Foreword

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

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

The government's target for annual headline inflation under the inflation targeting framework has been set at 3.0 percent ± 1.0 percentage point (ppt) for 2016-2018 by the Development Budget Coordination Committee (DBCC). This is consistent with the desired disinflation path over the medium term, favorable trends in inflation dynamics, and expected higher capacity of the economy for growth under a low inflation environment.

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

The Monetary Board approved this Inflation Report at its meeting on 13 October 2016.

AMANDO M. TETANGCO, JR.
Governor

The Monetary Policy of the Bangko Sentral ng Pilipinas

The BSP Mandate

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

Monetary Policy Instruments

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

Policy Target

The BSP's target for monetary policy uses the Consumer Price Index (CPI) or headline inflation rate, which is compiled and released to the public by the National Statistics Office (NSO). The policy target is set by the Development Budget Coordination Committee (DBCC)[2] in consultation with the BSP. The inflation target for 2016-2018 is 3.0 percent ± 1.0 ppt.[3]

BSP's Explanation Clauses

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

[1] The TDF was introduced under the interest rate corridor system which was implemented on 3 June 2016.
[2] The DBCC, created under Executive Order (E.O.) No. 232 dated 14 May 1970, is an inter-agency committee tasked primarily to formulate the National Government's fiscal program. It is composed of the Office of the President (OP), Department of Budget and Management (DBM), National Economic and Development Authority (NEDA), and the Department of Finance (DOF).
The BSP attends the Committee meetings as a resource agency.
[3] The inflation range target for 2015-2018 was announced thru DBCC Resolution No.2015-1 dated 27 January 2015. The decision to maintain the inflation range target for 2016-2018 was announced thru DBCC Resolution No.2015-7 dated 29 December 2015.

The Monetary Board

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

Chairman & Governor
Amando M. Tetangco, Jr.

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

The Advisory Committee

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

Chairman
Amando M. Tetangco, Jr.
Governor

Members
Diwa C. Guinigundo
Deputy Governor
Monetary Stability Sector

Nestor A. Espenilla, Jr.
Deputy Governor
Supervision and Examination Sector

Ma. Ramona GDT Santiago
Assistant Governor
Treasury Department

Francisco G. Dakila, Jr.
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Deputy Director, Financial Supervision Research and Consumer Protection Sub-sector

Lara Romina E. Ganapin
Bank Officer V, Department of Economic Research

Cherrie F. Ramos
Bank Officer V, Department of Economic Research

Jasmin E. Dacio
Bank Officer V, Department of Economic Research

Eduard Joseph DP Robleza
Bank Officer V, Department of Economic Research

Vanessa T. Españo
Bank Officer V, Department of Economic Research

Marites B. Oliva
Bank Officer V, Center for Monetary and Financial Policy

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

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

List of Acronyms, Abbreviations, and Symbols

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

Contents

Overview

Headline inflation accelerates but remains benign. Headline inflation for Q3 2016 rose to 2.0 percent, higher than the quarter- and year-ago rates of 1.5 percent and 0.6 percent, respectively. This brought average inflation for the year to 1.6 percent, still lower than the low end of the National Government's announced target of 3.0 percent ± 1.0 percentage point for 2016-2018. The higher inflation during the review quarter was driven mainly by price increases of certain food and non-food items. The ongoing lean season in rice production as well as weather-related supply disruptions of key food items pushed up food prices. Non-food inflation also increased as most non-food commodity groups posted higher inflation readings during the quarter. Similarly, core inflation rose to 2.0 percent from 1.7 percent in the previous quarter. This was supported by the alternative measures of core inflation computed by the BSP, all of which increased during the quarter. Meanwhile, despite the price developments during the review quarter, the number of CPI items with inflation rates greater than the upper end of the 2016 inflation target declined slightly to 25 items (from 26 items a quarter ago) which together comprised 10.4 percent of the CPI basket.

Inflation expectations continue to be subdued. The BSP's survey of private sector economists for September 2016 yielded an unchanged mean inflation forecast of 1.8 percent relative to June 2016. The average annual inflation forecast for 2017 also stayed at 2.7 percent. Meanwhile, the mean inflation forecast for 2018 declined marginally to 2.8 percent from 2.9 percent in the previous quarter. The lower inflation expectations were attributed to persistently low global oil prices, the prevailing slowdown in global economic growth, and stable food price conditions. These were seen to outweigh the upside risks brought by a possible rebound in oil prices, strong domestic demand, possible power rate adjustments, a weaker peso, and the impact of La Niña in the latter part of 2016 until the first quarter of 2017. On the other hand, the September 2016 Consensus Economics survey showed a lower mean inflation forecast for 2016 and 2017 at 1.8 percent (from 1.9 percent) and 2.7 percent (from 2.9 percent), respectively, compared to the previous quarter.

Nevertheless, domestic demand sustains robust growth. The domestic economy remained strong, expanding by 7.0 percent in Q2 2016, higher than the quarter- and year-ago expansions of 6.8 percent and 5.9 percent, respectively. This brought real GDP for the first half of the year to about 7.0 percent which was within the government's 2016 growth target of 6.5-7.5 percent. The Q2 growth was driven by increased capital formation, particularly in durable equipment and construction, and higher growth in consumer and government spending. Meanwhile, the accelerated growth of the services sector contributed primarily to the growth on the production side. Similarly, trends in higher-frequency demand indicators pointed to optimistic prospects in the near term. Vehicle sales continued to post high double-digit growth rates, supported by stable consumer demand amid the attractive financing plans and aggressive marketing promotions of car dealers.

Faster inflation in Q3 2016 although still benign

Moreover, the outlook for the domestic economy remained positive as the composite Purchasing Managers' Index pointed to expectations of brisker expansionary economic activities in the period ahead. At the same time, business and consumer expectations for the next quarter were notably more upbeat. These indicators support the view that the country's underlying domestic demand continues to be firm amid significant improvements in employment conditions.

Meanwhile, global economic activity remains tepid. Growth in the US economy continued to hold firm, as consumption and investment accelerated, while other major economies such as the euro area and Japan remained sluggish. On the other hand, several indicators pointed to a marginal improvement in China although investments in fixed assets slowed down. The more subdued outlook for advanced economies, particularly after the results of the UK Brexit vote, led a number of central banks to ease their monetary settings in order to stave off deflation risks.

Domestic financial system remains resilient despite uncertainties from the external and domestic fronts. The domestic financial system remained stable and resilient, anchored on solid macroeconomic fundamentals. In particular, the sustained strong Q2 GDP growth as well as the peaceful transition to the new administration provided boost to the domestic financial market. These were, however, dampened in part by uncertainty coming from the external environment. The subdued global growth outlook contributed to a generally muted market sentiment and factored into the depreciation of the peso during the review quarter. Nevertheless, the Philippine equities market continued its rally as it rose by 6.2 percent relative to the quarter-ago level, due in part to the delay in the US Fed's decision to postpone raising interest rates. Investor appetite for local currency government securities remained healthy, affirmed by the continued oversubscription in the scheduled GS auctions. Meanwhile, the country's debt spreads and risk premiums showed mixed trends, reflecting market gyrations. Meanwhile, the Philippine banking system remained sound, resilient and capable of supporting the expanding economy, marked by a continued increase in assets, lending, and deposits, and with capital adequacy ratios comfortably above the BSP's prescribed levels and international norms. In addition, based on the latest survey round, bank lending standards for loans to both enterprises and households were also broadly unchanged during the quarter, indicating a generally stable supply of credit.

Monetary policy settings were maintained in Q3 2016. The BSP decided to maintain its key policy interest rate for the overnight reverse repurchase or RRP facility at its August and September monetary policy meetings. The reserve requirement ratios were likewise left unchanged. The BSP's decision to maintain key policy rates was based on its assessment that the inflation environment remained manageable.

In addition, latest baseline forecasts show that inflation could settle below the low-end of the government's target range in 2016 and approach the midpoint of the target range in 2017 and 2018. Pending petitions for adjustments in electricity rates along with the proposed adjustment in the excise tax rates of petroleum products and the corresponding second-round effect on transport fares were the main upside risks to inflation. On the other hand, slower global economic activity stood as the key downside risk. Nevertheless, domestic demand indicators continued to confirm the assessment of sustained momentum in real sector activity. Moreover, the continued expansion in liquidity and credit conditions indicate an environment conducive to supporting economic activity.

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

Prevailing monetary policy settings, thus, remain appropriate. Notwithstanding the slightly below-target inflation forecast for 2016, monetary easing does not appear to be warranted at this juncture as transitory supply-side factors, which are largely outside the direct influence of monetary policy, continue to underpin the benign inflation readings. Inflation expectations likewise remain firmly anchored within the inflation target band for 2017 and 2018 while settling slightly below the lower bound of the target range for 2016. Moreover, demand conditions remain firm, with sustained GDP growth momentum, supported by strong business and consumer confidence. In addition, the continued growth in money supply and bank lending signify that overall monetary conditions remain sufficiently accommodative.

In sum, prevailing conditions for inflation as well as output continue to support maintaining present monetary policy settings. Keeping a steady hand on policy levers also remains prudent for the BSP given the challenging global economic environment and uncertainty over growth prospects and monetary policy action in major advanced economies. Going forward, the BSP will continue to monitor domestic and external developments to ensure that the monetary policy stance remains consistent with its price and financial stability objective.

I. Inflation and Real Sector Developments

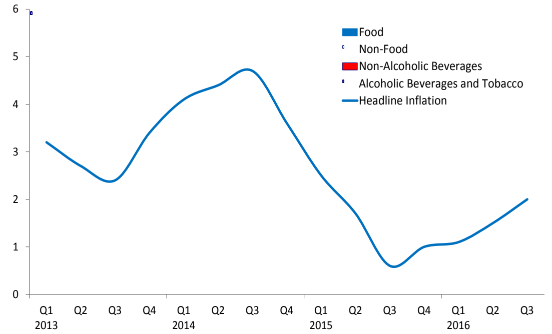
Prices

Headline Inflation. Headline inflation for Q3 2016 rose to 2.0 percent from 1.5 percent in the previous quarter and higher than the 0.6 percent in the same period a year ago as selected items under food and non-food categories started rising.

Domestic inflation accelerates on higher food prices

The average headline inflation for Q1-Q3 2016 at 1.6 percent was below the low end of the National Government's (NG) announced target of 3.0 percent ± 1.0 percentage point (ppt).

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



Source: Philipine Statistical Authority (PSA), BSP

Core Inflation. Core inflation, which excludes certain volatile food and energy items, also accelerated to 2.0 percent from 1.7 percent in the previous quarter. Likewise, all three alternative measures of core inflation computed by the BSP increased in Q3 2016. The trimmed mean, weighted median, and net of volatile items rose to 1.8 percent (from 1.5 percent), 2.1 percent (from 1.7 percent), and 1.7 percent (from 1.3 percent), respectively.

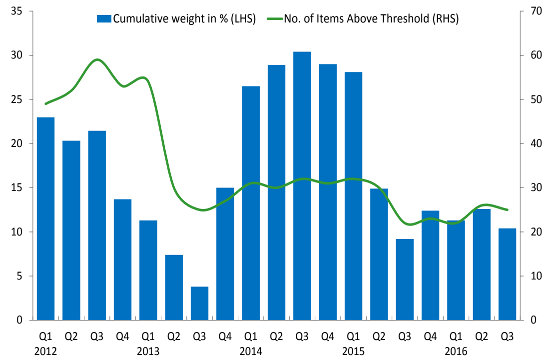
Table 1. Alternative Core Inflation Measures
quarterly averages of year-on-year change

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

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

Meanwhile, the number of items with inflation rates greater than the threshold of 4.0 percent (the upper end of the 2016 inflation target) was slightly lower at 25 items in Q3 2016 from 26 items in the previous quarter. Majority of these items are food commodities. These 25 items accounted for 10.4 percent of the CPI basket, lower than the quarter-ago share of 12.6 percent.

Chart 2. CPI Items with Inflation Rates Above Threshold



Source: Philippine Statistics Authority, BSP staff estimates

Alternatively, CPI items with inflation below 2 percent (the low end of the 2016 inflation target) went down to 134 items in Q3 2016 from 147 items in the previous quarter although the equivalent weight of these items still accounted for almost half of the CPI basket at 48.3 percent.

Consequently, CPI items within the target range of 2-4 percent increased to 74 items (from 60 items), accounting for 41.3 percent and almost double its previous weight of 26.6 percent.

Food Inflation. Food inflation went up as prices of key food items increased, particularly fish, milk, cheese and eggs as well as oils and fats. Rice inflation also turned positive in Q3 2016 after four consecutive negative outturns as domestic rice prices increased due to the ongoing lean season and adverse effect of El Niño and Typhoon 'Nona' on rice production. Meanwhile, prices of other agricultural products, including fruits, were higher due to limited supply owing to recent weather-related production disruptions.

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

Commodity	2015				2016		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Food and Non-Alcoholic Beverages	**4.8**	**3.0**	**1.1**	**1.3**	**1.6**	**2.3**	**2.7**
Food	5.0	3.1	1.1	1.3	1.6	2.4	2.8
Bread and Cereals	5.7	2.6	-0.5	-1.6	-1.2	-0.2	0.9
Rice	7.2	3.3	-0.9	-2.5	-2.0	-0.9	0.5
Corn	2.4	0.2	-0.6	-0.4	1.7	2.6	2.5
Meat	4.2	1.3	0.4	0.8	1.0	2.2	2.0
Fish	5.1	5.3	3.2	3.7	2.8	2.7	4.3
Milk, Cheese and Eggs	4.4	3.3	1.9	1.3	1.2	1.5	2.0
Oils and Fats	2.7	0.9	-0.3	-0.2	0.3	2.1	3.9
Fruit	11.4	9.6	4.9	3.5	3.3	4.4	7.0
Vegetables	1.1	0.3	0.2	9.0	10.3	12.9	9.9
Sugar, Jam, Honey	3.8	4.2	2.9	3.9	6.4	5.0	3.4
Food Products, N.E.C.	4.8	4.6	3.8	2.7	3.1	-1.0	-2.4
Non-Alcoholic Beverages	2.1	2.2	1.8	1.4	1.2	1.2	1.2
Alcoholic Beverages and Tobacco	4.0	3.8	3.7	3.9	4.9	5.5	6.0

Source of Basic Data: PSA, BSP

Non-Food Inflation. At the same time, non-food inflation increased to 1.2 percent from 0.6 percent as most non-food commodity groups also posted higher inflation readings in Q3 2016. Notably, prices were higher for clothing and footwear, housing rentals, and services specifically, those pertaining to health, restaurants, and catering. This was slightly tempered by the continued decline in prices of oil-related CPI items due to rollbacks in domestic prices of selected petroleum products.

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

Commodity	2015				2016		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Non-Food	**0.6**	**0.5**	**0.1**	**0.5**	**0.5**	**0.6**	**1.2**
Clothing and Footwear	3.1	2.6	2.3	2.3	1.9	2.3	2.6
Housing, Water, Electricity, Gas and Other Fuels	-1.1	-1.1	-1.7	-1.2	-1.0	-1.0	0.2
Electricty, Gas, and Other Fuels	-8.7	-8.2	-9.8	-8.8	-6.9	-6.7	-3.2
Furnishings, Household Equipment & Routine Maintenance of the House	2.2	2.1	1.7	1.6	1.5	1.6	2.1
Health	2.7	2.3	1.7	1.8	1.9	2.4	2.7
Transport	-0.7	0.0	-0.5	0.9	0.3	0.0	0.0
Transport Services	2.6	2.9	2.5	3.3	1.2	0.7	0.3
Communication	-0.1	-0.1	0.0	0.0	0.1	0.2	0.1
Recreation and Culture	1.1	1.1	1.0	1.0	1.1	1.6	1.7
Education	5.1	4.7	3.6	3.6	3.6	3.0	1.8
Restaurant and Miscellaneous Goods and Services	1.6	1.2	1.2	1.3	1.6	2.2	2.4

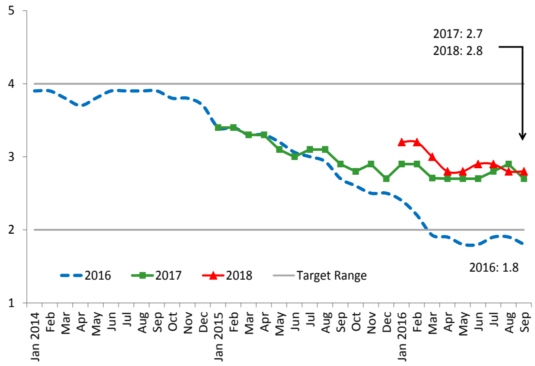
Source of Basic Data: PSA, BSP

Private Sector Economists' Inflation Forecasts. Results of the BSP's survey of private sector economists for September 2016 showed that the mean inflation forecast for 2016 was unchanged relative to the results in June 2016.[4]

Mean inflation forecast for 2016 stay subdued

In particular, the mean inflation forecast for 2016 remained at 1.8 percent relative to June 2016. The average annual inflation forecast for 2017 also stayed at 2.7 percent. Meanwhile, the mean inflation forecast for 2018 went down marginally to 2.8 percent from 2.9 percent in the previous quarter.

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



Source: BSP

Analysts attributed their subdued inflation expectations to persistently low global oil prices, sub-par global economic growth, and stable food price conditions. These were seen to outweigh the upside risks brought by a possible rebound in oil prices, strong domestic demand, possible power rate adjustments, a weaker peso, and the impact of La Niña in the latter part of 2016 until the first quarter of 2017.

