INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/287

PHILIPPINES

September 2018

2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PHILIPPINES

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2018 Article IV consultation with the Philippines, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 17, 2018 consideration of the staff report that concluded the Article IV consultation with the Philippines.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 17, 2018, following discussions that ended on July 25, 2018, with the officials of the Philippines on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 28, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for the Philippines.

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

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International Monetary Fund
Washington, D.C.

Press Release No. 18/360
FOR IMMEDIATE RELEASE
September 27, 2018

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

IMF Executive Board Concludes 2018 Article IV Consultation with the Philippines

On September 17, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Philippines.

Real GDP grew by 6.7 percent in 2017 and by 6.3 percent in the first half of 2018 (y/y) led by strong public investment. Inflation rose to 6.4 percent (y/y) in August 2018, averaging 4.8 percent year to date and above the inflation target band of 2−4 percent, led by adjustments in excise taxes, the rise in global oil prices, the weaker peso, and above-trend growth. Investment-led growth and sustained supply pressures have likely raised employment with renewed wage demand pressures. Following surpluses before 2016, the current account deficit widened to 0.8 percent of GDP in 2017, driven mainly by imports of capital goods, oil, and raw materials, reflecting strong investment growth.

The economy continues to perform well but is facing new challenges. Real GDP growth is projected to grow strongly in 2018 and 2019, supported by domestic demand. However, poverty and inequality challenges remain, inflation has risen, and external uncertainty has increased. The medium-term economic outlook remains favorable, but short-term risks have risen. Real GDP growth is projected at just under 7 percent over the medium term. Inflation is projected at above the 4 percent upper target bound in 2018 and stay in the upper half of the target band (3−4 percent) during 2019–2020. The current account deficit is projected to remain manageable, financed largely by foreign direct investment. Downside risks stem mainly from rising inflation, continued rapid credit growth, higher U.S. interest rates and U.S. dollar, volatile capital flows, and trade tensions.

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

Executive Board Assessment[2]

Executive Directors commended the authorities for the strong economic performance owing to sound macroeconomic management and continued reforms to promote inclusive growth. Directors noted that short-term risks have increased from rising inflation and a less favorable external environment, and underscored the need to adjust the policy mix to address these risks. Nonetheless, the medium-term economic outlook remains favorable, placing the Philippines in a good position to tackle still-elevated poverty and inequality.

Directors broadly urged the authorities to consider adjusting the fiscal stance over 2018-2019 to continue to support pro-growth infrastructure investment and social spending while containing nonpriority spending, in order to avoid overburdening monetary policy. They stressed the importance of careful selection and management of infrastructure projects to maximize their impact on growth.

Directors supported the authorities' reforms to make tax incentives more effective in achieving national policy goals and improve economy-wide productivity. Enhancing the VAT refund system and strengthening the international taxation framework will also be steps in the right direction. Directors suggested complementing these reforms with enhanced social protection.

Directors welcomed recent decisions of the Bangko Sentral ng Pilipinas (BSP) to increase the policy rate and its announced readiness to take further actions to safeguard price stability. In this context, they recommended carefully monitoring both supply-and demand-side pressures. They also welcomed the BSP's decision to delay the bank reserve requirement cuts until inflation expectations are more firmly anchored. Directors supported the authorities' policy of allowing the exchange rate to move freely in line with market forces, while limiting foreign exchange intervention to address disorderly market conditions. They welcomed the recent launch of national retail payment systems and the progress made with domestic capital market and FX liberalization reforms.

Directors noted that the financial system appears sound. They welcomed the BSP's recent macroprudential measures to safeguard financial stability against systemic risks and noted the need for continued vigilance. While the pace of credit growth has slowed recently, the credit-to-GDP gap has widened. In this regard, Directors supported the BSP's plan to introduce a countercyclical buffer for banks and underscored the need to close data gaps on nonbank financial institutions and conglomerates. Directors encouraged the approval of the amendments to the BSP charter.

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

Directors welcomed the progress made by the authorities on structural reforms and encouraged them to deepen the reform efforts in seeking broader economic benefits. They supported the authorities' plan to replace the rice import quota system with one based on tariffs, while emphasizing the need to support small farmers affected by the reform. Directors noted the need to promote competition by opening new sectors of the economy to foreign investment, improve the business environment through better infrastructure, create more and better jobs through investment in human capital and labor market reforms, and modernize the bank secrecy legal framework.

Philippines: Selected Economic Indicators

	2013	2014		2015	2016	2017	2018 Proj.	2019 Proj.
	(Annual percentage change, unless otherwise indicated)							
National account								
Real GDP	7.1	6.1		6.1	6.9	6.7	6.5	6.7
Consumption	5.5	5.3		6.5	7.4	6.0	6.5	6.5
Private	5.6	5.6		6.3	7.1	5.9	5.8	5.9
Public	5.0	3.3		7.6	9.0	7.0	11.3	10.7
Gross fixed capital formation	11.8	7.2		16.9	26.1	9.5	18.6	11.7
Domestic demand	6.8	5.7		8.7	11.7	6.9	9.7	8.0
Net exports (contribution to growth)	-2.6	1.0		-3.1	-4.9	-0.8	-4.0	-2.2
Real GDP per capita	5.2	4.3		4.3	5.2	5.2	4.4	4.6
Output gap (percent, +=above potential)	0.5	0.3		-0.1	0.1	0.0	0.2	0.1
Labor market								
Unemployment rate (percent of labor force)	7.1	6.8	1/	6.3	5.4	5.7	5.5	5.4
Underemployment rate (percent of employed persons)	19.3	18.4		18.5	18.3	16.1	…	…
Employment (percent change)	0.9	0.4		2.8	4.7	-1.6	2.5	2.4
Non-agriculture daily wages (Q4/Q4) 2/	2.2	0.0		3.2	2.1	4.3	4.3	…
Price								
Consumer prices (period average, 2012 basket)	2.6	3.6		0.7	1.3	2.9	4.9	3.9
Consumer prices (end of period, 2012 basket)	3.8	1.9		0.7	2.2	2.9	5.2	3.6
Residential real estate (Q4/Q4)	…	…		…	3.3	5.7	…	…
Money and credit								
3-month PHIREF rate (percent, end of period) 3/	-0.4	1.8		2.7	2.0	3.3	4.0	…
Credit to the private sector (percent of GDP)	35.9	39.2		41.8	44.7	47.8	51.5	53.8
Credit to the private sector (percent change)	17.2	19.6		12.4	16.4	16.6	20.0	15.8
Public finances (in percent of GDP)								
National government overall balance 4/	-1.5	-0.6		-1.4	-2.4	-2.2	-2.8	-3.2
Revenue and grants	14.8	15.1		15.4	15.2	15.6	16.0	16.2
Total expenditure and net lending	16.3	15.7		16.8	17.6	17.9	18.8	19.4
General government gross debt	45.7	42.1		41.5	39.0	39.9	39.5	38.9
Balance of payments (in percent of GDP)								
Current account balance	4.2	3.8		2.5	-0.4	-0.8	-1.5	-1.5
FDI, net	0.0	0.4		0.0	-1.9	-2.6	-2.5	-2.3
Gross reserves (US$ billions)	83.2	79.5		80.7	80.7	81.6	76.3	73.9
Gross reserves (percent of short-term debt)	406.2	413.3		409.5	423.9	422.9	384.7	372.0
Total external debt	28.9	27.3		26.5	24.5	23.3	21.3	19.5
Memorandum items:								
Nominal GDP (US$ billions)	271.8	284.6		292.8	304.9	313.6	334.7	360.7
Nominal GDP per capita (US$)	2,768	2,849		2,883	2,953	2,989	3,129	3,305
GDP (in billions of pesos)	11,538	12,634		13,322	14,480	15,806	17,574	19,480
Real effective exchange rate (2005=100)	109.9	109.5		116.8	113.2	108.6	…	…
Peso per U.S. dollar (period average) 5/	42.4	44.4		45.5	47.5	50.4	53.4	…

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

1/ Estimates exclude data of the entire Region VIII.
2/ In National Capital Region. Latest observation as of June 2018.
3/ Benchmark rate for the peso floating leg of a 3-month interest rate swap. Latest observation as of July 2018.
4/ IMF definition. Excludes privatization receipts and includes deficit from restructuring of the previous Central Bank-Board of Liquidators.
5/ Latest observation as of July 2018.

INTERNATIONAL MONETARY FUND

PHILIPPINES

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

August 28, 2018

KEY ISSUES

Context. The Philippines economy continues to do well but is facing new challenges from rising inflation and a less benign external environment, in addition to persistent poverty and inequality. The new environment requires adjustment of the policy mix to balance growth and stability objectives, while fostering inclusion.

Outlook. GDP is projected to grow at 6.5 percent in 2018 and 6.7 percent in 2019, led by domestic demand. Despite recent tightening of monetary policy, inflation is projected to remain above the 4 percent upper target bound in 2018 and stay in the upper half of the target band (3–4 percent) during 2019–2020. Output is expected to stay above potential in 2018−2020.

Main Policy Recommendations

- A neutral fiscal stance over 2018–2019 is warranted to balance growth and stability objectives. Streamlining tax incentive system would be more effective in achieving national policy goals and generate economy-wide productivity gains.

- The BSP should look to tighten monetary policy further. The exact pace of monetary tightening should depend on evolving external and domestic conditions. Exchange rate flexibility should continue to support the economy's ability to adapt to external shocks.

- The approval of the proposed amendments to the BSP charter is a top priority. The BSP should move forward in its plans to implement banks' countercyclical capital buffer requirement.

- Reform efforts should continue and even deepen, including replacing the rice import quota system with a tariff-based system, further lifting restrictions on foreign investment, improving the ease of doing business, and promoting financial inclusion.

Approved By
Kenneth H. Kang and Mary B. Goodman

Mission dates: July 11–25, 2018
Staff team: Luis E. Breuer (Head), Philippe Karam, Minsuk Kim, Si Guo (all APD). Yongzheng Yang (Resident Representative) and his staff, Mia Agcaoili and Khristine Racoma, supported the mission. Juda Agung (Executive Director) and Edna Villa (Alternate Executive Director) joined some of the meetings. Agnes Isnawangsih, To-Nhu Dao, and Nong Jotikasthira assisted in preparing this report.

CONTENTS

APPENDICES

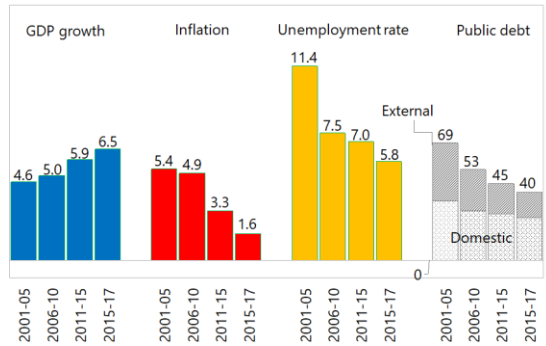
Glossary

AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
BPO	Business Process Outsourcing
bps	Basis Points
BSP	Bangko Sentral ng Pilipinas
CAD	Current Account Deficit
CCyB	Countercyclical Capital Buffer
CET1	Common Equity Tier 1
CIT	Corporate Income Tax
CPI	Consumer Price Index
DSGE	Dynamic Stochastic General Equilibrium
D-SIBs	Domestic Systematically Important Banks
FDI	Foreign Direct Investment
FINL	Foreign Investment Negative List
FX	Foreign Exchange
GDP	Gross Domestic Product
ICT	Information and Communications Technology
IRC	Interest Rate Corridor
m/m	Month-on-Month
NBFIs	Nonbank Financial Institutions
NFCs	Nonfinancial Corporates
NRIRs	Neutral Real Interest Rates
ODF	Overnight Deposit Facility
OMOs	Open Market Operations
PPP	Public Private Partnership
PSA	Philippines Statistics Agency
REER	Real Effective Exchange Rate
REST	Real Estate Stress Test
RRP	Reverse Repurchase Facility
SDA	Special Deposit Account
SIP	Selected Issues Paper
SMEs	Small and Medium-Sized Enterprises
TDF	Term Deposit Facility
TRAIN	Tax Reform for Acceleration and Inclusion
y/y	Year-on-Year

CONTEXT

1. **The Philippines has been one of Asia's strong performers over the past years**. Sound policies and a favorable external environment have delivered robust growth, low inflation, and a strong fiscal position. Nevertheless, poverty and inequality remain high, underscoring the need for inclusive policies. The economic cabinet, which has been delegated the policymaking responsibilities, has adopted a long-term perspective on policies and reforms, which has contributed to strengthening confidence in the economy.

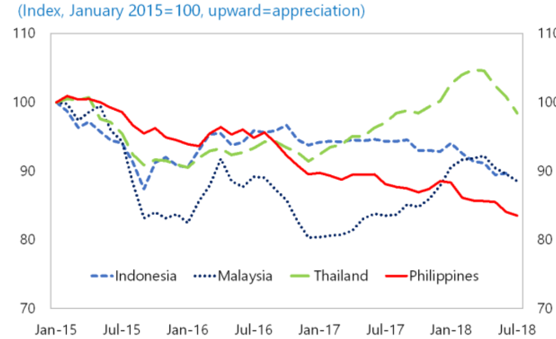
Economic Performance During 2001–2017



Sources: Haver Analytics; Philippines, Department of Finance; and IMF staff

2. **The economy faces near-term challenges from the risk of overheating and a less benign external environment**. The projected positive output gap, rising inflation and inflation expectations, high and sustained credit growth, and the planned fiscal expansion in 2018−2019 point to the risk of overheating. The rise of inflation to above the target in recent months has weakened political support for tax reform. The combination of tighter global financial conditions, higher oil prices, a widening current account deficit (CAD) and portfolio outflows, have put downward pressure on the peso.

Selected Exchange Rates Against U.S. Dollar
(Index, January 2015=100, upward=appreciation)



Sources: Haver Analytics; and IMF staff estimates.

RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

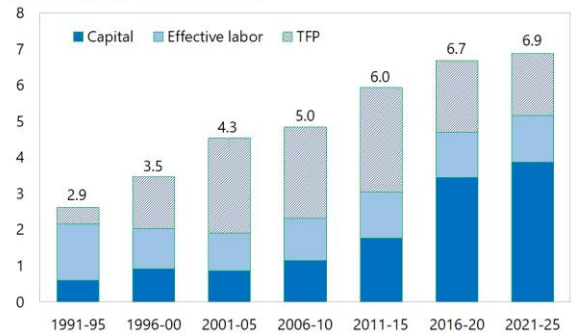
3. **Growth, inflation, and external account**. Real GDP in 2017 grew at 6.7 percent and 6.3 percent in 2018:H1, y/y, led by strong public investment (Figure 1). Inflation rose to 5.7 percent (y/y) in July 2018, averaging 4.5 percent year to date and above the inflation target band of 2−4 percent, led by adjustments in excise taxes, the rise in global oil prices, the weaker peso, and above-trend growth. Investment-led growth and sustained supply pressures have likely raised employment and renewed wage demand pressures respectively. Following surpluses before 2016, the CAD widened to 0.8 percent of GDP in 2017, driven mainly by imports of capital goods, oil, and raw materials, reflecting strong investment growth (Figure 4).

4. **Bank credit growth and stability**. Bank credit continues to outpace the rate of economic growth. Banks' high capitalization and stable nonperforming loans, and low exposure to external

and FX-denominated financing provide some buffer against financial stability risks. While the pace of credit growth has slowed recently, the credit-to-GDP gap has widened, approaching early warning levels (Figure 5). Financial intermediation by the less regulated nonbank financial institutions (NBFIs) is small but has grown rapidly in recent years.

5. Outlook. Real GDP is projected to grow at 6.5 percent in 2018 and 6.7 percent in 2019, led by strong domestic demand. The government's infrastructure push and stable FDI are expected to support investment growth. Private consumption would remain robust, underpinned by remittances and rising employment. Despite the monetary tightening since May that raised the policy rate to 4 percent, inflation is projected at above the 4 percent upper target bound in 2018 and stay in the upper half of the target band (3–4 percent) during 2019–2020. Output would stay above potential in 2018-2020, and the CAD is expected to widen to 1.5 percent of GDP in 2018 driven by a continued rise of capital goods imports, mostly financed by FDI. Over the medium term, real GDP growth would gradually rise to 6.9 percent as implementation of structural reforms promote investment and innovation.

Potential GDP Growth
(In percent, adjusted for inflation)



Sources: Barro and Lee (2016) Educational Attainment Dataset; and IMF staff estimates.

6. Risks (Appendix I). On balance, risks to the growth outlook are tilted to the downside, stemming mainly from rising inflation and overheating, higher oil prices, high credit growth, intensification of global trade tension, and the impact of higher U.S. interest rates and volatile capital flows on borrowing costs over the short term. On the upside, fiscal incentive for streamlining and liberalizing foreign investment, if approved and implemented, would boost productivity over the medium term and strengthen investor confidence.

External Sector Assessment

7. External sector. In 2017, the external position was assessed to be broadly in line with fundamentals and desirable policies (Appendix II). The cyclically-adjusted current account balance was -1.0 percent of GDP, within the range of the estimated current account norm of between -2.0 and 0.8 percent of GDP, driven by demographics and strong growth potential. The real effective exchange rate was assessed to be broadly consistent with fundamentals and desirable policy settings in 2017. Gross reserves, at US$76.7 billion as of July 2018 and equivalent to 192 percent of the IMF's reserve adequacy metric for 2017, are ample. Compared to its regional peers, the peso depreciated significantly, by almost 6.0 percent in January–July against the U.S. dollar and about 4.5 percent in nominal effective terms.

Authorities' Views

8. The authorities expected robust growth momentum to continue, with risks mainly originating from external sources. The projected 7–8 percent growth over the medium-term would be driven by strong private consumption, higher public spending in infrastructure and social programs, resurgence in manufacturing, and growing FDI and tourism. Based on an assessment of inflation dynamics, output, liquidity, and credit conditions, the authorities continued to see limited evidence of overheating in the economy, with the initial impact of excise tax increases on inflation stabilizing and new bank credit mostly directed to productive sectors. They expected the approval of the pending rice reform bill to replace rice import quotas with tariffs to help reduce consumer prices. The authorities agreed with the main thrust of the staff's external sector assessment, while noting that the recent widening of the CAD has been driven by imports of capital goods, raw materials and intermediate/manufactured goods related to infrastructure investment and overall strong domestic demand. Meanwhile, they expect that while the potential direct impact of global trade tensions may not be substantial, continued trade friction could, nevertheless, affect overall investment sentiment, and increasing uncertainty on the global growth prospects could take its toll on the external sector. Nonetheless, authorities viewed that the Philippines can rely on increasing intraregional trade, strengthening domestic demand, and its robust external payments position as buffers against possible negative effects of protectionist measures.

POLICY ISSUES

A. Adjusting the Policy Mix to a Changing Economic Environment

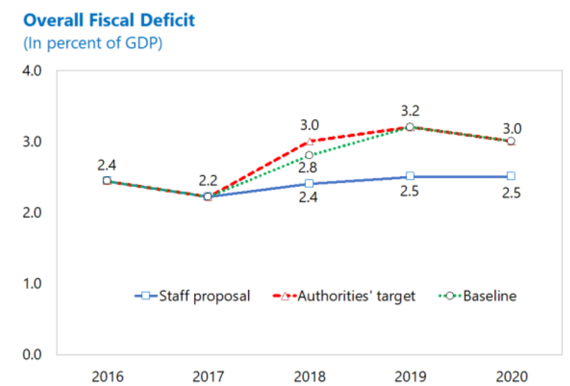
9. There is a need to adjust the policy mix to address rising domestic and external imbalances. The planned fiscal stimulus, combined with strong private investment and consumption growth, will feed price and current account pressures. Monetary policy should continue to be tightened to protect price stability and preserve market confidence, supported by a shift to a neutral fiscal stance centered on priority infrastructure and social spending. Exchange rate should remain flexible to play its shock absorber role against external shocks, while macroprudential measures should safeguard financial stability by keeping systemic risks in check.

Fiscal Policy—Supporting Inclusive Growth while Safeguarding Stability

10. On current policies, fiscal policy would be expansionary in 2018–2019. The authorities plan to raise the deficit from 2.2 percent of GDP in 2017 to 3 percent in 2018 and 3.2 percent in 2019, implying a fiscal impulse of 0.5 percent and 0.2 percent, respectively, led by infrastructure investment and social spending. In contrast, staff projects a lower deficit of 2.8 percent in 2018 given implementation constraints. As of June 2018, the deficit stood at 1.1 percent of projected 2018 GDP against the authorities' target of 1.5 percent as revenue has outperformed due to an effective implementation of the Tax Reform for Acceleration and Inclusion (TRAIN), the *first package* of the government's Comprehensive Tax Reform Program, while public spending remains broadly on target.

11. The Philippines has some fiscal space. Prudent fiscal management and sustained reforms helped bring the general government gross debt to 40 percent of GDP in 2017 from 52.4 percent in 2007 (Appendix III). Gross financing and long-term adjustment needs are low, although the government's reliance on external financing poses a moderate risk.

