IMF Country Report No. 17/334

PHILIPPINES

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT

November 2017

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 2017 Article IV consultation with the Philippines, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on lapse of time basis, following discussions that ended on August 8, 2017, 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 October 10, 2017.
- An **Informational Annex** prepared by the IMF staff.

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

Selected Issues

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COMMUNICATIONS DEPARTMENT

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November 6, 2017

International Monetary Fund
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Washington, D. C. 20431 USA

IMF Executive Board Concludes 2017 Article IV Consultation with the Philippines

On October 26, 2017, the Executive Board of the IMF concluded the Article IV consultation[1] with the Philippines, and considered and endorsed the staff appraisal without a meeting.[2]

The Philippine economy has continued to perform well. Real GDP growth reached 6.9 percent in 2016 and 6.4 percent in the first half of 2017, led by robust domestic demand, a recovery in exports, and a fiscal impulse. Headline and core inflation have remained near the center of the target band (3±1 percent) in 2017, reflecting stable commodity prices and a near zero output gap. The unemployment rate remains low at 5.5 percent. The external and fiscal positions are robust, with the current account balance near zero, gross international reserves at US$81 billion (or 8.7 months of imports of goods and services), the national government deficit at 2.4 percent of GDP, and the general government net debt at 34.6 percent of GDP.

The outlook for the Philippine economy is favorable despite external headwinds. Real GDP growth is projected at 6.6 percent in 2017 and 6.7 percent in 2018, owing to continued robust domestic demand. Inflation is expected to stay near the center of the Bangko Sentral ng Pilipinas's (BSP) target band due to stable commodity prices and well-anchored inflation expectations. The current account balance is projected to record a small deficit in 2017, because of strong infrastructure-related import growth. Public debt is expected to fall further as percent of GDP. Risks to the outlook are tilted to the downside, but the Philippines is well equipped to respond should risks materialize given its strong fundamentals and available policy space.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

Executive Board Assessment

In concluding the 2017 Article IV consultation with the Philippines, Executive Directors endorsed staff's appraisal, as follows:

The strong performance of the economy has continued, with rapid economic growth and low inflation. Economic growth is projected to remain high, supported by robust domestic demand, while inflation is expected to remain near the center of the target band. However, credit growth has accelerated, and although most indicators find no evidence of credit booms so far, some indicators suggest that credit gaps could approach early warning levels in 2017–18.

Risks to the outlook are tilted to the downside and stem mainly from external sources. The combination of high credit growth, buoyant private investment, and fiscal expansion without tax reform could lead to overheating of the economy. On the upside, approval of the first tax reform package would lead to a sustainable increase in infrastructure investment. The Philippines is well equipped to respond if risks materialize given its strong fundamentals and available policy space.

The external sector remains moderately stronger than warranted by fundamentals and desirable policies. The CAB remains above its estimated norm, largely due to inadequate infrastructure, and the gap is expected to close over time as infrastructure is upgraded. The undervaluation of the REER is estimated between zero and 4 percent, considering the estimated CAB gap and the structural impediments to investment. Foreign reserves remain sizable, but this is broadly justified by the country's exposure to natural disaster and capital flow volatility.

This setting provides a good opportunity for the authorities to pursue their inclusive growth agenda. Despite the strong economic growth in the recent years, poverty and inequality remain high and the country needs to create jobs for its young and growing population. Sustaining the growth momentum in an uncertain and volatile external environment requires protecting policy anchors, adapting policies to changing conditions, and maintaining vigilance against risks.

Staff supports the authorities' plans to gradually scale up productive infrastructure and targeted social spending, while keeping a broadly neutral fiscal stance. Staff supports the authorities' ambitious development agenda, but recommends calibrating fiscal policy to balance against the risk of overheating. The increase in priority spending should be financed through additional revenue mobilization, including by widening the tax base, so that the fiscal stance remains broadly neutral. Avoiding procyclicality in fiscal policy would require a tighter fiscal stance if economic growth is stronger than expected. Staff also supports the 3 percent of GDP national government deficit ceiling, which would reinforce policy credibility and keep the general government net debt on a stable path.

Staff welcomes the first tax reform package designed to create additional fiscal space, and encourages the authorities to consider additional revenue measures. The ambitious development agenda depends on a series of comprehensive tax reforms that could create additional fiscal space. Staff appreciates the breadth of the envisaged tax reforms, but cautions that reform efforts may have a lower revenue yield than originally projected because of dilution in Congress. Accordingly, staff encourages the authorities to consider lowering the threshold for PIT, raising the VAT rate, rationalizing tax concessions and exemptions, and accelerating the implementation of new excises on automobiles and petroleum products.

The stance of monetary policy remains appropriate, but the BSP should be ready to tighten if there are signs of overheating. The authorities' intention to unwind the high banks' reserve requirements over time would reduce macrofinancial risks. However, this reform should be carefully calibrated and timed, and should aim to keep domestic liquidity broadly unchanged. The exchange rate should continue to move freely in line with market forces, with foreign exchange intervention limited to smoothing excessive volatility in both directions.

The main systemic risks to financial stability are high credit growth and concentration. High credit growth, especially to the real estate and household sectors, merit continued monitoring. In addition, some conglomerates and real estate developers have leveraged significantly, while shadow-banking activities have expanded. The conglomerate structure and data gaps generates challenges to measure concentration but capital market development could help reduce bank loan concentration by diversifying the sources of funding for large conglomerates. Staff supports the authorities' efforts to have legal access to information on conglomerates' finances.

Macroprudential policies should be used to address systemic risks to financial stability. In case of a broad-based credit boom, the BSP should raise capital requirements, supported by monetary policy tightening if accompanied by overheating. Targeted macroprudential policies should be used if sectoral credit growth is excessive. Staff welcomes the early adoption of the Basel III guidelines on banks, and the role of the new financial stability department at the BSP in mainstreaming macrofinancial surveillance and strengthening the macroprudential framework.

The financial stability framework would greatly benefit from amendments of the BSP Charter. The Charter should be amended to better serve the needs of a modern financial sector and economy. Staff supports the proposed revisions that (i) introduce a financial stability mandate; (ii) extend the supervisory perimeter; (iii) establish legal protection for supervisors; (iv) increase the BSP's capital; and (v) allow the BSP to issue its own securities.

Staff supports ongoing reforms aimed at lowering poverty and maximizing the demographic dividend. The authorities are appropriately focusing on investing in infrastructure and human capital, reducing regional disparities, eliminating quantitative restrictions in rice imports, and improving access to finance including through capital market development. Regulatory reforms to reduce the costs of doing business and openness to foreign investment would help promoting domestic competition.

Staff welcomes the recent amendment to the AML law to include casinos. Notwithstanding this notable progress, the AML/CFT framework could be strengthened further by amending the bank secrecy law and making tax evasion a predicate crime.

Philippines: Selected Economic Indicators, 2012–18

	2012	2013	2014	2015	2016	2017 Proj.	2018 Proj.
GDP and prices (percent change)							
Real GDP	6.7	7.1	6.1	6.1	6.9	6.6	6.7
Real GDP per capita	4.1	5.2	4.3	4.3	5.2	4.5	4.6
CPI (annual average)	3.2	3.0	4.1	1.4	1.8	3.1	3.0
CPI (end year)	3.0	4.1	2.7	1.5	2.6	2.9	3.0
Investment and saving (percent of GDP)							
Gross investment	18.2	20.0	20.6	21.2	24.3	25.6	25.9
National saving	21.0	24.2	24.3	23.7	24.0	25.5	25.5
Public finances (percent of GDP)							
National government balance (authorities' definition)	-2.3	-1.4	-0.6	-0.9	-2.4	-3.0	-3.0
National government balance 1/	-2.4	-1.5	-0.6	-1.4	-2.4	-3.0	-3.0
Nonfinancial public sector balance 2/	-0.6	0.6	0.9	0.4	-0.3	-0.8	-0.9
Revenue and grants	19.4	20.2	19.8	19.7	19.4	19.5	19.5
Expenditure	20.0	19.6	18.9	19.3	19.7	20.3	20.4
Nonfinancial public sector net debt	53.0	51.3	47.9	47.2	44.7	42.9	41.2
Monetary sector (percent change, end of period)							
Broad money (M3) 3/	9.4	31.8	11.2	9.4	12.8	13.5	...
Interest rate (91-day treasury bill, end of period, in percent) 4/	0.5	0.5	1.4	1.8	1.6	2.2	...
Credit to the private sector (in percent) 3/	16.2	16.4	19.9	13.6	17.3	19.7	...
External sector							
Export value (percent change)	21.2	-4.0	11.9	-13.3	-1.1	9.9	7.0
Import value (percent change)	11.3	-4.8	8.0	-1.0	17.7	12.0	8.5
Current account (percent of GDP)	2.8	4.2	3.8	2.5	-0.3	-0.1	-0.3
Capital account (US$ billions)	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Financial account (US$ billions) 5/	-6.7	2.2	9.6	2.3	-0.4	-0.3	-0.7
Direct investment (net) 5/	1.0	-0.1	1.0	-0.1	-5.9	-4.5	-4.7
Errors and omissions (US$ billions)	-4.6	-4.2	-4.1	-2.4	0.1	0.0	0.0
Overall balance (US$ billions)	9.2	5.1	-2.9	2.6	-0.4	0.0	-0.4
Total external debt (percent of GDP)	32.0	28.9	27.3	26.5	24.5	23.0	20.5
Debt service ratio 6/	9.9	11.1	8.4	7.7	9.7	10.0	9.2
Reserves (US$ billions)	83.8	83.2	79.5	80.7	80.7	80.9	80.6
Reserves/short-term liabilities 7/	397.9	406.2	413.3	409.5	408.3	399.1	396.2
Exchange rate (period averages)							
Pesos per U.S. dollar 8/	42.2	42.4	44.4	45.5	47.5	50.2	...
Nominal effective exchange rate (2005=100) 8/	102.6	105.4	102.7	108.8	104.6	99.9	...
Real effective exchange rate (2005=100) 8/	105.6	109.9	109.5	116.8	113.2	109.7	...
Nominal GDP per capita(US$)	2,591.5	2,768.5	2,849.3	2,882.8	2,953.3	3,023.0	3,302.3
Output gap (in percent)	-0.3	0.5	0.3	-0.1	0.1	0.0	-0.1

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

1/ IMF definition. Excludes privatization receipts and includes deficit from restructuring of the previous Central Bank-Board of Liquidators.
2/ Includes the national government, 14 government-owned enterprises, social security institutions, and local governments.
3/ Universal and commercial banks. The latest observation is July 2017, year-on-year.
4/ Secondary market rate. The latest observation is August 2017.
5/ In BPM6. A rise in either assets or liabilities is always positive and a decrease is always negative. Net investment is assets minus liabilities.
6/ In percent of exports of goods and nonfactor services.
7/ Reserves as a percent of short-term debt (including medium- and long-term debt due in the following year).
8/ Average January-August, 2017.

INTERNATIONAL MONETARY FUND

PHILIPPINES

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

October 10, 2017

KEY ISSUES

Context. The Philippine economy has performed well and is in a favorable position to address its socioeconomic challenges. Sound policies have delivered solid growth, low inflation, financial stability, and external and fiscal buffers. However, poverty remains high and the country needs to create jobs for its young and growing population. Sustaining the growth momentum in an uncertain and volatile external environment requires tackling the constraints to inclusive growth, while protecting policy anchors, adapting policies to changing conditions, and maintaining vigilance against risks, including from high credit growth, loan concentration, and overheating.

Outlook. Growth is projected at 6.6 percent in 2017 and 6.8 percent in the medium term, led by robust domestic demand. Inflation is expected to remain close to the center of the target band (3±1 percent). The current account balance is projected to turn into deficit starting in 2017 due to robust import growth.

Main policy recommendations:

- The current fiscal stance and deficit target are appropriate. Fiscal policy is focused on boosting productive investment in physical and human capital, and targeted social protection. However, the rise in this priority spending should be kept in line with the revenue gains from tax and administrative reforms to ensure meeting the fiscal deficit target, protecting confidence, avoiding overheating and ensuring debt sustainability.
- The monetary policy stance remains appropriate. However, the central bank (BSP) should be ready to tighten if inflationary pressures build. The authorities' intention to unwind the high reserve requirements on banks over time would help reduce macrofinancial risks, but this reform should be carefully calibrated and timed to keep domestic liquidity broadly unchanged.
- Macroprudential policies should be used against systemic risks to financial stability. The BSP should stand ready to raise capital requirements in case of a broad-based credit boom, supported by monetary policy tightening, if accompanied by overheating. Targeted macroprudential policies should be used in case of excessive credit growth to specific sectors.
- Structural policies should promote inclusion and focus on reducing regional disparities, opening to foreign direct investment, promoting capital market development and financial inclusion, and reducing gender gaps.

Approved By
Kenneth H. Kang and Vitaliy Kramarenko

Mission dates: July 26-August 8, 2017
Staff team: Luis E. Breuer (Head), Elena Loukoianova, Jaime Guajardo, Minsuk Kim (all APD), Serhan Cevik (FAD), and Shanaka Jayanath Peiris (Resident Representative). Edna Villa (Alternate Executive Director) joined some of the meetings.

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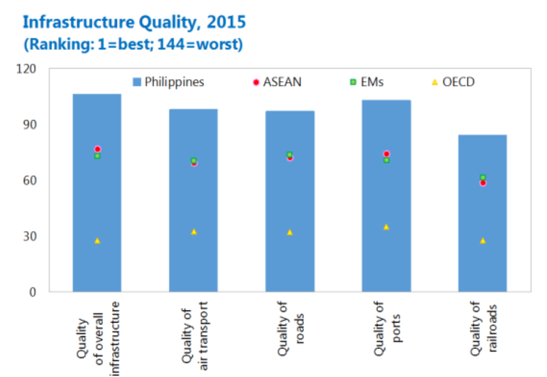
APPENDICES

CONTEXT

1. **The Philippine economy has performed well and is in a favorable position to address its socioeconomic challenges**. Sound policies during successive administrations have delivered sustained growth, low inflation, financial stability, and strong external and fiscal positions. However, poverty and inequality remain high and the country needs to create jobs for its young and growing population. Accordingly, the authorities are focusing on sustaining rapid growth to reduce poverty and maximize the demographic dividend. To this end, actions are needed to address the constraints to inclusive growth, including the low quality of infrastructure and human capital, while maintaining macrofinancial stability.

2. **Fiscal policy is focusing on closing the infrastructure gap and enhancing human capital**. The 2016 Article IV consultation called for scaling up infrastructure and social spending financed with additional revenue and some higher borrowing. The authorities raised the national government deficit target to 3 percent of GDP from 2017 and submitted a comprehensive tax reform package to Congress. Extra revenues are to be spent in infrastructure and social areas. In 2016, staff also recommended strengthening domestic competition, easing foreign investment restrictions, and promoting capital market development.



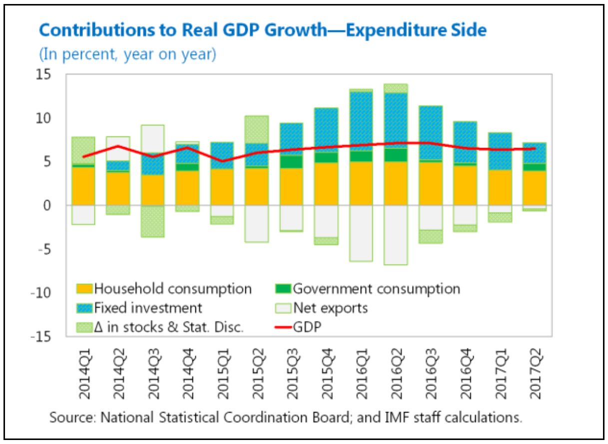
Source: World Economic Forum.

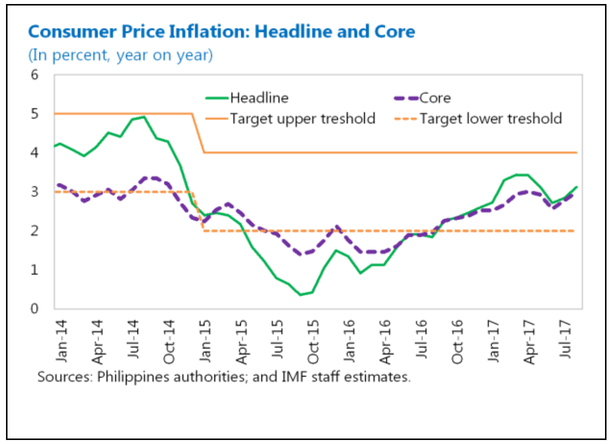
RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

Macroeconomic developments remain favorable, with robust economic growth and low inflation. The banking system appears sound, although high credit growth should be closely monitored. The fiscal and external positions are strong. Risks are tilted to the downside and stem mainly from external sources, with potential overheating being the main domestic risk.

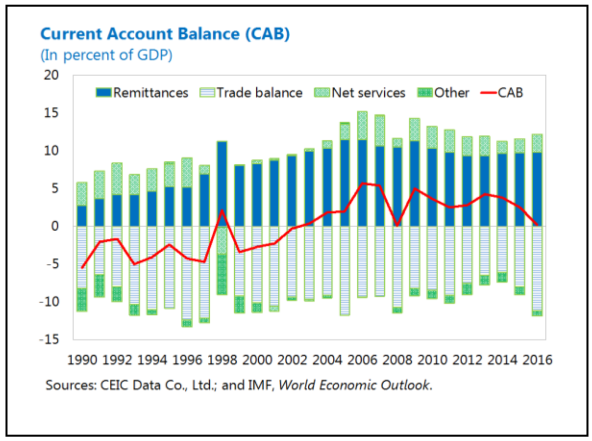
A. Recent Developments

3. **Economic performance remains strong, with high growth and low inflation**. Growth reached 6.9 percent in 2016, led by strong domestic demand that more than offset the drag from net exports, and the unemployment rate fell from 6.3 percent in 2015 to 5.5 percent in 2016. Consumption and investment grew rapidly. Fiscal policy was accommodative. Although growth slowed to 6.4 percent in H1: 2017, this was partly due to a temporary slowdown in public spending and strong base effects from the pre-election period in H1:2016. Headline and core inflation have stayed within the target band since September 2016, as commodity prices have recovered.



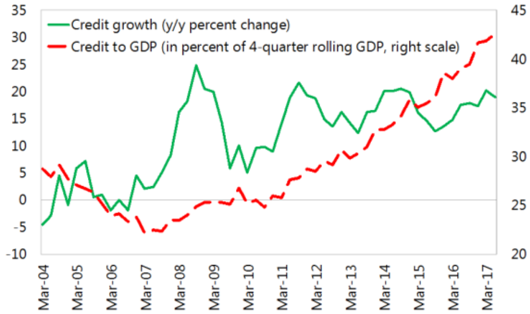


4. The current account balance (CAB) fell to near zero in 2016, from a surplus of 2.5 percent of GDP in 2015. This reflected a rise in imports of capital goods and slower growth of exports and remittances. Export growth has recovered in H1:2017, while strong import growth has continued. The peso has depreciated by 7 percent vis-à-vis the U.S. dollar since end-2015, more than other currencies in the region. Foreign reserves have remained stable at US$81 billion (8.7 months of imports of goods and services), indicating limited FX intervention.



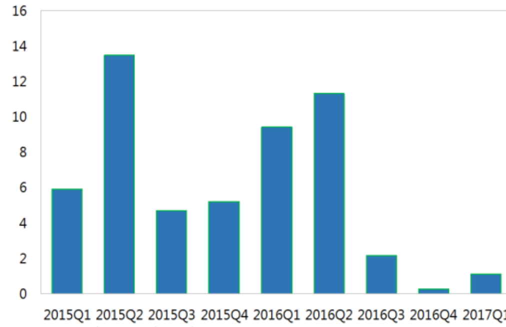
5. The banking sector remains stable, although high credit growth should be closely monitored. The banking sector appears sound based on financial soundness indicators (FSIs), with ample liquidity, high capital, and low nonperforming loans (NPLs). However, credit growth has accelerated from 13.6 percent in 2015 to 19.7 percent in July 2017, led by consumer credit and real estate loans. Although most indicators show no evidence of a credit boom so far, property prices have stabilized, and lending standards have not deteriorated, some indicators suggest that, under current trends, credit gaps could approach early warning levels of credit booms in 2017–18 (Appendix I). Financial intermediation by nonbank financial institutions (NBFIs), not regulated by the BSP, remains small but is growing fast. The stock of bank credit and credit to households are low compared to peer countries, although both have been rising fast in recent years.

Bank Credit Growth and Credit to GDP
(In percent)



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

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



Sources: Bangko Sentral ng Pilipinas (BSP).

B. Outlook and Risks

6. **The medium-term macroeconomic outlook remains favorable**. Growth is projected to remain close to potential at 6.6 percent in 2017, and 6.8 percent in the medium term, led by robust domestic demand. The baseline scenario assumes no tax reform, with fiscal policy providing a boost to growth in 2017 and remaining broadly neutral in 2018–22. The output gap is estimated to remain near zero. Inflation is expected to stay near the center of the target band due to stable commodity prices and well-anchored inflation expectations. The CAB is projected to remain negative in 2017 due to robust growth of infrastructure-related imports, financed by FDI inflows, with international reserves declining slightly.

7. **Risks are tilted to the downside and stem mainly from external sources** (Appendix II). External risks include spillovers from lower growth in China and U.S. monetary policy tightening.[1] While global growth may surprise on the upside, rising doubts about globalization in some advanced economies could hamper the business process outsourcing industry, remittances, and exports. On the domestic side, the combination of high credit growth, buoyant private investment, and fiscal expansion without tax reform could lead to overheating, which could lower the CAB, lead to peso depreciation, and raise external borrowing costs. Other domestic risks include natural disasters and security-related events. On the upside, the approval of the first tax reform package could lead to a sustainable rise in infrastructure investment and higher potential growth. The Philippines is well equipped to respond should risks materialize given its strong fundamentals and available policy space.

8. **Scenario analysis highlights the risk of overheating, especially if higher infrastructure investment is not financed with additional revenue** (Table 8):

- In line with the authorities' plans, the *"reform-and-spend"* scenario assumes a gradual increase in revenue from tax and administrative reforms and in infrastructure spending of 2 percent of GDP and 1.6 percent by 2022; a rise in social spending by 0.4 percent of GDP; and structural reforms

[1] See Chapter 1, "Spillover Effects from United States Policy Shifts and Lower Growth in China," *Philippines—Selected Issues*, forthcoming.

in capital and labor markets and the removal of quantitative restrictions in rice imports. Potential growth rises to 7.5 percent by 2022 due to a higher investment and gains in productivity and employment. Inflation rises temporarily due to the demand impulse and tax reform, but returns to the target as productive capacity increases and monetary policy tightens. Higher growth and social spending would lead to faster poverty reduction than in the baseline scenario. The impact could be larger with well-targeted social policies, including to rural areas.

- The *"no reform-and-spend"* scenario assumes that the tax reform brings no additional revenue, but infrastructure spending rises as in the first scenario financed with public debt, and no structural reforms. In this context, the national government deficit widens to 5.5 percent of GDP by 2022 and the debt-to-GDP ratio increases by 7 percent. Potential growth rises less than in the previous scenario, to 7 percent, as higher borrowing costs constrain private investment. The output gap turns positive, and the CAB falls, leading to peso depreciation and higher inflation, which in turn result in tighter monetary policy. Poverty would fall by less than in the previous scenario as growth is lower and fiscal space to expand social protection is more limited.

C. External Sector Assessment

9. The external sector has moved closer to equilibrium, and external debt is sustainable. The CAB has fallen, but remains moderately stronger than warranted by fundamentals and desirable policies. The CAB gap is estimated at 1.7 percent of GDP in 2016 (3.2 percentage points less than in 2015), with 1 percent due to policy gaps mainly from abroad and the remainder primarily due to inadequate infrastructure (Appendix III). The latter should close over time as infrastructure is upgraded. Regarding the real effective exchange rate (REER), the IMF External Balance Assessment (EBA) models to assess the REER gap produce counterintuitive results, with a wide range of estimates and large unexplained residuals.[2] Staff gives more weight to the estimates of the CAB gap, and assess the REER gap at between zero and 4 percent considering the estimated CAB gap and inadequate infrastructure. While foreign reserves are sizable, at 226 percent of the IMF's reserve adequacy metric, this is broadly justified by the country's exposure to natural disasters and capital flow volatility. External debt is moderate even after large shocks to interest rates, growth, or the exchange rate (Appendix IV). The exchange rate should continue to move freely in line with market forces, with intervention limited to smoothing excessive volatility in both directions.

