INTERNATIONAL MONETARY FUND

IMF Country Report No. 21/177

PHILIPPINES

August 2021

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR PHILIPPINES

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2021 Article IV consultation with the Philippines, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its July 23, 2021 consideration of the staff report that concluded the Article IV consultation with the Philippines.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 23, 2021, following discussions that ended on June 11, 2021, with the officials of the Philippines on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 8, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Philippines.

The documents listed below will be separately released.

Selected Issues

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

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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2021 Article IV Consultation with the Philippines

FOR IMMEDIATE RELEASE

Washington, DC – August 6, 2021: The Executive Board of the International Monetary Fund (IMF) concluded the 2021 Article IV consultation[1] with the Philippines.

The economy is recovering after a major, pandemic-induced economic downturn. Real GDP contracted by 9.6 percent in 2020. The authorities have deployed a comprehensive set of policy responses that have helped to mitigate the socioeconomic impact and maintain financial stability. While a moderate economic recovery started in the third quarter of 2020, the second COVID-19 wave of infections that emerged in early 2021 will likely slow the economic recovery in the first half of the year. CPI inflation averaged 4.4 percent through June 2021, above the authorities' target band of 2 to 4 percent, reflecting primarily food supply shocks and the price impact of pandemic-related transportation supply restrictions. A sharp import compression in 2020 resulted in a current account surplus of 3.6 percent of GDP. Vaccination has started and is poised to accelerate from midyear.

The recovery is expected to gain momentum in the second half of 2021 and in 2022. Real GDP is projected to expand by 5.4 percent in 2021 and 7.0 percent in 2022, due to continued easing of quarantine measures, progress in vaccinations, and macroeconomic policy support. Medium-term economic growth is forecast to return to the pre-pandemic rate of 6.5 percent. Headline inflation is expected to decrease to 3.3 percent by end-2021, as the transitory drivers taper off and reach the mid-point of the target band over the medium term. With the economic recovery, the projected rebound in investment, and a more expansionary fiscal policy stance, the current account surplus is expected to narrow in 2021 and reach a deficit of 1.8 percent of GDP in the medium term. The risks to the outlook are larger than usual and tilted to the downside, given risks of a protracted pandemic and uncertainty around the vaccine program. Banks benefit from strong capital and liquidity buffers but are facing rising asset quality risks.

Executive Board Assessment[2]

Executive Directors commended the authorities' comprehensive policy response to the COVID-19 pandemic, which has helped to cushion its socio-economic impact. Strong fundamentals and prudent macroeconomic policies have helped to maintain macro-financial stability. Directors noted that there are larger-than-expected uncertainties, including related to the pandemic and the vaccination program. They underscored the importance of continuing

[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.

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

supportive macroeconomic policies and prioritizing health policy responses to sustain the recovery.

Directors agreed that the expansionary fiscal stance strikes an appropriate balance between recovery needs and fiscal prudence, with the priority given to health, social, and infrastructure spending. They noted that the Philippines has some fiscal space to respond flexibly if downside risks materialize. Directors welcomed the authorities' commitment to fiscal consolidation, and in this regard, emphasized the benefits of adopting a medium-term fiscal strategy, centered on revenue mobilization and expenditure control, to anchor their commitments. They encouraged continued efforts to enhance fiscal transparency and accountability, including procurement procedures.

Noting the economic slack and inflation outlook, Directors agreed that the monetary policy stance should remain accommodative and data driven, mindful of risks to financial stability. They recommended gradually phasing out direct budgetary financing to safeguard the central bank's operational capacity and independence. A clear communication strategy would help enhance the effectiveness of monetary policy as normalization begins. Directors observed that the large current account surplus in 2020, which led to a large buildup of foreign reserves, is likely temporary. They saw an important role for the exchange rate in absorbing external shocks.

Directors highlighted that adequate credit provisioning and measures to strengthen prudential supervision remain important to preserve banking system soundness. They recommended that regulatory forbearance be allowed to expire as scheduled, and generally saw merit in limiting dividend payouts to allow for capital retention when needed. Directors underscored the urgent need to strengthen the bank resolution framework and enhance AML/CFT implementation, in line with the 2021 FSAP recommendations. Steadfast efforts are needed to facilitate swift exit from the FATF grey list and reduce the risk of disruptions to cross-border financial flows.

Directors welcomed the authorities' emphasis on structural reforms to improve the business environment and foster more sustainable, inclusive, and greener growth. They stressed the importance of investment in training and education to facilitate sectoral reallocation. Directors also encouraged efforts to increase spending on social protection, strengthen public service delivery, and implement climate-related initiatives.

Philippines: Selected Economic Indicators

	2017	2018	2019	2020	2021 Proj.	2022 Proj.
	(Annual percentage change, unless otherwise indicated)					
National account						
Real GDP	6.9	6.3	6.1	-9.6	5.4	7.0
Consumption	6.0	6.8	6.3	-5.2	4.5	7.0
Private	6.0	5.8	5.9	-7.9	3.4	6.4
Public	6.5	13.4	9.1	10.5	9.9	9.6
Gross fixed capital formation	10.6	12.9	3.9	-27.5	5.6	10.3
Final domestic demand	7.1	8.2	5.7	-10.6	4.7	7.7
Net exports (contribution to growth)	-0.9	-2.3	-0.2	4.0	0.2	-1.4
Real GDP per capita	5.2	4.7	4.6	-10.8	3.8	5.4
Output gap (percent, +=above potential)	0.4	0.2	-0.1	-8.6	-3.9	-0.7
Labor market						
Unemployment rate (percent of labor force)	5.7	5.3	5.1	10.4	7.6	6.3
Underemployment rate (percent of employed persons)	16.1	16.4	13.8	16.2	…	…
Employment	-1.6	2.0	1.9	-6.1	5.2	3.2
Price						
Consumer prices (period average)	2.9	5.2	2.5	2.6	4.2	3.0
Consumer prices (end of period)	2.9	5.1	2.5	3.5	3.3	3.0
Core consumer prices (period average)	2.5	4.1	3.2	3.1	…	…
Residential real estate (Q4/Q4)	5.5	0.5	10.4	0.8	…	…
Money and credit (end of period)						
3-month PHIREF rate (in percent) 1/	3.3	6.5	3.1	1.3	…	…
Claims on private sector (in percent of GDP)	45.6	47.6	48.0	51.9	48.5	47.6
Claims on private sector	16.4	15.1	7.8	-0.6	1.0	8.0
Monetary base	13.7	6.4	-3.0	5.1	6.0	10.5
Broad money	11.3	9.0	9.8	8.6	6.2	9.1
Public finances (in percent of GDP)						
National government overall balance 2/	-2.1	-3.1	-3.4	-7.6	-9.6	-7.7
Revenue and grants	14.9	15.5	16.1	15.9	14.9	15.4
Total expenditure and net lending	17.1	18.7	19.5	23.6	24.5	23.1
General government gross debt	38.1	37.1	37.0	51.9	57.7	60.2
Balance of payments (in percent of GDP)						
Current account balance	-0.7	-2.6	-0.8	3.6	0.4	-1.8
FDI, net	-2.1	-1.7	-1.4	-0.8	-0.4	-0.9
Total external debt	22.3	22.8	22.2	27.2	25.0	24.4
Gross reserves						
Gross reserves (US$ billions)	81.6	79.2	87.8	110.1	103.6	98.3
Gross reserves (percent of short-term debt, remaining maturity)	419.3	364.9	398.3	552.6	508.3	459.0
Memorandum items:						
Nominal GDP (US$ billions)	328.5	346.8	376.8	361.5	400.6	433.6
Nominal GDP per capita (US$)	3,153	3,280	3,512	3,323	3,628	3,867
GDP (in billions of pesos)	16,557	18,265	19,518	17,939	19,390	21,320
Real effective exchange rate (2010=100)	103.4	100.5	105.4	111.5	…	…
Peso per U.S. dollar (period average)	50.4	52.7	51.8	49.6	…	…

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

1/ Benchmark rate for the peso floating leg of a 3-month interest rate swap.

2/ IMF definition. Excludes privatization receipts and includes deficit from restructuring of the previous Central Bank-Board of Liquidators.

INTERNATIONAL MONETARY FUND

PHILIPPINES

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

July 8, 2021

KEY ISSUES

Context: The economy is recovering after a major, pandemic-induced economic downturn. The authorities have deployed a comprehensive set of policy responses that have helped to mitigate the socioeconomic impact and maintain financial stability. The economic recovery slowed in the first half of 2021 due to a second wave of COVID-19 infections. Vaccination has started and is poised to accelerate from midyear.

Outlook and risks: Continued macroeconomic policy support in 2021, further gradual improvements in the pandemic situation, and higher partner country growth are expected to drive the economic rebound in the remainder of 2021 and in 2022. The risks to the outlook are larger than usual and tilted to the downside, given risks of a protracted pandemic and uncertainty around the vaccine program. Banks benefit from strong capital and liquidity buffers but are facing rising asset quality risks.

Main policy recommendations:

- The expansionary fiscal stance in 2021 strikes an appropriate balance between recovery needs and fiscal prudence. Steadfast budget execution with flexibility to address evolving priorities would ensure the effectiveness of this support. Monetary policy should remain accommodative, given economic slack and inflation prospects.
- The Philippines has some fiscal space to respond if downside risks materialize. A medium-term fiscal strategy could serve to anchor the authorities' commitment to fiscal prudence and the gradual return to lower budget deficits, reinforcing confidence.
- For adequate credit provision during the recovery, banks should have the flexibility to use the capital conservation buffers as provided in the Basel capital frameworks. Dividend payouts should be limited for capital retention when needed amid higher asset quality risks, and regulatory forbearance should phase out as scheduled. Effective AML/CFT implementation would help prevent disruptions of cross-border financial flows from the Philippines' grey-listing by the Financial Action Taskforce.
- Steady structural reforms, combined with a continued public infrastructure push, could help rekindle investment and return to the high, pre-pandemic rates of economic growth. Increasing spending on social protection and education, strengthening public service delivery further, and meeting commitments on climate change would foster more inclusive and greener growth.

Approved By
Odd Per Brekk and Rupa Duttagupta

Mission dates: May 21-June 11, 2021
The mission comprised Thomas Helbling (head), Eugenio Cerutti, Sarwat Jahan, Yu Ching Wong, Bo Hyun Chang, and Yongzheng Yang (Resident Representative) (all APD). Staff in the office of the Resident Representative supported the mission. Alisara Mahasandana, Rosemary Lim, Firman Mochtar, and Dennis Bautista (OED) joined some of the meetings. Agnes Isnawangsih, Nong Jotikasthira (both APD), and Yiliang Li (Oxford University) contributed to the preparation of this report.