12. Nonetheless, the current environment warrants a neutral fiscal stance to balance growth and stability objectives. A neutral stance over 2018–2019, implying a deficit of 2.4 percent in 2018 and 2.5 percent in 2019, would support pro-growth infrastructure investment without overburdening monetary policy, limit overheating risks, and help preserve buffer against unexpected adverse shocks. This could be achieved by intensifying efforts on the revenue side and containing nonpriority spending, such as new hiring of public sector employees and non-urgent capital projects. Further reduction in nonpriority spending, especially those unrelated to flagship infrastructure projects and social protection, would be warranted if tightening of global financial conditions engenders a surge in borrowing costs, while expanding social protection spending as needed.



Sources: Philippine authorities; and IMF staff proposal.

13. The planned tax incentive reform would make the system more effective and generate economy-wide productivity gains. The current regime provides extensive tax incentives based on more than 220 laws and granted at the discretion of 14 investment promotion agencies without adequate central control, at an estimated fiscal cost of over 2 percent of GDP. *Package 2* of the tax reform program focuses on streamlining tax incentives while gradually reducing the corporate income tax (CIT) rate from 30 to 25 percent. The reform would make tax incentives more effective in achieving national policy goals and improve overall productivity. Any CIT rate reduction, however, should be conditional on proportionate fiscal incentive consolidation to offset revenue losses.

14. Enhancing the VAT refund system would support the tax reforms. These require sustained efforts to improve tax authority's administrative capacity through training and establishing dedicated staff teams. Other measures could include launching a pilot project to implement a risk-based approach for VAT refund. Such an approach could modernize and improve the entire operation of tax administration.

15. The international taxation framework could be strengthened. Outbound FDI by Philippines-based multinational corporations has risen significantly over the recent years, increasing the risk of revenue losses from base erosion and profit shifting. Addressing this risk would require increasing capacity building efforts and implementing prioritized reforms, such as limiting corporations' interest payment deductions to a specified percentage of earnings before interest, taxes, depreciation and amortization. Strengthening transfer pricing enforcement could also address revenue losses caused by tax incentives that could allow for domestic transfer pricing.

16. There is room to gradually expand social protection. Reallocating resources from nonpriority spending, and unconditional cash transfers eventually, would allow the expansion of other programs that have been assessed to be effective in reducing poverty such as the conditional cash transfer program. Public spending on education, health, and infrastructure could also place priority on improving access to public services by low-income households (Box 1). Implementation of the approved national identification system will help improve targeting of social spending.

17. Public expenditure management should aim to maximize the return from the large infrastructure investment. Priority should be on selection and prioritization of capital projects, periodic review of ongoing programs and projects, and contingent liability management and oversight over PPP. The IMF technical assistance which conducted a Public Investment Management Assessment has helped identify specific areas of reform in public investment management and institutions.

Authorities' Views

18. The authorities underscored the need for uninterrupted investment in infrastructure projects but were open to review the staff's advice on the neutral fiscal stance. They saw limited scope for spending adjustment for those infrastructure projects already under construction but noted that some room exists elsewhere in case the overall spending needs to be adjusted. Regarding the tax incentive reform, the authorities' goal is to make the system more performance-based and transparent, including by strengthening the cost-benefit analysis and delegating the central oversight role to the Department of Finance. The CIT rate cuts would supersede incentive consolidation. The authorities also agreed on the need for gradual expansion of social protection programs and further improvement of their public investment management and prospective assessment by the IMF.

Monetary and Exchange Rate Policy—Tackling Inflation, Modernizing Operations, and Maintaining a Flexible Exchange Rate

19. While temporary supply-side factors explain much of the rise in headline inflation, demand-side pressures also played a role. The price change in core services, which is less affected by those factors and hence a better indicator of domestic demand pressure, has picked up substantially since late 2017 (Box 2). The risk of unanchored inflation expectations has risen, based on survey results, and the government bond yield curve steepened, consistent with higher inflation expectations. Addressing potential second-round effects from supply pressures on broader prices and rising wage demand pressures has become a major policy issue.

Inflation Decomposition and Momentum

(In percent)

	(1) 2018 July (y/y)	(2) 2017 Average (y/y)	(3)=(1)-(2) Differences	(4)=(3)*CPI Weight Contribution
Headline	**5.7**	**2.9**	**2.8**	**2.8**
Food, Beverages and Tobacco	7.8	3.3	4.5	1.8
Gas, fuel and lubricants	20.5	10.2	10.3	0.5
Core goods	1.8	1.7	0.1	0.0
Core services	3.5	1.7	1.8	0.5
Residual (net contibutions from other items)				0.0

Sources: Philippine Statistics Authority; and IMF staff estimates.

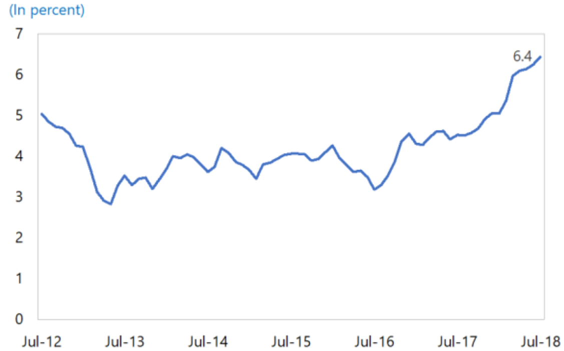
Inflation Expectations: Up Versus Down

(Diffusion index, +0 = higher inflation expected in the current quarter)

Source: Bangko Sentral Ng Pilipinas; and IMF staff estimates.

Ten-Year Treasury Bond Yield

(In percent)



Sources: Haver Analytics; and IMF staff estimates.

20. **The BSP's recent decisions to raise its policy rate were appropriate and the BSP should look to do more**. Despite the monetary tightening since May that raised the policy rate by 100 bps to 4 percent this year, monetary policy remains accommodative. Staff estimates the real policy rate to be close to zero percent as of August 2018, 1–2 percentage points below the neutral real interest rate, implying the need for further tightening (Box 3). Higher rates will also mitigate inflation risks from the expected fiscal stimulus, weaker currency, and help anchor inflation expectations. The exact pace of monetary tightening should depend on evolving external and domestic conditions.

21. **Exchange rate flexibility should continue to support the economy's ability to adapt to external shocks**. With official international reserves more than adequate, the authorities should continue with the policy of allowing the exchange rate to move freely in line with market forces, while limiting foreign exchange intervention to avoid disorderly market conditions.

22. **The BSP has made progress in implementing its interest corridor system (IRC), and staff supports continued fine-tunings of monetary operations** (Box 4). The recent advances in domestic capital market and FX liberalization reforms are also welcome and should be sustained.

While the monetary effect of two bank reserve requirement cuts in 2018 (lowering the ratio to 18 from 20 percent) were largely sterilized by BSP's term deposit auctions, the authorities' decision to put further cuts on hold until inflation expectations are well anchored is appropriate.

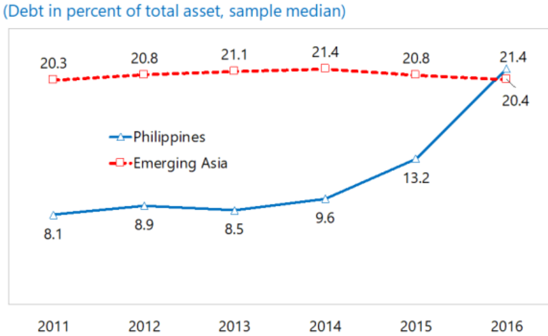
Authorities' Views

23. **The BSP agreed that the higher inflation was mainly driven by supply-side factors and recent tightening of monetary policy was meant to signal the BSP's strong commitment to ensuring macroeconomic stability**, by helping anchor inflation expectations and tempering further second-round effects. At the same time, they noted the possibility of demand-side pressures that needs to be closely evaluated and monitored. The main risks to the inflation outlook would include additional upward adjustments of minimum wages, transport fares, and electricity rates. The BSP agreed that the exchange rate should remain flexible; nevertheless, sustained pressures on the peso could adversely affect inflation, requiring vigilance against the potential inflation threat from peso volatility and second-round effects. The authorities expressed strong willingness to undertake follow-through actions to help ensure inflation expectations are anchored and that the inflation target for 2019 is attained. They also plan to sustain efforts to improve the IRC and monetary operations.

B. Addressing Systemic Financial Stability Risks

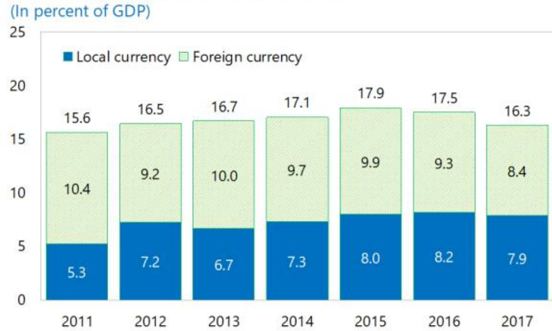
24. **The financial system appears sound, dominated by well-capitalized banks, but available data suggest that corporate leverage has increased**. Historic low borrowing costs have fueled credit growth and asset price inflation. With increasing loans, corporate leverage for listed firms, measured by debt-to-asset ratio, has risen to 21.4 percent in 2016, surpassing the average in peer countries. Large data gaps prevent a more recent analysis and anecdotal evidence suggest that corporate FX debt has fallen. Credit growth slowed in 2018 across most sectors but is expected to accelerate as private investment gathers momentum.

Corporate Leverage 1/
(Debt in percent of total asset, sample median)



Sources: IMF Corporate Vulnerability Utility Database; and IMF staff estimates.
1/ Based on 237 publicly traded nonfinancial firms in 2016.

Nonfinancial Corporate Debt Issuance 1/
(In percent of GDP)



Sources: IMF, Vulnerability Exercise Securities Database; and IMF staff estimates.
1/ Includes syndicated loans and based on residence of issuer.

25. **New initiatives have been proposed to address the slow progress in closing existing data gaps**. Data gaps are particularly large for non-financial corporates (NFCs) and NBFIs outside

the BSP's regulatory perimeter. The lack of timely available data has hampered the BSP's ability to identify and monitor emerging systemic risks outside the banking system and formulate more targeted policy measures. An Electronic Information Sharing project launched in May is intended to provide a centralized, web-based system to facilitate the sharing of reports of supervised institutions in the Philippines, which include audited financial statements of the top 1,000 corporations and related key performance indicators. Furthermore, requirements of more granular data in the reporting templates on real estate and project finance are expected to help BSP's surveillance of vulnerabilities from related exposures and policy response to emerging credit concentration risks.

26. The approval of the proposed amendments to the BSP charter should be a priority. These will grant the BSP the authority to obtain data from any person including the NFCs for statistical and policy development purposes and for safeguarding the soundness of the banks. Other important elements of the new charter include the capitalization of the BSP, legal protection for staff, and the ability to issue BSP instruments to better control inflation.

27. The BSP has implemented macroprudential tools to pre-empt the buildup of risks to financial stability, but additional efforts are needed. The BSP has revised its guidelines on liquidity risk management, implemented targeted macroprudential policies to stem excessive credit growth in specific sectors, and approved the adoption of the Net Stable Funding Ratio to enhance banks' ability to absorb liquidity stress. The real estate stress test (REST) limits of 25 percent write-off rates on real estate, to ensure banks have a sufficient capital buffer to withstand potential property price corrections, has been effective in moderating real estate loan growth from its previous high levels. The BSP plans to introduce the framework for implementing banks' countercyclical capital buffer (CCyB), with the level initially set at zero. Clear communication with market participants will be important, including on the methodology and comprehensive set of indicators that will be used to calibrate the CCyB, which in staff's assessment will need to be set above zero considering sustained rapid credit growth and credit-to-GDP gap approaching early warning levels (Figure 5). Against further concerns of credit risk, additional measures by BSP, namely the Debt-to-Earnings-of-Borrowers' Test (DEBT), and the Borrowers Interconnectedness Index (BII) aim at assessing the debt servicing capacity of systemic borrowers under stressed market conditions, and concentration of the systemic importance of conglomerates in the banking system, respectively.

Authorities' Views

28. The authorities view the domestic banks' credit exposure as firmly supported by demand of a growing economy, with appropriate tools in place to safeguard financial stability. BSP's macroprudential and strong financial surveillance policies have aimed at improving governance practices and the risk management system to support expanded lending activities. This has included adopting guidelines on Credit Risk Management Practices and on the conduct of stress testing exercises (i.e., the REST and the DEBT tests), assuming Basel III reforms which include adopting a minimum leverage ratio, enhancing the liquidity position of financial institutions, a supervisory framework for D-SIBs, and imposing the Capital Conservation Buffer as a CET1 requirement to absorb market shocks. More recently, communication issues raised by the banking industry regarding a CCyB proposal are being strengthened to secure its adoption, by stressing the CCyB buffer function in protecting the banking sector from the buildup of systemic vulnerabilities.

C. Structural Reforms to Support Inclusive Growth

29. The reform momentum should be sustained to foster inclusive growth. Despite rapid growth in recent years, poverty and inequality remain high (Figure 7), while there is room to continue to improve the business environment (Figure 8). Stringent foreign ownership restrictions and high non-tariff barriers have hampered competition and technology spillovers. Staff supports the authorities' reform agenda to address these problems, including:

- Replacing the rice import quota system with one based on tariffs, which would benefit consumers by reducing domestic rice prices. This action should be accompanied with policies to support the affected small farmers through training and crop substitution.

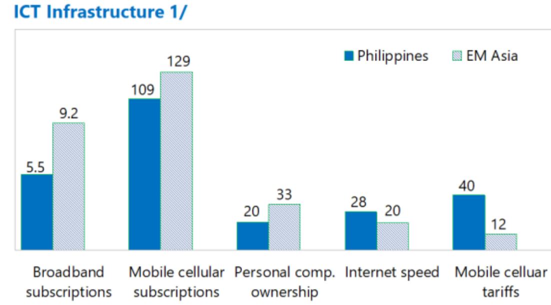
- Shortening the foreign investment negative list (FINL), combined with effective implementation of the Ease of Doing Business Law and the Philippine Competition Act, including by streamlining government procedures and cutting the processing time for permits would support private investment.

- Financial inclusion initiatives, including plans to create a central registry system for movable assets, which would allow easier access to credit for small- and medium-sized companies by expanding the set of eligible collateral for bank loans.

30. There is a need to modernize the labor market regulation. The authorities' intention to eliminate the practice of repeatedly using temporary contracts (to avoid paying workers fringe benefits) is sensible. To avoid adverse effects on employment, this should be accompanied with actions that can provide more flexibility to the labor markets, such as simplifying the procedures and reducing the pecuniary costs required for laying off workers with regular status.

31. More investment in human and physical capital would be needed to leverage digital technologies. The use of mobile financial transactions is widespread in the Philippines, supported by the recent introduction of a nationwide digital identification system and retail payment systems. To reap their full benefits, however, more investment is needed in education and training and ICT infrastructure, accompanied by efforts to enhance cybersecurity. The authorities' digital strategy is appropriately aligned with these priorities (Box 5).

ICT Infrastructure 1/



Sources: World Bank, World Development Indicators; World Economic Forum, The Global Technology Report 2016; and IMF staff estimates.
1/ Fixed broadband and mobile celluar subscriptions are per 100 people. Internet speed is proxied by internet bandwidth in kb/second per user. Personal computer ownership is in percent of total households. Mobile celluar tariffs are per PPP $/min.

32. Important challenges remain in the AML/CFT framework, despite recent improvements. The amended legislation covers casinos, which are now required to perform customer identification and meet record-keeping obligations, and report to the financial intelligence unit all single casino transactions above PHP5 million. Nonetheless, the AML/CFT framework could be strengthened further by amending the bank secrecy law and making tax evasion a predicate crime. The relaxation of bank secrecy law and enhanced customer due diligence measures for domestic politically exposed persons will also help improve tax compliance and anti-corruption.

Authorities' Views

33. The authorities highlighted significant progress in promoting inclusive growth and reaffirmed their commitment to accelerate reforms. The restrictions on foreign investment have been significantly eased in recent years and the authorities plan to further shorten the FINL through executive orders and legislations. They saw a shift to a tariff-based rice import system as an important priority to promote lower domestic prices and improve access to rice by poor households. The authorities also recognized the need to protect the vulnerable farmers from increased rice imports; hence the proposed legislation also states that the proceeds from tariffs will be utilized to provide additional resources to farmers to further enhance productivity and competitiveness. They underscored the need to further develop domestic capital markets to better support the national infrastructure initiative and noted their ongoing initiatives to leverage digital technologies to promote financial inclusion and address potential disruptions to BPOs. The authorities also note the recent anti-corruption efforts, including the approval of the Ease of Doing Business Law and the creation of the Presidential Anti-Corruption Commission, and their legislative initiatives to ease bank secrecy for tax compliance verification.

STAFF APPRAISAL

34. The economy continues to perform well but is facing new challenges. Real GDP is projected to grow strongly in 2018 and 2019, supported by domestic demand. However, short-term risks have risen, including inflation and overheating risks, and greater external uncertainty. The medium-term economic outlook remains favorable, which places the country in a good position to tackle still elevated levels of poverty and inequality.

35. To balance growth and stability objectives, the authorities should adopt a neutral fiscal stance over 2018–2019. This implies an overall deficit of 2.4 percent in 2018 and 2.5 percent of GDP in 2019 (compared to staff's current baseline of 2.8 and 3.2 percent), which would support pro-growth infrastructure investment without overburdening monetary policy, while containing inflationary pressures. Raising tax revenues and reallocating spending from nonpriority programs can support the continued expansion of public investment and social spending.

36. Further monetary policy tightening to anchor inflation expectations is needed and its pace should be conditional on domestic and external developments. The BSP's recent decisions to increase the policy rate three times this year were appropriate. With policy rates still well below neutral, staff welcomes the BSP's announced readiness to take further action to safeguard price stability by controlling potential second-round effects from sustained supply pressures and rising wage inflation as well as its decision to delay the bank reserve requirement cuts until inflationary expectations are more firmly anchored.

37. Exchange rate flexibility should continue to support the economy's ability to adapt to external shocks. Foreign exchange intervention should be limited to preventing disorderly market conditions. The external position was assessed to be broadly in line with fundamentals and desirable policies.

38. Macroprudential measures backed by sound financial surveillance should continue to safeguard financial stability against systemic risks, including those related to conglomerate structures and real estate. Implementation of the CCyB should aim at maintaining the banking sector's appropriate flow of credit through the cycle, while there is a need to close data gaps on NBFIs and conglomerates.

39. Authorities should maintain the momentum for reforms in seeking broader economic benefits. Priorities include amendments to the BSP Charter, streamlining tax incentives, modernizing the bank secrecy legal framework, promoting competition by opening new sectors of the economy to foreign investment, and further improving the business environment, including through better infrastructure and labor regulations, and strengthened governance.

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

Box 1. Distributional Effects of TRAIN—Scenario Analysis

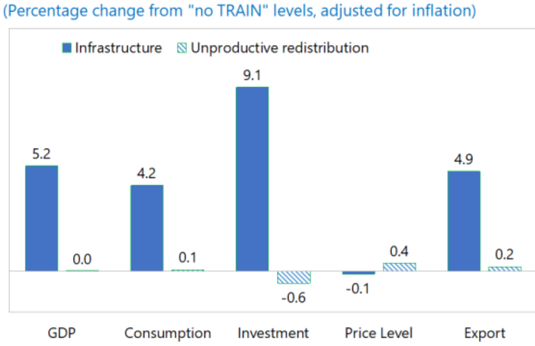
Model simulation results suggest TRAIN can bring significant output gains and reduce poverty, provided its revenue is used for productive investment. But lowering inequality would require targeted pro-poor investment in physical and human capital such as the conditional cash transfer program.

TRAIN could have significant distributional impacts over the long term, depending on how its revenue is used. While essential to finance infrastructure investment without endangering long-run fiscal sustainability, the tax reform package by itself is regressive, with most of the revenue raised from consumption taxes. This aspect of the TRAIN underscores the need for designing an expenditure strategy that is both growth-enhancing and inclusive.

TRAIN's growth and distributional effects are analyzed using a DSGE model. The theoretical framework, based on Peralta-Alva and others (2017), features three sectors—services, manufacturing, and an informal one not subject to taxation. The model is calibrated to match key characteristics of the Philippine economy, including the level and composition of tax revenue—labor, corporate income, and consumption taxes—and the overall consumption inequality (GINI index).

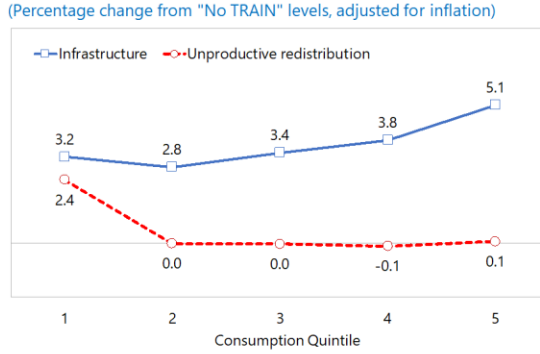
Two illustrative scenarios are considered to highlight the different effects of spending strategies linked to TRAIN. In the first scenario ("Infrastructure"), TRAIN revenue is invested in infrastructure projects every year and perpetually, which boosts productivity and leads to higher private investment. In the second scenario ("Unproductive Redistribution"), the revenue is redistributed equally to households as lump-sum transfers, which they can either consume or save. Under both scenarios, the annual TRAIN revenue is assumed to amount to 0.6 percent of GDP—1.5 percent gain from consumption tax increases, net of 0.8 percent of GDP revenue loss from personal income tax reduction. The steady states under the two scenarios are benchmarked against a baseline of no TRAIN.

