

The Philippine Economy

From Building to Sustaining Resilience

1st Monthly General Membership Meeting
Bank Marketing Association of the Philippines
13 February 2018, Tower Club, Makati

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Bangko Sentral ng Pilipinas



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Megatrends transforming the operating environment



Rebalancing of the world economy



Changes in demographics



Rapid urbanization



Climate change



Disruptive technologies



Threats of retreat from multilateralism



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PH remains in a position of strength

	Key Indicators	2005 – 2009	2010 – 2015	2016	2017	2018
Strong growth momentum	Real GDP growth (%)	4.4	6.2	6.9	6.7	n.a.
Benign inflation	Headline inflation (%)	5.5	3.4	1.8	3.2	4.0 (Jan)
Sustained fiscal discipline	Fiscal balance (% of GDP)	-1.7	-1.8	-2.4	-1.9 (Jan-Sep)	n.a.
Ample liquidity and credit	Domestic Liquidity (% of GDP)	47.2	55.6	65.6	67.4	n.a.
	(% y-o-y change)	15.1	13.2	12.8	11.9	
Sound and stable banking system	Outstanding loans -U/KBs (% y-o-y change)	8.9	15.7	17.3	19.0	n.a.
	Non-performing loans (% of total loans) - U/KBs*	5.0	2.2	1.4	1.4 (end-Nov)	n.a.
	Capital Adequacy Ratio (consolidated basis) - U/KBs**	16.7	17.2	15.1	15.7 (end-Sep)	n.a.
Robust external payments position	Current Account Balance (US\$ Bn)	5.1	8.2	-1.0	0.03 (Jan-Sep)	n.a.
	(% of GDP)	3.6	3.2	-0.3	0.01 (Jan-Sep)	
	Gross International Reserves (in months of imports of goods and services and primary income)	6.4	10.8	8.8	8.3	8.2 (end-Jan)
	External debt (% of GDP)	46.1	30.9	24.5	23.4 (end-Sep)	n.a.
	External debt service ratio (% of exports of goods, receipts of services & income)	12.3	7.9	7.0	6.1 (Jan-Oct)	n.a.

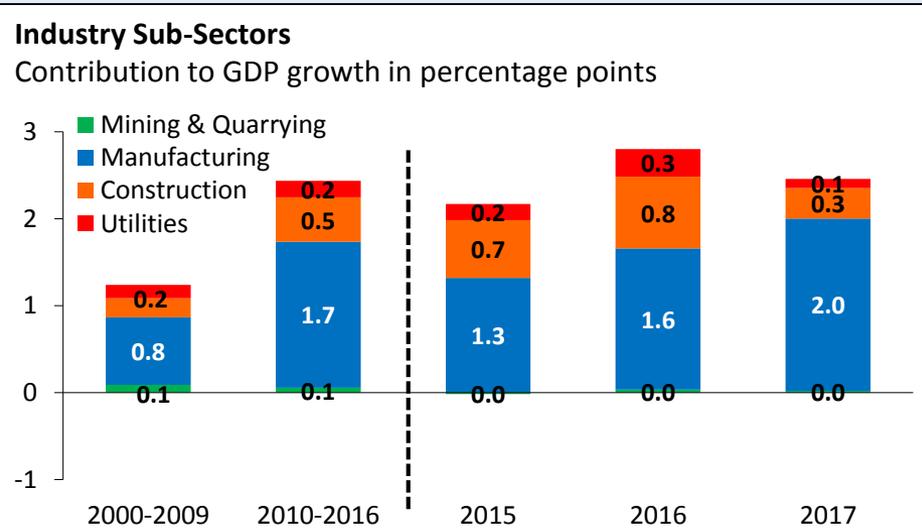
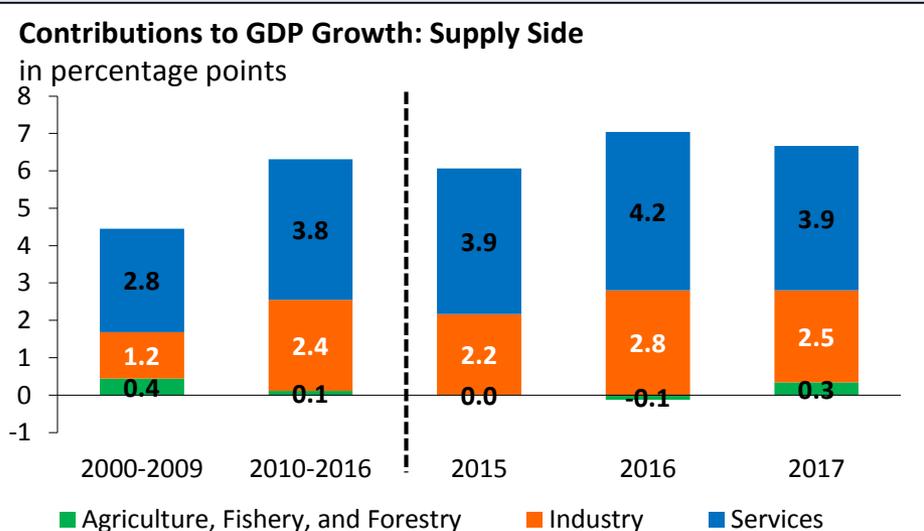
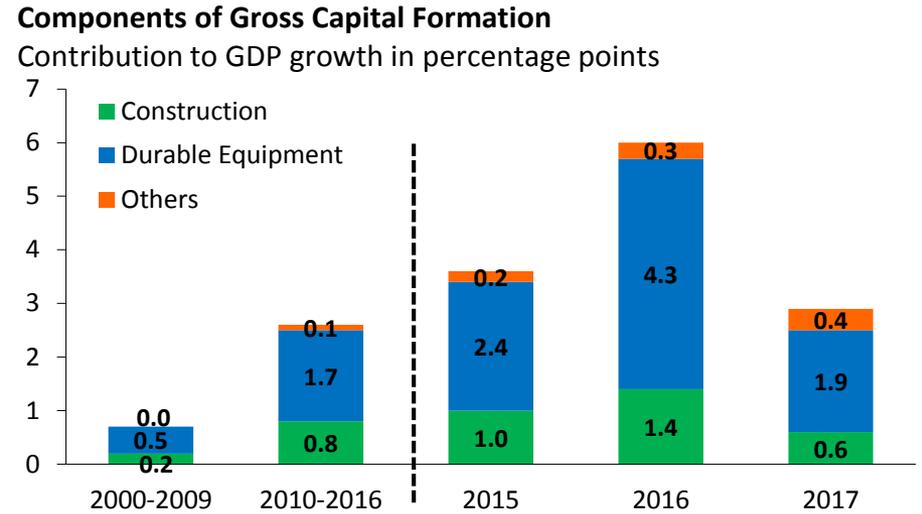
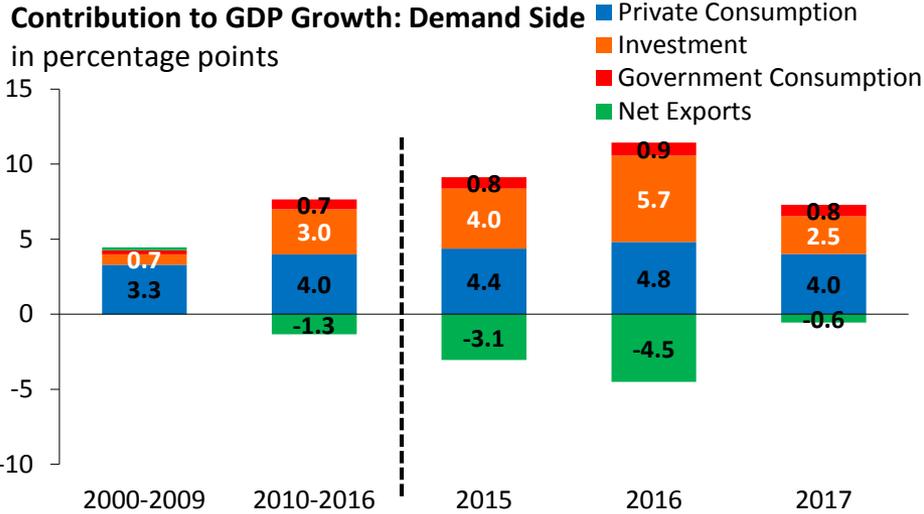
* Data starting 2012 are computed as prescribed under BSP Circular No. 772. Gross NPL represents the actual level of NPL without any adjustment for loans treated as "loss" and fully provisioned. U/KBs stand for universal and commercial banks.

**Computation based on the combined reports of parent bank (head office and branches) and its subsidiaries engaged in financial undertakings but excluding insurance; also excludes trust department; 2007-2013 figures are calculated under the Basel II regime while 2014-2016 figures are under Basel III framework.

n.a. - not available

Growing contributions of investments and manufacturing reflect ongoing transformation of the economy

Positive economic growth for 76 consecutive quarters

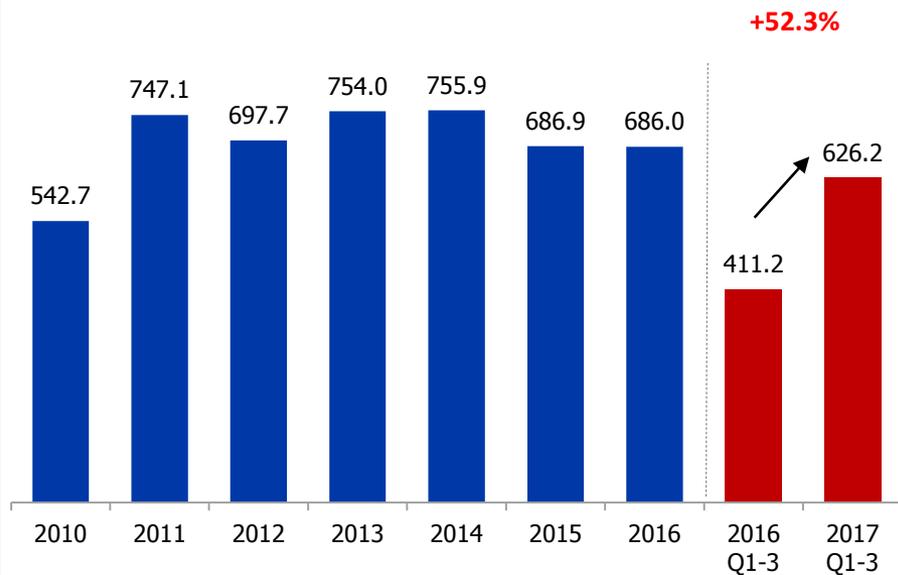


Rising investments boost growth and create jobs

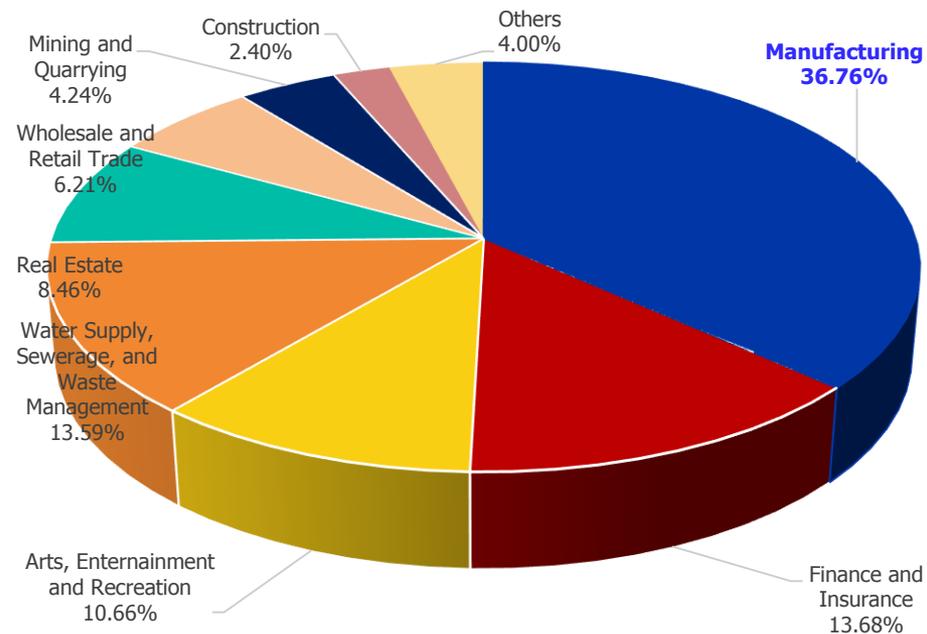
Rising investment pledges favorable for growth prospects

Considerable foreign interest in the manufacturing sector

Total Approved Investments* (PHP bn)