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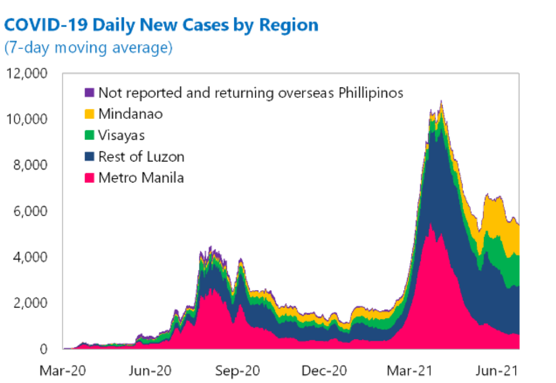
CONTEXT

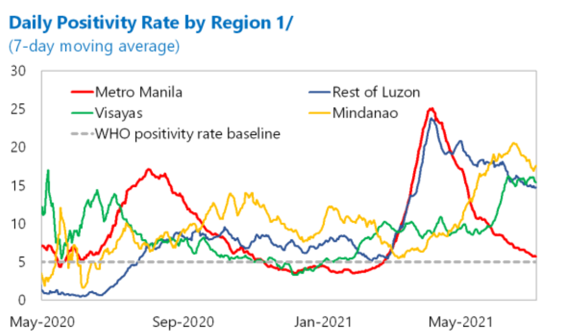
1. **Before the pandemic, the Philippines was one of the best performing economies in the region**. Sustained reforms and prudent macroeconomic policies supported strong economic growth and helped contain external and macro-financial vulnerabilities. While poverty and inequality were declining, they remained high, and the ease of doing business suffered from capacity and other constraints. The authorities' socioeconomic policy agenda—focused on infrastructure, education, and health—has aimed to address these challenges.

THE PHILIPPINES AND THE PANDEMIC

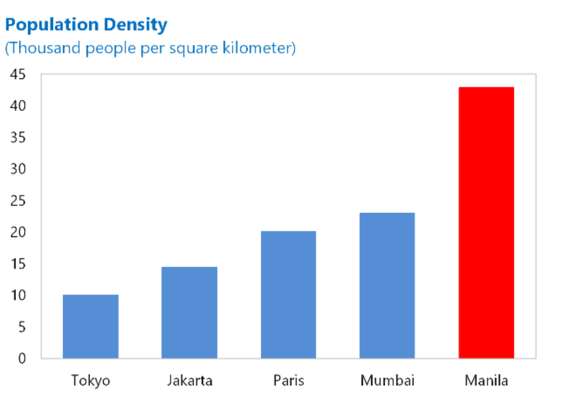
2. **The Philippines has faced important trade-offs between pandemic containment and restrictions affecting economic activity**. Early, stringent containment measures helped delay domestic coronavirus transmission. Subsequent developments highlighted that, after some initial easing, pandemic control required continued, comparatively severe restrictions (Figure 1). The specific trade-offs partly reflected structural factors, including health sector capacity constraints, a large informal sector, and high population density and transportation system bottlenecks in urban areas, notably Metro Manila.



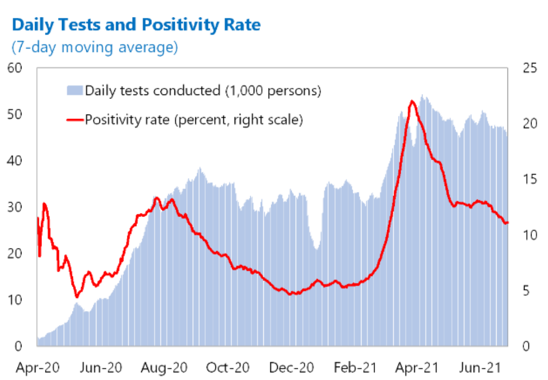
Sources: Philippines Department of Health; and IMF staff estimates.



Sources: Department of Health as of July 5, 2021; and IMF staff estimates.
1/ The information reported has a lag time of 2 days. As per Department of Health, the total number of COVID-19-positive individuals does not equate to the official number of confirmed cases.

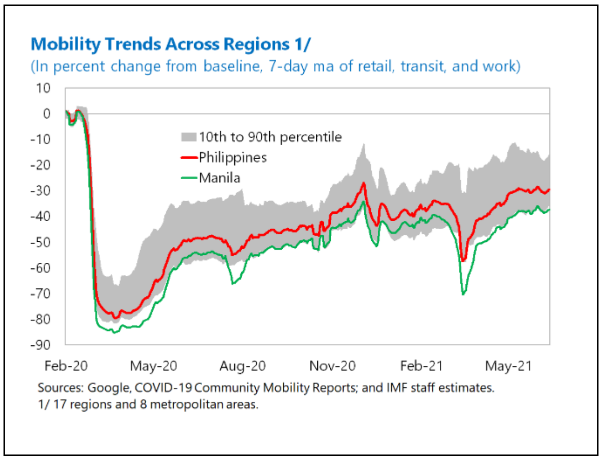


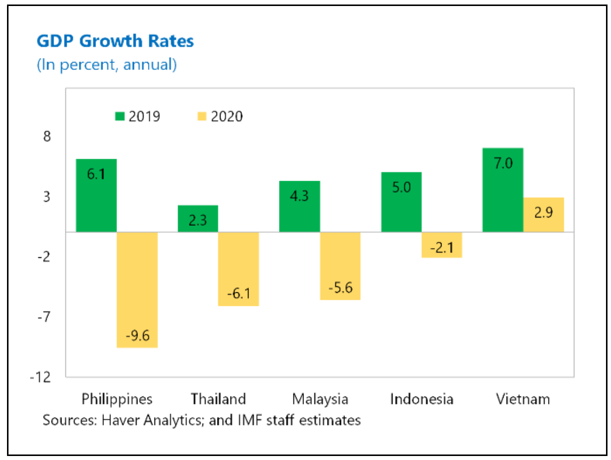
Source: World Population Review.



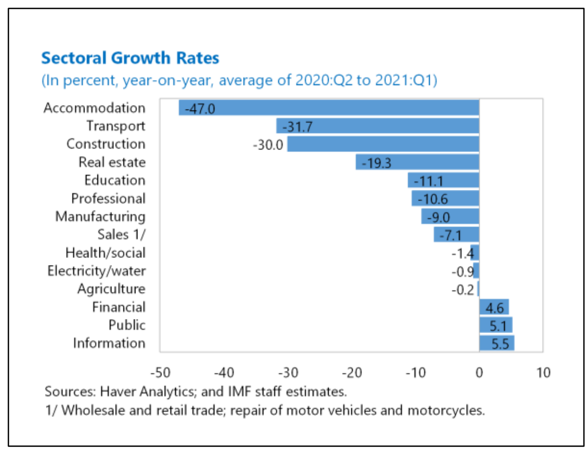
Sources: Philippines Department of Health; and IMF staff estimates.

3. The pandemic and containment resulted in significant supply and mobility disruptions that triggered a major economic downturn. Real GDP declined by 9.6 percent in 2020, driven by a contraction in the first half of the year. A moderate economic recovery started in the third quarter of 2020, supported by an easing of containment measures and policy stimulus (Figure 2). CPI inflation started increasing in the last quarter, reflecting primarily food supply shocks and the price impact of pandemic-related transportation supply restrictions.[1] In 2021, headline CPI averaged 4.4 percent through June, above the authorities' target band of 2 to 4 percent (Figure 3).





4. The pandemic-related disruptions to economic activity across sectors were broader than in other countries. Contact-intensive services sectors were hit hard, as elsewhere, but other sectors also suffered, including construction and manufacturing (Appendix I discusses the labor market impact). On the demand side, the retreat in gross fixed capital formation was relatively severe, including in public investment, resulting in a sharp import contraction and a positive contribution of net exports to growth.



5. The authorities responded with a comprehensive policy package to the COVID-19 pandemic. The package included fiscal, monetary, and financial policy measures (see Box 1). The fiscal support, which included two stimulus packages (Bayanihan Acts I and II) in 2020 and the CREATE tax reform package, which included an accelerated reduction of corporate income tax rates

[1] The African Swine Flu virus emerged in late 2019 and spread further in 2020. In November 2020, the Philippines was hit by two severe typhoons that affected over 7.5 million people and caused substantial damages, including to crops.

Box 1. Major Policy Responses to COVID-19 in the Philippines, 2020–21

List of Measures (Announced or under implementation)	Expected Size 1/ (In percent of 2020 GDP)	Disbursement 1/2/ (In percent of total allotment released)	Disbursement 1/2/ (In percent of total obligation)
Fiscal			
Above the line measures			
Revenue Measures			
BSP remitted PHP 20 billion as dividend to the government	0.1	100.0	100.0
Corporate income tax reduction and fees waived 3/	0.8	Permanent change	Permanent change
Expenditure Measures			
Support to healthcare sector to fight COVID-19 4/	0.9	28.9	56.1
Social assistance 5/	1.3	89.8	97.8
Cash-for-work programs/employment 6/	0.2	88.1	94.6
Assistance to MSMEs	0.3	88.7	100.0
Agriculture	0.2	81.8	85.1
Education	0.1	46.4	72.3
Targeted support to hard hit sectors 7/	0.1	89.5	98.9
Assistance to local government units	0.2	99.7	99.7
Capital injection to cover loan and interest payment of beneficiaries	0.3	100.0	100.0
Other components	0.1	54.8	63.6
Total above the line measures excluding BSP's dividend payments	**4.4**		
Below the line measures			
Capital injection and Credit Guarantees 8/	0.6	...	
Total below the line measures	**0.6**		
Total Measures	**5.0**		

Monetary and Other Central Bank Policies

- Cut policy rate five times by a cumulative 200 bps to 2 percent.
- Lowered the reserve requirement ratio for banks by 200 bps to 12 percent.
- Relaxed the requirements for accessing the rediscount window.
- Provided short-term liquidity in the financial system through BSP's purchase of government securities in the secondary market.
- BSP purchased PHP 300 billion of government securities in primary market transactions through a repurchase agreement in March 2020 (redeemed on September 2020) to support the government's program.
- The BSP also extended PHP 540 billion to the government in October and this was repaid on December 18, 2020. A second provisional advance of PHP 540 billion to the government was approved on December 28, 2020.

Financial

- A 30-day mandatory moratorium (ended on June 1, 2020) on all bank loan repayments during the Enhanced Community Quarantine period (part of the Bayanihan Act, March 2020). Another 60-day moratorium from mid-September to all loans that are falling due on or before December 31, 2020 (part of the Bayanihan Act II).
- Relaxation of asset classification and provisioning requirements: (i) exclusion from the past due (PD) and nonperforming loan (NPL) classification until December 2021 for loans which should have reclassified as PD as of March 8, 2020, and loans that have become PD or NPL after March 8, 2020 up to March 31, 2021, (ii) staggered booking of allowance for credit losses for loans directly affected by COVID-19 as of March 8, 2020, for a maximum period of five years, subject to BSP approval.
- A temporary increase of single borrower's limit to 30 percent from 25 percent until December 31, 2021 (extended from March 31, 2021).
- A temporary relaxation of maximum penalties on required reserve deficiencies (expired March 31, 2021).
- A temporary relaxation of prudential regulations allowing banks to reclassify available-for-sale securities subject to mark-to-market valuation to held-to-maturity securities valued at book value (expired September 30, 2020).
- A temporary reduction of MSMEs credit risk weights to 50 percent, below the Basel III minimum of 75 percent (subject to review by end-December 2021).
- Inclusion of MSME loans and loans to large enterprises in the calculation of compliance with reserve requirements subject to conditions (until December 31, 2021).
- Increase banks' real estate loan share limit to 25 percent from 20 percent of total loan portfolio (net of interbank loans).
- Passed the Financial Institution Strategic Transfer (FIST) Act to encourage the sale of distressed assets by financial institutions by providing incentives.

