IMF Country Report No. 15/246

PHILIPPINES

September 2015

2015 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 2015 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 August 26, 2015 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 August 26, 2015, following discussions that ended on May 26, 2015, 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 July 24, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Philippines.

The documents listed below have been or will be separately released.

Selected Issues

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.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

Press Release No. 15/401
FOR IMMEDIATE RELEASE
September 4, 2015

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

IMF Executive Board Concludes 2015 Article IV Consultation with Philippines

On August 26, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Philippines.[1]

The Philippine economy continues to expand strongly in line with potential growth. Real GDP grew by 6.1 percent in 2014, driven by household consumption, private construction, and exports of goods and services. Economic growth slowed in the first quarter of 2015, due mainly to temporary factors, including the effects of dry weather on agricultural production, weak global demand for exports, and slow budget execution. Inflation fell below the bottom of the BSP’s target band (3±1 percent) in June 2015, led by lower fuel and food prices. As the economy is growing broadly at potential, there is no evidence of price or wage pressures, and considerable slack in the labor market remains. The current dry weather associated with El Niño conditions has not yet resulted in higher inflation. The external and fiscal positions are strong, with a 2014 current account surplus of 4.4 percent of GDP, gross international reserves of $79.5 billion (or 406.5 percent of short-term debt by residual maturity), a national government fiscal deficit of 0.6 percent of GDP, and general government debt at 36.4 percent of GDP.

The outlook for the Philippine economy remains favorable despite uneven and generally weaker global growth prospects. Real GDP is projected to grow by 6.2 percent in 2015, as lower commodity prices lift household consumption and improved budget execution raises public spending. Lower fuel prices, partly offset by somewhat higher food prices due to assumed moderate El Niño conditions, should help keep inflation in the bottom half of the BSP’s target band. The current account surplus is expected to rise in 2015 due to lower oil prices and continued inflows from business process outsourcing and remittances. Fiscal policy is expected to remain prudent. Risks to the outlook are tilted to the downside. The Philippine authorities are

[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.

well equipped to respond as needed with suitable policies should any risks materialize, particularly given the strong fundamentals and ample policy space.

Executive Board Assessment[2]

Executive Directors commended the Philippine authorities for their prudent macroeconomic management, which has delivered strong outcomes and has set the stage for favorable growth prospects despite external headwinds. Looking ahead, Directors encouraged continued vigilance in managing risks, and supported the authorities' focus on infrastructure investment, structural reforms, and on improving living conditions and achieving more inclusive growth.

Directors welcomed the government's plan to step up infrastructure investment and social spending, and return to the medium term fiscal deficit target of 2 percent of GDP. They noted that the planned increase in public expenditure in 2015 is appropriate from both cyclical and development perspectives, given the current low inflation, large infrastructure and social needs, and low and declining public debt. Directors also encouraged further efforts to strengthen public financial management and budget execution, and to mobilize revenue to meet the large social and infrastructure needs.

Directors considered the current monetary policy stance as appropriate in view of the low inflation, moderating and more balanced credit growth, and moderating—albeit still robust—economic activity. They encouraged continued vigilance, in particular if inflation or credit growth were to accelerate with signs of potential overheating. Directors supported the central bank's plan to implement an interest rate corridor to improve monetary policy transmission, and encouraged the passage of the central bank charter that would authorize the issuance of central bank bills and increase minimum capital. Directors also emphasized continued exchange rate flexibility, with participation limited to smoothing excessive volatility.

Directors noted that the financial system remains sound. They welcomed the use of targeted prudential policies to limit financial excesses and strengthen resilience, and noted that more stringent prudential regulations may be needed should any systemic risks become apparent. Directors encouraged the passage of the draft law that broadens the central bank's financial stability mandate, and welcomed the central bank's efforts to enhance access to information on conglomerates' finances.

Directors supported the authorities' medium term priorities that would allow the country to reap the dividends from its young and growing population. These priorities should include raising infrastructure spending, facilitating public private partnerships, improving the business climate, and enhancing human capital and social services for the poor. Directors also welcomed the focus

---

[2] At the conclusion of the discussion, the Deputy 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.

on financial deepening and inclusion as essential elements of the authorities' inclusive growth strategy. They noted that alternative means of financing and hedging, such as bond and equity markets, could help finance large infrastructure needs. Directors welcomed the recent release of the national strategy for financial inclusion.

Philippines: Selected Economic Indicators, 2010–16

	2010	2011	2012	2013	2014	2015	2016
						Staff proj.	
GDP and prices (percent change)							
Real GDP	7.6	3.7	6.7	7.1	6.1	6.2	6.5
CPI (annual average)	3.8	4.7	3.2	2.9	4.2	2.1	3.5
CPI (end year)	3.6	4.2	3.0	4.1	2.7	3.4	2.7
Investment and saving (percent of GDP)							
Gross investment	20.5	20.5	18.2	20.0	20.9	22.0	22.3
National saving	24.1	23.0	21.0	24.2	25.4	27.1	26.7
Public finances (percent of GDP)							
National government balance (authorities' definition)	-3.5	-2.0	-2.3	-1.4	-0.6	-1.5	-2.0
National government balance 1/	-3.6	-2.1	-2.4	-1.5	-0.6	-1.5	-2.0
Nonfinancial public sector balance 2/	-3.3	-0.8	-0.6	0.6	0.9	0.0	-0.5
Revenue and grants	18.5	18.6	19.4	20.1	20.1	20.6	20.7
Expenditure	21.7	19.4	20.0	19.5	19.2	20.6	21.2
Nonfinancial public sector debt	54.8	55.3	53.0	51.3	47.8	45.5	42.5
Monetary sector (percent change, end of period)							
Broad money (M3) 3/	10.0	7.1	9.4	31.8	11.2	9.3	...
Interest rate (91-day treasury bill, end of period, in percent) 4/	1.3	1.7	0.5	0.5	2.5	2.1	...
Credit to the private sector (in percent) 3/	8.9	19.3	16.2	16.4	19.9	14.5	...
External sector							
Export value, goods (percent change)	26.2	4.1	21.2	-4.0	7.3	3.5	5.5
Import value, goods (percent change)	24.7	9.5	11.3	-4.8	2.3	1.6	7.1
Current account (percent of GDP)	3.6	2.5	2.8	4.2	4.4	5.0	4.5
Capital account (US$ billions)	0.1	0.2	0.1	0.1	0.1	0.1	0.1
Financial account (US$ billions) 5/	-11.5	-5.3	-6.8	2.2	10.1	7.1	6.1
Direct investment (net) 5/	1.6	0.3	1.0	-0.1	0.8	0.0	-0.7
Errors and omissions (US$ billions)	-3.5	0.3	-4.6	-4.2	-5.5	-5.2	-4.9
Overall balance (US$ billions)	15.2	11.4	9.2	5.1	-2.9	3.1	4.3
Total external debt (percent of GDP) 6/	36.9	33.7	32.0	28.9	27.3	25.6	23.1
Debt service ratio 7/	13.6	13.6	9.9	11.1	8.7	7.8	10.6
Reserves(US$ billions)	62.4	75.3	83.8	83.2	79.5	81.7	84.5
Reserves/short-term liabilities 8/	403.3	482.5	397.9	405.5	406.5	361.2	366.8
Exchange rate (period averages)							
Pesos per U.S. dollar 9/	45.1	43.3	42.2	42.4	44.4	44.5	n.a.
Nominal effective exchange rate (2005 =100) 9/	100.0	99.0	102.6	105.4	102.7	109.6	n.a.
Real effective exchange rate (2005 =100) 9/	100.0	100.7	105.6	109.8	109.5	117.9	n.a.

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, May 2015 (year-on-year).

4/ Secondary market rate, the latest data point is May 2015.

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/ Data for 2015 corresponds to January - May.

INTERNATIONAL MONETARY FUND

PHILIPPINES

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

July 24, 2015

KEY ISSUES

Context: The Philippine economy is expected to grow in line with potential, at around 6½ percent per annum. Inflation is projected to remain within the BSP's target band (3±1 percent). The external position is strong and fiscal policy is prudent, with a declining public debt ratio. Its small, bank-centric financial system has strong buffers, and risks associated with bank-corporate-real estate linkages are currently contained.

Poor infrastructure has constrained private investment and job creation. Public investment continues to be low due to weak implementation capacity despite an increase in the investment budget and progress on fiscal transparency. Investment in human capital has been raised but needs to be stepped up. Financial development and inclusion, as well as structural reforms to foster competition and diversification, are essential for inclusive growth.

Risks: Tilted to the downside; tighter global financial conditions and a surge in financial volatility leading to sharp capital outflows; continuing weak budget execution; and severe El Niño conditions.

Macrofinancial linkages: This consultation aimed at enhancing macrofinancial surveillance, with a focus on balancing the need for financial deepening and inclusion against the need to safeguard financial stability, through the following:

- Analysis of global spillovers onto real and financial variables, corporate sector vulnerabilities, and corporate-real estate linkages.
- Analysis of real and financial cycles and their interrelations.
- Integration of the depository corporations survey into the macro framework.
- Modeling the impact of alternative public investment funding on interest rates and the economy.
- A framework for financial development and inclusion.

Policy recommendations:

- Fiscal policy should focus on improving social services and infrastructure quality. Additional revenue is needed to scale up public investment and social spending while ensuring debt sustainability.
- Monetary policy should continue to focus on price stability and avoiding excessive credit growth.
- Macroprudential policy should continue to guard against systemic risks to financial stability, including in specific sectors.
- Structural reforms and financial deepening will be critical to benefit from the demographic dividend and to make growth more inclusive.

Approved By
Hoe Ee Khor and Mary Goodman

Mission dates: May 14–26, 2015
Staff team: Chikahisa Sumi (Head), Clinton Shiells, Jaime Guajardo, Rui Mano (all APD), Takuji Komatsuzaki (FAD), Bradley Jones (MCM), and Shanaka Peiris (Resident Representative). Hoe Ee Khor (APD) joined the second half of the mission. Marzunisham Omar (Executive Director) and Thomas Marcelo (Senior Advisor to the Executive Director) joined some of the meetings.

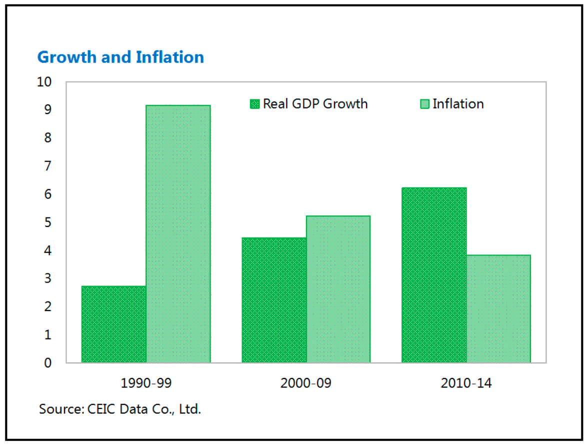
CONTENTS

TABLES

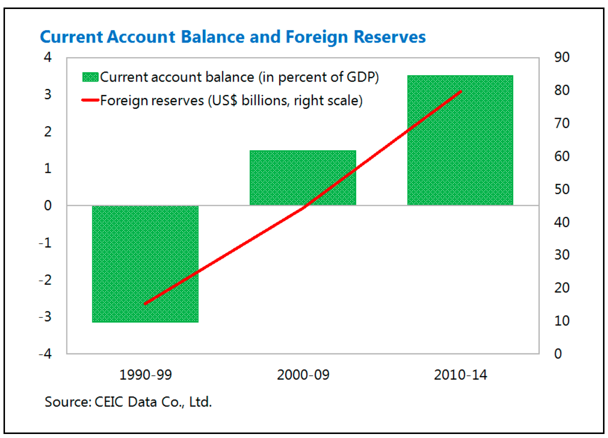
APPENDICES

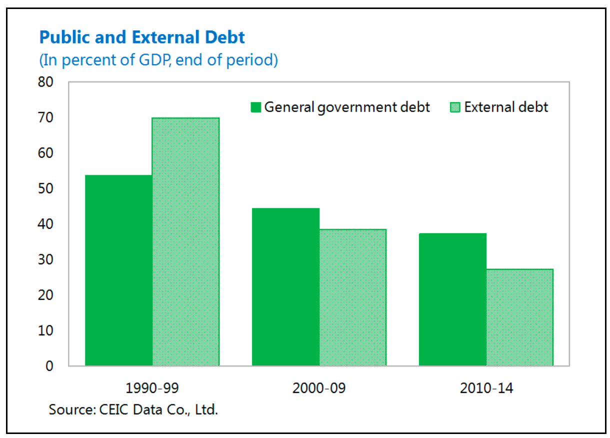
CONTEXT

1. **Addressing the large infrastructure gap is needed to raise potential growth and reduce poverty and external imbalances, supported by financial deepening while safeguarding financial stability**. This necessitates revenue mobilization and capital market development. The latter is important to provide an alternative source of financing for Public Private Partnership (PPP) projects, and private investments including small- to medium-sized enterprises (SMEs). Monetary and macroprudential policies should aim at avoiding excessive credit growth and balance sheet mismatches. All this comes at a time of heightened global financial uncertainty that could spill over to emerging market economies (EMEs) like the Philippines.



2. **The remarkable improvement in the Philippine economy since 2010 reflects prudent macroeconomic policies, as well as the favorable global financial cycle**. Achieving the authorities' growth target of 7–8 percent per annum will require tackling long-standing barriers to investment and broad-based growth.





3. **The current administration, whose term ends in June 2016, should continue to institutionalize governance reforms and fiscal transparency and initiate economic reforms that the next government can take forward to lift the country's growth potential**. In particular, economic policy should focus on scaling up infrastructure and human capital investment and spending for social needs to reduce poverty. This would help ensure that the Philippines' young and growing population has adequate job opportunities at home, reducing labor migration, especially of skilled labor.

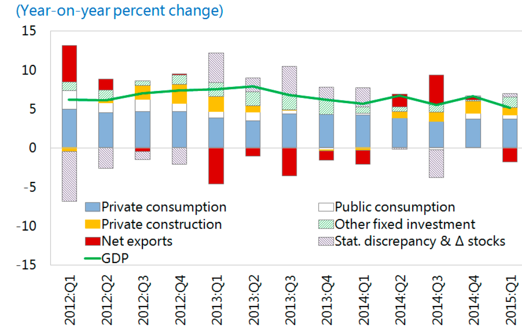
4. **At the conclusion of the 2014 Article IV consultation, Executive Directors commended the authorities' prudent policies that had delivered strong macroeconomic outcomes and set the stage for favorable growth prospects**. However, they noted potential risks from tighter global financial conditions, and therefore stressed the importance of continued prudent macroeconomic policies while stepping up reforms to sustain strong growth and reduce poverty.

RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

A. Recent Developments

5. **Real GDP grew by 6.1 percent in 2014 but slowed to 5.2 percent in the first quarter of 2015**. The main growth drivers in 2014 were household consumption, private construction, and exports of goods and services. The first quarter 2015 slowdown was due mainly to temporary factors, including the effects of dry weather on agricultural production, weak global demand, and slow budget execution.

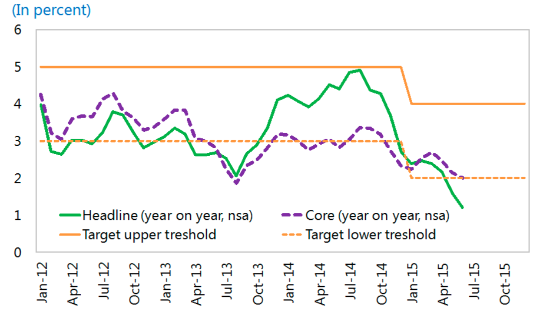
Contributions to GDP Growth
(Year-on-year percent change)



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

6. **Inflation fell below the bottom of the BSP's target band (3±1 percent) in May 2015, led by lower fuel and food prices**. After reaching 4.9 percent (y/y) in August 2014, inflation fell to 1.2 percent in June 2015. As the economy is growing broadly at potential, there is no evidence of price or wage pressures, and considerable slack in the labor market remains. The current dry weather associated with El Niño has not yet resulted in higher inflation.

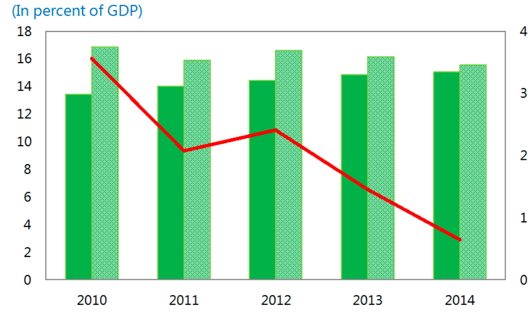
Consumer Price Inflation: Headline and Core
(In percent)



Sources: Philippines authorities; and IMF staff estimates.

7. **The fiscal deficit was smaller than the 2 percent of GDP target in 2014 due to slow budget execution**. Revenue increased as a share of GDP due to improvements in tax administration. Expenditures, especially capital spending, fell short of the budget largely due to weak implementation capacity and slow adjustment to reforms in some line ministries, and delayed post-typhoon reconstruction. A Supreme Court ruling that made aspects of the administration's Disbursement Acceleration Program unconstitutional further

National Government Balance
(In percent of GDP)

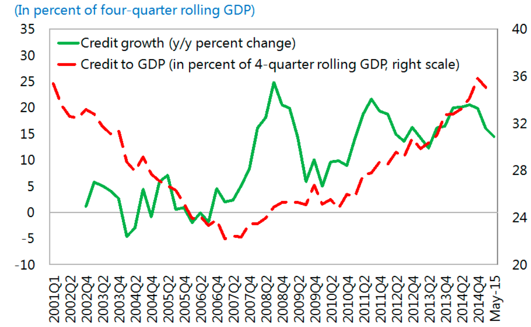


Sources: Philippine authorities; and IMF staff estimates.

slowed budget execution in 2014. Budget execution remained slow in the first quarter of 2015, particularly for capital spending. However, momentum is building on the implementation of PPP projects.

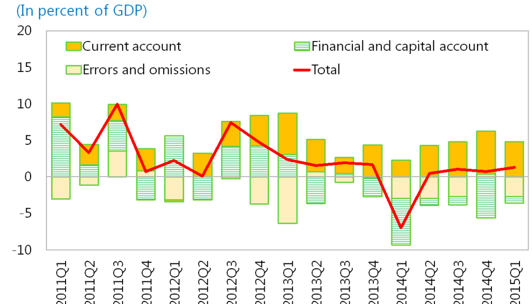
8. Credit growth was strong in 2014 but slowed and became more balanced in the first five months of this year. While broad based, the slowdown was sharper for those sectors that saw faster credit growth in the recent past, including construction and real estate. Banks remain well capitalized, with low levels of nonperforming loans and abundant liquidity.

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



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

Balance of Payments 1/
(In percent of GDP)



Source: CEIC Data Company Ltd.
1/ BPM6 basis.

9. The current account surplus rose in 2014 against the backdrop of lower oil prices, subdued import volumes, and robust export growth. Gross foreign reserves were US$81 billion in June 2015. While the peso has remained stable vis-à-vis the U.S. dollar since early 2014, it has appreciated significantly in effective terms along with the U.S. dollar.

B. Outlook and Risks

10. Economic growth is expected to pick up slightly in 2015, with credit growth and inflation remaining moderate and the current account surplus rising. Real GDP is projected to grow by 6.2 percent in 2015 as lower commodity prices lift household consumption and improved budget execution raises public spending. Consistent with projected investment growth, credit is expected to grow at about 15 percent (or about 2 percentage points of GDP) in 2015, in line with what appears to be a sustainable pace of financial deepening, although this warrants close monitoring on an ongoing basis. Lower oil prices, partly offset by somewhat higher food prices deriving from El Niño conditions, should keep inflation near the bottom of the BSP's target band. The current account surplus is expected to widen to 5.0 percent of GDP in 2015 due to lower oil prices and continued inflows from Business Process Outsourcing (BPO) and remittances.

11. Over the medium term, economic growth is projected at 6.5 percent, in line with potential growth (Box 1). Public and private investments are projected to lead the growth, as increased public infrastructure spending and implementation of PPP projects should crowd in private investment. Inflation is expected to increase as oil prices rise but is projected to remain within the BSP's target range. The pickup of public and private investments, together with a trend real effective appreciation of the peso, is expected to narrow the current account surplus and relieve pressure on domestic capacity constraints going forward, with higher U.S. interest rates tending to tighten lending conditions consistent with moderate credit growth going forward.

12. Risks to the outlook are tilted to the downside (Appendix 1). An upside risk is a stronger lift to demand from lower oil prices. On the downside, tighter global financial conditions and a surge in financial volatility, amplified by low market liquidity, could lead to sharp capital outflows and tightening of domestic financing conditions, with significant macrofinancial spillovers on the economy, but the Philippines' strong macroeconomic fundamentals should provide a cushion (Box 2). Continued weak budget execution could slow down needed improvements in public infrastructure, while the risk of a larger than budgeted deficit due to election spending is limited given the government's strong commitment. Finally, there is a downside risk associated with severe El Niño conditions, leading to a poor harvest regionally and a rapid run-up in food prices. This could induce inflation to rise sharply and breach the target band, affecting the poor quite severely. The Philippine authorities are well equipped to respond as needed with suitable policies should any of these risk scenarios materialize, particularly given the strong fundamentals, ample policy space, and strong foreign reserve position.

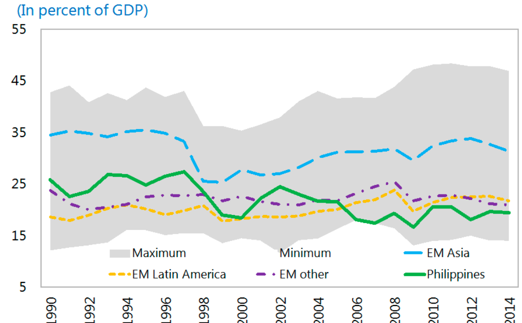
C. External Sector Assessment

13. The Philippines' external position strengthened significantly since 2010. The current account has moved to a structural surplus and gross international reserves increased to US$80 billion (28 percent of GDP) or 217 percent of the IMF's metric of reserve adequacy at end-2014, well in excess of the 100–150 percent suggested range. The external sector is moderately stronger than warranted by fundamentals and desired policies, consistent with moderate currency undervaluation, reflecting mainly the low level of investment.

- *Current account:* The IMF External Balance Assessment (EBA) model places the predicted current account at 7.8 percent of GDP below the actual current account in 2014, although Philippines specific factors such as natural disaster risk and remittances could explain up to 4 percentage points of GDP of the residual (see Appendix 2). The recent appreciation of the peso could help narrow the current account gap over time, but lower oil prices are likely to more than offset this effect in 2015.

- *Addressing imbalances:* The Philippines' current account gap is attributable to its low level of investment compared with other EMEs. Raising the investment rate and thus boosting potential growth, by improving the business environment and infrastructure, would help reduce external imbalances. The current account gap would also decrease as budget execution improves.

Investment
(In percent of GDP)



Source: IMF, *World Economic Outlook*.

- *International reserves*. Reserve accumulation since 2010 has reflected current and financial account surpluses. The BSP accumulated sizable reserves in 2010–12 when ultra accommodative monetary policies in the advanced economies (AEs) stimulated large capital flows into the Philippines and other EMEs. Since the taper tantrum in mid-2013, there have been large capital outflows triggered in part by a tightening of eligibility for the Special Deposit Account (SDA) facility, which led to an exodus of foreign funds; however, foreign reserves have remained broadly stable supported by current account surpluses. Staff continues to recommend that the exchange rate be allowed to move freely in line with market forces with intervention limited to smoothing excessive volatility in both directions.