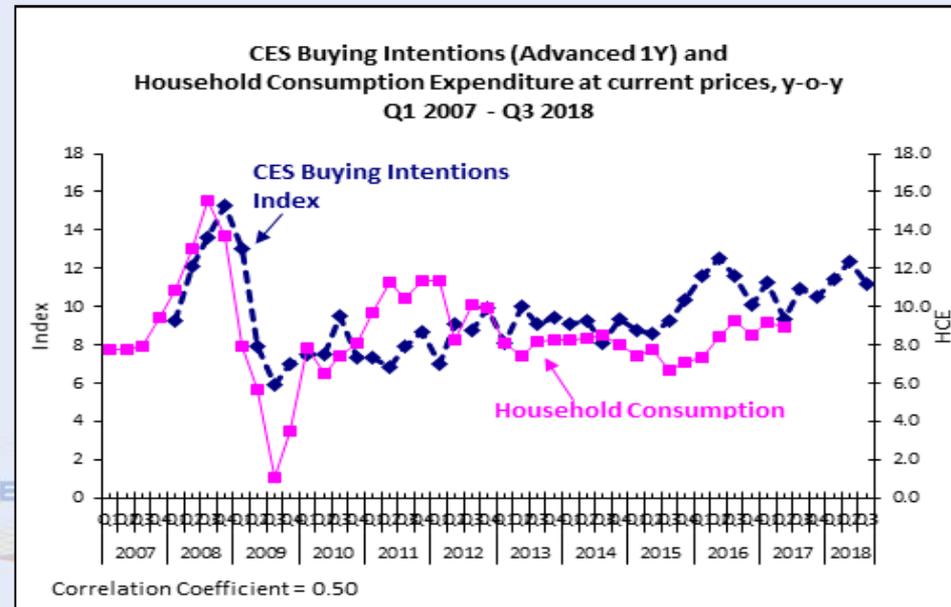
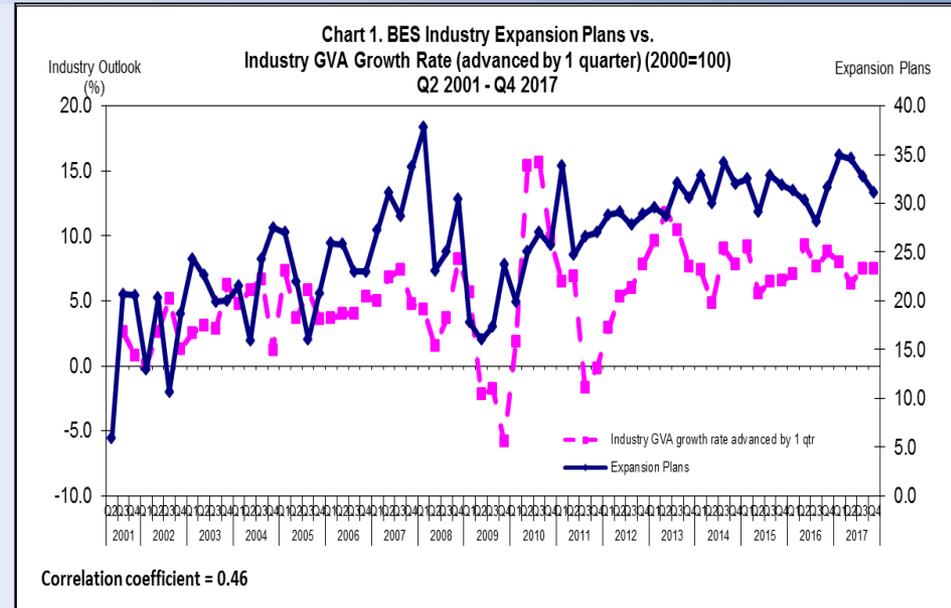
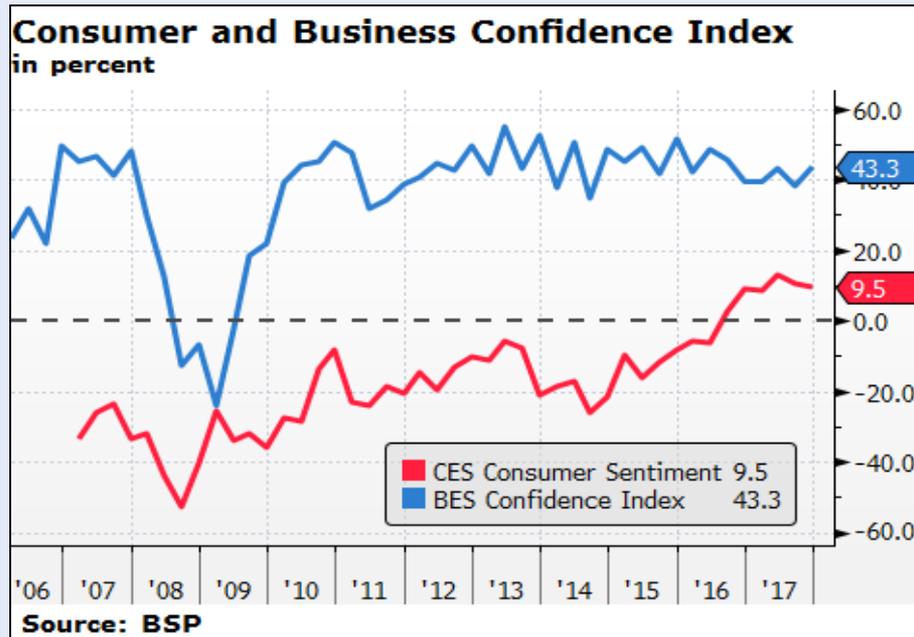


Net FDI Average Percent Share to Net Equity by Industry, 2012-2016



Source: PSA, NEDA, BSP, * Investment approved by the Philippines' Investment Promotion Agencies – Board of Investments (BOI), Clark Development Corporation (CDC), Philippine Economic Zone Authority (PEZA), Subic Bay Metropolitan Authority (SBMA), Authority of the Freeport Area of Bataan (AFAB), BOI-Autonomous Region of Muslim Mindanao (BOI-ARMM), and Cagayan Economic Zone Authority (CEZA)

Q4 2017 business outlook more upbeat due to expected seasonal demand; consumers remain optimistic

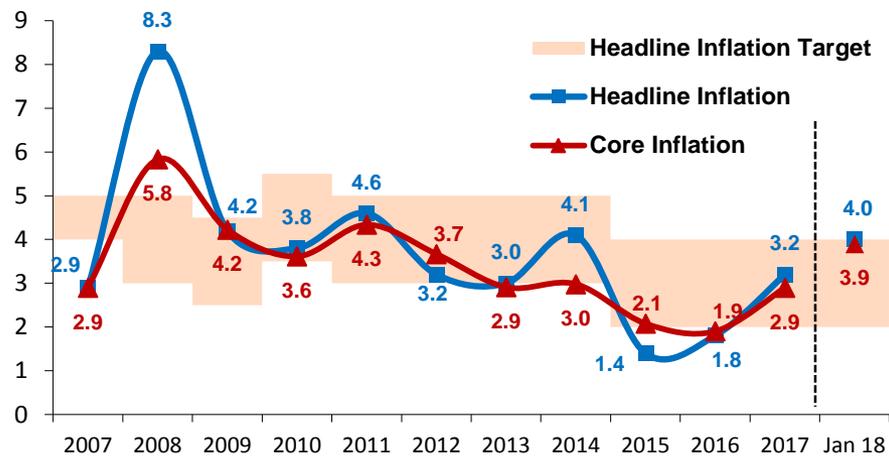


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Positive alignment between growth and inflation lingers

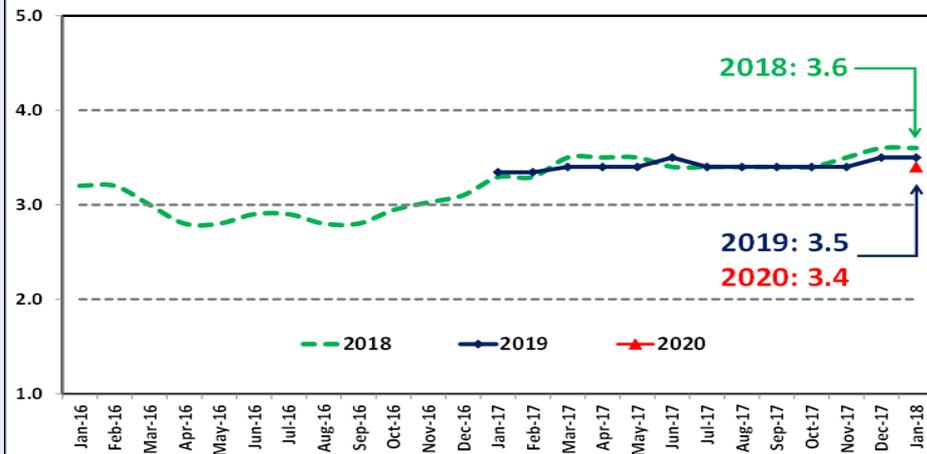
Low and stable inflation outturn

Headline and Core inflation (%), 2006=100

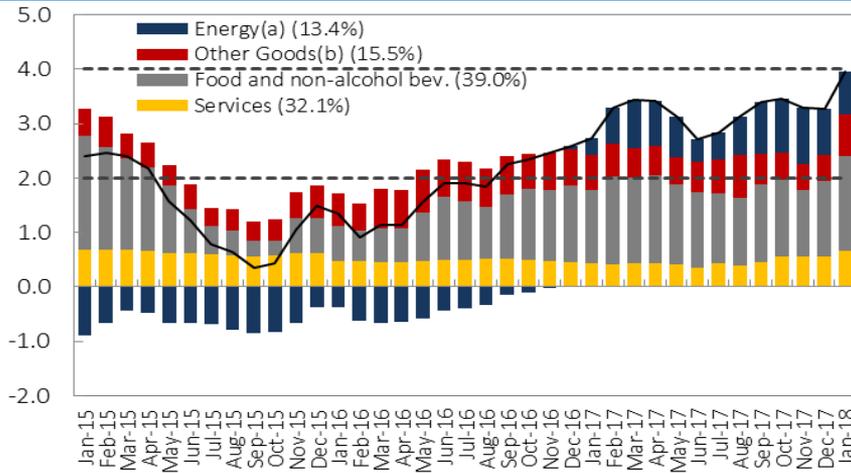


Well-anchored inflation expectations

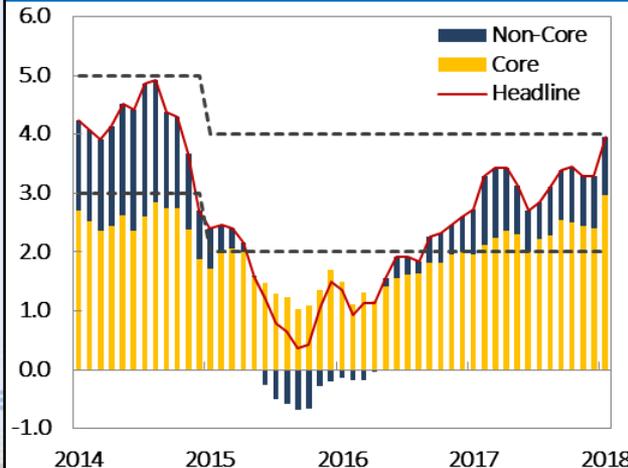
BSP Private Sector Economists' Survey
Mean forecast for full year, in percent



Factors Driving Headline Inflation



Contribution of Core and Non-Core Items to Inflation



Note:

Non-core items refer to: rice, corn, meat (fresh, chilled or frozen), fresh fruits, vegetables cultivated for their fruit, fresh or dried vegetables cultivated for their roots, fresh or dried, natural gas, liquefied or in the gaseous state, and gas oils for motor vehicles

Some supply-side pressures pose risks to inflation path

KEY FACTORS SHAPING INFLATION

Weather developments and rice tariffication

- Prevailing weak La Niña conditions favorable to *palay* production
- But potential risks could emerge (e.g., Mt. Mayon eruption)
- Proposed reform in the rice industry involving the replacement of quantitative restrictions with tariffs could reduce rice prices

Global oil supply and demand

- Crude oil prices rise in January 2018 while futures prices still show downward path over the medium-term

Tax Reform for Acceleration and Inclusion (TRAIN)

- Price pressures could come from higher consumption taxes and increased demand (higher infrastructure spending and disposable income)
- Impact is transitory: 2018 inflation could be above the target but inflation is expected to average within target by 2019

Prevailing weak La Niña conditions favorable to palay production...