1/ Based on allotment released for 2020 and 2021 under Bayanihan I & II and other releases. Data as of May 31, 2021. Allotments refer to authorization issued by the Department of Budget Management to an agency allowing the agency to incur obligation for specified amounts contained in a legislative appropriation. Obligations pertain to the funds which were actually contracted out by the implementing agencies.
2/ Bayanihan II funds that have not been disbursed in 2020 can be disbursed until June 30, 2021.
3/ CREATE Act reduced the tax rate from 30 to 25 percent and FIST Act waived fees.
4/ Includes procurement of PPEs, COVID-19 testing kits, hiring health care workers, special allowance, hazard pay, medical infrastructure, and research and development.
5/ Includes emergency subsidy program for low-income beneficiaries and assistance for the informal sector.
6/ Includes assistance for displaced formal and informal workers, as well as emergency repatriation program for overseas workers.
7/ Hard hit sectors include tourism and transportation sectors.
8/ COVID-19 response under Bayanihan II provided for a capital injection of PHP 5 billion to PhilGuarantee which could support loan guarantee of PHP 100 billion, Total guarantee approved as of end-March 2021 is PHP 1.473 billion to 12,122 MSMEs. No guarantee has been claimed under the COVID-19 response package for MSMEs.

compared to earlier plans.[2] In total, the direct budgetary support amounted to 4.4 percent of 2020 GDP. The government also introduced below-the-line measures, mainly for credit guarantees, that amounted to about 0.6 percent of 2020 GDP.

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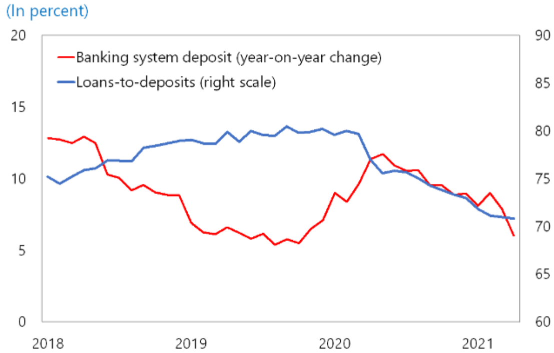
[2] CREATE refers to the *Corporate Recovery and Tax Incentives for Enterprises* Act, approved in March 2021. The Act provides for performance-based, targeted and timebound tax incentives for new investment and firms by a Fiscal

(continued)

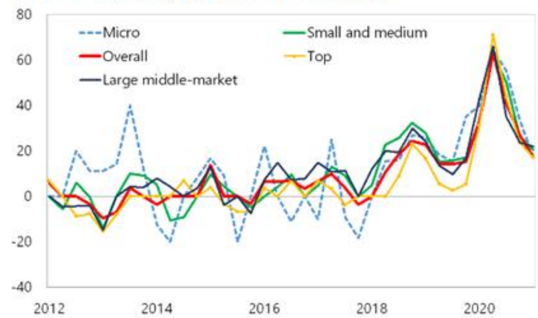
6. Private sector credit has declined. Policy rate cuts and liquidity injections by Bangko Sentral ng Pilipinas (BSP), and higher net savings of households and firms have lifted bank funding (Figure 4). Reflecting tighter bank loan standards, and weak economic activity and investment, outstanding bank loans started to decline in late 2020, led by sharp contractions in car loans and credit card debt (Figure 5).

Banking System Liquidity
(In percent)



Sources: Bangko Sentral ng Philippinas; and Haver Analystics.

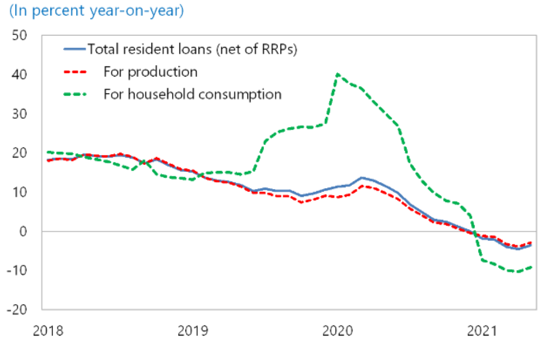
Change in Bank's Credit Standards for Loans to Enterprises
(Above 0 = tightening, expectations for next quarter)



Source: Bangko Sentral ng Pilipinas, Senior Bank Loan Survey.

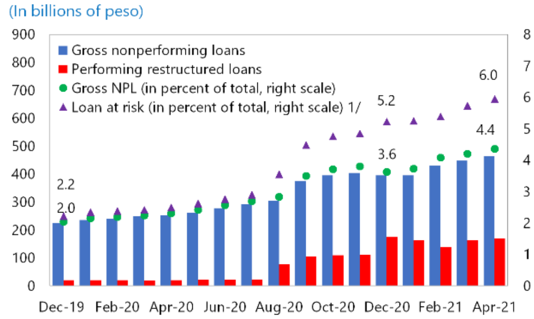
7. Banks remain well capitalized but face declines in asset quality. The overall and Tier 1 capital adequacy ratios (CARs) increased by about 1½ percentage points each since end-2019 to 16.6 percent and 15.7 percent of risk-weighted assets, respectively, as of 2021:Q1 (Table 7). Nonperforming loans (NPLs) in the banking system rose to 4.4 percent of total loans in April 2021, twice the level at end-2019, while loans at risk (nonperforming plus performing restructured loans) increased to 6.0 percent of total loans, compared to 2.2 percent at end-2019. Increased delinquencies in loans for household consumption and real estate activities accounted for the bulk of the rising NPLs.

Universal and Commercial Bank Loans
(In percent year-on-year)



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

Banking System's Asset Quality
(In billions of peso)

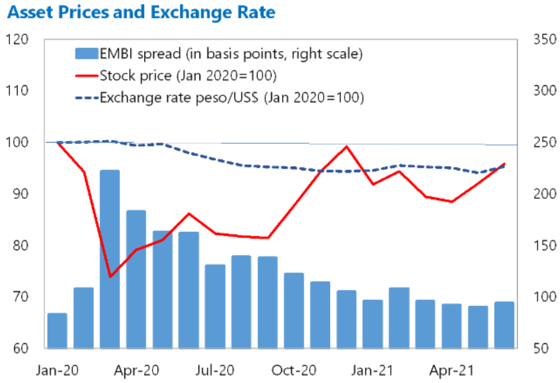


Sources: Bangko Sentral ng Pilipinas; and IMF staff estimates.
1/ Nonperforming plus performing restructured loans.

Incentives Review Board (FIRB) jointly chaired by the Secretary of Finance and the Secretary of Trade and Industry, replacing a decentralized system of tax incentive provision by individual ministries and agencies. To ease the impact of the pandemic, CREATE speeds up the reduction in the corporate income tax rate.

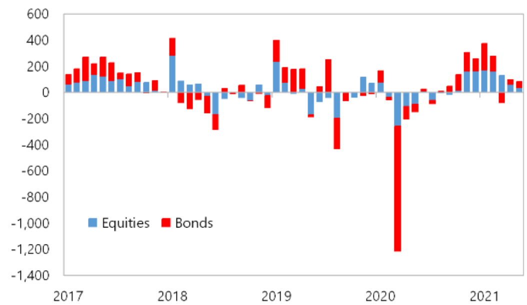
8. **Financial market conditions have remained broadly favorable after a brief period of volatility in March 2020**. The peso appreciated, including during the market turmoil, with a large balance of payment surplus (Figure 6). Equities and bond portfolio flows reverted to net inflows in September 2020, following large outflows at the onset of the pandemic. Domestic corporates increased local currency bond issuance markedly in 2020:Q3, capitalizing on investor appetite to secure funding. Foreign bank funding of the government and domestic banks increased substantially in 2020:Q4 after earlier contraction.

Asset Prices and Exchange Rate



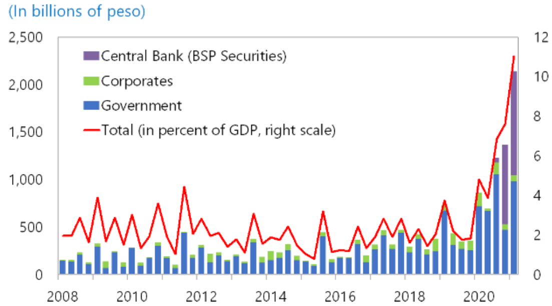
Source: Haver Analytics.

Portfolio Flows
(In millions of U.S. dollar)



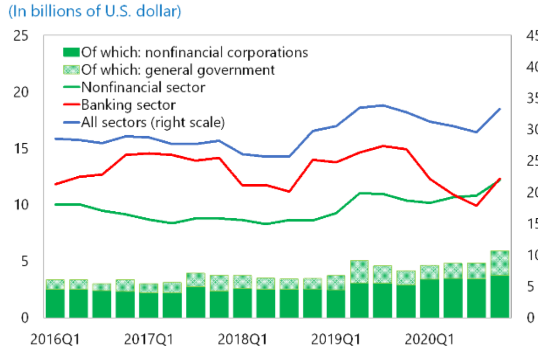
Source: Haver Analytics.

Local Currency Bond Issuance
(In billions of peso)



Sources: Bloomberg L.P.; and ADB Asian Bond Online.
Note: BSP Securities are issued by the BSP since September 2020 for its monetary policy implementation and liquidity management operations.

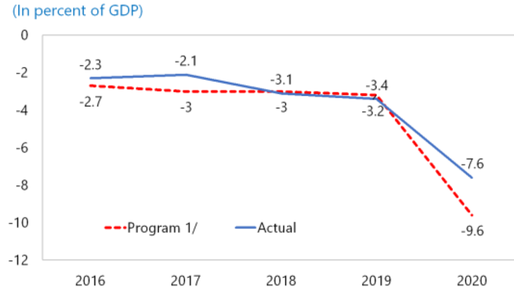
Cross-border Claims of Banks on Residents of Philippines
(In billions of U.S. dollar)



Source: Bank for International Settlements.

9. **The 2020 fiscal outturn was better than programmed in the revised mid-2020 budget, mainly due to revenue overperformance**. Despite the pandemic, the revenue collection was 13 percent higher than projected, in part due to improved collection through digitalization. Total expenditure was about 2.5 percent less than programmed and unused appropriations were allowed to be carried into 2021. Disbursements

National Government Deficit
(In percent of GDP)



Source: Philippine authorities.
1/ Program deficit is based on the projected GDP at the time the budget was programmed.

for the COVID-19 response under the Bayanihan I package, which was enacted in March 2020, were high (about 88 percent of the allotments or 95 percent of obligations). Total infrastructure spending exceeded the programmed amount, as implementation of projects picked-up under the *Build, Build, Build* program (Figure 7).[3]

OUTLOOK, RISKS AND SPILLOVERS, AND EXTERNAL SECTOR ASSESSMENT

10. The second COVID-19 wave of infections that emerged in early 2021 slowed the economic recovery in the first half of the year. In response, the government tightened containment measures in Metro Manila and adjacent areas through April and part of May.[4] Mobility and economic activity declined accordingly. The authorities aim to secure 173 million doses of vaccine in 2021 to meet the target of inoculating 70 percent of the country's target population. The program is still in the early phase, but significantly higher vaccine supplies are scheduled to arrive in the second half of 2021.

11. The economic recovery is projected to strengthen in the second half of 2021 and in 2022. The strengthening in activity will be underpinned by (i) greater mobility, confidence, and economic reopening, as the pandemic situation improves after recent containment measures and further progress in vaccination; (ii) continued policy support, including an infrastructure boost and accommodative monetary policy; and (iii) an improvement in global growth. Headline inflation is expected to decrease to 3.3 percent by end-2021, as the effect of the recent food price increases tapers off while transportation capacity increases.

