INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/309

PHILIPPINES

September 2016

2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE PHILIPPINES

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 2016 Article IV consultation with the Philippines, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 14, 2016 consideration of the staff report that concluded the Article IV consultation with the Philippines.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 14, 2016, following discussions that ended on July 12, 2016, 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 August 26, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Philippines.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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September 26, 2016

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2016 Article IV Consultation with the Philippines

On September 14, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Philippines.

The Philippine economy has continued to perform strongly. Real GDP regained strength from a slowdown in mid-2015 to record a robust 5.9 percent growth rate in 2015 and 6.9 percent in the first half of 2016. Both consumption and investment grew rapidly, while net exports were held back by weak external demand. Job creation was also strong, with the unemployment rate declining to 6.3 percent in 2015 and 6.0 percent in the first half of 2016. Inflation has remained moderate, falling below the BSP’s target band (3±1 percent) in 2015 and the first seven months of 2016 due to lower commodity prices. The external and fiscal position remained robust in 2015, with a current account surplus of 2.9 percent of GDP, gross international reserves of US$81 billion (or 11 months of imports of goods and services), a national government fiscal deficit of 1.4 percent of GDP, and general government debt at 35 percent of GDP.

The outlook for the Philippine economy remains favorable despite external headwinds. Real GDP growth is expected at 6.4 percent in 2016 and 6.7 percent in 2017 on continued robust domestic demand and a modest recovery in exports. Unemployment is projected to decline to 5.9 percent in 2016 and 5.7 percent in 2017. Inflation is expected to return to within the BSP’s target range later this year and in 2017 as commodity prices stabilize and strong economic activity continues. The current account surplus is expected to decline in 2016−17 due to higher commodity prices and infrastructure related imports. The public debt-to-GDP ratio is expected to remain in a declining trend. Risks to the outlook are tilted to the downside. The Philippine authorities are well equipped to respond as needed with suitable policies should any risks materialize, particularly given the strong fundamentals and ample policy space.

[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.

Executive Board Assessment[2]

Executive Directors commended the authorities for their continued strong macroeconomic management, with robust growth and low inflation. Directors noted, however, that the favorable macroeconomic performance has not led to corresponding improvements in poverty reduction, inequality, and unemployment. They considered that the new administration has an opportunity to put the economy on a higher and more equitable growth path. Directors encouraged efforts to increase investments in infrastructure and human capital, improve targeting of social spending, enhance competitiveness and foreign direct investment, and making the financial system deeper and more inclusive.

Directors supported the increase in the fiscal deficit target to 3 percent of GDP from 2017, anchoring fiscal policy to a broadly stable public debt-to-GDP ratio. They noted that this would allow a welcome boost to infrastructure and social spending, while ensuring fiscal sustainability. Directors highlighted the need for additional revenue to finance further infrastructure and social spending and welcomed the authorities' plans to implement a comprehensive tax reform that would be revenue positive, more equitable, and efficient. They urged the authorities to formulate a medium-term public infrastructure plan with clear project prioritization and appropriate choices between budget and PPP spending, with due consideration of contingent liabilities. Further efforts to strengthen public financial management and budget execution were also encouraged.

Directors considered the current monetary policy stance as appropriate in view of the low inflation and near zero output gap. However, they noted the need for continued vigilance, particularly in light of the fiscal stimulus. Directors encouraged the Bangko Sentral ng Pilipinas (BSP) to stand ready to take measures if there are signs of overheating or accelerating credit growth. They commended the BSP for the smooth implementation of the new interest rate corridor and deposit auctions, which will improve monetary policy transmission and help develop domestic capital markets. Directors encouraged passage of the central bank charter that would authorize the issuance of central bank bills and BSP recapitalization. They emphasized the need for continued exchange rate flexibility.

Directors noted that the financial system remains sound. They supported the authorities' use of targeted prudential policies to strengthen resilience and limit systemic risks. Directors encouraged broadening the central bank's financial stability mandate.

Directors supported the authorities' goal to accelerate poverty reduction and their priorities for structural reforms. They called for well-targeted infrastructure and social spending, including for education and health, especially in rural areas, as well as continued efforts to enhance competition and open the economy to foreign investment. Directors also welcomed the focus on financial deepening and inclusion as essential elements of the authorities' inclusive growth strategy. They emphasized the importance of strengthening the AML framework, including to make tax evasion a predicate crime.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Philippines: Selected Economic Indicators, 2011–17

	2011	2012	2013	2014	2015	2016 Proj.	2017 Proj.
GDP and prices (percent change)							
Real GDP	3.7	6.7	7.1	6.2	5.9	6.4	6.7
CPI (annual average)	4.7	3.2	2.9	4.2	1.4	2.0	3.4
CPI (end year)	4.2	3.0	4.1	2.7	1.5	2.9	3.2
Investment and saving (percent of GDP)							
Gross investment	20.5	18.2	20.0	20.5	20.6	23.7	24.7
National saving	23.0	21.0	24.2	24.3	23.4	25.5	26.1
Public finances (percent of GDP)							
National government balance (authorities' definition)	-2.0	-2.3	-1.4	-0.6	-0.9	-2.0	-3.0
National government balance 1/	-2.0	-2.4	-1.5	-0.6	-1.4	-2.0	-3.0
Nonfinancial public sector balance 2/	-0.7	-0.6	0.6	0.9	0.1	-0.5	-1.6
Revenue and grants	18.6	19.4	20.2	19.8	19.6	19.6	19.7
Expenditure	19.3	20.0	19.6	18.9	19.5	20.1	21.3
Nonfinancial public sector debt	55.3	53.0	51.3	47.8	45.8	43.5	41.4
Monetary sector (percent change, end of period)							
Broad money (M3) 3/	7.1	9.4	31.8	11.2	9.4	12.4	...
Interest rate (91-day treasury bill, end of period, in percent) 4/	1.7	0.5	0.5	2.5	2.7	1.8	...
Credit to the private sector (in percent) 3/	19.3	16.2	16.4	19.9	13.6	17.6	...
External sector							
Export value (percent change) 5/	4.1	21.2	-4.0	11.9	-13.1	-3.4	4.1
Import value (percent change) 5/	9.5	11.3	-4.8	8.0	-3.2	4.0	6.0
Current account (percent of GDP)	2.5	2.8	4.2	3.8	2.9	1.8	1.4
Capital account (US$ billions)	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Financial account (US$ billions) 5/	-5.3	-6.8	2.2	9.6	2.5	0.4	0.5
Direct investment (net) 5/	0.3	1.0	-0.1	1.0	-0.1	-1.0	-1.1
Errors and omissions (US$ billions)	0.3	-4.6	-4.2	-4.1	-3.3	-2.5	-2.3
Overall balance (US$ billions)	11.4	9.2	5.1	-2.9	2.6	2.7	2.1
Total external debt (percent of GDP) 6/	33.7	32.0	28.9	27.3	26.5	25.1	22.7
Debt service ratio 7/	13.6	9.9	11.1	8.4	7.4	11.2	10.7
Reserves (US$ billions)	75.3	83.8	83.2	79.5	80.7	84.0	86.5
Reserves/short-term liabilities 8/	482.5	397.9	406.2	418.9	396.9	397.5	401.7
Exchange rate (period averages)							
Pesos per U.S. dollar	43.3	42.2	42.4	44.4	45.5	47.0	...
Nominal effective exchange rate (2005 =100)	99.0	102.6	105.4	102.7	108.8	106.0	...
Real effective exchange rate (2005 =100)	100.7	105.6	109.8	109.4	116.7	114.4	...

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/ Universal and Commercial Banks. The latest observation is June 2016 (year-on-year).
4/ Secondary market rate. The latest observation in July 2016.
5/ In BPM6. An increase in either assets or liabilities is always positive and a decrease is always negative. Net investment is assets minus liabilities.
6/ Includes external debt not registered with the central bank, and private capital lease agreements.
7/ In percent of exports of goods and nonfactor services.
8/ Reserves as a percent of short-term debt (including medium- and long-term debt due in the following year).
9/ Average January-June 2016.

INTERNATIONAL MONETARY FUND

PHILIPPINES

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

August 26, 2016

KEY ISSUES

Context: The Philippine economy has performed well in recent years with rising potential growth and strong macro fundamentals. Economic growth is supported by robust domestic demand and is broadly in line with potential while the outlook for inflation is well within the target band (3±1 percent). The external position is sound and fiscal policy is prudent, with a low and declining debt-to-GDP ratio.

The strong economic performance, however, has not yet fully benefited a wide range of the population. Poverty and inequality remain high. Poor infrastructure has constrained private investment and job creation. Public investment has risen but continues to be low due to weak implementation capacity, while progress has been made on fiscal transparency. Investment in infrastructure and human capital, financed through increased government revenues while allowing a small increase in the deficit, is needed alongside structural reforms to reap the Philippines' demographic dividend, promote inclusive growth and reduce poverty.

Risks: Tilted to the downside. Upside risks include stronger domestic demand spurred by low commodity prices and further improvements in budget execution. On the downside, lower growth in China, tighter global financial conditions, and a surge in global financial volatility could lead to capital outflows.

Main policy recommendations:

- Fiscal policy should focus on the medium-term priorities of boosting investment in infrastructure and human capital. While allowing a small increase in the deficit (to 3 percent of GDP), additional revenue should be secured and expenditure management improved to safeguard fiscal sustainability and anchor fiscal policy by stabilizing the debt-to-GDP ratio at its current low level.
- The monetary policy stance, underpinned by an improved operational framework, is appropriate for now and there is space to respond to shocks if needed.
- The Bangko Sentral ng Pilipinas (BSP) should continue to monitor the financial system to ensure that emerging systemic risks are dealt with through suitable macroprudential measures, including risks relating to credit growth in the real estate sector and concentration.
- Structural reforms priorities include opening up to foreign direct investment and enhancing competition.

Approved By
Odd Per Brekk and Petya Koeva Brooks

Mission dates: June 29-July 12, 2016
Staff team: Chikahisa Sumi (Head), Clinton Shiells, Jaime Guajardo, Rui Mano (all APD), Takuji Komatsuzaki (FAD), Chikako Baba (MCM), and Shanaka Jayanath Peiris (Resident Representative). Marzunisham Omar (Executive Director) and Thomas Marcelo (Senior Advisor to the Executive Director) joined some of the meetings.

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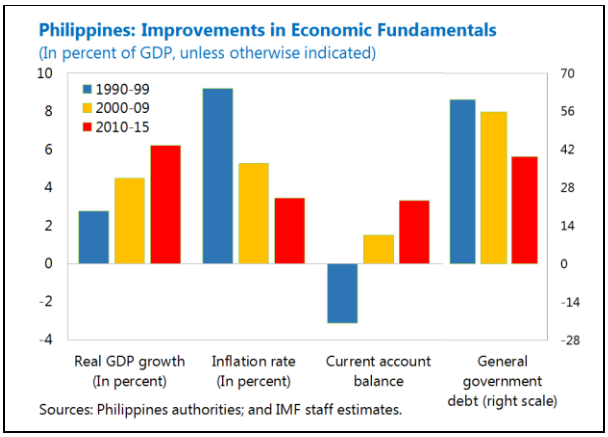
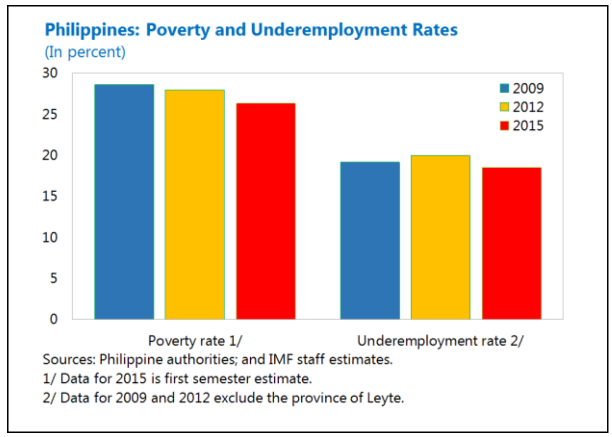
CONTEXT

1. **The Philippine economy has performed well during the past several years and the strong macro fundamentals provide a solid foundation to meet the remaining challenges**. Sound macroeconomic policies have delivered solid economic growth and reduced unemployment, low inflation, and financial stability as well as a strong fiscal position. However, underemployment and poverty rates have remained stubbornly high. Inequality remains among the highest in the region. Competition has been limited including by restrictions on foreign direct investment and by regulatory behavior.

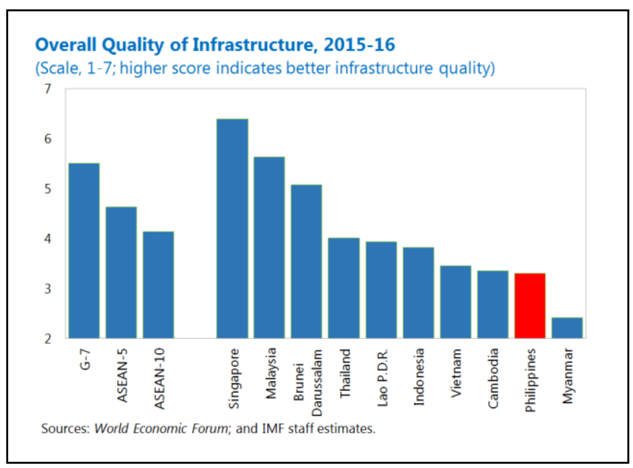


Philippines: Improvements in Economic Fundamentals
(In percent of GDP, unless otherwise indicated)
Sources: Philippines authorities; and IMF staff estimates.



Philippines: Poverty and Underemployment Rates
(In percent)
Sources: Philippine authorities; and IMF staff estimates.
1/ Data for 2015 is first semester estimate.
2/ Data for 2009 and 2012 exclude the province of Leyte.

2. **Poor infrastructure has constrained private investment and job creation, and residual excess liquidity from capital inflows following the Global Financial Crisis impede monetary policy transmission**. The 2015 Article IV consultation called for increasing public infrastructure and social spending, financed by raising government revenues, to help reap the Philippines' demographic dividend and lay the foundation for sustainable growth, along with structural reforms to increase competitiveness. Public infrastructure investment has accelerated recently but remains constrained by limited government revenue collection and incomplete public financial management (PFM) reforms, along with slow spending processes. BSP initiated an upgrade of their Interest Rate Corridor (IRC) system to improve monetary policy transmission.



Overall Quality of Infrastructure, 2015-16
(Scale, 1-7; higher score indicates better infrastructure quality)
Sources: *World Economic Forum*; and IMF staff estimates.

3. **Rodrigo Duterte, Mayor of the Philippines' third largest city Davao, was inaugurated as the new president in June, with a ten-point economic policy agenda calling for continuing prudent economic policies and a more ambitious inclusive growth and structural reform strategy**. While primarily focusing on law and order, President Duterte tapped into a desire for

change among a large part of the population to tackle the high levels of poverty and inequality that persists especially in rural areas despite years of robust economic growth. The President's ten-point plan (Box 1) includes: accelerating infrastructure investment; raising competitiveness by relaxing constitutional restrictions on foreign direct investment; ensuring security of land tenure; strengthening the education system; implementing a comprehensive tax policy reform, modernizing tax collection agencies; and improving social welfare programs. The mission discussed the ten-point agenda with the new administration and provided a number of policy options to consider, as elaborated below.

Box 1. Philippines: President Duterte's Ten-Point Socioeconomic Agenda

- Promoting law and order.
- Continuing and maintaining current macroeconomic policies, including fiscal, monetary, and trade policies;
- Instituting progressive tax reform and more effective tax collection while indexing taxes to inflation, in line with the plan to submit to congress a tax reform package by September;
- Increasing competitiveness and the ease of doing business, drawing upon successful models used to attract business to local cities such as Davao, as well as pursuing the relaxation of the constitutional restrictions on foreign ownership, except with regard to land ownership, in order to attract foreign direct investment;
- Accelerating annual infrastructure spending to account for at least 5 percent of GDP, with public-private partnership projects playing a key role;
- Promoting rural and value chain development towards increasing agricultural and rural enterprise productivity and rural tourism;
- Ensuring security of land tenure to encourage investment and address bottlenecks in land management and titling agencies;
- Investing in human capital development, including health and education systems, as well as matching skills and training to meet the demands of businesses and the private sector;
- Promoting science, technology, and the creative arts to enhance innovation and creative capacity towards self-sustaining and inclusive development;
- Improving social protection programs, including the government's conditional cash transfer program, in order to protect the poor against instability and economic shocks; and
- Strengthening the implementation of the Responsible Parenthood and Reproductive Health Law to enable, especially, poor couples to make informed choices on financial and family planning.

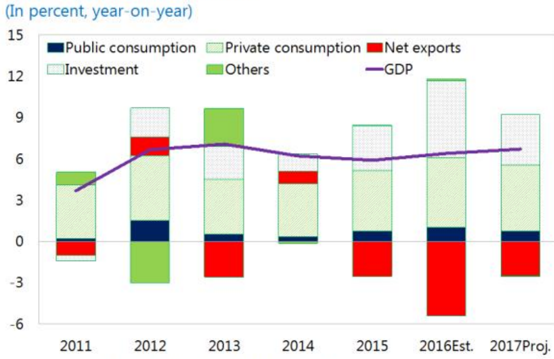
RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

Macroeconomic developments remain favorable and the financial system is sound and stable, although there are risks. Economic growth continues to be strong as robust domestic demand offsets continued weak external demand. Inflation has been below the target band, reflecting low food and oil prices, but is expected to rise to the middle of the band in 2017. The fiscal and external positions are strong. Risks remain tilted to the downside including from global financial volatility.

A. Recent Developments

4. Growth and inflation. Real GDP regained strength from a slowdown in mid-2015 to record a robust 5.9 percent growth rate in 2015 and 6.9 percent in the first half of 2016. Both consumption and investment have grown rapidly, while net exports have been held back by weak external demand. Real GDP growth is projected at 6.4 percent in 2016 and 6.7 percent in 2017 on continued robust private domestic demand and higher public spending. Exports would recover only modestly, although worker remittances and receipts from Business Process Outsourcing would help cushion the impact of the weak external environment. The output gap is expected to remain near zero in 2016–17. Amid strong economic activity, inflation fell below the target band (3±1 percent) in 2015 and the first seven months of 2016 due to lower food and fuel prices, but is expected to return to within the target range later this year and in 2017 as commodity prices stabilize and strong economic activity continues.

Contribution to GDP Growth
(In percent, year-on-year)



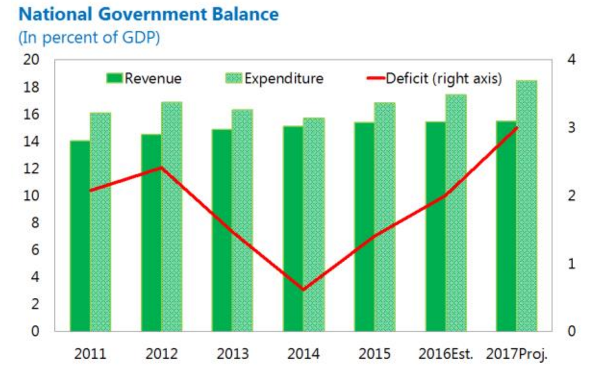
Sources: Haver Data Analytics; and IMF staff estimates.

Philippines: Output Gap Estimates Under Different Models
(In percent)

	Production Function	HP Filter	Multivariate Filter 1/	Credit Neutral 2/
2015	0.16	-0.01	0.04	0.22
2016	-0.28	-0.12	0.23	0.24
2017	-0.62	-0.07	0.12	0.36

1/ Using IMF, WP/15/79 priors for EM countries in Appendix Table B2.
2/ Using a specification with both real credit growth and real equity price growth with one lag.

5. Fiscal developments. The national government budget deficit reached 1.4 percent of GDP in 2015 based on IMF staff definition, below the 2 percent medium-term target because of slow budget execution early in the year. Budget execution improved thereafter reflecting enhanced public finance and procurement management, making the 2 percent deficit target attainable in 2016. This would imply a fiscal stimulus of 0.6 percent of GDP in 2016. Indeed, there are upside risks coming from better than anticipated budget execution and a higher deficit this year. The new administration plans to increase the deficit target to 3 percent of GDP starting in 2017, to raise infrastructure and social spending, implying a fiscal stimulus of 1 percent of GDP in 2017.



Sources: Philippine authorities; and IMF staff estimates.

6. Macro-financial issues. Following the global financial crisis, the Philippines received sizeable inflows, both from remittances and portfolio investment, resulting in a buildup of reserves and persistent excess liquidity, and market interest rates have often been below the floor of the BSP's IRC. These factors have kept effective borrowing costs at historic lows and fueled credit growth alongside real estate price inflation, albeit within a reasonable range. BSP's macroprudential policies in 2014 on real estate lending and tightening of lending standards more generally moderated bank credit growth from 20 percent in 2014 to 13.6 percent in 2015. However, there has been some rekindling as credit grew by 17.6 percent in June 2016 (y/y), with credit to construction and real estate growing above 20 percent. This, and the rapid increase in corporate leverage, warrant close monitoring by the BSP.[1] [2] Financial intermediation by nonbank financial institutions, which are not regulated by the BSP, remains small but has grown rapidly in recent years. The Philippines' stock of bank credit, at 39 percent of GDP in 2015, remains lower than in other

[1] Deviations of credit-to-GDP from a backward looking trend (Dell'Ariccia and others, 2012) and cycles in real credit per capita compared to its trend (Mendoza and Terrones, 2008) show credit growth within the usual cutoffs, the increase in bank credit to GDP is just below the 3 percentage point cutoff, and the credit gap (Drehmann and others, 2010) just exceeds the 10 percent of GDP cutoff (Box 2).

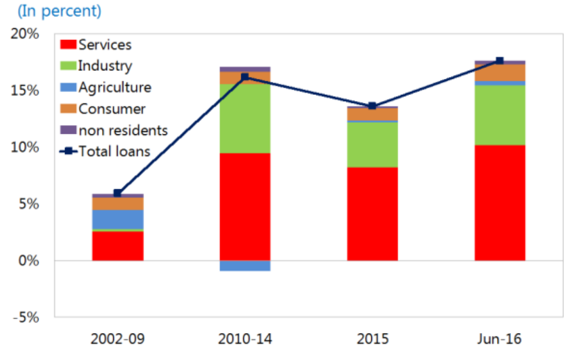
[2] Financial market development in the Philippines is at levels that are broadly consistent with those seen elsewhere in Emerging Asia, after adjusting for differences in per capita income (see Chapter 5 of *Philippines—Selected Issues*, IMF Country Report No 15/247).

Box 2. Philippines: Credit Developments

Credit growth has rekindled in 2016 after slowing in 2015. While most indicators suggest that credit growth remains below typical cutoffs for credit booms, the mixed signals provided by available indicators and the composition of credit growth across sectors warrant careful monitoring. The output gap remains near zero even when financial variables are considered in the estimation.

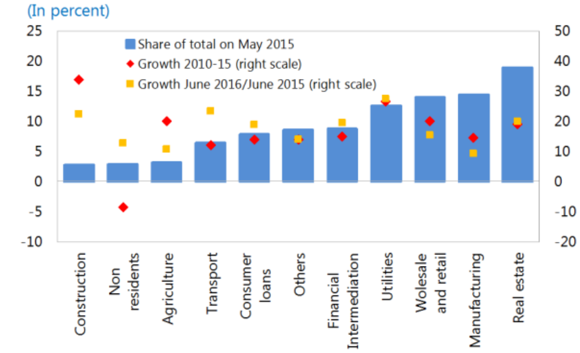
Credit growth has picked up in 2016. Credit growth moderated from 20 percent in 2014 to 13.6 percent in 2015 following the BSP's decision to tighten monetary policy and raise bank reserve requirements in 2014. However, credit growth has rekindled to 17.6 percent in June 2016, especially for services (18.1 percent) and industry (17.5 percent). Moreover, credit growth for construction and real estate remained above 20 percent in June 2016, warranting close monitoring of credit developments for these sectors.

Contributions to Banks Loans Growth
(In percent)



Source: IMF staff estimates.

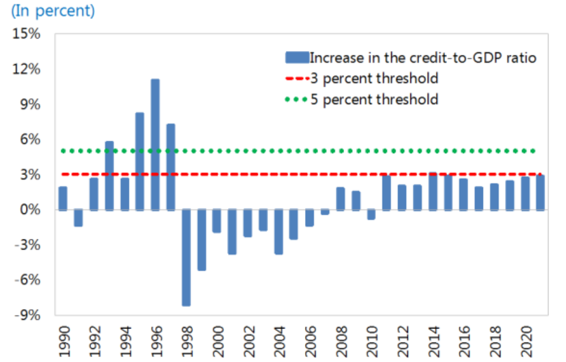
Bank Credit Growth by Economic Sector
(In percent)



Source: IMF staff estimates.

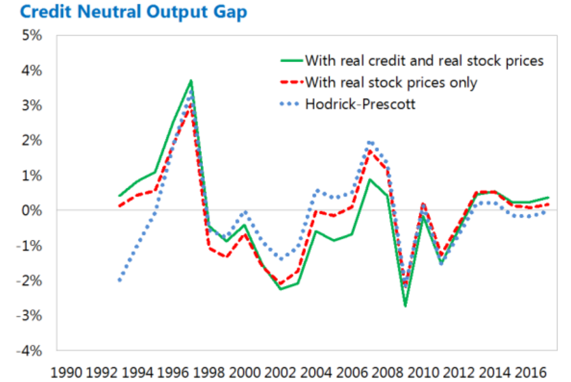
Credit growth remains below credit boom levels according to most but not all indicators. Staff updated last year's estimates of credit booms.[1] The approach of Mendoza and Terrones (2008), which looks at deviations of real credit per capita from trend, shows that credit growth remains in line with trend. The approach of Dell'Ariccia and others (2012), which looks at deviations of the credit-to-GDP ratio from a backward looking trend, also find no evidence of credit booms, with the growth differential between credit and GDP remaining below the 10 percent cutoff. However, the approach in Chapter 3 of the IMF's Global Financial Stability Report of September 2011, shows that the increase in the credit-to-GDP ratio remains just below the 3 percent threshold for early warning of credit booms. Similarly, the approach of Drehmann and others (2010), which looks at deviations of the credit-to-GDP ratio from a Hodrick-Prescott trend with a high smoothing parameter, finds that the credit-to-GDP ratio barely exceeds the 10 percent of GDP cutoff in 2016.

Change in the Credit-to-GDP Ratio
(In percent)



Source: IMF staff estimates.

Credit Neutral Output Gap



Source: IMF staff estimates.

Financial variables contain useful information about the business cycle position. Expansions coinciding with rapid credit and asset price growth are stronger, while recessions coinciding with credit and asset price busts are longer and deeper. Staff updated last year's estimates of the output gap using the BIS approach that integrates financial variables (real credit and stock prices) into a broader measure of the output gap. The results indicate that the output gap in the Philippines in 2016–17 is near zero, although slightly positive, consistent with the recent pickup in credit growth.

