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Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2014 Article IV consultation with the Philippines, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 8, 2014, following discussions that ended on March 26, 2014, with the officials of the Philippines on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 18, 2014.
- An **Informational Annex** prepared by the IMF.
- A **Press Release** summarizing the views of the Executive Board as expressed during its July 8, 2014 consideration of the staff report that concluded the Article IV consultation with Philippines.

The following document has been or will be separately released.

Selected Issues Paper

The publication policy for staff reports and other documents allows for the deletion of market-sensitive information.

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STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

June 18, 2014

KEY ISSUES

Context. Growth remains rapid, but has moderated from the 7¼ percent recorded in 2013. Remittances and accommodative monetary and financial conditions remain the primary growth drivers, despite volatile capital flows, slowing activity in the region and severe natural disasters. Inflation has picked up to over 4 percent, while the current account remains in surplus. Local financial markets were moderately impacted by the Fed's "taper talk and action," weakening the peso and equity prices. Credit growth has quickened, especially to construction.

Potential growth has risen to about 6–6¼ percent. However, persistent weakness in the business climate is a risk to sustained growth and hinders job creation. Foreign ownership restrictions, inadequate infrastructure and high doing-business costs have held back overall investment and employment. Along with frequent natural disasters, this has kept poverty elevated, thereby sustaining outward migration.

Outlook and risks. Normalizing financial conditions are forecast to ease growth to 6–6½ percent over the medium term, while keeping inflation within the band and moderating the current account surplus. Abrupt changes in global financial conditions and a sharp growth slowdown in EMs are among the external growth risks. On the domestic front, excessive flow of real and financial resources to the property sector could increase volatility of asset prices and GDP growth over the longer run.

Policy recommendations. A more restrictive policy stance is needed to preserve macro-financial stability, with rebalancing of the mix to allow higher public investment spending, while implementing reforms to sustain vibrant growth and make it more inclusive:

- Absorbing liquidity and raising official interest rates would address second-round inflation effects and potential overheating and financial stability risks. Allowing the exchange rate to adjust more fully to structural inflows, while smoothing the effect of cyclical flows, would limit further sustained reserve buildup.
- Addressing specific risks from real estate and large credit exposures requires further targeted measures and broadening the BSP's mandate to include financial stability. This would help prevent diversion of systemic risk to shadow banking and strengthen tools to manage risks from deepening cross-border financial integration.
- Raising the fiscal deficit from below 1½ percent of GDP in 2013 to 2 percent of GDP in 2014 to accommodate reconstruction spending should be accompanied by tighter monetary and financial conditions. Mobilizing sizable additional stable revenue would ensure room for structural spending priorities while preserving fiscal prudence.
- Improving the investment climate by relaxing foreign ownership limits, reducing red tape, limiting tax holidays, and reducing labor and product market rigidities would enhance competition, support PPP execution and create employment opportunities within the Philippines.

Approved By
Hoe Ee Khor and Athanasios Arvanitis

Mission dates: March 12–26, 2014
Staff team: Rachel van Elkan (Head), Jaime Guajardo, Huaizhu Xie, Christiane Kneer (all APD), Takuji Komatsuzaki (FAD), and Shanaka Peiris (Resident Representative). Hoe Ee Khor (APD) joined the second half of the mission. Wimbo Santoso (Executive Director) and Alphew Cheng (advisor to the Executive Director) joined some of the meetings.

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CONTEXT

1. **Against unsettled global capital markets, the Philippines delivered another impressive macroeconomic performance in 2013**. Despite volatile capital flows, slowing activity in the region and a series of calamitous natural disasters, growth accelerated last year, supported by accommodative monetary and financial conditions and growing remittances. Potential growth has also risen, led by improved productivity and faster capital accumulation. Recognizing the progress made in strengthening external and fiscal positions and adopting sound policy frameworks, the three major rating agencies elevated the Philippines to investment grade in 2013, with a further upgrade by one agency in early 2014.

2. **Nonetheless, persistent weaknesses in the business climate remain a risk to sustained growth and kept unemployment elevated**. Structural rigidities may now be imposing speed limits on non-inflationary GDP growth despite progress in improving competitiveness rankings and public sector transparency. In addition, job creation has not kept pace with the rapidly growing labor force, and structural under- and unemployment rates remain relatively high. As a result, poverty remains widespread and a large share of the population is vulnerable to falling into poverty as a result of natural disasters and other shocks (Box 1). Weak labor market and welfare prospects are continuing to sustain outward migration and inward remittances. In addition, foreign ownership restrictions and a weak investment climate combined with ample liquidity is supporting demand for financial assets and real estate and construction activities.

3. **Strong popular support provides space for the government to accelerate its economic and social reform agenda**. More than half way into his single six-year term, President Aquino continues to enjoy high approval ratings in part reflecting his administration's pledge to improve governance and make growth more inclusive. The historic peace agreement between the government and the Moro Islamic Liberation Front (MILF), signed in March 2014 and the corresponding legislation is awaiting ratification by Congress, offers the prospect of significantly improving the welfare of the people of Mindanao, one of the poorest regions of the country. In response to typhoon Yolanda, the government has committed to "build back better" to strengthen resilience to natural disasters. Nonetheless, the government has acknowledged that more needs to be done in the critical areas of poverty reduction, implementing vital infrastructure, reducing business costs and executing agrarian reform, and has pledged to deliver rapid and palpable results.[1] The next presidential election is scheduled for mid-2016.

4. **In concluding the 2013 Article IV consultation, Executive Directors commended the authorities' prudent policies that delivered strong macroeconomic outcomes and set the stage for favorable growth prospects**. However, they also noted potential risks from global uncertainties, volatile capital inflows, bank's increasing exposure to some sectors, and the possibility

[1] *Philippine Development Plan 2011–16: Midterm Update*.

of stretched asset prices. They therefore stressed the importance of continued prudent macroeconomic policies while stepping up reforms to bolster resilience, sustain high growth, and reduce poverty. Over the past year, the authorities have continued to make progress on several of these fronts, tailored to reflect the change in global capital flows.

RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

5. **GDP expanded by a rapid 7¼ percent in 2013, bringing average growth for the past four years to 6⅓ percent** (Figures 1 and 2). Consumption and investment were the primary growth drivers, supported by remittances and accommodative monetary and financial conditions, while the external sector remained a drag on growth owing to subdued goods exports (Box 2). On the supply side, services, manufacturing and—through mid 2013—construction propelled output, with agriculture remaining broadly flat. In view of its occurrence late in the year, typhoon Yolanda is thought to have shaved only ¼ percentage point off annual 2013 growth, but with a somewhat greater impact likely this year. Growth eased in Q1:2014 (q/q) partly on other temporary factors (weak export demand by several advanced countries and a slowdown in residential construction as a large number of condominium units are coming on stream), and increasingly binding capacity constraints (in electricity generation due to maintenance shutdowns and adverse weather, and in road infrastructure from the main port).

6. **Inflation has picked up since late 2013 and the current account surplus increased**. Inflation lay below the bottom of the target band (4±1 percent) for much of last year despite high capacity utilization and a modest positive output gap. This reflected benign global price developments, reinforced by peso appreciation during H1:2013.[2] However, inflation rose to 4 percent late in the year on pass through of the weaker peso, typhoon-related disruptions to food production, increases in rice prices and higher electricity prices due to maintenance shutdowns, and reached 4½ percent in May. These supply-side pressures are likely to be larger and more persistent in the context of accommodative policies and a regionally centralized wage bargaining framework. The current account surplus increased to 3½ percent of GDP in 2013 (from below 3 percent the previous year) on a narrowing trade deficit.

7. **Philippine financial markets were moderately impacted by the announcement and subsequent implementation of tapering by the U.S. Federal Reserve**. During May 2013-January 2014, portfolio rebalancing resulted in capital outflows and caused the peso to depreciate by a cumulative 9 percent, equity prices to decline by 17 percent, and long term interest rates to rise by 50–150 basis points (Figures 3–5 and Box 3). In addition, official reserves declined moderately, but remain high relative to the Fund's reserve adequacy benchmark. While more restrained than in several other emerging markets, these financial market movements

[2] Global common factors—strongly associated with world commodity prices, the U.S. dollar nominal effective exchange rate, and the "great moderation" of inflation—are found to account for about 60 percent of inflation variability in the Philippines (see Chapter 1 of the accompanying selected issues).

helped unwind some of the previous sharp increases in equity prices and the exchange rate that occurred in recent years partly in response to accommodative financial policies. More recently, the resumption of financial inflows has caused prices to recover some of their previous losses.

Staff Position

8. Growth is forecast to remain strong, albeit easing on the assumption of tighter domestic financial conditions.

- Under the baseline scenario of tighter funding conditions and lending standards, growth is expected to moderate in 2014 to 6¼ percent—although rising on a sequential quarterly basis in response to strengthening activity in advanced economies and stepped up reconstruction spending.[3] With potential growth having edged up to around 6¼ percent (Box 4), staff expects the small positive output gap will stabilize this year. Second-round effects from recent supply shocks and exchange rate depreciation are expected to offset subdued external prices, bringing end-2014 inflation to 4 percent. The current account surplus is forecast to narrow marginally this year on a pickup in imports for reconstruction.

- Thereafter, and without further structural reforms, growth is projected to converge to 6 percent to unwind the positive output gap. Persistent structural inflows from abroad—though more subdued than in recent years—are expected to gradually return the real exchange rate to its strengthening trend. The resulting increase in imports—supported also by larger infrastructure investments—will narrow the current account surplus and relieve pressure on domestic capacity constraints. This would help temper inflation, but likely keep it above the midpoint of the new lower target band (3±1 percent) to be adopted from January 2015.

9. Risks to this baseline growth outlook stem from both external and domestic sources, and are tilted to the downside (Appendix 1). While a faster pick up in advanced economies would support Philippine growth, exiting rapidly from exceptionally loose monetary policies abroad—possibly in response to growing financial market distortions—could heighten volatility in global financial markets, impacting domestic credit conditions and those corporates and households that are over leveraged. A sharp slowdown in China or emerging markets more broadly, or a major geopolitical incident that disrupts regional or global trade, as well as commodity and financial flows, would also adversely impact the Philippines. On the domestic front, excessive flow of real and financial resources to the property sector could boost near term growth but lead to increased volatility of asset prices and GDP growth over longer horizons. Natural disasters also pose a risk to economic activity.

[3] The Consensus Forecast in June has GDP growth averaging 6.3 percent for 2014, with a range of 5.9–7.3 percent.

Authorities' Views

10. Despite a buffeting by global and domestic stresses, growth in 2013 remained resilient owing to strong policy frameworks and payoff from earlier reforms. Diversified growth drivers, a strong external position, a sound financial system, and prudent fiscal and debt management allowed the economy to ride out the turbulence in global financial markets. Looking ahead, ongoing improvements in production efficiency are expected to support a higher path for potential and actual growth while also bringing about lower inflation. GDP growth is projected to increase from 6.5−7.5 percent in 2014 to 7.5−8.5 percent in 2016 while inflation is expected to ease to 3±1percent, and the current account to remain in surplus.

11. Although the economy is expected to continue to perform strongly, the authorities were cognizant of risks—particularly on the global front—that could heighten volatility. Uncertainty about future policy steps in advanced economies could trigger renewed financial market turbulence. Slower growth in Asia could reduce intra-Asian trade that, until now, has compensated for previous weakness in exports to advanced economies. Political risks could affect international commodity prices and capital markets, and weaken growth prospects. On the domestic side, the threat of natural disasters is ever present, and the authorities remain alert to potential risks to financial stability, including in real estate, and will continue to respond proactively, as needed.

PRESERVING STABILITY AMID STRUCTURAL AND CYCLICAL FLOWS

A. External Sector Assessment

Staff Position

12. Notwithstanding volatility in financial flows, the external sector strengthened during 2013. Responding to a shift in interest rate differentials, some previously accumulated capital flows reversed during mid 2013-early 2014. This selling pressure was accommodated by a combination of peso depreciation and drawdown of reserves. However, the overall balance of payments remained positive for the year on the rising current account surplus.

13. In recent years, the Philippines' external sector facilitated reserve accumulation by the official sector. Tending to lean against the wind of inflows has helped build a large reserve buffer against future external shocks and smoothed adjustment to a stronger equilibrium real exchange rate resulting from sustained remittances and other structural current account inflows. In the process, the nominal exchange rate has tended to move broadly in line with those of regional trade partners, and the reserve position is now stronger than warranted for precautionary purposes. While the EBA methodology places the gap between the current account and its norm at near 7 percent of GDP for 2013, extensions to these methods to account

for exposure to natural disasters and remittance income reduce the gap to around 3 percent of GDP (of which 0.5 percent and 0.2 percent, respectively, reflect policy gaps in the rest of the world and in the Philippines) (Appendix 2). From a multilateral perspective, this suggests the external sector was moderately stronger than warranted by medium-term fundamentals in 2013, consistent with moderate currency undervaluation.

Authorities' Views

14. **The exchange rate regime continues to be market-determined and the change in reserves level remains consistent with the objective of smoothing excessive volatility in the foreign exchange market**. Policies allowed the peso to appreciate over the past decade consistent with sustained structural inflows, which enabled reserves to reach a comfortable level. In late 2013 to early 2014, reserves showed a moderate drop as a result of foreign exchange operations and government debt servicing. Going forward, the REER is expected to move in line with structural flows and reserves may accumulate at a slower pace than in previous years as higher global interest rates moderate capital inflows.

B. Monetary and Exchange Rate Policy[4]

Background

15. **Short-term market interest rates remain at exceptionally low levels**. Domestic interest rates have been compressed by loose monetary policies abroad and ample domestic liquidity partly reflecting the BSP's decision to restrict nonbanks' direct access to its Special Deposit Account (SDA)—one of its main sterilization instruments. This released some 5 percent of GDP in liquidity in late 2013, although two recent increases in reserve requirements (RRs) (by 1 percentage point each in April and May) absorbed part of the net injection.[5] The 3-month T-bill rate is currently 1.1 percent, well below the policy (reverse repo) interest rate (3.5 percent) and the SDA rate (2 percent), and considerably negative in real terms. Credit growth by universal and commercial banks accelerated to an annual rate of almost 21 percent in April.

Staff Position

16. **Policymakers adeptly steered the Philippine economy through turbulent financial conditions brought by unconventional monetary policies in advanced countries, but domestic monetary and financial conditions are now too accommodative**. The BSP's policies since the GFC have generally delivered low inflation, helped moderate capital inflows, and offset

[4] This section reflects policy actions and public statements that occurred after the mission.

[5] The restriction on SDA access affected some 11 percent of GDP in assets, although the net liquidity released—after flow back through deposits placed with banks (which are subject to RR) and trusts—was less than half that amount. The increase in RR in March and May absorbed about 1 percentage point of GDP in liquidity. RRs are now 20 percent for universal and commercial banks, and 8 percent and 5 percent, respectively, for thrift or rural banks (which comprise 10 percent of banking sector assets). RRs for rural banks were adjusted in March only.

the restrictive fiscal stance in 2013 (Box 5). However, the liquidity overhang from past forex accumulation has been exacerbated by the recent restriction on direct access to the SDA, reducing the intensity of sterilization. As a result, the domestic impact of the tighter U.S. financial conditions since mid-2013 has been muted, especially for short-term interest rates. The drawdown of official reserves in response cyclical outflows and the increase in RRs earlier this year were therefore welcome. Nonetheless, liquidity remains excessive, with real market interest rates remaining very low or negative (Figure 6).

17. The economy is well positioned to absorb a gradual tightening of monetary policy. Upfront measures to withdraw liquidity and raise real interest rates would help prevent second round inflation effects and address potential overheating and financial stability risks. Doing so would also create policy space to accommodate fiscal spending for post typhoon reconstruction and infrastructure upgrading (see below).

- *Sterilization and official interest rates*. Absorbing excess liquidity by further increasing RRs—which are levied only on banks, and are already high—could have the unintended effect of encouraging financial intermediation to shift to nonbanks,[6] while also lowering the effective return on SDA placements for those funds channeled through banks, which are subject to RRs. Instead, the BSP should raise the SDA and policy rates in order to attract additional funds to BSP facilities and hence pull up market interest rates.[7] In addition, the BSP could resume forex swaps, while the Treasury could overfund the fiscal deficit in the local debt market with proceeds kept at the BSP in the Treasury Single Account or make government securities available to the BSP for repo operations.[8] Moreover, approving the draft revisions to the BSP Charter that allows the BSP to issue its own bills and ensures a minimum level of capital would increase the BSP's policy space.

- *Exchange rate and reserves*. With official reserves more than adequate to respond to shocks, the exchange rate should appreciate more fully in response to sustained structural balance of payments inflows (including remittances and FDI) (Figure 7). On the other hand, smoothing the exchange rate effect—and sterilizing the liquidity impact—of cyclical capital flows (including portfolio and currency and deposit flows) is appropriate because the domestic investor base remains small relative to the potential scale of volatile capital flows.[9]

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[6] While RRs on rural and thrift banks are much lower, these institutions are likely close substitutes to informal, unregulated intermediation.

[7] The effectiveness of the policy rate is however limited by the small amount of repo-able securities held by the BSP.

[8] On the other hand, if outflow pressures resume, unsterilized sales of official reserves would help reduce liquidity, while preventing an outflow-depreciation feedback loop.

[9] This implies dampening exchange rate variability at intermediate frequencies corresponding to capital flow cycles. However, retaining variability at higher frequencies is useful to discourage carry trade inflows.

Authorities' Views

18. In recent years, large and volatile capital inflows have augmented current account-related inflows, complicating the task of liquidity management. The BSP adopted a series of measures to moderate inflows, while also relying on a range of sterilization instruments. Restricting nonbanks' direct access to the SDA since late 2013 was intended to encourage some funds placed therein to migrate toward productive investment and align ability to access the standing facility to international norms. However, liquidity expanded strongly due to both the operational adjustment in the SDA facility and sustained credit growth. In early 2014, the BSP siphoned off some liquidity by raising reserve requirements by 2 percentage points and allowing official reserves to decline.

19. Buoyant domestic growth prospects provide some scope for measured adjustments in the BSP's policy instruments in order to safeguard price and financial stability. Further normalization of U.S. monetary and financial conditions would help drain domestic liquidity, but changing market expectations on Fed actions could trigger some volatility. With inflation expected to be within the target range and inflation expectations remaining well-anchored, the BSP has continued to rely on an enhanced policy toolkit rather than the policy rate alone. Recently, the BSP raised reserve requirements as a preemptive macroprudential measure to guard against potential financial stability risks brought by strong growth in liquidity and credit. Any further adjustments in policy settings will be data dependent and based on the evolving outlook for inflation and output. Allowing the BSP to issue its own securities and ensuring a minimum level of capital will help increase flexibility over the amount, timing, and duration of sterilization operations.

C. Financial Sector Issues

Background

20. Amid buoyant GDP, credit and real estate activity, financial soundness indicators signal continued strong performance. During 2013, Philippine banks achieved robust profits, low NPLs, and maintained capital adequacy ratios well above newly introduced Basel III requirements (Figure 8).[10] Banks are not dependent on external financing, relying mainly on domestic deposit funding. Bank lending has accelerated since end 2013, reaching almost 21 percent in April. At around 35 percent of GDP, credit penetration of the private sector through banks is low from a regional perspective (but in line with EMs in other regions), although nonbank financing is also significant (Box 7). Large corporates are issuing debt

[10]Minimum capital requirements in the Philippines are higher than BIS recommendations. From January 1, 2014, Philippine banks must maintain a minimum common equity tier 1 (CET1) ratio of 6.0 percent (BIS recommends 4.0 percent by January 1, 2014 and 4.5 percent by January 1, 2015). Including the 2.5 percent capital-conservation buffer, the minimum required CET1 ratio is 8.5 percent (BIS recommends 7 percent). The minimum total capital adequacy ratio (CAR) is 10.0 percent (BIS recommends 8.0 percent).

securities, enabling them to lock in fixed rate funding, lengthen maturities, and bypass bank exposure limits on individual borrowers. Issuance has risen sharply, with the amount issued during January-May 2014 exceeding the 2013 annual total. The pace of property price increases quickened to 13 percent year-on-year for condominiums and 5¾ percent for office space in Q4:2013,[11] although construction activity has recently slowed (Appendix 3). Banks' real estate exposure amounted 21¾ percent of total loan portfolios at end 2013, and has been growing faster than other segments. Sixty percent of real estate loans are to commercial entities (developers and construction companies) with the rest to households. Real estate developers and their affiliated conglomerates are also active in debt and equity markets, and developers—as well as several public agencies—provide credit directly to home buyers (thought to total around 7½ percent of GDP, including mortgage lending by banks). Nonbank real estate lenders tend to apply weaker credit standards than banks.

Staff Position

21. Pockets of risk have emerged against the backdrop of prolonged loose credit conditions. Abundant liquidity and very low short-term market rates are exacerbating the risk that prices of property and financial assets could move ahead of fundamentals. With the aggregate leverage ratio for listed companies at 100 percent in 2012, the rise in corporate indebtedness needs to be watched. Moreover, the distribution of debt is skewed toward more leveraged firms, increasing vulnerability to interest rate and refinancing risks. Targeted measures adopted in recent years by the BSP, in its role as banking supervisor, to enhance the monitoring and regulation of banks were appropriate.[12] The Financial Stability Coordination Council, established in early 2014, will help to bridge the gaps in financial oversight mandates across the different member agencies. Nonetheless, financial deepening and search for yield in the context of low interest rates and migration of credit provision to less regulated and less closely supervised lenders raises repricing and credit quality risks and reduces transparency. Further preemptive action is warranted:

- *Real estate*. Compliance with existing loan-to-value (LtV) ceilings on bank mortgages (the standard cap is 60 percent, but banks routinely offer 80 percent, including in situations where a lower cap is applicable) should be strictly enforced. Requiring standardized contracts for nonbank (including real estate developer) financing of property purchases, overseen by the SEC—as regulator of nonbank financial institutions—and the BSP—as consumer finance advocate—would strengthen credit underwriting and consumer protection standards and improve data collection. Applying higher risk weights than the standard 50 percent for individual and corporate borrowers with multiple mortgages should be

[11] This reflects prices in high-end areas of metro Manila, which is the only available series.

[12] In addition to requiring higher minimum capital standards than Basel recommendations and limiting NDF positions, the BSP broadened the coverage of banks' real estate activities that it monitors (although there is no explicit ceiling on broad exposure), and banks are permitted to purchase developers' previously issued loans to buyers ("contract-to-sell" (CTS) securitization agreements) only if the loans meet minimum standards. Actual CTS purchases account for only 1 percent of banks' loan portfolios.

considered to discourage speculative activity. In addition, tax advantages for real estate in the current corporate tax system—preferential treatment of real estate capital gains for firms whose primary business activity is not related to real estate, and tax holidays for constructing low-mid price housing—should be eliminated to discourage speculative demand and oversupply and also help avoid overburdening macroprudential policy. Replacing tax holidays with well-targeted subsidies for low-income buyers would improve efficiency.

- *Loan concentration*. In view of the conglomerate structure of the economy, large bank exposures to single borrowers can create systemic risks. Recent measures to roll back exemptions to single borrower limits (SBLs) and tighten related conditions are welcome.[13] To better manage risks from concentrated exposures, interdependent companies within a conglomerate group should be classified as a single borrower, consistent with the new Basel Committee guidelines for measuring and controlling large exposures. In addition, amending the BSP Charter to allow the BSP to request and receive information on all members of conglomerate groups affiliated with banks would strengthen the effectiveness of supervision.

- *Financial stability architecture*. Migration of credit outside the banking sector offers diversification benefits, but assessment and oversight of the sector are likely complicated by resulting data and regulatory gaps. With no entity having a legal mandate for financial stability, tightening micro and macroprudential regulations on banks—including RRs and real estate exposure caps—may have the unintended effect of pushing activity into segments with less-stringent regulatory requirements, including shadow financing of real estate. Expanding the BSP's remit to include broad financial stability (as a secondary objective to the main goal of price stability) would help counteract migration of risk beyond the current regulatory perimeter. This and other needed amendments to the BSP Charter related to supervision—limited scope to access data on all banks' related entities, weak legal protection for supervisors in the conduct of their duties, and the "extraordinary due diligence" requirement on supervisors—should be rapidly approved. The recent approval of the law allowing additional foreign bank entry into the domestic market through subsidiaries or branches (to a maximum of 40 percent of sector assets)—in preparation for the start of the ASEAN Economic Community—will bring a more competitive environment and could reduce concentration exposures at individual banks. However, managing the associated risks requires vigilant oversight and strong coordination with home country supervisors.

Authorities' Views

22. The authorities remain watchful for financial stability risks that may arise from strong credit growth, and stand ready to adopt new macroprudential measures as necessary.

[13] Specifically, the temporary exemption to the single borrower limit (the standard limit is 25 percent of bank capital) for purchases of oil (an additional 15 percentage points) lapsed in March 2014, and while the temporary exemption to finance PPPs (an additional 25 percent) was kept until 2016, new provisions were added excluding affiliates of the lending bank from the SBL exemption.

Fundamental support to real estate is provided by large unmet housing needs, sustained growth of remittances and the business process outsourcing sector (with the latter fuelling demand for both office and residential space), and prudent business practices of major real estate developers. Standard indicators—price to rent ratios, occupancy rates, and bank exposures—do not signal quantity imbalances or price bubbles in the property sector. Nonetheless, there has been a notable increase in purchasing and renting of residences by young professionals, of luxury condominiums by high-income expatriates, and of properties for the use of—or investment by—Overseas Filipinos. The BSP closely monitors lending to real estate and has required banks to carry out stress tests twice a year on the effect of a 20 percent and 50 percent write off of various credit exposures, including real estate, on banks' balance sheets.[14] The existing 20 percent cap on banks' real estate exposures may be modified or new macroprudential measures introduced based on the results of the stress tests and enhanced monitoring by the BSP. Regarding the temporary SBL exemptions, banks' PPP exposures are currently very small. On foreign bank entry, scope exists to increase the number of market participants, and this is consistent with preparations for ASEAN economic integration by 2020. Amending the BSP Charter is one of the government's legislative priorities.

D. Fiscal Policy

Background

23. From a macroeconomic perspective, fiscal policy has focused in recent years on strengthening resilience and building a fiscal buffer. Sustained primary surpluses and rapid GDP growth caused general government debt to continue to moderate, reaching 39 percent of GDP at end-2013. In addition, the quality of public debt in terms of maturity, repricing risk, and currency composition has improved (Appendix 4). In 2013, the consolidated general government account was close to balance—with a deficit of less than 1½ percent of GDP at the national government (NG) level, well below the 2 percent target—on higher revenue collection coupled with slow budget execution. The authorities are targeting a NG deficit of 2 percent of GDP through 2016 (consistent with a general government deficit of about 1 percent of GDP). For 2014, this includes 1 percentage point of GDP in post-disaster reconstruction spending, of which one-fifth is financed by reallocating other expenditure.

Staff Position

24. Conditioned on adopting appropriately restrictive monetary and financial policies, raising the fiscal deficit from 2014 is warranted to accommodate reconstruction and other priority spending. Spending bottlenecks kept fiscal policy countercyclical in 2013, partly mitigating the accommodative monetary conditions. Scope to make room for reconstruction spending solely by reallocating other expenditure is constrained by the low fiscal spending ratio

[14] Banks are expected to maintain a capital adequacy ratio of 10 percent after adjusting for the stress test results, with universal and commercial banks required to also maintain a common equity Tier 1 ratio of at least 6 percent.

that, in turn, reflects low tax collections and previous spending bottlenecks, and the need to protect priority social spending.[15] Raising the NG deficit from below 1½ percent of GDP in 2013 to 2 percent of GDP in 2014, as budgeted, would, however, imply a stimulus on the order of 1 percent of potential GDP at a time when the output gap is already positive, and should therefore be countered with tighter monetary and credit conditions. Keeping the NG deficit unchanged thereafter is seen as broadly neutral and would continue to moderate the public debt ratio to below 30 percent of GDP by 2019.

25. Significant additional revenue is required to finance large recurrent priority spending needs. To achieve the authorities' ambitious—though appropriate—planned increase in infrastructure and social spending (see below) and offset revenue loss from possible future reductions in statutory tax rates, adjustments in tax brackets, and dissipation of cyclical revenue, a significant increase in structural revenue is needed.[16] Mobilizing the needed revenue should rely primarily on broadening the tax base by reducing corporate income tax holidays, narrowing the VAT gap, and adopting a new mining strategy,[17] supported by further improvements in tax administration. If adopted, the identified tax policy measures could yield 2–3 percentage points of GDP, sufficient to finance the envisaged doubling in infrastructure spending.

Authorities' Views

26. The trend decline in public debt demonstrates the government's commitment to fiscal prudence as it continues to generate fiscal space in support of policy priorities. Favorable domestic funding conditions and achieving investment grade lowered government-borrowing costs, allowing fiscal resources to be redirected to projects supportive of inclusive growth. Slow absorption of funds by some government agencies has held back spending in recent years. However, the increased fiscal space this generated provides the government flexibility to increase spending in 2014. The government is also pursuing various expenditure management reforms to sustain the higher momentum in government spending.

27. Revenues have been boosted by enhanced tax administration, which will ensure that positive developments in government finances will continue. To promote and sustain macroeconomic stability, spending must be supported by adequate revenue. Hence, continuing to improve tax administration through various revenue enhancement measures and programs,

[15] Spending on conditional cash transfers is expected to increase by 0.1 percentage points of GDP in 2014.

[16] Of the 1¾ percentage point increase in the revenue ratio during 2010–13, ⅓ percentage points reflects higher "sin tax" excise rates on alcohol and tobacco, with about ¾ percentage points attributed to improved tax administration and compliance.

[17] Although the Philippines is estimated to possess the 5th largest mineral deposits in the world, valued around US$1.4 trillion, mining accounts for only 1 percent of GDP. This reflects a moratorium on new projects during 2011 to mid-2013 and lingering uncertainty regarding the new mining tax regime. To realize mining's potential contribution to GDP and public finances, a new mining strategy is needed, based on good stewardship of resources and more equitable tax arrangements.

while moving forward with rationalizing fiscal incentives, developing the fiscal regime for the mining industry and fully implementing the 2012 sin tax law are priorities.