12. The pandemic is expected to have longer-term economic effects. The output gap is expected to close in 2023, and medium-term economic growth is forecast to return to the pre-pandemic rate of 6.5 percent by 2024. The real GDP level in 2025 is projected to be 15 percent below that in the January 2020 WEO pre-COVID-19. This scarring reflects several factors, including the (i) likely persistent pandemic effects on tourism and other service sectors; (ii) impact of the major downturn on investment; (iii) skill losses from high un- and underemployment; and (iv) increased poverty.

13. The risks to the near-term economic outlook are larger than usual and tilted to the downside, due to uncertainty about the pandemic and the vaccine rollout.

- On the downside, risks of a virus resurgence will remain high until a sufficiently high proportion of the population is vaccinated, underscoring risks from a delay in the vaccine rollout schedule.

[3] The overall spending on infrastructure includes spending for projects executed by the national government, spending on infrastructure subsidies or equity participation to government owned and controlled corporations, and transfers to local government units intended for infrastructure projects.

[4] The government put National Capital Region and adjacent areas in the enhanced community quarantine, the strictest containment measures, from March 29 to April 11, 2021, and in a modified enhanced community quarantine from April 12 to April 30.

The macro-financial legacy of the pandemic could be deeper than expected, as the extent of banks' asset quality problems will only become clear once the full impact of the pandemic is realized and after supportive and forbearance policy measures are unwound. The inclusion of the Philippines in the Financial Action Task Force's (FATF) list, due to deficiencies in the Anti-Money Laundering and Combatting Financing of Terrorism (AML/CFT) regime, could adversely affect cross border financial flows. Spillovers from rising U.S. yields have already been reflected in a steeper yield curve in the Philippines. Further increases in U.S. yields could lead to tightening domestic credit conditions.

- On the upside, the economy could recover faster than expected if quarantine measures could be eased sooner with more effective, agile containment measures, especially if reinforced by faster progress in the vaccine program. More support for businesses and households most affected by the pandemic and acceleration of structural reforms could help reduce economic scarring (Appendix II).

14. The external position is assessed to be stronger than the level implied by fundamentals and desirable policies, mostly reflecting pandemic-related factors. The current account turned from a deficit of US$3 billion in 2019 to a surplus of US$13 billion (3.6 percent of GDP) in 2020. This turnaround largely reflected the temporary, but comparatively large economic impact of the pandemic and the associated import compression. While the turnaround also led to a current account gap of over 2 percent of GDP in the external balance assessment (EBA), this gap broadly matches the policy gaps identified in the EBA, and in staff's view, the constellation of gaps largely reflect pandemic-related circumstances that will unwind once the recovery takes hold (Appendix III). Foreign reserves in percent of the adequacy metric are expected to decrease, as domestic FX market conditions will normalize in the recovery.

Authorities' Views

15. The authorities expect a stronger growth rebound in 2021–22. The authorities expect growth of 6 to 7 percent in 2021 and 7 to 9 percent in 2022. While they agreed that economic activity in the first half of 2021 had been adversely affected by the COVID-19 resurgence, they noted that the quarantine measures were less restrictive than those applied in 2020 and that public demand continued to increase with policy support. The BSP expects annual average inflation in 2021 of 4 percent, just at the upper bound of its 2 to 4 percent target range. The impact of the temporary supply factors behind the recent inflation increase would reverse soon, given non-monetary measures, while economic slack would continue to exert downward pressure on prices.

16. The authorities saw the risks to the economic outlook as broadly balanced. They shared concerns about renewed virus resurgence because of new variants, given developments elsewhere. The authorities noted, however, that despite the global vaccine supply constraints that had initially slowed, the vaccination program has been accelerated. If needed, renewed tightening of quarantine measures would be more localized, as the capacity for testing, tracing, and isolating had been strengthened. In the BSP's view, the spillover impact of a stronger-than-expected rise in global inflation and higher international commodity markets would be limited, given current economic slack, and increased domestic supply capacity with easing pandemic restrictions.

POLICIES TO SECURE THE RECOVERY AND BOLSTER MEDIUM-TERM PROSPECTS

17. The policy discussions focused on policies to nurture the economic recovery, manage risks, and mitigate economic scarring; the strategy to sustain fiscal space; and structural reforms priorities after the pandemic. The large uncertainty around the resolution of the pandemic will require policy flexibility.

A. Fiscal Policy

18. The authorities envision an expansionary fiscal stance in 2021 to support economic recovery, including higher infrastructure spending. Under the updated fiscal program of May 2021, the budget deficit is projected to increase by 2 percentage points to 9.6 percent of GDP, implying a fiscal impulse of 2.4 percent (Table). The program was enhanced through the carryover of unused 2020 budget and Bayanihan II Act appropriations.[5] Spending on infrastructure projects by the national government rises by 11.7 percent, with the total infrastructure program increasing by 17 percent. While infrastructure remains a priority, the 2021 budget also provides for higher spending on health care, including new health programs to tackle the pandemic, and social protection. The disbursement of the remaining Bayanihan II allotments and the lowering of corporate income tax will help support the recovery.

Philippines: National Government Fiscal Measures, 2020–22 1/

(In percent of GDP)

	2020 Outcome	2021 2/ 3/ May 2021 Programmed Budget	2022 3/
Revenue and grants	15.9	14.9	15.4
Of which: BSP advance dividend payment	0.1	...	
Of which: revenue and fees from CREATE and FIST		-0.7	
Expenditures and net lending	23.6	24.5	23.1
Current Expenditure	18.5	19.0	17.1
Capital and Equity Expenditure	4.9	5.3	5.8
Of which : infrastructure 4/	3.8	3.9	4.6
Of which : Bayanihan I & II and other release	2.3	1.0	
Of which:			
Social assistance 5/	1.2	0.0	
Health care sector	0.2	0.6	
Agriculture, education, and hard hit sectors 6/	0.2	0.1	
Assistance for MSMEs	0.3	0.0	
Cash-for-work programs 7/	0.2	0.0	
Assistance to LGUs	0.2	0.0	
Capital injection for loan and interest payment	0.0	0.2	
Others	0.0	0.0	
Overall balance	-7.6	-9.6	-7.7
Financing			
Of which :			
External (net) 8/	3.3	1.9	2.1
Domestic (net) 8/	8.2	7.7	5.6
Memorandum items:			
Cyclically adjusted primary balance			
(In percent of potential GDP)	-3.7	-6.0	-4.8
Fiscal impulse (- withdrawal)	2.2	2.4	-1.2
Infrastructure program 9/	4.8	5.3	5.9

Sources: Philippine authorities; and IMF staff estimates.

1/ Based on data as of May 31, 2021. Assuming all allotments released for Bayanihan II are fully disbursed in 2021.
2/ Based on the mid-year fiscal budget announced during the 179th DBCC Meeting held on May 18, 2021.
3/ Numbers expressed as a ratio of GDP are different from the authorities numbers as IMF staff projection of GDP is used.
4/ Denotes national government infrastructure expenditure.
5/ Includes emergency subsidy program for low-income beneficiaries and assistance for the informal sector.
6/ Hard hit sectors include tourism and transportations sectors.
7/ Includes assistance for displaced formal and informal workers, as well as emergency repatriation program for overseas workers.
8/ Net financing denotes disbursement minus amortization.
9/ NG infrastructure, infrastructure subsidy/equity to GOCCs, and transfers to LGUs intended for infrastructure activities.

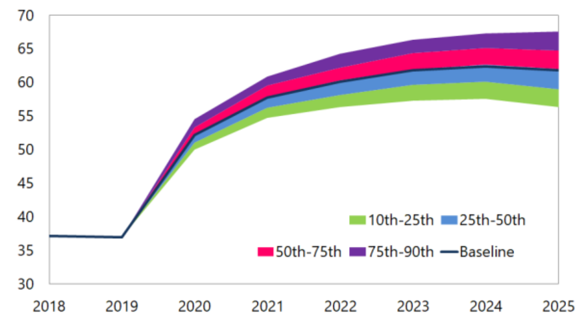
19. This fiscal stance strikes an appropriate balance between available fiscal space and recovery needs—steadfast implementation and flexibility to meet emerging priorities would ensure its impact. Emerging priorities could include additional needs for: (i) the health sector,

[5] The government budget is operating simultaneously under the current FY 2021 General Appropriations Act (GAA), and the extended FY 2020 GAA and the Bayanihan to Recover as One (Bayanihan II) Act appropriations.

including the vaccine program; (ii) short-term support for sectors hit hard by renewed containment measures; and (iii) social protection.

20. If downside risks materialize, the Philippines has some fiscal space to respond. Fiscal space narrowed in 2020—the general gross public debt-to-GDP ratio is estimated to have increased to about 52 percent of GDP by year-end (from 37 percent at end-2019). Under staff's baseline scenario, general government gross debt would peak at about 62 percent of GDP in 2024, just above the government's indicative cap of 60 percent. As debt could raise further above the cap under a downside scenario, the indicative cap should serve as a medium-term anchor that allows for fiscal policy flexibility in the near-term. Debt sustainability analysis suggests that the Philippines still has some fiscal space (Appendix IV).[6]

General Government: Evolution of Debt-to-GDP Ratio 1/



Source: IMF staff estimates.
1/ The fan chart shows a probabilistic view of how the debt/GDP could evolve over the medium term using historical data on real GDP growth, real interest rate, real exchange rate and primary balance to gauge the distribution of risks around the baseline.

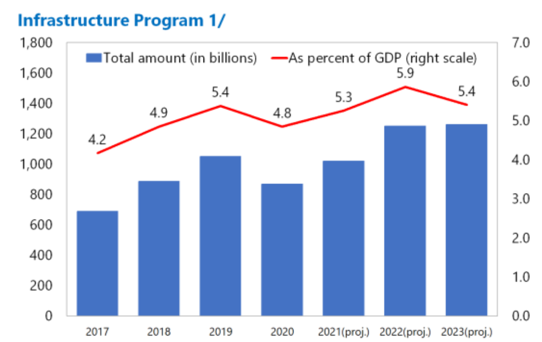
21. The adoption of a medium-term fiscal strategy would help rebuild fiscal space. While the Philippines can afford gradual withdrawal of fiscal support after the pandemic, fiscal space should be rebuilt, to allow flexibility to respond to large future shocks. Beyond the unwinding of COVID-19 related support, additional measures will be needed, given economic scarring, the revenue impact of CREATE, and the implications of the Mandanas ruling for revenue sharing with local government units (LGUs).[7] Measures could include further strengthening of revenue administration; reductions in tax exemptions and loopholes; and taxation of the digital economy. The efforts should be reinforced by further steps in improving expenditure control and increasing efficiency in public service delivery (including at the LGU level, as fiscal devolution is needed to rebalance fiscal responsibilities after the Mandanas ruling), and by structural reforms lifting investment and economic growth. A medium-term fiscal strategy could serve to anchor the authorities' commitment to fiscal prudence and the gradual return to lower budget deficits. The inclusion of measures would reinforce confidence into its role as a policy anchor.

[6] The MAC DSA threshold of 70 percent indicates that emerging market economies above this threshold are more likely to face debt distress.