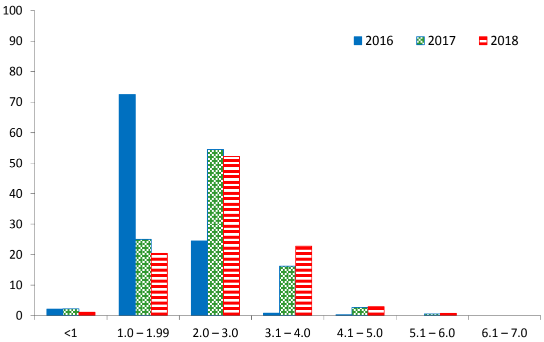
Based on the probability distribution of the forecasts provided by 20 out of 25 respondents, there was a 72.5-percent chance that average inflation for 2016 will settle between the 1.0-1.99 percent range. Meanwhile, there was a 25.3-percent chance that the 2016 inflation rate will fall within the 2-4 percent target range. For 2017, the respondents assigned a 70.7-percent

[4] There were 25 respondents in the BSP's survey of private sector economists in September 2016. The survey was conducted between 7-30 September 2016.

chance that inflation will fall within the 2-4 percent target range.

Chart 4. Probability Distribution for Analysts' Inflation Forecasts*

2016-2018



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

Results of the September 2016 Consensus Economics survey showed a lower mean inflation forecast for 2016 at 1.8 percent (from 1.9 percent in June 2016). Likewise, the mean inflation forecast for 2017 was lower at 2.7 percent from 2.9 percent.[5]

Table 4. Private Sector Forecasts for Inflation, June 2016

annual percentage change

	2016		2017	2018
	Q4	FY	FY	FY
1) Al-Amanah Islamic Bank	1.70	1.90	2.00	2.00
2) Asia ING	2.00	1.60	2.80	3.00
3) Bangkok Bank	2.20	2.00	2.70	3.00
4) Bank of Commerce	2.03	1.67	-	-
5) Bank of China	1.80	2.20	3.00	3.00
6) Banco de Oro	2.14	1.70	2.90	3.30
7) Barclays Capital	2.30	1.80	2.50	-
8) Chinabank	2.10	1.60	2.30	2.50
9) Citibank	2.00	1.60	2.70	3.30
10) CTBC Bank	2.10	1.60	2.20	3.00
11) Deutsche Bank	-	-	3.20	-
12) Eastwest Bank	1.95	1.95	2.00	2.40
13) IDEA	2.00	1.70	2.50	3.00
14) Korea Exchange Bank	2.60	2.60	2.60	2.70
15) Land Bank of the Philippines	1.90-2.20	2.00-2.30	2.10-2.50	2.10-2.50
16) Maybank	2.35	1.70	2.70	3.00
17) Metrobank	-	2.00	3.80	3.80
18) Multinat'l Inv. Banc	2.20	1.70	2.50	-
19) Mizuho	2.00	1.70	2.50	-
20) Phil. Equity Partners	2.40	1.78	3.20	-
21) RCBC	2.10-2.40	1.70-1.90	2.70-3.20	2.50-3.00
22) Robinsons Bank	1.90	1.60	3.00	2.00
23) Security Bank	2.00	1.63	3.10	3.40
24) UBS	1.70	1.60	2.60	-
25) Union Bank	2.15	1.70	3.46	2.54
Median Forecast	2.1	1.7	2.7	3.0
Mean Forecast	**2.1**	**1.8**	**2.7**	**2.8**
High	2.6	2.6	3.8	3.8
Low	1.7	1.6	2.0	2.0
Number of Observations	23	24	24	18
Government Target	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**	**3.0±1.00**

Source: BSP

[5] There were 18 respondents in the Consensus Economics' survey in September 2016.

Based on the BSP Business Expectations Survey (BES), majority of firms in Q3 2016 continued to expect inflation to increase in the current quarter relative to the previous quarter although there had been a marked decline in their number (from a diffusion index of 31.4 percent to 25.3 percent).

Inflation expectations trend lower

There were fewer firms that expected inflation to increase in the next quarter (from a diffusion index of 32.3 percent to 28.0 percent).

Similarly, results of the Q3 2016 BSP Consumer Expectations Survey (CES) showed that respondents anticipated inflation to move at a modest rate of 1.8 percent from 3.4 percent in the previous quarter.

Energy prices. The average Dubai crude oil was steady in Q3 2016 compared to the previous quarter as recent developments continued to influence international oil prices towards opposite directions.

Global oil prices steady as oversupply concerns are offset by OPEC efforts to stabilize market price

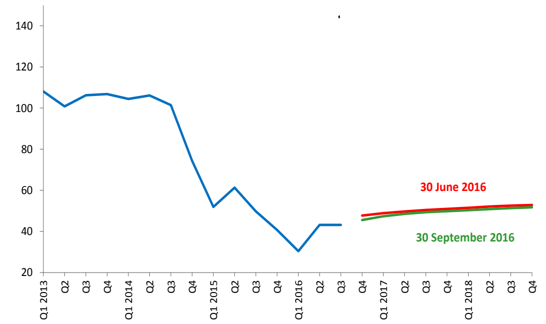
During the start of the quarter, Dubai crude prices fell on renewed supply concerns as active US rigs started rising mid-June, encouraged by rising prices, suggesting increased drilling activity in the country's onshore production. At the same time, the lower-than-expected demand during the US summer driving season (April to September) also contributed to the price decrease. Meanwhile, production from Iran continued to increase, consistent with its plan to reach pre-sanction levels while Gabon has officially rejoined the Organization of Petroleum Exporting Countries (OPEC) on 1 July 2016, which could contribute more than 0.2 mb/d of crude and liquid fuels.[6]

[6] Gabon left the OPEC in January 1995. Source: US EIA Short-Term Energy Outlook, July 2016

However, Dubai crude prices rebounded sharply in August amid speculation of a possible output freeze agreement between the OPEC members; similar to the rally in the April 2016 Doha meeting. Prices started declining in early-September on rising doubts over the deal with Iran's rising production, which was further exacerbated after Saudi Arabia and Russia failed to give specific measures on how to stabilize prices in its joint press statement at the G-20 meeting. Nonetheless, in an unexpected move on 28 September, OPEC announced a preliminary agreement to limit oil ouput following its recent meeting in Algeria.

In Q3 2016, futures data for Dubai showed a lower path for 2017 to 2020 compared to the estimates in the previous quarter.[7] Specifically, prices of future Dubai contracts only reached US$50 per barrel in end-2017.

Chart 5. Spot and Estimated Prices of Dubai Crude Oil



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

In its September report,[8] the US EIA revised both supply forecasts for 2016 and 2017 downward compared to its June 2016 report. The revision was due largely to lower US tight oil production, though this was tempered slightly by expectations of higher output from Iran and other major OPEC members as they strive to maintain market share.

Demand estimates for 2016 was slightly higher compared to the June 2016 reported levels, which projected an increase of 1.48 mb/d (from 1.45 mb/d) in global consumption. By contrast, US EIA projected global oil demand for 2017 to increase by only 1.4 mb/d from 1.5 mb/d in its June report. India and China continued to account for the increase in consumption of petroleum and other liquid fuels used for transportation fuels and new propane dehydrogenation plants (PDH).

[7] Future prices derived using Brent crude futures data. Source: BSP-staff calculations, Bloomberg

[8] US EIA Short-Term Energy Outlook, September 2016. Source: https://www.eia.gov/forecasts/steo/

Demand-supply gap seen to narrow in 2017

Projections on oil consumption from other energy agencies were mixed. The International Energy Agency (IEA) kept its demand forecast steady in its September report[9] relative to the previous quarter. Meanwhile, OPEC adjusted its demand forecasts slightly upward by 1.23 mb/d for 2016 from an increase of only 1.20 mb/d in its earlier report due to higher consumption for OECD Europe and Asia in the first half of 2016.[10]

On the domestic front, prices of most petroleum products declined relative to previous end-quarter levels. Except for gasoline, prices of kerosene, diesel, and LPG declined by ₱0.82, ₱1.45, and ₱1.08 per liter respectively. Relative to year-ago levels, however, only LPG prices recorded an upward adjustment.

Table 5. Domestic Retail Pump Prices

peso/liter; end-quarter prices

Quarter	Gasoline	Kerosene	Diesel	LPG
2014 Q1	53.75	50.87	44.25	41.73
Q2	54.95	51.51	43.70	40.27
Q3	52.15	47.99	40.70	38.74
Q4	41.20	37.39	30.05	33.87
2015 Q1	42.60	35.59	28.85	31.19
Q2	45.90	37.49	29.65	30.18
Q3	42.25	33.44	26.80	28.00
Q4	38.10	29.07	22.60	32.14
2016 Q1	39.00	30.32	22.80	27.69
Q2	41.15	33.53	27.95	29.12
Q3	41.60	32.71	26.50	28.03
Quarter-on-Quarter Change				
2016 Q3	0.45	(0.82)	(1.45)	(1.09)
Year-on-Year Change				
2016 Q3	(0.65)	(0.73)	(0.30)	0.03

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

[9] IEA Oil Market Report, September 2016. https://www.iea.org/oilmarketreport/omrpublic/

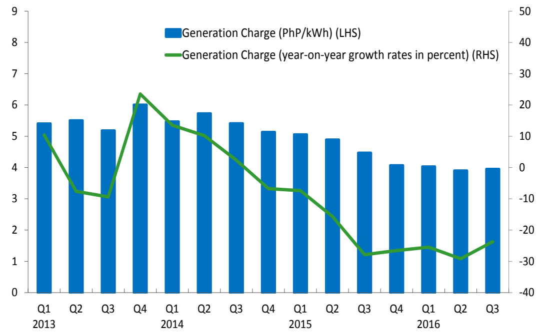
[10] OPEC Monthly Oil Market Report, September 2016. http://www.opec.org/opec_web/en/publications/338.htm

Power. Overall electricity rates slightly went down in Q3 2016 due to lower generation costs and transmission charge.

Lower generation and transmission charges lead to decrease in electricity prices

During the review quarter, the average generation charge dropped by ₱0.05 per kilowatt hour (kWh) to ₱3.95 per kWh from ₱3.90 per kWh in Q2 2016. The decline in the average electricity rates during the quarter was driven partly by the lower generation cost from the Wholesale Electricity Spot Market (WESM) due to fewer forced outages experienced in the July supply month. At the same time, the decrease in transmission charge in September was due mainly to the reduction in the ancillary charges of the National Grid Corporation of the Philippines' (NGCP).[11]

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



Source: Meralco

Meanwhile, potential sources of upside pressures on electricity charges remained. Meralco has existing petitions for rate increases with ERC which include the petition to implement the Maximum Average Price for 2012- 2015; amended application for a rate increase in the January 2014 billing (consisting of incremental fuel costs and deferred generation cost to be collected monthly for six months); and petitions for the refund of generation over/under recovery (GOUR), transmission over/under recovery (TOUR), system loss over/under recovery (SLOUR), and lifeline subsidy over/under recovery (LSOUR) for the period January-December 2011. In addition, the Power Sector Assets and Liabilities Management (PSALM) has several pending petitions with ERC for the recovery of True-Up Adjustments of Fuel and Purchased Power Costs (TAFPPC), Foreign Exchange Related Costs (TAFxA) and Purchased Power Costs and Foreign Exchange Related Costs by the National Power Corporation (NPC), and NPC's Stranded Debt portion of the universal charge. Likewise, NGCP also filed several petitions to recover connection charges and residual sub-transmission charges for 2011-2013 and the costs of repair on damages caused by force majeure events such as earthquake, flooding, landslides, and lightning incidents in 2011-2012.

[11] Ancillary charges are payments for ancillary services by National Grid Corporation of the Philippines (NGCP) which were underpaid from 2008-2009.

MWSS implements rate adjustments for concessionaires due to FCDA

Water. Effective 1 July 2016, the all-in-water rates of Manila Water Company, Inc. (MWCI) and Maynilad Water Services, Inc (MWSI) slightly went down by ₱0.02/cu.m. and ₱0.01/cu.m., respectively.

The decrease was due to the foreign currency differential adjustment (FCDA) approved by the Metropolitan Waterworks and Sewerage System-Regulatory Office (MWSS-RO) for Q3 2016.

Aggregate Demand and Supply

The Philippine economy expanded by 7 percent in Q2 2016, higher than the 6.8-percent acceleration in the previous quarter and 5.9-percent growth in the same period last year.

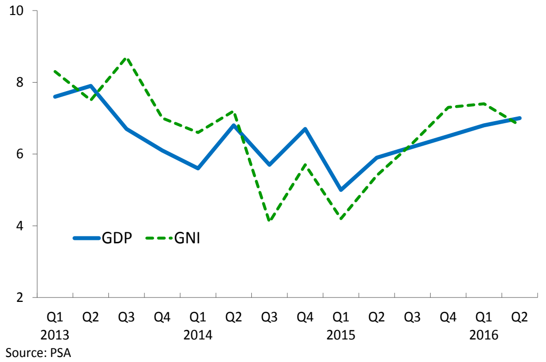
Real GDP growth brisker than previous quarter

The Q2 gross domestic product (GDP) was driven by increased capital formation, particularly in durable equipment and construction, and higher growth in consumer and government spending. Meanwhile, the accelerated growth of the services sector contributed mainly to growth on the production side. On a seasonally-adjusted basis, q-o-q GDP growth accelerated to 1.8 percent in Q2 2016 from 1.3 percent in Q1 2016.

Gross national income (GNI) decelerated to 6.8 percent in Q2 2016 from the previous quarter's growth of 7.4 percent. Likewise, net primary income posted growth of 6.2 percent in Q2 2016, lower than the 9.9 percent growth in the previous quarter but higher than 2.5 percent in Q2 2015. This can be attributed to the slowdown in the growth of compensation inflow and property income.

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

at constant prices



Aggregate Demand. On the expenditure side, higher capital formation, household and government spending led to the acceleration in economic growth (contributing 5.7 ppts, 4.9 ppts, and 1.6 ppts, respectively, to overall GDP growth). These offset the negative contribution of net exports (-6.6 ppts), which was due mainly to the slowdown of exports of goods growth and the higher expansion in imports of goods and services.

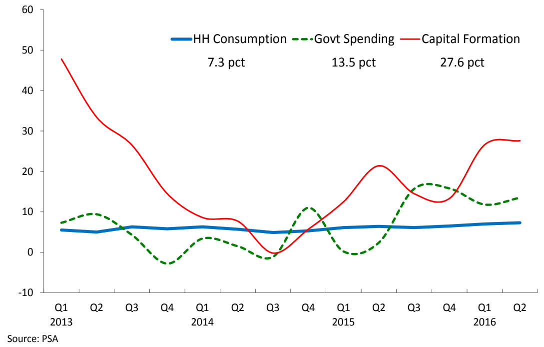
Election-related spending and low inflation lift consumption

Household spending, which accounted for more than two-thirds of the country's output at 66.7 percent, rose by 7.3 percent in Q2 2016, a slight acceleration from the 7-percent growth in the previous quarter. The top contributors to growth of household final consumption expenditure were food and non-alcoholic beverages (3 ppts), transport (1 ppt) and miscellaneous goods and services (1 ppt).

Moreover, election-related spending as well as stable and low inflation rate helped boost consumer spending.

Chart 8. Gross Domestic Product by Expenditure Shares

at constant prices



Capital formation rose by 27.6 percent in Q2 2016 from 26.6 percent in Q1 2016. The expansion in capital formation can be attributed mainly to the following:

(a) rise in private investments in durable equipment (42.8 percent in Q2 2016 from 39.8 percent a quarter ago) particularly road vehicles which grew by 65 percent from 38.5 percent in the previous quarter;

(b) slightly higher growth in private construction (8.3 percent in Q2 2016 from 8.1 percent in the previous quarter) as well as sustained increase in public construction, although lower at 27.9 percent in Q2 2016 from 41.1 percent in Q1 2016;

(c) slightly higher growth in investments in intellectual property products to 40 percent from 39.7 percent in the previous quarter due to increased investments in computer software and databases; and

(d) lower withdrawals in inventories in Q2 2016 (₱1.1 billion) compared to those in the same period last year (₱2.2 billion).

Government expenditures rose by 13.5 percent in Q2 2016 from 11.8 percent in Q1 2016 due to the implementation of social programs of the government as well as the conduct of the 2016 national and local elections.

Overall exports growth declined in Q2 2016 to 6.6 percent from the quarter-ago growth rate of 7.3 percent. The expansion in exports of services compared to a quarter ago (15.3 percent from 14.1 percent) was weighed down by the slowdown in exports of goods growth (4.1 percent from 5.2 percent). The weakening of growth in exports of goods was mainly due to the 0.2 percent decrease in exports of semiconductors (which accounted for almost half of total exports of goods). Meanwhile, growth in exports of services was driven by the 16.6 percent increase in exports of miscellaneous services (e.g., explicitly charged and other financial services, and telecommunications services) from 14.2 percent a quarter ago, contributing 13.1 ppts to the growth of exports of services.

Table 6. Economic Performance

at constant 2000 prices; growth rate in percent

Table 6. Economic Performance
at constant 2000 prices
growth rate in percent

BY EXPENDITURE ITEM	2015 Q1	2015 Q2	2015 Q3	2015 Q4	2016 Q1	2016 Q2
Household Consumption	6.1	6.4	6.1	6.5	7.0	7.3
Government Consumption	0.2	2.4	15.7	15.8	11.8	13.5
Capital Formation	12.5	21.4	14.5	13.3	26.6	27.6
Fixed Capital Formation	8.8	12.7	13.9	24.2	28.2	27.2
Exports	10.6	5.1	9.8	10.9	7.3	6.6
Imports	12.2	12.6	16.2	14.9	19.0	20.9

Source: PSA

Meanwhile, overall imports posted 20.9 percent growth for the quarter, higher than the quarter-ago increase of 19 percent, owing to the accelerated growth in imports of both goods and services. Growth in imports of semiconductors and transport equipment contributed mainly to the 22.9 percent growth of imports of goods for the quarter from 21.5 percent a quarter ago. Similarly, imports of services went up by 13.3 percent (from 10.3 percent a quarter ago) due largely to the expansion of imports of miscellaneous services, such as telecommunication services (24.9 percent from 11 percent).