Macroeconomic Impacts
(Percentage change from "no TRAIN" levels, adjusted for inflation)



Source: IMF staff estimates.

Distributional Impacts on Average Consumption
(Percentage change from "No TRAIN" levels, adjusted for inflation)



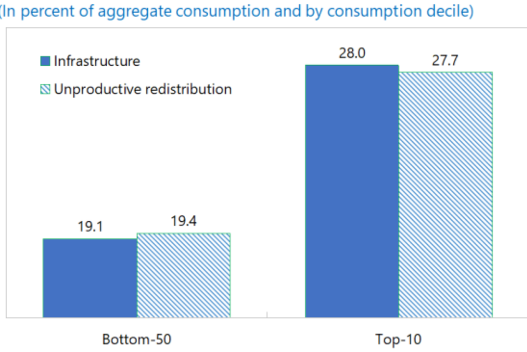
Source: IMF staff estimates.

Box 1. Distributional Effects of TRAIN—Scenario Analysis (Concluded)

Under the infrastructure scenario, all households would be better off, especially the poor. Infrastructure investment would increase output and reduce prices in the long run as the productive capacity expands. This strategy also lowers poverty by boosting the average real consumption of the lowest household quintile. In comparison, "unproductive redistribution" would lower investment with virtually unchanged output, engendering higher prices in the long term. Importantly, poverty reduction would be less than in the infrastructure scenario.

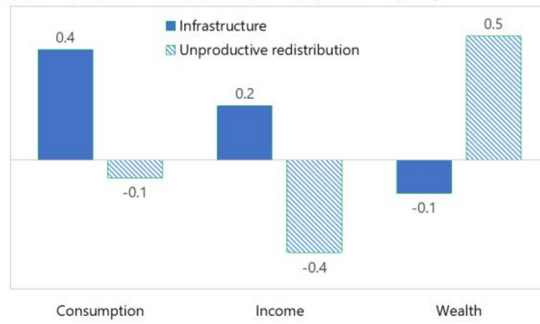
Regarding inequality, the results provide a mixed picture. Consumption inequality worsens in the infrastructure scenario, although marginally so, as richer households consume more than the poor. However, the opposite holds for wealth inequality: the poor households accumulate more wealth relative to their existing saving given the higher income generated by infrastructure investment. The higher saving provides a stronger buffer against large economic shocks, allowing these households to better smooth their consumption profile over time.

Consumption Share of Bottom-50 and Top-10 Percent
(In percent of aggregate consumption and by consumption decile)



Sources: IMF staff estimates.

Impacts on Inequality: GINI Index
(Difference from "no TRAIN" levels, 100 = perfect inequality)

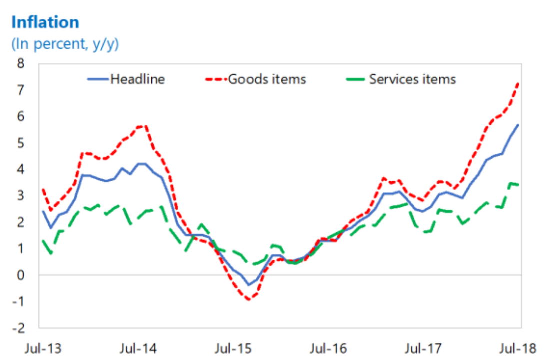


Source: IMF staff estimates.

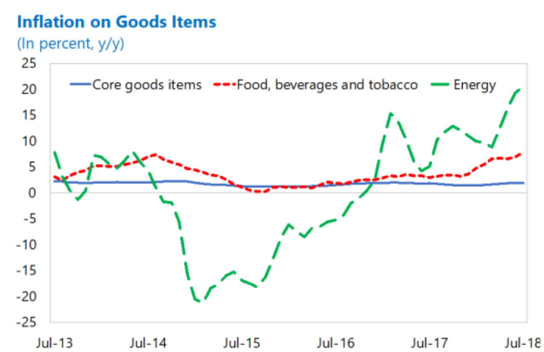
The analysis highlights the merit of targeted public investment in physical and human capital, which can have more direct and larger impact on poverty and inequality. These include targeted social protection program, such as the conditional cash transfer program, or basic infrastructure in rural areas, such as farm-to-market roads or water and sanitation facilities.

Box 2. Inflation Momentum and Decomposition

Headline inflation rose sharply in 2018 to 5.7 percent (y/y) in July from an average of 2.9 percent (y/y) in 2017, **driven primarily by goods inflation**. Registering the highest reading since 2013 (2012 weights), a large part of the increase stems from higher (supply-driven) excise taxes on auto, fuel, tobacco, and sweetened beverages, higher global oil and gas prices, and challenges in managing rice inventories. *Goods inflation* (58 percent of the CPI basket) accelerated from 3.6 percent (y/y) in December 2017 to 7.2 percent (y/y) in July 2018. Energy and food items were the main contributors, with energy inflation rising fast following higher international oil prices since the beginning of 2015 and increased excise tax on oil imports implemented in January 2018. Non-energy goods inflation, however, was mainly driven by domestic factors as non-oil import price growth was mild. *Services inflation* also rose in 2018, from 1.9 percent (y/y) in Dec 2017 to 3.4 percent (y/y) in July 2018.



Sources: Philippine Statistics Authority; and IMF staff estimates.



Sources: Philippine Statistics Authority; and IMF staff estimates.

Core inflation has also accelerated in 2018, with core services rising more sharply than goods. Measuring the CPI change for the core consumption basket after removing selected food and energy items (largely affected by supply factors),[1] core inflation rose moderately to 3.0 percent (y/y) as of July 2018. Measured on month-to-month basis (annualized), core inflation moderated somewhat in 2018:Q2 (2.4 percent) relative to Q1 (4.8 percent) before it picked up again in July (5.5 percent). Within core inflation:

Sources: Philippines Statistics Authority; and IMF staff estimates.

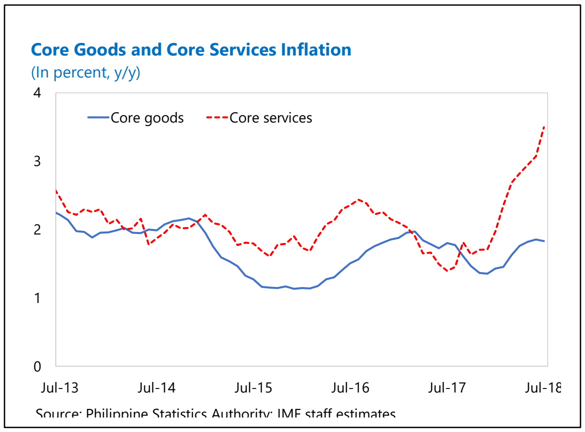
- *Core goods* experienced a moderate rise in price changes from 1.4 percent (y/y) in December 2017 to 1.8 percent (y/y) in July 2018.

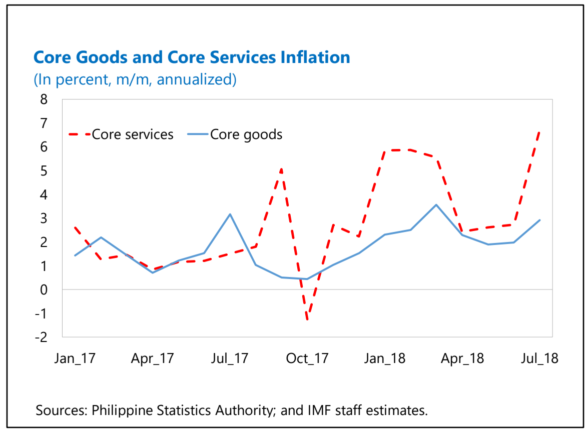
____

1/ Coverage of core goods and services items defined by staff is different from the Philippines Statistics Agency (PSA). Core basket covers 80 percent of the CPI basket (2012 weight) per PSA versus 42 percent per staff. Staff excludes items whose prices are less market-based (e.g. education services) and all food and beverage items (rather than selected food and beverage items per PSA).

Box 2. Inflation Momentum and Decomposition (Concluded)

- *Core services* inflation (as a relevant indicator for domestic demand or wage pressures) has risen more sharply in 2018 (from 1.7 percent (y/y) in Dec 2017 to 3.5 percent in July 2018 (y/y), suggesting rising inflation pressures beyond supply and external factors (i.e., import prices and exchange rate fluctuations).[2] The fastest rises appear to be in health services, restaurant, and housing prices.





In summary, higher core services inflation suggests inflationary pressures are partly driven by demand factors. It implies that inflationary pressures have spread from items directly affected by supply-side factors (such as rice and oil) to a broader spectrum of the economy. Although this trend abated somewhat in 2018:Q2 compared to 2018:Q1, its pickup in July requires continued monitoring.

2/ Core services are considered services items whose prices are more market-based (i.e., housing and catering services) and non-core services include items whose prices are less market-based (i.e., education services).

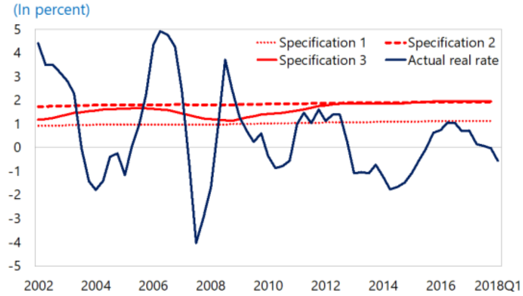
Box 3. Estimating the Neutral Real Interest Rates

To evaluate the monetary stance in the Philippines, we estimate the neutral real interest rates (NRIRs) and compare them to actual. NRIR refers to the equilibrium interest rate where output is at its potential and inflation is stable. It is unobservable and must be estimated.

Actual real interest rates in Philippines have been on a declining path since the early 2000s. Along this path, real rates experienced bouts of temporary increases while also turning negative on occasions. [1/]

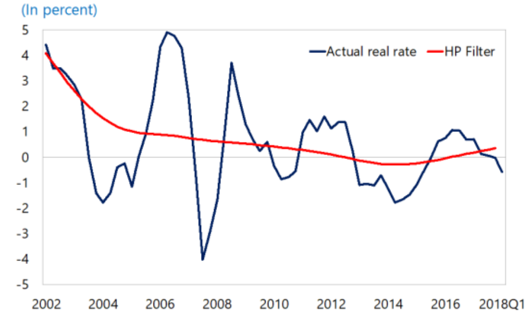
Structural-based estimates of the NRIRs have increased slightly in the past few years, falling within the 1−2 percent range.[2/] These stable or slightly increasing NRIRs are consistent with the robust potential growth in the Philippines. Estimated neutral rates above actual rates point to a monetary stance that has been broadly loose since the global financial crisis (i.e., a period of monetary stimulus). A statistically-driven approach (Hodrick- Prescott (HP) univariate filtering) points to NRIR estimates declining steadily from 4 to 0.1 percent during 2000−2017—this method treats the trend of actual rates as proxy for neutral, ignoring the possibility that actual rates can deviate from neutral for a prolonged period time. As such, staff assesses the structural-based estimates of the NRIRs to better reflect the Philippines' strong output and consumption growth conditions.

NRIR: LW Method 1/
(In percent)



Source: IMF staff estimates.
1/ Different specifications refer to differences in the starting year of the sample and the imputed elasticities of NRIRs with respect to trend growth rates.

NRIR: HP Filter Method
(In percent)



Source: IMF staff estimates.

1/ The real interest rate refers to the annualized nominal policy rates minus inflation expectations. For policy rates, we use the weighted average of various BSP policy rates (RRP, TDF, ODF). For expected inflation rates, we use data from BSP Business Expectations Survey from 2013, and actual inflation rates before 2013.

2/ See Laubach and Williams, LW, methodology (2003).

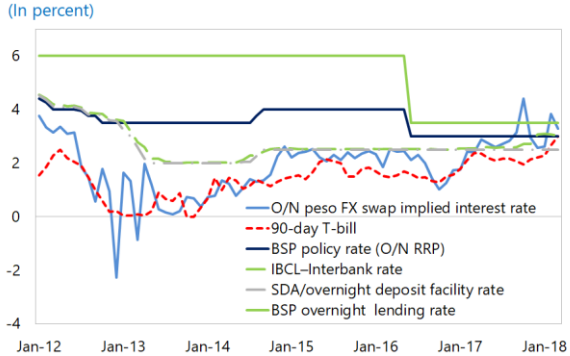
Box 4. Progress in Modernizing the Monetary Policy Framework

In 2016, the BSP adopted an interest rate corridor (IRC) system for monetary operations. The 100-basis-point-wide IRC consists of the overnight deposit and lending rates (the floor and ceiling of the IRC) and the Reverse Repurchase Facility (RRP) rate in the middle of the IRC. The system has sought to improve monetary policy transmission by better aligning money market rates with the policy rate (RRP rate), foster money market development, and encourage banks to manage liquidity more actively. Historically, the large structural excess liquidity led to interbank interest rates falling below the RRP rate, with low market activity.

In late 2017, the BSP's OMO started to push market rates into the upper half of the IRC (left text chart). The BSP absorbed liquidity using regular Term Deposit Facility (TDF). By late 2017, short-term market rates had drifted up within the BSP's IRC and very few funds remained in the BSP's overnight deposit standing facility. A reduction in structural excess liquidity reflecting a reversal of capital flows also helped push market interest rates higher. The interbank market has become more active as banks have had to more intensively manage their liquidity needs.

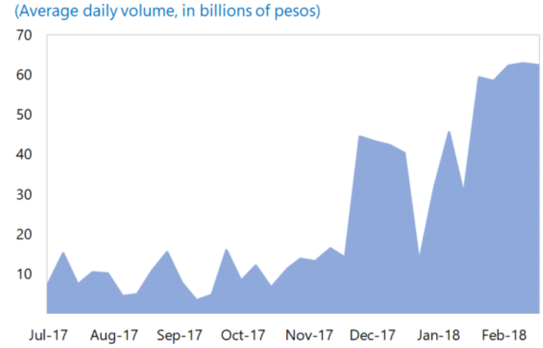
Attention is shifting towards fine-tuning of operations, in keeping market rates close to the policy rate. This entails, increasing the frequency of OMOs, catalyzing interbank market development through working with other agencies to develop the repo market, upgrading the settlement infrastructure used for repo transactions, developing more indicators of repo activities, and changing the way the BSP trade repos in its RRP facility. In shifting the policy rate from a fixed rate on the RRP operation to a target for market rates, the operating target can be specified as a combination of available market rates. The BSP could then offer its overnight RRP instrument via variable-rate auctions to boost price discovery in the repo market as it develops further. Last, reduce reserve requirements gradually, liquidity conditions permitting, and lengthen the reserves maintenance period (to 2–4 weeks).

BSP Policy and Market Rates, 2012-2018
(In percent)



Source: Bangko Sentral ng Pilipinas.

Interbank Call Loan Market Activity
(Average daily volume, in billions of pesos)



Source: Bangko Sentral ng Pilipinas.

Box 5. Digital Strategy in the Philippines

The Philippine government sees the development of its digital economy as a strategic priority. Four strategic pillars are identified to achieve the objective of transitioning to a digital economy: transparent government and efficient services delivery; internet opportunities for all people; investing in people—digital literacy for all; and ICT industry and business innovation for national development. To support these pillars, the government has also formulated a National Broadband Plan to guide the development of information infrastructure.

The National Government Portal is a key project to promote e-governance and improve government services through online platforms. The goal is to create a single online entity wherein all web-based government information is centralized, eliminating the need for maintaining multiple systems and reducing the time needed to visit government offices. The President has recently signed into law a congress-approved bill to establish a national identification system, which, once implemented, would improve service delivery through better targeting of government services. The government is also establishing an e-invoicing system to facilitate payments and tax administration.

Digitalization in the financial sector has been a major focus in improving efficiency and financial inclusion. The BSP has set an ambitious target of raising the share of electronic transactions from the present 1 percent to 20 percent by 2020. To this end, the BSP has launched two automated clearing houses under the National Retail Payments System ("PESONet" and "InstaPay"), with the latter largely aimed at SMEs and individuals to improve financial inclusion.

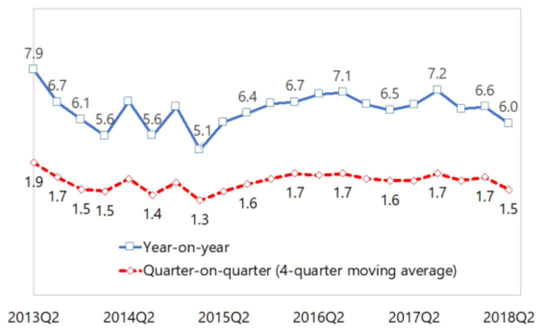
The government is working with the private sector to ensure its continued success in the digital age. Automation based on artificial intelligence is widely seen as a threat to low-skill, manual, and routine work, especially within the BPO industry. The government is working with the BPO industry to upgrade the skills of BPO workforces, focusing on training and retooling. This would support the industry's efforts to move up the value chains and remain competitive. The government has also recognized the country's weaknesses in digital infrastructure and is attempting to bring a third telecom player to break the current duopoly in the sector.

Regulatory reforms are supporting the digital economy strategy. To encourage digital innovation, the BSP has adopted a sandbox approach to regulating fintech firms. The government has also formulated a National Cybersecurity Plan and is pushing for digital literacy through training and information outreach.

Figure 1. Drivers of Growth

Growth has been strong…

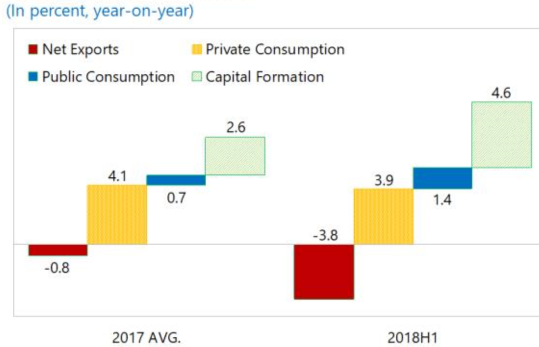
Real GDP Growth
(In percent)



Sources: Haver Analytics; and IMF staff estimates.

…driven by domestic demand and especially investment…

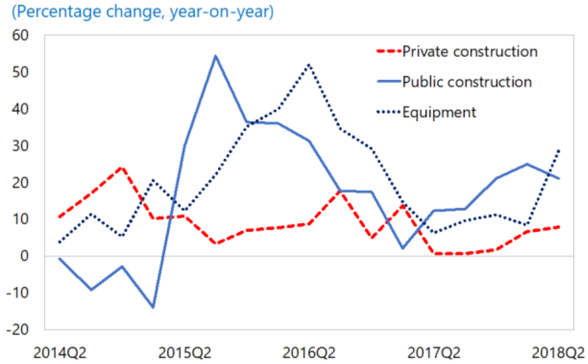
Contribution to GDP Growth
(In percent, year-on-year)



Sources: Philippine Statistics Offices; and IMF staff estimates.

…led by public construction and equipment investment.

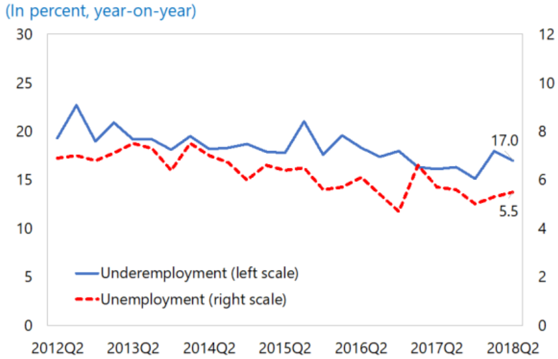
Fixed Investment
(Percentage change, year-on-year)



Sources: Haver Analytics; and IMF staff estimates.

Higher labor market participation in 2018:Q1 led to an uptick in unemployment, despite strong employment.

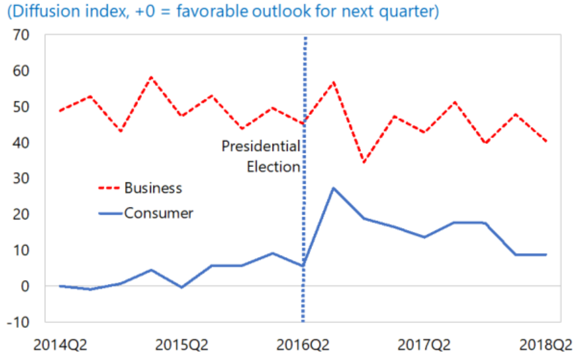
Unemployment and Underemployment Rate
(In percent, year-on-year)



Sources: Haver Analytics; and IMF staff estimates.

Business and consumer confidence remain strong, but below their post-election peaks.

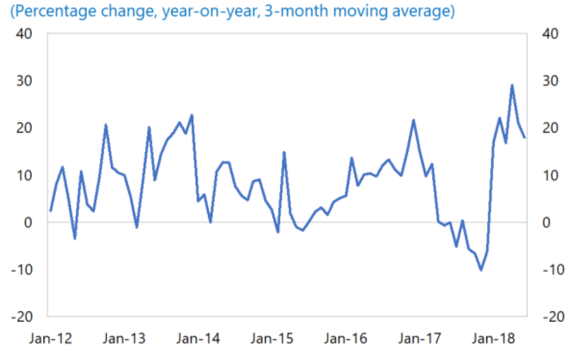
Consumer and Business Confidence Index
(Diffusion index, +0 = favorable outlook for next quarter)



Sources: Bangko Sentral ng Pilipinas; and IMF staff estimates.