Authorities' Views

10. The authorities broadly agreed with staff's projections, risks, and scenario analysis. Staff's "reform-and-spend" scenario shows that their growth target (7 percent to 8 percent in 2018–22) is reachable if tax reform is approved and infrastructure spending is gradually scaled up. They agreed with the assessment of external risks, but noted that the domestic risk of overheating is modest as they believe that the current growth momentum with low inflation is sustainable. They

[2] These models point to an overvaluation of the peso between 4 percent and 23 percent in 2016, which is difficult to reconcile with a positive CAB gap. Moreover, these models have several shortcomings as explained in Appendix III.

expressed their commitment to the 3 percent of GDP national government deficit target, which should prevent fiscal expansions after 2017. Credit has been expanding rapidly in line with strong and sustained economic growth. Nevertheless, the authorities are closely monitoring developments and stand ready to respond with appropriate measures, if necessary.

11. The authorities also broadly concurred with the external sector assessment. They agreed that the CAB gap is due to external policy gaps and inadequate infrastructure and should close over time. In addition, the EBA model does not capture other factors that could explain the strength of the external sector in recent years, such as remittances (10 percent of GDP), sales from the business process outsourcing industry (8 percent of GDP), and exposure to natural disasters that lead to lower investment and higher precautionary savings. They noted the need for more detailed explanation of the large differences between the estimates of the REER gap based on the CAB gap and those based on the REER approaches.

POLICIES FOR INCLUSIVE GROWTH AND STABILITY

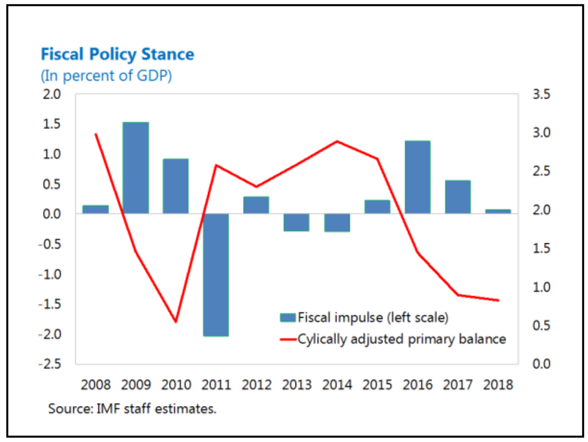
The main policy priorities include raising public spending in infrastructure, human capital, and social protection, financed by higher revenue, to make growth more inclusive and maximize the demographic dividend. However, sustaining the growth momentum in an uncertain external environment requires protecting policy anchors, adapting policies to changing conditions, and maintaining vigilance against risks, including from high credit growth, loan concentration, and overheating.

A. Fiscal Policy

12. The Philippines has some fiscal space, which should be used judiciously to scale up productive spending, while protecting confidence and avoiding overheating. Prudent fiscal management, paired with strong economic growth, has lowered the general government net debt from 68 percent of GDP in 2003 to 34.6 percent in 2016.[3] Both gross financing and long-term adjustment needs are manageable, although external financing requirements and the share of general government net debt held by nonresidents remain somewhat elevated. There is a low risk of debt stress both under the baseline and an expansionary scenario, but some vulnerability to macro-fiscal shocks such as lower GDP growth, contingent liabilities, and natural disasters (Appendix IV). Thus, on balance, the Philippines has some fiscal space, which should be used to increase productive public investment in physical and human capital over the medium term. However, with the output gap now closed, fiscal policy should be calibrated—together with other macroeconomic policies—to balance against the risk of overheating. Accordingly, a tighter fiscal stance would be appropriate if economic growth turns out to be stronger than expected in 2018 and beyond.

[3] The general government net debt is the sum of the national government net debt (gross obligations minus the bond sinking fund) and the net debt of the social security institutions and local governments.

13. Fiscal policy has been expansionary due mainly to higher infrastructure and social spending. The cyclically adjusted general government primary surplus narrowed to 1.4 percent of GDP in 2016 from 2.7 percent in 2015. Fiscal policy would also be expansionary in 2017, providing an additional fiscal impulse of 0.6 percent of GDP. The 2018 national government budget and the medium-term budget framework have deficit targets of 3 percent of GDP, implying a broadly neutral policy stance from 2018 onwards. This is an appropriate fiscal stance to reinforce policy credibility by keeping a broadly stable general government net debt-to-GDP ratio.



14. The authorities are seeking to create additional fiscal space through structural fiscal reforms.

- Staff supports the *budget reform bill* submitted to Congress to improve the budget process and public financial management (PFM) procedures by having annual appropriations on a cash basis (instead of obligations), strengthening cash flow management and implementing the Treasury Single Account (TSA),[4] and establishing the new Office of the Comptroller General.

- Staff also supports the *tax reform bill* submitted to Congress. The general government tax-to-GDP ratio, at 14.6 percent in 2016, is low relative to peers and development needs. The reform was expected to yield additional revenue of 2 percent of GDP in the medium term, with another 1 percent from administrative reforms (Appendix V). However, the bill has been diluted in Congress and, if ratified as is, would reduce the revenue yield (excluding administrative reforms) from 0.9 percent of GDP to 0.5 percent in 2018, with smaller revenue losses in the medium term. Moreover, by raising the minimum taxable income threshold to PHP 250,000, the reform leaves 83 percent of the workforce outside the tax net and increases the risks of tax evasion.[5] Staff encouraged the authorities to consider a lower threshold just above the minimum wage of about PHP 150,000 and indexation to the minimum wage increases.

15. Building on recent institutional reforms, the authorities could start to consider the next generation of fiscal reforms, including a fiscal responsibility law (FRL). This law would contain explicit fiscal rules designed to avoid procyclicality, anchor debt sustainability, and establish

[4] As of end-March 2017, around 50 percent of total central government balances is still outside the TSA system.

[5] Under the existing personal income tax (PIT) system, about 28 percent of the workforce have a tax-exempt status.

an independent fiscal council to improve accountability, following the implementation of the *budget reform bill* that enhances transparency. The objective is to anchor the government's core fiscal operations, and accordingly numerical fiscal rules are designed to focus on the national government using gross data.[6] Some characteristics of an illustrative FRL with explicit fiscal rules calibrated to the Philippines that the authorities could consider in the medium term include: (i) a national government gross debt anchor of 45 percent of GDP (currently consistent with a general government net debt of 35 percent of GDP, which is similar to staff advice during the 2016 Article IV consultation);[7] (ii) a cyclically adjusted national government primary deficit target of 2 percent of potential GDP; and (iii) an expenditure rule linking the growth rate of total spending excluding social assistance to potential GDP growth.[8]

16. Achieving inclusive growth requires a carefully balanced and sequenced approach to revenue and spending plans. Contingency plans are needed in case the tax reform is delayed or weakened, including moderating the increase in public investment, raising the value-added tax (VAT) rate, rationalizing tax incentives, and accelerating the implementation of new excises on automobiles and petroleum products.

- ***Broadening the tax base and enhancing efficiency***. The Philippines has an opportunity to raise additional revenues, reduce distortions, and attain an efficient and equitable tax system.[9] Efforts should aim to eliminate exemptions for upper-income taxpayers, strengthen revenue administration, and rationalize the VAT and corporate income tax (CIT) systems by streamlining concessions and exemptions to broaden the tax base.[10]

- ***Improving the composition and quality of spending***. Rebalancing outlays toward investment would raise growth potential. Staff welcomes the Rightsizing the National Government Act that eliminates redundant functions and strengthens agencies that need additional resources, but noted the need for strong public investment management processes. Staff encouraged the authorities to seek IMF technical assistance on the Public Investment Management Assessment (PIMA) tool, which provides an evaluation of institutions relevant to public investment at three key stages of the public investment cycle—planning, allocation and implementation.

17. Fiscal policy could foster more inclusive growth by facilitating a broader sharing of the benefits of development. The authorities have enhanced spending on education and health through the extension of high school program and the expansion of universal health insurance. Nonetheless, public health and education expenditures are lower than in ASEAN peers (1.2 percent

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[6] In most countries, debt rules are set in gross rather than net terms, as it is difficult to know how liquid the government's assets are, particularly in times of financial stress.

[7] See Appendix IV for a detailed discussion of the different public debt aggregates.

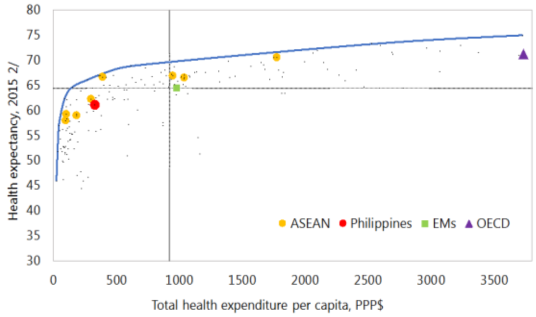
[8] See Chapter 2, "The Case for Fiscal Responsibility Law," *Philippines—Selected Issues*, forthcoming.

[9] The VAT code has more than 140 exemptions totaling 3.5 percent of GDP in 2016. There are many tax incentives granted by 18 investment promotion agencies under 180 separate bills without a central control over the design and cost-benefit analysis. The CIT expenditures were estimated at 1.5 percent of GDP in 2014.

[10] See Chapter 3, "Does Taxation Stifle Corporate Investment?," *Philippines—Selected Issues*, forthcoming.

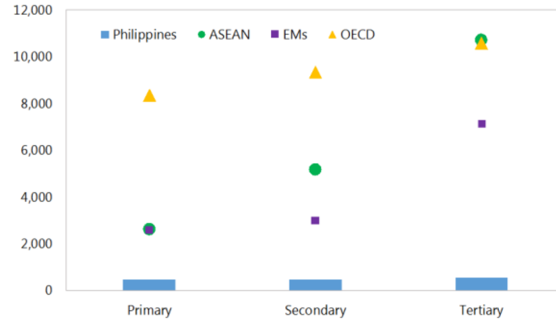
of GDP in 2015, compared to 2.2 percent for health, and 2.8 percent compared to 4.1 percent for education). The authorities plan to raise education spending to 4 percent of GDP in 2017.

Health Efficiency Frontier, Latest Value Available 1/



Sources: IMF FAD Expenditure Assessment Tool (EAT); World Bank; World Health Organization.
1/ Dash lines are the average of ASEAN.
2/ Healthy life expectancy (HALE) is a measure of health expectancy that applies disability weights to health states to compute the equivalent number of years of life expected to be lived in full health.

Government Education Expenditure per Student, PPP$ Adjusted, Latest Value Available



Source: : IMF FAD Expenditure Assessment Tool (EAT); and the World Bank.

18. The authorities are seeking to better monitor and control contingent liabilities and off-budget borrowing. Based on the *2015 Fiscal Transparency Evaluation*, staff noted the need for central oversight and Department of Finance's gateway role in the PPP process and large infrastructure projects, which are critical to contain risks and safeguard transparency. It is also vital to integrate PPP projects with the overall investment strategy and budget cycle, conduct a detailed feasibility study and value-for-money analysis, strengthen the risk management system, bring all PPP-contracting agencies into the coverage of fiscal accounts, and regularly publish data on all outstanding PPP commitments.[11] Similarly, the Department of Finance should have the final approval capacity for any off-budget borrowing contracted through government controlled and owned corporations.

19. Addressing regional disparities may require additional administrative reforms. To improve regional development, staff recommended synchronizing the devolution of revenue and expenditure assignments to subnational governments with the development of their institutional capacity.[12] Staff also stressed the need for modernizing subnational taxation—by centralizing and updating property valuations and simplifying the local business tax on turnover—and instituting adequate borrowing rules and procedures for subnational governments.

Authorities Views

20. The authorities reiterated their commitment to fiscal prudence, while scaling up public investment and social spending. They concurred with staff's assessment and policy advice, noting significant efforts to reform the tax system in an efficient and equitable manner and strengthen the budget process and PFM procedures to ensure prudent and transparent fiscal management. In view

[11] In line with the IMF's *Government Finance Statistics Manual 2014*, PPPs meeting certain criteria should be included in the government's balance sheet, even if carried out by a private company.

[12] IMF, 2009, "Macro Policy Lessons for a Sound Design of Fiscal Decentralization," Fiscal Affairs Department.

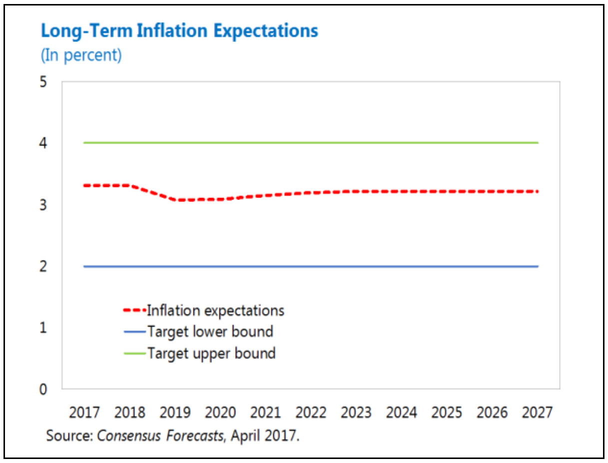
of the country's development needs, the authorities plan to significantly increase infrastructure spending as percent of GDP over the next five years and raise budgetary allocations to education, healthcare and other social areas in the medium term. They agreed on the need to maintain prudent fiscal policies and create additional fiscal space through tax reforms and expenditure rationalization and restated their commitment to the 3 percent of GDP national government deficit target. The authorities appreciated staff's analytical presentation on how to strengthen the fiscal management framework in the future, including through an illustrative FRL calibrated for the Philippines, which will provide useful inputs to their future deliberations.

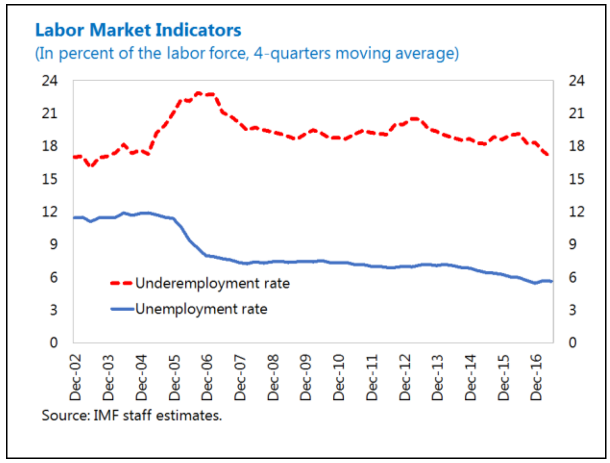
B. Monetary Policy

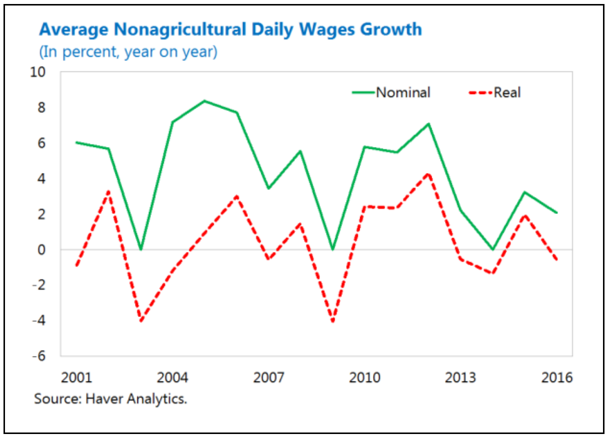
21. While monetary policy has been formally on hold since 2014, the effective policy rate (weighted average on all sterilization instruments) has risen by 60 basis points since mid-2016 through the reform of monetary operations. The BSP adopted an interest rate corridor with a term deposit auction facility to manage liquidity in June 2016, which has improved monetary policy transmission and raised the effective policy rate. While the policy rate remains low at 3 percent (real policy rate near zero), unremunerated reserve requirements (RRs) for banks are high at 20 percent. This has resulted in high interest rate margins and a tighter monetary policy stance than implied by the policy rate. High RRs have also increased financial intermediation costs and the risk that financial intermediation may migrate to the less regulated NBFIs.

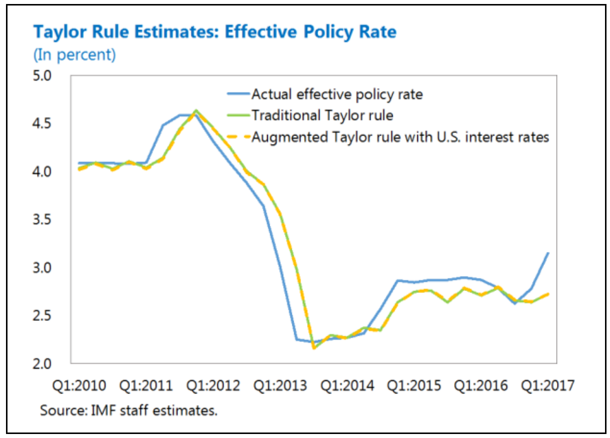
22. The current monetary policy stance remains appropriate, but the BSP should be ready to tighten if signs of overheating emerge. Inflation is projected at the center of the target band, the output gap is estimated at near zero, and inflation expectations are well anchored. There is also spare capacity in the labor market, with underemployment at 17 percent[13] and modest wage growth since 2013. The effective policy rate remains close to the rates implied by a Taylor rule reaction function. However, there are upside risks to inflation from commodity prices, pass through from peso depreciation, electricity tariffs, fuel excises, and robust economic and credit activity. The BSP must continue to be vigilant to risks of overheating. An acceleration in credit growth with rising inflation, a stronger-than-expected impact of the fiscal expansion on inflation, or rising external pressures could warrant monetary policy tightening. On the other hand, the BSP has also space to loosen monetary policy should downside risks materialize.

[13] Underemployment refers to employed persons who want additional working hours in their present job, or to have an additional or new job with longer working hours.









23. **The authorities' intention to unwind high RRs on banks is appropriate, but this requires careful calibration and timing**. Lowering RRs would reduce macrofinancial risks and improve financial intermediation. However, the timing and pace of this reform should be data driven and contingent on the inflation outlook and domestic liquidity conditions. This reform should aim to keep domestic liquidity broadly unchanged, for which the BSP has several options: (i) increasing the size of the term deposit auctions to absorb the liquidity released by the reduction in RRs. This will also require allowing for higher interest rates in the term deposit auctions and preemptively raising the policy rate; (ii) considering unsterilized sales of foreign reserves when foreign exchange flows decline; and (iii) remunerating RRs during the transition period. Effective communication of the impact of this reform is crucial.

Authorities' Views

24. **The authorities agreed with the assessment of the monetary policy stance and staff's suggested approach to unwind high RRs**. They agreed that the monetary policy stance is appropriate given the stable inflation outlook, and noted that the BSP follows a data-dependent path and will be ready to adjust monetary policy if inflation pressures build. Although the authorities are prepared to lower the RRs over the medium term, they considered current domestic conditions of strong credit growth and high domestic liquidity as not conducive for this reform. They would

prefer to be deliberate in adjusting the RR based on the emerging credit and liquidity conditions to achieve their inflation targets. They agreed that unsterilized sales of foreign reserves when foreign exchange flows decline would help reduce excess domestic liquidity.

C. Macrofinancial Linkages and Systemic Financial Stability Risks

25. Macrofinancial linkages arise from the global financial cycle (global interest rates and global financial volatility) through capital flows and their impact on domestic financial conditions. The Philippines received sizeable foreign exchange inflows after the global financial crisis, resulting in persistent liquidity overhang and a buildup of foreign reserves. Effective borrowing costs fell, fueling credit growth and asset price inflation. Nonfinancial corporate (NFC) leverage has risen, but remains moderate compared to peers. Credit growth has accelerated, especially to the real estate sector and households. Financial intermediation by NBFIs, which are not regulated by the BSP, remains small but is growing fast.

26. FSIs suggest that the banking sector is sound, but there are pockets of vulnerability in the NFC sector. Banks remain well capitalized, with ample liquidity, and low NPLs. Although official data on NFC leverage is not available, commercial sources indicate that it is moderate at 30 percent of GDP, with a low share in foreign currency. Moreover, the share of NFC debt at risk is among the lowest in emerging market economies.[14] However, some real estate developers have leveraged significantly, while expanding shadow-banking activities through their acceptance of advances from households.[15] The authorities have several initiatives to fill data gaps that hinder supervision, such as the Financial Sector Coordination Council's (FSCC's) efforts to enhance corporate sector balance sheet data, and efforts covering shadow banking activities by real estate developers. Staff supports giving the Security and Exchange Commission (SEC) legal access to information on conglomerates' finances.

27. The main systemic risks to financial stability are high credit growth and concentration. Although not yet at credit boom levels, high credit growth, including for real estate and households, merit continued monitoring.[16] Staff welcomes the upcoming launch of a consumer credit bureau database, which should improve transparency and availability of borrower data. The lapse of the additional Single Borrower Limit for PPPs and petroleum importers have mitigated concentration risks, but the opaque conglomerate structure and data gaps makes it hard to measure the banks' exposure and intercompany linkages. Capital market development can help reduce bank loan concentration by diversifying the sources of funding for large conglomerates.

28. Macroprudential policies should be used to address systemic risks to financial stability. The BSP should stand ready to raise capital requirements in case of a broad-based credit boom,

[14] IMF, *Global Financial Stability Report*, October 2016.

[15] Buyers that do not qualify for bank loans can make advances for properties under construction. These advances are considered trade receivables by real estate developers, who keep ownership of the property until fully paid. Thus, these fully collateralized loans are exposed to default, if house prices decline or interest rates increase.

[16] Although growing fast, household leverage at around 18 percent of GDP, remains low compared to peers.

supported by monetary policy tightening, if accompanied by overheating. Targeted macroprudential policies should be used in case of excessive credit growth to some sectors. For real estate credit, in addition to the stress test on banks' exposures, the authorities should consider higher risk weights or provisioning requirements on real estate loans above a certain loan-to-value ratio. For household loans, the authorities should improve data collection on borrowers' debt-to-income (DTI) and consider higher risk weights or provisioning requirements on DTI ratios. Staff welcomes the early adoption of the Basel III guidelines and the role of the new financial stability department at the BSP entrusted with mainstreaming macrofinancial surveillance and strengthening the macroprudential framework. Staff encouraged the authorities to consider introducing stress tests on debt-to-earnings ratios for corporates and developing a borrowers' interconnectedness index.

29. Approving the amendment to the BSP charter is crucial to preserve financial stability and improve monetary policy transmission. The current BSP charter, adopted in the early 1990s, needs to be modernized in line with a changing financial sector. The main amendments currently in Congress are: (i) introducing a financial stability mandate; (ii) extending the supervisory perimeter; (iii) establishing legal protection for supervisors; (iv) increasing the BSP's capital; and (v) allowing the BSP to issue its own securities. In the interim period, enhanced coordination among the financial sector regulators through the FSCC should continue.

Authorities' Views

30. The authorities broadly agreed with the assessment of systemic risks and policies to address them. The authorities are monitoring the growth of credit in general and developments in the real estate and household sectors, in particular, but they do not believe that there are signs of imminent market dislocation. They point out that the growth in credit is from a relatively low base and partly reflects the significant achievements in financial inclusion. They believe that the requirement to undertake stress tests on banks' real state exposures, and the 20 percent concentration limit, has helped moderate real estate credit growth. Stress test results show that banks are resilient to a 20 percent write-off on their exposure to the top 20 conglomerates. The authorities also noted that the BSP's supervisory framework has strengthened in recent years, including through the adoption of Basel III guidelines. The BSP also requires banks to report interrelated loans and can partly monitor concentration risks. Moreover, the FSCC is launching a survey that would profile the outstanding debt obligations of NFCs, although this will be voluntary for nonlisted companies.

D. Structural Policies and Inclusive Growth

31. The authorities' main goal is to sustain rapid inclusive growth to significantly lower poverty and maximize the demographic dividend. The Philippines has a young and growing population, and thus an important priority is to provide the new labor force entrants with good job opportunities.[17] With eradicating poverty by 2040 being a long-term objective,[18] the government aims to reduce poverty to 14 percent in 2022 (from 21.6 percent in 2015), with a focus on rural areas. However, the Philippines has had a low elasticity of poverty reduction to growth in the past, partly due to weak employment generation, structurally high underemployment, and slow technical change, caused, in turn, by low human and physical capital investment. Thus, achieving the authorities' objectives would require a broad set of structural reforms.