Other Demand Indicators. High-frequency demand indicators supported the view of a sustained robust economic activity. The property sector continued to expand, vehicle sales sustained its double-digit growth while the composite Purchasing Managers' Index remained above the 50-point expansion threshold, indicating continued firm domestic demand. Moreover, business and consumer confidence for the current quarter improved notably while next-quarter indices point to more upbeat sentiments.

Property Prices

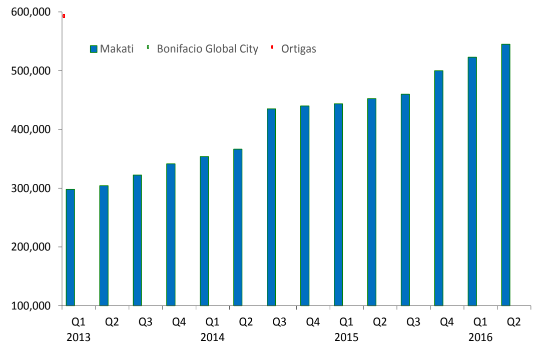
Land Values, Metro Manila. Data from Colliers International indicated that implied land values[12] in the Makati CBD and Ortigas Center appreciated in Q2 2016 from quarter- and year-ago levels. Implied land values in the Makati CBD reached ₱545,000/sq.m. in Q2 2016, higher by 4.2 percent and 20.4 percent relative to the levels recorded in Q1 2016 and Q2 2015, respectively. Similarly, implied land values in the Ortigas Center rose by 4.0 percent quarter-on-quarter and 18.8 percent year-on-year to ₱196,000/sq.m.

Implied land values rise but remain below 1997 levels in real terms

Land values in the Makati CBD were above their 1997 levels in nominal terms, but about 55.4 percent of their 1997 levels in real terms. Meanwhile, land values in the Ortigas Center were almost the same as their 1997 level in nominal terms and about 43.1 percent in real terms.

Chart 9. Land Values

average price per square meter



Source: Colliers International Philippines

Lower office vacancy rates due to slower completions

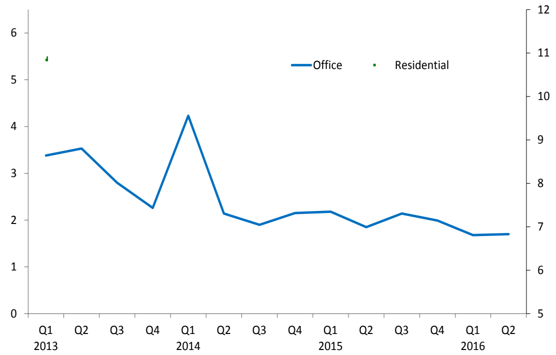
[12] In the absence of reported closed transactions, implied land values based on trends are used by Colliers International to monitor prices.

Vacancy Rates, Makati CBD. The office vacancy rate in the Makati CBD was stable at 1.7 percent relative to the previous quarter. Moreover, the office vacancy rate for the quarter was lower relative to the year-ago level of 1.9 percent due to lack in supply of new office space. Colliers expects office vacancy to remain at low single-digit levels for the short term due to lower office space completions amid construction delays.

Makati CBD residential vacancy rate higher on tenant preference for other locations

The residential vacancy rate in the Makati CBD increased to 10.3 percent in Q2 2016 from 9.6 percent in the previous quarter. The residential vacancy rate in Q2 2016 was also higher than the year-ago level of 7.6 percent due to a slowdown in take-up in the Makati CBD amid tenant preference for new condominium units in the Makati fringe areas and other CBDs. The delivery of new residential condominium units in the Makati CBD within the next 12 months is expected to raise vacancy rates further to 12.3 percent by Q2 2017.

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



Source: Colliers International Philippines

Rental Values, Makati CBD. Monthly Grade A office[13] rents in the Makati CBD reached ₱915/sq.m. in Q2 2016, representing an increase of 0.5 percent from the previous quarter.

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

Office rental values increase in nominal terms

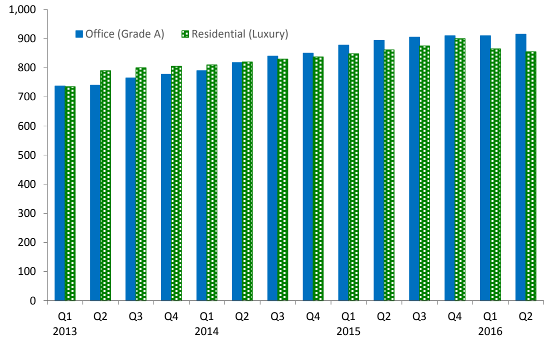
Similarly, monthly Grade A office rents in the Makati CBD were higher by 2.3 percent relative to Q2 2015. Office rental values for Grade A offices were above their 1997 levels in nominal terms. In real terms, office rental values were about half of the comparable levels in 1997.

Monthly rents for luxury three-bedroom condominium units in the Makati CBD was at ₱855/sq.m. in Q2 2016, declining by 1.2 percent from the previous quarter. Likewise, monthly rents for the 3-bedroom segment were lower by 0.8 percent compared to the year-ago levels. The decline in rental rates was due to stable supply of residential units amid the slower take up.

Luxury rental values decline slightly on stable supply of residential units

Residential rental values for luxury three-bedroom high-rise units were above their 1997 levels in nominal terms but were only about 77.8 percent of their 1997 levels in real terms.

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



Source: Colliers International Philippines

Capital Values, Makati CBD. Capital values[14] for office buildings in the Makati CBD in Q2 2016 were higher in nominal terms than their quarter- and year-ago levels.

Capital values for residential buildings decline on muted prospects

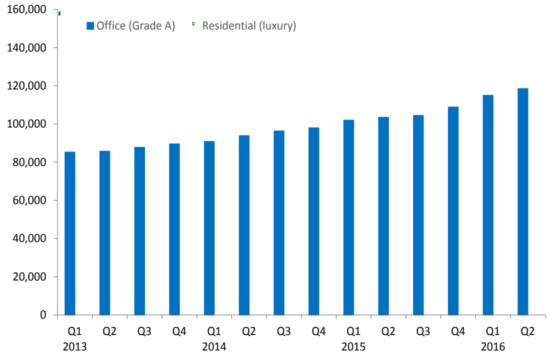
Grade A office capital values in the Makati CBD rose to ₱118,500/sq.m., higher by 3.0 percent and by 14.5 percent compared to the quarter- and year-ago levels, respectively. Grade A office capital values were also higher than the 1997 levels in nominal terms. Nevertheless, in real terms, office capital values were about 64.4 percent of the comparable levels in 1997.

Capital values for luxury residential buildings[15] in Makati CBD in Q2 2016 declined to ₱147,500/sq.m. from their quarter- and year-ago levels. Average prices for three-bedroom luxury residential condominium units decreased by 2.7 percent quarter-on-quarter and 1.0 percent year-on-year. Colliers attribute the decline in capital values to muted prospects for the residential segment amid oversupply concerns.

Capital values for luxury residential buildings were above their 1997 levels in nominal terms. In real terms, residential capital values were about 65.3 percent of the comparable levels in 1997.

Chart 12. Capital Values (Makati Central Business District)

price per square meter



Source: Colliers International Philippines

BSP Residential Real Estate Price Index (RREPI).[16] Residential property prices grew by 11.3 percent in Q2 2016 as the RREPI increased to 122.8 from 110.3 in the same quarter a year ago. Moreover, the growth in residential property prices in Q2 2016 was higher than the 9.4-percent increase posted in the previous quarter.

Residential property prices increase in Q2 2016

Among the four major types of housing unit, single detached housing units registered the highest growth in prices at 18.6 percent, followed by townhouses at 14.7 percent. Meanwhile, the prices of condominium units decreased marginally by 0.1 percent.

Growth in real property prices in Areas Outside the National Capital Region (AONCR) outpaced NCR in Q2 2016. Growth in residential real property prices in AONCR accelerated by 18.4 percent while that of NCR moderated to 2.7 percent in Q2 2016. This is due largely to the higher rates of increase in prices of single detached housing units and townhouses in AONCR compared to those of NCR. Moreover, the prices of condominium units declined in NCR but increased slightly in AONCR.

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

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

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

Table 7. Residential Real Estate Price Index
Q1 2014=100; growth rate in percent

Quarter	Residential Real Estate Price Index [1]		
	Overall	NCR	AONCR
2015 Q2	110.3 [r]	114.7 [r]	106.2 [r]
Q3	111.0 [r]	115.6 [r]	107.0 [r]
Q4	113.6 [r]	116.2 [r]	111.3 [r]
2016 Q1	115.9 [r]	116.5 [r]	115.5 [r]
Q2	122.8	117.8	125.7
	Year-on-Year Growth Rates		
2015 Q2	13.5 [r]	17.6 [r]	9.9 [r]
Q3	4.7 [r]	8.0 [r]	2.8 [r]
Q4	5.2 [r]	5.8 [r]	6.2 [r]
2016 Q1	9.4 [r]	10.0 [r]	9.0 [r]
Q2	11.3	2.7	18.4
	Quarter-on-Quarter Growth Rates		
2015 Q2	4.2 [r]	8.3 [r]	0.2 [r]
Q3	0.6 [r]	0.8 [r]	0.8 [r]
Q4	2.3 [r]	0.5 [r]	4.0 [r]
2016 Q1	2.0 [r]	0.3 [r]	3.8 [r]
Q2	6.0	1.1	8.8

[1] All types of housing unit and is based on bank reports on residential real estate loans granted per BSP Circular No. 892 dated 16 November 2015; No index generated for apartments due to very few observations.
[r] revised
Source: BSP

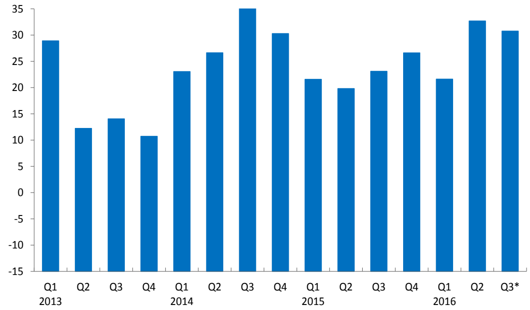
Vehicle Sales. Sales of new vehicles[17] grew by 30.8 percent y-o-y in the first two months of Q3 2016 from a 19.8-percent growth recorded in the same period a year ago. According to the Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI), the sustained growth in automotive sales is due to stable consumer demand amid the attractive financing plans and aggressive marketing promotions of car dealers.

Sales of new vehicles continue to be robust

Commercial vehicles, which account for about 64.2 percent of total vehicle sales, expanded by 47.4 percent y-o-y in the first two months of Q3 2016. Commercial vehicles sold during the quarter reached 40,073 units from 27,195 units in the same period in 2015. Meanwhile, the growth of passenger car sales from CAMPI members slowed down to 8.8 percent y-o-y in July-August 2016, accruing to a total of 22,366 units from 20,555 units sold in the same period in 2015.

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

Chart 13. Vehicle Sales
number of units



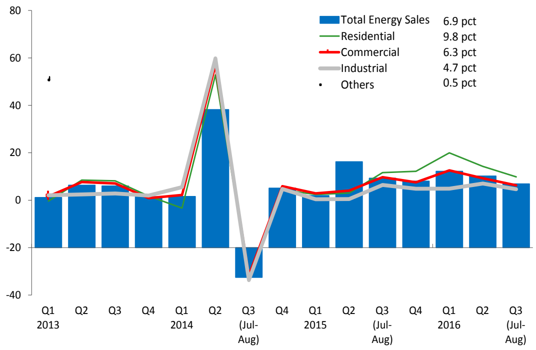
* July-August 2016
Source: Chamber of Automotive Manufacturers of the Philippines, Inc. (CAMPI)

Energy Sales. Meralco's energy sales for the first two months of Q3 2016 expanded by 6.9 percent, lower than the 9.3-percent growth reported in the same period a year ago.

Energy sales continue to increase

Energy sales from the residential sector, commercial sector and industrial sector increased by 9.8 percent, 6.3 percent, and 4.7 percent, respectively.

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



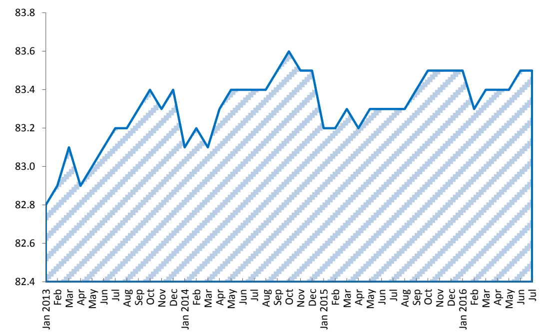
Source: Meralco, BSP calculations

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

Capacity utilization in manufacturing remains above 80 percent

Of the 690 respondent-establishments, 58.4 percent operated at least at 80.0 percent capacity in July 2016. Data showed that the manufacturing companies have been operating at above 80.0-percent capacity since 2010.

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



Source: PSA

Volume and Value of Production. Preliminary results of the MISSI showed that the volume of production index (VoPI) sustained its 10.1 percent year-on-year growth in June 2016.

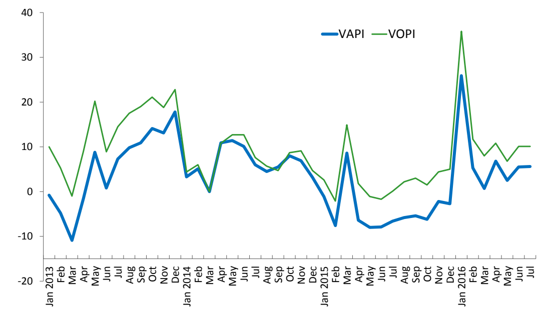
Manufacturing output sustains growth

The continued expansion in VoPI was led by the double-digit increment in the production of basic metals (64.1 percent), machinery except electrical (27.2 percent), food (14.1 percent), transport equipment (35.8 percent), rubber and plastic products (29.7 percent), beverages (10.9 percent), tobacco products (19.6 percent), and wood and wood products (19.7 percent).

Factory output—as measured by the VoPI—grew due largely to strong private consumption and investments, as reported by the National Economic and Development Authority (NEDA) in a press statement dated 9 September 2016. In particular, the double-digit growth in transport equipment was a result of strong demand for light commercial vehicles, while growth in food manufacturing was attributed to improved efficiencies, lower material prices, increases in out-of-home food consumption, and the growing number of convenience stores nationwide. However, NEDA noted some seasonal factors which could temper production such as interruption in business operations during the rainy season, planting and closed milling season, and closed fishing season in Davao between July and September 2016.

Similarly, the value of production index (VaPI) also grew at a broadly steady rate of 5.6 percent in July 2016 from 5.5 percent in the previous month. The same set of VoPI gainers led the expansion in the VaPI that include the following sub-sectors: basic metals (56.9 percent), food manufacturing (15.7 percent), transport equipment (33.7 percent), rubber and plastic products (27.1 percent), beverages (15.8 percent), tobacco products (19.8 percent), and wood and wood products (18.5 percent).

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



Source: PSA

Business Expectations. Business outlook on the economy turned slightly less optimistic for Q3 2016,[18] with the overall confidence index (CI)[19] declining to 45.4 percent compared to 48.7 percent in the Q2 2016 survey. This indicates that the number of optimists declined but continued to be greater than the number of pessimists during the quarter. Despite the typical decline in sentiment during the third quarter due to seasonal factors, the current quarter index is the highest Q3 reading of all time.

Business outlook less optimistic in Q3 but more upbeat in the next quarter

The less buoyant outlook of respondents was attributed to expectations of: (a) interruption of business activities during the rainy season; (b) slack in demand during the planting and closed milling seasons; (c) lower consumer demand as households prioritized enrolment expenses; (d) implementation of stricter new mining policies that put some mining concessions on hold;[20] (e) closed fishing season in Davao Gulf from July to September;[21] (f) stiff competition; and (g) concerns over the weak global economy.

The sentiment of businesses in the Philippines mirrored the less buoyant business outlook in the US, UK, Germany and Hong Kong, but was in contrast to the more bullish views of those in France, Italy, South Korea, India and Switzerland.

Table 8. Business Expectations Survey

BUSINESS OUTLOOK INDEX		Current Quarter	Next Quarter
2015	Q1	45.2	58.2
	Q2	49.2	47.3
	Q3	41.4	53.1
	Q4	51.3	43.9
2016	Q1	41.9	49.6
	Q2	48.7	45.3
	Q3	45.4	56.8

Source: BSP

For the quarter ahead (Q4 2016), business outlook turned more upbeat as the next quarter index rose to 56.8 percent from 45.3 percent in the previous quarter's survey results. This reading suggests that growth could accelerate in the last quarter of 2016. Respondents' more positive outlook for Q4 2016 was due to expectations of: (a) the expected uptick in consumer demand during the holiday, harvest and milling seasons;, (b) increased confidence in the new administration; (c) continued increase in orders and projects translating to higher volume of production; (d) expansion of businesses and new product lines; (e) introduction of new and enhanced business strategies and processes; (f) improved farm gate prices; and (g) opening of high seas/fishing operations in October. Their more positive outlook was driven further by expectations of an acceleration in the roll-out of infrastructure and other development projects under the public-private partnership (PPP) program and the favorable macroeconomic conditions in the country (particularly, stable inflation and low interest rates), sustained foreign investment inflows and the steady stream of overseas Filipinos' (OFs) remittances.