Authorities' Views

14. The authorities emphasized the structural causes of the current account surplus and unique role of worker remittances, which are not well captured in the EBA model. They observed that the peso has been broadly unchanged vis-à-vis the U.S. dollar since early-2014 while the gross international reserves have been broadly stable. The problem of low investment is likely to be addressed going forward given the large pipeline of infrastructure projects. The exchange rate continues to be market determined, with foreign exchange intervention limited to smoothing excessive volatility.

POLICIES FOR MACROECONOMIC AND FINANCIAL STABILITY

A. Fiscal Policy

15. Fiscal policy should focus on supporting infrastructure investment and inclusive growth. Returning to the authorities' medium-term deficit target of 2 percent of GDP by increasing public infrastructure spending and implementing much-needed post-typhoon reconstruction and social spending in the 2015 budget is appropriate given the needs in these priority areas and on the back of expenditure under-execution in 2014. It is also consistent with debt sustainability as the 2 percent of GDP deficit target would steadily reduce the general government debt-to-GDP ratio over the medium term to below 30 percent (from 36.4 percent of GDP in 2014). Staff's fiscal projections are in line with this, but less ambitious than the authorities' in 2015 in light of limitations in current execution capacity. Going forward, the authorities plan to increase infrastructure spending from 3 percent of GDP in 2014 to 5 percent by 2016, including by facilitating PPP projects. Staff projects public capital expenditure at 3.8 percent of GDP in 2016, while PPP projects could amount to 1 percent of GDP, bringing overall infrastructure investment to 4.8 percent of GDP in that year. An increase in public investment, combined with improvement in efficiency, would contribute to higher economic growth in the medium term (Box 3).

16. Public expenditure management needs to be strengthened further. Sustained efforts to improve the investment selection and implementation processes will be required. Moreover, a better system for projecting and tracking spending is needed to strengthen budgeting and cash management. Staff urges the passage of the Public Financial Management (PFM) bill to further strengthen the overall PFM governance framework and supports the authorities' continuing effort to improve PFM, as acknowledged in the Fund's Fiscal Transparency Evaluation (FTE). Regarding the PPPs, amendments to the Build Operate Transfer (BOT) law and Right of Way Bill will institutionalize the progress that has been made so far and further strengthen the legal framework, which will in turn help ensure robust implementation of projects.

17. There is limited scope to cut other expenditure to support budgetary spending on infrastructure and social needs. At less than 20 percent of GDP for the general government, total expenditure is lower than the average for the ASEAN-5 and much lower than the emerging and developing countries average. Moreover, the Philippines does not have energy subsidies, the public wage bill is small, and key public services like tax collections and customs enforcement are facing large manpower shortages.

18. The authorities' initiative to strengthen revenue collections is welcome. Additional revenue will be needed to support higher spending on infrastructure and social needs. Congress has already passed the Tax Incentives Management and Transparency Act (TIMTA), which would provide for regular reviews of tax incentives and make them more transparent. Staff supports ongoing tax administration reform that has improved arrears collection, VAT compliance including through targeted audits, and filing rates for large taxpayers. These gains should more than offset the negative effects from the lower oil prices and slightly increase the tax revenue-to-GDP ratio in 2015.

19. Staff strongly encourages a tax reform package that is net revenue enhancing. This would entail, for instance, rationalization of tax incentives, reducing certain VAT exemptions, and increases in fuel excises, that more than compensate for any revenue-losing measures in the corporate and personal income tax reform.[1] The authorities are crafting a tax reform package that appears to be net revenue enhancing and have requested Fund TA on some aspects. Even in the current pre-election context, staff strongly urges the authorities to avoid any tax package that would entail a net revenue loss. In this regard, it is encouraging that Congressional leaders have vowed not to reduce taxes before compensatory measures are enacted. Staff also supports the Department of Finance's efforts to amend the bank secrecy law to allow the tax authorities' access to individual bank deposit information and make tax evasion a predicate crime for money laundering in order to improve the efficiency and equity of revenue collection. Staff simulations indicate that a tax-financed public investment increase would result in a more favorable public debt trajectory, which would translate into superior output growth over the medium term (Box 3).

Authorities' Views

20. The authorities acknowledged the sizeable challenges involved in getting the spending agencies to accelerate infrastructure project implementation. Their own investigation shows that

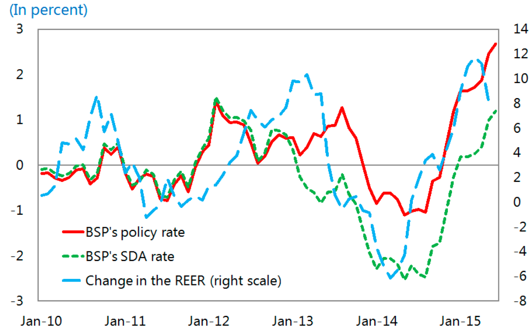
[1] Staff has estimated that revenue mobilization of 2–3 percentage points of GDP is attainable, as stated in last year's staff report.

capacity constraints had played a major role in implementation delays in 2014. The authorities are addressing the procurement issues by requiring strengthening of procurement units at spending agencies and revising operational regulations. A Presidential order has been issued to create a Delivery Unit in major departments to monitor closely, trouble shoot, and report on implementation delays. The authorities noted their commitment to improving infrastructure, including by increasing the share of infrastructure in the budget and the implementation of several PPP projects. Revenue targets are challenging but they provide incentives for increased collections and administrative reforms as shown by the steady increase in revenue under the current administration. There is a need for comprehensive tax reform to widen the tax base. Allowing tax collectors access to bank deposits and making tax evasion a predicate crime are needed to improve compliance. The authorities value IMF TA highly and hope to benefit from additional TA going forward.

B. Monetary Policy

21. Current monetary settings are appropriate judging from: inflation projections within the target band; estimates of the output gap near zero even with financial variables added (Box 1)**; and credit growth within normal metrics**. Credit growth was strong in 2014, including in the construction and real estate sectors, spurring concerns about rising macrofinancial imbalances. The BSP's tightening measures last year (the banks' required reserve ratio was increased by 200 basis points, to 20 percent, and policy rates were increased by 50 basis points), and autonomous tightening since then due to rising real interest rates and an appreciating REER, has succeeded in moderating credit growth, making it more balanced, and bringing inflation down, by the first half of 2015. One-off effects of lower oil prices are expected to dissipate by late 2015, following which inflation is still expected to remain comfortably within the target band. Moreover, significant slack remains in the labor market.

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



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

22. Nevertheless, the BSP should remain vigilant and be ready to tighten policy if signs of rising inflation pressure and accelerating broad-based credit growth were to emerge going forward. However, rapid food price increases due to El Niño related drought should be addressed by allowing food imports in a timely manner and would not justify monetary tightening unless second round effects were to appear.

23. Monetary transmission has improved as the structural liquidity overhang has been reduced but more work is needed given that the pass-through from policy rates to retail rates remains weak. A liquidity overhang persists, although this has declined significantly from last year, reflecting the BSP's preemptive tightening in 2014 and capital outflows. Staff supports the BSP's efforts to improve the effectiveness of monetary policy transmission through the implementation of an interest rate corridor, following up on Fund TA, and supported by implementing deposit auctions and reforming the reverse repo auction mechanism, and passage of the BSP charter that authorizes the issuance of central bank bills and a minimum capital level. With the greater use of open market operations to manage liquidity, the required reserve ratio can be lowered over the medium term to reduce intermediation cost and improve efficiency.

Authorities' Views

24. The BSP views the current monetary policy stance as appropriate. The authorities see no need to adjust monetary policy at the moment as inflation is in the lower end of the target band, credit growth is moderating, and economic growth is still robust, but agree that they will remain vigilant.

25. The BSP shared the staff's assessment that El Niño effects could pose a major risk to food prices in 2015. The National Food Authority council has authorized an additional 500 thousand metric tons of rice imports in 2015, which should mitigate the effects of El Niño conditions on rice prices and inflation.

C. Financial Cycles, Systemic Risks, and Macroprudential Policies

26. Given the Philippines' bank-centric financial system and high concentration of conglomerates, macrofinancial linkages have largely taken the form of corporate leverage cycles financed by banks. In the boom phase of the global financial cycle, this led to leveraged investment in the construction and real estate sectors, with rising capital market issuances, although banks were constrained by their 25 percent single borrower limits in some cases. As the BSP tightened monetary policy and used its macroprudential tools to target risky activities, credit has moderated and the sectoral composition has become more balanced. Wholesale bank funding from abroad is minimal and subject to strict limits. At 7 percent of GDP, household debt does not appear to pose systemic risks.

27. Credit growth since 2010 has been rapid but has been below typical metrics of credit booms. In 2014, credit growth came close to exceeding some of these metrics but prompt BSP action brought it back down (Box 1). Going forward, credit is expected to increase by about 2 percentage points of GDP per year, a rate of financial deepening that appears to be sustainable based on cross-country studies. However, its sustainability will need to be assessed carefully on an ongoing basis in view of concentration and other risks identified below. Credit growth to real estate and construction has moderated. As noted above, projected credit growth is consistent with investment and economic growth.

28. Nonfinancial corporates appear broadly resilient to shocks but a definitive assessment requires finer data. Staff encourages the authorities to work further on filling these data gaps, particularly concerning intra-group linkages. Nonfinancial corporate debt is low but rising and leverage is unevenly distributed, making some firms vulnerable to a rise in interest rates (Box 2).

Foreign exchange exposure appears low given moderate foreign exchange debt and existing natural hedges.

29. Bank and nonfinancial corporate exposure to real estate has risen but risks are still moderate. Nonbank financial institutions (NBFIs) remain small but are growing rapidly. Existing data on the exposure of NBFIs to real estate are scarce but a plan has been developed to fill data gaps with IMF TA.[2] An official residential price index is currently under construction by the BSP and Philippines Statistical Agency, while the few commercially available measures show modest price growth in most segments.

30. Macroprudential policies should continue to play an important role by limiting any buildup of systemic vulnerabilities, including due to excessive credit growth in specific sectors.[3] In light of the acceleration in credit growth in 2014 and risks of domestic asset price booms, the BSP conducted stress tests on banks' real estate loan exposures and required corrective actions, enhanced monitoring of banks' exposures to all types of real estate, and provided guidance on real estate mortgage loans, setting their maximum loan value at 60 percent of the appraised value. These measures have helped to restrain credit growth to the real estate sector. Single borrower limits (set at 25 percent of core capital) should be strictly enforced with the additional 25 percent allowance for exposures to PPPs allowed to lapse. Staff encourages ongoing efforts to strengthen the financial stability supervisory framework, including by capacity building and enhanced coordination among the stakeholders of the Financial Stability Coordinating Council. In particular, staff supports the draft bill broadening the BSP's financial stability mandate and providing it with greater access to nonbank financial information that is currently being discussed in Congress. The SEC has taken steps to enhance its corporate data collection efforts and promote capital market development, and staff encourages further efforts in this direction.

Authorities' Views

31. The BSP views credit expansion by banks, in concert with other forms of financial deepening and inclusion, as needed to support growth over the medium term. They welcomed the recent shift in credit growth away from real estate into productive areas like manufacturing. The Philippines cannot rely solely on banking to finance its ambitious infrastructure investment. Financial market development is needed to help finance large forthcoming PPP projects. The BSP had already liberalized entry for foreign banks and five foreign banks have been approved for entry, which is a major step because it increases competition, reduces concentration risks, and eases the constraints that single borrower limits impose on aggregate financing of infrastructure investment.

---

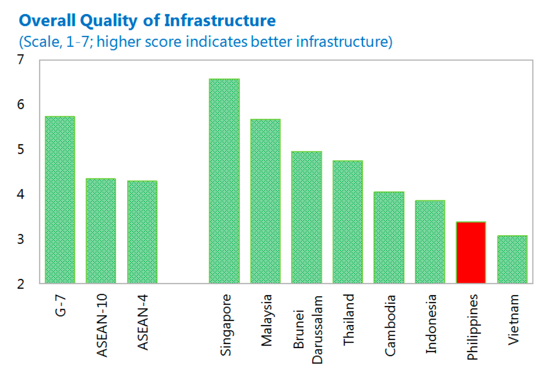
[2] Banks account for nearly 80 percent of financial system assets. The BSP also supervises NBFIs accounting for a further 4 percent of the system. The insurance industry, which accounts for 7 percent of assets, is supervised by the Insurance Commission, while the remainder largely fall under the supervisory purview of the Securities and Exchange Commission (SEC). Important supervisory gaps in the financial system relate to: (i) real estate financing provided by developers and conglomerates; (ii) bank secrecy laws; (iii) legal restrictions on interagency information sharing; and (iv) mapping conglomerate exposures.

[3] Minimum capital requirements in the Philippines are higher than the Basel III requirements.

INVESTMENT, FINANCIAL DEVELOPMENT, AND INCLUSIVE GROWTH

A. Investment and Social Needs

32. Boosting the level of investment is a major structural challenge. Public and private investment rates in the Philippines are well below regional peers, as reflected in its low capital stock and infrastructure quality. The main impediments to private investment are inadequate infrastructure, a weak investment climate, and restrictions on foreign direct investment. Immediate priorities include implementation of the transport system in Manila (Manila Dream Plan approved by NEDA) and improvements in airports, road connectivity, and seaports across the country.



Source: IMF, *World Economic Outlook*.

33. Another key structural challenge is to make growth more inclusive. Although poverty has fallen, it remains high (see selected issues paper, Chapter 6). Given that rice is an important item in household consumption, staff urges the authorities to proceed with the reform of the National Food Authority and ease quantitative rice import restrictions to lower rice prices. Faster employment creation would also help alleviate poverty, including by developing the agribusiness, tourism and mining sectors, which can be labor intensive and have a comparative advantage. Addressing the uncertainty and non-transferability of property rights on agricultural land would support its use as collateral for bank loans and improve access to financing. The recent amendments to the cabotage law (that reduces the high cost of inter-island shipping) and enactment of a competition law would help spur a level playing field but the costs of doing business would need to be reduced particularly for micro- and small- and medium-sized enterprises (MSMEs). Expanded education and training programs, such as those conducted by the Technical Education and Skills Development Authority, would address skills mismatches. Job opportunities would be created through the further expansion of BPOs by moving to higher value added segments, and promotion of light manufacturing for under-skilled workers.

Authorities' Views

34. The government has augmented a number of growth-inclusive budgetary expenditures. This includes expansion of the Conditional Cash Transfer (CCT) program to high school students, indigenous peoples, homeless itinerants, and families; strengthening of kindergarten and high school education as part of the K to 12 program; and expanding the health insurance program to cover the poor and the informal sectors, hiring and assignment of doctors and nurses to rural areas, and the construction and equipping of rural and barangay health stations. Many of these initiatives have been financed by revenue from "sin taxes."

35. The government agreed that the phasing out of quota restrictions on rice importation with adequate support for farmers is important for poverty reduction. The worsening of poverty indicators in 2014, despite income growth among the low income segments, was attributable to the sharp rice price increase caused by the delay in rice imports and distribution. By allowing the market to determine the level of rice importation, rice prices are expected to become less susceptible to supply shocks, and in turn, more favorable to the poor.

B. Financial Development and Inclusion

36. There is a tension between the important goals of financial deepening and inclusion and financial stability. Financial development in the Philippines is progressing broadly in line with its income level but considerable growth potential remains. Recent efforts to advance financial development as a means of promoting faster and more inclusive growth should be encouraged and focused on expanding the role of the capital markets, with particular emphasis on long-term financing for infrastructure investment (PPPs), and expanding the existing set of financial inclusion initiatives. World Bank and other metrics underscore the need for financial deepening and inclusion (see selected issues paper, Chapter 5).

37. The capital markets could facilitate better risk sharing and open up new sources of long-term financing for both SMEs and infrastructure development projects (see selected issues paper, Chapter 5). The latter function is especially relevant given the low investment rate in the Philippines and the banking sector's preference for financing working capital and short-term loans. More generally, the development of a broader set of long-term financial securities (project bonds, asset backed securities, etc.) would better allow issuers to align funding needs with the duration, income, and diversification needs of investors like pension funds and insurers.

38. A more stable macroeconomic environment has supported capital market development in recent years but more can be done. Key policy priorities include developing an organized market for repo and risk management instruments, a smoother liquidity profile across the government yield curve, establishing guidelines for structured credit issuance, and revitalizing the 'second board' for SME equity listings by lowering listing and transaction costs. The enabling environment could be made even more conducive to capital market development if taxation policy incentivizes greater activity from both issuers and investors.[4] Full engagement by regulators and industry participants in the ASEAN Capital Markets Forum would also be welcome as a means of better integrating and deepening the Philippines' securities markets over time.

39. A new national financial inclusion strategy, focused on access, education and consumer protection, was recently released. There is a strong need to increase the provision of

[4] Some measures that could be helpful in this regard include concessionary tax treatment for long-term savings vehicles, streamlining the withholding tax registration process, and reducing taxes on initial public offerings.

banking and payment services, particularly outside the heavily urbanized regions. Formal micro-lending initiatives should also be encouraged. The notable increase in micro-insurance penetration in recent years should continue given that coverage in the Philippines remains low.

Authorities' Views

40. Capital market development and financial inclusion are essential to promote financing for PPPs and wider access to finance. The BSP agreed that capital market development is needed given the inherent difficulty that banks have in providing long-term financing for PPPs while mitigating concentration risk. Integration with ASEAN capital markets should be pursued. The new national financial inclusion strategy provides a framework for bringing much-needed financial services to all. Policy frameworks in the areas of micro health insurance and agriculture micro insurance are under consultation, while the blueprint for a movable collateral registry covering an expanded list of financial assets is being finalized.

STAFF APPRAISAL

41. The Philippine economy has continued to perform strongly. Sound macroeconomic policies and prudent financial sector supervision, combined with strong macroeconomic fundamentals, have delivered solid economic growth, low inflation, and financial stability.

42. The macroeconomic outlook is expected to remain favorable. Despite the temporary slowdown in the first quarter of this year, the economy is expected to grow at a robust 6.2 percent in 2015, with credit growing at a moderate pace, and inflation in the lower half of the target range.

43. This favorable outlook faces several downside risks. Tighter global financial conditions and a surge in financial volatility could lead to sharp capital outflows, continued weak budget execution could slow down much needed improvements in infrastructure, and more severe El Niño conditions could lead to higher inflation and affect the poor severely.

44. Staff supports the government's plan to raise infrastructure investment and return to its medium-term fiscal deficit target of 2 percent of GDP. The increase in public spending in the 2015 budget is appropriate from a cyclical and development perspective, given the low inflation environment, large infrastructure and social needs, low and declining public debt, low long-term interest rates, and post-typhoon reconstruction needs.

45. Public expenditure management should be strengthened further. Staff urges the passage of the PFM bill, more efficient expenditure tracking and cash management, and amendments to the BOT law and Right of Way bill to strengthen the implementation of PPPs.

46. Additional revenue is needed to finance large infrastructure and social needs. The authorities are urged to ensure net revenue enhancement in their tax reform package by rationalizing tax incentives, streamlining VAT exemptions, and raising fuel excises, to offset the losses from the proposed reductions in corporate and personal income taxes. To strengthen tax collection, the tax authorities should be given access to individual bank deposit information and tax evasion should be made a predicate crime.

47. Monetary policy is currently appropriate. Nonetheless, the BSP should remain vigilant and be ready to tighten if inflation or credit growth were to accelerate and there are signs of overheating. The BSP is encouraged to implement the interest rate corridor to improve monetary policy transmission, to be supported by the passage of the BSP charter that authorizes the issuance of central bank bills and a minimum capital level. With official reserves more than adequate, the exchange rate should continue to be allowed to move freely in line with market forces, while smoothing excessive volatility in both directions.

48. Macroprudential policies should be used to guard against systemic risks to financial stability, including in specific sectors. Staff supports the authorities' use of targeted prudential policies to tame financial excesses and strengthen resilience. More stringent prudential regulations may be needed if any systemic risks become apparent. Broadening the BSP's financial stability mandate remains a priority, and staff supports the draft law being discussed in Congress. Staff also supports the authorities' efforts to be allowed better access to information on conglomerates' finances.

49. The authorities are encouraged to focus on key medium-term priorities to allow the country reap the dividends from its young and growing population. This will involve increasing infrastructure spending, facilitating PPPs, and improving the investment climate. Staff supports the government's plans to improve human capital and social services for the poor.

50. Financial deepening and inclusion are also essential elements of the authorities' inclusive growth strategy. While expanded bank lending in productive sectors will facilitate growth, the composition of credit growth should be closely monitored on an ongoing basis to avoid risks from credit booms. Staff believes that further development of alternative forms of financing and hedging, such as corporate bond and equity markets, is needed to support infrastructure investment, and welcomes the recent release of the national strategy for financial inclusion.

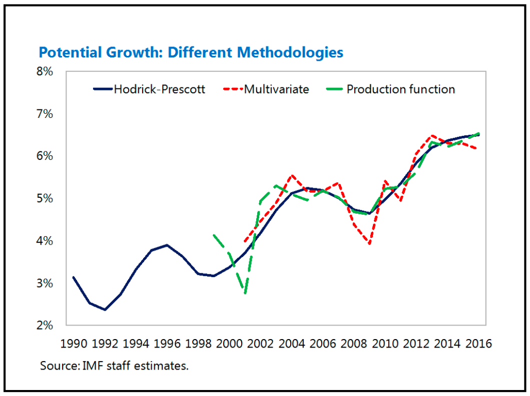
51. The Philippines' strong growth performance in recent years is attributable to prudent macroeconomic policies, strong capital inflows from the expansion phase in the global financial cycle, and the boom in the BPO industry, but it has the potential to perform even more strongly. Poverty incidence needs to fall more, infrastructure quality and financial market access for poor households and SMEs need to improve, and the financial sector needs further development. With the strengthened governance structure, the government is advised to push economic reforms firmly to reach its growth targets in the context of a turn in the global financial cycle while maintaining macroeconomic and financial stability.

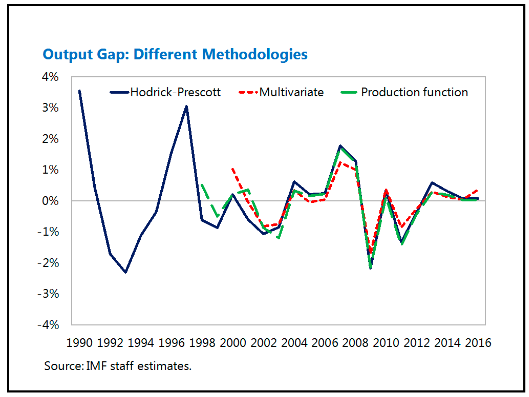
52. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Box 1. Philippines: Real and Financial Cycles

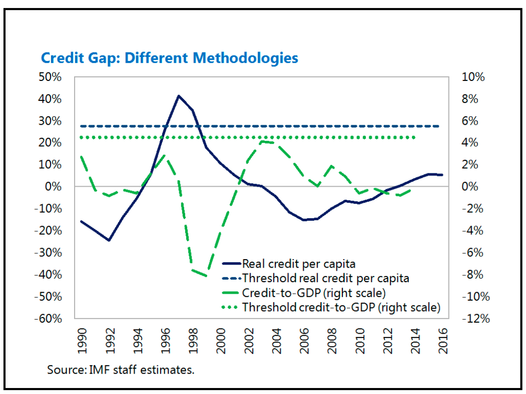
The output gap is near zero in 2015 even if measures are augmented by financial variables. Following the tightening of monetary policy in 2014, the credit gap is also near zero in 2015, with credit growth below typical metrics of credit booms.