[7] The Mandanas Ruling, confirmed by the Supreme Court in 2019, stipulates that the collection from all national taxes, with some allowable exclusions as mandated by law, will be included in the base for determining the total allotment to the local government units (LGUs). Prior to the ruling, the LGUs received 40 percent of the tax collected by the Bureau of Internal Revenue. Under the new rule, the base should include all collections of national taxes and is computed based on the actual tax collection in the third fiscal year preceding the current fiscal year. The allotment to the LGUs will increase by about 0.8 percent of the authorities' projected GDP in 2022 due to the ruling. The LGUs are expected to increase their devolved functions in a phased manner, with support for capacity development. In 2022, a Growth Equity Fund will be set-up to assist the least capable LGUs, including to implement infrastructure projects.

22. To bolster the effectiveness of COVID-19-related fiscal measures, the authorities took several steps to foster transparency and safeguard public accountability. The measures included public consultations; regular reporting to Congress; and web publication of allotment releases for COVID-19 measures by the Department of Budget and Management. While procurement rules were simplified for emergency cases, all contracts under these rules are mandated to be posted online for tracking and transparency. The inclusion of beneficial ownership information of awarded companies in publications of COVID-19 spending would further enhance transparency and accountability.

23. With the welcome infrastructure push, continued reforms in public investment management would help raise investment efficiency. The government infrastructure push has increased program spending in the past few years, although there was some slowing in 2020, as strict quarantine measures weighed on construction activity. While the authorities have enhanced transparency in procurement by requiring related information to be posted on an on-line portal, the remaining digitalization steps should be completed, including through the launch of the modernized Philippine Government Electronic Procurement System.



Sources: Philippine authorities; and IMF staff projections.
1/ Based on staff projection of nominal GDP for 2021-2023.

Authorities' Views

24. The authorities highlighted that the fiscal program in 2021 provided strong support to the economic recovery. They emphasized that the 2021 program uses a three-pronged approach of support: (i) reviving infrastructure development (rebound); (ii) responding to the pandemic with a focus on health and nutrition (reset); and (iii) adapting to the post-pandemic environment (recover). The carryover of the unspent appropriations in the 2020 budget and from the Bayanihan II Law to 2021, which were approved by Congress, provided needed additional fiscal stimulus. Depending on the evolving economic situation, they could consider additional spending measures in the health or social assistance areas, contingent on raising additional revenue and generating savings to keep the budget deficit as programed. With the aim of greater revenue collection, they are contemplating increasing dividend rates on government-owned and controlled corporations (GOCCs). The authorities were confident that they could implement the planned infrastructure program in 2021, pointing to a strong implementation record relative to budget in 2020 despite the pandemic.

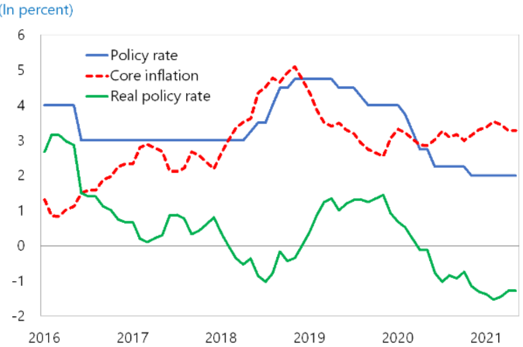
25. The authorities are committed to rebuilding fiscal space in the medium term. The commitment to fiscal prudence was embodied in the multi-year fiscal program developed by the Development Budget Coordination Committee, which targets a return to the smaller budget deficits (as a percent of GDP) recorded before the pandemic. Potential measures to underpin this commitment could include reforms to the military and uniformed personnel pension scheme, and the taxation of the digital economy. Officials also pointed to progress in improving the effectiveness of tax collecting agencies through digital transformation and noted that implementation efforts in this area would continue. In addition, steps to strengthen the capacity of the local government units (LGUs) to manage the devolved expenditure functions effectively would eventually allow the National Government to reduce expenditure for devolved functions and services.

26. The authorities underscored that they would continue to promote fiscal transparency and accountability, including on COVID-19 related spending. Online reports on COVID-19 related spending, as well as information on tax relief measures, grants and loans, and public procurement to support COVID-19 response programs are regularly published, and also submitted to Congress and the Commission on Audit (COA). The COA is mandated to conduct and publish ex-post audit reports on all public funds, including emergency spending. In addition, two portals were launched to provide information on local and foreign humanitarian assistance and procurement projects, respectively, amid the pandemic.[8]

B. Monetary and Exchange Rate Policies

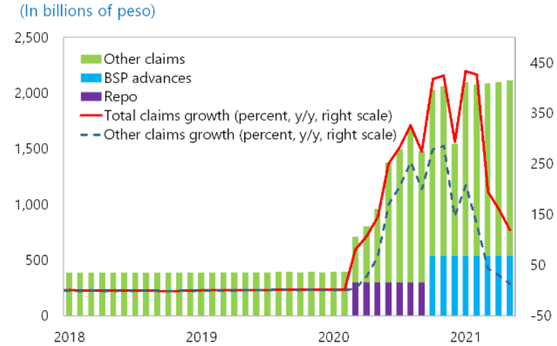
27. BSP appropriately loosened its monetary policy stance in 2020 and increased liquidity provision. It cut the policy rate by a cumulative 200 basis points, resulting in a negative real policy rate for much of the year, and it reduced the reserve requirement ratio by 200 basis points.[9] Secondary market purchases of government securities helped shore up domestic market liquidity and reduced risks of market instability from higher budget financing. Through direct advances to the Bureau of the Treasury, the BSP provided budget financing flexibility.

Core Inflation and Policy Rate
(In percent)



Sources: Haver Analytics; and IMF staff estimates.

BSP Claims on Central Government
(In billions of peso)



Sources: Haver Analytics; and IMF staff estimates.

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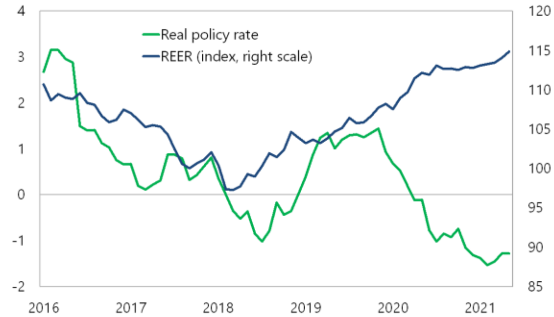
[8] The portals are the Philippine Humanitarian Assistance Registry and the Government Procurement Policy Board Online Portal.

[9] In 2018, the neutral policy rate was assessed to be in the range of 1–2 percent (see IMF Country Report No. 18/287), suggesting that the current settings with a real policy rate of around –1½ percent entail substantial monetary policy accommodation. At 12 percent, the reserve requirement ratio is still relatively high.

28. Looking ahead, under the baseline, monetary policy should remain supportive, as economic slack would help contain inflation. The recent acceleration primarily reflects supply shocks, and inflation should start reversing toward the midpoint of the target range later in the year. There is a possibility that the recent inflation increase could become more entrenched, given local or global factors, including global commodity prices, and if so, BSP should stand ready to adjust the policy stance. Conversely, if downside risks to the recovery materialize, inflation would, depending on the driver, likely be lower than expected, and BSP has room for further accommodative monetary responses, as needed. Renewed temporary recourse to BSP advances should be a last-resort measure linked to domestic bond market conditions, within the limits set in the BSP charter.[10]

Real Policy Rate and REER
(In percent, adjusted for core inflation)



Sources: Haver Analytics; and IMF staff estimates.

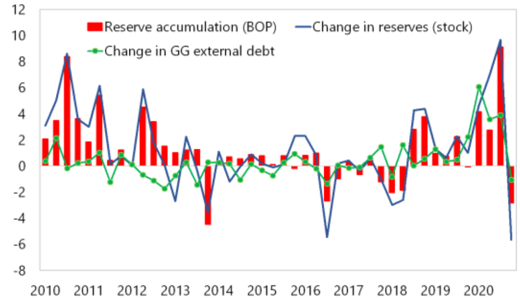
29. Communication about the sequencing of the exit could enhance monetary policy effectiveness even if policy normalization is not imminent. While monetary policy decisions should remain data-driven, the termination of direct budgetary financing through renewal of BSP's advances should be the first step in policy normalization, to preserve the BSP's operational capacity and independence.

30. The peso has appreciated in real effective terms despite policy rate cuts, the pandemic, and an economic downturn. The appreciation likely reflected the temporary but large imbalances between FX flow demand and supply as a result of the COVID-19 shock in a shallow domestic market for foreign exchange, given the limited integration of domestic bond markets with international markets. On the supply side, exports, remittances, and capital inflows held up, while on the demand side, FX needs from imports dropped sharply. Peso appreciation has lowered inflation pressures, but it has weighed on external competitiveness and domestic demand in the presence of significant economic slack.

31. The accumulation of foreign reserves in 2020 partly reflected BSP intervention to smooth peso volatility amid exceptional, pandemic-related balance of payments strength. The sizable increase in the stock of foreign reserves in 2020 was driven both by reserve accumulation and valuation changes (chart). The former reflected BSP FX market intervention (FXI) as well as

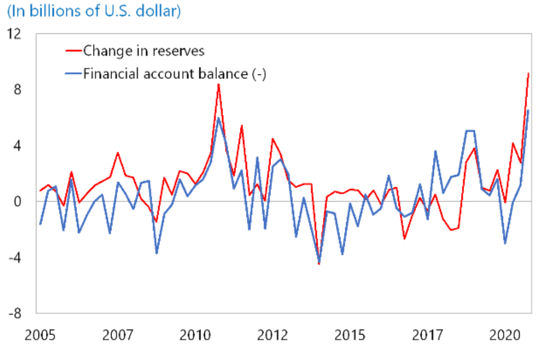
[10] The BSP charter allows for temporary 3-month advances to the Bureau of the Treasury that are capped at 20 percent of the average revenue of the national government in the past three years and that can be renewed once. Under Bayanihan II, the BSP was authorized to provide additional direct provisional advances to the National Government to finance expenditures approved by Congress that will address and respond to the COVID-19 situation, up to 10 percent of the government's average income for fiscal years 2017 to 2019. This option has not been used.

the larger government FX holdings at BSP after sizeable increases in FX bond issuance in 2020, partly for precautionary reasons. The latter largely reflected the switch from valuation of gold holdings at cost to valuation at market prices in July 2020. The BSP's FXI in 2020 slowed the peso appreciation in a shallow FX market amid a larger economic downturn and higher uncertainty because of the COVID-19 pandemic in the Philippines than in most other countries.

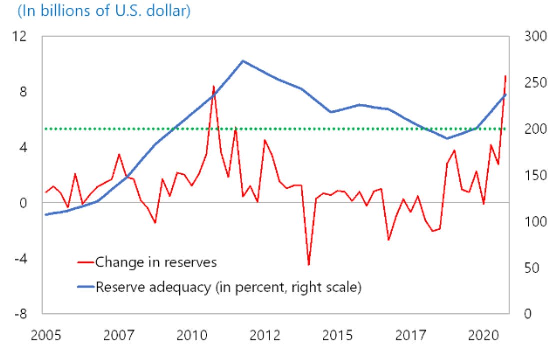


Source: Bangko Sentral ng Pilipinas.

32. A further buildup of foreign reserves would be costly and have diminishing prudential value, given current high levels. The factors contributing to the domestic FX flow imbalances and exceptional balance of payments strength are expected to diminish with the advancement of the economic recovery. The exchange rate should then play its role as a shock absorber. Publishing foreign exchange intervention (FXI) data, with appropriate lags and aggregation to guard against market sensitivities, would enhance the transparency of the inflation targeting regime and BSP's exchange rate policy.