Forecast probabilities of ENSO events As of 11 January 2018			
Season	La Niña	Neutral	El Niño
DJF 2018	97%	3%	0%
JFM 2018	85%	15%	0%
FMA 2018	63%	36%	1%
MAM 2018	46%	50%	4%
AMJ 2018	34%	58%	8%
MJJ 2018	26%	58%	16%
JJA 2018	25%	53%	22%
JAS 2018	22%	52%	26%
ASO 2018	23%	49%	28%

Forecast probabilities of ENSO events As of 14 December 2017			
Season	La Niña	Neutral	El Niño
NDJ 2017	98%	2%	0%
DJF 2018	92%	8%	0%
JFM 2018	82%	17%	1%
FMA 2018	66%	32%	2%
MAM 2018	48%	48%	4%
AMJ 2018	35%	56%	9%
MJJ 2018	28%	55%	17%
JJA 2018	24%	54%	22%
JAS 2018	23%	51%	26%

Source: International Research Institute for Climate and Society and Climate Prediction Center



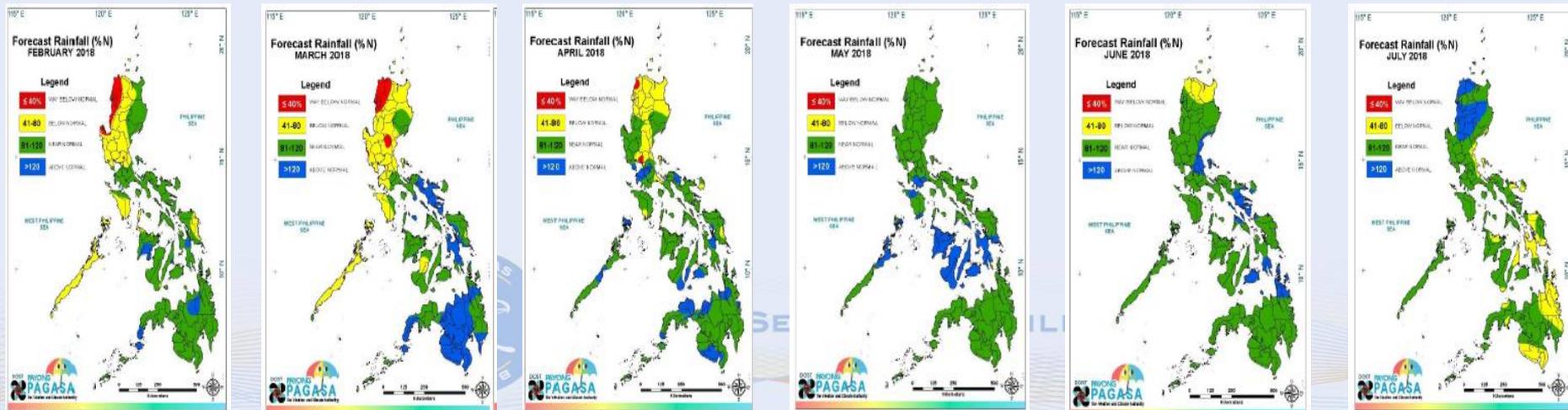
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PAGASA: 4 to 8 tropical cyclones (TCs) expected from February to July 2018

Rainfall Forecast as of **13 December 2017** (Feb. – June 2018)



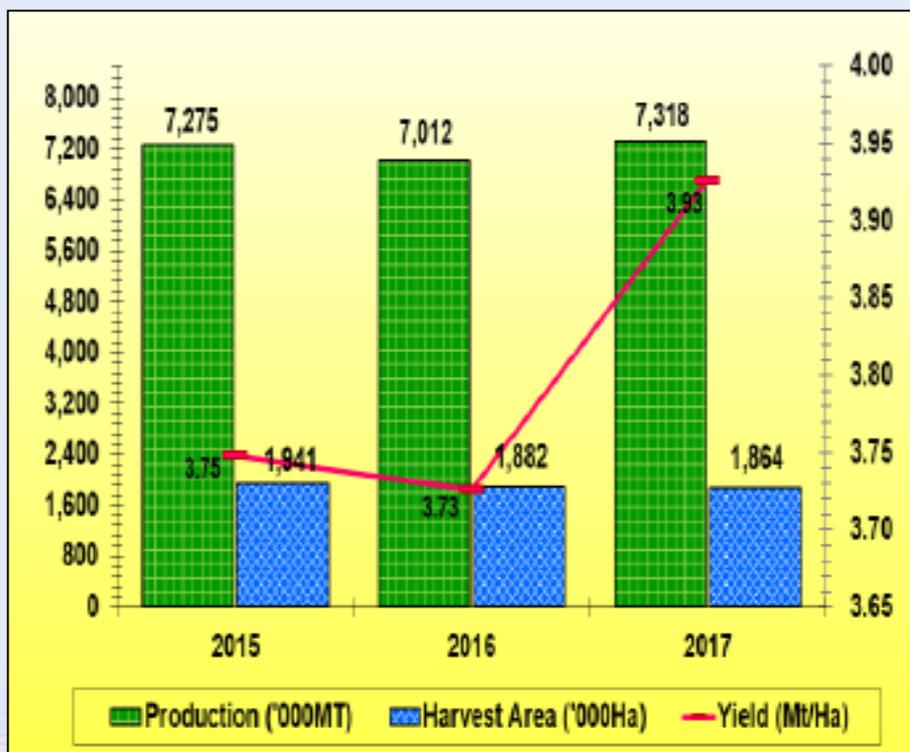
Rainfall Forecast as of **24 January 2018** (Feb. – July 2018)



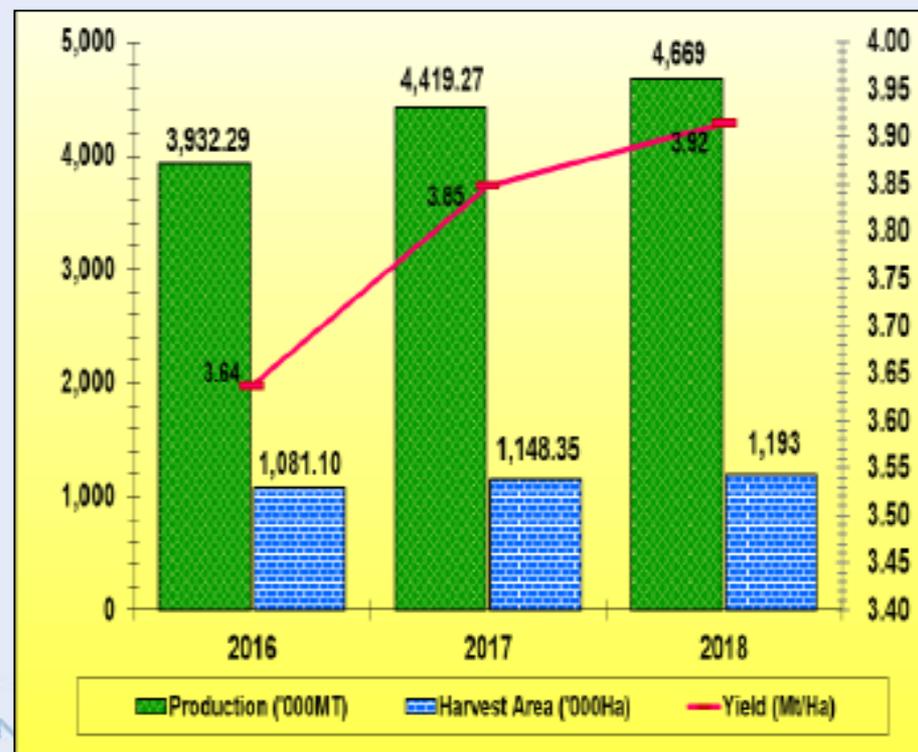
Crop production projected to increase in Q1 2018

Prospects are favorable for *palay* output given expectations of sufficient water supply and good weather conditions during the cropping period in Q1 2018.

Palay Crop Estimates
October – December 2015 - 2017



Palay Crop Estimates
January – March 2016 - 2018



Source: PSA Rice and Corn Situation Outlook Report (January 2018)

Tariffication will benefit both consumers and producers

- **Consumers, especially the poor, will benefit from lower prices:***
 - ✓ Weight of rice in CPI is 8.9%
 - ✓ Approximately 72% of all Philippine households and 34% of rice producing households are net consumers**
- **BSP estimates of impact on headline inflation**
 - ✓ Estimated price gap of about ₱4.00/kg using weighted average of import parity price (Vietnam, Thailand, India and Pakistan) and domestic wholesale price of RMR***
 - ✓ Downward impact on inflation could potentially offset most of the transitory impact of TRAIN

Source: *Briones, et. al (2017) projected that retail prices will decrease by about ₱6.97/kg after tariffication.

**OECD Review: Agricultural Policies in the Philippines, 2017

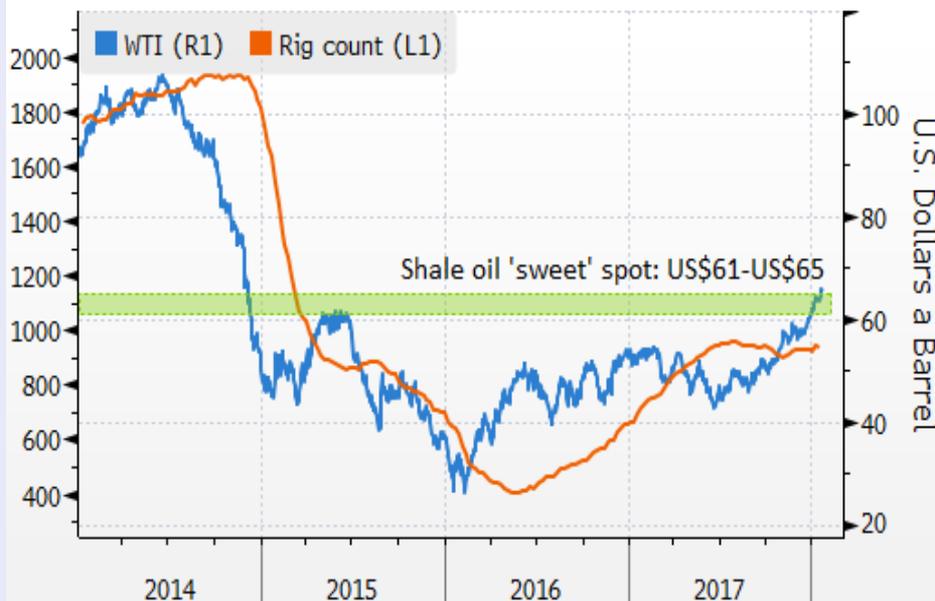
*** Based on methodology used in the 2016 DA-PhilRice-IRRI study, *"Competitiveness of Philippine Rice in Asia"*

Oil prices could drop in the medium term based on Brent crude futures prices

- ✓ Expectations of higher US shale oil production (based on US EIA and IEA reports)

Drill Zone

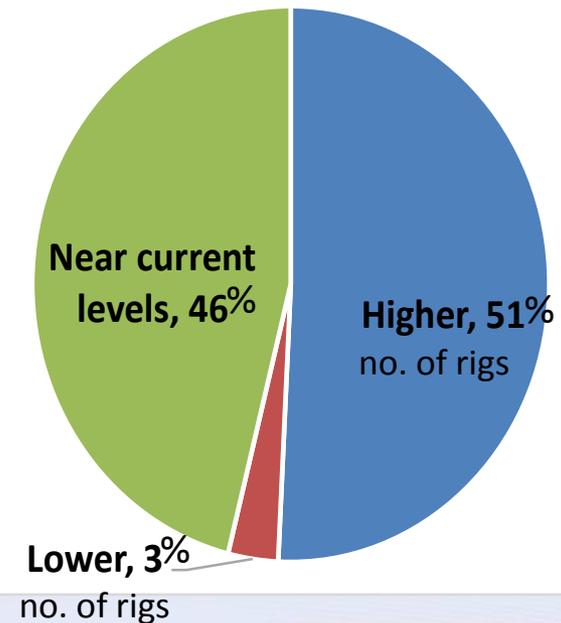
U.S. rig count may expand after prices jump to sweet spot



Source: Nymex; Baker Hughes

CL1 Comdty (Generic 1st 'CL' Future) WTI/Rigs Daily 06JAN2014-26JAN2018 Copyright© 2018 Bloomberg Finance L.P. 26-Jan-2018 15:11:04

Do you expect the number of U.S. rigs drilling for oil six months from now to be higher, lower or near current levels?



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Potential sources of second-round impact and mitigating social programs and other measures

Potential second-round effects	Mitigating Social Programs and Other Measures
<ul style="list-style-type: none">• Minimum wage adjustment• Transport fare hike• Inflation expectations	<ul style="list-style-type: none">• Unconditional cash transfers for the poorest households• Subsidy for jeepney drivers (<i>Pantawid-Pasada</i>) and PUV modernization• Subsidy for small power utilities group (<i>Pantawid-Kuryente</i>)• Reform in the rice industry• Close monitoring of prices