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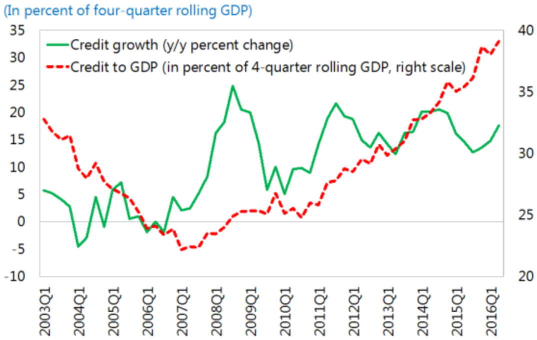
1/ Chapter 2, *Philippines—Selected Issues* (IMF Country Report No 15/247).

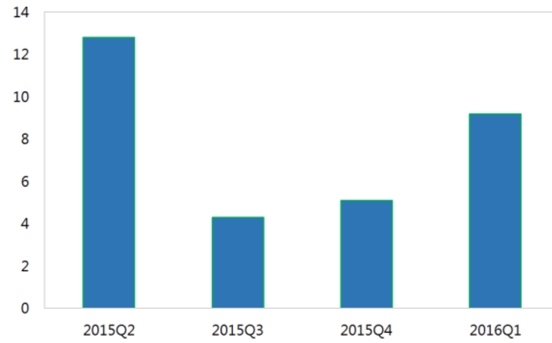
emerging market economies, mainly reflecting still low access of households to formal financial institutions, suggesting a need for further financial deepening and inclusion. Capital flows and the exchange rate have not been significantly affected by recent bouts of global financial volatility compared to neighboring countries.

Bank Credit Growth and Credit to GDP
(In percent of four-quarter rolling GDP)



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

Philippines: Residential Real Estate Price Index
(In percent, year-on-year)



Sources: Bangko Sentral ng Pilipinas (BSP).

7. External sector. The current account surplus fell to 2.9 percent of GDP in 2015 despite the large drop in fuel imports (by 1.3 percent of GDP), reflecting a deceleration in remittances, a decline in exports, and a large increase in imports of capital and intermediate goods. The current account surplus is projected to fall further in 2016–17 due to higher commodity prices and infrastructure related imports. The peso depreciated vis-à-vis the U.S. dollar in 2015 but by less than other regional currencies, and it has been stable in 2016. International reserves have remained broadly unchanged since 2012 at around US$80 billion (or 231 percent of the Fund's reserve adequacy metric) and external debt declined to 27 percent of GDP in 2015.

B. Outlook and Risks

8. Outlook. Tables 1–8 present the staff baseline scenario with real GDP growth in the 6−7 percent range. Private credit growth is consistent with a normal pace of financial development over the medium term, remaining below estimated credit boom thresholds. This scenario assumes that the authorities implement fiscal and structural policies already committed (see Box 3), including the proposed new fiscal framework with a central government budget deficit of 3 percent of GDP in the medium term. The baseline does not include new tax policy measures being formulated, and thus the revenue-to-GDP ratio is likely to remain broadly unchanged at around 15½ percent of GDP alongside public investment at about 5 percent of GDP, which is still lower than most countries in the region.

Box 3. Philippines: Assumptions Underlying the Baseline and IMF Staff's Recommended Scenarios

Baseline scenario. This scenario assumes that the authorities implement fiscal and structural policies already committed. In particular:

- National government budget deficit of 2 percent in 2016, rising to 3 percent in 2017–21;
- National government revenue projection assumes unchanged tax policies and tax administration;
- National government expenditures reflect PFM improvements already underway, with capital and equity expenditure rising from 3.3 percent of GDP in 2015 to 5.3 percent in 2021; and
- Structural reforms reflect measures already underway during the previous administration, including PFM and other governance reforms (e.g., the PPP and PFM laws), both in line with track records during the last few years, and structural reforms for which legislation has been passed such as the new competition law, opening up the financial sector to foreign investment, and the Right of Way law for infrastructure projects.

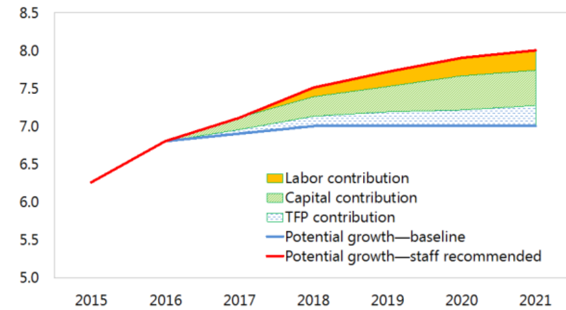
IMF staff's recommended scenario. This scenario includes staff's recommended fiscal and structural reforms aimed at achieving the authorities' development objectives for growth and poverty reduction, building on the government's ten-point economic agenda. In particular:

- National government budget deficit of 2 percent in 2016, rising to 3 percent in 2017–21;
- National government revenue projection assumes the IMF staff's preferred revenue package, yielding 3.0 percentage points of GDP gradually over the 2017–19 period;
- National government expenditures incorporate additional social spending of 1.5 percentage points of GDP and additional infrastructure spending of 1.5 percentage points of GDP (both relative to the baseline scenario), financed by the additional revenue collections; and
- Additional structural reform measures, including easing foreign investor restrictions in the negative list and in the constitution, land titling reform for use of land as collateral in agriculture, and labor market reforms, which are on the President's platform but have not yet been legislated.

9. Risks. On balance, risks to the outlook remain tilted to the downside. Upside risks include a stronger lift to domestic demand from low commodity prices and additional improvements in budget execution. On the downside, slow budget execution or revenue shortages could dampen growth. Moreover, lower growth in China and the region, tighter global financial conditions, and a surge in global financial volatility could lead to capital outflows and tightening of domestic financial conditions with attendant impacts on investment and growth, though the Philippines is less vulnerable to China and financial spillovers than the rest of the region. Risks to financial stability stem from concentration relating to the conglomerate structure and rapid credit expansion in the real estate sector, as elaborated below. Finally, natural disasters pose an ongoing risk. The Philippines is well equipped to respond if any of these risks materialize, particularly given the country's strong fundamentals and ample policy space. For instance, in response to possible volatility or a reversal in capital flows, there is scope to allow for exchange rate flexibility, limiting intervention to smoothing excess volatility, and for easing monetary or fiscal policy if the real economy slows down significantly.

10. Scenario analysis. The baseline scenario, which only includes the fiscal and structural policies already committed, falls short of achieving the authorities' stated development objectives for growth and poverty reduction. Table 8 and Box 3 provide a second scenario that incorporates the staff's recommended fiscal and structural reforms aimed at achieving the authorities' development objectives, building on the new government's ten-point plan. Substantially higher public infrastructure spending will require raising additional revenues, supported by a more realistic fiscal framework that maintains debt sustainability. Monetary policy will need to remain vigilant given the additional fiscal stimulus and until the fiscal deficit stabilizes at a higher level. Under the staff's recommended scenario, annual growth would be about 1 percentage point higher owing to higher investment, including private investment crowded in by higher public investment, and bolder structural reforms that increase total factor productivity (TFP) growth gradually over the medium term.[3] Well-targeted and higher social spending would help reduce poverty towards the government's target. Enhanced infrastructure investment, including in areas that have benefited little from such investment in the past, would help create jobs and make growth more inclusive. Structural reforms, such as liberalizing foreign investment and land use, would help catalyze the effects of higher government spending.

Philippines: Potential GDP Growth in the Baseline and Staff's Recommended Scenario
(In percent)



Sources: Philippine authorities; and IMF staff estimates.

C. External Sector Assessment

11. The external sector balance has declined somewhat as noted above but remains moderately stronger than warranted by fundamentals and desirable policies (Appendix 3). This is primarily due to structural impediments to investment and precautionary savings to self-insure against natural disaster risk, rather than a misaligned real exchange rate level. Accordingly, the current account gap should close over the medium term as public infrastructure investment increases in line with the authorities' plans. Staff assess the peso to be broadly in line with fundamentals and desired policies because the current account gap is due to the above-mentioned structural factors. While the level of international reserves is above the Fund's Reserve Adequacy metric, this is broadly justified by the vulnerability to natural disasters and capital flow volatility. Staff continues to support the BSP's view that the exchange rate should act as a buffer to external shocks and be allowed to move freely in line with market forces, with intervention limited to smoothing excessive volatility in both directions.

[3] As TFP is calculated as a residual, the short-run growth contribution from TFP in 2017 reflects higher capacity utilization.

Authorities' Views

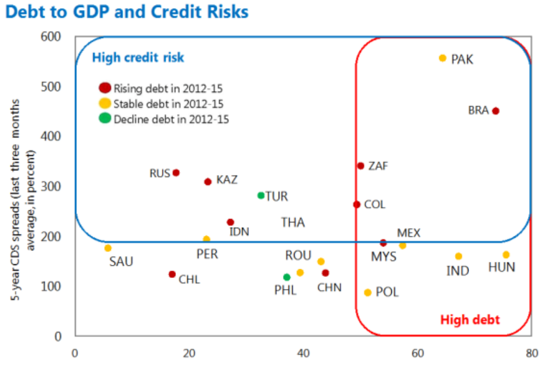
12. The authorities appreciated staff's analysis of the medium-term outlook and alternative scenarios. They are optimistic about the growth potential of the economy despite weak global prospects. Consistent with their strategy to boost infrastructure spending, they project growth at 6.0–7.0 percent in 2016, 6.5–7.5 percent in 2017, and 7–8 percent during 2018–22. The authorities also considered that the current account surplus reflects structural bottlenecks rather than exchange rate misalignment. The current account surplus should decline going forward in line with the plans to boost infrastructure investment, while exchange rate flexibility would continue.

POLICIES FOR MACROECONOMIC AND FINANCIAL STABILITY

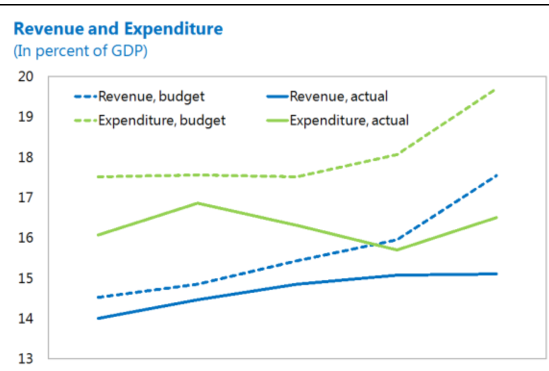
Stepping up infrastructure and human capital investment will need to be supported by strengthening the macroeconomic policy framework, while containing financial stability risks. Substantially higher public infrastructure spending will require the government to raise additional revenues, supported by a more realistic fiscal framework that maintains debt sustainability. Monetary policy will need to remain vigilant to risks of overheating given the additional fiscal stimulus and until the fiscal deficit stabilizes at a higher level. The main macro-financial risks that will need to be managed are concentration risks associated with the economy's conglomerate structure and sectoral risks stemming from the pickup in credit growth particularly in the real estate sector.

A. Fiscal Policy

13. A two-pillar framework would suit the Philippines, with the public debt-to-GDP ratio as an anchor, complemented by a central government overall deficit as an operational target (Box 4). The debt ratio would set an upper limit to fiscal slippages and preserve fiscal sustainability, while the deficit target would provide operational guidance for policy formulation as it has a close link to debt dynamics. The operational target should be based on realistic growth and revenue projections and implemented flexibly to avoid procyclical fiscal management.



Sources: Bloomberg, L.P.; Markit; and IMF staff estimates.



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

Box 4. Philippines: New Fiscal Framework

The public debt-to-GDP ratio should serve as the fiscal anchor. This should be complemented with a flexible overall fiscal deficit-to-GDP ratio as the operational target.

Given the Philippines' low and declining debt-to-GDP ratio, the new fiscal framework should aim to preserve fiscal sustainability, while at the same time be flexible enough to allow for fiscal space to deal with uncertainties and risks. There are four main types of fiscal rules: debt rules, budget balance rules, expenditure rules, and revenue rules. These rules have different properties with respect to debt sustainability, economic stabilization, operational guidance for fiscal policy, and transparency. Many countries combine multiple fiscal rules given the trade-offs among them.

Debt rules set an explicit limit for public debt in percent of GDP. This type of rule is the most effective in terms of ensuring convergence to a debt target. However, it does not provide sufficient guidance for fiscal policy when debt is well below its ceiling.

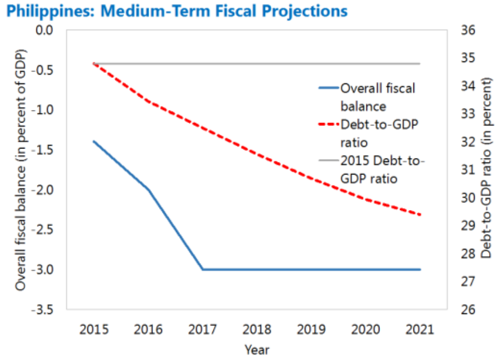
Budget balance rules constrain the variable that primarily influences the debt ratio and is largely under the control of policymakers. They can be specified based on the overall balance, or can explicitly account for economic shocks. The latter add flexibility, but estimating the adjustment, typically through the output gap, makes it more difficult to communicate and monitor.

Expenditure rules usually set permanent limits on total, primary, or current spending in absolute terms, growth rates, or in percent of GDP. As such, these rules are not linked directly to the debt sustainability objective since they do not constrain the revenue side. They can provide, however, an operational tool to trigger the required fiscal consolidation consistent with sustainability when they are accompanied by debt or budget balance rules. Another advantage of expenditure rules is that they are relatively easy to implement and monitoring compliance is relatively straightforward.

Revenue rules set ceilings or floors on revenues and are aimed at boosting revenue collections and/or preventing an excessive tax burden. These rules are also not directly linked to the control of public debt, as they do not constrain spending.

Staff recommends a two-pillar approach for the Philippines, with the consolidated general government debt-to-GDP ratio as an anchor, complemented by a central government overall deficit as an operational target. A natural anchor to preserve fiscal sustainability would be the debt ratio, which creates an upper limit to repeated (cumulative) fiscal slippages.[1] However, the estimation of the ratio ex ante is subject to a large degree of uncertainty, and its effective implementation requires an operating target, which would be under the direct control of the government. For this operating target, a central government overall deficit is appropriate, as the authorities are used to the concept and operation, and it also has a close link to debt dynamics.

Philippines: Medium-Term Fiscal Projections



The fiscal anchor should target a broadly stable debt-to-GDP ratio at the current level of 36 percent of GDP, while the deficit target should be raised to 3 percent of GDP to allow for priority expenditures and retain some margin. A rise in the deficit target from 2 percent of GDP to 3 percent from 2017 would reduce the debt-to-GDP ratio to under 31 percent by 2021, thus providing a margin of 5 percent of GDP to respond to materialization of fiscal risks and uncertainty around the baseline projections. For instance, PPPs have continued to expand from ₱1.1 trillion in 2013 to ₱1.4 trillion in June 2016, with a proportionate increase in associated contingent liabilities. Natural disasters are also a threat and their economic cost can be large. For example, typhoon Yolanda in 2013 caused damages by 4 percent of GDP.[2] Moreover, a one-standard deviation shock to GDP growth for two years (with growth falling to 4.5 percent in 2017 and 2018) would increase the debt-to-GDP ratio by 3 percentage points by 2021.

The new administration has set a medium-term overall deficit target of 3 percent based on appropriate revenue projections. The previous administration's fiscal deficit targets were based on aspirational revenue targets. Moreover, expenditure was withheld in case of a revenue shortfall to secure the 2 percent of GDP fiscal deficit target, which impeded efficient expenditure and risked procyclical fiscal management. In July 2016, the Development Budget Coordinating Committee (DBCC) decided to set the deficit target at 3 percent of GDP from 2017 onwards based on appropriate revenue projections. Although this initiative is likely to reduce the revenue shortfalls, these may still happen due to cyclical fluctuations, in which case staff would favor a flexible deficit target that allows automatic stabilizers to work, to avoid withholding expenditure and making fiscal policy procyclical.

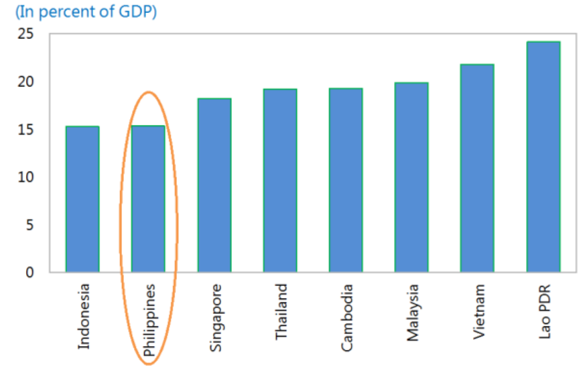
Increasing flexibility in the deficit target warrants consideration. The overall deficit target has an inherent weakness because, if implemented too rigidly, it could force procyclical fiscal management. A number of options are available to increase flexibility, depending upon country circumstances. For example, an escape clause under well-defined circumstances (e.g., emergencies caused by natural disasters and exceptionally adverse national economic conditions) and clear guidelines on how to get back on the stable debt path would prevent procyclical fiscal management in severe downturns.

1/ The convergence of the debt-to-GDP ratio is the appropriate criterion for fiscal solvency because it ensures that the intertemporal budget constraint of the government is met and because GDP represents the pool of resources over which the government can potentially have claims to service the debt.
2/ EM-DAT: The CRED/OFDA International Disaster Database.

14. The fiscal anchor should target a broadly stable consolidated general government debt-to-GDP ratio at the current level (36 percent of GDP) over the medium term, while the national government deficit target should be increased to 3 percent of GDP. Public debt decreased from 44 percent of GDP in 2009 to 36 percent in 2015. While it does not need to decline further, particularly given the large infrastructure and social needs, the credibility of fiscal management earned in recent years needs to be preserved. A broadly stable debt-to-GDP ratio balances these two considerations. The deficit target of 3 percent of GDP, higher than the 2 percent under the previous administration, would allow the authorities to address the Philippines' large infrastructure and social gaps to promote inclusive growth. It would also reduce the debt-to-GDP ratio to under 31 percent in 2021, thus providing a margin of 5 percent of GDP to respond to materialization of fiscal risks and uncertainty around the baseline projections through flexible implementation.

15. The Philippines needs to reform its tax system and administration to collect more revenue for additional infrastructure and social spending and to make it more equitable and efficient. Tax collections are low compared to neighboring countries, reflecting low compliance and extensive exemptions, yet the personal income tax brackets have crept upwards due to inflation. Staff supports the authorities' push for a comprehensive tax policy reform that is net revenue positive with due attention paid to equity. The comprehensive tax reform package could include a reform of the personal income tax (PIT) that simplifies the rate structure, indexes tax brackets for inflation, and eliminates exemptions such as that of the minimum wage and that of the 13th month salary (Box 5).[4] Revenue losses from the PIT reform could be more than offset by higher excises on fuel (including diesel, which is currently not subject to an excise tax) as well as rationalization of VAT exemptions (for senior citizens, disabled people, electricity transmission, social housing, and cooperatives),[5] and excises on sweetened beverages and higher motor vehicles taxes or registration fees. The package could also include simplifying the corporate income tax (CIT) rate structure and rationalizing tax incentives. A harmonization of financial sector taxes as part of the

Goverment Revenues, 2014
(In percent of GDP)



Source: IMF, *Goverment Finance Statistics*.

[4] The exemption for minimum wage earners effectively exempts a large share of the labor force. It also creates a vertical inequity, as those with wages earning slightly higher than the minimum wage are taxed on their full income (less the personal allowance), while those earning the minimum wage are untaxed. The 13th month salary exemption is also highly regressive.

[5] Removal of exemptions for senior citizens, disabled people, and social housing could be accompanied by well-targeted transfers to help cushion the social impact. Other measures in the comprehensive tax reform package would help make the burden more equitable such as the PIT reform.

Box 5. Philippines: Comprehensive Tax Reform Package

The IMF with the World Bank proposes a comprehensive tax reform package that is net revenue positive, equitable, and efficient.

A comprehensive tax reform is needed that is net revenue positive with due attention paid to equity and efficiency. There are several important problems in the tax system, principally including: (i) the extreme erosion of the corporate income tax base through the granting of myriad investment incentives—largely in the form of long tax holidays, followed by in many cases a permanent tax rate of 5 percent in lieu of all other regular taxes; (ii) the strict banking secrecy law, which prohibits the Bureau of Internal Revenue (BIR) from obtaining any data regarding taxpayer's income or wealth from Philippine banks; and (iii) the erosion over the last 20 years of the tax bracket levels for the personal income tax and the ad hoc adjustment of the PIT through nonsystematic exemptions and measures. The latter two problems have especially important implications for equity.

The IMF with the World Bank provided a comprehensive tax reform proposal (see table). This proposal takes as anchors: the need to reduce investment incentives—while recognizing that this is not possible in full or immediately—in order to improve economic efficiency and to permit, eventually, a reduction of the headline CIT rate;[1] the need to ease the strict bank secrecy law which prevents enforcement of modern tax compliance with regard to income taxes—and which will ultimately reduce the attractiveness of the country for legitimate international investors; the goal of rationalizing the treatment of different forms of income from capital; the need to improve the logic and equity of the PIT structure; and the need to increase the level of taxation of fuel, both to raise revenue and to mitigate substantial negative externalities including health and congestion effects. All of these factors bear on the competitiveness and attractiveness of the Philippines as a location for investment.

Philippines: IMF-World Bank Comprehensive Tax Reform Proposal

Tax	Measures
Labor Income Taxation	A simpler bracket structure (15 percent, 25 percent, 30 percent) for both wage earners and self-employed, elimination of minimum wage exemption and 13th month bonus exemption, adjustments in personal exemptions and child allowances.
Capital Income Taxation	Simplify withholding of the capital income taxation. In particular, the rate should be set to 15 percent (matching the lowest bracket of labor income taxation) regardless of whether it is on interest, dividends, or capital gains.
CIT	Rationalization of tax incentives. In particular, target tax holidays to sectors that are strategically important. The Fiscal Incentives Rationalization bill should be supported as a meaningful first step toward necessary reform of tax incentives. A CIT rate decrease should be considered only after the incentives start to be phased out.
VAT	Removal of exemptions for senior citizens, disabled people, electricity transmission, social housing, and cooperatives.
Fuel Excise	Substantially increase fuel excise tax and reintroduce diesel excise tax , while roughly harmonizing tax rates.
Sugar-sweetened Beverage Excise	Introduce new tax on a broad spectrum of beverages that contain caloric sweeteners / added sugar and artificial non caloric sweeteners.
Motor Vehicle Taxation	Increase tax on motor vehicle sales in a progressive manner and administratively raise motor vehicle user fee.
Real Property Tax (RPT)	Increase propety valuation plus two percent national surtax on top of RPT rate of local government units.
Bank Secrecy Law	Eliminate the strong bank secrecy law, which prohibits BIR from obtaining any data regarding taxpayer's income or wealth from Philippine banks.

1/ In particular, reduction of the CIT rate from 30 percent to 25 percent should only be considered if fiscal incentive rationalization has already started. The Philippines already has the lowest outturn for corporate taxes in ASEAN while having the highest rate because of the numerous tax incentives from BOI, PEZA, and other regional incentive schemes (e.g., Subic, Clark and other free trade zones). Moreover, the Philippines also has the lowest FDI-to-GDP ratio even after having the most generous tax incentive structure.

ASEAN financial integration roadmap would reduce transaction costs and promote financial intermediation. Staff supports the Department of Finance's efforts to amend the bank secrecy law to allow the tax authorities access to individual bank account information and make tax evasion a predicate crime for money laundering in order to improve the efficiency and equity of revenue collection. More broadly, strengthening tax administration should be a priority, although substantial revenue gains would be expected only in the longer term.

16. The authorities should formulate a medium-term public infrastructure plan with clear prioritization of projects and appropriate choices between budgetary and PPP spending, with due consideration of contingent liabilities (CLs). Staff support the authorities' target to increase public infrastructure spending to at least 5 percent of GDP over the medium term, which would still be below the average level in the rest of the region,[6] and would favor higher infrastructure spending if done efficiently and if additional revenues are available to finance it. These investments would be more effective for poverty reduction if focused on areas such as telecoms, logistics, ports, healthcare and schools, particularly in rural areas and smaller cities. They should aim to encourage creation of high quality jobs, boost human capital of the growing young population, alleviate supply bottlenecks, and provide a basis for more geographically balanced development. Staff noted that the IMF, jointly with the ADB, stands ready to help the authorities increase efficiency and review investment guidelines including PPPs through a Public Investment Management Assessment (PIMA). Staff welcomed the Right of Way Act that will help speed up the implementation of public infrastructure, and support the proposed PPP Act that will strengthen the planning and implementation framework for PPPs. Regarding CLs, the temporary PPP policy guidelines that fully guarantee the debt of PPP projects should be reconsidered.

Authorities' Views

17. The authorities appreciated the debt sustainability analysis that supported the medium-term fiscal targets and were in broad agreement with the proposed fiscal anchor. They plan to target a 3 percent of GDP fiscal deficit starting in 2017 while making revenue projections more realistic. The authorities are confident that capacity including at the level of line ministries has improved sufficiently to achieve the spending level necessary to achieve the target. A Public Investment Management Assessment (PIMA) focused on practical recommendations would be useful.

18. The government plans to prioritize infrastructure investment on inter-island connectivity, logistics, farm-to-market roads and tourism sites, and address congestion in Metro Manila and other urban areas, as well as social spending. To expedite decongestion and critical infrastructure projects, the administration has requested emergency powers from congress for a limited period of time. This would authorize the President to adopt alternative methods of procurement for the construction repair, rehabilitation, improvement or maintenance of transportation projects aimed at the reduction of traffic congestion in Metro Manila and other urban

[6] IMF, FAD's Investment and Capital Stock Dataset. Available via www.imf.org.

areas. These include limited source bidding or selective bidding, direct contracting or single source procurement, repeat order, shopping, and negotiated procurement.

19. The government plans to submit a tax reform plan to congress by mid-September. It would be net revenue positive and include a higher income tax threshold and lowering of the PIT tax rates coupled with expansion of the VAT base by limiting VAT exemptions, hikes in fuel excise taxes, and introduction of excise tax on sweetened beverages. They agreed that any reduction in CIT rates should be accompanied by rationalization of tax incentives.

B. Monetary Policy

20. The flexible inflation targeting regime has served the Philippines well. BSP enhanced its capacity for liquidity and inflation forecasting recently, strengthening the framework. Headline inflation has generally fallen within the target band in recent years and greater exchange rate flexibility has helped cushion the impact of external shocks. However, most of the liquidity injected by the buildup of international reserves in the period of unconventional monetary policies in the advanced economies was passively sterilized by the BSP's Special Deposit Account (SDA) Facility. This was partly because the BSP charter limited the BSP's ability to issue its own debt securities for monetary operations, leading to excess liquidity and lower money market interest rates that continue to impede monetary policy transmission. Staff supports the reform to the IRC that would improve the transmission of monetary policy, and recommended resubmitting amendments to the BSP charter that would allow for issuance of BSP securities, recapitalization of the BSP, and money market development plans.