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



Sources: Bangko Sentral ng Philipinas through Haver Analytics; and IMF staff estimates.

Authorities' Views

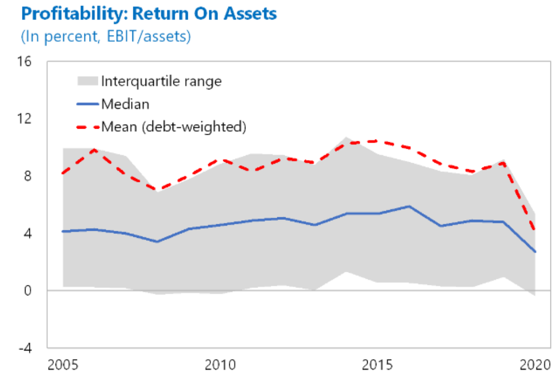
33. The authorities underscored that the accommodative monetary policy stance was appropriate, given the inflation outlook. The BSP expects that headline inflation would decline below the upper bound of the inflation target range well before year-end, as the remaining price impact of the temporary supply factors would be reduced through policies, including non-monetary measures. They noted that annual price increases for most goods and services were below the 2 percent lower bound of the target range, reflecting the downward pressure from economic slack, which would soon become more dominant. Against this backdrop, upside risks to inflation were low, even with spillovers from higher inflation abroad, and the BSP was of the view that the policy rate should remain at current low levels for as long as necessary, while monitoring risks.

34. The BSP underscored that the exceptional circumstances during the pandemic required the use of instruments that had not been used recently. Senior officials underscored that these instruments were authorized in the BSP charter. They also noted that direct advances by BSP to the Treasury were both temporary and limited in size, emphasizing its main intent as a crisis intervention measure in line with best practice for this instrument. The reason for using these instruments was to ensure broad market liquidity at a time of uncertainty and stress, with increased demand for liquidity. Once the recovery was firmly entrenched, the BSP expected the need for advances would diminish rapidly. Officials noted that secondary purchases of government securities were akin to open market operations with a broader set of market participants. As such, a more frequent use of such operations could be considered, as it might strengthen the effectiveness of monetary operations in some circumstances.

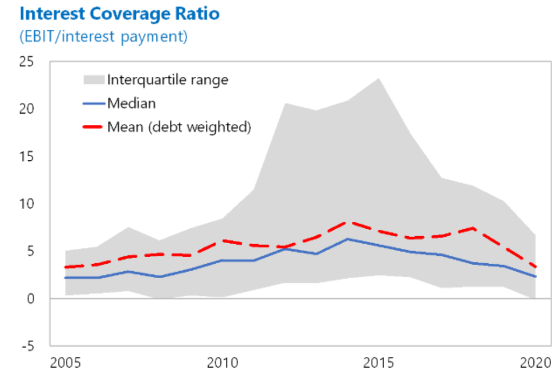
35. The authorities remained of the view that the external position was broadly in line with macroeconomic fundamentals. They noted, however, that the import compression last year resulted in FX market imbalances, as FX supply declined by much less than demand, which, in a shallow market, led to increased exchange rate volatility. In these circumstances, BSP participated in the FX market to smooth excess exchange rate volatility. BSP officials further emphasized that the main motives for foreign reserve accumulation in 2020 were precautionary, reflecting concerns about possible market volatility amid increased government financing needs and increased uncertainty, domestically and internationally. They underscored that aside from FX operations. the increase in the stock of foreign reserves in 2020 also reflected valuation changes and national government deposits with the BSP from its loan proceeds. On publishing foreign exchange intervention (FXI) data, BSP senior officials were of the view that the market already had a good understanding of BSP's FXI operations. Further disclosure of FXI data, even with appropriate lags, was unlikely to contribute to the understanding of the BSP's policies.

C. Financial Sector Policies

36. Despite sizeable capital and liquidity buffers, banks face uncertain and possibly significant asset quality risks. Large banks in the Philippines are tightly interlinked with nonfinancial corporates through conglomerate ownership structures and significant exposures. Stress tests results in the 2021 FSAP suggested that banks' solvency and liquidity were relatively resilient under the stresses from an economic downturn under the baseline scenario. Banks could, however, experience systemic solvency distress under a much more severe adverse scenario. So far, the rise in NPLs has not been as large as initially expected, due largely to the resilience of conglomerate businesses and their financial strength, improvements in banks' risk management from past crisis experiences, and proactive loan restructuring. Nevertheless, a further deterioration of asset quality is expected, mainly due to the lagged macro impact of the crisis.



Sources: S&P Capital IQ; and IMF staff estimates.



Sources: S&P Capital IQ; and IMF staff estimates.

37. Ensuring adequate credit provision in the economic recovery while preserving banks' financial health will be important policy challenges. With still large uncertainty about the pandemic and its impact on asset quality, banks will likely remain risk averse and apply tight lending standards for some time. Loans under regulatory relief measures accounted for only about 3 percent of total NPLs as of end-September 2020, as listed banks considered the benefit to be small compared to the reputational costs. Micro, small and medium-sized enterprises' (MSMEs) take up rate of the government's credit guarantee scheme under the COVID-19 response has been low to date.

38. Adjustments to the regulatory and supervisory policy agenda, and the effective implementation of the credit guarantee scheme and Financial Institution Strategic Transfer (FIST) Act will help in addressing these challenges. It will therefore be important to:

- ***Allow regulatory forbearance measures to be phased out as scheduled and use the flexibility in the Basel capital framework***. With the regulatory forbearance measures put in place in 2020—including delayed NPL recognition (until December 2021) and staggered provisioning (over a maximum period of five years, subject to BSP approval)—risks are that the underlying financial health of banks might be overstated. These risks remain until the measures lapse, although few banks have made use of them so far. In the meantime, bank dividend distributions should be limited for capital retention for banks that use forbearance. Immediate remedial measures should be imposed on banks that do not meet minimum capital requirements, while BSP should encourage proactive provisioning more broadly. To foster lending, the BSP could encourage the temporary use of capital conservation buffers for banks that sufficiently provision for credit risk.

- ***Accelerate the implementation of the government's credit guarantee program and implement regulation to ensure the effectiveness of FIST***. If downside risks to the recovery materialize, including, possibly, higher NPL ratios, the government's credit guarantee scheme would likely play a more important supportive role, as banks' risks aversion in lending decisions would increase (Box 2). The asset management companies set up under FIST would promote the timely disposal of nonperforming assets and improve bank liquidity (Box 3).

39. In anticipation of further recovery, the BSP should strengthen its capacity to enhance financial system resilience. This could include operationalizing the countercyclical capital buffer (CCyB) and developing targeted macroprudential measures, such as debt-to-income caps. The BSP could also enhance its capacity to monitor real estate-related financial system risks, including by developing indicators for commercial real estate. In line with the 2021 FSAP recommendations, strengthening the bank resolution framework—streamlining the prompt corrective action framework and working on resolvability assessments and resolution planning—is urgent, given the downside risks to bank health (Appendix V).

40. The implementation of the AML/CFT regime should be strengthened urgently and initiatives to amend bank secrecy laws are welcome. Sustained implementation of key AML/CFT recommendations in the 2019 Mutual Evaluation Report (MER) is critical, including risk-based supervision of high-risk sectors, transparency of beneficial ownership information, financial intelligence on proceeds-generating crimes (e.g., corruption and tax evasion) including effective access to information covered by bank secrecy and targeted financial sanctions. Addressing these deficiencies promptly would help to support efforts to exit the FATF list and minimize the adverse impact on critical remittances and investment flows that support the economy. The impediments posed by the bank secrecy laws, despite the available workarounds, impair the effective prudential supervision by the financial sector regulators. Amending the bank secrecy laws would improve transparency and supervision for financial stability purposes, strengthen the effectiveness of the AML/CFT regime, and reduce vulnerabilities to corruption.

Authorities' Views

41. While the authorities shared the view that a further deterioration of banks' asset quality was likely, they expected the situation to remain manageable. The BSP projects the NPL ratio to rise to 6 percent by end-2021. However, BSP officials highlighted that banks' initial position was strong at the onset of the pandemic, they were and remain well capitalized, with ample liquidity. They also noted that system-wide loan performance statistics continued to provide an adequate picture of loan performance. The statistics are based on actual past-due and non-performing loans, as well as actual credit losses, which all banks, including those that have used regulatory relief, must include in their prudential reports. The BSP argued against blanket prohibition of dividend distribution; a case-by-case basis was preferable, considering factors such as the bank's varied internal capital targets, risk profile and stress testing results, and the use of regulatory relief.

42. The authorities are considering steps to enhance financial system resilience. The June 8 assessment of systemic financial stability risks by the Financial Stability Coordination Council pointed to leverage risk as its primary concern, given the negative effect of the pandemic on corporate sales and incomes increased pressures on debt servicing capacity. They agreed that an expansion of the macroprudential toolkit and strengthening bank resolution framework would help enhance the resilience of the financial system. The authorities have introduced and started implementation of key AML/CFT measures in order to strengthen the country's AML/CFT regime. This contributes to the country's compliance with the International Co-operation Review Group (ICRG) action plans. Since these reforms are ongoing and the economy is recovering, the authorities are optimistic that it will be able to address all remaining AML/CFT issues raised by the FATF.

D. Structural Policies

43. The strong structural reform momentum should be maintained to help rekindle investment and return to high rates of economic growth. Effective implementation of the ease of doing business and the CREATE Law would lower the burden of MSMEs hit by COVID-19 and promote investment and new businesses, helping to mitigate economic scarring after the pandemic. The impact of these reforms would be reinforced by the easing of restrictions on foreign direct investment—passing the Public Service Act, the Amendments to the Foreign Investments Act, and the Retail Trade Liberalization Act would be critical steps. Progress in the digitalization of public services and improving digital and physical connectivity throughout the Philippines' archipelago would be an important third pillar.

44. The reform momentum should include steps to reduce poverty and inequality. Rapid progress in rolling out the National ID system would support this transformation, by supporting greater efficiency in public sector service delivery, including in social protection and other measures to reduce inequality. Continued investment in education and infrastructure will play an important role in facilitating development and transition into higher-income jobs.[11]

45. The Philippines should build on its strong drive to implement climate change-related initiatives. The authorities recently announced their Nationally Determined Contribution to the Paris Agreement, aiming to reduce emissions by 75 percent by 2030 compared to a business-as-usual baseline. They are preparing laws and regulation to increase the share of renewables in electricity production to reach a target of 35 percent by 2030. The continued budgetary allocations to spending on climate change adaptation and strengthening resilience to natural disasters, with a budget tagging system, are welcome.[12] The Single-Use Plastics Regulation Bill would help to reduce the high rate of plastic waste.

Authorities' Views

46. The authorities were optimistic about keeping up the momentum in structural reforms. Four important reform bills were submitted to Congress during the pandemic, including CREATE, the corporate tax reform bill. Highlighting progress in the digitalization in revenue collection last year, the authorities remain committed to completing the digitalization of government operations by 2030. Another reform priority was the improvement of public financial management at the level of LGUs, to strengthen their effectiveness in managing devolved responsibilities and services, to strengthen their governance, and to optimize their substantially higher share in national taxes under the Mandanas ruling.[13] The institutionalization of best PFM

[11] See Cerutti and Li, "The Agricultural Exodus in the Philippines: Are Wage Differentials Driving the Process?," IMF Working Paper (forthcoming).