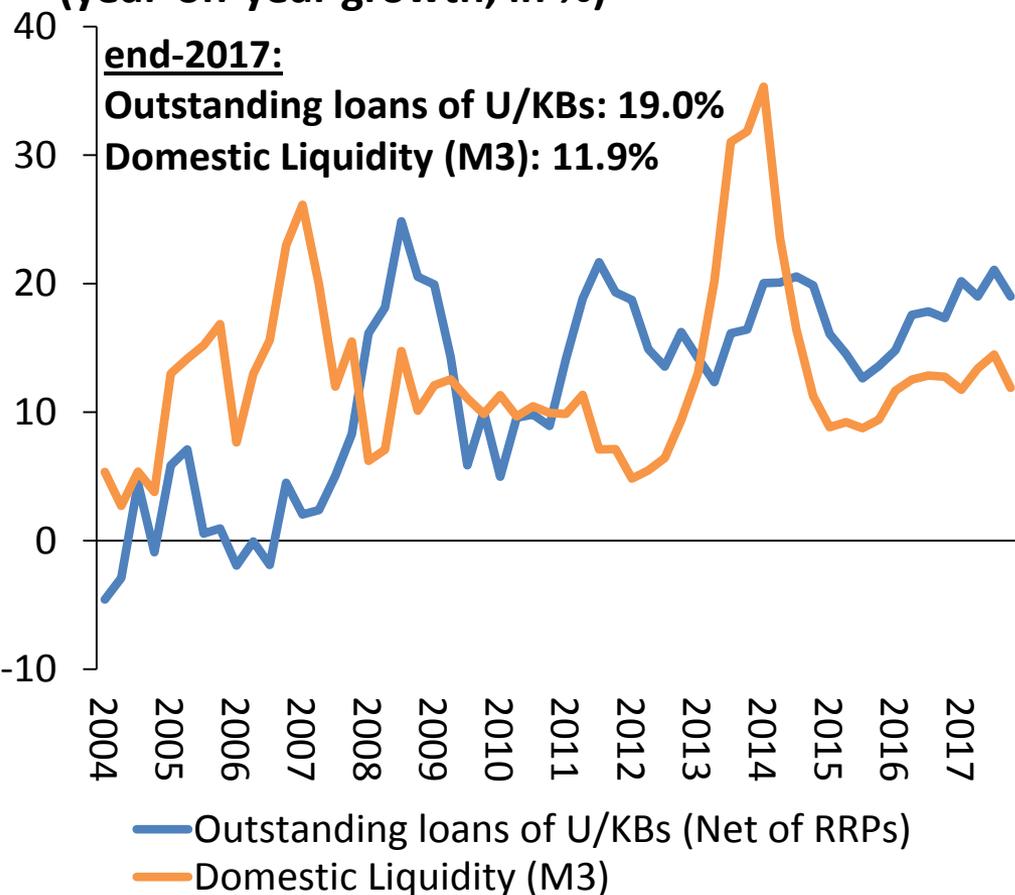


Credit growth consistent with expanding economic activity

*Supportive liquidity conditions
and upbeat bank lending*

*Solid demand for loans across key
economic sectors*

**M3 and Outstanding Loans of U/KBs
(year-on-year growth, in %)**



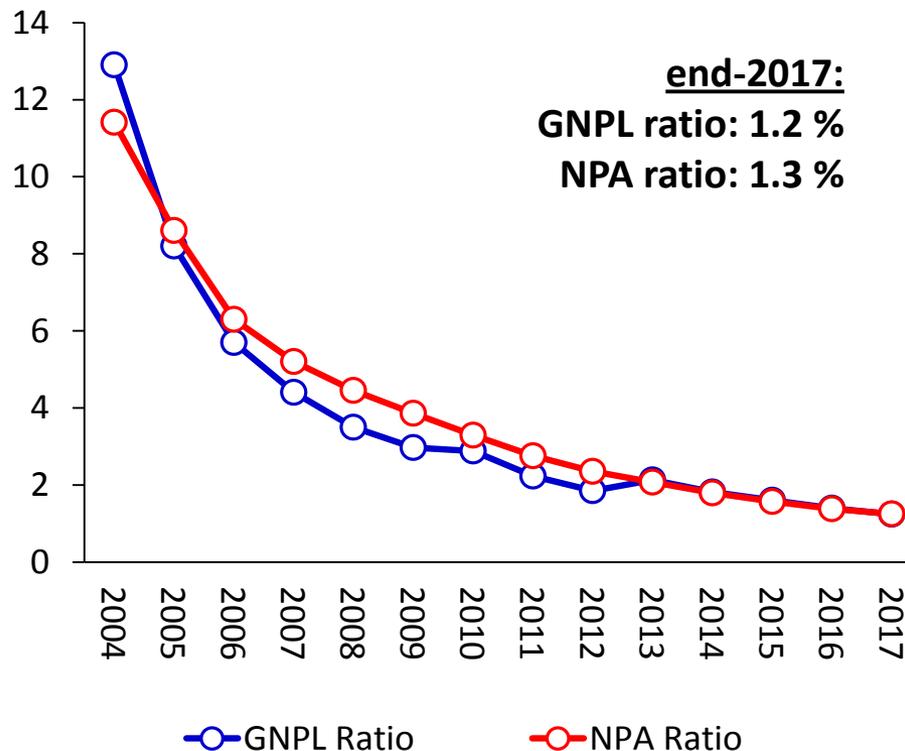
Sectors	Share to Total KB Loans (Net of RRP)	Contribution to KB Loan Growth (Net of RRP)
Wholesale and Retail Trade, Repair of Motor Vehicles and Motorcycles; Transportation and Storage; and Information and Communication	21.0	4.4
Real Estate Activities	17.5	3.4
Manufacturing	13.1	1.6
Electricity, Gas, Steam and Air conditioning Supply; and Water Supply, Sewerage and Waste Management	12.5	2.9
Financial and Insurance Activities	8.4	1.4
Households	7.8	1.4
Agriculture, Forestry and Fishing	2.3	-0.4
Other sectors	17.4	4.3
Growth of KB Loans (end-2017)	100.0	19.0

PH banks remain as effective intermediary of funds

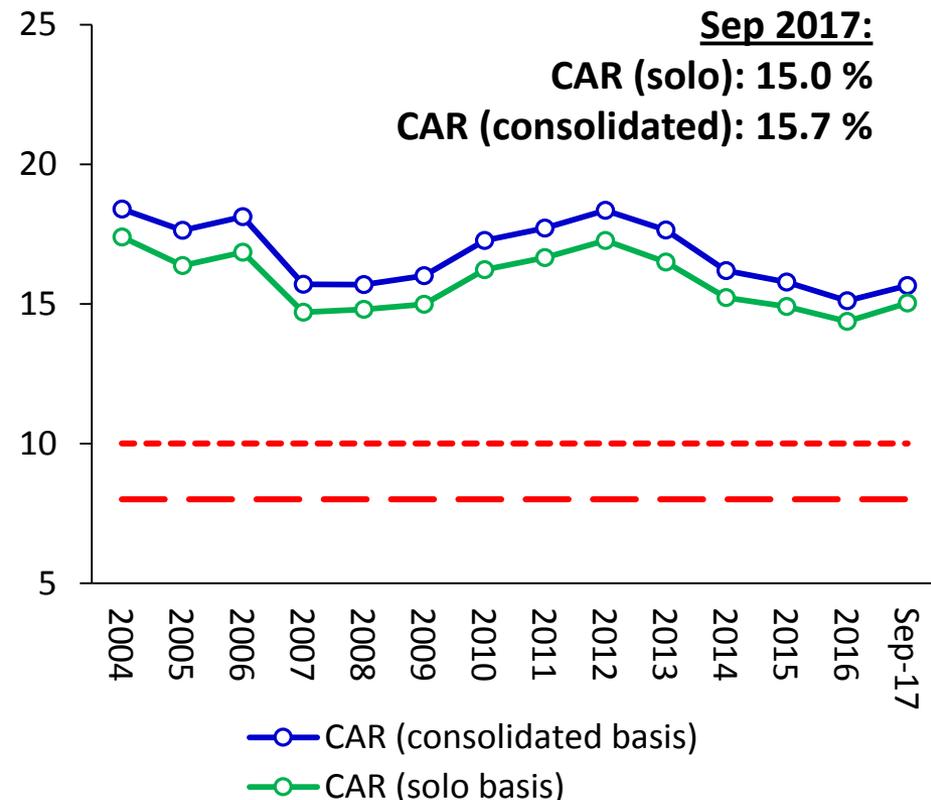
Quality of assets and loan portfolios sustains improvement.

Philippine banks remain **adequately capitalized** providing buffers to mitigate shocks.

Non-Performing Loans (Gross) and Non-Performing Assets Ratios of UKBs (in percent)



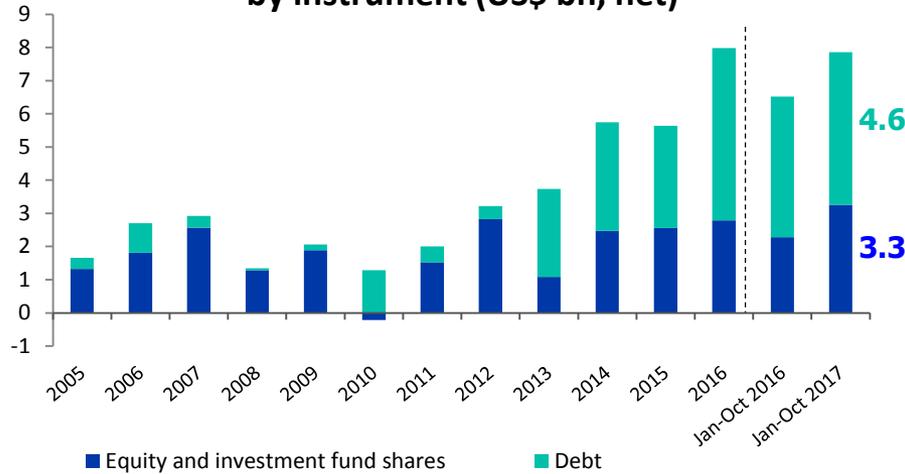
Capital Adequacy Ratio of UKBs (in percent)



PH has adequate buffer from global headwinds

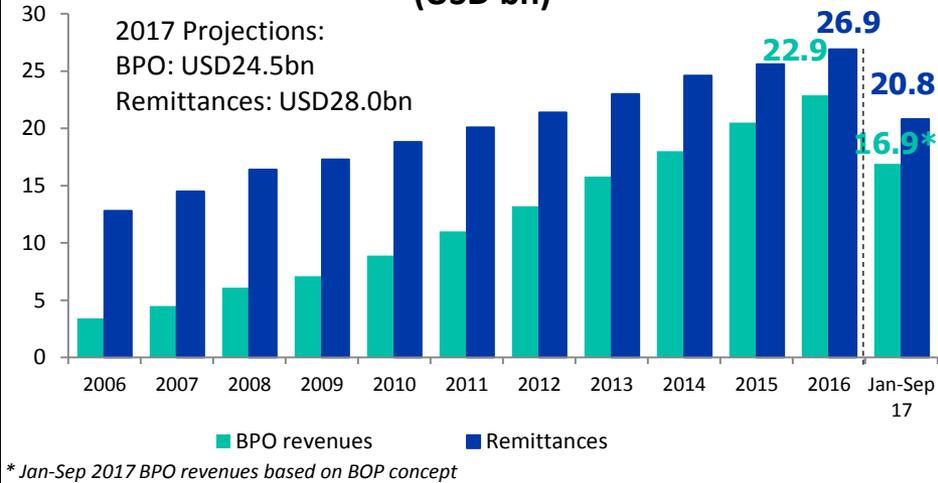
Resilient foreign direct investments

Non-Residents' direct investments, by instrument (US\$ bn, net)



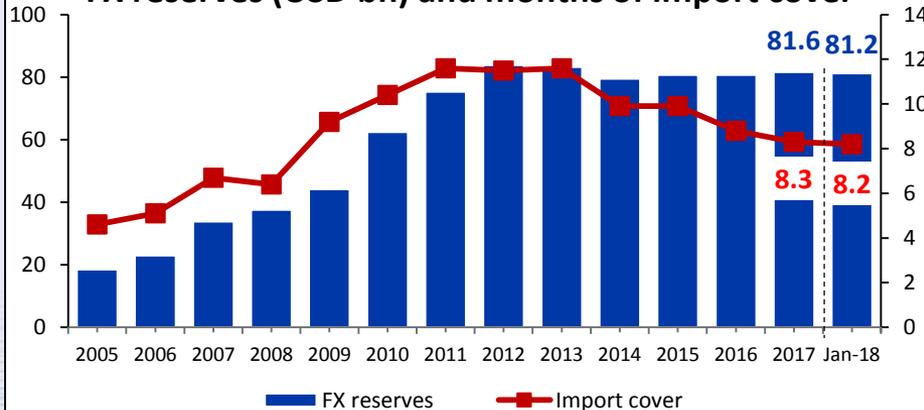
Structural flows from remittances and BPOs

Overseas Filipinos' cash remittances and BPO revenues (USD bn)



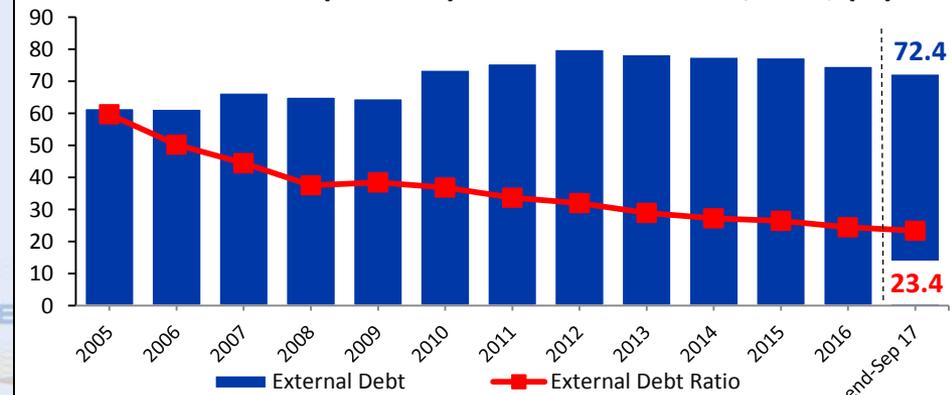
Ample cushion from external headwinds

FX reserves (USD bn) and months of import cover



Improved debt profile

External debt (USD bn) and external debt/GDP, (%)



Structural transformation of PH supported by decades of reforms

- **Long track record of purposeful structural reforms contributed to PH strength and flexibility in dealing with challenges brought by globalization**

Selected Structural/Policy Reforms in the Philippine Economy (1993-present)