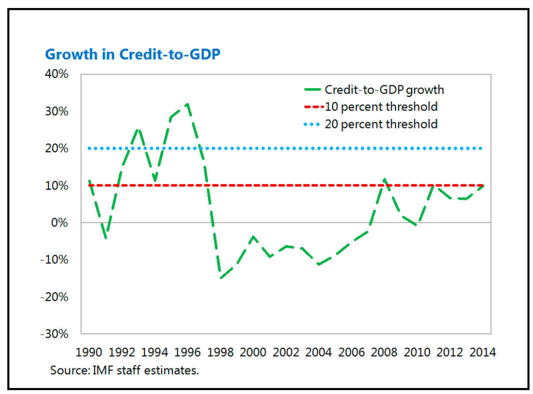
Staff estimates of the real cycle indicate that the output gap is near zero in 2015. The Hodrick-Prescott filter, a multivariate filter, and a production function were used to estimate the Philippine output gap (see the selected issues paper, Chapter 2). Actual data up to 2014 and staff projections for 2015–20 were used. All approaches yield remarkably similar results, with potential output growth accelerating to 6.5 percent in 2015–16, and the output gap closing in 2015.



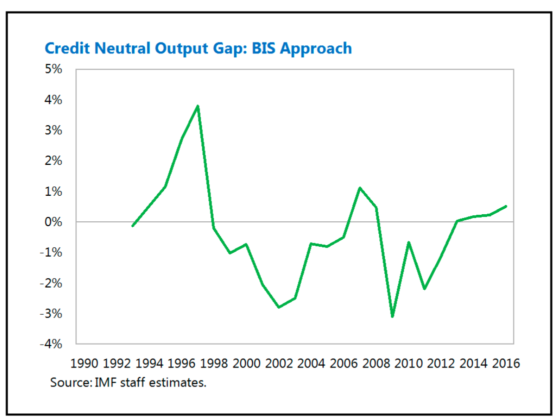


Alternative estimates of the financial cycle suggest that, after the tightening of monetary policy in 2014, the credit gap is zero or slightly positive in 2015. The approach of Mendoza and Terrones (2008), which looks at cycles in real credit per capita compared to its trend, suggests a slightly positive credit gap in 2015–16, but below the credit boom threshold. Dell'Aricia and others (2012) look at deviations of credit-to-GDP from a backward looking trend. A credit boom is identified when the deviation from trend is larger than a threshold and growth of credit-to-GDP is larger than 10 percent, or when the latter is larger than 20 percent. This approach shows that the deviation of credit-to-GDP from trend was zero in 2014, below the threshold for credit booms, but growth of credit-to-GDP was close to 10 percent.





Financial variables contain useful information concerning the business cycle position. Expansions that coincide with rapid credit and asset price growth are stronger, while recessions coinciding with credit and asset price busts are longer and deeper. We used the BIS approach to integrate financial variables (real credit and stock prices), into a broader measure of the output gap. Results indicate that the output gap in the Philippines in 2015–16 is slightly larger when financial variables are included, consistent with a slightly positive credit gap. However, even in this case the output gap is very small.



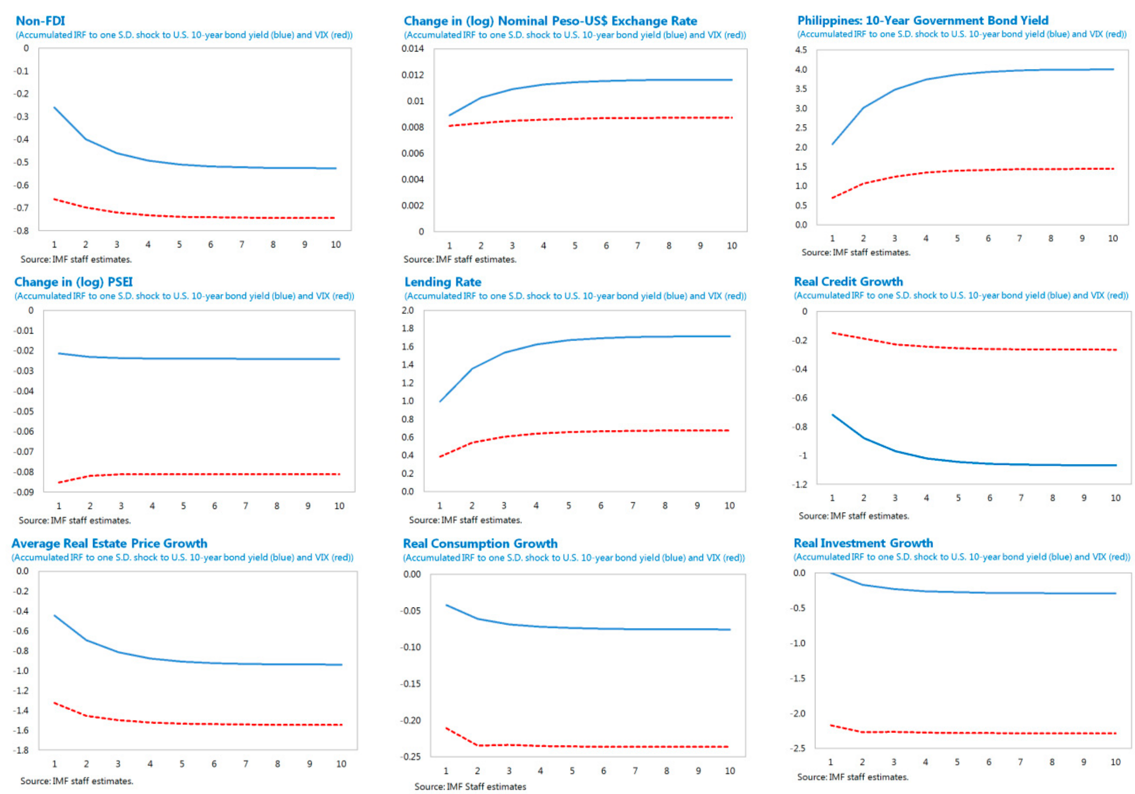
Box 2. Global Financial Cycle and Nonfinancial Corporate Sector Vulnerabilities

Higher U.S. interest rates would likely tighten financial conditions in the Philippines significantly, particularly if accompanied by higher volatility. Despite recent borrowing, nonfinancial corporates appear resilient.

Staff analysis suggests that the surge in capital inflows between 2010 and mid-2013 can largely be explained by global financial factors such as the VIX and U.S. short-term interest rates, with exchange rate expectations and domestic fundamentals playing a supporting role. Moreover, local bond yields and retail bank rates seem to be driven largely by the same global factors and U.S. term premia.

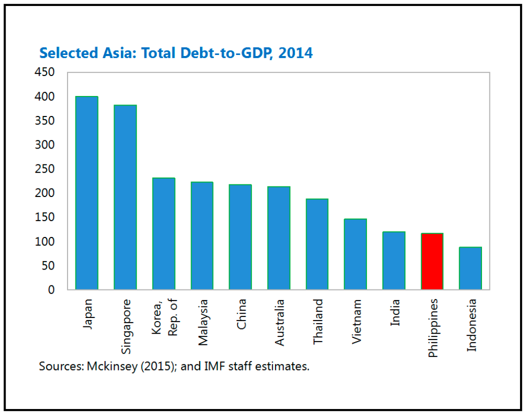
Higher U.S. bond yields coupled with bouts of global volatility could tighten domestic financial conditions and lower Philippine growth. A BVAR model shows that the VIX affects domestic demand via capital flows and asset re-pricing, whereas U.S. 10-year T-bond yields affect bank credit and investment (see selected issues paper, Chapter 1).

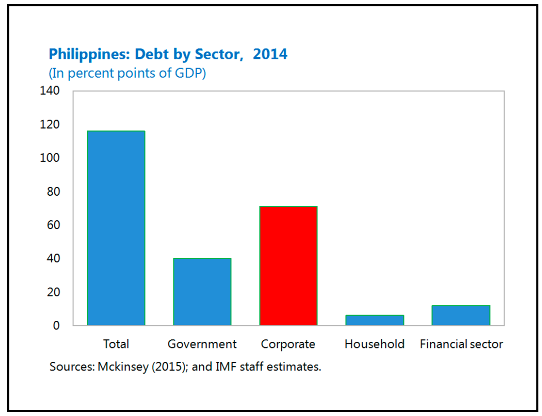
Accumulated Response to One Cholesky S.D. Shock to U.S. LT Interest Rate (Blue) and VIX (Red)



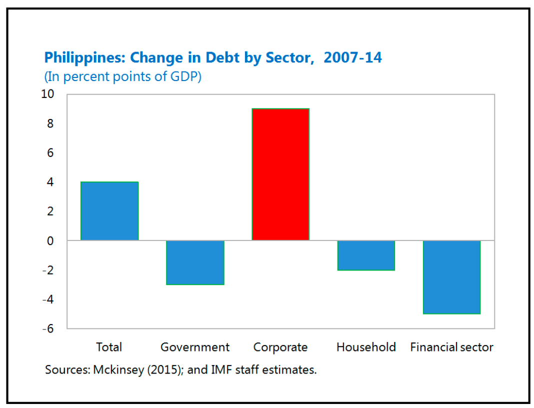
Box 2. Global Financial Cycle and Nonfinancial Corporate Sector Vulnerabilities (Concluded)

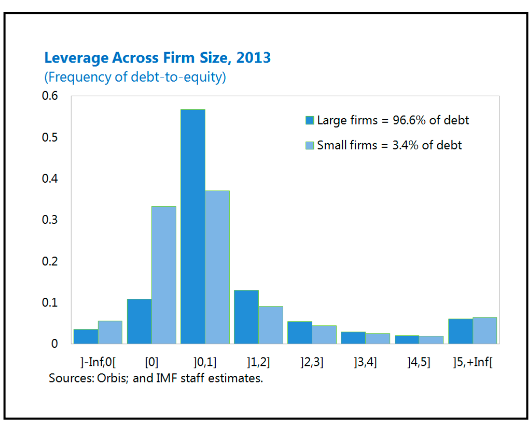
Given expected tighter financial conditions and resulting balance sheet effects, staff found moderate but concentrated leverage (see selected issues paper, Chapter 2). Nonfinancial corporate debt grew substantially since 2007 yet total debt is still low compared to peers. Turning away from aggregated data, which potentially masks pockets of vulnerability, and using firm-level data reveals that leverage and debt-at-risk vary significantly across sectors and that small firms, although more leveraged, do not pose systemic risks given their small debt share.

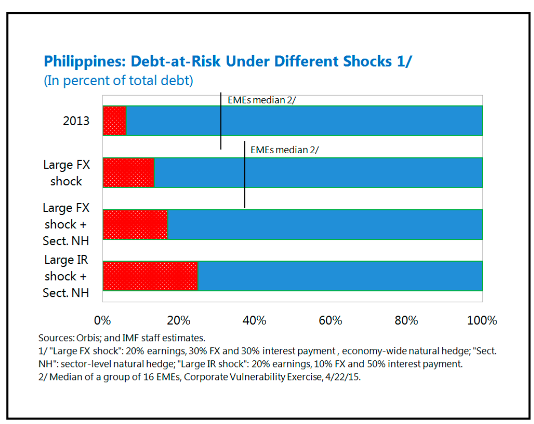




The Philippine nonfinancial sector seems resilient to large shocks compared to other EMEs. Firms are more sensitive to interest rate shocks compared to FX shocks, due to low FX debt and natural hedges. Some real estate developers may be more vulnerable, in particular those involved in the rising unregulated shadow banking activity. Thus, firm-level developments should be closely monitored.





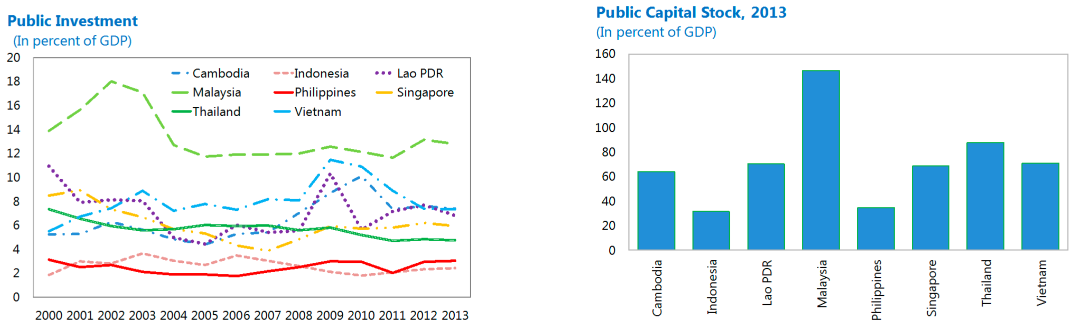


Box 3. Philippines: Improving Public Infrastructure

Improving public infrastructure would result in a sustained output increase and external rebalancing. Tax financed infrastructure yields better results in the long run. The effect is augmented when combined with increased efficiency.

While a need to increase public investment spending is clear, its efficiency should also be enhanced. Reflecting the persistently low level of public investment, public capital in the Philippines remains among the lowest in ASEAN, at about 35 percent of GDP (Figure 1). Thus there is a clear need to increase public investment. Better planning, better budget allocation, and more efficient implementation should improve public investment efficiency, as it would translate the same level of public investment into higher access to quality public infrastructure services (see selected issues paper, Chapter 4).

Figure 1. ASEAN: Public Investment and Public Capital Stock



Source: IMF, *Making Public Investment More Efficient* (forthcoming).

Sources: IMF, *Making Public Investment More Efficient* (forthcoming).

Model simulations suggest that improving public infrastructure would result in a sustained output increase (Figure 2). Two scenarios are considered using the IMF's Global Integrated Monetary and Fiscal Model (GIMF): (i) a permanent increase in public investment from 3 percent to 5 percent of GDP in all subsequent years, financed by borrowing; (ii) the same increase in public investment, financed by an increase in consumption taxes. Then, each is divided into sub scenarios, with and without a gradual improvement in public investment efficiency.[1/] All scenarios exhibit sustained output increases because the public infrastructure improvement amounts to a permanent improvement in the general productivity of the economy, which crowds in private investment.

Each scenario affects the economy differently. The debt-financed scenario results in a substantial increase in the public debt-to-GDP ratio, increasing the borrowing cost and constraining investment. In contrast, consumption is initially subdued in the tax-financed scenario because of the lower disposal income. Both scenarios benefit from increased efficiency.

____

1/ The initial level of public investment efficiency is set according to the *Public Investment Management Index* (PIMI) developed in Dabla-Norris and others (2012).

Box 3. Philippines: Improving Public Infrastructure (Concluded)

Public infrastructure improvement influences the current account and inflation as well. It worsens the current account, helping with external rebalancing. It also generates additional domestic demand initially and thus creates inflationary pressures. Over time, the increase in supply capacity alleviates the inflationary pressures.

Figure 2. Main Simulation Results

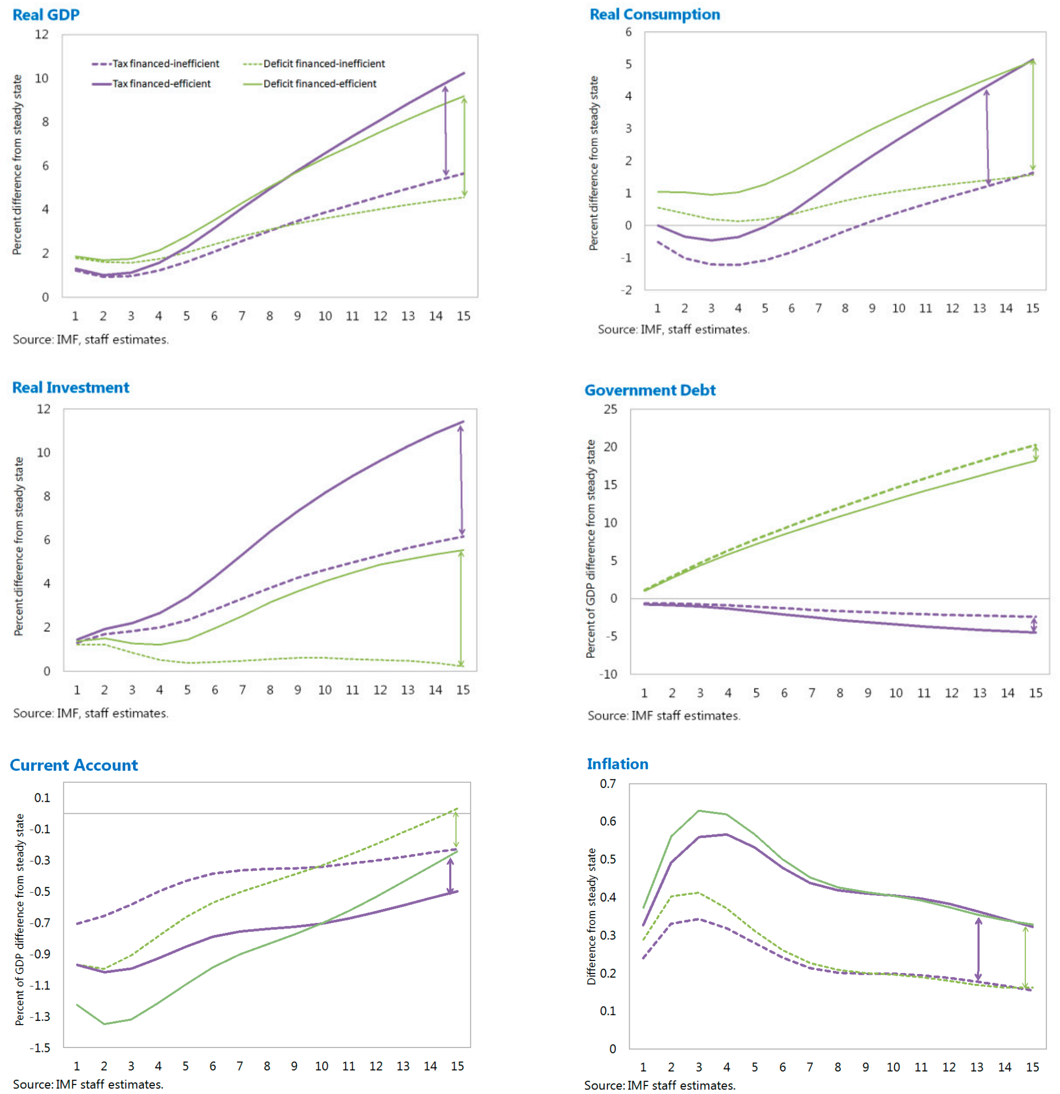
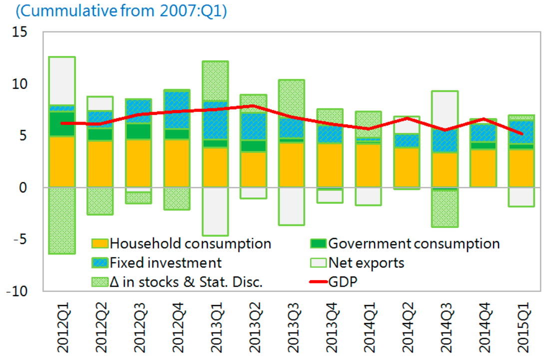


Figure 1. Philippines: Real Sector

Growth is still strong but moderating in 2015:Q1…

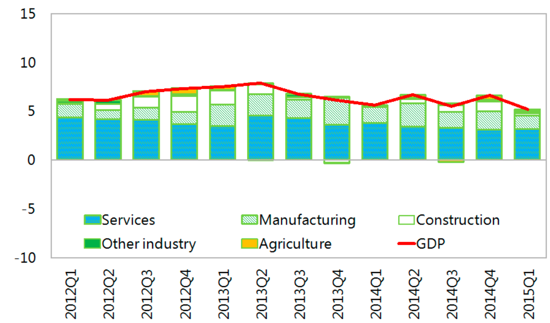
Contributions to Real GDP Growth—Expenditure Side
(Cummulative from 2007:Q1)



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

…led by services and manufacturing.

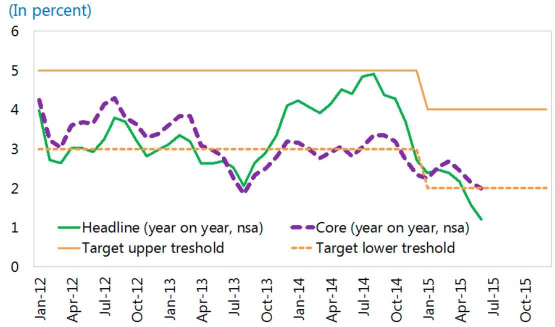
Contributions to Real GDP Growth—Supply Side
(Cummulative from 2007:Q1)



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

Inflation is moderate…

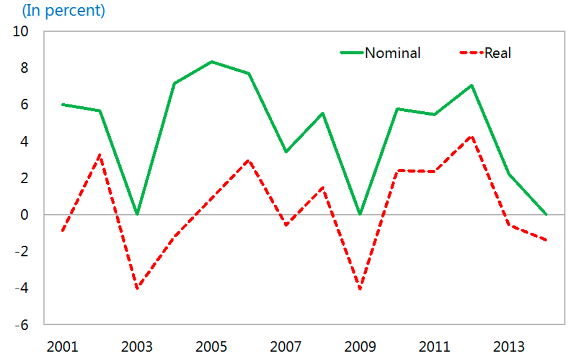
Consumer Price Inflation: Headline and Core
(In percent)



Sources: Philippines authorities; and IMF staff estimates.

…and there are no wage pressures.

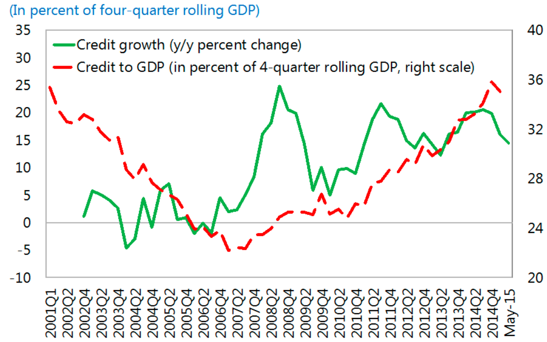
Average Nonagricultural Daily Wages Growth
(In percent)



Source: Haver Analytics.

Credit growth has moderated…

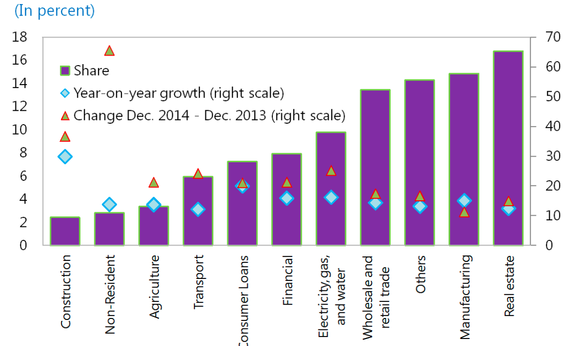
Bank Credit Growth and Credit to GDP
(In percent of four-quarter rolling GDP)



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

…including for construction and real estate.