21. Excess liquidity in the banking system has declined slightly since mid-2013 but is still substantial. It is currently being absorbed by the Overnight Deposit Facility (previously the SDA Facility), Overnight RRP Facility, Term Deposit Facility (TDF), and through the banks' required reserves. In early June, the BSP introduced a new IRC, without changing the de facto monetary policy stance (Box 6). By expanding the liquidity absorption using the new TDF auctions, the IRC aims at aligning market interest rates with the policy rate and improving the transmission mechanism in line with Fund TA advice.

22. The current monetary policy stance is appropriate. Inflation is projected at the bottom of the BSP's target range this year, and to rise to the center of the band next year, as the one-off effects of lower commodity prices dissipate and domestic demand remains strong. While Fund staff estimates show that the effective policy interest rate is broadly in line with Taylor rule implied levels, there is excess liquidity and the transition to the new IRC is ongoing. The baseline scenario incorporates the

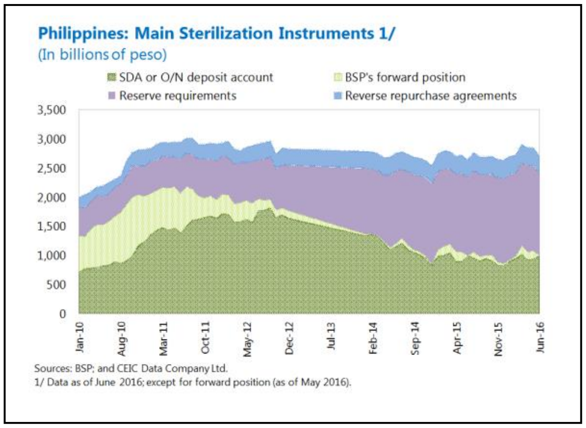
Philippines: Headline Inflation Projection and Target Band
(In percent)

Sources: Philippine authorities; and IMF staff estimates.

Box 6. Philippines: Monetary Transmission and the Interest Rate Corridor

The BSP's IRC with liquidity operations is designed to strengthen the effectiveness of monetary policy while maintaining the current monetary policy stance. Thus far, implementation of the new IRC has proceeded smoothly.

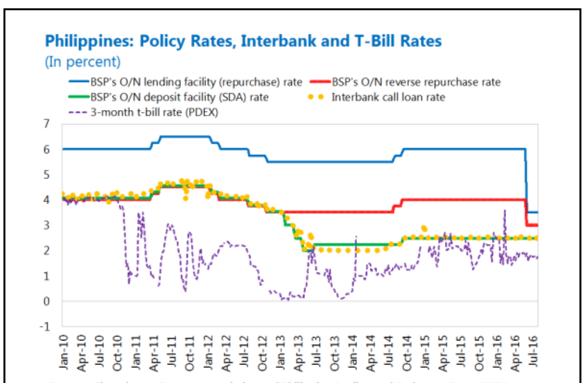
Structural excess liquidity has caused market interest rates to trade below the BSP's policy rate. The rate on the overnight reverse repurchase (RRP) operations is the key policy rate to signal the BSP's monetary policy stance. However, most of the liquidity injected by the buildup of reserves in the period of unconventional monetary policies in the advanced economies was passively sterilized by the BSP's Special Deposit Account (SDA) Facility. This reflected the limited amount of treasury securities held by the BSP for the RRP operations and inability to issue its own debt securities. Since the BSP lowered the SDA rate without changing the RRP rate in 2013, market interest rates have followed the SDA rate and remained significantly below the policy rate, with the SDA rate becoming a more relevant benchmark rate.



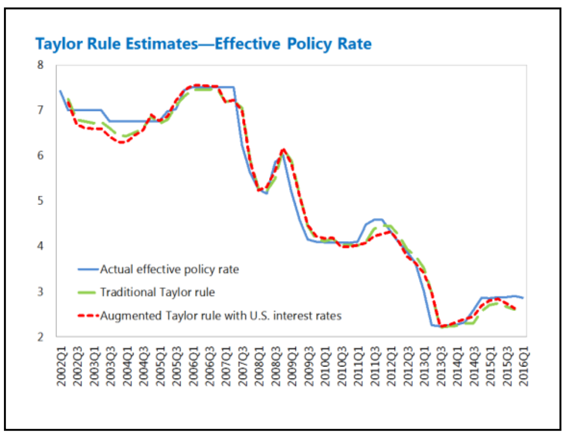
Sources: BSP; and CEIC Data Company Ltd.
1/ Data as of June 2016; except for forward position (as of May 2016).

BSP adopted a new IRC with liquidity operations to strengthen the effectiveness of monetary policy. On June 3, 2016, the BSP formally shifted its monetary operations to an IRC system that aims to influence short-term market interest rates to move closely with the BSP's policy rate. The IRC is structured as a mid-corridor system, with the Overnight Lending Facility (OLF) and the Overnight Deposit Facility (ODF) (renamed from the SDA facility) forming the upper and lower bounds of the corridor, while the overnight RRP rate is set at the middle of the corridor. BSP also introduced the Term Deposit Auction Facility (TDF) as the main tool for absorbing liquidity and as a variable rate auction supporting price discovery in the money market. The initial TDF auctions have been small and were oversubscribed by a large margin and market rates have remained at the floor of the IRC. BSP is expected to increase its deposit auction volumes to promote gradual convergence of TDF and market interest rates toward the policy (RRP) rate.

The level and structure of the IRC was calibrated to the desired neutral monetary policy stance. BSP clearly communicated that the IRC reforms were primarily operational in nature and have not materially affected prevailing monetary policy settings upon implementation despite a drop in the policy rate (RRP). In particular, the interest rate at the floor of the corridor, where the bulk of BSP's liquidity absorption with the market currently takes place, has been kept steady since the launch of the IRC system. This is consistent with staff estimates of the effective policy rate (measured by the weighted average of SDA and RRP rates) and SDA rate implied by the traditional and augmented Taylor rule reaction functions, suggesting that the IRC policy rate settings are broadly appropriate in current conditions. Once most of the liquidity is absorbed through open market operations and market rates are well anchored within the corridor, the BSP plans to reduce the relatively high required reserve ratio on banks gradually to minimize the risks of financial disintermediation.



Sources: Bloomberg L.P.; , Haver Analytics; and Philippine Dealing and Exchange Corp. (PDEX).



implementation of the new IRC, with market rates gradually converging to the policy rate with the scaling up of deposit auctions. Significantly faster-than-projected credit growth with inflationary pressures, or a stronger-than-expected impact of the fiscal expansion on inflation would warrant a monetary policy tightening relative to the baseline. On the other hand, the Philippines has space to loosen monetary policy should downside risks or a shortage of liquidity materialize, including by reducing the banks' required reserve ratio, which is among the highest in the region.

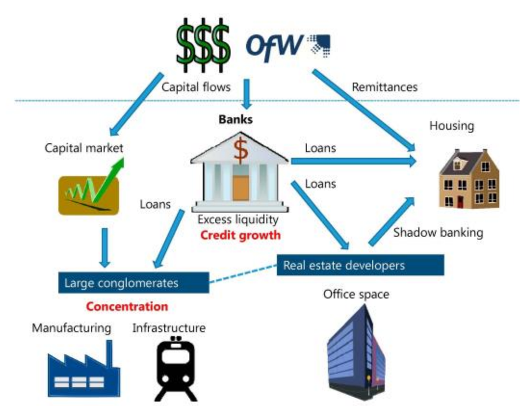
Authorities' Views

23. Monetary policies of some advanced economies have led to surges in capital inflows, which continue to pose a challenge for monetary policy formulation and implementation. In their view, the favorable inflation performance suggests that the BSP has sufficiently sterilized the resulting excess liquidity through its deposit facilities. It has continued to rely on its broad toolkit for monetary policy such as the use of reserve requirements to manage liquidity and the conduct of foreign exchange operations to smooth volatility. It has also introduced new sterilization tools and instruments to actively manage liquidity under the IRC system. The new IRC is an operational adjustment designed to improve monetary policy transmission, and the experience thus far has been favorable. The BSP was in broad agreement with staff's policy recommendations concerning monetary policy going forward.

C. Macro-Financial Linkages and Systemic Financial Stability Risks

24. The main macro-financial risks are concentration risks associated with the conglomerate structure of the economy and rapid credit growth to real estate. Building upon last year's Article IV consultation, the staff assessed macro-financial linkages. It prepared updated estimates of credit cycles (Box 2), analyzed bank-corporate linkages more deeply and updated the corporate stress tests (Box 7), and advised the authorities to fill data gaps identified using the Fund's Balance Sheet Approach (Box 8). Several initiatives are underway to fill these data gaps, including the Securities and Exchange Commission's (SEC's) efforts to enhance corporate sector balance sheet data, as well as other efforts covering shadow banking activities by real estate developers.

Philippines: Macro-Financial Linkages



Box 7. Philippine Nonfinancial Corporates: Limited Aggregate Risks Mask Pockets of Vulnerability

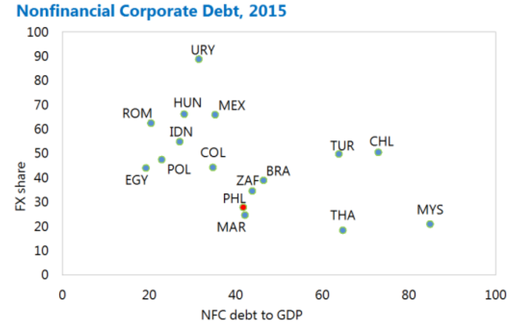
Nonfinancial corporate debt in the Philippines is now comparable to peers although foreign exchange exposure is limited. Overall debt at risk is still low but there are pockets of vulnerability. Concentration risks warrant continued monitoring.

Aggregate debt of Philippine nonfinancial corporates (NFCs) is expanding rapidly and is now comparable to that of its peers, although foreign exchange (FX) exposure is limited. Debt of the universe of Philippine NFCs increased from around 28 percent of GDP in 2009 to just under 42 percent in 2015, driven chiefly by the issuance of corporate bonds and domestic bank loans in local currency. Consequently, although NFC debt is now at a level comparable to that of many peers, aggregate FX exposures have remained low at under 28 percent of total debt, or about 12 percent of GDP in 2015.

Firm-level stress tests show that overall debt-at-risk is still low, but there are pockets of vulnerability. Staff updated last year's stress test exercise[1] for 4,083 firms covered by the Orbis database and found debt-at-risk (debt of firms with an interest coverage ratio below 1.5) is relatively modest at 32 percent of total debt under the most severe scenario—a level similar to that of other emerging market economies (EMEs) in 2013. However, risks remain concentrated in particular sectors such as real estate and other services.

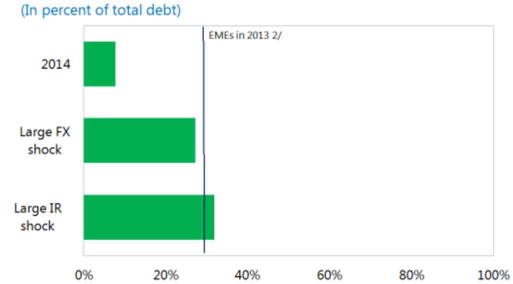
Concentration risks arising from the conglomerate structure and rapid expansion of real estate developers warrant continued monitoring. Using data for 20 large Philippine corporates (9 banks, 7 real estate developers, and 4 holding companies), staff assessed whether pockets of vulnerability can pose wider systemic risks following Segoviano and Goodhart (2009).[2] Staff found that systemic risk has declined since the GFC, although it has ticked up of late, but at the same time, real estate developers are becoming more systemically important. Given the rapid expansion of their activities, including shadow banking, and links through the conglomerate structure, real estate developers continue to warrant close monitoring.

Nonfinancial Corporate Debt, 2015



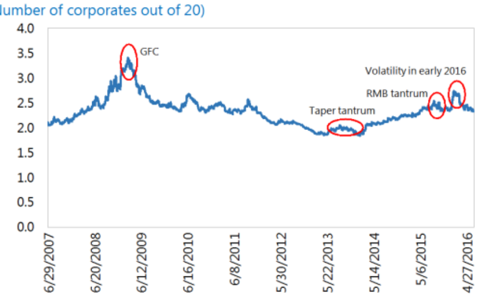
Sources: Dealogic; Bank for International Settlements; IMF, *International Financial Statistics;* and IMF staff estimates.

Debt-at-Risk Under Different Shocks 1/
(In percent of total debt)



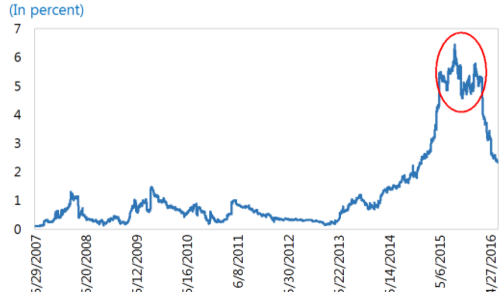
Sources: Orbis; and IMF staff estimates.
1/ "Large FX shock": 20% earnings, 30% FX and 30% interest payment, sector-level natural hedge; "Large IR shock": 20% earnings, 10% FX and 50% interest payment, sector-level natural hedge.
2/ Median of a group of 16 EMEs in 2013.

Expected Number of Corporates in Distress if at Least One Corporate Becomes Distressed
(Number of corporates out of 20)



Sources: FSM; and IMF staff estimates.

Probability That All 13 Non-RE Developers Go into Distress if all Seven RE Developers Go into Distress
(In percent)



Sources: FSM, staff estimates.

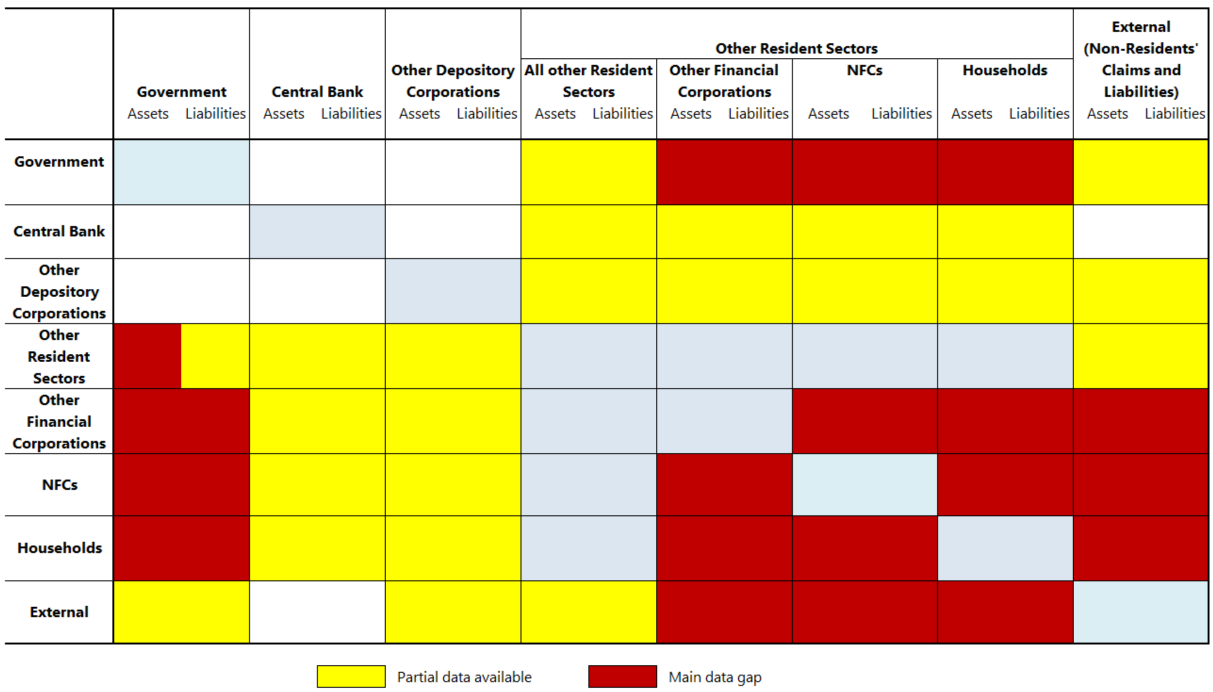
1/ Chapter 3 of *Philippines—Selected Issues*, IMF Country Report No. 15/247.
2/ This method estimates the joint density of portfolio returns given each firm's individual probability of distress—the probability that returns of a firm in the portfolio are below a given threshold—using the principle of maximum entropy and a copula approach (see IMF, WP/09/04), The density is used to compute objects of interest, such as those presented in the two charts at the bottom.

Box 8. Philippines: Addressing the Remaining Data Gaps Continues to be a Priority

There are significant data gaps on balance sheet exposures of other financial corporations, nonfinancial corporations, and households. Several initiatives are underway by BSP, SEC, and other agencies to fill these gaps but it will be some time before the data gaps are filled.

Staff used the Fund's Balance Sheet Approach (BSA) to identify data gaps. The BSA is an analytical representation of the balance sheet of institutional sectors including their cross-holdings. It is typically used to assess the exposure of individual sectors to shocks as well as to study how shocks get transmitted across sectors.

Philippines: Net Intersectoral Asset and Liability Positions (Balance Sheet Matrix)



The main gaps pertain to "Other Resident Sectors" and the breakdown of Government assets. The Philippines does not yet systematically collect information on several resident sectors, for example it is still in the process of compiling the Other Financial Corporations Survey (OFCS). Moreover, the breakdown of external positions of the nonbank and nongovernment sectors is also not available in the International Investment Position (IIP) and balance of payments (BOP) statistics. Finally, Philippine Government Financial Statistics (GFS) only contain information on liabilities, and does not disaggregate "Other Resident Sectors."

The Philippine authorities have several ongoing initiatives to fill these data gaps. Most importantly, the Securities and Exchange Commission (SEC) is responsible for two main parallel processes to collect financial statement data more efficiently and in greater detail: implementing the extensible business reporting language (XBRL) and the comprehensive form of financial statements (CFFS). Data collected by SEC through these initiatives will feed into several important surveys, such as OFCS, BOP, IIP, flow of funds (FOF), sectoral balance sheet (SBS), debt securities statistics, corporate leverage, and a financial social accounting matrix (FSAM). In addition, BSP is working with the Housing and Land Use Regulatory Board (HLURB) to collect standardized information about certain aspects (e.g., trade receivables) of the balance sheet of real estate developers.

Ultimately, the Philippine Statistics Authority (PSA) will consolidate the data into a sectoral balance sheet (SBS), although likely not before 2018.

Box 8. Philippines: Addressing the Remaining Data Gaps Continues to be a Priority (Concluded)

Philippines: Main Ongoing Initiatives to Address Data Gaps

Main initiative	Description	Agencies Responsible	Status/Progress
Corporate registry adopts extensible business reporting language (XBRL)	XBRL's goal is to migrate all corporate reporting to an electronic format.	Securities and Exchange Commission (SEC)	Progressing with Japan International Cooperation Agency (JICA) support. Still unclear if all firms will be covered. Full implementation expected for the reporting year of 2016.
Implementing data collection through comprehensive form of financial statements (CFFS)	The CFFS is an enhanced version of the existing General Form of Financial Statements (GFFS).	Securities and Exchange Commission (SEC)	The Steering Committee of the Financial Stability Coordinating Council (FSCC) already endorsed the CFFS designed by the BSP. BSP will conduct a series of information sessions and workshops with SEC-supervised entities, which are tentatively scheduled for end-July to August 2016. Still unclear which corporates will need to comply. Full implementation expected by September 2016.
Collecting Other Financial Corporations Survey (OFCS)	The OFCS is an analytical survey that provides a comprehensive measure of the claims (or assets) and liabilities of the other financial corporations (OFCs) in the Philippines. The compilation of OFCS is in adherence to the Special Data Dissemination Standard (SDDS) Plus which the Philippines target to complete by 2019.	Bangko Sentral Pilipinas (BSP)	The BSP is already collecting information on OFCs under its supervision.
		Governance Commission on Government Owned-or-Controlled Corporations (GCG)	Joint BSP-GCG-supervised OFCs info sessions held November 2015 and February 2016. Standard report forms (covering period 2012-2015) expected to be submitted to the BSP by 31 August 2016.
		Insurance Commission (IC)	Joint BSP-IC-supervised OFCs workshops set to be conducted by September 2016.
		Securities and Exchange Commission (SEC)	Data collection through GFFS (see above).
Improving balance of payments (BOP) and international investment position (IIP) statistics	Disaggregate Other Resident sectors into Households, OFCs and nonfinancial corporations (NFCs) in the BOP and IIP statistics as per the sixth edition of IMF's balance of payments and international investment position manual (BPM6).	BSP	The BSP's International Transactions Reporting System (ITRS) is currently being enhanced to improve BOP data capture. Full implementation of CFFS and OFCS (see above) needed for IIP data disaggregation.
Residential real estate price index (RREPI)	The Residential Real Estate Price Index (RREPI) measures the change in the prices of residential properties in the Philippines. The availability of data on property prices is one of the information gaps identified in the Group of Twenty (G-20) report following the Global Financial Crisis, and is also included in the SDDS Plus.	BSP	The maiden results of the RREPI were released by the BSP last 6 June 2016. This covers the period Q2:2015 to Q1:2016 with Q1:2014 as base period. The RREPI will be generated by the BSP on a quarterly basis.
Uniform reporting template covering real estate developers	Form to collect standardized information from real estate developers on particular aspects of their financial statements like trade receivables that reflect shadow banking activities.	BSP, FSCC Shadow Banking Real Estate Working Group (SBREWG) / Housing and Land Use Regulatory Board (HLURB)	The BSP has forwarded the template to the HLURB for implementation. MOA between HLURB and SBREWG member agencies is being drafted.
Sectoral balance sheet (SBS)	The SBS, which is one of the IMF's SDDS Plus data categories, reports the disaggregation of financial assets and liabilities by economic sectors, including the non-financial, financial, general government, household and rest of the world sectors.	Philippine Statistics Authority (PSA)	While the compilation of the financial sector balance sheet will be generated by the BSP, the consolidation of the whole SBS will be spearheaded by the Philippine Statistics Authority (PSA). As discussed during the inter-agency meeting on SDDS Plus matters last 2 May 2016, the PSA intends to start the preparatory stages on the SBS by 2017 (at least with those sectors where data are readily available).

Source: Bangko Sentral ng Pilipinas (BSP), Department of Economic Statistics; and discussion during the 2016 Article IV consultation.

25. **Systemic risks appear contained but merit continued monitoring**. While most indicators suggest that credit growth remains below typical cutoffs for credit booms, the mixed signals provided by available indicators and the composition of credit growth across sectors warrant careful monitoring to continue assessing the need for macroprudential measures, including countercyclical capital buffers (Text table), supported by strong microprudential supervision. Firm-level stress tests show that overall debt-at-risk is still low in nonfinancial corporates but there are pockets of vulnerability, where leverage has increased and is concentrated. Nonfinancial corporate debt in the Philippines is now comparable to peers although foreign exchange exposure is limited. A part of real estate financing, while likely still small, is provided by real estate developers to household borrowers who cannot yet borrow from banks but data gaps hinder further assessment. Concentration risks arising from the conglomerate structure and rapid expansion of real estate developers warrant continued monitoring. When credit growth becomes excessive for some sectors, the BSP would consider targeted macroprudential policy responses. Such measures could include higher risk

weights on real estate loans and lending to real estate developers. Additionally, concentration risks associated with conglomerate structures and rising corporate leverage make it important to allow the additional Single Borrower Limit (SBL) for PPP to lapse in December 2016 as planned. Finally, the banks' ability to absorb mark-to-market losses from higher market interest rates and corporate vulnerabilities relating to exchange rate shocks should be further assessed with enhanced balance sheet data.

Philippines: Prudential Policy

Risks	Previously Taken Policy	Potential Prudential and Structural Policy
Rapid credit growth	▪ Higher reserve requirement	▪ Countercyclical capital requirement
Real estate loans	▪ Real estate stress tests and remedial measures for capital shortfalls ▪ Cap on real estate loans exposure ▪ Loan-to-collateral limit	▪ Higher risk weights or provisioning requirements on real estate loans ▪ Expansion of the BSP's regulatory perimeter to lending activities by real estate developers
Concentration	▪ Stress tests on conglomerate exposure	▪ Lapse of exemptions to the single borrower limit
Other (structural, fx)	▪ Identification of systemic banks ▪ Cap on banks' NDF positions ▪ Higher capital requirements	▪ Capital market development ▪ Liberalization of foreign investments

26. The authorities' initiatives to strengthen systemic risk monitoring are welcome. BSP recently decided to strengthen its financial stability function to mainstream macro-financial surveillance and a prudential framework, drawing on recent Fund TA. These efforts should continue to be complemented by expanding the regulatory perimeter, particularly to include real estate developers and the nexus of conglomerates and banks. In this regard, staff supports explicitly assigning a financial stability mandate to the BSP through amendments to its charter. Staff also welcomes the regulatory agencies' concerted efforts to maintain financial stability through the Financial Stability Coordination Council (FSCC).

Authorities' Views

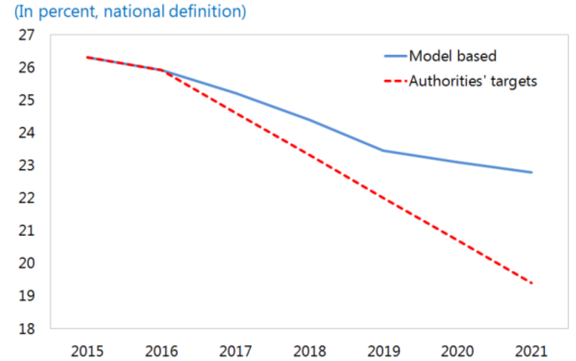
27. Macroprudential policies will continue to be applied. Unconventional monetary policies in the advanced economies have placed banking supervision in emerging market economies in a more complicated situation. BSP regularly conducts real estate stress tests and requires remedial actions, including curtailing lending or raising capital. Although there are not immediate signs of vulnerabilities in the household sector relating to real estate holdings, additional targeted measures would be considered when needed. The measures already implemented, such as the real estate stress tests, have moderated bank credit growth, and the BSP considers it premature to undertake additional macroprudential measures particularly targeting the real estate sector at the current juncture. However, the BSP is enhancing monitoring of risks and will move proactively to limit them in a targeted manner like it did with setting sector-specific capital charges for nondeliverable forwards in response to systemic risks from foreign exchange exposures.