Manufacturing production rebounded in 2018, following the fall in 2017 partly due to the post-election base effect.

Manufacturing Production Volume
(Percentage change, year-on-year, 3-month moving average)

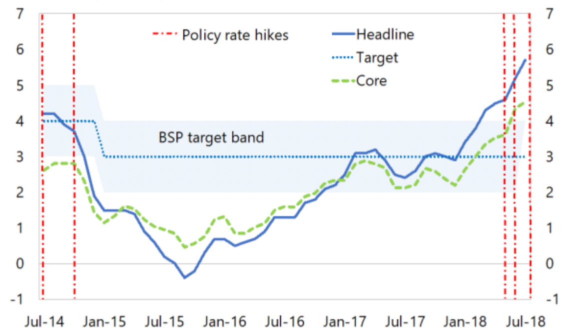


Sources: Philippine Statistics Authority; and IMF staff estimates.

Figure 2. Inflation Dynamics

Inflation has surpassed the BSP's target ceiling and the last peak in 2014…

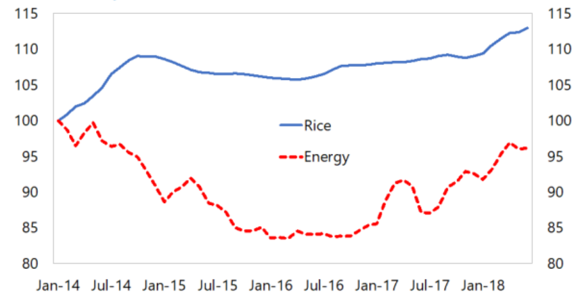
Consumer Price Inflation
(In percent, year-on-year, 2012 basket)



Sources: Bangko Sentral Ng Pilipinas; and IMF staff estimates.

…. reflecting higher rice and energy prices…

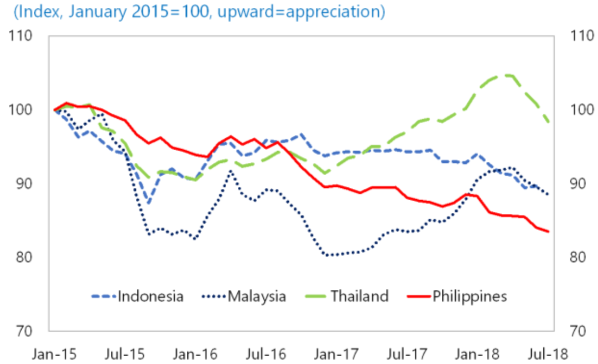
Consumer Price: Rice and Energy 1/
(Index, January 2014=100, 2012 basket)



Sources: Philippine Statistics Authority; and IMF staff estimates.
1/ The rice price before March 2018 is spliced using the 2006 basket series.

…and pass-through from depreciation.

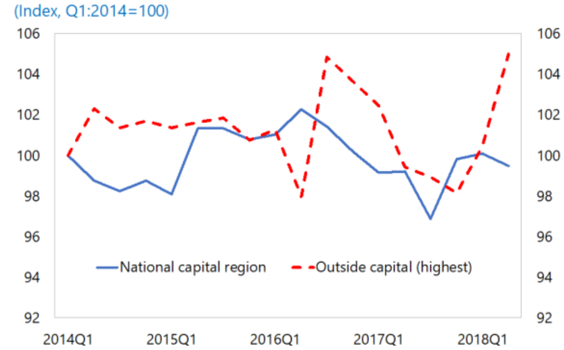
Selected Exchange Rates Against U.S. Dollar
(Index, January 2015=100, upward=appreciation)



Sources: Haver Analytics; and IMF staff estimates.

Demand-side pressures appear to be rising, especially outside the National Capital Region…

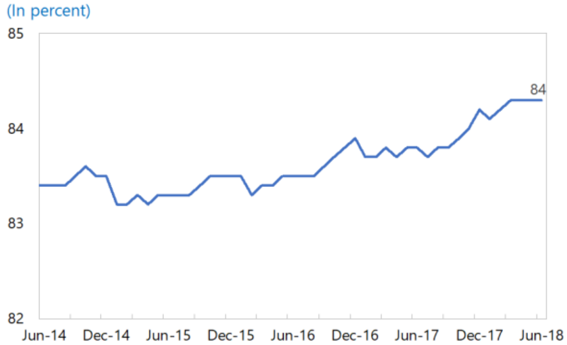
Real Non-Agriculture Daily Wage
(Index, Q1:2014=100)



Sources: Haver Analytics; and IMF staff estimates.

…and economic slack is diminishing…

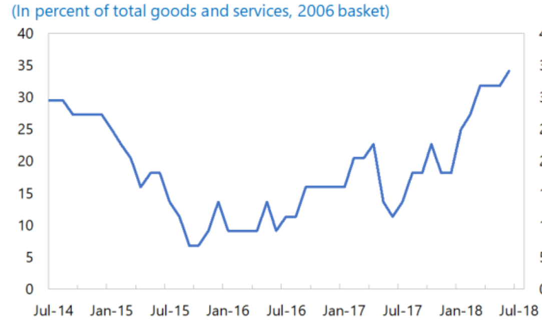
Manufacturing Capacity Utilization
(In percent)



Sources: Philippine Statistics Authority; and IMF staff estimates.

…with inflation becoming more broad-based.

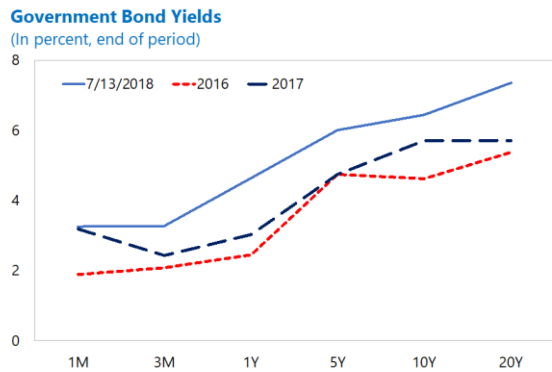
Share of Goods and Services with Over 4 Percent Inflation 1/
(In percent of total goods and services, 2006 basket)



Sources: Philippine Statistics Authority; and IMF staff estimates.
1/ Based on the 2012 basket series from March 2018 and onward.

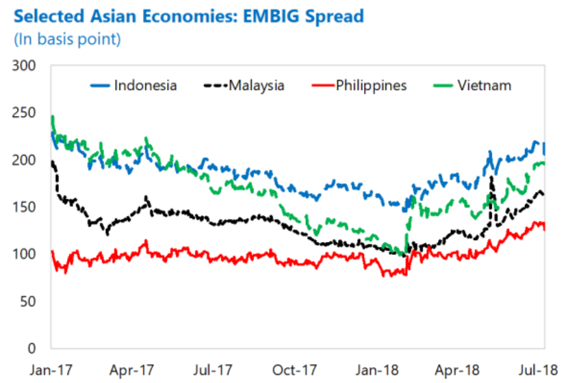
Figure 3. Monetary and Financial Conditions

The treasury yield curve has steepened in 2018…



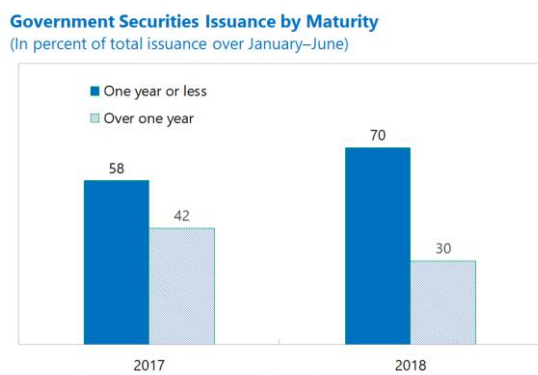
Sources: Bloomberg L.P.; and IMF staff estimates.

…accompanied by higher sovereign premium as global financial conditions have tightened.



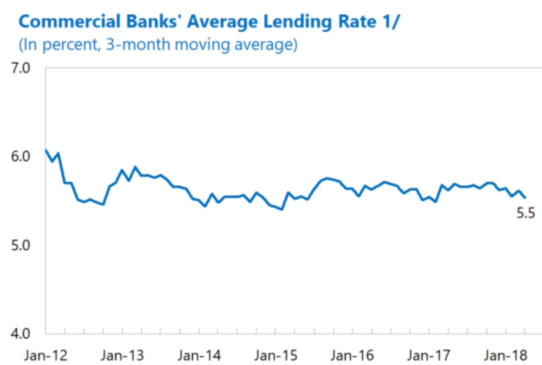
Sources: Bloomberg L.P.; and IMF staff estimates.

Government financing has shifted toward short-term debt.



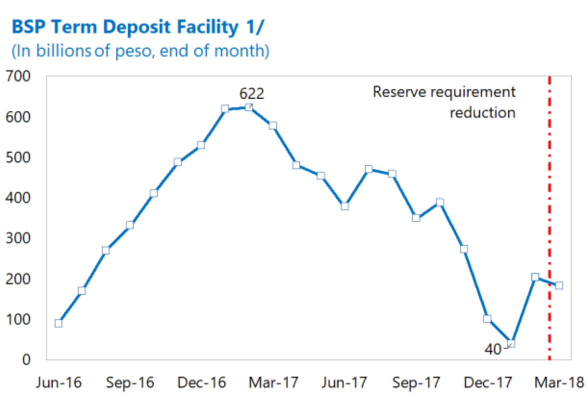
Sources: Bureau of the Treasury; and IMF staff estimates.

Bank lending rates have yet to reflect the higher market rates.



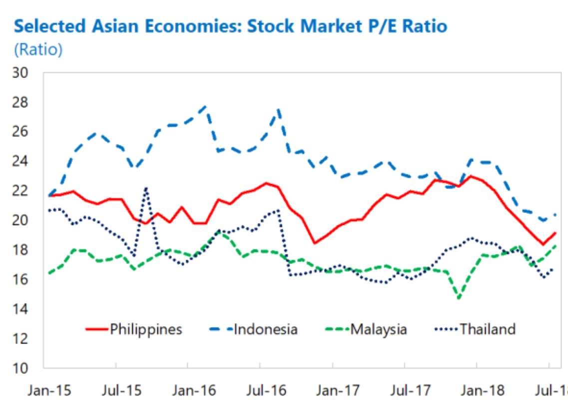
Sources: CEIC Data Co. Ltd.; and IMF staff estimates.
1/ Average of 10 commercial banks' interest income on peso-denominated loans.

The liquidity released from the reserve requirement reduction was largely absorbed by the increased TDF auctions.



Sources: Bangko Sentral ng Pilipinas; and IMF staff estimates.
1/ Variable rate, multiple-price auctions offered at seven, 14, and 28-day tenors.

Stock market valuation remains stable, although slightly higher than some countries in the region.

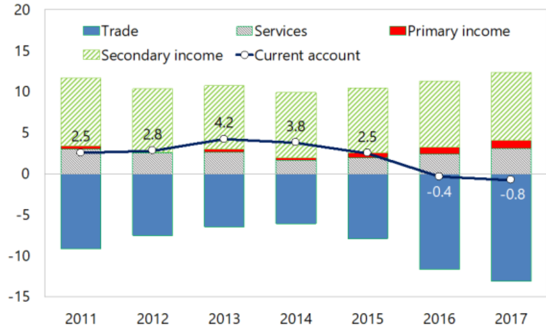


Sources: Bloomberg L.P.; and IMF staff estimates.

Figure 4. External Sector

The current account balance declined in 2017…

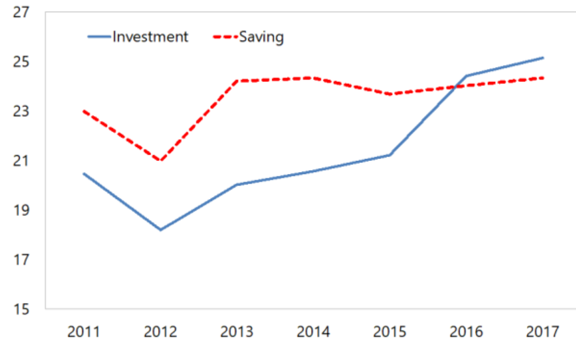
Current Account Balance
(In percent of GDP)



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

…primarily due to higher investment.

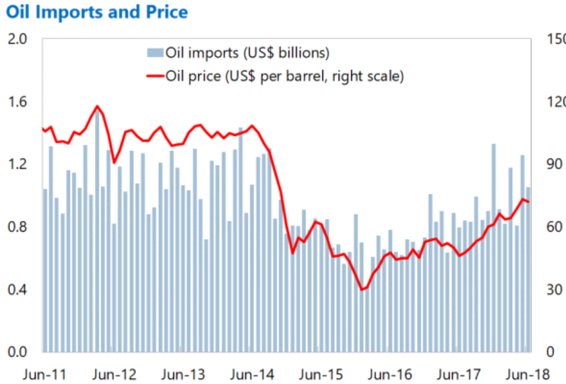
Saving and Investment
(In percent of GDP)



Source: IMF staff estimates.

and higher oil prices.

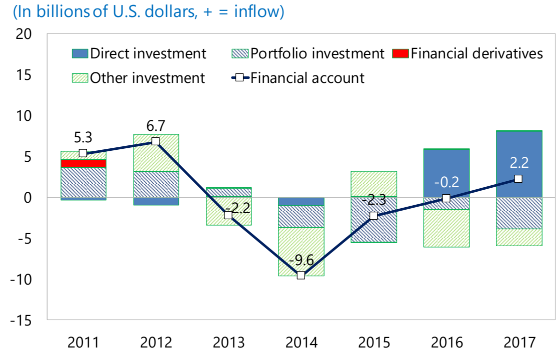
Oil Imports and Price



Sources: IMF, Commodity Price System; and CEIC Data Co. Ltd.

FDI inflows in 2017 more than offset the outflows in portfolio and other investment.

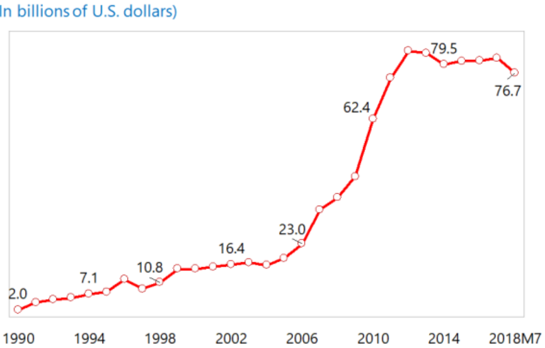
Capital Flows
(In billions of U.S. dollars, + = inflow)



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

International reserves declined…

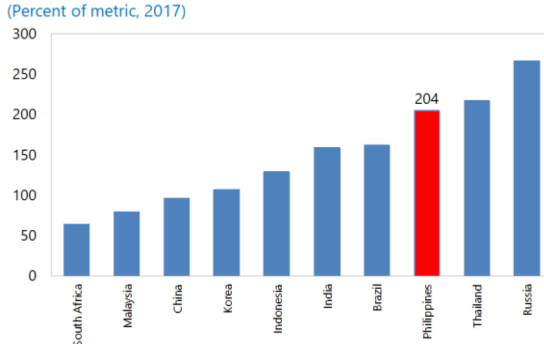
International Reserves
(In billions of U.S. dollars)



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

…but are ample.

Reserves Against IMF Adequacy Metric
(Percent of metric, 2017)

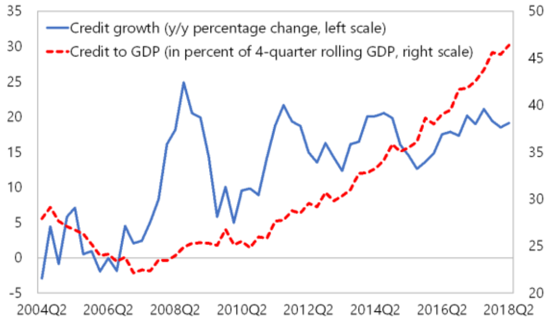


Source: IMF staff estimates.

Figure 5. Macrofinancial Linkages

Credit growth has accelerated since late 2015…

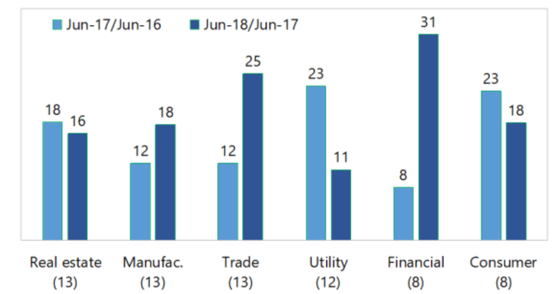
Bank Credit Growth and Credit-to-GDP Ratio 1/



Sources: CEIC Data Company Ltd; and IMF staff estimates.
1/ Loans by universal and commercial banks, net of reverse repos.

…especially in trade and financial.

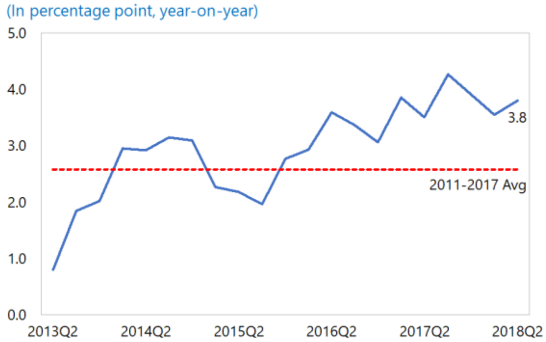
Universal and Commercial Banks: Loan By Sector 1/
(Percentage change, year-on-year)



Sources: CEIC Data Company Ltd; and IMF staff estimates.
1/ Figures in parantheses denote the share of respectives sectors in total bank loan outstanding as of end-March, 2018.

However, the pace of the credit-to-GDP increment has stayed above the post-GFC average…

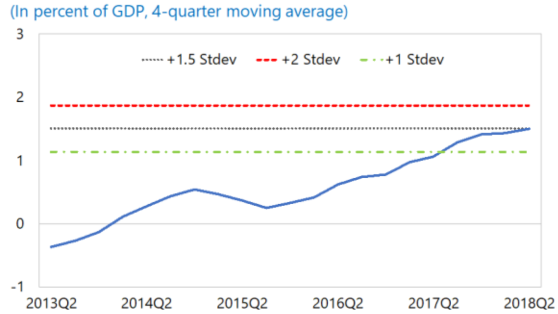
Change in Credit-to-GDP Ratio
(In percentage point, year-on-year)



Sources: Bangko Sentral ng Pilipinas; and IMF staff estimates.

…and the credit-to-GDP gap continues to rise, approaching early warning levels.

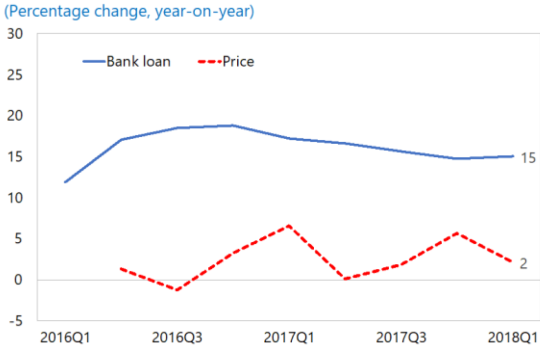
Credit-to-GDP Gap 1/
(In percent of GDP, 4-quarter moving average)



Sources: Bangko Sentral ng Pilipinas; and IMF staff estimates.
1/ Calculated using a one-sided Hodrick-Prescott filter with the smoothing parameter of 400,000. The sample gap average (2011Q1-2018Q1) is added to the thresholds.

The housing market is strong and warrants close monitoring.

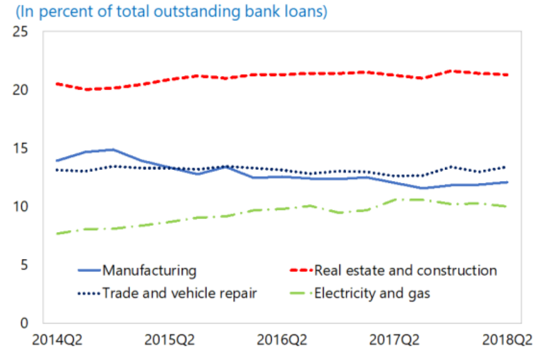
Residential Real Estate: Bank Loan and Price Growth
(Percentage change, year-on-year)



Sources: Bangko Sentral ng Pilipinas; and IMF staff estimates.

There are no evident signs of sector-specific credit boom.

Share of Corporate Loan by Sector
(In percent of total outstanding bank loans)

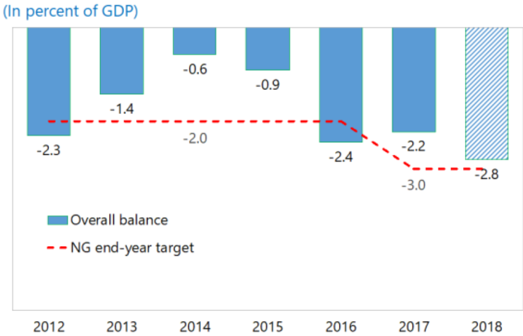


Sources: Bangko Sentral ng Pilipinas; and IMF staff estimates.