32. The authorities' priorities for structural reforms aim to promote inclusion. The focus is on higher investment in infrastructure and human capital, sound urban development, and access to finance. Monetary and financial policies should support this agenda through price stability and financial inclusion (Appendix VI). Regulatory policy should promote competition and openness to foreign investment, while ensuring adequate consumer protection. Social policies should expand protection to uncovered sectors, disaster risk mitigation, and access to healthcare. Eliminating quantitative restrictions in rice imports while supporting affected farmers, would help reduce consumer price inflation and poverty.

33. The Philippines scores well on gender equality, but female labor force participation could be improved. Since the early 2000s, the share of adult Filipino women participating in the labor market has stagnated at 50 percent. This has led to a high gender gap compared with other ASEAN countries. In this regard, the target to raise female labor force participation by 2 percent under the PDP is welcome. Improving access to affordable child care and strengthening retraining programs aimed at returning female workers can help narrow this gap.[19]

Philippines: Selected Gender Inequality Indicators

	2010	2015
GNI per capita (2011 PPP$)		
Women	5,951	6,843
Men	9,035	9,919
Labor market		
Labor force participation rate (percent)		
Women	50.2	50.5
Men	79.6	78.8
Female share of employment in non-agriculture (percent)	42.0	41.3
Unemployment rate, female-to-male ratio	0.92	0.92
Education		
Mean years of schooling (years)		
Women	9.2	9.5
Men	9.0	9.2
Population with at least some secondary education (percent)		
Women	67.5	72.8
Men	66.7	70.3
Health		
Maternal mortality ratio (deaths per 100,000 live births)	129	114
Life expectancy at birth (years)		
Women	71.2	71.9
Men	64.5	65.0
Political empowerment		
Share of seats in parliament (percent)	21.5	27.1

Sources: United Nations, *Human Development* data; and IMF staff estimates.

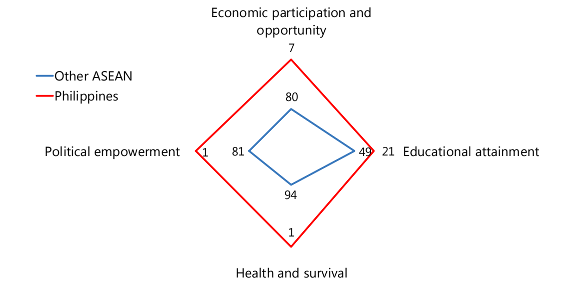
[17] The average growth rate of the labor force was 2.2 percent during 2010−16, or about 1 million people per year.

[18] The Philippine Development Plan (PDP) for 2017–22.

[19] IMF, Staff Discussion Note, SDN/13/10.

Global Gender Gap Ranking, 2016 1/

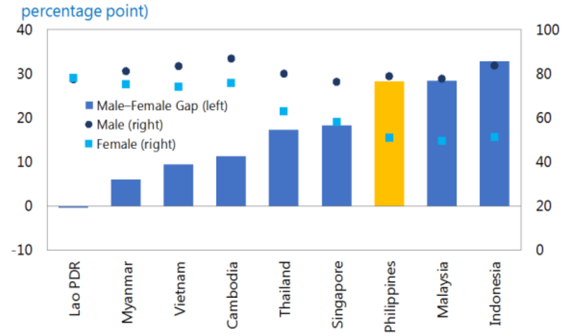
(Periphery = Highest ranking in gender equality)



Sources: World Economic Forum, *Global Gender Gap Report 2016*; and IMF staff estimates.
1/ "Economic Participation and Opportunity" is base on the gender gap in labor force participation, earned income, and the number of legislators and managers; "Education Attainment" on the gap in primary-, secondary-, and tertiary-level education and the literacy rate; "Health and Survival" on the sex ratio at birth and the gap in life expectancy; "Political Empowerment" on the gap in ministerial-level and parliamentary positions, and the terms of years in executive office.

Gender Gap in Labor Force Participation, 2016

(Difference between male and female labor force participation rate, percentage point)



Sources: World Bank, *World Development Indicators* (modeled ILO estimates); and IMF staff estimates.

34. Capital market development would help finance infrastructure projects and limit concentration risks in the banking system. Capital market development would facilitate investment in long-term government bonds, lower borrowing costs, and improve monetary policy transmission. The focus should be on developing secondary markets, introducing new instruments, ensuring proper supervision and regulation to promote secondary market trading, and revamping the primary dealer system to incentivize more active market-making, including through the introduction of the repo system.

35. The authorities are tightening anti-money laundering (AML) legislation in line with Financial Action Task Force standards. Following last year's theft of Bangladesh's foreign reserves laundered through casinos in the Philippines, the Asia-Pacific Group on Anti-Money Laundering reiterated its recommendation to include casinos in the AML legislation.[20] The law was amended to cover casinos (including internet and ship-based gaming sites), which are now required to perform customer identification and record keeping obligations, and report to the financial intelligence unit all single casino cash transactions above PHP 5 million (approximately US$99,000). Notwithstanding this notable progress, the AML/CFT framework could be strengthened further by amending the bank secrecy law and making tax evasion a predicate crime.

Authorities' Views

36. The authorities reaffirmed their commitment to inclusive growth reforms while maintaining fiscal prudence. The Philippines' basic education program has recently been extended from a 10-year to a 12-year system, to make high school graduates more employable and better prepared for higher education. Public health insurance has also been expanded to cover a larger share of the population. The authorities also intend to push forward financial inclusion measures, including by enhancing the digitalization of the financial system. The Foreign Investment Negative List (FINL) is being reviewed with the aim of attracting more FDI. The authorities are taking steps to

[20] After the enactment of the Republic Act No. 10365 in 2013, which strengthened the anti-money laundering legislation, the Philippines was removed from the FATF's list of jurisdictions with serious AML/CFT deficiencies. However, casinos were not put under scrutiny of this law as it may have discouraged tourism and casino activity.

implement a capital market reform package as proposed by recent IMF technical assistance. They are also aiming to raise female labor force participation by providing childcare support. The current tax reform proposal includes an easing of the bank secrecy law for tax purposes, which should also improve the AML/CFT framework.

STAFF APPRAISAL

37. The strong performance of the economy has continued, with rapid economic growth and low inflation. Economic growth is projected to remain high, supported by robust domestic demand, while inflation is expected to remain near the center of the target band. However, credit growth has accelerated, and although most indicators find no evidence of credit booms so far, some indicators suggest that credit gaps could approach early warning levels in 2017–18.

38. Risks to the outlook are tilted to the downside and stem mainly from external sources. The combination of high credit growth, buoyant private investment, and fiscal expansion without tax reform could lead to overheating of the economy. On the upside, approval of the first tax reform package would lead to a sustainable increase in infrastructure investment. The Philippines is well equipped to respond if risks materialize given its strong fundamentals and available policy space.

39. The external sector remains moderately stronger than warranted by fundamentals and desirable policies. The CAB remains above its estimated norm, largely due to inadequate infrastructure, and the gap is expected to close over time as infrastructure is upgraded. The undervaluation of the REER is estimated between zero and 4 percent, considering the estimated CAB gap and the structural impediments to investment. Foreign reserves remain sizable, but this is broadly justified by the country's exposure to natural disaster and capital flow volatility.

40. This setting provides a good opportunity for the authorities to pursue their inclusive growth agenda. Despite the strong economic growth in the recent years, poverty and inequality remain high and the country needs to create jobs for its young and growing population. Sustaining the growth momentum in an uncertain and volatile external environment requires protecting policy anchors, adapting policies to changing conditions, and maintaining vigilance against risks.

41. Staff supports the authorities' plans to gradually scale up productive infrastructure and targeted social spending, while keeping a broadly neutral fiscal stance. Staff supports the authorities' ambitious development agenda, but recommends calibrating fiscal policy to balance against the risk of overheating. The increase in priority spending should be financed through additional revenue mobilization, including by widening the tax base, so that the fiscal stance remains broadly neutral. Avoiding procyclicality in fiscal policy would require a tighter fiscal stance if economic growth is stronger than expected. Staff also supports the 3 percent of GDP national government deficit ceiling, which would reinforce policy credibility and keep the general government net debt on a stable path.

42. Staff welcomes the first tax reform package designed to create additional fiscal space, and encourages the authorities to consider additional revenue measures. The ambitious development agenda depends on a series of comprehensive tax reforms that could create additional fiscal space. Staff appreciates the breadth of the envisaged tax reforms, but cautions that reform efforts may have a lower revenue yield than originally projected because of dilution in Congress. Accordingly, staff encourages the authorities to consider lowering the threshold for PIT, raising the VAT rate, rationalizing tax concessions and exemptions, and accelerating the implementation of new excises on automobiles and petroleum products.

43. The stance of monetary policy remains appropriate, but the BSP should be ready to tighten if there are signs of overheating. The authorities' intention to unwind the high banks' RRs over time would reduce macrofinancial risks. However, this reform should be carefully calibrated and timed, and should aim to keep domestic liquidity broadly unchanged. The exchange rate should continue to move freely in line with market forces, with foreign exchange intervention limited to smoothing excessive volatility in both directions.

44. The main systemic risks to financial stability are high credit growth and concentration. High credit growth, especially to the real estate and household sectors, merit continued monitoring. In addition, some conglomerates and real estate developers have leveraged significantly, while shadow-banking activities have expanded. The opaque conglomerate structure and data gaps generates challenges to measure concentration but capital market development could help reduce bank loan concentration by diversifying the sources of funding for large conglomerates. Staff supports the authorities' efforts to have legal access to information on conglomerates' finances.

45. Macroprudential policies should be used to address systemic risks to financial stability. In case of a broad-based credit boom, the BSP should raise capital requirements, supported by monetary policy tightening if accompanied by overheating. Targeted macroprudential policies should be used if sectoral credit growth is excessive. Staff welcomes the early adoption of the Basel III guidelines on banks, and the role of the new financial stability department at the BSP in mainstreaming macrofinancial surveillance and strengthening the macroprudential framework.

46. The financial stability framework would greatly benefit from amendments of the BSP Charter. The Charter should be amended to better serve the needs of a modern financial sector and economy. Staff supports the proposed revisions that (i) introduce a financial stability mandate; (ii) extend the supervisory perimeter; (iii) establish legal protection for supervisors; (iv) increase the BSP's capital; and (v) allow the BSP to issue its own securities.

47. Staff supports ongoing reforms aimed at lowering poverty and maximizing the demographic dividend. The authorities are appropriately focusing on investing in infrastructure and human capital, reducing regional disparities, eliminating quantitative restrictions in rice imports, and improving access to finance including through capital market development. Regulatory reforms to reduce the costs of doing business and openness to foreign investment would help promoting domestic competition.

48. Staff welcomes the recent amendment to the AML law to include casinos. Notwithstanding this notable progress, the AML/CFT framework could be strengthened further by amending the bank secrecy law and making tax evasion a predicate crime.

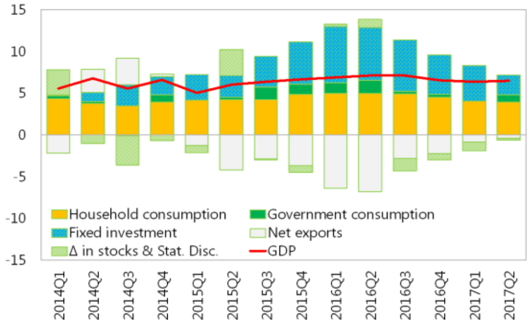
49. It is recommended that the next Article IV consultations take place on the standard 12-month cycle.

Figure 1. Philippines: Real Sector

Growth remains strong, led by robust domestic demand…

Contributions to Real GDP Growth—Expenditure Side

(In percent, year on year)

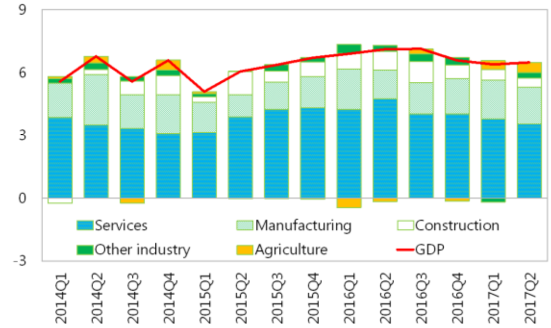


Source: National Statistical Coordination Board; and IMF staff calculations.

…and robust growth of services and manufacturing output.

Contributions to Real GDP Growth—Supply Side

(In percent, year on year)

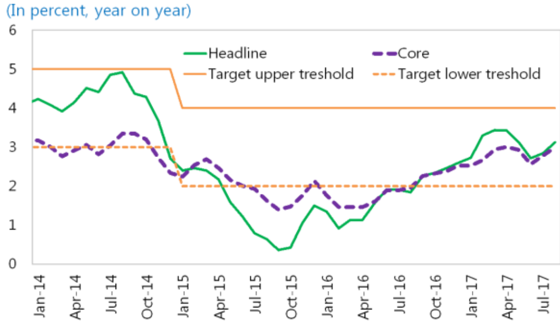


Source: National Statistical Coordination Board; and IMF staff calculations.

Inflation remains close to the center of the target range…

Consumer Price Inflation: Headline and Core

(In percent, year on year)

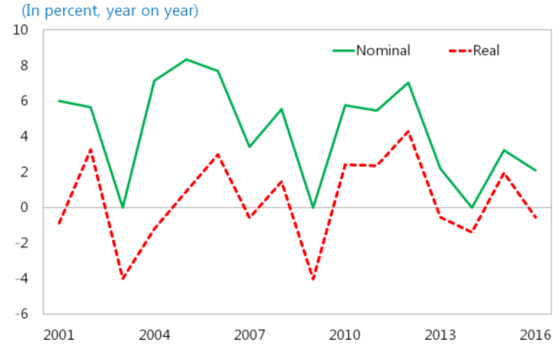


Sources: Philippines authorities; and IMF staff estimates.

…while wage growth has been moderate.

Average Nonagricultural Daily Wages Growth

(In percent, year on year)

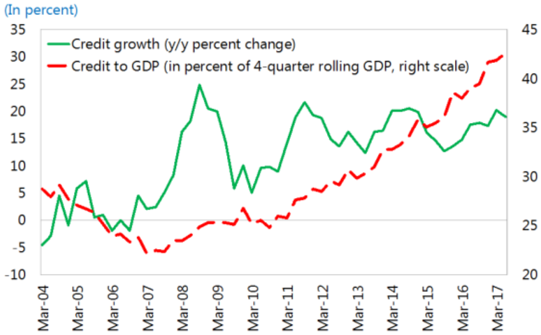


Source: Haver Analytics.

Credit growth has rekindled in recent months…

Bank Credit Growth and Credit to GDP

(In percent)

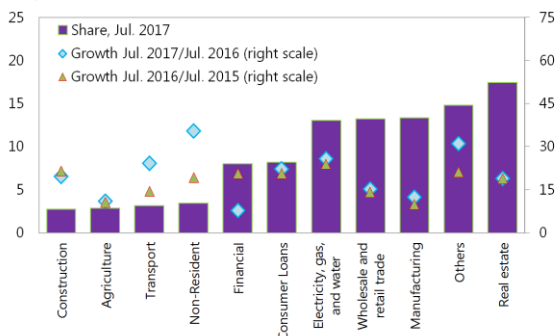


Sources: CEIC Data Company Ltd; and IMF staff estimates.

…including for manufacturing, consumers, and non-residents.

Universal and Commercial Banks: Loans by Sector

(In percent)



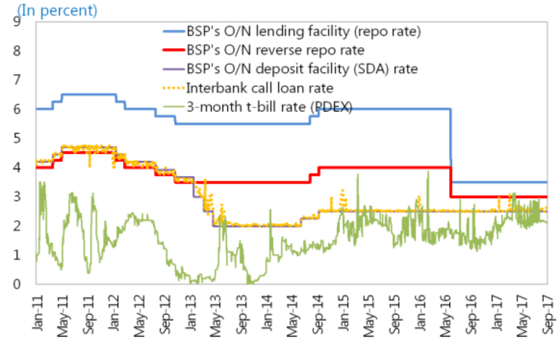
Sources: CEIC Data Company Ltd; and IMF staff calculations.

Figure 2. Philippines: Monetary and Financial Conditions

Monetary policy has been on hold since 2014. The new IRC with liquidity operations, adopted in June 2016, has brought the T-bill rates closer to the policy rate…

Policy Rates, Interbank and T-Bill Rates

(In percent)

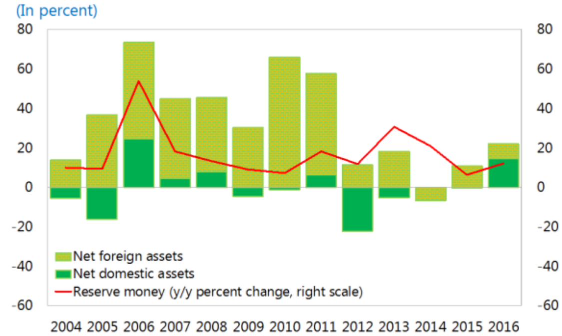


Sources: Bloomberg L.P.; Haver Analytics; and Philippine Dealing and Exchange Corp. (PDEX).

…while the growth rates of reserve money and net foreign assets have remained moderate.

Contribution to Reserve Money Growth

(In percent)

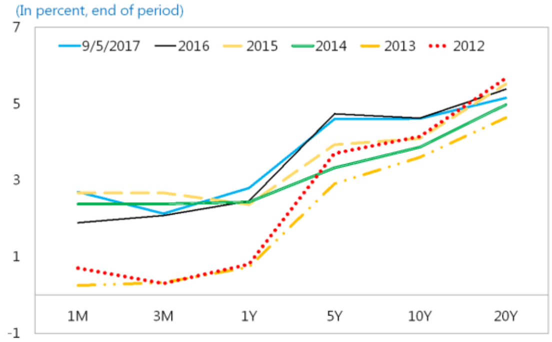


Sources: Haver Analytics.

The yield curve has been broadly stable since 2016, although slightly steeper than in 2014-15…

Government Bond Yields

(In percent, end of period)

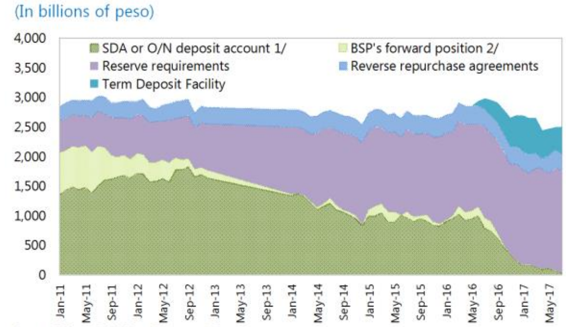


Source: Bloomberg L.P.

…as liquidity in the system has stabilized, with about two-thirds of it absorbed through banks' reserve requirements.

Philippines: Main Sterilization Instruments

(In billions of peso)



Sources: BSP; and CEIC Data Company Ltd.

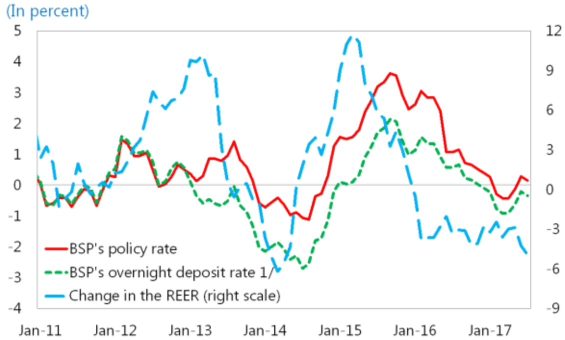
1/ Beginning June 3, 2016, special deposit accounts (SDAs) were replaced by the overnight deposit accounts in line with the BSP's interest rate corridor implementation.

2/ Data on BSP's forward position as of t-2.

Higher inflation has reduced real policy rates in 2016-17, while the peso has depreciated in real effective terms…

Real Interest Rate and Change in the REER

(In percent)



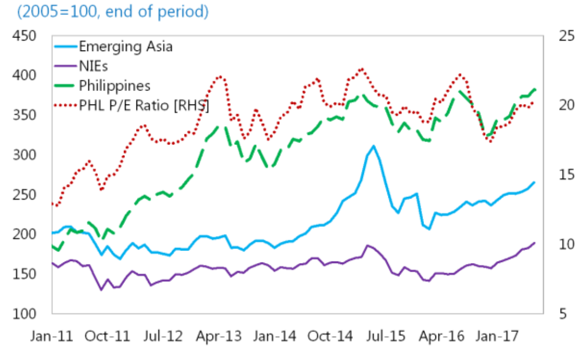
Sources: CEIC Data Co., Ltd.; and IMF staff estimates.

1/ Before June, 2016, it corresponds to the rate on the Special Deposits Accounts.

…while stock market valuations have recovered after the selloff following the U.S. elections.

Stock Market Indices

(2005=100, end of period)

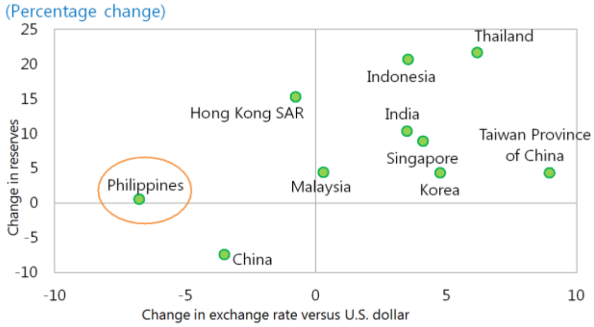


Sources: Bloomberg LP; CEIC Data Company Ltd.; and IMF staff calculations.

Figure 3. Philippines: Financial Market Comparisons

Foreign reserves have been broadly stable since end-2015…

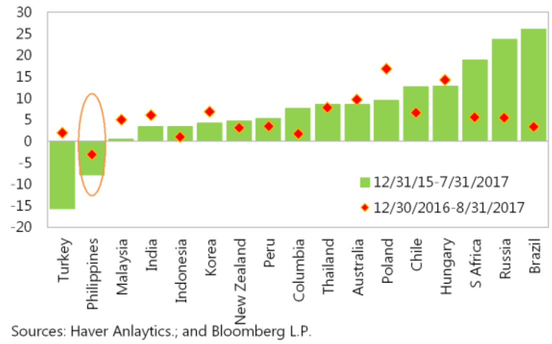
Appreciation and Reserve Accumulation, 2016-17 1/ 2/
(Percentage change)



Sources: Bloomberg L.P.; CEIC Data Co. Ltd.; and IMF staff estimates.
1/ The reference period is July 2017 versus December 2015.
2/ Positive change in exchange rate means appreciation.

…while the nominal exchange rate has depreciated.

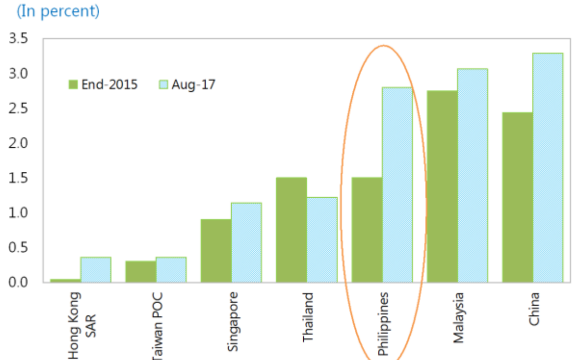
Change in Exchange Rate versus U.S. dollar 1/
(In percent)



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

With the new IRC, T-Bill Yields have moved closer to the policy rate, but remain comparable to other Asian economies.

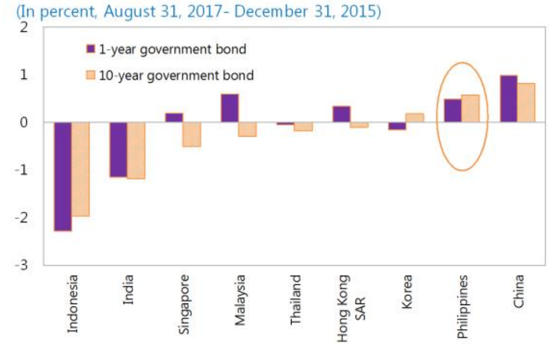
Three-Month Treasury Bill Yields
(In percent)



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

Government bond yields have also risen with the adoption of the new IRC in June 2016…

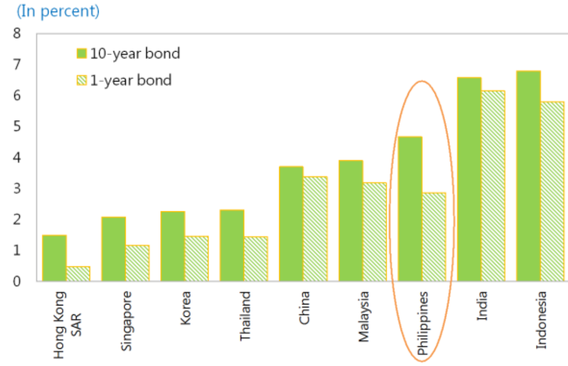
Change in Government Bond Yields
(In percent, August 31, 2017- December 31, 2015)



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

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

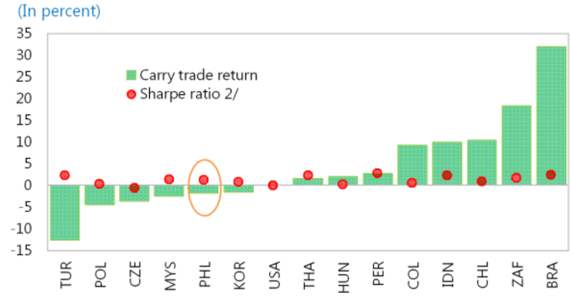
Government Bond Yields, August 2017
(In percent)



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

While negative returns to carry trade remain small in the Philippines compared to peers.