STRUCTURAL TRANSFORMATION FOR QUALITY GROWTH

Background

28. Sustaining growth. The Philippines has advanced 28 places since 2009 (to 59th position) in the World Economic Forum's Global Competitiveness Rankings. However, large gaps remain in infrastructure adequacy, government bureaucracy and red tape, and labor regulations. The government plans to more than double its infrastructure spending to 5 percent of GDP by 2016 and established a pipeline of Public Private Partnership (PPP) projects (Box 6). According to the World Bank, foreign ownership limits in the Philippines are among the most restrictive in East Asia, consistent with its very low FDI stock.[18] The high statutory corporate income tax rate (30 percent) combined with widespread income tax holidays creates inefficiencies and disproportionately benefits incumbents. Limited competition in key industries also serves to discourage investment.

29. Increasing inclusiveness. The incidence of poverty fell to 25 percent in mid 2013 from 28 percent in 2012, the first sizable decline in a decade, although the series of natural disasters in late 2013 may have partly reversed this progress.[19] In the labor market, employment grew only half as fast as GDP in 2013—well below the rate needed to absorb the nearly one million labor force entrants each year—although the unemployment rate declined to 7 percent in April 2014, nearly ½ percentage point lower than a year earlier.[20] The underemployment rate, although moderating to 18¼ percent in April, remains elevated. Agriculture, which provides some 31 percent of employment, has stagnated on high transport costs and unclear property rights stemming from land reform for small-scale farmers, which have discouraged sectoral investment and resulted in low productivity and employment. Public social assistance has expanded significantly in recent years through conditional cash transfers (CCTs, Box 8) and

[18] The Constitution explicitly restricts foreign ownership and management in a number of sectors. For natural resources, public utilities, and educational institutions, corporations must be at least 60 percent owned by Filipinos. Advertising is restricted to corporations 70 percent owned by Filipinos, while mass media and all professions are open only to Filipinos. In addition to the constitutional restrictions, the Foreign Investment Act gives the Philippine president the authority to impose foreign ownership restrictions in other sectors through the bi-annual Foreign Investment Negative List. The latest order, issued in October 2012, expanded the number of restricted sectors and activities. Since 2000, only large retailers and casinos have seen reductions in foreign ownership restrictions.

[19] Based on the national definition of poverty. On the World Bank's US$2 per day threshold (in purchasing power terms), some 41 percent of the population was below the poverty line in 2009, compared to 29 percent under the national definition (Figure 9).

[20] Employment gains over the past year were mainly in retail and wholesale trade and construction. Nonetheless, recent growth has been less employment intensive than previously, leading to some 500,000 missing jobs as of 2013 and still high structural unemployment (Chapter 2 of the accompanying selected issues).

universal health insurance coverage (with the latter financed by higher excise taxes on tobacco and alcohol since 2013.

Staff Position

30. Continuing to improve the business climate would help maintain the economy's growth momentum and broaden its sectoral underpinnings. Recent improvements in fiscal transparency and public financial management have helped to increase the efficiency of public spending and instill better governance, which should help catalyze private sector activity (Box 9). Deeper integration through the ASEAN Economic Community 2015 and other prospective multilateral trade agreements (RCEP, TPP) will intensify regional competition in product markets and for investment. Scaling back generous perpetual income tax holidays that favor incumbents, relaxing limits on foreign ownership, approving a comprehensive Competition Law that establishes an independent fair trade commission, and further improving the investment climate—including by cutting red tape, which raises the level and unpredictability of business costs—would help realize the potential benefits these arrangements can bring in terms of new sources of growth and employment. Reducing the infrastructure backlog in transport and electricity is critical, but removing operational bottlenecks and regulatory uncertainty, which are impeding the execution of public projects and PPPs, is also essential.

31. Sustained job rich growth is needed to help break the cycle of poverty and outward labor flows. Increased public spending on CCTs, universal health coverage for the poor and public education are helping to better social outcomes. However, creating stable jobs is the one of the most effective ways to achieve permanent poverty reduction. In addition to improving the overall business climate (as discussed above), faster growth in labor intensive sectors—agro business and activities of micro, small, and medium sized firms—is needed to absorb the large pool of less skilled workers, many of whom are underemployed. Granting individual ownership titles to small land parcels would allow land to be used as collateral to back business loans, while building farm-to-market roads and increasing competition on inter island shipping would lower transport costs. Reducing red tape and labor market rigidities (including high firing costs and strict limits on apprenticeships and fixed-term contracts), which disproportionately burden SMEs, would support business expansion and job creation. Small-scale entrepreneurs would also benefit from greater access to formal credit services, where intermediation costs are lower.[21] Boosting resilience to natural disasters through "build back better" programs and low cost insurance schemes would reduce the risk that households fall back into poverty when a natural disaster strikes. Improving prospects for domestic employment would reduce incentives for working abroad, and the concomitant social hardships and challenges for macroeconomic management from large remittances in the absence of compensating productivity gains.

[21] See Chapter 3 of the accompanying selected issues.

Authorities' Views

32. The authorities remain committed to achieving rapid, socially inclusive economic growth. The President's good governance agenda has proven to be an effective reform platform for delivering significant improvements in government efficiency and transparency, as noted by the World Economic Forum, the IFC, and in the IMF's Fiscal Transparency Assessment. Further boosting public spending on social programs and infrastructure are planned, in line with available revenue, with PPPs serving to mobilize private sector resources for infrastructure development. To reap the benefits of ASEAN integration, further improvements to the investment environment will be directed toward relaxing those foreign ownership limits that do not require amending the constitution, rationalizing tax incentives, and institutionalizing transparency and governance reforms to ensure their irreversibility.

STAFF APPRAISAL

33. The Philippine economy continued to perform robustly in 2013. Strong macroeconomic fundamentals and financial sector buffers, together with the authorities' flexible policy response to evolving external conditions, cushioned the impact of volatile capital flows. However, domestic monetary and financial conditions are now very accommodative. Notable progress was also achieved in lowering the poverty rate, although the incidence of poverty and under- and unemployment remain elevated.

34. Macroeconomic prospects are expected to remain favorable going forward. Reconstruction from super typhoon Yolanda, infrastructure spending and remittance-driven private consumption will support rapid GDP growth, but the pace is likely to ease somewhat on more restrictive financing conditions that would help to temper inflation, narrow the positive output gap, and enhance financial stability. The current account surplus is forecast to decline gradually, with the real effective exchange rate moving in line with structural flows.

35. This favorable outlook could be buffeted by external and domestic events. Abrupt exit from exceptionally loose monetary policies abroad, a sharp slowdown in China or other emerging markets, or a major geopolitical incident could impact global or regional trade and capital flows and adversely affect the Philippine economy. On the domestic front, rapid credit growth or a disproportionate flow of resources to the property sector could boost short-term growth but heighten volatility thereafter, impacting over-leveraged households and corporates.

36. The challenge is to deliver high quality growth. Better realizing the Philippines' potential for rapid, sustained and more inclusive growth calls for further reducing bottlenecks to investment and formal sector employment that may be discouraging broad based business activities. A more diversified production structure would strengthen resilience to economic shocks, which unduly impact the poor. Favorable demographics are a missed opportunity if the economy cannot effectively absorb the growing working age population. Better domestic job opportunities would reduce poverty, thereby curtailing outward migration and the

accompanying social hardships and sustained remittance inflows that can complicate macroeconomic management in the absence of compensating productivity gains.

37. **The economy is well positioned for a more restrictive policy setting, together with a needed rebalancing of the policy mix towards an expansionary fiscal policy**. The large buildup of reserves in recent years by leaning against the wind of sustained inflows suggests the external sector is moderately stronger than warranted by medium-term fundamentals. Incomplete sterilization and exceptionally loose monetary policies in advanced economies compressed domestic interest rates to low levels. A tighter overall policy stance is now needed to maintain macrofinancial stability, with a rebalancing of the policy mix in order to accommodate fiscal spending for post typhoon reconstruction and infrastructure upgrading.

38. **Continuing to proactively tighten monetary conditions would address both potential inflation and generalized financial stability risks**. With market interest rates well below the policy rate, the BSP's decisions to withdraw liquidity by drawing down reserves and raising reserve requirements earlier this year were appropriate. Additional tightening of monetary and financial conditions is needed with a focus on measures that would not encourage a further shift in financial intermediation to nonbanks, including by raising official interest rates. Providing the BSP with suitable instruments to undertake sterilization would improve the effectiveness of monetary policy. With official reserves more than adequate, the exchange rate should adjust more fully to structural balance of payments flows, while symmetrically smoothing the effect of cyclical capital flows.

39. **Additional targeted action is needed to contain specific risks to the financial system**. Early adoption of Basel III capital requirements, monitoring a broader definition of banks' real estate exposure, standardizing "contract to sell" financing arrangements for developers, and establishing the Financial Stability Coordination Council were appropriate preemptive responses to deepening financial intermediation. Taking further measures is advised to contain risks in the property sector and to improve oversight and better manage risks from large exposures. Therefore, the recently-announced bank stress tests for real estate exposure are commendable. Widening the BSP's mandate to include financial stability would help prevent diversion of systemic risk to the shadow-banking sector and strengthen powers for managing risks associated with greater cross border financial integration.

40. **Continuing to focus on mobilizing stable sources of revenue would ensure room for structural spending priorities while preserving fiscal prudence**. Increasing the national government deficit to 2 percent of GDP in 2014 and maintaining it thereafter is appropriate to continue to build fiscal buffers and moderate the debt ratio. To achieve sustainable and inclusive economic growth, larger public spending is needed for disaster remediation, infrastructure upgrading and to support improved social outcomes. Meeting these spending demands requires a sizable tax effort, which should focus mainly on broadening the tax base by reducing exemptions and allowances and adopting a new mining strategy, supported by improvements in tax administration.

41. Further reforms to attract investment and create new employment would help sustain vibrant economic growth and make it more inclusive. Relaxing limits on foreign ownership, reducing red tape, and limiting tax holidays that tend to favor incumbents and distort the tax system would increase market contestability, support execution of PPPs, and better position the Philippines to benefit from the growth and employment opportunities of deeper regional integration. Increasing job creation in agriculture and in micro and small firms calls for establishing clear property rights for small-scale farms, expanding access to formal credit, and reducing labor market rigidities.

42. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Box 1. Philippines: Natural Disaster Risks and Addressing Their Social and Economic Consequences

Disaster risk: The Philippines ranked third highest in the 2012 World Risk Index, which measures exposure to natural hazards and the capacity to cope and adapt to these events.[1/] Island states and archipelago countries were found to be most at risk given their susceptibility to cyclones, floods, and sea-level rise, especially in countries with weak economic and social development. The Pacific Rim—where the Philippines is located—is also exposed to earthquakes. In fact, a World Bank study finds that half the Philippines' land area, and 80 percent of its population, is vulnerable to natural disasters (World Bank, 2008).

World Risk Index

Rank	Country	Risk (In percent)
1	Vanuatu	36.31
2	Tonga	28.62
3	**Philippines**	**27.98**
4	Guatemala	20.75
5	Bangladesh	20.22
6	Solomon Islands	18.15
7	Costa Rica	17.38
8	Cambodia	17.17
9	Timor-Leste	17.13
10	El Salvador	16.89
11	Brunei Darussalam	15.92
12	Papua New Guinea	15.81
13	Mauritius	15.39
14	Nicaragua	15.36
15	Fiji	13.69

Source: Alliance Development Works, *WorldRiskReport 2012*.

According to the Center for Research on the Epidemiology of Disasters, 225 significant natural disasters were recorded in the Philippines during 2000–12.[2/] Tropical storms and floods were the most frequent events, as well as the most damaging in terms of lives lost and affected population.

The private sector has typically borne 90 percent of the damage and losses from natural disasters in the Philippines, according to the Global Facility for Disaster Reduction and Recovery.[3/] Property loss and population displacement disrupt employment patterns, often for prolonged periods. Poorer segments of the population tend to be the most affected, leading to a sustained increase in localized poverty rates.

Typhoon Yolanda, the strongest storm ever to make landfall and with a storm surge of up to 7 meters, struck the central Philippines on November 8, 2013. According to the United Nations, 6,201 people were killed, 1,785 remain missing, 4.1 million people were displaced, and 1.1 million houses were damaged or destroyed.[4/] All told, 14 million people (more than 14 percent of the population) were impacted by the storm.

Prior to the storm, the affected region accounted for 17½ percent of GDP and included 31 percent of the population (29 million people). The area is intensive in agriculture (27 percent of national output), with a smaller share of countrywide industry and services. Average household income in 2012 was 75 percent of the national average, and more than half of all households were heavily dependent on income from agriculture and remittances. Poverty rates in the region—ranging between 29 percent and 41 percent—were well above the national average of 22 percent.

The official estimate of the typhoon-related damage and loss amounts to US$13 billion (about 5 percent of GDP), including destroyed physical assets and near-term foregone income. As with previous disasters, the private sector is thought to have incurred about 90 percent of the cost. Private losses were uninsured. Preliminary estimates suggest that the impact on economic activity at the national level was fairly limited, reflecting the relatively lower incomes and weaker economic dynamism of the affected regions.

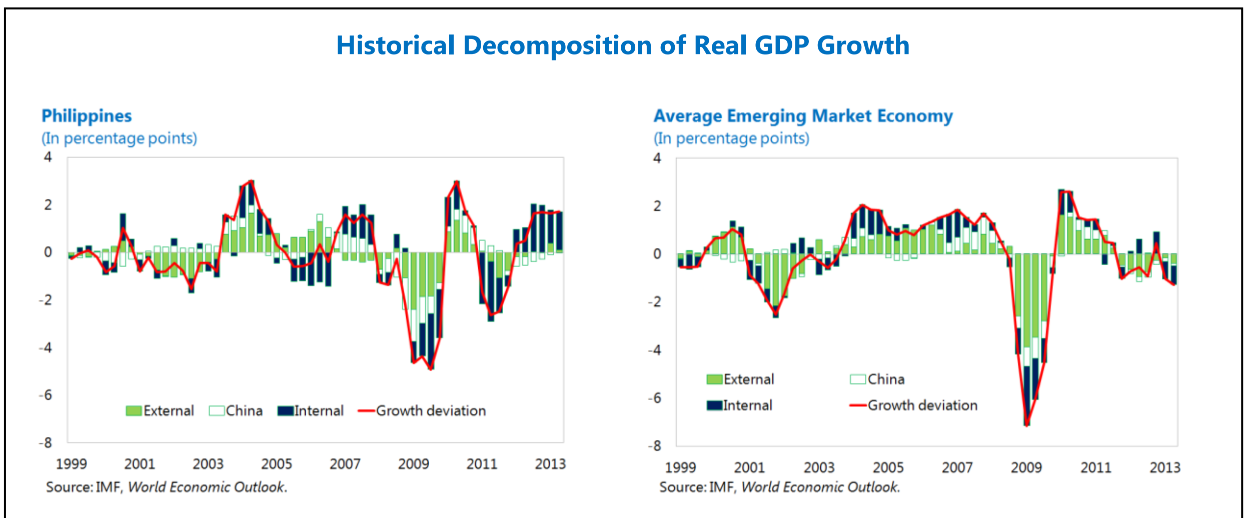
Fiscal response: The government's Reconstruction Assistance on Yolanda (RAY) plan from December 2013 is intended to guide the public sector's recovery and reconstruction response. Based on the principle of building back better, economic and social conditions are to be restored or improved compared with pre-typhoon levels, and disaster resilience is to be upgraded. The plan envisages close coordination between government agencies, local government units, international donors, civil society, and the private sector. The government has earmarked some ₱ 120 billion (1 percent of GDP) for reconstruction spending in 2014. In addition, a Multi-donor Trust Fund will be established to coordinate the deployment of foreign grants. For the longer term, the government is considering to establish a Climate Change and Disaster Resiliency Fund to reduce vulnerability and economic losses associated with future natural disasters.

1/ Alliance Development Works, United Nations University Institute for Environment and Human Safety, and The Nature Conservancy, *World Risk Report*, 2012, Berlin.
2/ Centre for Research on the Epidemiology of Disasters (CRED), *Annual Disaster Statistical Review 2012*.
3/ ADB, UN, World Bank Group and other GFDRR Partners, *Philippines—Typhoons Ondoy and Pepeng: Post-Disaster Needs Assessment*.
4/ United Nations Office for the Coordination of Humanitarian Affairs.

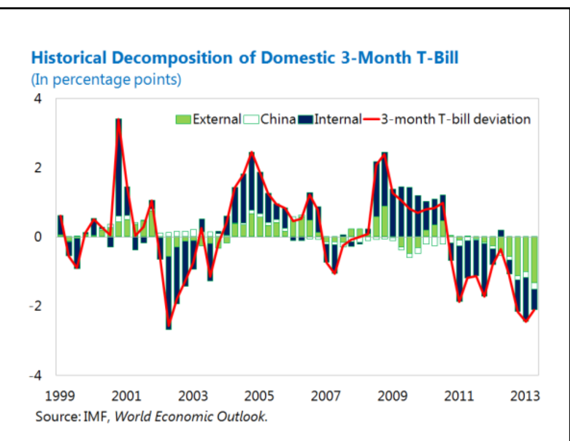
Box 2. What is Driving Philippines' Growth?

While growth in many EMs has recently slowed, in the Philippines, growth has remained resilient. To what extent does this divergent growth path reflect domestic factors—such as policy responses and structural reforms—and how much can be attributed to external developments in major economies— including unconventional monetary policies (UMPs), and shifts in foreign demand and commodity prices? This box examines this question using a structural VAR developed for Emerging Market Economies (EMEs) in the April 2014 *World Economic Outlook*. External effects are measured by: (i) a U.S. block (real GDP growth, inflation, 10-year treasury bond yield); (ii) a China block (real GDP growth); (iii) a block for financial and trade prices (composite EMBI Global and country-specific terms of trade); and (iv) a country-specific domestic block (real GDP growth, inflation, real exchange rate change against the U.S. dollar, short-term interest rate). Identification is established on the assumption that external variables are unaffected by domestic variables within a given quarter.

For the Philippines, the model finds that since the GFC: (i) the explanatory power of external factors has gradually waned (giving a greater role to internal factors, which are obtained residually); (ii) China's contribution has generally been smaller than that of other external factors, although typically of the same sign; and (iii) contributions from external and internal factors have generally been of the same sign for much of the post GFC period, but recently, they have moved in opposite directions, with external factors creating a small drag on growth, reflecting the China slowdown. For other EMEs, the growth pattern and its decomposition were similar to the Philippines' during 2009–10. Thereafter, however, external factors dominated, dragging down growth.



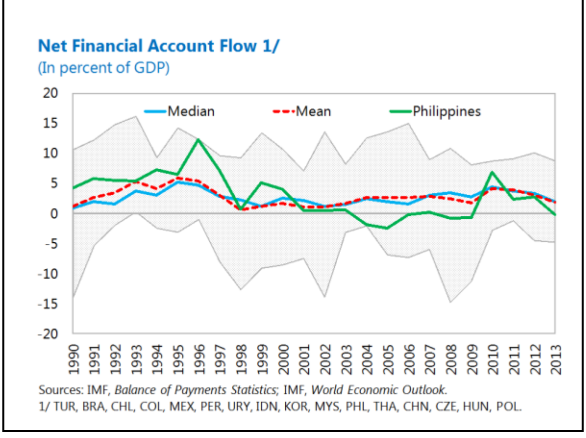
Why have internal factors tended to play a more prominent role in Philippine GDP growth recently, in contrast to other EMEs? Part of the explanation may be due to the fact that the Philippines is relatively less open to trade and financial flows than most other EMEs. In fact, external growth contributions around the start of the GFC were smaller in the Philippines than in other EMEs. Also, actual (and potential) growth is thought to have risen in recent years in response to ongoing structural reforms.



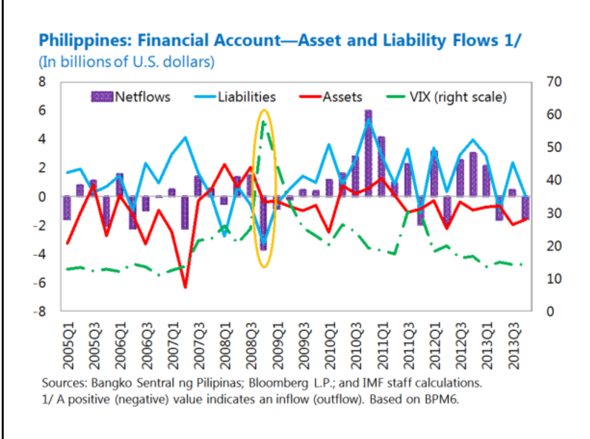
In addition, domestic interest rates are also likely to have played a role. This can be seen by decomposing the domestic 3-month T-bill rate using the same structural VAR model as above. External contributions to domestic interest rates are found to have turned increasingly negative in recent years as activity in major economies slowed, world commodity prices moderated, UMPs were introduced, and EMEs' interest spreads narrowed. However, internal factors also played a large dampening role since 2011. This likely reflects the impact of sizable structural current account inflows that—being only partly sterilized—further loosened domestic monetary and financial conditions and, in turn, provided additional support for GDP growth.

Box 3. Philippines: Financial Flows

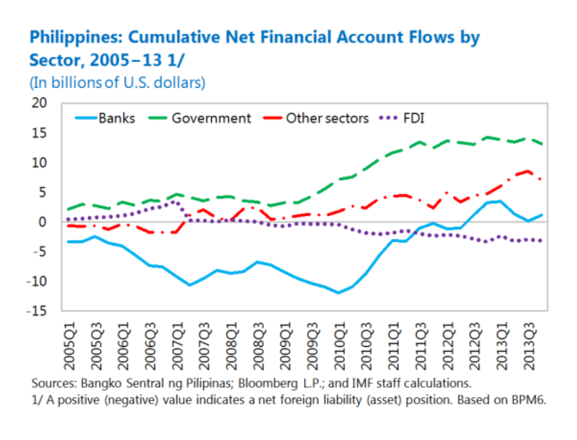
As a share of GDP, net financial flows into the Philippines have moved broadly in line with the emerging market average during the past two decades. However, financial flows were above average prior to the Asian Financial Crisis, peaking at 12¼ percent of GDP in 1996, then moderating during the 2000s, and rebounding briefly in the aftermath of the global financial crisis (GFC). Net financial flows were near zero in 2013.



Underlying this pattern of net flows are larger—and opposing—gross flows by residents and nonresidents. Specifically, nonresidents lend to Philippine residents (i.e., residents are incurring liabilities) while residents simultaneously place assets abroad, and vice versa. This offsetting pattern of gross capital flows may reflect portfolio diversification by residents in the presence of relatively shallow domestic capital markets, as noted in the WEO (October 2013). It is also likely to reflect placement abroad by residents of collateral needed to secure external loans and round tripping by domestic banks in response to restrictions on shifting forex funding between banks' peso and foreign currency banking units. However, this "normal" offsetting pattern was interrupted during the extreme risk aversion at the height of the GFC, when asset and liability flows were reinforcing, implying that both residents and nonresidents exited, in contrast to the home bias behavior evident in other EMs at that time.

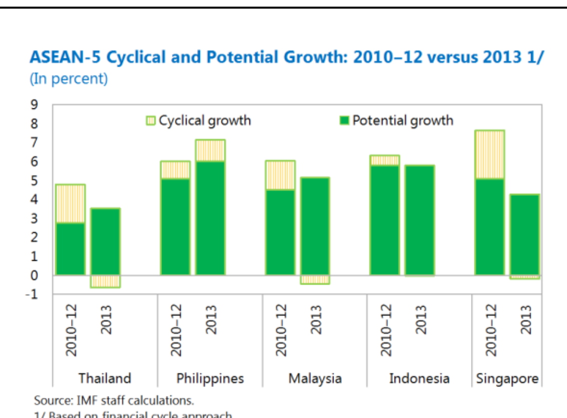


Cumulative financial flow data since 2005 indicate that banks initially experienced financial outflows (reflecting placement of assets abroad), but then gradually drew down those assets beginning in early 2010 to reach a small net external liability position in 2012. Banks cut their external borrowing immediately following the Fed's taper talk in Q2:2013. Government liabilities picked up in the two years following the GFC (coinciding with the temporary fiscal stimulus), but these have stabilized since 2011. Liabilities of other sectors to nonresidents also ticked up since the GFC. On the other hand, cumulative net FDI flows are marginally negative, indicating that residents' outward FDI exceeds nonresidents' inward FDI.



Box 4. Philippines: What is Happening to Potential Growth?

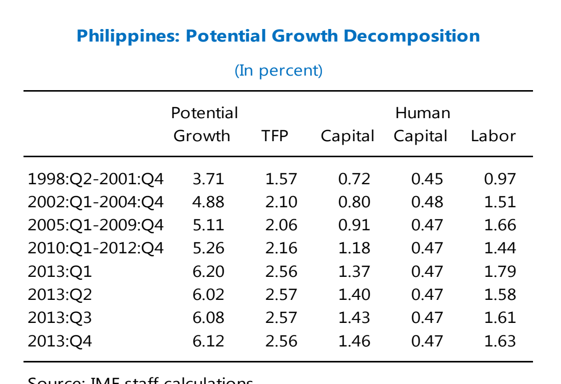
Previously dubbed the "sick man of Asia" for its relatively slow growth in previous decades, the Philippines recorded among the fastest growth in Asia during the past two years. Rapid growth occurred alongside strong macroeconomic outcomes and a focus on good governance that earned the Philippines an investment grade credit rating in 2013, reduced risk premia and buoyed consumer and investor confidence. At the same time, global and domestic financing conditions were accommodative. Does the recent growth performance reflect increased potential or is it due to cyclical factors? The answer to this question is critical for designing appropriate macroeconomic policies and for identifying structural policies that can help sustain the growth takeoff.



Source: IMF staff calculations.
1/ Based on financial cycle approach.

Several approaches are used to estimate potential growth. Three widely-used approaches are applied here. Although each is subject to uncertainty, the fact that a similar picture emerges from each—namely, that potential growth in the Philippines has increased from around 4–5 percent in the 2000s to about 6–6½ percent by 2013—suggests the results are robust.

- ***Univariate filtering***. The Hodrick-Prescott (HP) approach is commonly used to decompose output into cycle and trend components. However, the financial cycle—which tends to occur at lower frequencies than business cycles and may not be associated with inflation—can also impact GDP growth. Extending the HP filter to incorporate information about the financial cycle (e.g., real credit, property prices) yields a finance-neutral estimate of potential output (Borio and others, 2013). Applying this approach shows that potential growth rose more in the Philippines in 2013 than the other ASEAN-5, even controlling for increase in cyclical growth. Nonetheless, the cyclical component of growth was around 1 percent of GDP.



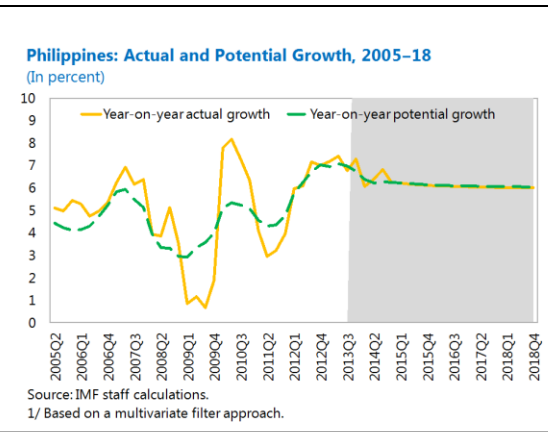
Philippines: Potential Growth Decomposition
(In percent)

	Potential Growth	TFP	Capital	Human Capital	Labor
1998:Q2-2001:Q4	3.71	1.57	0.72	0.45	0.97
2002:Q1-2004:Q4	4.88	2.10	0.80	0.48	1.51
2005:Q1-2009:Q4	5.11	2.06	0.91	0.47	1.66
2010:Q1-2012:Q4	5.26	2.16	1.18	0.47	1.44
2013:Q1	6.20	2.56	1.37	0.47	1.79
2013:Q2	6.02	2.57	1.40	0.47	1.58
2013:Q3	6.08	2.57	1.43	0.47	1.61
2013:Q4	6.12	2.56	1.46	0.47	1.63

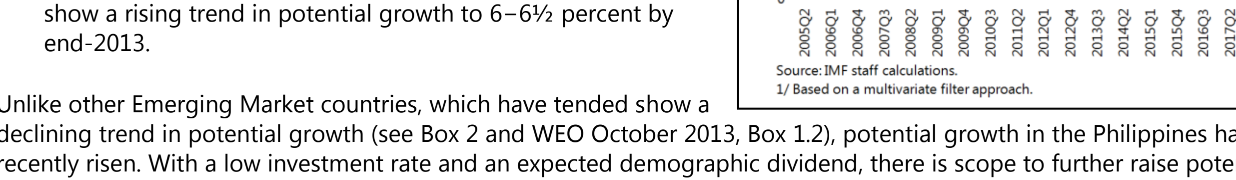
Source: IMF staff calculations.

- ***Production function***. A simple growth accounting framework based on a production function is used to decompose potential output into its determinants—human capital augmented-labor, capital, and a residual (interpreted as total factor productivity, TFP). The results suggest that potential growth has risen to about 6–6¼ in 2013 led by an increase in TFP and capital accumulation.

- ***Multivariate time-series***. A multivariate filter is constructed that leverages information from output, inflation, unemployment, capacity utilization and expectations of inflation and growth (from Consensus Forecasts) to infer potential growth, both historically and in real time. The results show a rising trend in potential growth to 6–6½ percent by end-2013.



Source: IMF staff calculations.
1/ Based on a multivariate filter approach.



Unlike other Emerging Market countries, which have tended show a declining trend in potential growth (see Box 2 and WEO October 2013, Box 1.2), potential growth in the Philippines has recently risen. With a low investment rate and an expected demographic dividend, there is scope to further raise potential growth through capital deepening and higher employment, as well as sustaining the trend rise in TFP, provided further progress is made on improving the business climate.