Universal and Commercial Banks: Loans by Sector, 2015 M4
(In percent)

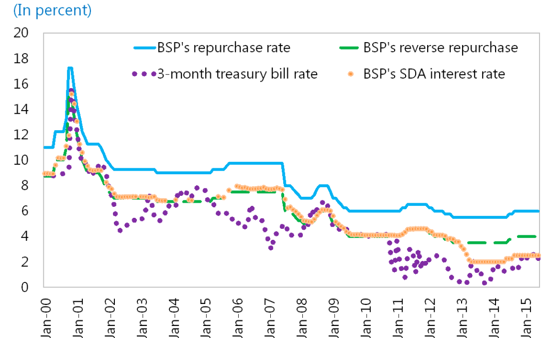


Sources: CEIC Data Company Ltd; and IMF staff calculations.

Figure 2. Philippines: Monetary and Financial Conditions

Monetary policy was tightened last year as the gap between T-bill rates and policy rates has narrowed…

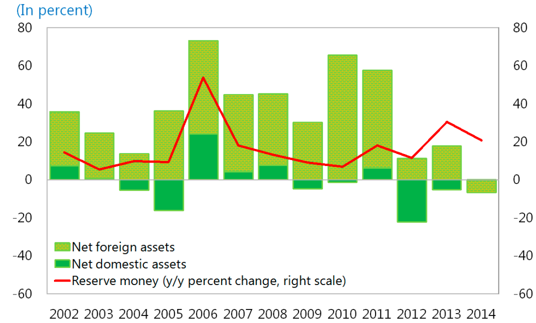
Policy Rates and Three-Month T-Bill Rates
(In percent)



Sources: CEIC Data Co., Ltd.; and Haver Analytics.

…and reserve money growth has slowed.

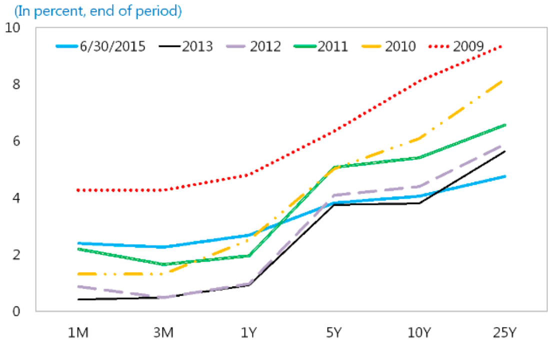
Contribution to Reserve Money Growth
(In percent)



Sources: Haver Analytics.

Monetary tightening has shifted the short end of the yield curve upward…

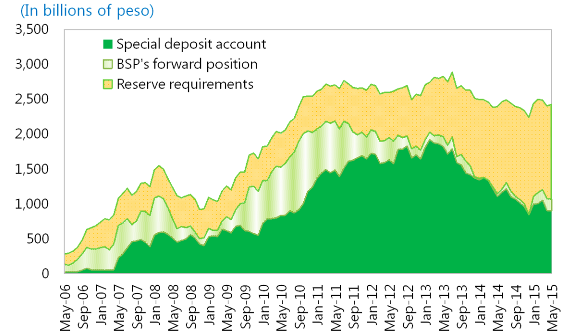
Government Bond Yields
(In percent, end of period)



Source: Bloomberg L.P.

…as the BSP has increasingly absorbed liquidity using the required reserve ratio.

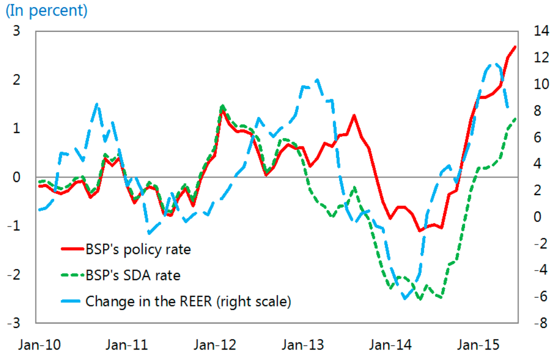
Main Sterilization Instruments
(In billions of peso)



Sources: BSP; and CEIC Data Company Ltd.

Monetary conditions have tightened autonomously due to the increase in real interest rates and the REER since last year…

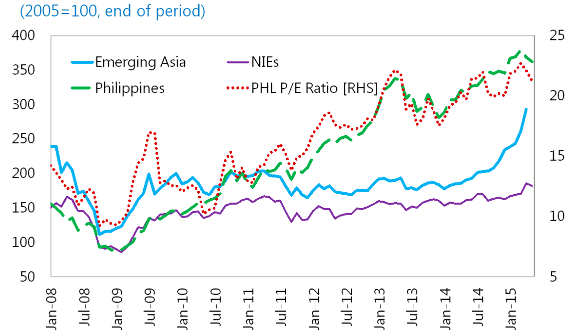
Real Interest Rate and Change in the REER
(In percent)



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

…while stock market valuations have continued to rise.

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

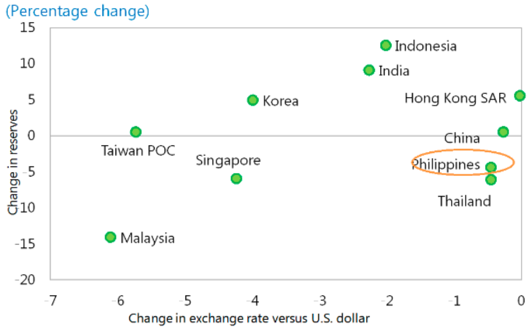


Sources: Bloomberg LP; CEIC Data Company Ltd.; and IMF staff calculations.

Figure 3. Philippines: Financial Market Comparisons

Foreign reserves have fallen modestly...

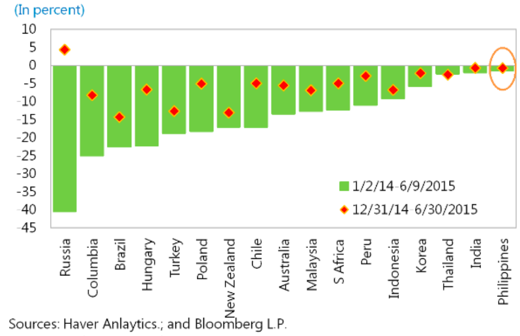
Appreciation and Reserve Accumulation, 2014 1/ 2/
(Percentage change)



1/ The reference period is December 2014 versus December 2013.
2/ Positive change in exchange rate means appreciation.

...while the exchange rate has been stable.

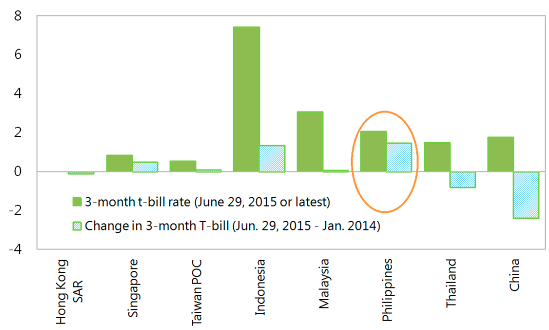
Change in Exchange Rate versus U.S. dollar 1/
(In percent)



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

Monetary conditions have tightened but yields are comparable to other Asian economies.

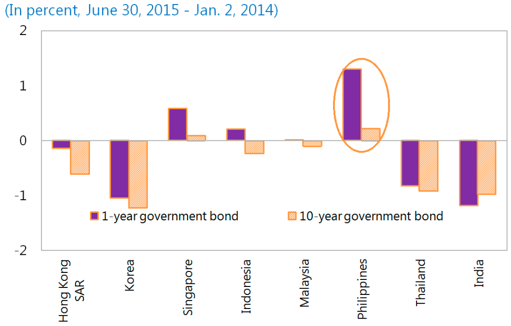
Three-Month Treasury Bill Yields
(In percent)



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

Long-term government bond yields have also increased...

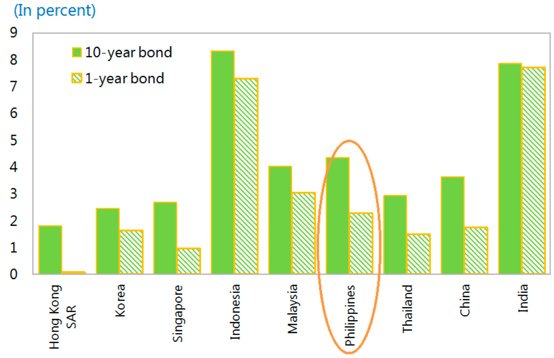
Change in Government Bond Yields
(In percent, June 30, 2015 - Jan. 2, 2014)



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

...but remain lower than some others in the region.

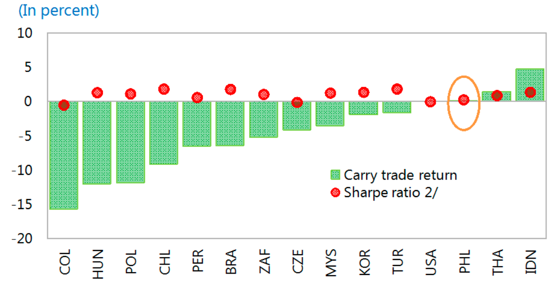
Government Bond Yields, June 2015
(In percent)



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

While negative returns to carry trade have persisted in some EMEs, this is no longer the case for the Philippines.

Carry Trade Return, 2014 1/
(In percent)

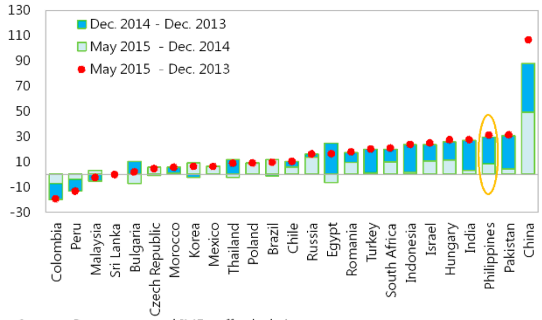


Sources: Bloomberg LP; and IMF staff calculations.
1/ Exchange rate-adjusted return on a one-year local currency government bond versus a one-year U.S. treasury bond.
2/ A measure of risk-adjusted return, calculated as average monthly carry trade return divided by the standard deviation of returns.

Figure 4. Philippines: Cross-Country Financial Market Developments

Stock market valuation changes have been sizable compared to some other EMEs...

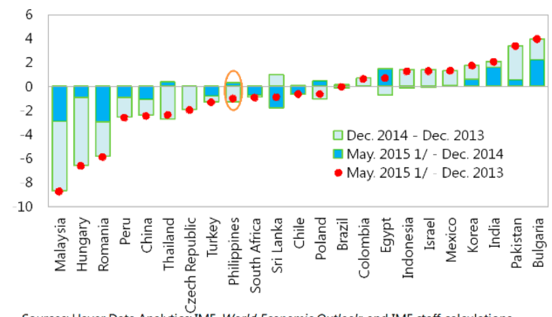
Stock Market Index Changes
(Percent change)



Sources: Datastream; and IMF staff calculations.

...and foreign reserves have been broadly stable.

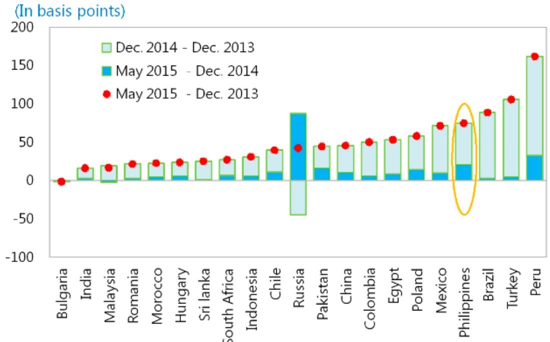
Changes in Stock of Reserves
(In percent of 2014 GDP)



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

The Philippines' sovereign spreads have increased compared to some EMEs...

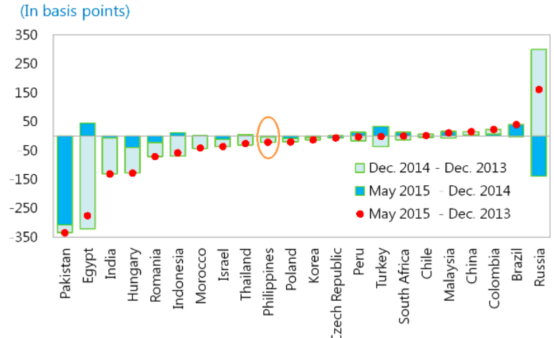
EMBI Changes
(In basis points)



Sources: Datastream; and IMF staff calculations.

...although its CDS spreads have remained low.

CDS Spread Changes
(In basis points)

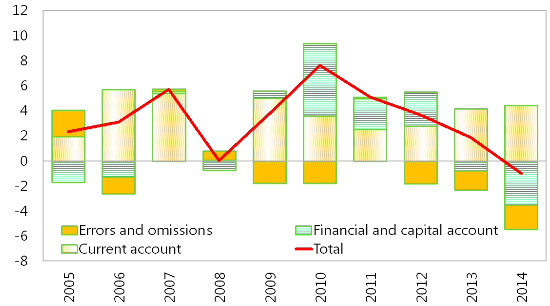


Sources: Datastream; and IMF staff calculations.

Figure 5. Philippines: External Sector

The overall balance of payments has moved from surplus to a modest deficit...

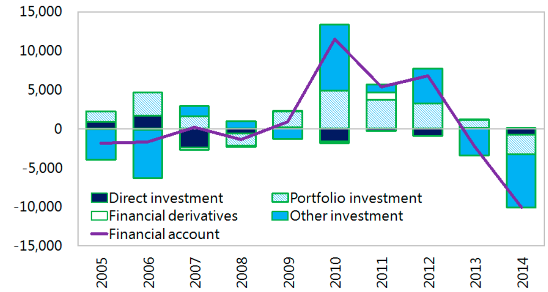
Balance of Payments 1/
(In percent of GDP)



Source: CEIC Data Company Ltd.
1/ BPM6 basis.

...driven by financial account outflows since mid 2013.

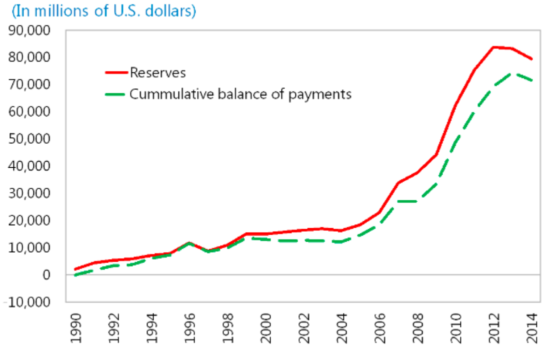
Capital Inflows 1/
(In millions of U.S. dollars)



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

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

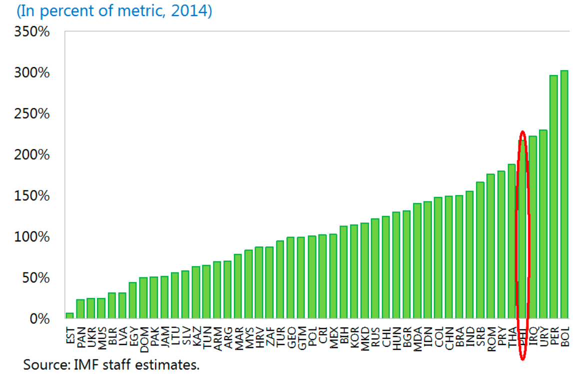
Philippines: International Reserves
(In millions of U.S. dollars)



Source: IMF, *International Financial Statistics.*

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

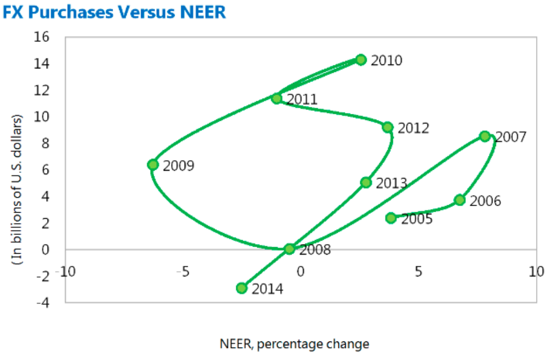
Reserves Against Adequacy Metric
(In percent of metric, 2014)



Source: IMF staff estimates.

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

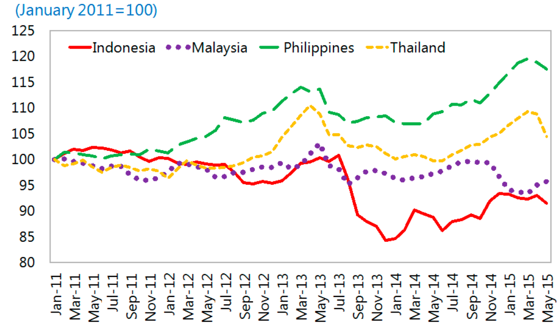
FX Purchases Versus NEER



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

...and the REER has appreciated compared to other ASEAN currencies.

REER in ASEAN
(January 2011=100)

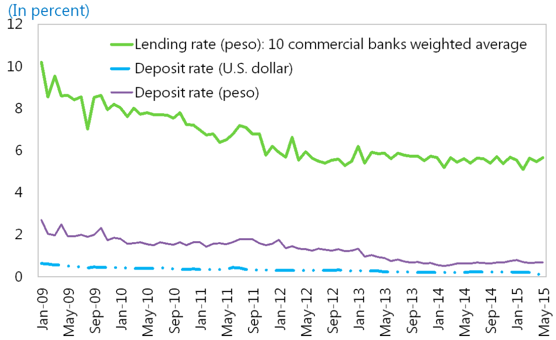


Source: IMF, *Information Notice System.*

Figure 6. Philippines: Banking Sector

Loan/deposit rate spreads have remained high…

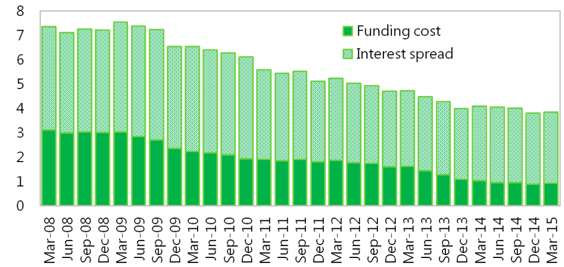
Lending and Deposit Rates
(In percent)



Sources: CEIC Data Co. Ltd.

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

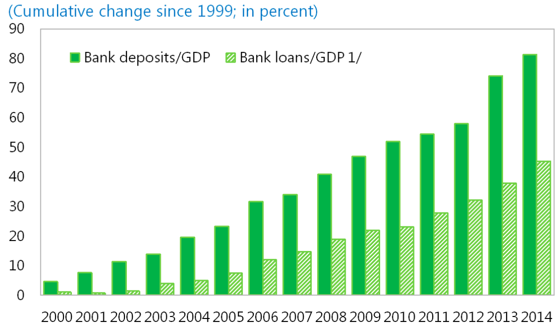
Universal and Commercial Banks: Funding Cost and Interest Spread 1/
(In percent)



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.

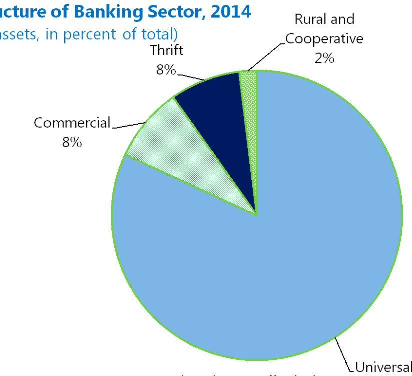
Philippine Banking System: Deposits and Loans
(Cumulative change since 1999; in percent)



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.

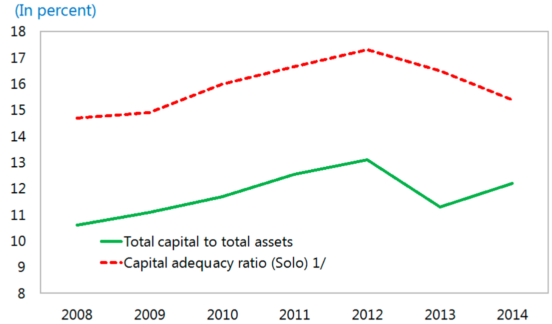
Structure of Banking Sector, 2014
(By assets, in percent of total)



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

The Philippine banking system is well capitalized…

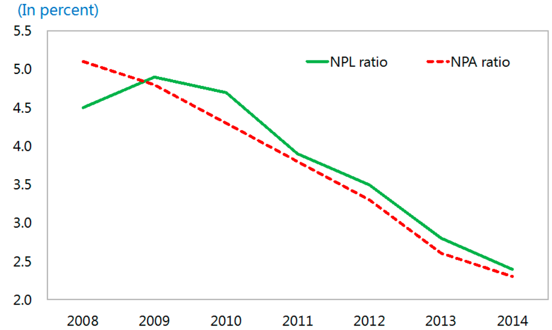
Capital Adequacy
(In percent)



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)

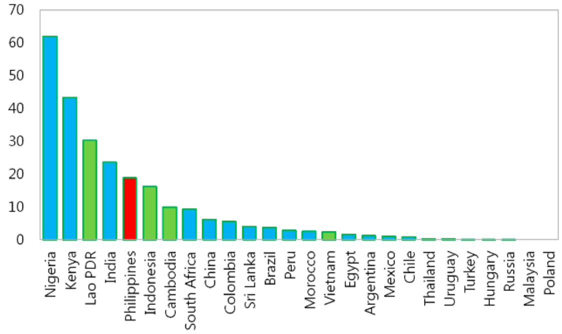


Source: Philippines authorities, *Status Report on the Philippines Financial System*.

Figure 7. Emerging Markets: Social Conditions and Income Distribution

Poverty in the Philippines has fallen but remains high…

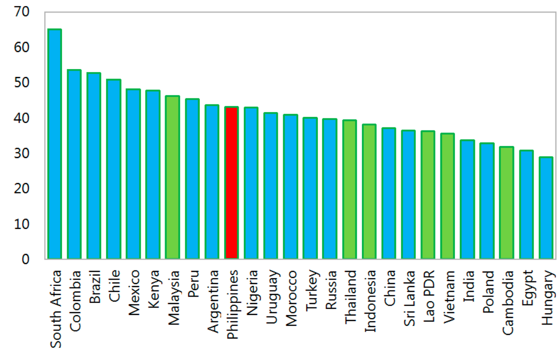
Poverty Rate at $1.25 a Day
(Purchasing power parity, in percent)



Source: World Bank, *World Development Indicators*.

…as is income inequality.

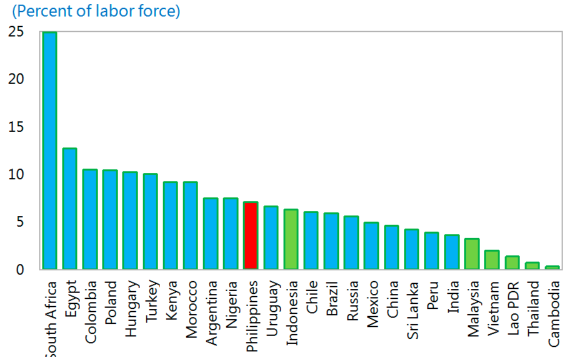
Income Inequality: GINI Coefficient



Source: World Bank, *World Development Indicators*.

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

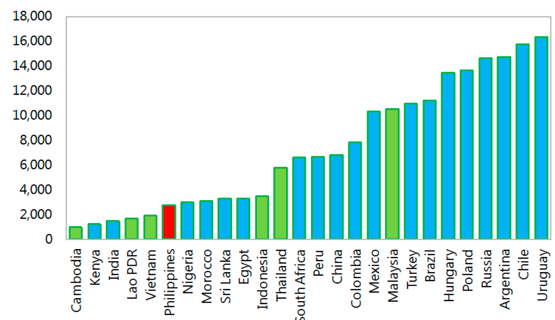
Unemployment Rate in 2013
(Percent of labor force)



Source: World Bank, *World Development Indicators*.