Carry Trade Return, 2016 1/
(In percent)



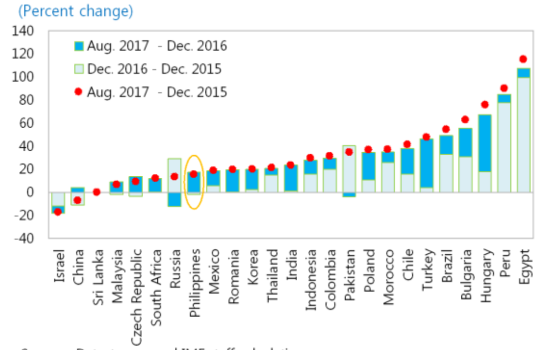
Sources: Bloomberg LP; and IMF staff calculations.
1/ Exchange rate-adjusted return on a one-year local currency government bond versus a one-year U.S. treasury bond.
2/ A measure of risk-adjusted return, calculated as average monthly carry trade return divided by the standard deviation of returns.

Figure 4. Philippines: Cross-Country Financial Market Developments

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

Stock Market Index Changes

(Percent change)

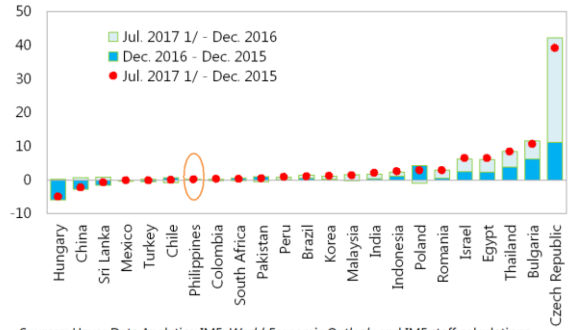


Sources: Datastream; and IMF staff calculations.

…and foreign reserves have been broadly stable.

Changes in Stock of Reserves

(In percent of 2016 GDP)

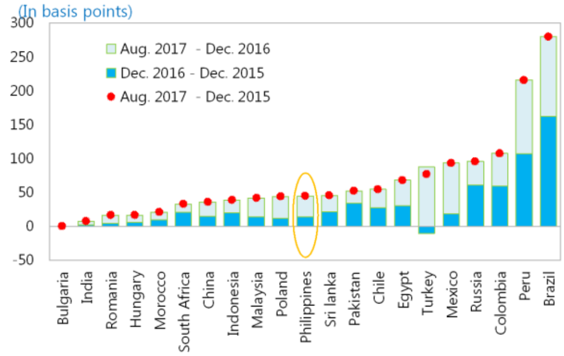


Sources: Haver Data Analytics; IMF, *World Economic Outlook*; and IMF staff calculations.
1/ Or latest data available.

The Philippines' sovereign spreads have risen, although less than in other emerging market economies…

EMBI Changes

(In basis points)

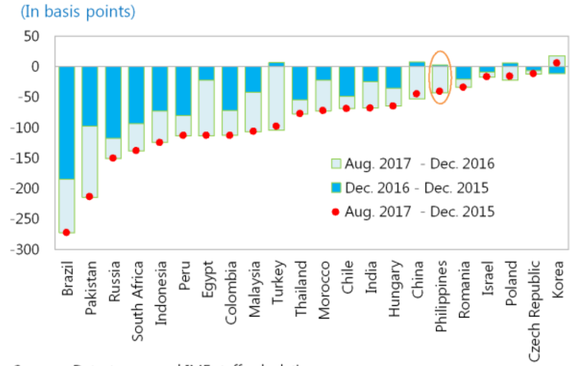


Sources: Datastream; and IMF staff calculations.

…and its CDS spreads have declined somewhat.

CDS Spread Changes

(In basis points)



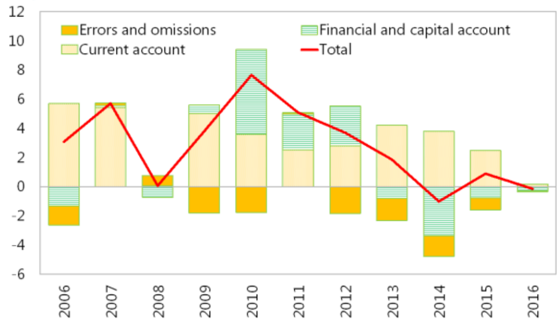
Sources: Datastream; and IMF staff calculations.

Figure 5. Philippines: External Sector

The balance of payments was broadly in balance in 2016, with the current account balance declining sharply to near zero…

Balance of Payments

(In percent of GDP)

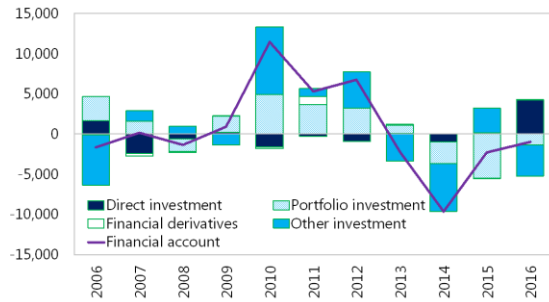


Source: CEIC Data Company Ltd.

…and portfolio capital outflows slowing. FDI inflows also increased significantly.

Capital Inflows 1/

(In millions of U.S. dollars)



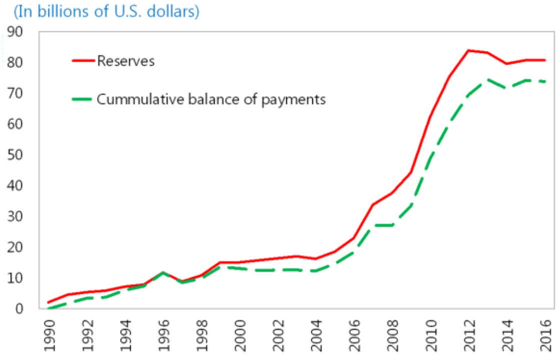
Source: CEIC Data Company Ltd.

1/ Positive implies inflow.

International reserves have stabilized after the rapid reserve accumulation between 2007 and 2012…

Philippines: International Reserves

(In billions of U.S. dollars)

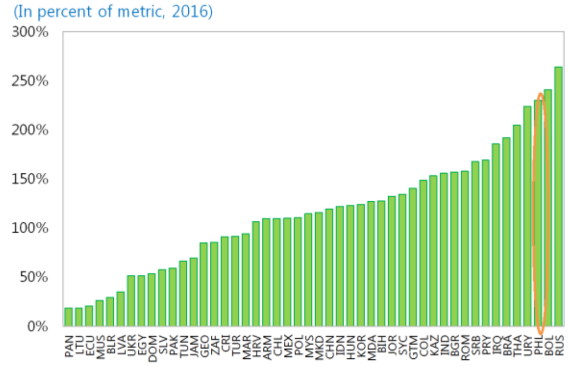


Sources: CEIC Data Co. Ltd.; and IMF staff estimates.

…but they remain well above the IMF's reserve adequacy metric.

Reserves Against Adequacy Metric

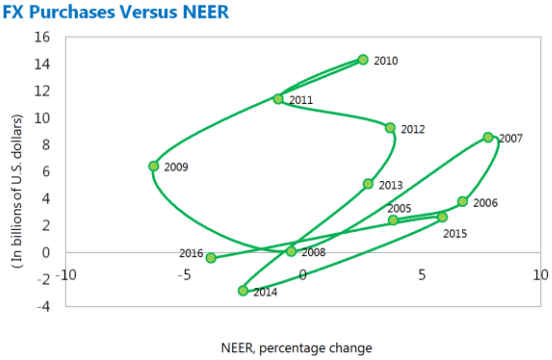
(In percent of metric, 2016)



Source: IMF staff estimates.

The BSP has relied more on exchange rate fluctuations than changes in FX reserves since 2014…

FX Purchases Versus NEER

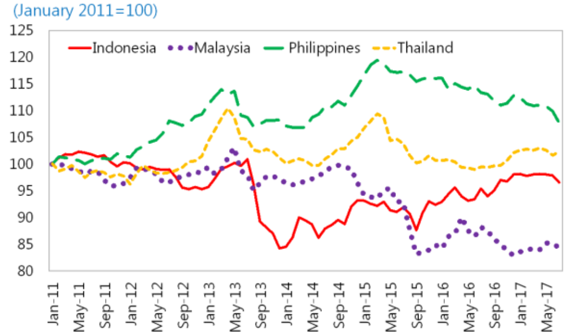


Sources: Haver Analytics; and IMF, *Information Notice System*.

…and the REER has depreciated since early 2015.

REER in ASEAN

(January 2011=100)

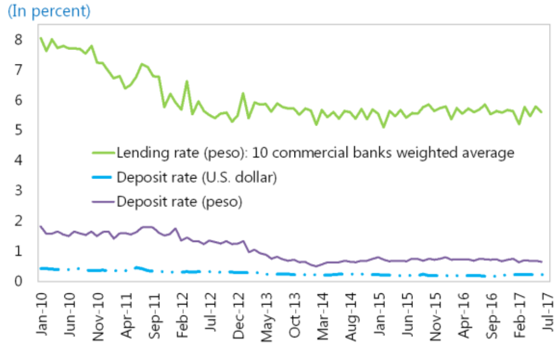


Source: IMF staff estimates.

Figure 6. Philippines: Banking Sector

Loan to deposit rate spreads have remained high, partly due to the high unremunerated Banks' reserve requirements…

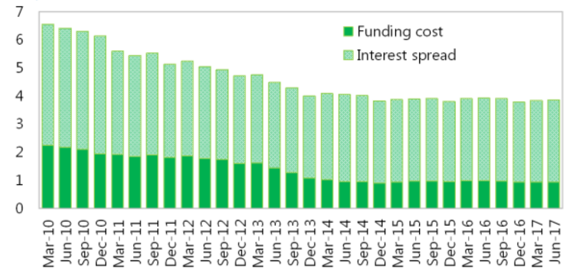
Lending and Deposit Rates
(In percent)



Sources: CEIC Data Co. Ltd.

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

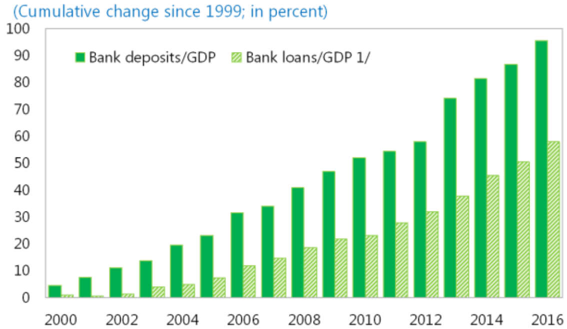
Universal and Commercial Banks: Funding Cost and Interest Spread 1/
(In percent)



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

Bank loans remain significantly lower than bank deposits.

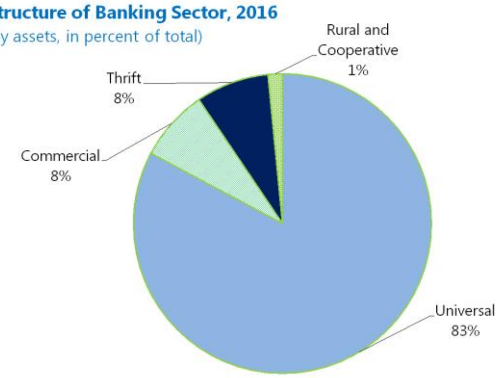
Philippine Banking System: Deposits and Loans
(Cumulative change since 1999; in percent)



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.

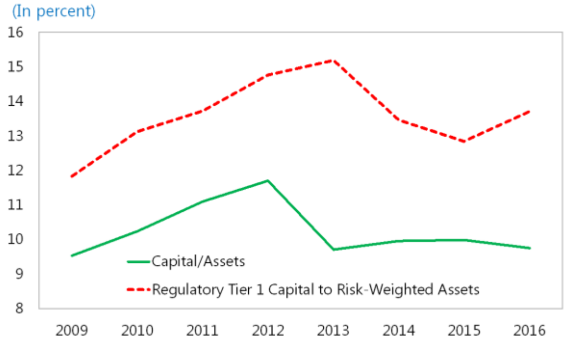
Structure of Banking Sector, 2016
(By assets, in percent of total)



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

The Philippine banking system is well capitalized…

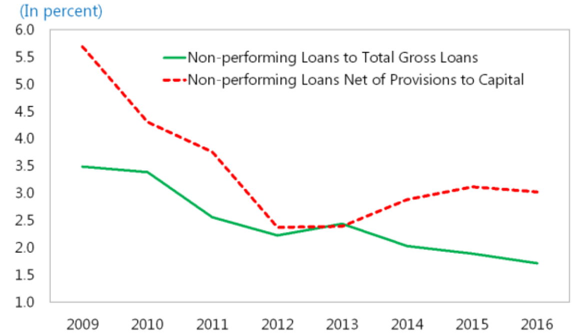
Capital Adequacy
(In percent)



Source: IMF, Financial Soundness Indicators.

…with low and declining NPL ratios.

Asset Quality
(In percent)

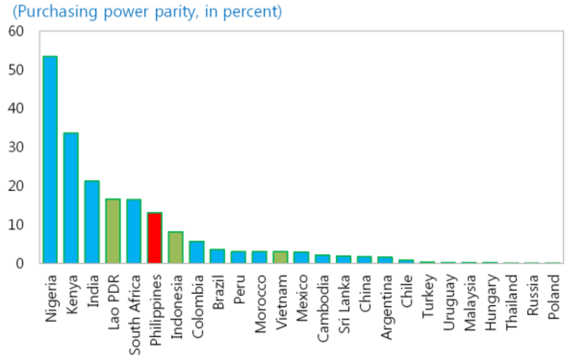


Source: IMF, *Financial Soundness Indicators*.

Figure 7. Emerging Markets: Social Conditions and Income Distribution

Poverty in the Philippines has recently fallen, but remains high...

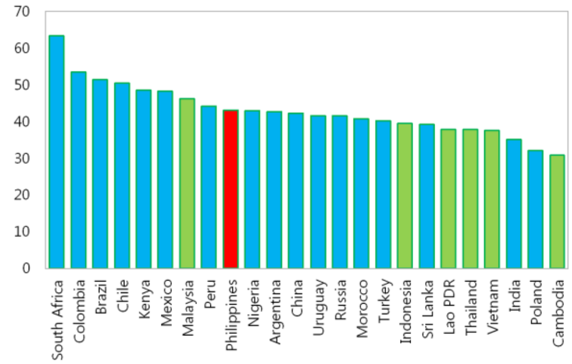
Poverty Rate at $1.90 a Day
(Purchasing power parity, in percent)



Source: World Bank, *World Development Indicators.*

...as is income inequality.

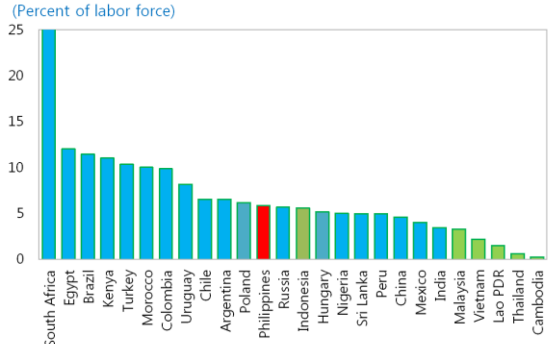
Income Inequality: GINI Coefficient



Source: World Bank, *World Development Indicators.*

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

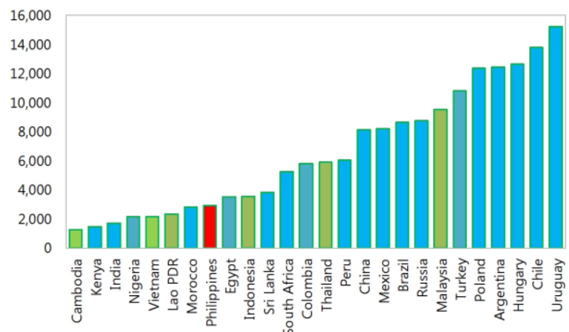
Unemployment Rate in 2016
(Percent of labor force)



Source: World Bank, *World Development Indicators.*

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

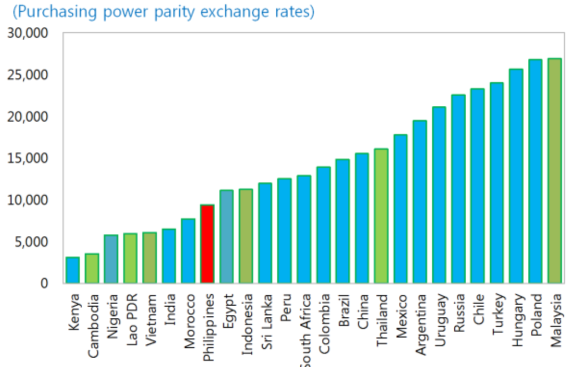
GDP Per Capita in U.S. Dollar, 2016
(Market exchange rates)



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, 2016
(Purchasing power parity exchange rates)



Sources: World Bank, *World Development Indicators.*

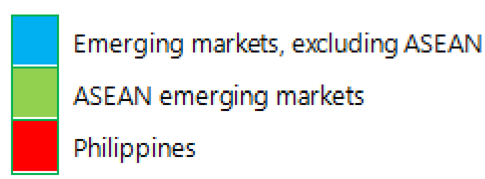


Table 1. Philippines: Selected Economic Indicators, 2012–18

Nominal GDP (2016): P 14,481 billion ($305 billion)
Population (2016): 103.2 million
GDP per capita (2016): $2,927
Poverty headcount ratio at $1.90 a day at PPP (2012): 13 percent
IMF quota: SDR 2,042.9 million
Main products and exports: electronics, agriculture products, and business process outsourcing
Unemployment rate (2016): 5.5 percent

	2012	2013	2014	2015	2016	2017 Proj.	2018 Proj.
GDP and prices (percent change)							
Real GDP	6.7	7.1	6.1	6.1	6.9	6.6	6.7
Real GDP per capita	4.1	5.2	4.3	4.3	5.2	4.5	4.6
CPI (annual average)	3.2	3.0	4.1	1.4	1.8	3.1	3.0
CPI (end year)	3.0	4.1	2.7	1.5	2.6	2.9	3.0
Investment and saving (percent of GDP)							
Gross investment	18.2	20.0	20.6	21.2	24.3	25.6	25.9
National saving	21.0	24.2	24.3	23.7	24.0	25.5	25.5
Public finances (percent of GDP)							
National government balance (authorities' definition)	-2.3	-1.4	-0.6	-0.9	-2.4	-3.0	-3.0
National government balance 1/	-2.4	-1.5	-0.6	-1.4	-2.4	-3.0	-3.0
Nonfinancial public sector balance 2/	-0.6	0.6	0.9	0.4	-0.3	-0.8	-0.9
Revenue and grants	19.4	20.2	19.8	19.7	19.4	19.5	19.5
Expenditure	20.0	19.6	18.9	19.3	19.7	20.3	20.4
Nonfinancial public sector net debt	53.0	51.3	47.9	47.2	44.7	42.9	41.2
Monetary sector (percent change, end of period)							
Broad money (M3) 3/	9.4	31.8	11.2	9.4	12.8	13.5	...
Interest rate (91-day treasury bill, end of period, in percent) 4/	0.5	0.5	1.4	1.8	1.6	2.2	...
Credit to the private sector (in percent) 3/	16.2	16.4	19.9	13.6	17.3	19.7	...
External sector							
Export value (percent change)	21.2	-4.0	11.9	-13.3	-1.1	9.9	7.0
Import value (percent change)	11.3	-4.8	8.0	-1.0	17.7	12.0	8.5
Current account (percent of GDP)	2.8	4.2	3.8	2.5	-0.3	-0.1	-0.3
Capital account (US$ billions)	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Financial account (US$ billions) 5/	-6.7	2.2	9.6	2.3	-0.4	-0.3	-0.7
Direct investment (net) 5/	1.0	-0.1	1.0	-0.1	-5.9	-4.5	-4.7
Errors and omissions (US$ billions)	-4.6	-4.2	-4.1	-2.4	0.1	0.0	0.0
Overall balance (US$ billions)	9.2	5.1	-2.9	2.6	-0.4	0.0	-0.4
Total external debt (percent of GDP)	32.0	28.9	27.3	26.5	24.5	23.0	20.5
Debt service ratio 6/	9.9	11.1	8.4	7.7	9.7	10.0	9.2
Reserves(US$ billions)	83.8	83.2	79.5	80.7	80.7	80.9	80.6
Reserves/short-term liabilities 7/	397.9	406.2	413.3	409.5	408.3	399.1	396.2
Exchange rate (period averages)							
Pesos per U.S. dollar 8/	42.2	42.4	44.4	45.5	47.5	50.2	...
Nominal effective exchange rate (2005=100) 8/	102.6	105.4	102.7	108.8	104.6	99.9	...
Real effective exchange rate (2005=100) 8/	105.6	109.9	109.5	116.8	113.2	109.7	...
Nominal GDP per capita(US$)	2,591.5	2,768.5	2,849.3	2,882.8	2,953.3	3,023.0	3,302.3
Output gap (in percent)	-0.3	0.5	0.3	-0.1	0.1	0.0	-0.1

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

1/ IMF definition. Excludes privatization receipts and includes deficit from restructuring of the previous Central Bank-Board of Liquidators.
2/ Includes the national government, 14 government-owned enterprises, social security institutions, and local governments.
3/ Universal and commercial banks. The latest observation is July 2017, year-on-year.
4/ Secondary market rate. The latest observation is August 2017.
5/ In BPM6. A rise in either assets or liabilities is always positive and a decrease is always negative. Net investment is assets minus liabilities.
6/ In percent of exports of goods and nonfactor services.
7/ Reserves as a percent of short-term debt (including medium- and long-term debt due in the following year).
8/ Average January-August, 2017.

Table 2. Philippines: National Government Cash Accounts, 2012–18

(In billions of pesos, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017 Proj.	2018 Proj.
Revenue and grants	1,535	1,716	1,909	2,109	2,196	2,419	2,658
Tax revenue	1,361	1,535	1,719	1,815	1,980	2,179	2,396
Net income and profits	643	718	785	846	925	1,018	1,120
Excises	98	146	166	190	205	228	249
VAT	451	490	558	562	615	676	734
Tariffs	41	35	56	57	59	67	85
Other 1/	129	146	154	160	179	190	209
Nontax revenue	166	178	187	231	215	241	262
Expenditure and net lending	1,778	1,880	1,982	2,231	2,549	2,897	3,182
Current expenditures	1,391	1,519	1,617	1,785	1,929	2,113	2,327
Personnel services	543	582	604	664	723	802	891
Maintenance and operations	237	283	309	403	439	460	506
Allotments to local government un	219	242	273	312	343	380	416
Subsidies	42	66	80	78	103	113	124
Tax expenditure	38	23	30	18	16	17	19
Interest	313	323	321	309	304	341	371
Capital and equity expenditure	359	344	351	436	606	767	836
Capital expenditure	338	333	350	435	594	754	822
Equity	21	11	2	1	12	13	14
Net lending	27	17	13	10	15	17	18
Balance	-251	-167	-75	-184	-354	-478	-524
On the authorities' presentation 2/	-242	-164	-73	-122	-353	-478	-525

Sources: Philippine authorities; and IMF staff projections.