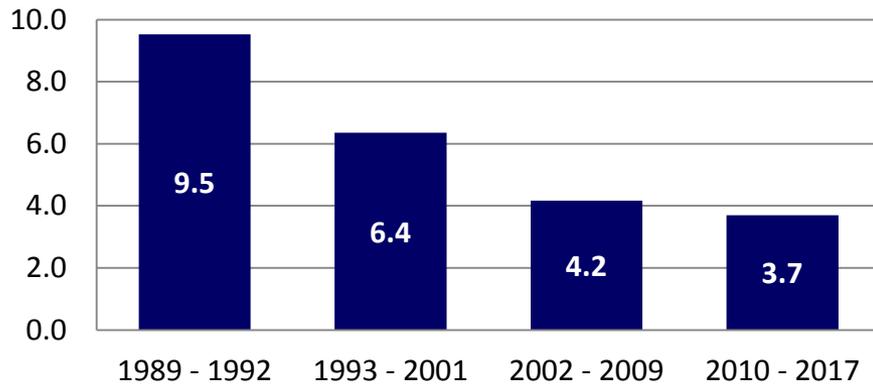
1993	Creation of the Bangko Sentral ng Pilipinas
1994 - 2001	Harmonization of the BSP's Business Expectations Survey (BES) with International Practices; Liberalization of foreign bank entry and the telecommunications industry; Privatization of water services (MWSS); Deregulation of the oil industry; Passage of the Philippine E-Commerce Act; Liberalization of the power sector; Introduction of Tariff Reform Program (TRP) III; Accession to the World Trade Organization (WTO)
2002	Adoption by BSP of Inflation Targeting Framework
2003-2009	Launch of the BSP's Consumer Expectations Survey (CES); Passage of the Securitization Act; Adoption of Basel II; Passage of expanded value-added tax; Establishment of the Wholesale Electricity Spot Market (WESM); Full implementation of risk-based bank supervision; Privatization of the National Transmission Corporation and National Power Corporation
2011-2015	Adoption of phased-in migration to Basel III; Liberalization of entry of foreign banks in the Philippines; Implementation of macroprudential measures on real estate exposure; Passage of the Philippine Competition Act
2016-2017	Adoption by BSP of Interest Rate Corridor (IRC) Framework; Credit Card Industry Regulation Law; Amendment to Foreign Investment Restrictions; Economic and Financial Literacy Act; Freedom of Information; Further Liberalization of FX regulations; Implementation of Interest Rate Corridor; Financial Inclusion Steering Committee; Implementing Rules and Regulations of the Philippine Competition Act; Designated Casinos as Covered Persons under the Anti-Money Laundering Act
Other Structural Reforms in the Pipeline for 2018-onwards	Amendments to the Bangko Sentral ng Pilipinas Charter; Amendments to Bank Secrecy Laws; Comprehensive Tax Reform Package; and Rationalization of Fiscal Incentives Law, among others

BSP committed to pursue policies supportive of growth

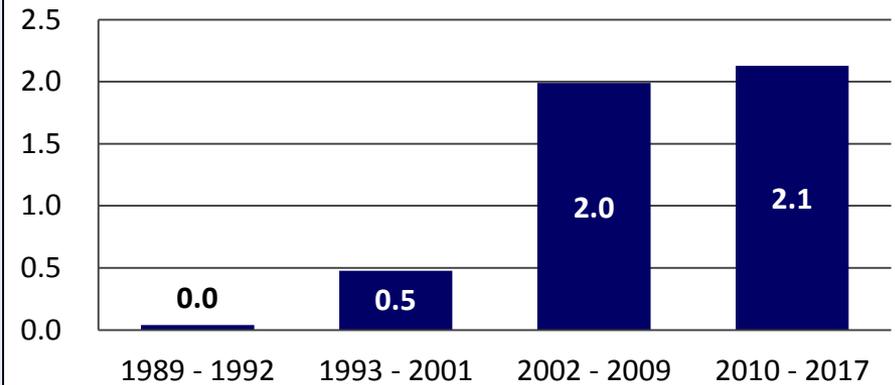
Policy Thrusts	Initiatives
Conduct appropriate monetary policy stance (Monetary Sector)	<ul style="list-style-type: none"><input type="checkbox"/> Adoption of the inflation targeting framework<input type="checkbox"/> Implementation of the interest rate corridor (IRC) system<input type="checkbox"/> Conduct of expectations surveys (e.g., Business Expectations Survey, Consumer Expectations Survey, Private Sector Economists' Survey)
Strengthen resilience to external shocks (External Sector)	<ul style="list-style-type: none"><input type="checkbox"/> Liberalization of foreign exchange (FX) regulatory framework<input type="checkbox"/> Adherence to market-determined exchange rate regime<input type="checkbox"/> Accumulation of ample foreign exchange reserves
Continue to initiate key financial reforms (Financial Sector)	<ul style="list-style-type: none"><input type="checkbox"/> Enhancement of the macroprudential toolkit, such as the introduction of the Real Estate Stress Test (REST), placement of a cap on real estate loans, and use of an Early Warning System (EWS)<input type="checkbox"/> Liberalization of the Philippine banking system<input type="checkbox"/> Implementation of risk-based bank supervision

Improved potential capacity to sustain growth trajectory

Incremental Capital-Output Ratio

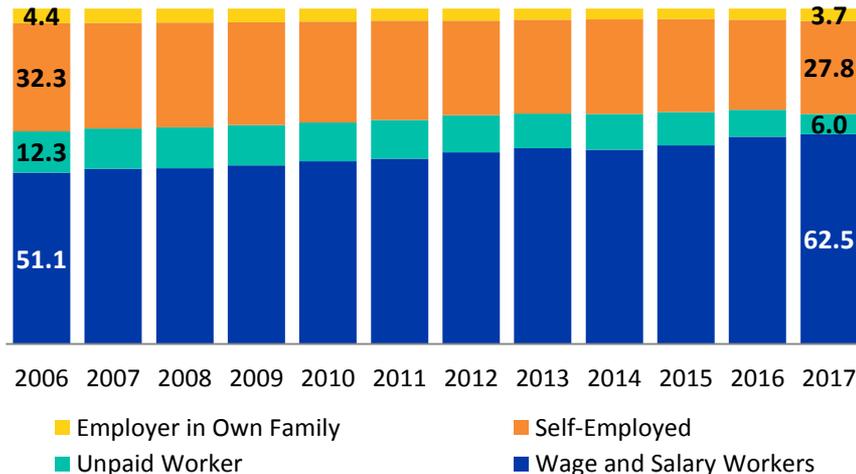


Total Factor Productivity

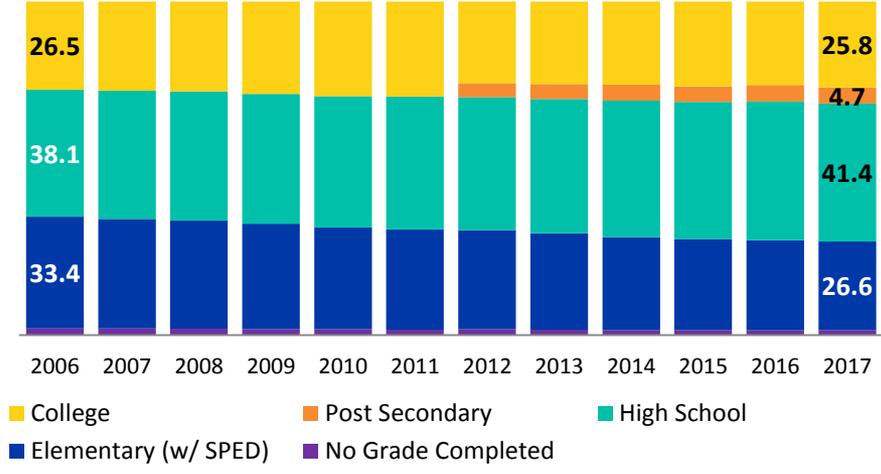


Source: Latest BSP staff estimates

Employment Share by Class of Workers



Employment Share by Educational Attainment



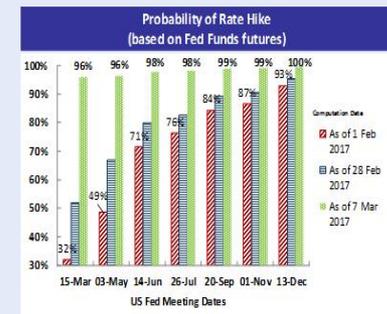
Source: PSA

Downside risks to growth

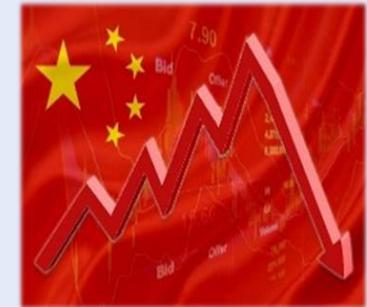
EXTERNAL



Political and policy uncertainty



US Fed policy normalization



China's economic rebalancing

DOMESTIC



Infrastructure gaps



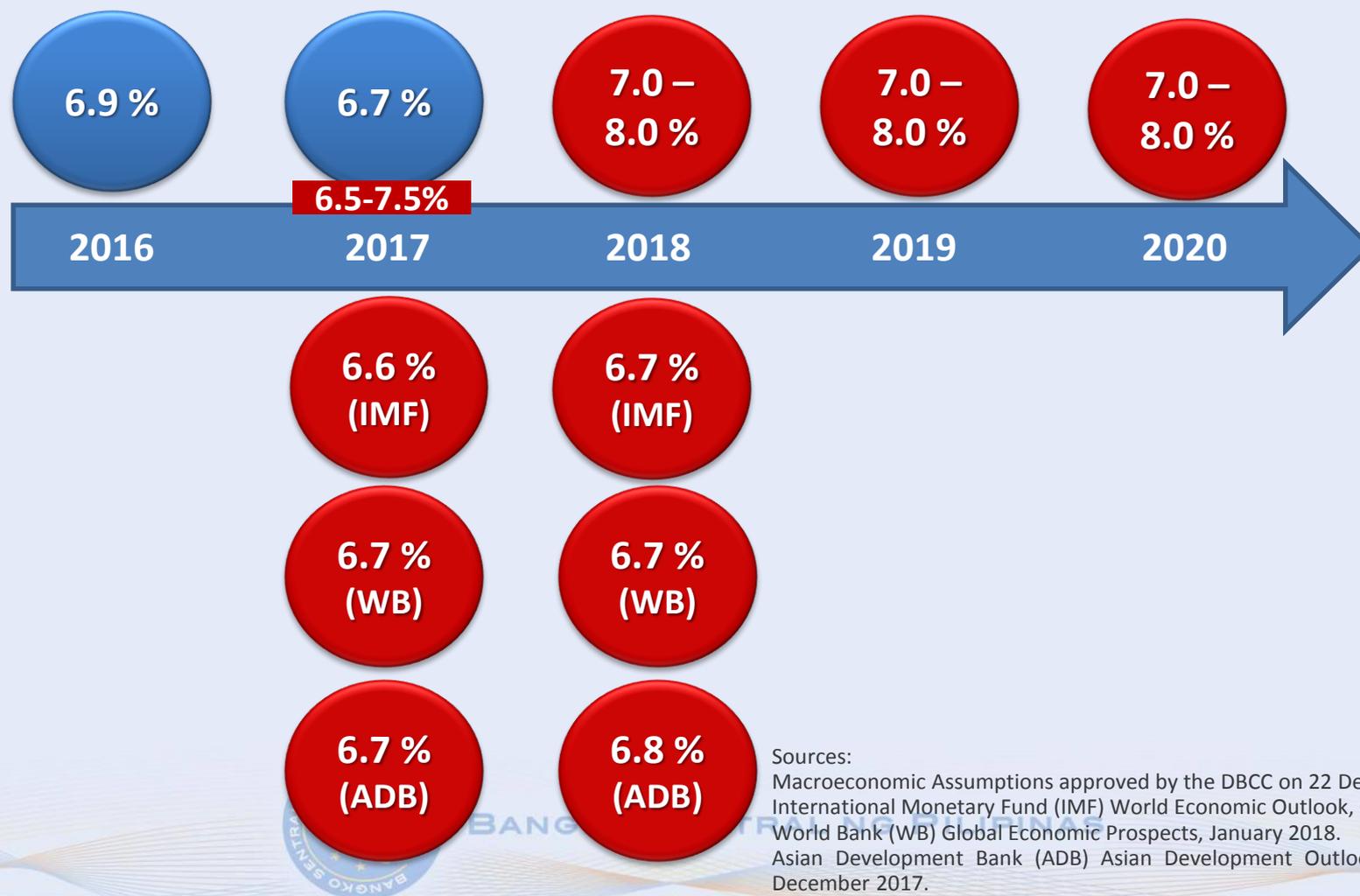
Shortfalls in TRAIN implementation



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Prospects for the Philippine economy remain bright

- The Philippine economy is expected to **sustain its growth momentum** over the medium term, consistent with third-party assessments



Philippine economy poised to sustain its growth momentum

- Robust monetary, financial, and external sectors are expected to continue to lend support to economic growth over the near and medium term

Indicators	Actual			Projections	
	2016	2017	2018	2017	2018
GDP Growth (% , 2000=100)	6.9	6.7	n.a.	6.5 – 7.5 ^{a/}	7.0 – 8.0 ^{a/}
Fiscal Balance (% of GDP)	-2.4	-1.9 (Jan-Sep)	n.a.	-3.0 ^{a/}	-3.0 ^{a/}
Headline Inflation (% , 2006=100)	1.8	3.2	4.0 (Jan)	2.0 – 4.0 ^{a/}	2.0 – 4.0 ^{a/}
Merchandise Exports, per BPM6 concept (% growth rate)	-1.1	16.2 (Jan-Sep)	n.a.	11.0 ^{a/ c/}	9.0 ^{a/ c/}
Merchandise Imports, per BPM6 concept (% growth rate)	17.7	13.3 (Jan-Sep)	n.a.	10.0 ^{a/ c/}	10.0 ^{a/ c/}
OF Remittances ^{b/} Amount (USD bn)	26.9	25.3 (Jan-Nov)	n.a.	28.0 ^{c/}	29.1 ^{c/}
Growth Rate (%)	5.0	4.0 (Jan-Nov)		4.0 ^{c/}	4.0 ^{c/}
Balance of Payments (USD bn)	-0.4	-0.9	n.a.	-1.4 ^{c/}	-1.0 ^{c/}
Gross International Reserves (USD bn)	80.7	81.6	81.2 (end-Jan)	80.7 ^{c/}	80.0 ^{c/}

^{a/} Approved by the DBCC on 22 December 2017.