Box 5. Philippines: Recent Monetary and Liquidity Policy Measures

During the past several years, the BSP deployed a range of policy tools to discourage speculative activity, strengthen liquidity management, and lower sterilization costs:

- Prohibited (since end 2013) external funds and direct placements by nonbanks in the SDA—a short-term sterilization facility with a balance that peaked around US$40 billion (16 percent of GDP) in early 2013—and gradually lowered the remuneration rate to 2 percent (since April 2013), below the 3½ percent policy rate;
- Ceased to remunerate (since April 2012) and raised the rate of required reserves (now at 20 percent for universal and commercial banks as of May 2014);
- Increased capital charges (in January 2012) and introduced limits on banks' nondeliverable forward (NDF) positions (in March 2013);
- Gradually curtailed (beginning in late 2010) its forex forward book (counterpart to one leg of banks' forward positions, used for hedging); and
- Together with the Treasury, implemented the Treasury Single Account (since late 2013), consolidating national government cash resources into an account at the BSP.

Box 6. Philippines: Status of Public-Private Partnership Projects

To help close the Philippines' large infrastructure gap, in 2010 the government launched a series of Public-Private Partnership (PPP) projects. The projects span various sectors, with transport infrastructure accounting for the largest share. Over the past year, the pipeline of PPPs was expanded considerably from 22 to 57 projects, with a total identified cost of 9 percent of 2013 GDP, although numerous projects have yet to be priced. Issues arising in the planning, bidding, and implementation stages have slowed progress considerably, however. Seven projects with a total value of 62.6 billion pesos have been awarded to private contractors, and are at various stages of execution, although none was completed by end 2013. In this context, proposed amendments to the Build-Operate-Transfer law that give the national government additional powers in the case of PPPs of national importance to facilitate land acquisition for these projects could relieve some regulatory uncertainty for investors and accelerate project execution. Public resources to meet contingent fiscal liabilities arising from PPPs were increased in the 2014 Budget.

Philippines: Public-Private Partnerships: Pipeline Projects 1/

	Project cost (In billions of pesos)	Number of Projects 2/
Agriculture	...	1
Education	20.1	2
Energy	...	1
Health	5.7	5
Justice	40.3	1
Population/census	...	1
Road network	223.6	12
Transportation	741.0	29
Water	43.1	2
Local government	0.2	3
Total	1,074.0	57
(In percent of GDP)	9.3	...

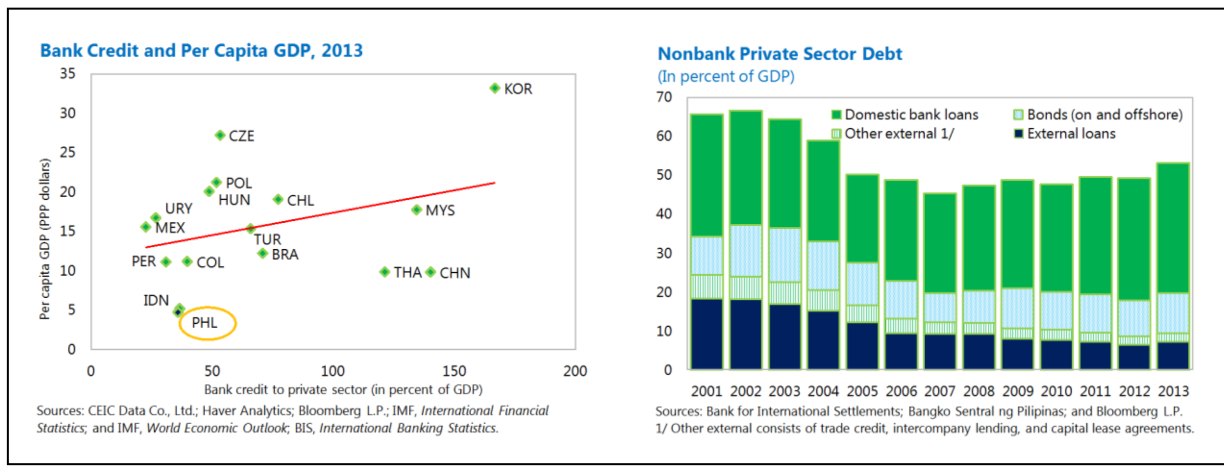
Source: Philippines PPP center.

1/ Includes seven projects for which contracts have been awarded.
2/ Includes 28 projects without an estimate of project cost.

Box 7. Philippines: A Cross-Country Perspective on Bank Credit Penetration

After contracting sharply in the aftermath of the Asian Financial Crisis, the GDP ratio of bank credit to the private sector in the Philippines has risen steadily since mid-2006, reaching 35 percent of GDP in 2013. Lending by banks has been growing at an annual rate of 10–20 percent in recent years.

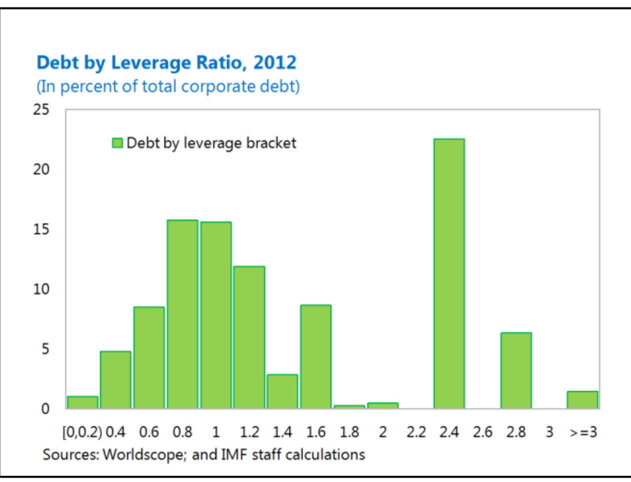
The Philippines' bank credit ratio (BCR) is low relative to many EMs in Asia and Europe, but similar to that in major Latin American EMs and Indonesia. However, conditioned on per capita income, the Philippines' (and Indonesia's) BCR appears relatively high. Unlike many other EMs, households account for a small share of banks' loan portfolios (7 percent of GDP and 15¾ percent of total bank loans).



Sources: CEIC Data Co., Ltd.; Haver Analytics; Bloomberg L.P.; IMF, *International Financial Statistics*; and IMF, *World Economic Outlook*; BIS, *International Banking Statistics*.

Sources: Bank for International Settlements; Bangko Sentral ng Pilipinas; and Bloomberg L.P.
1/ Other external consists of trade credit, intercompany lending, and capital lease agreements.

While domestic bank loans still dominate, other sources of formal credit (bonds, external loans) are gaining in importance, and total debt of the nonbank private sector has risen steadily to around 55 percent of GDP. The vast majority of this debt is extended to corporates. On average, leverage of listed companies is low at 100 percent in 2012. However, debt is unevenly distributed across firms, and companies with leverage ratios above 200 percent account for about one-third of total corporate debt.



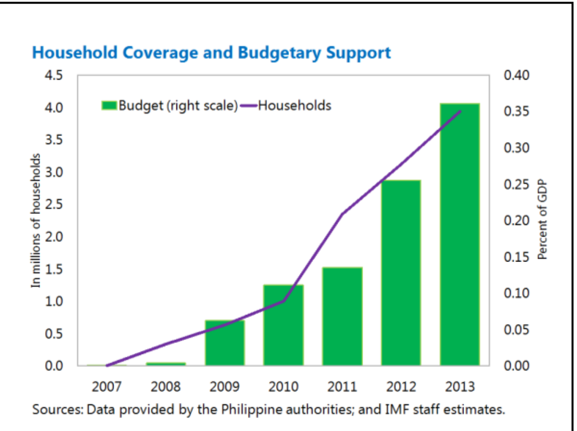
Sources: Worldscope; and IMF staff calculations

Informal credit activity is also thought to be sizable. About 10 percent of households include an overseas Filipino worker who sends back remittances. While a large part of these inflows is channeled to banks and other formal savings vehicles, a sizable part is deployed in the informal sector. Survey results indicate that 39 percent of the adult population obtained a loan from friends or family during the previous year, compared to 11 percent for a bank loan. Nonbank borrowing is considerably more prevalent in the Philippines than in other EMs.

Box 8. Philippines: Conditional Cash Transfer Program

The Philippines' Conditional Cash Transfer (CCT) program provides modest cash transfers to poor households in exchange for recipients' compliance with certain basic education and health requirements.[1/] The program, which began as a pilot in 2007, has grown rapidly, and at end 2013 covered 3.9 million households, or 75 percent of all households identified as poor by the national targeting scheme. With growth of close to 70 percent per annum during 2010–13, the budget expenditure reached nearly 0.4 percent of GDP by 2013.[2/]

While the Philippines' CCT is relatively recent compared with Latin American countries, where programs were initiated in the 1990s, coverage is now the third largest in the world (behind Brazil and Mexico). Together with universal health insurance, the CCT program is a cornerstone of the Philippine authorities' social protection efforts. The design of the CCT program was modeled on the Latin American programs, although assistance to children is provided for a longer period (from birth to age 14) than in the Latin American programs (Reyes and others, 2013).



Sources: Data provided by the Philippine authorities; and IMF staff estimates.

Studies have found generally good compliance and positive impacts from the program. The World Bank (2013) concludes the program is meeting its objective of improving school attendance and health outcomes for younger children, although there was no significant impact on school enrollment among older children aged 12–14 years.

The authorities are further expanding the program in 2014. Coverage is targeted to expand to 4.3 million households and the program is to be extended to children up to 18 years of age. In support of these goals, the CCT allocation in the 2014 budget is 42 percent higher than in the 2013 budget.

1/ To be eligible, households must reside in poor areas, be classified as poor, have a pregnant woman or at least one child of eligible age, and be willing to commit to meeting program conditions. Conditions are: (i) pregnant women must avail of pre- and post-natal care and be attended during childbirth by a trained health professional, (ii) parents must attend Family Development Sessions (FDS), (iii) 0–5 year old children must receive regular preventive health checkups and vaccines, (iv) 6–14 years old children must receive deworming pills twice a year, and (v) all child beneficiaries (0–18 years old) must enroll in school and maintain a class attendance of at least 85 percent per month. Benefitting households receive ₱500 per month for health and nutrition expenses, and ₱300 per child for educational expenses, up to three children. Starting 2014, they will receive ₱500 per older child up to 18 years of age.

2/ Numbers represent budget allocation up to 2010 and actual expenditure in 2011–13.

Box 9. Philippines: Progress in Fiscal Transparency

Improving fiscal transparency has been a priority in the Philippines in recent years. The public financial management (PFM) reform strategy is a key plank in support of the Philippines governance reform agenda. The Philippines has also played a leading role in international fiscal transparency initiatives, such as the Global Initiative for Fiscal Transparency (GIFT).

The authorities' reform efforts are beginning to bear fruit, as recognized by the IMF's Fiscal Transparency Evaluation in early 2014 that reached a broadly favorable conclusion. The evaluation assessed the Philippines' PFM practices against the draft Fiscal Transparency Code covering the three pillars of fiscal reporting, fiscal forecasting and budgeting, and fiscal risk analysis and management.

Fiscal reporting is relatively comprehensive, frequent and timely. Comparability of fiscal data against the original budget is difficult, however, reflecting fragmentation of agencies involved. Fiscal forecasting and budgeting is generally good, with several recent improvements, especially regarding fiscal policy objectives, performance orientation, public participation, and the comprehensiveness and orderliness of the budget. However, budget credibility is undermined by the complexity and large flexibility of the annual budget framework. Fiscal risk analysis and management is relatively strong, as shown by the publication of a comprehensive fiscal risk statement with a relatively comprehensive collation of risks that could affect public finances. However, improvements are needed in a few areas, especially to capture risks from guarantees and PPPs, assess the scope of tax expenditures, and introduce a longer-term perspective in the fiscal sustainability analysis. The evaluation reveals two crosscutting issues spanning across the three pillars: (i) the fragmentation of responsibilities for fiscal management in the public sector, and (ii) the complexity and flexibility of the budget system, which complicates fiscal reporting. The evaluation proposed twelve priority recommendations to address existing gaps.

Philippines: Impact of Selected Past Reforms on *FTC* Assessment

Reform Conducted	Main Principle of the Improved	Impact on the Assessment
Disclosure of revenue and expenditure from off-budget accounts in budget documentation	Budget Unity	Basic → Good
Presentation of aggregated three-year fiscal plan in budget documentation	Medium-Term Budget Framework	Not Met → Basic
Output performance indicators in budget documentation	Performance Information	Basic → Good
Accessible summary of the budget and grassroots participatory budgeting process	Public Participation	Not Met → Advanced
Mid-year report discussing half-year execution and macroeconomic and fiscal outlooks	Forecast Reconciliation	Not Met → Basic
Macro-sensitivity analysis with alternative interest and exchange rate scenarios	Macroeconomic Risks	Not Met → Good
Annual fiscal risk statement	Specific Fiscal Risks	Not Met → Advanced

Source: IMF staff.

Since then, progress in fiscal transparency has continued. The authorities are rolling out technological innovations to speed up budget release and procurement transactions, improve information flows and strengthen transparency and accountability. The Government Integrated Financial Management Information System (GIFMIS), which enables timely and more comprehensive monitoring of budget execution and agency utilization of funds, is currently being developed with a plan to pilot in 2015 and full implementation in 2016. The authorities also adopted the Treasury Single Account in 2014 for central government deposits that will be progressively expanded to the wider public sector. Philippines also recently introduced public websites to track expenditures of public calamity-related resources and to monitor foreign aid receipts. In fiscal risk management, the authorities intend to strengthen disclosure and management of contingent liabilities, including PPPs. Finally, the 2014 budget introduced performance-informed budgeting.

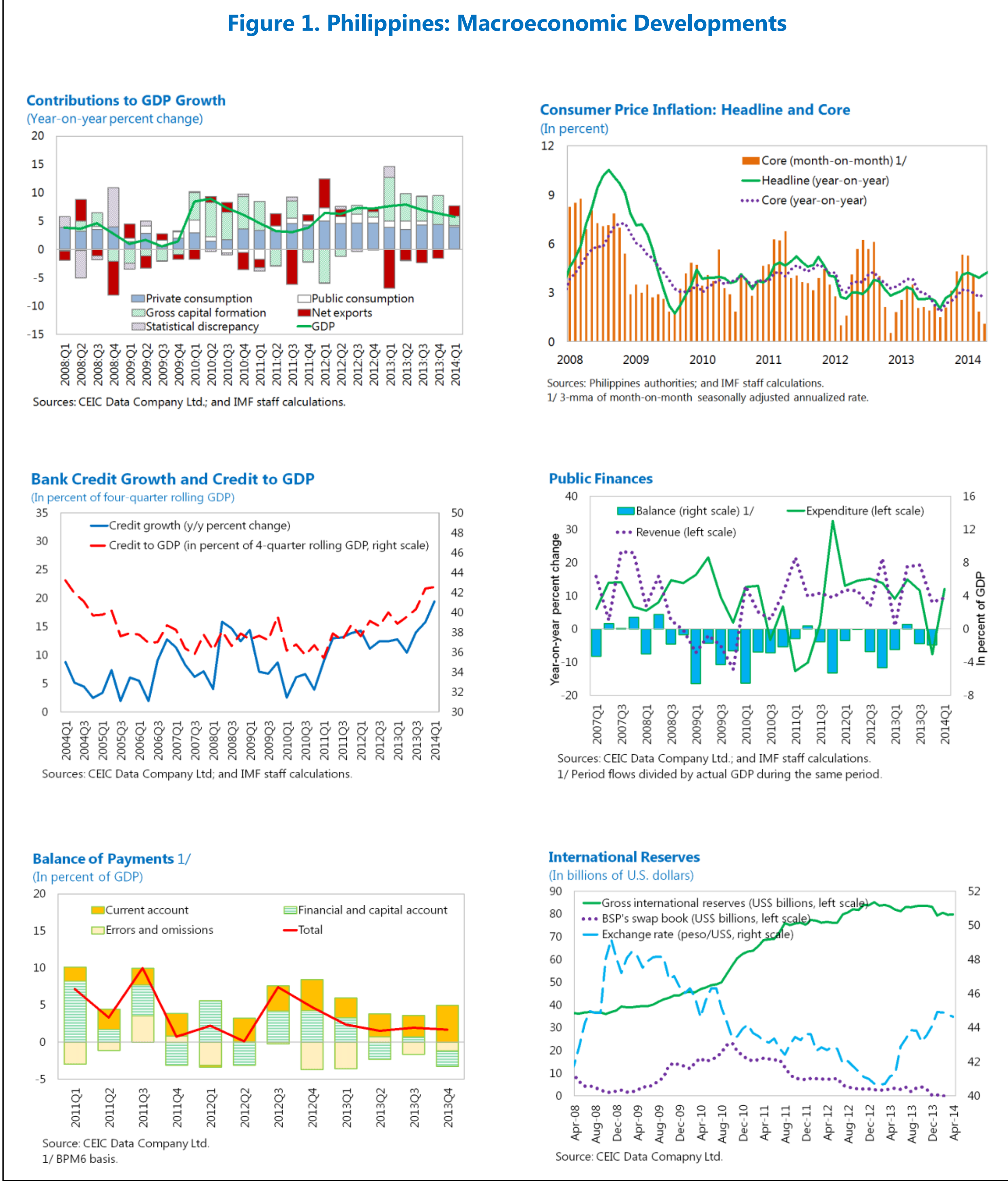
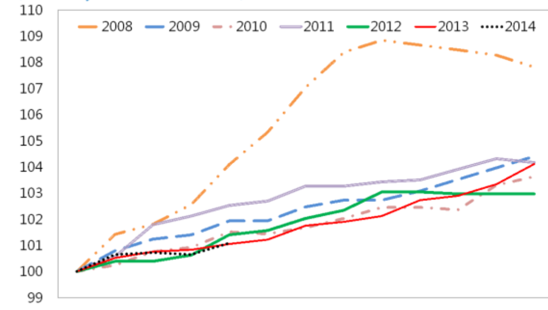


Figure 1. Philippines: Macroeconomic Developments
Contributions to GDP Growth
(Year-on-year percent change)
Private consumption
Public consumption
Gross capital formation
Net exports
Statistical discrepancy
GDP
Sources: CEIC Data Company Ltd.; and IMF staff calculations.
Consumer Price Inflation: Headline and Core
(In percent)
Core (month-on-month) 1/
Headline (year-on-year)
Core (year-on-year)
Sources: Philippines authorities; and IMF staff calculations.
1/ 3-mma of month-on-month seasonally adjusted annualized rate.
Bank Credit Growth and Credit to GDP
(In percent of four-quarter rolling GDP)
Credit growth (y/y percent change)
Credit to GDP (in percent of 4-quarter rolling GDP, right scale)
Sources: CEIC Data Company Ltd; and IMF staff calculations.
Public Finances
Balance (right scale) 1/
Expenditure (left scale)
Revenue (left scale)
Year-on-year percent change
In percent of GDP
Sources: CEIC Data Company Ltd.; and IMF staff calculations.
1/ Period flows divided by actual GDP during the same period.
Balance of Payments 1/
(In percent of GDP)
Current account
Financial and capital account
Errors and omissions
Total
Source: CEIC Data Company Ltd.
1/ BPM6 basis.
International Reserves
(In billions of U.S. dollars)
Gross international reserves (US$ billions, left scale)
BSP's swap book (US$ billions, left scale)
Exchange rate (peso/US$, right scale)
Source: CEIC Data Comapny Ltd.

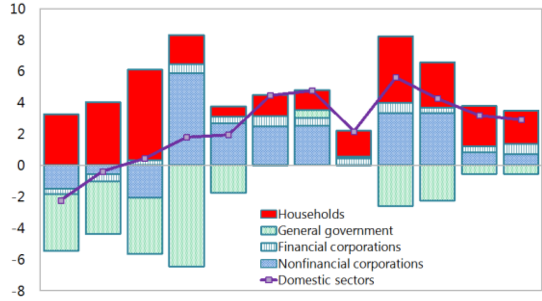
Figure 2. Philippines: Real Sector

Consumer Price Index
(Previous year's December=100)



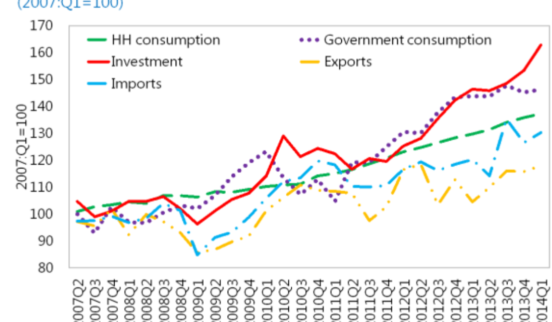
Sources: CEIC Data Company Ltd.

Flow of Funds: Net Lending by Sector
(In percent of GDP)



Source: Philippines authorities.

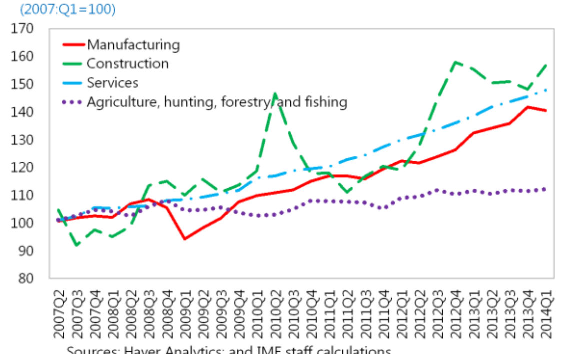
Real GDP by Expenditure, Seasonally Adjusted
(2007:Q1=100)



Sources: Haver Analytics; and IMF staff calculations.

Real GDP by Industry, Seasonally Adjusted

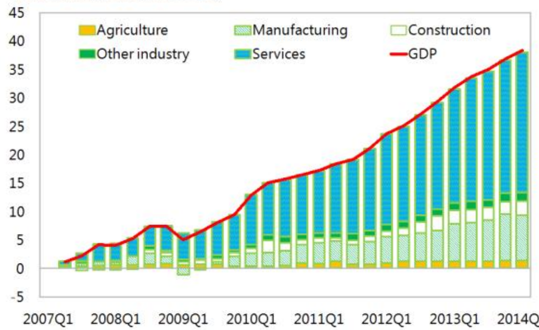
(2007:Q1=100)



Sources: Haver Analytics; and IMF staff calculations.

Contributions to Real GDP Growth—Supply Side

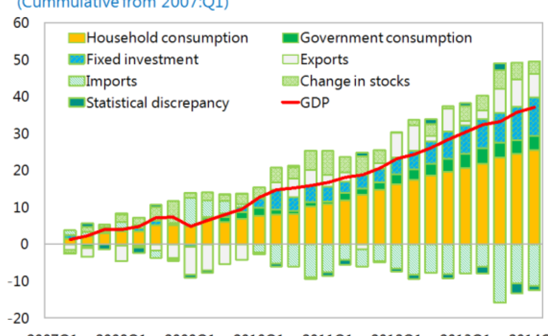
(Cummulative from 2007:Q1)



Source: National Statistical Coordination Board; and IMF staff calculations.

Contributions to Real GDP Growth—Expenditure Side

(Cummulative from 2007:Q1)



Source: National Statistical Coordination Board; and IMF staff calculations.

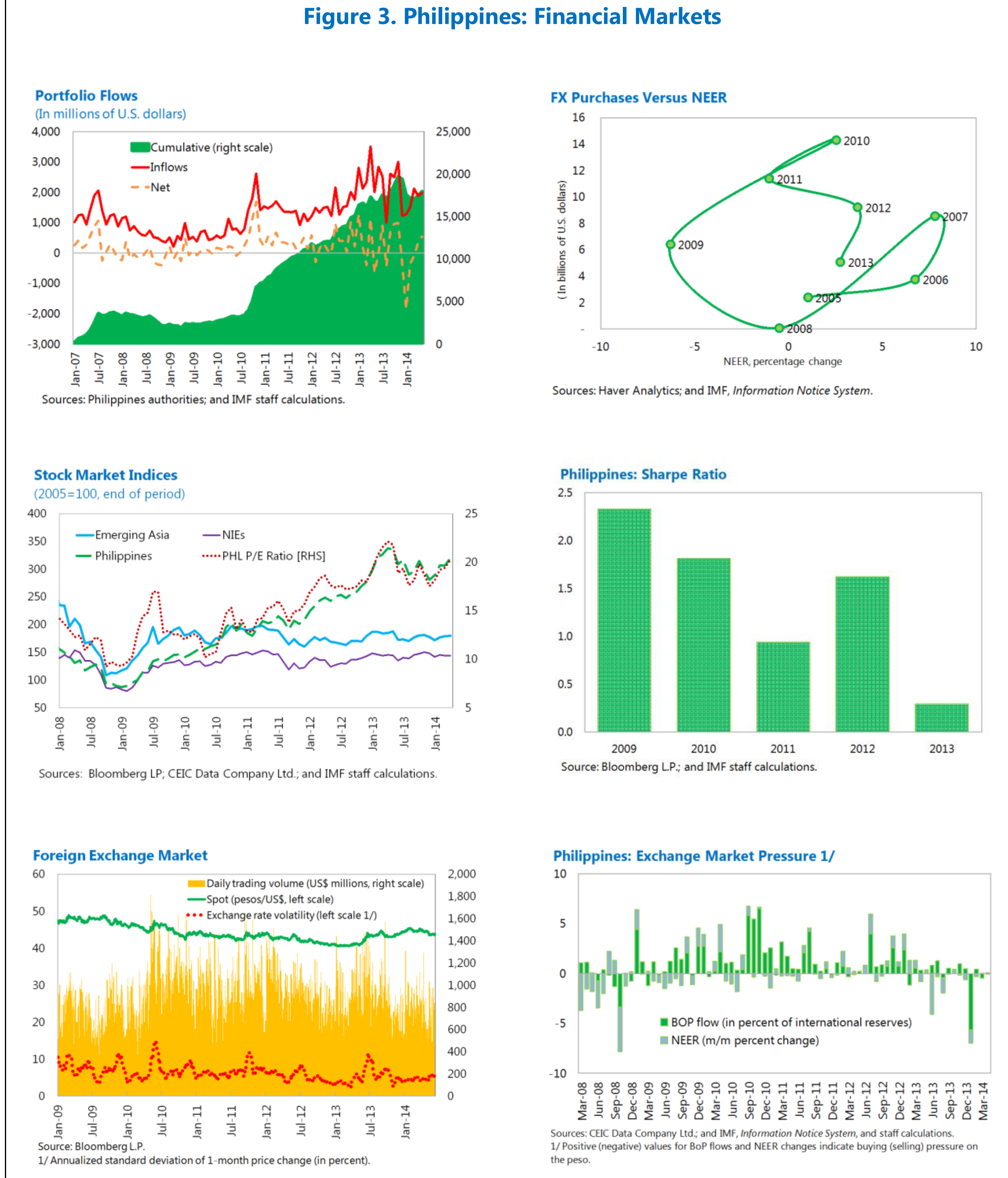
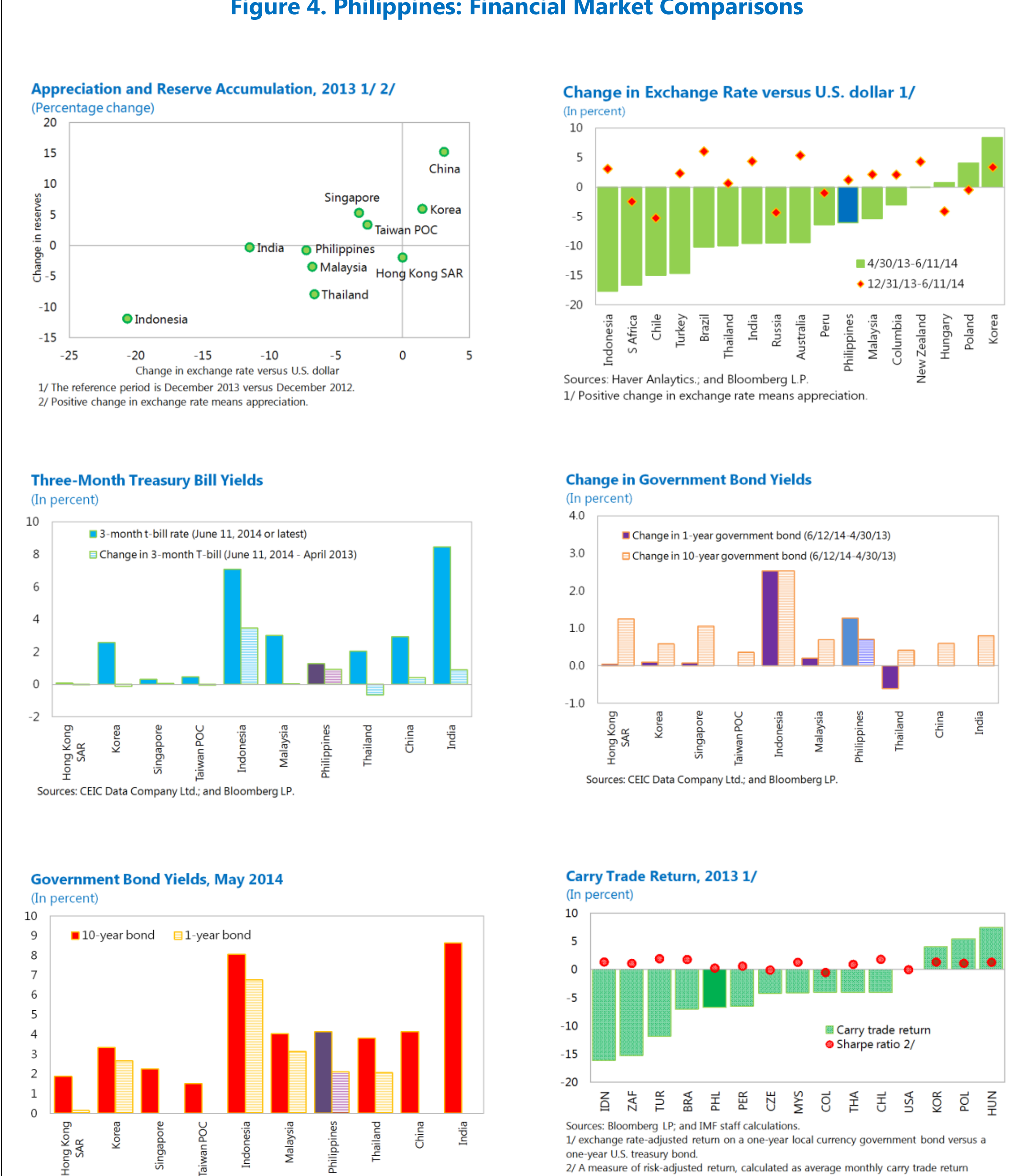


Figure 3. Philippines: Financial Markets
Portfolio Flows
(In millions of U.S. dollars)
Cumulative (right scale)
Inflows
Net
Sources: Philippines authorities; and IMF staff calculations.
FX Purchases Versus NEER
(In billions of U.S. dollars)
NEER, percentage change
Sources: Haver Analytics; and IMF, Information Notice System.
Stock Market Indices
(2005=100, end of period)
Emerging Asia
NIEs
Philippines
PHL P/E Ratio [RHS]
Sources: Bloomberg LP; CEIC Data Company Ltd.; and IMF staff calculations.
Philippines: Sharpe Ratio
Source: Bloomberg L.P.; and IMF staff calculations.
Foreign Exchange Market
Daily trading volume (US$ millions, right scale)
Spot (pesos/US$, left scale)
Exchange rate volatility (left scale 1/)
Source: Bloomberg L.P.
1/ Annualized standard deviation of 1-month price change (in percent).
Philippines: Exchange Market Pressure 1/
BOP flow (in percent of international reserves)
NEER (m/m percent change)
Sources: CEIC Data Company Ltd.; and IMF, Information Notice System, and staff calculations.
1/ Positive (negative) values for BoP flows and NEER changes indicate buying (selling) pressure on the peso.