Consumer Expectations. Consumer outlook improved for Q3 2016,[22] with the optimists

[18] The Q3 2016 BES was conducted during the period 1 July - 12 August 2016 among 1,474 firms surveyed nationwide. Respondents were drawn from the combined list of the Securities and Exchange Commission's Top 7,000 Corporations in 2010 and Business World's Top 1,000 Corporations in 2014, consisting of 587 companies in NCR and 887 firms in AONCR, covering all 17 regions nationwide. The survey response rate for this quarter was higher at 83.8 percent from 82.9 percent in the previous quarter. The response rates were both higher for NCR at 80.7 percent from 80.2 percent in the previous quarter; and AONCR at 85.8 percent from 84.7 percent in Q2 2016.

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

[20] Beginning 8 July until end-August 2016, the Department of Environment and Natural Resources (DENR) is conducting a nationwide audit of Philippine mining companies to ensure the implementation of Administrative Order DAO 2015-07 that requires all miners to secure ISO 14001 (an environmental management certification). Adherence to international standards will ensure that appropriate measures are put in place to minimize the negative impact of mining on the environment. As of 17 August 2016, eight nickel mines have closed after their licenses were suspended for breaching environmental standards.

[21] The Bureau of Fisheries and Aquatic Resources (BFAR) has implemented the fishing ban in Davao Gulf for the third consecutive year under Joint Department of Agriculture-Department of Interior and Local Government (DA-DILG) Administrative Order 02 Series of 2014 (JAO 02) establishing the closed fishing season from 1 June to end of August every year.

[22] The Q3 2016 CES was conducted during the period 1-12 July 2016 among 5,810 households nationwide. Respondents were drawn from the Philippine Statistics Authority (PSA) 2003 and 2013 Master Sample List of Households. Of the sample size, 5,627 households responded to the survey, equivalent to a response rate of 96.9 percent.

outnumbering the pessimists for the first time since the nationwide survey started in Q1 2007. The overall confidence index (CI)[23] turned positive and registered its highest reading at 2.5 percent from -6.4 percent for Q2 2016.

Consumer confidence for the current and next quarters improve notably

Consumer optimism for the quarter was buoyed by: (a) improvements in the peace and order situation; (b) availability of more jobs; (c) stable prices of commodities; (d) anticipated increase in salaries; (e) effective government policies; (f) assumption into office of the new administration as well as its pronounced campaign against drugs; and (g) assistance from government such as the Pantawid Pamilyang Pilipino Program (4Ps).

The outlook of consumers in the Philippines mirrored the positive sentiment of consumers in Australia, Canada, China, Indonesia, South Korea, Taiwan, and Thailand but was in contrast to the less favorable views of those in Euro Area, Japan, and United Kingdom, as well as the steady outlook in the United States for Q3 2016.

Table 9. Consumer Expectations Survey

CONSUMER OUTLOOK INDEX		Current Quarter	Next 3 Months	Next 12 Months
2015	Q1	-10.0	4.4	17.3
	Q2	-16.2	-0.4	16.4
	Q3	-11.6	5.8	15.8
	Q4	-8.1	5.7	18.0
2016	Q1	-5.7	9.1	25.4
	Q2	-6.4	5.6	26.6
	Q3	2.5	27.3	43.8

Source: BSP

For the next quarter (Q4 2016), consumer confidence was more upbeat as the CI surged to 27.3 percent from 5.6 percent a quarter ago while the year ahead CI rose to 43.8 percent from 26.6 percent in the previous quarter's survey. Notably, consumer outlook for both the next quarter and the year ahead also posted record high CIs since Q1 2007. Consumers were of the view that improvements in the peace and order situation, availability of more jobs, salary increases, and good governance would continue over the next 12 months. They also anticipated possible decrease in prices of goods, lesser household expenses as well as an increase in household income and savings which could translate to growth in real income and higher purchasing power of the household.

Purchasing Managers' Index.[24] The composite PMI remained firmly above the 50-point expansion threshold[25] at 55.8 in July 2016, higher than the recorded index of 55.1 in the previous month.

PMI remains above the 50-point expansion threshold

The increment was due mainly to the faster rate of expansion of the services and retail and wholesale sectors, despite the slowdown in manufacturing. All the respondent-establishments expect business activities to slow down in August 2016, as typically observed.

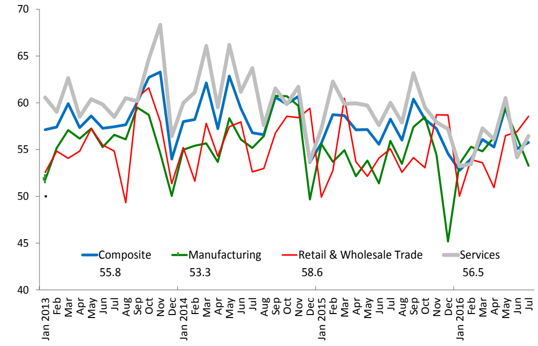
The respondents consist of 2,904 households in NCR (with 96.7 percent response rate) and 2,723 households in AONCR (with 97.0 percent response rate). About 46.9 percent of the respondents were from the low-income group, 38.8 percent from the middle-income group, and 14.2 percent from the high-income group.

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

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

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

Chart 17. Purchasing Managers' Index



Source: Philippine Institute of Supply Management (PISM)

The manufacturing PMI decreased by 2.7 index points to 53.3 in July 2016 from 56.0 in June 2016. Business operations decelerated due to lower off-season demand. The heavy rains experienced in some parts of the country also affected the internal operations of some firms. As a result, all the indices recorded slower rate of expansion except for the Supplier Deliveries Index. The rise in Supplier Deliveries Index was attributed to lesser consumer activities and smoother traffic flow during the month of July. Meanwhile, the indices of nine (out of 12) manufacturing subsectors were lower, four of which were below the 50-point threshold that include publishing, rubber and plastic, basic metals, and fabricated metals subsectors.

By contrast, the services PMI rose by 2.3 index points to 56.5 in July 2016 from 54.2 in the previous month. The month-on-month improvement was due to the higher volume of customer orders, more aggressive promotions, and expanded business operations. Consequently, four of the six indices expanded at a faster rate namely Business Activity Index, New Orders Index, Average Operating Costs Index, and Employment Index. Meanwhile, the Employment Index was at 50.3 in July, almost at contraction territory, as the uncertainty of job contractualization affected the investments in human resources. On the other hand, the Price Charge Index increased due to the competitive conditions among firms amid higher business costs. Ten (out of 14) subsectors expanded in July 2016 led by construction (72.1) and renting of goods and equipment (63.8).

Similarly, the retail and wholesale PMI also went up by 1.7 index points to 58.6 in July 2016 from 56.9 a month ago. The month-on-month increase was attributed mainly to expanded marketing initiatives and customers' preference for shorter-trip purchases (or purchases involving lesser intermediaries). All the indices expanded well above the 50-point threshold in preparation for the surge in demand in September. Meanwhile, both the retail and wholesale subsectors improved month-on-month. In particular, the retail subsector PMI increased by 2.0 index points to 60.1 in July 2016 from 58.1 in June 2016. The wholesale subsector PMI also went up by 5.6 index points to 56.8 from 51.2 during the same review period.

External Demand

Exports. Exports of goods remained in negative growth territory, contracting by 6.6 percent in Q2 2016. Nevertheless, exports for Q2 2016 improved slightly compared to the 7.9-percent and 8.4-percent declines registered in Q2 2015 and Q1 2016, respectively. Foreign shipments across all export commodities decreased.

Exports of goods remain negative

The continued decline in exports can be attributed to lower demand from the country's Asian trading partners,[26] which account for bulk of the country's exports.

Table 10. Exports of Goods
growth rate in percent

COMMODITY GROUP	2015	2016	
	Q2	Q1	Q2
Coconut Products	-17.3	-42.3	-16.0
Sugar and Products	-68.8	328.0	-73.6
Fruits and Vegetables	-21.7	6.9	-22.3
Other Agro-Based Products	-23.9	-24.8	-15.9
Forest Products	-15.4	-49.2	-81.2
Mineral Products	-39.0	-33.9	-44.7
Petroleum Products	-15.0	-42.2	-22.6
Manufactures	-2.7	-6.0	-3.0
Special Transactions	-43.6	-10.8	12.7
Total Exports	**-7.9**	**-8.4**	**-6.6**

Source: BSP staff computations based on data from the PSA

Imports. Imports of goods expanded by 27.3 percent in Q2 2016, an increase from the 8.8-percent growth a quarter ago and the 3.7-percent rise in the same quarter a year ago.

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

Imports of goods improve

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

Table 11. Imports of Goods
growth rate in percent

COMMODITY GROUP	2015	2016	
	Q2	Q1	Q2
Capital Goods	17.6	49.7	72.7
Raw Materials and Intermediate Goods	6.0	-4.3	13.1
Mineral Fuels and Lubricants	-28.0	-32.1	-12.3
Consumer Goods	27.6	16.8	33.2
Special Transactions	-14.7	39.7	75.6
Total Imports	**3.7**	**8.8**	**27.3**

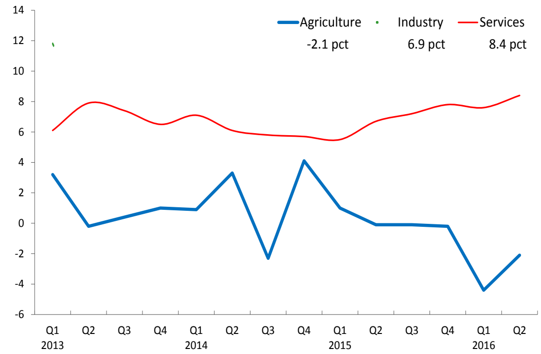
Source: BSP staff computations based on data from the PSA

Aggregate Supply. On the production side, Q2 2016 economic growth was driven mainly by the services sector (contributing 4.8 ppts) and the industry sector (contributing 2.3 ppts). Meanwhile, agriculture slightly weighed down on GDP with a -0.2 ppt. contribution.

Services sector continues to be the main driver of output growth on the production side

The services sector expanded by 8.4 percent in Q2 2016, higher than the 7.6 percent growth in Q1 2016. Major contributors to the sector's growth were trade and repair of motor vehicles, motorcycles, personal and household goods (2.4 ppts), real estate, renting and business activities (1.9 ppts), and other services (1.8 ppts). Growth in trade and repair of motor vehicles, motorcycles, personal, and household goods increased by 8.9 percent, the highest since Q3 2010, which can be attributed mainly to growth in retail trade. Meanwhile, growth in real estate, renting and business activities improved to 9.4 percent from 9 percent in the previous quarter, on account of the growth in renting and other business activities (albeit lower at 15.7 percent from 17.8 percent a quarter ago). Moreover, the growth in other services was due primarily to the accelerated increase in recreational, cultural and sporting activities from a quarter ago (16.7 percent from 7.7 percent) and education (7.7 percent from 4.9 percent).

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



Source: PSA

Meanwhile, the industry sector grew by 6.9 percent during the quarter, lower compared to 9 percent in Q1 2016. This was due to the decline in mining and quarrying and the slowdown of manufacturing, construction and electricity, gas and water supply. The 9.7-percent drop in mining and quarrying activities was driven primarily by the slump in nickel mining (-37.5 percent from -7.4 percent). Meanwhile, the slowdown in growth in manufacturing came mainly from radio, television and communication equipment and apparatus (-3.5 percent from 12.9 percent), and chemical and chemical products (3.2 percent from 41.8 percent). The deceleration in the growth in construction was due to the slowdown in growth of public construction. Lastly, the slightly slower increase in electricity, gas and water supply came from the contraction in steam (-0.6 percent from 7.3 percent) and the lower growth in water supply compared to a quarter ago (5.5 percent from 9.7 percent).

The agriculture, hunting, forestry and fishery (AHFF) sector continued to contract by 2.1 percent. The tightening came mainly from the negative growth of palay production and fishing (particularly in the production of skipjack and yellowfin tuna). The sector's performance was negatively affected by El Niño.

Table 12. Economic Performance
at constant 2000 prices; growth rate in percent

BY INDUSTRIAL ORIGIN	2015				2016	
	Q1	Q2	Q3	Q4	Q1	Q2
Agri., Hunting, Forestry and Fishing	1.0	-0.1	-0.1	-0.2	-4.4	-2.1
Agriculture and Forestry	1.7	-0.1	-0.1	0.5	-4.1	-1.3
Fishing	-2.9	0.0	0.0	-3.5	-5.9	-5.9
Industry Sector	5.3	6.1	6.1	6.5	9.0	6.9
Mining and Quarrying	-2.5	-8.6	0.5	14.0	11.1	-9.7
Manufacturing	6.0	4.7	5.8	6.1	8.0	6.3
Construction	3.9	16.6	7.8	8.2	12.4	11.0
Electricity, Gas and Water Supply	5.0	4.6	7.0	5.2	9.9	9.8
Service Sector	5.5	6.7	7.2	7.8	7.6	8.4
Transport, Storage and Communication	8.4	6.6	8.0	9.1	5.4	7.0
Trade and Repair of Motor Vehicles, Motorcycles, Personal and Household Goods	5.9	6.7	8.4	7.3	7.5	8.9
Financial Intermediation	4.3	5.8	5.4	8.7	9.7	6.6
Real Estate, Renting and Business Activities	6.4	6.9	7.8	7.8	9.0	9.4
Public Administration and Defense; Compulsory Social Security	-4.0	-0.8	2.6	7.3	5.2	6.4
Other Services	6.5	10.6	6.8	7.3	7.4	9.4

Source: PSA

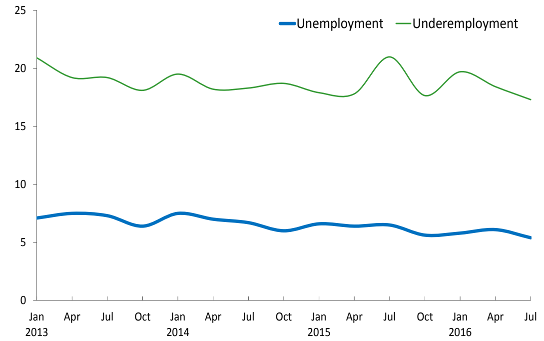
Labor Market Conditions

In the July 2016 round of the Labor Force Survey (LFS), the Philippine labor market posted a significant improvement as unemployment rate, underemployment rate and youth unemployment rate all declined to their lowest levels since 2005. This made the unemployment rate target for the year of 6.5 percent to 6.7 percent highly attainable as actual unemployment rate for the first three quarters of 2016 averaged at 5.8 percent while year-to-date average underemployment rate of 18.5 percent is relatively closer to the full year target of 17.0 percent.[27] Notwithstanding, the still double-digit 14.2 percent youth unemployment rate in the first three quarters of 2016 requires the government to further intensify its effort to help the unemployed youth, including the unutilized/ underutilized youth and the vulnerable workers.[28]

Significant improvement in unemployment rate

The country's unemployment rate settled at 5.4 percent in July 2016, the lowest recorded unemployment rate in the past decade. This is equivalent to 2.3 million unemployed individuals, or the second lowest unemployment level since Q4 2007 when the country recorded an unemployment level of 2.2 million. A notable development was also recorded in the unemployment rate among the youth (15-24 years old), which was recorded at 13.5 percent, the lowest rate since 2005. However, the latest youth unemployment rate is still more than double the rate at the national level and more than triple the rate of unemployment for the 25 to 54 age group. The youth comprises 48.2 percent of the total unemployed and 22 percent of the total young working population were unutilized as they were neither in school nor in the labor force.[29] In July 2015, the youth unemployment rate was at 16.4 percent while total unemployment rate was 6.5 percent.

Chart 19. Unemployment and Underemployment
in percent



Source: PSA

With the continued strong economic growth, total employment level reached 41.0 million in July 2016, 94.6 percent of the total labor force or the country's highest employment rate since 2005. The services sector remained as the country's primary employment contributor, with 55.3 percent share, and the main sources of employment are wholesale and retail trade (19.9 percent share to total employment), transportation and storage (7.6 percent), and other services activities (6.8 percent) sub-sectors. The agriculture sector continued to be the second highest source of employment, contributing more than a quarter (26.9 percent) of total employment, although there is a downtrend in the share of agriculture employment in recent period. The industry sector comprised 17.8 percent of the total employment and this was mainly attributed to increased production activities in construction (8.6 percent) and manufacturing (8.3 percent) sub-sectors. Most of the employed are wage and

[27] The Philippine Development Plan 2011-2016 Midterm Update did not indicate youth unemployment rate targets for 2014 to 2016.

[28] NEDA (2016), "Vibrant Labor Market Accompanies GDP Growth," NEDA Press Release, 9 September 2016.

[29] NEDA (2016).

salary workers (61.5 percent), although the share of vulnerable workers such as self-employed and unpaid family workers is still high at 35 percent. In July 2015, total employment level was 39.2 million, with employment rate of 93.5 percent.

Meanwhile, the underemployment rate[30] was recorded at 17.3 percent, also a record low since 2005. Most of the underemployed are in services and agriculture sectors and more than half of them are visible (55.3 percent share and a rate of 9.6 percent).[31,32] Nevertheless, an increase in the level of economic activities is expected in the third quarter of 2016 as the country's overall mean hours of work (hours per week) reached 42.7, also a record high since 2005. In July 2015, underemployment rate was 21.0 percent while mean hours of work was 42.4.

The latest labor turnover rate data indicates that employment in large enterprises in Metro Manila grew by 0.6 percent in the fourth quarter of 2015, a deceleration from the 1.0 percent employment growth in the same period in 2014. This could indicate a weaker employment condition in large business enterprises in the region, reverting to a similar condition in the first quarter of 2015, after posting a strong growth in the second and third quarters of the said year. These fourth quarter 2015 and 2014 employment growth rates based on labor turnover rate data appear to be consistent with the results of the October 2015 and 2014 rounds of labor force surveys (LFS), which indicate that total employment in the National Capital Region grew by 0.5 percent in October 2015 from 4.1 percent in October 2014. However, the LFS data is released earlier than the labor turnover rate by five months.