^{b/} Cash remittances coursed through banks.

^{c/} Approved by the Monetary Board on 28 November 2017.

*Inflation forecasts as part of macroassumptions for the national budget.

r – revised; n.a. – not available

Key take-aways

- ***The Philippine economy is in a position of strength to weather volatilities and uncertainties in the global environment.*** Domestic sources of resilience allow us to sustain the alignment between positive economic growth and low inflation.
- ***Amid external challenges, the current landscape provides plentiful opportunities for domestic and foreign investors alike.*** The Philippine economy offers sustainability and stability, hence continues to be a viable destination for business and investment.
- ***The BSP remains committed to staying the course:*** (a) maintaining price stability; (b) promoting financial sector soundness; (c) strengthening resilience against external shocks; and (d) advocating for inclusive growth.



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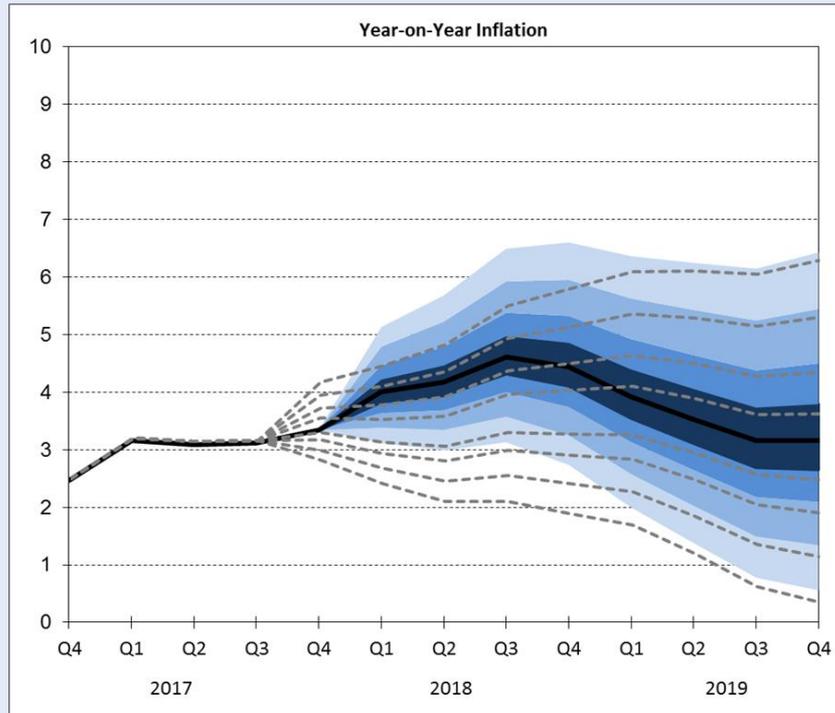
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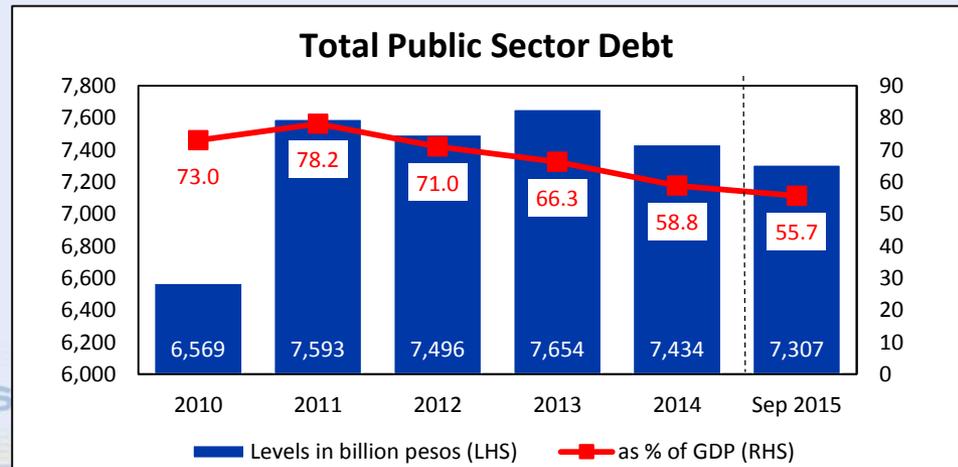
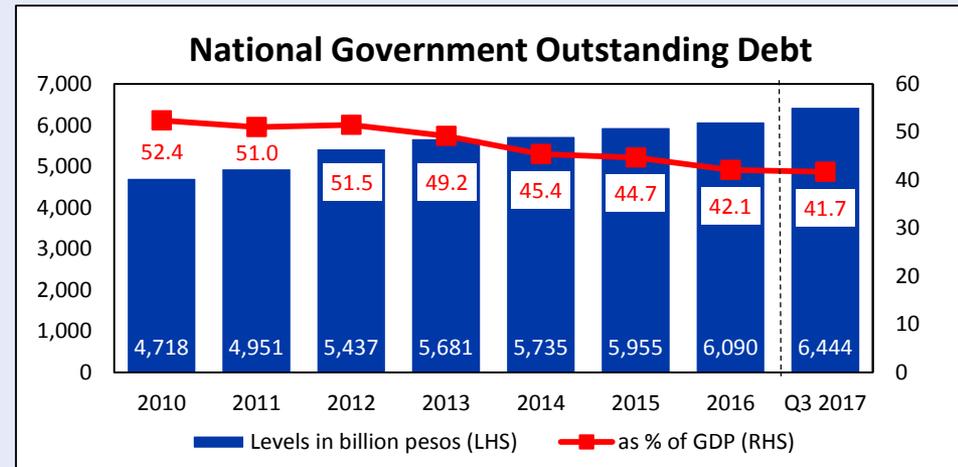
Ample policy space, both on the monetary and fiscal side

Inflation forecasts show higher outturns for 2018 and is expected to moderate to within target in 2019



As of 5 December 2017 (14 December 2017 MB Meeting)
 As of 6 February 2018 (8 February 2018 MB Meeting)

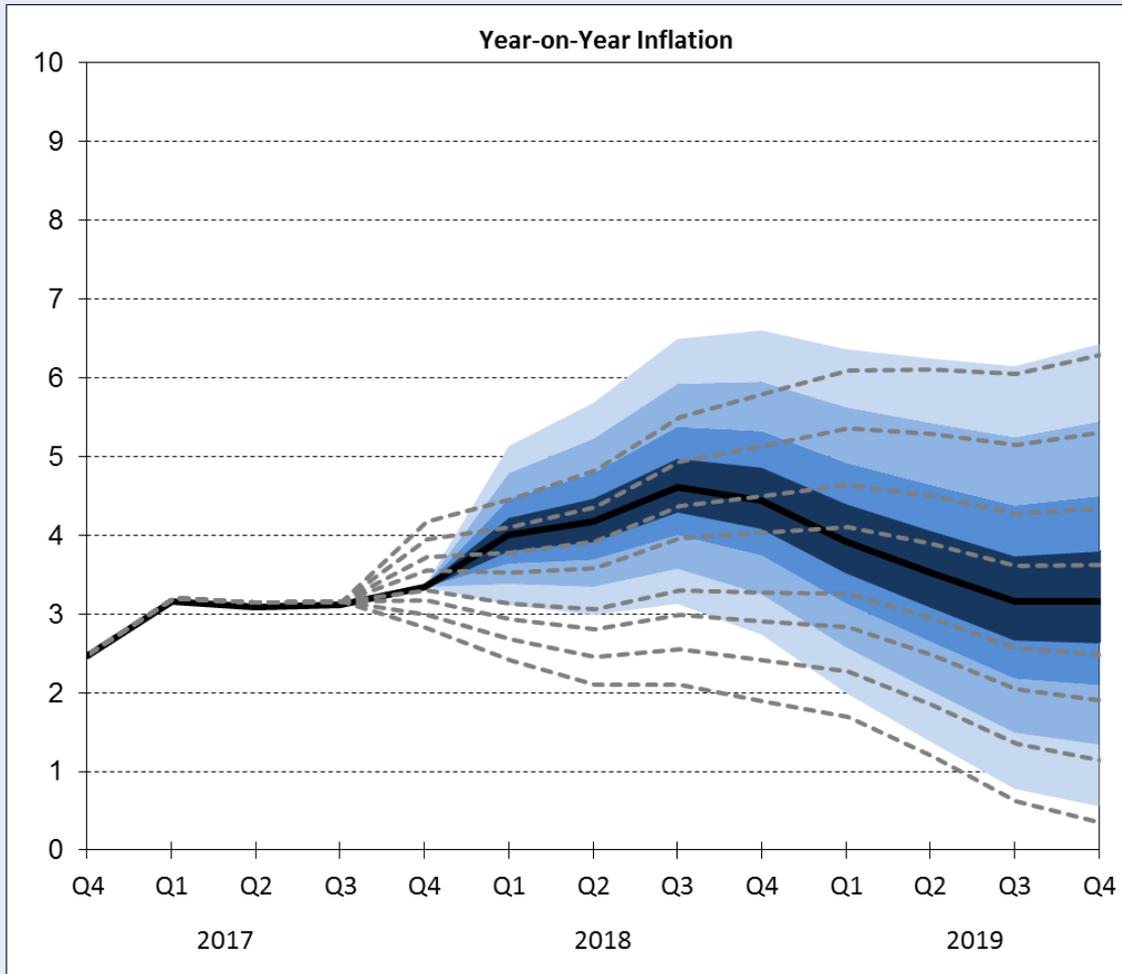
Sufficient fiscal space allows the opportunity for increased spending while keeping debt sustainable.



Source: BSP



Risks to future inflation remain skewed to the upside



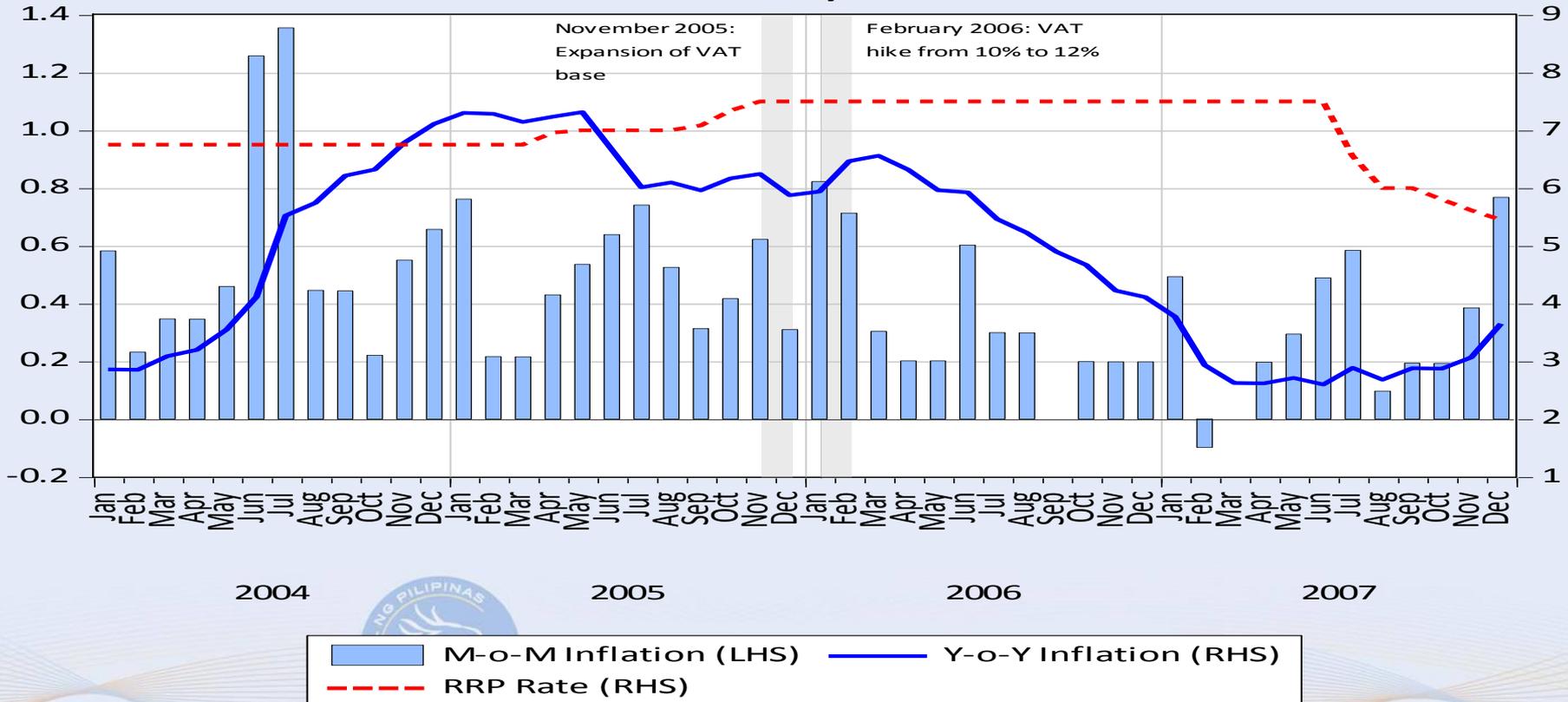
Confidence	Projection Ranges (%)	
	2018	2019
25%	4.0 - 4.6	3.0 - 4.0
50%	3.8 - 5.0	2.5 - 4.6
75%	3.4 - 5.5	1.9 - 5.4
90%	3.0 - 6.0	1.2 - 6.3

