INTERNATIONAL MONETARY FUND

IMF Country Report No. 12/49

THE PHILIPPINES

2011 ARTICLE IV CONSULTATION

March 2012

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 2012 Article IV consultation with Philippines, the following documents have been released and are included in this package:

- **Staff Report** for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on December 13, 2011, with the officials of Philippines on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 18, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Staff Statement** of February 17, 2012
- **Informational Annex** prepared by the IMF.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its February 17, 2012 discussion of the staff report that concluded the Article IV consultation.
- **Statement by the Executive Director** for Philippines.

The document listed below has been or will be separately released.

Philippines—Selected Issues

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

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INTERNATIONAL MONETARY FUND

PHILIPPINES

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION

January 18, 2012

KEY ISSUES

Context. The Philippines is being affected along with other countries in the region by the fragile global environment. But macroeconomic conditions are generally sound and the authorities' policy management is supporting confidence. The key challenge now is to navigate through the period of global uncertainty to maintain macroeconomic stability while building the foundations for faster and more inclusive growth.

Outlook and risks. Domestic demand should support growth in 2012, as public spending picks up after a sharp decline in 2011, and the staff expects growth to rise from 3.7 percent in 2011 to 4.2 percent in 2012. The global economy remains a key downside risk as spillovers could affect the Philippines through several channels, although the authorities have built up policy space for a strong response.

Monetary policy has responded well to changing circumstances. Monetary conditions are supportive of growth while keeping inflation manageable. Policy easing is not needed at this time, but policy could be recalibrated if downside risks materialize.

Fiscal policy should provide welcome support for growth in 2012 as expenditures rise from their unexpectedly low level in 2011. Over the medium term, the planned fiscal consolidation should strengthen the ability of the budget to respond to shocks. Expenditure is being reoriented toward key priorities for inclusive growth. Higher revenue will be needed in order to attain these objectives.

Financial sector resilience has been maintained through the global turbulence in recent quarters. But careful monitoring should continue of vulnerabilities from concentration and interest rate risk, real estate exposures, and global spillovers.

Building strong inclusive growth is a key part of the authorities' medium-term development plan. The focus is, appropriately, on both raising growth and implementing mutually reinforcing measures to strengthen inclusiveness.

Approved By
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Mission Dates: December 1–13, 2011.

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INTRODUCTION

1. **The Philippines is being affected along with other countries in the region by the fragile global environment**. After reaching 7.6 percent in 2010, growth slowed to 3.6 percent (y/y) during the first three quarters of 2011. But macroeconomic conditions have remained generally sound, with inflation within the official target range, the national government deficit low, the balance of payments in surplus, and the financial sector withstanding the global stress. The authorities' policy management and focus on strengthening governance and other pillars of growth and inclusiveness have helped confidence domestically and among foreign investors, as reflected in positive business and consumer sentiment, capital inflows, and ratings upgrades by Fitch and Moody's in 2011.

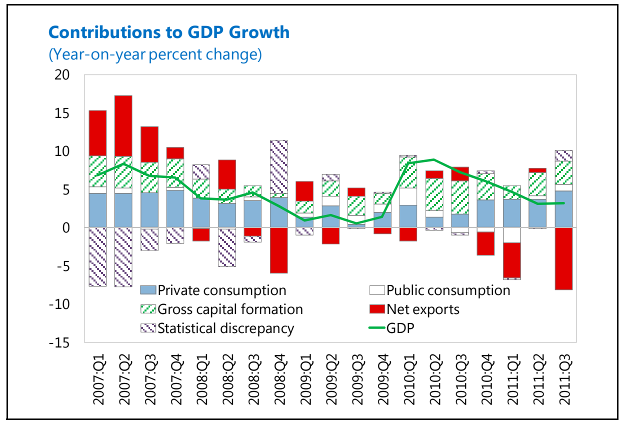
2. **In concluding the 2010 Article IV consultation, Executive Directors saw a need for carefully managing the exit from stimulus policies in a challenging external environment while moving ahead with reforms to strengthen medium-term growth**. Monetary policy has indeed responded flexibly to circumstances, fiscal policy will combine medium-term consolidation with support for near-term growth, and the Philippines Development Plan lays out a multi-pronged growth strategy. Meanwhile, the authorities continue to make progress in following up on the recommendations of the 2010 Financial Sector Stability Assessment (FSSA) update.

3. **Against this background, the discussions focused on the challenge of navigating through the global uncertainty to maintain macroeconomic stability while building the foundations for stronger inclusive growth**. The authorities and staff agreed that policies are appropriately focused on supporting growth while keeping inflation manageable, strengthening medium-term public finances while continuing to build infrastructure and social safety nets, and monitoring proactively the resilience of the financial sector. The global turbulence represents a clear downside risk to the outlook, but the authorities have built up space for a wide-ranging policy response should further negative shocks occur. Looking ahead, it will be important for the authorities to give life to the vision of the medium-term Philippines Development Plan (PDP) to strengthen the structural basis for inclusive growth.

ECONOMIC CONTEXT

A. Developments: Growth Has Slowed but Macroeconomic Conditions Are Generally Sound

4. Economic activity slowed down during the first three quarters of 2011 (Figure 1). The slowdown reflected a fall in electronics exports, particularly of semiconductors, and lower public construction. Exports were subdued by the weak global environment and by supply chain disruptions following the March 2011 Japan earthquake tragedy. Public construction fell as a result of improved budget processes that temporarily slowed down project approvals and also reduced costs. Inventories have built up as demand turned out to be weaker than businesses envisaged earlier in the year. Unemployment and underemployment remain relatively high, at over 7 percent and 19 percent, respectively. Private consumption, however, has been well supported by robust remittances. On the supply side, services growth has remained strong, reflecting a continued expansion in business-process outsourcing (BPO) and real estate activity. But the export weakness has led to a slowing in manufacturing growth, while twin typhoons in September 2011 caused extensive damage to agricultural output. For the economy as a whole, the output gap has now turned negative.



5. Financial conditions have remained supportive of growth (Figure 2). The authorities have unwound crisis-related liquidity support measures and started to tighten monetary policy since March 2011. Real policy rates have turned positive and reserve money has been kept in check by partially sterilizing the rise in net foreign assets through the BSP's special deposit accounts (SDA), which have risen to very high levels. In recent months, amid elevated global uncertainties and low core inflation, monetary tightening has paused. Real lending rates, however, are well below pre-crisis levels, interbank and short-term government bond yields remain below policy rates, and credit growth is rapid (22 percent, y/y, as of November). These monetary conditions have not, however, led to inflation pressure because of the emerging slack in the economy.

6. Core inflation pressures have remained moderate. Headline inflation has generally held steady at around 4½ percent (y/y) through November 2011, slightly above the midpoint of the 3–5 percent target range. Core inflation (excluding volatile food and energy items) has been contained in the 3½–4 percent range.

7. Fiscal policy has contracted more sharply than the authorities envisaged (Figure 3). The national government deficit during January–November (P 96 billion; 1 percent of GDP) fell substantially short of the annual budget objective (P 300 billion; 3 percent of GDP) mainly reflecting lower capital expenditure, particularly on public construction. In October, the government announced a fast-tracking of spending of about 0.7 percent of GDP on infrastructure, local government transfers, and job training that has provided a stimulus to growth in late 2011. However, for the year as a whole the staff expects the deficit to fall to 1½ percent of GDP, which would represent a fiscal withdrawal of 1.8 percent of GDP.

8. The balance of payments remains in sizable surplus, reflecting both the current and capital account (Figure 4). Remittances, BPO exports, and capital inflows have offset the impact of lower electronics exports. During 2011, international reserves rose by $12.9 billion to $75.3 billion (11 months of imports). The BSP forward book, meanwhile, declined by $10 billion during January-November, with most of the decline occurring in September when the Philippines was among the Asian economies affected by the rise in global risk aversion and reversal of capital flows from emerging markets. The episode also led to a temporary drop in reserves and the exchange rate and a jump in sovereign spreads. During January-November, the peso appreciated by 0.7 percent in real effective terms.

B. Outlook: Domestic Demand Should Support Growth, but External Environment is a Downside Risk

Staff Views

9. Domestic demand should support growth in 2012, offsetting sluggish external demand. Growth is projected to rise from 3.7 percent in 2011 to 4.2 percent in 2012 as public and private demand strengthen, reflecting a recovery in government spending, the start of long-awaited public-private partnerships (PPPs), supportive monetary conditions, and robust remittances. With external demand still weak, net exports will continue to make a negative contribution to growth in 2012, although the drag should be smaller than in 2011 as the unwinding of inventories reduces import growth. The balance of payments is likely to remain in surplus as remittances and service exports fuel the current account, and positive growth and yield differentials versus advanced countries attract capital inflows. Inflation should move toward the mid-point of the BSP's target range in the absence of food and fuel price shocks, as the negative output gap holds down price pressures.

10. **The outlook is subject to significant downside risks that arise mainly from global spillovers**. Measures to revitalize investment may increase growth relative to the staff's forecast, but on balance the global economy represents a clear downside risk. Renewed shocks to global activity, or a prolonged period of sluggish growth, could have substantial spillovers to the domestic economy through goods and services exports, financial flows, and remittances (Box 1). At home, low lending rates may continue to fuel credit demand, and banks may face pressure to loosen lending standards as excess reserves build up and rates on alternative assets (such as Treasury bills) remain low.

11. **Over the medium term, growth is projected to recover to its potential rate of around 5 percent**. Although external demand may remain sluggish for some time, the impact on net exports would be mitigated by the fact that electronics (the main export) rely to a significant extent on imported inputs. Domestic demand should be supported by remittances and a continued expansion of BPO, tourism, and other sectors. The staff's growth projection is lower than the authorities' 7–8 percent growth target, which in the staff's view would require additional measures to attain. Measures would be needed in particular to further strengthen the investment environment and public infrastructure, as well as job creation and productivity. The balance of payments should remain in surplus as remittances and export diversification contribute to a current account surplus of nearly 2 percent of GDP and structural drivers continue to attract capital inflows.

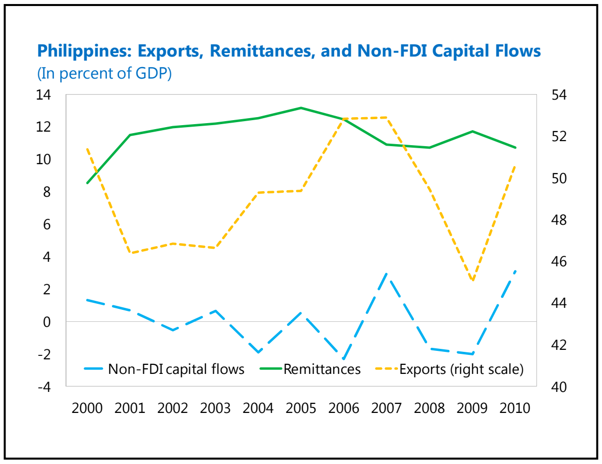
Authorities' Views

12. **The authorities shared the staff's outlook and assessment of risks, although they expected growth to be somewhat higher**. Agriculture, tourism, BPOs, construction, and a resumption of the Asian supply chain could contribute to a recovery in growth to 5 percent or higher in 2012 and, combined with measures to boost investment, toward the 7−8 percent target over the medium term. However, the authorities broadly shared the staff's views on the risks to the outlook, and noted the significant impact that negative shocks from advanced economies were already having on the Philippines. The BSP was actively monitoring risks to macroeconomic stability through its early warning and financial stress exercises and found the system to be resilient to a range of potential shocks.

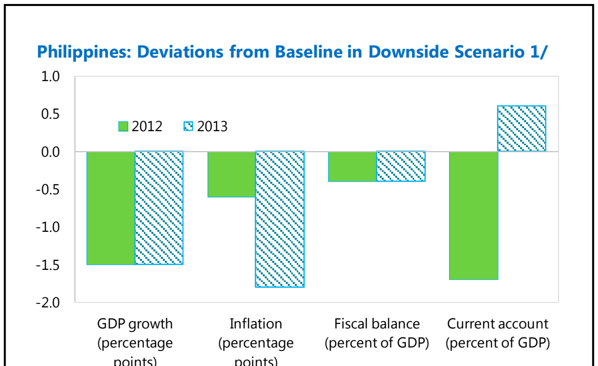
Box 1. Philippines: Spillovers from the Global Economy 1/

As a small open economy, the Philippines is influenced by global developments through both trade and financial channels. Weaker global growth causes demand for exports to decline, which in turn also affects consumption and investment. The financial system has only limited exposure to Europe and little reliance on foreign wholesale funding, but contagion could still occur through pullbacks of credit by European banks to the domestic corporate sector or a retreat by foreign investors from local equity and bond markets.

Exports, remittances, and portfolio and other capital flows are important transmission channels for external shocks. The share of goods and services exports in GDP is about 50 percent, making trade a key channel. Supply chain disruptions can have significant effects, as seen in the aftermath of the natural disasters in Japan. Philippine exports have benefited in recent years from rising demand by China, which has become an important trade partner. By the same token, a slowdown in China would affect the Philippines. The euro area has also become more important as a destination for Philippine intermediate goods exports and its share is twice as large as in ASEAN peers. More generally, the euro area and United States are key trading partners, each accounting for around 15 percent of merchandise exports, and are important destinations for Overseas Filipino Workers (OFWs). Remittances are equivalent to around 10 percent of GDP and, although they held up well during 2008–2009, a global downturn would hurt the earnings on which they are based. Non-FDI capital flows have increased in importance, driven by portfolio inflows.



The staff estimates that in a downside global scenario Philippine growth could drop by about two thirds of the decline in external growth before any fiscal and monetary response. The trade channel is more important than the financial channels. In an illustrative scenario, the output gap would turn negative, contributing to a decline in inflation, and the fiscal balance would deteriorate due to revenue automatic stabilizers. The impact on exports and fixed investment is larger than the impact on private consumption, reflecting the resilience of remittances. The current account balance falls at first as exports decline faster than imports, and then rises as weaker domestic demand leads to lower imports.



1/ Assumes a -3.5 percent shock to output in the euro area and -1 percent in the United States for two years. Incorporates effects on other major economies based on the *Global Integrated Monetary and Fiscal* (GIMF) model.

1/ See selected issues paper for details.

MAINTAINING MACROECONOMIC STABILITY IN AN UNCERTAIN GLOBAL ENVIRONMENT

A. Monetary Policy: Supporting Growth While Keeping Inflation Manageable

Staff Views

13. **Monetary policy has responded well to changing circumstances**. The start of monetary tightening in early 2011 helped to forestall inflation pressures. The pause in recent months has been justified by heightened global downside risks, low core inflation, and the relatively short lags in the Philippines between policy moves and inflation. Policy easing is, however, not needed at this time because monetary conditions are still supportive of growth. At the same time, the authorities would need to respond proactively if inflation and activity were to show signs of picking up faster than anticipated.

14. **The monetary transmission mechanism is hampered by the fall in short-term Treasury and interbank rates below policy rates.**[1] In particular, moves in the policy rate might have only a limited impact on lending rates, which are influenced by interbank and Treasury rates. The BSP's ability to mop up excess liquidity associated with large external inflows is constrained by its small remaining holdings of treasury securities for repo operations and its lack of legal authority to issue central bank securities for monetary policy operations. It is important in this context for the BSP to have the tools necessary for active liquidity management, including the ability to issue its own bills. In the interim, a close coordination of Treasury issuances and monetary policy could help strengthen the monetary mechanism.

Authorities Views

15. **The authorities agreed with the staff's characterization of monetary policy**. In particular, they appreciated the staff's view that the pause in monetary tightening was warranted. They viewed inflation pressures as moderate but felt that monetary easing was not needed at this juncture, because monetary policy was already supportive of growth and fiscal policy was expected to provide stimulus in the near term. Monetary policy could be eased if growth prospects were to deteriorate further. They agreed that it would be helpful for the BSP to be allowed to issue its own bills to enhance the effectiveness of monetary policy.

[1] Chapter 2 of the selected issues paper provides further analysis.

B. Reserves and Exchange Rate: A Cushion for Dealing with Adverse Shocks

Background

16. **The authorities have used a varied toolkit for managing external inflows to the Philippines in recent years**. The exchange rate has appreciated in real effective terms. Meanwhile, international reserves have risen rapidly, including during the global financial crisis, and are well above standard precautionary metrics as well as the Fund's new adequacy metric. The BSP has sterilized much of the reserve buildup in order to avoid an undue expansion in monetary aggregates, and sterilization costs have increased owing to domestic-foreign interest differentials. The authorities have liberalized controls on capital outflows, prepaid some external debt, and had in place for some years macro-prudential measures that have worked well. Effective January 2012, the BSP raised market risk weights on banks' nondeliverable forward (NDF) positions, which were considered to be large in size and speculative in nature. The move was seen as a macro-prudential measure to forestall systemic risk to the banking system from exchange market volatility.

Philippines: Net International Reserves, End-2010

	In Months of Imports	In Percent of Short-Term Debt (STD)	In Percent of Broad Money	In Percent of STD and Foreign Currency Deposits	In Percent of New IMF Metric
Indonesia	7.5	132.6	35.0	...	150.9
Malaysia	6.8	353.4	30.3	221.8	113.8
Philippines	10.2	375.8	50.3	157.2	310.4
Thailand	10.0	307.9	44.0	282.6	308.4

Sources: CEIC Data Company Ltd; IMF, WEO database; IMF Policy Papers, *Assessing Reserve Adequacy* (February 2011); and IMF staff calculations.

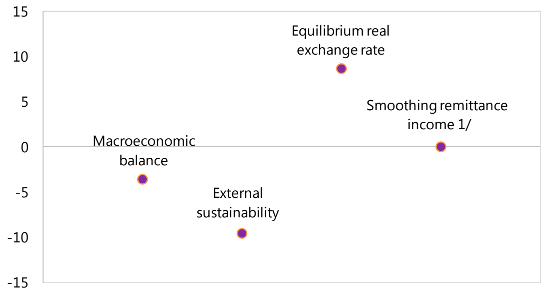
Staff's View

17. **Reserves and exchange rate flexibility can provide a cushion against external shocks while facilitating adjustment to sustained external inflows**. The real exchange rate remains broadly in line with its medium-term fundamentals based on the standard approaches as well as an alternative estimation that takes into account long-term trends in remittances and the

current account that may differ from medium-term outcomes.[2] The staff supports the authorities' stated policy of limiting foreign exchange market intervention to smoothing operations and allowing the exchange rate to adjust to market pressures. In this context, should volatile outflows occur, there is scope to use reserves to smooth the effects of such outflows. The regulatory move with respect to NDFs could be a useful part of the macro-prudential toolkit and help avoid disruptions to the onshore foreign exchange market. With the exchange rate not overvalued, sustained inflow pressures over the medium term, however, would need to be met by exchange rate adjustment.

Real Exchange Rate Assessments

(Deviation from equilibrium, in percent)



Source: IMF staff estimates.

1/ This approach derives a current account norm by smoothing remittance income to yield a constant real income stream per capita.