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

2/ 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, 2012–18

(In percent of GDP, unless otherwise indicated)

	2012	2013	2014	2015	2016	2017 Proj.	2018 Proj.
Revenue and grants	14.5	14.9	15.1	15.8	15.2	15.2	15.2
Tax revenue	12.9	13.3	13.6	13.6	13.7	13.7	13.7
Net income and profits	6.1	6.2	6.2	6.4	6.4	6.4	6.4
Excises	0.9	1.3	1.3	1.4	1.4	1.4	1.4
VAT	4.3	4.2	4.4	4.2	4.2	4.3	4.2
Tariffs	0.4	0.3	0.4	0.4	0.4	0.4	0.5
Other 1/	1.2	1.3	1.2	1.2	1.2	1.2	1.2
Nontax revenue	1.6	1.5	1.5	1.7	1.5	1.5	1.5
Expenditure and net lending	16.8	16.3	15.7	16.7	17.6	18.3	18.2
Current expenditures	13.2	13.2	12.8	13.3	13.2	13.3	13.3
Personnel services	5.1	5.0	4.8	5.0	5.0	5.1	5.1
Maintenance and operations	2.2	2.5	2.4	3.0	3.0	2.9	2.9
Allotments to local government units	2.1	2.1	2.2	2.3	2.4	2.4	2.4
Subsidies	0.4	0.6	0.6	0.6	0.7	0.7	0.7
Tax expenditure	0.4	0.2	0.2	0.1	0.1	0.1	0.1
Interest	3.0	2.8	2.5	2.3	2.1	2.1	2.1
Capital and equity expenditure	3.4	3.0	2.8	3.3	4.2	4.8	4.8
Capital expenditure	3.2	2.9	2.8	3.3	4.1	4.8	4.7
Equity	0.2	0.1	0.0	0.0	0.1	0.1	0.1
Net lending	0.3	0.1	0.1	0.1	0.1	0.1	0.1
Balance	-2.4	-1.5	-0.6	-1.4	-2.4	-3.0	-3.0
On the authorities' presentation 2/	-2.3	-1.4	-0.6	-0.9	-2.4	-3.0	-3.0
Memorandum items:							
National government							
Primary balance	0.6	1.4	1.9	0.9	-0.3	-0.9	-0.9
Net debt 3/	44.2	42.8	39.8	39.5	37.7	37.0	36.3
(In percent of national government revenues)	306.0	287.9	263.6	256.8	248.2	242.4	238.1
Gross financing requirement 4/	9.1	5.9	4.7	5.2	5.9	6.3	6.8
Nonfinancial public sector (NFPS) 5/							
Balance	-0.6	0.6	0.9	0.4	-0.3	-0.8	-0.9
Net debt	53.0	51.3	47.9	47.2	44.7	42.9	41.2
(In percent of NFPS revenues)	273.1	254.7	242.2	239.7	229.7	219.7	211.2
Consolidated public sector balance 6/	2.6	1.4	1.1	2.5	3.4	3.9	3.8

Sources: Philippine authorities; and IMF staff projections.

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

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

3/ Consolidated (net of national government debt held by the sinking fund) and excluding contingent/guaranteed debt.

4/ Defined as the deficit, plus amortization of medium- and long-term debt, plus the stock of short-term debt at the end of

5/ 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.

6/ Includes nonfinancial public sector, government financial institutions, and BSP. Balance is cash basis.

Table 4. Philippines: General Government Operations, 2012–18 1/

(In percent of GDP)

	2012	2013	2014	2015	2016	2017 Proj.	2018 Proj.
Revenue	18.6	18.9	19.0	19.4	19.1	19.2	19.2
Taxes	14.1	14.5	14.5	14.5	14.6	14.6	14.6
Taxes on income, profits, and capital gains	6.1	6.2	6.2	6.4	6.4	6.4	6.4
Taxes on goods and services	6.2	6.6	6.6	6.6	6.6	6.6	6.6
Taxes on international trade and transactions	0.4	0.3	0.4	0.4	0.4	0.4	0.5
Taxes not elsewhere classified	1.4	1.4	1.2	1.2	1.2	1.1	1.1
Social contributions	2.0	2.1	2.2	2.4	2.4	2.4	2.4
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue	2.5	2.3	2.3	2.5	2.2	2.2	2.2
Total expenditure	18.9	18.7	18.1	18.8	19.5	20.2	20.2
Expense	15.3	15.3	15.0	15.1	14.9	15.0	15.1
Compensation of employees 2/	5.1	5.0	4.8	5.0	5.0	5.1	5.1
Purchases/use of goods and services 2/	2.2	2.5	2.4	3.0	2.9	2.9	2.9
Interest 2/	2.6	2.5	2.3	2.1	1.8	1.9	1.9
Social benefits	1.8	1.9	2.1	2.2	2.2	2.3	2.3
Expense not elsewhere classified	3.4	3.4	3.4	2.8	2.9	2.9	2.9
Net acquisition of nonfinancial assets	3.6	3.3	3.1	3.7	4.6	5.1	5.1
Net lending/borrowing	-0.3	0.2	0.9	0.6	-0.4	-1.0	-1.0
National government	-1.9	-1.2	-0.5	-1.3	-2.2	-2.8	-2.8
Local government units	0.7	0.7	0.7	1.3	1.3	1.3	1.3
Social security institutions (SSIs)	0.9	0.7	0.7	0.6	0.6	0.5	0.4
Net acquisition of financial assets	4.6	2.9	2.1	1.1	1.2	2.4	2.4
Net incurrence of liabilities	4.9	2.7	1.2	0.6	1.6	3.4	3.4
Memorandum items:							
Primary balance	2.3	2.7	3.1	2.6	1.5	0.9	0.8
Cyclically adjusted primary balance	2.3	2.6	2.9	2.7	1.4	0.9	0.8
General government net debt	40.6	39.3	36.4	36.2	34.6	33.9	33.2

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, 2012–18 1/

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

	2012	2013	2014	2015	2016	2017 Proj.	2018 Proj.
Total							
Net foreign assets	3,248,548	3,575,054	3,752,095	3,998,805	4,309,185	4,345,967	4,375,604
Net domestic assets	2,979,116	4,479,152	5,303,853	5,889,913	6,897,329	8,055,893	9,499,005
Net claims on nonfinancial public sector	1,298,189	1,287,632	1,470,598	1,610,012	1,940,899	2,052,896	2,391,783
Claims on private sector	3,528,922	4,137,658	4,949,747	5,564,246	6,474,979	7,706,620	9,046,027
Net claims on other financial corporations	-767,601	178,728	274,276	294,392	480,267	570,939	683,215
Capital accounts	-1,113,606	-1,203,888	-1,463,098	-1,683,623	-2,084,472	-2,374,607	-2,739,988
Other items (Net)	33,212	79,022	72,329	104,885	85,657	100,045	117,967
Broad money	6,227,664	8,054,206	9,055,948	9,888,717	11,206,515	12,401,860	13,874,608
National currency	5,227,220	6,915,929	7,698,512	8,409,149	9,477,963	10,488,932	11,734,516
Foreign currency	1,000,443	1,138,277	1,357,436	1,479,569	1,728,552	1,912,928	2,140,092
Bangko Sentral ng Pilipinas							
Net foreign assets	3,382,382	3,643,852	3,514,364	3,762,866	3,946,649	3,861,973	3,776,011
Net domestic assets	-1,886,211	-1,712,821	-1,189,691	-1,293,108	-1,187,000	-787,254	-336,385
Claims on private sector	1	1	1	1	1	1	1
Net claims on financial corporations	-1,810,951	-1,576,264	-1,072,412	-1,065,162	-998,702	-662,369	-283,023
Capital accounts	-1,760	-3,821	-5,945	-112,830	-356,730	-236,594	-101,094
Other items (net)	-13,655	-17,763	-4,266	-5,322	-76,327	-50,623	-21,631
Base money	1,475,633	1,926,202	2,323,905	2,467,059	2,757,772	3,072,843	3,437,749
Currency in circulation	692,657	797,452	929,502	1,005,195	1,124,193	1,252,630	1,401,382
Other depository corporations liabilities	782,647	1,128,302	1,386,745	1,456,213	1,631,643	1,818,055	2,033,953
Other liquid liabilities	20,538	4,829	768	2,699	1,877	1,877	1,877
Other depository corporations							
Net foreign assets	-133,834	-68,798	237,731	235,938	362,536	483,994	599,592
Net domestic assets	5,781,849	7,477,386	8,095,638	8,852,999	9,919,002	10,894,412	12,130,247
Net claims on nonfinancial public sector	1,358,035	1,402,605	1,577,668	1,719,807	1,696,140	1,890,554	2,322,399
Claims on private sector	3,528,921	4,137,658	4,949,746	5,564,246	6,474,978	7,706,619	9,046,027
Net claims on financial corporations	1,969,705	3,045,147	2,955,906	3,036,214	3,323,534	3,385,828	3,304,378
Capital accounts	-1,111,846	-1,200,066	-1,457,153	-1,570,792	-1,727,742	-2,138,013	-2,638,894
Other items (Net)	37,034	92,043	69,471	103,524	152,092	49,423	96,336
Liquid liabilities	5,648,015	7,408,588	8,333,369	9,088,937	10,281,538	11,378,406	12,729,839
Memorandum items:							
Broad money (percent change)	7.0	29.3	12.4	9.2	13.3	10.7	11.9
Claims on private sector (percent change)	14.1	17.2	19.6	12.4	16.4	19.0	17.4
Broad money (in percent of GDP)	59.0	69.8	71.7	74.2	77.4	78.1	79.5
Claims on private sector (percent of GDP)	33.4	35.9	39.2	41.8	44.7	48.6	51.8
Nominal GDP	10,561,089	11,538,410	12,634,187	13,322,041	14,480,720	15,871,797	17,449,660

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, 2012–2018 1/

(In billions of U.S. dollars)

	2012	2013	2014	2015	2016	2017 Proj.	2018 Proj.
Current account balance	6.9	11.4	10.8	7.3	-1.0	-0.3	-1.1
Trade balance of goods and services	-12.7	-10.6	-12.8	-17.9	-28.5	-30.1	-32.7
Goods	-18.9	-17.7	-17.3	-23.3	-35.5	-39.1	-43.1
Exports, f.o.b.	46.4	44.5	49.8	43.2	42.7	47.7	51.1
Imports, f.o.b.	65.3	62.2	67.2	66.5	78.3	86.8	94.2
Services	6.2	7.0	4.6	5.5	7.0	9.0	10.4
Receipts	20.4	23.3	25.5	29.1	31.3	34.5	37.6
Payments	14.3	16.3	20.9	23.6	24.2	25.4	27.2
Primary income, net	0.2	1.0	0.7	1.9	2.6	3.3	3.6
Receipts, *of which* :	8.3	8.4	8.8	9.5	9.5	10.0	10.5
Resident workers abroad	6.5	7.0	7.4	7.8	7.5	8.0	8.4
Payments	8.1	7.4	8.1	7.6	7.0	6.7	6.9
Interest payments	3.1	2.8	2.6	2.5	2.4	2.5	2.5
Secondary income, net	19.5	21.1	22.8	23.3	25.0	26.5	28.0
Receipts, *of which* :	20.1	21.7	23.4	24.1	25.7	27.2	28.8
Nonresident workers remittances	18.0	19.3	20.8	21.5	23.2	24.5	26.0
Payments	0.6	0.6	0.7	0.8	0.7	0.7	0.8
Capital account	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Financial account 2/	-6.7	2.2	9.6	2.3	-0.4	-0.3	-0.7
Direct investment	1.0	-0.1	1.0	-0.1	-5.9	-4.5	-4.7
Portfolio investment	-3.2	-1.0	2.7	5.5	1.4	1.6	1.8
Equity	-1.7	0.1	-1.0	1.3	0.1	0.0	0.1
Debt	-1.5	-1.1	3.7	4.2	1.5	1.5	1.7
Financial derivatives	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Other investment, *of which* :	-4.5	3.4	5.9	-3.1	4.1	2.7	2.3
Currency and deposits	-1.5	1.4	3.5	-0.7	0.8	0.7	0.6
Loans	-2.3	1.4	2.0	-2.4	3.6	2.2	1.9
Errors and omissions	-4.6	-4.2	-4.1	-2.4	0.1	0.0	0.0
Overall balance	9.2	5.1	-2.9	2.6	-0.4	0.0	-0.4
Memorandum items:							
Current account (in percent of GDP)	2.8	4.2	3.8	2.5	-0.3	-0.1	-0.3
Short-term debt (original maturity)	16.5	16.9	16.2	15.1	14.5	14.5	14.6
Short-term debt (residual maturity)	21.1	20.5	19.2	19.7	19.8	20.3	20.3
Gross reserves	83.8	83.2	79.5	80.7	80.7	80.9	80.6
(in percent of st. debt by res. maturity) 3/	397.9	406.2	413.3	409.5	408.3	399.1	396.2
External debt (in billions)	79.9	78.5	77.7	77.5	74.8	73.8	73.2
(in percent of GDP)	32.0	28.9	27.3	26.5	24.5	23.0	20.5
Debt service ratio 4/	9.9	11.1	8.4	7.7	9.7	10.0	9.2
Export value (percent change)	21.2	-4.0	11.9	-13.3	-1.1	9.9	7.0
Import value (percent change)	11.3	-4.8	8.0	-1.0	17.7	12.0	8.5
Gross external financing needs 5/	8.7	9.7	9.7	12.0	20.1	20.6	21.4
Remittances value (percent change)	6.5	8.6	7.5	3.8	4.9	6.0	6.0
Remittances (in percent of GDP)	9.3	9.3	9.6	9.7	9.7	10.1	9.6

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, 2014–22

(In percent of GDP, unless otherwise indicated)

	2014	2015	2016	2017	2018	Proj. 2019	2020	2021	2022
GDP and prices									
Real GDP (percent change)	6.1	6.1	6.9	6.6	6.7	6.8	6.8	6.8	6.8
CPI (percent change, annual average)	4.1	1.4	1.8	3.1	3.0	3.0	3.0	3.0	3.0
GDP by expenditure									
Consumption (percent change)	5.3	6.5	7.1	6.6	6.8	6.8	6.8	6.8	6.8
Private	5.6	6.3	7.0	6.6	6.8	6.8	6.8	6.8	6.8
Public	3.3	7.6	8.4	7.0	6.9	6.8	6.8	6.8	6.8
Gross fixed investment (percent change)	7.2	16.9	25.2	11.0	8.0	7.0	7.0	7.0	7.0
Net exports (contribution to growth)	1.0	-3.1	-4.5	-1.6	-1.0	-0.7	-0.7	-0.7	-0.7
Investment and saving									
Gross investment	20.6	21.2	24.3	25.6	25.9	25.7	25.8	25.8	25.9
Private	17.8	17.9	20.2	20.9	21.3	21.0	21.1	21.2	21.3
Public	2.7	3.3	4.1	4.6	4.6	4.7	4.6	4.6	4.6
National saving	24.3	23.7	24.5	25.5	25.5	25.2	25.0	24.9	24.8
Private	21.2	20.5	21.1	22.1	22.3	21.9	21.8	21.8	21.6
Public	3.1	3.2	3.4	3.3	3.3	3.3	3.2	3.2	3.2
Public finances									
Nonfinancial public sector balance 1/	0.9	0.4	-0.3	-0.8	-0.9	-1.0	-1.0	-1.1	-1.1
Primary balance	3.7	3.0	2.0	1.4	1.4	1.2	1.1	1.0	1.0
Revenue and grants	19.8	19.7	19.4	19.5	19.5	19.5	19.5	19.5	19.5
Expenditure (primary)	16.1	16.7	17.4	18.1	18.1	18.3	18.4	18.5	18.5
Interest	2.8	2.6	2.3	2.3	2.2	2.2	2.2	2.1	2.1
Nonfinancial public sector gross financing needs	3.4	3.6	3.9	4.2	4.7	5.2	5.6	5.9	6.1
Domestic	2.6	2.6	3.2	3.5	4.1	4.6	5.0	5.4	5.6
Foreign currency	0.8	1.0	0.7	0.7	0.7	0.6	0.6	0.5	0.5
National government balance (authorities definition)	-0.6	-0.9	-2.4	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0
National government balance	-0.6	-1.4	-2.4	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0
Nonfinancial public sector net debt	47.9	47.2	44.7	42.9	41.2	39.6	38.1	36.8	35.6
External sector									
Export value (percent change)	11.9	-13.3	0.6	9.9	7.0	7.0	7.0	7.0	7.0
Import value (percent change)	8.0	-1.0	16.6	12.0	8.5	8.4	8.3	8.2	8.1
Trade balance of goods and services	-4.5	-6.0	-8.1	-8.5	-8.3	-7.9	-7.6	-7.4	-7.2
Current account	3.8	2.5	0.2	-0.1	-0.3	-0.5	-0.7	-0.9	-1.0
Reserves (US$ billions)	79.5	80.7	81.0	80.9	80.6	80.3	80.0	79.7	79.4
Reserves/short-term liabilities 2/	413.3	409.7	400.4	399.1	396.2	392.7	386.6	379.5	370.5
Total external debt	27.3	26.5	24.5	23.0	20.5	18.3	16.5	15.0	13.7
Debt service ratio (in percent of exports of goods and ser	8.4	7.7	9.5	10.0	9.2	8.5	7.8	7.3	6.7
Monetary sector:									
Credit to private sector 3/	39.2	41.8	44.7	48.6	51.8	55.1	58.4	61.7	65.0
Credit to private sector (percent change) 3/	19.6	12.4	16.4	19.0	17.4	17.0	16.6	16.1	15.4

Sources: Philippine authorities; and IMF staff projections.

1/ Includes the national government, 14 government-owned enterprises, social security institutions, and local governments. Cash basis.
2/ Reserves as a percent of short-term debt (including medium- and long-term debt due in the following year).
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: Baseline and Alternative Scenarios, 2016–22 1/

(In percent of GDP, unless otherwise indicated)

	2016	2017	2018	2019	2020	2021	2022
				Baseline Scenario			
National government cash accounts							
Revenue and grants	15.2	15.2	15.2	15.3	15.3	15.3	15.3
Expenditure and net lending	17.6	18.3	18.2	18.2	18.2	18.2	18.2
Interest payments	2.1	2.1	2.1	2.1	2.1	2.1	2.0
Capital and equity expenditure	4.3	4.8	4.8	4.8	4.8	4.7	4.7
Balance	-2.4	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0
National government net debt 1/	37.7	37.0	36.3	35.6	35.0	34.4	34.0
General government							
Cyclically adjusted primary balance	1.4	0.9	0.8	0.7	0.6	0.5	0.5
Memorandum items							
Real GDP growth (in percent)	6.9	6.6	6.7	6.8	6.8	6.8	6.8
Inflation (annual average, in percent)	1.8	3.1	3.0	3.0	3.0	3.0	3.0
Current account balance	0.2	-0.1	-0.3	-0.5	-0.7	-0.9	-1.0
National saving	24.5	25.5	25.5	25.2	25.0	24.9	24.8
Gross investment	24.3	25.6	25.9	25.7	25.8	25.8	25.9
				Reform-and-Spend Scenario 2/			
National government cash accounts							
Revenue and grants	15.2	15.2	16.2	16.8	17.1	17.1	17.3
Expenditure and net lending	17.6	18.2	19.3	19.8	20.1	20.0	20.2
Interest payments	2.1	2.1	2.1	2.1	2.1	2.1	2.0
Capital and equity expenditure	4.3	4.8	5.5	6.0	6.1	6.2	6.3
Balance	-2.4	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0
National government net debt 1/	37.7	36.9	36.7	35.9	35.2	34.4	33.8
General government							
Cyclically adjusted primary balance	1.4	0.8	0.1	0.5	0.4	0.4	0.4
Memorandum items							
Real GDP growth (in percent)	6.9	6.6	7.0	7.2	7.3	7.4	7.5
Inflation (annual average, in percent)	1.8	3.1	3.8	3.6	3.0	3.0	3.0
Current account balance	0.2	-0.1	-0.4	-0.8	-1.2	-1.5	-1.8
National saving	24.5	25.5	26.1	26.4	26.5	26.6	26.7
Gross investment	24.3	25.6	26.4	26.9	27.2	27.5	27.8
				No Reform-and-Spend Scenario 3/			
National government cash accounts							
Revenue and grants	15.2	15.2	15.2	15.2	15.2	15.2	15.2
Expenditure and net lending	17.6	18.2	19.3	19.9	20.2	20.5	20.7
Interest payments	2.1	2.1	2.2	2.3	2.4	2.6	2.7
Capital and equity expenditure	4.3	4.8	5.5	6.0	6.1	6.2	6.2
Balance	-2.4	-3.0	-4.1	-4.7	-5.0	-5.2	-5.5
National government net debt 1/	37.7	36.9	37.4	37.8	38.8	39.9	41.3
General government							
Cyclically adjusted primary balance	1.4	0.8	-0.9	-1.0	-1.2	-1.4	-1.4
Memorandum items							
Real GDP growth (in percent)	6.9	6.6	6.9	7.0	7.0	6.9	6.8
Inflation (annual average, in percent)	1.8	3.1	4.2	4.1	3.5	3.5	3.4
Current account balance	0.2	-0.1	-0.6	-1.0	-1.5	-2.0	-2.5
National saving	24.5	25.5	25.8	25.5	25.3	25.0	24.7
Gross investment	24.3	25.6	26.3	26.5	26.8	27.0	27.2

Sources: Philippine authorities; and IMF staff calculations.

1/ Net of national government debt held by the sinking fund and excluding contingent/guaranteed debt.

2/ In line with the authorities' plans, the "Reform-and-Spend" scenario assumes a gradual increase in revenue due to tax and administrative reforms of 2 percent of GDP by 2022, a gradual rise in infrastructure investment of 1.6 percent of GDP, and an increase in social spending of 0.4 percent of GDP. It also assumes the implementation of structural reforms such as easing access to foreign direct investment, enhancing domestic competition, and removing quatitative restriction on rice imports. The increase in infrastructure investment and structural reforms crowd in private investment, which lead to higher real GDP growth. Inflation increases temporarily due to the demand stimulus and tax reform, but returns to the target as productive capacity rises and monetary policy tightens. The current account deficit widens due to higher investment-related imports.

3/ The "No Reform-and -Spend" scenario assumes that the tax reform brings no additional revenue, but infrastructure investment increases by 1.6 percent of GDP by 2022 financed with public debt, and no structural reforms. As a result, the fiscal position deteriorates and growth increases less than in the "Reform-and-Spend" scenario due to higher borrowing costs that constrain private investment. The output gap and inflation increase more due to lower expansion in productive capacity and peso depreciation, requiring a tighter monetary policy stance. The current account deficit widens by more.

Table 9. Philippines: Financial Soundness Indicators, 2012–16

(In percent)

	2012	2013	2014	2015	2016
Capital adequacy					
Regulatory capital to risk-weighted assets 1/	17.8	17.0	16.1	15.3	15.6
Regulatory Tier-1 capital to risk-weighted assets 1/	14.8	15.2	13.5	12.8	13.7
Capital to total assets	11.7	9.7	9.9	10.0	9.7
Non-performing Loans Net of Provisions to Capital	2.4	2.4	2.9	3.1	3.0
Net open position in foreign exchange to capital 1/	8.7	3.3	5.1	2.4	2.9
Gross asset position in financial derivatives to capital	4.6	4.5	4.6	1.7	1.8
Gross liability position in financial derivatives to capital	0.1	0.0	0.0	0.0	0.0
Asset quality					
Non-performing loans to total gross loans	2.2	2.4	2.0	1.9	1.7
Specific provisions to nonperforming loans	76.0	80.6	73.5	70.1	69.7
Earnings and profitability					
Return on assets	1.8	1.9	1.6	1.4	1.3
Return on equity	15.8	17.8	15.9	13.8	13.7
Interest margin to gross income	57.8	57.7	66.6	70.7	69.2
Trading income to gross income	21.3	21.8	8.6	5.7	8.3
Noninterest expenses to gross income	58.7	56.1	58.6	61.3	60.8
Personel expenses to noninterest expenses	37.3	35.9	36.8	37.6	36.7
Liquidity and funding					
Liquid assets to total assets	36.6	42.8	42.4	38.8	35.6
Liquid assets to short-term liabilities	53.3	67.3	64.5	60.6	54.6
Non-interbank loans to customer deposits	0.7	0.7	0.7	0.8	0.8
Sensitivity to market risk					
Foreign currency denominated loans to total loans	10.6	12.1	13.0	11.9	11.9
Foreign currency denominated liabilities to total liabilities	20.8	19.1	19.5	20.3	20.7
Real estate markets					
Residential real estate prices RREPI (percent change)	…	…	…	6.0	0.2
Residential real estate loans to total loans	6.9	7.1	7.3	7.2	7.3
Commercial real estate loans to total loans	10.8	11.5	11.6	13.9	14.3

Source: Philippines authorities; IMF, *Financial Soundness Indicators*; and IMF staff estimates.