28. In order to manage concentration risks, BSP intends to allow the additional SBL limit for PPPs, adopted six years ago in the context of an underdeveloped capital market, to lapse at the time of its sunset at end-2016. The SBL exemption was a calculated move put in place without compromising the overall prudential regulation framework. Additional prudential measures were put in place to help ensure financial stability, including the implementation of strengthened capital requirements and risk management. To facilitate financing for infrastructure investments even under lowered SBL limits, the BSP recently rationalized limits on PPP project loans to related parties, by excluding properly ring-fenced project finances.

STRUCTURAL POLICIES IN SUPPORT OF INCLUSIVE GROWTH

29. The authorities are targeting a faster reduction in poverty than in recent years, which will require well targeted social and infrastructure expenditure, especially in rural areas where poverty incidence is highest. The Philippines' high poverty rate fell only by 0.3 percentage points per year, from 28.8 percent in 2006 to 26.3 percent in 2015 (national definition). The new authorities target a reduction in the poverty rate of 1.25 to 1.5 percentage points per year during their term, with a cumulative decline of 7.5 percent to 9 percent in six years. Staff assessed the likelihood of achieving these ambitious targets in the staff recommended scenario.[7] The results show that poverty would fall only by 0.6 percentage points per year, less than half the government's target, through the increase in the level of expenditure per se. Therefore, in order to achieve this target, it is imperative that the scale up in social and infrastructure is well targeted to the most vulnerable, particularly in rural areas, and accompanied by strong structural policies. In this respect, staff welcomes the plans to improve

Philippines: Poverty Rate
(In percent, national definition)



Sources: Philippine authorities; and IMF staff estimates.

[7] Staff estimated the effect of public expenditure on poverty reduction by a two-step approach, drawing on existing studies: the first step identifies the effect of public expenditure on inequality, while the second step identifies the effect of inequality and growth on poverty. This analysis was based on "Building Inclusive Growth in the Philippines," in *Philippines—Selected Issues*, Chapter 3, IMF Country Report No. 12/50; and "The Impact of Tax and Expenditure Policies on income Distribution: Evidence from a Large Panel of Countries," Hacienda Publica Espanola 200.

(continued)

the conditional cash transfer program, raise investment in education and health, promote rural and value chain development, and ensure land tenure in agriculture.

30. Staff supports the new administration's priorities for structural reforms. The most macro-critical reforms include raising infrastructure investment and enhancing competition, by amending the PPP law and opening up to foreign investment with a focus on lifting the constitutional provision that prohibits more than a 40 percent foreign stake in utilities.[8] Enhanced competition in the crucial transport, telecommunications, and logistics sectors should be achieved through steadfast implementation of the competition law, and also drawing up a national competition policy and avoiding regulations that unduly discourage new entrants. The recent passage of the Customs Modernization and Tariff Act (CMTA) and Cabotage Act is a welcome first step. Foreign investment could be liberalized by easing the constitutional restrictions and/or the negative list of the foreign investment act. Emerging macro-critical issues include: addressing low agricultural productivity by facilitating the transferability of land titles and for use as collateral to access credit; and addressing labor market imperfections and the skills mismatch to benefit from the demographic dividend, thereby helping to reduce poverty and youth unemployment.

31. Capital market development is crucial for growth and infrastructure investment, and for the mitigation of concentration risks in the banking system. Currently the government securities market is segmented and liquidity is low even at benchmark maturities due to an excessive number of issuances, pricing convention, and the absence of a formal primary dealer (PD) system or well-functioning market maker mechanism. Developing the capital market, including through building a reliable benchmark yield curve, is important for mobilizing saving for productive investment and growth, a key policy priority. Efforts should be also made to develop instruments that would raise additional financing for PPP infrastructure projects (Box 9). Banks are near their single borrower limits for lending to conglomerates including infrastructure PPPs. Capital market development is all the more important in view of staff's recommendation that the BSP allow the PPP exemption from the 25 percent SBL to lapse. There is scope for financing brown field infrastructure projects by issuing nonrecourse infrastructure bonds and asset backed securities that are collateralized on the project's future cash flows. This would allow banks to offload the brown field assets and invest in green field infrastructure projects, while staying within the reduced single borrower limits. Addressing the impediments to securitization and supporting regionally accepted ratings would be important in this endeavor. The development of an institutional investor base would also be important in this regard, including the implementation of the Personal Equity & Retirement Account (PERA) Law. Real Estate Investment Trusts (REITs) would also contribute to this end.

[8] While amending the constitution might face challenges, the Senate and House of Representatives have already agreed to form a Constitutional Assembly to this end.

Box 9. Philippines: Infrastructure Financing and Capital Market Development

Market-based financing can mitigate constraints in infrastructure financing. The Philippine capital market is developing but challenges remain, including the need for a deep and liquid government bond market to provide a reliable yield curve.

Opening up new avenues of financing is important for infrastructure investment in the Philippines. Infrastructure financing in the Philippines has relied on loan syndication by banks. While some infrastructure projects have been financed through corporate bond issuances by holding companies with infrastructure exposure, project bonds have rarely been issued. However, continued reliance on bank loans for large infrastructure projects will face constraints associated with high concentration and asset-liability mismatch risks.

Market-based financing can be useful for brownfield infrastructure investments.[1] During the planning and construction phases of infrastructure projects, banks usually provide the largest share of financing, reflecting their expertise in monitoring the projects and the relative ease of debt restructuring in cases of unforeseen events. Bond financing can be rather costly due to high default risk. Once the infrastructure project becomes operational and starts generating stable cash flows, bond financing becomes a natural and economically appropriate choice to refinance or securitize initial bank loans at a low cost. Such bonds will offload a pool of illiquid assets from banks and create space for new greenfield investments by banks. In addition, these bonds can be attractive for institutional investors, such as pension funds and insurance companies, who need a diversified portfolio of long-term assets to match the long-term duration of liabilities.

Countries have taken different approaches to infrastructure financing.[2] Infrastructure financing is often led by the public sector because investment profiles of infrastructure investments are not conducive to purely private investments. For example, in China, loans by state-owned banks with guarantees from local governments have been a major source. In Brazil, long-term private sector corporate finance has been dominated by a publicly-owned development bank at a subsidized rate. As a result, local debt market development has lagged, although the financial sector in Brazil is otherwise sophisticated. Some countries have been successful in developing local bond markets to support long-term infrastructure projects. In particular, pension reforms in Canada and Chile have helped to provide a stable long-term investor base and assisted local capital market development. Malaysia has also successfully developed its capital market for infrastructure financing through reforms in the regulatory framework and market infrastructure developments.

In the Philippines, challenges to developing the local bond market as a source of financing for infrastructure investment remain. Deep and liquid government bond markets—anchored by a well-functioning money market—would be needed to provide a reliable yield curve, which would support the pricing of other fixed-income instruments. Addressing irregular liquidity across the yield curve by concentrating issuance and trading activity at benchmark maturities is a key priority in this regard. Other important building blocks include a prudent regulatory and supervisory framework for capital markets, key market infrastructure, and high-quality credit information services. Taxes may also affect the financial viability of investment vehicles.

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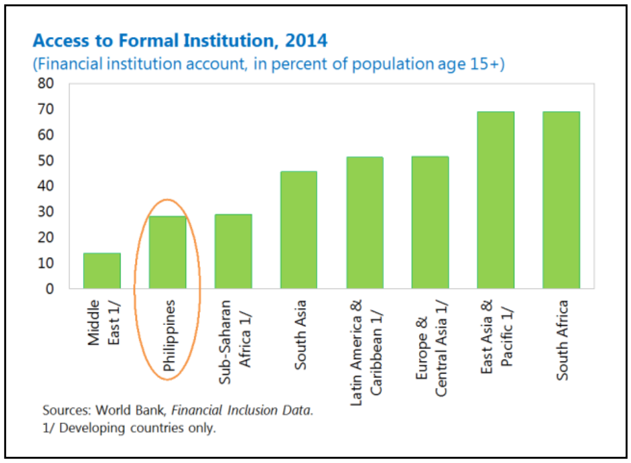
1/ Ehlers, Torsten, 2014, "Understanding the Challenges for Infrastructure Finance," BIS Working Paper No 454.
2/ Asian Development Bank, 2015, *Local Currency Bonds and Infrastructure Finance in ASEAN+3;* IMF, 2016, "Infrastructure in Latin America and the Caribbean," Chapter 5 in IMF *Regional Economic Outlook: Western Hemisphere*; and Walsh, J.P., C. Park and J. Yu, 2011, "Financing Infrastructure in India: Macroeconomic Lessons and Emerging Market Case Studies," IMF Working Paper No. 11/181.

32. Promoting financial inclusion is another priority. Access to formal financial services is low especially in rural areas. In addition, the cost of remittances has increased due to closure of correspondent banking relationships in the context of de-risking of banks globally. In this regard, additional new technologies for international money transfers can be usefully studied and encouraged, while monitoring their introduction to mitigate risk. Development of the insurance market would help promote inclusive growth and poverty reduction. Staff also welcomes a creation of a multiagency committee chaired by the BSP to provide strategic direction and oversight the implementation of the 2015 national financial inclusion strategy.



33. The recent theft of US$81 million from Bangladesh's official international reserves laundered through casinos in the Philippines highlights the need to tighten anti-money laundering legislation and procedures. Staff's view is that the AML law needs to be strengthened, along with amendment of the bank secrecy law, and is ready to provide further technical support to help formulate these amendments if desired. The amendments should include the coverage of casinos under the AML law and making tax evasion a predicate crime. The BSP and Department of Finance are already working with Congress on amendments to the AML laws. The BSP also relaxed foreign exchange regulations in August 2016 including documentary requirements for banks to migrate transactions in the informal market to the banking system.

Authorities' Views

34. Making growth more inclusive is a key priority for the new administration. The authorities noted that poverty reduction was slow in the past, but they plan to speed it up. They welcome staff's analysis on poverty reduction and agreed that meeting the ambitious targets would require well targeted social and infrastructure spending, particularly in the provinces. The authorities also recognize the need to develop and deepen capital markets and promote financial inclusion. The Bureau of the Treasury, together with the BSP and SEC, plan to introduce a new repo instrument and PD system. In addition, the authorities are finalizing work on other initiatives, including the introduction of an overnight index swap facility and a pricing benchmark framework. To promote financial deepening and inclusion, the BSP approved entry of a number of foreign banks to foster competition in the banking sector and provide better access and options to the underserved areas. The authorities have also resubmitted draft amendments to the AML law and the bank secrecy law to Congress. As part of its supervisory enforcement action, the BSP recently imposed a record ₱1.0 billion (US$21 million) fine against the domestic bank involved in the Bangladesh cyber heist.

STAFF APPRAISAL

35. The Philippine economy has continued to show strong economic growth coupled with low inflation. Sound macroeconomic policies and prudent financial sector supervision have contributed to solid macroeconomic fundamentals. Strong economic growth in the first half of 2016 reflects the strength of domestic demand. Inflation is expected to move within the target range. Credit growth has picked up, but most indicators suggest that credit growth remains below typical cutoffs for credit booms. There is a continuing need to monitor macro-financial risks in light of recent rapid credit growth.

36. The favorable macroeconomic performance in recent years has not led to corresponding improvements in social indicators. Income inequality and poverty persist and the unemployment rate has come down only slowly. Staff supports the authorities' efforts to implement reforms that would strengthen social indicators.

37. The new administration has an opportunity to put the economy on a higher and more equitable growth path while reaping the dividends from its young and growing population. Building on the Philippines' sound macroeconomic policies, this will involve increasing infrastructure spending, facilitating PPPs and opening the economy to foreign investment, as well as improving the investment climate. Staff supports the government's plans to improve human capital and social services for the poor. It also supports the efforts to promote development in a more geographically balanced manner.

38. Staff supports the government's plan to raise infrastructure and social spending and increase its medium-term fiscal deficit target to 3 percent of GDP, anchored to a stable debt-to-GDP ratio. The increase in public spending in the 2016 budget is appropriate given the large infrastructure and social needs, while output is expected to remain close to potential. The new fiscal deficit target would keep the debt-to-GDP ratio stable and allows a cushion for unforeseen contingencies such as disaster risk and contingent liabilities arising from PPPs.

39. A comprehensive tax reform is needed to make the system more equitable and efficient, and to raise additional revenue to finance large infrastructure and social needs. While the authorities' intention to pass a comprehensive tax reform package is welcome, they are further urged to eliminate the 13th month salary exemption from the PIT and raise taxes and fees on motor vehicles. It will also be very important to rationalize tax incentives at the same time as CIT rates are lowered to avoid a revenue loss and to increase efficiency. To strengthen tax collection, the tax authorities should be given access to individual bank account information and tax evasion should be made a predicate crime.

40. **The authorities should formulate a medium-term public infrastructure plan** with clear prioritization of projects and appropriate choices between budgetary and PPP spending, with due consideration of contingent liabilities. Staff support the authorities' target to increase public infrastructure spending to at least 5 percent of GDP over the medium term. It will be important that such spending is done efficiently in key strategic areas and that additional revenues are available to finance it.

41. **Monetary policy settings are currently appropriate**. Nonetheless, the BSP should stand ready to tighten if there are signs of overheating or credit growth accelerating with inflationary pressures. The adoption of the new interest rate corridor is commendable and efforts to absorb additional liquidity through stepping up the size of deposit auctions should continue. This would allow the BSP to lower the currently high banks' required reserve ratio over time. Passage of a new BSP charter that authorizes the issuance of central bank bills and increases BSP's capital would help support monetary policy effectiveness. With official international reserves more than adequate, the policy of allowing the exchange rate to move freely in line with market forces, while smoothing excessive volatility in both directions, should continue.

42. **Macroprudential policies should be used to guard against systemic risks to financial stability, including those relating to conglomerate structures and real estate**. Staff supports the authorities' use of targeted prudential policies to tame financial excesses, including credit surges, and strengthen resilience. More stringent prudential regulations may be needed if systemic risks become apparent. Broadening the BSP's financial stability mandate remains a priority, and staff supports the authorities' proposed amendments to the BSP charter. Staff also supports the authorities' efforts to allow better access to information on conglomerates' finances.

43. **Financial deepening and inclusion are also essential elements of the authorities' inclusive growth strategy**. While the composition of credit growth including in the real estate sector should be closely monitored on an ongoing basis to avoid risks from credit booms, expanded bank lending to productive sectors will facilitate inclusive growth. Staff believes that further development of alternative forms of financing and hedging, such as new technologies to increase the access to financial services by a larger share of the population, and development of corporate bond and equity markets, is needed to support infrastructure investment.

44. **Staff supports the authorities' objective to accelerate poverty reduction**. Achieving this goal will require that the scale up in social and infrastructure is well targeted to the most vulnerable, particularly in rural areas, and accompanied by strong structural policies. Staff welcomes the authorities' initiatives in the 10-point policy agenda to increase social spending and promote rural development and agriculture.

45. **Staff also supports the authorities' efforts to step up structural reforms**. Raising infrastructure investment and competition, opening the economy to foreign investment, addressing low agricultural productivity, and removing labor market imperfections and the skills mismatch to benefit from the demographic dividend, would have large growth dividends and would help lower poverty and youth unemployment.

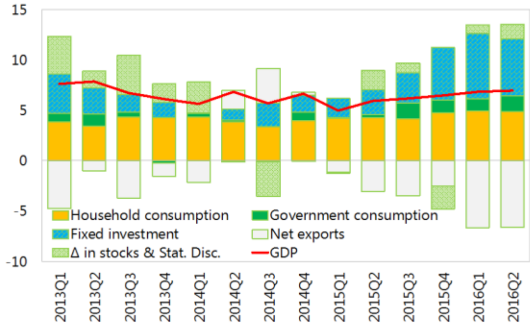
46. The recent incident of funds being illegally shifted from Bangladesh underscores the importance of tightening anti-money laundering provisions in the Philippines. Staff strongly encourages the authorities to pass amendments to the AML law that would remove the exemption for casinos and make tax evasion a predicate crime, and ease bank secrecy laws.

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

Figure 1. Philippines: Real Sector

Domestic demand is supporting strong growth…

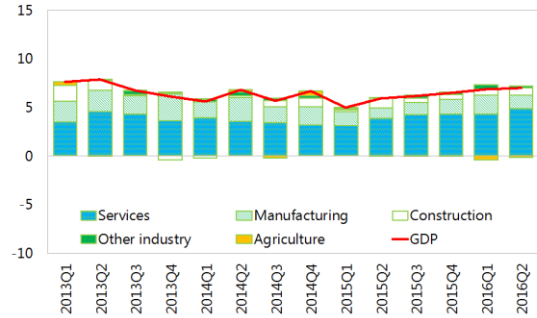
Contributions to Real GDP Growth—Expenditure Side
(Cummulative from 2007:Q1)



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

…led by services and manufacturing.

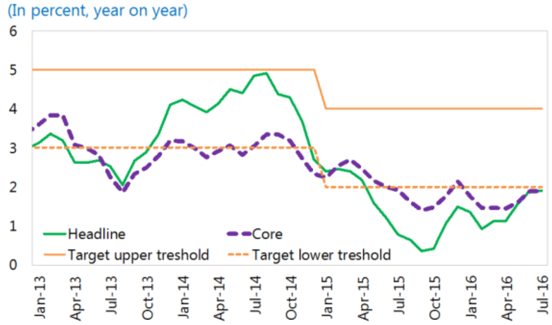
Contributions to Real GDP Growth—Supply Side
(Cummulative from 2007:Q1)



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

Inflation is moderate…

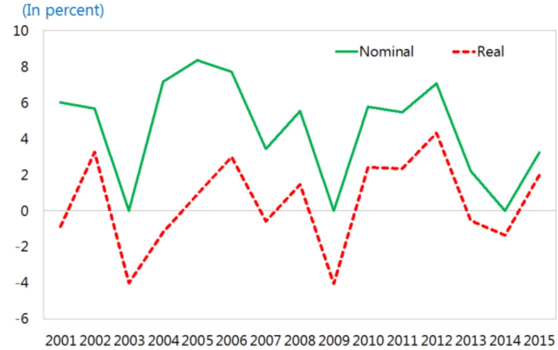
Consumer Price Inflation: Headline and Core
(In percent, year on year)



Sources: Philippines authorities; and IMF staff estimates.

…and wage growth has picked up slightly.

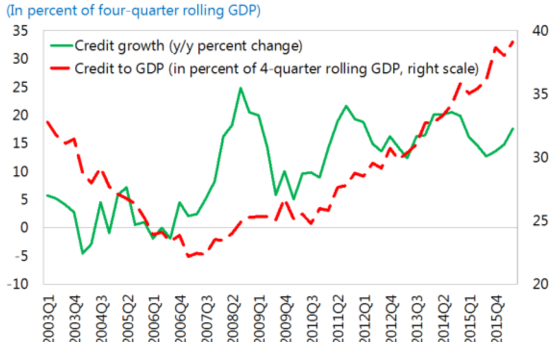
Average Nonagricultural Daily Wages Growth
(In percent)



Source: Haver Analytics.

Credit growth remains high and has picked up recently…

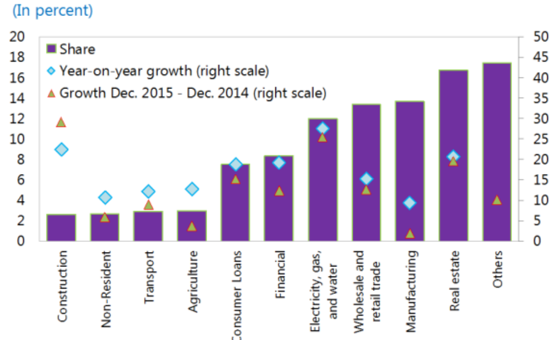
Bank Credit Growth and Credit to GDP
(In percent of four-quarter rolling GDP)



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

…including for construction and real estate.

Universal and Commercial Banks: Loans by Sector, June 2016
(In percent)

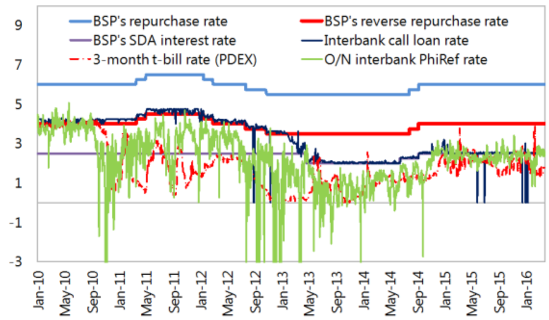


Sources: CEIC Data Company Ltd; and IMF staff calculations.

Figure 2. Philippines: Monetary and Financial Conditions

Monetary policy has remained on hold since 2014, while the gap between T-bill rates and policy rates has narrowed…

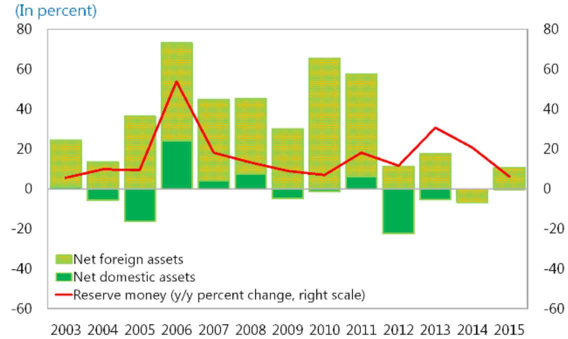
Policy Rates, Interbank and T-Bill Rates
(In percent)



Sources: Bloomberg L.P.; Haver Analytics; and Philippine Dealing and Exchange Corp. (PDEX).

…and reserve money growth has slowed.

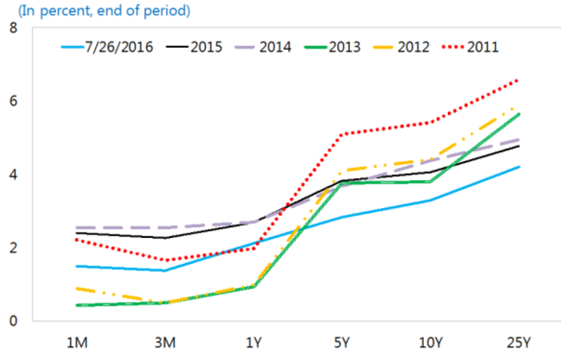
Contribution to Reserve Money Growth
(In percent)



Sources: Haver Analytics.

Government bond yields have declined in 2016…

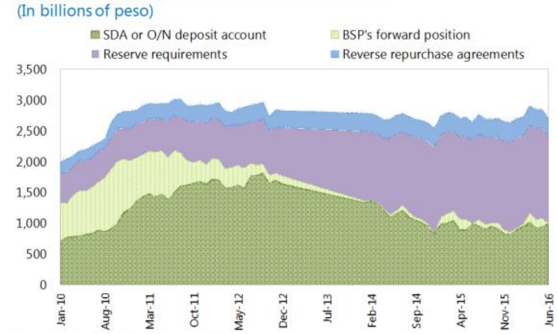
Government Bond Yields
(In percent, end of period)



Source: Bloomberg L.P.; and CEIC Data Co. Ltd.

…as liquidity in the system has stabilized, with about half of it being absorbed by the banks' required reserves.

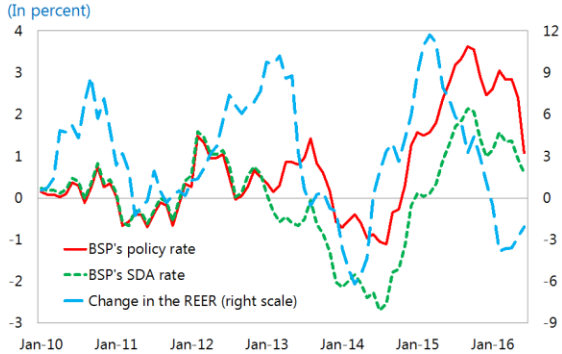
Philippines: Main Sterilization Instruments 1/
(In billions of peso)



Sources: BSP; and CEIC Data Company Ltd.
1/ Data as of June 2016; except for forward position (as of May 2016).

Monetary conditions have eased somewhat this year, after tightening autonomously in 2015…

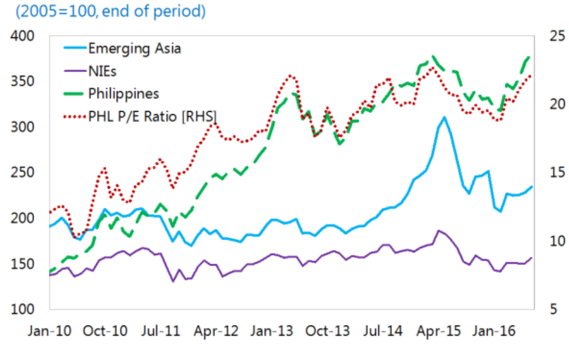
Real Interest Rate and Change in the REER
(In percent)



Sources: CEIC Data Co., Ltd.; and IMF staff estimates.

…while stock market valuations have recovered after the selloff in the second half of 2015.

Stock Market Indices
(2005=100, end of period)

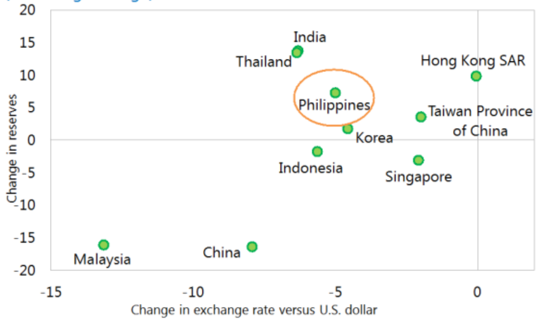


Sources: Bloomberg LP; CEIC Data Company Ltd.; and IMF staff calculations.

Figure 3. Philippines: Financial Market Comparisons

Foreign reserves have been broadly stable…

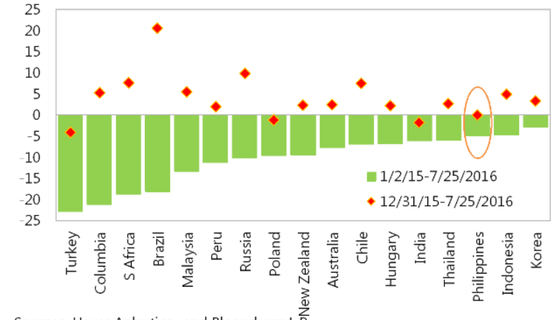
Appreciation and Reserve Accumulation, 2015-16 1/ 2/
(Percentage change)



1/ The reference period is June 2016 versus December 2014.
2/ Positive change in exchange rate means appreciation.

…as has the nominal exchange rate.