Figure 6. Fiscal Developments

The overall deficit declined in 2017 due to revenue overperformance and below-target current spending.

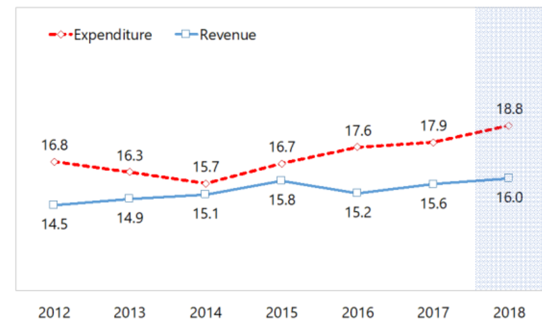
National Government: Overall Balance
(In percent of GDP)



Sources: Haver Analytics; and IMF staff estimates and projection for 2018.

Expenditure growth has outpaced revenue since 2014…

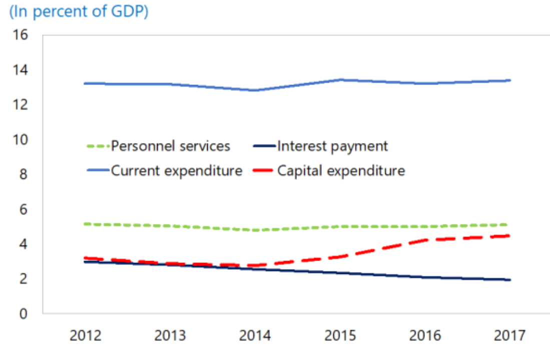
National Government: Revenue and Expenditure
(In percent of GDP)



Sources: Haver Analytics; and IMF staff estimates and projection for 2018.

…led by capital expenditure, including infrastructure.

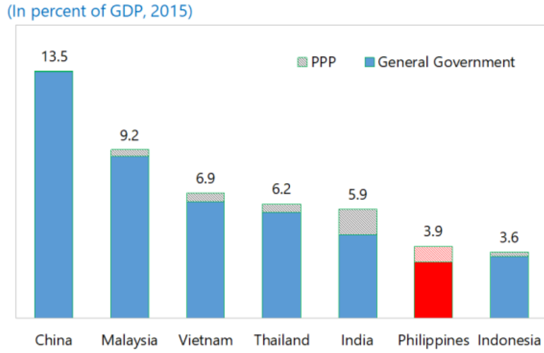
National Government: Expenditure by Type
(In percent of GDP)



Sources: Department of Budget and Management; and IMF staff estimates.

But public investment had remained low compared to Asian peers.

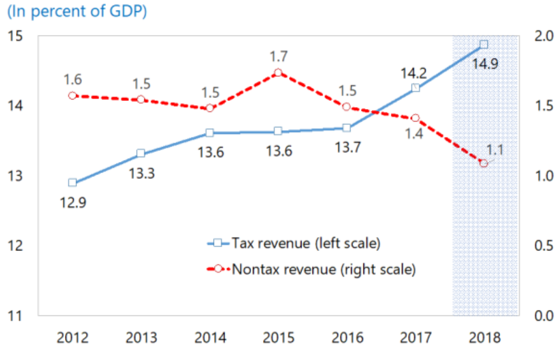
Public Investment
(In percent of GDP, 2015)



Sources: IMF Investment and Capital Stock Dataset; and IMF staff estimates.

Tax revenue is expected to rise further in 2018, partly reflecting the implementation of the TRAIN.

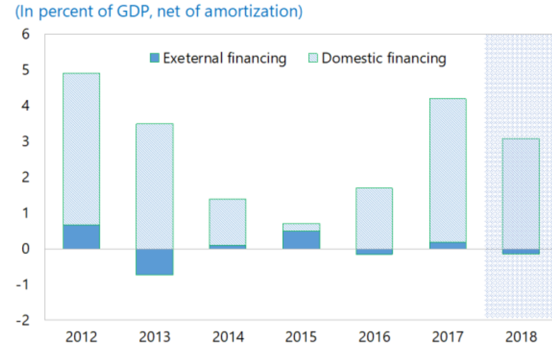
National Government: Revenue by Source
(In percent of GDP)



Sources: Department of Finance; and IMF staff estimates and projection for 2018.

Financing has mostly relied on domestic sources.

National Government: Financing by Source
(In percent of GDP, net of amortization)

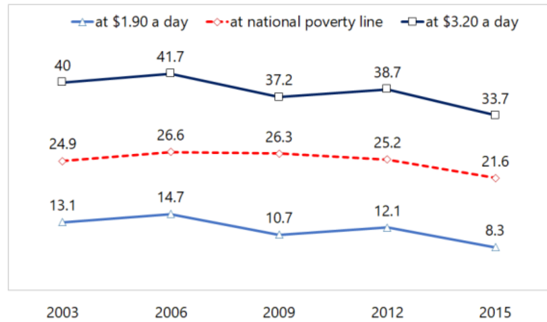


Sources: Bureau of Treasury; and IMF staff estimates and projection for 2018.

Figure 7. Poverty and Inequality

Poverty has been falling…

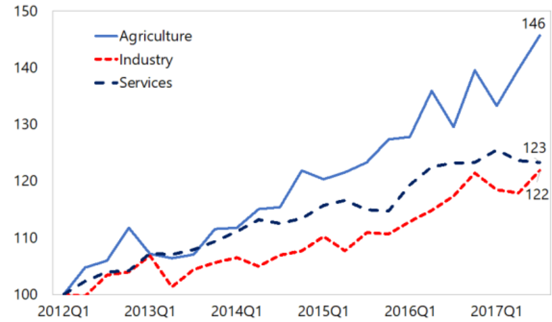
Poverty Rate
(In percent of population)



Sources: World Bank, World Development Indicators; and IMF staff estimates.

…partly due to higher agriculture wage growth in relatively poor rural areas.

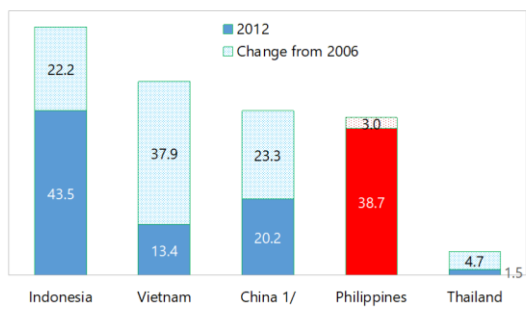
Average Daily Wage by Sector
(Index, Q1:2012=100)



Sources: Philippines Statistics Authority; and IMF staff estimates.

But poverty had remained persistently high, especially compared to Asian peers.

Poverty Rate in Selected Asian Economies: 2006–2012
(Poverty headcount ratio at $3.20 a day, 2011 PPP, in percent of population)



Sources: World Bank, World Development Indicators; and IMF staff estimates.
1/ The base year is 2005.

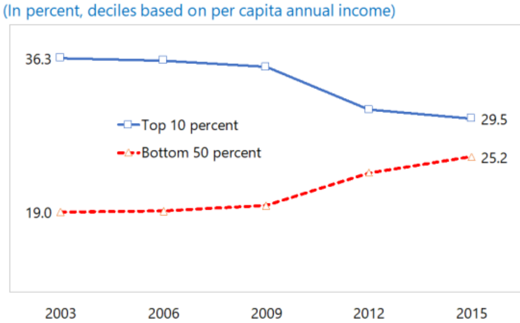
Lack of high-quality non-agriculture jobs outside the national capital region could have contributed.

Non-Agriculture Wage Outside National Capital Region 1/
(In percent of national capital region wage level, in real terms)

Sources: Bangko Sentral ng Pilipinas; and IMF staff estimates.
1/ Based on the highest wage level outside the national capital region.

Inequality has improved markedly since 2009…

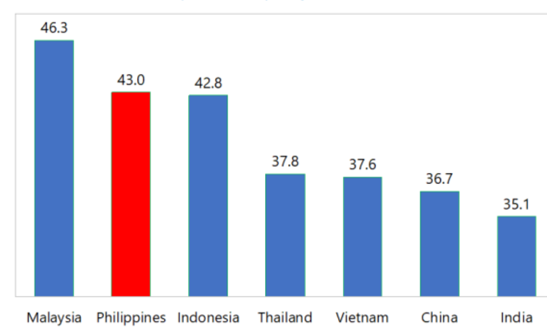
Income Share Held by Top 10 and Bottom 20 Percent
(In percent, deciles based on per capita annual income)



Sources: Philippine Statistics Authority, Family Income and Expenditure Survey; and IMF staff estimates.

…but is still high by regional standards.

Income Inequality in Selected Asian Economies
(GINI index, 2015, 100=perfect inequality)

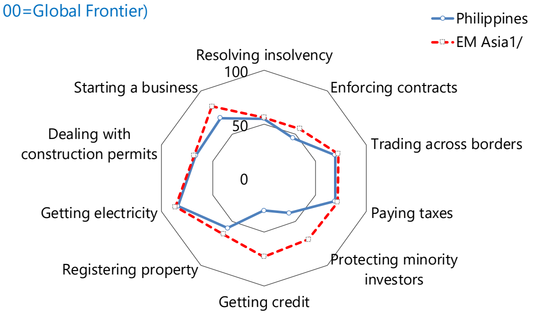


Source: IMF, FAD Income Inequality Dataset; and IMF staff estimates.

Figure 8. Business Environment 1/

The overall business environment in the Philippines has much room for improvement…

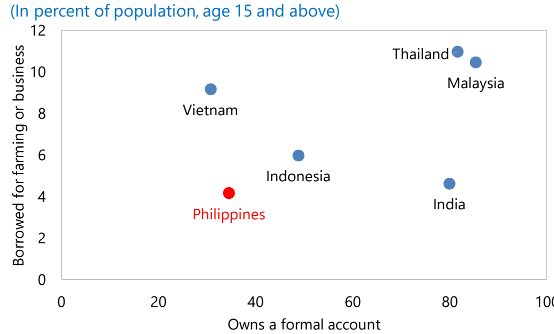
Ease of Doing Business: Distance to Frontier Score
(100=Global Frontier)



Sources: World Bank, Doing Business 2018; and IMF staff estimates.
1/ Average of India, Indonesia, Malaysia, Thailand, and Vietnam.

…including the access to financial services.

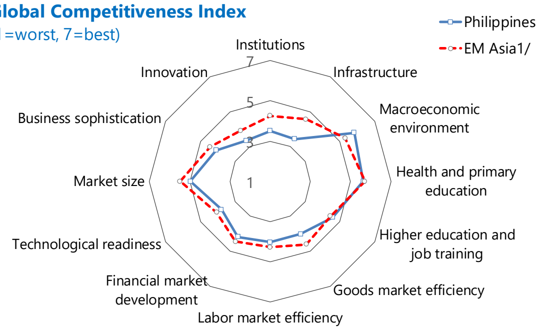
Access to Financial Services
(In percent of population, age 15 and above)



Sources: World Bank, Global Financial Inclusion Database 2017; and IMF staff estimates.

The Philippines also lags its competitors in terms of infrastructure…

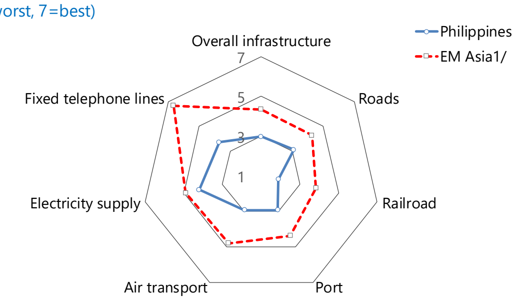
Global Competitiveness Index
(1=worst, 7=best)



Sources: World Economic Forum, Global Competitiveness Report 2017-2018 edition; and IMF staff estimates.
1/ Average of India, Indonesia, Malaysia, Thailand, and Vietnam.

Quality upgrades are needed across all sectors.

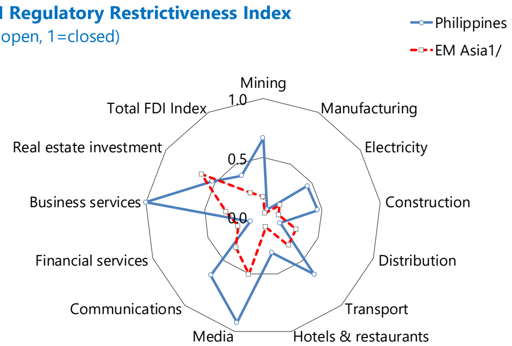
Global Competitiveness Index: Quality of Infrastructure
(1=worst, 7=best)



Sources: World Economic Forum, Global Competitiveness Report 2017-2018 edition; and IMF staff estimates.
1/ Average of India, Indonesia, Malaysia, Thailand, and Vietnam.

The regulatory barriers to FDI remain high…

FDI Regulatory Restrictiveness Index
(0=open, 1=closed)



Sources: OECD, FDI Regulatory Restrictiveness Index, 2017; and IMF staff estimates.

…as well as the impediments to cross-border trade.

Procedural Barriers to Trade
(Distance from ASEAN best practice, 0=best practice in ASEAN)

Sources: OECD, Trade Facilitation Indicators, 2017; and IMF staff estimates.

1/ The indicators above should be taken with caution and come with the following limitations: The World Bank Doing Business indicators, from which the distance to frontier scores are derived, measure de jure business regulation facing domestic small and medium-size firms, usually using the largest city to represent the economy. The World Economic Forum Global Competitiveness Index are partly based on opinion survey of business executives. The OECD FDI restrictiveness index captures stated regulatory restrictions in national documents, and the Trade Facilitation Indicators are partly based on survey data.

Table 1. Philippines: Selected Economic Indicators, 2013–19

Demographic: Population (2017): 104.9 million; Life expectancy at birth (2016): 69
Poverty (2015, percent of population): Below $1.90 a day: 8.3; Below the national poverty line: 21.6
Inequality (2015, income shares): Top 10 percent: 31.3; Bottom 20 percent: 6.6
Business environment (2017 country ranking): Ease of doing business: 113 (out of 190); Starting a business: 173 (out of 190)
IMF quota: SDR 2,042.9 million
Main products and exports: electronics, agriculture products, and business process outsourcing

	2013	2014	2015	2016	2017	2018 Proj.	2019 Proj.
	(Annual percentage change, unless otherwise indicated)						
National account							
Real GDP	7.1	6.1	6.1	6.9	6.7	6.5	6.7
Consumption	5.5	5.3	6.5	7.4	6.0	6.5	6.5
Private	5.6	5.6	6.3	7.1	5.9	5.8	5.9
Public	5.0	3.3	7.6	9.0	7.0	11.3	10.7
Gross fixed capital formation	11.8	7.2	16.9	26.1	9.5	18.6	11.7
Domestic demand	6.8	5.7	8.7	11.7	6.9	9.7	8.0
Net exports (contribution to growth)	-2.6	1.0	-3.1	-4.9	-0.8	-4.0	-2.2
Real GDP per capita	5.2	4.3	4.3	5.2	5.2	4.4	4.6
Output gap (percent, +=above potential)	0.5	0.3	-0.1	0.1	0.0	0.2	0.1
Labor market							
Unemployment rate (percent of labor force)	7.1	6.8 1/	6.3	5.4	5.7	5.5	5.4
Underemployment rate (percent of employed persons)	19.3	18.4	18.5	18.3	16.1	…	…
Employment (percent change)	0.9	0.4	2.8	4.7	-1.6	2.5	2.4
Non-agriculture daily wages (Q4/Q4) 2/	2.2	0.0	3.2	2.1	4.3	4.3	…
Price							
Consumer prices (period average, 2012 basket)	2.6	3.6	0.7	1.3	2.9	4.9	3.9
Consumer prices (end of period, 2012 basket)	3.8	1.9	0.7	2.2	2.9	5.2	3.6
Residential real estate (Q4/Q4)	…	…	…	3.3	5.7	…	…
Money and credit							
3-month PHIREF rate (percent, end of period) 3/	-0.4	1.8	2.7	2.0	3.3	4.0	…
Credit to the private sector (percent of GDP)	35.9	39.2	41.8	44.7	47.8	51.5	53.8
Credit to the private sector (percent change)	17.2	19.6	12.4	16.4	16.6	20.0	15.8
Public finances (in percent of GDP)							
National government overall balance 4/	-1.5	-0.6	-1.4	-2.4	-2.2	-2.8	-3.2
Revenue and grants	14.8	15.1	15.4	15.2	15.6	16.0	16.2
Total expenditure and net lending	16.3	15.7	16.8	17.6	17.9	18.8	19.4
General government gross debt	45.7	42.1	41.5	39.0	39.9	39.5	38.9
Balance of payments (in percent of GDP)							
Current account balance	4.2	3.8	2.5	-0.4	-0.8	-1.5	-1.5
FDI, net	0.0	0.4	0.0	-1.9	-2.6	-2.5	-2.3
Gross reserves (US$ billions)	83.2	79.5	80.7	80.7	81.6	76.3	73.9
Gross reserves (percent of short-term debt)	406.2	413.3	409.5	423.9	422.9	384.7	372.0
Total external debt	28.9	27.3	26.5	24.5	23.3	21.3	19.5
Memorandum items:							
Nominal GDP (US$ billions)	271.8	284.6	292.8	304.9	313.6	334.7	360.7
Nominal GDP per capita (US$)	2,768	2,849	2,883	2,953	2,989	3,129	3,305
GDP (in billions of pesos)	11,538	12,634	13,322	14,480	15,806	17,574	19,480
Real effective exchange rate (2005=100)	109.9	109.5	116.8	113.2	108.6	…	…
Peso per U.S. dollar (period average) 5/	42.4	44.4	45.5	47.5	50.4	53.4	…

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

1/ Estimates exclude data of the entire Region VIII.
2/ In National Capital Region. Latest observation as of June 2018.
3/ Benchmark rate for the peso floating leg of a 3-month interest rate swap. Latest observation as of July 2018.
4/ IMF definition. Excludes privatization receipts and includes deficit from restructuring of the previous Central Bank-Board of Liquidators.
5/ Latest observation as of July 2018.

Table 2. Philippines: National Government Cash Accounts, 2013–19

(In percent of GDP, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018 Proj.	2019 Proj.
Revenue and grants	14.8	15.1	15.4	15.2	15.6	16.0	16.2
Tax revenue	13.3	13.6	13.6	13.7	14.2	14.9	15.2
Net income and profits	6.2	6.2	6.4	6.4	6.5	5.6	5.6
Excises	1.3	1.3	1.4	1.4	1.7	2.7	2.9
VAT	4.2	4.4	4.2	4.2	4.4	4.8	4.7
Tariffs	0.3	0.4	0.4	0.4	0.4	0.4	0.4
Other 1/	1.3	1.2	1.2	1.2	1.2	1.5	1.5
Nontax revenue	1.5	1.5	1.7	1.5	1.4	1.1	1.0
Expenditure and net lending	16.3	15.7	16.8	17.6	17.9	18.8	19.4
Current expenditures	13.2	12.8	13.4	13.2	13.4	13.7	13.9
Personnel services	5.0	4.8	5.0	5.0	5.1	5.2	5.2
Maintenance and operations	2.5	2.4	3.0	2.9	2.9	2.9	3.0
Allotments to LGUs	2.1	2.2	2.3	2.4	2.5	2.5	2.5
Subsidies	0.6	0.6	0.6	0.7	0.8	0.8	0.8
Tax expenditure	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Interest	2.8	2.6	2.3	2.1	2.0	2.2	2.3
Capital and equity expenditure	3.0	2.8	3.3	4.3	4.5	5.1	5.5
Capital expenditure	2.9	2.8	3.3	4.2	4.5	5.1	5.5
Equity	0.1	0.0	0.0	0.1	0.0	0.0	0.0
Net lending	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Balance	-1.5	-0.6	-1.4	-2.4	-2.2	-2.8	-3.2
On the authorities' presentation 2/	-1.4	-0.6	-0.9	-2.4	-2.2	-2.8	-3.2
Financing	1.5	0.6	1.4	2.4	2.2	2.8	3.2
External financing (net)	-0.7	0.1	0.5	-0.2	0.2	-0.1	-0.1
Domestic financing (net)	3.5	1.3	0.2	1.7	4.0	3.0	3.4
Change in cash (negative=accumulation)	-1.3	-0.8	0.2	0.9	-2.0	-0.1	-0.1
Privatization	0.0	0.0	0.5	0.0	0.0	0.0	0.0
Memorandum items:							
Cyclically-adjusted primary balance 3/	1.3	1.7	1.0	-0.4	-0.3	-0.6	-0.9
Structural primary balance 3/	0.0	2.1	1.3	-0.1	-0.1	-0.5	-0.9
Gross financing requirement 4/	5.9	4.7	5.2	5.9	5.2	5.9	6.1
National government gross debt 5/	49.2	45.4	44.7	42.1	42.1	41.6	41.1
Domestic	32.4	30.2	29.2	27.2	28.1	28.3	28.9
External	16.9	15.2	15.5	14.9	14.0	13.3	12.1
GDP (in billions of pesos)	11,538	12,634	13,322	14,480	15,806	17,574	19,480

Sources: Philippine authorities; and IMF staff projections.