Figure 4. Philippines: Financial Market Comparisons



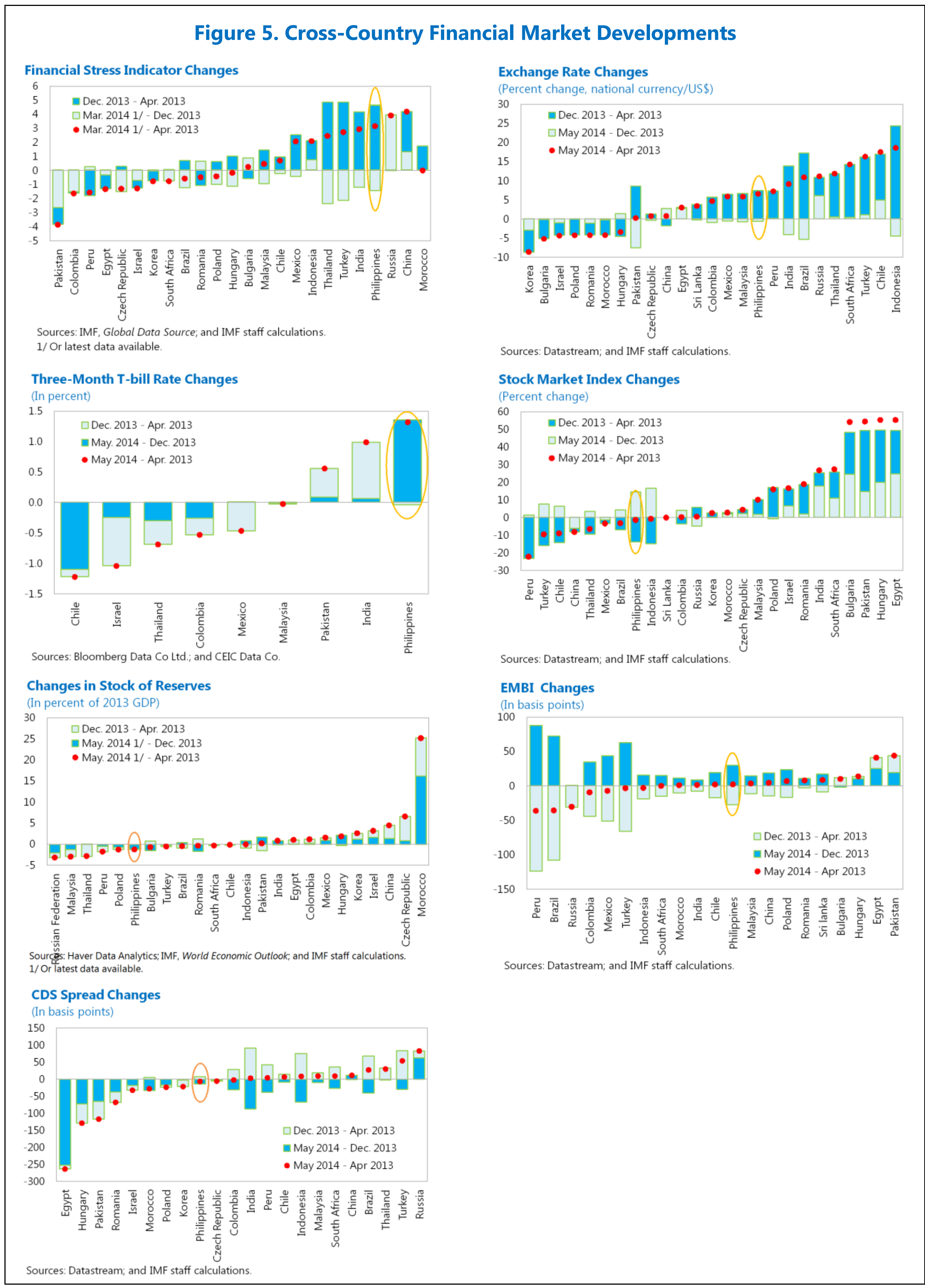


Figure 5. Cross-Country Financial Market Developments
Financial Stress Indicator Changes
Dec. 2013 - Apr. 2013
Mar. 2014 1/ - Dec. 2013
Mar. 2014 1/ - Apr. 2013
Pakistan
Colombia
Peru
Egypt
Czech Republic
Israel
Korea
South Africa
Brazil
Romania
Poland
Hungary
Bulgaria
Malaysia
Chile
Mexico
Indonesia
Thailand
Turkey
India
Philippines
Russia
China
Morocco
Sources: IMF, Global Data Source; and IMF staff calculations.
1/ Or latest data available.
Exchange Rate Changes
(Percent change, national currency/US$)
Dec. 2013 - Apr. 2013
May 2014 - Dec. 2013
May 2014 - Apr 2013
Sources: Datastream; and IMF staff calculations.
Three-Month T-bill Rate Changes
(In percent)
Dec. 2013 - Apr. 2013
May. 2014 - Dec. 2013
May 2014 - Apr. 2013
Sources: Bloomberg Data Co Ltd.; and CEIC Data Co.
Stock Market Index Changes
(Percent change)
Dec. 2013 - Apr. 2013
May 2014 - Dec. 2013
May 2014 - Apr 2013
Sources: Datastream; and IMF staff calculations.
Changes in Stock of Reserves
(In percent of 2013 GDP)
Dec. 2013 - Apr. 2013
May. 2014 1/ - Dec. 2013
May. 2014 1/ - Apr. 2013
Russian Federation
Sources: Haver Data Analytics; IMF, World Economic Outlook; and IMF staff calculations.
1/ Or latest data available.
EMBI Changes
(In basis points)
Dec. 2013 - Apr. 2013
May 2014 - Dec. 2013
May 2014 - Apr 2013
Sources: Datastream; and IMF staff calculations.
CDS Spread Changes
(In basis points)
Dec. 2013 - Apr. 2013
May 2014 - Dec. 2013
May 2014 - Apr 2013
Sources: Datastream; and IMF staff calculations.

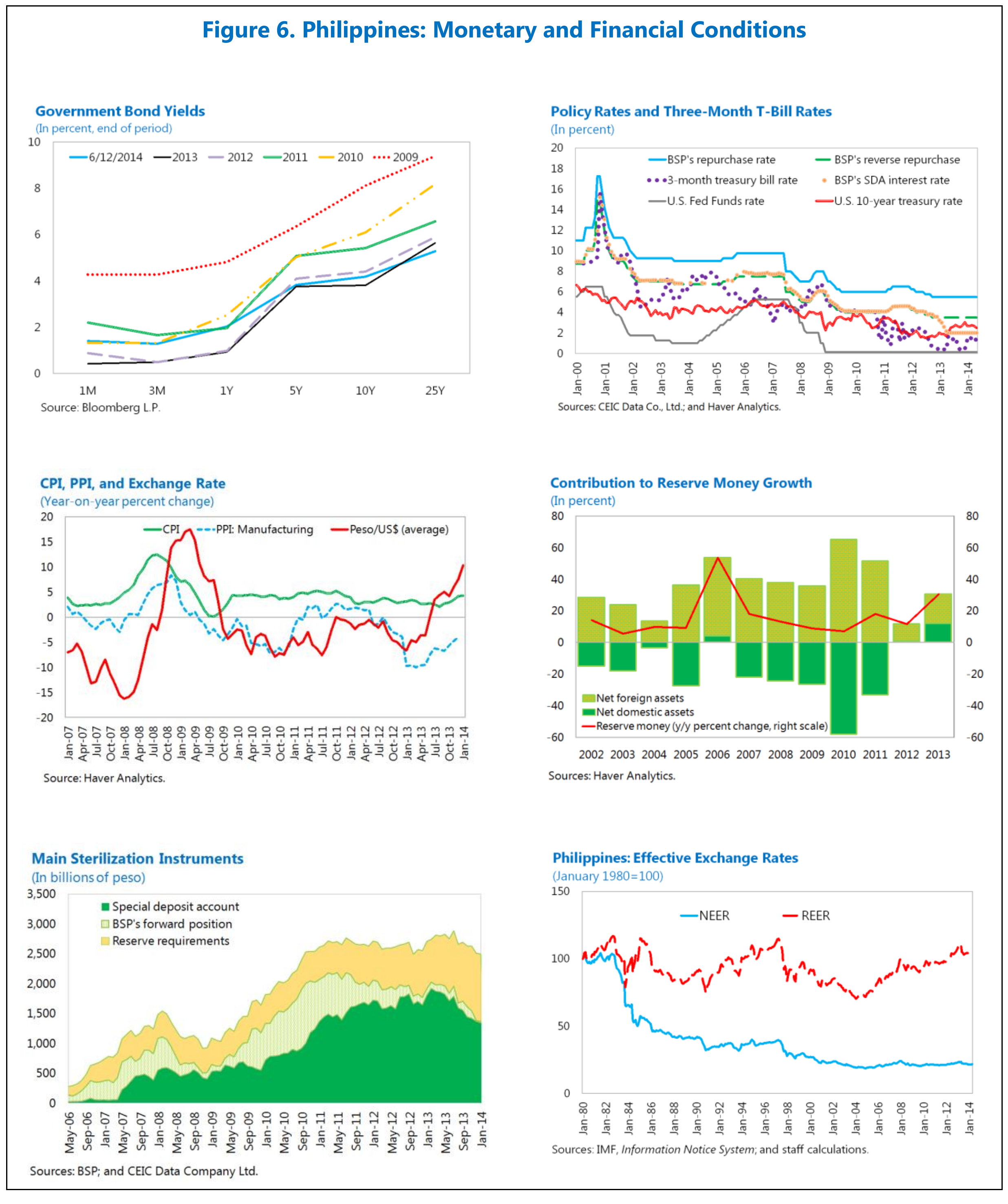


Figure 6. Philippines: Monetary and Financial Conditions
Government Bond Yields
(In percent, end of period)
6/12/2014
2013
2012
2011
2010
2009
1M
3M
1Y
5Y
10Y
25Y
Source: Bloomberg L.P.
Policy Rates and Three-Month T-Bill Rates
(In percent)
BSP's repurchase rate
BSP's reverse repurchase
3-month treasury bill rate
BSP's SDA interest rate
U.S. Fed Funds rate
U.S. 10-year treasury rate
Sources: CEIC Data Co., Ltd.; and Haver Analytics.
CPI, PPI, and Exchange Rate
(Year-on-year percent change)
CPI
PPI: Manufacturing
Peso/US$ (average)
Source: Haver Analytics.
Contribution to Reserve Money Growth
(In percent)
Net foreign assets
Net domestic assets
Reserve money (y/y percent change, right scale)
Sources: Haver Analytics.
Main Sterilization Instruments
(In billions of peso)
Special deposit account
BSP's forward position
Reserve requirements
Sources: BSP; and CEIC Data Company Ltd.
Philippines: Effective Exchange Rates
(January 1980=100)
NEER
REER
Sources: IMF, Information Notice System; and staff calculations.

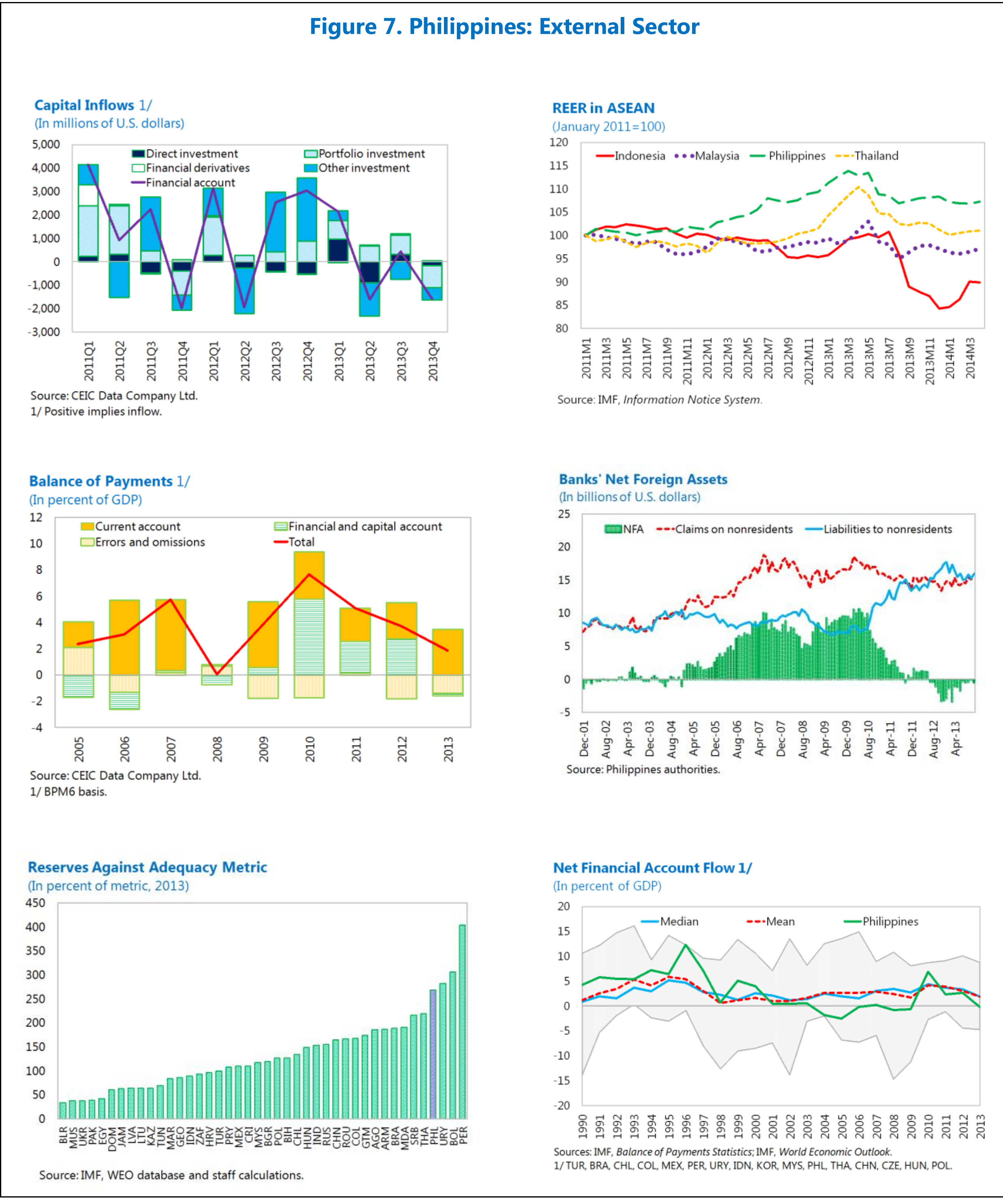
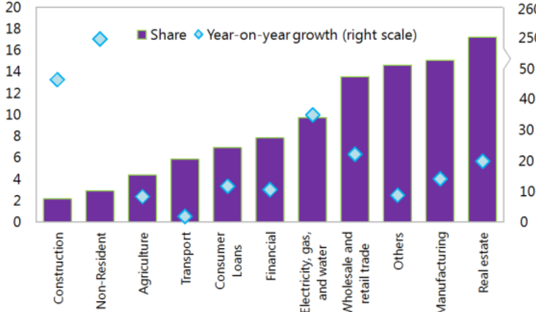


Figure 7. Philippines: External Sector
Capital Inflows 1/
(In millions of U.S. dollars)
Direct investment
Portfolio investment
Financial derivatives
Other investment
Financial account
Source: CEIC Data Company Ltd.
1/ Positive implies inflow.
REER in ASEAN
(January 2011=100)
Indonesia
Malaysia
Philippines
Thailand
Source: IMF, Information Notice System.
Balance of Payments 1/
(In percent of GDP)
Current account
Financial and capital account
Errors and omissions
Total
Source: CEIC Data Company Ltd.
1/ BPM6 basis.
Banks' Net Foreign Assets
(In billions of U.S. dollars)
NFA
Claims on nonresidents
Liabilities to nonresidents
Source: Philippines authorities.
Reserves Against Adequacy Metric
(In percent of metric, 2013)
Source: IMF, WEO database and staff calculations.
Net Financial Account Flow 1/
(In percent of GDP)
Median
Mean
Philippines
Sources: IMF, Balance of Payments Statistics; IMF, World Economic Outlook.
1/ TUR, BRA, CHL, COL, MEX, PER, URY, IDN, KOR, MYS, PHL, THA, CHN, CZE, HUN, POL.

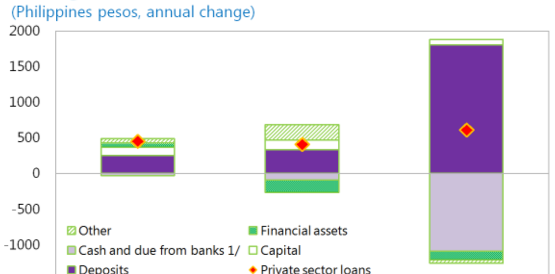
Figure 8. Philippines: Banking Sector

Universal and Commercial Banks: Loans by Sector, 2014:Q1
(In percent)



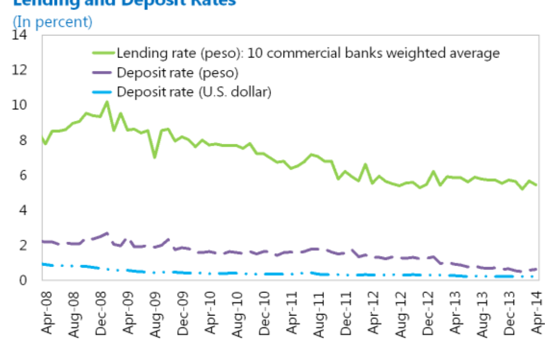
Sources: CEIC Data Company Ltd; and IMF staff calculations.

Funding of Increase in Bank Loans to the Private Sector
(Philippines pesos, annual change)



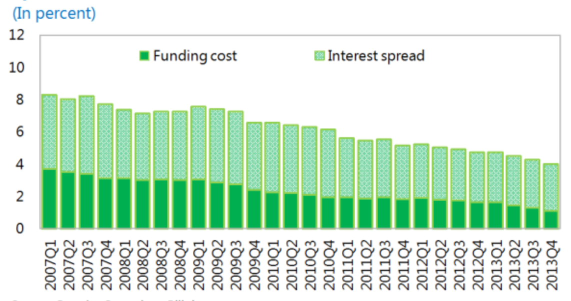
Sources: Central bank of Philippines; and IMF staff estimates and calculations.
1/ Includes SDA holdings at BSP.

Lending and Deposit Rates
(In percent)



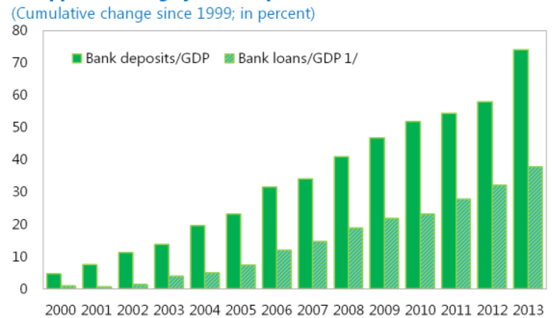
Sources: CEIC Data Co. Ltd.

Universal and Commercial Banks: Funding Cost and Interest Spread 1/
(In percent)



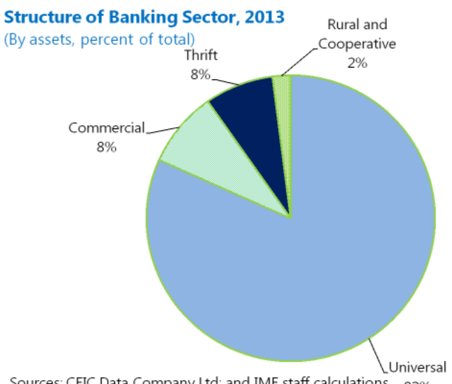
Source: Bangko Sentral ng Pilipinas.
1/ Funding cost: ratio of annualized interest expense to interest bearing liabilities. Interest Spread: earning assets yield—funding cost.

Philippine Banking System: Deposits and Loans
(Cumulative change since 1999; in percent)



Sources: CEIC Data Company Ltd; and IMF staff calculations.
1/ Not including real and other properties acquired.

Structure of Banking Sector, 2013
(By assets, percent of total)



Sources: CEIC Data Company Ltd; and IMF staff calculations.

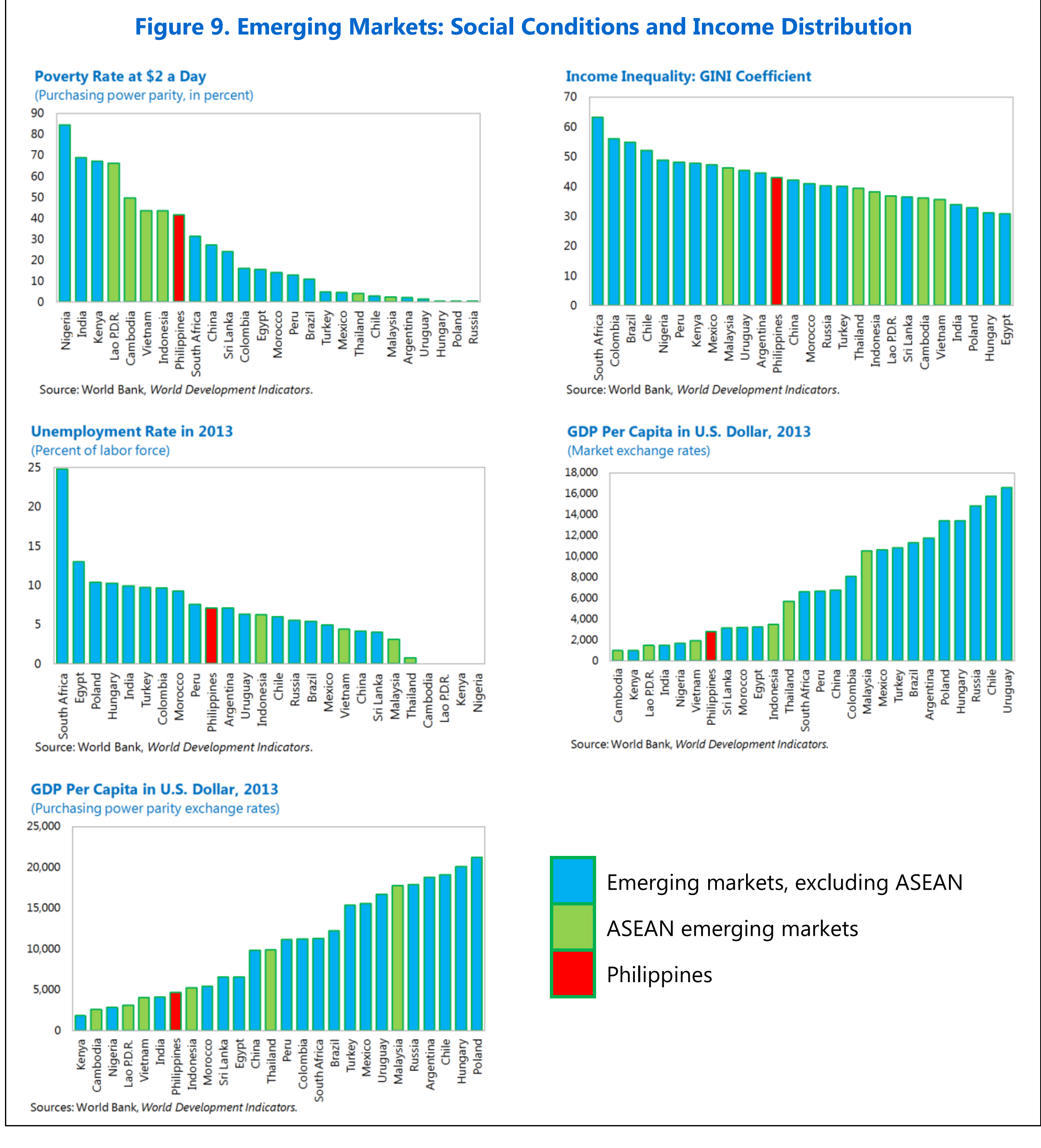


Figure 9. Emerging Markets: Social Conditions and Income Distribution
Poverty Rate at $2 a Day
(Purchasing power parity, in percent)
Source: World Bank, World Development Indicators.
Income Inequality: GINI Coefficient
Source: World Bank, World Development Indicators.
Unemployment Rate in 2013
(Percent of labor force)
Source: World Bank, World Development Indicators.
GDP Per Capita in U.S. Dollar, 2013
(Market exchange rates)
Source: World Bank, World Development Indicators.
GDP Per Capita in U.S. Dollar, 2013
(Purchasing power parity exchange rates)
Sources: World Bank, World Development Indicators.
Emerging markets, excluding ASEAN
ASEAN emerging markets
Philippines

Table 1. Philippines: Selected Economic Indicators, 2010–15

Nominal GDP (2013): P 11,548 billion ($272 billion)
Population (2013): 98.2 million
GDP per capita (2013): $2,771
Poverty headcount ratio at $2 a day at PPP (2009): 42 percent
IMF quota: SDR 1,019.3 million
Main products and exports: electronics, agriculture products, and business process outsourcing
Unemployment rate (April 2014): 7.0 percent

	2010	2011	2012	2013	2014	2015
					Staff proj.	
GDP and prices (percent change)						
Real GDP	7.6	3.7	6.8	7.2	6.2	6.5
CPI (annual average)	3.8	4.7	3.2	2.9	4.4	3.8
CPI (end year)	3.6	4.2	3.0	4.1	4.1	3.5
Investment and saving (percent of GDP)						
Gross investment	20.5	20.5	18.1	19.7	20.7	21.1
National saving	25.0	23.6	21.0	23.1	23.9	23.7
Public finances (percent of GDP)						
National government balance (authorities' definition)	-3.5	-2.0	-2.3	-1.4	-2.0	-2.0
National government balance 1/	-3.6	-2.1	-2.4	-1.4	-2.0	-2.0
Nonfinancial public sector balance 2/	-3.3	-0.8	-1.0	0.3	-0.5	-0.6
Revenue and grants	18.5	18.6	19.0	19.8	20.2	20.1
Expenditure	21.7	19.4	20.0	19.5	20.7	20.7
Nonfinancial public sector debt	54.8	55.3	52.9	50.1	45.6	41.6
Monetary sector (percent change, end of period)						
Broad money (M3)	10.0	7.1	9.4	31.8	32.1 3/	...
Interest rate (91-day treasury bill, end of period, in percent) 4/	1.3	1.7	0.5	0.5	1.2 5/	...
Credit to the private sector (in percent)	8.9	19.3	16.2	16.4	20.9 3/	...
External sector						
Export value (percent change)	26.2	4.1	21.2	-3.6	5.5	6.6
Import value (percent change)	24.7	9.5	11.3	-3.1	8.2	9.0
Current account (percent of GDP)	3.6	2.5	2.8	3.5	3.2	2.6
Capital account (US$ billions)	0.1	0.2	0.1	0.1	0.1	0.1
Financial account (US$ billions) /6	-11.5	-5.3	-6.8	0.6	1.7	-1.5
Direct investment (net) /6	1.6	0.3	1.0	-0.2	-0.8	-1.5
Errors and omissions (US$ billions)	-3.5	0.3	-4.6	-3.8	-3.2	-2.5
Overall balance (US$ billions)	15.2	11.4	9.2	5.1	4.5	7.7
Total external debt (percent of GDP) 7/	36.9	33.7	31.9	28.8	27.9	25.5
Debt service ratio 8/	13.6	13.6	9.9	10.3	11.9	11.3
Reserves(US$ billions)	62.4	75.3	83.8	83.2	87.7	95.4
Reserves/short-term liabilities 9/	402.0	475.3	407.2	369.0	372.9	381.8
Exchange rate (period averages)						
Pesos per U.S. dollar	45.1	43.3	42.2	42.4	44.6 10/	...
Nominal effective exchange rate (2005 =100)	110.0	108.9	112.9	116.0	111.3 10/	...
Real effective exchange rate (2005 =100)	127.0	127.8	134.1	139.4	136.0 10/	...

Sources: Philippine authorities; World Bank; and IMF staff projections.

1/ Fund definition. Excludes privatization receipts and includes deficit from restructuring of the previous central bank (Central Bank-Board of Liquidators).
2/ Includes the national government, 14 government-owned enterprises, social security institutions, and local governments.
3/ April 2014 (year-on-year).
4/ Secondary market rate.
5/ May 2014.
6/ In BPM6. An increase in either assets or liabilities is always positive and a decrease is always negative. Net investment is assets minus liabilities.
7/ Includes external debt not registered with the central bank, and
8/ In percent of exports of goods and nonfactor services.
9/ Reserves as a percent of short-term debt (including medium- and long-term debt due in the following year).
10/ Average January - May, 2014.

