations and Income Tax Expense/(Benefit)	**9.168**	**2.070**	**-77.4**
Gain/(Loss) on FXR Fluctuations[4]	15.478	53.133	243.3
Income Tax Expense/(Benefit)	1.140	15.354	1,246.8
Net Income/(Loss) After Tax	**23.506**	**39.849**	**69.5**

Note: Details may not add up to total due to rounding.
[1] This includes trading gains/losses, fees, penalties and other operating income, among others.
[2] 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.
[3] With the implementation of the Interest Rate Corridor (IRC) system on 3 June 2016, the earlier entry on the Reverse Repurchase Agreement has been renamed into the Reverse Repurchase Facility while the Special Deposit Account Facility was replaced with Overnight Deposit Facility and Term Deposit Facility.
[4] 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.
[a] Audited but subject to restatement
[p] Based on the preliminary and unaudited BSP income statement as of end-December 2018 prepared by the Financial Accounting Department (FAD) of the BSP
.. No transaction
.... Not computed

Source: Bangko Sentral ng Pilipinas

15 BSP: CONDENSED STATEMENT OF CONDITION

in thousand pesos

ASSETS	31 Dec 2018*	31 Dec 2017**
Foreign Currency Financial Assets		
Deposits with Foreign Banks	1,123,248,163	831,774,931
Other Cash Balances	1,131,823	233,179
Investment Securities	2,134,396,095	2,719,308,711
Foreign Securities Purchased under Agreements to Resell	388,368,175	25,521,651
Loan to International Monetary Fund (IMF)	2,111,093	2,687,564
Gold	428,575,279	416,509,799
IMF Special Drawing Rights	62,332,053	60,560,218
Gross International Reserves	**4,140,162,681**	**4,056,596,053**
Other Foreign Currency Receivables	93,407,616	91,737,574
Non-IR Foreign Currency	33,256	32,471
Derivative Instruments in a Gain Position	52,563	99,983
Total Foreign Currency Financial Assets	**4,233,656,116**	**4,148,466,081**
Local Currency Financial Assets		
Investment Securities	223,298,757	224,616,053
Loans and Advances	277,505,654	187,418,104
Due from Administrator of Funds	30,583,503	30,629,080
Other Receivables	33,092,816	20,488,516
Total Local Currency Financial Assets	**564,480,730**	**463,151,753**
Total Financial Assets	**4,798,136,846**	**4,611,617,834**
Acquired Assets Held for Sale	152,912	59,556
Investment Property	13,874,715	15,200,084
Bank Premises, Furniture, Fixtures and Equipment	23,725,039	23,065,045
Intangible Assets	234,255	253,085
Inventories	10,689,228	8,049,021
Property Dividend to NG	285,214	285,214
Deferred Tax Assets	2,655,843	6,147,803
Miscellaneous Assets	1,537,314	2,280,312
Total Other Assets	**53,154,520**	**55,340,120**
TOTAL ASSETS	**4,851,291,366**	**4,666,957,954**

* Preliminary and unaudited

** Audited but subject to restatement

Source: Financial Accounting Department (FAD), Bangko Sentral ng Pilipinas

15 BSP: CONDENSED STATEMENT OF CONDITION (continuation)

in thousand pesos

LIABILITIES AND CAPITAL	31 Dec 2018*	31 Dec 2017**
Foreign Currency Financial Liabilities		
Short-Term Deposits	94,492,770	16,101,750
Loans Payable	30,359	30,448
Bonds Payable	26,290,225	24,986,493
Allocation of IMF Special Drawing Rights	61,368,544	59,856,929
Derivatives liability	0	0
Derivative Instruments in a Loss Position	0	4,479
Other Liabilities	5,644,763	6,388,166
Total Foreign Currency Financial Liabilities	**187,826,661**	**107,368,265**
Local Currency Financial Liabilities		
Government Deposits	76,704,188	311,708,439
Deposits of Banks and Quasi-Banks	1,882,212,579	1,902,087,916
Deposits of the IMF and Other Fis	122,832,916	115,052,829
Securities Sold Under Agreements to Repurchase	300,986,093	305,057,187
Special Deposit Account	0	0
Term Deposit Account	69,195,713	100,957,503
Overnight Deposit Account	58,643,762	85,472,353
Total Local Currency Financial Liabilities	**2,510,575,251**	**2,820,336,227**
Total Financial Liabilities	**2,698,401,912**	**2,927,704,492**
Other Liabilities		
Currency in Circulation	1,490,240,286	1,267,482,317
Retirement Benefit Obligations	2,962,060	2,998,142
Miscellaneous Liabilities	7,818,030	6,082,872
Deferred Tax Liability	8,943	7,444
Dividends Payable	449,345	449,345
Revaluation of Foreign Currency Accounts	534,976,388	381,544,828
Total Other Liabilities	**2,036,455,052**	**1,658,564,948**
TOTAL LIABILITIES	**4,734,856,964**	**4,586,269,440**
Capital Accounts		
Capital	50,000,000	50,000,000
Surplus	-9,277,000	-45,608,051
Unrealized Gains/(Losses) on Investments	-1,807,783	-1,324,098
Capital Reserves	77,519,185	77,620,663
TOTAL CAPITAL ACCOUNTS	**116,434,402**	**80,688,514**
TOTAL LIABILITIES AND CAPITAL ACCOUNTS	**4,851,291,366**	**4,666,957,954**