Per capita GDP is low…

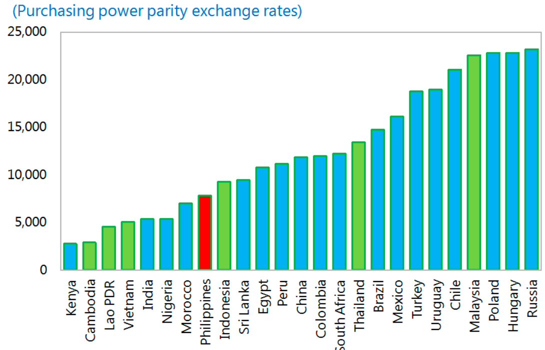
GDP Per Capita in U.S. Dollar, 2013
(Market exchange rates)



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, 2013
(Purchasing power parity exchange rates)



Sources: World Bank, *World Development Indicators*.

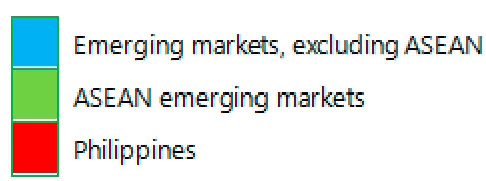


Table 1. Philippines: Selected Economic Indicators, 2010–16

Nominal GDP (2014): P 12,643 billion ($285 billion)
Population (2013): 98.2 million
GDP per capita in nominal terms: $2,772
Poverty headcount ratio at $1.25 a day at PPP (2012): 19 percent
IMF quota: SDR 1,019.3 million
Main products and exports: electronics, agriculture products, and business process outsourcing
Unemployment rate (Q2:2015): 6.4 percent

	2010	2011	2012	2013	2014	2015	2016
						Staff proj.	
GDP and prices (percent change)							
Real GDP	7.6	3.7	6.7	7.1	6.1	6.2	6.5
CPI (annual average)	3.8	4.7	3.2	2.9	4.2	2.1	3.5
CPI (end year)	3.6	4.2	3.0	4.1	2.7	3.4	2.7
Investment and saving (percent of GDP)							
Gross investment	20.5	20.5	18.2	20.0	20.9	22.0	22.3
National saving	24.1	23.0	21.0	24.2	25.4	27.1	26.7
Public finances (percent of GDP)							
National government balance (authorities' definition)	-3.5	-2.0	-2.3	-1.4	-0.6	-1.5	-2.0
National government balance 1/	-3.6	-2.1	-2.4	-1.5	-0.6	-1.5	-2.0
Nonfinancial public sector balance 2/	-3.3	-0.8	-0.6	0.6	0.9	0.0	-0.5
Revenue and grants	18.5	18.6	19.4	20.1	20.1	20.6	20.7
Expenditure	21.7	19.4	20.0	19.5	19.2	20.6	21.2
Nonfinancial public sector debt	54.8	55.3	53.0	51.3	47.8	45.5	42.5
Monetary sector (percent change, end of period)							
Broad money (M3) 3/	10.0	7.1	9.4	31.8	11.2 /	9.3	...
Interest rate (91-day treasury bill, end of period, in percent) 4/	1.3	1.7	0.5	0.5	2.5 /	2.1	...
Credit to the private sector (in percent) 3/	8.9	19.3	16.2	16.4	19.9 /	14.5	...
External sector							
Export value, goods (percent change)	26.2	4.1	21.2	-4.0	7.3	3.5	5.5
Import value, goods (percent change)	24.7	9.5	11.3	-4.8	2.3	1.6	7.1
Current account (percent of GDP)	3.6	2.5	2.8	4.2	4.4	5.0	4.5
Capital account (US$ billions)	0.1	0.2	0.1	0.1	0.1	0.1	0.1
Financial account (US$ billions) 5/	-11.5	-5.3	-6.8	2.2	10.1	7.1	6.1
Direct investment (net) 5/	1.6	0.3	1.0	-0.1	0.8	0.0	-0.7
Errors and omissions (US$ billions)	-3.5	0.3	-4.6	-4.2	-5.5	-5.2	-4.9
Overall balance (US$ billions)	15.2	11.4	9.2	5.1	-2.9	3.1	4.3
Total external debt (percent of GDP) 6/	36.9	33.7	32.0	28.9	27.3	25.6	23.1
Debt service ratio 7/	13.6	13.6	9.9	11.1	8.7	7.8	10.6
Reserves(US$ billions)	62.4	75.3	83.8	83.2	79.5	81.7	84.5
Reserves/short-term liabilities 8/	403.3	482.5	397.9	405.5	406.5	361.2	366.8
Exchange rate (period averages)							
Pesos per U.S. dollar	45.1	43.3	42.2	42.4	44.4	44.5 9/	n.a.
Nominal effective exchange rate (2005 =100)	100.0	99.0	102.6	105.4	102.7	109.6 9/	n.a.
Real effective exchange rate (2005 =100)	100.0	100.7	105.6	109.8	109.5	117.9 9/	n.a.

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, May 2015 (year-on-year).
4/ Secondary market rate, the latest data point is May 2015.
5/ In BPM6. An increase in either assets or liabilities is always positive and a decrease is always negative. Net investment is assets minus
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/ January - May 2015.

Table 2. Philippines: National Government Cash Accounts, 2010–16

(In billions of pesos, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015		2016
						Budget	Proj.	Proj.
Revenue and grants	1,208	1,359	1,527	1,713	1,907	2,337	2,082	2,314
Tax revenue	1,094	1,202	1,361	1,536	1,720	2,194	1,877	2,090
Net income and profits	489	572	643	718	785	...	872	966
Excises	88	88	98	146	166	...	177	194
VAT	330	383	451	490	558	...	603	688
Tariffs	81	42	41	35	56	...	61	62
Other 1/ 2/	106	117	129	146	155	...	164	181
Nontax revenue	114	157	166	178	187	141	206	224
Expenditure and net lending	1,529	1,561	1,781	1,881	1,984	2,621	2,291	2,618
Current expenditures	1,237	1,293	1,394	1,521	1,619	1,927	1,824	2,028
Personnel services	469	500	543	582	604	...	666	756
Maintenance and operations	182	201	237	283	309	...	361	397
Allotments to local government units	216	230	219	242	273	...	313	360
Subsidies	21	46	42	66	80	...	87	96
Tax expenditure	47	34	38	23	30	...	32	35
Interest	301	282	316	324	324	375	366	384
Capital and equity expenditure	283	250	359	344	351	668	448	569
Capital expenditure	281	237	338	333	350	639	446	566
Equity	2	13	21	11	2	29	2	2
Net lending	9	18	27	17	13	27	20	21
Balance	-321	-201	-254	-168	-77	-284	-209	-303
On the authorities' presentation 3/	-314	-198	-243	-164	-73	-284	-206	-299

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, 2010–16

(In percent of GDP, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015 Budget 8/	2015 Proj.	2016 Proj.
Revenue and grants	13.4	14.0	14.5	14.8	15.1	16.7	15.3	15.4
Tax revenue	12.1	12.4	12.9	13.3	13.6	15.7	13.8	13.9
Net income and profits	5.4	5.9	6.1	6.2	6.2	...	6.4	6.4
Excises	1.0	0.9	0.9	1.3	1.3	...	1.3	1.3
VAT	3.7	3.9	4.3	4.2	4.4	...	4.4	4.6
Tariffs	0.9	0.4	0.4	0.3	0.4	...	0.4	0.4
Other 1/ 2/	1.2	1.2	1.2	1.3	1.2	...	1.2	1.2
Nontax revenue	1.3	1.6	1.6	1.5	1.5	1.0	1.5	1.5
Expenditure and net lending	17.0	16.1	16.9	16.3	15.7	18.7	16.8	17.4
Current expenditures	13.7	13.3	13.2	13.2	12.8	13.8	13.4	13.5
Personnel services	5.2	5.2	5.1	5.0	4.8	...	4.9	5.0
Maintenance and operations	2.0	2.1	2.2	2.4	2.4	...	2.6	2.6
Allotments to local government units	2.4	2.4	2.1	2.1	2.2	...	2.3	2.4
Subsidies	0.2	0.5	0.4	0.6	0.6	...	0.6	0.6
Tax expenditure	0.5	0.3	0.4	0.2	0.2	...	0.2	0.2
Interest	3.3	2.9	3.0	2.8	2.6	2.7	2.7	2.6
Capital and equity expenditure	3.1	2.6	3.4	3.0	2.8	4.8	3.3	3.8
Capital expenditure	3.1	2.4	3.2	2.9	2.8	4.6	3.3	3.8
Equity	0.0	0.1	0.2	0.1	0.0	0.2	0.0	0.0
Net lending	0.1	0.2	0.3	0.1	0.1	0.2	0.1	0.1
Balance	-3.6	-2.1	-2.4	-1.5	-0.6	-2.0	-1.5	-2.0
On the authorities' presentation 3/	-3.5	-2.0	-2.3	-1.4	-0.6	-2.0	-1.5	-2.0
Memorandum items:								
National government								
Primary balance	-0.2	0.8	0.6	1.4	1.9	0.7	1.2	0.5
Debt 4/	46.2	44.9	44.2	42.7	39.7	...	38.5	36.6
(In percent of national government revenues)	344.3	320.9	306.0	287.9	263.4	...	252.2	238.0
Gross financing requirement 5/	14.9	12.1	9.1	5.9	4.7	...	7.1	8.5
Nonfinancial public sector (NFPS) 6/								
Balance	-3.3	-0.8	-0.6	0.6	0.9	...	0.0	-0.5
Debt	54.8	55.3	53.0	51.3	47.8	...	45.5	42.5
(In percent of NFPS revenues)	296.3	297.6	273.1	254.8	237.7	...	221.4	205.0
Consolidated public sector balance 7/	4.7	2.9	2.6	1.4	1.1	...	1.7	2.2

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).
4/ Consolidated (net of national government debt held by the sinking fund) and excluding contingent/guaranteed debt.
5/ Defined as the deficit, plus amortization of medium- and long-term debt, plus the stock of short-term debt at the end of the last period.
6/ Includes the national government, 14 government-owned enterprises, social security institutions, and local governments. Debt is consolidated (net of intra-nonfinancial public sector holdings of debt). Balance is cash basis.
7/ Includes nonfinancial public sector, government financial institutions, and BSP. Balance is cash basis.
8/ Using the nominal GDP in the authorities' budget.

Table 4. Philippines: General Government Operations, 2010–16 1/

(In percent of GDP)

	2010	2011	2012	2013	2014	2015 Proj.	2016 Proj.
Revenue	16.8	17.6	18.6	18.8	19.3	19.5	19.6
Taxes	12.9	13.2	14.1	14.5	14.8	14.9	15.1
Taxes on income, profits, and capital gains	5.4	5.9	6.1	6.2	6.2	6.4	6.4
Taxes on goods and services	5.5	5.8	6.2	6.6	6.7	6.7	6.8
Taxes on international trade and transactions	0.9	0.4	0.4	0.3	0.4	0.4	0.4
Taxes not elsewhere classified	1.1	1.1	1.4	1.4	1.4	1.4	1.4
Social contributions	1.9	1.9	2.0	2.0	2.2	2.2	2.2
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue	2.0	2.5	2.5	2.3	2.3	2.3	2.3
Total expenditure	19.2	18.0	18.9	18.6	18.4	19.6	20.2
Expense	15.6	15.1	15.3	15.3	15.1	15.7	15.8
Compensation of employees 2/	5.2	5.2	5.1	5.0	4.8	4.9	5.0
Purchases/use of goods and services 2/	2.0	2.1	2.2	2.4	2.4	2.6	2.6
Interest 2/	3.0	2.6	2.6	2.5	2.2	2.4	2.2
Social benefits	1.7	1.8	1.8	1.9	2.1	2.3	2.4
Expense not elsewhere classified	3.6	3.5	3.4	3.4	3.5	3.5	3.5
Net acquisition of nonfinancial assets	3.5	2.9	3.6	3.3	3.3	3.9	4.5
Net lending/borrowing	-2.4	-0.4	-0.3	0.2	0.9	-0.1	-0.6
National government	-3.4	-1.8	-1.9	-1.2	-0.5	-1.4	-1.9
Local government units	0.6	0.7	0.7	0.7	0.7	0.7	0.8
Social security institutions (SSIs)	0.5	0.7	0.9	0.7	0.7	0.5	0.5
Net acquisition of financial assets	1.7	0.8	4.6	3.0	2.1	2.2	1.7
Net incurrence of liabilities	4.0	1.2	4.9	2.7	1.2	2.3	2.3
Memorandum items:							
National government cash holdings	3.0	...	...	...	...	...	...
Consolidated general government debt	43.5	41.4	40.6	39.2	36.4	35.2	33.3

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, 2010–16 1/

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

	2010	2011	2012	2013	2014	2015 Proj.	2016 Proj.
Total							
Net foreign assets	2,865,080	3,242,542	3,248,548	3,575,054	3,752,064	4,090,631	4,439,969
Net domestic assets	2,663,012	2,578,913	2,979,116	4,479,152	5,303,883	6,028,250	6,973,161
Net claims on nonfinancial public sector	1,367,338	1,520,559	1,298,189	1,287,632	1,470,598	1,593,362	1,814,788
Claims on private sector	2,663,097	3,093,882	3,528,922	4,137,658	4,949,747	5,673,829	6,521,516
Net claims on other financial corporations	-410,931	-894,944	-767,601	178,728	274,276	321,735	382,166
Capital accounts	1,080,747	1,258,757	1,113,606	1,203,888	1,462,499	1,642,237	1,839,653
Other items (net)	124,255	118,172	33,212	79,022	71,760	81,560	94,345
Broad money	5,528,092	5,821,454	6,227,664	8,054,206	9,055,947	10,118,882	11,413,130
National currency	4,462,086	4,801,830	5,227,220	6,915,929	7,698,511	8,602,117	9,702,365
Foreign currency	1,066,007	1,019,625	1,000,443	1,138,277	1,357,436	1,516,764	1,710,765
Bangko Sentral ng Pilipinas							
Net foreign assets	2,657,283	3,233,794	3,382,382	3,643,852	3,514,334	3,593,027	3,695,597
Net domestic assets	-1,503,158	-1,908,654	-1,886,211	-1,712,821	-1,189,662	-901,068	-550,717
Claims on private sector	1	1	1	1	1	1	1
Net claims on financial corporations	-1,417,264	-1,846,634	-1,810,951	-1,576,264	-1,072,410	-812,260	-496,439
Capital accounts	233,202	287,252	1,760	3,821	5,346	4,049	2,475
Other items (net)	-14,953	-12,445	-13,655	-17,763	-4,837	-3,664	-2,239
Base money	1,120,546	1,323,000	1,475,633	1,926,202	2,323,905	2,691,192	3,144,113
Currency in circulation	601,275	648,911	692,657	797,452	929,502	1,076,407	1,257,564
Other depository corporations liabilities	518,755	673,511	782,647	1,128,302	1,386,745	1,605,916	1,876,188
Other liquid liabilities	33,579	2,139	20,538	4,829	767	767	767
Other Depository Corporations							
Net foreign assets	207,797	8,748	-133,834	-68,798	237,731	497,605	744,372
Net domestic assets	4,807,774	5,295,056	5,781,849	7,477,386	8,095,638	8,813,665	9,757,589
Net claims on nonfinancial public sector	1,205,078	1,282,883	1,358,035	1,402,605	1,577,668	1,674,456	1,864,347
Claims on private sector	2,663,096	3,093,881	3,528,921	4,137,658	4,949,746	5,673,829	6,521,515
Net claims on financial corporations	1,642,090	1,751,828	1,969,705	3,045,147	2,955,906	3,025,672	3,116,800
Capital accounts	847,546	971,505	1,111,846	1,200,066	1,457,153	1,638,188	1,837,178
Other items (net)	145,056	137,969	37,034	92,043	69,471	77,896	92,105
Liquid liabilities	5,015,571	5,303,804	5,648,015	7,408,588	8,333,369	9,311,270	10,501,961
Memorandum Items							
Broad Money (percent change)	10.9	5.3	7.0	29.3	12.4	11.7	12.8
Claims on private sector (percent change)	13.8	16.2	14.1	17.2	19.6	14.6	14.9
Broad Money (percent of GDP)	61.4	60.0	59.0	69.8	71.6	74.2	75.9
Claims on private sector (percent of GDP)	29.6	31.9	33.4	35.8	39.2	41.6	43.4
Nominal GDP	9,003,479	9,708,334	10,561,086	11,542,285	12,642,736	13,644,813	15,038,870

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, 2010–2016 1/

(In billions of U.S. dollars)

	2010	2011	2012	2013	2014	2015	2016
						Staff proj.	
Current account balance	7.2	5.6	6.9	11.4	12.7	15.3	15.2
Trade balance of goods and services	-11.1	-13.9	-12.7	-10.6	-11.0	-9.4	-10.6
Goods	-16.9	-20.4	-18.9	-17.7	-15.9	-15.2	-17.1
Exports, f.o.b.	36.8	38.3	46.4	44.5	47.8	49.4	52.1
Imports, f.o.b.	53.6	58.7	65.3	62.2	63.6	64.6	69.2
Services	5.8	6.6	6.2	7.0	4.9	5.8	6.5
Receipts	17.8	18.9	20.4	23.3	24.8	27.2	29.8
Payments	12.0	12.3	14.3	16.3	20.0	21.4	23.3
Primary income, net	0.7	0.9	0.2	1.0	1.1	0.9	0.8
Receipts, *of which* :	6.7	7.6	8.3	8.4	9.0	9.6	10.1
Resident workers abroad	5.1	5.9	6.5	7.0	7.5	7.9	8.4
Payments	6.0	6.7	8.1	7.4	8.0	8.6	9.3
Interest payments	2.7	2.9	3.1	2.8	2.6	3.4	3.3
Secondary income, net	17.6	18.6	19.5	21.1	22.6	23.8	25.0
Receipts, *of which* :	18.0	19.0	20.1	21.7	23.2	24.5	25.9
Nonresident workers remittances	16.2	17.1	18.0	19.3	20.4	21.9	23.1
Payments	0.4	0.5	0.6	0.6	0.7	0.8	0.9
Capital account	0.1	0.2	0.1	0.1	0.1	0.1	0.1
Financial account 2/	-11.5	-5.3	-6.7	2.2	10.1	7.1	6.1
Direct investment	1.6	0.3	1.0	-0.1	0.8	0.0	-0.7
Portfolio investment	-4.9	-3.7	-3.2	-1.0	2.5	0.7	0.6
Equity	-0.8	-1.0	-1.7	0.1	-1.0	-1.2	-1.2
Debt	-4.1	-2.6	-1.5	-1.1	3.4	1.8	1.7
Financial derivatives	0.2	-1.0	0.0	-0.1	0.0	0.0	0.0
Other investment, *of which* :	-8.4	-1.0	-4.5	3.4	6.9	6.5	6.3
Currency and deposits	-0.2	2.3	-1.5	1.4	4.5	3.8	3.2
Loans	-7.0	-3.6	-2.3	1.4	2.0	1.9	1.9
Errors and omissions	-3.5	0.3	-4.6	-4.2	-5.5	-5.2	-4.9
Overall balance	15.2	11.4	9.2	5.1	-2.9	3.1	4.3
Memorandum items:							
Current account/GDP	3.6	2.5	2.8	4.2	4.4	5.0	4.5
Short-term debt (original maturity)	10.5	12.1	16.5	16.9	16.2	16.5	16.8
Short-term debt (residual maturity)	15.5	15.6	21.1	20.5	19.6	22.6	23.0
Gross reserves	62.4	75.3	83.8	83.2	79.5	81.7	84.5
(in percent of st. debt by res. maturity) 3/	403.3	482.5	397.9	405.5	406.5	361.2	366.8
External debt (in billions)	73.6	75.6	79.9	78.5	77.7	78.0	78.4
(in percent of GDP)	36.9	33.7	32.0	28.9	27.3	25.6	23.1
Debt service ratio 4/	13.6	13.6	9.9	11.1	8.7	7.8	10.6
Export value (percent change)	26.2	4.1	21.2	-4.0	7.3	3.5	5.5
Import value (percent change)	24.7	9.5	11.3	-4.8	2.3	1.6	7.1
Gross external financing needs 5/	4.1	9.8	8.7	9.7	7.9	6.8	7.4
Cash Remittances (percent change)	8.2	7.2	6.3	7.4	5.9	5.6	5.6

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, 2012–20

(In percent of GDP, unless otherwise indicated)

	2012	2013	2014	Staff proj. 2015	2016	2017	2018	2019	2020
GDP and prices									
Real GDP (percent change)	6.7	7.1	6.1	6.2	6.5	6.5	6.5	6.5	6.5
CPI (percent change, annual average)	3.2	2.9	4.2	2.1	3.5	3.5	3.5	3.5	3.5
GDP by expenditure									
Consumption (percent change)	7.7	5.5	4.9	6.2	6.3	6.5	6.5	6.5	6.5
Private	6.6	5.6	5.4	6.0	6.2	6.5	6.5	6.5	6.5
Public	15.5	5.0	1.7	7.6	7.0	6.5	6.5	6.5	6.5
Gross fixed investment (percent change)	10.8	12.2	6.8	8.5	8.3	8.6	8.5	8.5	8.5
Net exports (contribution to growth)	1.4	-2.6	1.0	-1.2	-0.2	-0.3	-0.3	-0.4	-0.5
Investment and saving									
Gross investment	18.2	20.0	20.9	22.0	22.3	22.5	22.8	23.1	23.4
Private	15.0	17.1	18.0	18.5	18.2	18.3	18.5	18.7	18.9
Public	3.2	2.9	2.9	3.5	4.1	4.2	4.2	4.3	4.5
National saving	21.0	24.2	25.4	27.1	26.7	26.5	26.3	26.1	25.9
Private	19.2	21.3	22.0	24.0	23.7	23.4	23.2	22.9	22.7
Public	1.8	2.9	3.3	3.0	3.1	3.1	3.1	3.2	3.2
Public finances									
Nonfinancial public sector balance 1/	-0.6	0.6	0.9	0.0	-0.5	-0.6	-0.7	-0.8	-0.9
Primary balance	2.7	3.7	3.7	2.8	2.2	1.9	1.7	1.4	1.1
Revenue and grants	19.4	20.1	20.1	20.6	20.7	20.7	20.8	20.8	20.8
Expenditure (primary)	16.7	16.5	16.4	17.7	18.6	18.8	19.1	19.4	19.7
Interest	3.3	3.1	2.8	2.8	2.7	2.5	2.4	2.2	2.0
Nonfinancial public sector gross financing need	7.7	4.0	3.4	5.8	7.1	7.1	7.7	8.3	9.0
Domestic	6.2	3.7	2.5	4.6	6.0	6.6	7.2	7.9	8.6
Foreign currency	1.5	0.3	0.8	1.2	1.1	0.5	0.4	0.4	0.4
National government balance (authorities definition)	-2.3	-1.4	-0.6	-1.5	-2.0	-2.0	-2.0	-2.0	-2.0
National government balance	-2.4	-1.5	-0.6	-1.5	-2.0	-2.0	-2.0	-2.0	-2.0
Nonfinancial public sector debt	53.0	51.3	47.8	45.5	42.5	39.6	37.0	34.6	32.4
External sector									
Export value, goods (percent change)	21.2	-4.0	7.3	3.5	5.5	5.5	5.5	5.5	5.4
Import value, goods (percent change)	11.3	-4.8	2.3	1.6	7.1	7.2	7.3	7.5	7.7
Trade balance of goods and services	-5.1	-4.1	-4.1	-3.4	-3.5	-3.6	-3.7	-3.7	-3.8
Current account	2.8	4.2	4.4	5.0	4.5	4.0	3.5	3.0	2.5
Reserves (US$ billions)	83.8	83.2	79.5	81.7	84.5	87.8	91.6	95.0	97.4
Reserves/short-term liabilities 2/	397.9	405.5	406.5	361.2	366.8	376.1	387.0	395.5	399.8
Total external debt	32.0	28.9	27.3	25.6	23.1	21.0	19.1	17.3	15.7
Debt service ratio (in percent of exports of goods and services)	9.9	11.1	8.7	7.8	10.6	10.0	9.3	8.6	8.0
Monetary sector:									
Credit to private sector 3/	33.4	35.8	39.2	41.6	43.4	45.4	47.6	49.8	52.0
Credit to private sector (percent change) 3/	14.1	17.2	19.6	14.6	14.9	15.4	15.4	15.3	15.2

Sources: Philippine authorities; and IMF staff projections.