Table 2. Philippines: National Government Cash Accounts, 2009–15

(In billions of pesos, unless otherwise indicated)

	2009	2010	2011	2012	2013		2014		2015
					Budget	Prel.	Budget	Proj.	Proj.
Revenue and grants	1,123	1,208	1,359	1,527	1,778	1,713	2,018	1,925	2,118
Tax revenue	983	1,094	1,202	1,361	1,651	1,536	1,880	1,723	1,910
Net income and profits	452	489	572	643	...	718	...	806	904
Excises	68	88	88	98	...	146	...	171	188
VAT	302	330	383	451	...	490	...	550	606
Tariffs	68	81	42	41	...	35	...	38	39
Other 1/ 2/	92	106	117	129	...	146	...	158	175
Nontax revenue	140	114	157	166	127	178	136	202	208
Expenditure and net lending	1,429	1,529	1,561	1,781	2,022	1,881	2,284	2,185	2,406
Current expenditures	1,149	1,237	1,293	1,394	1,586	1,521	1,764	1,710	1,881
Personnel services	414	469	500	543	641	582	689	635	722
Maintenance and operations	176	182	201	237	299	283	379	363	388
Allotments to local government units	203	216	229	219	242	242	273	272	312
Subsidies	17	21	46	42	42	66	43	61	67
Tax expenditure	52	47	34	38	27	23	27	26	28
Interest	286	301	282	316	335	324	353	354	365
Capital and equity expenditure	275	283	250	359	410	344	495	457	505
Net lending	5	9	18	28	27	17	25	18	20
Balance	-306	-321	-201	-254	-244	-168	-266	-260	-288
On the authorities' presentation 3/	-299	-314	-198	-243	-241	-164	-266	-258	-286

Sources: Philippine authorities; and IMF staff projections.

1/ Projections include possible gains from tax administrative measures for 2013 and 2014.

2/ Includes other percentage taxes, documentary stamp tax, and noncash collections. Noncash collections are also reflected as tax expenditures under current expenditures.

3/ Includes privatization receipts as revenue and excludes the operations of the Central Bank-Board of Liquidators (CB-BOL).

Table 3. Philippines: National Government Cash Accounts, 2009–15

(In percent of GDP, unless otherwise indicated)

	2009	2010	2011	2012	2013		2014		2015
					Budget 8/	Prel.	Budget 8/	Proj.	Proj.
Revenue and grants	14.1	13.4	14.0	14.4	14.9	14.8	15.1	15.1	15.0
Tax revenue	12.3	12.1	12.4	12.9	13.8	13.3	14.1	13.5	13.5
Net income and profits	5.6	5.4	5.9	6.1	...	6.2	...	6.3	6.4
Excises	0.9	1.0	0.9	0.9	...	1.3	...	1.3	1.3
VAT	3.8	3.7	3.9	4.3	...	4.2	...	4.3	4.3
Tariffs	0.9	0.9	0.4	0.4	...	0.3	...	0.3	0.3
Other 1/ 2/	1.2	1.2	1.2	1.2	...	1.3	...	1.2	1.2
Nontax revenue	1.7	1.3	1.6	1.6	1.1	1.5	1.0	1.6	1.5
Expenditure and net lending	17.8	17.0	16.1	16.9	16.9	16.3	17.1	17.1	17.0
Current expenditures	14.3	13.8	13.3	13.4	13.3	13.2	13.0	13.4	13.3
Personnel services	5.2	5.2	5.2	5.1	5.4	5.0	...	5.0	5.1
Maintenance and operations	2.2	2.1	2.1	2.4	2.5	2.5	...	2.9	2.8
Allotments to local government units	2.5	2.4	2.4	2.1	2.0	2.1	...	2.1	2.2
Subsidies	0.2	0.2	0.5	0.4	0.4	0.6	...	0.5	0.5
Tax expenditure	0.6	0.5	0.3	0.4	0.2	0.2	...	0.2	0.2
Interest	3.6	3.3	2.9	3.0	2.8	2.8	...	2.8	2.6
Capital and equity expenditure	3.4	3.1	2.6	3.2	3.4	3.0	3.9	3.6	3.6
Net lending	0.1	0.1	0.2	0.3	0.2	0.1	0.2	0.1	0.1
Balance	-3.8	-3.6	-2.1	-2.4	-2.0	-1.4	-2.0	-2.0	-2.0
On the authorities' presentation 3/	-3.7	-3.5	-2.0	-2.3	-2.0	-1.4	-2.0	-2.0	-2.0
Memorandum items:									
National government									
Primary balance	-0.2	-0.2	0.8	0.6	0.8	1.4	0.5	0.7	0.5
Debt 4/	47.1	46.2	44.9	44.2	...	42.3	...	39.5	37.0
(In percent of national government revenues)	334.8	344.3	320.9	306.0	...	285.4	...	261.9	246.8
Gross financing requirement 5/	17.6	14.9	12.1	9.1	...	5.9	...	8.3	8.2
Nonfinancial public sector (NFPS) 6/									
Balance	-3.1	-3.3	-0.8	-1.0	...	0.3	...	-0.5	-0.6
Debt	58.1	54.8	55.3	52.9	...	50.1	...	45.6	41.6
(In percent of NFPS revenues)	291.0	296.3	297.6	278.0	...	252.8	...	225.9	206.9
Consolidated public sector balance 7/	5.2	4.7	2.9	2.2	...	1.0	...	1.3	1.2

Sources: IMF staff estimates and projections.

1/ Projections include possible gains from tax administrative measures for 2013 and 2014.
2/ Includes other percentage taxes, documentary stamp tax, and noncash collections. Noncash collections are also reflected as tax expenditures under current expenditures.
3/ Includes privatization receipts as revenue and excludes the operations of the Central Bank-Board of Liquidators (CB-BOL).
4/ Consolidated (net of national government debt held by the sinking fund) and excluding contingent/guaranteed debt.
5/ Defined as the deficit, plus amortization of medium- and long-term debt, plus the stock of short-term debt at the end of the
6/ Includes the national government, 14 government-owned enterprises, social security institutions, and local governments. Debt is consolidated (net of intra-nonfinancial public sector holdings of debt). Balance is cash basis.
7/ Includes nonfinancial public sector, government financial institutions, and BSP. Balance is cash basis.
8/ Using the nominal GDP in the Budget.

Table 4. Philippines: General Government Operations, 2009–15 1/

(In percent of GDP)

	2009	2010	2011	2012	2013 Prel.	2014 Proj.	2015 Proj.
Revenue	17.5	16.8	17.6	18.3	18.5	18.9	18.8
Taxes	13.1	12.9	13.2	13.7	14.1	14.3	14.4
Taxes on income, profits, and capital gains	5.6	5.4	5.9	6.1	6.2	6.3	6.4
Taxes on goods and services	5.5	5.5	5.8	6.1	6.5	6.6	6.6
Taxes on international trade and transactions	0.9	0.9	0.4	0.4	0.3	0.3	0.3
Taxes not elsewhere classified	1.1	1.1	1.1	1.1	1.2	1.1	1.1
Social contributions	1.9	1.9	1.9	2.0	2.0	2.2	2.2
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue	2.4	2.0	2.5	2.5	2.3	2.4	2.3
Total expenditure	20.1	19.2	18.0	18.9	18.6	19.8	19.8
Expense	16.2	15.7	15.1	15.5	15.3	15.8	15.7
Compensation of employees 2/	5.2	5.2	5.2	5.1	5.0	5.0	5.1
Purchases/use of goods and services 2/	2.2	2.1	2.1	2.4	2.5	2.9	2.8
Interest 2/	3.3	3.0	2.6	2.6	2.5	2.5	2.3
Social benefits	1.7	1.7	1.8	1.8	1.9	2.1	2.2
Expense not elsewhere classified	3.8	3.6	3.5	3.4	3.4	3.4	3.4
Net acquisition of nonfinancial assets	3.9	3.5	2.9	3.4	3.3	4.0	4.1
Net lending/borrowing	-2.6	-2.4	-0.4	-0.6	-0.1	-0.9	-1.0
National government	-3.7	-3.4	-1.8	-1.9	-1.2	-1.8	-1.8
Local government units	0.5	0.6	0.7	0.4	0.4	0.3	0.3
Social security institutions (SSIs)	0.5	0.5	0.7	0.9	0.7	0.5	0.4
Net acquisition of financial assets	0.3	1.7	0.8	4.3	2.7	1.3	1.1
Net incurrence of liabilities	2.9	4.0	1.2	4.9	2.8	2.3	2.2
Memorandum items:							
National government cash holdings	2.9	3.0	...	...	...	...	...
Consolidated general government debt	44.3	43.5	41.4	40.6	39.1	36.2	33.8

Sources: Philippine authorities; and IMF staff projections.

1/ Based on GFSM2001. General government includes the national government, social security institutions, and local governments.

2/ National government only. The expense item related to SSIs and local governments are not separately available and are included in the amount for expense not elsewhere classified.

Table 5. Philippines: Depository Corporation Survey, 2009–13

(In millions of pesos, unless otherwise indicated)

	2009 Dec.	2010 Dec.	2011 Dec.	2012 Dec.	2013 Dec
Total					
Net foreign assets	2,425,533	2,865,080	3,242,542	3,251,086	3,578,070
Net domestic assets	2,559,352	2,663,012	2,578,913	2,976,578	4,476,137
Net claims on nonfinancial public sector	1,189,045	1,367,338	1,520,559	1,298,189	1,287,632
Claims on private sector	2,340,648	2,663,097	3,093,882	3,528,922	4,137,658
Net claims on other financial corporations	-114,655	-410,931	-894,944	-767,601	178,728
Capital accounts	1,044,020	1,080,747	1,258,757	1,113,606	1,203,888
Other items (net)	188,334	124,255	118,172	30,674	76,006
Broad money	4,984,885	5,528,092	5,821,454	6,227,664	8,054,206
National currency	3,954,497	4,462,086	4,801,830	5,227,220	6,915,929
Foreign currency	1,030,388	1,066,007	1,019,625	1,000,443	1,138,277
Bangko Sentral ng Pilipinas					
Net foreign assets	1,969,717	2,657,283	3,233,794	3,384,920	3,646,868
Net domestic assets	-890,023	-1,503,158	-1,908,654	-1,888,750	-1,715,837
Claims on private sector	1	1	1	1	1
Net claims on financial corporations	-689,101	-1,417,264	-1,846,634	-1,810,951	-1,576,264
Capital accounts	323,242	233,202	287,252	1,760	3,821
Other items (net)	-16,863	-14,953	-12,445	-16,193	-20,779
Base money	1,047,928	1,120,546	1,323,000	1,475,633	1,926,202
Currency in circulation	582,533	601,275	648,911	692,657	797,452
Other depository corporations liabilities	464,965	518,755	673,511	782,647	1,128,302
Other liquid liabilities	31,767	33,579	2,139	20,538	4,829
Other Depository Corporations					
Net foreign assets	455,815	207,797	8,748	-133,834	-68,798
Net domestic assets	4,035,382	4,807,774	5,295,056	5,781,849	7,477,386
Net claims on nonfinancial public sector	1,049,864	1,205,078	1,282,883	1,358,035	1,402,605
Claims on private sector	2,340,647	2,663,096	3,093,881	3,528,921	4,137,658
Net claims on financial corporations	1,146,154	1,642,090	1,751,828	1,969,705	3,045,147
Capital accounts	720,778	847,546	971,505	1,111,846	1,200,066
Other items (net)	219,495	145,056	137,969	37,034	92,043
Liquid liabilities	4,491,197	5,015,571	5,303,804	5,648,015	7,408,588

Source: IMF, *International Financial Statistics*.

Table 6. Philippines: Balance of Payments, 2010–2015

(In billions of U.S. dollars)

	2010	2011	2012	2013	2014	2015
					Staff Proj.	
Current account balance	7.2	5.6	6.9	9.4	9.2	8.7
Trade balance of goods and services	-11.1	-13.9	-12.7	-11.7	-13.4	-15.5
Goods	-16.9	-20.4	-18.9	-18.5	-21.2	-24.3
Exports, f.o.b.	36.8	38.3	46.4	44.7	47.2	50.3
Imports, f.o.b.	53.6	58.7	65.3	63.3	68.4	74.6
Services	5.8	6.6	6.2	6.8	7.8	8.8
Receipts	17.8	18.9	20.4	21.8	24.3	27.0
Payments	12.0	12.3	14.3	15.0	16.5	18.3
Primary income, net	0.7	0.9	0.2	-0.3	-0.3	-0.3
Receipts, *of which* :	6.7	7.6	8.3	8.0	8.6	9.3
Resident workers abroad	5.1	5.9	6.5	7.0	7.5	8.0
Payments	6.0	6.7	8.1	8.3	8.9	9.6
Interest payments	2.6	2.8	3.0	2.8	3.8	3.9
Secondary income, net	17.6	18.6	19.5	21.4	22.9	24.5
Receipts, *of which* :	18.0	19.0	20.1	22.0	23.6	25.2
Nonresident workers remittances	16.2	17.1	18.0	19.3	20.9	22.6
Payments	0.4	0.5	0.6	0.6	0.7	0.7
Capital account	0.1	0.2	0.1	0.1	0.1	0.1
Financial account 2/	-11.5	-5.3	-6.8	0.6	1.7	-1.5
Direct investment	1.6	0.3	1.0	-0.2	-0.8	-1.5
Portfolio investment	-4.9	-3.7	-3.2	-1.3	-1.3	-2.7
Equity	-0.8	-1.0	-1.7	0.1	-0.1	-0.9
Debt	-4.1	-2.6	-1.5	-1.4	-1.4	-2.0
Financial derivatives	0.2	-1.0	0.0	-0.1	0.0	0.0
Other investment, *of which* :	-8.4	-1.0	-4.5	2.3	3.9	2.7
Currency and deposits	-0.2	2.3	-1.5	0.3	1.6	1.1
Loans	-7.0	-3.6	-2.3	1.4	2.7	1.7
Errors and omissions	-3.5	0.3	-4.6	-3.8	-3.2	-2.5
Overall balance	15.2	11.4	9.2	5.1	4.5	7.7
Memorandum items:						
Current account/GDP	3.6	2.5	2.8	3.5	3.2	2.6
Short-term debt (original maturity)	10.6	12.3	16.6	17.0	17.8	19.0
Short-term debt (residual maturity)	15.5	15.8	20.6	22.5	23.5	25.0
Gross reserves	62.4	75.3	83.8	83.2	87.7	95.4
(in percent of st. debt by res. maturity) 3/	402.0	475.3	407.2	369.0	372.9	381.8
Monitored external debt (in billions) 4/	73.6	75.5	79.8	78.4	81.0	84.5
(in percent of GDP)	36.9	33.7	31.9	28.8	27.9	25.5
Debt service ratio 5/	13.6	13.6	9.9	10.3	11.9	11.3
Export value (percent change)	26.2	4.1	21.2	-3.6	5.5	6.6
Import value (percent change)	24.7	9.5	11.3	-3.1	8.2	9.0
Gross external financing needs 6/	4.1	9.9	8.9	11.2	13.3	14.8
Remittances value (percent change)	8.3	7.1	6.5	7.5	8.3	7.7

Sources: Philippine authorities; and Fund staff projections.

1/ In BPM6.
2/ An increase in either assets or liabilities is always positive and a decrease is always negative. Net investment is assets minus liabilities. A negative financial account balance means that the change in liabilities is greater than the change in assets, while a positive financial account balance means that the change in assets is greater than the change in liabilities.
3/ As a percent of short-term debt.
4/ Includes some external debt not registered with the central bank and private capital lease agreements.
5/ In percent of goods and nonfactor services exports.
6/ Current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at the end of the previous period.

Table 7. Philippines: Medium-Term Outlook, 2011–19

(In percent of GDP, unless otherwise indicated)

				Staff Proj.					
	2011	2012	2013	2014	2015	2016	2017	2018	2019
GDP and prices									
Real GDP (percent change)	3.7	6.8	7.2	6.2	6.5	6.2	6.0	6.0	6.0
CPI (percent change, annual average)	4.7	3.2	2.9	4.4	3.8	3.5	3.5	3.5	3.5
GDP by expenditure									
Consumption (percent change)	5.1	7.7	5.9	5.7	6.7	6.2	6.0	6.0	6.0
Private	5.6	6.6	5.7	6.0	6.5	6.2	6.0	6.0	6.0
Public	2.1	15.5	7.7	4.4	8.2	6.2	6.0	6.0	6.0
Gross fixed investment (percent change)	-1.9	10.8	11.9	12.2	11.0	8.7	8.2	8.2	8.2
Net exports (contribution to growth)	-1.0	1.7	-3.1	-0.6	-0.7	-0.8	-0.8	-0.8	-0.8
Investment and saving									
Gross investment	20.5	18.1	19.7	20.7	21.1	22.9	23.4	23.9	24.4
Private	18.4	15.1	16.8	17.1	17.4	19.2	19.7	20.2	20.7
Public	2.1	3.0	2.9	3.6	3.7	3.8	3.8	3.8	3.8
National saving	23.6	21.0	23.1	23.9	23.7	25.0	25.0	25.0	25.0
Private	22.6	19.7	20.5	21.3	21.1	22.3	22.3	22.4	22.4
Public	1.0	1.2	2.6	2.6	2.6	2.7	2.6	2.6	2.6
Public finances									
Nonfinancial public sector balance 1/	-0.8	-1.0	0.3	-0.5	-0.6	-0.6	-0.6	-0.7	-0.8
Primary balance	2.4	2.3	3.3	2.4	2.1	2.0	1.8	1.6	1.4
Revenue and grants	18.6	19.0	19.8	20.2	20.1	20.2	20.2	20.1	20.1
Expenditure (primary)	16.2	16.7	16.5	17.8	18.0	18.2	18.4	18.6	18.8
Interest	3.2	3.3	3.1	2.9	2.7	2.6	2.4	2.3	2.1
Nonfinancial public sector gross financing need	11.4	8.0	4.3	6.8	6.6	7.1	6.9	6.7	6.7
Domestic	9.4	6.5	4.0	5.4	5.4	6.0	5.7	5.7	5.8
Foreign currency	2.0	1.5	0.3	1.3	1.2	1.1	1.2	1.0	1.0
National government balance (authorities definition)	-2.0	-2.3	-1.4	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0
National government balance	-2.1	-2.4	-1.4	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0
Nonfinancial public sector debt	55.3	52.9	50.1	45.6	41.6	38.3	35.4	32.7	30.1
External sector									
Export value (percent change)	4.1	21.2	-3.6	5.5	6.6	6.4	6.4	6.4	6.4
Import value (percent change)	9.5	11.3	-3.1	8.2	9.0	9.4	9.3	9.5	9.5
Trade balance of goods and services	-6.2	-5.1	-4.3	-4.6	-4.7	-4.9	-5.1	-5.3	-5.5
Current account	2.5	2.8	3.5	3.2	2.6	2.0	1.5	1.0	0.5
Reserves (US$ billions)	75.3	83.8	83.2	87.7	95.4	103.9	113.2	121.9	129.9
Reserves/short-term liabilities 2/	475.3	407.2	369.0	372.9	381.8	393.9	409.0	420.9	428.3
Total external debt	33.7	31.9	28.8	27.9	25.5	23.7	22.0	20.4	18.9
Debt service ratio (in percent of exports of goods and servic	13.6	9.9	10.3	11.9	11.3	10.5	9.8	9.0	8.4

Sources: Philippine authorities; and IMF staff projections.

1/ Includes the national government, 14 government-owned enterprises, social security institutions, and local governments. Cash basis.

2/ Reserves as a percent of short-term debt (including medium- and long-term debt due in the following year).

Table 8. Philippines: Banking Sector Indicators, 2009–13

(In percent)

	2009	2010	2011	2012	2013
Capital adequacy					
Total capital to total assets	11.1	11.7	12.6	13.1	11.3
Capital adequacy ratio (Solo) 1/	14.9	16.0	16.7	17.3	17.5
Asset quality					
NPL ratio 2/	4.1	3.9	3.0	2.6	2.9
NPA ratio 3/	4.5	3.9	3.3	2.9	2.6
Distressed asset ratio 4/	9.3	8.8	7.0	6.0	5.6
NPL coverage ratio 5/	93.1	97.6	103.7	113.0	118.7
NPA coverage ratio 6/	48.7	52.7	57.1	63.1	73.0
Profitability					
Return on assets	1.2	1.4	1.5	1.6	1.6
Return on equity	10.8	12.2	12.1	12.4	13.3
Cost-to-income ratio	65.8	63.6	65.0	63.2	60.6
Liquidity					
Liquid assets to deposits	52.7	59.7	56.5	57.5	59.5
Loans (gross) to deposits	68.1	64.5	70.0	73.5	64.3

Source: Philippines authorities, *Status Report on the Philippines Financial System* .

1/ Solo refers to the head office and branches.

2/ Nonperforming loans over total loan portfolio excluding interbank loans.

3/ (Nonperforming loans + real and other property aquired (ROPA)) over total gross assets, where ROPA is a measure of the stock of foreclosed properties held by a bank.

4/ Ratio of (NPLs + Gross ROPA + current restructured loans) to (Gross total loan portfolio + Gross ROPA).

5/ Ratio of loan loss reserves to NPLs.

6/ Ratio of valuation reserves (for loans and ROPA) to NPAs.

Table 9. Philippines: Indicators of External Vulnerability, 2007–13

(In percent of GDP, unless otherwise indicated)

	2007	2008	2009	2010	2011	2012	2013
External indicators (including external liquidity)							
Gross international reserves, (in billions U.S. dollars)	33.8	37.6	44.2	62.4	75.3	83.8	83.2
Maturing short-term debt (in billions U.S. dollars)	9.9	10.0	6.5	10.6	12.3	16.6	17.0
Amortization of medium and long-term debt (in billions U.S. dollars)	4.1	4.1	4.3	4.8	5.0	3.6	4.0
Net FDI inflows (in billions of U.S. dollars)	2.5	0.6	-0.2	1.6	0.3	1.0	-0.2
FX deposits residents (in billions of U.S. dollars)	19.5	20.6	22.8	25.1	24.3	25.3	26.1
Total gross external debt	44.6	37.5	38.4	36.9	33.7	31.9	28.8
Nonfinancial public sector indicators:							
Overall balance	0.2	-0.3	-3.1	-3.3	-0.8	-1.0	0.3
Primary balance	4.6	3.7	0.8	0.4	2.4	2.3	3.3
Debt	58.9	58.2	58.1	54.8	55.3	52.9	49.3
Debt denominated in FX or linked to the exchange rate (in percent of total)	57.2	58.5	58.8	53.2	47.0	36.0	35.0
Short-term general government debt (original maturity, in percent of total)	16.5	18.2	14.1	11.2	6.0	5.1	5.6
Average effective interest rate of government debt (in percent)	6.8	7.5	7.0	7.1	6.3	6.4	6.3
Amortization of total debt	15.9	15.6	12.8	10.7	8.3	6.7	4.8

Sources: Philippine authorities; and IMF staff estimates.

Appendix 1. Philippines: Risk Assessment Matrix 1/

Nature/Source of Main Threats	Likelihood of Risk	Transmission Channels	Expected Impact of Risk	Recommended Policy Response
Surges in global financial market volatility	High	• Bouts of heightened risk aversion and a sharp increase in long-term interest rates • Sharp reversal in external financing, leading to a further peso depreciation	**Medium** • Prices of financial assets decline further, generating negative wealth effects and mark-to-market losses. • Rising credit cost causes real estate prices to fall and construction activity to drop. • Banks' NPLs may increase from very low levels, but effect on capital is likely manageable. • Some leveraged real estate developers and related corporate entities could face debt service difficulties. • Remittances are an important funding source for bank credit, which should help avoid severe funding pressures and a credit crunch and help insulate domestic demand. • Effective depreciation would boost net exports to cushion effect on growth.	• Adopt countercyclical macroprudential policies (e.g., countercyclical capital charge on RE or general provisioning requirement on new RE loans). • Undertake some forex intervention to avert a vicious depreciation-outflows cycle that would stoke inflation, but a weaker exchange rate would be appropriate. • Ensure banks have adequate capital buffers and do not exceed standard ceilings on exposures to a single borrower (defined to include all affiliated entities).
Sharp growth slowdown in China in the medium term	Medium	• A slowdown in China's domestic demand contracts regional exports and GDP growth. • Investor sentiment toward the region would weaken. • Financial and real investment linkages by Chinese corporates to the Philippines are small. • Some Philippine conglomerates have significant real estate and retail investments in China.	**High** • Philippine direct exports to China have grown rapidly over the decade and amount to 13 percent of total (3 percent of GDP), but domestic value-added content is much smaller. • Indirect effects through weaker regional growth could dominate. • Some corporates could face problems servicing debt, with knock-on effects to local equity markets and credit conditions.	• If China's growth slowdown is persistent, the equilibrium real exchange rate will likely decline. In addition, the Philippines should implement structural reforms to improve its business environment to spur new sources of growth.
Domestic asset price bubble fueled by abundant liquidity	Medium	• Continued inflows into financial assets and real estate as perceived future returns exceed higher funding costs. • Activity in construction and related services and manufacturing accelerates. Credit exposure to the real estate sector grows.	**Medium** • Real estate prices continue to grow rapidly, attracting additional resources to the sector, and boosting near-term growth. • Vulnerability of the financial system builds. Asset price correction through financial accelerator channels weakens growth.	• Strictly enforce existing macroprudential policies and tighten further. • Ensure adequate bank capital to absorb credit losses. Expand the BSP's mandate to include financial stability, allowing it to oversee all nonbank credit provision.
Default by a highly-leveraged domestic conglomerate	Low	• Default by one part of a group on its foreign obligations and/or domestic loans. • With a handful of large conglomerates following broadly similar business models, and bank exposure to them equivalent to a sizable share of total capital, systemic risks are heightened.	**Medium** • Loans to the entire group are written down, causing a major reduction in bank capital. Reduced bank capital could create a domestic credit crunch. • Concerns arise about the profitability and liquidity of other major conglomerates, raising their funding costs.	• Proactive rollback by the BSP of banks' single borrower limit (defined to encompass all affiliated entities), underpinned by credible agreements between banks and the conglomerate. • In case of default, rapidly recapitalize banks to prevent disruptive credit contraction. • Avoid regulatory forbearance and fiscal transfers to the affected conglomerate. • Enhance the BSP's bank supervisory capacity by allowing it to collect information on all bank-affiliated entities.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Appendix 2. Philippines—External Sector Assessment

Current Account

1. The Philippines's current account balance (CAB) has been in surplus during most of the 2000s, supported by strong worker remittances and dynamic service exports (Figure 2.1). After running deficits during most of the 1990s, the CAB moved into surplus in 2003, peaking at 5.7 percent of GDP in 2006. This reflected growing worker remittances, a narrowing trade deficit, as well as higher net service exports. Since the global financial crisis, the CAB has been on a moderating trend, but rose again by 0.7 percent of GDP in 2013 to 3.5 percent of GDP on a stronger trade balance.

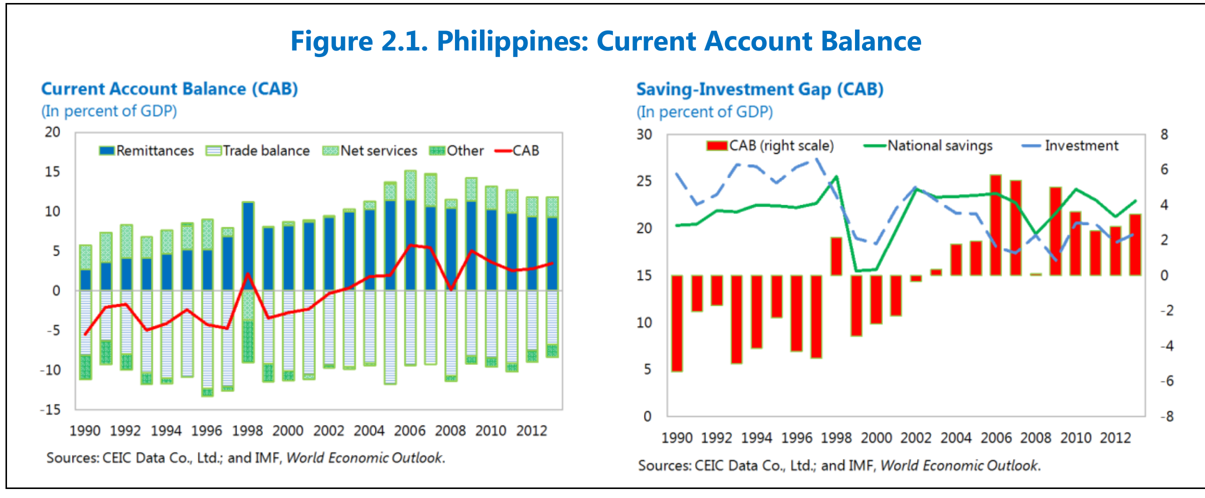
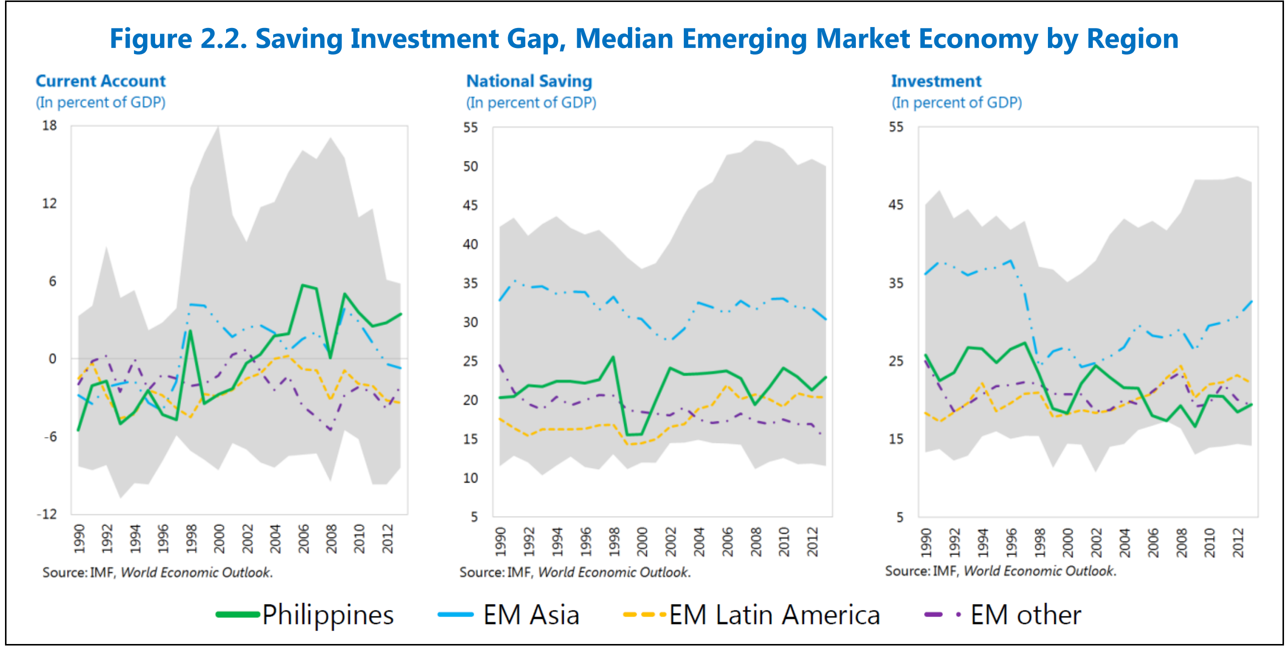


Figure 2.1. Philippines: Current Account Balance

2. The strengthening of the CAB since the mid-1990s reflects mainly a sustained fall in the investment-to-GDP ratio since the Asian financial crisis. Gross capital formation declined from above 25 percent of GDP in the pre-Asian crisis period to below 20 percent of GDP since the mid 2000s. National saving also increased, but to a smaller extent (by about 1 percent of GDP on average). Since the global financial crisis, the smaller CAB reflects the faster decline in saving than investment, although in 2013 both rose, with saving rising faster.