1/ The last obserbation is Q3:2016.

Table 10. Philippines: Indicators of External Vulnerability, 2012–16

(In percent of GDP, unless otherwise indicated)

	2012	2013	2014	2015	2016
External indicators (including external liquidity)					
Gross international reserves, (in billions U.S. dollars)	83.8	83.2	79.5	80.7	81.0
Maturing short-term debt (in billions U.S. dollars)	16.5	16.9	16.2	15.1	14.5
Amortization of medium and long-term debt (in billions U.S. dollars)	3.6	4.6	3.6	3.0	4.6
Net FDI inflows (in billions of U.S. dollars) 1/	1.0	-0.1	1.0	-0.1	-4.2
FX deposits residents (in billions of U.S. dollars)	25.3	26.1	32.1	32.7	36.1
Total gross external debt	32.0	28.9	27.3	26.5	24.5
Nonfinancial public sector indicators:					
Overall balance	-0.6	0.6	0.9	0.4	-0.3
Primary balance	2.7	3.7	3.7	3.0	2.0
Net debt	53.0	51.3	47.9	47.2	44.7
Net debt denominated in FX or linked to the exchange rate (in percent of total)	36.0	33.5	31.9	33.1	33.4
Short-term net general government debt (original maturity, in percent of total)	5.1	5.6	4.9	4.4	4.7
Average effective interest rate of general government debt (in percent)	6.4	6.3	6.0	5.6	5.2
Amortization of total general government debt	6.7	5.0	4.0	3.9	3.8

Sources: Philippine authorities; and IMF staff estimates.

1/ In BPM6.

Table 11. Philippine: 2016 Article IV Recommendations and Related Policy Actions

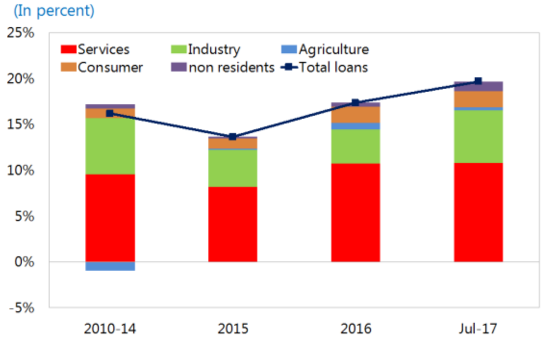
2016 Article IV Recommendations	Policy Actions Taken
Fiscal Policy	
Maintain the general government net debt-to-GDP ratio broadly stable at around 35 percent while raising the national government deficit target to 3 percent of GDP to increase priority expenditures.	The national government deficit target was raised to 3 percent of GDP in 2017, with the general government net debt-to-GDP ratio projected to decline to 33.7 percent in-2017.
Scale up public investment in infrastructure and human capital.	The national government increased capital outlays from 3.3 percent of GDP in 2015 to 4.2 percent in 2016 and to a projected 4.8 percent in 2017.
Reform the tax system and administration to raise additional revenue.	The government submitted a comprehensive tax reform bill to Congress, which has passed the House and now under discussion at the Senate.
Monetary Policy	
Stand ready to tighten the policy stance in response to faster-than-expected credit growth with inflationary pressures, or a stronger-than-expceted impact of the fiscal expansion on inflation.	In June 2016, the BSP introduced a new interest rate corridor with a term deposit auction facility to manage liquidity. This has resulted in a de facto monetary tightening of about 60 basis points.
Macro-prudential Policy	
Monitor emerging sytemic risks (especially in the real estate sector) and stand ready to respond with targeted macroprudential measures.	The BSP set up a new financial stability department (December 2016) to enhance risk monitoring, and strengthened its in-house supervisory training
Allow the additional Single Borrower Limit (SBL) for PPP to lapse in December 2016.	Implemented as recommended.
Assign an explicit financial stability mandate to the BSP through amendments to its charter.	An amendment to the BSP charter was submitted to Congress, which would expand the BSP's regulatory perimeter to the less regulated non-bank sector.
Structural Policy	
Lift or ease legal and administrative restrictions on inward FDI	The recently published Philippines Development Plan 2017-22 aims to relax regulatory restrictions on FDI, including amenments to the Constitution.
Develop capital market instruments to support infrastructure financing.	The authorities are drawing up a comprehensive capital market development strategy, including enhancing the primary market issuance policy and introducing an interdealer repo market.

Appendix I. Bank Credit Developments

Credit growth has accelerated in 2017. Although most indicators show no evidence of credit booms so far, some indicators suggest that credit gaps could approach early warning levels in 2017–18. The latter, and the high growth of credit to some sectors, warrant continued monitoring.

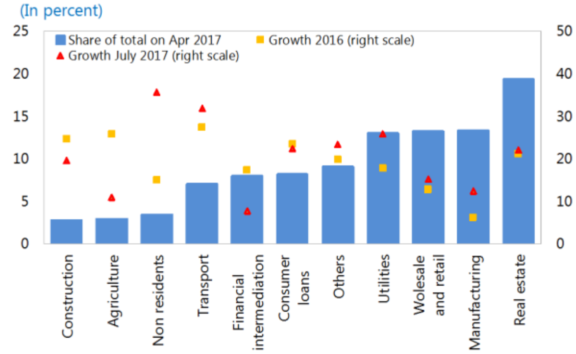
Bank credit growth has picked up, increasing from 13.6 percent in 2015 to 19.7 percent in July 2017. This was initially due to a pickup in credit to the service sector and consumer loans, and more recently to the manufacturing and nonresident sectors. Consumer loans have been growing at over 20 percent since mid-2016, albeit from a low base, while real estate loans, the largest banks' exposure, have continued to grow at around 19 percent. These trends warrant close monitoring of credit developments for these sectors.

Contributions to Credit Growth
(In percent)



Source: IMF staff estimates.

Credit Growth by Economic Sector
(In percent)

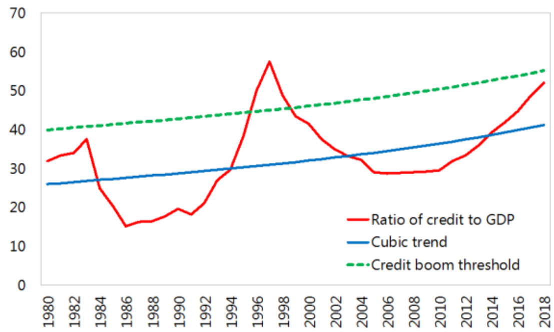


Source: IMF staff estimates.

Credit gaps are below credit boom levels in most but not all indicators. Staff analyzed several indicators to identify credit booms. The approach of Mendoza and Terrones (2008), which looks at deviations of real credit per capita from trend, shows that credit aggregates are close to trend. The approach of Dell'Ariccia and others (2012), which looks at deviations of the credit-to-GDP ratio from a cubic trend, also finds no evidence of credit booms, with the growth differential between credit and GDP remaining below the 10 percent cutoff. However, the approach of the IMF's Global Financial Stability Report of September 2011, shows that the rise in the credit-to-GDP ratio was close to the 3 percent cutoff for early warning of credit booms in 2016, and could slightly surpass this threshold in 2017–18. Similarly, the approach of Drehmann and others (2010), which looks at deviations of the credit-to-GDP ratio from a Hodrick-Prescott trend with a high smoothing parameter, finds that the credit-to-GDP ratio could exceed the 10 percent of GDP cutoff in 2018.

Ratio of Credit to GDP

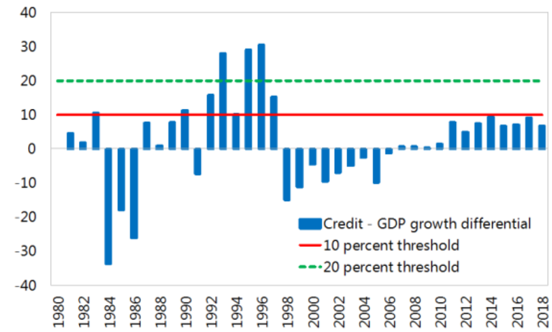
(In percent, based on Dell'Aricia and others, 2012)



Source: IMF staff estimates.

Growth Differential Between Credit and GDP

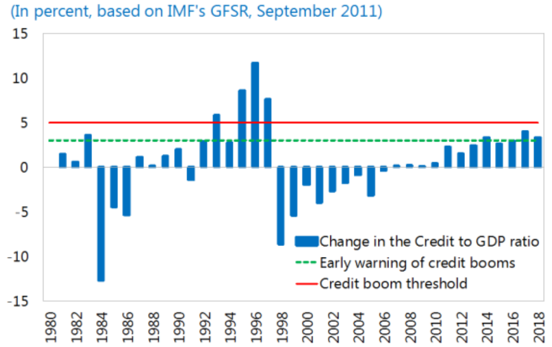
(In percent, based on Dell'Aricia and others, 2012)



Source: IMF staff estimates.

Change in the Credit to GDP Ratio

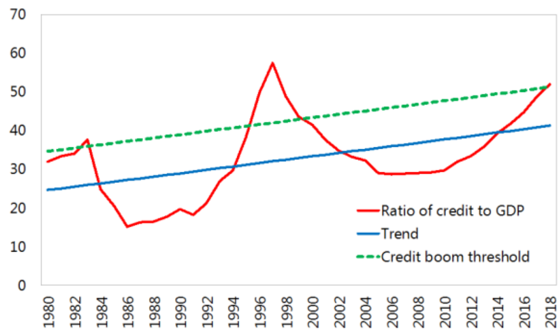
(In percent, based on IMF's GFSR, September 2011)



Source: IMF staff estimates.

Ratio of Credit to GDP

(In percent, based on Drehmann and others, 2010)



Source: IMF staff estimates.

Appendix II. Philippines—Risk Assessment Matrix 1/

Nature/Source of Main Threats	Likelihood of Risk/Time Horizon	Transmission Channels	Expected Impact of Risk	Recommended Policy Response
Retreat from cross-border integration.	Medium /Short to Medium Term	A fraying consensus about the benefits of globalization could bring about protectionism and economic isolationism. Leading to reduced global and regional policy collaboration, with negative consequences for trade, capital and labor flows, sentiment, and growth.	**High** Protectionist policies in advanced economies could hamper remittances, exports, and business process outsourcing (BPO). Real GDP growth would fall, and the current account balance would deteriorate, requiring additional external financing. The economy would become more vulnerable to external financing risks, although the large foreign reserves would provide a buffer.	Maintain exchange rate flexibility to serve as a shock absorber, limiting FX intervention to smooth excessive volatility. Improve the domestic business environment to enhance the competitiveness of exports and the BPO industry. Diversify the sources of economic growth to ensure sufficient employment opportunities domestically.
Higher global interest rates/surge in the U.S. dollar	High /Short Term	Sharp capital outflows, leading to a peso depreciation vis-à-vis the U.S. dollar. Tighter domestic financial conditions, asset price declines and higher credit spreads.	**Medium/High** Rising credit cost slows down real estate and construction activity. Banks' NPLs may increase from low levels, but effect on capital is likely manageable. Some leveraged corporates may face debt service difficulties. The macroeconomic impact should be limited due to strong fundamentals. Depreciation of the peso would cushion the growth impact.	Ensure banks have adequate capital buffers and do not exceed standard ceilings on exposures to a single borrower. Consider adopting macroprudential policies targeted to specific sectors. Allow for exchange rate flexibility, limiting intervention to smoothing excessive volatility. Ease monetary or fiscal policy if real economy slows down significantly.
Significant growth slowdown in China and other regional economies	Medium /Short to Medium Term	A slowdown in China reduces regional exports and economic growth. Investor sentiment toward the region weakens.	**Medium** Moderate impact through direct exports to China as they are small compared to peers. Indirect effects through weaker regional growth could dominate. Some corporates could face debt servicing problems, with knock-on effects to local equity markets and credit conditions.	Maintain 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 boost public infrastructure spending to spur new sources of growth.
Domestic asset price and credit boom fueled by abundant liquidity	Medium /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 over the medium term weakens growth, including through financial sector deleveraging.	Enforce existing macroprudential policies and implement new real estate specific measures. Ensure that banks have adequate capital buffers to absorb credit losses. Coordinated and strengthened surveillance on nonbank activities, including expansion of the BSP's mandate to include nonbanks.
Large increase in infrastructure investment financed with debt instead of additional revenue	Low /Medium Term	The tax reform fails to pass in Congress, or the approved reform is too diluted. Infrastructure spending is increased as planned. Public debt increases, leading to higher borrowing costs for the government.	**Medium** The increase in public investment leads to overheating and only modest gains in potential GDP in the medium-term. The increase in public debt leads to higher borrowing costs for the government. The fiscal impulse leads to tighter monetary policy and higher domestic interest rates. Private investment increases only slightly due to higher financing costs.	Approve the tax reform in Congress as proposed by the government. Introduce additional revenue raising reforms if the current tax reform proposal fails to pass. In the absence of additional revenue, increase public investment more gradually. Tighten monetary policy in case of overheating and rising inflationary pressures.
Climate change related natural disaster	Medium /Medium Term	Natural disaster destroys physical and human capital. Population is displaced and businesses close. Uncertainty increases and investment declines.	**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, to make it more resilient to natural disasters. Ensure sufficient fiscal buffers to fund social and reconstruction spending. Explore private and public sector options for insurance to natural disasters.
Additional revenue from tax reforms finance large increases in infrastructure investment	Medium /Medium Term	Tax and administrative reforms results in large revenue gains. Infrastructure investment rises financed by additional revenue. Inflation rises in the short term and monetary policy tightens.	**High** Economic activity increases in the short term due to the demand impulse. Private investment and potential growth increase in the medium term. Monetary policy eases in the medium term as productive capacity expands.	Select public investment projects that would maximize the impact on potential growth. Compensate the impact of the tax reform on the poor through targeted transfers. Keep the increase in public spending in line with the revenue gains to avoid overheating.

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 III. Philippines—External Sector Assessment

The Philippines' external position remains moderately stronger than warranted by fundamentals and desirable policies despite the recent fall in the current account balance (CAB). The CAB approach of the IMF's External Balance Assessment (EBA) model indicates that the Philippines' CAB is above the level implied by fundamentals and desired policies. This is primarily due to policy gaps from abroad and structural impediments to investment such as inadequate infrastructure. Thus, the CAB gap should close over time as external policy gaps narrow and infrastructure is upgraded in line with the authorities' plans. Regarding the real effective exchange rate (REER), the EBA models to estimate the REER gap produce counterintuitive results, with estimates within a wide range and large unexplained residuals. Staff gives more weight to the estimates of the CAB gap, and thus assess the REER gap at between zero and 4 percent considering the estimated CAB gap and inadequate infrastructure.

- *Current account balance.* The CAB fell to near zero in 2016, from 2.5 percent of GDP in 2015, due to a rise in imports of capital goods and slower growth of exports and remittances. Still, the EBA model places the gap between the CAB and its norm—the CAB consistent with fundamentals and desired policies—at 1.2 percent of GDP in 2016 (3.7 percentage points lower than in 2015). Deviations of policies from desired levels explain 1 percentage points, of which 0.8 percentage points are due to policy gaps in other countries. The other 0.2 percent of GDP is left unexplained by the EBA model and could be explained by inadequate infrastructure.

- *Real effective exchange rate*. The peso depreciated by 3.1 percent in real effective terms in 2016, and by 3.9 percent in nominal effective terms. The EBA models for the REER index and level produce counterintuitive results and large unexplained residuals, pointing to an overvaluation of the peso between 4 percent and 23 percent in 2016. At the same time, applying an elasticity to the CAB gap point to an undervaluation of 3.9 percent. Staff gives more weight to the current account regression approach. The EBA REER index approach is less reliable in countries with large structural changes and short data spans. The EBA REER level approach relies on purchasing power parity prices, which suffer from data quality issues. Thus, the REER gap is assessed between zero and 4 percent considering the estimated CAB gap and inadequate infrastructure.

- *Reducing imbalances:* The large current account surpluses during 2004–15 reflected low levels of investment in the Philippines compared with other emerging market economies. This changed in 2016, when a pickup in investment in the Philippines reduced imbalances by bringing the CAB closer to its norm. Going forward, staff expects public infrastructure spending to increase, which should catalyze private investment, lower the CAB, and reduce the estimated CAB gap further.

- *International reserves.* The Philippines's has ample reserves at US$81 billion or 226 percent of the IMF's reserve adequacy metric in 2016. While the level of reserves is above adequacy levels, this is broadly justified by the country's exposure to natural disasters and capital flow volatility. Staff agrees with the BSP that the exchange rate should continue to be allowed to move freely in line with market forces, with intervention limited to smoothing excessive volatility in both directions.

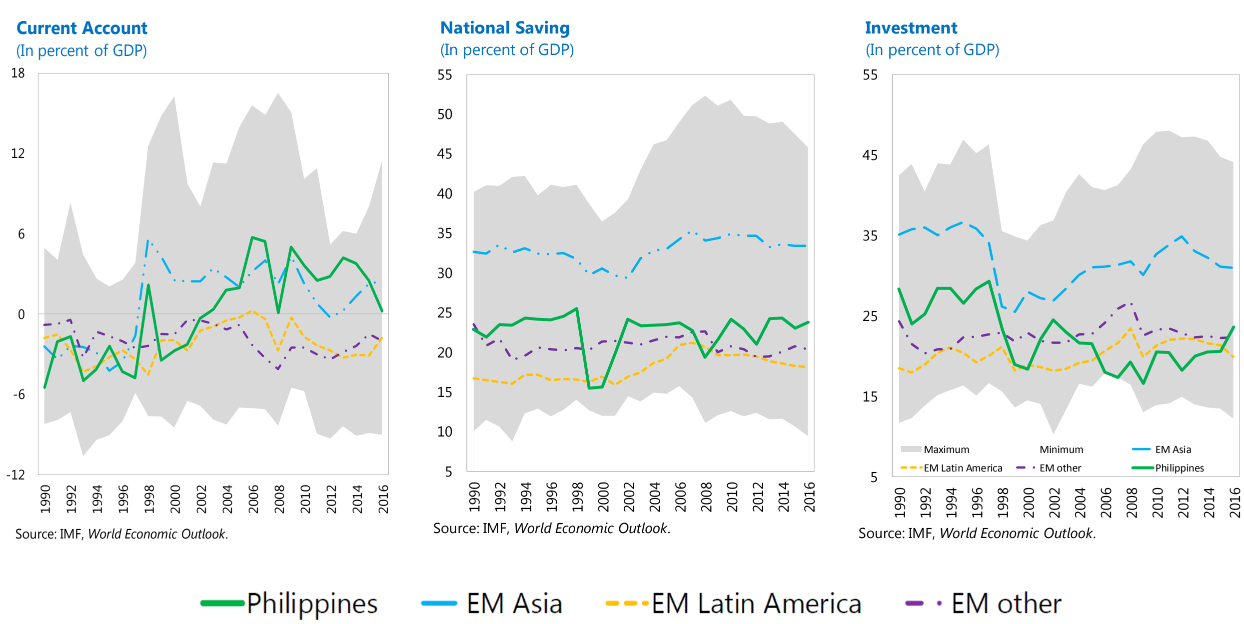
Table 1. External Balance Assessment 1/

Method		Current Account Regression Approach	REER Index Regression Approach	REER Level Regression Approach
Assessment period		2016	2016	2016
Cyclically adjusted CAB (percent of GDP)	A	-0.4	--	--
EBA's CAB norm (percent of GDP)	B	-1.6	--	--
EBA's CAB gap (percent of GDP)	(A-B)	1.2	--	--
Policy gaps (percent of GDP)	C	1.0	--	--
Unexplained residual (percent of GDP)	(A-B-C)	0.2	--	--
REER gap (percent) 2/ 3/	D	-3.9	3.8	22.6
Of which:				
Contribution of identified policy gaps	E	-3.2	-1.0	-1.3
Unexplained residual	(D-E)	-0.6	4.8	23.9

Source: IMF staff estimates.

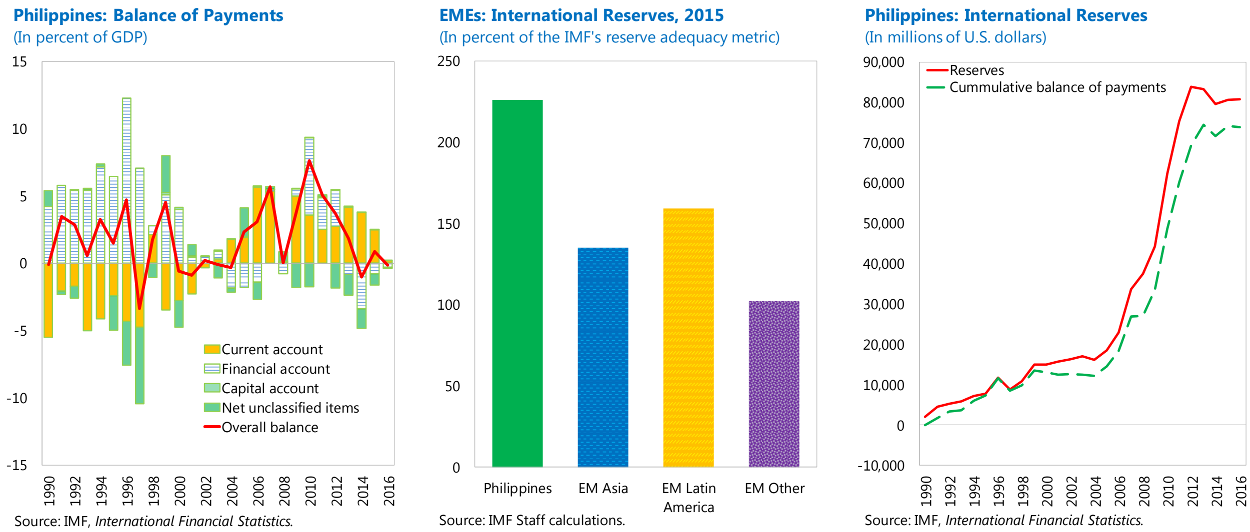
1/ Based on the EBA update of June 2017.
2/ A positive REER gap indicates overvaluation.
3/ The value for the current account regression approach is the CAB gap (A-B), divided by the elasticity of the CAB with respect to the REER, estimated at -0.31 using autoregressive distributed lag (ADL) model.

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



- *Size of capital flows*. The Philippines received sizeable foreign exchange inflows in the years following the global financial crisis, both from the current and financial accounts, resulting in a build-up of reserves. This has changed since 2013, when capital inflows turned into outflows, and reserves remained broadly stable. Going forward, international reserves are projected to decline slightly in U.S. dollars and as percent of the IMF's reserve adequacy metric. Foreign direct investment rose in 2016 and is expected to increase further going forward.

Figure 2. Philippines: Balance of Payments and International Reserves



Appendix IV. Public and External Debt Sustainability Analysis

The Philippines' general government gross debt remains moderate and sustainable at 42.7 percent of GDP in 2016, with net debt at 34.6 percent, but is vulnerable to growth shocks and fiscal risks associated with contingent liabilities and natural disasters. In the baseline scenario, the general government gross debt-to-GDP ratio is projected to decline to 34.3 percent by 2022, with net debt falling to 30.9 percent. However, debt dynamics remain exposed to the volatility of growth, exchange rate and international capital flows, resulting in directional changes or slower pace of reduction under extreme scenarios of lower economic growth and higher real interest rates. External debt also remains moderate and sustainable at 24.5 percent of GDP in 2016, which under the baseline scenario is projected to decline to 13.7 percent by 2022.

A. Public Sector Debt Aggregates

The public debt sustainability analysis (DSA) focuses on general government gross debt. Staff presents different public sector debt aggregates in the report:

- National government gross debt (42.1 percent of GDP in 2016) considers only the national government's gross obligations.
- National government net debt (37.7 percent of GDP in 2016) is equal to the national government gross debt minus the bond sinking fund (4.4 percent of GDP in 2016).
- General government gross debt (42.7 percent of GDP in 2016) is the sum of the national government gross debt and the gross debt of the social security institutions and local governments.
- General government net debt (34.6 percent of GDP in 2016) is equal to the general government gross debt minus the bond sinking fund and holdings of national government bonds by the social security institutions and local governments.
- Nonfinancial public sector net debt (44.7 percent of GDP in 2016) corresponds to the general government net debt plus the net debt of the 14 state-owned enterprises (SOEs). The latter stood at 10.1 percent of GDP in 2016.