Authorities' Views

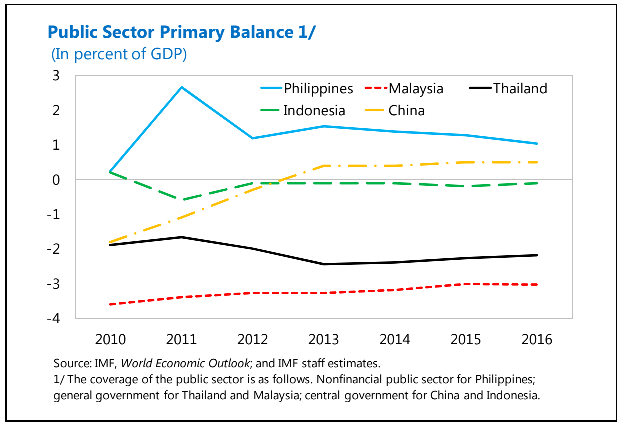
18. The authorities emphasized that their response to external inflows was based on striking a balance among a range of measures in the toolkit. Reserves were high but not, they felt, as excessive as the Fund's adequacy metric would suggest since the insurance value was hard to measure. Reserves had provided an important buffer during the global crisis as well as the turbulence during 2011. Moreover, markets and rating agencies tended to react negatively toward emerging economies whose reserve levels fell abruptly.

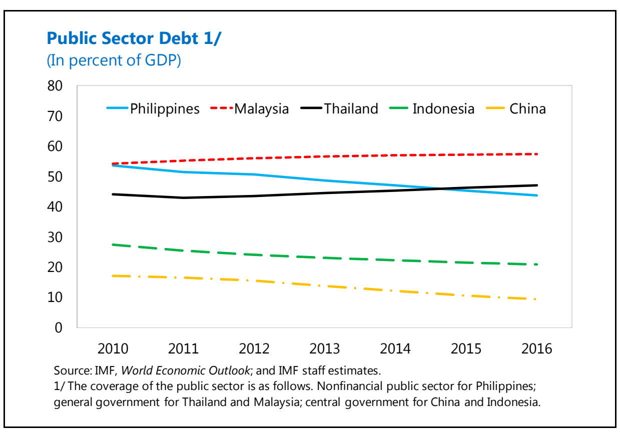
[2] Box 2 of IMF Country Report No. 11/59 provides further background on the alternative estimation.

C. Fiscal Policy: Medium-Term Consolidation Plans Allow for Near-Term Expansion

Background

19. The authorities remain committed to pursuing a gradual fiscal consolidation over the medium term. The fiscal plan announced in 2010 envisaged a gradual reduction in the national government deficit from 3½ percent of GDP in 2010 to 2 percent of GDP from 2013 onwards. In 2011, the deficit has fallen significantly below the targeted 3 percent of GDP, but the authorities have retained the deficit targets for 2012 (2.6 percent of GDP) and the medium term. Under the envisaged path, fiscal consolidation over the medium term would allow for a stimulus in 2012 as expenditures pick up after their temporary drop in 2011. Over the medium term, the consolidation path would generate primary surpluses of about 1 percent of GDP and reduce the public debt to GDP ratio from 51 percent in 2011 to 44 percent by 2016.





20. The main elements of the authorities' fiscal strategy are stronger tax administration, a reorientation of expenditure toward social sectors and infrastructure, and a public debt management strategy that reduces exchange rate and maturity risk. Tax administration efforts are being supported by technical assistance from the U.S. Millennium Challenge Corporation compact and the Fund, and are estimated to have generated a substantial gain in revenue in 2011 (½ percent of GDP). Expenditure plans include a greater emphasis on basic education, an expansion of conditional cash transfers (CCTs) that directly benefit vulnerable people, and wider health care coverage. The PPP projects to develop infrastructure will start from 2012. The civil service wage bill, however, will continue to rise in 2012 as a result of wage adjustments under the ongoing 2009–2012 Salary Standardization exercise and will account for 40 percent of primary expenditure. The debt profile is sustainable under a range of shocks and, to reduce vulnerabilities further, the authorities have continued to issue peso-denominated global bonds and conduct debt swaps that, respectively, reduce the shares of foreign currency and short-term debt.

Staff's Views

21. The staff supports the government's intention to follow a revenue-based fiscal consolidation over the medium term that nonetheless allows for a supportive stance in the near term.[3] Notwithstanding the rise in the deficit in 2012, the medium-term debt path would still be lower than the original plan envisaged, owing to the greater than intended debt reduction in 2011. The planned medium-term consolidation would help to expand the space for the budget to deal effectively with potential shocks including frequent natural disasters, further anchor expectations, and reduce the government's gross financing requirement. Given the Philippines' substantial social and infrastructure needs for building faster and more inclusive growth, it is appropriate that consolidation efforts are focusing on raising the (low) ratio of revenue to GDP while reorienting expenditure toward priority areas. Once the current round of civil service wage adjustments is completed, the civil service wage bill should be carefully managed in order to avoid crowding out other priority spending.

22. Achieving the authorities' fiscal objectives will require a sizable tax effort. The staff supports the authorities' initial focus on improving tax administration that should help over time to enhance revenue collection. Early actions to simplify the tax system and broaden the base should complement the planned tax administration measures, whose full benefit is hard to predict and will take time to materialize. In 2012, in order for the budgeted expenditure and deficit objectives to be achieved, an increase in revenue will be required equivalent to 1½ percent of GDP. The authorities estimate, and the staff agrees, that tax administration improvements could yield revenue increases equivalent to ½ percent of GDP. Consequently, additional tax measures are likely needed, such as measures to reform excises, rationalize fiscal incentives, and address inefficiencies in the VAT to broaden the tax base.[4] Such measures would also make the tax system more equitable and easier to administer. In this context, the staff welcomes the authorities' recent submission of bills to Congress to rationalize "sin taxes" and streamline tax incentives that would go some way toward raising the additional revenue needed.

[3] On a cyclically-adjusted basis, fiscal policy would provide a 0.8 percent of GDP stimulus in 2012.

[4] A reform of excises on alcohol and tobacco (so-called "sin taxes"), for example, could potentially yield additional revenue of ½ percent of GDP in 2012 and 1 percent of GDP in 2013.

23. The authorities continue to make important progress in strengthening the fiscal framework. Key recent initiatives include passage of the Government-Owned and Controlled Corporation (GOCC) reform act, and the introduction of zero-based budgeting and a fiscal risk statement.[5] These initiatives will also complement the authorities' efforts to limit rice and transport subsidies by GOCCs and move instead to better targeted CCTs, and efforts to monitor GOCCs' contingent liabilities. The planned PPPs should be helpful for building infrastructure, but their fiscal risks should be monitored carefully and reflected in the fiscal accounts.[6] The pension system for uniformed personnel is due to experience a substantial increase in benefit payments over the coming years that needs to be managed in a fiscally sustainable way.

Authorities' Views

24. The authorities reiterated their firm commitment to medium-term fiscal consolidation. This commitment and the improvement in the public debt profile over the past year as a result of debt management operations to reduce currency and rollover risks had helped to improve the credibility of the fiscal framework and been recognized by markets and rating agencies. The authorities continued to view their fiscal plans as achieving a good balance between fiscal consolidation and an appropriate level of development spending.

25. The authorities will continue to reorient expenditure toward key priorities for inclusive growth such as social safety nets, human capital, and infrastructure. With new budget processes in place and greater transparency in public spending, the execution of public projects should be easier and less costly to implement in future, allowing budget spending to rise toward targeted levels. The PPPs that would start in 2012 would gather pace in future years. The

[5] Under zero-based budgeting, proposed expenditures are justified afresh each year instead of as an increase to the previous year's expenditure. The fiscal risk statement is an official government document that contains quantitative and qualitative evaluations of major fiscal risks.

[6] The existing PPP framework includes a Build Operate Transfer law and a centralized PPP knowledge center that provide a good foundation for PPPs. The next steps could include further strengthening the stringency of gateway safeguards.

authorities may consider introduction of a performance-based compensation system for civil servants that would enhance efficiency of the service and could help to keep in check the wage bill. The authorities were considering options to put the pension system for uniformed personnel on a sustainable footing.

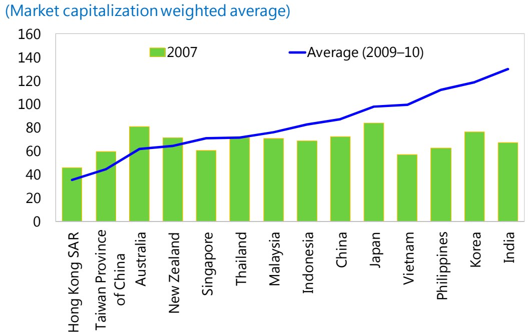
26. The increase in revenue that would be required for fulfilling the 2012 deficit and expenditure objectives would be delivered by the improvements in tax administration and the sin tax and incentives measures. Other tax reforms were not planned at this time, reflecting both the authorities' desire to first maximize the gains from improving tax administration and simplifying the tax system and the fact that the appetite for tax measures in the legislature may wane as the May 2013 mid-term elections approach. Should these revenue gains prove insufficient for meeting the fiscal objectives, the authorities would reduce nonpriority expenditure or speed up privatization to provide additional resources to support spending.[8]

D. Financial Sector: Monitoring Spillover Risks and Vulnerabilities and Maintaining Resilience

Background

27. The financial sector has been resilient to the global turbulence so far. Banking sector indicators remain consistent with the 2010 Financial System Stability Assessment (FSSA) of the sector's soundness.[7] The BSP's recent bank stress testing exercise suggested that the banking sector is well placed to withstand the direct effects of a range of shocks. Asset price overheating has not been a concern, with equity price earnings ratios broadly in line with historical averages and property price increases moderate. Financial markets were buffeted during the period of emerging market stress in August-September, but recovered in subsequent months.

Selected Asia: Debt to Equity Ratio
(Market capitalization weighted average)



Sources: Worldscope database; and IMF staff calculations.

[7] Universal and commercial banks' nonperforming loan ratios have remained low (2.6 percent) and banks' capital adequacy ratios high (16.4 percent) as of June 2011 (latest data available).

[8] The latter option would, however, be reflected in a higher deficit under IMF definitions, which view privatization proceeds as financing items rather than revenue. Also, while privatization can provide resources in the short term, it does not diminish the need for sustainable tax revenue increases over time.

Staff's Views

28. The staff welcomes the authorities' careful monitoring of risks to the financial sector. Potential spillovers from global financial disruptions, real estate exposures, rapid credit growth, and concentration and interest rate risk represent some of the key vulnerabilities.[9] The financial system has only limited exposure to Europe (1½ percent of total assets), but contagion could occur through pullbacks of credit by European banks, whose lending is equivalent to nearly 10 percent of GDP, or a retreat by foreign investors from local markets. The prominent role of conglomerates as recipients of bank credit and as owners of banks, as well as the high leverage in parts of the corporate sector, call for a close monitoring of conglomerates and of potential feedback loops among banks. Rapid credit growth may pose risks for lending standards and asset quality as the credit cycle matures. In the real estate sector, anecdotal evidence of a rise in vacancy rates and softening of rents in certain niche segments may be a sign of emerging excess supply. The real estate exposures of nonbank financial institutions, and of property developers who fall outside the regulatory purview, could be an emerging vulnerability that requires close coordination among regulators. A contingency plan may be useful for preparing how to deal with a potential tail event.

29. The authorities have continued to strengthen the supervisory and regulatory framework in recent years, and have built on the progress noted in the 2010 FSSA update. The improvements have helped the financial sector to stay resilient through the global crisis and more recent strains. An important next step for bank supervision will be prompt Congressional approval of the amendments to the New Central Banking Act (NCBA) that would enhance supervision by providing supervisors with greater legal powers and protecting them from litigation, lifting the remaining constraints of bank secrecy laws on examiners, and further strengthening the prompt corrective action and bank resolution framework, as the FSSA Update recommended. The amendments would also allow the BSP to issue its own debt securities, providing a much-needed instrument to strengthen liquidity management. With respect to the AML/CFT regime, the authorities are committed to addressing the gaps noted by the Financial Action Task Force (FATF) and are awaiting Congressional approval of bills that they have submitted with legislative amendments to adequately criminalize money laundering and terrorist financing.

[9] Concentration and interest rate risk are structural features of the Philippine financial system, owing to the dominant role of conglomerates in corporate and bank ownership (which magnifies "connected" lending in banks' portfolios) and the large shares of securities in banks' assets. Single borrower limits contain banks' exposure to conglomerates but are subject to exemptions such as higher limits for petroleum-related enterprises.

Authorities' Views

30. The authorities broadly shared the staff's assessment of financial sector soundness and vulnerabilities. They noted, however, that European banks in the Philippines were liquid, had access to a large local deposit base, and had not displayed undue signs of stress during recent episodes of global turbulence. Trade finance and dollar funding, for example, had not been interrupted. They noted that conglomerates' revenue was well diversified across different business lines, which mitigated concentration risk, and that supervisors continued to pay close attention to the way systemically important conglomerates interface with banks. Regulators were coordinating closely to monitor potential vulnerabilities related to real estate.

E. Response to Renewed Global Shocks

Staff's Views

31. Further negative global shocks could have substantial spillovers to the Philippines, but there is policy space to respond across a broad front. Many of the measures that were used successfully during the 2008–2009 global crisis could be reactivated. Reserves can be used to smooth the impact, and the exchange rate can also absorb part of the shock. Monetary tightening could be recalibrated or even temporarily reversed if needed. Fiscal policy will anyway provide a stimulus to growth in 2012, and there is scope to let the automatic stabilizers operate. If necessary, expenditures could temporarily be boosted faster than currently planned subject to appropriate expenditure management safeguards and within a strategy for medium-term consolidation. The fiscal multipliers would appear to have a larger impact than easier monetary conditions at this juncture, possibly because interest rates are already relatively low and lending conditions accommodative (Box 2). Financial market liquidity could be supported by special facilities, foreign exchange swaps, and lower reserve requirements.

Authorities' Views

32. The authorities were also of the view that policy space exists for a strong response to further shocks. They had already prepared contingency plans and agreed that the 2008–2009 toolkit remained useful. Current policy settings were seen as supportive of growth, with the monetary stance not restrictive and fiscal policy set to expand in 2012.

Box 2. Philippines: The Effectiveness of Macroeconomic Policy Responses to Global Shocks

It is important for macroeconomic policy to stand ready to respond flexibly to changing circumstances given heightened global uncertainties. A key policy issue is the relative strengths of monetary and fiscal policy in affecting short-term output developments in the context of the flexible exchange rate regime. Headline inflation is also susceptible to volatile commodity prices. The standard policy response to commodity price shocks, particularly in advanced economies, is to accommodate the first round effects of food and energy price swings on the Consumer Price Index (CPI) but not the second round effects on other CPI components and inflation expectations.

The GDP impact of macroeconomic policies and the second-round effects of commodity prices for the Philippines are estimated by an extended Global Projection Model (GPM) using Bayesian techniques.[1/] The key results are:

- The short-term impact of a 1 percent of GDP fiscal stimulus is slightly greater than the combined impact of a 100 basis points change in the policy interest rates and lending conditions (measured as the spread between the 91-day T-bill rate and the policy rate).[2/] The impact of exchange rate depreciation is relatively weak.

	Fiscal Balance (In percent of GDP)	Policy Rate (In percentage points)	Lending Conditions (In percentage points)	Real Exchange Rate (In percent)
Short-term impact on output gap	0.21	0.06	0.13	0.02

- Global fuel and food prices can have a significant impact on headline inflation and significant second-round effects, which suggest a need to take account of the impact of volatile commodity prices when evaluating the inflation forecast and the monetary stance.

Fiscal policy would be more effective than monetary policy in supporting economic activity in the current juncture. In particular, a cut in policy rates would only have a modest impact of economic activity without a concomitant easing of lending conditions. With T-bill rates close to the lower bound and lending rates already at historical lows, the scope for a substantial easing of lending conditions is limited.

1/ The extended GPM model-based results in IMF Country Report No. 11/58 and the selected issues paper estimate the impact of monetary and fiscal policies as well as the role of global commodity prices and macro-financial linkages through a lending conditions variable.

2/ The estimates of the fiscal and monetary impact were also comparable to a simple recursive VAR analysis.

BUILDING FASTER AND MORE INCLUSIVE GROWTH

Background

33. The Philippines faces a difficult challenge with respect to poverty reduction. In recent decades, poverty has fallen, but it has done so relatively slowly and during the 2000s some of this progress was even reversed. The limited progress in poverty reduction has owed to both the relatively slow pace of growth in the Philippines, which historically has lagged its Asian neighbors, and rising income inequality, which has blunted the impact of growth on the living standards of the poor (Box 3).

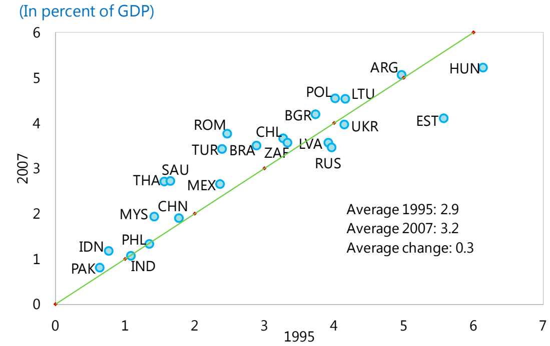
34. Low investment is a long-standing impediment to higher growth in the Philippines. Low fiscal revenue has constrained public investment, and business climate perceptions, infrastructure limitations, and costly power have held back private investment. In addition, employment and underemployment remain high, particularly among young people.

Staff's Views

35. In order to raise living standards across the board, it will be necessary both to raise the pace of growth and to ensure that the benefits of growth are shared more widely. The authorities' emphasis on raising revenue in order to expand public investment and on improving governance and the business climate is well placed. Also appropriate is the emphasis on strengthening human capital, job training, and job search assistance, which will help employment. The most sustainable source of faster growth is higher total factor productivity, which would be helped by improvements in human capital and institutional quality, and by greater agricultural productivity and an expansion of the industrial and service sectors that would also expand employment.

36. In order to be more inclusive, higher growth will need to be accompanied by a set of mutual reinforcing policies. The staff supports the emphasis in the PDP on policies to complement efforts to strengthen growth, and in particular to strengthen social safety nets, infrastructure, governance, and human capital as well as to improve the access to finance by the poor. The ongoing reorientation of public spending in the 2012 budget is very helpful in this regard. Cross-country experience suggests that higher health and education spending, for example, helps to increase the

Public Health Spending in Emerging Economies, 1995–2007
(In percent of GDP)



Source: World Health Organization.

Box 3. Philippines: Building Inclusive Growth 1/

Poverty in the Philippines has fallen in recent decades. Poverty reduction has, however, been relatively limited owing to both relatively slow growth and a low elasticity of poverty reduction with respect to growth. The low elasticity may owe in part to high and rising inequality, which reflects unequal distribution of growth and regional development, rapid population growth, declines in the relative price of labor provided by the poor, and limited access by the poor to social and financial services.