3. Relative to GDP, the Philippines' CAB was similar to that of other emerging market economies (EMEs) during the 1990s, but has been stronger than most peers in the 2000s (Figure 2.2). This reflects mainly changes in the Philippines' investment behavior, which before the Asian financial crisis was higher than the median for Latin American and other EMEs, but dipped below most others during the 2000s. However, relative to the median Asian EME, the Philippines has always had a lower investment ratio. On the other hand, the Philippine national saving ratio has increased only marginally over time, and has consistently been somewhat higher than the ratios in Latin America and other regions, but lower than for Asian EMEs.

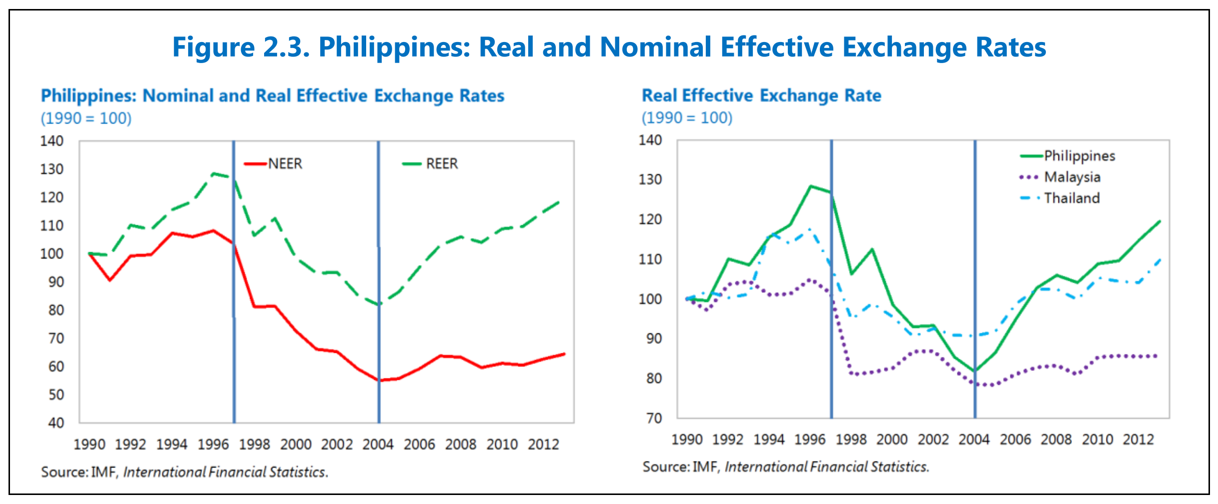
Figure 2.2. Saving Investment Gap, Median Emerging Market Economy by Region



Effective Exchange Rate

4. After declining continuously since the Asian financial crisis, the Philippines' real effective exchange rate (REER) has been on an upward trend since 2004 (Figure 2.3). The post Asian crisis real depreciation was mostly due to a fall in the nominal effective exchange rate (NEER). The early part of the post 2004 real appreciation was also associated with nominal appreciation, but since 2007 the real appreciation has been fully due to the inflation differential between the Philippines and its trading partners, with the NEER remaining stable. The Philippines' post-Asian crisis real depreciation was stronger than in Malaysia and Thailand. However, this was reversed since 2004, when the Philippine peso appreciated faster in real terms (46 percent on average in the Philippines, against 21 and 9 percent, respectively in Thailand and Malaysia).

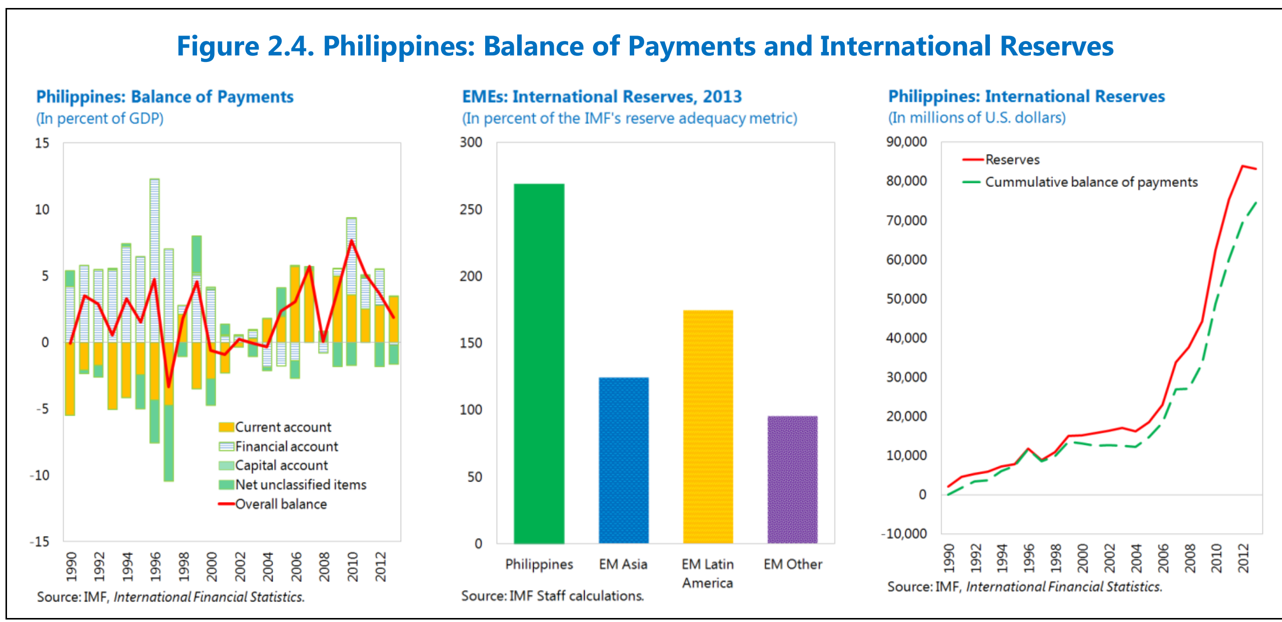
Figure 2.3. Philippines: Real and Nominal Effective Exchange Rates



Reserve Accumulation, Reserve Adequacy and Net International Investment Position

5. The Philippines has accumulated sizable international reserves since the Asian financial crisis, and especially since the global financial crisis (Figure 2.4). The BoP surplus reflects mainly current flows, although net financial inflows contributed to reserve accumulation on occasion (2000, and 2010–12). As a result, the stock of foreign reserves has risen markedly since the Asian financial crisis (by 11 percentage points of GDP since 1997). Reserve accumulation accelerated in the aftermath of the global financial crisis, but slowed in 2013 due to financial outflows. At end 2013, reserves stood at 31 percent of GDP, and 2.7 times the Fund's EM reserve adequacy metric (against the benchmark of 1 to 1½ times). Reserves were also 3½ times short-term external debt on a residual maturity basis and more than 12 months of imports of goods and services. This suggests the Philippines holds more reserves than is warranted to meet normal expected contingencies.

Figure 2.4. Philippines: Balance of Payments and International Reserves



6. The net international investment position (NIIP) has improved considerably on net foreign asset buildup by the private and public sectors, which mirrors sustained current account surpluses. The Philippines' NIIP stood at -49 percent of GDP in 2001 and rose to –14 percent of GDP at end 2012. About three-quarters of the increase reflects a decline in liabilities (mostly other investment and to some extent direct investment). The remaining part is due to increased foreign assets, mostly official reserves. As of end-2012, reserve assets accounted for 70 percent of total external assets (US$120 billion), while liabilities from portfolio investment and other investment accounted for 47 and 35 percent of total external liabilities (US$154 billion), respectively.

External Balance Assessment (EBA)

7. The IMF assesses the external sector of its member countries using the External Balance Assessment (EBA) methodology. EBA comprises three approaches for assessing the CAB and REER compared to their norms based on the country's fundamentals and desired policies (Table 2.1 and Figure 2.5).

Table 2.1. External Balance Assessment (EBA): CAB and REER Gaps 1/

Method	Current Account Regression Approach	REER Regression Approach	External Sustainability Approach
Assessment period	(2013)	(2013)	(2019)
Actual CAB (percent of GDP)	3.5	---	0.6
CAB norm (percent of GDP)	-3.5	---	-0.7
CAB gap (percent of GDP) 2/	6.9	---	1.3
Of which:			
Contribution of identified policy gaps	0.7	---	---
Unexplained residual	6.3	---	---
REER gap (percent) 3/	---	7.0	-8.3
Of which:			
Contribution of identified policy gaps	---	0.0	---
Unexplained residual	---	7.0	---

Source: IMF staff estimates, based on the 2013 external balance assessment.
1/ Based on the EBA 2.0 update of April 2014.
2/ The CAB gap is defined as the difference between the actual CAB and the CAB norm.
3/ A negative REER gap indicates undervaluation. The REER gap for the external sustainability approach corresponds to the current account gap, divided by the semi-elasticity of the current account with respect to the REER (estimated at 0.16 for the Philippines).

- The EBA's Current Account Regression approach suggests that a current account deficit—rather than a surplus—is appropriate for the Philippines. This reflects the Philippines' fast growing population, low per capita income, and strong growth prospects relative to its peers, despite sizable institutional risk.[1] The gap between the fitted and the actual CAB first opened in 2001, and has since widened, reaching 6.3 percent of GDP in 2013. The gap rises to 6.9 percent of GDP when deviations of domestic and foreign policies from their desired levels are taken into account, although most of the policy deviations are due to the rest of the world.

- The External Sustainability approach suggests that the Philippines' medium-term CAB is slightly larger than the CAB needed to stabilize the NFA-to-GDP ratio.

- The EBA's REER approach suggests that the REER was mildly stronger than warranted by fundamentals and desired policies in 2013.

[1] Institutional/political risk is found to reduce the Philippines' predicted CAB by 2 percentage points of GDP.

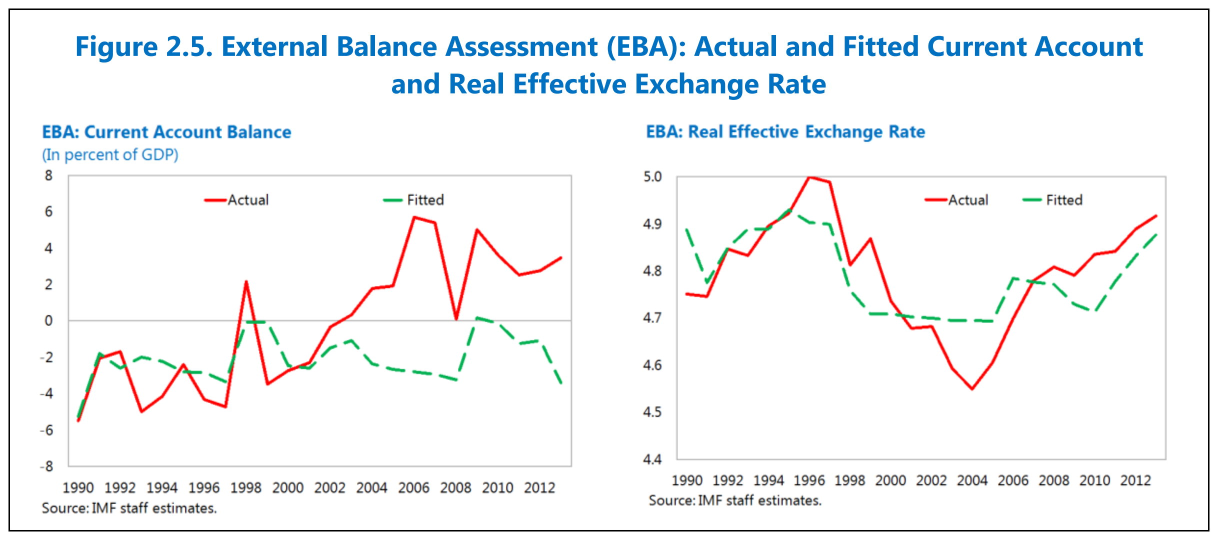


Figure 2.5. External Balance Assessment (EBA): Actual and Fitted Current Account and Real Effective Exchange Rate

8. Technical factors suggest that in the Philippine case, more weight should be given to the current account regression approach than to the other two approaches. The EBA REER regression cannot capture the effect on the REER of the rise in permanent income from remittances and other current earnings. Moreover, the model relies heavily on comparing current with past levels of the REER, making the result sensitive to the sample period used and less informative for countries with large swings in the REER.[1] The External Sustainability approach does not assess the appropriateness of the level of the NFA that is being stabilized. In the Philippine case, arguably a more negative NFA position and a lower CAB would be consistent with the country's stage of development and population dynamics.

Extensions to EBA and Other Considerations

9. The EBA current account regression approach does not take account of several specific factors relevant for the Philippines' CAB:

- ***Risk of natural disasters***: Natural disasters represent a significant uninsurable risk for the Philippines, especially the private sector. This could lead to higher precautionary saving and lower investment (owing to reduced risk-adjusted returns). While on occasion post-disaster reconstruction spending might be expected to boost investment spending, in practice, such effects have been limited.

- ***Worker remittances***: The strengthening in the Philippines' CAB coincided with an increase in remittances from overseas workers. As a result, Philippine gross national income is now

[1] Because the REER is an index of relative prices, making cross-country comparisons is infeasible, thus country dummies are included in the regression. This ensures that the residuals sum to zero for each country over the sample period. With the actual REER having been on an upward trend in recent years, the fixed effect leads to an under prediction of recent REER appreciation. Therefore, the REER model result of overvaluation may in large part be a consequence of the methodology, rather than a reflection of fundamental economic considerations.

some 15 percent above GDP.[1] This increase in income may have pushed up the equilibrium real exchange rate by raising prices of nontraded goods and services, thereby *weakening* the trade balance (and the CAB excluding remittances) relative to the counterfactual (see Appendix II of the 2013 SR). On the other hand, spending from remittances could be lower than from other types of income if remittance income is perceived to be more uncertain. To the extent that individual foreign workers perceive a high idiosyncratic risk that their work contracts may not be renewed, the saving rate out of remittances may be higher than from other types of income. This would tend to *raise* the CAB.

- ***Income inequality and target savers***: The Philippines' high-income inequality may boost the saving rate as high-income households tend to have a lower propensity to consume. The lack of access to formal banking services by a large share of the population may also increase the saving rate because of the need to pre-finance the purchase housing or durable goods.

- ***Impediments to investment***: As noted above, the strengthening of the Philippines' CAB since the Asian crisis coincided with a marked decline in the investment ratio. Balance sheet repair and rebuilding financial wealth in the aftermath of the Asian financial crisis could have depressed investment on a persistent basis.[2] A weak business environment and inadequate infrastructure—above and beyond that already captured in the EBA CA regression through the institutional/political risk variable—could also depress investment.

GNI versus GDP

10. Using gross national income, rather than GDP, to evaluate the current account in EBA leads to a smaller gap between the current account and its norm. While GNI is similar to GDP for most countries, GNI is nearly 15 percent larger than GDP in the Philippines owing to worker remittances that supplement residents' domestically-generated income. GNI is a better measure of income, and hence the basis for saving-investment decisions, implying that the CAB should be scaled by GNI rather than GDP.[3] In addition, some of the explanatory variables in EBA should

[1] While official data indicate that in 2013 remittances were equivalent to 9¼ percent of GDP, survey based data indicate that unregistered remittances are about 50 percent larger than those coming through official channels and captured in official statistics. Therefore, in calculating GNI, staff assumes that total remittances are 1½ times the officially reported amount (i.e., 15 percent of GDP). This GNI concept differs from the one used by the National Statistics Office, which assumes all overseas foreign workers are residents, and includes all their income earned abroad in GNI, resulting in GNI exceeding GDP by about 20 percent in 2013. However, this would tend to overstate the amount of resources available to people residing in the Philippines because many OFWs have long standing ties to their host countries and consume much of their income abroad.

[2] For example, the *World Economic Outlook* (Chapter 4, October 2009) finds a significant and persistent fall in investment after banking crises. Investment falls by 30 percent relative to pre-crisis trend even seven years after the crisis. Chapter 3 of the *April 2014 World Economic Outlook* finds that, after financial crisis, the investment rate falls by about 3 percentage points of GDP relative to pre-crisis trends.

[3] We assume that underreporting of remittances is offset by underreporting of net imports, implying that the current account is correctly measured. This accords with anecdotal reports of customs underreporting and the findings of *Global Financial Integrity*'s "Illicit Financial Flows to and from the Philippines: A Study in Dynamic Simulation, 1960–2011" (February 2014), which finds that underreporting of net trade in 2011 (correcting for entrepot trade with Hong Kong SAR) amounted to 8 percent of GDP.

also be rescaled using GNI, including the gap in income per capita, net foreign assets to GDP, public health spending to GDP, cyclically adjusted fiscal balance to GDP, change in foreign reserves to GDP, and credit to private sector to GDP.[1] Rescaling the CAB and the relevant explanatory variables with GNI instead of GDP reduces the estimated current account gap by 1.5 percentage points to 5.4 percent (Table 2.2).

Table 2.2. EBA: Current Account Assessment, 2013 1/

	Current Account (CA) Regression				
	Actual	With actual policies ("P")		With recommended policies ("P*")	
	CA/Y	Predicted CA/Y	Residual	EBA norm	EBA total CA gap
CA with GDP	3.5%	-2.8%	6.3%	-3.5%	6.9%
CA with GNI	3.0%	-1.8%	4.8%	-2.3%	5.4%

Source: IMF staff estimates, based on the 2013 external balance assessment.
1/ Y denotes either domestically generated income (GDP) or total income (GNI).

Role of Natural Disasters and Remittances

11. Cross-country empirical analysis suggests that precautionary saving due to exposure to natural disasters has a significant impact on the CAB, but worker remittances do not (Table 2.3). To analyze the impact of these variables on the CAB requires going beyond the EBA country sample, which does not include many small countries that are highly exposed to natural disasters or receive large amounts (relative to GDP) of worker remittances. Instead, a CGER-type macro-balance methodology is used.[2] Extending the CGER-type model by adding the Country Risk Index from the 2013 World Risk Report as an explanatory variable produces a significant result at the 10 percent level in the restricted model (Table 2.3, Column D), indicating that exposure to natural disasters raises the CAB for high-risk countries.[3]

[1] Because EBA is estimated on a large set of countries for which GDP is close to GNI, the estimated EBA coefficients remain valid.

[2] Based on "Exchange Rate Assessments: Tools for Advanced, Emerging, and Developing Economies" by Francis Vitek (2014). The model covers 184 countries with annual data between 1973 and 2012. This paper already includes gross worker remittance inflows as one of the determinants of the CAB (Table 1, Column A), but it is not statistically significant, and thus is excluded from the restricted model (Table 1, Column B).

[3] See United Nations University, WorldRiskReport 2012. When the Country Risk Index is added to the EBA current account regression, the coefficient is not statistically significant and has the wrong sign. When gross remittance inflows are added to the EBA current account regression, the coefficient is statistically significant and of the correct sign. However, these results are largely driven by the Philippines. When a dummy for remittances to the Philippines is added, the variable is no longer statistically significant. Similarly, when net remittance inflows are considered, instead of gross remittances, the variable is not statistically significant independent of whether the Philippines is included in the regression or not. However, the EBA country sample is not appropriate for assessing the effect of remittances or exposure to natural disasters because most countries in the sample are not affected by these phenomenon.

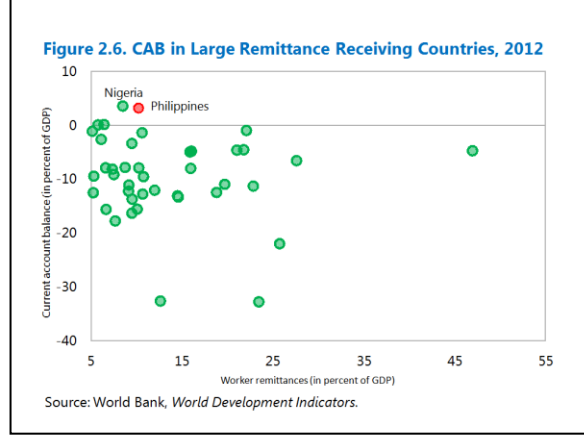
Table 2.3. Estimation Results for the Macroeconomic Balance Approach 1/

	Original Models 2/		Extended Models	
	A	B	C	D
	Unrestricted	Restricted	Unrestricted	Restricted
Relative old age dependency	0.103	---	0.039	---
Relative population growth	-0.234	-0.099	-0.405	-0.112
Relative income	-0.003	0.005 *	0.002	0.011 ***
Relative output growth	-0.256 ***	-0.039 *	-0.252 **	-0.037
Oil trade balance	0.109	0.172 **	0.094	0.164 *
Relative fiscal balance	0.286 ***	0.070 *	0.271 **	0.065
Initial net foreign assets	0.023 ***	0.033 ****	0.020 ***	0.028 ***
Aid inflows	-0.268 ****	-0.195 ***	-0.274 ****	-0.189 **
Remittance inflows	-0.139	---	-0.150	---
World risk index	---	---	0.120	0.187 **
R-squared	0.267	0.356	0.268	0.357
Cross section observations	146	171	141	162
Time series observations	21	22	21	22

1/ One sided statistical significance at the 1 percent, 5 percent, 10 percent, and 20 percent levels is indicated by ****, ***, **, and *, respectively.
2/ From "Exchange Rate Assessments: Tools for Advanced, Emerging, and Developing Economies" by Francis Vitek (2014). The restricted model excludes the two least statistically significant variables: relative old age dependency and remittance inflows.

12. For the Philippines—with the third highest global risk ranking—these empirical results suggest that the CAB is raised by 3½ percentage points of GDP relative to peers on account of the country's risk of natural disasters.[1] The world risk index consists of two parts—exposure and vulnerability—and the Philippines scores high on both components. High exposure reflects the Philippines' geography, while high vulnerability is due to its low level of development, poor infrastructure and building standards, and lagging coping and adaptive capacities. Vulnerability to natural disasters is therefore amenable to improvement. Reducing vulnerability to the level of Malaysia (while keeping exposure unchanged) would lower the predicted CAB by about 1 percentage point of GDP (i.e., a net *increase* of 2½ percent of GDP relative to the cross-country average), while reducing vulnerability to the level of Japan would lower the CAB by about 2 percentage points of GDP (i.e., a net *increase* of 1½ percent of GDP).

Figure 2.6. CAB in Large Remittance Receiving Countries, 2012



Source: World Bank, *World Development Indicators*.

13. Because these estimates of the impact of natural disasters on the CAB are obtained outside of EBA, we err on the conservative side and assume the impact of high exposure and vulnerability to natural disasters on the Philippine current account is 2½ percent of GDP. This

[1] This corresponds to the difference between the Philippines' world risk index and the cross-country mean value for 2013 times the coefficient on this variable shown in Table 3, Column D (i.e., 0.2*0.187).

corresponds to the midpoint between the estimate at the current levels of exposure and vulnerability (3½ percent of GDP) and the best case scenario in which exposure is reduced to the level of Japan (1½ percent of GDP).

14. While cross-country empirical analysis suggests that worker remittances do not have a significant impact on the CAB (Table 2.3, columns A and C), Vitek (2014) finds they are associated with a significantly more appreciated REER. Taken together, these results suggest that the stronger REER brought by remittances weakens the trade balance, with the decline in the trade balance fully offsetting the amount of remittance inflows, and thus leaving the CAB unchanged. The Philippines, where the increase in worker remittances was accompanied by a stronger CAB, is an exception to this general pattern. In fact, among countries receiving worker remittances of 5 percent of GDP or more, only the Philippines and Nigeria had a current account surplus in 2012 (Figure 2.6).

Overall Assessment

15. Several nonstandard factors are thought to have strengthened the Philippines' current account balance. These include heightened exposure to natural disaster risk, understating national income by using GDP, lingering effects of the Asian financial crisis on saving and investment behavior, elevated income inequality, limited access to credit by much of the population, risk of contract nonrenewal for foreign workers, and a weak investment climate. While reliable quantification of impacts is problematic, their total contribution could approach 4 percentage points of GDP. This would reduce the current account gap to about 3 percent of GDP (Table 2.4).

Table 2.4. External Balance Assessment: Accounting for Nonstandard Factors

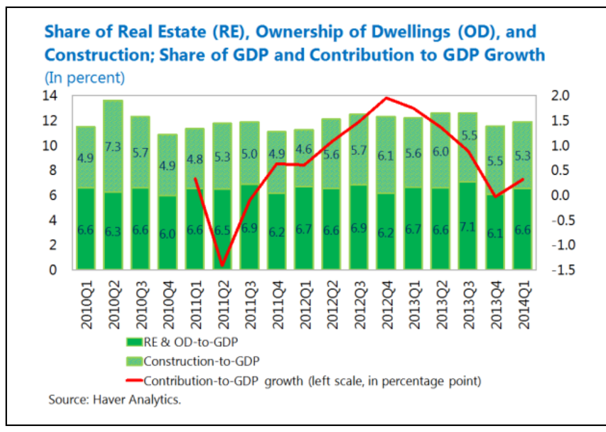
Method		Current Account Regression Approach
Assessment period		(2013)
Actual CAB (percent of GDP)	A	3.5
EBA's CAB norm (percent of GDP) 1/	B	-3.5
EBA's CAB gap (percent of GDP)	(A-B)	6.9
Accounting for nonstandard factors:		
Effect of GNI Adjustment	C	1.5
Effect of Natural Disasters Adjustment	D	2.5
Revised CAB gap (percent of GDP)	(A-B-C-D)	2.9

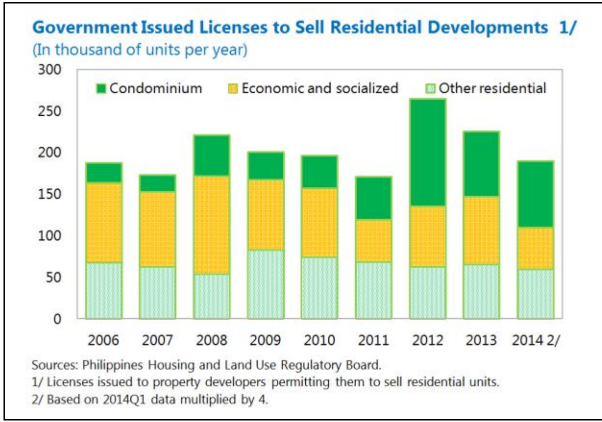
Source: IMF staff estimates.
1/ Based on the EBA 2.0 update of April 2014.

16. Staff is of the view that the external sector is moderately stronger than warranted by medium-term fundamentals and desired policies, implying moderate currency undervaluation. With official reserves now more than adequate for precautionary purposes, sustained gradual real appreciation and stepped up imports of investment goods over the medium term are expected to narrow the current account gap and bring the external sector toward its multilaterally consistent equilibrium.