Among the major sectors, labor turnover rates data by enterprise indicate that only services sector posted an employment growth of 0.9 percent in the fourth quarter of 2015. This was partially offset by 6.2 percent and 0.9 percent contractions in agriculture and industry sectors, respectively. Most of the subsectors posted faster accession rate relative to separation rate, although this was partially offset by the significantly higher separation rate relative to accession rate in agriculture, forestry and fishing, mining and quarrying, construction, information and communication subsectors. The total accession rate was at 8.5 percent, still due largely to replacement as the rates of hiring to replace workers were high in wholesale and retail trade, repair of motor vehicles and motorcycles, education, and accommodation and food service activities. Meanwhile, the 7.9 percent separation rate was mostly employer-initiated (e.g., layoffs) and this was most apparent in mining and quarrying, construction and wholesale and retail trade, repair of motor vehicles and motorcycles. Since the third quarter of 2013, most of the separation rate in Metro Manila has been employer-initiated, except in the second quarter of 2015, which was dominated by employees quitting their jobs.

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[30] Majority of the underemployed are wage and salary workers in private establishments.

[31] Visible underemployment refers to the proportion of employed individuals who are working for less than 40 hours and seeking additional hours of work.

[32] The invisible underemployment (underemployed full-time workers or those who work 40 hours or more per week but still wanted more work) has 44.7 percent share and a rate of 7.7 percent. Most of these are in services and industry sectors.

II. Monetary and Financial Market Conditions

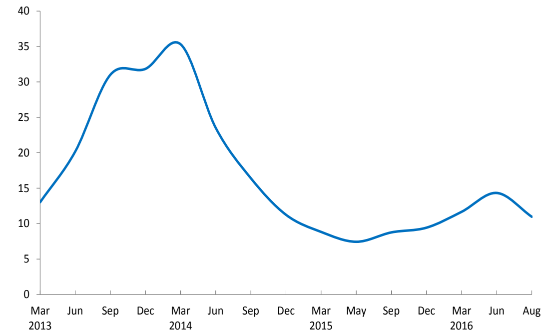
Domestic Liquidity and Credit Conditions

Domestic liquidity (M3) grew by 11.8 percent year-on-year in August to ₱8.7 trillion. This was slightly slower than the 12.4-percent expansion recorded in end-Q2 2016.

Domestic liquidity continues to expand…

Money supply continued to expand due largely to sustained demand for credit.

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



Source: BSP

Domestic claims grew by 14.9 percent in August from 16.9 percent in end-Q2 2016 as credits to the private sector increased further. Net claims on the central government also rose by 18.2 percent in August from 25.3 percent at the end of the previous quarter as a result of withdrawals by the National Government of its deposits with the BSP.

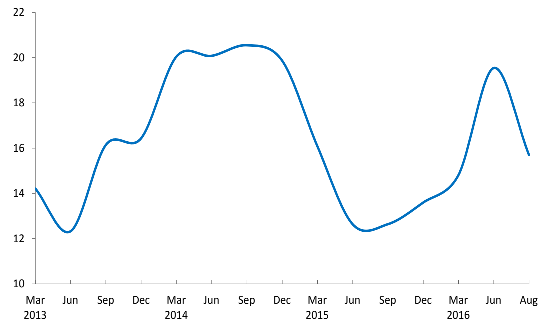
The growth in net foreign assets (NFA) was slower at 8.8 percent y-o-y in August from 11.1 percent in end-Q2 2016. The BSP's NFA position continued to expand on the back of robust foreign exchange inflows coming mainly from overseas Filipinos' remittances, business process outsourcing receipts, and portfolio investments. The NFA of banks likewise rose, driven largely by the increase in banks' foreign assets resulting from deposits with other banks and investments in marketable debt securities.

Preliminary data as of August 2016 show that outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, grew by 17.3 percent y-o-y relative to the 17.6 percent and 12.6 percent growth posted at end-Q2 2016 and end-Q3 2015, respectively.

…as lending sustains growth due to production activities

The sustained increase in bank lending was due largely to loans for production activities, which expanded by 17.3 percent y-o-y in August 2016 from a 17.7-percent growth in end-Q2 2016 and 13.2 percent rise in end-Q3 2015.

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



Source: BSP

The expansion in production loans was driven primarily by increased lending to the following sectors: real estate activities; electricity, gas, steam and airconditioning supply; wholesale and retail trade, repair of motor vehicles and motorcycles; financial and insurance activities; information and communication; and manufacturing. Meanwhile, loans for household consumption grew by 20.3 percent y-o-y as of end-August 2016, higher than the 18.7 percent and 12.7 percent growth recorded in end-Q2 2016 and end-Q3 2015, respectively.

Credit Standards. Results of the Q3 2016 Senior Bank Loan Officers' Survey (SLOS)[33] showed that

[33] The survey consists of questions on loan officers' perceptions relating to the overall credit standards of universal/commercial banks (U/KBs) in the Philippines, as well as to factors affecting the supply of and demand for loans by both enterprises and

most of the respondent banks maintained their credit standards for loans to both enterprises and households during the quarter based on the modal approach.[34] This is the 30th consecutive quarter since Q2 2009 that the majority of banks reported broadly unchanged credit standards.

The diffusion index (DI) approach,[35,36] however, pointed to a net tightening of overall credit standards for loans extended to business and households. In the previous quarter, credit standards for corporate lending also showed net tightening while those for household loans were unchanged.

Banks generally maintain credit standards during the quarter

Lending to Enterprises. Most banks (93.1 percent of banks that responded to the question) indicated that credit standards for loans to enterprises remained unchanged during the quarter using the modal approach.

However, results based on the DI approach indicated net tightening as respondent banks indicating tighter overall credit standards outnumbered those that indicated the opposite. The tighter overall credit standards was attributed by respondent banks to the deterioration in the profitability of bank's portfolio, less favorable economic outlook, perceived stricter financial system regulations, banks' reduced tolerance for risk, and deterioration of borrowers' profiles. In terms of specific credit standards, the net tightening in overall credit standards for business loans reflected overall stricter loan covenants and collateral requirements as well as increased use of interest rate floors across all firm sizes, except micro enterprises.[37]

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

	2015				2016		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Tightened Considerably	3.4	0.0	0.0	3.2	3.3	0.0	0.0
Tightened Somewhat	13.8	3.2	6.3	0.0	6.7	9.7	6.9
Remained Basically Unchanged	**79.3**	**93.5**	**87.5**	**90.3**	**86.7**	**87.1**	**93.1**
Eased Somewhat	3.4	3.2	6.3	6.5	3.3	3.2	0.0
Eased Considerably	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Diffusion Index for Credit Standards	**13.8**	**0.0**	**0.0**	**-3.2**	**6.7**	**6.5**	**6.9**
Weighted Diffusion Index for Credit Standards	**8.6**	**0.0**	**0.0**	**0.0**	**5.0**	**3.2**	**3.4**
Mean	2.8	3.0	3.0	3.0	2.9	2.9	2.9
Number of Banks Responding	**29**	**31**	**32**	**31**	**30**	**31**	**29**

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

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

Over the next quarter, results based on the modal approach showed that most of the respondent banks anticipate unchanged credit standards. Meanwhile, the DI approach showed that some respondent banks expect credit standards to tighten largely on account of banks' less favorable outlook on the economy as well as expectations of deterioration in the profitability of their loan portfolio.

Lending to Households The survey results likewise showed that most of the respondent banks (90.9 percent) continued to report unchanged overall credit standards for loans extended to households.

The DI approach, however, showed a net tightening of overall credit standards for household loans in Q3 2016 as banks that reported tightening of credit standards outnumbered those that reported easing of credit standards during the

households. Survey questionnaires were sent to 35 U/KBs, of which, 32 banks responded to the current survey representing a response rate of 91.4 percent. As of end-June 2016, U/KB loans accounted for about 86.8 percent of the banking system's total outstanding loans net of BSP RRP agreements.

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

[35] In the diffusion index approach, a positive diffusion index (DI) for credit standards indicates that the proportion of banks that have tightened their credit standards are greater compared to those that eased ("net tightening"), whereas a negative DI for credit standards indicates that more banks have eased their credit standards compared to those that tightened ("net easing").

[36] From Q1 2010 to Q4 2012 survey rounds, the BSP used largely the DI approach in the analysis of survey results. Beginning in Q1 2013, the BSP used both the modal and DI approaches in assessing the results of the survey.

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

quarter. The tighter credit standards were attributed by respondent banks largely to their perception of stricter financial regulations. In particular, banks' responses indicated banks' wider loan margins for housing loans and auto loans, and tighter collateral requirements for housing loans, auto loans and personal or salary loans.

Over the next quarter, results based on the modal approach indicated that majority of the respondent banks anticipate unchanged overall credit standards. However, the DI approach showed expectations of net easing of overall credit standards for Q4 2016 across all types of household loans (except auto loans), as respondent banks expect higher tolerance for risk, an improvement in borrowers' profiles, and more aggressive competition from banks and non-bank lenders.

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

	2015				2016		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Tightened Considerably	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tightened Somewhat	10.5	9.5	4.2	4.5	9.5	8.3	9.1
Remained Basically Unchanged	**84.2**	**81.0**	**87.5**	**81.8**	**81.0**	**83.3**	**90.9**
Eased Somewhat	5.3	9.5	8.3	13.6	9.5	8.3	0.0
Eased Considerably	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Diffusion Index for Credit Standards	**5.3**	**0.0**	**-4.2**	**-9.1**	**0.0**	**0.0**	**9.1**
Weighted Diffusion Index for Credit Standards	**2.6**	**0.0**	**-2.1**	**-4.5**	**0.0**	**0.0**	**4.5**
Mean	2.9	3.0	3.0	3.1	3.0	3.0	2.9
Number of Banks Responding	**19**	**21**	**24**	**22**	**21**	**24**	**22**

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

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

Using the DI approach, however, results showed a net increase in loan demand[38] across all firm sizes and all types of household loans. The net increase in loan demand of firms was attributed mainly by banks to higher requirements of borrower firms for working capital and accounts receivable financing. Meanwhile, the net increase in demand for household loans reflected largely banks' more attractive financing terms and higher household consumption.

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

Real Estate Loans. Most of the respondent banks (85.7 percent) also indicated unchanged credit standards for commercial real estate loans in Q3 2016.

The DI approach, however, continued to indicate a net tightening of overall credit standards for the third consecutive quarter. The tighter overall credit standards for commercial real estate loans reflected respondent banks' wider loan margins, reduced credit line sizes, stricter collateral requirements and loan covenants, shorter loan maturity, and increased use of interest rate floors.

Credit standards for real estate loans remain steady

Demand for commercial real estate loans was also unchanged in Q3 2016 based on the modal approach. The DI approach, however, indicated a net increase in demand for the said type of loan on the back of increased working capital and inventory financing needs of borrowers and clients' improved economic outlook.

Over the next quarter, although most of the respondent banks anticipate generally steady loan demand, a number of banks expect demand for commercial real estate loans to continue to increase.

Meanwhile, in the case of housing loans extended to households, most of the respondent banks (89.5 percent) reported unchanged credit standards.

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

Using the DI approach, however, a slight tightening of credit standards for housing loans was noted in Q3 2016. The net tightening of credit standards for housing loans was attributed by respondent banks largely to perceived stricter financial system regulations and as well as clients' less favorable economic outlook.

Over the next quarter, results based on the modal approach showed expectations of broadly unchanged overall credit standards for housing loans. However, results based on the DI approach indicated that some banks foresee a net easing of credit standards for housing loans in Q4 2016 on expectations of an improvement in the profitability of banks' portfolio, more aggressive competition from banks and non-bank lenders, and increased tolerance for risk. At the same time, results continued to show increased demand for housing loans in Q3 2016 as well as expectations of a continued increase in demand for the said type of loan in the next quarter.

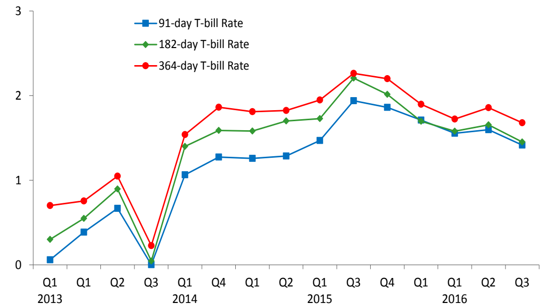
Interest Rates

Primary Interest Rates. In Q3 2016, the average 91-day, 182-day, and 364-day T-bill rates in the primary market decreased to 1.416 percent, 1.452 percent, and 1.679 percent from 1.597 percent, 1.654 percent, and 1.857 percent, respectively, in Q2 2016.

T-bill rates in the primary market decline

The results of the auction reflected strong demand for short-term securities on continued expectation of a US Fed hike in the coming months.

Chart 22. Treasury Bill Rates
in percent



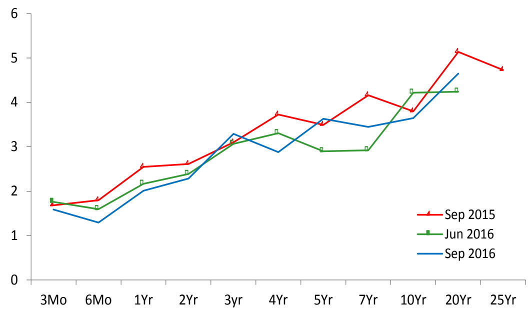
Source: BTr

Yield Curve. As of end-September 2016, the secondary market yield for government securities (GS) declined generally, except for the 3-year, 5-year, 7-year and 20-year GS, relative to the end-June 2016 levels, amid sustained buying interest on strong market demand following the first auction under the IRC system on 3 June 2016 and as market players invested their excess liquidity and serviced their clients' requirements.

Yield curve declines amid buying interest

Debt paper yields were lower by a range of 10.2 bps (2-year GS) to 57.3 bps (10-year GS) compared to end-June 2016 levels. By contrast, the interest rates for the 3-year, 5-year, 7-year and 20-year GS rose by 22.7 bps, 73.2 bps, 52.9 bps and 40.7 bps, respectively.

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



Source: Bloomberg

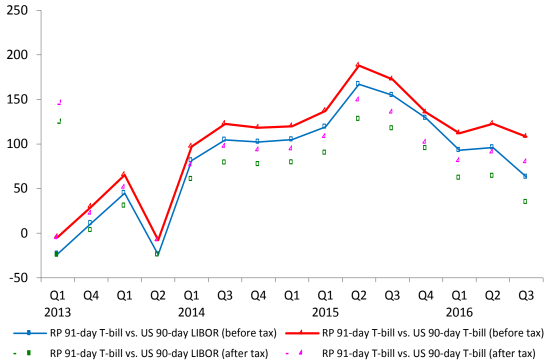
Relative to year-ago levels, the secondary market yields of GS likewise decreased generally by a range of 9.6 bps for the 3-month GS to 84.7 bps for the 4-year GS except for the 3-year and 5-year GS which rose by 19.1 bps and 14.0 bps.

Interest Rate Differentials. The average differentials between domestic and US interest rates, gross and net of tax, narrowed in Q3 2016 relative to the previous quarter.

Interest rate differentials narrow

The average 91-day RP T-bill rate declined q-o-q by 18.8 bps to 1.416 percent in Q3 2016 from 1.604 percent in Q2 2016. Meanwhile, the average US 90-day T-bill rate LIBOR decreased by 4.2 bps to 0.335 percent while the average US 90-day LIBOR increased by 14.2 bps to 0.785 percent in Q3 2016. These developments led to narrower positive gross and net of tax differentials between the 91-day RP T-bill rate and US interest rates. Meanwhile, foreign interest rates showed mixed trends during the quarter following the release of better-than-expected US data on employment, manufacturing activity, consumer spending and retail sales vis a vis lower-than-expected data on home sales and industrial production.

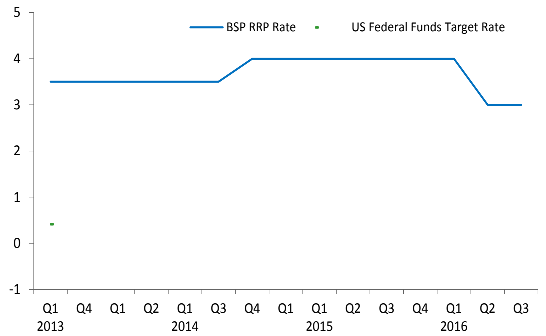
Chart 24. Interest rate Differentials
quarterly averages; in basis points



Source: Bloomberg, BTr and BSP

The positive differential between the BSP's overnight borrowing or RRP rate and the US Fed funds target rate was unchanged at 2.50-2.75 bps in Q3 2016, as the policy settings for both central banks were kept steady.

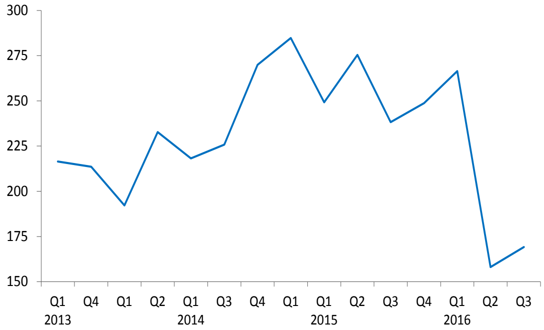
Chart 25. BSP RRP Rate and US Federal Funds Target Rate
in percent



Source: Bloomberg and BSP

Meanwhile, the interest rate differential between the BSP's overnight RRP rate and the US Fed funds target rate adjusted for risk[39] widened to 169 bps as of end-September 2016 from 158 bps in end-June 2016 due to lower risk premium.