As the Philippine Development Plan 2011–2016 notes, a strong and sustainable rise in living standards requires growth to be both faster and more inclusive. The PDP notes that growth has been slow compared with others in the region; the benefits of economic and social progress have not been broadly shared; and corruption and governance concerns have at times undermined the public's sense of ownership and control over public policy. It emphasizes infrastructure, governance, human capital, and social safety net as key for strong and inclusive growth.

Rapid and sustained growth requires strengthening all three pillars of potential growth. Staff analysis suggests that higher investment in better institutional quality and human capital, and a transition of economic activity from agriculture to industry and services could raise potential growth in the Philippines. In addition, redundancy costs are relatively high, and active labor market measures such as job training and search assistance may be helpful to reduce mismatches in the labor market as well as to increase employment.

A set of mutually reinforcing policies will likely be needed to increase the inclusiveness of growth. Staff cross-country analysis shows that high inflation is detrimental to inclusiveness.[2/] Greater productivity in agriculture, possibly through better rural infrastructure and extension services, and a shift in labor towards services, such as BPO and tourism, could help to reduce inequality. The relatively low share of education, health, and pension spending in GDP in the Philippines also points to an important role for fiscal policy in strengthening inclusiveness.

Philippines: Estimation of the Model, Full Sample 1/

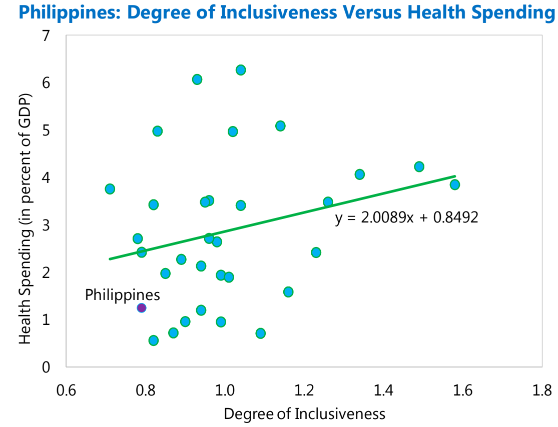
(Dependent variable: Ratio of the bottom quintile to mean per capita income)

	1	2
Constant	21.7 ***	17.3 ***
	(45.1)	(5.88)
Log (consumer price Index)		-0.39 *
		(-1.67)
Health expenditure per capita (US$)	0.009 ***	
	(4.29)	
Agriculture's value added (percent of GDP)		0.29 ***
		(3.81)
Employment in services (percent of total)		0.12 **
		(2.37)
Observations	206	185
Adjusted R-squared	0.92	0.95

Source: IMF staff calculations.

1/ t statistics are in parentheses; The asterisks *, **, *** denote significant at the 10 percent, 5 percent, and 1 percent levels, respectively.

Philippines: Degree of Inclusiveness Versus Health Spending



1/ See selected issues paper for details.

2/ The degree of inclusiveness is measured by the ratio of "the poor"—the income of the bottom quintile of the income distribution—and mean per capita income.

inclusiveness of growth. Experience suggests that higher agricultural productivity and a shift to labor-intensive manufacturing and service sectors are also associated with greater inclusiveness.

Authorities' Views

37. The authorities emphasized that their focus was on achieving not just faster but more inclusive growth. Improvements in the investment climate, the PPP projects, and a diversification of economic activity would see a rise in growth over time. In addition, the priorities in the PDP would be implemented and would enhance inclusiveness.

STAFF APPRAISAL

38. The Philippines is being affected along with other countries in the region by the fragile global economic environment, but macroeconomic conditions remain generally sound. The authorities' policy management is supporting confidence and has built up room for a strong response should further negative shocks occur.

39. In 2012, domestic demand should drive a modest pickup in growth, notwithstanding sluggish external demand. The staff expects GDP growth to rise from 3.7 percent in 2011 to 4.2 percent in 2012 based on a recovery in public spending, supportive monetary conditions, and robust remittances. Over the medium term, growth should recover to around 5 percent. Inflation should remain within the 3–5 percent official target range.

40. The outlook is subject to significant downside risks that arise mainly from the global economy. The staff welcomes the authorities' efforts to monitor actively the risks to macroeconomic stability through early warning and financial stress exercises. Renewed shocks to global markets or activity, or a prolonged period of sluggish world growth, would hurt Philippine goods and services exports, financial flows, and remittances. At home, rapid credit growth may pose risks for lending standards and asset quality as the credit cycle matures.

41. A key policy challenge for the Philippine authorities is to navigate through the uncertain global environment to maintain macroeconomic stability and build strong inclusive growth. The authorities' macroeconomic policies are appropriately focused on supporting growth while keeping inflation manageable, strengthening medium-term public finances while continuing to build infrastructure and social safety nets, and improving governance.

42. Monetary policy has responded well to changing circumstances. Policy tightening in early 2011 helped to forestall inflation pressures, while the pause in tightening in recent months is justified in view of extreme global downside risks and low core inflation. Policy easing, however, is not needed at this time because monetary conditions are still supportive of growth. Monetary policy could be recalibrated if global downside risks were to materialize.

43. International reserves and exchange rate flexibility provide a cushion against external shocks while facilitating the adjustment to sustained inflows. The staff estimates the real effective exchange rate to be broadly in line with medium-term fundamentals. Meanwhile, reserve levels are well above standard precautionary metrics and, should volatile outflows occur, there is scope to use reserves to smooth the effects of such outflows. Over time, with the exchange rate not overvalued, there is scope to rely more on exchange rate flexibility in response to sustained inflows.

44. Fiscal policy focuses appropriately on consolidation in the medium term while providing welcome support for growth in 2012. In 2012, expenditure should pick up under more efficient and transparent budget processes. Over the medium term, the planned consolidation would strengthen the ability of the budget to respond to future shocks, including natural disasters. Expenditure is being appropriately reoriented toward social and infrastructure priorities for inclusive growth. Higher revenue will be needed to meet the government's deficit and expenditure objectives. The authorities' emphasis on strengthening tax administration is appropriate and the Fund continues to support these efforts through technical assistance. In addition, it will be important to reform excises, rationalize fiscal incentives, and broaden the tax base. The staff welcomes the continuing progress being made to strengthen the fiscal framework.

45. The financial sector has been resilient to the global turbulence so far. The staff welcomes the authorities' continued attention to monitoring key vulnerabilities, including concentration risk, interest rate risk, and potential spillovers from global financial disruptions. Real estate exposures of nonbank financial institutions and property developers bear monitoring and close coordination among regulators.

46. To further strengthen banking supervision, an important next step will be to approve promptly amendments to the New Central Banking Act. The amendments should also allow the BSP to issue its own debt securities, providing a much-needed instrument to strengthen liquidity management.

47. In the event of a further negative global shock that spills over to the Philippines, the staff agrees with the authorities that a range of policy tools could be deployed in response. Many measures that were successfully used during the 2008–2009 global crisis could be reactivated. Reserves can be used to smooth the impact, and the exchange rate can also absorb part of the shock. Monetary policy could be eased if needed. Fiscal policy will anyway provide a stimulus to growth in 2012. There is scope to let the automatic stabilizers operate and, if necessary, temporarily to boost expenditures, subject to sound expenditure management and within a strategy for medium-term consolidation. Financial market liquidity could be supported by special facilities, foreign exchange swaps, and lower reserve requirements.

48. The staff fully supports the authorities' emphasis on building faster and more inclusive growth. A broad-based improvement in living standards requires both faster growth and a set of mutually reinforcing policies to increase inclusiveness. The reorientation of government spending toward social priorities, the Philippine Development Plan (PDP)'s focus on improving governance, infrastructure, human capital, and social safety nets, and efforts to broaden the access to finance are very appropriate. Progress in these areas, along with higher government revenue, will help to raise private and public investment and boost inclusive growth.

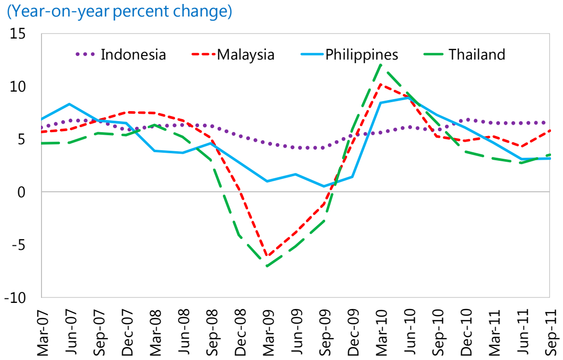
49. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Philippines—Real Sector

***Main Message**: Growth slowed down in 2011 and high frequency indicators suggest that it remained moderate in recent months. Growth would need to be faster and more inclusive to make a dent in poverty and reduce high-income inequality.*

The economy slowed down amid weaker global demand.

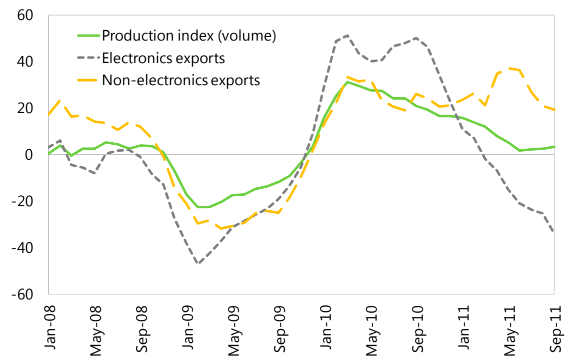
GDP Growth
(Year-on-year percent change)



Source: IMF, WEO database.

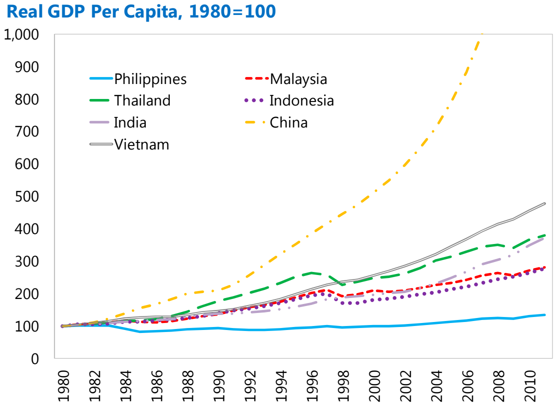
And high frequency indicators suggest that growth remains moderate.

High Frequency Indicators
(3mma, year-on-year percent change)



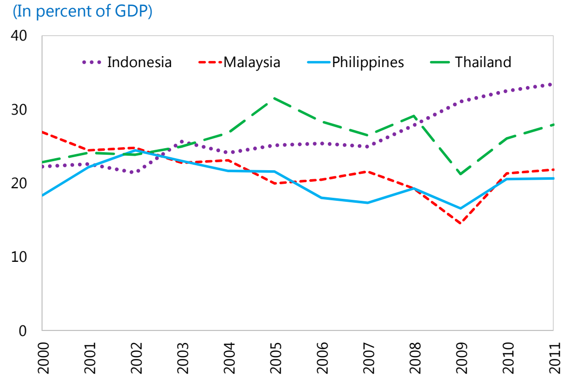
Growth has been slower than in comparator countries.

Real GDP Per Capita, 1980=100



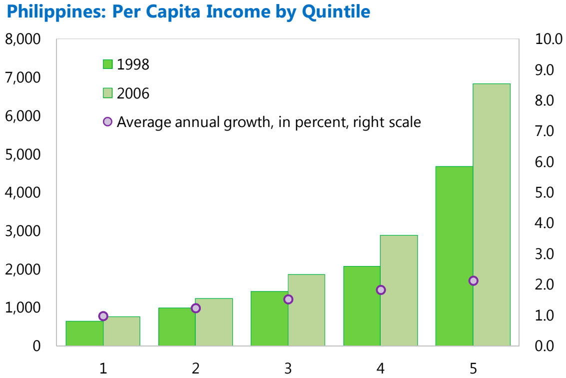
And the low investment ratio has held back potential growth.

Investment Ratio
(In percent of GDP)



Income of the poor has grown more slowly than income of the upper quintiles.

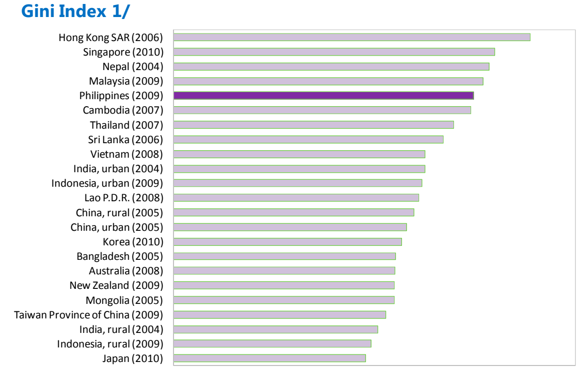
Philippines: Per Capita Income by Quintile



Source: IMF, *Asia and Pacific Regional Economic Outlook*.

Income inequality also remains high.

Gini Index 1/



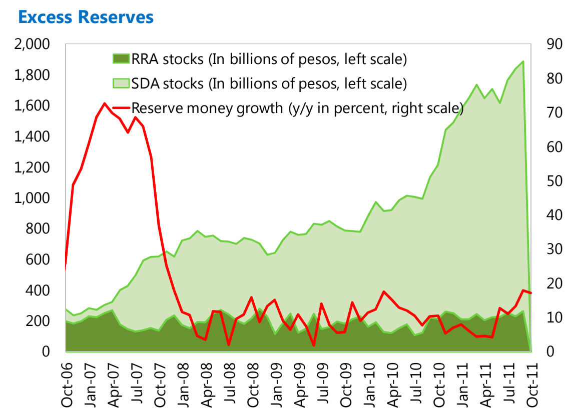
Source: World Bank, PovcalNet database.
1/ In parentheses is the latest available year.

Sources: CEIC Data Company Ltd.; and IMF, WEO database.

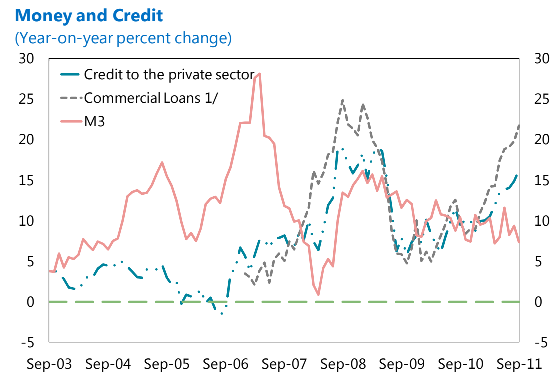
Figure 2. Philippines—Monetary Policy and Inflation

***Main Message**: Monetary conditions remain accommodative although policy rates have risen. A pause in tightening is now underway amid elevated global uncertainty.*

Excess reserves in the banking system have risen to record levels.

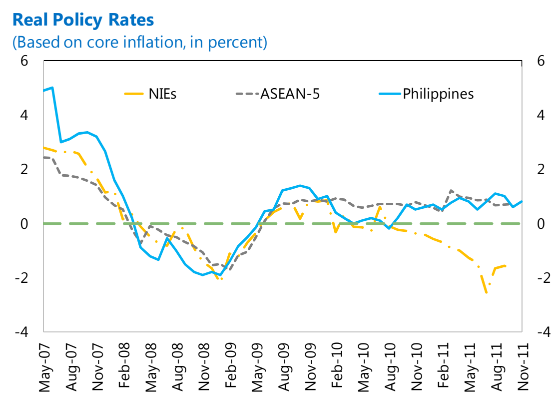


And credit growth has picked up to double-digit levels.

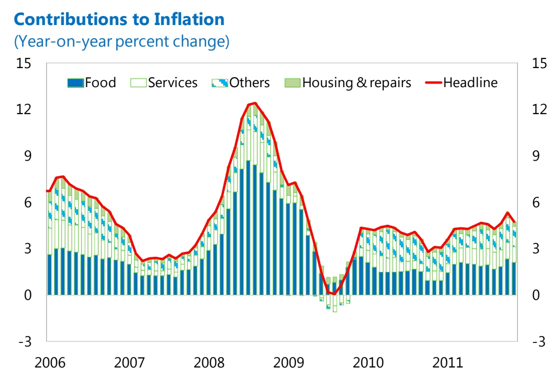


1/ Net of RRPs.

Real policy interest rates have risen and are now positive.

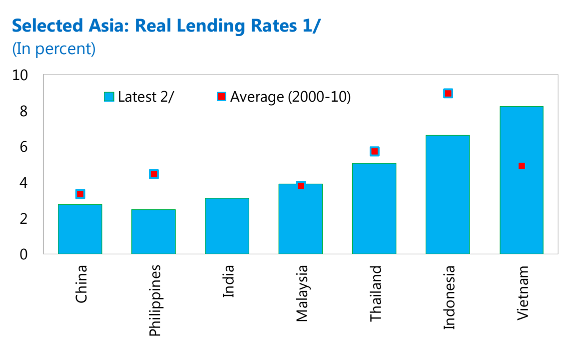


Inflation has moderated.



Sources: Philippine authorities; and IMF staff calculations.

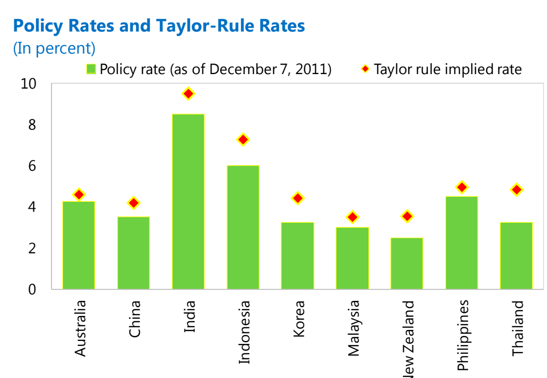
But real lending rates remain historically low.



1/ Real lending rates are defined as nominal lending rates adjusted for consensus 1-year ahead inflation expectation.

2/ Latest data refers to November 2011 except for Philippines and Vietnam (September 2011).

Policy rates remain below estimated Taylor-rule rates.



Sources: CEIC; Haver Analytics; and IMF, WEO database and staff estimates.

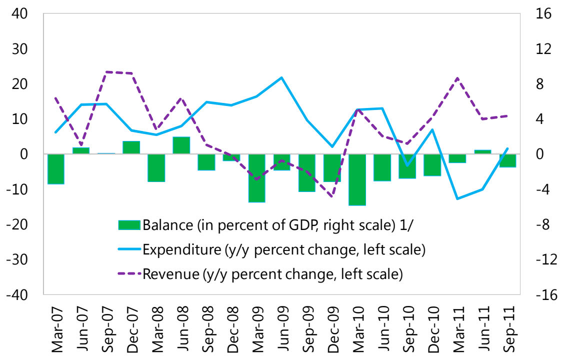
Sources: Bloomberg; CEIC Data Company Ltd.; IMF, *Asia and Pacific Regional Economic Outlook* (October 2011).

Figure 3. Philippines—Public Finances

***Main Message**: The authorities are moving forward with a revenue-led fiscal consolidation strategy over the medium term while reorienting spending towards social sectors and infrastructure.*

Fiscal policy has tightened in 2011 owing to under execution of the budget...