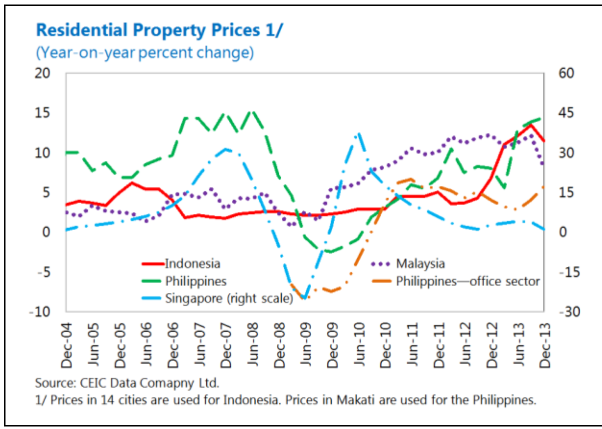
Appendix 3. Philippines—Developments in Real Estate

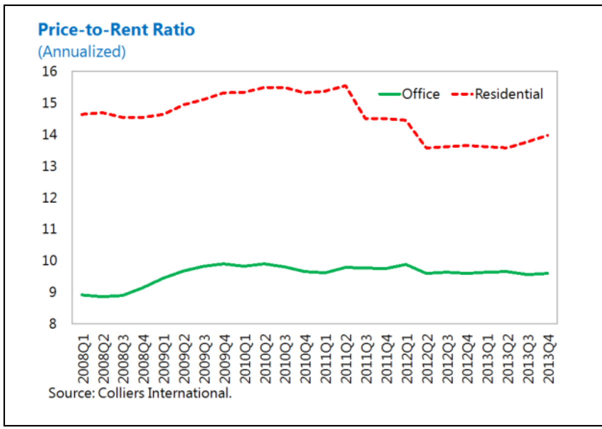
1. ***Real activity***. Accounting for 12 percent of aggregate output, the construction, real estate and ownership of dwellings sectors have been important drivers of GDP growth in recent years, contributing 1.1 percentage points in 2013, although down from 1.4 percentage points in 2012. Private construction activity declined by 6 percent (y/y) in Q1:2014, pulling down GDP growth by 0.4 percentage point. The slowdown in residential construction is also evident from the drop in the number of licenses issued by the Housing and Land Use Regulatory Board to developers allowing them to sell residential properties. According to Colliers International, this slowdown reflects the expected completion of a large number of mid- and high-cost condominium buildings this year, and construction activity will rebound once the existing properties have been sold. License-to-sell data also indicate that construction activity is shifting toward socialized and low-cost housing, which provide tax exemptions to developers.





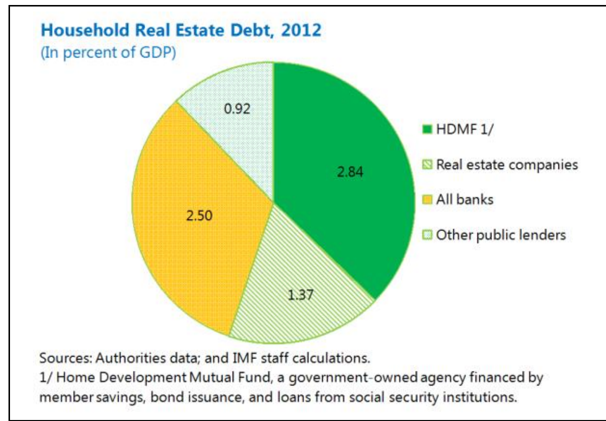
2. ***Property prices***. In Q4:2013, prices of mid- and high-end condominiums in upscale areas of metro Manila (only available price series) rose by 13 percent, y/y, similar to growth rates that prevailed prior to the GFC. However, in real terms, condo prices remain below their peak that prevailed prior to the Asian financial crisis. This likely reflects in part the large supply increase in this market segment in recent years. In fact, according to the official Philippine Housing Industry Plan for 2012–30, supply of units in the mid- and high-cost segments of the housing market is adequate, while the low-end of the market is characterized by severe shortages. Despite the recent price increases, residential price-to-rent ratios have remained relatively stable at around 14 percent.



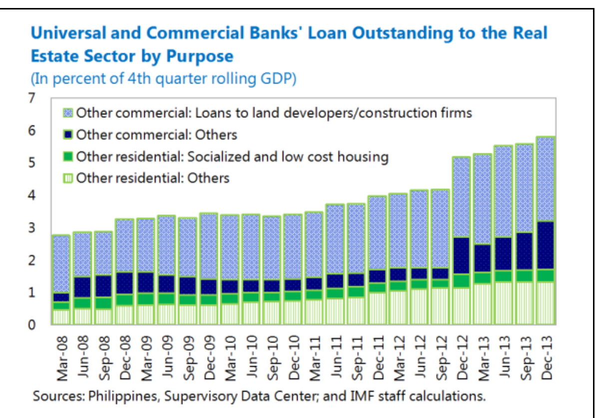


3. *Real estate financing*. A variety of financing sources is available to residential buyers and property developers:

- *Households* tap loans from banks and nonbank government financial institutions, developer financing, and also pay using own resources (especially in the case of overseas Filipino workers which are thought to account for 20 percent of buyers from major developers). Household real estate debt amounted to just over 7½ percent of GDP in 2012, with government nonbank lenders providing half the total. Residential RE loans from banks are used mainly to purchase high-end properties, and the growth rate of these loans has recently slowed sharply.

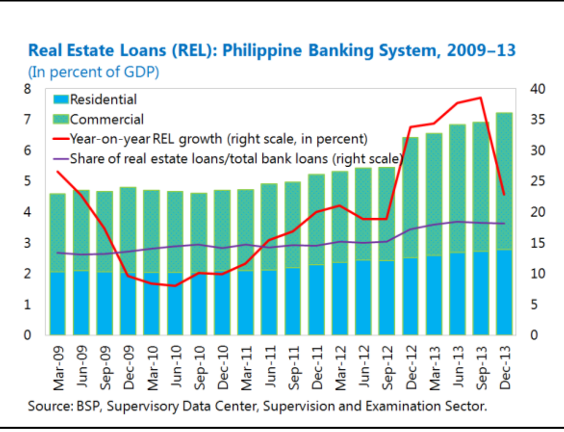


Sources: Authorities data; and IMF staff calculations.
1/ Home Development Mutual Fund, a government-owned agency financed by member savings, bond issuance, and loans from social security institutions.



Sources: Philippines, Supervisory Data Center; and IMF staff calculations.

- *Property developers and construction companies* rely on financing from banks, installment payments from buyers, and accessing capital markets. Loans to this segment account for 45 percent of banks' RE loans, which in turn account for 18 percent of banks' total loan portfolios. The growth rate of construction loans remains rapid, albeit from a low base. Receivables from buyers amount to only 1½ percent of GDP. Real estate firms and their affiliated holding companies are also major issuers of debt securities and equity offerings.

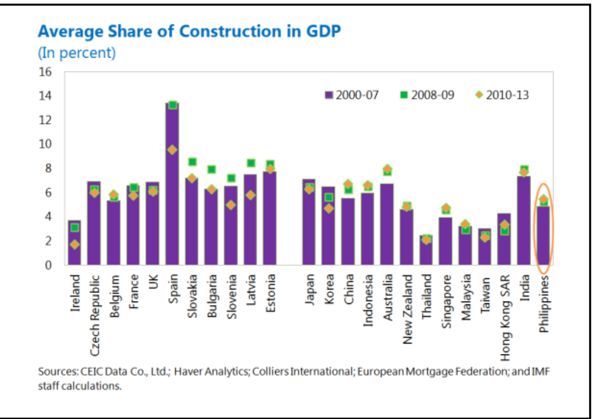


Source: BSP, Supervisory Data Center, Supervision and Examination Sector.

4. *Cross-country comparisons*. Cumulative increases in real house prices in the Philippines are modest compared to many other countries. Within Asia, real price increases during 2010–13 were considerably smaller than in India, Hong Kong SAR, Taiwan POC, and Malaysia. Philippines' cumulative real house price increases in recent years are very modest compared with price developments in European countries during the previous decade. The Philippines' price-to-rent ratio declined modestly since 2010, and does not signal price misalignment.

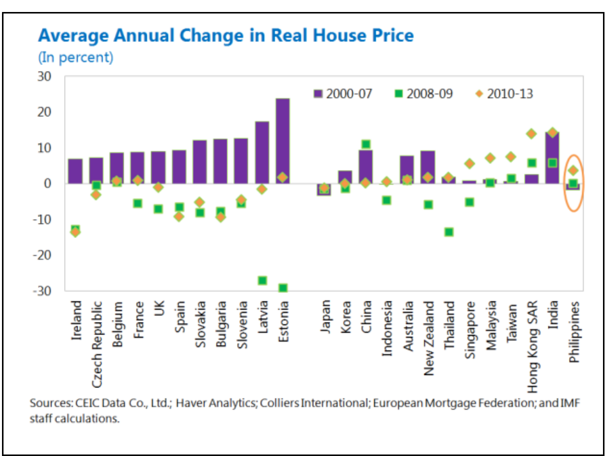
5. The share of total construction activity in GDP in the Philippines has tended to be relatively high, and inched up in recent years, surpassing shares in numerous Asia-Pacific countries, except Australia, India, Indonesia, China and Japan. However, the share of construction in GDP in the Philippines is well below shares in most European countries during the previous decade, and even more recently, with the exception of Ireland. While it is reasonable to expect a negative relationship between property price developments and construction activity, the evidence is weak based on the sample used here in the absence of a broad set of control variables.

Average Share of Construction in GDP
(In percent)



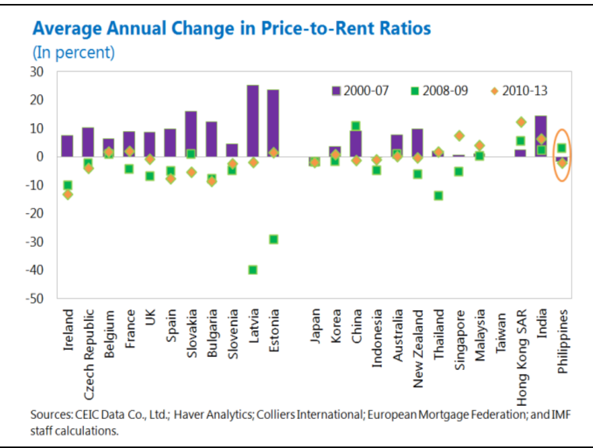
Sources: CEIC Data Co., Ltd.; Haver Analytics; Colliers International; European Mortgage Federation; and IMF staff calculations.

Average Annual Change in Real House Price
(In percent)



Sources: CEIC Data Co., Ltd.; Haver Analytics; Colliers International; European Mortgage Federation; and IMF staff calculations.

Average Annual Change in Price-to-Rent Ratios
(In percent)



Sources: CEIC Data Co., Ltd.; Haver Analytics; Colliers International; European Mortgage Federation; and IMF staff calculations.

Appendix 4. Philippines—Debt Sustainability Analysis

1. The composition of public debt has improved significantly, reflecting the authorities' efforts in prudent debt management:

- The average maturity of debt has increased sharply. For peso-denominated central government debt, the share with maturity of 10 years or longer has risen from 10 percent in 2009 to 42 percent in 2013. With some 90 percent of net general government financing needs having been met by issuing debt with maturities of 10 years or longer in 2013, maturity extension is set to continue.

- Foreign currency denominated debt has fallen below one-half of the total general government debt, and its share is projected to continue to decrease.

- The ratio of public debt with floating interest rates is also low, at around 7.5 percent.

- The authorities are diversifying the investor base, including by issuing retail bonds, and with maturities of up to 25 years.

2. The three major rating agencies elevated the Philippines to investment grade status during 2013, with a further upgrade by one agency in early 2014.

3. Public debt in the Philippines is sustainable. The baseline scenario projects that the general government debt-to-GDP ratio will continue to moderate from about 39 percent in 2013 to about 27 percent of GDP in 2019. Primary surpluses are the main reason for the expected decrease. The authorities' commitment to a 2 percent of GDP headline deficit at the national government level over the medium term implies an average annual primary surplus of over 1 percent of GDP at the general government level. This exceeds the debt stabilizing primary deficit of 0.6 percent of GDP, based on the assumption of 6 percent real GDP growth, and 3.5 percent inflation in the medium term. Moreover, the growth-interest rate differential will also contribute to debt reduction, with robust real GDP growth offsetting gradually rising interest rates. Gross financing needs will remain moderate at around 4–6 percent of GDP throughout the projection period, although representing a relatively high one-third of general government tax revenue.

4. Alternative scenarios reveal that the baseline scenario is conservative. The Philippines achieved a large scale public debt reduction during the past decade, supported by primary surpluses, high output growth, and exchange rate appreciation. The historical scenario, in which real GDP growth, real interest rates, and primary balances are set to 2004–2013 averages, would lead to more rapid reduction in debt and gross financing needs than in the baseline scenario. Keeping constant the primary surplus at the level projected for 2014 (1.9 percent of GDP) would also lead to a lower path for the debt-to-GDP ratio and gross financing needs than in the baseline scenario.

5. The outlook for economy-wide external debt also remains positive. In recent years, external debt has steadily declined from close to 80 percent of GDP in 2001 to below 30 percent of GDP at end2013. Under staff's baseline scenario, external debt as a ratio to GDP is expected to continue falling over the medium term due to sustained current account surpluses, strong GDP growth, and continued peso appreciation. Moreover, debt dynamics appear resilient to various shocks: one-half standard deviation shocks to interest rates, growth, and the current account lead to only modest deteriorations in external debt ratios over the medium term. However, exchange rate volatility remains a vulnerability as a one-time real depreciation of 30 percent in 2014 would raise the external debt-to-GDP ratio by 12 percentage points.

Philippines—Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(In percent of GDP, unless otherwise indicated)

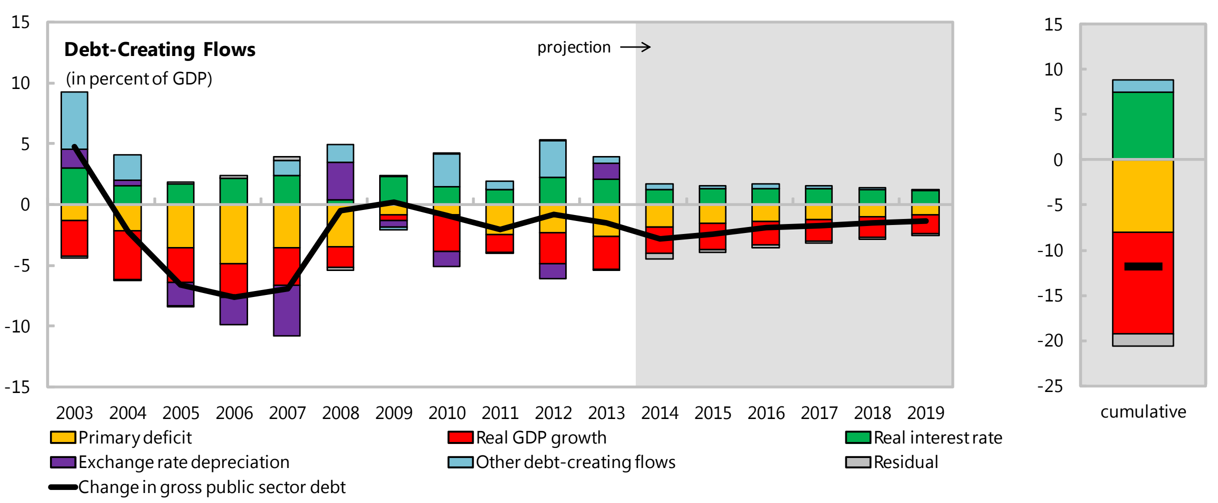
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	51.4	40.6	39.1	36.2	33.8	31.9	30.2	28.7	27.3
Public gross financing needs	15.9	7.4	4.6	6.0	5.6	5.2	4.9	4.7	4.5
Real GDP growth (in percent)	5.0	6.8	7.2	6.2	6.5	6.2	6.0	6.0	6.0
Inflation (GDP deflator, in percent)	4.6	1.9	2.0	4.1	3.8	3.5	3.5	3.5	3.5
Nominal GDP growth (in percent)	9.8	8.8	9.3	10.5	10.6	9.9	9.7	9.7	9.8
Effective interest rate (in percent) [4/]	8.4	7.8	7.5	7.8	7.9	8.0	8.0	8.1	8.1

As of May 27, 2014		
Sovereign Spreads		
EMBI (bp) 3/		122
CDS (bp)		96
Ratings	Foreign	Local
Moody's	Baa3	Baa3
S&Ps	BBB	BBB
Fitch	BBB-	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-2.4	-0.8	-1.5	-2.8	-2.4	-1.9	-1.7	-1.5	-1.4	-11.8	
Identified debt-creating flows	-2.5	-0.9	-1.4	-2.4	-2.2	-1.7	-1.5	-1.3	-1.2	-10.4	
Primary deficit	-2.6	-2.3	-2.7	-1.9	-1.6	-1.4	-1.3	-1.0	-0.8	-8.0	-0.6
Primary (noninterest) revenue and gran	17.9	18.3	18.5	18.9	18.8	18.9	18.9	18.8	18.8	113.1	
Primary (noninterest) expenditure	15.3	15.9	15.8	17.0	17.3	17.5	17.6	17.8	18.0	105.1	
Automatic debt dynamics [5/]	-1.3	-1.7	0.7	-1.0	-0.9	-0.6	-0.5	-0.5	-0.4	-3.8	
Interest rate/growth differential [6/]	-0.7	-0.4	-0.6	-1.0	-0.9	-0.6	-0.5	-0.5	-0.4	-3.8	
Of which: real interest rate	1.8	2.2	2.0	1.2	1.3	1.3	1.3	1.2	1.2	7.4	
Of which: real GDP growth	-2.5	-2.6	-2.7	-2.2	-2.1	-1.9	-1.8	-1.7	-1.6	-11.2	
Exchange rate depreciation [7/]	-0.6	-1.3	1.4	…	…	…	…	…	…	…	
Other identified debt-creating flows	1.4	3.1	0.5	0.4	0.3	0.3	0.2	0.2	0.0	1.4	
Privatization proceeds (negative)	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
GG Accumulation of liquid assets	1.6	3.2	0.6	0.4	0.3	0.3	0.2	0.2	0.0	1.5	
Residual, including asset changes [8/]	0.0	0.1	-0.1	-0.5	-0.2	-0.2	-0.2	-0.2	-0.2	-1.4	



Source: IMF staff.

1/ Public sector is defined as non-financial public sector.

2/ Based on available data.

3/ EMBI.

4/ Defined as interest payments divided by debt stock at the end of previous year.

5/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

8/ For projections, this line includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Philippines—Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity

(in percent of GDP)

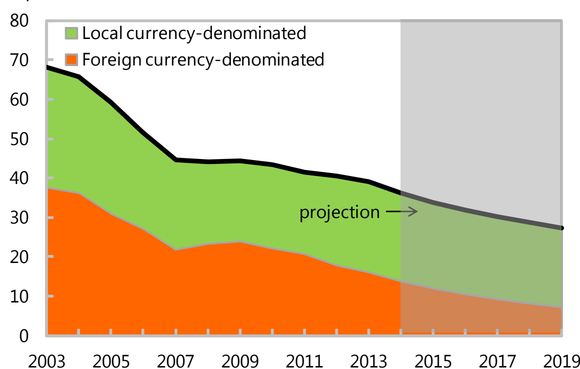
Medium and long-term
Short-term
projection

80 70 60 50 40 30 20 10 0

2003 2005 2007 2009 2011 2013 2015 2017 2019

By Currency

(in percent of GDP)

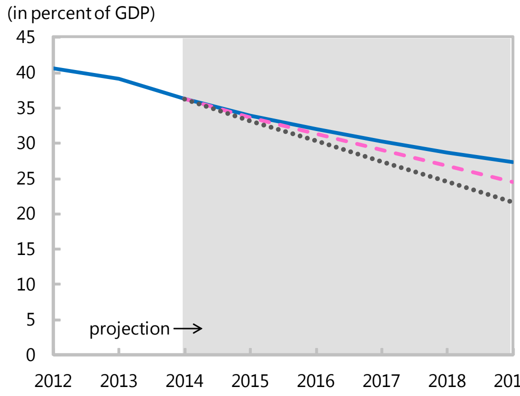


Alternative Scenarios

Baseline — Historical — Constant Primary Balance

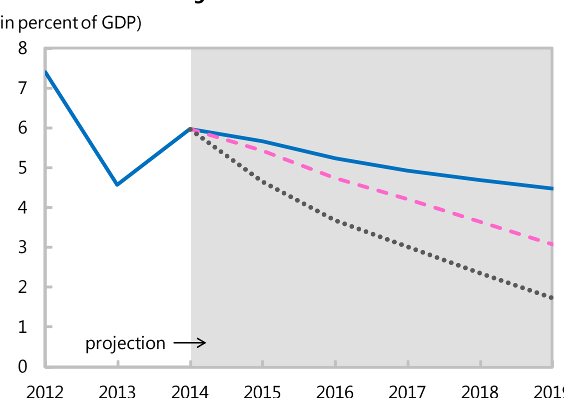
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

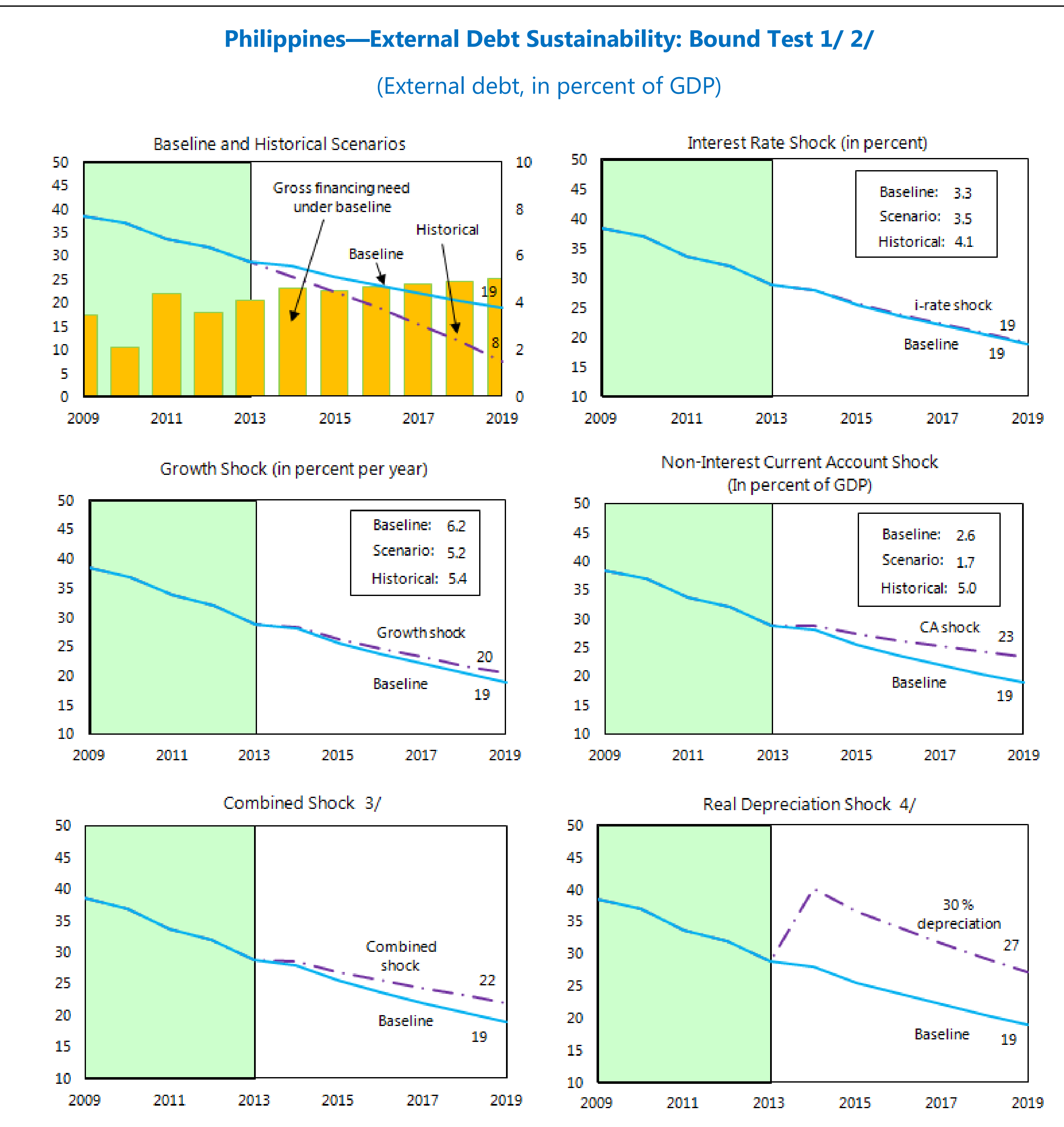
Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	6.2	6.5	6.2	6.0	6.0	6.0
Inflation	4.1	3.8	3.5	3.5	3.5	3.5
Primary Balance	1.9	1.6	1.4	1.3	1.0	0.8
Effective interest rate	7.8	7.9	8.0	8.0	8.1	8.1
Constant Primary Balance Scenario						
Real GDP growth	6.2	6.5	6.2	6.0	6.0	6.0
Inflation	4.1	3.8	3.5	3.5	3.5	3.5
Primary Balance	1.9	1.9	1.9	1.9	1.9	1.9
Effective interest rate	7.8	8.0	8.2	8.2	8.3	8.4

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	6.2	5.4	5.4	5.4	5.4	5.4
Inflation	4.1	3.8	3.5	3.5	3.5	3.5
Primary Balance	1.9	2.7	2.7	2.7	2.7	2.7
Effective interest rate	7.8	8.0	8.2	8.3	8.4	8.6

Source: IMF staff.

Philippines—External Debt Sustainability: Bound Test 1/ 2/

(External debt, in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2014.

Philippines—External Debt Sustainability Framework, 2009–2019

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2009	2010	2011	2012	2013			2014	2015	2016	2017	2018	2019	Debt-stabilizing non-interest current account 6/
1 Baseline: External debt	38.4	36.9	33.7	31.9	28.8			27.9	25.5	23.7	22.0	20.4	18.9	-2.5
2 Change in external debt	0.9	-1.5	-3.2	-1.8	-3.1			-0.9	-2.4	-1.8	-1.7	-1.6	-1.5	
3 Identified external debt-creating flows (4+8+9)	-4.2	-9.2	-6.8	-6.6	-6.1			-5.2	-4.9	-4.4	-3.8	-3.2	-2.6	
4 Current account deficit, excluding interest payments	-6.5	-4.9	-3.8	-4.0	-4.5			-4.2	-3.5	-2.8	-2.2	-1.6	-1.1	
5 Deficit in balance of goods and services	-56.6	-60.2	-57.2	-58.5	-53.2			-53.9	-51.4	-50.0	-48.7	-47.5	-46.3	
6 Exports	25.7	27.3	25.5	26.7	24.5			24.6	23.4	22.5	21.8	21.1	20.4	
7 Imports	-31.0	-32.9	-31.7	-31.8	-28.8			-29.3	-28.0	-27.5	-26.9	-26.4	-25.9	
8 Net non-debt creating capital inflows (negative)	-0.3	0.4	-0.3	-0.3	-0.1			-0.3	-0.7	-0.9	-1.0	-1.0	-1.0	
9 Automatic debt dynamics 1/	2.6	-4.7	-2.7	-2.2	-1.5			-0.7	-0.7	-0.7	-0.6	-0.6	-0.6	
10 Contribution from nominal interest rate	1.5	1.3	1.3	1.2	1.0			1.0	0.9	0.8	0.7	0.6	0.5	
11 Contribution from real GDP growth	-0.4	-2.5	-1.2	-2.1	-2.1			-1.7	-1.6	-1.4	-1.3	-1.2	-1.1	
12 Contribution from price and exchange rate changes 2/	1.6	-3.5	-2.8	-1.4	-0.5			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	5.1	7.6	3.6	4.8	3.0			4.3	2.5	2.6	2.1	1.6	1.1	
External debt-to-exports ratio (in percent)	149.8	135.0	132.1	119.5	117.8			113.3	109.2	105.1	100.9	96.6	92.6	
Gross external financing need (in billions of US dollars) 4/	5.9	4.1	9.9	8.9	11.2			13.3	14.8	17.4	20.0	22.9	26.2	
in percent of GDP	3.5	2.1	4.4	3.6	4.1			4.6	4.5	4.7	4.8	4.9	5.0	
Scenario with key variables at their historical averages 5/				31.9	28.8	10-Year Historical Average	10-Year Standard Deviation	25.5	22.5	19.2	15.6	11.7	7.6	-0.9
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	1.1	7.6	3.7	6.8	7.2	5.4	2.0	6.2	6.5	6.2	6.0	6.0	6.0	
GDP deflator in US dollars (change in percent)	-4.0	10.1	8.3	4.5	1.4	6.9	5.8	0.4	7.2	5.5	5.5	5.6	5.6	
Nominal external interest rate (in percent)	3.9	4.1	3.9	4.0	3.6	4.1	0.3	3.7	3.7	3.3	3.2	3.1	2.9	
Growth of exports (US dollar terms, in percent)	-9.4	26.2	4.8	16.9	-0.4	9.1	11.0	7.5	8.2	8.1	8.2	8.3	8.2	
Growth of imports (US dollar terms, in percent)	-19.0	25.8	8.2	12.0	-1.7	8.4	12.0	8.5	9.4	9.7	9.6	9.8	9.8	
Current account balance, excluding interest payments	6.5	4.9	3.8	4.0	4.5	5.0	1.8	4.2	3.5	2.8	2.2	1.6	1.1	
Net non-debt creating capital inflows	0.3	-0.4	0.3	0.3	0.1	0.3	1.0	0.3	0.7	0.9	1.0	1.0	1.0	

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate,

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

INTERNATIONAL MONETARY FUND

THE PHILIPPINES

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

June 23, 2014

Prepared By

Asia and Pacific Department

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FUND RELATIONS

(As of May 31, 2014)

Membership Status: Joined December 27, 1945; Article VIII

General Resources Account

	SDR Millions	Percent of Quota
Quota	1,019.30	100.00
Fund holdings of currency	673.70	66.09
Reserve position in Fund	345.60	33.91
Lending to the Fund New Arrangements to Borrow	44.80	

SDR Department

	SDR Millions	Percent of Allocation
Net cumulative allocation	837.96	100.00
Holdings	846.17	100.98

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR millions)	Amount Drawn (SDR millions)
Stand-by	04/01/98	12/31/00	1,020.79	783.23
EFF	06/24/94	03/31/98	791.20	791.20
Stand-by	02/20/91	03/31/93	334.20	334.20

Projected Payments to Fund: None

Exchange Arrangement

The de jure exchange rate arrangement is classified as *free floating*, while the de facto exchange arrangement is classified as *floating*. The value of the Philippine peso is determined in the interbank foreign exchange market; the Bangko Sentral intervenes in the spot and forward markets in order to smooth undue short-term volatility in the exchange rate and to strategically build forex reserves. The Philippines maintains an exchange system that is free of multiple currency practices and

restrictions on the making of payments and transfers for current international transactions except for exchange restrictions maintained for security reasons and notified to the Fund pursuant to Executive Board Decision 144-(52/51).