1/ Includes the national government, 14 government-owned enterprises, social security institutions, and local governments. Cash basis.
2/ Reserves as a percent of short-term debt (including medium- and long-term debt due in the following year).
3/ 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: Banking Sector Indicators, 2009–14

(In percent)

	2009	2010	2011	2012	2013	2014
Capital adequacy						
Total capital to total assets	11.1	11.7	12.6	13.1	11.3	12.2
Capital adequacy ratio (Solo) 1/	14.9	16.0	16.7	17.4	16.6	15.4
Asset quality						
NPL ratio 2/	4.1	3.9	3.0	2.6	2.9	2.4
NPA ratio 3/	4.5	3.9	3.3	2.9	2.6	2.3
Distressed asset ratio 4/	9.3	8.8	7.0	6.0	5.6	4.6
NPL coverage ratio 5/	93.1	97.6	103.7	113.0	118.7	119.8
NPA coverage ratio 6/	48.7	52.7	57.1	63.1	73.0	77.1
Profitability						
Return on assets	1.2	1.4	1.5	1.6	1.6	1.3
Return on equity	10.8	12.2	12.1	12.4	13.3	10.9
Cost-to-income ratio	65.8	63.6	65.0	63.5	60.5	62.4
Liquidity						
Liquid assets to deposits	52.7	59.7	56.5	57.5	59.5	55.6
Loans (gross) to deposits	68.1	64.5	70.0	73.5	64.3	68.4

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

1/ Solo refers to the head office and branches.

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

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

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

5/ Ratio of loan loss reserves to NPLs.

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

Table 9. Philippines: Indicators of External Vulnerability, 2009–14

(In percent of GDP, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014
External indicators (including external liquidity)						
Gross international reserves, (in billions U.S. dollars)	44.2	62.4	75.3	83.8	83.2	79.5
Maturing short-term debt (in billions U.S. dollars)	6.5	10.5	12.1	16.5	16.9	16.2
Amortization of medium and long-term debt (in billions U.S. dollars)	4.3	4.8	5.0	3.6	4.6	3.6
Net FDI inflows (in billions of U.S. dollars)	-0.2	1.6	0.3	1.0	-0.1	0.8
FX deposits residents (in billions of U.S. dollars)	22.8	25.1	24.3	25.3	26.1	32.1
Total gross external debt	38.4	36.9	33.7	32.0	28.9	27.3
Nonfinancial public sector indicators:						
Overall balance	-3.2	-3.3	-0.8	-0.6	0.6	0.9
Primary balance	0.7	0.4	2.4	2.7	3.7	3.7
Debt	58.1	54.8	55.3	53.0	51.3	47.8
Debt denominated in FX or linked to the exchange rate (in percent of total)	58.8	53.2	47.0	36.0	33.5	31.9
Short-term general government debt (original maturity, in percent of total)	14.1	11.2	6.0	5.1	5.6	4.9
Average effective interest rate of government debt (in percent)	7.0	7.1	6.3	6.4	6.3	6.0
Amortization of total debt	12.8	10.7	8.2	6.7	5.0	4.0

Sources: Philippine authorities; and IMF staff estimates.

Appendix 1. 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 global financial conditions and a surge in financial volatility	High/ Short Term	• Sharp asset price adjustment and decompression of credit spreads. • The associated volatility surge could be amplified by low market liquidity. • Sharp capital outflows, leading to a peso depreciation.	**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. • 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. • 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.	**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.
Continued low infrastructure and social spending	Medium/ Short and Medium Term	• Continued weak budget execution limits social and infrastructure spending in the near term. • Continued low revenue base limits 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 conditional cash transfer 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. • Establish a fund to finance social and reconstruction spending after natural disasters. • Explore private and public sector options for insurance.
Severe El Niño weather conditions	Low/ Short Term	• Drought in many regions results in a poor harvest. • Reduced supply leads to agricultural price increases.	**Medium** • Results in consumer price inflation above the upper limit of the BSP's target band. • Increases the cost of food for consumers, particularly the poor. • The loss of real income to consumers reduces economic growth.	• Relax food import restrictions to avoid sharp agricultural price increases and release buffer stocks. • Consider monetary policy tightening if second-round price effects appear.

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 2. Philippines—External Sector Assessment

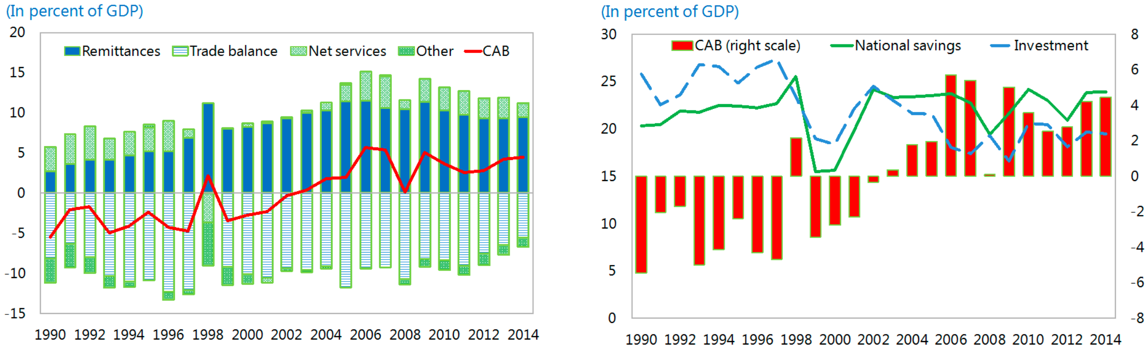
Current Account

1. The Philippines' current account balance (CAB) has recorded significant surpluses in the last decade, with strong remittances and service exports more than offsetting persistent trade deficits (Figure 2.1). After being in deficit during most of the 1990s, the CAB turned into surplus since 2003, peaking at 5.7 percent of GDP in 2006. Initially this reflected growing remittances, but later it also reflected lower trade deficits and higher net service exports due to business process outsourcing. The CAB increased to over 4 percent of GDP in 2013–14 mainly due to smaller trade deficits.

Figure 2.1. Philippines: Current Account Balance

Current Account Balance (CAB)
(In percent of GDP)

Saving-Investment Gap (CAB)
(In percent of GDP)



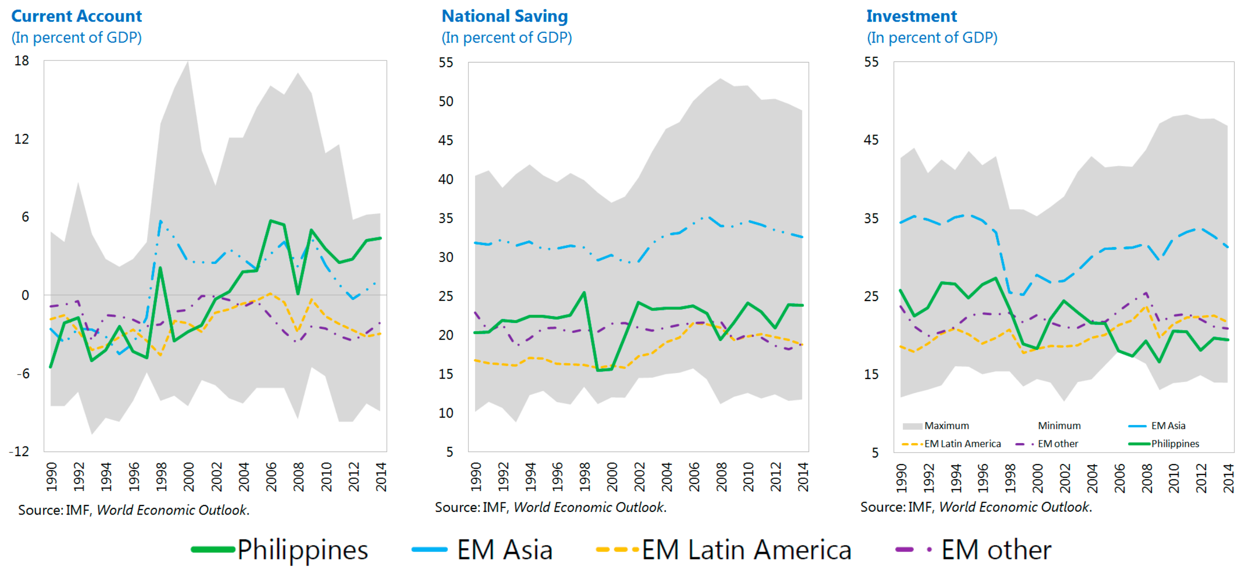
Sources: CEIC Data Co., Ltd.; and IMF, *World Economic Outlook*.

Sources: CEIC Data Co., Ltd.; and IMF, *World Economic Outlook*.

2. The strengthening of the CAB since the late-1990s mainly corresponds to a sustained fall in the investment-to-GDP ratio since the Asian financial crisis. Gross capital formation declined from above 25 percent of GDP in the pre-Asian crisis period to below 20 percent of GDP since 2006. National saving also rose, but only by about 1 percent of GDP. The recent increase in the CAB in 2013–14 has reflected a faster pickup in saving than in investment.

3. Relative to GDP, the Philippine CAB was similar to that of other emerging market economies (EMEs) in the 1990s, but larger than most peers in the 2000s (Figure 2.2). This change corresponds to a shift in the Philippines' investment-to-GDP ratio, which before the Asian financial crisis was above the average ratios of Latin American or other EMEs, but has been below these comparators since 2006. Relative to the average Asian EME, the Philippines has always had a lower investment ratio, especially since 2003. At the same time, the Philippine national saving ratio has risen only marginally over time, and has consistently been somewhat higher than the ratios in Latin America and other regions, but lower than those for Asian EMEs.

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

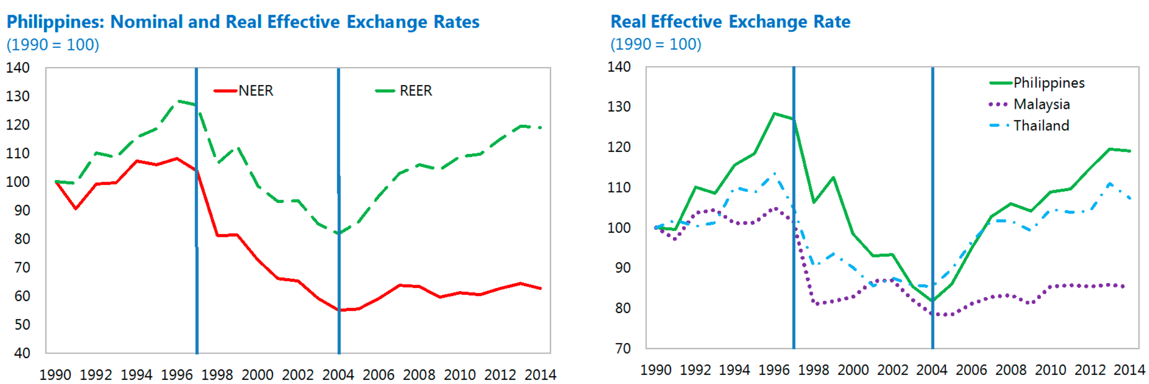


Source: IMF, *World Economic Outlook*.

Effective Exchange Rate

4. After declining continuously since the Asian financial crisis, the Philippines' real effective exchange rate (REER) has been on an upward trend since 2004 (Figure 2.3). The post Asian crisis real depreciation was mostly due to a fall in the nominal effective exchange rate (NEER). The early part of the post 2004 real appreciation was also associated with nominal appreciation, but since 2007 it has been due to the inflation differential between the Philippines and its trading partners, with the NEER remaining stable. The post-1998 real depreciation was stronger in the Philippines than in Malaysia and Thailand, but the post-2004 appreciation has also been stronger in the Philippines (46 percent in the Philippines, against 26 and 9 percent, respectively in Thailand and Malaysia).

Figure 2.3. Philippines: Real and Nominal Effective Exchange Rates

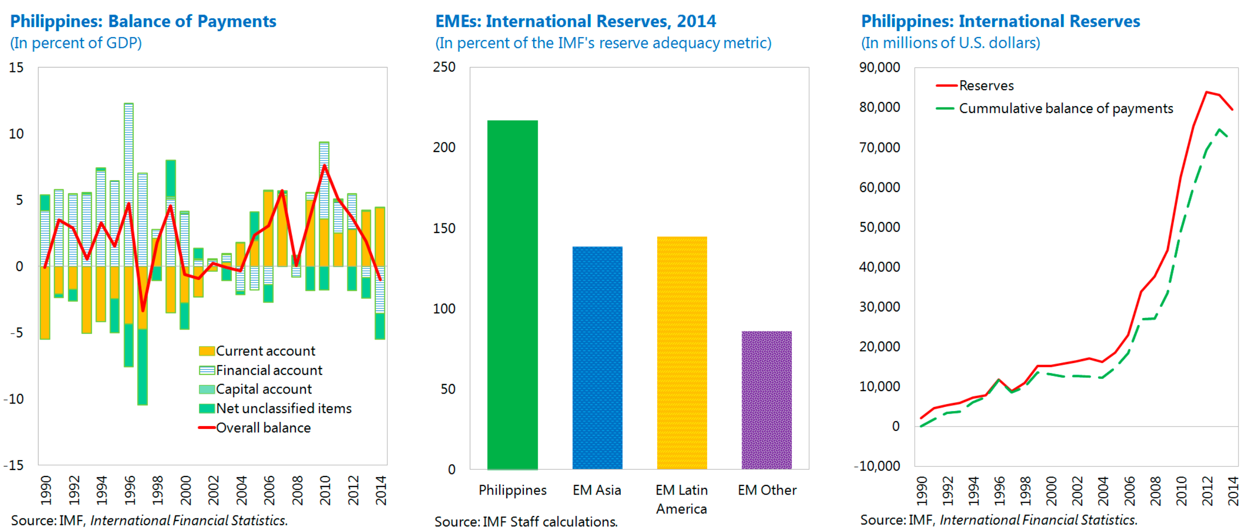


Source: IMF, *International Financial Statistics*.

Reserve Accumulation, Reserve Adequacy and Net International Investment Position

5. The Philippines has accumulated sizable international reserves since the Asian financial crisis, and especially since the global financial crisis (Figure 2.4). The balance of payments surplus reflects mainly current account surpluses, but the financial account also contributed to reserve accumulation in 2010–12. As a result, the stock of foreign reserves has risen by 18 percent of GDP since 1997. The fast pace of reserve accumulation in 2010–12 slowed in 2013 and reversed in 2014 due to capital outflows. At end 2014, reserves were 28 percent of GDP and 2.2 times the IMF's reserve adequacy metric (against the benchmark of 1 to 1½ times). Reserves were also 3½ times short-term external debt on a residual maturity basis and 11 months of imports of goods and services. This suggests that the Philippines holds more reserves than is warranted to meet normal contingencies.

Figure 2.4. Philippines: Balance of Payments and International Reserves



6. The Philippines' net international investment position (NIIP) has improved sharply mirroring sustained current account surpluses. The NIIP rose from −49 percent of GDP in 2001 to −14 percent in 2014. Three-fifths of this increase was due to the fall in other investment liabilities, with the other two-fifths due to increased assets, mostly official reserves and foreign direct investment. Reserve assets accounted for 54 percent of total assets (US$149 billion) in 2014, while portfolio investment and other investment liabilities amounted to 43 percent and 26 percent of total liabilities (US$189 billion).

External Balance Assessment (EBA)

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

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

Method	Current Account Regression Approach	REER Index Regression Approach	REER Levels Regression Approach	External Sustainability Approach
Assessment period	2014	2014	2014	2020
Actual CAB (percent of GDP)	4.4	---	---	2.5
CAB norm (percent of GDP)	-3.3	---	---	-1.0
CAB gap (percent of GDP) 2/	7.8	---	---	3.5
Of which:				
Contribution of identified policy gaps	1.7	---	---	---
Unexplained residual	6.1	---	---	---
REER gap (percent) 3/	---	2.4	18.1	---
Of which:				
Contribution of identified policy gaps	---	-0.6	-1.1	---
Unexplained residual	---	3.0	19.2	---

Source: IMF staff estimates, based on the 2014 external balance assessment.
1/ Based on the EBA update of February 2015.
2/ The CAB gap is defined as the difference between the actual CAB and the CAB norm.
3/ A positive REER gap indicates overvaluation.

- The EBA's Current Account Regression approach suggests that a current account deficit—rather than a surplus—is appropriate for the Philippines. This reflects the economy's low per capita income, fast growing population, and strong growth prospects, despite sizable institutional risk.[1] The gap between the actual and the fitted CAB turned positive since 2002, reaching a peak of 6.1 percent of GDP in 2014. The gap rises to 7.8 percent of GDP when deviations of domestic and foreign policies from their desired levels are considered, with about half of the deviation due domestic policies (mainly a too tight fiscal policy stance in the Philippines), and the other half due to policy deviations abroad.

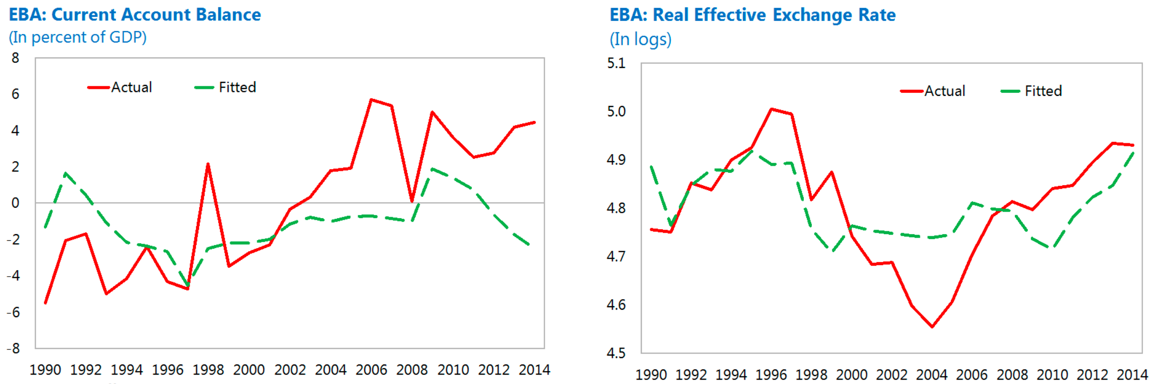
- The External Sustainability approach suggests that the Philippines' medium-term CAB is larger than the CAB needed to stabilize the NFA-to-GDP ratio.

- The EBA's REER index approach suggests that the REER was slightly stronger than warranted by fundamentals and desired policies in 2014.

- The EBA's REER level approach also suggests that the REER was stronger than warranted by fundamentals and desired policies, with a larger degree of overvaluation than for the EBA's REER index approach.

[1] Institutional/political risk increases the Philippines' predicted CAB by about 2 percent of GDP.

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



Source: IMF staff estimates.

Source: IMF staff estimates.

8. Technical factors suggest that the current account regression approach is preferable to the other approaches. The EBA REER index approach is less reliable in countries with large structural changes and short data spans. This method cannot use cross-country information as the REER indexes are set equal to 100 for all countries in a given year regardless of their external position. By using country fixed effects, this approach forces gaps for each country to average to zero over time, which tends to understate the REER gaps. The EBA REER level approach tackles this issue by relying on purchasing power parity prices to construct REER levels. However, this method depends on price level data collected under the International Comparison Program (ICP), both for the construction of the level of the REER and the relative prices of tradable to non-tradable goods. Despite recent progress in ICP's sampling and methodology, overall data quality is still a concern. The current account regression approach, on the other hand, does not have price measurement issues and takes full advantage of cross-country information. The External Sustainability approach does not assess the appropriateness of the level of the NFA that is being stabilized. In the Philippine case, arguably a more negative NFA position and a lower CAB would be consistent with the country's stage of development and population dynamics.

Extensions to EBA and Other Considerations

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

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

- ***Worker remittances***: The increase in the Philippines' CAB coincided with a raise in remittances, which have been relatively resilient to changes in the external environment. As a result, Philippine gross national income (GNI) is about 15 percent above GDP.[2] This increase in income may have pushed up the equilibrium real exchange rate by raising prices of nontraded goods and services, thereby *weakening* the trade balance. However, spending from remittances could be lower than that from other types of income if remittance income is perceived as more uncertain. If there is a high risk that contracts abroad may not be renewed, the saving rate out of remittances may be higher than from other types of income, which would tend to raise the CAB.

- ***Impediments to investment***: The strengthening of the Philippines' CAB since the late-1990s also coincided with a marked fall in the investment-to-GDP ratio. Balance sheet repair in the aftermath of the Asian financial crisis could have depressed investment on a persistent basis. A weak business environment and inadequate infrastructure could also be restraining investment.

GNI versus GDP

10. Using GNI instead of GDP in EBA leads to a smaller gap between the CAB and its norm for the Philippines. While GNI is similar to GDP for most countries, GNI is nearly 15 percent larger than GDP in the Philippines due to worker remittances. GNI is a better measure of income and the basis for saving-investment decisions, implying that the CAB should be scaled by GNI instead of GDP.[3] Moreover, some explanatory variables in EBA should also be scaled by GNI, including income per capita, net foreign assets to GDP, public health spending to GDP, the cyclically adjusted fiscal balance to GDP, the change in foreign reserves to GDP, and credit to private sector to GDP.[4] Rescaling the CAB and relevant explanatory variables with GNI reduces the current account gap by about 1.5 percentage points to 6.3 percent (Table 2.2). It also reduces the contribution of policy gaps by about 0.3 percentage points to 1.4 percent.

[2] While official data indicate that in 2014 remittances were equivalent to 9½ percent of GDP, survey based data indicate that unregistered remittances are about 50 percent larger than those coming through official channels and captured in official statistics. Therefore, in calculating GNI, staff assumes that total remittances are 1½ times the officially reported amount (i.e., 15 percent of GDP). This GNI concept differs from the one of the National Statistics Office, which assumes that all overseas foreign workers are residents, and includes all their income earned abroad in GNI, resulting in GNI exceeding GDP by about 21 percent in 2014. However, this overstates disposable income for people residing in the Philippines as overseas foreign workers consume much of their income abroad.