As SOE debt is small, the DSA assumes that they can repay it, with no contingent liabilities to the general government. In addition, the DSA focuses on gross debt as it is difficult to know how liquid the government assets are, particularly in times of financial stress. Thus, the relevant public debt aggregate for the Philippines' DSA is the general government gross debt.[1]

B. Background and Realism of Key Assumptions

Baseline projections point to strong and sustainable macroeconomic performance over the medium term. The assumptions underpinning the DSA for the Philippines' public and external debt are those of the medium-term baseline scenario presented in the staff report.[2] Real GDP growth is projected to remain at 6.8 percent per annum over the medium term, with consumer price inflation at the center of the central bank's target range. Past projections of growth outcomes indicate reasonable forecast errors without a systematic bias that would undermine the DSA. Under the baseline, the national government's deficit is anchored to a non-binding target of 3 percent of GDP from 2017 (higher than the previous target of 2 percent), which leads to a decline in the general government primary surplus from 1.5 percent of GDP in 2016 to 0.4 percent in 2022. The external debt projections also consider the paths for the current account balance and other external debt creating flows in staff's medium-term baseline scenario.

C. Public Debt Sustainability

General government gross debt in the Philippines is projected to remain on a downward trajectory under current policies. The 2016 DSA assessed the risk of debt distress to be low owing to prudent fiscal policies contributing to a sustained decline in the debt-to-GDP ratio. Looking forward, the general government gross debt-to-GDP ratio is projected to fall from 42.7 percent of GDP in 2016 to 34.3 percent in 2022, with net debt declining from 34.6 percent to 30.9 percent, even with an elevated profile for the fiscal deficit in 2017 and beyond. On a cumulative basis, the interest rate-growth differential is the main factor behind the projected fall in public debt, as real GDP growth is high. Furthermore, the primary budget balance also makes a significant contribution to the reduction in general government gross debt. Gross financing needs remain comfortable at around 3.5 percent of GDP throughout the projection period. The debt composition is also projected to be stable with a relatively low share of short-term debt and foreign currency-denominated debt, in line with the authorities' debt management policy.

Alternative scenarios suggest that staff's baseline is conservative by historical standards. The Philippines achieved a large-scale reduction in general government gross debt since 1999, 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 2007–2016 averages, leads to faster reduction in debt and gross financing needs than in staff's baseline. The scenario with a constant primary budget surplus at the projected 2017 level

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[1] However, the appropriate public debt aggregate to target under a fiscal rule on the national government is different. For this, staff uses national government gross debt as it is unclear how freely the government can use the bond sinking fund.

[2] The new DSA framework is described in http://www.imf.org/external/no/pp/eng/2013/050913.pdf.

of 1.2 percent of GDP also leads to lower debt-to-GDP ratios and gross financing needs than in staff's baseline scenario.

D. External Debt Sustainability

Total external debt in the Philippines is sustainable. External debt fell sharply in the 2000s, from a peak of 76.4 percent of GDP in 2001 to 24.5 percent in 2016, due to sustained current account surpluses, strong output growth, and currency appreciation. Under staff's baseline scenario, these trends are projected to continue, with external debt falling to 13.7 percent of GDP in 2022. 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 2007–2016 averages, leads to a faster reduction in external debt than in staff's baseline. Moreover, debt dynamics appear resilient to various shocks: one-half standard deviation shocks to interest rates, growth, and the current account lead to only modest increases in external debt ratios over the medium term. However, exchange rate volatility remains a vulnerability as a one-time exchange rate depreciation of 30 percent in 2017 would raise the external debt-to-GDP ratio by about 9.3 percentage points. However, even in this case external debt would fall below current levels by 2022.

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

(In percent of GDP, unless otherwise indicated)

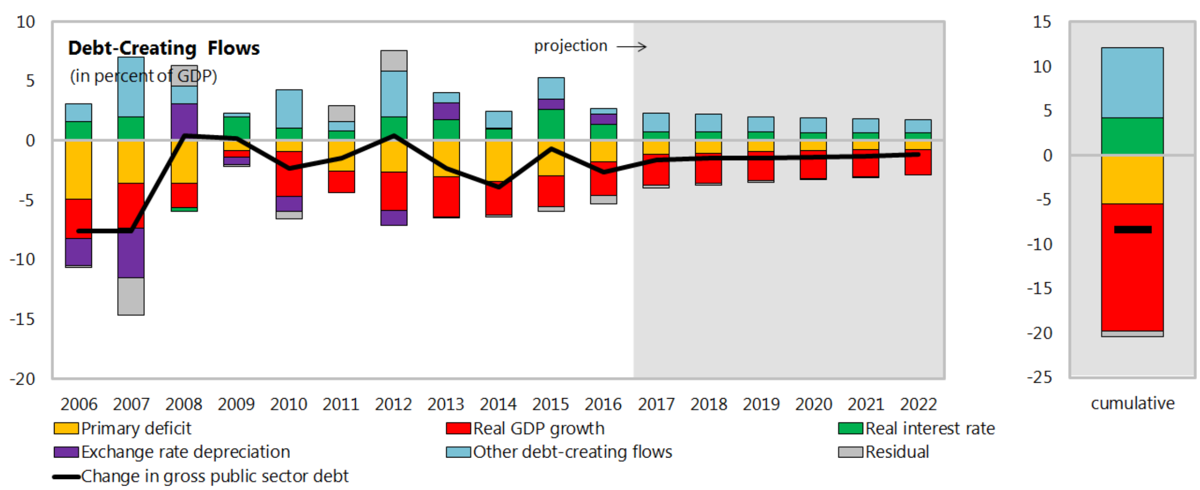
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2006-2014 [2/]	2015	2016	2017	2018	2019	2020	2021	2022
General government gross debt	53.5	45.3	42.7	41.0	39.5	38.1	36.7	35.4	34.3
General government gross financing needs	11.6	3.4	3.9	4.0	3.5	3.4	3.4	3.2	3.0
Real GDP growth (in percent)	5.4	6.1	6.9	6.6	6.7	6.8	6.8	6.8	6.8
Inflation (GDP deflator, in percent)	3.8	-0.6	1.7	3.0	3.0	3.0	3.0	3.0	3.0
Nominal GDP growth (in percent)	9.3	5.4	8.7	9.8	9.9	10.0	10.0	10.0	10.0
Effective interest rate (in percent) [4/]	6.5	5.3	5.0	5.1	5.2	5.2	5.2	5.1	5.2
General government net debt [5/]	42.9	36.2	34.6	33.8	33.1	32.5	31.9	31.4	30.9

As of August 18, 2017		
Sovereign Spreads		
EMBIG (bp) 3/		99
5Y CDS (bp)		68
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BBB	BBB
Fitch	BBB+	BBB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [10/]
Change in general government gross debt	-2.7	-0.7	-2.6	-1.6	-1.5	-1.5	-1.4	-1.3	-1.1	-8.4	-0.4
Identified debt-creating flows	-2.7	-0.3	-2.0	-1.4	-1.4	-1.3	-1.2	-1.2	-1.1	-7.7	
Primary deficit	-2.8	-2.9	-1.7	-1.2	-1.1	-0.9	-0.8	-0.7	-0.7	-5.4	
Primary (noninterest) revenue and grants	18.3	19.4	19.1	19.2	19.2	19.2	19.2	19.2	19.2	115.1	
Primary (noninterest) expenditure	15.5	16.5	17.4	18.0	18.1	18.3	18.4	18.4	18.5	109.7	
Automatic debt dynamics [6/]	-2.0	0.8	-0.7	-1.8	-1.8	-1.7	-1.7	-1.6	-1.5	-10.1	
Interest rate/growth differential [7/]	-1.4	0.0	-1.5	-1.8	-1.8	-1.7	-1.7	-1.6	-1.5	-10.1	
Of which: real interest rate	1.3	2.6	1.4	0.8	0.7	0.7	0.7	0.6	0.7	4.2	
Of which: real GDP growth	-2.7	-2.6	-2.9	-2.6	-2.5	-2.4	-2.4	-2.3	-2.2	-14.3	
Exchange rate depreciation [8/]	-0.5	0.9	0.8	…	…	…	…	…	…	…	
Other identified debt-creating flows	2.1	1.8	0.5	1.6	1.5	1.3	1.2	1.2	1.1	7.9	
Privatization proceeds (negative)	0.2	0.0	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
GG Accumulation of liquid assets	1.9	1.8	0.0	1.6	1.5	1.3	1.2	1.2	1.1	7.9	
Residual, including asset changes [9/]	0.0	-0.4	-0.7	-0.2	-0.1	-0.1	-0.1	-0.1	0.0	-0.7	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ EMBIG.

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

5/ Defined as general government gross debt minus the bond sinking fund and the national government bonds held by the social security institutions and local governments.

6/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = 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).

7/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

8/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

9/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

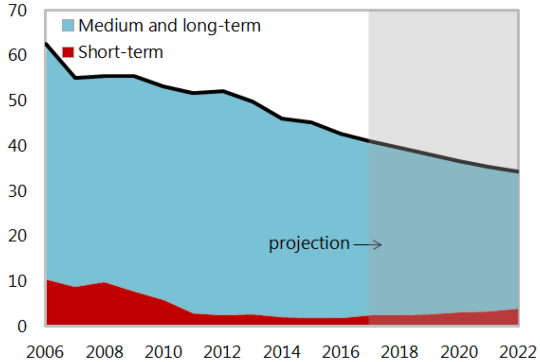
10/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Philippines—Public DSA—Composition of General Government Gross Debt and Alternative Scenarios

Composition of General Government Gross Debt

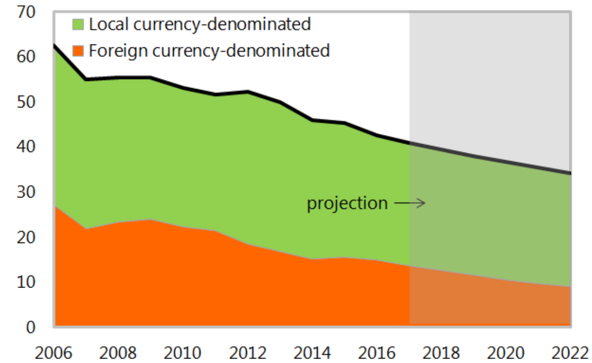
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

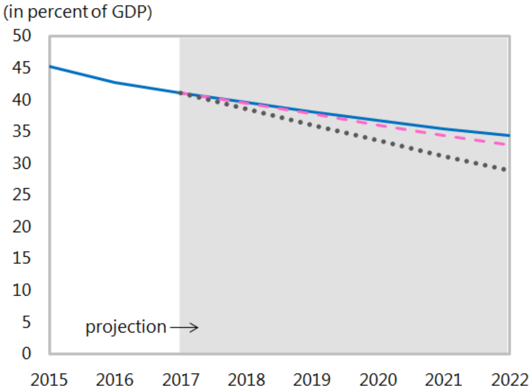


Alternative Scenarios

Baseline   Historical   Constant Primary Balance

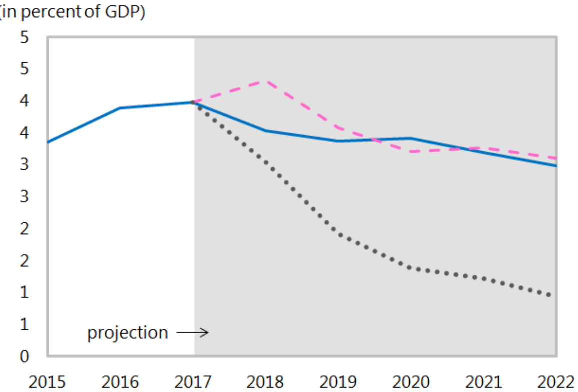
National Government Gross Debt

(in percent of GDP)



General Government Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

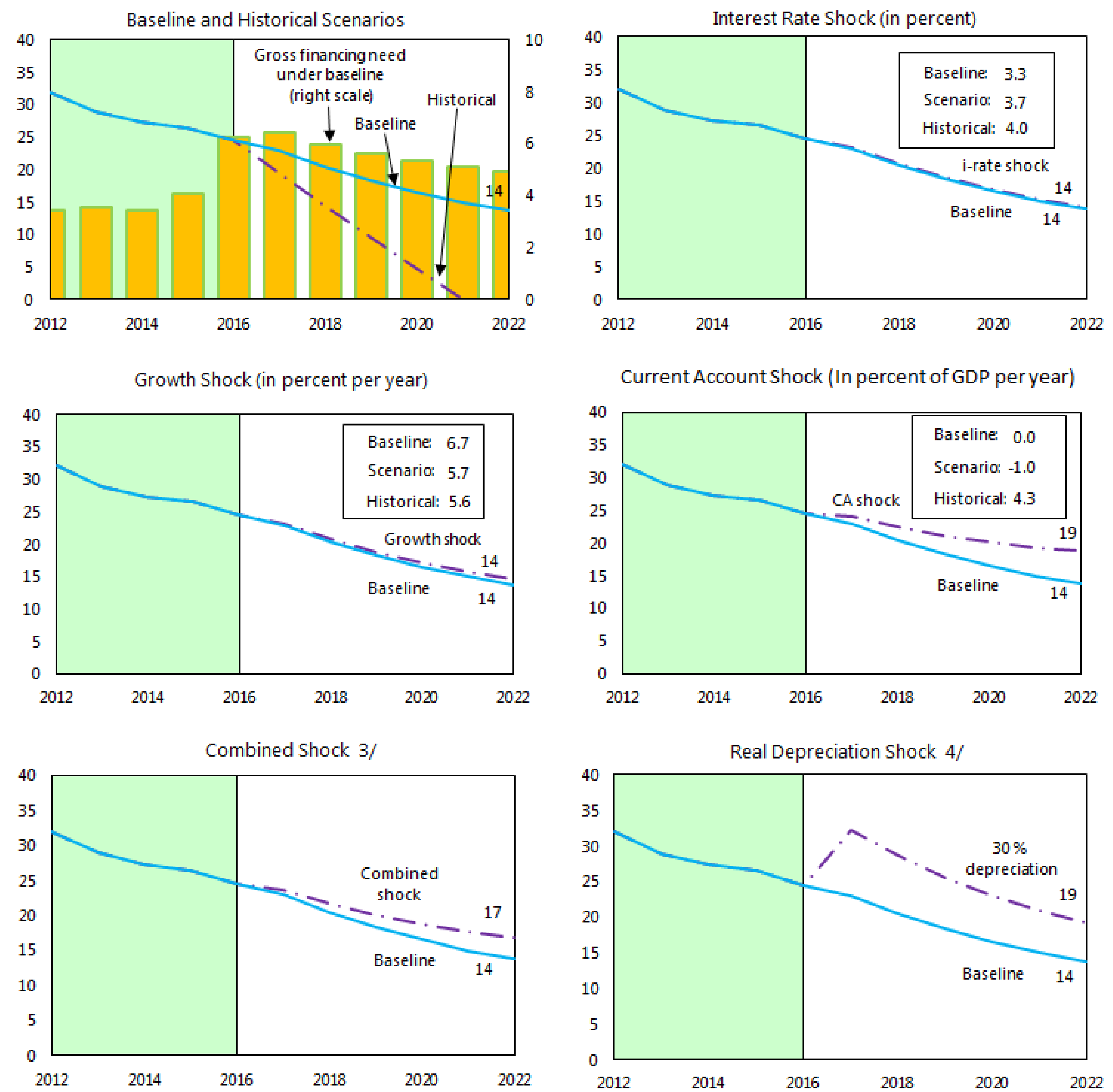
Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	6.6	6.7	6.8	6.8	6.8	6.8
Inflation	3.0	3.0	3.0	3.0	3.0	3.0
Primary Balance	1.2	1.1	0.9	0.8	0.7	0.7
Effective interest rate	5.1	5.2	5.2	5.2	5.1	5.2
Constant Primary Balance Scenario						
Real GDP growth	6.6	6.7	6.8	6.8	6.8	6.8
Inflation	3.0	3.0	3.0	3.0	3.0	3.0
Primary Balance	1.2	1.2	1.2	1.2	1.2	1.2
Effective interest rate	5.1	5.2	5.1	5.2	5.1	5.2

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	6.6	5.6	5.6	5.6	5.6	5.6
Inflation	3.0	3.0	3.0	3.0	3.0	3.0
Primary Balance	1.2	2.5	2.5	2.5	2.5	2.5
Effective interest rate	5.1	5.2	5.3	5.4	5.3	5.4

Source: IMF staff.

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

(External debt, in percent of GDP)



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

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

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

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

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

Philippines—External Debt Sustainability Framework, 2012–2022

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2012	2013	2014	2015	2016			2017	2018	2019	2020	2021	2022	Debt-stabilizing non-interest current account 6/
1 Baseline: External debt	32.0	28.9	27.3	26.5	24.5			23.0	20.5	18.3	16.5	15.0	13.7	-1.9
2 Change in external debt	-1.7	-3.1	-1.6	-0.8	-1.9			-1.5	-2.5	-2.2	-1.8	-1.5	-1.2	
3 Identified external debt-creating flows (4+8+9)	-6.5	-6.8	-5.2	-3.1	-2.8			-2.9	-2.4	-2.0	-1.6	-1.2	-0.9	
4 Current account deficit, excluding interest payments	-4.0	-5.3	-4.8	-3.4	-1.0			-0.7	-0.4	-0.1	0.2	0.4	0.6	
5 Deficit in balance of goods and services	-58.5	-53.8	-57.4	-55.5	-57.9			-60.5	-58.7	-57.0	-55.4	-53.8	-52.5	
6 Exports	26.7	25.0	26.5	24.7	24.5			25.6	24.8	24.0	23.3	22.6	22.1	
7 Imports	-31.8	-28.9	-30.9	-30.8	-33.4			-34.9	-33.9	-33.0	-32.1	-31.2	-30.4	
8 Net non-debt creating capital inflows (negative)	-0.3	0.0	-0.1	0.2	-1.4			-1.5	-1.4	-1.3	-1.2	-1.1	-1.0	
9 Automatic debt dynamics 1/	-2.2	-1.5	-0.4	0.1	-0.3			-0.8	-0.7	-0.6	-0.6	-0.5	-0.5	
10 Contribution from nominal interest rate	1.2	1.1	1.0	0.9	0.8			0.8	0.7	0.6	0.5	0.5	0.4	
11 Contribution from real GDP growth	-2.0	-2.1	-1.7	-1.6	-1.8			-1.5	-1.4	-1.3	-1.1	-1.0	-0.9	
12 Contribution from price and exchange rate changes 2/	-1.4	-0.5	0.3	0.8	0.6			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	4.8	3.7	3.6	2.2	0.8			1.4	-0.1	-0.1	-0.2	-0.3	-0.3	
External debt-to-exports ratio (in percent)	119.6	115.7	103.1	107.2	99.9			89.8	82.6	76.1	70.7	66.1	62.2	
Gross external financing need (in billions of US dollars) 4/	8.7	9.7	9.7	12.0	19.1			20.6	21.4	22.4	23.7	25.1	26.7	
in percent of GDP	3.5	3.6	3.4	4.1	6.3			6.4	6.0	5.6	5.4	5.1	4.9	
Scenario with key variables at their historical averages 5/	32.0	28.9	27.3	26.5	0.0	10-Year Historical Average	10-Year Standard Deviation	19.5	14.5	9.6	4.8	0.1	0.0	-0.2
Key Macroeconomic Assumptions Underlying Baseline														
hid Nominal GDP (US dollars)	250.1	271.8	284.6	292.8	304.9			321.2	357.9	397.8	442.2	491.6	543.7	
Real GDP growth (in percent)	6.7	7.1	6.1	6.1	6.9	5.6	2.0	6.6	6.7	6.8	6.8	6.8	6.8	
GDP deflator in US dollars (change in percent)	4.6	1.5	-1.4	-3.0	-2.6	4.0	6.8	-1.2	4.4	4.1	4.1	4.1	3.5	
Nominal external interest rate (in percent)	4.0	3.7	3.5	3.3	3.3	4.0	0.8	3.4	3.3	3.3	3.2	3.2	3.2	
Growth of exports (US dollar terms, in percent)	16.9	1.5	11.0	-4.1	3.5	6.4	10.3	9.9	7.8	7.8	7.9	7.9	7.9	
Growth of imports (US dollar terms, in percent)	12.0	-1.4	12.2	2.3	12.9	8.3	12.2	10.3	8.1	8.1	8.1	8.0	8.0	
Current account balance, excluding interest payments	4.0	5.3	4.8	3.4	1.0	4.3	2.0	0.7	0.4	0.1	-0.2	-0.4	-0.6	
Net non-debt creating capital inflows	0.3	0.0	0.1	-0.2	1.4	0.5	0.6	1.5	1.4	1.3	1.2	1.1	1.0	

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

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

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

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

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

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

Appendix V. Update on Tax Reform Proposals

The Philippines has achieved macroeconomic stabilization and set the stage for growth acceleration, but it lags in public investment in critical infrastructure and human capital. The extent of revenue mobilization—relative to peers and the country's own potential—is a significant bottleneck to raise government spending without undermining macro-financial stability and debt sustainability. This is partly because of narrow tax bases in most of the main areas of taxation and partly due to administrative shortcomings. To this end, the authorities have unveiled a comprehensive tax reform agenda, with the first package of reforms concentrating on personal income tax, excises and value-added tax.

Personal Income Tax Schedule

Taxable base	Tax rate
Current	
Not over P10,000	5%
Over P10,000 but not over P30,000	P500 + 10% of the excess over P10,000
Over P30,000 but not over P70,000	P2,500 + 15% of the excess over P30,000
Over P70,000 but not over P140,000	P8,500 + 20% of the excess over P70,000
Over P140,000 but not over P250,000	P22,500 + 25% of the excess over P140,000
Over P250,000 but not over P500,000	P50,000 + 30% of the excess o+ver P250,000
Over P500,000	P125,000 + 32% of the excess over P500,000
Reform Proposal for 2017-2019	
Not over P250,000	0%
Over P250,000 but not over P400,000	20% of the excess over P250,000
Over P400,000 but not over P800,000	P30,000 + 25% of the excess over P400,000
Over P800,000 but not over P2,000,000	P130,000 + 30% of the excess over P800,000
Over P2,000,000 but not over P5,000,000	P490,000 + 32% of the excess over P2,000,000
Over P5,000,000	P1,450,000 + 35% of the excess over P5,000,000
Reform Proposal for 2020 and beyond	
Not over P250,000	0%
Over P250,000 but not over P400,000	15% of the excess over P250,000
Over P400,000 but not over P800,000	P22,500 + 20% of the excess over P400,000
Over P800,000 but not over P2,000,000	P102,500 + 25% of the excess over P800,000
Over P2,000,000 but not over P5,000,000	P402,500 + 30% of the excess over P2,000,000
Over P5,000,000	P1,302,500 + 35% of the excess over P5,000,000

Source: Philippines, Department of Finance.

Personal income tax (PIT). The government's proposal raises the minimum taxable income from PHP 10,000 to PHP 250,000 and reduces the number of tax brackets from seven to six with a progressive schedule.

Excises. Fuel excise taxes in the Philippines are currently too low to offset negative externalities caused by petroleum consumption, including not only global carbon emissions, but also local air pollution and traffic congestion. Also, the DoF estimates that the top 10 percent of households in the Philippines consume more than half of fuel products, enjoying the benefits of an untargeted tax subsidy. The tax reform bill proposes to impose:

Excises Taxes on Petroleum Products

(In Philippine peso per liter or kilogram)

Fuel Product	Current Tax	Reform Proposal 2018	Reform Proposal 2019	Reform Proposal 2020
Diesel	...	3.00	5.00	6.00
Bunker oil, kerosene, LPG	3.50 to 5.35	Additional 3.00	Additional 5.00	Additional 6.00
Gasoline, greases,	3.50 to 5.35	Additional 8.00	Additional 9.00	Additional 10.00

Source: Philippines, Department of Finance.

- An excise tax on diesel, kerosene, liquefied petroleum gas, and bunker oil of PHP 3 per liter in 2018, which is set to increase to PHP 5 per liter in 2019 and PHP 6 per liter in 2020;

- An additional tax on other petroleum products, including gasoline, lubricating oils, and greases, of PHP 8 per liter in 2018, which will increase to PHP 9 per liter in 2019 and PHP 10 per liter in 2020;

- An additional excise on automobiles that is increasing in a progressive manner with rates linked to the net selling price on top of a fixed amount; and

- A new tax on sugar-sweetened beverages of PHP 10 per liter (earmarked for the Health Promotion Fund established to address health concerns associated with sugar-sweetened beverages).