 As of 5 December 2017 (14 December 2017 MB Meeting)
 As of 6 February 2018 (8 February 2018 MB Meeting)

Tax Reform Episodes: Experience from the RVAT Law

- Price pressures from previous tax reform episodes were viewed as temporary in nature and did not require a policy response from the BSP

Inflation (2006=100, in percent), RVAT Reform Implementation and BSP Policy Rate



Source: BSP staff calculations

Tax Reform Episodes: Experience from the Sin Tax Reform Law

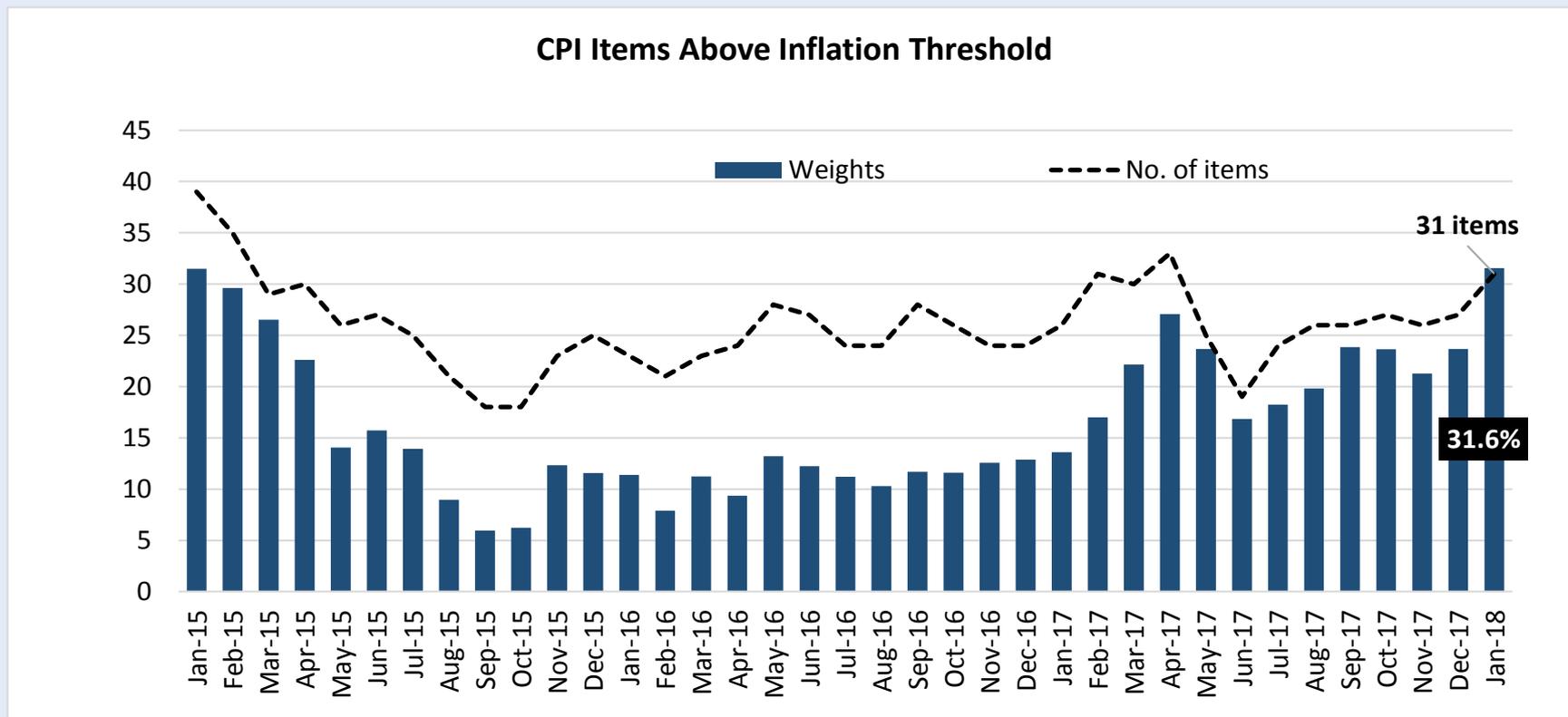
- Price pressures from previous tax reform episodes were viewed as temporary in nature and did not require a policy response from the BSP

Inflation of Alcoholic Beverages and Tobacco, Sin Tax Reform Implementation and BSP Policy Rate



Source: BSP staff calculations

Number of items with inflation rates above the threshold increased



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... but potential risks could emerge (e.g., Mayon eruption)

1. With the higher domestic oil prices due to TRAIN implementation, there have been reports of retailers passing on additional cost to consumers
2. Weather disturbances could affect harvest in February-March 2018
3. Damage from *Mayon* eruption could reduce overall domestic supply of rice; Bicol Region is the 5th top *palay* producer in 2017

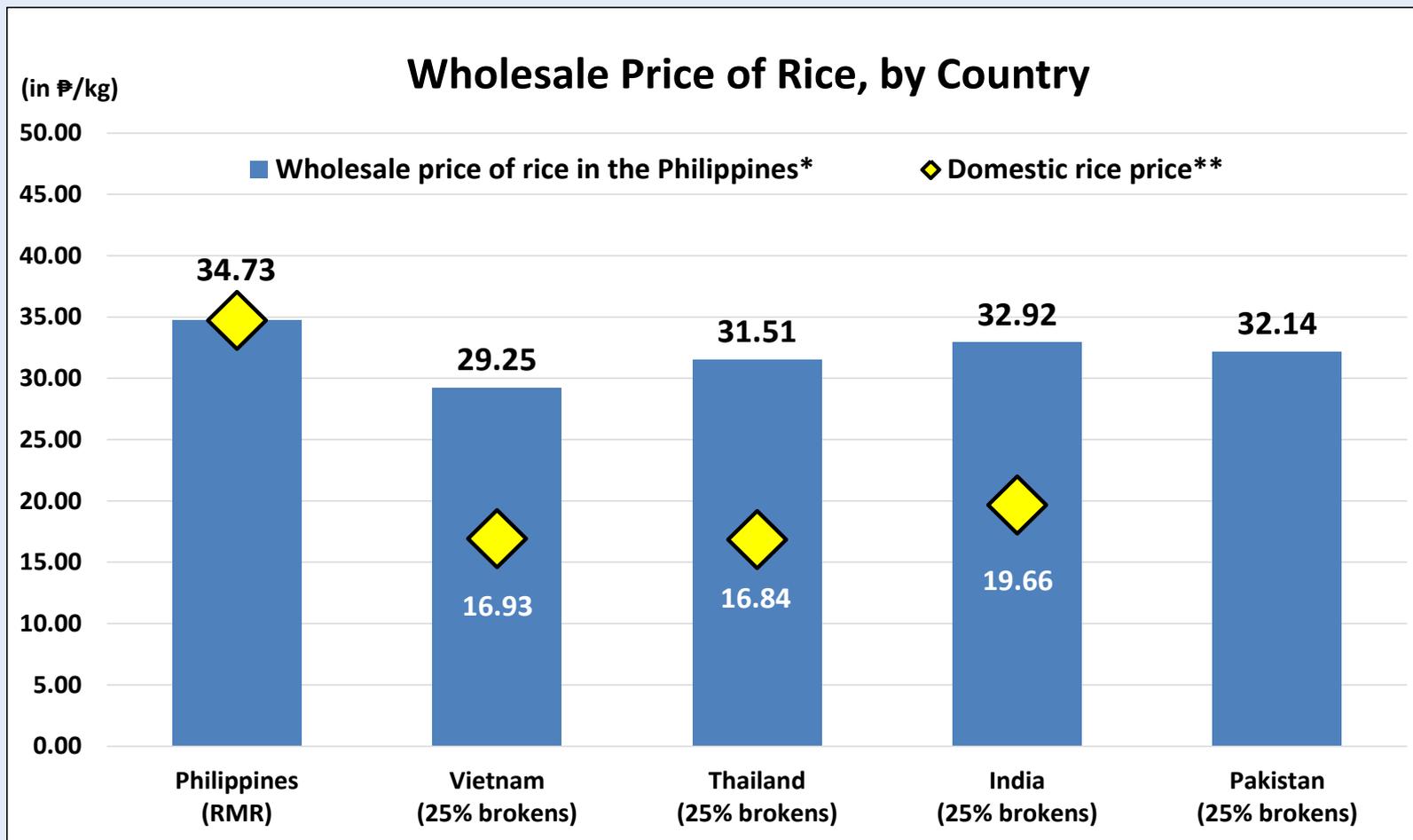


Nonetheless, there are possible mitigating factors that could temper price pressures

1. Strengthening price monitoring through joint efforts from the Department of Trade and Industry and the Department of Agriculture
2. Stabilization of rice prices through rice importation from the private sector (expected to arrive in Q1 2018) under MAV and by tapping the 250 TMT standby authority for NFA importation
3. Proposed rehabilitation plan from different banner programs for rice, corn, high value crops development, agriculture, livestock, and poultry



Rice Tariffication: Domestic versus Imported Rice Prices



**Source: FAO-GIEWS. No data available for Pakistan.

Note: All rice prices (except the Philippines) were in US\$. Prices were converted using the ₱50.4/US\$ conversion rate (Source: BSP website, 2017 FX average).

* Based on DER staff estimates sourced from different data and reports from PSA, FAO, BSP

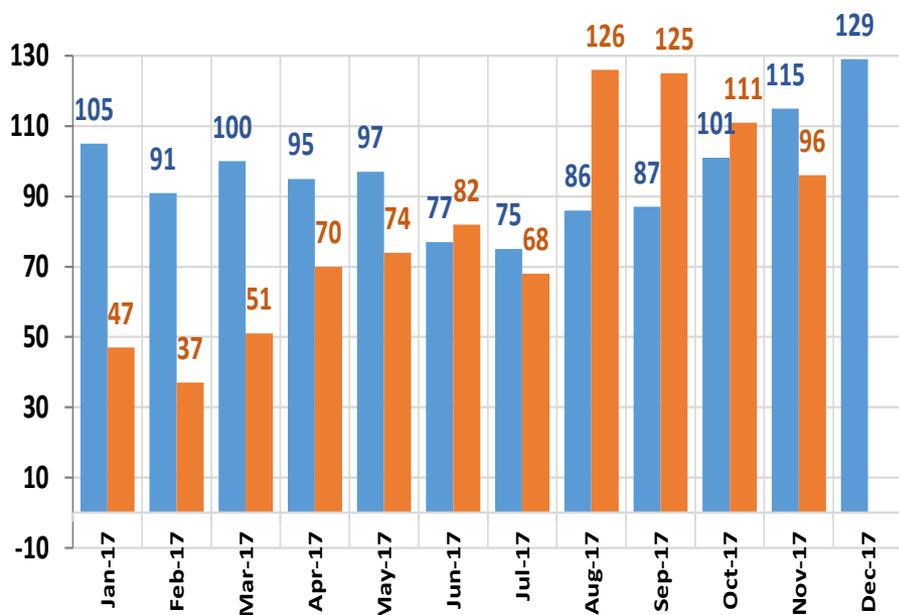
Crude oil prices rose in January 2018 while futures prices still show downward path over the medium-term

- OPEC compliance exceeds 100 pct in December 2017
- Supply disruptions from OPEC and non-OPEC producers
- Declining US commercial crude oil inventory due to higher refinery demand