1/ Includes other percentage taxes, documentary stamp tax, and non-cash collections.
2/ Includes privatization receipts as revenue and excludes the operations of the Central Bank-Board of Liquidators.
3/ In percent of potential GDP. Compared to the cyclically-adjusted balance, the structural balance also controls for the effect of cyclical fluctuations
4/ Defined as the sum of deficit, amortization of medium- and long-term debt, and the stock of outstanding short-term debt.
5/ Includes national government debt held by the bond sinking fund and excludes contingent/guaranteed debt.

Table 3. Philippines: General Government Operations, 2013–19 1/

(In percent of GDP, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018 Proj.	2019 Proj.
Revenue	18.8	19.0	19.4	19.1	19.6	19.9	20.1
Taxes	14.5	14.5	14.5	14.6	15.1	15.8	16.1
Taxes on income, profits, and capital gains	6.2	6.2	6.4	6.4	6.5	5.6	5.6
Taxes on goods and services	6.6	6.6	6.6	6.6	7.1	8.4	8.6
Taxes on international trade and transactions	0.3	0.4	0.4	0.4	0.4	0.4	0.4
Taxes not elsewhere classified	1.4	1.2	1.2	1.2	1.2	1.4	1.4
Social contributions	2.1	2.2	2.4	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	2.3	2.3	2.5	2.2	2.1	1.7	1.7
Total expenditure	18.7	18.1	18.8	19.5	19.9	20.9	21.5
Expense	15.3	15.0	15.1	14.9	15.1	15.4	15.7
Compensation of employees 2/	5.0	4.8	5.0	5.0	5.1	5.2	5.2
Purchases/use of goods and services 2/	2.5	2.4	3.0	2.9	2.9	2.9	3.0
Interest 2/	2.5	2.3	2.1	1.8	1.7	1.9	2.0
Social benefits	1.9	2.1	2.2	2.2	2.4	2.5	2.6
Expense not elsewhere classified	3.4	3.4	2.8	2.9	2.9	2.9	2.9
Net acquisition of nonfinancial assets	3.3	3.1	3.7	4.6	4.9	5.4	5.8
Net lending/borrowing	0.2	0.9	0.6	-0.4	-0.4	-1.0	-1.4
Memorandum items:							
Primary balance	2.7	3.1	2.7	1.5	1.3	1.0	0.6
General government gross debt 3/	45.7	42.1	41.5	39.0	39.9	39.5	38.9
Domestic	28.9	26.9	26.0	24.1	25.9	26.1	26.8
Foreign	16.9	15.2	15.5	14.9	14.0	13.3	12.1
GDP (in billions of pesos)	11,538	12,634	13,322	14,480	15,806	17,574	19,480

Sources: Philippine authorities; and IMF staff projections.

1/ Based on GFSM2001. General government includes the national government, social security institutions (SSIs), and local government units (LGUs).

2/ National government only. The expense item related to SSIs and LGUs are not separately available and included under "Expense not elsewhere classified."

3/ Includes national government debt held by the bond sinking fund and excludes contingent/guaranteed debt.

Table 4. Philippines: Depository Corporation Survey, 2013–19 1/

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

	2013	2014	2015	2016	2017	2018 Proj.	2019 Proj.
Total							
Net foreign assets	3,575	3,752	3,999	4,309	4,403	4,620	4,765
Net domestic assets	4,479	5,304	5,890	6,897	8,083	9,448	10,986
Net claims on nonfinancial public sector	1,288	1,471	1,610	1,941	1,993	2,496	2,898
Claims on private sector	4,138	4,963	5,564	6,486	7,550	9,057	10,486
Net claims on other financial corporations	179	274	294	480	921	1,076	1,261
Broad money	8,054	9,050	9,889	11,215	12,487	14,068	15,751
National currency	6,925	7,704	8,429	9,506	10,636	11,983	13,417
Foreign currency	1,129	1,346	1,458	1,709	1,851	2,085	2,335
Bangko Sentral ng Pilipinas							
Net foreign assets	3,644	3,514	3,763	3,947	4,004	4,010	3,951
Net domestic assets	-1,713	-1,190	-1,293	-1,187	-864	-540	-47
Claims on private sector	0	0	0	0	0	0	0
Net claims on financial corporations	-1,576	-1,072	-1,065	-999	-384	-240	-21
Base money	1,926	2,324	2,467	2,758	3,137	3,467	3,901
Currency in circulation	797	930	1,005	1,124	1,267	1,401	1,576
Other depository corporations liabilities	1,128	1,387	1,456	1,632	1,867	2,064	2,322
Other liquid liabilities	5	1	3	2	3	3	3
Other depository corporations							
Net foreign assets	-69	238	236	363	400	610	813
Net domestic assets	7,477	8,096	8,853	9,919	11,034	12,272	13,611
Net claims on nonfinancial public sector	1,403	1,578	1,720	1,696	1,935	2,460	2,895
Claims on private sector	4,138	4,963	5,564	6,486	7,551	9,057	10,486
Net claims on financial corporations	3,045	2,956	3,036	3,324	3,401	3,703	3,868
Liquid liabilities	7,409	8,329	9,089	10,290	11,434	12,882	14,424
Memorandum items:							
Broad money (percent change)	28.8	12.4	9.3	13.4	11.3	12.7	12.0
Claims on private sector (percent change)	16.5	19.9	12.1	16.6	16.4	20.0	15.8
Broad money (in percent of GDP)	69.8	71.6	74.2	77.5	79.0	80.0	80.9
Claims on private sector (percent of GDP)	35.9	39.3	41.8	44.8	47.8	51.5	53.8
Nominal GDP	11,538	12,634	13,322	14,480	15,806	17,574	19,480

Sources: 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 5. Philippines: Balance of Payments, 2013–19

(In BPM6, billions of U.S. dollars, unless otherwise indicated)

	2013	2014	2015	2016	2017	2018 Proj.	2019 Proj.
Current account balance	11.4	10.8	7.3	-1.2	-2.5	-5.1	-5.3
Trade balance of goods and services	-10.6	-12.8	-17.9	-28.5	-31.7	-35.9	-37.6
Goods	-17.7	-17.3	-23.3	-35.5	-41.2	-47.9	-51.2
Exports, f.o.b.	44.5	49.8	43.2	42.7	48.2	52.6	56.6
Imports, f.o.b.	62.2	67.2	66.5	78.3	89.4	100.4	107.9
Services	7.0	4.6	5.5	7.0	9.5	12.0	13.6
Receipts	23.3	25.5	29.1	31.2	35.6	39.2	41.8
Payments	16.3	20.9	23.6	24.2	26.1	27.2	28.2
Primary income, net	1.0	0.7	1.9	2.6	3.1	3.5	3.5
Receipts from resident workers abroad	7.0	7.4	7.8	7.5	7.9	8.4	8.8
Secondary income, net	21.1	22.8	23.3	24.7	26.1	27.3	28.8
Recepits from nonresident workers remittances	19.3	20.8	21.5	23.2	24.1	25.3	26.7
Payments	0.6	0.7	0.8	0.7	0.7	0.8	0.9
Capital account	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Financial account 1/	2.2	9.6	2.3	0.2	-2.2	0.3	-3.1
Direct investment	-0.1	1.0	-0.1	-5.9	-8.1	-8.2	-8.4
Portfolio investment	-1.0	2.7	5.5	1.5	3.9	4.1	1.6
Financial derivatives	-0.1	0.0	0.0	0.0	-0.1	-0.1	-0.1
Other investment	3.4	5.9	-3.1	4.6	2.1	4.4	3.8
Errors and omissions	-4.2	-4.1	-2.4	0.3	-0.6	0.0	0.0
Overall balance	5.1	-2.9	2.6	-1.0	-0.9	-5.3	-2.2
Memorandum items:							
Nominal GDP (US$ billions)	272	285	293	305	314	335	361
Current account (percent of GDP)	4.2	3.8	2.5	-0.4	-0.8	-1.5	-1.5
Short-term debt (original maturity)	16.9	16.2	15.1	14.5	14.3	14.1	14.1
Short-term debt (residual maturity)	20.5	19.2	19.7	19.0	19.3	19.8	19.9
Gross reserves	83.2	79.5	80.7	80.7	81.6	76.3	73.9
External debt (US$ billions)	78.5	77.7	77.5	74.8	73.1	71.3	70.4
External debt (percent of GDP)	28.9	27.3	26.5	24.5	23.3	21.3	19.5

Sources: Philippine authorities; and Fund staff projections.

1/ An increase in either assets or liabilities is positive and a decrease is 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.

Table 6. Philippines: Medium-Term Outlook, 2016–23

(In percent of GDP, unless otherwise indicated)

	2016	2017	2018 Proj.	2019 Proj.	2020 Proj.	2021 Proj.	2022 Proj.	2023 Proj.
GDP and prices								
Real GDP (percent change)	6.9	6.7	6.5	6.7	6.7	6.8	6.9	6.9
CPI (percent change, annual average)	1.3	2.9	4.9	3.9	3.3	3.1	3.0	3.0
GDP by expenditure								
Consumption (percent change)	7.4	6.0	6.5	6.5	6.5	6.7	6.7	6.7
Private	7.1	5.9	5.8	5.9	6.3	6.6	6.7	6.6
Public	9.0	7.0	11.3	10.7	7.5	7.0	7.0	7.0
Gross fixed investment (percent change)	26.1	9.5	18.6	11.7	8.8	6.8	6.9	7.1
Net exports (contribution to growth)	-4.9	-0.8	-4.0	-2.2	-1.3	-0.8	-0.8	-0.8
Investment and saving								
Gross investment	24.4	25.1	27.5	28.6	29.0	29.1	29.1	29.2
Private	20.3	20.9	22.7	23.3	23.6	23.6	23.4	23.5
Public	4.1	4.2	4.8	5.2	5.4	5.5	5.6	5.7
National saving	24.0	24.3	26.0	27.1	27.8	27.8	27.8	27.8
Private	19.9	20.0	21.8	22.9	23.3	23.3	23.3	23.4
Public	4.1	4.4	4.2	4.2	4.5	4.5	4.5	4.4
Public finances								
National government balance	-2.4	-2.2	-2.8	-3.2	-3.0	-3.0	-3.0	-3.0
Total revenue	15.2	15.6	16.0	16.2	16.4	16.5	16.6	16.7
Total expenditure and net lending	17.6	17.9	18.8	19.4	19.4	19.4	19.6	19.7
General government gross debt	39.0	39.9	39.5	38.9	38.2	37.6	37.0	36.5
External sector								
Trade balance of goods and services	-9.3	-10.1	-9.2	-8.8	-8.6	-8.5	-8.2	-8.2
Current account	-0.4	-0.8	-1.5	-1.5	-1.3	-1.3	-1.3	-1.3
Reserves (US$ billions)	80.7	81.6	76.3	73.9	73.5	73.5	73.2	72.1
Reserves/short-term liabilities 1/	423.9	422.9	384.7	372.0	365.6	358.7	358.4	344.2
Total external debt	24.5	23.3	21.3	19.5	17.9	16.6	15.4	14.3
Monetary sector:								
Credit to private sector 2/	44.7	47.8	51.5	53.8	55.2	56.3	56.7	57.4
Credit to private sector (percent change) 2/	16.4	16.6	20.0	15.8	13.2	12.1	10.8	11.6

Sources: Philippine authorities; and IMF staff projections.

1/ Remaining maturity basis.

2/ Based on the depository corporations survey. In addition 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 7. Philippines: Financial Soundness Indicators, 2013–17

(In percent)

	2013	2014	2015	2016	2017
Capital adequacy					
Regulatory capital to risk-weighted assets	17.0	16.1	15.3	14.5	14.4
Regulatory Tier-1 capital to risk-weighted assets	15.2	13.5	12.8	12.6	12.7
Capital to total assets	9.7	9.9	10.0	9.7	10.0
Non-performing Loans Net of Provisions to Capital	2.4	2.9	3.1	3.0	3.1
Net open position in foreign exchange to capital	3.3	5.1	2.4	2.0	7.9
Gross asset position in financial derivatives to capital	4.5	4.6	1.7	1.8	1.6
Gross liability position in financial derivatives to capital	0.0	0.0	0.0	0.0	0.0
Asset quality					
Non-performing loans to total gross loans	2.4	2.0	1.9	1.7	1.6
Specific provisions to nonperforming loans	80.6	73.5	70.1	69.7	66.9
Earnings and profitability					
Return on assets	1.9	1.6	1.4	1.3	1.3
Return on equity	17.8	15.9	13.8	13.7	13.6
Interest margin to gross income	57.7	66.6	70.7	69.2	73.9
Trading income to gross income	21.8	8.6	5.7	8.3	4.3
Noninterest expenses to gross income	56.1	58.6	61.3	60.8	60.9
Personel expenses to noninterest expenses	35.9	36.8	37.6	36.7	36.6
Liquidity and funding					
Liquid assets to total assets	42.8	42.4	38.8	35.6	32.9
Liquid assets to short-term liabilities	67.3	64.5	60.6	54.6	51.8
Non-interbank loans to customer deposits	0.7	0.7	0.8	0.8	0.8
Sensitivity to market risk					
Foreign currency denominated loans to total loans	12.1	13.0	11.9	11.9	11.1
Foreign currency denominated liabilities to total liabilities	19.1	19.5	20.3	20.7	20.2
Real estate markets					
Residential real estate loans to total loans	7.1	7.3	7.2	7.3	7.2
Commercial real estate loans to total loans	11.5	11.6	13.9	14.3	14.1

Sources: Philippine authorities; IMF, *Financial Soundness Indicators*; and IMF staff estimates.

Table 8. Philippines: Indicators of External Vulnerability, 2013–17

(In percent of GDP, unless otherwise indicated)

	2013	2014	2015	2016	2017
External indicators (including external liquidity)					
Gross international reserves (US$ billions)	83.2	79.5	80.7	80.7	81.6
Maturing short-term debt (US$ billions)	16.9	16.2	15.1	14.5	14.3
Amortization of medium and long-term debt (US$ billions)	4.6	3.6	3.0	4.6	4.8
Net FDI inflows (in BPM6, US$ billions)	-0.1	1.0	-0.1	-5.9	-8.1
FX deposits residents (US$ billions)	26.1	32.1	32.7	36.1	39.5
Total gross external debt	28.9	27.3	26.5	24.5	23.3
Fiscal indicators:					
National government overall balance	-1.5	-0.6	-1.4	-2.4	-2.2
National government cyclically-adjusted primary balance	1.3	1.7	1.0	-0.4	-0.3
Net debt denominated in FX or linked to the exchange rate (in percent of total)	33.5	31.9	33.0	33.3	30.8
Average effective interest rate of general government debt (in percent)	6.3	6.0	5.6	5.2	5.1
Amortization of total general government debt	5.0	4.0	3.9	3.8	3.4

Sources: Philippine authorities; and IMF staff estimates.

Table 9. Philippines: 2017 Article IV Recommendations and Related Policy Actions

2017 Article IV Recommendations	Related Policy Actions
Fiscal Policy	
The authorities' planned fiscal expansion in 2017 to a 3 percent deficit and a broadly neutral stance from 2018 onwards is appropriate.	The fiscal deficit in 2017 was short of the target at 2.2 percent, reflecting revenue overperformance and spending shortfall.
Scale up public investment in infrastructure and human capital.	The national government increased infrastructure outlays from 3.4 percent of GDP in 2016 to 3.6 percent in 2017.
Reform the tax system and administration to raise additional revenue.	The first package of the Comprehensive Tax Reform Program ("TRAIN") has been implemented since January 2018, which is expected to generate about 0.5 percent of GDP additional revenue in 2018 from excise tax increases, VAT base broadening, and administrative measures. Package 2 of the tax reform has also been submitted to Congress, which aims to streamline tax incentives.
Monetary Policy	
Monitor emerging systemic risks (especially in the real estate sector) and stand ready to respond with targeted macroprudential measures.	Implemented (i) REST limits of 25 percent write-off rates on real estate and (ii) expanded reporting requirements on residential real estate prices, which helped moderate related loan growth.
The timing and pace of lowering the reserve requirement ratios (RRs) require careful calibration to keep domestic liquidity broadly unchanged.	The two reserve requirement cuts in 2018:H1 were largely sterilized by the BSP's term deposit auctions.
Stand ready to tighten the policy stance if risks of overheating emerge.	(i) The BSP continued to implement the interest rate corridor system to manage liquidity. This has resulted in a de facto increase in short-term market interest rates. (ii) The BSP raised policy rates by one percent so far in 2018.
Macroprudential Policy	
Develop capital markets to reduce bank loan concentration.	Introduced a roadmap to develop the local debt market; launched an interdealer government securities repo program and supporting regulations to expand the depth and breadth of capital markets transactions.
Macroprudential policies to address systemic risks to financial stability	The BSP is proposing the following macroprudential policies: countercyclical capital buffer; debt to earnings of borrowers test (DEBT); and borrowers' interconnectedness index (BII) to better manage credit exposures of banks and borrowers, by end-2018.
Strengthen financial stability mandate of the BSP through amendments to its charter.	The House of Representatives has approved an amendment to the BSP charter granting the authority to obtain data and information aimed at safeguarding the soundness of the banks; capitalization of the BSP; and legally protecting staff.
Structural Policy	
Lift or ease legal and administrative restrictions on inward FDI, including by shortening the Foreign Investment Negative List (FINL).	The latest FINL (11th) would be the shortest to date, leaving the restrictions on only the following industries--electricity transmission and distribution, and water and sewage system. The list has been submitted to the President for approval.
Eliminate quantitative restrictions on rice imports.	A reform bill has been submitted to Congress, which would replace the current quota-based system for rice imports with one based on tariffs (35 percent). If implemented, rice imports will be liberalized, allowing private companies to compete for importation of rice.
Promote financial inclusion	The Secured Transaction Bill has been approved by Congress. The bill aims to improve access by small and medium-sized firms by clearly specifying the set of movable assets eligible as collateral and establish a central electronic registry system for movable assets.
Reduce the costs of doing business	The Ease of Doing Business Law has been implemented since May 2018, which requires all local government units to streamline procedures and shorten the processing time for government transactions and permits to 3-20 working days depending on the complexity.

Table 10. Philippines: Comprehensive Tax Reform Program (CTRP)

CTRP Packages	Expected Revenue 1/ 2018	2019	2020	2021	2022	Implementation Status (as of Aug. 2018)
	(In percent of GDP)					
Package 1A (TRAIN)						Under implementation
Personal income tax	-0.8	-0.8	-0.8	-0.8	-0.8	
VAT base broadening	0.3	0.4	0.4	0.4	0.3	
Excise tax 2/	0.7	0.8	0.9	0.8	0.8	
Tax administration reform	0.2	0.2	0.2	0.2	0.2	
Others 3/	0.2	0.2	0.2	0.2	0.2	
Sub-total	**0.5**	**0.7**	**0.9**	**0.8**	**0.7**	
Package 1B						Pending in Congress
Motor vehicle users' charge	0.0	0.0	0.1	0.1	0.1	
Bank secrecy law relaxation	0.0	0.1	0.1	0.1	0.1	
Tax amnesty	0.0	0.1	0.0	0.0	0.0	
Sub-total	0.0	0.2	0.2	0.2	0.1	
Package 1 (=1A+1B)	**0.5**	**0.9**	**1.0**	**0.9**	**0.8**	
Package 2						Pending in Congress
CIT reduction			-0.1	-0.3	-0.4	
Tax incentive streamlining			0.1	0.3	0.4	
Package 2+						Pending in Congress
Excise tax on "sin" products 4/			0.3	0.3	0.3	
Royalty from non-mineral reservations			0.01	0.01	0.01	
Package 3						Pending in Congress
Property valuation and tax 5/						
Package 4						Submitted to Congress
Capital income tax simplification		0.1	0.1	0.0	0.0	
Total	**0.5**	**1.0**	**1.4**	**1.3**	**1.2**	
Memorandum items:						
Social Protection Expenditure						Under implementation
Cash transfer	0.1	0.2	0.2	0.0	0.0	
Transportation subsidy	0.01	0.02	0.0	0.0	0.0	

1/ For national government and based on the authorities' estimates.
2/ Includes auto, fuel, sugar-sweetened beverages, and tobacco products.
3/ Includes documentary stamp tax and other miscellaneous fees and taxes.
4/ Includes tobacco, alcohol and mining.
5/ Updating property values closer to market prices and modernizing the valuation system.

Appendix I. Risk Assessment Matrix[1/]

Source of Risk	Location of Source	Relative Likelihood	Time Horizon	Expected Impact	Direction of Impact	Inputs for Assessment 4/	Main Impacts → Recommended Policy Actions
Sharp tightening of global financial conditions 2/	External	H	ST	M – H	↓	DSGE simulation (2017 SIP)	Higher cost of financing, depreciation pass-through to inflation, weaker consumption. → Allow the exchange rate to adjust fully. Tighten fiscal policy while protecting pro-growth and pro-poor spending. Approve the new BSP charter.
Rising protectionism and retreat from multilateralism 3/	External	H	ST, MT	M	↓	Staff estimate	Slower export growth and weaker FDI inflows, resulting in reduced technology spillovers and lower growth potential. → Accelerate productivity-enhancing structural reforms and remove barriers to trade and inward FDIs (Figure 8).
Approval of the tax incentive rationalization bill	Domestic	M	MT	M – H	↑	IMF TA reports	More efficient use of fiscal resources, boost investor confidence, more level playing field for businesses. → Implement other business-friendly reforms to attract FDIs.
Excessive real estate and consumer credit growth	Domestic	M	ST, MT	M	↑	Empirical estimation (2015 SIP)	Greater inflation pressures, higher corporate leverage, weaker bank balance sheets, including higher NPLs. → Use targeted macroprudential measures and tighten monetary policy if credit growth becomes broad-based accompanied by prolonged above-target inflation.