Chart 26. Risk-Adjusted Differentials
in basis points



Source: Bloomberg and BSP

The decline in the risk premium in end-September could be attributed to the 11.0-bps increase in the 10-year US note to 1.57 percent as the 10-year ROP note remained steady at 2.38 percent. The 10-year US note rose on increased investor appetite for other riskier assets such as equities following the release of upbeat US economic data and the possibility of a December 2016 interest rate hike.

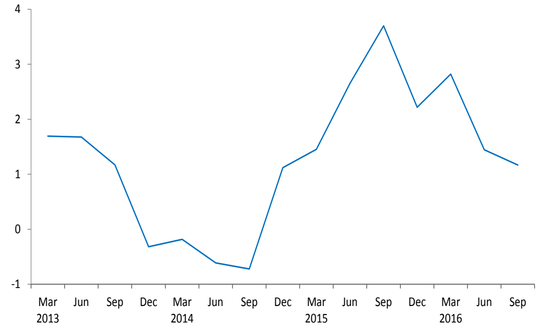
Meanwhile, the domestic real lending rate[40] decreased further to 1.2 percent in September 2016 from 1.4 percent in June 2016. This was due to the 40-bp and 20-bp rise in inflation and actual bank lending rate[41], respectively, to 2.3 percent and 3.5 percent in September 2016.

Real lending rate decreases

The Philippines' real lending rate was the second lowest in a sample of 10 Asian countries, with Indonesia recording the highest real lending rate at 8.4 percent while Hong Kong posted the lowest at 0.7 percent.

[39] The difference between the 10-year ROP note and the 10-year US Treasury note is used as proxy for the risk premium.
[40] Real lending rate is measured as the difference between actual bank lending rate and inflation.
[41] The actual bank lending rate for the Philippines is the weighted average interest rate charged by reporting commercial banks on loans and discounts granted during the period.

Chart 27. Philippines' Real Lending Rate
in percent



Source: PSA and BSP

Financial Market Conditions

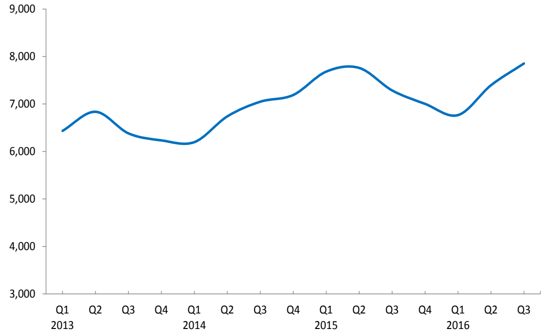
The domestic financial system remained resilient, supported by strong macroeconomic fundamentals during the review quarter.

Domestic financial market conditions reflect external uncertainty

The optimism following the orderly transition to the new administration provided a boost to domestic markets. This was, however, dampened partially by uncertainty coming mainly from the external front. Nevertheless, the sustained growth of the domestic economy and healthy banking system contributed to the better performance of the Philippine financial market relative to other countries in the region.

Stock Market. The Philippine Stock Exchange index (PSEi) continued to rally in Q3 2016 as it rose by 6.2 percent relative to the quarter-ago level to average 7,853.3 index points during the period in review.

Chart 28. Quarterly Average PSEi
In basis points



Source: Philippine Stock Exchange, BSP

In contrast to the quarter-on-quarter rally, however, the trend month-on-month showed a deceleration in the benchmark index.

Local stocks continue to rally in Q3 2016

In July, optimism over the inauguration of the new administration, the two successful maiden IPOs conducted during the month and the country's robust macroeconomic fundamentals saw the benchmark index post the highest level in 15 months on 21 July at 8,102.3 index points, a 16.5-percent climb year-to-date.

However, in the succeeding two months, the PSEi declined from the peak posted in July as fears over the impact of the July Brexit vote on the domestic economy and reports of mixed performance of corporate earnings in Q2 triggered profit-taking and tempered gains in the remaining months of the quarter.

The consolidation was tempered partly by the US Federal Reserves' decision in 21 September to hold off policy adjustments, the Bank of Japan's (BOJ) move to address deflation and revive their economy, and investors hunting for bargains to take advantage of previous lows. As of 30 September 2016, the PSEi closed at 7,629.73 index points, lower than the level in end-August by 2.0 percent but still higher on a year-to-date basis by 9.7 percent.

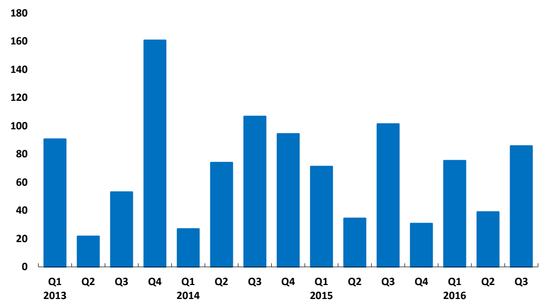
Meanwhile, the declining month-on-month trend in the PSEi was reflected in other stock indicators. Total market capitalization fell by 1.85 percent to ₱14.97 trillion by end September from ₱15.25 trillion in end-June. Preliminary data from the PSE also showed that foreign investors posted lower net purchases of ₱7.0 billion during the quarter-in-review as the net purchases posted in July (amounting to ₱21.0 billion) were offset partly by the net sales in August (amounting to ₱0.6 billion) and September (amounting to ₱13.4 billion). Similarly, data from Bloomberg reflected a deceleration in the domestic price-earnings ratio from 22.04x in end-June to 21.36x in end-September.

Government Securities. Results of the Treasury bill (T-bill) auctions conducted in Q3 2016 (July-September) continued to show strong investor appetite for short-dated government securities with total subscription for the quarter amounting to ₱145.7 billion, about 2.4 times the ₱60.0 billion total offered amount. The oversubscription for the quarter (amounting to ₱85.7 billion) was higher than the ₱39.0-billion oversubscription in the previous quarter.

Demand for local GS remains robust

The Bureau of the Treasury (BTr) decided to award in full bids for all tenors in the auctions held during the review quarter on the back of favorable offered rates amid strong demand of investors for T-bills.

Chart 29. Total Oversubscription of T-bill Auctions



Source: Bureau of the Treasury

Sovereign Bond and CDS Spreads. In July, debt spreads narrowed as investor sentiment improved due to positive macroeconomic developments reported in the US. The muted market was boosted by the upbeat US jobs report for June which provided additional 287,000 workers in the US labor market, putting downward pressure on unemployment.

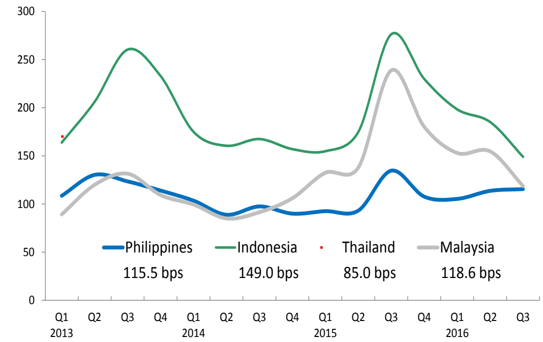
In August, debt spreads continued to narrow as the global economic and financial environment remained calm. The tightening in debt spreads were due to (i) the mild recovery seen in China's economy as it grew by 6.7 percent in June which is above the expectations of 6.6 percent growth; and (ii) the additional stimulus provided by the BOJ to boost their economy. In the Philippines, the sustained robust economic performance further propelled investor sentiment as the country's GDP grew by 7.0 percent in Q2 2016, the fastest since the third quarter of 2013.

In September, debt spreads widened as uncertainties on the timing and potential impact of a further US rate hike, slowdown in China, volatility in oil prices, and the result of the UK Brexit referendum all contributed to market worries. However, the upbeat Q2 economic growth of 7.0 percent tempered spreads from widening significantly.

Debt spreads narrower on improved US economic data

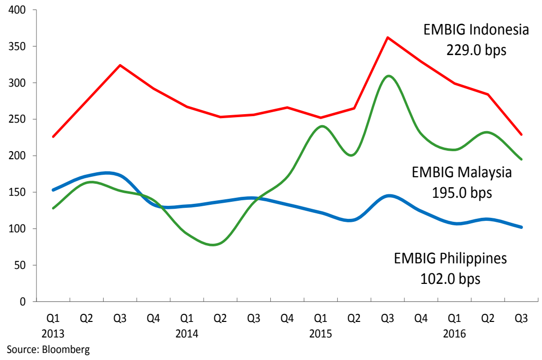
By 30 September, the Philippines' 5-year sovereign credit default swaps (CDS) stood at 115.5 bps, higher than the 112.0 bps in end-Q2 but remained lower than Indonesia's 149.0 bps and Malaysia's 118.6 bps. Meanwhile, the EMBIG-Philippines ended the quarter narrower at 102.0 bps compared to the previous quarter's closing of 113.0 bps.

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



Source: Bloomberg

Chart 31. EMBIG Spreads of Selected ASEAN Countries
in basis points



Banking System

The Philippine banking system continues to be resilient in supporting economy's long-term growth. This was evident in banks' balance sheets that are marked by steady growth in assets and deposits.

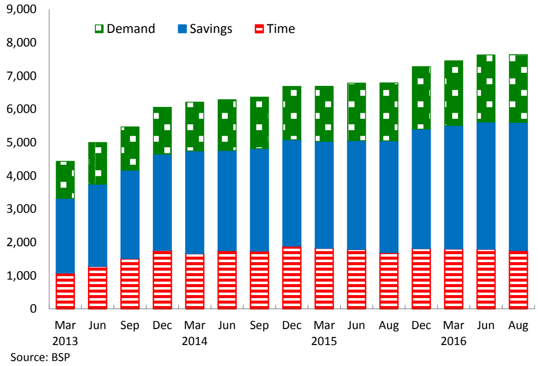
The Philippine banking system posts steady growth in assets and deposits

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

Savings Mobilization. Savings and demand deposits remained the primary sources of funds for the banking system. Banks' total deposits[42] as of end-August 2016 amounted to ₱7.6 trillion, higher than the year- and quarter-ago levels by 12.5 percent and 0.1 percent, respectively. On a y-o-y basis, savings, demand, and time deposits expanded by 14.8 percent, 16.8 percent, and 3.5 percent, respectively.[43] Similarly, foreign currency deposits owned by residents (FCD-Residents) grew by 6.4 percent, to ₱1.5 trillion.[44]

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

Chart 32. Deposit Liabilities of Banks
in billion pesos

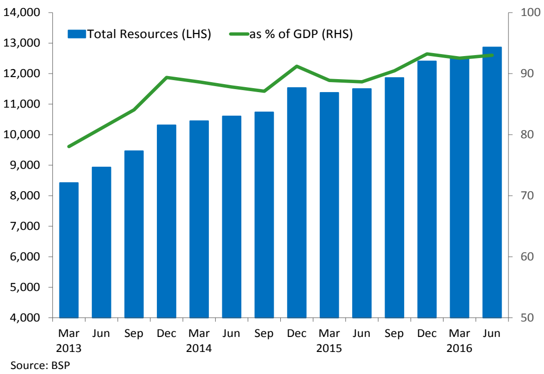


Institutional Developments. The total resources of the banking system grew by 11.8 percent to ₱12.9 trillion as of end-June 2016 from the year-ago level of ₱11.5 trillion.

Total resources of the banking system continue to rise

As a percent of GDP, total resources stood at 93.0 percent.

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



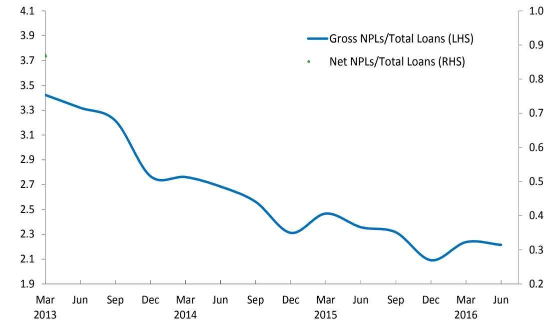
The number of banking institutions (head offices) fell to 618 as of end-June 2016 from the year- and quarter- ago levels of 638 and 622, respectively, indicating continued consolidation of banks as well as the exit of weaker players in the banking system. By banking classification, banks (head offices) consisted of 41 universal and commercial banks (U/KBs), 64 thrift banks (TBs), and 513 rural banks (RBs). Meanwhile, the operating network (head offices and branches/agencies) of the banking system expanded to 10,936 offices in Q2 2016 from 10,528 offices during the same period in the previous year and 10,849 offices in Q1 2016, due mainly to the increase in the branches/agencies of U/KBs, TBs and RBs.

The Philippine banking system's gross non-performing loan (GNPL) ratio as of end-June 2016 remained at its end-March level of 2.2 percent, an improvement from the previous year's level of 2.4 percent.[45]

Asset quality of Philippine banks continues to improve, y-o-y

Banks' initiatives to improve their asset quality along with prudent lending regulations helped maintain the GNPL ratio below its pre-Asian crisis level of 3.5 percent.[46] The net non-performing loan (NNPL) ratio remained at its end-March level of 0.8 percent, an increase from the year-ago level of 0.7 percent. In computing for the NNPLs, specific allowances for credit losses[47] on total loan portfolio (TLP) are deducted from the GNPLs. The said allowances increased slightly to ₱95.2 billion as of end-June 2016 from ₱94.6 billion posted a quarter ago, and decreased from a year ago level of ₱102.3 billion.

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



Source: BSP

[45] For comparative purposes, computations for periods prior to January 2013 are aligned with Circular No. 772. Certain ratios were rounded-off to the nearest hundredths to show marginal movements.
[46] The 3.5 percent NPL ratio was based on the pre-2013 definition.
[47] This type of provisioning applies to loan accounts classified under loans especially mentioned (LEM), substandard-secured loans, substandard-unsecured loans, doubtful accounts and loans considered as loss accounts.

The Philippine banking system's GNPL ratio of 2.2 percent was higher relative to those of South Korea (1.9 percent) and Malaysia (1.3 percent), but lower than Indonesia (3.0 percent) and Thailand (2.7 percent).[48]

The loan exposures of banks remained adequately covered as the banking system registered an NPL coverage ratio of 111.9 percent in end-June 2016. This ratio was lower than 112.5 percent registered a year ago and 118.4 percent posted in end-March 2016. The decrease in the coverage ratio was due to the relatively faster build-up in GNPL relative to the loan loss provision which only had a marginal increase.

Compliance with the BSP capital framework for U/KBs under the Basel III framework[49] took effect on 1 January 2014. The new Basel III regime incorporates adjustments to the treatment of bank capital in ways that enhance the use of the CAR as a prudential measure.

The capital adequacy ratio (CAR) of universal and commercial banks (U/KBs) stood at 15.0 percent on solo basis and 15.8 percent on consolidated basis as of end-March 2016. These figures were well above the BSP regulatory threshold of 10.0 percent and international minimum of 8.0 percent. The U/KBs' latest CAR on solo and consolidated bases rose quarter-on-quarter from 14.9 percent and 15.8 percent, respectively.

Banks maintain high levels of CAR amid tighter capital requirements

The CAR of U/KBs on a consolidated basis at 15.8 percent was higher than South Korea (14.0 percent) and lower than Indonesia

[48] Sources: IMF and financial stability reports, Indonesia (Banks' Nonperforming Loans to Gross Loans Ratio, Q2 2016); Malaysia (Banking System's Net Impaired Loans, Q2 2016); Thailand (Total Financial Institutions' Gross NPLs, Q2 2016); and South Korea (Domestic Banks' Substandard or Below Loans, Q1 2016).
[49] Basel III no longer counts towards "bank capital" those Basel II-compliant capital instruments that do not have the feature of loss absorbency. Loss absorbency refers to the ability of bank-eligible capital instruments other than common equity to behave and act in the same way as common equity shares at the point where the bank takes losses and becomes non-viable. In addition, Basel III now deducts from capital the investments of banks in non-allied undertakings, defined benefit pension fund assets, goodwill and other intangible assets.

(21.2 percent), Thailand (17.8 percent) and Malaysia (16.4 percent).[50]

Exchange Rate

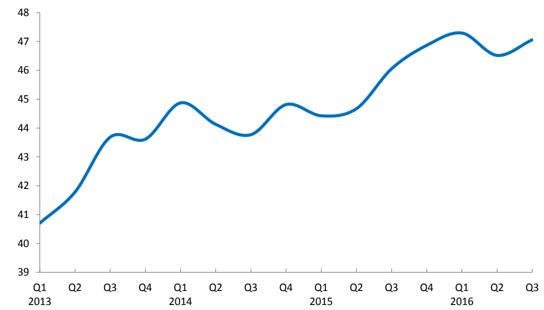
The peso depreciated against the US dollar in Q3 2016. On a quarter-on-quarter basis, the peso weakened by 1.1 percent to average ₱47.06/US$1 from the previous quarter's average of ₱46.52/US$1. On a year-on-year basis, the peso likewise depreciated by 2.1 percent relative to the ₱46.05/US$1 average in Q3 2015.[51]

Peso weakens on Fed hike prospects

The weakening of the peso during the review quarter was due mainly to the renewed prospects of a hike in the US Fed funds rate and concerns over the Chinese economy and declining oil prices.

In July 2016, the peso depreciated against the US dollar by 1.3 percent to average ₱47.06/US$1 relative to the ₱46.46/US$1 a month ago due to worries on declining oil prices and concerns over a potential Chinese economic slowdown which have weakened risk appetite for emerging market assets.