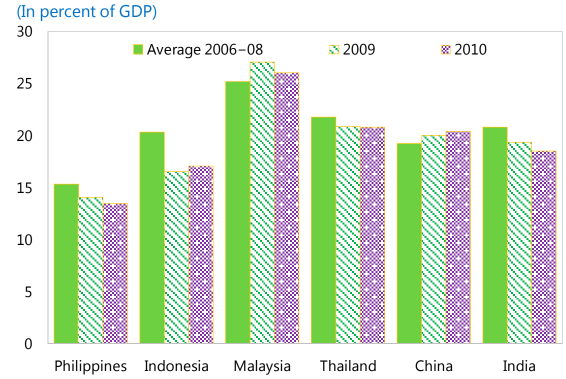
Public Finances



1/ Period flows divided by actual GDP during the same period.

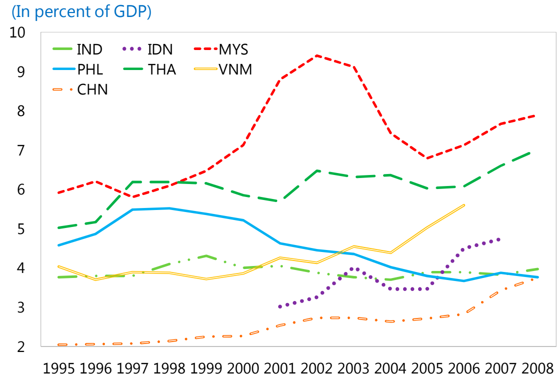
...while government revenue remains low compared to peers.

Revenues
(In percent of GDP)



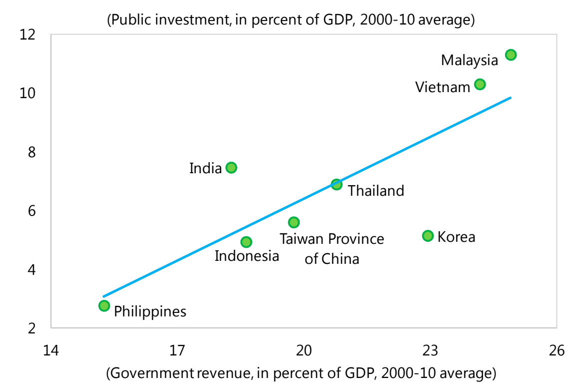
Low fiscal revenue constrains social spending...

Public Spending on Education and Health
(In percent of GDP)



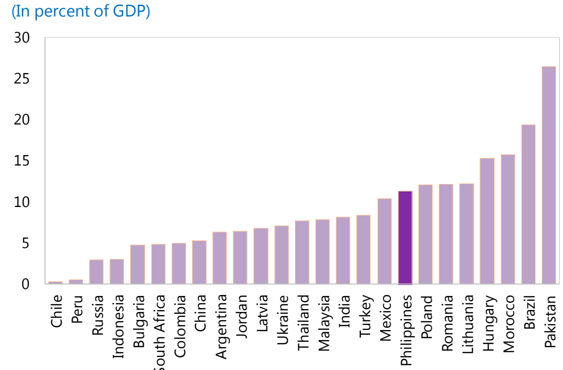
...and public investment.

Link Between Government Revenue and Public Investment



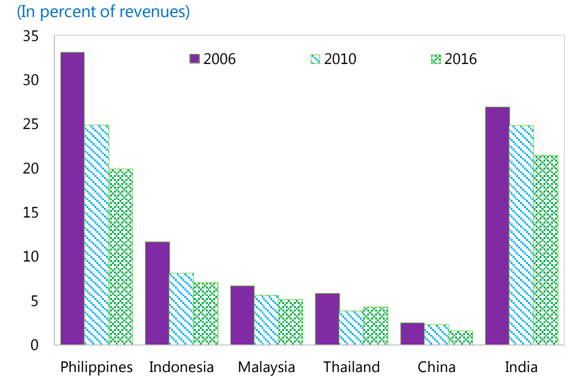
Although public debt declined, the government's gross funding needs are still substantial...

Gross Funding Needs, 2011
(In percent of GDP)



...and interest expenditure is high relative to revenue, reflecting the Philippines' low revenue ratio.

Interest Payment
(In percent of revenues)



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

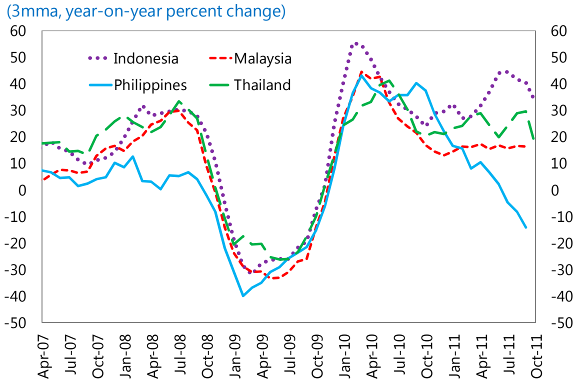
Figure 4. Philippines—Balance of Payments and External Adjustment

***Main Message**: The balance of payments has remained strong. Exports have been weak and capital inflows have moderated since August, but remittances have been resilient.*

Exports have been growing more slowly than in other ASEAN economies.

Exports of Goods

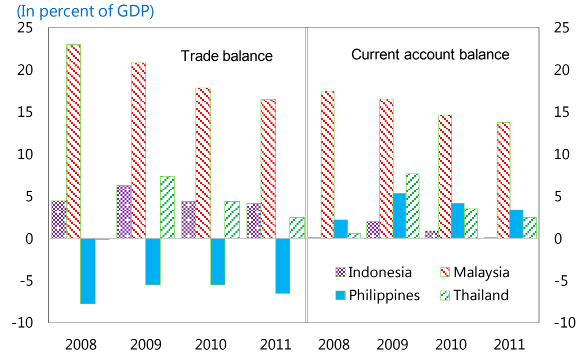
(3mma, year-on-year percent change)



The current account balance remains in surplus, supported by resilient remittances.

Trade Balance and Current Account Balance

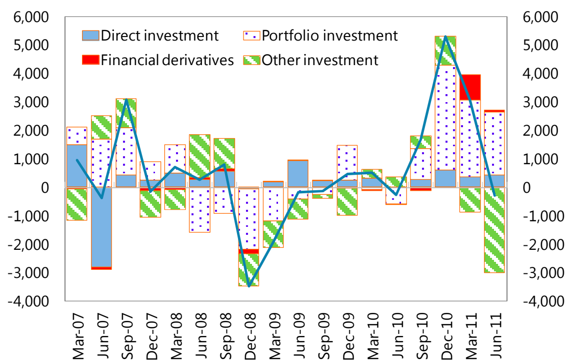
(In percent of GDP)



Capital inflows have moderated since the peak in late 2010...

Capital Inflows

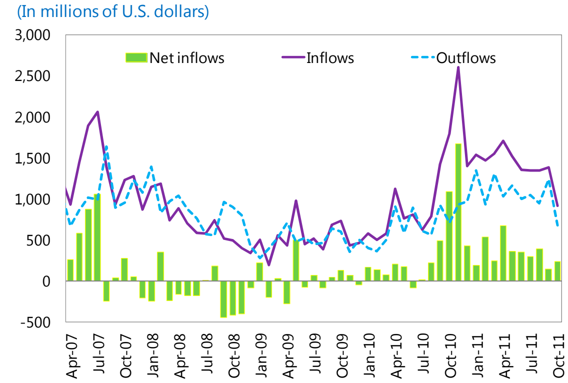
(In millions of U.S. dollars)



...including portfolio investment inflows.

Foreign Portfolio Investment

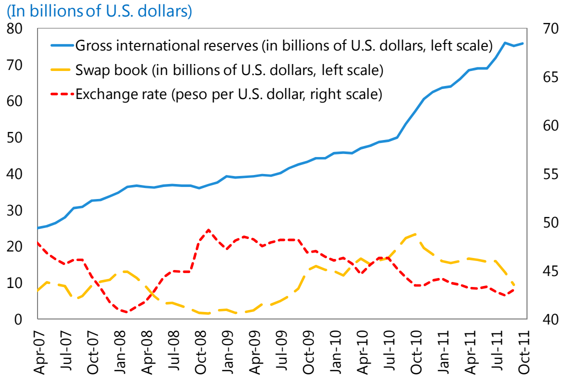
(In millions of U.S. dollars)



International reserves have risen at a record pace.

International Reserves

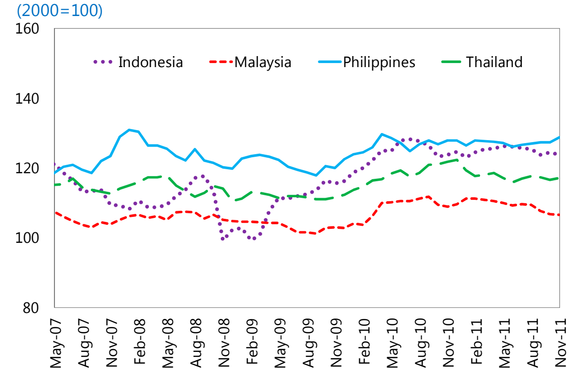
(In billions of U.S. dollars)



The peso has remained roughly unchanged in real effective terms.

Real Effective Exchange Rate

(2000=100)



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

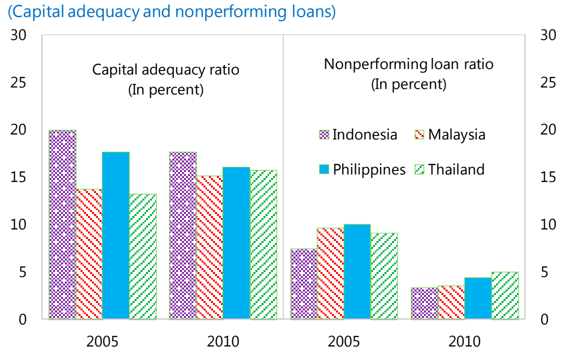
Figure 5. Financial Stability and Asset Prices

***Main Message**: The financial sector remains sound. P/E ratios have increased in recent months, while property prices and credit to the real estate sector have remained moderate.*

Philippine banks are well-capitalized, and nonperforming loans are relatively low.

Financial Sector Soundness

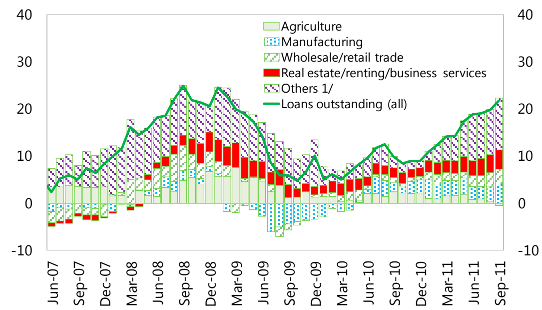
(Capital adequacy and nonperforming loans)



Bank lending has started to pick up in recent months across all sectors.

Loans Outstanding: Contribution to Growth

(Year-on-year percent change)

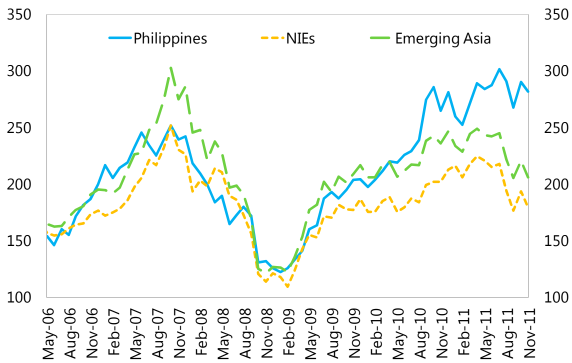


1/ Others include electricity, transportation, financial intermediation, and household consumption.

Equity prices have reached their pre-crisis levels.

Stock Market Indices

(2000=100, end of period)



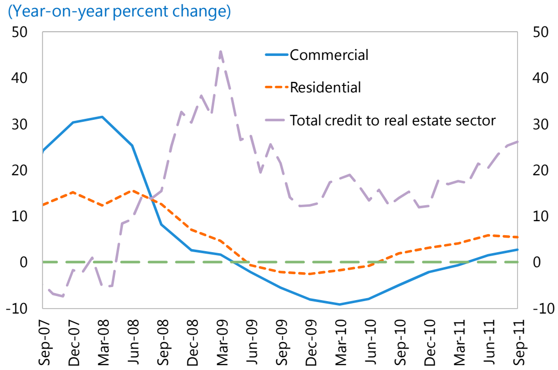
And P/E ratios have increased in recent months.

Price to Earnings Ratios

Property prices remain moderate notwithstanding the pre-crisis run up in prices and real estate credit.

Real Estate Prices and Credit Growth

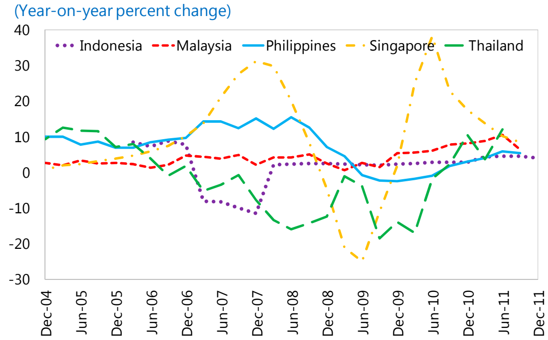
(Year-on-year percent change)



The residential property market remains soft unlike in some countries in the region.

Residential Property Prices 1/

(Year-on-year percent change)



1/ Prices in 14 cities are used for Indonesia. Prices in Makati are used for the Philippines.

Sources: Bloomberg L.P.; CEIC Data Company Ltd.; and Philippine authorities.

Table 1. Philippines: Selected Economic Indicators, 2008–13

Nominal GDP (2010): P 9,003 billion ($199.6 billion)
Population (2010): 94.0 million
GDP per capita (2010): $2,123
Poverty headcount ratio at $2 a day at PPP (2006): 45 percent
IMF quota: SDR 1,019.3 million
Main products and exports: Electronics and agricultural products
Unemployment rate (July 2011): 7.1 percent

	2008	2009	2010	2011	2012	2013
				Staff proj.		
GDP and prices (percent change)						
Real GDP	4.2	1.1	7.6	3.7	4.2	4.7
CPI (annual average)	9.3	3.2	3.8	4.5	4.0	4.0
CPI (end year)	8.0	4.3	3.1	4.6	4.4	4.0
Investment and saving (percent of GDP)						
Gross investment	19.3	16.6	20.5	20.8	20.6	21.0
National saving 1/	21.4	22.1	25.0	24.0	22.5	22.8
Public finances (percent of GDP)						
National government balance (authorities definition)	-0.9	-3.7	-3.5	-1.5	-2.6	-2.0
National government balance 2/	-1.4	-3.8	-3.6	-1.5	-2.7	-2.0
Nonfinancial public sector balance 3/	-0.3	-3.2	-3.4	-0.6	-2.3	-1.7
Revenue and grants 4/	22.0	19.9	18.4	18.3	18.6	19.0
Expenditure	22.3	23.1	21.8	18.9	21.0	20.7
Nonfinancial public sector debt	58.2	58.1	53.5	51.3	50.6	48.8
Monetary sector (percent change, end of period)						
Broad money (M3)	10.0	8.6	10.9	7.2 5/	...	...
Interest rate (91-day treasury bill, end of period, in percent) 6/	5.8	4.3	1.3	1.7 7/	...	...
Credit to the private sector 8/	20.5	10.0	8.9	22.5 9/	...	...
External sector						
Export value (percent change)	-2.5	-22.1	34.9	-1.5	0.5	3.4
Import value (percent change)	5.6	-24.0	32.9	7.7	2.1	4.7
Current account (percent of GDP)	2.1	5.6	4.5	3.2	1.8	1.9
Capital and Financial account (US$ billions, excluding errors and omissions)	-1.6	-1.6	7.3	4.0	3.6	3.6
Direct investment (net)	1.3	1.6	1.2	1.0	1.1	1.1
Other	-2.9	-3.2	6.1	3.0	2.5	2.5
Errors and omissions (US$ billions)	-1.9	-1.3	-2.0	0.0	0.0	0.0
Overall balance (US$ billions)	0.1	6.4	14.3	10.9	7.8	8.1
Total external debt (percent of GDP) 10/	37.6	38.5	36.9	36.5	36.5	36.2
Debt service ratio 11/	12.7	14.3	11.2	12.5	12.2	13.6
Reserves, adjusted (US$ billions) 12/	35.9	44.2	62.4	75.3	84.7	94.8
Reserves/short-term liabilities, adjusted 13/	283.2	391.3	375.8	469.1	463.3	504.0
Exchange rate (period averages)						
Pesos per U.S. dollar	44.5	47.6	45.1	43.3	...	...
Nominal effective exchange rate (2005 =100)	113.5	106.7	109.4	108.5	...	...
Real effective exchange rate (2005 =100)	124.5	121.2	126.8	127.5	...	...

Sources: Philippine authorities; and IMF staff projections.

1/ The saving rate (percent of GDP) is calculated as the sum of the investment rate (percent of GDP) and the current account (percent of GDP).
2/ Fund definition. Excludes privatization receipts and includes deficit from restructuring of the central bank (Central Bank-Board of Liquidators).
3/ Includes the national government, Central Bank-Board of Liquidators, 14 monitored government-owned enterprises, social security institutions, and local governments.
4/ Excludes public financial institutions and privatization receipts.
5/ November 2011 (year-on-year).
6/ Secondary market rate.
7/ December 2011.
8/ Commercial Banks Loans excluding BSP Reverse Repurchase Agreements.
9/ November 2011.
10/ Includes liabilities of foreign banks in the Philippines to their headquarters, branches and agencies, external debt not registered with the central bank, and private capital lease agreements.
11/ In percent of exports of goods and nonfactor services.
12/ Adjusted for gold and securities pledged as collateral against short-term liabilities.
13/ Short-term liabilities include medium- and long-term debt due in the following year.

Table 2. Philippines: National Government Cash Accounts, 2008–13

(In billions of pesos, unless otherwise noted)

	2008	2009	2010	2011 Budget	2011 Rev. Proj.	2012 Budget	2012 Proj.	2013 Proj.
Revenue and grants	1,173	1,128	1,208	1,408	1,361	1,569	1,474	1,640
Tax revenue	1,049	988	1,094	1,273	1,205	1,445	1,329	1,485
Net income and profits	482	452	489	…	572	…	620	675
Excises	77	68	88	…	91	…	98	106
VAT	297	302	330	…	369	…	392	421
Tariffs	88	68	81	…	56	…	53	56
Other 1/ 2/	105	97	106	…	116	…	166	227
Nontax revenue	124	140	114	134	156	123	144	155
Expenditure and net lending	1,282	1,429	1,529	1,714	1,507	1,861	1,758	1,873
Current expenditures	1,043	1,149	1,240	1,371	1,269	1,481	1,431	1,584
Personnel services	375	414	469	542	505	596	576	627
Maintenance and operations	139	178	189	215	179	276	246	279
Allotments to local government units	171	203	219	230	237	219	219	255
Subsidies	17	17	17	20	31	18	18	25
Tax expenditure	59	51	46	39	32	33	33	36
Interest	283	286	301	324	285	340	340	361
Capital and equity expenditure 3/	225	275	280	320	221	357	304	278
Net lending	14	5	9	23	17	23	23	11
Balance	-109	-301	-321	-306	-146	-292	-284	-233
On the authorities' presentation 4/	-68	-294	-314	-300	-143	-286	-278	-227

Sources: Philippine authorities; and IMF staff projections.