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 ("L" (low) is meant to indicate a probability below 10 percent, "M" (medium) a probability between 10 percent and 30 percent, and "H" (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.

2/ Sharp tightening of global financial conditions causes higher debt service and refinancing risks; stress on leveraged firms, households, and vulnerable sovereigns; capital account pressures; and a broad-based downturn. Tighter financial conditions could be triggered by a sharper-than-expected increase in U.S. interest rates (prompted by higher-than-expected inflation) or the materialization of other risks.

3/ Global imbalances and fraying consensus about the benefits of globalization lead to trade wars and spreading isolationism. This threatens the global trade system, regional integration, labor mobility, as well as global and regional policy and regulatory collaboration. In the short term, increased uncertainty about growth triggered by escalating trade tensions leads to increased financial market volatility. Negative consequences for growth are, in turn, exacerbated by adverse changes in market sentiment and investment.

4/ "2017 SIP" and "2015 SIP" refer to IMF Country Report No. 17/335 and No. 15/247, respectively.

Appendix II. External Sector Assessment

Foreign Asset and Liability Position

1. *Background*. The net international investment position (NIIP) was −14 percent of GDP by end-2017, which is broadly unchanged from five years ago (−13 percent of GDP in 2013). External assets and liabilities were 54 percent and 68 percent of GDP, respectively. Reserves held by the BSP accounted for about half of the total external assets. Key components of external liabilities included FDI liabilities (25 percent of GDP) and portfolio investment (28 percent of GDP). Government external debt was about 10 percent of GDP.

2. *Assessment*. The structure of the external balance sheet, especially the large share of FDI liabilities in total external liabilities and ample reserves, entails relatively low vulnerabilities.

Current Account

3. *Background*. The current account balance has been on a declining path, from an average of 3.2 percent of GDP during 2010−2015 to −0.4 percent of GDP in 2016 and −0.8 percent of GDP in 2017. The decline is largely explained by the widening deficits for trade in goods, which ultimately reflects the higher demand from strong investment growth in recent years.

EBA Current Account Model

	In Percent of GDP
Current account	
Actual	-0.8
Cyclically adjusted	-1.0
Norm	-0.6
Gap	-0.4
Of which:	
Policy gap	-0.5
Fiscal policy	0.7
Credit growth	-0.8

Source: IMF staff estimates.

4. *Assessment*. The external position in 2017 was broadly in line with fundamentals and desirable policy settings. The CA norm estimated using the benchmark EBA model was −0.6 percent of GDP, with a standard error of 1.4 percent of GDP. Considering the standard error of EBA estimation, staff estimates a CA norm range between -2.0 and 0.8 percent of GDP. The cyclically-adjusted balance was -1.0 percent of GDP. The midpoint of the CA gap, measured by the difference between the cyclically-adjusted balance and the midpoint of the CA norm, was −0.4 percent of GDP (with a CA gap range between -1.8 and 1.0 percent of GDP). The policy gap was −0.4 percent of GDP: the positive policy gap from fiscal policy (mainly driven by the misalignment in other countries) was more than offset by the impact of the fast credit growth that brought the credit-to-GDP ratio to the level above the trend (Technical Notes 1 and 2).

Real Exchange Rate

5. *Background*. The peso depreciated by 4.1 percent in real effective terms in 2017, and by 5.7 percent in nominal effective terms. The depreciation mainly reflects the role of the floating peso as a shock absorber, given the widening CAD and the materialized and expected U.S. interest rate hikes.

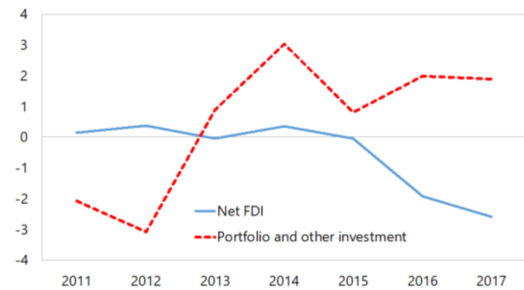
6. *Assessment*. The real effective exchange rate (REER) was broadly in line with fundamentals and desirable policy settings. Using standard trade elasticities, a CA gap between −1.8 and 1.0 percent of GDP was equivalent to a REER gap between -5 and 8 percent. The REER norms from the EBA REER-Index and REER-Level model were about 5 ppt and 11 ppt weaker than the actual REER in 2017. However, given the deviations (from norm) in the REER-Index and REER-Level models were largely driven by unexplained residuals, the overall assessment is based on the CA model.

7. The REER depreciated by 1.2 percent in the first seven months of 2018. The development does not warrant a change of assessment.

Capital and Financial Accounts

8. *Background*. Net FDI inflows increased substantially in recent years, from around zero before 2015 to 2.6 percent of GDP in 2017. Portfolio and other investments, however, registered net outflows in 2017, reflecting increasing overseas investment of residents and the portfolio rebalancing in the context of U.S. interest rates hike. Overall, the financial account balance turned negative to −0.7 percent of GDP (i.e., net inflows) from 0.1 percent of GDP in 2016.

Balance of Payments: Financial Account 1/
(In percent of GDP)



Source: Bangko Sentral ng Pilipinas.
1/ Negative (positive) values mean net inflows (outflows).

9. *Assessment*. As a small open economy, Philippines is inevitably exposed to the external shocks such as the increase in U.S. interest rates. However, given the large amount of foreign reserves and flexible exchange rate regime, the vulnerabilities are limited.

FX Intervention and Reserves Level

10. *Background*. The exchange rate is classified as floating. The value of the Philippine peso is determined in the interbank foreign exchange market. The BSP intervenes in the spot and forward markets to smooth short-term exchange rate volatilities. Intervention data is not available. Gross reserves were about US$81.6 billion (about 26 percent of GDP) at end-2017 and fell to US$76.7 billion by July 2018, largely reflecting the widening trade deficit and portfolio outflows.

11. *Assessment*. Reserves as of end-2017 were about eight months of imports, or about 204 percent of the IMF's reserve adequacy metric. Both approaches indicate that reserves level is ample. The development in 2018 does not change the assessment.

12. **Technical Note 1**. The CA norm is assessed based on the refined EBA-CA model. Compared with previous EBA vintages, it makes a few improvements in accounting for the effects of demographics and credit growth, and in data measurement. For the Philippines, the refined model yields a better fit (i.e., a smaller regression residual) and a higher CA norm than previous versions.

This is because the refined model estimates a smaller impact of productivity level and expected output growth (both factors tend to lower the Philippines' CA norm) on the current account.

13. Technical Note 2. The revised EBA-CA model uses the share of prime savers (ages 45−64) as one of the determinant variables. However, the life expectancy in Philippines (as well as in five other countries) is lower than in other countries in the sample, making this variable less valid for Philippines. A revised EBA model with special adjustment to demographic variables (redefining prime savers as population from 40 to 59) was estimated and the CA norm in 2017 was about −1.9 percent of GDP. Although the two models yield different estimates for CA norm and CA gaps, the differences do not change the overall assessment that the external position in 2017 was in line with fundamentals under desirable policy settings.

Appendix III. Public and External Debt Sustainability Analysis

The Philippines' general government gross debt remains moderate and sustainable at 40 percent of GDP as of end-2017. In the baseline scenario, the debt-to-GDP ratio is projected to decline to 36.5 percent in 2023. It is most vulnerable to a growth shock, followed by real interest rate and exchange rate shocks. External debt stands at a moderate 23.3 percent of GDP as of end-2017 and projected to fall to 14.3 percent in 2023, although vulnerable to large depreciation or current account balance deterioration.

Background and Realism of Key Assumptions

1. **Baseline projections are predicated on strong and sustained macroeconomic performance over the medium term**. Real GDP growth is projected to gradually rise to 6.9 percent per annum in 2023, with inflation returning to 3 percent as the economy's productive capacity expands. The national government deficit would reach 3 percent of GDP in 2020 and remain at this level until 2023. The 2018 current account deficit is projected to expand to 1.5 percent of GDP due to higher infrastructure-related imports and stabilize at 1.3 percent in 2023.

Debt Sustainability

2. **Public debt in the Philippines is on a gradual downward path under current policies**. Prudent fiscal management and strong growth are expected to reduce the general government gross debt-to-GDP ratio from 40 percent of GDP in 2017 to 36.5 percent in 2023. The decline would be led by significant primary budget surplus, which staff assesses as comfortably achievable based on international experience. The gross financing needs remain comfortable at around 4.0−4.5 percent of GDP in 2019−2023. The debt composition is expected to be stable with a relatively low share of foreign currency-denominated debt, in line with the authorities' debt management policy.

3. **Alternative scenarios suggest that staff's baseline is conservative by historical standards**. The historical scenario leads to faster reduction in debt and gross financing needs than in staff's baseline, reflecting the Philippines' large-scale debt consolidation since 1999 and strong GDP growth. Under the constant primary balance scenario, the gross financing needs would gradually rise to 6.4 percent of GDP in 2023 compared to 4.4 percent in the baseline, although the debt ratio would still fall more than the baseline. In response to macroeconomic shocks, the debt ratio would fail to decline to a growth shock (39.6 percent of GDP in 2023).

4. **Total external debt in the Philippines is also sustainable**. The baseline external debt-to-GDP ratio is expected to fall to 14.3 percent of GDP in 2023, from 23.3 percent in 2017. The historical scenario suggests that staff's baseline is conservative, and debt dynamics appear resilient to various shocks including to interest rates, growth, and the current account. A one-time depreciation of 30 percent in 2019 would temporarily raise the debt ratio by 9 percentage points, but still reduce it below the 2017 level by 2023.

Figure AIII.1. Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(In percent of GDP, unless otherwise indicated)

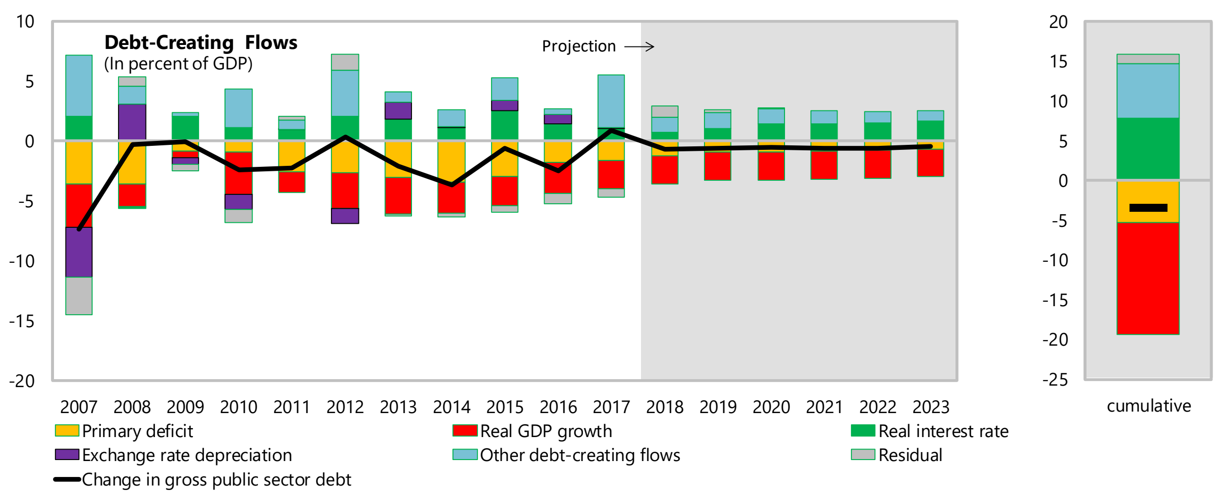
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2007-2015 [2/]	2016	2017	2018	2019	2020	2021	2022	2023
General government gross debt	47.9	39.0	39.9	39.3	38.7	38.1	37.5	36.9	36.5
General government gross financing needs	10.3	3.9	3.5	4.8	4.3	4.4	4.3	4.2	4.4
Real GDP growth (in percent)	5.5	6.9	6.7	6.5	6.7	6.7	6.8	6.9	6.9
Inflation (GDP deflator, in percent)	3.1	1.7	2.3	4.4	3.9	3.3	3.1	3.0	3.0
Nominal GDP growth (in percent)	8.8	8.7	9.2	11.2	10.8	10.3	10.0	10.1	10.1
Effective interest rate (in percent) [4/]	6.7	5.5	5.5	6.6	7.1	7.7	7.5	7.6	8.2
General government net debt [5/]	41.2	34.6	36.6	36.1	35.6	35.0	34.4	33.8	33.3

As of August 10, 2018		
Sovereign Spreads		
EMBIG (bp) 3/		109
5Y CDS (bp)		78
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BBB	BBB
Fitch	BBB	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2007-2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing primary balance [10/]
Change in general government gross debt	-2.0	-2.5	0.9	-0.7	-0.6	-0.5	-0.6	-0.6	-0.4	-3.4	
Identified debt-creating flows	-1.6	-1.6	1.5	-1.6	-0.8	-0.6	-0.6	-0.6	-0.4	-4.7	
Primary deficit	-2.6	-1.7	-1.6	-1.2	-0.9	-0.9	-0.9	-0.8	-0.6	-5.3	0.2
Primary (noninterest) revenue and grants	18.3	19.1	19.6	19.9	20.1	20.3	20.4	20.5	20.6	121.9	
Primary (noninterest) expenditure	15.7	17.4	17.9	18.7	19.3	19.4	19.5	19.8	20.0	116.6	
Automatic debt dynamics [6/]	-1.2	-0.4	-1.3	-1.6	-1.3	-0.9	-0.9	-0.9	-0.6	-6.2	
Interest rate/growth differential [7/]	-1.0	-1.2	-1.3	-1.6	-1.3	-0.9	-0.9	-0.9	-0.6	-6.2	
Of which: real interest rate	1.5	1.4	1.1	0.7	1.0	1.5	1.4	1.5	1.7	7.8	
Of which: real GDP growth	-2.5	-2.6	-2.4	-2.3	-2.4	-2.4	-2.3	-2.4	-2.3	-14.1	
Exchange rate depreciation [8/]	-0.2	0.8	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	2.1	0.5	4.4	1.3	1.4	1.2	1.1	1.0	0.8	6.9	
Privatization proceeds (negative)	0.2	0.4	0.0	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	0.1	4.4	1.3	1.4	1.2	1.1	1.0	0.8	6.9	
Residual, including asset changes [9/]	-0.4	-0.8	-0.7	0.9	0.2	0.1	0.0	0.0	0.0	1.2	



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 $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ 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 $r - \pi (1+g)$ and the real growth contribution as $-g$.

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

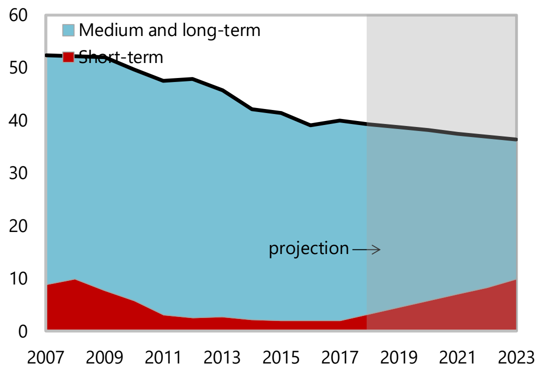
9/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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.

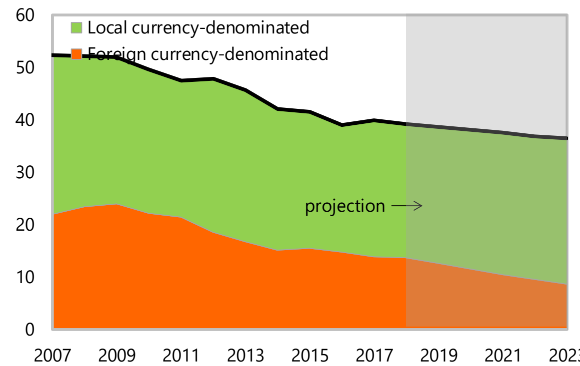
Figure AIII.2. Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of General Government Gross Debt

By Maturity
(in percent of GDP)



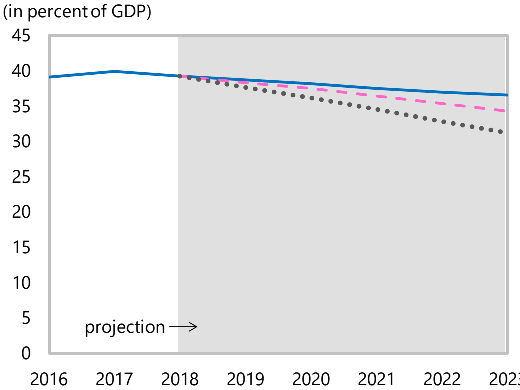
By Currency
(in percent of GDP)



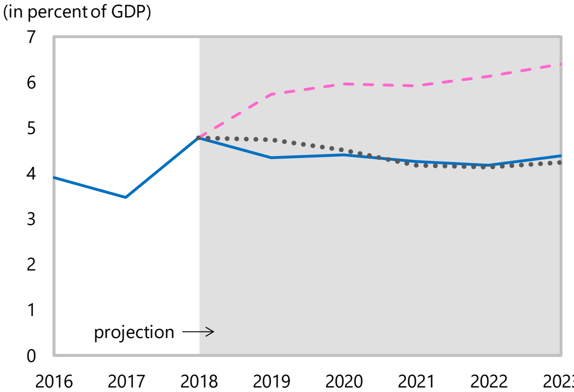
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

General Government Gross Debt
(in percent of GDP)



General Government Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

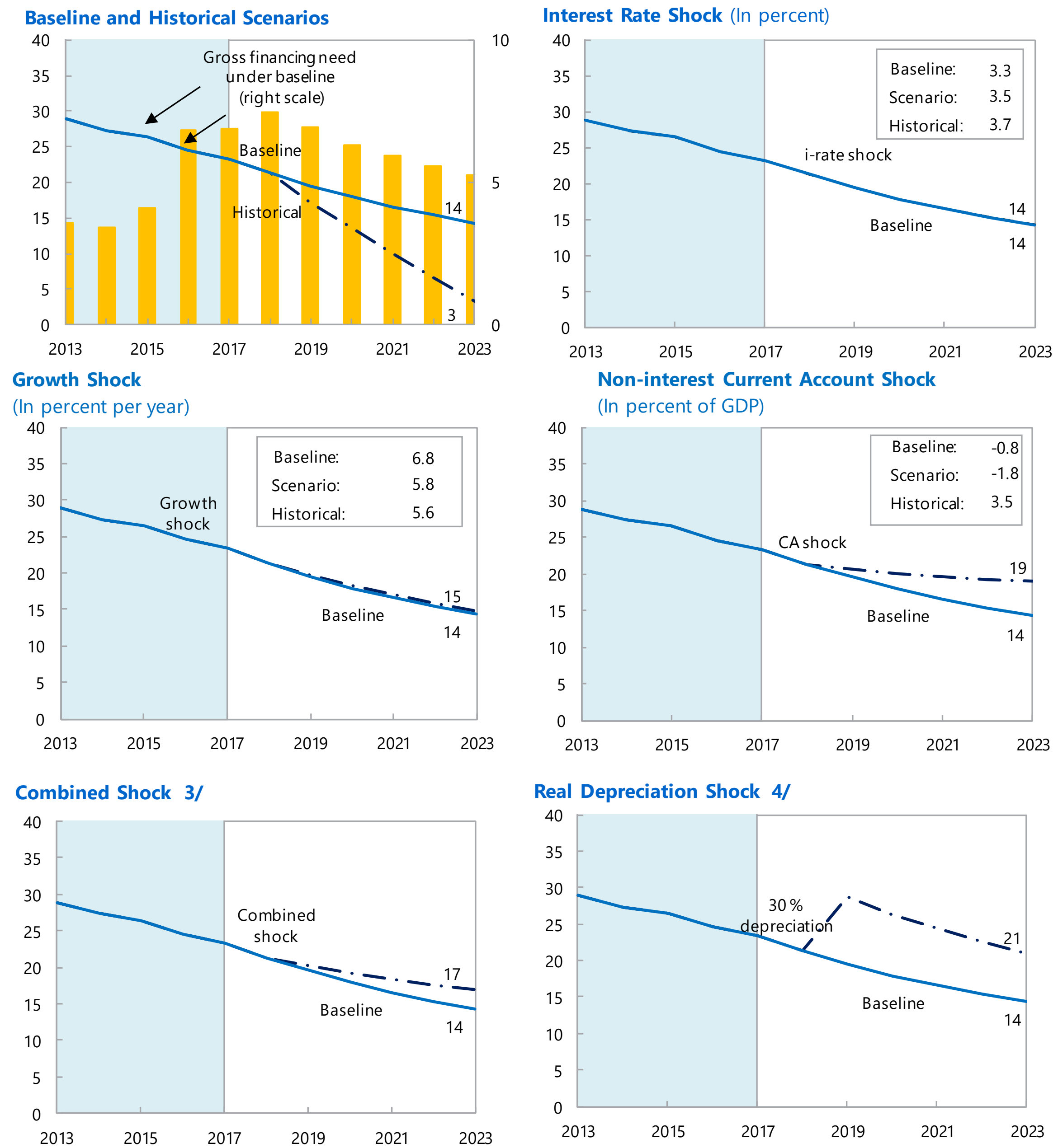
Baseline Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	6.5	6.7	6.7	6.8	6.9	6.9
Inflation	4.4	3.9	3.3	3.1	3.0	3.0
Primary Balance	1.2	0.9	0.9	0.9	0.8	0.6
Effective interest rate	6.6	7.1	7.7	7.5	7.6	8.2
Constant Primary Balance Scenario						
Real GDP growth	6.5	6.7	6.7	6.8	6.9	6.9
Inflation	4.4	3.9	3.3	3.1	3.0	3.0
Primary Balance	1.2	1.2	1.2	1.2	1.2	1.2
Effective interest rate	6.6	7.1	7.7	7.4	7.5	8.2

Historical Scenario	2018	2019	2020	2021	2022	2023
Real GDP growth	6.5	5.6	5.6	5.6	5.6	5.6
Inflation	4.4	3.9	3.3	3.1	3.0	3.0
Primary Balance	1.2	2.3	2.3	2.3	2.3	2.3
Effective interest rate	6.6	7.1	7.7	7.4	7.5	8.2

Source: IMF staff.