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



Source: Reference Exchange Rate Bulletin, Treasury Department, BSP

Meanwhile, in August, the peso appreciated slightly against the US dollar by 0.8 percent to average ₱46.68/US$1 owing to the recovery in oil prices and weak retail sales data in the US which renewed expectations of a delay in the timing of the next US policy rate hike.[52]

In September, the peso depreciated anew by 1.6 percent to average ₱47.43/US$1 due to net selling by foreign investors in the local stock market, higher corporate demand for dollars, and better-than-expected US jobless claims data which bolstered hopes the Federal Reserve would raise interest rates by December 2016. Overall, the sustained inflows of foreign exchange from remittances of overseas Filipinos, foreign direct investments, BPO and tourism receipts, as well as the ample level of the country's gross international reserves and the country's robust economic growth continued to provide support to the peso.[53]

On a year-to-date basis, the peso depreciated against the US dollar by 3.0 percent on 30 September 2016 as it closed at ₱48.50/US$1, moving in tandem with the Chinese yuan and Indian rupee, and in contrast with most Asian countries which appreciated vis-à-vis the US dollar.[54]

In terms of volatility, which is measured by the coefficient of variation (COV) of the peso's daily closing rates, the peso stood at 1.17 percent during the third quarter of 2016, higher relative to the 0.74 percent in the previous quarter.[55]

[50] Sources: IMF and financial stability reports, Indonesia (Banks, Regulatory Capital to Risk-Weighted Assets Ratio Q2 2016); Thailand (Commercial Banks' Capital Funds Percentage of Risk Assets, July 2016); Malaysia (Banking System's Total Capital Ratio, Q2 2016); and South Korea (Domestic Banks' Capital Ratio, Q1 2016).

[51] Dollar rates or the reciprocal of the peso-dollar rates were used to compute for the percentage change.

[52] Retail sales in the US showed no growth in July from June 2016, following an upwardly revised 0.8 percent gain in the previous period and below market expectations of 0.4 percent rise. (Source: US Census Bureau).

[53] GIR stood at US$85.9 billion as of end-August 2016 (preliminary).

[54] Based on the last done deal transaction in the afternoon.

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

Table 15. Year-to-Date Changes in Selected Dollar Rates
appreciation/(-depreciation); in percent

	2013	2014	2015	2016*
Korean Won	1.1	-4.3	-6.6	6.7
Thai Baht (Onshore)	-4.6	-0.7	-8.9	3.8
Singaporean Dollar	-2.7	-4.5	-6.0	3.9
Indian Rupee	-11.4	-2.9	-4.9	-0.8
Indonesian Rupiah	-19.1	-2.1	-9.8	5.9
Philippine Peso	**-7.0**	**-0.7**	**-5.0**	**-3.0**
Japanese Yen	-16.3	-12.5	-0.5	19.1
Malaysian Ringgit	-5.5	-6.3	-18.6	3.7
Chinese Yuan	2.6	-2.7	-4.3	-2.6
New Taiwan Dollar	-1.9	-6.2	-3.6	4.9

Notes:
- Negative value represents depreciation of the currency against the US dollar.
- YTD changes are computed as the percent change between the closing prices for the year indicated versus the closing prices for the preceding year.
* Data as of 4:00 p.m., 30 September 2016
Source: Treasury Department - BSP

On a real trade-weighted basis, the peso gained external price competitiveness in Q3 2016, against the basket of currencies of all trading partners (TPI), trading partners in advanced (TPI-A) and developing countries (TPI-D) as the real effective exchange rate (REER) index of the peso decreased by 3.2 percent, 4.0 percent, and 2.7 percent, respectively, relative to Q2 2016. Behind this development were the combined effects of the nominal depreciation of the peso and the narrowing inflation differential against these currency baskets.[56,57]

The peso likewise gained external price competitiveness against the TPI, TPI-A, and TPI-D baskets relative to Q3 2015. This developed as the nominal depreciation of the peso offset the impact of widening inflation differential, resulting to a decrease in the REER index of the peso by 3.7 percent, 7.0 percent, and 1.2 percent against the TPI, TPI-A, and TPI-D baskets, respectively.

[56] 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.
[57] The REER index represents the Nominal Effective Exchange Rate (NEER) index of the peso, adjusted for inflation rate differentials with the countries whose currencies comprise the NEER index basket. A decrease in the REER index indicates some gain in the external price competitiveness of the peso, while a significant increase indicates the opposite. The NEER index, meanwhile, represents the weighted average exchange rate of the peso vis-à-vis a basket of foreign currencies.

III. Fiscal developments

The National Government (NG) recorded a fiscal deficit of ₱171.0 billion for the period January-July 2016, almost ten times higher compared to the ₱18.5-billion deficit incurred in the previous year.

NG posts higher deficit as of end-July 2016

Netting out the interest payments in NG expenditures, the primary surplus amounted to ₱22.7 billion, which is only about 11 percent of the ₱190.7 billion primary surplus recorded in the same period a year ago.

Revenues increased by 1.0 percent to ₱1,271.2 billion in January-July 2016 compared to ₱1,264.2 billion in the same period in 2015. The Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC) contributed ₱900.9 billion and ₱221.5 billion, respectively. The revenues of the BIR and BOC were higher by 9 percent and 6 percent, respectively, compared to their levels a year ago. Meanwhile, income from the BTr fell by 10 percent to ₱72.8 billion.

Table 16. National Government Fiscal Performance
in billion pesos

	2015		2016		Growth Rate (in percent)		Q2 2016 Program	Percentage Share to Q1 2016 Program
	Jan-Jun	Jan-Jul	Jan-Jun	Jan-Jul	Jan-Jun	Jan-Jul		
Surplus/(Deficit)	13.7	-18.5	-120.3	-171.0	-975.3	826.6	-100.2	120.1
Revenues	1,085.7	1,264.2	1,101.0	1,271.2	1.4	0.6	1,293.0	85.2
Expenditures	1,072.0	1,282.7	1,221.3	1,442.2	13.9	12.4	1,393.2	87.7

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

Expenditures for the period in review amounted to ₱1,442.2 billion, 12 percent higher than the expenditures in the same period in 2015. Excluding interest payments, expenditures went up by 16 percent to ₱1,248.5 billion. Meanwhile, interest payment was ₱15.5-billion lower compared to its year-ago level, amounting to ₱193.7 billion in January- July 2016.

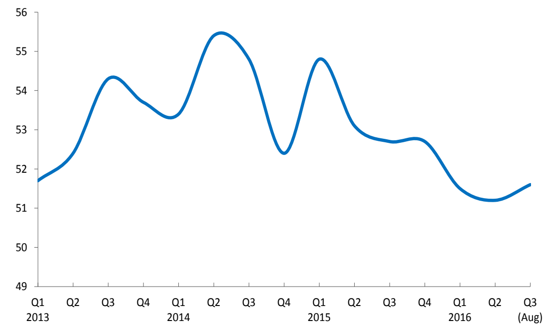
IV. External Developments

The JP Morgan Global All-Industry Output Index was broadly steady at 51.6 in August from 51.5 in July, as growth in both the manufacturing and service sectors inched slightly higher.

Global economic activity remains subdued

Output expanded in the euro area, US, China, Russia, UK, and India. By contrast, Brazil and Japan saw further declines in output.[58]

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



Source: Markit Economics

US. Real GDP increased by 1.4 percent on a seasonally adjusted q-o-q basis in Q2 2016 after expanding by 0.8 percent in the previous quarter. On a y-o-y basis, real output growth was slower at 1.3 percent in Q2 2016 from 1.6 percent in Q1 2016. The faster q-o-q expansion during the quarter reflected an acceleration in personal consumption expenditures and upturns in nonresidential fixed investment and in exports.[59]

Growth in the US economy holds firm

Meanwhile, the manufacturing PMI rose to 51.5 in September from 49.4 in August, signaling an expansion in output as new orders increased.[60]

Inflation on a y-o-y basis rose to 1.1 percent in August from 0.8 percent in July, as the indices for shelter and medical care rose. Meanwhile, the food and energy indices were broadly unchanged. The unemployment rate was steady at 4.9 percent in August for the third consecutive month. Total nonfarm payroll employment increased by 151,000 during the month, with gains noted especially in service-related industries.

Consumer confidence improved as the Conference Board Consumer Confidence Index rose to 104.1 in September from 101.8 in August.[61] Similarly, the Thomson-Reuters/University of Michigan Index of Consumer Sentiment increased to 91.2 in September from 89.8 in August[62] primarily as a result of consumers' more positive outlook for employment.

Euro Area. On a q-o-q basis, real GDP grew by 0.3 percent in Q2 2016, slower than the 0.5-percent growth in Q1 2016. On a y-o-y basis, real GDP growth was broadly stable at 1.6 percent in Q2 2016 from 1.7 percent in the previous quarter.[63]

Meanwhile, the composite PMI for the euro area eased slightly to 52.6 in September from 52.9 in August. While manufacturing production expanded with faster inflows of domestic orders and new export business, service sector orders rose at a weaker pace. Output growth eased in Germany with the slowdown in the service sector. By contrast, services expanded in France and more

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

[59] US Bureau of Economic Analysis, "National Income and Product Accounts Gross Domestic Product: Second Quarter 2016 (Third Estimate)," news release, 29 September 2016. http://www.bea.gov/newsreleases/national/gdp/2016/pdf/gdp2q16_3rd.pdf

[60] Institute for Supply Management, "September 2016 Manufacturing ISM *Report On Business*", 3 October 2016, https://www.instituteforsupplymanagement.org

[61] The Conference Board, "The Conference Board Consumer Confidence Index Increased in September." 27 September 2016. http://www.conference-board.org/

[62] University of Michigan Survey of Consumers, "Consumer expectations remain positive," 30 September 2016. http://www.sca.isr.umich.edu/

[63] Eurostat news release 168/2016 dated 6 September 2016.

than offset the stagnation in manufacturing production in the country.[64]

Economic activity in the euro area remains muted

The seasonally adjusted unemployment rate held steady at 10.1 percent in August for the fifth consecutive month.[65] Meanwhile, inflation rose to 0.4 percent in September from 0.2 percent in August, with the largest upward contributions seen to have come from services, food, alcohol, and tobacco.[66]

The European Commission's Economic Sentiment Indicator for the euro area rose to 104.9 in September from 103.5 in August owing to increasing business confidence across industries on managers' improved assessment of domestic and export demand. Consumer confidence was likewise stronger, reflecting more positive views on savings and overall economic conditions.[67]

Japan. On a q-o-q basis, real GDP increased by 0.2 percent in Q2 2016 after increasing by 0.5 percent in the previous quarter. Meanwhile, on a y-o-y basis, real GDP growth was 0.8 percent in Q2 2016 following the 0.2-percent increase in Q1 2016.[68]

Manufacturing activity in Japan improves slightly

The seasonally adjusted manufacturing PMI rose to 50.4 in September from 49.5 in the previous month, signaling a modest improvement in manufacturing operating conditions, particularly production. However, total new orders continued to decline, albeit at a weaker pace, reflecting weak domestic demand.[69]

[64] Markit Flash Eurozone Composite PMI – final data, http://www.markiteconomics.com/
[65] Eurostat news release 186/2016 dated 30 September 2016.
[66] Flash estimate only. Eurostat news release 187/2016 dated 30 September 2016.
[67] European Commission. http://ec.europa.eu/
[68] Department of National Accounts, Economic and Social Research Institute, Cabinet Office. http://www.esri.cao.go.jp/
[69] Nikkei Japan Manufacturing PMI, http://www.markiteconomics.com/

Inflation was at -0.5 percent in August from -0.4 percent a month earlier, while the seasonally adjusted unemployment rate rose to 3.1 percent in August from 3.0 percent in July.

China. Real GDP grew by 6.7 percent y-o-y in Q2 2016, the same pace as in the previous quarter. Agricultural and industrial production showed steady growth, while investment in fixed assets slowed down.

Indicators point to a marginal recovery in Chinese economic activity

Meanwhile, the seasonally adjusted manufacturing PMI was broadly steady at 50.1 in September from 50.0 in August, indicating a marginal improvement in manufacturing output and total new orders.[70]

Inflation declined to 1.3 percent in August from 1.8 percent in July. The increases in the prices of food, tobacco, liquor, and meat (particularly pork) drove inflation.

India. Real GDP increased by 7.1 percent y-o-y in Q2 2016, slower than the 7.9-percent expansion in the previous quarter, with manufacturing; utilities; trade, hotels, transport, communication, and broadcasting; and financial, insurance, real estate and professional services all expanding by at least 7.0 percent.[71]

Output growth in India remains robust

Meanwhile, the composite PMI increased to 54.6 in August from 52.4 in July, reflecting mainly the faster growth in both the manufacturing and service sectors.

Inflation declined to 5.1 percent in August from 6.1 percent in July.

[70] Caixin China General Manufacturing PMI, http://www.markiteconomics.com/
[71] Central Statistics Office of India. http://mospi.nic.in/Mospi_New/Site/home.aspx

Policy Actions by Central Banks. On 13 July 2016, Bank Negara Malaysia cut its overnight policy rate by 25 bps to 3.0 percent from 3.25 percent. Both the ceiling and floor rates were likewise lowered to 3.25 percent and 2.75 percent, respectively. Real GDP growth in Malaysia has been decelerating as weak external demand continues to weigh down on exports. Meanwhile, inflation is around 2 percent, which is at the low end of the projected range of 2-3 percent for 2016.

A number of central banks ease their monetary policy settings

On 29 July 2016, the Bank of Japan (BOJ) maintained its base money annual growth target at 80 trillion yen but expanded its purchase of exchange-traded funds (ETFs) so that outstanding amount will increase at an annual pace of 6 trillion yen (from 3.3 trillion yen). In addition, the BOJ increased its lending program to US$24 billion (from US$12 billion) to support growth. Both policy easing measures were launched to prevent uncertainties surrounding the external economic environment, including the recent outcome of the UK referendum and slowdown in emerging economies, from adversely affecting domestic business confidence and consumer sentiment. Furthermore, on 21 September 2016, the BOJ introduced “QQE with Yield Curve Control” to strengthen its policy framework. The new policy framework consists of two major components: (1) “yield curve control” in which the BOJ will control short-term and long-term interest rates; (2) an “inflation-overshooting commitment” in which the BOJ commits to expanding the monetary base until year-on-year inflation rate exceeds and stays above the price stability target of 2 percent. Inflation in Japan has been in the negative territory, considerably lower than the 2-percent announced target.

On 2 August 2016, the Reserve Bank of Australia reduced its cash rate for the second time in 2016 by 25 bps, bringing its policy rate down to 1.50 percent. Inflation eased further in Q2 2016 to 1.0 percent, which is below the announced target of 2-3 percent. Meanwhile, latest data suggest that output growth will continue at a moderate pace despite the deterioration in business sentiment.

On 3 August 2016, the Bank of England (BOE) launched a four-pronged stimulus package to support the UK economy. The package consists of:
(1) cutting the bank rate by 25 bps to 0.25 percent;
(2) introducing a new Term Funding Scheme (TFS);
(3) purchasing UK corporate bonds; and
(4) expanding the asset purchase scheme for UK government bonds. Following the outcome of the UK EU referendum, the medium-term economic outlook declined significantly. Year-on-year headline inflation is currently at 0.60 percent in July and remains below its 2-percent target although the fall in sterling is expected to push inflation higher in the near term.

On 10 August 2016, the Reserve Bank of New Zealand (RBNZ) reduced its overnight cash rate by another 25 bps to 2.0 percent to prevent inflation expectations from further declining amid a low-inflation environment. New Zealand’s headline inflation remained subdued at 0.4 percent for Q2 2016, significantly below RBNZ’s announced target of 1.0-3.0 percent, as tradable inflation remained in negative territory.

On 22 September 2016, Bank Indonesia decided to reduce the 7-day reverse repo rate for the fifth time this year to support domestic growth amid a low-inflation environment and expectations of limited fiscal stimulus from the government. Consequently, both deposit and lending facility rates were likewise cut by 25 bps to 4.25 percent and 5.75 percent, respectively. Inflation in Indonesia has been decelerating in recent months, averaging below the set target of 3-5 percent for 2016 at 1.74 percent as of August 2016.

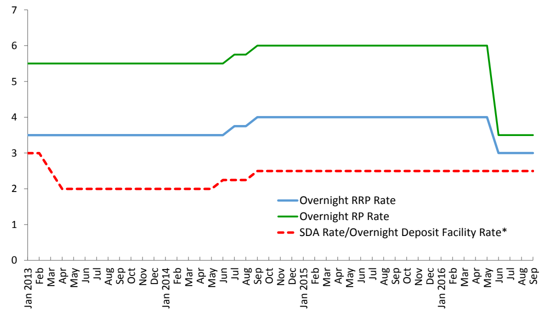
V. Monetary Policy Developments

During its monetary policy meetings in 11 August and 22 September, the BSP decided to maintain its key policy interest rate at 3.0 percent for the overnight reverse repurchase or RRP facility. The corresponding interest rates on the overnight lending and deposit facilities were also kept steady. The reserve requirement ratios were likewise left unchanged.

The BSP maintains monetary policy settings in the third quarter of the year

The BSP's decision to maintain key policy rates was based on its assessment that the inflation environment remains manageable. Latest forecasts continued to indicate that average inflation is likely to settle slightly below the 3.0 percent ± 1.0 percentage point target range in 2016 and rise toward the mid-point of the target range in 2017 and 2018. The BSP noted that inflation is still being driven mainly by supply-side factors. Nevertheless, inflation expectations remained broadly in line with the inflation target over the policy horizon.

Chart 37. BSP Policy Rates
in percent



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

The BSP likewise recognized that while global economic conditions have remained subdued since the previous meeting, trends in domestic economic activity showed sustained firmness, supported by solid private household consumption and investment, buoyant business and consumer sentiment, and adequate credit and domestic liquidity. Given the fiscal space, higher public spending was also expected to further boost domestic demand.

At the same time, during the recent monetary policy meeting, the overall balance of risks surrounding the inflation outlook appeared tilted to the upside, with pending petitions for adjustments in electricity rates along with the proposed adjustment in the excise tax rates of petroleum products and the potential second-round effect on transport fares. On the other hand, slower global economic activity stood as the main downside risk.