1/ Projections include possible gains from tax administrative measures for 2012 and 2013.

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

3/ Excludes purchase of National Power Corporation (NPC) securities and other on lending; includes capital transfers to local government units (LGUs). May exceed public investment in years when capital transfers to LGUs exceed their reported capital spending.

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

Table 3. Philippines: National Government Cash Accounts, 2008–13

(In percent of GDP, unless otherwise noted)

	2008	2009	2010	2011		2012		2013
				Budget	Rev. Proj.	Budget	Proj.	
Revenue and grants	15.2	14.1	13.4	14.4	13.9	14.5	13.9	14.2
Tax revenue	13.6	12.3	12.1	13.0	12.3	13.4	12.6	12.9
Net income and profits	6.2	5.6	5.4	...	5.9	...	5.9	5.9
Excises	1.0	0.9	1.0	...	0.9	...	0.9	0.9
VAT	3.8	3.8	3.7	...	3.8	...	3.7	3.7
Tariffs	1.1	0.9	0.9	...	0.6	...	0.5	0.5
Other 1/ 2/	1.4	1.2	1.2	...	1.2	...	1.6	2.0
Nontax revenue	1.6	1.7	1.3	1.4	1.6	1.1	1.4	1.3
Expenditure and net lending	16.6	17.8	17.0	17.6	15.4	17.2	16.6	16.3
Current expenditures	13.5	14.3	13.8	14.0	13.0	13.7	13.5	13.7
Personnel services	4.9	5.2	5.2	5.6	5.2	5.5	5.4	5.4
Maintenance and operations	1.8	2.2	2.1	2.2	1.8	2.5	2.3	2.4
Allotments to local government units	2.2	2.5	2.4	2.4	2.4	2.0	2.1	2.2
Subsidies	0.2	0.2	0.2	0.2	0.3	0.2	0.2	0.2
Tax expenditure	0.8	0.6	0.5	0.4	0.3	0.3	0.3	0.3
Interest	3.7	3.6	3.3	3.3	2.9	3.1	3.2	3.1
Capital and equity expenditure 3/	2.9	3.4	3.1	3.3	2.3	3.3	2.9	2.4
Net lending	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.1
Balance	-1.4	-3.8	-3.6	-3.1	-1.5	-2.7	-2.7	-2.0
On the authorities' presentation 4/	-0.9	-3.7	-3.5	-3.1	-1.5	-2.6	-2.6	-2.0
Memorandum items:								
Nonfinancial public sector balance 5/	-0.3	-3.2	-3.4	...	-0.6	...	-2.3	-1.7
Consolidated public sector balance 5/	0.0	-3.1	-4.0	...	-1.2	...	-3.0	-2.4
Primary national government balance	2.2	-0.2	-0.2	0.2	1.4	0.4	0.5	1.1
National government debt 6/	46.7	47.1	44.9	...	42.9	...	42.2	40.7
(Percent of NG revenues)	307.4	334.8	334.8	...	307.6	...	303.1	285.8
Nonfinancial public sector debt /7	58.2	58.1	53.5	...	51.3	...	50.6	48.8
(Percent of NFPS revenues)	264.7	291.7	291.0	...	280.5	...	271.9	257.3
National government gross financing requirement 8/	14.1	17.6	14.9	...	11.3	...	10.2	10.1
GDP (in billions of pesos)	7,721	8,026	9,003	9,761	9,761	10,823	10,578	11,521

Sources: Philippine authorities; and IMF staff projections.

1/ Projections include possible gains from tax administrative measures for 2012 and 2013.
2/ Includes other percentage taxes, documentary stamp tax, and noncash collections. Noncash collections are also reflected as tax expenditures under current expenditures.
3/ Excludes purchase of National Power Corporation (NPC) securities and other on lending; includes capital transfers to local government units (LGUs). May exceed public investment in years when capital transfers to LGUs exceed their reported capital spending.
4/ Includes privatization receipts as revenue and excludes the operations of the Central Bank-Board of Liquidators (CB-BOL).
5/ Excludes privatization receipts from revenue.
6/ Consolidated (net of national government debt held by the sinking fund) and excluding contingent/guaranteed debt.
7/ Nonfinancial public sector includes the national government, CB-BOL, 14 monitored government-owned enterprises, social security institutions, and local governments. Debt is consolidated (net of intra-nonfinancial public sector holdings of debt).
8/ Defined as the deficit, plus amortization of medium- and long-term debt, plus the stock of short-term debt at the end of the last period, plus market financing on behalf of NPC.

Table 4. Philippines: Depository Survey, 2008–11

(In billions of pesos, unless otherwise indicated)

	2008 Dec.	2009 Dec.	2010 Dec.	2011 Aug.
Depository Corporations				
Net foreign assets	2,027,856	2,425,533	2,865,080	3,182,886
Net domestic assets	2,560,622	2,559,344	2,662,986	2,249,598
Net claims on nonfinancial public sector	1,108,389	1,189,037	1,367,313	1,335,247
Claims on private sector	2,244,079	2,340,648	2,663,097	2,896,340
Net claims on other financial corporations	66,114	-114,655	-410,931	-887,134
Capital accounts	1,012,094	1,044,020	1,080,747	1,138,132
Other items (net)	154,134	188,334	124,255	43,277
Broad money	4,588,478	4,984,876	5,528,067	5,432,484
National currency	3,656,740	3,954,489	4,462,060	4,398,961
Foreign currency	931,738	1,030,388	1,066,007	1,033,524
Central Bank of the Philippines				
Net foreign assets	1,680,066	1,969,717	2,657,283	3,141,921
Net domestic assets	-704,227	-890,032	-1,503,183	-2,038,958
Claims on private sector	1	1	1	1
Net claims on financial corporations	-529,536	-689,101	-1,417,264	-1,815,212
Capital accounts	388,093	323,242	233,202	217,553
Other items (net)	8,593	-16,863	-14,953	-20,602
Base money	961,466	1,047,928	1,120,546	1,097,534
Currency in circulation	545,095	582,533	601,275	528,341
Other depository corporations liabilities	414,384	464,965	518,755	568,607
Other liquid liabilities	14,373	31,758	33,554	5,429
Other Depository Corporations				
Net foreign assets	347,790	455,815	207,797	40,965
Net domestic assets	3,791,351	4,035,382	4,807,774	4,967,626
Net claims on nonfinancial public sector	903,582	1,049,864	1,205,078	1,320,839
Claims on private sector	2,244,078	2,340,647	2,663,096	2,896,339
Net claims on financial corporations	1,014,447	1,146,154	1,642,090	1,608,120
Capital accounts	624,001	720,778	847,546	920,579
Other items (net)	253,245	219,495	145,056	62,906
Liquid liabilities	4,139,141	4,491,197	5,015,571	5,008,591

Sources: Philippine authoriites, *New Depository Corporation Survey*; and CEIC Data Co., Ltd.

Table 5. Philippines: Balance of Payments, 2008–2013

(In billions of U.S. dollars)

	2008	2009	2010	2011	2012	2013
Current account balance	3.6	9.4	8.9	7.0	4.2	4.5
Trade balance	-12.9	-8.8	-11.0	-16.5	-17.6	-19.1
Exports, f.o.b.	48.3	37.6	50.7	50.0	50.2	52.0
Imports, f.o.b.	61.1	46.5	61.7	66.5	67.9	71.0
Services (net)	1.2	2.1	2.9	3.4	4.3	5.2
Receipts	9.7	11.0	14.4	16.1	17.6	19.3
Payments	8.6	8.9	11.4	12.7	13.3	14.1
Income	0.1	-0.2	0.3	2.3	-1.0	-1.0
Receipts, *of which* :	6.0	5.7	6.1	8.2	6.7	7.0
Remittances of resident workers abroad 1/	4.1	4.6	5.1	5.5	5.8	6.1
Payments	5.9	5.9	5.7	5.8	7.7	8.0
Interest payments	3.2	2.6	2.5	2.6	4.3	4.4
Transfers (net)	15.2	16.3	16.6	17.7	18.5	19.4
Receipts, *of which* :	15.8	16.9	17.4	18.6	19.5	20.4
Nonresident workers remittances 1/	14.5	15.1	16.2	17.1	17.9	18.8
Payments	0.5	0.6	0.8	0.9	0.9	1.0
Capital and financial account	-1.6	-1.6	7.3	4.0	3.6	3.6
Capital account	0.1	0.1	0.1	0.1	0.1	0.1
Financial account	-1.7	-1.7	7.2	3.9	3.5	3.5
Direct investment	1.3	1.6	1.2	1.0	1.1	1.1
Portfolio investment	-3.6	-0.6	4.1	4.1	3.6	3.6
Equity	-1.2	-1.1	0.5	1.0	0.5	0.5
Debt	-2.4	0.5	3.6	3.1	3.1	3.1
Financial derivatives	-0.1	0.0	-0.2	0.0	0.0	0.0
Other investment, *of which* :	0.8	-2.7	2.1	-1.3	-1.1	-1.1
Currency and deposits	-3.7	4.0	-1.1	-1.2	-1.2	-1.2
Loans	-0.1	-2.4	4.8	-0.4	-0.3	-0.3
Errors and omissions	-1.9	-1.3	-2.0	0.2	0.0	0.0
Overall balance	0.1	6.4	14.3	11.1	7.8	8.1
Overall financing	-0.1	-6.4	-14.3	-11.1	-7.8	-8.1
Monetisation of gold and revaluation	2.2	1.8	3.8	1.8	1.8	1.9
Change in net international reserves (increase =-)	-2.3	-8.2	-18.1	-12.9	-9.6	-10.0
BSP gross reserves (increase =-)	-3.8	-6.7	-18.1	-12.9	-9.6	-10.0
Fund credit (net)	0.0	0.0	0.0	0.0	0.0	0.0
Change in other BSP liabilities	1.5	-1.5	0.0	0.0	0.0	0.0
Memorandum items:						
Current account/GDP	2.1	5.6	4.5	3.2	1.8	1.9
Short-term debt (original maturity)	10.0	6.5	10.6	11.4	12.3	13.3
Short-term debt (residual maturity)	14.3	11.3	16.6	16.1	18.3	18.8
Gross reserves	37.6	44.2	62.4	75.3	84.7	94.8
Adjusted gross reserves 2/	35.9	44.2	62.4	75.3	84.7	94.8
(in percent of st. debt by res. maturity) 3/	283.2	391.3	375.8	469.1	463.3	504.0
Net international reserves	36.0	44.2	62.4	75.3	84.7	94.8
Monitored external debt (in billions) 4/	65.3	64.9	73.7	78.2	83.2	88.2
(in percent of GDP)	37.6	38.5	36.9	36.5	36.5	36.2
Debt service ratio 5/	12.7	14.3	11.2	12.5	12.2	13.6
Export value (percent change)	-2.5	-22.1	34.9	-1.5	0.5	3.4
Import value (percent change)	5.6	-24.0	32.9	7.7	2.1	4.7
Gross external financing needs 6/	10.4	5.0	2.4	9.6	11.9	13.8
GDP (in billions)	173.6	168.5	199.6	213.9	228.1	243.6
Remittances value (percent change)	14.4	5.9	8.3	7.0	5.1	5.1
Change in swaps position (+ = increase in assets)	-8.4	11.2	4.3	…	…	…
Capital and financial account excluding change in swaps	-10.0	9.6	11.6	…	…	…

Sources: Philippine authorities; and Fund staff projections.

1/ The 2003–04 revisions to the data separate remittances made by Filipino residents working abroad (income), and nonresident workers' remittances (transfers).
2/ Gross reserves less gold and securities pledged as collateral against short term liabilities.
3/ As a percent of short-term debt, excluding pledged assets of the central bank.
4/ Monitored external liabilities are defined as external debt plus liabilities of foreign banks in the Philippines to their headquarters, branches and agencies, some external debt not registered with the central bank and private capital lease agreements.
5/ In percent of goods and nonfactor services exports.
6/ Defined as the current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at the end of the previous period.

Table 6. Philippines: Baseline Medium-Term Outlook, 2008–16

(In percent of GDP, unless otherwise indicated)

				Staff Proj.					
	2008	2009	2010	2011	2012	2013	2014	2015	2016
GDP and prices									
Real GDP (percent change)	4.2	1.1	7.6	3.7	4.2	4.7	5.0	5.0	5.0
GDP per capita (US$)	1,918	1,827	2,123	2,232	2,334	2,444	2,568	2,699	2,840
CPI (percent change, average)	9.3	3.2	3.8	4.5	4.0	4.0	4.0	4.0	4.0
Investment and saving									
Gross investment	19.3	16.6	20.5	20.8	20.6	21.0	21.1	21.2	21.3
Private	16.4	13.6	17.6	18.9	18.2	18.9	19.1	19.2	19.3
Public	2.9	3.0	2.9	1.9	2.4	2.1	2.0	2.0	2.0
National saving 1/	21.4	22.1	25.0	24.0	22.5	22.8	23.0	23.1	23.2
Private	18.5	22.3	26.2	23.4	23.0	23.1	23.3	23.5	23.7
Public	2.9	-0.2	-1.2	0.7	-0.5	-0.3	-0.3	-0.4	-0.5
Foreign saving	-2.1	-5.6	-4.5	-3.2	-1.8	-1.9	-1.9	-1.9	-1.9
Public finances									
Nonfinancial public sector balance 2/	-0.3	-3.2	-3.4	-0.6	-2.3	-1.7	-1.8	-1.7	-1.9
Primary balance	3.7	0.7	0.2	2.7	1.2	1.5	1.4	1.3	1.0
Revenue and grants 3/	22.0	19.9	18.4	18.3	18.6	19.0	19.0	19.0	19.1
Expenditure (primary) 4/	18.3	19.2	18.2	15.6	17.4	17.4	17.6	17.7	18.0
Interest	4.0	3.9	3.7	3.2	3.5	3.3	3.2	3.0	2.9
Nonfinancial public sector gross financing	14.0	18.0	15.2	10.6	10.0	9.9	9.5	9.0	9.2
Domestic	12.9	13.9	12.4	8.6	8.3	7.2	6.9	6.6	7.0
Foreign currency	1.0	4.1	2.9	2.0	1.7	2.7	2.6	2.4	2.2
National government balance (authorities definition)	-0.9	-3.7	-3.5	-1.5	-2.6	-2.0	-2.0	-2.0	-2.0
National government balance 5/	-1.4	-3.8	-3.6	-1.5	-2.7	-2.0	-2.1	-2.0	-2.1
Nonfinancial public sector debt 6/	58.2	58.1	53.5	51.3	50.6	48.8	47.0	45.3	43.7
External sector									
Export value (percent change)	-2.5	-22.1	34.9	-1.5	0.5	3.4	3.4	3.5	3.6
Import value (percent change)	5.6	-24.0	32.9	7.7	2.1	4.7	4.7	5.0	5.0
Trade balance	-7.4	-5.2	-5.5	-7.7	-7.7	-7.8	-7.9	-8.0	-8.1
Current account	2.1	5.6	4.5	3.2	1.8	1.9	1.9	1.9	1.9
FDI (net, US$ billions)	1.3	1.6	1.2	1.0	1.1	1.1	1.1	1.2	1.3
Reserves, adjusted (US$ billions) 7/	35.9	44.2	62.4	75.3	84.7	94.8	105.2	116.2	127.8
Reserves/short-term liabilities, adjusted 8/	283.2	391.3	375.8	469.1	463.3	504.0	527.2	542.2	559.6
Gross external financing requirements (US$ billions) 9/	10.4	5.0	2.4	9.6	11.9	13.8	14.0	14.6	15.7
Total external debt (in percent of GDP) 10/	37.6	38.5	36.9	36.5	36.5	36.2	35.7	35.1	34.4
Debt service ratio (in percent of exports of goods and servic	12.7	14.3	11.2	12.5	12.2	13.6	12.4	11.7	11.2

Sources: Philippine authorities; and IMF staff projections.

1/ The saving rate is calculated as the sum of the investment rate and the current account balance (all as a percent of GDP).
2/ Nonfinancial public sector includes the national government, CB-BOL, 14 monitored government-owned enterprises, social security institutions, and local governments.
3/ The sum of all nonfinancial public sector revenue net of intra-public sector payments. It is assumed that 80 percent of Bureau of Treasury revenue represents interest and dividends from other parts of the nonfinancial public sector. Privatization receipts are
4/ Defined as the difference between nonfinancial public sector revenue and primary balance.
5/ Excludes privatization receipts of the national government, and includes net deficit from restructuring the central bank.
6/ Net of intra-nonfinancial public sector holdings of debt.
7/ Gross reserves less gold and securities pledged as collateral against short-term liabilities.
8/ Reserves as a percent of short-term debt (including medium- and long-term debt due in the following year). Both reserves and debt were adjusted for gold-backed loans.
9/ Current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at the end of the previous period.
10/ Defined as external debt plus liabilities of foreign banks in the Philippines to their headquarters, branches and agencies, some external debt not registered with the central bank and private capital lease agreements.

Table 7. Philippines: Banking Sector Indicators, 2008–11 1/

(In percent)

	2008	2009	2010	2011 Q1
Capital adequacy				
Total capital accounts to total assets	10.6	11.1	11.7	12.0
Capital adequacy ratio (Solo) 2/	14.7	14.9	16.0	16.5
Asset quality				
NPL ratio 3/	4.5	4.1	3.9	4.0
NPA ratio 4/	5.1	4.5	3.9	3.9
Distressed asset ratio 5/	10.8	9.3	8.8	8.7
NPL coverage ratio 6/	86.0	93.1	97.6	101.4
NPA coverage ratio 7/	44.4	48.7	52.7	56.4
Profitability				
Return on assets	0.8	1.2	1.4	1.5
Return on equity	6.9	10.8	12.2	13.0
Cost-to-income ratio	74.2	65.8	63.6	63.2
Liquidity				
Liquid assets to deposits	52.5	52.7	59.7	60.2
Loans (gross) to deposits	69.7	68.1	64.5	65.0

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

1/ ROPA = Real and Other Property Acquired. ROPA is a measure of the stock of foreclosed properties held by a bank.
2/ Based on the new framework, universal/commercial banks are to incorporate operational risk in addition to credit and market risks.
3/ Nonperforming loans (NPL) over total loan portfolio excluding interbank loans (IBL).
4/ (Nonperforming loans + ROPA) over total gross assets.
5/ Ratio of (NPLs + Gross ROPA + current restructured loans) to (Gross total loan portfolio + Gross ROPA).
6/ Ratio of loan loss reserves to NPLs.
7/ Ratio of valuation reserves (for loans and ROPA) to NPAs.