Figure AIII.3. External Debt Sustainability: Bound Test 1/ 2/

(External debt, in percent of GDP)



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

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

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five 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 2010.

Table AIII.1. Philippines: External Debt Sustainability Framework, 2013–2023

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2013	2014	2015	2016	2017			2018	2019	2020	2021	2022	2023	Debt-stabilizing non-interest current account 6/
1 Baseline: External debt	28.9	27.3	26.5	24.5	23.3			21.3	19.5	17.9	16.6	15.4	14.3	-2.6
2 Change in external debt	-3.1	-1.6	-0.8	-1.9	-1.2			-2.0	-1.8	-1.6	-1.3	-1.3	-1.1	
3 Identified external debt-creating flows (4+8+9)	-6.8	-5.1	-3.0	-2.6	-2.6			-2.2	-2.1	-2.1	-1.9	-1.7	-1.4	
4 Current account deficit, excluding interest payments	-5.3	-4.8	-3.4	-0.5	0.0			0.8	0.8	0.7	0.7	0.8	0.9	
5 Deficit in balance of goods and services	3.9	4.5	6.1	9.3	10.1			10.7	10.4	10.0	9.8	9.5	9.1	
6 Exports	25.0	26.5	24.7	24.3	26.7			27.4	27.3	27.1	26.9	26.6	26.6	
7 Imports	28.9	30.9	30.8	33.6	36.8			38.1	37.7	37.1	36.7	36.1	35.7	
8 Net non-debt creating capital inflows (negative)	0.0	-0.1	0.2	-2.0	-2.7			-2.2	-2.3	-2.2	-2.0	-1.9	-1.7	
9 Automatic debt dynamics 1/	-1.5	-0.3	0.1	-0.2	0.1			-0.7	-0.7	-0.6	-0.6	-0.5	-0.5	
10 Contribution from nominal interest rate	1.1	1.0	0.9	0.8	0.8			0.7	0.7	0.6	0.5	0.5	0.5	
11 Contribution from real GDP growth	-2.1	-1.7	-1.6	-1.7	-1.6			-1.4	-1.3	-1.2	-1.1	-1.0	-1.0	
12 Contribution from price and exchange rate changes 2/	-0.5	0.4	0.8	0.7	0.9			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	3.7	3.6	2.2	0.7	1.4			0.1	0.3	0.5	0.6	0.4	0.3	
External debt-to-exports ratio (in percent)	115.7	103.1	107.2	101.1	87.2			77.7	71.5	66.1	61.8	57.8	53.7	
Gross external financing need (in billions of US dollars) 4/	9.7	9.7	12.0	20.9	21.6			25.1	25.1	24.9	25.5	26.4	27.4	
in percent of GDP	3.6	3.4	4.1	6.9	6.9			7.5	7.0	6.3	5.9	5.6	5.3	
Scenario with key variables at their historical averages 5/								21.3	17.1	13.5	10.0	6.7	3.3	-0.6
Key Macroeconomic Assumptions Underlying Baseline						10-Year Historical Average	10-Year Standard Deviation							
Real GDP growth (in percent)	7.1	6.1	6.1	6.9	6.7	5.6	2.0	6.5	6.7	6.7	6.8	6.9	6.9	
GDP deflator in US dollars (change in percent)	1.5	-1.4	-3.0	-2.6	-3.6	2.2	6.0	0.2	1.0	2.4	2.1	3.0	3.0	
Nominal external interest rate (in percent)	3.7	3.5	3.3	3.3	3.4	3.7	0.4	3.4	3.4	3.3	3.3	3.3	3.2	
Growth of exports (US dollar terms, in percent)	1.5	11.0	-4.1	2.3	13.3	6.6	10.5	9.4	7.4	8.5	8.2	8.9	10.1	
Growth of imports (US dollar terms, in percent)	-1.4	12.2	2.3	13.7	12.7	8.5	12.3	10.5	6.7	7.5	7.8	8.3	8.9	
Current account balance, excluding interest payments	5.3	4.8	3.4	0.5	0.0	3.5	2.1	-0.8	-0.8	-0.7	-0.7	-0.8	-0.9	
Net non-debt creating capital inflows	0.0	0.1	-0.2	2.0	2.7	0.4	1.1	2.2	2.3	2.2	2.0	1.9	1.7	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

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

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

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

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

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

INTERNATIONAL MONETARY FUND

PHILIPPINES

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

August 28, 2018

Prepared By | Asia and Pacific Department

CONTENTS

FUND RELATIONS

(As of July 31, 2018)

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)	1,731.10	84.74
Reserve tranche position	311.83	15.26
Lending to the Fund New Arrangements to Borrow	35.82	

SDR Department

	SDR Millions	Percent of Allocation
Net cumulative allocation	837.96	100.00
Holdings	849.35	101.36

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 2017 Article IV consultation was held on October 26, 2017 (IMF Country Report No. 17/334).

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.

Capacity Development

The Philippines is an intensive user of IMF capacity development (CD) assistance, particularly in fiscal and monetary and financial areas. The authorities have shown strong ownership and absorbed Fund CD well. They have made great strides in modernizing their legal, regulatory, and operational frameworks, as demonstrated by, among others, the ongoing tax reform, a strengthened supervision framework, and the introduction of an interest rate corridor (IRC) system. The Fund has responded to the authorities' efforts favorably and provided considerable assistance, making the Philippines one of the largest recipients of Fund CD resources among emerging markets.

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. An MCM TA mission on capital account liberalization and foreign exchange market development took place during September-October 2017, which provided recommendations on reforms to facilitate the safe liberalization of capital flows, decrease market segmentation and promote market development.

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 has been the Resident Representative for the Philippines since September 2017.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

- World Bank: http://financesapp.worldbank.org/en/countries/Philippines/.
- Asian Development Bank: https://www.adb.org/sites/default/files/publication/27790/phi-2017.pdf.

STATISTICAL ISSUES

(As of August 20, 2018)

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 efforts are underway to rebase the national accounts from 2000 to 2012 and fully implement the *System of National Accounts, 2008. This is expected to be released in the near future. The authorities have made strides to improve the quality of the data*. Work is underway to improve (i) the accuracy of the GDP volume measures; (ii) the coverage of the public corporations sector; (iii) the accuracy of the quarterly GDP data; and (iv) the adoption of benchmark techniques to reconcile quarterly and annual national accounts estimates. The NSCB is currently participating in the IMF Statistics Department's *Project on the Implementation of the System of National Accounts and the International Comparison Program,* funded by the Government of Japan. This three-year technical assistance project provides assistance to improve the quality of the national accounts and price statistics. **Price statistics**: In March 2018, the National Statistics Office introduced a rebased consumer price index (CPI). The updated CPI is compiled using weights based on the 2012 Family Income and Expenditure Survey. Data from the 2013 Commodity and Outlet Survey were used to augment the provincial market baskets. One important methodological change implemented in the updated CPI is the use of the "chained" method. This method allows for timely addition of new items to the basket and the exclusion of any obsolete commodities. The CPI data is classified according to the internationally recommended *Classification of Individual Consumption by Purpose (COICOP)* for the classification of all items.	
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: The authorities report monthly monetary statistics for the central bank with a lag of more than one-month and other depository corporations with a lag of more than two months, using the standardized report forms for publication in the *International Financial Statistics*. The authorities are in the process of improving the timeliness of monthly statistics for the central bank, the most recent data was submitted with a one-month lag. A joint effort between the Insurance Commission, SEC, GOCs, BSP to gather data and publish the Other Financial Corporations (OFCs) Survey is ongoing. A monetary and financial statistics mission is planned for FY19 to advance work on OFCs data. **Financial Soundness Indicators**: The authorities report all 12 core financial soundness indicators (FSIs), 9 of the 13 encouraged FSIs for deposit takers, and 2 FSIs for real estate markets—on a quarterly basis—for posting on the IMF's FSI website with one quarter lag.	
Government finance statistics: Provision of fiscal data is broadly adequate for surveillance. Philippines report data for the budgetary central government in the GFSM 2014 format. Major areas for improvement include expanding the sector coverage beyond the budgetary central government and reporting of financial balance sheet.	
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 14, 2018)

	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	8/14/2018	8/14/2018	D	D	D	O	O
International reserve assets and reserve liabilities of the monetary authorities[1]	7/2018	8/2018	M	M	M	LO	LO
Reserve/base money	6/8/2018	7/2/2018	D	W	W	O, LO, LO, LNO	LO, O, O, O, LO
Broad money	6/2018	8/2018	M	M	M		
Central bank balance sheet	7/2018	8/2018	M	M	M		
Consolidated balance sheet of the banking system[2]	6/2018	8/2018	M	M	M		
Interest rates[3]	8/14/2018	8/14/2018	D	D	D	O	O
Consumer price index	7/2018	8/2018	M	M	M	O, O, O, O	O, LO, O, LO, LO
Revenue, expenditure, balance and composition of financing[4]—general government[4]	6/2018	8/2018	Q	Q	Q	LO, LO, O, O	LO, LO, LO, LO, LO
Revenue, expenditure, balance and composition of financing[4]—central government	6/2018	8/2018	M	M	M		
Stocks of central government and central government-guaranteed debt[5]	6/2018	8/2018	M	M	M	LNO	LNO
External current account balance	3/2018	6/2018	M	M	M	O, LO, LO, LO	LNO, LO, O, LO, LO
Exports and imports of goods and services	3/2018	6/2018	M	M	M		
GDP/GNP	Q2:2018	8/2018	Q	Q	Q	LO, LO, O, LO	LNO, LNO, O, LO, O
Gross external debt	Q1:2018	6/2018	Q	Q	Q	O	O
International investment position[6]	Q1:2018	6/2018	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 banks, and domestic nonbank financing
[3]. Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7]Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).
[8] Reflects the assessment provided in the data ROSC or the Substantive Update (published on August 25, 2004 and based on the findings of the mission that took place during September 1–16, 2003) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, sc classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[9] Same as footnote 8, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation intermediate data and statistical outputs, and revision studies.

Statement by IMF Staff Representative on Philippines
September 17, 2018

The information below has become available following the issuance of the staff report. It does not alter the thrust of the staff appraisal.

1. Headline CPI inflation picked up to 6.4 percent (y/y) in August from 5.7 percent in July, which brings the year-to-date average to 4.8 percent (y/y). Core CPI inflation rose to 4.8 percent (y/y) in August from 4.5 percent in July, resulting in a 3.7 percent (y/y) year-to-date average.

2. Since end-July, the peso has depreciated by 1.8 percent against the U.S. dollar, equity prices fell by 1.0 percent, and the 10-year government bond yield rose by 93 basis points. On a year-to-date basis, the peso has depreciated by 7.8 percent, equity prices fell by 12.9 percent, and the 10-year government bond yield rose by 177 basis points.

3. Gross international reserves increased from US$76.7 billion at end-July to US$77.8 billion at end-August.

Statement by Ms. Edna C. Villa, Alternate Executive Director
September 17, 2018

The Philippine Authorities wish to thank the IMF team, led by Mr. Luis Breuer, for their continued candid and constructive engagement. The Authorities were encouraged by the generally positive assessment of the Philippine domestic conditions, and took note of the variance in views, particularly on the risk of overheating as well as the appropriate timing of policy adjustments. The Authorities welcomed the analytical work presented by staff, including on the effects of the new Comprehensive Tax Reform Package and its first tranche, the Tax Reform for Acceleration and Inclusion (TRAIN-1); and the disaggregation of supply side and demand side inflation impulses. The Authorities will thoughtfully consider these as they refine policies, particularly in light of heightened global economic and financial uncertainty.

Recent Macroeconomic Developments

Supported by sound macroeconomic policies, the Philippines continues to be one of Asia's best performing economies. Real GDP grew 6.7 percent in 2017 and 6.3 percent in H12018, bringing to 78 the number of consecutive quarters of positive economic growth. On the demand side, growth has increasingly been fueled by investments, while private and public consumption have been sustained. On the supply side, strong manufacturing and construction have been key growth drivers.

Fiscal performance has been strong. Revenues exceeded target by 8.1 percent in H12018, which provided space for expenditures to meet the target. Revenues generated from the recently implemented tax reform measures under TRAIN-1 exceeded projections by nearly 12 percent.

Inflation for the first eight months of the year averaged 4.8 percent (yoy), which is above the government's announced target range of 2-4 percent for the year. The *main* drivers of overall inflation are still supply side factors, relating to rising international oil prices, higher excise taxes, and weather-related supply disruptions. The Authorities have undertaken immediate measures to mitigate supply bottlenecks for rice and key products. In parallel, they are escalating reforms (such as the rice tariffication bill) to address medium-term supply-related issues.

While the peso has depreciated 6.6 percent in the first eight months of the year, it has maintained its external price competitiveness against baskets of currencies of trading partners. The recent movements in the currency have been influenced by shifts in market sentiment linked in turn to external developments, including those from tighter global financial conditions and market volatility in emerging markets, as well as the impending interest rate hikes by the Fed. At the same time, the depreciation of the peso appears to be driven mainly by the increase in dollar requirements due to the following fundamental factors: (1) sustained rise in the demand for imported goods (such as capital goods; intermediate and raw materials; and consumer goods); (2) residents' increasing direct and portfolio investments abroad; and (3) debt prepayments by the government and private corporations including payments of inter-company loans. Despite their consequent pressures on the local currency, the BSP welcomes these developments as they are indicative of robust economic expansion. Nonetheless, the peso is expected to remain broadly stable on account of the country's sound macroeconomic fundamentals – including robust GDP growth, strong and resilient banking system, and prudent fiscal position. Gross international reserves (GIR) at end August 2018 stood at US$77.8 billion, adequate for more than 7.5 months' import cover. The GIR will continue to be funded by steady BPO revenues and overseas workers' remittances.

The positive economic story in the Philippines is also underpinned by a stable and well-functioning banking system. Total assets of the banking system have continued to grow. System balance sheets remain strong, with CAR above regulatory standards and international norms at 14.5 percent on a solo basis and 15.1 percent on a consolidated basis. NPLs at end June 2018 stood at 1.3 percent, remaining well below the pre-GFC level of 4 percent. Credit growth at 19.6 percent continued to be directed towards the major production sectors of the economy.

Outlook, Risks and Strategic Policy Directions

Going forward, Authorities see sustained robust economic growth, driven by higher public spending on infrastructure through the "Build, build, build" program of the current administration, the sustained resurgence in manufacturing and growing foreign investments and tourism. Nevertheless, *Authorities will review their economic growth projection of 7–8 percent over the medium term.* Staff's projections are less optimistic. Staff see that maintaining fiscal stimulus at the planned 3.0 percent and 3.2 percent in 2018 and 2019, respectively, combined with strong private investment and consumption would feed into price and current account pressures.

A. Fiscal Policy

Authorities are keeping their expansionary fiscal policy, as originally programmed. While they have carefully considered the staff policy recommendation to keep a neutral fiscal stance to balance growth and stability, Authorities continue to see the imperative for stronger investment in infrastructure. They are mindful of the significant infrastructure gap that urgently needs to be filled to enable the country to sustain the momentum of economic growth. During the previous political administration, the priority was to strengthen governance reforms. With improvements in the procurement processes in place, Authorities can now ramp up infrastructure spending. Accelerated investments in social services, particularly education and social protection, are also urgently needed. Authorities are convinced that retaining these priorities will allow the country to capitalize on the Philippines' demographic advantages to drive the country towards upper-middle income status by 2022. Good revenue performance under TRAIN-1 is expected to be sustained, which should help build the necessary buffers for unforeseen slippages elsewhere.

Authorities positively acknowledge the Fund’s recently concluded technical assistance through the Public Investment Management Assessment (PIMA) which would help guide reforms to ensure that program prioritization, especially on infrastructure and social protection spending, maximizes the return on investment. For 2020 to 2022, the deficit target will revert to 3 percent of GDP, as the government remains committed to long-term fiscal sustainability. The debt-to-GDP ratio is expected to continue its downward trajectory in the medium-term from 42.1 percent in 2017 to 38.6 percent in 2022. *A financing program that will continue <u>to favor domestic borrowings</u> will support this.* Proactive liability management has decreased the burden of debt on the budget, creating more fiscal space to fund social commitments.

B. Monetary Policy

Authorities share staff’s assessment that the less than benign external environment has complicated the conduct of monetary policy. Earlier this year, economic data suggested that an adjustment in policy rate was not warranted, as the uptick in prices was driven mainly by supply-side factors. Moreover, BSP forecasts then continued to show inflationary impulses as transitory and moderating to a target-consistent path in 2019. However, as international oil prices remained volatile and as the pace of policy normalization in AEs progressed, capital outflows from EMEs put significant pressure on the exchange rate. Authorities recognized that sustained pressure on the peso, along with the initial impact of TRAIN-1 on domestic prices and the broadening rise in prices, could adversely affect inflation expectations and trigger second round effects. Therefore, to prevent any de- anchoring of inflation expectations, the BSP raised its policy rate by a cumulative 100-basis points between May and August. With inflation in August tipping at 6.4 percent, the BSP maintains its strong commitment to weigh the need for further monetary policy action at its next policy meeting later this month. It has indicated clearly to the market that it is ready to undertake any follow-through action to safeguard the inflation target for 2019, including closely monitoring the possibility of demand-side pressures.

Part of staff argument for a neutral fiscal stance was to “limit overheating risks” and avoid “overburdening monetary policy.**”** While Authorities are cognizant of elevated risks, *they continue to see <u>few signs of possible overheating</u> in the economy*. The recent output number remains in line with long-run trend, and credit conditions continue to be manageable. *Monetary policy is vigilant with <u>sufficient policy space</u> to respond to ongoing price pressures.* With technical assistance from the Fund, the BSP will also continue to enhance its monetary policy operations framework to sustain the effectiveness of monetary policy transmission. In addition, the BSP will keep pushing for the passage of amendments to the BSP Charter, which would further strengthen its ability to fulfill its mandate of price and financial stability.

Moreover, the BSP will continue to closely work with other government agencies and legislators towards the swift passage of laws that would lift the quantitative restrictions on rice, and thereby alleviate rice price pressures. House Bill 7735 (The Revised Agricultural Tariffication Act) was already approved by the House of the Representatives on

14 August 2018, while the Senate version of the Bill is pending before the Senate Committee on Agriculture and Food.

C. Financial System Stability and Inclusion Policies

Authorities welcome staff's assessment that the financial system is sound and that the BSP has appropriately implemented macroprudential policies to pre-empt the build-up of risks to financial stability. BSP regulations to safeguard the resilience of banks are in the pipeline. These include refinements to existing stress tests; introduction of a Debt-to- Earnings of Borrowers' Test (DEBT) and the Borrowers' Interconnected Index (BII); and the adoption of a countercyclical capital buffer (CCyB). Moreover, as regulator, the BSP supports responsible fintech innovation, given the latter's link to increased efficiencies and financial inclusion. The BSP has refined regulations to effectively respond to trends in digitization, fintech and technology-related risks. Among others, the BSP has updated the regulatory framework for money service businesses to enhance customer due diligence, established a framework for regulating virtual currency exchanges, and is in collaboration with co-regulators and the private sector on how best to benefit from pioneering technologies. The BSP has also piloted Regtech solutions to strengthen risk-based regulatory and supervisory activities. These pilots relate to handling consumer complaints and improving supervisory reporting.

D. Structural Reform Policy

Authorities are cognizant that while there have been inroads into poverty alleviation and improving inequality, much more could be done to attract investments to fuel economic growth, encourage enterprises to hire more workers, improve their competitiveness and thus deliver on social benefits. The policy thrusts of Authorities include:

- Further liberalizing investment through shortening the list of foreign investments subject to restrictions. While the list is the shortest it has been in years, Authorities plan to further shorten it through executive orders and legislations.

- Sustaining the implementation of TRAIN-1, which increased the disposable income of 99 percent of the working population. This is expected to help build a stronger middle class and lift one million Filipinos from poverty each year.

- Rationalizing fiscal incentives and reducing CIT (both are under the second package of tax reforms (TRAIN-2), which is pending in Congress). This will create a level playing field for enterprises and attract new players to compete.

- Further developing the domestic capital market so it can support and leverage on digital technology to promote financial inclusion, while ensuring cyber security risks are manageable.