[12] The chapter on "Vulnerability to Climate Change and Natural Disaster" in IMF Country Report No. 20/37, provides further background on the policies to address climate change and increase resilience to natural disasters.

[13] The authorities noted that Executive Order No. 138, dated June 1,2021, had been issued for this purpose.

practices, including the cash budgeting system, was another priority.[14] Officials also underscored the need to further fast track the rollout of the national digital ID system. This system was an essential prerequisite for improving the delivery of public services and related governance. The goal was to register 50 million citizens by end-2021.

47. The authorities highlighted the resolve to continue to improve the business environment and broadening climate change policy efforts. The Anti-Red Tape Authority, in collaboration with other agencies, has established the national-business one stop shop and continues to streamline government services to facilitate interactions with the private sector. The authorities have accelerated policy development in all climate change areas, reviewing options to strengthen insurance and risk transfer mechanisms for natural disasters, continuing the implementation of infrastructure projects to strengthen resilience to climate change, and preparing legislation and regulation to increase the share of renewable sources in electricity generation and to increase energy efficiency in construction and transportation.

E. Capacity Development

48. Integration of capacity development (CD) with surveillance suggest a focus on strengthening institutional capacity to address the fallout from the pandemic. For example, possible increases in risks to banks' asset quality and prolonged weakness in corporate earnings in some sectors highlight the potential need for greater capacity in bank resolution, crisis management, and corporate restructuring. The Fund's CD should therefore focus on enhancing such institutional capacity, including in monetary policy communication; bank resolution, crisis management, and corporate restructuring; debt management and capital market development; public investment management; and fintech-related policy issues (Appendix VI).

STAFF APPRAISAL

49. The Philippines has deployed a comprehensive policy response to cushion the impact of the COVID-19 pandemic. As elsewhere, the pandemic has led to socio-economic hardship and an economic downturn. The policy response has involved health, fiscal, monetary, and financial policies, which have helped to save lives and livelihoods, and to preserve macro-financial stability through the downturn and a period of global market stress.

50. The economic recovery slowed in the first half of 2021 due to a second wave of coronavirus infections but is poised for a rebound in the second half. Strong policy support will be the main driver of the rebound, including through broader and faster COVID-19 vaccine distribution, more agile quarantine measures and the associated increase in mobility, and improved global economic conditions.

[14] An updated and simplified version of the Budget Modernization Bill has been refiled in Congress for this purpose this year.

51. The economic outlook and vulnerabilities are subject to a larger-than-usual uncertainty. Delays in the COVID-19 vaccination program and a protracted pandemic would be important downside risks, while faster resolution of the pandemic and economic reopening would be an upside risk. With strong initial capital and liquidity positions, banks should be well positioned to absorb the economic downturn and the deterioration in underlying asset quality but credit conditions could remain slow to improve.

52. The sharp turnaround in the external current account balance to a surplus is likely temporary. It reflected the sharp domestic demand contraction, which resulted in import compression during the pandemic, thereby lowering external financing requirements. It is expected to reverse once economic activity returns to capacity. The external position in 2020 was stronger than the level implied by medium-term fundamentals and desirable policies.

53. With strong budget implementation, the expansionary fiscal stance in 2021 and recent expenditure reprioritization should help foster the recovery. The fiscal program provides for a sizeable fiscal impulse of more than 2 percent of GDP and strikes an appropriate balance between fiscal prudence and recovery needs. The expenditure composition in the revised May 2021 budget program supports the recovery priorities in health, social assistance, and infrastructure.

54. If downside risks to the economic recovery materialize, the Philippines has some fiscal space to respond. The indicative public debt cap of 60 percent of GDP should serve as a medium-term anchor and allow for flexibility in fiscal policy in the short term. The eventual rebuilding of fiscal space will enable adequate responses to large shocks in the future and should be facilitated by the formulation of an explicit strategy, including fiscal targets.

55. The monetary policy stance is appropriately accommodative, given the inflation outlook. Economic slack should help to contain inflation, as the temporary impact of domestic supply shocks has already started to reverse. While monetary policy decisions about exit should await the recovery becoming more entrenched, phasing out direct budgetary financing should be the first step in policy normalization, to preserve the BSP's operational capacity and independence.

56. The balance of payments impact of the pandemic led to a large buildup of reserves in 2020, and further foreign reserve accumulation would not be warranted. The buildup of reserves in 2020 reflects imbalances in the FX market in exceptional times and the economic costs of increased exchange rate volatility during a downturn. However, a further buildup of reserves would likely have small prudential benefits compared to the opportunity costs it entails. The exchange rate should continue to play an important role as a shock absorber.

57. Prudential regulation and supervision could be further strengthened to promote the health of the banking system amid higher asset quality risks. It is critical to ensure adequate provisioning, timely remedial measures in case of capital shortfalls, and, when needed, temporary limits to dividend payouts for capital retention. Regulatory forbearance should expire as scheduled. Timely implementation of the credit guarantee scheme for MSMEs and the FIST law would facilitate credit recovery. The effectiveness of the AML/CFT regime should be urgently enhanced to support a swift exit from the FATF grey list and reduce risks of disruptions to cross-border financial flows.

58. Steadfast implementation of structural reforms would help rekindle investment and a return to high rates of economic growth. Building on recent achievements, continued efforts to ease impediments to investment and reduce infrastructure gaps would help promote investment and new businesses, thereby mitigating the impact of economic scarring after the pandemic. These efforts should be combined by targeted training and education efforts, which would facilitate labor movements across sectors. Increased spending on social protection, particularly health and education, further strengthening public service delivery, and meeting commitments on climate change would foster more inclusive and greener growth.

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

Box 2. Credit Guarantee Scheme to Support MSME Financing

Improving the access to financing by MSMEs would help to mitigate the adverse impact of the pandemic shock and support economic recovery. The government's new credit guarantee scheme could play an important role in this respect by providing credit risk mitigation to financial institutions. Faster implementation would likely require increasing operational capacity.

The Philippine Guarantee Corporation (PhilGuarantee) was established as a unified credit guarantee institution in 2019. Its establishment reflected the government's objective to consolidate state guarantee functions in one institution to manage resources and run operations more efficiently. PhilGuarantee was the former Philippine Export-Import Credit Agency (PhilEXIM), the surviving entity after the merger of PhilEXIM and Home Guaranty Corporation (HGC). It also took over the guarantee functions and funds of the Small Business Corporation (SBC) and the Industrial Guarantee Loan Fund (IGLF), and the administration of the Agricultural Fund Pool (AGFP). It started operations on September 1, 2019. It is designated as a nonbank financial institution and subject to supervision and examination by the BSP.

PhilGuarantee

(March 31, 2021)

	In billions of peso
Asset	63.3
Equity	28.9
CAR (percent)	20.2
Authorized capital	50.0
Guarantee capacity	750.0
Outstanding guarantee portfolio	172.9

Source: PhilGuarantee.

A credit guarantee scheme focusing on MSMEs hit by the COVID-19 shock was established as part of the Bayanihan II support package. The fiscal package provided PhilGuarantee an additional PHP 5 billion capital, with an allocation of PHP 2 billion for MSMEs; PHP 2 billion for housing and PHP 1 billion for large corporations, which could support loan guarantee of about PHP 100 billion (0.5 percent of 2021 GDP). To date, 34 banks (9 commercial banks, 8 thrift banks and 17 rural banks) have signed up since the MSME Credit Guarantee Program (MCGP) was launched in December 2020. The MCGP provides a loan guarantee of 50 percent. As of end-March 2021, loan guarantees to 12,122 MSMEs had been approved. The guarantees covered loans of PHP 1.5 billion as of end-March 2021. About three-quarters of the MSMEs covered are from the wholesale and retail commerce sectors, accounting for two-thirds of the guarantee value. No guarantee has been called to date under the COVID-19 response package for MSMEs.

MSME Credit Guarantee Program

Eligible borrowers	▪ MSMEs affected by the COVID-19 ▪ In operation for at least one year prior to March 16, 2020 ▪ With satisfactory credit rating for the past one year
Eligible loans	▪ Up to PHP 50 million per borrower ▪ 50 percent guarantee of loan principal for one year for working capital loans
Guarantee fee	▪ 1 percent per annum

Source: PhilGuarantee.

Faster implementation of the credit guarantee program could facilitate credit extension and foster the economic recovery. Increasing the operational guarantee processing capacity of PhilGuarantee by hiring additional staff would be crucial. Alternatively, PhilGuarantee could also provide guarantees for portfolios of MSME loans rather than individual loans. Given joint risk sharing with banks, risks of moral hazard would likely be limited. Greater flexibility in the eligibility criteria would allow to extend credit guarantees to existing MSMEs that may not have credit history and new MSMEs, which would broaden the reach of the program. Overall, the state guarantee scheme should strike an appropriate balance between the need to provide credit support during economic distress and the preservation of sound financial practices and adequate safeguards, given contingent fiscal risks.

Box 3. Financial Institutions Strategic Transfer Act to Support Economic Recovery and the Financial System

The Financial Institutions Strategic Transfer (FIST) Act has been introduced to facilitate the resolution of nonperforming, distressed assets owned by financial institutions to mitigate the impact of the pandemic. The goal is to restore lending capacity by helping financial institutions *to improve their balance sheet.*

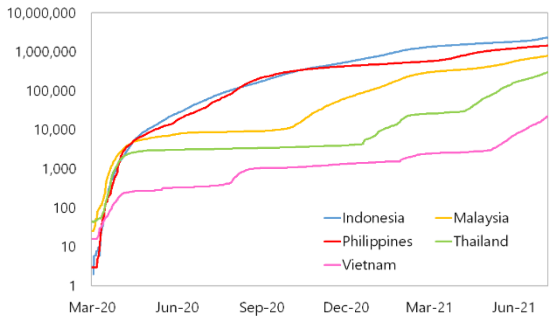
The FIST law passed in February 2021 facilitates the sale of nonperforming assets (NPAs) by financial institutions to Financial Institutions Strategic Transfer Corporations (FISTCs) and Special Purpose Vehicles specializing in the resolution of such assets. The government provides financial institutions with tax and regulatory incentives to encourage offloading their nonperforming assets to FISTCs. The Securities and Exchange Commission (SEC), BSP, Department of Finance (DOF), Bureau of Internal Revenue and Land Registration Authority promulgated the law's implementing rules and regulations on March 26, 2021. Under the law, a certificate of eligibility of the NPAs which will be the subject of the transfer will be issued by the regulatory authority—the BSP, DOF, SEC, or the Insurance Commission (IC)—for the purpose of obtaining tax exemptions and fee privileges. Eligible NPAs are those that have been classified as NPAs on or before December 31, 2022.

The tax exemptions provided under the FIST Law would lower transaction costs to promote the permanent removal of risk from financial institutions' balance sheets. This would free up capital to augment the financial institutions' liquidity and capacity to expand lending activities. There could also be potential efficiency gains in asset resolution if homogenous NPAs are pooled from different financial institutions or managed by specialized investors that have the risk appetite to deal with NPAs. Nonetheless, there are upfront costs (i.e., tax and fees exempted), and there could be a learning curve in the private sector in establishing the expertise required to establish and operationalize FISTCs. The success in the implementation of FIST Act would also depend on the participation of financial institutions, including their willingness to accept a haircut on the sale of their NPAs and the effectiveness of the supervisory oversight of the appropriate regulatory authorities over financial institutions and FISTCs.

Figure 1. COVID-19 Developments

The Philippines has seen a significant spread of COVID-19.