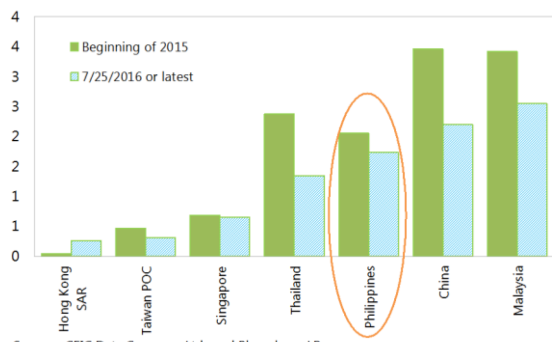
Change in Exchange Rate versus U.S. dollar 1/
(In percent)



Sources: Haver Anlaytics.; and Bloomberg L.P.
1/ Positive change in exchange rate means appreciation.

Monetary conditions have eased somewhat, but yields are comparable to other Asian economies.

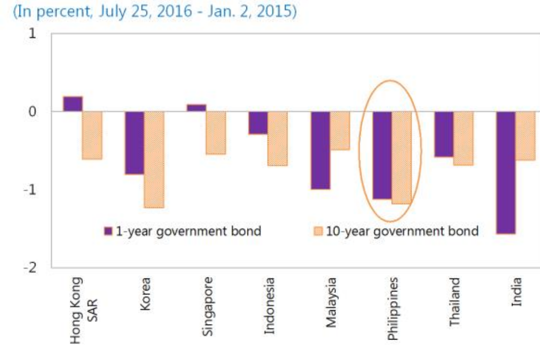
Three-Month Treasury Bill Yields
(In percent)



Sources: CEIC Data Company Ltd.; and Bloomberg LP.

Long-term government bond yields have declined in line with those of neighboring countries…

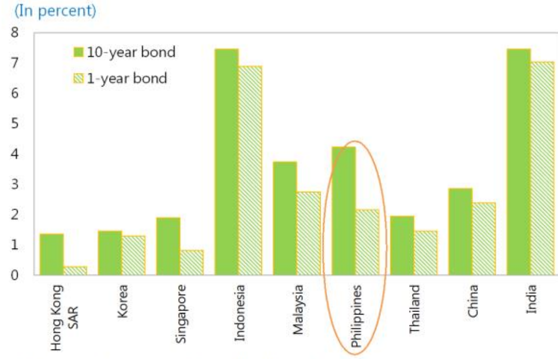
Change in Government Bond Yields
(In percent, July 25, 2016 - Jan. 2, 2015)



Sources: CEIC Data Company Ltd.; and Bloomberg LP.

…and remain comparable to those of some other countries in the region.

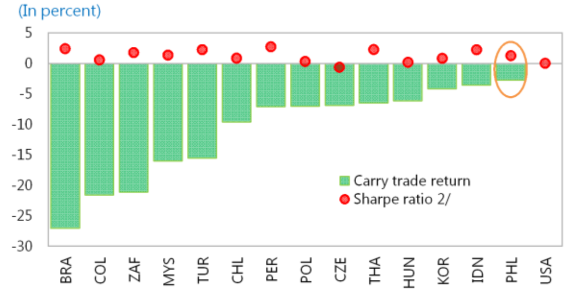
Government Bond Yields, June 2016
(In percent)



Sources: CEIC Data Company Ltd.; and Bloomberg LP.

While negative returns to carry trade have persisted in some EMEs, these have been smaller in the Philippines.

Carry Trade Return, 2015 1/
(In percent)

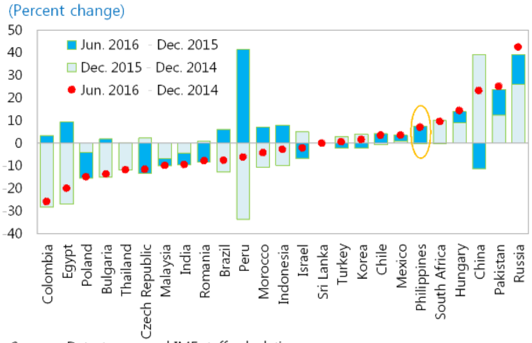


Sources: Bloomberg LP; and IMF staff calculations.
1/ Exchange rate-adjusted return on a one-year local currency government bond versus a one-year U.S. treasury bond.
2/ A measure of risk-adjusted return, calculated as average monthly carry trade return divided by the standard deviation of returns.

Figure 4. Philippines: Cross-Country Financial Market Developments

Stock market valuation changes have been moderate compared to some other EMEs…

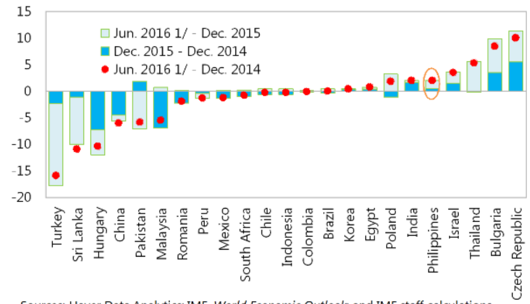
Stock Market Index Changes
(Percent change)



Sources: Datastream; and IMF staff calculations.

…and foreign reserves have been broadly stable.

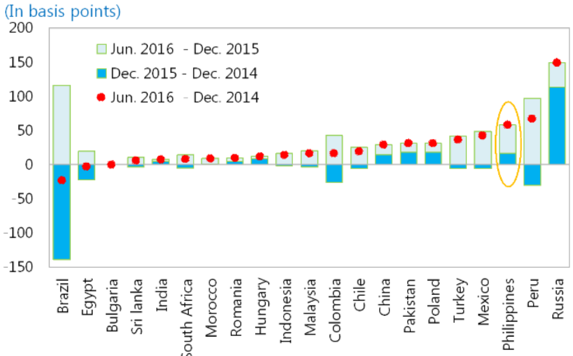
Changes in Stock of Reserves
(In percent of 2015 GDP)



Sources: Haver Data Analytics; IMF, *World Economic Outlook*; and IMF staff calculations.
1/ Or latest data available.

The Philippines' sovereign spreads have increased somewhat more than in other EMEs…

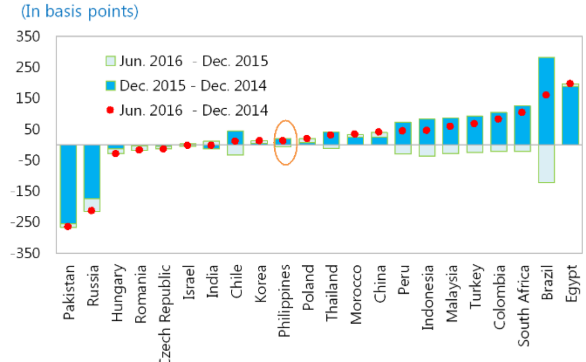
EMBI Changes
(In basis points)



Sources: Datastream; and IMF staff calculations.

…although its CDS spreads have remained stable.

CDS Spread Changes
(In basis points)

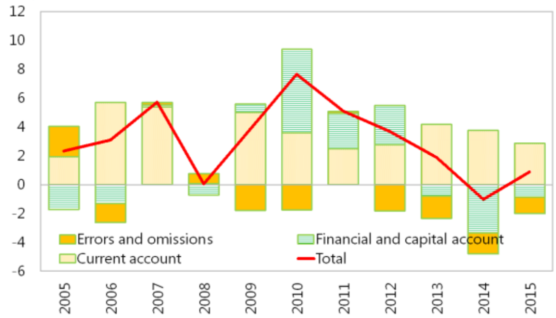


Sources: Datastream; and IMF staff calculations.

Figure 5. Philippines: External Sector

The overall balance of payments was in modest surplus…

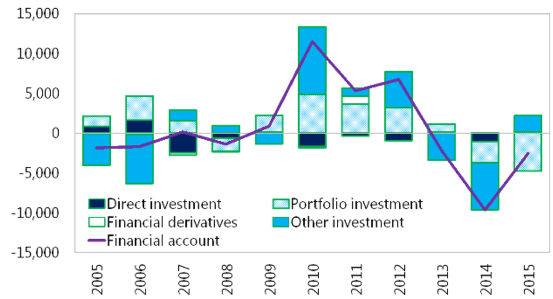
Balance of Payments
(In percent of GDP)



Source: CEIC Data Company Ltd.

…as financial account outflows have slowed.

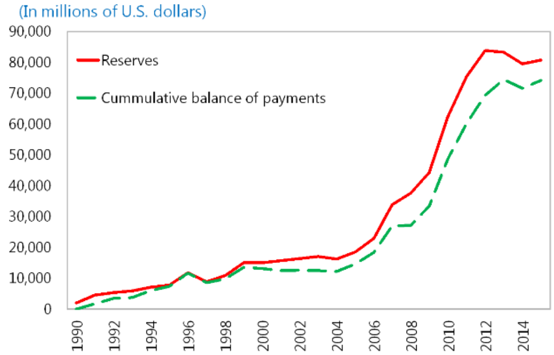
Capital Inflows 1/
(In millions of U.S. dollars)



Source: CEIC Data Company Ltd.
1/ Positive implies inflow.

Following the rapid reserve accumulation up to 2012, reserves have leveled off…

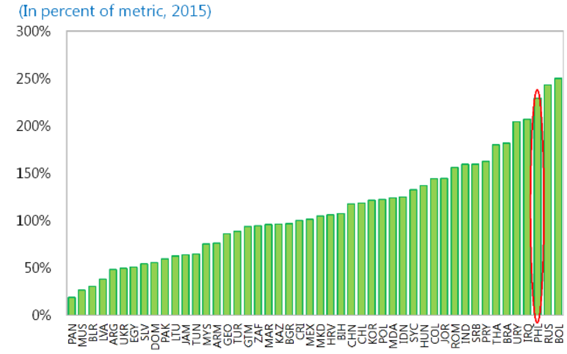
Philippines: International Reserves
(In millions of U.S. dollars)



Source: IMF, *International Financial Statistics.*

…and are well above the Fund's reserve adequacy metric.

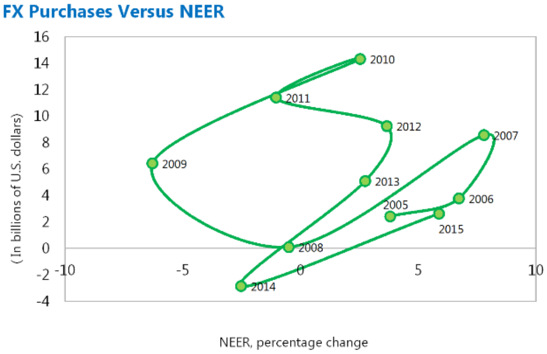
Reserves Against Adequacy Metric
(In percent of metric, 2015)



Source: IMF staff estimates.

The BSP has taken the opportunity to build FX reserves during periods of balance of payments surpluses…

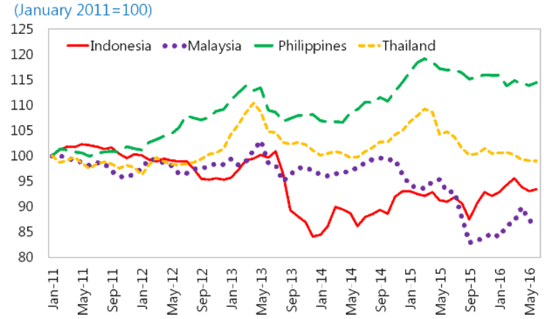
FX Purchases Versus NEER



Sources: Haver Analytics; and IMF, *Information Notice System.*

…and the REER has depreciated since early 2015, although less than in Malaysia and Thailand.

REER in ASEAN
(January 2011=100)

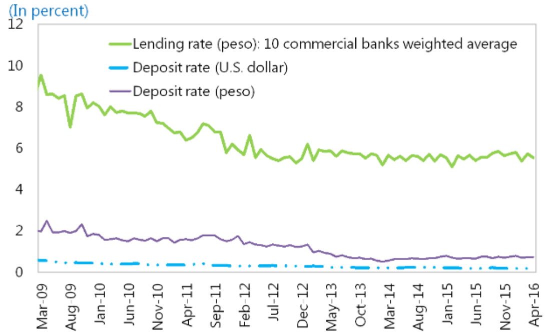


Source: IMF, *Information Notice System.*

Figure 6. Philippines: Banking Sector

Loan/deposit rate spreads have remained high…

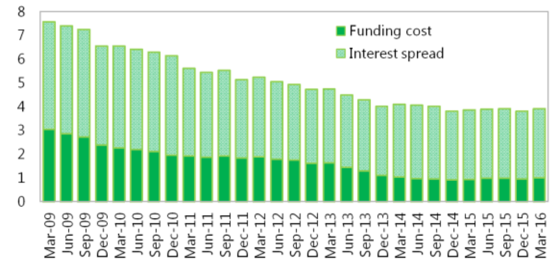
Lending and Deposit Rates
(In percent)



Sources: CEIC Data Co. Ltd.

…and interest spreads for banks are high relative to funding costs.

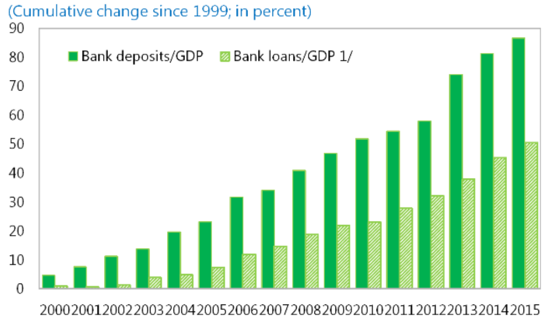
Universal and Commercial Banks: Funding Cost and Interest Spread 1/
(In percent)



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

Loan/deposit ratios have remained low.

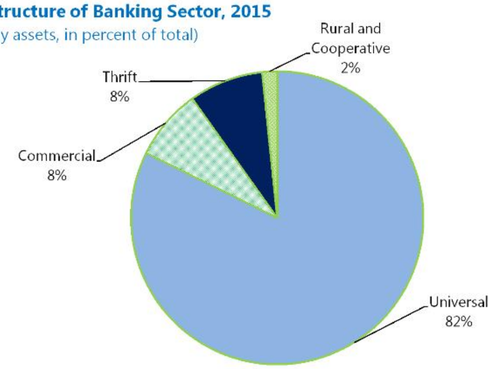
Philippine Banking System: Deposits and Loans
(Cumulative change since 1999; in percent)



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

Universal banks have the largest share of banking system assets.

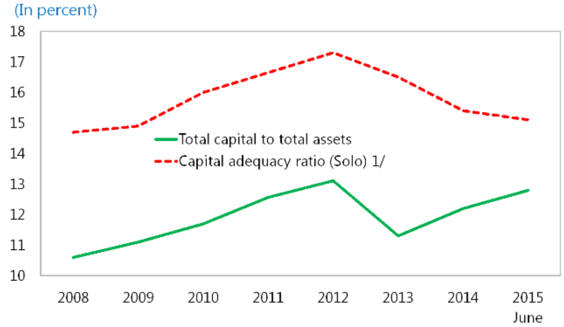
Structure of Banking Sector, 2015
(By assets, in percent of total)



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

The Philippine banking system is well capitalized…

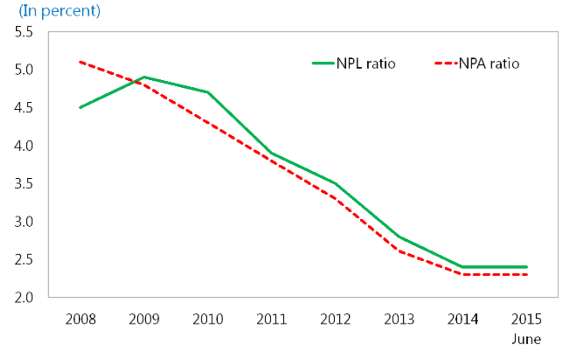
Capital Adequacy
(In percent)



Source: Philippines authorities, *Status Report on the Philippines Financial System*.
1/ Solo refers to head office and branches.

…with low and declining NPL ratios.

Asset Quality
(In percent)

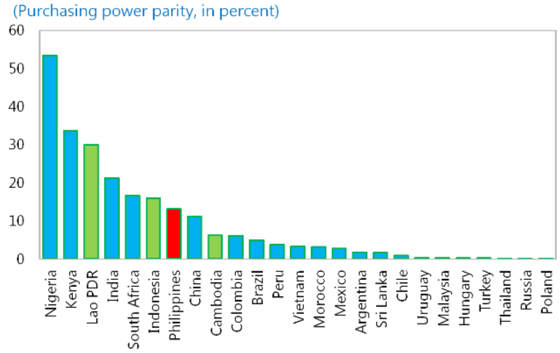


Source: Philippines authorities, *Status Report on the Philippines Financial System*.

Figure 7. Emerging Markets: Social Conditions and Income Distribution

Poverty in the Philippines has fallen but remains high…

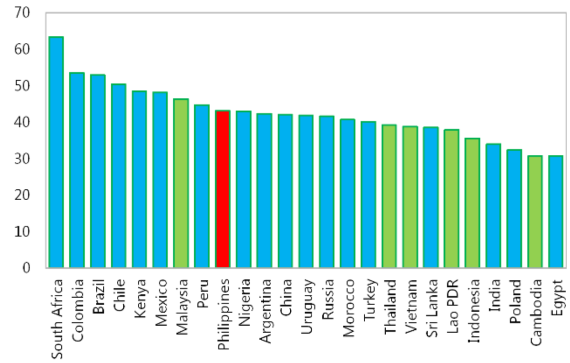
Poverty Rate at $1.90 a Day
(Purchasing power parity, in percent)



Source: World Bank, *World Development Indicators*.

…as is income inequality.

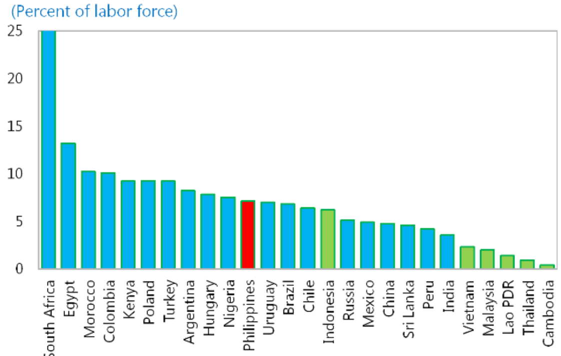
Income Inequality: GINI Coefficient



Source: World Bank, *World Development Indicators*.

The unemployment rate has also fallen but is high relative to other ASEAN peers.

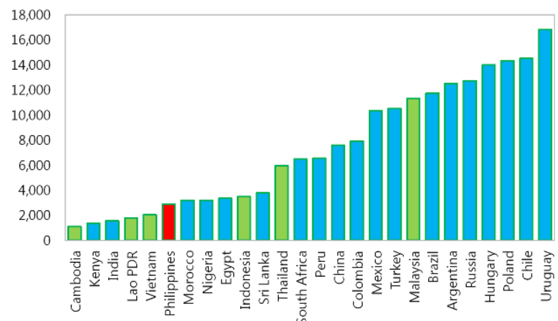
Unemployment Rate in 2014
(Percent of labor force)



Source: World Bank, *World Development Indicators*.

Per capita GDP is among the lowest in the emerging market economies…

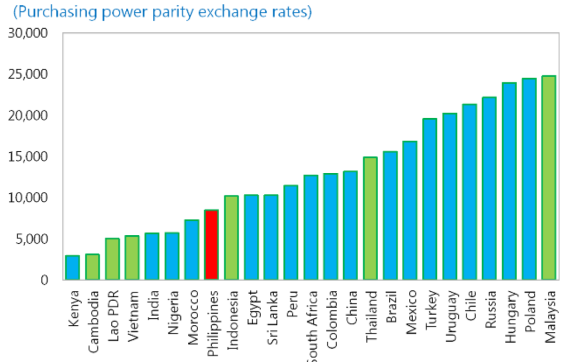
GDP Per Capita in U.S. Dollar, 2014
(Market exchange rates)



Source: World Bank, *World Development Indicators*.

…while per capita GNI is somewhat higher as this includes the Philippines' sizable remittances.

GNI Per Capita in U.S. Dollar, 2014
(Purchasing power parity exchange rates)



Sources: World Bank, *World Development Indicators*.

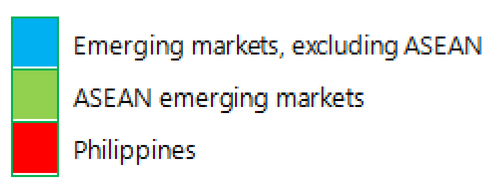


Table 1. Philippines: Selected Economic Indicators, 2011–17

Nominal GDP (2015): P 13,307 billion ($292 billion)
Population (2015): 102 million
GDP per capita (2015): $2,863
Poverty headcount ratio at $1.25 a day at PPP (2012): 19 percent
IMF quota: SDR 2,042.9 million
Main products and exports: electronics, agriculture products, and business process outsourcing
Unemployment rate (2015): 6.3 percent

	2011	2012	2013	2014	2015	2016	2017
						Proj.	
GDP and prices (percent change)							
Real GDP	3.7	6.7	7.1	6.2	5.9	6.4	6.7
CPI (annual average)	4.7	3.2	2.9	4.2	1.4	2.0	3.4
CPI (end year)	4.2	3.0	4.1	2.7	1.5	2.9	3.2
Investment and saving (percent of GDP)							
Gross investment	20.5	18.2	20.0	20.5	20.6	23.7	24.7
National saving	23.0	21.0	24.2	24.3	23.4	25.5	26.1
Public finances (percent of GDP)							
National government balance (authorities' definition)	-2.0	-2.3	-1.4	-0.6	-0.9	-2.0	-3.0
National government balance 1/	-2.0	-2.4	-1.5	-0.6	-1.4	-2.0	-3.0
Nonfinancial public sector balance 2/	-0.7	-0.6	0.6	0.9	0.1	-0.5	-1.6
Revenue and grants	18.6	19.4	20.2	19.8	19.6	19.6	19.7
Expenditure	19.3	20.0	19.6	18.9	19.5	20.1	21.3
Nonfinancial public sector debt	55.3	53.0	51.3	47.8	45.8	43.5	41.4
Monetary sector (percent change, end of period)							
Broad money (M3) 3/	7.1	9.4	31.8	11.2	9.4	12.4	...
Interest rate (91-day treasury bill, end of period, in percent) 4/	1.7	0.5	0.5	2.5	2.7	1.8	...
Credit to the private sector (in percent) 3/	19.3	16.2	16.4	19.9	13.6	17.6	...
External sector							
Export value (percent change) 5/	4.1	21.2	-4.0	11.9	-13.1	-3.4	4.1
Import value (percent change) 5/	9.5	11.3	-4.8	8.0	-3.2	4.0	6.0
Current account (percent of GDP)	2.5	2.8	4.2	3.8	2.9	1.8	1.4
Capital account (US$ billions)	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Financial account (US$ billions) 5/	-5.3	-6.8	2.2	9.6	2.5	0.4	0.5
Direct investment (net) 5/	0.3	1.0	-0.1	1.0	-0.1	-1.0	-1.1
Errors and omissions (US$ billions)	0.3	-4.6	-4.2	-4.1	-3.3	-2.5	-2.3
Overall balance (US$ billions)	11.4	9.2	5.1	-2.9	2.6	2.7	2.1
Total external debt (percent of GDP) 6/	33.7	32.0	28.9	27.3	26.5	25.1	22.7
Debt service ratio 7/	13.6	9.9	11.1	8.4	7.4	11.2	10.7
Reserves(US$ billions)	75.3	83.8	83.2	79.5	80.7	84.0	86.5
Reserves/short-term liabilities 8/	482.5	397.9	406.2	418.9	396.9	397.5	401.7
Exchange rate (period averages)							
Pesos per U.S. dollar	43.3	42.2	42.4	44.4	45.5	47.0 9/	...
Nominal effective exchange rate (2005 =100)	99.0	102.6	105.4	102.7	108.8	106.0 9/	...
Real effective exchange rate (2005 =100)	100.7	105.6	109.8	109.4	116.7	114.4 9/	...

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/ Universal and Commercial Banks. The latest observation is June 2016 (year-on-year).
4/ Secondary market rate. The latest observation in July 2016.
5/ In BPM6. An increase in either assets or liabilities is always positive and a decrease is always negative. Net investment is assets minus liabilities.
6/ Includes external debt not registered with the central bank, and private capital lease agreements.
7/ In percent of exports of goods and nonfactor services.
8/ Reserves as a percent of short-term debt (including medium- and long-term debt due in the following year).
9/ Average January-June 2016.

Table 2. Philippines: National Government Cash Accounts, 2011–17

(In billions of pesos, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016		2017
						Budget	Proj.	Proj.
Revenue and grants	1,359	1,527	1,713	1,906	2,047	2,697	2,223	2,461
Tax revenue	1,202	1,361	1,536	1,719	1,815	2,543	1,976	2,185
Net income and profits	572	643	718	785	846	…	916	1,017
Excises	88	98	146	166	190	…	205	225
VAT	383	451	490	558	562	…	625	694
Tariffs	42	41	35	56	57	…	61	62
Other 1/ 2/	117	129	146	154	160	…	169	187
Nontax revenue	157	166	178	187	231	154	246	277
Expenditure and net lending	1,553	1,781	1,881	1,984	2,233	2,995	2,511	2,938
Current expenditures	1,285	1,394	1,521	1,619	1,788	2,205	1,966	2,145
Personnel services	500	543	582	604	664	…	729	813
Maintenance and operations	193	237	283	309	403	…	438	484
Allotments to local government units	230	219	242	273	312	…	359	394
Subsidies	46	42	66	80	78	…	85	93
Tax expenditure	34	38	23	30	18	…	19	21
Interest	282	316	324	324	313	393	336	341
Capital and equity expenditure	250	359	344	351	436	764	535	781
Capital expenditure	237	338	333	350	435	…	534	781
Equity	13	21	11	2	1	…	1	1
Net lending	18	27	17	13	10	27	11	12
Balance	-193	-254	-168	-78	-187	-299	-288	-477
On the authorities' presentation 3/	-190	-243	-164	-74	-121	-299	-284	-472

Sources: Philippine authorities; and IMF staff projections.