Table 8. Philippines: Indicators of External Vulnerability, 2008–12

(In percent of GDP, unless otherwise indicated)

	2008	2009	2010	2011	2012
				Staff proj.	
External indicators (including external liquidity):					
Gross international reserves, adjusted (in billions U.S. dollars) 1/	35.9	44.2	62.4	75.3	84.7
Maturing short-term debt (in billions U.S. dollars)	10.0	6.5	10.6	11.9	12.9
Amortization of medium and long-term debt (in billions U.S. dollars)	4.1	4.3	4.8	6.0	4.7
Net FDI inflows (in billions of U.S. dollars)	1.3	1.6	1.2	1.0	1.1
FX deposits residents (in billions of U.S. dollars) 2/	20.6	22.8	25.1	...	...
Total gross external debt	37.6	38.5	36.9	36.5	36.5
Public sector indicators:					
Overall balance	-0.3	-3.2	-3.4	-0.6	-2.3
Primary balance	3.7	0.7	0.2	2.7	1.2
Nonfinancial public sector debt (NFPSD)	58.2	58.1	53.5	51.3	50.6
NFPSD denominated in FX or linked to the exchange rate (in percent of NFPSD)	58.5	58.8	54.1	53.1	52.5
Short-term general government debt (original maturity, in percent of NFPSD)	18.2	14.1	11.2	7.9	8.5
Average effective interest rate of government debt (in percent)	7.5	7.0	7.1	6.6	7.4
Amortization of total debt	15.6	12.8	10.5	8.5	8.2

Sources: Philippine authorities; and IMF staff projections.

1/ Gross reserves less gold and securities pledged as collateral against short-term liabilities.
2/ As of June, 2010.

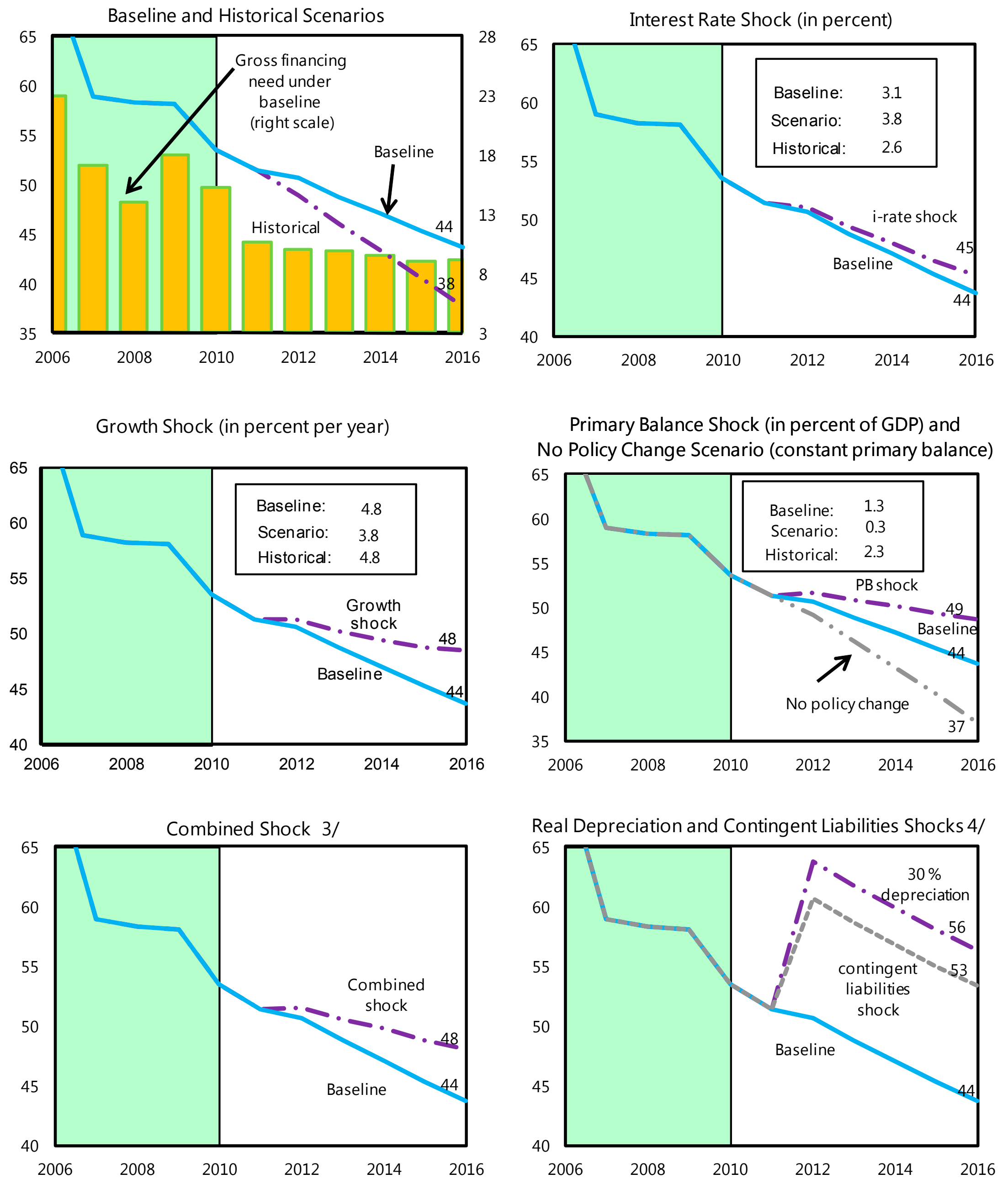
APPENDIX I: —DEBT SUSTAINABILITY ANALYSIS

1. **The outlook for public debt dynamics is favorable**. Nonfinancial sector public debt has been steadily declining from 96 percent of GDP in 2003 to 53.5 percent of GDP in 2010. Based on the government's medium-term objective of a national government deficit to 2 percent of GDP, public debt is projected to continue this declining trend to 44 percent of GDP by 2016. Gross financing need is also expected to decline from 15 percent of GDP in 2010 to 9 percent of GDP by 2016. If the deficit were to remain 1 percent of GDP higher than currently projected or if medium-term growth were lower by 1 percent, the decline in public debt will be more gradual and debt levels would remain at around 50 percent of GDP through 2016. Given the high share of foreign currency debt, the main vulnerability arises from exchange rate risk.

2. **Projected external debt dynamics are stable**. In recent years, external debt has steadily declined, from nearly 80 percent of GDP in 2001 to below 40 percent of GDP at end-2010. Under the staff's baseline scenario, the external debt ratio is projected to decline slightly, a result of current account surpluses. Further, the debt dynamics appear to be relatively resilient to various shocks: one-half standard deviation shocks to interest rates, growth, and the current account lead to only a modest deterioration in the debt ratios over the medium term. However, exchange rate volatility remains a vulnerability as a one-time real depreciation of 30 percent would entail a 14 percent jump in the external debt ratio from its end-2010 level.

Figure I.1. Philippines: Public Debt Sustainability: Bound Tests 1/ 2/

(Public debt, in percent of GDP)

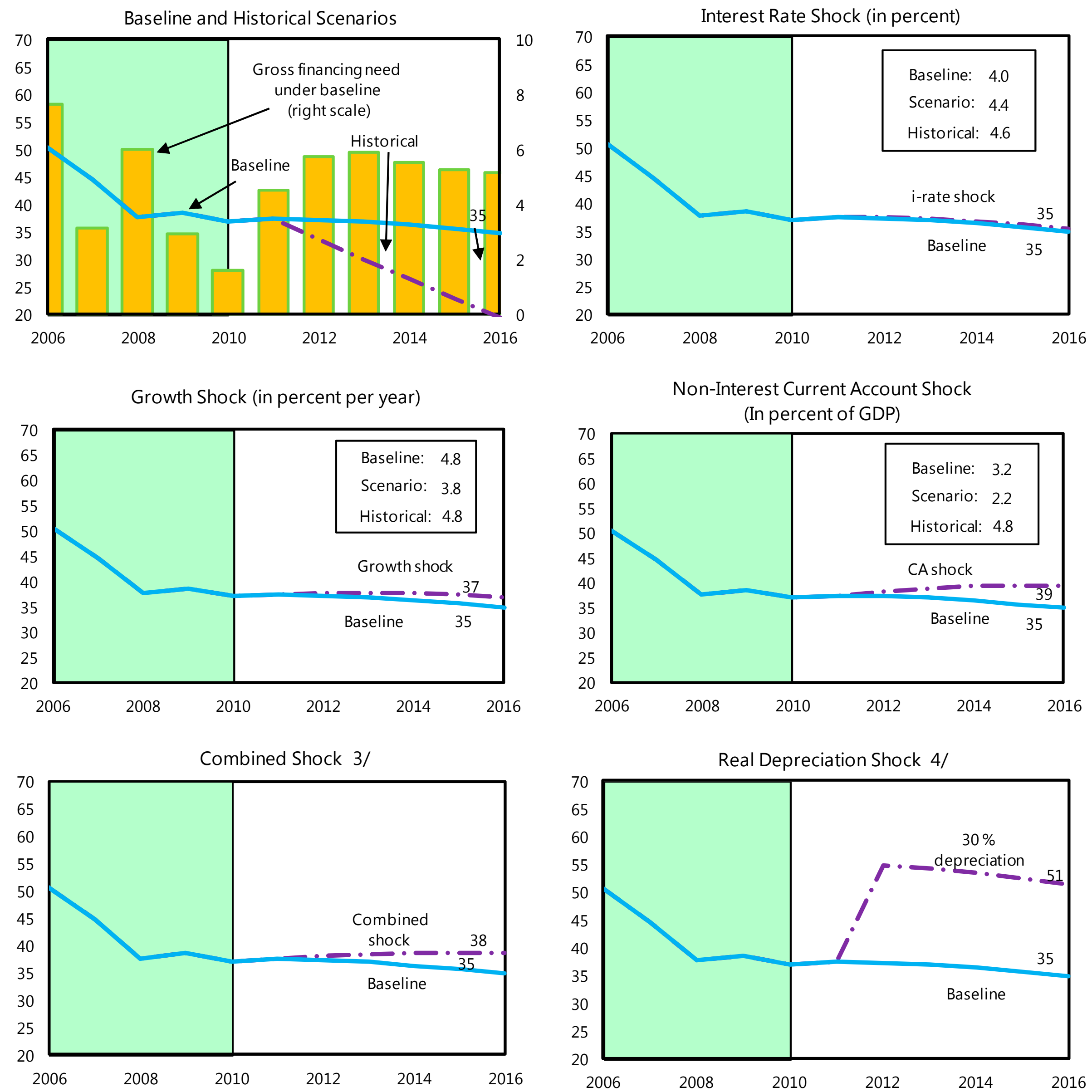


Sources: International Monetary Fund, country desk data; and staff estimates.

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 primary balance.
4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Figure I.2. Philippines: External Debt Sustainability: Bound Tests 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

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

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 I.1. Philippines: Public Sector Debt Sustainability Framework, 2006?2016

(In percent of GDP, unless otherwise indicated)

		Actual					Projections					
		2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
1	Baseline: public sector debt 1/	71.1	58.9	58.2	58.1	53.5	51.3	50.6	48.8	47.0	45.3	43.7
	Of which: foreign-currency denominated	43.5	33.7	34.0	34.1	29.0	27.3	26.6	26.2	25.8	25.5	24.6
2	Change in public sector debt	-11.2	-12.2	-0.7	-0.1	-4.6	-2.2	-0.7	-1.9	-1.7	-1.8	-1.6
3	Identified debt-creating flows (4+7+12)	-10.9	-13.3	-0.8	-0.7	-4.2	-3.4	-1.5	-2.2	-2.2	-2.1	-1.8
4	Primary deficit	-5.6	-4.6	-3.7	-0.7	-0.2	-2.7	-1.2	-1.5	-1.4	-1.3	-1.0
5	Revenue and grants	22.1	23.2	22.0	19.9	18.4	18.3	18.6	19.0	19.0	19.0	19.1
6	Primary (noninterest) expenditure	16.5	18.6	18.3	19.2	18.2	15.6	17.4	17.4	17.6	17.7	18.0
7	Automatic debt dynamics 2/	-5.8	-8.5	2.3	0.9	-4.3	-0.9	-0.4	-0.9	-0.9	-0.9	-0.9
8	Contribution from interest rate/growth differential 3/	-2.2	-2.0	-2.4	1.7	-2.6	-0.9	-0.4	-0.9	-0.9	-0.9	-0.9
9	*Of which*: contribution from real interest rate	1.7	2.3	-0.2	2.4	1.3	0.9	1.5	1.3	1.3	1.2	1.2
10	*Of which*: contribution from real GDP growth	-3.9	-4.3	-2.2	-0.6	-4.0	-1.8	-2.0	-2.2	-2.2	-2.2	-2.1
11	Contribution from exchange rate depreciation 4/	-3.5	-6.5	4.6	-0.8	-1.7	...	...	...	...	...	...
12	Other identified debt-creating flows	0.4	-0.2	0.7	-0.9	0.3	0.2	0.1	0.2	0.1	0.1	0.1
13	Privatization receipts (negative)	-0.1	-1.3	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
14	Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
15	Other (specify, e.g., bank recapitalization)	0.5	1.1	1.1	-0.9	0.4	0.2	0.2	0.2	0.2	0.1	0.1
16	Residual, including asset changes (2-3) 5/	-0.3	1.1	0.1	0.5	-0.3	1.2	0.8	0.4	0.4	0.3	0.2
	Public sector debt-to-revenue ratio 1/	321.5	253.5	264.7	291.7	291.0	280.5	271.9	257.3	247.8	238.1	229.3
	Gross financing need 6/	23.0	17.1	14.0	18.0	15.2	10.6	10.0	9.9	9.5	9.0	9.2
	In billions of U.S. dollars	28.1	25.5	24.2	30.3	30.4	22.5	22.6	24.2	24.7	25.2	27.6
	Scenario with key variables at their historical averages 7/						51.3	48.9	46.1	43.4	40.6	37.7
	Scenario with no policy change (constant primary balance) in 2011?2016						51.3	49.2	46.2	43.2	40.1	36.9
	Key macroeconomic and fiscal assumptions underlying baseline											
	Real GDP growth (in percent)	5.2	6.6	4.2	1.1	7.6	3.7	4.2	4.7	5.0	5.0	5.0
	Average nominal interest rate on public debt (in percent) 8/	7.5	6.8	7.5	7.0	7.1	6.6	7.4	7.0	7.1	7.0	7.1
	Average real interest rate (nominal rate minus change in GDP deflator, in percent)	2.5	3.7	0.0	4.3	2.8	2.0	3.4	3.0	3.1	3.0	3.1
	Nominal appreciation (increase in U.S. dollar value of local currency, in percent)	8.0	18.7	-12.8	2.4	5.6	...	...	...	...	...	...
	Inflation rate (GDP deflator, in percent)	4.9	3.1	7.5	2.8	4.2	4.6	4.0	4.0	4.0	4.0	4.0
	Growth of real primary spending (deflated by GDP deflator, in percent)	1.9	20.5	2.2	6.2	1.8	-10.7	16.1	4.7	6.1	5.8	6.6
	Primary deficit	-5.6	-4.6	-3.7	-0.7	-0.2	-2.7	-1.2	-1.5	-1.4	-1.3	-1.0

1/ Coverage of public sector is for non-financial public sector gross debt.
2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Derived as nominal interest expenditure divided by previous period debt stock.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table I.2. Philippines: External Debt Sustainability Framework, 2006–2016

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2006	2007	2008	2009	2010			2011	2012	2013	2014	2015	2016	Debt-stabilizing non-interest current account 6/
Baseline: external debt	50.4	44.6	37.6	38.5	36.9			37.4	37.2	36.9	36.3	35.6	34.8	-2.0
Change in external debt	-9.8	-5.8	-7.0	0.9	-1.6			0.5	-0.2	-0.3	-0.6	-0.7	-0.8	
Identified external debt-creating flows (4+8+9)	-18.2	-15.6	-8.3	-4.7	-11.3			-5.5	-3.5	-4.0	-4.1	-4.3	-4.3	
Current account deficit, excluding interest payments	-7.0	-7.1	-4.0	-7.1	-5.8			-4.3	-3.0	-3.2	-3.2	-3.2	-3.1	
Deficit in balance of goods and services	5.4	4.1	6.8	4.0	4.0			6.1	6.3	5.8	5.6	5.5	5.3	
Exports	43.3	39.7	33.4	28.9	32.6			30.9	29.7	29.2	28.6	28.1	27.6	
Imports	48.7	43.8	40.1	32.9	36.6			37.1	36.0	35.0	34.3	33.6	32.9	
Net nondebt creating capital inflows (negative)	-4.4	-1.7	0.0	-0.3	-0.9			-0.9	-0.7	-0.7	-0.6	-0.6	-0.6	
Automatic debt dynamics 1/	-6.7	-6.7	-4.4	2.7	-4.7			-0.2	0.1	-0.1	-0.3	-0.5	-0.5	
Contribution from nominal interest rate	2.7	2.4	1.9	1.5	1.3			1.0	1.6	1.5	1.4	1.2	1.1	
Contribution from real GDP growth	-2.7	-2.7	-1.6	-0.4	-2.5			-1.3	-1.5	-1.6	-1.7	-1.7	-1.7	
Contribution from price and exchange rate changes 2/	-6.7	-6.4	-4.6	1.6	-3.5			...	...	...	...	...	...	
Residual, including change in gross foreign assets (2-3) 3/	8.3	9.8	1.3	5.6	9.8			5.9	3.4	3.7	3.6	3.6	3.5	
External debt-to-exports ratio (in percent)	116.4	112.5	112.6	133.4	113.3			121.0	125.3	126.3	126.8	126.7	126.1	
Gross external financing need (in billions of U.S. dollars) 4/	9.3	4.7	10.4	5.0	2.4			9.7	13.1	14.4	14.4	14.7	15.6	
In percent of GDP	7.6	3.1	6.0	3.0	1.2			4.5	5.7	5.9	5.5	5.2	5.2	
Scenario with key variables at their historical averages 5/						10-Year Historical Average	10-Year Standard Deviation	37.4	33.6	30.0	26.4	22.9	19.5	-2.4
Key macroeconomic assumptions underlying baseline														
Real GDP growth (in percent)	5.2	6.6	4.2	1.1	7.6	4.8	1.9	3.7	4.2	4.7	5.0	5.0	5.0	
GDP deflator in U.S. dollars (change in percent)	12.7	14.6	11.6	-4.0	10.1	4.7	7.8	3.4	2.6	2.1	2.1	2.2	2.3	
Nominal external interest rate (in percent)	5.3	5.8	4.8	3.9	4.1	4.6	0.6	3.0	4.5	4.4	4.2	3.7	3.4	
Growth of exports (U.S. dollar terms, in percent)	18.3	11.9	-2.2	-16.1	33.9	5.8	15.0	1.6	2.6	5.0	5.2	5.4	5.5	
Growth of imports (U.S. dollar terms, in percent)	10.5	9.8	6.5	-20.6	32.1	5.0	13.9	8.4	3.7	4.1	4.8	5.2	5.2	
Current account balance, excluding interest payments	7.0	7.1	4.0	7.1	5.8	4.8	2.0	4.3	3.0	3.2	3.2	3.2	3.1	
Net nondebt creating capital inflows	4.4	1.7	0.0	0.3	0.9	1.4	1.4	0.9	0.7	0.7	0.6	0.6	0.6	

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 U.S. 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
3/ For projection, line includes the impact of price and exchange rate changes.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

APPENDIX II: —TRANSITION TO GFSM 2001

The presentation of national government operations in the main text of the staff report follows the GFSM 1986 format (on a cash basis). To promote international compatibility of government operations, preliminary data consolidated to the general government level in a GFSM 2001 format is presented in this Appendix. The authorities are in the process of improving the coverage and reporting of fiscal data.