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

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

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

	Current Account (CA) Regression				
	Actual	With actual policies ("P")		With recommended policies ("P*")	
	CA/Y	Predicted CA/Y	Residual	EBA norm	EBA total CA gap
CA with GDP	4.4%	-1.7%	6.1%	-3.3%	7.8%
CA with GNI	3.9%	-1.0%	4.9%	-2.5%	6.3%

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

Role of Natural Disasters, Infrastructure, and Remittances

11. Cross-country empirical analysis suggests that precautionary saving and disincentives to investment due to exposure to natural disasters—including through low infrastructure quality—has a significant impact on the CAB, but worker remittances do not (see 2014 Staff Report). Using a CGER-type macro-balance model covering a wide range of countries, last years' staff report showed that worker remittances did not have a statistically significant effect on the CAB.[5] However, the Country Risk Index from the World Risk Report had a significant impact, indicating that exposure to natural disasters raises the CAB for high-risk countries.

12. As the Philippines has the third highest global risk ranking, these results increased its CAB by 3½ percent of GDP due to the country's risk of natural disasters. The world risk index consists of two parts—exposure and vulnerability—and the Philippines scores high on both. High exposure reflects the Philippines' geography, while high vulnerability reflects low infrastructure quality and lagging coping and adaptive capacities. Vulnerability to natural disasters is thus amenable to improvement. Reducing vulnerability (by improving infrastructure quality) to the level of Malaysia, while keeping exposure unchanged, would lower the predicted CAB by 1 percent of GDP (i.e., a net *rise* of 2½ percent of GDP relative to the cross-country average), while reducing vulnerability to the level of Japan would lower the CAB by about 2 percent of GDP (i.e., a net *increase* of 1½ percent of GDP).

13. Because the estimates of the impact of natural disasters on the CAB were obtained outside EBA, we are conservative and assume that the impact of high exposure and vulnerability to natural

[5] Based on "Exchange Rate Assessments: Tools for Advanced, Emerging, and Developing Economies" by Francis Vitek (2014), which covers 184 countries with annual data between 1973 and 2012. While this paper finds that worker remittances do not have a significant impact on the CAB, it finds that worker remittances are associated with a significantly more appreciated REER. Taken together, these results suggest that the stronger REER brought by remittances weakens the trade balance, with the decline in the trade balance fully offsetting the amount of remittance inflows, and thus leaving the CAB unchanged.

disasters on the Philippine current account is 2½ percent of GDP. This corresponds to the case in which vulnerability (infrastructure quality) is improved to the level of Malaysia.

Overall Assessment

14. Several Philippine specific factors may have strengthened the Philippines' current account balance. These include heightened exposure to natural disaster risk, understating national income by using GDP instead of GNI, low infrastructure quality and a weak investment climate. While reliable quantification of impacts is problematic, their total contribution could approach 4 percentage points of GDP. This would reduce the current account gap to 3.8 percent of GDP, of which 1.4 percentage points of GDP corresponds to deviations of policies from desired levels (Table 2.3).

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

Table 2.3. External Balance Assessment: Accounting for Nonstandard Factors

Method		Current Account Regression Approach
Assessment period		2014
Actual CAB (percent of GDP)	A	4.4
EBA's CAB norm (percent of GDP) 1/	B	-3.3
EBA's CAB gap (percent of GDP)	(A-B)	7.8
Accounting for nonstandard factors:		
GNI Adjustment	C	1.5
Natural disasters (Infrastructure quality) adjustment	D	2.5
Revised CAB gap (percent of GDP)	(A-B-C-D)	3.8
Policy gaps (percent of GDP)	E	1.4
Unexplained residual (percent of GDP)	(A-B-C-D-E)	2.4

Source: IMF staff estimates.

1/ Based on the EBA update of February 2015.

Appendix 3. Philippines—Debt Sustainability Analysis

1. Public debt in the Philippines is sustainable. Staff's baseline scenario projects that the general government debt-to-GDP ratio will continue its downward trend started in the last decade, falling from 36 percent of GDP in 2014 to 27 percent in 2020. Primary surpluses are the main factor behind this projected decline. The authorities' commitment to the 2 percent of GDP overall deficit target at the national government level implies an average annual primary surplus of well over 1 percent of GDP at the general government level. This exceeds the debt-stabilizing primary balance by about 2 percentage points of GDP, based on the assumption of 6.5 percent real GDP growth and 3.5 percent average inflation in the medium term. Moreover, the growth-interest rate differential will also contribute to debt reduction, with robust real GDP growth offsetting gradually increasing interest rates. Gross financing needs will remain comfortably around 4 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.

2. 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 2005–2014 averages, leads to faster reduction in debt and gross financing needs than in staff's baseline. The scenario with a constant primary surplus at projected 2015 level of 2.3 percent of GDP also leads to lower debt-to-GDP ratios and gross financing needs than in staff's baseline scenario.

3. Overall external debt in the Philippines is also sustainable. External debt fell sharply in the 2000s, from a peak of 76 percent of GDP in 2001 to 27 percent in 2014, due to sustained current account surpluses, strong output growth, and peso appreciation. Under staff's baseline scenario, these trends are projected to continue, with external debt expected to fall to 16 percent of GDP in 2020. 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 2005–2014 averages, leads to 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 hikes 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 2015 would raise the external debt-to-GDP ratio by about 11 percentage points.

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

(In percent of GDP, unless otherwise indicated)

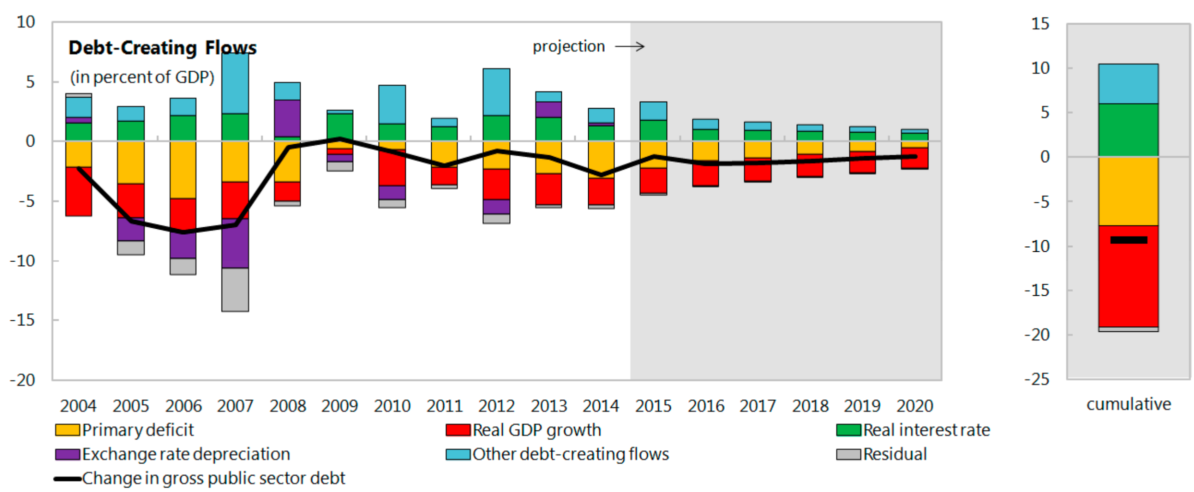
Debt, Economic and Market Indicators 1/

	Actual			Projections					
	2004-2012 2/	2013	2014	2015	2016	2017	2018	2019	2020
Nominal gross public debt	48.4	39.2	36.4	35.2	33.3	31.5	29.9	28.4	27.1
Public gross financing needs	14.2	4.7	3.5	4.0	4.0	3.7	3.9	3.7	3.6
Real GDP growth (in percent)	5.2	7.1	6.1	6.2	6.5	6.5	6.5	6.5	6.5
Inflation (GDP deflator, in percent)	4.4	2.1	3.2	1.6	3.5	3.5	3.5	3.5	3.5
Nominal GDP growth (in percent)	9.8	9.3	9.5	7.9	10.2	10.2	10.2	10.2	10.2
Effective interest rate (in percent) 4/	8.0	6.7	6.3	6.9	6.8	6.7	6.7	6.7	6.4

As of June 19, 2015		
Sovereign Spreads		
EMBI (bp) 3/		109
CDS (bp)		87
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BBB	BBB
Fitch	BBB-	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing primary balance 9/
Change in gross public sector debt	-3.0	-1.4	-2.8	-1.2	-1.9	-1.8	-1.6	-1.4	-1.3	-9.3	
Identified debt-creating flows	-2.1	-1.1	-2.5	-1.1	-1.8	-1.7	-1.5	-1.4	-1.2	-8.8	
Primary deficit	-2.6	-2.7	-3.1	-2.3	-1.6	-1.4	-1.1	-0.9	-0.5	-7.8	-0.7
Primary (noninterest) revenue and gran	18.0	18.8	19.3	19.5	19.6	19.6	19.7	19.7	19.7	117.8	
Primary (noninterest) expenditure	15.4	16.2	16.2	17.2	18.0	18.3	18.6	18.8	19.2	110.0	
Automatic debt dynamics 5/	-1.6	0.7	-0.7	-0.3	-1.1	-1.0	-1.0	-1.0	-1.0	-5.4	
Interest rate/growth differential 6/	-0.8	-0.7	-0.9	-0.3	-1.1	-1.0	-1.0	-1.0	-1.0	-5.4	
Of which: real interest rate	1.7	2.0	1.3	1.8	1.0	0.9	0.9	0.8	0.7	6.0	
Of which: real GDP growth	-2.4	-2.6	-2.2	-2.1	-2.1	-2.0	-1.9	-1.8	-1.7	-11.4	
Exchange rate depreciation 7/	-0.9	1.4	0.2	…	…	…	…	…	…	…	
Other identified debt-creating flows	2.1	0.9	1.3	1.5	0.9	0.7	0.6	0.5	0.3	4.4	
Privatization proceeds (negative)	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
GG Accumulation of liquid assets	1.9	0.8	1.2	1.5	0.9	0.7	0.5	0.4	0.3	4.3	
Residual, including asset changes 8/	-1.0	-0.2	-0.3	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5	



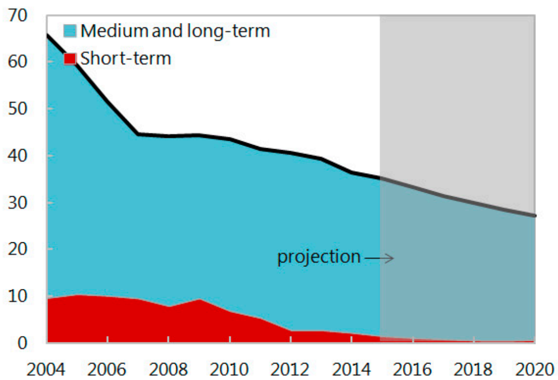
Source: IMF staff.
1/ Public sector is defined as general government.
2/ Based on available data.
3/ EMBI.
4/ Defined as interest payments divided by debt stock at the end of previous year.
5/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate;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

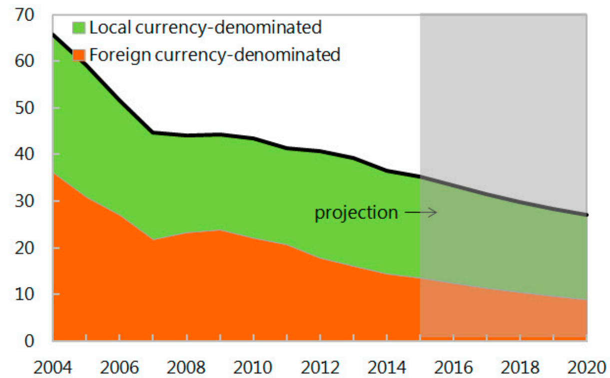
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

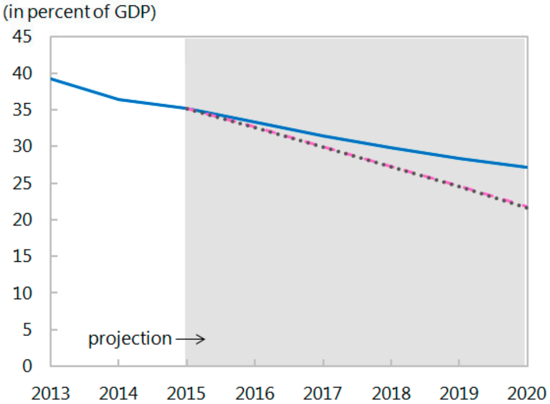


Alternative Scenarios

Baseline   Historical   Constant Primary Balance

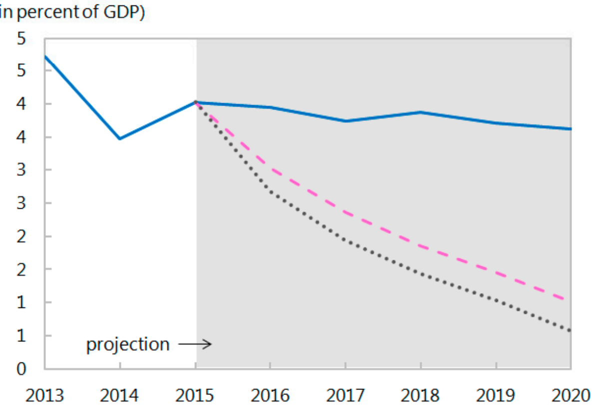
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

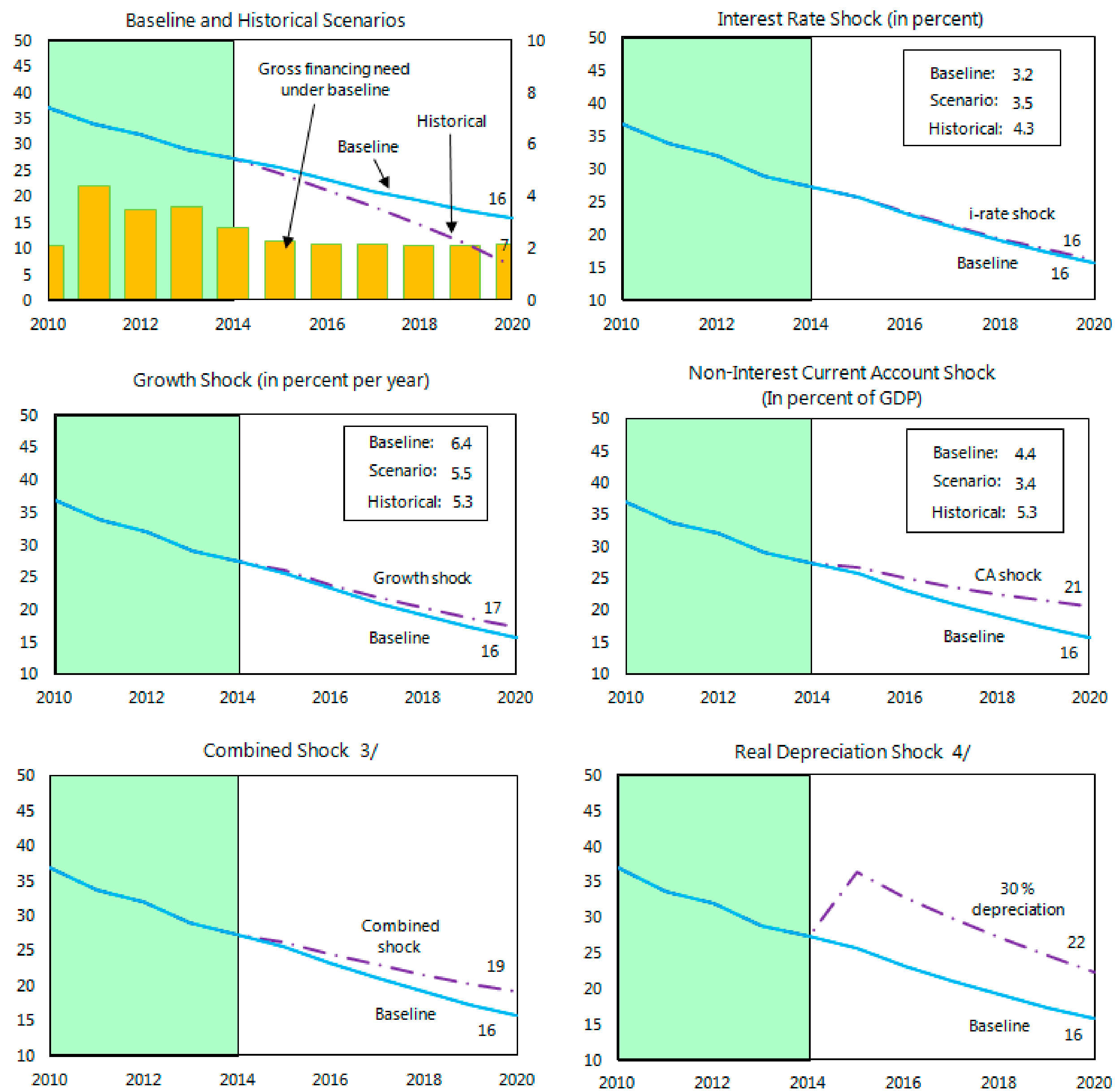
Baseline Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	6.2	6.5	6.5	6.5	6.5	6.5
Inflation	1.6	3.5	3.5	3.5	3.5	3.5
Primary Balance	2.3	1.6	1.4	1.1	0.9	0.5
Effective interest rate	6.9	6.8	6.7	6.7	6.7	6.4
Constant Primary Balance Scenario						
Real GDP growth	6.2	6.5	6.5	6.5	6.5	6.5
Inflation	1.6	3.5	3.5	3.5	3.5	3.5
Primary Balance	2.3	2.3	2.3	2.3	2.3	2.3
Effective interest rate	6.9	6.9	6.9	7.0	6.9	6.7

Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	6.2	5.3	5.3	5.3	5.3	5.3
Inflation	1.6	3.5	3.5	3.5	3.5	3.5
Primary Balance	2.3	2.7	2.7	2.7	2.7	2.7
Effective interest rate	6.9	6.9	6.9	7.0	7.0	6.8

Source: IMF staff.

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

(External debt, in percent of GDP)



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

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

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

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

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

Philippines—External Debt Sustainability Framework, 2009–2019

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2010	2011	2012	2013	2014			2015	2016	2017	2018	2019	2020	Debt-stabilizing non-interest current account 6/
1 Baseline: External debt	36.9	33.7	32.0	28.9	27.3			25.6	23.1	21.0	19.1	17.3	15.7	-1.8
2 Change in external debt	-1.6	-3.2	-1.7	-3.1	-1.6			-1.7	-2.5	-2.1	-1.9	-1.7	-1.6	
3 Identified external debt-creating flows (4+8+9)	-10.2	-6.8	-6.5	-6.8	-6.0			-7.1	-6.6	-6.1	-5.6	-4.9	-4.2	
4 Current account deficit, excluding interest payments	-4.9	-3.8	-4.0	-5.3	-5.4			-5.9	-5.3	-4.7	-4.1	-3.5	-3.0	
5 Deficit in balance of goods and services	-60.2	-57.2	-58.5	-53.8	-54.9			-53.3	-51.4	-49.8	-48.1	-46.6	-45.2	
6 Exports	27.3	25.5	26.7	25.0	25.5			25.1	24.2	23.3	22.4	21.7	20.9	
7 Imports	-32.9	-31.7	-31.8	-28.9	-29.4			-28.2	-27.3	-26.5	-25.7	-25.0	-24.3	
8 Net non-debt creating capital inflows (negative)	-0.6	-0.3	-0.3	0.0	-0.1			-0.5	-0.6	-0.7	-0.8	-0.7	-0.6	
9 Automatic debt dynamics 1/	-4.7	-2.7	-2.2	-1.5	-0.4			-0.7	-0.7	-0.7	-0.6	-0.6	-0.6	
10 Contribution from nominal interest rate	1.3	1.3	1.2	1.1	1.0			0.9	0.8	0.7	0.6	0.5	0.5	
11 Contribution from real GDP growth	-2.5	-1.2	-2.0	-2.1	-1.7			-1.6	-1.5	-1.4	-1.2	-1.1	-1.0	
12 Contribution from price and exchange rate changes 2/	-3.5	-2.8	-1.4	-0.5	0.3			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	8.6	3.6	4.8	3.7	4.4			5.4	4.2	4.0	3.7	3.1	2.6	
External debt-to-exports ratio (in percent)	134.9	132.2	119.6	115.7	107.0			101.8	95.8	90.2	84.9	80.0	75.4	
Gross external financing need (in billions of US dollars) 4/	4.1	9.9	8.7	9.7	7.9			6.8	7.4	8.0	8.7	9.7	11.1	
in percent of GDP	2.1	4.4	3.5	3.6	2.8			2.2	2.2	2.1	2.1	2.1	2.2	
Scenario with key variables at their historical averages 5/			32.0	28.9	0.0	10-Year Historical Average	10-Year Standard Deviation	24.4	21.3	18.0	14.6	10.8	6.7	-1.5
Key Macroeconomic Assumptions Underlying Baseline														
hid Nominal GDP (US dollars)	199.6	224.1	250.1	271.9	284.6			304.9	339.1	376.2	417.5	463.3	514.3	
Real GDP growth (in percent)	7.6	3.7	6.7	7.1	6.1	5.3	2.0	6.2	6.5	6.5	6.5	6.5	6.5	
GDP deflator in US dollars (change in percent)	10.1	8.3	4.6	1.6	-1.4	6.6	6.2	0.9	4.4	4.2	4.2	4.2	4.2	
Nominal external interest rate (in percent)	3.9	3.9	4.0	3.7	3.5	4.3	0.8	3.4	3.3	3.2	3.1	3.0	2.9	
Growth of exports (US dollar terms, in percent)	26.2	4.8	16.9	1.5	7.0	8.8	10.9	5.5	6.9	7.0	7.0	7.0	7.0	
Growth of imports (US dollar terms, in percent)	25.8	8.2	12.0	-1.4	6.5	8.3	12.0	2.9	7.6	7.6	7.7	7.9	8.1	
Current account balance, excluding interest payments	4.9	3.8	4.0	5.3	5.4	5.3	1.9	5.9	5.3	4.7	4.1	3.5	3.0	
Net non-debt creating capital inflows	0.6	0.3	0.3	0.0	0.1	1.1	1.5	0.5	0.6	0.7	0.8	0.7	0.6	

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

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

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

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

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

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

INTERNATIONAL MONETARY FUND

PHILIPPINES

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 24, 2015

Prepared By Asia and Pacific Department

CONTENTS

FUND RELATIONS

(As of June 30, 2015)

Membership Status: Joined December 27, 1945; Article VIII

General Resources Account

	SDR Millions	Percent of Quota
Quota	1,019.30	100.00
Fund holdings of currency	735.86	72.19
Reserve position	283.45	27.81
Lending to the Fund New Arrangements to Borrow	32.80	

SDR Department

	SDR Millions	Percent of Allocation
Net cumulative allocation	837.96	100.00
Holdings	846.36	101.00

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

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

Projected Payments to Fund: None

Exchange Arrangement

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

The Philippines maintains an exchange system that is free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions except for exchange restrictions maintained for security reasons and notified to the Fund pursuant to Executive Board Decision 144-(52/51).

Article IV Consultation

Philippines is on the standard 12-month cycle. The 2014 Article IV consultation was held on July 8, 2014 (IMF Country Report No. 14/245).