1/ Projections include possible gains from tax administrative measures for 2015 and 2016.
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, 2011–17

(In percent of GDP, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016 Budget Proj.	2016 Staff Proj.	2017 Proj.
Revenue and grants	14.0	14.5	14.8	15.1	15.4	18.1	15.4	15.4
Tax revenue	12.4	12.9	13.3	13.6	13.6	17.0	13.7	13.7
Net income and profits	5.9	6.1	6.2	6.2	6.4	...	6.3	6.4
Excises	0.9	0.9	1.3	1.3	1.4	...	1.4	1.4
VAT	3.9	4.3	4.2	4.4	4.2	...	4.3	4.4
Tariffs	0.4	0.4	0.3	0.4	0.4	...	0.4	0.4
Other 1/ 2/	1.2	1.2	1.3	1.2	1.2	...	1.2	1.2
Nontax revenue	1.6	1.6	1.5	1.5	1.7	1.0	1.7	1.7
Expenditure and net lending	16.0	16.9	16.3	15.7	16.8	20.1	17.4	18.4
Current expenditures	13.2	13.2	13.2	12.8	13.4	14.8	13.6	13.5
Personnel services	5.2	5.1	5.0	4.8	5.0	...	5.1	5.1
Maintenance and operations	2.0	2.2	2.5	2.4	3.0	...	3.0	3.0
Allotments to local government units	2.4	2.1	2.1	2.2	2.3	...	2.5	2.5
Subsidies	0.5	0.4	0.6	0.6	0.6	...	0.6	0.6
Tax expenditure	0.3	0.4	0.2	0.2	0.1	...	0.1	0.1
Interest	2.9	3.0	2.8	2.6	2.3	2.6	2.3	2.1
Capital and equity expenditure	2.6	3.4	3.0	2.8	3.3	5.1	3.7	4.9
Of which : Infrastructure outlays	1.6	2.6	2.3	2.2	2.6	4.2	3.0	4.2
Net lending	0.2	0.3	0.1	0.1	0.1	0.2	0.1	0.1
Balance	-2.0	-2.4	-1.5	-0.6	-1.4	-2.0	-2.0	-3.0
On the authorities' presentation 3/	-2.0	-2.3	-1.4	-0.6	-0.9	-2.0	-2.0	-3.0
Memorandum items:								
Nonfinancial public sector balance 4/	-0.7	-0.6	0.6	0.9	0.1	...	-0.5	-1.6
Consolidated public sector balance 4/	2.8	2.6	1.4	1.1	2.1	...	2.6	3.5
Primary national government balance	0.9	0.6	1.4	1.9	0.9	0.6	0.3	-0.9
National government debt 5/	44.9	44.2	42.8	39.7	39.5	...	38.1	37.0
(percent of NG revenues)	320.9	306.0	287.9	263.6	256.8	...	247.1	239.6
Nonfinancial public sector debt 6/	55.3	53.0	51.4	47.8	47.3	...	44.9	42.9
(percent of NFPS revenues)	297.6	273.1	254.8	242.2	241.1	...	228.8	217.9
National government gross financing requirement 7/	12.0	9.1	5.9	4.7	5.2	...	8.0	9.1
GDP (in billions of pesos)	9,708	10,561	11,538	12,645	13,307	14,931	14,431	15,931

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).
4/ Excludes privatization receipts from revenue.
5/ Consolidated (net of national government debt held by the sinking fund) and excluding contingent/guaranteed debt.
6/ Nonfinancial public sector includes the national government, CB-BOL, 14 monitored government-owned enterprises, social security institutions, and local governments. Debt is consolidated (net of intra-nonfinancial public sector holdings of debt).
7/ Defined as the deficit, plus amortization of medium- and long-term debt, plus the stock of short-term debt at the end of the last period.

Table 4. Philippines: General Government Operations, 2011–17 1/

(In percent of GDP)

	2011	2012	2013	2014	2015	2016 Proj.	2017 Proj.
Revenue	17.6	18.6	18.9	18.9	19.3	19.3	19.4
Taxes	13.2	14.1	14.5	14.4	14.5	14.5	14.6
Taxes on income, profits, and capital gains	5.9	6.1	6.2	6.2	6.4	6.3	6.4
Taxes on goods and services	5.8	6.2	6.6	6.6	6.5	6.6	6.7
Taxes on international trade and transactions	0.4	0.4	0.3	0.4	0.4	0.4	0.4
Taxes not elsewhere classified	1.1	1.4	1.4	1.2	1.2	1.1	1.1
Social contributions	1.9	2.0	2.1	2.2	2.4	2.4	2.4
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue	2.5	2.5	2.3	2.3	2.4	2.4	2.4
Total expenditure	17.9	18.9	18.7	18.1	19.1	19.7	20.9
Expense	15.0	15.3	15.3	15.0	15.5	15.6	15.6
Compensation of employees 2/	5.2	5.1	5.0	4.8	5.0	5.1	5.1
Purchases/use of goods and services 2/	2.0	2.2	2.5	2.4	3.0	3.0	3.0
Interest 2/	2.6	2.6	2.5	2.2	2.1	2.0	1.8
Social benefits	1.8	1.8	1.9	2.1	2.2	2.4	2.5
Expense not elsewhere classified	3.5	3.4	3.4	3.4	3.2	3.1	3.1
Net acquisition of nonfinancial assets	2.9	3.6	3.3	3.1	3.6	4.1	5.3
Net lending/borrowing	-0.3	-0.3	0.2	0.9	0.2	-0.4	-1.5
National government	-1.7	-1.9	-1.2	-0.5	-1.3	-1.9	-2.9
Local government units	0.7	0.7	0.7	0.7	0.9	1.0	1.0
Social security institutions (SSIs)	0.7	0.9	0.7	0.7	0.6	0.5	0.4
Net acquisition of financial assets	0.9	4.6	2.9	2.1	0.8	2.0	1.8
Net incurrence of liabilities	1.2	4.9	2.7	1.2	0.5	2.4	3.3
Memorandum items:							
National government cash holdings	…	…	…	…	…	…	…
Consolidated general government debt	41.4	40.6	39.3	36.4	36.3	34.8	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, 2011–17 1/

(End of period, in billions of pesos, unless otherwise indicated)

	2011	2012	2013	2014	2015	2016	2017
						Proj.	
Total							
Net Foreign Assets	3,242,542	3,248,548	3,575,054	3,752,064	3,998,793	4,132,224	4,283,029
Net Domestic Assets	2,578,913	2,979,116	4,479,152	5,303,883	5,886,165	6,659,968	7,821,592
Net Claims On Nonfinancial Public Sector	1,520,559	1,298,189	1,287,632	1,470,598	1,611,377	1,650,095	2,024,099
Claims On Private Sector	3,093,882	3,528,922	4,137,658	4,949,747	5,562,223	6,396,556	7,356,040
Net Claims On Other Financial Corporations	-894,944	-767,601	178,728	274,276	294,501	343,217	413,080
Capital Accounts	-1,258,757	-1,113,606	-1,203,888	-1,462,541	-1,679,344	-1,840,113	-2,101,063
Other Items (Net)	118,172	33,212	79,022	71,802	97,408	110,213	129,436
Broad Money	5,821,454	6,227,664	8,054,206	9,055,947	9,884,958	10,792,192	12,104,620
National Currency	4,801,830	5,227,220	6,915,929	7,698,511	8,405,390	9,176,830	10,292,816
Foreign Currency	1,019,625	1,000,443	1,138,277	1,357,436	1,479,569	1,615,362	1,811,805
Bangko Sentral ng Pilipinas							
Net Foreign Assets	3,233,794	3,382,382	3,643,852	3,514,334	3,762,866	3,832,804	3,909,871
Net Domestic Assets	-1,908,654	-1,886,211	-1,712,821	-1,189,662	-1,293,108	-949,713	-554,092
Claims On Private Sector	1	1	1	1	1	1	1
Net Claims On Financial Corporations	-1,846,634	-1,810,951	-1,576,264	-1,072,410	-1,065,162	-782,299	-456,418
Capital Accounts	-287,252	-1,760	-3,821	-5,387	-112,423	-82,568	-48,173
Other Items (Net)	-12,445	-13,655	-17,763	-4,795	-5,729	-4,208	-2,455
Base Money	1,323,000	1,475,633	1,926,202	2,323,905	2,467,059	2,880,393	3,353,080
Currency In Circulation	648,911	692,657	797,452	929,502	1,005,195	1,173,606	1,366,201
Other Depository Corporations Liabilities	673,511	782,647	1,128,302	1,386,745	1,456,213	1,700,189	1,979,199
Other Liquid Liabilities	2,139	20,538	4,829	767	2,699	2,699	2,699
Other Depository Corporations							
Net Foreign Assets	8,748	-133,834	-68,798	237,731	235,927	299,420	373,158
Net Domestic Assets	5,295,056	5,781,849	7,477,386	8,095,638	8,849,210	9,619,364	10,751,888
Net Claims On Nonfinancial Public Sector	1,282,883	1,358,035	1,402,605	1,577,668	1,721,173	1,730,726	2,071,129
Claims On Private Sector	3,093,881	3,528,921	4,137,658	4,949,746	5,562,222	6,396,555	7,356,039
Net Claims On Financial Corporations	1,751,828	1,969,705	3,045,147	2,955,906	3,035,984	3,143,623	3,250,629
Capital Accounts	-971,505	-1,111,846	-1,200,066	-1,457,153	-1,566,921	-1,757,545	-2,052,890
Other Items (Net)	137,969	37,034	92,043	69,471	96,752	106,005	126,981
Liquid Liabilities	5,303,804	5,648,015	7,408,588	8,333,369	9,085,137	9,918,784	11,125,045
Memorandum items:							
Broad Money (percent change)	5.3	7.0	29.3	12.4	9.2	9.2	12.2
Claims on private sector (percent change)	16.2	14.1	17.2	19.6	12.4	15.0	15.0
Broad Money (percent of GDP)	60.0	59.0	69.8	71.6	74.3	74.8	76.0
Claims on private sector (percent of GDP)	31.9	33.4	35.9	39.1	41.8	44.3	46.2
Nominal GDP	9,708,334	10,561,086	11,538,412	12,645,050	13,307,357	14,431,107	15,930,681

Source: IMF, *International Financial Statistics*, and IMF staff projections.

1/ It includes the Bangko Sentral ng Pilipinas (BSP), the accounts of the Central Government arising from its holdings of transactions with the International Monetary Fund, and Other Depository Corporations such as universal and commercial banks, thrift banks, rural banks, non-stock savings and loan associations and non-banks with quasi-banking functions.

Table 6. Philippines: Balance of Payments, 2011–2017 1/

(In billions of U.S. dollars)

	2011	2012	2013	2014	2015	2016	2017
						Proj.	
Current account balance	5.6	6.9	11.4	10.8	8.4	5.5	4.9
Trade balance of goods and services	-13.9	-12.7	-10.6	-12.8	-17.5	-20.7	-22.2
Goods	-20.4	-18.9	-17.7	-17.3	-21.7	-25.8	-28.1
Exports, f.o.b.	38.3	46.4	44.5	49.8	43.3	41.8	43.5
Imports, f.o.b.	58.7	65.3	62.2	67.2	65.0	67.6	71.6
Services	6.6	6.2	7.0	4.6	4.2	5.0	5.9
Receipts	18.9	20.4	23.3	25.5	28.2	30.8	33.8
Payments	12.3	14.3	16.3	20.9	23.9	25.8	27.9
Primary income, net	0.9	0.2	1.0	0.7	2.3	2.1	2.0
Receipts, *of which* :	7.6	8.3	8.4	8.8	9.5	9.8	10.2
Resident workers abroad	5.9	6.5	7.0	7.4	7.8	8.5	9.3
Payments	6.7	8.1	7.4	8.1	7.2	7.7	8.2
Interest payments	2.8	3.0	2.9	2.8	2.5	2.6	2.5
Secondary income, net	18.6	19.5	21.1	22.8	23.5	24.2	25.1
Receipts, *of which* :	19.0	20.1	21.7	23.4	24.3	25.1	26.1
Nonresident workers remittances	17.1	18.0	19.3	20.8	21.7	22.3	23.2
Payments	0.5	0.6	0.6	0.7	0.8	0.9	1.0
Capital account	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Financial account 2/	-5.3	-6.8	2.2	9.6	2.5	0.4	0.5
Direct investment	0.3	1.0	-0.1	1.0	-0.1	-1.0	-1.1
Portfolio investment	-3.7	-3.2	-1.0	2.7	4.8	2.7	2.3
Equity	-1.0	-1.7	0.1	-1.0	1.0	0.5	0.3
Debt	-2.6	-1.5	-1.1	3.7	3.7	2.3	2.0
Financial derivatives	-1.0	0.0	-0.1	0.0	0.0	0.0	0.0
Other investment, *of which* :	-1.0	-4.5	3.4	5.9	-2.1	-1.3	-0.6
Currency and deposits	2.3	-1.5	1.4	3.5	0.5	0.8	1.0
Loans	-3.6	-2.3	1.4	2.0	-2.5	-1.6	-0.7
Errors and omissions	0.3	-4.6	-4.2	-4.1	-3.3	-2.5	-2.3
Overall balance	11.4	9.2	5.1	-2.9	2.6	2.7	2.1
Memorandum items:							
Current account/GDP	2.5	2.8	4.2	3.8	2.9	1.8	1.4
Short-term debt (original maturity)	12.1	16.5	16.9	16.2	15.1	15.4	15.8
Short-term debt (residual maturity)	15.6	21.1	20.5	19.0	20.7	21.1	21.5
Gross reserves	75.3	83.8	83.2	79.5	80.7	84.0	86.5
(in percent of st. debt by res. maturity) 3/	482.5	397.9	406.2	418.9	396.9	397.5	401.7
External debt (in billions)	75.6	79.9	78.5	77.7	77.5	78.1	79.1
(in percent of GDP)	33.7	32.0	28.9	27.3	26.5	25.1	22.7
Debt service ratio 4/	13.6	9.9	11.1	8.4	7.4	11.2	10.7
Export value (percent change) 1/	4.1	21.2	-4.0	11.9	-13.1	-3.4	4.1
Import value (percent change) 1/	9.5	11.3	-4.8	8.0	-3.2	4.0	6.0
Gross external financing needs 5/	9.8	8.7	9.7	9.7	10.6	15.1	16.3
Remittances value (percent change)	7.2	6.3	7.4	7.2	4.6	4.6	5.4

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/ In percent of goods and nonfactor services exports.
5/ 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, 2013–21

(In percent of GDP, unless otherwise indicated)

				Proj.					
	2013	2014	2015	2016	2017	2018	2019	2020	2021
GDP and prices									
Real GDP (percent change)	7.1	6.2	5.9	6.4	6.7	6.8	6.9	7.0	7.0
CPI (percent change, annual average)	2.9	4.2	1.4	2.0	3.4	3.5	3.5	3.5	3.5
GDP by expenditure									
Consumption (percent change)	5.5	5.2	6.5	7.6	6.9	6.8	6.9	7.0	7.0
Private	5.6	5.5	6.3	7.3	6.8	6.8	6.9	7.0	7.0
Public	5.0	3.3	7.8	9.9	7.2	6.8	6.9	7.0	7.0
Gross fixed investment (percent change)	11.8	6.2	15.2	24.1	13.5	9.9	9.8	9.6	9.6
Net exports (contribution to growth)	-2.6	0.9	-2.5	-5.4	-2.5	-1.5	-1.5	-1.5	-1.6
Investment and saving									
Gross investment	20.0	20.5	20.6	23.7	24.7	25.6	26.4	27.1	27.9
Private	17.1	17.8	17.3	20.0	19.8	20.6	21.2	21.9	22.5
Public	2.9	2.7	3.2	3.7	4.9	5.0	5.2	5.2	5.3
National saving	24.2	24.3	23.4	25.5	26.1	26.7	27.2	27.6	28.1
Private	21.3	21.2	20.7	22.8	23.3	23.9	24.3	24.8	25.2
Public	2.9	3.1	2.8	2.7	2.8	2.8	2.9	2.9	2.9
Public finances									
Nonfinancial public sector balance 1/	0.6	0.9	0.1	-0.5	-1.6	-1.8	-1.9	-2.0	-2.1
Primary balance	3.7	3.7	2.6	2.0	0.7	0.5	0.2	0.0	-0.3
Revenue and grants	20.2	19.8	19.6	19.6	19.7	19.7	19.8	19.8	19.7
Expenditure (primary)	16.5	16.1	17.0	17.7	19.0	19.3	19.6	19.8	20.1
Interest	3.1	2.8	2.6	2.5	2.2	2.2	2.1	2.0	1.8
Nonfinancial public sector gross financing need	4.0	3.4	3.9	6.5	7.7	9.1	10.5	11.8	13.0
Domestic	3.7	2.6	2.9	5.4	7.0	8.5	10.0	11.3	12.6
Foreign currency	0.3	0.8	1.0	1.1	0.7	0.6	0.6	0.5	0.5
National government balance (authorities definition)	-1.4	-0.6	-0.9	-2.0	-3.0	-3.0	-3.0	-3.0	-3.0
National government balance	-1.5	-0.6	-1.4	-2.0	-3.0	-3.0	-3.0	-3.0	-3.0
Nonfinancial public sector debt	51.3	47.8	47.3	44.9	42.9	41.0	39.2	37.6	36.2
External sector									
Export value (percent change) 2/	-4.0	11.9	-13.1	-3.4	4.1	5.0	5.0	5.0	5.0
Import value (percent change) 2/	-4.8	8.0	-3.2	4.0	6.0	6.9	7.1	7.0	7.3
Trade balance of goods and services	-3.9	-4.5	-6.0	-6.1	-6.0	-5.7	-5.5	-5.4	-5.3
Current account	4.2	3.8	2.9	1.8	1.4	1.1	0.8	0.5	0.2
Reserves (US$ billions)	83.2	79.5	80.7	84.0	86.5	88.3	89.7	90.6	90.7
Reserves/short-term liabilities 3/	406.2	418.9	396.9	397.5	401.7	401.5	399.2	393.8	507.9
Total external debt	28.9	27.3	26.5	25.1	22.7	20.6	18.8	17.1	15.7
Debt service ratio (in percent of exports of goods and services)	11.1	8.4	7.4	11.2	10.7	9.9	9.2	8.5	8.0
Monetary sector:									
Credit to private sector 4/	35.9	39.1	41.8	44.3	46.2	48.3	50.8	53.7	56.8
Credit to private sector (percent change) 4/	17.2	19.6	12.4	15.0	15.0	15.7	16.4	17.0	17.0

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/ In BPM6.
3/ Reserves as a percent of short-term debt (including medium- and long-term debt due in the following year).
4/ Based on the depository corporations survey. Inaddition to universal and commercial banks, it includes thrift banks, rural banks, non-stock savings and loan associations and non-banks with quasi-banking functions.

Table 8. Philippines: Baseline and Staff's Preferred Scenarios, 2015–21 1/

(In percent of GDP, unless otherwise indicated)

	2015	2016	2017	2018	2019	2020	2021
				Baseline Scenario			
National government cash accounts							
Revenue and grants	15.4	15.4	15.4	15.5	15.5	15.5	15.5
Tax revenue	13.6	13.7	13.7	13.8	13.8	13.8	13.7
Nontax revenue	1.7	1.7	1.7	1.7	1.8	1.8	1.8
Expenditure and net lending	16.8	17.4	18.4	18.5	18.5	18.6	18.5
Current expenditures	13.4	13.6	13.5	13.4	13.3	13.3	13.1
Capital and equity expenditure	3.3	3.7	4.9	5.0	5.2	5.2	5.3
Net lending	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Balance	-1.4	-2.0	-3.0	-3.0	-3.0	-3.0	-3.0
General government debt	36.3	34.8	33.8	32.9	32.0	31.2	30.6
Real, external, and social indicators							
Real GDP growth (in percent)	5.9	6.4	6.7	6.8	6.9	7.0	7.0
Inflation (annual average, in percent)	1.4	2.0	3.4	3.5	3.5	3.5	3.5
Current account balance	2.9	1.8	1.4	1.1	0.8	0.5	0.2
National saving	23.4	25.5	26.1	26.7	27.2	27.6	28.1
Gross investment	20.6	23.7	24.7	25.6	26.4	27.1	27.9
Unemployment rate (in percent)	6.3	5.9	5.7	5.6	5.5	5.5	5.5
Poverty rate (in percent)	26.5	25.8	25.1	24.4	23.7	23.0	22.3
				Staff's Recommended Scenario 2/			
National government cash accounts							
Revenue and grants	15.4	15.4	16.4	17.5	18.5	18.5	18.5
Tax revenue	13.6	13.7	14.7	15.8	16.8	16.8	16.7
Nontax revenue	1.7	1.7	1.7	1.7	1.8	1.8	1.8
Expenditure and net lending	16.8	17.4	19.4	20.5	21.5	21.6	21.5
Current expenditures	13.4	13.6	14.0	14.4	14.8	14.8	14.6
Capital and equity expenditure	3.3	3.7	5.4	6.0	6.7	6.7	6.8
Net lending	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Balance	-1.4	-2.0	-3.0	-3.0	-3.0	-3.0	-3.0
General government debt	36.3	34.8	33.5	32.4	31.2	30.2	29.3
Real, external, and social indicators							
Real GDP growth (in percent)	5.9	6.4	7.2	7.4	7.6	7.8	8.0
Inflation (annual average, in percent)	1.4	2.0	3.7	3.8	3.8	3.6	3.5
Current account balance	2.9	1.8	0.7	-0.3	-1.3	-1.6	-1.9
National saving	23.4	25.5	26.0	26.5	26.9	27.4	28.0
Gross investment	20.6	23.7	25.3	26.8	28.2	29.0	29.9
Unemployment rate (in percent)	6.3	5.9	5.6	5.4	5.2	5.0	5.0
Poverty rate (in percent)	26.5	25.8	24.5	23.2	21.9	20.6	19.3

Sources: Philippine authorities; and IMF staff calculations.

1/ The assumptions underlying the baseline and staff's recommended scenario are presented in Box 2. Staff's recommended scenario includes a tax reform that raises 3 percent of GDP in extra revenue over time, in increments of 1 percentage point per year starting in 2017. The extra revenue is used to finance additional social and capital expenditure by equal amounts. The larger fiscal multipliers of investment and social expenditure than that of taxes lead to an increase in real GDP growth of 0.5 percent relative to the baseline scenario in 2017-19, with growth increasing by another 0.1 percent in 2018 and 0.2 percent in 2019 due to crowding in of private investment and enhanced public investment efficiency. Over the medium term, growth rises to 8 percent in 2020-21 due to higher public and private investment, gains in productivity associated to the liberalization of FDI and reform of land titles, and faster employment growth due to labor market reforms. Inflation raises somewhat reflecting the demand stimulus partly offset by a tightening of monetary policy and higher potential growth, and the current account surplus declines because of higher investment and lower saving.

2/ The estimated impact of the reforms included in the staff's recommended scenario are based on Komatsuzaki 2016 (Improving Public Infrastructure in the Philippines, IMF WP/16/39) and Dabla-Norris and others 2015 (Structural Reforms and Productivity Growth in Emerging Market and Developing Economies, IMF WP/16/15).

Table 9. Philippines: Banking Sector Indicators, 2011–15

(In percent)

	2011	2012	2013	2014	2015
Capital adequacy					
Total capital to total assets	12.6	13.1	11.3	12.2	11.6
Capital adequacy ratio (Solo) 1/	16.7	17.3	16.5	15.4	15.1
Asset quality					
NPL ratio 2/	3.9	3.5	2.9	2.4	2.2
NPA ratio 3/	3.8	3.3	2.6	2.3	2.0
Distressed asset ratio 4/	7.9	6.8	5.6	4.6	4.0
NPL coverage ratio 5/	102.7	109.6	118.7	119.7	118.0
NPA coverage ratio 6/	62.4	68.1	73.0	77.0	77.1
Profitability					
Return on assets	1.5	1.6	1.6	1.3	1.1
Return on equity	12.1	12.4	13.3	10.8	9.6
Cost-to-income ratio	65.0	63.5	60.3	62.3	64.3
Liquidity					
Liquid assets to deposits	56.5	57.5	59.5	55.6	53.5
Loans (gross) to deposits	70.0	73.5	64.4	68.4	70.7

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 10. Philippines: Indicators of External Vulnerability, 2010–15

(In percent of GDP, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015
External indicators (including external liquidity)						
Gross international reserves, (in billions U.S. dollars)	62.4	75.3	83.8	83.2	79.5	80.7
Maturing short-term debt (in billions U.S. dollars)	10.5	12.1	16.5	16.9	16.2	15.1
Amortization of medium and long-term debt (in billions U.S. dollars)	4.8	5.0	3.6	4.6	3.6	2.7
Net FDI inflows (in billions of U.S. dollars) 1/	1.6	0.3	1.0	-0.1	1.0	-0.1
FX deposits residents (in billions of U.S. dollars)	25.1	24.3	25.3	26.1	32.1	32.7
Total gross external debt	36.9	33.7	32.0	28.9	27.3	26.5
Nonfinancial public sector indicators:						
Overall balance	-3.3	-0.8	-0.6	0.6	0.9	0.1
Primary balance	0.4	2.4	2.7	3.7	3.7	2.6
Debt	54.8	55.3	53.0	51.4	47.8	45.8
Debt denominated in FX or linked to the exchange rate (in percent of total)	53.2	47.0	36.0	33.5	31.9	33.8
Short-term general government debt (original maturity, in percent of total)	11.2	6.0	5.1	5.6	4.9	4.4
Average effective interest rate of government debt (in percent)	7.1	6.3	6.4	6.3	6.0	5.6
Amortization of total debt	10.7	8.2	6.7	5.0	4.0	3.8

Sources: Philippine authorities; and IMF staff estimates.

1/ In BPM6.

Appendix I. Philippines—Risk Assessment Matrix 1/

Nature/Source of Main Threats	Likelihood of Risk/ Time Horizon	Transmission Channels	Expected Impact of Risk	Recommended Policy Response
Tighter or more volatile global financial conditions	High/ Short Term	• Sharp asset price decline and decompression of credit spreads; surge in the U.S. dollar. • The associated volatility surge could be amplified by low market liquidity. • Sharp capital outflows, leading to a peso depreciation. • Yields on domestic government securities may rise suddenly in response to sharp capital outflows. • The conglomerate structure could amplify transmission.	Medium • Asset prices fall, generating negative wealth effects. • Rising credit cost slows down real estate and construction activity. • Banks' NPLs may increase from very low levels, but effect on capital is likely manageable. • Some leveraged corporates may face debt service difficulties. • Banks may suffer mark-to-market losses on their government securities. • The impact should be limited due to strong macro fundamentals. Effective depreciation would cushion the effect on growth.	• Ensure banks have adequate capital buffers and do not exceed standard ceilings on exposures to a single borrower (defined to include all affiliated entities). • Consider adopting countercyclical macroprudential policies. • Allow for exchange rate flexibility, limiting intervention to smoothing excessive volatility. • Ease monetary or fiscal policy if real economy slows down significantly.
Sharp growth slowdown in China and other regional economies in the medium term	Low/ Short and Medium Term	• A slowdown in China reduces regional exports and GDP growth. • Territorial disputes could trigger trade disruptions. • Investor sentiment toward the region would weaken.	High • Direct exports to China have grown rapidly over the decade, but less so in value-added terms. • 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.	• Allow for exchange rate flexibility to serve as a shock absorber. Let the exchange rate adjust to the new equilibrium if China's growth slowdown is persistent. • Implement structural reforms and consider accelerating public infrastructure spending to spur new sources of growth.
Domestic asset price boom fueled by abundant liquidity	Low/ Medium Term	• Continued inflows into financial assets and real estate. • Construction and real estate related activity accelerates. • Credit exposure to the real estate sector grows. • The conglomerate structure could amplify transmission.	Medium • Real estate prices grow rapidly, attracting additional real and financial resources to the sector, and boosting near-term growth. • Vulnerability of the financial system builds. • Asset price correction weakens growth, including through financial sector deleveraging.	• Enforce existing macroprudential policies and implement additional real estate specific measures. • Ensure adequate bank capital to absorb credit losses. • Coordinated and strengthened surveillance on nonbank activities, including expansion of the BSP's mandate to include nonbanks.
Stronger lift to domestic demand from lower commodity prices	Low/ Short Term	• Low commodity prices lead to overheating. • Pick-up in government spending adds to demand pressures.	Medium • Inflation begins to pick up. • Rapid credit growth increases financial stability risks.	• Monetary policy should focus on maintaining price stability. • Macroprudential policy should be deployed to limit the buildup of systemic vulnerabilities, including in specific sectors.
Low infrastructure and social spending	Medium/ Short and Medium Term	• Weak budget execution limits social and infrastructure spending in the near term. • Weak tax administration limits revenue, constraining social and infrastructure spending in the medium term. • Technical factors limit PPP deployment.	High • Fails to crowd in private investment. • Limits potential output growth over the longer term. • Limits opportunities to the growing working age population and stimulates migration. • Poverty remains high with risk of social fragmentation, impeding economic growth.	• Strengthen the public expenditure framework in support of infrastructure and social spending. • Improve the scope for PPPs to develop infrastructure. • Broaden the tax base and improve tax administration to raise additional revenue. • Further expand well targeted transfers and universal health care.
Climate change related natural disaster	Medium/ Medium Term	• Natural disaster destroys physical and human capital. • Results in population displacement and closure of businesses. • Going forward, increases uncertainty and discourages investment.	Medium • Results in a loss of output and high unemployment and poverty. • Requires additional budgetary resources for reconstruction and social needs. • Increased uncertainty reduces investment and potential growth.	• Accelerate infrastructure improvements, especially in the areas which make it more resilient to natural disasters. • Explore private and public sector options for insurance.