OPEC and Non-OPEC Compliance Rate

in percent

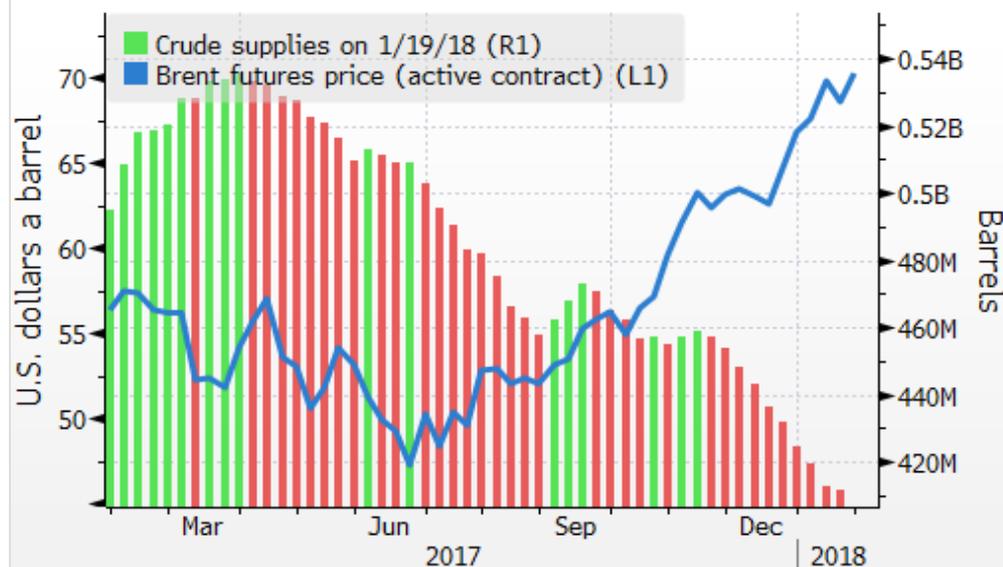
■ OPEC ■ Non-OPEC



Source: International Energy Agency, Oil Market Report

Shrinking Stockpiles

U.S. crude inventories extend decline for an eighth week



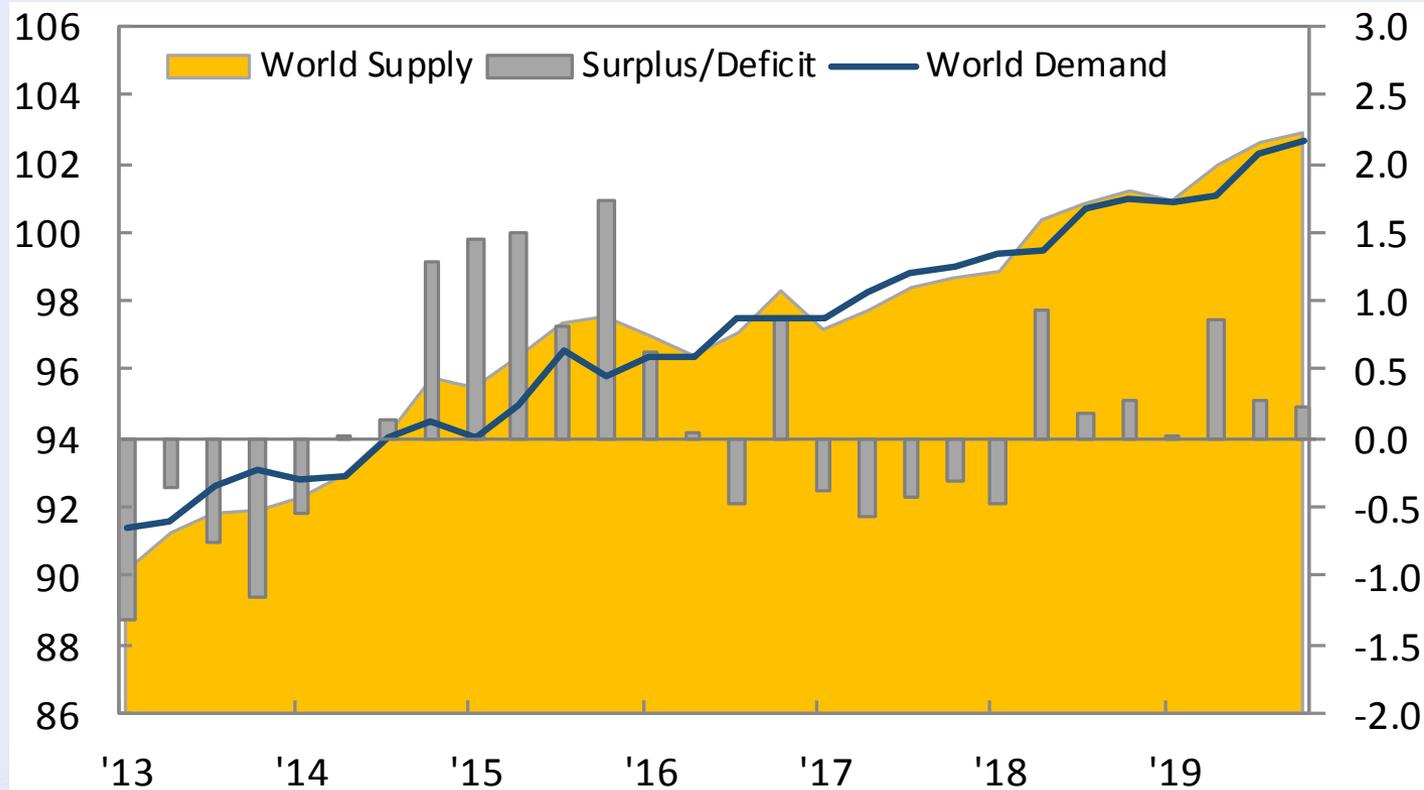
Source: Nymex; EIA

DOESCRUD Index (DOE Crude Oil Total Inventory Data (excluding Strategic Petroleum Reserve))
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EIA expects supply to outstrip demand in 2018-2019

- Supply to come from OECD countries: US, Canada, Norway
- Demand to come from Asia, specifically China and India

Global Supply-Demand Balance (in million barrels)



Source: US Energy Information Administration, Short-Term Energy Outlook, January 2018

Note: Supply includes production of crude oil (including lease condensates), natural gas plant liquids, biofuels, other liquids, and refinery processing gains.

Philippine output growth slowed down in Q4 2017 but within potential; output gap remains below 1 percent

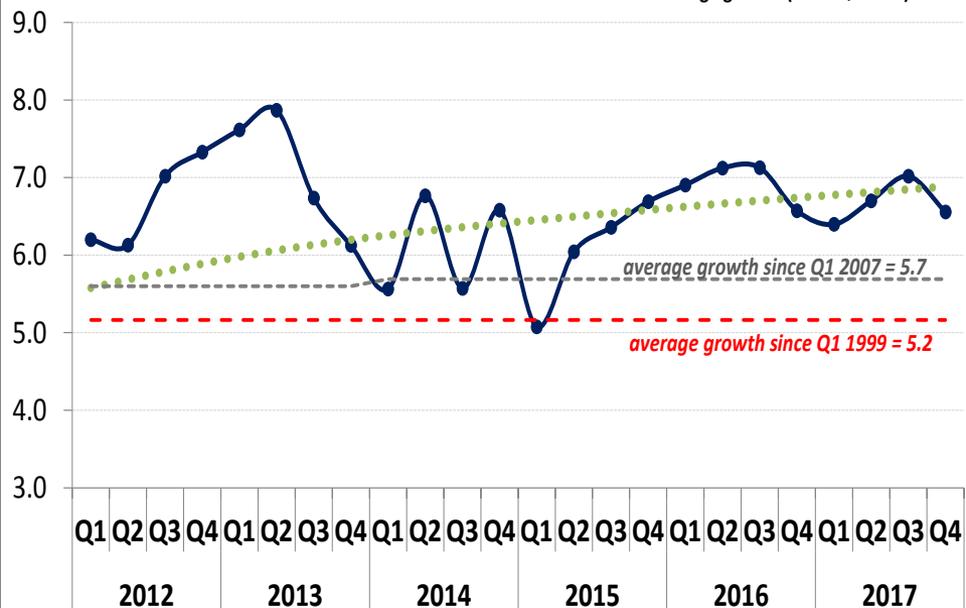
- Domestic demand continues to drive output growth

Gross Domestic Product

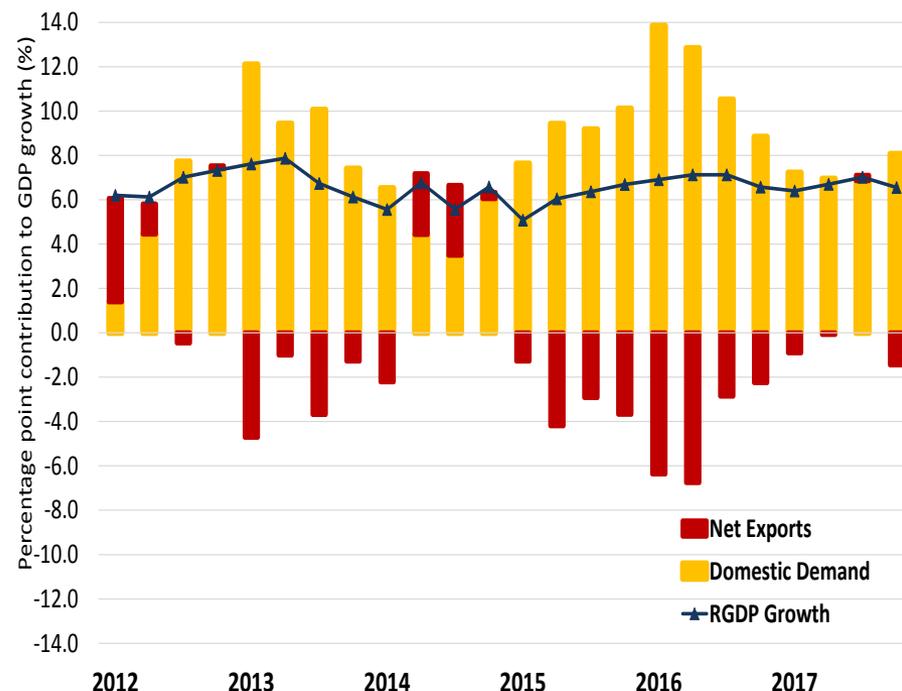
At Constant 2000 Prices

Growth Rate (%)

- Year-on-Year Growth Rate (%)
- Trend
- - - average growth (from Q1 1999)
- - - average growth (from Q1 2007)



Contribution to GDP: Domestic Demand and Net Exports

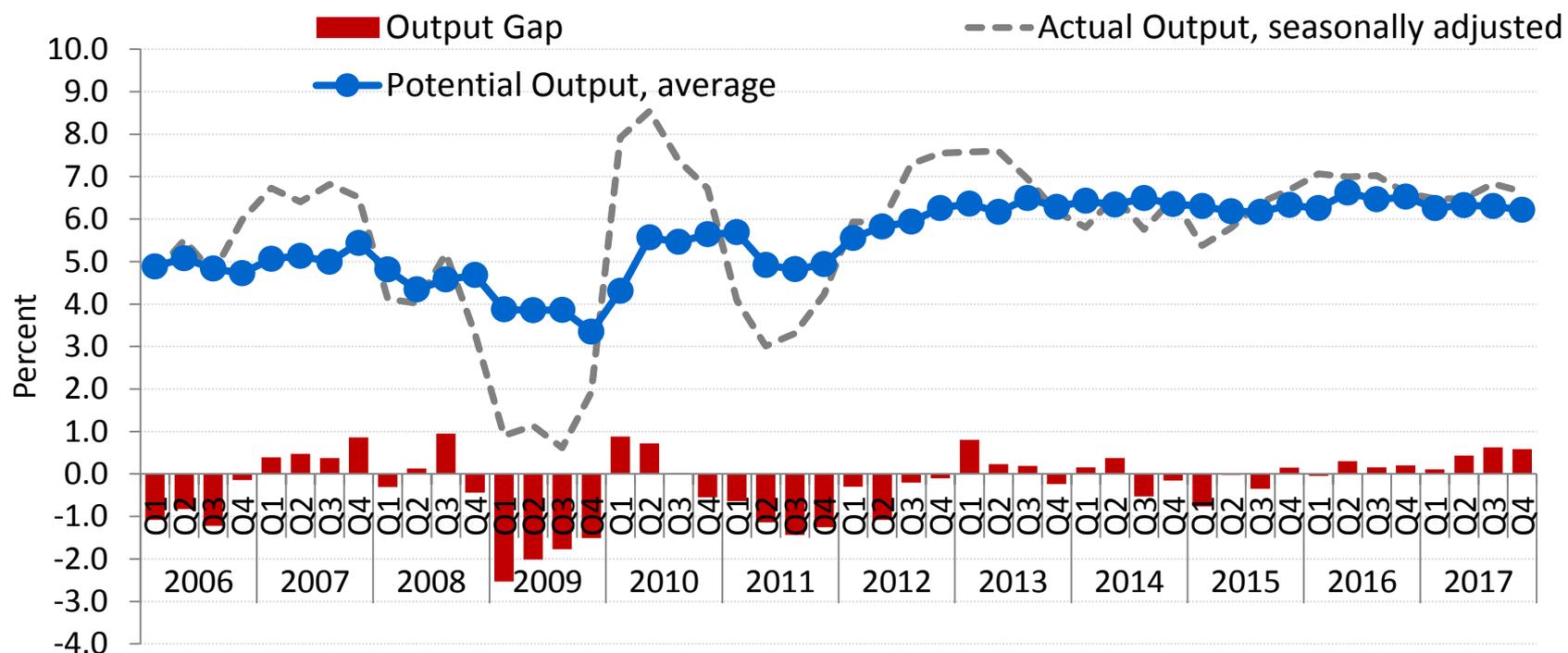


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Domestic growth remains within potential

- Consolidated potential output growth above 6.0 pct consistent with a slightly positive output gap in recent quarters

Quarterly Potential Output Growth & Output Gap Estimates*



*Based on average of potential output estimates from six approaches: (1) Filters using data for 2000-2017; (2) HP filter using data for 2009-2017; (3) multivariate filter (MMPH); (4) production function; (5) MUCM; and (6) structural vector autoregressive (SVAR) system