Table II.1. Philippines: General Government Operations, 2007–11

(In percent of GDP)

	2007	2008	2009	2010	2011 Proj.
Revenue	18.7	18.7	17.4	16.7	17.3
Taxes	14.4	14.4	13.1	12.9	13.1
Taxes on income, profits, and capital gains	6.2	6.2	5.6	5.4	5.9
Taxes on goods and services	6.0	5.8	5.6	5.6	5.6
Taxes on international trade and transactions	1.0	1.1	0.9	0.9	0.6
Taxes not elsewhere classified	1.2	1.2	1.0	1.0	1.0
Social contributions	1.9	1.8	1.9	1.9	1.9
Grants	0.0	0.0	0.0	0.0	0.0
Other revenue	2.4	2.4	2.4	1.9	2.3
Total expenditure	19.0	18.6	20.1	19.2	17.5
Expense	16.3	15.8	16.7	16.1	15.4
Compensation of employees 1/	5.1	4.9	5.2	5.2	5.2
Purchases/use of goods and services 1/	1.8	1.8	2.2	2.1	1.8
Interest 1/	3.7	3.4	3.3	3.0	2.6
Social benefits	1.5	1.5	1.7	1.7	1.7
Expense not elsewhere classified	4.1	4.2	4.3	4.1	4.0
Net acquisition of nonfinancial assets	2.7	2.9	3.4	3.1	2.2
Net lending/borrowing	-0.3	0.0	-2.7	-2.5	-0.3
National government	-1.4	-1.2	-3.7	-3.4	-1.2
Local government units	0.3	0.5	0.4	0.4	0.4
Social security institutions (SSIs)	0.8	0.8	0.5	0.5	0.6
Net acquisition of financial assets	1.3	1.8	0.2	1.5	1.5
Net incurrence of liabilities	1.6	1.8	2.9	4.0	1.7
Memorandum items:					
National government cash holdings	3.6	3.8	2.9	3.0	…
Consolidated general government debt	44.6	44.2	44.3	42.2	40.4

Sources: Philippine authorities; and IMF staff projections.

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

INTERNATIONAL MONETARY FUND

PHILIPPINES

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 18, 2012

Prepared By	Asia and Pacific Department

CONTENTS

ANNEX I: PHILIPPINES—FUND RELATIONS

(As of December 31, 2011)

I. Membership Status: Joined December 27, 1945; Article VIII

II. General Resources Account

	SDR Millions	Percent of Quota
Quota	1,019.30	100.00
Fund holdings of currency	711.81	69.83
Reserve position in Fund	307.51	30.17

III. SDR Department

	SDR Millions	Percent of Allocation
Net cumulative allocation	837.96	100.00
Holdings	728.13	86.89

IV. Outstanding Purchases and Loans: None

V. 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

VI. Projected Payments to Fund (SDR millions; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2012	2013	2014	2015	2016
Principal					
Charges/interest	0.15	0.13	0.13	0.13	0.13
Total	0.15	0.13	0.13	0.13	0.13

VII. Exchange Arrangement:

The de jure exchange rate arrangement is *free floating*, while the de facto exchange arrangement is classified as *floating*. The value of the Philippine peso is determined in the interbank foreign exchange market; the Bangko Sentral intervenes in the spot and forward markets in order to smooth undue short-term fluctuations in the exchange rate and to strategically build reserves. The Philippines has not introduced any new exchange measure that could give rise to multiple currency practices and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions.

VIII. Article IV Consultation:

The Philippines is on the standard 12-month cycle. The 2010 Article IV consultation was discussed by the Executive Board on February 18, 2011 (IMF Country Report No. 11/59).

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

MCM: The Philippines' 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 update mission took place in November 2009.

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.

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

X. Technical Assistance:

An MCM resident banking supervision advisor has been stationed in Manila since May 2003, to assist the BSP in the implementation of a new supervisory model. MCM TA in the area of problem bank identification, management, and resolution took place in March 2009 and, together with TA on banking supervision, in April-May and October-December 2010 and a TA mission on stress testing visited Manila in June 2009. The Japan Administered Account for Selected IMF Activities inspection visit took place in May 2010.

A STA peripatetic mission visited Manila in July–August 2003, January–February 2004, and February–March 2005 to provide TA in balance of payments and international investment position statistics and in implementing the recommendations made by the ROSC Data Module mission. An STA mission took place in March-April 2006 to assist the authorities in compiling and disseminating government finance statistics in accordance with *Government Finance Statistics Manual 2001*. A STA mission took place in August 2009 to finalize a monetary statistics compilation system based on the Standardized Report Forms.

In the fiscal area, FAD has executed a TA project financed by the Millennium Challenge Corporation to improve the basic functions of tax administration by the Bureau of Internal Revenue, in line with recommendations made by FAD TA missions in 2005, 2008, and 2009. The project provides for a resident tax advisor as well as an extensive program of short-term expert visits. FAD TA on tax policy in 2010 and 2011 assessed the Philippines' tax system and advised on a road map for a pro-growth and equitable tax system. On public financial management areas, FAD has provided TA on spending controls and cash management, including through a peripatetic advisor on cash management since 2009.

An LEG legal expert visited Manila to discuss anti-money laundering initiatives in March 2002 and for the regional United Nations Security Council Resolutions/Financing of Terrorism Convention Project workshop in July 2010.

XI. Resident Representative:

A Resident Representative has been stationed in Manila since January 1984. Mr. Dennis Botman assumed the post of Resident Representative in January 2009.

ANNEX II: PHILIPPINES—IMF-WORLD BANK COLLABORATION

(As of December 30, 2011)

1. The Bank and the Fund country teams on the Philippines led by Mr. Rogier van den Brink, Lead Economist, World Bank, and Mr. Vivek Arora, Assistant Director, IMF mission chief, respectively, exchanged views to coordinate the teams' work during 2012.[1]

2. The teams agreed on the Philippines' main macroeconomic challenges. The key policy challenge now is to navigate the uncertain global environment to maintain macroeconomic stability, create policy space to meet future potential shocks, and build the foundations for faster and more inclusive growth.

3. Maintaining macroeconomic stability in an uncertain global environment. Monetary policy has responded well to changing circumstances. International reserves and exchange rate flexibility provide a cushion against external shocks while facilitating the adjustment to sustained inflows. The staff supports the government's intention to follow a revenue-based fiscal consolidation over the medium term that nonetheless allows for a supportive stance in the near term. Achieving the fiscal objectives will require a sizable tax effort. The financial sector has been resilient to the global turbulence so far, and the authorities have continued to further strengthen the banking supervision framework.

4. Building inclusive growth. The authorities' 2011–2016 Philippine Development Plan (PDP) appropriately focuses on strengthening infrastructure, governance, human capital, and social safety nets for building faster and more inclusive growth. Implementation will be critical to raise fiscal revenue to support these objectives, reorient expenditure toward social and infrastructure priorities, and strengthen the investment environment and job creation. The current World Bank Philippines Country Assistance Strategy (CAS) has an overall theme of inclusive growth and five strategic objectives: stable macro stability; improved investment climate; better public service delivery; reduced vulnerabilities; and good governance. The CAS progress report (CASPR) updated the strategy in April 2011. It confirmed that the objectives remain valid and relevant against the PDP and assessed that the implementation was generally on track to deliver the majority of the envisioned outcomes.

5. Based on this shared assessment, the teams identified three structural reform areas as macro-critical, in view of their central role in achieving macroeconomic stability and sustained inclusive growth: (1) raising investment and pro-poor growth; (2) public finance and social safety nets; and (3) the financial sector. Table II.1 details the specific activities planned by the two country teams

[1] Other participating country team members included, on the Bank side, Kai Kaiser, Rosa Maria Alonso Terme, Yasuhiko Matsuda, Karl Kendrick Chua, Soonhwa Yi and, on the Fund side, Dennis Botman, Jay Peiris, Ola Melander, and Yoga Affandi.

over the period January 2012-December 2012, along with their expected deliveries, and the division of labor.

6. The teams have the following requests for information and collaboration from their counterparts:

- The Fund team requests to be kept informed of progress in World Bank's discussions with the government on financing of infrastructure, PPPs, and implementation of the development policy loan.[2] Review and sharing of analytical work, in particular the annually prepared Philippines Development Report (PDR), would be welcome, in addition to follow up from the 2010 FSAP, and on work related to the reform of social safety nets, public expenditure reviews, and public financial management.
- The Bank team requests to be kept informed of the Fund's assessments of macroeconomic policies and prospects and to coordinate closely the technical assistance work, especially in areas such as tax policy and administration, where the Bank has an existing program in place, as well as in public expenditure analysis and management, where extensive Bank work is ongoing. The World Bank would welcome an opportunity to participate in the 2012 Article IV mission meetings with the authorities.

7. No disagreement among the two teams emerged on either the key issues, challenges or on the division of tasks to tackle these. It was agreed that further details on collaboration, as necessary, will be agreed at the technical level as work progresses.

[2] A Concept Note Review for the second Development Policy Loan was held on December 5, 2011. The IMF's Vivek Arora was one of the peer reviewers.

Table II.1. Philippines: Bank and Fund Planned Activities in Macro-Critical Structural Reform Areas, January 2012-December 2012

	Products	Expected Delivery Date
Bank Work Program	• Philippines Development Report 2012 on employment • Quarterly Economic Updates • Public Expenditure Review II • Supervision on NPSTAR project • Development Policy Loan 2 • Govt. Integrated Fin. Mgmt Info. System (GIFMIS) • Report on migration and labor markets • Grant (TFSCB) on national accounts • Grant (TFSCB) on statistical development plan • Grant (AusAID) on developing enterprise survey • Grant (new IDF) on program evaluation • Strengthening Dept of Finance: Management of Fiscal Risk and GOCC/PPPs	• June 2012 • March, June, Sep, Dec. • June • Quarterly • May 2012 • To be determined • June 2012 • Closing in April 2012 • Closing in Oct. 2012 • Closing in Dec. 2012 • To start in March 2012 • June 2012
Fund Work Program	• Article IV consultation selected issues papers • Article IV staff report	• January 2012 • January 2012
	• Possible working papers on issues addressed during the Article IV mission ○ Building inclusive growth ○ Capital flows, financial intermediation, and macro-prudential policies ○ Commodity prices, lending conditions, and monetary policy	• Q1:2012
	• Banking supervision technical assistance (TA) • Tax administration TA • Public financial management (cash management and budget execution) TA • Tax policy TA	• Ongoing • Ongoing • Ongoing • Ongoing
Joint Work Program	• Collaboration and review of the Philippines Development Policy Loan. • Review of the Philippines Development Report 2012 on employment	End-2011 until May 2012 June 2012

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

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

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

ANNEX III: PHILIPPINES—RELATIONS WITH THE ASIAN DEVELOPMENT BANK

Since joining the Asian Development Bank (ADB) in 1966, the Philippines has received 196 sovereign loans for a total of $12,195.6 million, and 376 technical assistance (TA), including supplementary approvals, amounting to $190.7 million. The energy, public sector management, and agriculture and natural resources account for the largest proportion of ADB lending (combined 57.1 percent of the total) (Table III.1). As of December 16, 2011, cumulative direct value-added cofinancing for the Philippines since 1970 amounted to $2.7 billion for 41 investment projects and $41.9 million for 45 TA projects.

Table III.1. Cumulative ADB Lending to the Philippines
(As of 16 December 2011)

Sector	No. of Loans	Amount of Loans (US$ millions)	Percent (by amount)
Energy	26	2,688.2	22.0
Public sector management	9	2,378.0	19.5
Agriculture and natural resources	59	1,909.0	15.6
Finance	20	1,328.0	10.9
Transport and ICT	27	1,354.8	11.1
Water and other municipal infrastructure and services	27	1,042.9	8.6
Health and social protection	8	767.4	6.3
Multi-sector	7	301.2	2.5
Education	8	252.1	2.1
Industry and trade	5	174.0	1.4
Total	196	12,195.6	100.0

ADB's private sector operations in the Philippines began in 1986. As of September 2011, cumulative approvals in 26 projects amounted to $767.1 million. ADB's private sector operations in the Philippines included financing for power plants and investments in banks and private equity funds. In 2008, a $200 million loan was approved and disbursed for the acquisition, rehabilitation, and operation of the existing 600-megawatt Masinloc coal-fired thermal power plant in Zambales province by Masinloc Power Partners Co. Ltd. In 2009, a $100 million loan was approved for KEPCO SPC Power Corporation for the construction, operation and maintenance of a new coal fired power plant in the Visayas region using circulating fluidized bed technology.

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

ANNEX IV: PHILIPPINES—STATISTICAL ISSUES

(As of January 6, 2011)

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

II. Data Standards and Quality	
The 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 January 6, 2011)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items:	
						Data Quality—Methodological Soundness[8]	Data Quality—Accuracy and Reliability[9]
Exchange rates	12/20/11	12/20/11	D	D	D		
International reserve assets and reserve liabilities of the monetary authorities[1]	11/11	12/11	D	D	M		
Reserve/base money	11/11	12/11	D	W	W	O, LO, LO, LNO	LO, O, O, O, LO
Broad money	10/11	12/11	M	M	M		
Central bank balance sheet	8/11	11/11	M	M	M		
Consolidated balance sheet of the banking system	8/11	11/11	M	M	M		
Interest rates[2]	12/20/11	12/20/11	D	D	D		
Consumer price index	11/11	12/11	M	M	M	O, O, O, O	O, LO, O, LO, LO
Revenue, expenditure, balance and composition of financing[3]—general government[4]	2010	12/11	Q	Q	Q	LO, LO, O, O	LO, LO, LO, LO, LO
Revenue, expenditure, balance and composition of financing[3]—central government	10/11	12/11	M	M	M		
Stocks of central government and central government-guaranteed debt[5]	Q3:2011	12/11	Q	Q	Q		
External current account balance	Q3:2011	12/11	Q	Q	Q	O, LO, LO, LO	LNO, LO, O, LO, LO
Exports and imports of goods and services	Q3:2011	12/11	Q	Q	Q		
GDP/GNP	Q3:2011	11/11	Q	Q	Q	LO, LO, O, LO	LNO, LNO, O, LO, O
Gross external debt	Q2:2011	09/11	Q	Q	Q		
International investment position[6]	2010	09/11	A	A	A		

[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 settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).
[8] Reflects the assessment provided in the data ROSC or the Substantive Update (published on August 25, 2004, and based on the findings of the mission that took place during September 1–16, 2003) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, 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 of intermediate data and statistical outputs, and revision studies.

Statement by the IMF Staff Representative on the Philippines
February 17, 2012

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

Economic activity remains moderate. In the 4th quarter, GDP growth was roughly unchanged from the previous quarter at 3.7 percent (year/year). Household consumption was supported by robust remittances, and public expenditure picked up significantly as a result of the government's expenditure acceleration program launched last October. On the supply side, typhoons disrupted agricultural production, but strong services and public construction activity counteracted the effects on the overall economy. For 2011 as a whole, GDP growth was 3.7 percent, which coincided with the staff's forecast but was lower than the authorities' expectation (4.5 percent−5.5 percent).

External headwinds are affecting exports, but the balance of payments position remains strong. Exports continued to contract in December (by -20.7 percent, year/year), led by electronics. Net portfolio inflows stayed positive in December and January. International reserves rose to $77 billion in January (equivalent to 11 months of imports and to 5 times short-term external debt based on residual maturity). The peso has depreciated slightly in nominal and real effective terms since December.

Inflation pressures have continued to decline. Headline inflation moderated slightly faster than expected to 3.9 percent (year/year) in January, from 4.2 percent in December, largely owing to food prices. For 2011 as a whole, headline inflation averaged 4.4 percent on the 2000 basis (roughly equivalent to the staff's forecast).

Citing external headwinds to growth prospects and a moderate inflation outlook, the BSP cut policy interest rates by 25 basis points on January 19. The cut brought the key policy rate to 4.25 percent. On February 2, the Bangko Sentral ng Pilipinas (BSP) announced measures to rationalize reserve requirements. Effective April 2012, a unified reserve requirement would replace the existing statutory and liquidity reserve requirements; the reserve requirement would no longer be remunerated; and vault cash would no longer be an eligible form of reserve requirement compliance. To offset the impact of this move on banks' intermediation costs, the reserve requirement ratio would be reduced by 3 percentage points at the same time.

INTERNATIONAL MONETARY FUND
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March 5, 2012

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

IMF Executive Board Concludes 2011 Article IV Consultation with the Philippines

On February 17, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Philippines.[1]

Background

The Philippines is being affected along with other countries in the region by the fragile global environment. After reaching 7.6 percent in 2010, growth slowed to 3.7 percent in 2011. The slowdown reflected a fall in electronics exports and lower public construction. Exports were subdued by the weak global environment and by supply chain disruptions following the March 2011 Japan earthquake tragedy. Public construction fell as a result of improved budget processes that temporarily slowed down project approvals and also reduced costs. Unemployment and underemployment remain relatively high, at over 7 percent and 19 percent, respectively.

Financial conditions have remained supportive of growth. Real lending rates are well below pre-crisis levels, interbank and short-term government bond yields remain below policy rates, and credit growth is rapid (19.3 percent, year-on-year, as of December). These monetary conditions have not, however, led to inflation pressure because of the emerging slack in the economy.

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

Inflation pressures have continued to decline. For 2011 as a whole, headline inflation averaged 4.4 percent. Headline inflation moderated slightly faster than expected to 3.9 percent (year/year) in January, from 4.2 percent in December, largely owing to food prices.

The financial sector has been resilient to the global turbulence so far. Banking sector indicators remain consistent with the 2010 Financial System Stability Assessment (FSSA) of the sector's soundness. Financial markets were buffeted during the period of emerging market stress in August- September, but recovered in subsequent months. The Bangko Sentral ng Pilipinas (BSP)'s recent bank stress testing exercise suggested that the banking sector is well placed to withstand the direct effects of a range of shocks. The financial system has only limited exposure to Europe but contagion could occur through pullbacks of credit by European banks. The prominent role of conglomerates as recipients of bank credit and the high leverage in parts of the corporate sector, call for a close monitoring of conglomerates. Rapid credit growth may pose risks for lending standards and asset quality as the credit cycle matures including in the real estate sector.

Fiscal policy has contracted more sharply than the authorities envisaged. The national government deficit for 2011 (P 96 billion; 1 percent of GDP during January-November) fell substantially short of the annual budget objective (P 300 billion; 3 percent of GDP) mainly reflecting lower capital expenditure, particularly on public construction. In October, the government announced a fast-tracking of spending of about 0.7 percent of GDP on infrastructure, local government transfers, and job training that has provided a stimulus to growth in late 2011. However, for the year as a whole the staff expects the deficit to fall to 1½ percent of GDP, which would represent a fiscal withdrawal of 1.8 percent of GDP.