Article IV Consultation

Philippines is on the standard 12-month cycle. The 2013 Article IV consultation was held on March 29, 2013 (IMF Country Report No. 13/102).

Financial Sector Assessment Program (FSAP) and Report on Standards and Codes (ROSC) Participation:

MCM: A FSAP was conducted during the fourth quarter of 2001; FSAP missions visited Manila in October and November–December 2001. The final version of the report was discussed with the authorities in June 2002. The associated FSSA was discussed by the Executive Board together with the Article IV staff report in September 2002. The FSAP report was published in March 2004. The FSAP update mission took place in November 2009, and the report was published in April 2010.

FAD: Discussions on fiscal transparency were held in Manila in September 2001. The ROSC report was discussed by the Executive Board in September 2002 together with the Article IV staff report, and published in October 2002. The update to the ROSC report was published in June 2004. In addition, a pilot Fiscal Transparency Evaluation mission took place in February 2014.

STA: A ROSC Data Module mission was conducted in September 2003, and the report was published in August 2004.

Technical Assistance

The Philippines is an intensive user of IMF technical assistance (TA), particularly in fiscal and financial areas. Improvements have been made in all areas, but the translation of recommendations into law has lagged, except for the reform of excises on tobacco and alcohol and the revision to the BSP Charter for financial supervision, which is currently being discussed in parliament.

In the fiscal area, FAD has executed a TA project financed by the Millennium Challenge Corporation to improve the basic functions of tax administration by the Bureau of Internal Revenue, in line with recommendations made by FAD TA missions in 2005, 2008, and 2009. The project provided for a resident tax administration advisor and an extensive program of short-term expert visits. Seeking a pro-growth and equitable tax system, TA on tax policy in 2013 and early 2014 aimed to improve revenue yield, rationalize tax expenditures and reform natural resource-based taxation. FAD TA missions on tax policy provided advice that constituted the basis for the reform of excises on tobacco and alcoholic beverages implemented in early 2013. In the area of tax administration reform, progress has been made in the redesign of processes in the core functional areas of audit,

arrears management and, large taxpayer service. A series of TA missions on tax administration, arrears collections, compliance strategy and VAT audit took place in 2013 and early 2014.

TA on public financial management (PFM) seeks to establish effective and efficient Budget and Treasury Management. In line with past PFM advice, the government introduced a Treasury Single Account and is reviewing its cash management and planning. It now produces a midyear report on the macroeconomic and fiscal outlook and midyear budget execution. In addition, the revenue and expenditure from off budget accounts are now presented in budget documents. TA on PFM has also expanded to cover the two main fiscal institutions.

On the legal area, LEG provided TA to the Philippines on Central Banking Legislation in 2012, and provided advice on the amendment to the Philippines' Central Banking Law in November 2013. In April 2013, LEG also provided TA on Implementation of Targeted Financial Sanctions Obligations under UN Security Council Resolutions Relation to Terrorism Financing.

MCM TA activities in the Philippines seek to develop and implement a risk-focused supervisory approach in keeping with the Basel Core Principles and other key international supervisory practices. In terms of outcomes, the authorities adopted Basel II in 2005, and began implementing Pillar 2 (Internal Capital Adequacy Assessment Process (ICAAP)/supervisory review of capital adequacy) in 2011. In 2010–11, a more concerted effort was made to enhance enforcement and clear a backlog of problematic institutions; the policy on cease & desist orders (CDO) was approved in August 2011, and this was followed by the issuance of internal procedural guidance in October 2011. Another key outcome has been the implementation of the supervisory core training initiative that began in late 2010. More than ten committees have developed content for new courses, with initial rollout of the courses in 2011. In 2013, the implementation of the overall program deepened in supervisory capacity building. The in-house training initiative is now self-sustaining and the quality of the supervisory reports has shown considerable improvement. A series of TA missions on banking supervision and training took place in 2013 and early 2014. In addition, a TA mission on liquidity management and forecasting took place in February 2013, and two missions on supervisory enforcement took place in August 2013 and February 2014.

A series of STA TA missions on Government Finance Statistics took place in 2012 and 2013 to assist the authorities in compiling and disseminating government finance statistics in accordance with Government Finance Statistics Manual 2001. Additionally, during 2012 STA provided TA to the Philippines in the areas of Balance of Payments Statistics, Data Dissemination Standards, National Accounts, and producer and consumer price indices.

Resident Representative

A Resident Representative has been stationed in Manila since January 1984. Mr. Shanaka Jayanath Peiris has been the Resident Representative for the Philippines since September 2012.

IMF-WORLD BANK COLLABORATION

(As of April 23, 2014)

Background

The Bank and the Fund country teams for the Philippines exchanged views to coordinate the teams' work during 2014 through the resident representative's office and headquarters missions. The teams agreed on the Philippines' main macroeconomic challenges to navigate the uncertain global environment to maintain macroeconomic stability, create policy space to meet future potential shocks, and build the foundations for faster and more inclusive growth. Based on this shared assessment, the teams identified three structural reform areas as macro-critical, in view of their central role in achieving sustained inclusive growth: (1) raising investment, including public sector capital spending; (2) strengthening public finance and social safety nets; and (3) the financial sector. Table 1 details the specific activities planned by the two country teams during January 2014-December 2014, along with their expected deliverables, and the division of labor.

The Key Areas with Joint Programs

Strengthening Public Finance

The continued focus on mobilizing fiscal revenue help fund spending in support of sustained and inclusive growth, while strengthening the resilience to shocks. The Fund and the Bank have a long standing program of support for strengthening public finance and involve close coordination in support of tax administration reforms in the Bureau of Internal Revenue and Bureau of Customs; tax policy reform including fiscal incentives rationalization and monitoring of the sin tax implementation; management of fiscal risks; debt management strategy; strengthening the fiscal unit in the Department of Finance (focused on assessing and strengthening customs and BIR performance); and support for the Bureau of Treasury's lead role in implementation of a Single Treasury Account (TSA).

Financial Sector

A joint Bank/Fund Financial System Stability Assessment took place in 2009, following up on the initial joint FSAP in 2002. Following the FSAP recommendations, the Fund has focused on technical assistance in bank supervision. The Bank has taken the lead in the nonbank financial sector. Joint areas of interest are banking sector soundness, and capital market development.

Broad agreement among the two teams emerged on the key issues and challenges, and on the division of tasks to tackle these. It was agreed that further details on collaboration, as necessary, would be agreed at the technical level as work progresses. The teams have the following requests for information and collaboration from their counterparts:

- The Fund team requests to be kept informed of progress in World Bank's discussions with the government on financing of infrastructure, PPPs, and implementation of the development policy loan. Review and sharing of analytical work, in particular the Philippine Development Report (PDR) series, would be welcome, in addition to follow up from the 2010 FSAP, and on work related to the reform of social safety nets, public expenditure reviews, and public financial management.

- The Bank team requests to be kept informed of the Fund's assessments of macroeconomic policies and prospects and to coordinate closely the technical assistance work, especially in areas such as tax policy and administration, where the Bank has an existing program in place, as well as in public expenditure analysis and management, where extensive Bank work is ongoing.

Table 1. Philippines: Bank and Fund Planned and Ongoing Activities in Macro-Critical Structural Reform Areas, January 2014-December 2014

	Products	Expected Delivery Date
Bank Work Program	• Philippines Development Report on "Creating More and Better Jobs" • Philippine Economic Update • Programmatic policy analysis and implementation support for inclusive growth, to include policy notes on rice, cabotage, ports and shipping, agrarian reform, and regional development and integration • Programmatic support on improving statistics, including support to the new Philippine Statistics Authority and the Securities and Exchange Commission • Implementation completion report on the NPSTAR project • Backstopping of GFMIS implementation (AusAID) • Development Policy Loan 2 • Development Policy Loan 3 • Report on migration and remittances • Grant (AusAID) on developing an enterprise survey • Grant (IDF) on program evaluation • Financial Modeling for Deposit Insurance (FIRST) • Microinsurance reporting system (FIRST) • Financial Education and Consumer Protection with BSP (SECO) • Programmatic AAA for Financial Sector Development	• September 2013 (done) • Semi-annually • June 2013 to June 2016 • June 2013 to June 2016 • Project closing June 2013 • ongoing • Board, March 2013 • Concept Note, April 2014 • March 2013 • Closed in December 2013 • Closing in December 2015 • Completed in December 2013 • Closed in November2013 • October 2014 • July 2014
Fund Work Program	• Article IV consultation with a focus on adjusting to tighter external financing conditions while supporting sustained, more inclusive growth and containing stability risks. • Article IV staff report • Banking supervision technical assistance (TA) • Tax administration TA • Public financial management (cash management and budget execution) TA • Tax policy TA • Liquidity management and forecasting	• March 2014 • June 2014 • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing

Joint Work Program	• Close coordination in Support to Tax Administration Reforms in the BIR (IMF under an MCC supported work program and WB through its post-NPSTAR operation) , support for reinforcing reforms tax policy: fiscal incentives rationalization
	• Management of Fiscal Risk and GOCC/PPPs
	• DoF-BTr Debt Management Strategy
	• Support for Fiscal Intelligence Unit in DOF (focused on assessing and strengthening customs and BIR performance)
	• support for the Bureau of Treasury's lead role in implementation of a Single Treasury Account (TSA)
	• Collaboration and review of Philippines Development Policy Loans Program
	  • DPL 2 Board
	  • DPL 3 Concept Note
	• Review of Philippines Development Report on "Creating More and Better Jobs"
	• Review of Concept Note programmatic policy analysis and implementation support for inclusive growth
		• Ongoing
		• Ongoing
		• Ongoing
		• Ongoing
		• Ongoing
		• March 2013
		• April 2014
		• September 2013 (done)
		• April 2013

IMF-World Bank Collaboration Matrix: Macro-Critical Structural Issues

	Short-Term Reforms	Medium- and Long-Term Reforms of Direct Relevance to IMF 1/	Other Structural Reforms 2/
Raising potential growth	Investment incentives Energy sector taxation Oil deregulation law	Corporate sector Corporate sector performance and vulnerabilities (IMF/WB) Investment environment Regulatory framework (WB) Corruption /rule of law (WB) Investment incentives (IMF) Energy Sector Power supply and expected shortage (WB) Energy sector taxation (IMF) Rice market NFA operation and efficiency (WB) Pricing and subsidy of rice (WB/IMF) Labor market (WB in relation to education) Regulatory framework (WB) Wages/union structure (WB) Structural reforms in key sectors (e.g., ports and shipping, water, tourism, agriculture, and IT-enabled services) (WB)	Corporate governance Concentration/oligopoly/ monopoly (WB-2005 CEM)
Public finance	BIR reform Cash management Expenditure efficiency (capital spending)	Revenue administration BIR reform (IMF/WB) BOC (IMF in relation to customs)/WB in relation to trade facilitation) Revenue forecasting (WB/IMF) Public financial management Cash management (IMF) IFMIS/fiscal reporting (IMF) Budget preparation (IMF/WB) Budget execution (IMF/WB) Tax Policy (IMF/WB) Expenditure efficiency/policy Social safety net (WB) Level of spending (IMF/WB) Efficiency (WB) Medium-term Expenditure Framework (WB/IMF) GOCC reform (WB) Fiscal Responsibility Law (IMF/WB)	PPPs (WB/IMF) Debt Management (World Bank/IMF)
Financial sector		Bank supervision (IMF) Banking sector soundness (IMF/WB) PDIC Contingency Framework (IMF) Capital market development (IMF/WB) International coordination to limit regulatory arbitrage (IMF) Financial Inclusion (WB)	

1/ Issues directly relevant for IMF work; (IMF) means work done in-house, (IMF/WB) implies in-house work in parallel or collaboration with the WB; and no specific reference means input required from other institutions.
2/ Noncritical, but useful input to IMF analysis.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of December 2013)

Since joining the Asian Development Bank (ADB) in 1966, Philippines has received 222 sovereign loans and grants financed by ADB Special Funds for a total of $14,423.4 million including nonsovereign financing amounting to $792.2 million. The energy, public sector management, and agriculture and natural resources account for the largest proportion of ADB lending (combined 59.8 percent of the total) (Table 2). As of December 31, 2013, cumulative direct value-added cofinancing for Philippines since 1970 amounted to $2.75 billion for 51 investment projects and $81.9 million for 65 TA projects.

Table 2. Cumulative ADB Lending to Philippines
(As of December 2013)

Sector	No. of Loans	Amount of Loans (US$ millions)	Percent (by amount)
Energy	32	3,384.7	23.5
Public sector management	11	3,228.0	22.4
Agriculture and natural resources	61	2,010.4	14.0
Transport and ICT	30	1,463.9	10.2
Finance	22	1,366.0	9.5
Multi-sector	12	1,082.3	7.5
Water and other municipal infrastructure and services	27	1,042.9	7.2
Health and social protection	7	367.4	2.6
Education	8	252.1	1.8
Industry and trade	12	225.8	1.6
Total	222	14,423.4	100.0

ADB's private sector operations in Philippines began in 1986. As of December 2013, cumulative approvals in 27 projects amounted to $792.2 million. ADB's private sector operations in Philippines included financing for power plants and investments in banks and private equity funds. In 2008, a $200 million loan was approved and disbursed for the acquisition, rehabilitation, and operation of the existing 600-megawatt Masinloc coal-fired thermal power plant in Zambales province by Masinloc Power Partners Co. Ltd. In 2009, a $120 million loan was approved for KEPCO SPC Power Corporation for the construction, operation and maintenance of a new coal fired power plant in the Visayas region using circulating fluidized bed technology. In 2012, an equity investment of $25 million was approved for Philippine Investment Alliance for Infrastructure Fund.

The Country Partnership Strategy (CPS) 2011−2016 was endorsed by the ADB Board of Directors on October 26, 2011. The CPS is aligned with the government's Philippine Development Plan 2011−2016 and ADB's Strategy 2020. The key objective of ADB support will be to help Philippines achieve, high, inclusive, and sustainable growth. The intended outcomes of the CPS are: (i) improved investment climate and private sector development; (ii) more efficient, effective, and equitable social service delivery; (iii) reduced environmental degradation and vulnerability to climate change disasters; and (iv) strengthened governance and reduced corruption. The Country Operations Business Plan (COBP) 2014–2016, the third under the CPS 2011–2016, was approved on October 1, 2013.

STATISTICAL ISSUES

(As of June 2, 2014)

I. Assessment of Data Adequacy for Surveillance	
General: Data provision to the Fund has some shortcomings, but is broadly adequate for surveillance.	
National accounts: As part of a World Bank-funded project, *Improving the Quality and Usefulness of the Philippine System o f National Accounts,* the National Statistical Coordination Board (NSCB) rebased the national accounts from 1985 to 2000. Continuing improvements include ongoing efforts to fully implement the *System of National Accounts, 2008.* Despite the authorities' efforts to improve quality, weaknesses remain in the national accounts. These include the coverage of the GDP and the statistical discrepancies in the GDP estimates between the expenditure and production sides. The authorities are working on improving (i) the accuracy of the GDP volume measures; (ii) the coverage of the public corporations sector; (iii) the accuracy of the quarterly GDP data; and (iv) the adoption of benchmark techniques to reconcile quarterly and annual national accounts estimates. The NSCB is currently participating in the IMF Statistics Department's *Project on the Implementation of the System of National Accounts and the International Comparison Program,* funded by the Government of Japan. This three-year technical assistance project provides assistance to improve the quality of the national accounts and price statistics. **Price statistics**: In July 2011, the National Statistics Office introduced a rebased consumer price index (CPI). The updated CPI is compiled using weights based on the 2006 Family Income and Expenditure Survey. Data from the 2008 Commodity and Outlet Survey were used to augment the provincial market baskets. One important methodological change implemented in the updated CPI is the adoption of the internationally recommended *Classification of Individual Consumption by Purpose (COICOP)* for the classification of all items. As noted in the above section, assistance will be provided to improve the quality of price statistics in Philippines.	
External sector statistics: Steps have been taken to improve the quality of balance of payment statistics. In 2005, the Central Bank of Philippines (BSP) created a Department of Economic Statistics, with one of its units to concentrate on compiling, analyzing, and publishing the balance of payments and the international investment position. Since deregulation in the early 1990s, international transactions have increasingly flowed through nontraditional channels that are not adequately covered by the statistical reporting system. The authorities have introduced new data sources, including the Cross Border Transactions Survey and administrative-based reporting systems to address coverage issues, but challenges remain. The Foreign Currency Deposit Units (FCDUs), which account for about 70−75 percent of foreign exchange settlements, are exempt from reporting requirements because of strict banking secrecy rules.	
Monetary and financial statistics: Compilation of monetary and financial statistics (MFS) largely conforms to the Fund's methodology.	
Government finance statistics: Provision of fiscal data is broadly adequate for surveillance. Major areas for improvement include detailed data for levels of the public sector beyond the national government as well as transition of fiscal data reporting to the GFSM 2001 format. Fiscal Transparency ROSCs were conducted in 2002 and 2004.	
II. Data Standards and Quality	
Philippines subscribed to the Special Data Dissemination Standards (SDDS) in August 1996.	A data ROSC was published in August 2004.

Philippines: Table of Common Indicators Required for Surveillance

(As of May 31, 2014)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items:	
						Data Quality—Methodological Soundness[8]	Data Quality—Accuracy and Reliability[9]
Exchange rates	5/31/2014	5/31/2014	D	D	D	O	O
International reserve assets and reserve liabilities of the monetary authorities[1]	4/2014	5/2014	D	D	M	LO	LO
Reserve/base money	4/2014	5/2014	D	W	W	O, LO, LO, LNO	LO, O, O, O, LO
Broad money	3/2014	5/2014	M	M	M		
Central bank balance sheet	12/2013	5/2014	M	M	M		
Consolidated balance sheet of the banking system	3/2014	5/2014	M	M	M		
Interest rates[2]	5/31/2014	5/31/2014	D	D	D	O	O
Consumer price index	4/2014	5/2014	M	M	M	O, O, O, O	O, LO, O, LO, LO
Revenue, expenditure, balance and composition of financing[3]—general government[4]	2013	5/2014	Q	Q	Q	LO, LO, O, O	LO, LO, LO, LO, LO
Revenue, expenditure, balance and composition of financing[3]—central government	3/2014	5/2014	M	M	M		
Stocks of central government and central government-guaranteed debt[5]	3/2014	5/2014	M	M	M	LNO	LNO
External current account balance	12/2013	5/2014	M	M	M	O, LO, LO, LO	LNO, LO, O, LO, LO
Exports and imports of goods and services	12/2013	5/2014	M	M	M		
GDP/GNP	Q1:2014	5/2014	Q	Q	Q	LO, LO, O, LO	LNO, LNO, O, LO, O
Gross external debt	Q4:2013	5/2014	Q	Q	Q	O	O
International investment position[6]	2012	1/2014	A	A	A	O	O

[1] Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but sett other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).

[8] Reflects the assessment provided in the data ROSC or the Substantive Update (published on August 25, 2004, and based on the findings of the mission that took place during September 1–16, 2003) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, sc classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

[9] Same as footnote 8, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

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International Monetary Fund
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IMF Executive Board Concludes 2014 Article IV Consultation with the Philippines

On July 8, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Philippines and considered and endorsed the staff appraisal without a meeting.[2]

The Philippine economy has continued to perform robustly. GDP grew by 7¼ percent in 2013, supported by strong remittances from overseas workers and accommodative monetary and financial conditions. Due to its occurrence late in the year, super-typhoon Yolanda's impact on 2013 growth was limited, but a somewhat greater effect is likely in 2014. Growth is expected to ease in 2014 also in response to normalizing domestic financial conditions. Growth already slowed in the first quarter of 2014, in part due to temporary factors. Inflation remained below the bottom of the target band (4±1 percent) for much of last year, but picked up since late 2013 and is currently around 4½ percent because of pass through of the weaker peso, typhoon-related disruptions to food production, increases in rice prices and higher electricity prices. The current account surplus rose to 3½ percent of GDP in 2013 on a narrowing trade deficit. Risks to the growth outlook are tilted to the downside, and could stem from both domestic and external sources.

Strong GDP growth in recent years has translated into improved social conditions. Growth has become less employment intensive, but still reduced the elevated under- and unemployment rates. Poverty incidence, although declining, remains high, and a large share of the population remains vulnerable to falling into poverty as a result of natural disasters and other shocks.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] Article IV consultations are concluded without a Board meeting when the following conditions apply: (i) there are no acute or significant risks, or general policy issues requiring Board discussion; (ii) policies or circumstances are unlikely to have significant regional or global impact; (iii) in the event of a parallel program review is being completed, it is also completed on a lapse-of-time basis; and (iv) the use of Fund resources is not under discussion or anticipated.

On the policy front, domestic interest rates have been compressed by loose monetary policies abroad and ample domestic liquidity, partly reflecting the BSP's decision to restrict nonbanks' direct access to its Special Deposit Account (SDA)—one of its main sterilization instruments. Raising banks' reserve requirements by 2 percentage points earlier this year helped absorb part of the earlier net injection. Monetary and financial conditions have also been tightened by the more recent increase in the SDA rate by ¼ percentage point. In the banking system, financial soundness indicators signal continued strong performance, and capital adequacy ratios stand well above newly-introduced Basel III requirements. Bank credit growth recently accelerated to 21 percent and loan exposure to real estate has risen.

The level of public debt has moderated to 39 percent of GDP, alongside improvements in the maturity and currency composition. For 2014, the budget is targeting a deficit of 2 percent of GDP—up from the 1.4 percent of GDP achieved in 2013—that will accommodate post-disaster reconstruction spending. The government aims to double public infrastructure spending to 5 percent of GDP by 2016, financed by additional tax revenue, while keeping the deficit unchanged.

Executive Board Assessment

In concluding the 2014 Article IV consultation with the Philippines, Executive directors endorsed staff's appraisal, as follows:

The Philippine economy continued to perform robustly in 2013. Strong macroeconomic fundamentals and financial sector buffers, together with the authorities' flexible policy response to evolving external conditions, cushioned the impact of volatile capital flows. However, domestic monetary and financial conditions are now very accommodative. Notable progress was also achieved in lowering the poverty rate, although the incidence of poverty and under- and unemployment remain elevated.

Macroeconomic prospects are expected to remain favorable going forward. Reconstruction from super typhoon Yolanda, infrastructure spending and remittance-driven private consumption will support rapid GDP growth, but the pace is likely to ease somewhat on more restrictive financing conditions that would help to temper inflation, narrow the positive output gap, and enhance financial stability. The current account surplus is forecast to decline gradually, with the real effective exchange rate moving in line with structural flows.

This favorable outlook could be buffeted by external and domestic events. Abrupt exit from exceptionally loose monetary policies abroad, a sharp slowdown in China or other emerging markets, or a major geopolitical incident could impact global or regional trade and capital flows and adversely affect the Philippine economy. On the domestic front, rapid credit growth or a disproportionate flow of resources to the property sector could boost short-term growth but heighten volatility thereafter, impacting over-leveraged households and corporates.

The challenge is to deliver high-quality growth. Better realizing the Philippines' potential for rapid, sustained and more inclusive growth calls for further reducing bottlenecks to investment and formal sector employment that may be discouraging broad-based business activities. A more diversified production structure would strengthen resilience to economic shocks, which unduly impact the poor. Favorable demographics are a missed opportunity if the economy cannot effectively absorb the growing working-age population. Better domestic job opportunities would reduce poverty, thereby curtailing outward migration and the accompanying social hardships and sustained remittance inflows that can complicate macroeconomic management in the absence of compensating productivity gains.

The economy is well positioned for a more restrictive policy setting, together with a needed rebalancing of the policy mix towards an expansionary fiscal policy. The large buildup of reserves in recent years by leaning against the wind of sustained inflows suggests the external sector is moderately stronger than warranted by medium-term fundamentals. Incomplete sterilization and exceptionally loose monetary policies in advanced economies compressed domestic interest rates to low levels. A tighter overall policy stance is now needed to maintain macrofinancial stability, with a rebalancing of the policy mix in order to accommodate fiscal spending for post-typhoon reconstruction and infrastructure upgrading.

Continuing to proactively tighten monetary conditions would address both potential inflation and generalized financial stability risks. With market interest rates well below the policy rate, the Bangko Sentral ng Pilipinas (BSP) decisions to withdraw liquidity by drawing down reserves and raising reserve requirements earlier this year were appropriate. Additional tightening of monetary and financial conditions is needed with a focus on measures that would not encourage a further shift in financial intermediation to nonbanks, including by raising official interest rates. Providing the BSP with suitable instruments to undertake sterilization would improve the effectiveness of monetary policy. With official reserves more than adequate, the exchange rate should adjust more fully to structural balance of payments flows, while symmetrically smoothing the effect of cyclical capital flows.

Additional targeted action is needed to contain specific risks to the financial system. Early adoption of Basel III capital requirements, monitoring a broader definition of banks' real estate exposure, standardizing "contract to sell" financing arrangements for developers, and establishing the Financial Stability Coordination Council were appropriate preemptive responses to deepening financial intermediation. Taking further measures is advised to contain risks in the property sector and to improve oversight and better manage risks from large exposures. Therefore, the recently-announced bank stress tests for real estate exposure are commendable. Widening the BSP's mandate to include financial stability would help prevent diversion of systemic risk to the shadow-banking sector and strengthen powers for managing risks associated with greater cross-border financial integration.

Continuing to focus on mobilizing stable sources of revenue would ensure room for structural spending priorities while preserving fiscal prudence. Increasing the national government deficit

to 2 percent of GDP in 2014 and maintaining it thereafter is appropriate to continue to build fiscal buffers and moderate the debt ratio. To achieve sustainable and inclusive economic growth, larger public spending is needed for disaster remediation, infrastructure upgrading and to support improved social outcomes. Meeting these spending demands requires a sizable tax effort, which should focus mainly on broadening the tax base by reducing exemptions and allowances and adopting a new mining strategy, supported by improvements in tax administration.

Further reforms to attract investment and create new employment would help sustain vibrant economic growth and make it more inclusive. Relaxing limits on foreign ownership, reducing red tape, and limiting tax holidays that tend to favor incumbents and distort the tax system would increase market contestability, support execution of public-private partnerships and better position the Philippines to benefit from the growth and employment opportunities of deeper regional integration. Increasing job creation in agriculture and in micro and small firms calls for establishing clear property rights for small-scale farms, expanding access to formal credit, and reducing labor market rigidities.

Philippines: Selected Economic Indicators, 2010–15

	2010	2011	2012	2013	2014 Proj.	2015 Proj.
GDP and prices (percent change)						
Real GDP	7.6	3.7	6.8	7.2	6.2	6.5
CPI (annual average)	3.8	4.7	3.2	2.9	4.4	3.8
CPI (end year)	3.6	4.2	3.0	4.1	4.1	3.5
Investment and saving (percent of GDP)						
Gross investment	20.5	20.5	18.1	19.7	20.7	21.1
National saving	25.0	23.6	21.0	23.1	23.9	23.7
Public finances (percent of GDP)						
National government balance (authorities' definition)	-3.5	-2.0	-2.3	-1.4	-2.0	-2.0
National government balance 1/	-3.6	-2.1	-2.4	-1.4	-2.0	-2.0
Nonfinancial public sector balance 2/	-3.3	-0.8	-1.0	0.3	-0.5	-0.6
Revenue and grants	18.5	18.6	19.0	19.8	20.2	20.1
Expenditure	21.7	19.4	20.0	19.5	20.7	20.7
Nonfinancial public sector debt	54.8	55.3	52.9	50.1	45.6	41.6
Monetary sector (percent change, end of period)						
Broad money (M3)	10.0	7.1	9.4	31.8	32.1 3/	...
Interest rate (91-day treasury bill, end of period, in percent) 4/	1.3	1.7	0.5	0.5	1.2 5/	...
Credit to the private sector (in percent)	8.9	19.3	16.2	16.4	20.9 3/	...
External sector						
Export value (percent change)	26.2	4.1	21.2	-3.6	5.5	6.6
Import value (percent change)	24.7	9.5	11.3	-3.1	8.2	9.0
Current account (percent of GDP)	3.6	2.5	2.8	3.5	3.2	2.6
Capital account (US$ billions)	0.1	0.2	0.1	0.1	0.1	0.1
Financial account (US$ billions) /6	-11.5	-5.3	-6.8	0.6	1.7	-1.5
Direct investment (net) /6	1.6	0.3	1.0	-0.2	-0.8	-1.5
Errors and omissions (US$ billions)	-3.5	0.3	-4.6	-3.8	-3.2	-2.5
Overall balance (US$ billions)	15.2	11.4	9.2	5.1	4.5	7.7
Total external debt (percent of GDP) 7/	36.9	33.7	31.9	28.8	27.9	25.5
Debt service ratio 8/	13.6	13.6	9.9	10.3	11.9	11.3
Reserves(US$ billions)	62.4	75.3	83.8	83.2	87.7	95.4
Reserves/short-term liabilities 9/	402.0	475.3	407.2	369.0	372.9	381.8
Exchange rate (period averages)						
Pesos per U.S. dollar	45.1	43.3	42.2	42.4	44.610/	...
Nominal effective exchange rate (2005 =100)	110.0	108.9	112.9	116.0	111.310/	...
Real effective exchange rate (2005 =100)	127.0	127.8	134.1	139.4	136.0 10/	...

Sources: Philippine authorities; World Bank; and IMF staff projections.

1/ IMF definition. Excludes privatization receipts and includes deficit from restructuring of the previous central bank (Central Bank-Board of Liquidators).

2/ Includes the national government, 14 government-owned enterprises, social security institutions, and

local governments.
3/ April 2014 (year-on-year).
4/ Secondary market rate.
5/ May 2014.
6/ In BPM6. An increase in either assets or liabilities is always positive and a decrease is always negative. Net investment is assets minus liabilities.
7/ Includes external debt not registered with the central bank, and private capital lease agreements.
8/ In percent of exports of goods and nonfactor services.
9/ Reserves as a percent of short-term debt (including medium- and long-term debt due in the following year).
10/ Average January-May 2014.