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. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Appendix II. Philippines—Debt Sustainability Analysis

Public debt in the Philippines is sustainable. Staff's baseline scenario projects that the general government debt-to-GDP ratio will fall from 36 percent of GDP in 2015 to below 31 percent in 2021 despite the rise in the fiscal deficit target to 3 percent in 2017. The growth-interest rate differential is the main factor behind the projected fall in public debt, contributing 6.6 percentage points, as real GDP growth increases to 7 percent toward the end of the projection period. Moreover, the primary surpluses also contribute to the reduction in public debt by 2.5 percentage points. The gross financing needs remain comfortable at 4−5 percent of GDP throughout the projection period. The debt composition is also projected to remain stable with a relatively low share of short-term debt and foreign currency-denominated debt, in line with the authorities' debt management policy.

Alternative scenarios indicate that staff's baseline is conservative. The Philippines achieved a large scale public debt reduction in 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 equal to their 2006–2015 averages, leads to faster reduction in debt and gross financing needs than in staff's baseline. The scenario with a constant primary surplus at the projected 2016 level of 1.9 percent of GDP also leads to lower debt-to-GDP ratios and gross financing needs than in staff's baseline scenario.

Total external debt in the Philippines is also sustainable. External debt fell sharply in the 2000s, from a peak of 76.4 percent of GDP in 2001 to 26.5 percent in 2015, due to sustained current account surpluses, strong output growth, and currency appreciation. Under staff's baseline scenario, these trends are projected to continue, with external debt expected to fall to 15.7 percent of GDP in 2021. Alternative scenarios suggest that staff's baseline is conservative. The historical scenario, in which real GDP growth, real interest rates, and the non-interest current account balance are equal to their 2006–2015 averages, leads to a faster reduction in external debt than in staff's baseline. 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 increases 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 2016 would raise the external debt-to-GDP ratio by about 10 percentage points.

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

(In percent of GDP, unless otherwise indicated)

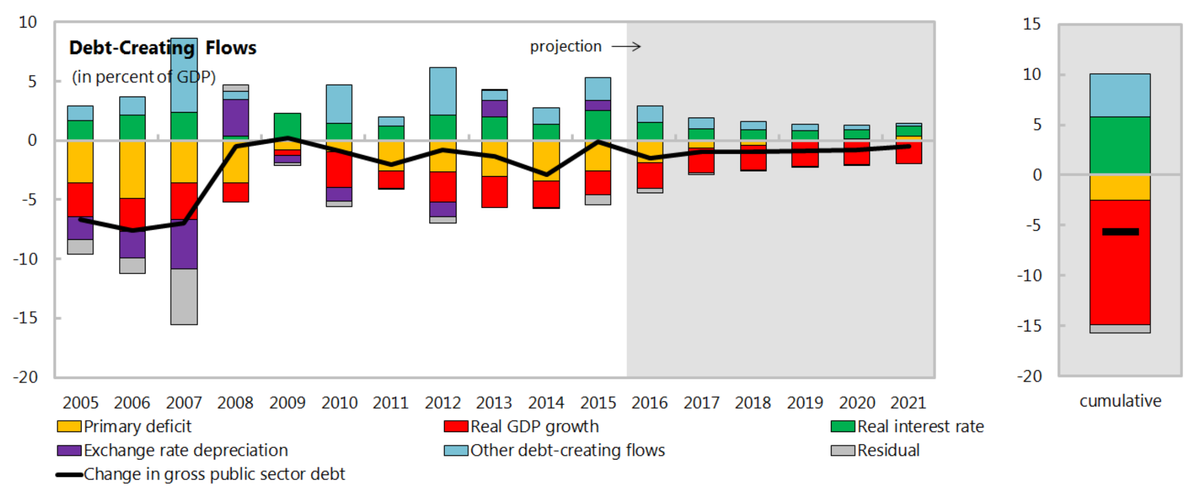
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2005-2013 [2/]	2014	2015	2016	2017	2018	2019	2020	2021
Nominal gross public debt	45.4	36.4	36.3	34.8	33.8	32.9	32.0	31.2	30.6
Public gross financing needs	13.0	3.2	3.6	3.6	4.4	4.3	4.5	4.4	4.4
Real GDP growth (in percent)	5.2	6.2	5.9	6.4	6.7	6.8	6.9	7.0	7.0
Inflation (GDP deflator, in percent)	4.0	3.2	-0.6	1.9	3.5	3.5	3.5	3.5	3.5
Nominal GDP growth (in percent)	9.5	9.6	5.2	8.4	10.4	10.5	10.7	10.7	10.7
Effective interest rate (in percent) [4/]	8.2	7.1	6.7	6.6	6.7	6.6	6.6	6.5	6.5

As of July 27, 2016		
Sovereign Spreads		
EMBI (bp) 3/		99
CDS (bp)		104
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BBB	BBB
Fitch	BBB-	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-2.9	-2.9	-0.1	-1.5	-1.0	-1.0	-0.9	-0.8	-0.5	-5.6	
Identified debt-creating flows	-2.1	-2.8	0.7	-1.1	-0.8	-0.9	-0.8	-0.7	-0.5	-4.8	
Primary deficit	-2.8	-3.4	-2.6	-1.9	-0.6	-0.4	-0.1	0.1	0.4	-2.5	-0.9
Primary (noninterest) revenue and gran	18.2	18.9	19.3	19.3	19.4	19.4	19.4	19.5	19.4	116.4	
Primary (noninterest) expenditure	15.3	15.5	16.7	17.4	18.8	19.0	19.3	19.6	19.8	113.9	
Automatic debt dynamics [5/]	-1.3	-0.8	1.3	-0.6	-1.2	-1.2	-1.2	-1.2	-1.2	-6.6	
Interest rate/growth differential [6/]	-0.5	-0.9	0.5	-0.6	-1.2	-1.2	-1.2	-1.2	-1.2	-6.6	
Of which: real interest rate	1.7	1.3	2.6	1.5	1.0	0.9	0.8	0.8	0.8	5.8	
Of which: real GDP growth	-2.3	-2.2	-2.0	-2.1	-2.1	-2.1	-2.0	-2.0	-2.0	-12.4	
Exchange rate depreciation [7/]	-0.8	0.1	0.8	…	…	…	…	…	…	…	
Other identified debt-creating flows	2.1	1.4	2.0	1.4	0.9	0.7	0.5	0.4	0.3	4.3	
Privatization proceeds (negative)	0.2	0.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
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	1.8	1.4	1.5	1.4	0.9	0.7	0.5	0.4	0.3	4.2	
Residual, including asset changes [8/]	-0.9	0.0	-0.9	-0.3	-0.1	-0.1	-0.1	-0.1	0.0	-0.8	

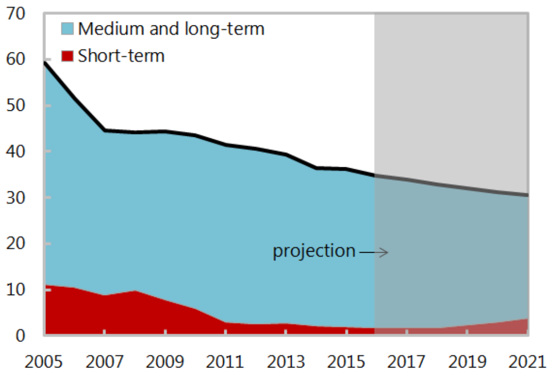


Source: IMF staff.
1/ Public sector is defined as general government.
2/ Based on available data.
3/ EMBI.
4/ Defined as interest payments divided by debt stock at the end of previous year.
5/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; 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.

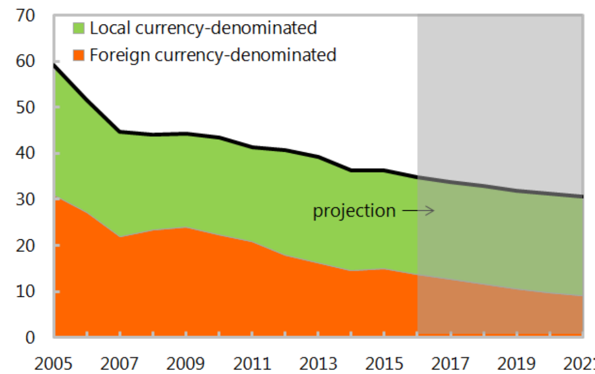
Philippines—Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



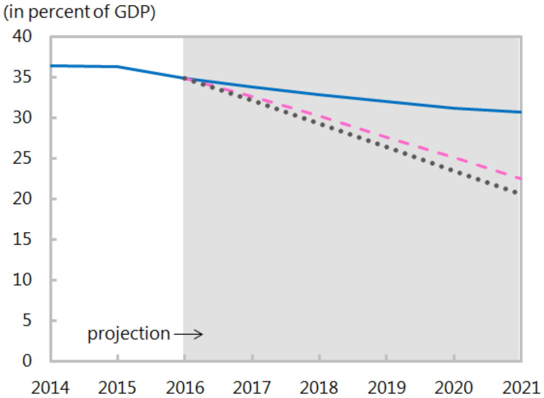
By Currency
(in percent of GDP)



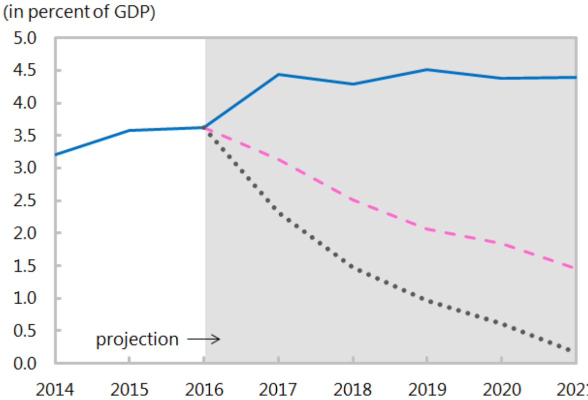
Alternative Scenarios

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)

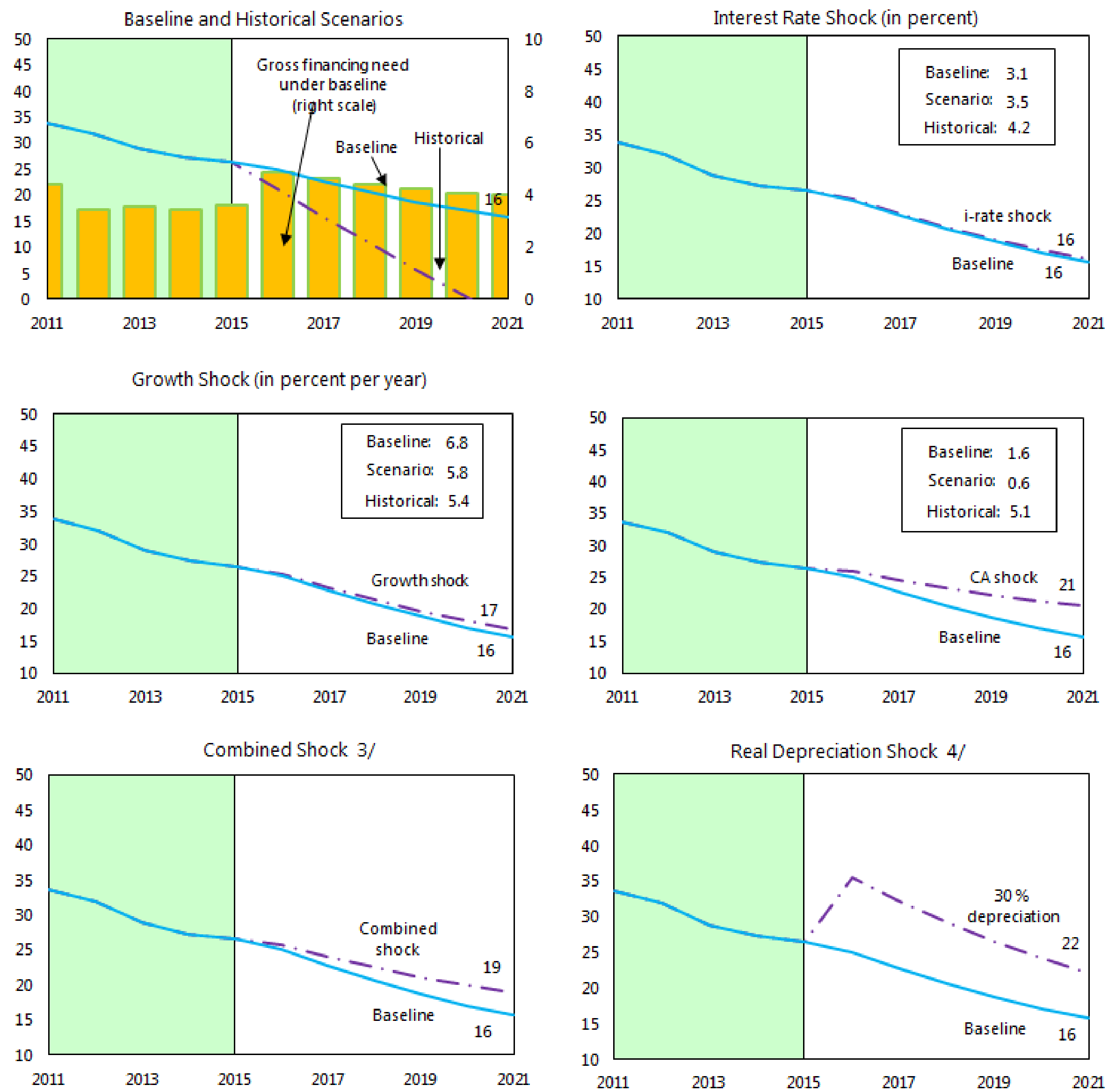
Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	6.4	6.7	6.8	6.9	7.0	7.0
Inflation	1.9	3.5	3.5	3.5	3.5	3.5
Primary Balance	1.9	0.6	0.4	0.1	-0.1	-0.4
Effective interest rate	6.6	6.7	6.6	6.6	6.5	6.5
Constant Primary Balance Scenario						
Real GDP growth	6.4	6.7	6.8	6.9	7.0	7.0
Inflation	1.9	3.5	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	6.6	6.8	6.8	6.8	6.7	6.8

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	6.4	5.4	5.4	5.4	5.4	5.4
Inflation	1.9	3.5	3.5	3.5	3.5	3.5
Primary Balance	1.9	2.8	2.8	2.8	2.8	2.8
Effective interest rate	6.6	6.8	7.0	7.1	7.1	7.2

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 the historical scenario, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

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, 2011–2021

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2011	2012	2013	2014	2015			2016	2017	2018	2019	2020	2021	Debt-stabilizing non-interest current account 6/
1 Baseline: External debt	33.7	32.0	28.9	27.3	26.5			25.1	22.7	20.6	18.8	17.1	15.7	-1.3
2 Change in external debt	-3.2	-1.7	-3.1	-1.6	-0.8			-1.4	-2.4	-2.1	-1.9	-1.7	-1.4	
3 Identified external debt-creating flows (4+8+9)	-6.8	-6.5	-6.8	-5.2	-3.4			-3.6	-3.2	-2.9	-2.5	-2.2	-1.8	
4 Current account deficit, excluding interest payments	-3.8	-4.0	-5.3	-4.8	-3.7			-2.6	-2.1	-1.7	-1.4	-1.0	-0.7	
5 Deficit in balance of goods and services	-57.2	-58.5	-53.8	-57.4	-54.8			-53.3	-50.7	-48.6	-46.4	-44.4	-42.8	
6 Exports	25.5	26.7	25.0	26.4	24.4			23.3	22.2	21.2	20.3	19.4	18.6	
7 Imports	-31.7	-31.8	-28.9	-30.9	-30.4			-30.0	-28.6	-27.3	-26.1	-25.0	-24.1	
8 Net non-debt creating capital inflows (negative)	-0.3	-0.3	0.0	-0.1	0.2			-0.2	-0.3	-0.4	-0.5	-0.5	-0.5	
9 Automatic debt dynamics 1/	-2.7	-2.2	-1.5	-0.4	0.1			-0.8	-0.8	-0.7	-0.7	-0.7	-0.6	
10 Contribution from nominal interest rate	1.3	1.2	1.1	1.0	0.9			0.8	0.7	0.6	0.6	0.5	0.4	
11 Contribution from real GDP growth	-1.2	-2.0	-2.1	-1.7	-1.6			-1.6	-1.5	-1.4	-1.3	-1.2	-1.1	
12 Contribution from price and exchange rate changes 2/	-2.8	-1.4	-0.5	0.3	0.8			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	3.6	4.8	3.7	3.6	2.6			2.2	0.9	0.8	0.7	0.5	0.4	
External debt-to-exports ratio (in percent)	132.2	119.6	115.7	103.1	108.4			107.5	102.3	97.1	92.4	88.2	84.3	
Gross external financing need (in billions of US dollars) 4/	9.9	8.7	9.7	9.7	10.6			15.1	16.3	17.2	18.4	19.9	21.7	
in percent of GDP	4.4	3.5	3.6	3.4	3.6			4.9	4.7	4.4	4.2	4.1	4.0	
Scenario with key variables at their historical averages 5/	33.7	32.0	28.9	27.3	26.5	10-Year Historical Average	10-Year Standard Deviation	21.1	15.9	10.8	5.8	0.9	-4.0	-0.5
Key Macroeconomic Assumptions Underlying Baseline														
hid Nominal GDP (US dollars)	224.1	250.1	271.8	284.8	292.5			311.7	348.6	389.5	435.9	488.0	542.9	
Real GDP growth (in percent)	3.7	6.7	7.1	6.2	5.9	5.4	2.0	6.4	6.7	6.8	6.9	7.0	7.0	
GDP deflator in US dollars (change in percent)	8.3	4.6	1.5	-1.4	-3.1	5.5	6.9	0.2	4.8	4.6	4.7	4.6	4.0	
Nominal external interest rate (in percent)	3.9	4.0	3.7	3.5	3.3	4.2	0.8	3.3	3.2	3.1	3.0	2.9	2.8	
Growth of exports (US dollar terms, in percent)	4.8	16.9	1.5	11.0	-5.1	8.3	11.7	1.7	6.4	7.0	7.0	6.8	6.9	
Growth of imports (US dollar terms, in percent)	8.2	12.0	-1.4	12.2	0.9	8.0	12.3	5.1	6.6	6.9	7.1	7.1	7.3	
Current account balance, excluding interest payments	3.8	4.0	5.3	4.8	3.7	5.1	2.0	2.6	2.1	1.7	1.4	1.0	0.7	
Net non-debt creating capital inflows	0.3	0.3	0.0	0.1	-0.2	0.7	1.4	0.2	0.3	0.4	0.5	0.5	0.5	

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.

Appendix III. Philippines—External Sector Assessment

The Philippines' external sector remains moderately stronger than warranted by fundamentals and desirable policies despite the recent decline in the current account surplus. The current account approach of the Fund's External Balance Assessment (EBA) model, adjusted by Philippines-specific factors, shows a current account balance slightly above the level implied by fundamentals and desired policies. On the other hand, staff assess the peso to be broadly in line with fundamentals and desired policies, although subject to a high degree of uncertainty. This apparent dichotomy is because the Philippines' current account surplus is determined by structural factors such as inadequate infrastructure, a weak business environment, and risks of natural disasters, which constrain private investment and lead to higher precautionary savings. Accordingly, the current account gap should decline once infrastructure is upgraded in line with the authorities' plans.

- *Current account*. The EBA model places the gap between the actual and the current account balance that is consistent with fundamentals and desired policies—the so called CAB norm—at 4.9 percent of GDP in 2015 (3 percentage points lower than in 2014). Deviations of policies from their desired levels explain 1.3 percent, with 0.4 percent due to a strong domestic fiscal stance and 0.9 percent to fiscal policy gaps in other countries. The other 3.6 percent of GDP is left unexplained by the EBA model. Philippines-specific factors such as natural disaster risks or worker remittances could explain between 2–3 percent, suggesting a current account balance modestly above its norm.[1,2]

- *Real effective exchange rate (REER).* The REER is assessed to be broadly in line with the level implied by fundamentals and desired policies. The EBA REER approaches (index and level) point to an overvaluation of the peso. On the other hand, applying an estimated elasticity to the assessed current account gap range point to an undervaluation of about 8 percent. Two key factors that are probably not well captured by such elasticity calculations are remittances and the need for a substantial ramp-up of capital goods imports to sustain a desirable increase in investment that started in 2015. Taking all of this conflicting evidence into account, staff find it appropriate to reflect the high degree of uncertainty and assess the REER broadly in line with fundamentals and desired policies.

[1] As noted in the 2014 *Philippines—Staff Report*, IMF Country Report 14/245, exposure to natural disasters is an uninsurable risk for the private sector. For the Philippines, this factor adds 1.5–2 percent of GDP to the CAB norm. Worker remittances are another important factor that drive a wedge between GDP and GNI, the latter being a better measure of income and the basis for saving-investment decisions. Using GNI instead of GDP as a measure of income in the EBA model adds another 0.5–1 percent of GDP to the CAB norm.

[2] Last year's sizeable EBA current account gap has declined due to both a smaller cyclically adjusted current account balance and a slightly larger CAB norm. At the same time, the Philippines' specific adjustments have been re-estimated and their impact is smaller than previously estimated. Therefore, the current account gap, although slightly below last year's, does not change the staff's bottom line assessment.

Table 1. External Balance Assessment: Desk Adjustments 1/

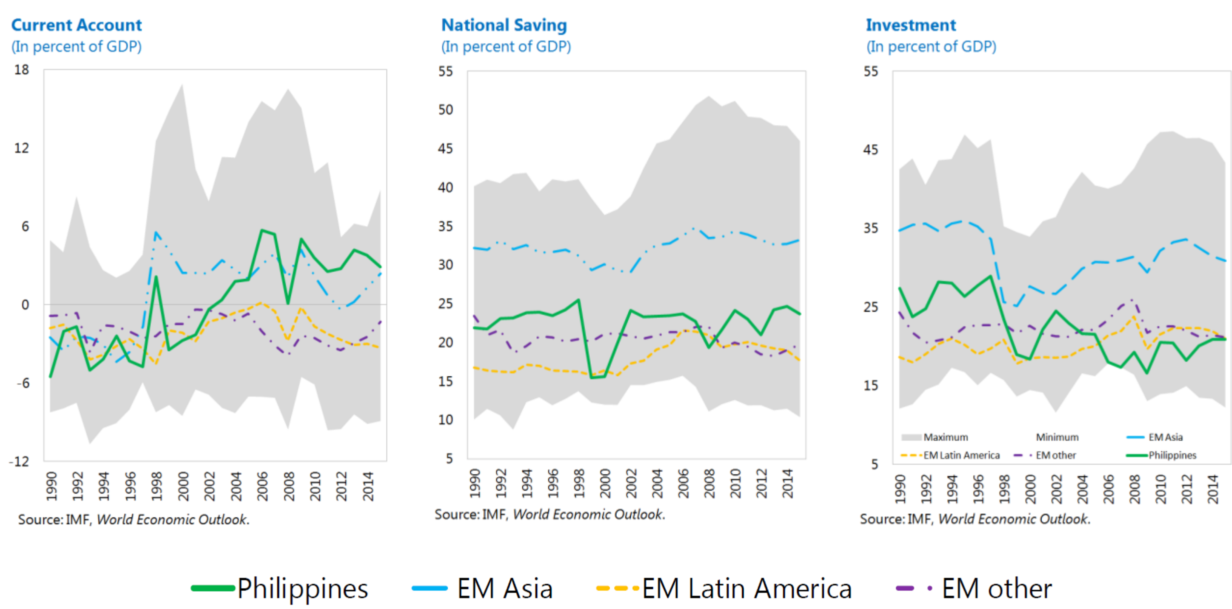
Method		Current Account Regression Approach	REER Index Regression Approach	REER Levels Regression Approach
Assessment period		2015	2015	2015
Cyclically adjusted CAB (percent of GDP)	A	3.0	--	--
EBA's CAB norm (percent of GDP)	B	-1.9	--	--
EBA's CAB gap (percent of GDP)	(A-B)	4.9	--	--
Desk Adjustments	C	2.0-3.0	--	--
Revised CAB gap (percent of GDP)	(A-B-C)	1.9-2.9	--	--
Policy gaps (percent of GDP)	D	1.3	--	--
Unexplained residual (percent of GDP)	(A-B-C-D)	0.6-1.6	--	--
REER gap (percent) 2/ 3/	E	-7.7	6.1	24.5
Of which:				
Contribution of identified policy gaps	F	-4.2	-1.0	-1.4
Unexplained residual	(E-F)	-3.5	7.1	25.9

Source: IMF staff estimates.

1/ Based on the EBA update of June 2016.
2/ A positive REER gap indicates overvaluation.
3/ The value for the current account regression approach corresponds to the average of the revised CAB gap (A-B-C), divided by the elasticity of the current account balance with respect to the REER, estimated at -0.31 using autoregressive distributed lag (ADL) model.

- *Addressing imbalances:* The Philippines' current account surplus reflects its low level of investment compared with other EMEs. Raising investment and thus boosting potential growth, by improving the business environment and infrastructure, would help reduce external imbalances going forward, without necessarily adjusting the exchange rate.