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 is executing a TA project financed by the Millennium Challenge Corporation to improve the basic functions of tax administration by the Bureau of Internal Revenue, in line with recommendations made by FAD TA missions in 2005, 2008, and 2009. The project provides for a resident tax administration advisor and an extensive program of short-term expert visits. A series of TA missions on collection enforcement, compliance improvement, program governance, taxpayer services and VAT audit took place in 2014 and early 2015. Progress has been made in VAT audit, arrears management and compliance improvement strategy. Seeking a pro-growth and equitable tax system, TA on tax policy in 2013 aimed to rationalize tax expenditures. 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. 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 and 2015. 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 TA activities in the Philippines have mainly focused on developing and implementing a risk-focused supervisory approach in keeping with the Basel Core Principles and other key international supervisory practices. In terms of outcomes, the authorities adopted Basel II in 2005, and began implementing Pillar 2 (Internal Capital Adequacy Assessment Process (ICAAP)/supervisory review of capital adequacy) in 2011. In 2010–11, a more concerted effort was made to enhance enforcement and clear a backlog of problematic institutions; the policy on cease & desist orders (CDO) was approved in August 2011, and this was followed by the issuance of internal procedural guidance in October 2011. Another key outcome has been the implementation of the supervisory core training initiative that began in late 2010. More than ten committees have developed content for new courses, with initial rollout of the courses in 2011. In 2013, the implementation of the overall program deepened in supervisory capacity building. The in-house training initiative is now self-sustaining, with some 16 courses developed, and the quality of the supervisory reports has shown considerable improvement. A series of TA missions on risk-based banking supervision, including on supervisory enforcement, bank resolution and training took place in 2013, 2014, and early 2015.

In addition to the TA program on supervision and problem banks, two TA missions on liquidity management and forecasting and on the implementation of an interest rate corridor took place 2013-2014. A workshop on the deepening of government securities market was also held in 2014. Lastly, in February 2015, a staff-led TA mission visited Manila to discuss a road map for a comprehensive financial stability framework, focusing on the institutional setup, monitoring and tools, and crisis management.

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).

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 26, 2015)

Background

The Bank and the Fund country teams for the Philippines exchanged views to coordinate the teams' work during 2015–16 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 2015-May 2016, 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; strengthening the fiscal unit in the Department of Finance (focused on assessing and strengthening customs and BIR performance); 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 2015-May 2016

	Products	Expected Delivery Date
Bank Work Program	• Philippines Development Report on "Creating More and Better Jobs" • Mindanao jobs report • Philippine Economic Update • Programmatic policy analysis and implementation support for inclusive growth, to include policy notes on rice, cabotage, ports and shipping, agrarian reform, and regional development and integration • Tax policy notes • Supporting update of Tax Expenditure Statement • 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 • Support to Securities and Exchange Commission to improve corporate financial statistics management • Implementation completion report on the NPSTAR project • Backstopping of GFMIS implementation (AusAID) • Development Policy Loan 2 • Development Policy Loan 3 • Development Policy Loan 4 with optional embedded catastrophe risk transaction • Report on migration and remittances • Grant (AusAID) on developing an enterprise survey • Grant (IDF) on program evaluation • Financial Modeling for Deposit Insurance (FIRST) • Microinsurance reporting system (FIRST) • Financial Education and Consumer Protection with BSP (SECO) • Programmatic AAA for Financial Sector Development • 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)	• September 2013 (done) • July 2016 • Semi-annually • June 2013 to June 2016 • July 2014 to July 2015 • June 2013 to June 2016 • Ongoing • Ongoing • TORs for Phase 2 completed in July 2015. • Project closing June 2013 • ongoing • Board, March 2013 • Board, September 2014 • Board expected in Sep 2015 • March 2013 • Closed in December 2013 • Closing in December 2015 • Completed in December 2013 • Closed in November2013 • October 2014 • July 2014 • Ongoing
Fund Work Program	• Article IV consultation with a focus on adjusting to tighter external financing conditions while supporting a well managed rise in investment and a more inclusive growth. • Article IV staff report • Tax administration TA • 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 2015 • August 2015 • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing
Joint Work Program	• Close coordination in support to Tax Administration Reforms in the BIR (IMF under an MCC supported work program and WB through its post-NPSTAR operation). • Management of Fiscal Risk and GOCC/PPPs • DoF-BTr Debt Management Strategy • Support for Fiscal Intelligence Unit in DOF (focused on assessing and strengthening customs and BIR performance) • Support for the Bureau of Treasury's lead role in implementation of a Single Treasury Account (TSA) and cash management • Implementation of PFM reforms related to Fiscal Transparency Evaluation of Fund and PEFA assessment update led by Bank. • Support to the discussions surrounding PFM Bill in Congress • Collaboration and review of Philippines Development Policy Loans Program • DPL4 Board • 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	• Ongoing • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing • September 2015 • September 2013 (done) • April 2013 • To be scheduled.

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 THE ASIAN DEVELOPMENT BANK

(As of July 1, 2015)

Since joining the Asian Development Bank (ADB) in 1966, the Philippines has received 223 sovereign loans and grants financed by ADB Special Funds for a total of $14,792.12 million including nonsovereign financing amounting to $887.15 million. Public sector management, energy, agriculture and natural resources, and transport account for the largest proportion of ADB lending (combined 69.77 percent of the total) (Table 2). As of July 1, 2015, cumulative direct value-added cofinancing for the Philippines amounted to $3.4 billion for 53 investment projects and $84.9 million for 68 TA projects.

Table 2. Cumulative Sovereign and Nonsovereign ADB Lending to Philippines
(As of July 1, 2015)

Sector	No. of Loans	Amount of Loans (US$ millions)	Percent (by amount)
Energy	33	3,428.8	22.0
Public sector management	13	3,828.0	24.5
Agriculture and natural resources	60	2,027.4	13.0
Transport and ICT	30	1,603.8	10.3
Finance	22	1,409.0	9.0
Multisector	9	1,073.3	6.9
Water and other municipal infrastructure and services	27	1,042.9	6.7
Health and social protection	7	367.4	2.4
Education	9	552.1	3.5
Industry and trade	12	272.1	1.7
Total	222	15,604.8	100.0

ADB’s private sector operations in the Philippines began in 1986. As of 1 July 2015, cumulative approvals in 29 projects amounted to $887.20 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 loan was approved for $20 million in January 2015 to support the 150-Megawatt Burgos Wind Farm 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 is underway, the results of which will inform the next CPS. The Country Operations Business Plan (COBP) 2014–2016, the third under the CPS 2011–2016, was approved on October 1, 2013. The next COBP is expected for ADB Management approval by October 2015.

STATISTICAL ISSUES

(As of June 10, 2015)

I. Assessment of Data Adequacy for Surveillance	
General: Data provision to the Fund has some shortcomings, but is broadly adequate for surveillance.	
National accounts: As part of a World Bank-funded project, *Improving the Quality and Usefulness of the Philippine System o f National Accounts,* the National Statistical Coordination Board (NSCB) rebased the national accounts from 1985 to 2000. Continuing improvements include ongoing efforts to fully implement the *System of National Accounts, 2008.* Despite the authorities' efforts to improve quality, weaknesses remain in the national accounts. These include the coverage of the GDP and the statistical discrepancies in the GDP estimates between the expenditure and production sides. The authorities are working on improving (i) the accuracy of the GDP volume measures; (ii) the coverage of the public corporations sector; (iii) the accuracy of the quarterly GDP data; and (iv) the adoption of benchmark techniques to reconcile quarterly and annual national accounts estimates. The NSCB is currently participating in the IMF Statistics Department's *Project on the Implementation of the System of National Accounts and the International Comparison Program,* funded by the Government of Japan. This three-year technical assistance project provides assistance to improve the quality of the national accounts and price statistics. 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 June 30, 2015)

	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	6/30/2015	6/30/2015	D	D	D	O	O
International reserve assets and reserve liabilities of the monetary authorities[1]	5/2015	6/2015	M	M	M	LO	LO
Reserve/base money	6/11/2015	6/11/2015	D	W	W	O, LO, LO, LNO	LO, O, O, O, LO
Broad money	5/2015	6/2015	M	M	M		
Central bank balance sheet	12/2014	5/2015	M	M	M		
Consolidated balance sheet of the banking system[2]	5/2015	6/2015	M	M	M		
Interest rates[3]	6/30/2015	6/30/2015	D	D	D	O	O
Consumer price index	5/2015	6/2015	M	M	M	O, O, O, O	O, LO, O, LO, LO
Revenue, expenditure, balance and composition of financing[4]—general government[4]	2014	5/2015	Q	Q	Q	LO, LO, O, O	LO, LO, LO, LO, LO
Revenue, expenditure, balance and composition of financing[4]—central government	4/2015	6/2015	M	M	M		
Stocks of central government and central government-guaranteed debt[5]	4/2015	5/2015	M	M	M	LNO	LNO
External current account balance	3/2015	6/2015	M	M	M	O, LO, LO, LO	LNO, LO, O, LO, LO
Exports and imports of goods and services	3/2015	6/2015	M	M	M		
GDP/GNP	Q1:2015	5/2015	Q	Q	Q	LO, LO, O, LO	LNO, LNO, O, LO, O
Gross external debt	Q1:2015	6/2015	Q	Q	Q	O	O
International investment position[6]	Q1:2015	6/2015	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 validatior 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
August 26, 2015

1. The Philippine authorities express their strong appreciation to staff for the constructive engagement and policy dialogue that took place during the 2015 Article IV Consultation. The discussions focused on macroeconomic and financial sector policies and structural reforms to sustain the economy's drive towards strong, balanced and inclusive growth. We are encouraged by staff's recognition that the authorities' sound macroeconomic management and prudent financial sector supervision, alongside strong macroeconomic fundamentals, have delivered solid economic growth, low inflation and financial stability. The authorities also thank the Fund for its ongoing support through invaluable technical assistance. They also greatly value the continued support of the Fund's management and the Executive Board. The authorities broadly concur with the thrust of the staff appraisal and would like to provide the following updates on recent macroeconomic developments and policies.

Recent Economic Developments and Outlook

2. The Philippine economy continued to grow strongly amid a challenging external economic environment, aided by low and stable inflation, a favorable external payments position, and a sound, stable and liquid banking system. Real GDP grew by 6.1 percent in 2014. The favorable growth performance was supported by household consumption, private construction, and exports of goods and services. Growth moderated to 5.2 percent in the first quarter of 2015 due mainly to temporary factors, including the lower-than-programmed pace of public spending, effects of dry weather on agricultural production and slower export growth. Headline inflation continued to decelerate to 0.8 percent in July 2015 from 1.2 percent in June 2015 due to the slower increases in food prices and lower fuel prices. The headline inflation for the first seven months of 2015 averaged 1.9 percent, which is slightly below the government's inflation target of 2.0-4.0 percent for the year.

3. The robust economic performance was supported by a sound and stable banking system, characterized by a steady growth of resources, healthy balance sheets and low non-performing loan ratios of below 2 percent for universal and commercial banks. The banking system is well capitalized with a capital ratio of 16.2 percent, which is well above the national requirement of 10 percent and twice the Basel standard of 8 percent. There was also a healthy increase in loans going to the key productive sectors which stood at 14.5 percent in June 2015. The Bangko Sentral ng Pilipinas' (BSP) survey of Senior Bank Loan Officers has consistently indicated that the lending standards of banks remain high.

4. The Philippines has continued to record current account surpluses in the past 10 years, supported by sustained overseas Filipino remittances, tourism receipts and business process outsourcing revenues. The country's balance of payments position registered a surplus in the first quarter of 2015 on account of the rising current account surplus and lower capital outflows. This has enabled the Philippines to maintain ample gross international reserves of US$80.4 billion as of July 2015, which is more than 10 months of imports of goods and services.

5. The authorities view the key risk factors to the outlook as emanating from the divergent monetary policy in the advanced economies, weaker growth prospects in Asia and volatility in oil prices. The authorities welcome staff's view that the Philippines' strong macroeconomic fundamentals should provide a cushion to withstand these risks.

6. The authorities target a GDP growth of 7.0-8.0 percent for 2015. Several developments should boost economic performance in 2015. Ample domestic liquidity as well as planned higher public infrastructure and social spending, in particular in view of the May 2016 general elections, are expected to support domestic economic activity. In addition, sustained growth in remittances would provide additional boost to domestic consumption. The government initiatives to mitigate El Niño dry weather conditions will support the agriculture sector, while FDI inflows associated with the liberalized entry of foreign banks and their corporate investors should also benefit the manufacturing and construction sectors. Lower oil prices, partly offset by the impact of stronger El Niño conditions on food prices and utility rates, should keep inflation in the lower half of the BSP target range of 2.0-4.0 percent.

Macroeconomic Policy Framework and Structural Reforms

Fiscal Policy

7. The authorities agree with staff's recommendation that fiscal policy should focus on supporting infrastructure investment and inclusive growth. The 2015 national budget, including the supplemental appropriations, provided increased allocations for public infrastructure spending, and for implementing typhoon Yolanda reconstruction and social spending. These budget priorities continue to be the focus in the proposed 2016 national budget.

8. Consistent with the Philippine Development Plan's (PDP) medium-term targets, the authorities have set the fiscal deficit target at 2.0 percent of GDP for 2016. The proposed expenditure program for 2016 amounts to PhP3 trillion, 15.2 percent higher than the 2015 expenditure program and corresponds to 19.5 percent of GDP (2015: 18.7 percent of GDP). The budget priorities include: (a) pursuing good governance through curbing corruption, and public financial management reform; (b) making growth inclusive through increasing the provision of basic education, universal health care and socialized housing, and expanding targeted conditional cash transfer programs

to benefit 4.6 million poor households, including victims of typhoon Yolanda and other calamities; (c) sustaining growth through strategic infrastructure development, strengthening tourism and agricultural development, reviving industrial development, and expanding tertiary and technical and vocational education and training programs; and (d) managing disaster risks through reforestation, water supply development, flood mitigation and drainage programs/projects. The proposed budget allocation for capital spending has been increased by 30 percent to provide for the construction of more schools, health facilities and the transport and road infrastructure programs. Similarly, the proposed budget allocation for social spending has been increased by 16 percent to support basic education, housing programs for the poor and health care provision.

9. To ensure the timely implementation of government programs and projects, the authorities have reduced lump sum funds and instead, channeled these into specific programs and projects. The Department of Budget and Management (DBM) has made the majority of funds available to government agencies at the start of the year. As of June 2015, 95 percent of agency budgets have already been released. An administrative order from the President was issued in March 2015 that directed agencies to adopt measures to clear procurement bottlenecks, improve reporting on project implementation, and complete documentary requirements for allotment release. The DBM also issued a budget circular in June 2015 strengthening the organizational structure of procurement units at spending agencies, and providing these units with additional staff to support their bids and awards committees. The authorities have also introduced cashless and checkless disbursement schemes, which have resulted in about 80 percent of payments to government suppliers being done through bank-to-bank transactions. The latest report from the DBM shows continuing improvement in national government disbursements, with capital outlays and maintenance, and other operating expenditures increasing by 20.1 percent in May 2015. Total year-on-year spending was also higher by 9.2 percent in May 2015.

10. Under the PDP, the overall strategy for infrastructure development is to increase public infrastructure spending to at least 5.0 percent of GDP in 2016 in order to support the growth requirements in the coming years. Government spending will be supplemented by private sector investments through public-private partnerships (PPPs), allowing public resources to be freed up for social spending. Over the years, PPPs have become an increasingly important tool for accelerating infrastructure development. At present, there are 50 PPP projects in the pipeline worth over US$23 billion. Since 2011, ten PPP contracts, totaling over US$4 billion, have been successfully awarded to the private sector.

11. To strengthen transparency and accountability, the authorities issued guidelines in July 2015 to implement the government's open data program and promote the use of digital payments in government transactions.

12. The authorities are also focusing on further improving tax administration and compliance, broadening the tax base and reducing exemptions to raise tax efforts to levels at par with regional peers in order to sustain higher public infrastructure and social spending.

Monetary Policy

13. The authorities reaffirm that monetary policy will remain focused on achieving the inflation target of 2.0-4.0 percent in 2015-2016. The authorities have also approved the medium-term inflation target of 2.0-4.0 percent for 2017-2018. The BSP's monetary policy actions in 2014 to act preemptively to address potential risks to price and financial stability have given the BSP sufficient policy space to consider measures that may be required by emerging monetary conditions. The BSP is committed to provide timely and calibrated responses, using its enhanced tool kit and sharpened surveillance capacity, to unfolding external events to ensure that the liquidity conditions do not become overly tight and interest rates do not get excessively volatile. At the most recent meeting of the Monetary Board (MB) on 13 August 2015, the MB decided to maintain the key policy interest rates at 4.0 percent for the overnight borrowing or reverse repurchase (RRP) facility and 6.0 percent for the overnight lending or repurchase (RP) facility. The interest rates on term RRPs, RPs and special deposit accounts were also kept steady. The reserve requirement ratios were likewise left unchanged. The policy decisions were based on the assessment that prevailing price and output conditions support maintaining current monetary policy settings.

14. To further improve the transmission of monetary policy, the BSP launched in February 2015 the RRP e-Trading System, a web-based system that will provide greater efficiency, security and flexibility in the BSP's RRP transactions.

15. The BSP is studying the adoption of an interest rate corridor framework, with technical assistance from the IMF, in implementing monetary policy to strengthen the transmission of policy rate adjustments to money market rates and the effectiveness of monetary policy on the whole.

16. To preserve the integrity of the Philippine currency, the BSP has continued the demonetization process for the old banknotes, which started in January 2015. The old banknote series launched in 1985 can still be used for payment transactions up to 31 December 2015. The new banknotes, which were issued in December 2010, use new and enhanced security features to protect against counterfeits.

17. On assessing the external sector, the authorities welcome the constructive assessment but stress the need for staff to be cautious with the application of the External Balance Assessment (EBA) approach in light of its limitation in the methodology. It is important to capture country-specific factors that are relevant to the Philippines, such as

the role of remittances, to ensure a consistent and comprehensive analysis prior to drawing possible policy implications.

18. The authorities will continue to adhere to a market-based exchange rate policy, with scope for occasional presence to maintain orderly conditions in the foreign exchange market.

Financial Sector Policy

19. The authorities continued to undertake supervisory and regulatory reforms to further ensure the continued soundness and stability of the financial system. The authorities are strengthening the financial stability supervisory framework, including through capacity building and enhanced coordination among the stakeholders of the Financial Sector Forum and the Financial Stability Coordinating Council. On enhancing financial stability, the recent policy measures and initiatives include: (a) enhanced reporting requirements on licenses that banks have acquired from or are renewing with the Securities and Exchange Commission and other regulatory authorities to perform securities-related operations; (b) establishment of a cross-border liquidity arrangement between the BSP and the Bank of Japan; (c) strengthened internal control and internal audit standards for financial institutions; (d) adoption of Basel III leverage ratio requirements; and (e) identification of domestic systemically important banks.

20. To support financial deepening through capital market development, the authorities issued: (a) enhanced rule on delivery of securities; (b) amended Unit Investment Trust Fund regulations to allow for a unit-paying feature; (c) revised guidelines on the listing of long-term negotiable certificates of time deposits in an accredited exchange to promote transparent pricing in financial instruments; (d) new guidelines on the establishment and operation of trust corporations; (e) new guidelines to segregate clients' assets from bank assets under a securities brokering arrangement; and (f) revised implementing rules and regulations of the Securities Regulation Code. The authorities also approved further amendments to foreign exchange regulations.

21. In pursuit of financial inclusion, the authorities have undertaken various initiatives on: (a) policy, regulation and supervision; (b) financial education (through the intensified economic and financial learning program) and consumer protection; (c) advocacy programs (such as the development of credit surety funds to broaden access by small and medium enterprises to collateral-free loans); and (d) financial inclusion data and measurement. The authorities also introduced regulation offering incentives for banks to extend their reach into unbanked areas of the country and launched a consolidation program for rural banks to promote mergers and consolidations and expand market reach.

22. To further the financial inclusion agenda, the authorities recently launched the National Strategy for Financial Inclusion (NSFI) to achieve sustained and broad-based

inclusive growth. The NSFI provides a framework for the government and the private sector to take a coordinated and systematic approach toward the development of a financial system that is accessible and responsive to the needs of the entire population.

Structural Reforms

23. The authorities continued to demonstrate strong commitment and ability to deliver on its structural reform agenda with the passage of several key legislations in 2014 and 2015, in order to boost productivity and competitiveness. On <u>competition</u>, the Competition Act provides for a national competition policy prohibiting anti-competitive agreements, abuse of dominant position and anti-competitive mergers and acquisitions. The law also establishes a Competition Commission to police the market for unfair trade schemes like cartels, price-fixing and other market-distorting practices. On <u>foreign investment liberalization</u>, a law allowing the full entry of foreign banks in the Philippines increased the ownership ceiling of foreign banks to 100 percent from 60 percent and liberalized branching requirements. The liberalization of the entry of foreign financial institutions positions the Philippines well for the ASEAN Banking Integration Framework.

24. On <u>shipping</u>, the Cabotage law was amended to allow foreign ships to transport import or export cargo directly to and from any local port other than the Port of Manila, which is expected to lower the cost of shipping in the Philippines. On <u>agriculture development</u>, a law on the sugarcane industry mandates the allocation of resources for the development of the industry through infrastructure development, product diversification, increased access to finance, and human resource development. On <u>enterprise development</u>, a law on the development of micro, small and medium enterprises (MSMEs) mandates the establishment of MSME support centers that will provide business registration assistance, business advisory services, business information and advocacy, and monitoring and evaluation of business processes for MSMEs. These structural reforms are expected to further strengthen competitiveness and improve the business environment for private investment.

25. On <u>education</u>, three new laws were introduced: (a) law on open distance learning, which expands access to quality tertiary education through the promotion of open learning and distance education programs in the country; (b) law establishing a college scholarship program for top graduates of all public high schools in state universities and colleges; and (c) law on ladderized education, which institutionalizes a ladderized education program that would formalize a system of accreditation and interface between technical-vocational education and training and higher education. On <u>health</u>, a law mandates that all senior citizens shall be covered by the national health insurance of *PhilHealth*. On <u>taxation of income</u>, a law raised the tax exemption ceiling on bonuses benefiting around half a million private and government employees. On <u>veterans' affairs</u>, a law increased the burial assistance provided for veterans. And on <u>governance</u>, the law

strengthening the functional and structural organization of the *Sandiganbayan*, an anti-graft court, allowed the creation of more divisions in the court, to speed up the resolution of corruption cases.

26. The authorities are also prioritizing the passage in 2015 and 2016 of the following legislative measures: (a) Tax Incentives Management and Transparency Act to enhance the transparency, efficiency and accountability in the grant and administration of tax incentives; (b) Fiscal Incentives Rationalization Bill to provide competitive incentives to investors; (c) Amendments to the BSP charter, which includes increasing the minimum capital of the BSP, allowing the BSP to put up reserves against foreign exchange fluctuations, and allowing the BSP to issue its own debt securities for open market operations; (d) Amendments to the Build-Operate-Transfer Law to strengthen the legal framework and help ensure effective implementation of PPP projects; (e) Amendments to the law on right-of-way acquisition that would address bottlenecks in infrastructure provision, including implementation delays in PPP projects; (f) Public Financial Management (PFM) law that consolidates all PFM reforms initiated by the authorities, supported by IMF technical assistance, in order to establish a transparent, accountable, and efficient government financial system to allow for more efficient expenditure tracking and cash management; and (g) Unified Uniformed Personnel Pension Reform Bill to establish a sustainable pension system for the country's uniformed services.

Final Remarks

27. Going forward, the Philippine economy should be able to sustain successive years of strong growth performance over the medium term. This growth has been and will be supported by sound and strong economic fundamentals, characterized by low and stable inflation, ample fiscal policy space, a sound and responsive banking system, an increasingly inclusive financial system, and a healthy external position, that have strengthened the robustness and resilience of the Philippine economy, in particular to external volatilities. Apart from the country's strong fundamentals, the authorities' commitment toward sustaining its structural reform agenda would lend critical support to lifting the country's growth potential.