* Preliminary and unaudited
** Audited but subject to restatement
Source: Financial Accounting Department (FAD), Bangko Sentral ng Pilipinas

16 BSP: CONDENSED STATEMENT OF INCOME AND EXPENSES WITH BUDGET INFORMATION

in thousand pesos

	31-Dec-18		31-Dec-17
	BUDGET*	ACTUAL**	ACTUAL***
Operating Income:			
Income from Foreign Currency Financial Assets			
Interest Income	51,105,817	67,568,924	51,211,735
Fees, Miscellaneous Foreign Currency Income & Trading Gains-Foreign	265,444	(18,455,438)	(1,715,939)
Total Income from Foreign Currency Financial Assets	**51,371,261**	**49,113,486**	**49,495,796**
Expenses on Foreign Currency Financial Liabilities			
Interest Expense	2,892,555	4,313,573	2,649,215
Other Foreign Currency Expenses	1,177,316	926,577	977,902
Total Expenses on Foreign Currency Liabilities	**4,069,871**	**5,240,150**	**3,627,117**
Net Income from Foreign Currency Financial Assets and Liabilities	**47,301,390**	**43,873,336**	**45,868,679**
Income from Local Currency Financial Assets			
Interest Income & Trading Gains Local	8,429,452	10,587,979	7,061,062
Total Income from Local Currency Financial Assets	**8,429,452**	**10,587,979**	**7,061,062**
Expenses on Local Currency Financial Liabilities			
Interest Expense	33,718,866	25,613,670	32,855,567
Provision for Probable Losses	-	38,748	56,496
Final Tax on Interest Income/Discounts	1,085,580	1,569,968	1,040,371
Total Expenses on Local Currency Financial Liabilities	**34,804,446**	**27,222,386**	**33,952,434**
Net Loss from Local Currency Financial Assets and Liabilities	**(26,374,994)**	**(16,634,407)**	**(26,891,372)**
Net Income from Financial Accounts	**20,926,396**	**27,238,929**	**18,977,307**
Other Operating Income	**6,785,545**	**8,567,339**	**19,007,626**
Currency Printing and Minting Cost	**14,514,084**	**11,259,711**	**8,060,938**
Operating Expenses:			
Personnel Services, Development and Training	13,134,029	14,020,852	13,443,159
Traveling	493,680	408,001	391,242
Taxes and Licenses	153,936	3,826,923	2,887,864
Currency and Gold Operations	395,512	381,775	320,609
Acquired Assets	564,782	237,566	212,337
Other Services	3,431,208	2,872,244	2,152,702
Probable losses on uncollectible rent/receivables	43,304	19,631	9,377
Fidelity Insurance	116,918	77,418	67,054
Light, Fuel & Water	273,077	339,565	302,463
Repairs & Maintenance	1,158,582	574,082	547,800
Communication Services	439,143	307,547	264,041
Supplies	96,318	49,231	62,937
Others	1,303,866	1,504,770	899,030
Depreciation	806,992	857,139	833,026
Market Decline of Acquired Assets	7,378	(127,949)	514,813
Total Operating Expenses	**18,987,517**	**22,476,551**	**20,755,752**
Net Income/(Loss) Before FX Rates Fluctuation	**(5,789,660)**	**2,070,006**	**9,168,243**
Net Realized Gain on FX Rates Fluctuation	**0**	**53,132,843**	**15,478,154**
Net Income/(Loss) Before Income Tax	**(5,789,660)**	**55,202,849**	**24,646,397**
Income Tax Expense		15,353,831	1,140,562
Net Income/(Loss) for the Year	**(5,789,660)**	**39,849,018**	**23,505,835**

* *Excluding PICCI budget*

** *Preliminary and unaudited*

*** *Audited but subject to restatement*

YEARS
1993 - 2018

BANGKO SENTRAL NG PILIPINAS

www.bsp.gov.ph