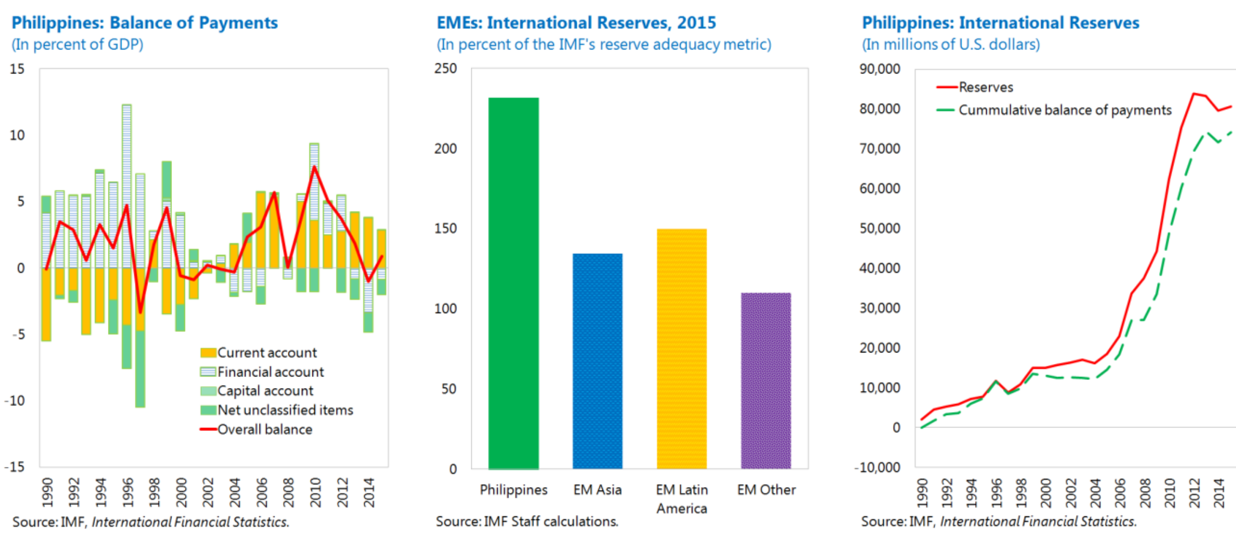
Figure 1. Saving Investment Gap, Median Emerging Market Economy by Region



- *International reserves.* The Philippines continues to have ample reserves, which stood at 229 percent of the Fund's reserve adequacy metric in 2015. While the level of reserves is above the RA metric, it is broadly justified by the vulnerability to natural disasters and capital flow volatility. Staff agrees with the BSP that the exchange rate should continue to be allowed to move freely in line with market forces with intervention limited to smoothing excessive volatility in both directions.

- *Size and importance of capital flows.* During the post global financial crisis years, the Philippines received sizeable foreign exchange inflows, both from remittances and portfolio investment, resulting in a build-up of reserves. Going forward, steady portfolio outflows are expected to continue, and gross reserves are projected to increase modestly over the medium term. The opening up of the economy may see a rise in foreign direct investment but be accompanied by higher imports of capital goods, particularly in the staff's recommended scenario.

Figure 2. Philippines: Balance of Payments and International Reserves



INTERNATIONAL MONETARY FUND

PHILIPPINES

August 26, 2016

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | Asia and Pacific Department

CONTENTS

FUND RELATIONS

(As of July 31, 2016)

Membership Status: Joined December 27, 1945; Article VIII

General Resources Account

	SDR Millions	Percent of Quota
Quota	2,042.90	100.00
IMF holdings of currency (holdings rate)	1,773.51	86.81
Reserve tranche position	269.44	13.19
Lending to the Fund New Arrangements to Borrow	51.70	

SDR Department

	SDR Millions	Percent of Allocation
Net cumulative allocation	837.96	100.00
Holdings	846.46	101.01

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 ng Pilipinas (BSP) 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 2015 Article IV consultation was held on August 26, 2015 (IMF Country Report No. 15/246).

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 and the report was published in June 2015 (IMF Country Report No. 15/156).

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.

FAD has concluded a five-year TA project financed by the Millennium Challenge Corporation to improve the basic functions of tax administration by the Bureau of Internal Revenue (BIR) (2011–16), in line with recommendations made by FAD TA missions in 2005, 2008, and 2009. The project provides for a resident tax administration advisor and an extensive program of short-term expert visits. In the extended project (2013–16) the main priorities were intended to "institutionalize" the new procedures implemented in the arrears management and VAT audit pilots, enhance the compliance improvement strategy (CIS), integrate redesigned business process with eTIS, and introduce further institutional, governance and management strengthening to help ensure sustainability of the reforms. Particular progress has been made in VAT audit, arrears management and compliance improvement strategy. In addition, TADAT assessment took place in December 2015 to provide a picture of the current state of operations within the BIR against international good practice in tax administration. A tax policy TA in April 2016 made a comprehensive proposal of tax reform in the ASEAN environment. FAD's past 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 and publication of tax expenditures to improve transparency and accountability of tax incentives supported by the Tax Investment and Management Act (TIMTA). TA on public financial management (PFM) seeks to establish effective and efficient budget and treasury management. In addition to the Fiscal Transparency Evaluation, TA on medium-term budget framework, government cash management, formulation and drafting of the PFM bill, and contingent liabilities management took place in 2014−2016. 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. Moreover, the PFM bill has been submitted to the Congress.

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 provided a series of TA in 2010−15 on developing and implementing a risk-focused supervisory approach in keeping with the Basel Core Principles and other key international supervisory practices and on timely identification and resolution of problem institutions. Among the long list achievements are: improved quality and timeliness of supervisory actions and related supervisory reports; issuance of new regulations covering securities investments and stress testing; and selected areas of Basel III implementation including liquidity coverage ratio and leverage ratios. MCM TA efforts were also devoted to the implementation of the supervisory core training initiative. The in-house training initiative is now self-sustaining, with 21 courses rolled out, and the quality of the supervisory reports has shown considerable improvement. Finally, two missions in 2015 and 2016 assessed the institutional needs for strengthening the framework for financial stability analysis and provided a road map for a comprehensive financial stability framework, focusing on the institutional setup, monitoring and tools, and crisis management.

In addition, three MCM TA missions on liquidity management and forecasting and on the implementation of an interest rate corridor took place 2013−2015 to strengthen monetary policy operational framework. The BSP has made progress on developing its liquidity forecast capacity, and the new interest rate corridor system was introduced in June 2016.

Other areas of MCM TA included advice on financial market development. A workshop on the deepening of government securities market was held in 2014, and TA on exchange consolidation and securities regulation was delivered in 2015.

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. In late 2014, a TA mission worked with the Philippine Statistics Authority (PSA) on source data and compilation procedures of quarterly accounts, and the implementation of the new System of National Accounts 2008 (2008 SNA).

Two MFS missions were fielded in August 2014 and September 2015 to advance the work on the introduction of the standardized report form (SRF) for other financial corporations (OFCs). The authorities have submitted test SRF-data for several types of OFCs, which have been reviewed by STA. It is expected that the SRF will be introduced by end-2016.

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 June 30, 2016)

Background

The Bank and the Fund country teams for the Philippines exchanged views to coordinate the teams' work during 2016–17 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) financial sector development. Table 1 details the specific activities planned by the two country teams during June 2016-June 2017, 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 to 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 involves close coordination in tax policy reform including fiscal incentives rationalization and monitoring of the sin tax implementation; management of fiscal risks and reporting; debt management strategy; assisting the Department of Budget and Management in improving public financial management and support for the Bureau of Treasury's lead role in implementation of a Single Treasury Account (TSA) and cash management.

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 and resolution. The Bank has taken the lead in the nonbank financial sector and crisis simulations. Joint areas of interest are banking sector soundness and resolution, financial inclusion 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 budget reform, tax policy and administration, financial sector development and soundness 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, June 2016-June 2017

	Products	Expected Delivery Date
Bank Work Program	• Mindanao jobs report • Philippine Economic Update • Programmatic policy analysis and implementation support for inclusive growth. • Tax policy notes • Technical support for discussions on TIMTA • Programmatic support on improving statistics, including support to the new Philippine Statistics Authority and the Securities and Exchange Commission • Implementation of policy reforms to enhance quality and quantity of public infrastructure spending particularly tracking of expenditures through use of Unified Account Code Structure (UACS) • Transition notes • Game changers for inclusive growth: an agenda for action • Report on the Observance of Standards and Codes, Accounting and Auditing (A&A ROSC) • Programmatic Public Sector Governance Program, including program spending assessments, a report on open government and program performance tracking and a report on Open Roads and an Open Roads platform • Supporting the development of a National Competition Policy • Local governance and accountability technical assistance • PFM project based on PEFA assessment • Financial development and inclusion • Development Policy Lending Series - DPL 4 and new series	• Ongoing • Semi-annually • Completed in June 2016 • Completed in June 2016 • Ongoing • Ongoing • Ongoing • Completed in July 2016 • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing
Fund Work Program	• Article IV consultation with a focus on the medium term challenges of supporting a well managed rise in investment and a more inclusive growth. • Article IV staff report • Public financial management (cash management, transparency and budget execution) TA • Tax policy TA • Banking supervision and bank resolution TA • Liquidity management and forecasting TA • Implementation of an interest rate corridor TA • Financial stability framework TA • Statistical data compilation and dissemination TA	• June/July 2016 • August 2016 • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing
Joint Work Program	• Joint tax policy note for the new administration • Management of Fiscal Risk and GOCC/PPPs • DoF-BTr Debt Management Strategy • Implementation of PFM reforms related to Fiscal Transparency Evaluation of Fund and PEFA assessment update led by Bank. • Review of tax policy notes by the Bank and update of recommendations by the Fund focused on financial sector taxes and related to ASEAN Economic Community 2016. • Macro-fiscal simulations of scaling up public investment and public investment management (PIM) institution reforms	• August 2016 • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing

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) PIM reforms and PPPs (WB/IMF) Debt Management(World Bank/IMF)	
Financial sector		Bank supervision and Financial Stability Framework (IMF) Banking sector soundness and resolution (IMF/WB) PDIC (WB) Contingency Framework (IMF/WB) Capital market development (IMF/WB) International coordination to limit regulatory arbitrage (IMF) Financial Inclusion (IMF/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 ASIAN DEVELOPMENT BANK

(As of June 30, 2016)

Since joining the Asian Development Bank (ADB) in 1966, the Philippines has received 237 sovereign loans and grants financed by ADB Special Funds for a total of $15,911.12 million including nonsovereign financing amounting to $995.37 million. Agriculture and natural resources, public sector management, energy, and finance sector account for the largest proportion of ADB lending (combined 60 percent of the total) (Table 2). As of 30 June 2016, cumulative direct value-added cofinancing for the Philippines amounted to $1.4 billion and $90.21 million for TA projects.

Table 2. Cumulative Sovereign and Nonsovereign ADB Lending to Philippines
(As of June 30, 2016)

Sector	No. of Loans	Amount of Loans (US$ millions)	Percent (by amount)
Energy	33	2,136.7	12.6
Public sector management	13	2,802.0	16.5
Agriculture and natural resources	60	3,128.1	18.4
Transport and ICT	31	1,584.7	9.3
Finance	35	1,993.9	11.7
Multisector	8	916.6	5.4
Water and other municipal infrastructure and services	29	1,685.6	9.9
Health and social protection	7	648.7	3.8
Education	11	1,320.5	7.8
Industry and trade	12	792.2	4.7
Total	239	17,009.9	100.0

ADB's private sector operations in the Philippines began in 1986. As of June 30, 2016, cumulative approvals in 30 projects amounted to $1,109 million. ADB's private sector operations in the Philippines include financing for power plants, roads, and air transport, and investments in banks and private equity funds. In December 2014, ADB approved a $75 million (₱3.375 billion) loan for the expansion and renovation of the Mactan Cebu Airport terminal (the first large-scale PPP project awarded under the Aquino government's PPP program). Another two loans were approved in 2015 for $20 million to support the 150-Megawatt Burgos Wind Farm Project, and for $221.807 million to support the Tiwi and Makban Geothermal Power Green Bonds project.

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. A CPS Final Review was completed in June 2016 and sent for validation to Independent Evaluation Department. The results will inform the next CPS 2017−2022. The Country Operations Business Plan (COBP) 2016–2018, the fifth under the CPS 2011–2016, was approved in December 2015. The next COBP 2017-2019 is expected for ADB Management approval by September 2016.

STATISTICAL ISSUES

(As of August 2, 2016)

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 of 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. National accounts are expected to be revised in the near future based on the recently released 2012 Census of Philippine Business and Industry (CPBI). **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: The BSP has completed the final-stage implementation of BOP compilation to BPM6 framework in March 2014. The compilation of IIP data based on BPM6 framework was completed in September 2014. 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. A joint effort between the Insurance Commission, SEC, GOCs, BSP to gather data and publish the Other Financial Corporation's Survey is ongoing.
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 July 25, 2016)

	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]	Memo Items: Data Quality—Accuracy and Reliability[9]
Exchange rates	7/25/2016	7/25/2016	D	D	D	O	O
International reserve assets and reserve liabilities of the monetary authorities[1]	6/2016	7/2016	M	M	M	LO	LO
Reserve/base money	6/11/2016	7/11/2016	D	W	W	O, LO, LO, LNO	LO, O, O, O, LO
Broad money	5/2016	7/2016	M	M	M		
Central bank balance sheet	3/2016	7/2016	M	M	M		
Consolidated balance sheet of the banking system[2]	5/2016	7/2016	M	M	M		
Interest rates[3]	6/30/2016	6/30/2016	D	D	D	O	O
Consumer price index	6/2016	7/2016	M	M	M	O, O, O, O	O, LO, O, LO, LO
Revenue, expenditure, balance and composition of financing[4]—general government[4]	2015	7/2016	Q	Q	Q	LO, LO, O, O	LO, LO, LO, LO, LO
Revenue, expenditure, balance and composition of financing[4]—central government	4/2016	7/2016	M	M	M		
Stocks of central government and central government-guaranteed debt[5]	4/2016	7/2016	M	M	M	LNO	LNO
External current account balance	3/2016	6/2016	M	M	M	O, LO, LO, LO	LNO, LO, O, LO, LO
Exports and imports of goods and services	3/2016	6/2016	M	M	M		
GDP/GNP	Q1:2016	6/2016	Q	Q	Q	LO, LO, O, LO	LNO, LNO, O, LO, O
Gross external debt	Q1:2016	6/2016	Q	Q	Q	O	O
International investment position[6]	Q1:2016	6/2016	Q	Q	Q	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] Foreign, domestic bank, and domestic nonbank financing

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

[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.

Statement by Mr. Marzunisham Omar, Executive Director and Mr. Thomas Benjamin Marcelo, Senior Advisor to the Executive Director
September 14, 2016

1. The Philippine authorities appreciate the constructive policy dialogue and useful insights shared by staff during the 2016 Article IV Consultation. The discussions focused on the policy priorities of the new administration, particularly on macroeconomic policies and structural reforms to sustain the strong growth and enhance its inclusiveness. The authorities welcome staff's assessment that sound macroeconomic policies have delivered solid economic growth and the challenge now is to make more people benefit from this growth through a durable reduction in poverty. The authorities broadly concur with staff assessment and key recommendations and would like to provide the following updates on recent economic developments and policies.

Recent Economic Developments and Outlook

2. The Philippine economy sustained its resilience and continued to grow strongly amid a still challenging global economic environment after posting real GDP growth of 7.0 percent in the second quarter of 2016, one of the fastest growth in the Asian region. The favorable growth performance was supported by continued robust private demand, strong investment, and increased government spending, particularly for infrastructure development. However, the agriculture sector contracted due to the lingering effects of El Niño. External demand remained weak, as exports of goods and services continued to slow down, despite the double digit growth of services exports.

3. The inflation environment over the past years has remained relatively benign in the context of low global commodity prices and favorable domestic food supply conditions. Meanwhile, the sound and stable banking system and robust external sector dynamics continue to provide solid support to the Philippine economy.

4. The authorities view the following as key risks to the outlook: (a) divergence in monetary policies in the advanced economies, which may raise near term financial market volatility; (b) lower oil prices, which may lead oil exporters to cut back on spending and capital expenditures with the impact on remittances; and (c) weather-related disruptions. The authorities welcome staff's view that the Philippines is well-equipped to deal with these challenges, should these materialize, given the country's strong fundamentals and ample policy space.

5. The authorities target a GDP growth of 6.0–7.0 percent in 2016. The smooth political transition and assurance of macroeconomic policy consistency and continuity by the new administration will likely keep business and consumer confidence strong to meet the full-year target. Over the medium term, the authorities are aiming for a steady acceleration of growth towards 7.0 to 8.0 percent to enable a durable reduction in poverty. The new administration will maintain sound macroeconomic policies, accelerate infrastructure spending, invest heavily in human capital development, and promote regional and rural development.

Macroeconomic Policies and Structural Reforms

Fiscal Policy

6. The authorities agree with staff's recommendation that fiscal policy should focus on accelerating infrastructure investment and higher and well-targeted social spending to promote more inclusive growth. The authorities have increased the annual fiscal deficit target from 2.0 percent of GDP in 2016 to 3.0 percent of GDP for 2017 until 2022 to allow for higher spending on infrastructure, agriculture and rural development, and social services with due regard to preserving debt sustainability. The proposed national budget for 2017 amounts to PhP3.35 trillion, 11.6 percent higher than the budget for 2015 and corresponds to 21 percent of GDP (2016: 19.5 percent of GDP). The country's total infrastructure spending for 2017 will increase to 5.4 percent of GDP (2016: 5.1 percent of GDP). The proposed budget allocation for infrastructure spending has been increased by 13.8 percent to fund transport infrastructure construction and rehabilitation of school buildings, and establishment of flood control systems. The proposed budget allocation for social spending has been significantly increased by 20.1 percent to support education and skills development programs, health care, socialized housing and resettlement, as well as the conditional cash transfer program.

7. As part of the new administration's reform agenda, the Department of Finance will be proposing to Congress a package of reform measures that includes lowering personal and corporate income taxes and simplifying tax processes. The revenue erosion from the lowering of income tax rates would be offset by reform initiatives that include broadening the tax base and collection, reviewing fiscal incentives, adjusting the fuel excise tax rates, imposing taxes on unhealthy food items, and eliminating some VAT exemptions. With these reform measures, the authorities aim to increase total revenue effort to about 17 percent of GDP in 2018 (2015: 15.9 percent of GDP) and about 18 percent of GDP by 2022.

8. The revenue measures will also help in further reducing the national government's outstanding debt to 40.9 percent of GDP in 2017 (2016: 42.7 percent of GDP) and place the debt-to-GDP ratio on a downward trajectory in the medium term. The authorities will continue to strengthen the resilience of the country's debt profile by maintaining a bias for domestic borrowings while optimizing available concessional loans from development partners.

9. The authorities' overall strategy for infrastructure development is to increase infrastructure spending to 6.0 to 7.0 percent of GDP during the period 2017–2022 to attain higher growth potential in the medium term. In support of this, the authorities have initiated reforms in investment programming and budgeting. A three-year rolling infrastructure program in the national budget starting 2017 was reinstituted, assuring fund allocation for well-developed and readily-implementable projects for three years. The process of investment programming is being streamlined through online submission and updating of priority programs and projects. The authorities are also working to speed up the appraisal and approval process for major capital projects while still ensuring the quality of infrastructure projects. The authorities are supporting amendments to the procurement law to simplify and streamline the process, delineating delivery responsibilities between national and local projects, and improving the absorptive capacity of government agencies through better planning and project execution.

10. In addition to public infrastructure investments, the revitalized public-private partnership (PPP) program will accelerate the roll out of infrastructure projects. While there is a solid pipeline of PPP projects that has keen investor support, the authorities are open to unsolicited proposals from the private sector.

11. Significant progress continues to be made on fiscal structural reforms, with the passage of laws on tax incentives management and transparency and customs modernization. To fast track infrastructure investment and PPPs, a law was amended to facilitate the acquisition of right-of-way site for national government infrastructure projects. The authorities are also supporting the passage of laws on government streamlining, budget reform (earlier supported by IMF technical assistance), and amendments to the law on build- operate-transfer schemes.

Monetary Policy

12. Monetary policy will remain focused on achieving the inflation target of 2.0–4.0 percent for 2017–2018. The authorities welcome staff's view that the current monetary policy stance remain appropriate. The authorities continue to see a manageable inflation outlook over the policy horizon. Latest forecasts continue to indicate that average inflation is likely to settle slightly below the 3.0 percent ± 1.0 percentage point target range in 2016 and rise toward the mid-point of the target range in 2017 and 2018. Inflation expectations also remain well-anchored within the inflation target band over 2017–2018 while the risks to future inflation appear to be broadly balanced.

13. The benign inflation environment also provided flexibility for the Bangko Sentral ng Pilipinas (BSP) to shift to an interest rate corridor system and implement key reforms in its monetary operations in June 2016 to further improve the transmission of monetary policy. The changes to the system for monetary operations involved: (a) modification of the RRP facility into an overnight facility; (b) introduction of the auction-based term deposit facility; (c) and conversion of standing facilities (repurchase and special deposit account windows) to overnight liquidity facilities. The BSP's main policy rate will continue to be the overnight RRP rate. Over time, the implementation of the interest rate corridor will allow for possible reduction in reserve requirements in line with international norms.

14. The authorities continue to maintain a market-based exchange rate policy, with scope for occasional presence to maintain orderly conditions in the foreign exchange market. In addition, the BSP has continued to further liberalize the foreign exchange regulatory framework, as part of continuing efforts to keep regulations appropriate for the changing needs of the Philippine economy and following the thrust towards greater openness in view of the country's increasing integration with global markets.

Financial Sector Policy

15. The Philippine financial system remained stable and resilient despite bouts of external volatility. The banking system is sound, underpinned by a continued increase in assets, lending, and deposits, and with capital adequacy ratios comfortably above the BSP's prescribed levels and international norms. The authorities continued to undertake supervisory and regulatory reforms to further ensure the continued soundness and stability of the financial system. On

enhancing financial stability, the recent policy measures and initiatives include: (a) amendment of the Philippine Deposit Insurance Corporation charter to enhance the liquidation and resolution framework for banks; (b) issuance of guidelines on operational risk management; (c) adoption of Basel III liquidity coverage ratio requirements; and (d) launching of new residential real estate price indices to assess the Philippines' real estate and credit market conditions. The authorities are prioritizing amendments to the BSP charter, Deposit Secrecy Law and Anti-Money Laundering Act, as well as supporting the passage of the Payments Systems Act and an expanded Islamic banking law.

16. To further develop the banking industry, the authorities approved the phased lifting of restrictions on the establishment of new banks. To support financial deepening, the authorities issued new guidelines on the creation of the personal management trust for estate planning and/or asset management of trust entities. To develop the capital markets, reforms focused on providing flexibility in raising foreign capital and encouraging more foreign investors to invest in the country. To support the financing of priority investments, the authorities approved amendments to rationalize lending rules to regulated parties. An agricultural value chain financing framework was also issued to address the associated credit risks with the agriculture and fisheries sector.

17. To further advance the financial inclusion agenda, a National Financial Inclusion Steering Committee was institutionalized by executive order to be the governing body providing strategic direction, guidance and oversight in the implementation of the National Strategy for Financial Inclusion. The Credit Surety Fund (CSF) Cooperative Act was passed and institutionalized the CSF program initiated by the BSP in 2008 to help micro, small and medium enterprises gain access to formal sources of credit. A law was also passed recognizing and regulating non-government organizations engaged in microfinance.

Structural Reforms

18. The authorities recognize the challenge to make the strong economic growth more sustainable and inclusive. Over the medium term, the authorities are setting a growth target of 7.0 to 8.0 percent and a reduction in poverty incidence from 26.3 percent in the first semester of 2015 to 17 percent by 2022. This will be supported by a comprehensive and accelerated structural reform agenda.

19. The structural reform priorities include strengthening institutions, reducing the cost of doing business, easing restriction on foreign investments, and strengthening agro-industrial linkages. Government processes are being reviewed to further cut red tape. A dozen government agencies have already been placed under a single leadership to streamline and enhance the anti-poverty programs of the government. An executive order was issued on freedom of information to promote greater transparency in the Executive Branch. A one-stop shop service for overseas Filipino workers was recently launched to ensure that government frontline services are made more accessible to Filipinos who are currently working or planning to work overseas. The authorities have likewise requested Congress to grant the President emergency powers to solve traffic and congestion problems in Metro Manila and other parts of the country.

20. The authorities are also committed to push for constitutional amendments to lift restrictive economic provisions to encourage greater foreign investments as well as to adopt a federal form of government to promote decentralization and regional development.

21. The authorities also continued to demonstrate strong commitment and ability to deliver on its structural reform agenda with the passage of several key legislations in 2015 and 2016, in order to boost productivity and competitiveness, such as the competition law and amendments to the cabotage law. On promoting employment generation and protection, new laws were introduced on job search assistance, overseas worker welfare administration, and labor dispute settlement. On supporting trade, laws were introduced on Halal products, anti-smuggling of agricultural products, and funding support for agriculture competitiveness. On education, laws were introduced on entrepreneurship and financial education among young Filipinos and college scholarships, grants-in-aid, and low-cost educational loans to poor students. On improving governance and strengthening of institutions, several laws established branches of the Regional Trial Court to speed up the resolution of cases. A law established the Department of Information and Communications Technology (DICT), which will focus on ICT matters including internet speed and online or electronic-related crimes. On disaster risk reduction and climate change adaptation, a law provides for funding support to modernize the national weather agency.

22. The authorities are also supporting the passage in 2016 and 2017 of the following legislative measures: (a) law on freedom of information to mandate the disclosure of public documents; (b) law on pension reform for uniformed personnel; (c) amendments to the bank secrecy law to strengthen efforts to curb tax evasion; and (d) amendments to the law on anti-money laundering to include casino operators in the coverage of the law and also make tax evasion a predicate crime.

23. The authorities, after broad consultations, have also developed AmBisyon Natin 2040, the long-term vision of the Philippines and will make this an anchor for development planning across administrations, thereby ensuring sustainability of development initiatives. The authorities have also initiated the groundwork for formulating the Philippine Development Plan 2017-2022 taking into account the new administration's socio-economic development agenda and long-term vision.

Final Remarks

24. The Philippines remains committed to continue implementing sound macroeconomic policies and wide-ranging structural reforms to support the strong and sustained growth of the economy and enable a durable reduction in unemployment and poverty. The authorities appreciate the Fund's support through training as well as technical assistance, particularly in fiscal and monetary policies, public financial management, financial stability, and macroeconomic and financial statistics. In this regard, the authorities continue to count on the Fund's support through policy advice and capacity building, tailored to the Philippines' specific needs and conditions.