With these considerations, the Monetary Board believed that current monetary policy settings remained appropriate. At the same time, increased uncertainty over prospects for growth and monetary policy action in major advanced economies warranted prudence in policy settings. Going forward, the BSP will continue to monitor emerging price and output conditions to ensure price and financial stability conducive to sustained economic growth.

VI. Inflation Outlook

BSP Inflation Forecasts[72]

Inflation is expected to remain benign over the policy horizon. The latest BSP baseline forecasts show that inflation could settle below the low-end of the government's target range of 3.0 percent ± 1.0 percentage point for 2016 and approach the midpoint of the target range in 2017 and 2018. The risks to future inflation appear to be tilted on the upside. Slower global economic activity poses the main downside risk. Pending petitions for adjustments in electricity rates along with the proposed adjustment in the excise tax rates of petroleum products and the corresponding second-round effect on transport fares are the main upside risks to inflation.

Inflation is expected to settle below the target range in 2016 and approach the midpoint of the target range in 2017 and 2018

Demand Conditions. Key demand indicators support the view of sustained momentum in domestic real sector activity. GDP growth rose to 7.0 percent in Q2 2016 from the revised 6.8 percent growth in the previous quarter. The acceleration in economic activity was driven mainly by robust investment, increased private consumption and sustained government spending, offsetting soft external demand.

Prospects for the domestic economy continue to remain favorable. GDP expansion in the second half of 2016 could remain robust due to stronger growth in manufacturing and public sector construction as well as the potential recovery of the agriculture sector with the end of the *El Niño* weather phenomenon. Personal consumption expenditures is likewise expected to remain firm, aided mainly by sustained remittance inflows and low inflation. Private capital formation should also contribute to economic growth with construction and investments in durable equipment expected to remain solid, particularly as more Public-Private Partnership (PPP) projects get underway.

High-frequency real sector indicators likewise point to favorable growth prospects in the near term. Production indices for the manufacturing sector suggest continued expansion with more than half of all major manufacturing sectors operating above 80 percent of their capacity. The composite PMI also remains firmly above the 50-point mark at 55.8 in July 2016. There have also been improvements in labor market conditions with lower unemployment rate compared to a year ago, based on the results of the July 2016 Labor Force Survey (LFS).

The optimistic economic outlook has also been reflected in the results of the BSP expectations surveys which indicate upbeat sentiment of households and firms for Q4 2016. This is broadly in line with the expectation of brisker operations and anticipated pick-up in the economic activity during the holiday season.

Supply Conditions. Commodity prices are likely to remain subdued, reflecting ample supply conditions. Food inflation is expected to remain benign over the near term given prospects of favorable domestic supply along with timely arrival of rice imports. The onset of neutral to weak *La Niña* weather phenomenon could result in a recovery in agricultural production from the drought or dry spell conditions caused by *El Niño*. However, the risk of more frequent and stronger tropical cyclones as well as sustained flooding could present upside pressures on inflation.

Favorable supply prospects are expected to keep price pressures at bay

Global agricultural prices are expected to decline in 2016 and could remain at moderate levels over the medium term. Forecasts by the IMF and the

[72] The inflation forecast path in this report refers to the forecasts presented during the 22 September 2016 monetary policy meeting. In the discussion, these forecasts are compared to the forecasts presented in the Q2 2016 Inflation Report (or the forecasts during the 23 June 2016 monetary policy meeting).

World Bank suggest lower benchmark prices of key grains (wheat, maize, and rice) in 2016.[73,74]

On the domestic front, *palay* and corn production could rise by 16.2 percent and 12.0 percent, respectively, in the third quarter of 2016 based on standing crops after contracting by 8.1 percent and 16.4 percent, respectively, in the first half of 2016. The expected rebound in *palay* and corn production could be attributed to sufficient rainfall conditions and the movement of planting from the previous quarter due to the end of the *El Niño* weather phenomenon. In addition, *palay* and corn production in the fourth quarter of 2016 could further expand by 3.4 percent and 4.8 percent, respectively, based on farmers' planting intentions.[75]

Sufficient supply conditions, both in the global and domestic fronts, should keep food price pressures at bay.

International oil prices are broadly unchanged compared to the previous quarter's level. As suggested by futures prices of oil and forecasts by multilateral agencies, modest gains in international oil prices are projected over the medium term.

Forecast by the EIA suggests that Brent crude oil price could average at US$42.54 per barrel in 2016. Meanwhile, IMF and World Bank expect crude oil prices to average at US$42.96 per barrel and US$43.00 per barrel in 2016, respectively. However, the volatility in the global oil price outlook remains elevated. The uncertainties surrounding the oil market could emanate from the re-entry of Iran in the global oil market, the weakness in oil consumption growth, and the responsiveness of non-OPEC production to low prices. Meanwhile, a collaborative production freeze or cut among major OPEC and non-OPEC countries and the accelerating pace in reductions of US rig counts could support a recovery in global crude oil prices.[76,77]

[73] IMF, Commodity Price Outlook and Risks, August 2016, available online at http://www.imf.org
[74] World Bank, Commodity Markets Outlook, July 2016, available online at http://www.worldbank.org
[75] PSA, Rice and Corn Situation Outlook Report, July 2016, available online at http://www.agstat.psa.gov.ph
[76] IMF, Commodity Price Outlook and Risks, August 2016, available online at http://www.imf.org
[77] EIA, Short-Term Energy Outlook,September 2016, available online at http://www.eia.gov

Output gap remains positive

The balance of demand and supply conditions as captured by the output gap (or the difference between actual and potential output), provides an indication of potential inflationary pressures in the near term. [78]

Given the latest GDP data, preliminary estimates by the BSP show a slightly higher positive output gap in Q2 2016 relative to the previous quarter. The output gap widened as the quarter-on-quarter q-o-q expansion in actual output growth outpaced the estimated potential output during the review period.[79]

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

1) BSP's overnight RRP rate at 3.00 percent from October 2016 to December 2018;

2) BSP's reserve requirement ratio at 20.0 percent from October2016 to December 2018;

3) NG fiscal deficits for 2016 to 2018, which are consistent with the DBCC-approved estimates;

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

5) Increase in nominal wage in June 2017 and June 2018 consistent with labor productivity growth and historical wage increases;

6) Real GDP growth is endogenously determined; and

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

[78] Inflation tends to rise (fall) when demand for goods and services exert pressure on the economy's ability to produce goods and services, i.e., when the output gap is positive (negative).
[79] Based on the seasonally-adjusted GDP growth

Risks to the Inflation Outlook

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

Projected inflation path for 2016 to 2018 is slightly lower

Compared to the previous inflation report, the latest fan chart presents a slight downward shift in the inflation projections for 2016 to 2018. The reduction in the projected inflation path could be attributed mainly to the slower world economic growth, lower oil prices, stronger domestic currency as well as lower-than-expected inflation outturns in the third quarter of 2016.

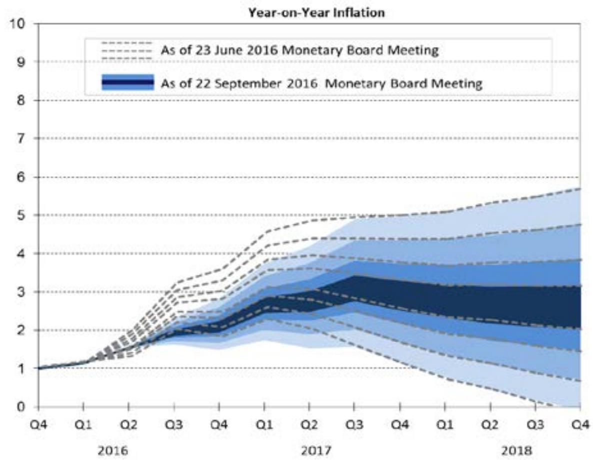
The BSP's review of current inflation dynamics suggests that the risks surrounding the inflation outlook appear to be tilted on the upside. This assessment is depicted in the latest fan chart wherein the projection bands above the central projection are greater than the bands below it. Pending petitions for adjustments in electricity rates along with the proposed adjustment in the excise tax rates of petroleum products and its potential second-round effect on transport fares represent the main upside risks, while the weakening of global economic activity provides downside risk.

The pending petition of Meralco on the December 2013 rate adjustment, which is still under the temporary restraining order of the Supreme Court, continues to represent an upside risk to the inflation outlook. In addition, potential increase in the excise tax rates of petroleum products and the corresponding second-round effect on transportation fares pose an upside risk to inflation. The Department of Finance (DOF) is proposing an increase in the excise tax rate of petroleum products such as gasoline, diesel, kerosene, and LPG. Moreover, the excise tax rates are planned to be indexed to inflation every year. Consequently, an increase in petroleum prices could have second-round effects on transportation fares. In addition to higher excise taxes on fuel, the DOF is also proposing other legislative tax measures such as the gradual reduction in corporate and personal income tax rates, broadening of the tax base for VAT, and higher excise taxes on sweetened beverage. These other measures could also have implications on the inflation outlook.

The risks to inflation outlook appear to be tilted on the upside

Meanwhile, the possibility of a further slowdown in global economic growth could imply weaker demand-related price pressures. The extended financial turbulence and higher risk aversion from the intensification of bank distress in some European economies; the potential disruptive rebalancing in China due to a reliance on credit growth; sizeable fiscal adjustments for commodity-exporting countries; financial stability issues in emerging market economies; geopolitical risks; climate-related factors, and the spread of diseases such as the Zika virus are potential sources of downside risks to global growth prospects.[80]

Chart 38. Inflation Projection



Source: BSP estimates

The fan chart shows the probability of various outcomes for inflation over the forecast horizon. The darkest band depicts the central projection, which corresponds to the BSP's baseline inflation forecast. It covers 25 percent of the probability

[80] IMF, World Economic Outlook, July 2016, available online at http://www.imf.org

distribution. Each successive pair of bands is drawn to cover a further 25 percent of probability, until 75 percent of the probability distribution is covered. Lastly, the lightest band covers the lower and upper 90 percent of the probability distribution. The bands widen (i.e., “fan out”) as the time frame is extended, indicating increasing uncertainty about outcomes. The band in wire mesh depicts the inflation profile in the previous report.

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

VII. Implications for the Monetary Policy Stance

The prevailing monetary policy settings remain appropriate. Based on the assessment as of the 22 September 2016 monetary policy meeting, inflation is still expected to average at the lower edge of the 3.0 percent ± 1.0 percentage point target range for 2016 and approach the mid-point of the target range in 2017-2018. Notwithstanding the slightly below-target inflation forecast for 2016, monetary easing does not appear to be warranted at this juncture as supply-side factors, which are largely outside the influence of monetary policy, continue to underpin domestic price movements and benign inflation readings.

Domestic demand continues to be firm

Inflation expectations—based on forecast surveys of private sector economists by the BSP and by Consensus Economics—also continue to be within target over 2017-2018 while settling slightly below the lower bound of the target range for 2016.

The risks to future inflation appear to be on the upside. Slower global economic activity poses the main downside risk to the inflation outlook, while pending petitions for adjustments in electricity rates along with the proposed adjustment in the excise tax rates of petroleum products (and possible knock-on effects on transport fares) constitute the main upside risks to inflation.

Demand conditions remain firm, with sustained GDP growth momentum, supported by strong business and consumer confidence and other growth drivers, particularly capital formation. GDP expanded by 7 percent year-on-year in Q2 2016, faster than the revised 6.8-percent growth in the previous quarter and the 5.9-percent growth in Q2 2015. Growth in the second quarter was driven by increasing capital formation, particularly in durable equipment and construction, and higher growth in consumer spending. Growth was also supported by election-related spending and the government's accelerated expenditure. On the production side, the robust growth of the services sector mainly contributed to growth. Overall domestic demand contributed 12.1 ppts to total output growth. This was partly tempered by weak external demand, with net exports pulling down aggregate growth by 6.6 ppts in Q2 2016.

Over the next few quarters, prospects for aggregate demand are expected to remain solid. Consumer sentiment for Q3 2016, improved significantly, with the confidence index turning positive — a first since the CES started in 2007. While seasonal factors weighed down on business sentiment in the third quarter, the current quarter index is the highest Q3 reading of all time. Business outlook also turned more upbeat for the quarter ahead (Q4 2016). The composite PMI for the Philippines remained firmly above the 50-point expansion threshold at 55.8 in July 2016 while average capacity utilization rate of the manufacturing sector was steady at 83.5 percent.

Overall monetary conditions also remain sufficiently favorable. The continued expansion of M3 in July 2016 by 13.1 percent, along with low interest rates and sustained bank lending growth at 17.7 percent, indicate that overall monetary conditions remain appropriate with respect to supporting economic activity.

At the same time, it remains prudent for the BSP to maintain present monetary policy settings in response to the continued uncertainty in the external environment. Global economic activity has also remained subdued. A number of central banks ease their monetary policy settings during the quarter to support domestic growth.

In sum, prevailing conditions for inflation as well as output continue to support maintaining present monetary policy settings. Notwithstanding below-target inflation forecast for 2016, inflation dynamics remain manageable given well-contained inflation expectations over the policy horizon. Most inflation pressures at present are mainly driven by supply-side causes. Latest baseline inflation forecasts extending to 2018 show that annual average inflation is likely to settle within the target range. Firm demand-side conditions suggest that deflationary risks are minimal. Moreover, further monetary stimulus does not appear warranted given the continued ample liquidity in the system, sustained credit expansion and ramped-up fiscal spending. Keeping a steady hand on policy levers also remains prudent for the BSP given the challenging global economic environment and uncertainty over growth prospects and monetary policy action in major advanced economies.

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent)		Monetary Policy Decisions
	RRP Overnight	RP Overnight	
2 0 0 8			
31 Jan 2008	5.00	7.00	The Monetary Board (MB) decided to reduce by 25 basis points (bps) the BSP's key policy interest rates to 5 percent for the overnight borrowing or reverse repurchase (RRP) facility and 7 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and special deposit accounts (SDAs) were also reduced accordingly. In its assessment of macroeconomic conditions, the MB noted that the latest inflation forecasts indicated that inflation would fall within the 4.0 percent ± 1 percentage point target range in 2008 and the 3.5 ± 1 percentage point target range in 2009.
13 Mar 2008	5.00	7.00	The MB decided to keep the BSP's key policy interest rates at 5 percent for the overnight borrowing or RRP facility and 7 percent for the overnight lending or RP facility. The MB also decided to implement immediately the following refinements in the SDA facility: (1) the closure of existing windows for the two-, three-, and six-month tenors; and (2) the reduction of the interest rates on the remaining tenors. The interest rates on term RRPs and RPs were also left unchanged.
24 Apr 2008	5.00	7.00	The MB kept the BSP's key policy interest rates at 5.0 percent for the overnight borrowing or RRP facility and 7.0 percent for the overnight lending or RP facility. The interest rates on term RRPs and RPs were also left unchanged.
5 Jun 2008	5.25	7.25	The MB decided to increase by 25 bps the BSP's key policy interest rates to 5.25 percent for the RRP facility and 7.25 percent for RP facility as emerging baseline forecasts indicate a likely breach of the inflation target for 2008 along with indications that supply-driven pressures are beginning to feed into demand. Given the early evidence of second-round effects, the MB recognized the need to act promptly to rein in inflationary expectations. The interest rates on term RRPs, RPs, and SDAs were also increased accordingly.
17 Jul 2008	5.75	7.75	The MB increased by 50 bps the BSP's key policy interest rates to 5.75 percent for the overnight borrowing or RRP facility and 7.75 percent for the overnight lending or RP facility. The interest rates on term RRPs, RPs, and SDAs were also increased accordingly.
28 Aug 2008	6.00	8.00	The MB increased by 25 bps the BSP's key policy interest rates to 6.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 8.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and SDAs were also increased accordingly.

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

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

Summary of Monetary Policy Decisions

Effectivity Date	Levels (in percent) RRP Overnight	Levels (in percent) RP Overnight	Monetary Policy Decisions
2 0 1 5			
12 Feb 2015 **26 Mar 2015** **14 May 2015** **25 Jun 2015** **13 Aug 2015** **24 Sep 2015** **12 Nov 2015** **17 Dec 2015**	4.00	6.00	The MB decided to maintain the BSP's key policy interest rates at 4.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and special deposit accounts were also kept steady. The reserve requirement ratios were left unchanged as well.
2 0 1 6			
11 Feb 2016 **23 Mar 2016** **12 May 2016**	4.00	6.00	The MB decided to maintain the BSP's key policy interest rates at 4.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs, and special deposit accounts were also kept steady. The reserve requirement ratios were left unchanged as well.
23 Jun 2016 **11 Aug 2016** **22 Sep 2016**	3.00	3.50	The BSP formally adopted an interest rate corridor (IRC) system as a framework for conducting its monetary operations. The shift to IRC is an operational adjustment and not a change in the monetary policy stance. The IRC is a system for guiding short-term market rates towards the BSP policy interest rate which is the overnight reverse repurchase (RRP) rate. The IRC system consists of the following instruments: standing liquidity facilities, namely, the overnight lending facility (OLF) and the overnight deposit facility (ODF); the overnight RRP facility; and a term deposit auction facility (TDF). The interest rates for the standing liquidity facilities form the upper and lower bound of the corridor while the overnight RRP rate is set at the middle of the corridor. The repurchase (RP) and Special Deposit Account (SDA) windows will be replaced by standing overnight lending and overnight deposit facilities, respectively. Meanwhile, the reverse repurchase (RRP) facility will be modified to a purely overnight RRP. In addition, the term deposit facility (TDF) will serve as the main tool for absorbing liquidity. The interest rates for these facilities will be set as follows starting 3 June 2016: • 3.5 percent in the overnight lending facility (a reduction of the interest rate for the upper bound of the corridor from the current overnight RP rate of 6.0 percent); • 3.0 percent in the overnight RRP rate (an adjustment from the current 4.0 percent); and • 2.5 percent in the overnight deposit facility (no change from the current SDA rate).

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

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

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