External headwinds are affecting exports, but the balance of payments position remains in sizable surplus reflecting continued net inflows in both the current and capital and financial accounts. Remittances, BPO exports, and capital inflows have offset the impact of lower electronics exports. During 2011, international reserves rose by nearly $13 billion to $75.3 billion (11 months of imports). The BSP forward book, meanwhile, declined by about $11 billion, with most of the decline occurring in September when the Philippines was among the Asian economies affected by the rise in global risk aversion and reversal of capital flows from emerging markets. The episode led to a temporary drop in reserves and the exchange rate and a jump in sovereign spreads. During 2011 as a whole, the peso remained stable in nominal and real effective terms.

Executive Board Assessment

Executive Directors commended the authorities for prudent policies that have underpinned a strong recovery and supported confidence. Directors noted the outlook for the near term is broadly favorable, but subject to significant external risks. In this context, the key policy challenge is to safeguard macroeconomic stability while building the foundations for stronger and more inclusive growth over the medium term.

Directors agreed that monetary policy has responded well to changing circumstances. They considered that monetary conditions are appropriately supportive of economic activity and that inflation is firmly in the middle of the target range. Noting that monetary transmission could be enhanced, Directors recommended the swift approval of amendments to the central bank act that would strengthen liquidity management and enhance policy effectiveness.

Directors supported the central bank's policy of allowing orderly adjustments of the exchange rate to market pressures. With official reserves well above standard precautionary metrics, they concurred that reserves could be drawn down to mitigate the impact of capital reversals, if needed. Directors also saw scope for further flexibility of the exchange rate in response to sustained inflows.

Directors regarded fiscal policy as appropriately focused on supporting growth in the near term while aiming for consolidation over the medium term. Directors welcomed the ongoing expenditure reorientation toward social and infrastructure priorities. Noting, however, that higher revenue will be needed to meet the authorities' objectives, they supported the authorities' efforts to strengthen tax administration and recommended further measures to reform excises, rationalize tax incentives, and broaden the tax base.

Directors took note of the resilience of the financial sector in a challenging environment. They encouraged the authorities to continue monitoring potential pressure points, including concentration and interest rate risks at banks, real estate exposures of nonbanks, and channels for inward spillovers of global financial turbulence. More broadly, Directors recommended further strengthening the supervisory and regulatory framework as well as the AML/CFT regime.

Directors supported the authorities' emphasis on building faster and more inclusive growth. They welcomed the focus of the Philippine Development Plan on improving governance, infrastructure, human capital, and social safety nets, as well as access to finance. Progress in these areas will help to spur investment, boost growth, and reduce poverty.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2011 Article IV Consultation with the Lebanon is also available

Philippines: Selected Economic Indicators, 2008–13

	2008	2009	2010	2011	2012	2013
				Staff proj.		
GDP and prices (percent change)						
Real GDP	4.2	1.1	7.6	3.7	4.2	4.7
CPI (annual average)	9.3	3.2	3.8	4.5	4.0	4.0
CPI (end year)	8.0	4.3	3.1	4.6	4.4	4.0
Investment and saving (percent of GDP)						
Gross investment	19.3	16.6	20.5	20.8	20.6	21.0
National saving 1/	21.4	22.1	25.0	24.0	22.5	22.8
Public finances (percent of GDP)						
National government balance (authorities definition)	-0.9	-3.7	-3.5	-1.5	-2.6	-2.0
National government balance 2/	-1.4	-3.8	-3.6	-1.5	-2.7	-2.0
Nonfinancial public sector balance 3/	-0.3	-3.2	-3.4	-0.6	-2.3	-1.7
Revenue and grants 4/	22.0	19.9	18.4	18.3	18.6	19.0
Expenditure	22.3	23.1	21.8	18.9	21.0	20.7
Nonfinancial public sector debt	58.2	58.1	53.5	51.3	50.6	48.8
Monetary sector (percent change, end of period)						
Broad money (M3)	10.0	8.6	10.9	7.2 5/	…	…
Interest rate (91-day treasury bill, end of period, in percent) 6/	5.8	4.3	1.3	1.7 7/	…	…
Credit to the private sector 8/	20.5	10.0	8.9	22.5 9/	…	…
External sector						
Export value (percent change)	-2.5	-22.1	34.9	-1.5	0.5	3.4
Import value (percent change)	5.6	-24.0	32.9	7.7	2.1	4.7
Current account (percent of GDP)	2.1	5.6	4.5	3.2	1.8	1.9
Capital and financial account (US$ billions, excluding errors and omissions)	-1.6	-1.6	7.3	4.0	3.6	3.6
Direct investment (net)	1.3	1.6	1.2	1.0	1.1	1.1
Other	-2.9	-3.2	6.1	3.0	2.5	2.5
Errors and omissions (US$ billions)	-1.9	-1.3	-2.0	0.0	0.0	0.0
Overall balance (US$ billions)	0.1	6.4	14.3	10.9	7.8	8.1
Total external debt (percent of GDP) 10/	37.6	38.5	36.9	36.5	36.5	36.2
Debt service ratio 11/	12.7	14.3	11.2	12.5	12.2	13.6
Reserves, adjusted (US$ billions) 12/	35.9	44.2	62.4	75.3	84.7	94.8
Reserves/short-term liabilities, adjusted 13/	283.2	391.3	375.8	469.1	463.3	504.0
Exchange rate (period averages)						
Pesos per U.S. dollar	44.5	47.6	45.1	43.3	…	…
Nominal effective exchange rate (2005 =100)	113.5	106.7	109.4	108.5	…	…
Real effective exchange rate (2005 =100)	124.5	121.2	126.8	127.5	…	…

Sources: Philippine authorities; and IMF staff projections.

1/ The saving rate (percent of GDP) is calculated as the sum of the investment rate (percent of GDP) and the current account (percent of GDP).
2/ Fund definition. Excludes privatization receipts and includes deficit from restructuring of the central bank (Central Bank-Board of Liquidators).
3/ Includes the national government, Central Bank-Board of Liquidators, 14 monitored government-owned enterprises, social security institutions, and local governments.
4/ Excludes public financial institutions and privatization receipts.
5/ November 2011 (year-on-year).
6/ Secondary market rate.
7/ December 2011.
8/ Commercial Banks Loans excluding BSP Reverse Repurchase Agreements.
9/ November 2011.
10/ Includes liabilities of foreign banks in the Philippines to their headquarters, branches and agencies, external debt not registered with the central bank, and private capital lease agreements.
11/ In percent of exports of goods and nonfactor services.
12/ Adjusted for gold and securities pledged as collateral against short-term liabilities.
13/ Short-term liabilities include medium- and long-term debt due in the following year.

Statement by Aida S. Budiman, Alternate Executive Director for the Philippines and Ernando Santos De Leon, Senior Advisor to Executive Director
February 17, 2012

Philippine authorities would like to express their gratitude to staff for the fruitful conduct of the 2011 Article IV Consultation. The focus of the Consultation on the challenge of maintaining economic stability in the face of global uncertainty while building the foundations for a more vibrant, sustainable and inclusive economic growth is indeed timely and beneficial. Achieving a faster and more inclusive economic growth is a key priority of Philippine authorities.

Recent economic developments and outlook

The Philippine economy continued to grow despite difficult external and domestic economic environments in 2011. The country's GDP grew at a modest pace of 3.7 percent in 2011, lower than the government's growth assumption of 4.5-5.5 percent for 2011 and less than half of the 7.6 percent growth in 2010. A myriad of external shocks has buffeted the economy since the beginning of the year, starting from the MENA crisis and the resulting high oil prices, the tragedies experienced by some countries in the region with their resulting supply chain disruptions, and the overall weakness of the world economy. In addition, natural calamities in the Philippines affected agriculture and infrastructure in 2011. A silver lining, however, has been the resilience in private consumption which continued to advance strongly, indicating the strength of consumer spending despite strong external headwinds and lower-than-program fiscal spending.

Macroeconomic conditions have continued to remain sound in 2011. Notwithstanding a fluid environment, authorities have successfully kept inflation within the target range of 3-5 percent for 2011 at 4.4 percent and 4.8 percent using the 2000-based Consumer Price Index (CPI) series and 2006-based CPI series, respectively. At the same time, the healthy external payments position of the country—indicated by a continued balance of payments (BOP) surplus—remained a source of resilience for the economy. Meanwhile, the Philippine banking system continued to be sound and robust, exhibiting steady asset growth, a growing deposit base, ample liquidity, sustained improvement in asset quality, and above-standard solvency ratios. The cash operations of the National Government yielded a lower deficit representing 1 percent of GDP due mainly to lower expenditures.

Authorities expect the economy to gain momentum, even as global growth continues to weaken in 2012. Economic growth is expected to accelerate to 5-6 percent on the strength of sustained public spending, timely start up of projects under the public-private partnerships (PPPs), supportive monetary policy and robust remittances. Headline inflation is expected to settle within the targeted range of 3-5 percent for 2012-2013. The fiscal deficit is anticipated to increase to 2.6 percent of GDP in 2012 even as revenue continues to rise with the pickup of expenditures after their temporary drop in 2011. On the external front, the balance of payments is anticipated to remain in surplus buoyed by higher remittances and service exports as well as capital inflows.

Macroeconomic policies

Strong economic fundamentals arising from sound policy management and commitment to the reform process have engendered confidence of both domestic and foreign investors as evidenced by positive business and consumer sentiment, capital flows and ratings upgrades of the country and the banking sector in 2011. Responsible macroeconomic management has also afforded authorities with adequate policy maneuverability to respond to external shocks in the period ahead.

On monetary policy. The Bangko Sentral ng Pilipinas (BSP) remains faithful to its mandate of maintaining domestic price stability while allowing room for non-inflationary economic growth. The BSP, therefore, continues to be watchful of evolving price and output conditions both on the global and domestic fronts, to ensure that monetary policy settings remain appropriate.

In the early months of 2011, authorities started monetary tightening on signs of broadening inflation pressures and substantial upside risk to the inflation outlook by raising policy rates twice by 25 basis points each in March and May 2011. The BSP also raised the reserve requirements by 1 percentage point each in June and August 2011 as a preemptive move to counter any additional inflationary pressures from excess liquidity. These preemptive actions have helped forestall inflation pressures. Subsequently, with demand-pull pressures expected to ease on prospects of slower output growth both globally and in the domestic economy, authorities decided to pause from their monetary tightening mode and assess the outlook for inflation and growth in the second half of 2011. In particular, renewed uncertainty over the strength and pace of the global economic recovery posed downside risk to the domestic economy. While initial assessment suggests that there should be no immediate concern for the observed uptrend in bank lending growth, such a condition required the maintenance of a prudent monetary policy stance to contain any upward pressures on asset prices. At the same time, authorities were also mindful of the remaining upside risks to inflation, including the potential impact of strong net capital inflows on domestic liquidity, pending petitions for electricity rate adjustments, and possible higher global rice prices.

Authorities would like to point out that since the time when the 2011 Article IV Consultation mission was concluded in Manila last December 13, 2011, the overall balance of global economic activity has tipped towards a further slowdown in 2012. Moreover, actual inflation turned out lower than expected in the Philippines, along with economic growth in 2011. In light of this, authorities decided to reduce policy interest rates by 25 basis points on January 19, 2012 based on its assessment that the inflation outlook remains comfortably within the target range, with expectations well-anchored. However, authorities remain cognizant that strong capital flows and their impact on domestic liquidity as well as disruptions in global oil supply continue to pose upside risk to inflation.

On fiscal policy. Authorities assure their unwavering commitment to achieve fiscal sustainability within the medium term and create fiscal space that will allow higher investment in infrastructure and social services. This commitment, along with the improvement of public debt profile resulting from prudent debt management have been recognized by markets and credit rating agencies.

In 2012, improvements in tax administration and the implementation of tax policy reforms, including the rationalization of the fiscal incentives system and the restructuring of the excise tax on alcohol and tobacco products, would aid in the attainment of the fiscal deficit target which is equivalent to 2.6 percent of GDP. In the event that these revenue gains are not sufficient to meet the fiscal objectives, authorities will reduce non-priority expenditure or speed up privatization to support planned spending. Authorities would reflect on other tax reforms after maximizing the gains from improved tax administration and simplified tax system.

On the expenditure side, with the new budget processes in place and greater transparency in public spending, enhanced efficiency in the implementation of public projects will help budget spending to meet the targeted level to boost domestic demand in 2012. In this regard, authorities have nearly released the total budget for 2012 to implementing agencies as early as January 2012. On the civil service wage bill, we would like to point out that the wage bill is merely a part of the general objective to transform the Executive branch into a more effective and efficient branch of government through the implementation of rationalization program that aims to build a leaner and well-motivated bureaucracy.

On foreign exchange policy. Authorities remain committed to a flexible exchange rate system whereby the determination of the exchange rate is left to market forces. Participation in the foreign exchange market by the BSP is limited to temper sharp fluctuations in the exchange rate for an orderly adjustment of the exchange rate to reflect current economic fundamentals. Authorities would like to emphasize that in managing protracted surge in capital flows, exchange rate adjustment and reserve accumulation are just among the broad range of measures in their toolkit. There are prudential and regulatory measures that have been effective in helping cope with the strong surge in capital flows and minimizing their negative implications on the conduct of monetary policy and financial stability during the 2008-2009 global financial crises. Authorities believe that this range of measures remain useful in the current setting. Moving forward, authorities will continue to monitor developments in the international financial markets with the view to better understand the underlying drivers of capital flows in the country to determine the appropriate policy responses to preserve macroeconomic and financial stability.

On financial sector policies. Significant headway has been achieved in improving risk management systems, strengthening the supervisory process, instituting good financial governance, enhancing coordination among financial regulators, and aligning accounting rules with international standards in recent period. These reforms have all contributed to the continued stability and soundness--balance sheets kept growing, asset quality continued to improve, and bank profitability continued to strengthen--of the Philippines banking system, amidst global economic slowdown in 2011. It is for this reason that an international credit rating agency has maintained a “stable” outlook on Philippines banks in 2011 noting that Philippine banks are likely to remain in relatively good shape even with the lingering uncertainties in the global environment.

The more recent banking reforms announced by authorities last January 2012 include: (1) requiring stand-alone thrift banks, rural banks and cooperative banks to be covered by the Basel 1.5 framework that upgrades them to higher capital adequacy standards (2) requiring banks to set aside more funds to cover non-deliverable forwards or NDFs for "net open positions" to reduce potential systemic risk and curb speculation (3) adoption of the more stringent standards of Basel 3 by commercial and universal banks in 2014, four years ahead of the timeline set by the Basel Committee on Banking Supervision and (4) adoption of a new set of enhanced standards on corporate governance in banks, as well as rules to strengthen banks' compliance systems.

Concerns have been raised about the potential spillovers from global financial disruptions, real estate exposures, rapid credit growth and concentration and interest rate risk in the banking sector. In this regard, authorities stressed that European banks operating in the Philippines are liquid, have access to a large deposit base and have not displayed signs of stress. Trade finance and dollar funding continues. Likewise, bonds and other instruments issued from the euro zone and held by domestic banks accounted for only 1.4 percent of their total assets as of June 30, 2011. While it is true that the Philippine banking system is not totally immune to concentration risk due to the conglomerated construct of the Philippine economy at large, the BSP has been resolute in instituting reforms to effectively mitigate such risks. One step toward this end is to efficiently monitor and identify the potential extent of exposure of the banking system to financial conglomerates through conglomerate maps. Moreover, conglomerates' revenue is well diversified, which mitigates concentration risk. Authorities would like to stress that the banking system is not securities-heavy and interest rate sensitive as banks' holdings of debt securities constitute only 22.2 percent of their total assets. Meanwhile, authorities continue to monitor signs of potential risks that rapid credit growth may pose for lending standards and asset quality.

An important next step for bank supervision will be prompt Congressional approval of the amendments to the New Central Banking Act (NCBA) that would enhance supervision by providing supervisors with greater legal powers and protecting them from litigation, lifting the remaining constraints of bank secrecy laws on examiners, further strengthening the prompt corrective action and bank resolution framework and prescribing higher ratios for individual financial institutions which are deemed to be exposed to more than normal risks as the FSSA Update recommended. The amendments should also allow the BSP to issue its own debt securities, providing a much-needed instrument to strengthen liquidity management and enhance the effectiveness of monetary policy.

Building inclusive growth

Authorities acknowledge that while some progress had been achieved in alleviating poverty in recent decades stronger actions and more sustained efforts in promoting inclusive growth are necessary if poverty incidence was to be reduced significantly in the Philippines.

Authorities believe that to achieve inclusive growth, the country needs to attain a high and sustained growth path, provide equal access to development opportunities across social spectrum, and implement responsive social safety nets that would assist those who are left behind by the character of growth. Authorities pointed out that building inclusive growth is a key part of their medium-term development plan that focuses on five cross-cutting key strategies, namely: (a) boosting competitiveness to generate employment; (b) improving access to financing; (c) investing massively in physical infrastructure; (d) promoting transparent and responsive governance; and (e) developing human resources through improved social services.

In this regard, the 2012 National Budget is reflective of the desire of the authorities to address poverty through greater focus in funding and fulfilling anti-corruption and good governance, empowerment of the poor, inclusive economic growth, just and lasting peace and the rule of law and integrity of the environment. The 2012 budget also sustains the tradition of transparency, accountability and citizen participation in public expenditure. Consistent with the goal to ensure ample education, public health and social protection for the poor, spending on the Social Services sector receives a significant share of the 2012 National Budget. Significant portion of the 2012 National Budget also went to Economic Services Sector to support rapid, sustained and inclusive growth. Taken together, these two expenditure items constituted more than half of the 2012 National Budget. Moreover, public-private partnership (PPP) Strategic Support Fund has been funded for various PPP ventures and for the preparation of business cases and feasibility studies.

On financial inclusiveness, the BSP has been implementing programs that facilitate access of certain sectors of the economy such as the small and medium enterprises (SMEs) and the agriculture sector to formal credit and financing. This includes microfinance which provides the country's entrepreneurial poor access to collateral-free loans and various financial services, including deposits, payment services, money transfers and insurance. The BSP's regulatory framework for the development of microfinance has been rated as the world's best, for three years in a row for pioneering in advocating use of responsible microfinance while ensuring adherence to safe and sound banking practices. To broaden access by small and medium-enterprises to collateral-free loans, the BSP has facilitated the development of credit surety funds or CSFs. Authorities have also intensified Economic and Financial Learning Program or EFLP which integrates all of BSP's educational outreach activities across different sectors of the society. For the BSP, having financially-literate Filipinos is a basic foundation in building a strong and inclusive financial system.

Final Remarks

Authorities see sustained growth for the Philippine economy in 2012 even as global outlook continues to weaken. This optimism is derived from the fact that the economy has stronger foundations to endure external shocks resulting from a long history of structural reforms that they continue to pursue and home-grown sources of resilience. Authorities also see that the simultaneous running of both monetary and fiscal engines will allow for economic recovery to proceed at a more vibrant and sustainable pace.