Excise Tax on Automobiles

Net selling price	2018	2019
Below PHP 600,000	3 percent	4 percent
PHP 600,000 to PHP 1,100,000	PHP 18,000 plus 30 percent above PHP 600,000	PHP 24,000 plus 40 percent above PHP 600,000
PHP 1,100,000 to PHP 2,100,000	PHP 168,000 plus 50 percent above PHP 1,100,000	PHP 224,000 plus 60 percent above PHP 1,100,000
PHP 2,100,000 to PHP 3,100,000	PHP 668,000 plus 80 percent above PHP 2,100,000	PHP 824,000 plus 100 percent above PHP 2,100,000
Above PHP 3,100,000	PHP 1,468,000 plus 90 percent above PHP 3,100,000	PHP 1,824,000 plus 120 percent above PHP 2,100,000

Source: Philippines, Department of Finance.

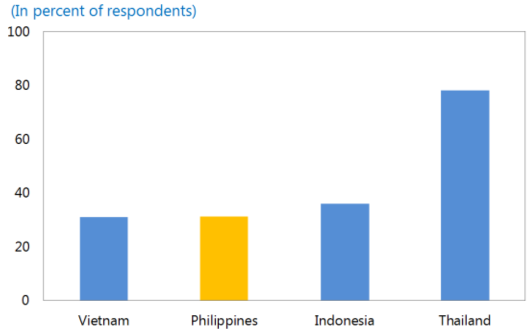
Value-added tax (VAT). The tax reform bill proposes to remove certain VAT exemptions granted to cooperatives (except those selling unprocessed agricultural products), power transmission, domestic shipping, residential leases and low-cost and socialized housing, boy and girl scouts, and special laws except those covering senior citizens and people with disability.

Other taxes. The tax reform bill restructures the tax regime for micro businesses to a flat rate of 8 percent (in lieu of income and VAT or other types of taxes) for businesses with gross sales less than PHP 3 million. Similarly, the proposal reduces the donor's tax to a single rate of 6 percent on net donations for gifts exceeding PHP 100,000 on an annual basis, regardless of the nature of the donor's relationship. Finally, tax reform bill imposes a single estate tax rate of 6 percent (instead of a tax schedule ranging from 5 to 20 percent based on the value of assets above PHP 200,000) and grants an amnesty in respect of estate tax for taxable year 2016 and prior years, which have remained unpaid as of end-2016.

Appendix VI. Financial Inclusion

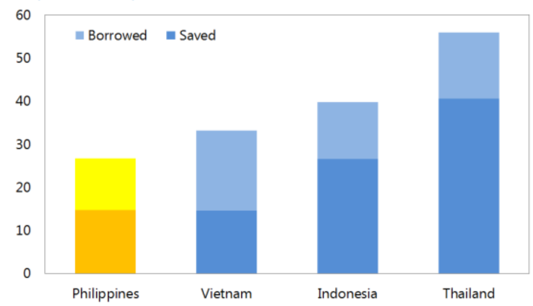
Financial inclusion is an important challenge for the Philippines. In an archipelago consisting of 7,107 islands, access to financial services remains challenging across the country, with 36.2 percent of municipalities left without a physical banking office (*Financial Inclusion Initiatives Report 2016*). International survey results indicate that the Philippines lags its regional peers in areas such as account penetration and usage of financial services. As of 2014, only about 28.1 percent of adults have an account at a financial institution, and less than 5 percent have outstanding mortgage (World Bank, *Global Findex Database*). Small and medium enterprises (SMEs) also continue to face difficulty in obtaining credit, with only 30.8 percent of them having bank loans or formal lines of credit.

Adults with Formal Account
(In percent of respondents)



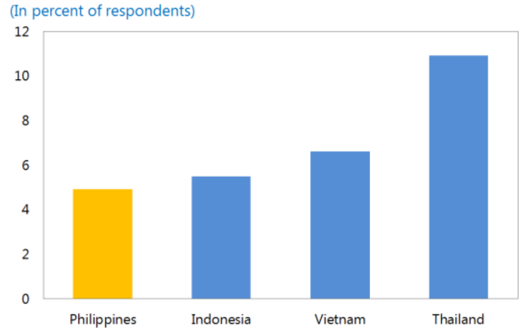
Sources: World Bank, *Global Findex 2014*; and IMF staff estimates.

Saving or Borrowing in the Past 12 Months
(In percent of respondents with an account in financial institutions)



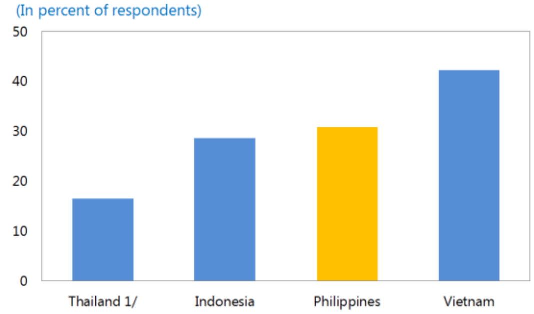
Sources: World Bank, *Global Findex 2014*; and IMF staff estimates.

Adults with Outstanding Mortgage
(In percent of respondents)



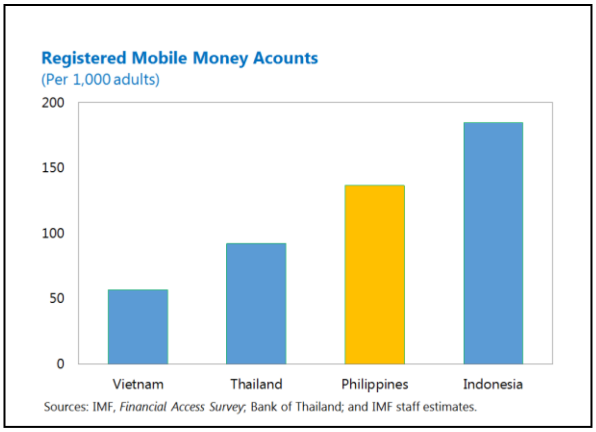
Sources: World Bank, *Global Findex 2014*; and IMF staff estimates.

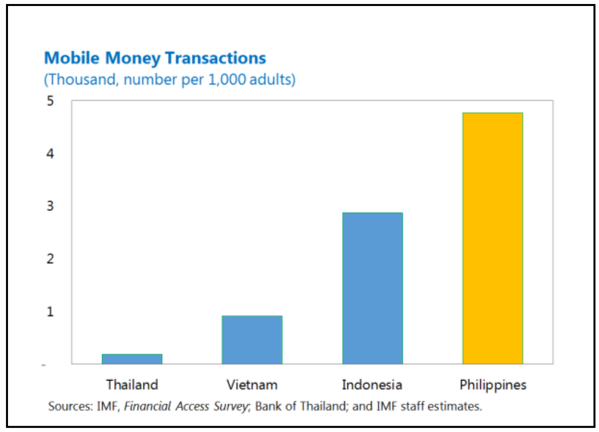
SMEs with Bank Loan or Line of Credit
(In percent of respondents)

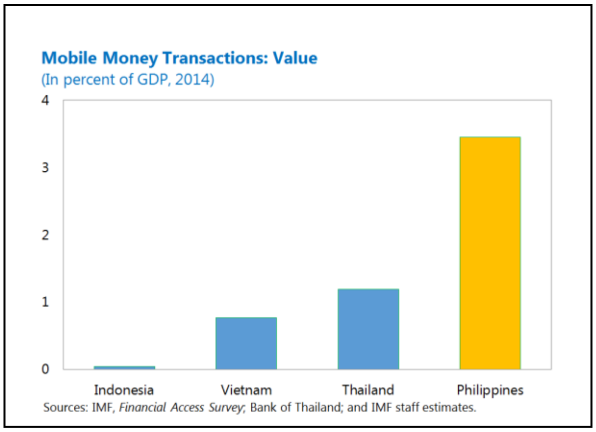


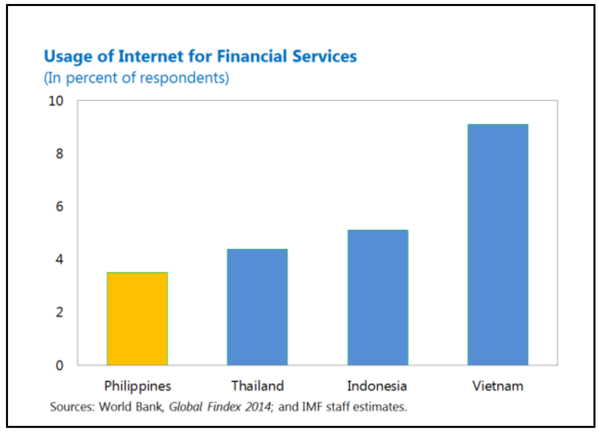
Sources: World Bank, *Enterprise Surveys*; and IMF staff estimates.
1/ As of 2016 for Thailand and 2015 for Indonesia, Philippines, and Vietnam.

Innovative technologies could offer new opportunities to fostering financial inclusion. Digital financial services could play complementary roles in overcoming geographical barriers to access, promoting competition, and facilitating data collection. The Philippines already leads its regional peers in the use of mobile networks for financial transactions, partly owing to strong policies in the past. This creates a conducive setting for further penetration of new technology-based financial services. To reap their full benefits, however, public investment in education and infrastructure, including in ICT, should also provide support.









Adequate financial supervision and consumer protection are essential to minimize associated financial stability risks. Financial inclusion can help promote inclusive growth provided risks are well managed.[1] Adoption of innovative financial services should be carefully paced considering the supervisory capacity in place. Cooperation at the international level, including with international bodies, could help better identify and understand these risks, and formulate appropriate regulatory responses at the national level (IMF, SDN/16/03). Financial inclusion should also be accompanied by a greater focus on consumer protection. These could include enhancing financial literacy programs with effective delivery channels and strengthening the administrative capacity for oversight and supervision (IMF, SDN/15/17). Institutionalizing financial education in the school system, as proposed in the *2014 Consumer Finance Survey*, could contribute to the former.

Notable policy initiatives are underway. Over the recent years, the Philippines has been at the forefront of the global financial inclusion agenda, especially in the areas of microfinance and mobile banking, and through active contribution to international fora. The launch of the National Strategy for Financial Inclusion in 2015 and the subsequent formation of the inter-agency Financial Inclusion Steering Committee were welcome steps and should be followed up with sustained implementation efforts. In particular, the National Retail Payments System project led by the BSP would help steer

[1] Looking at different segments of the population, the gap in financial inclusion is the most prominent across income groups. Compared to other countries in the region, poor Filipino households face disproportionately more limited access to financial services than the rich. The gender gap, on the other hand, is relatively small and often in favor of women in most financial inclusion indicators.

the prevailing use of physical checks and cash for retail inter-bank transactions toward electronic transfers, thus lowering the transaction costs and improving efficiency. The recent introduction of the regulatory framework for virtual currency exchanges is timely given the rapid increase in the transaction volume especially for remittances.

INTERNATIONAL MONETARY FUND

PHILIPPINES

October 10, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | Asia and Pacific Department

CONTENTS

FUND RELATIONS

(As of August 31, 2017)

Membership Status: Joined December 27, 1945; Article VIII

General Resources Account

	SDR Millions	Percent of Quota
Quota	2,042.90	100.00
IMF holdings of currency (holdings rate)	1,773.45	86.81
Reserve tranche position	269.53	13.19
Lending to the Fund New Arrangements to Borrow	47.42	

SDR Department

	SDR Millions	Percent of Allocation
Net cumulative allocation	837.96	100.00
Holdings	847.40	101.13

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 rate arrangement is classified as *floating*. The value of the Philippine peso is determined in the interbank foreign exchange market; the Bangko Sentral ng Pilipinas (BSP) intervenes in the spot and forward markets to smooth undue short-term volatility in the exchange rate. 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 Executive Board Meeting for the 2016 Article IV consultation was held on September 14, 2016 (IMF Country Report No. 16/309).

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 proved difficult in some cases.

FAD has concluded a five-year TA project financed by the Millennium Challenge Corporation to improve the basic functions of tax administration by the Bureau of Internal Revenue (BIR) (2011−16), in line with recommendations made by FAD TA missions in 2005, 2008, and 2009. The project provided for a resident tax administration advisor and an extensive program of short-term expert visits. In the extended project (2013–16), the main priorities were to “institutionalize” the new procedures implemented in the arrears management and VAT audit pilots, enhance the compliance improvement strategy (CIS), integrate redesigned business process with eTIS, and introduce further institutional, governance and management improvements to help ensure sustainability of the reforms. Progress has been made in VAT audit, arrears management and compliance improvement strategy. In addition, TADAT assessment took place in December 2015 to provide a picture of the current state of operations within the BIR against international good practice in tax administration. A tax policy TA in April 2016 made a comprehensive proposal of tax reform in the ASEAN environment. FAD's past TA missions on tax policy provided advice that constituted the basis for the reform of excises on tobacco and alcoholic beverages implemented in early 2013 and publication of tax expenditures to improve transparency and accountability of tax incentives supported by the Tax Investment and Management Act (TIMTA). TA on public financial management (PFM) has sought to establish effective and efficient budget and treasury management. In addition to the Fiscal Transparency Evaluation, TA on medium-term budget framework, government cash management, formulation and drafting of the PFM bill, and contingent liabilities management took place in 2014–2016. In line with past PFM advice, the government introduced a Treasury Single Account and is reviewing its cash management and planning. It now produces a midyear report on the macroeconomic and fiscal outlook and midyear budget execution. In addition, the revenue and expenditure from off budget accounts are now presented in budget documents. Moreover, the PFM bill has been submitted to the Congress. A TA mission in August 2017 reviewed ongoing reforms and recommended next steps for strengthening the treasury single account (TSA) system and government cash management.

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

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

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

Other areas of MCM TA included advice on financial market development. A workshop on the deepening of government securities market was held in 2014, and TA on exchange consolidation and securities regulation was delivered in 2015. An MCM TA mission in April 2017 provided recommendations on the appropriate sequencing of fixed income and derivative market reforms, building on the previous TAs on government securities markets and monetary operations.

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). A TA mission took place in August 2017 to enhance PSA capacity and improve the GDP and sectoral accounts. STA also organized a workshop in July 2017 to train the authorities on the compilation of chained indexes for producer and consumer prices.

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

Resident Representative

A Resident Representative has been stationed in Manila since January 1984. Mr. Yongzheng Yang took over from Mr. Shanaka Jayanath Peiris as the Resident Representative for the Philippines in September 2017.

IMF-WORLD BANK COLLABORATION

(As of August 21, 2017)

Background

The Bank and the Fund country teams for the Philippines exchanged views to coordinate the teams' work during 2017–18 through the resident representative's office. The teams agreed on the Philippines' main macroeconomic challenges to build the foundations for faster and more inclusive growth and navigate the uncertain global environment to maintain macroeconomic stability, including, creating policy space to meet future potential shocks. 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 financial management and the efficiency of spending, including for social safety nets; and (3) financial sector development, including financial inclusion. Table 1 details the specific activities planned by the two country teams during June 2017-June 2018, along with their expected deliverables, and the division of labor.

The Key Areas with Joint Programs

Strengthening Public Finance

The continued focus on mobilizing fiscal revenue to help fund spending in support of sustained and inclusive growth, while strengthening the resilience to shocks. The Fund and the Bank have a long standing program of support for strengthening public finance and involves close coordination in tax policy reform including fiscal incentives rationalization and monitoring of the sin tax implementation; management of fiscal risks and reporting; debt management strategy; assisting the Department of Budget and Management in improving public financial management and support for the Bureau of Treasury's lead role in implementation of a Single Treasury Account (TSA) and cash management.

Financial Sector

A joint Bank/Fund Financial System Stability Assessment took place in 2009, following up on the initial joint FSAP in 2002. Following the FSAP recommendations, the Fund has focused on technical assistance in bank supervision and resolution. The Bank has taken the lead in the nonbank financial sector, crisis simulations, and financial inclusion. 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 the implementation of development policy lending. Review and sharing of analytical work, 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 2017-June 2018

	Products	Expected Delivery Date
Bank Work Program	• Mindanao Jobs Report • Philippine Economic Update • Programmatic policy analysis and implementation support for inclusive growth. • Programmatic support on improving statistics, including support to the new Philippine Statistics Authority and the Securities and Exchange Commission • Game changers for inclusive growth: support to the tax reform, customs reform, competition reform and MSME development • Report on the Observance of Standards and Codes, Accounting and Auditing (A&A ROSC) • Programmatic Public Sector Governance Program, including program spending assessments, open government and program performance tracking and Open Roads and an Open Roads platform • Supporting the development of a National Competition Policy • Local governance and accountability technical assistance • PFM TA based on the PEFA assessment • Programmatic Support to Financial development and Inclusion • Development Policy Lending • Public Expenditure Review • Analysis on Productivity and Growth • E-government project preparation • Customs reform and trade modernization project preparations • Analytical work on MSME development • Analytical work on Capacity Needs and Capacity Building in the Public Sector	• Completed in June 2017 • Semi-annually • Completed in August 2017 • Ongoing • Ongoing • Completed in August 2017 • Ongoing • Ongoing • Completed in June 2017 • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing
Fund Work Program	• Article IV consultation with a focus on the medium-term challenges of supporting a well-managed rise in investment and a more inclusive growth. • Article IV staff report • Public financial management (cash management, transparency and budget execution) TA • Tax policy TA • Banking supervision and bank resolution TA • Liquidity management and forecasting TA • Financial stability framework TA • Securities supervision and regulation TA • Statistical data compilation and dissemination TA	• July/August 2017 • September 2017 • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing • Ongoing
Joint Work Program	• Management of Fiscal Risk and GOCC/PPPs • DoF-BTr Debt Management Strategy • Implementation of PFM reforms related to Fiscal Transparency Evaluation of Fund and PEFA assessment update led by Bank. • Review of tax policy notes by the Bank and update of recommendations by the Fund focused on financial sector taxes and related to ASEAN Economic Community 2016. • Macro-fiscal simulations of scaling up public investment and public investment management (PIM) institution reforms	• Ongoing • Ongoing • Ongoing • Ongoing • Ongoing

Table 2. 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 (WB) Regulatory framework (WB) Corruption /rule of law (WB) Investment incentives (IMF) Energy Sector (WB) Power supply and expected shortage (WB) Energy sector taxation (IMF) Rice market (WB) NFA operation and efficiency (WB) Pricing and subsidy of rice (WB/IMF) Labor market (WB) 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
Public finance	BIR reform Cash management Expenditure efficiency (capital spending)	Revenue administration BIR reform (IMF/WB) BOC (IMF/WB) Revenue forecasting (WB/IMF) Public financial management (WB) Cash management (IMF) IFMIS/fiscal reporting (IMF/WB) Budget preparation (IMF/WB) Budget execution (IMF/WB) Tax Policy (IMF/WB) Expenditure efficiency/policy (WB) 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 (WB/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) Islamic Finance (WB) AML (WB) Remittances (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 June 30, 2017)

Since joining the Asian Development Bank (ADB) in 1966, the Philippines has received 239 sovereign loans and grants financed by ADB Special Funds for a total of $16,461.42 million including nonsovereign financing amounting to $1,108.94 million. Agriculture and natural resources, public sector management, energy, and finance sector account for the largest proportion of ADB lending (combined 60 percent of the total) (Table 1). As of 30 June 2017, cumulative direct value-added cofinancing for the Philippines amounted to $1.4 billion and $100.95 million for TA projects.

Table 1. Cumulative Sovereign and Nonsovereign ADB Lending to Philippines
(As of June 30, 2017)

Sector	No. of Loans	Amount of Loans (US$ millions)	Percent (by amount)
Energy	33	2,136.7	12.2
Public sector management	15	3,352.0	19.1
Agriculture and natural resources	60	3,128.1	17.8
Transport and ICT	31	1,584.7	9.0
Finance	35	1,993.9	11.4
Multisector	8	916.6	5.2
Water and other municipal infrastructure and services	29	1,685.6	9.6
Health and social protection	7	648.7	3.7
Education	11	1,320.5	7.5
Industry and trade	12	793.2	4.5
Total	241	17,559.9	100.0

ADB's private sector operations in the Philippines began in 1986. As of June 30, 2017, cumulative approvals in 30 projects amounted to $1.1 billion. 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 January 2015, a loan was approved for $20 million to support the 150-Megawatt Burgos Wind Farm Project. In June 2015, ADB approved a direct loan without counterindemnity for up to P 1.8 billion, and a partial credit guarantee for up to P 8.02 billion to support the issuance of the Philippines' first Philippine peso-denominated green bond project. In December 2014, ADB approved a $75 million (P 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).

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 completed in June 2016 will inform the next CPS 2018−2023. The Country Operations Business Plan (COBP) 2017–2019, the sixth under the CPS 2011–2016, was approved in December 2016. The next COBP 2018-2020 is expected for ADB Management approval by September 2017.

STATISTICAL ISSUES

(As of August 4, 2017)

I. Assessment of Data Adequacy for Surveillance	
General: Data provision to the Fund has some shortcomings, but is broadly adequate for surveillance.	
National accounts: As part of a World Bank-funded project, *Improving the Quality and Usefulness of the Philippine System of National Accounts,* the National Statistical Coordination Board (NSCB) rebased the national accounts from 1985 to 2000. Continuing improvements include ongoing efforts to fully implement the *System of National Accounts, 2008*. Despite the authorities' efforts to improve quality, weaknesses remain in the national accounts. These include the coverage of the GDP and the statistical discrepancies in the GDP estimates between the expenditure and production sides. The authorities are working on improving (i) the accuracy of the GDP volume measures; (ii) the coverage of the public corporations sector; (iii) the accuracy of the quarterly GDP data; and (iv) the adoption of benchmark techniques to reconcile quarterly and annual national accounts estimates. The NSCB is currently participating in the IMF Statistics Department's *Project on the Implementation of the System of National Accounts and the International Comparison Program,* funded by the Government of Japan. This three-year technical assistance project provides assistance to improve the quality of the national accounts and price statistics. National accounts are expected to be revised in the near future based on the recently released 2012 Census of Philippine Business and Industry (CPBI). **Price statistics**: In July 2011, the National Statistics Office introduced a rebased consumer price index (CPI). The updated CPI is compiled using weights based on the 2006 Family Income and Expenditure Survey. Data from the 2008 Commodity and Outlet Survey were used to augment the provincial market baskets. One important methodological change implemented in the updated CPI is the adoption of the internationally recommended *Classification of Individual Consumption by Purpose (COICOP)* for the classification of all items. As noted in the above section, assistance will be provided to improve the quality of price statistics in Philippines.	
External sector statistics: The BSP completed the BOP compilation based on the BPM6 framework in March 2014, and that of the IIP 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 August 21, 2017)

	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	8/21/2017	8/1/2017	D	D	D	O	O
International reserve assets and reserve liabilities of the monetary authorities[1]	7/2017	8/2017	M	M	M	LO	LO
Reserve/base money	6/9/2017	7/9/2017	D	W	W	O, LO, LO, LNO	LO, O, O, O, LO
Broad money	6/2017	7/2017	M	M	M		
Central bank balance sheet	7/2017	8/2017	M	M	M		
Consolidated balance sheet of the banking system[2]	6/2017	8/2017	M	M	M		
Interest rates[3]	8/21/2017	8/21/2017	D	D	D	O	O
Consumer price index	7/2017	8/2017	M	M	M	O, O, O, O	O, LO, O, LO, LO
Revenue, expenditure, balance and composition of financing[4]—general government[4]	6/2017	7/2017	Q	Q	Q	LO, LO, O, O	LO, LO, LO, LO, LO
Revenue, expenditure, balance and composition of financing[4]—central government	6/2017	7/2017	M	M	M		
Stocks of central government and central government-guaranteed debt[5]	6/2017	7/2017	M	M	M	LNO	LNO
External current account balance	3/2017	6/2017	M	M	M	O, LO, LO, LO	LNO, LO, O, LO, LO
Exports and imports of goods and services	3/2017	6/2017	M	M	M		
GDP/GNP	Q2:2017	8/2017	Q	Q	Q	LO, LO, O, LO	LNO, LNO, O, LO, O
Gross external debt	Q1:2017	6/2017	Q	Q	Q	O	O
International investment position[6]	Q1:2017	6/2017	Q	Q	Q	O	O

[1] Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but sett other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Foreign, domestic bank, and domestic nonbank financing
[3]. Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).
[8] Reflects the assessment provided in the data ROSC or the Substantive Update (published on August 25, 2004, and based on the findings of the mission that took place during September 1–16, 2003) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, sc classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[9] Same as footnote 8, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation intermediate data and statistical outputs, and revision studies.