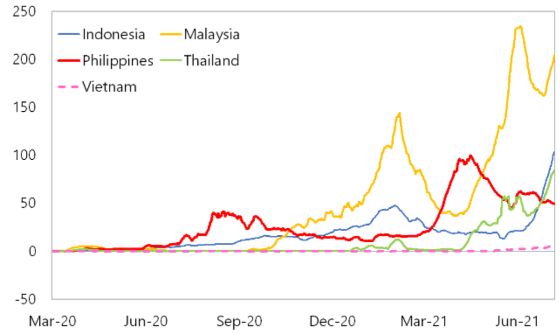
ASEAN: Number Cases
(In natural logarithmic scale, cumulative cases)



Sources: World Health Organization; and IMF staff estimates.

Daily new cases have stabilized after a second wave…

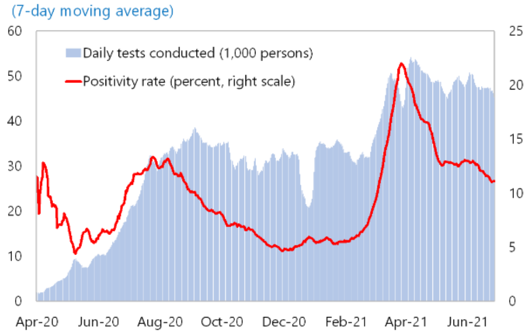
ASEAN: Number of New Cases
(7-day moving average, every 1 million population)



Sources: World Health Organization; and IMF staff estimates.

…and test positivity rates have declined from recent highs.

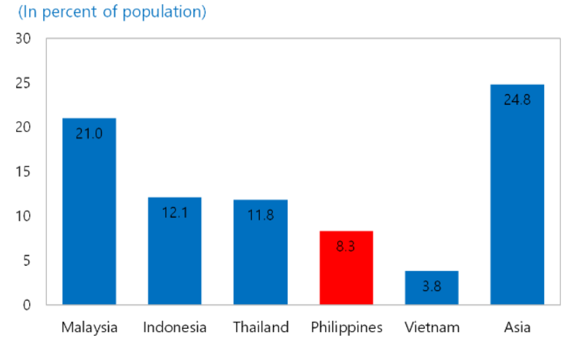
Daily Tests and Positivity Rate
(7-day moving average)



Sources: Philippines Department of Health; and IMF staff estimates.

Vaccination has started, aiming to inoculate 70 percent of the total target population.

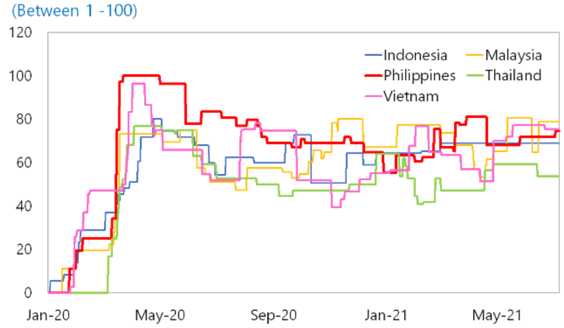
Vaccinated People for COVID-19 1/
(In percent of population)



Sources: Our World in Data; and IMF staff estimates.
1/ Received at least 1 dose of vaccine as of July 6, 2021.

Pandemic restrictions in the Philippines were eased after May 2020 but were tightened again recently.

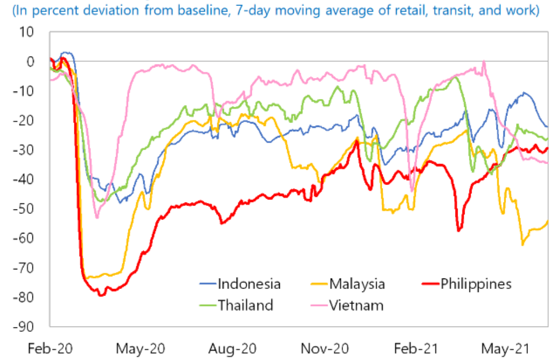
ASEAN: Index of COVID-19 Containtment Policy Stringency 1/
(Between 1 -100)



Source: University of Oxford, The Oxford COVID-19 Government Response Tracker.
1/ The index records the strictness of lockdown style policies; not scoring the appropriateness or effectiveness of a country's response. A higher number does not necessarily mean better.

Mobility is still below that in other ASEAN peers.

ASEAN: Mobility Trends
(In percent deviation from baseline, 7-day moving average of retail, transit, and work)

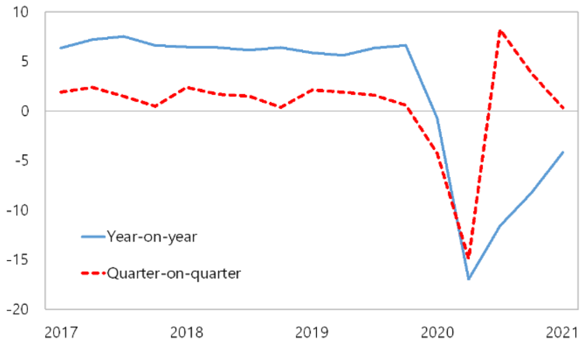


Sources: Google, COVID-19 Community Mobility Reports; and IMF staff estimates.

Figure 2. Drivers of Growth

Real GDP contracted in 2020:H1 and has recovered since.

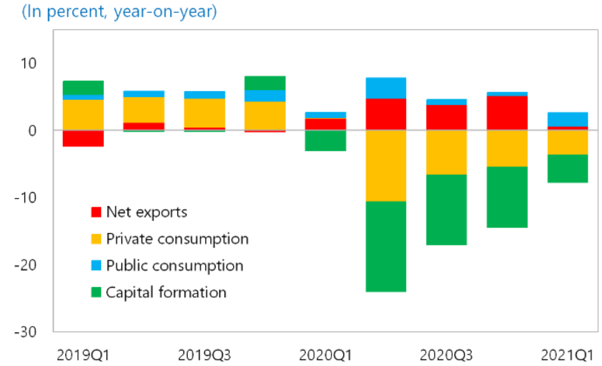
Real GDP Growth
(In percent)



Sources: Haver Analytics; and IMF staff estimates.

Lower private demand drove the decline in real GDP.

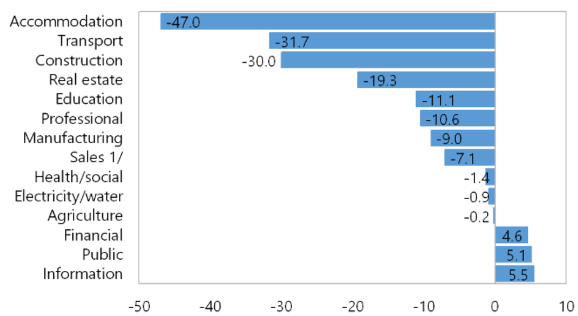
Contribution to GDP Growth
(In percent, year-on-year)



Sources: Philippine Statistics Authority; and IMF staff estimates.

Contact-intensive industries (e.g., accommodation, transport, construction) were hit harder by the pandemic.

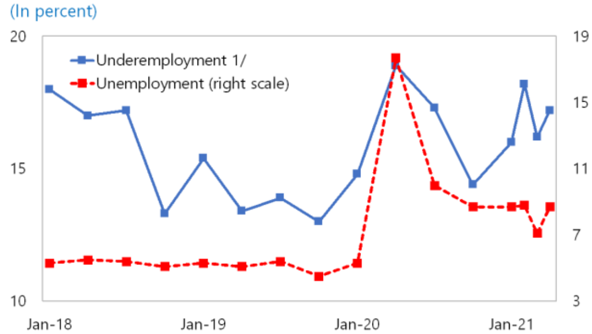
Sectoral Growth Rates
(In percent, year-on-year, average of 2020:Q2 to 2021:Q1)



Sources: Haver Analytics; and IMF staff estimates.
1/ Wholesale and retail trade; repair of motor vehicles and motorcycles.

Labor market indicators point to continued economic slack.

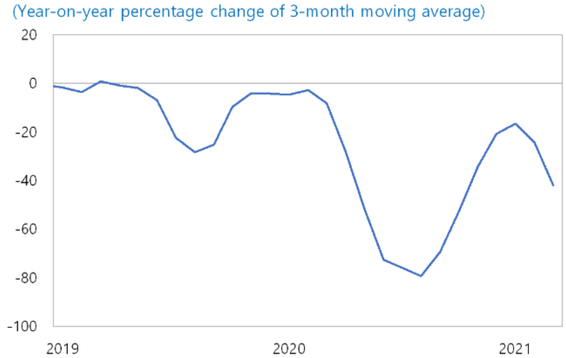
Unemployment and Underemployment Rate
(In percent)



Source: Philippines Statistics Authority.
1/ Employed persons who want additional hours of work in their present job, or to have additional job, or to have a new job with longer working hours.

Economic activity has slowed with the second virus wave…

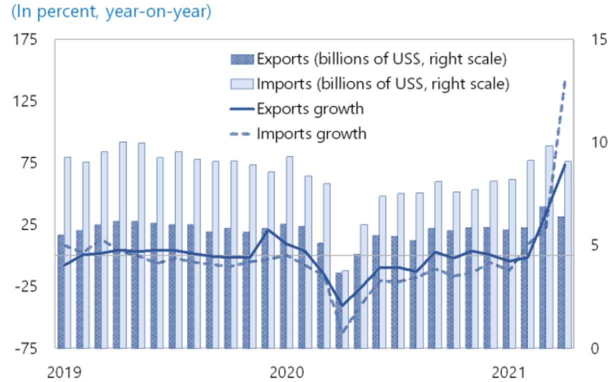
Manufacturing Production Volume
(Year-on-year percentage change of 3-month moving average)



Sources: Philippine Statistics Authority; and IMF staff estimates.

…including in export sectors.

Exports and Imports Growth
(In percent, year-on-year)

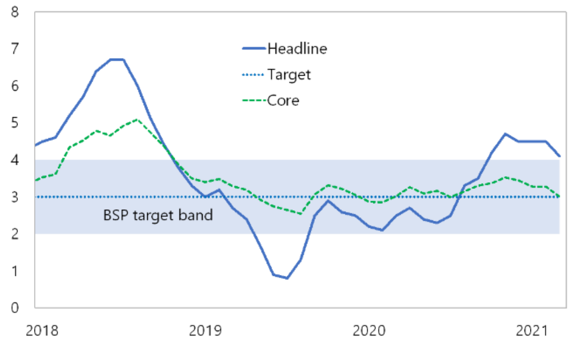


Sources: Haver Analytics; and IMF staff estimate.

Figure 3. Inflation Dynamics

Inflation started increasing noticeably in 2020:M11 and rose above the target band (2–4 percent) beginning 2021:M1

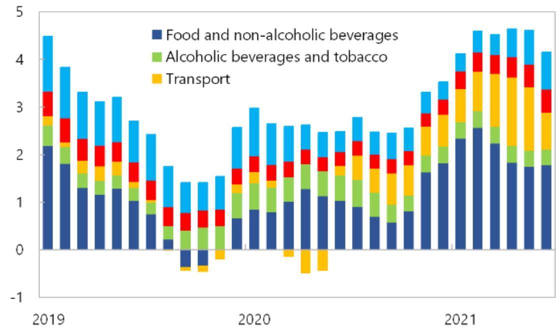
Consumer Price Inflation
(In percent, year-on-year)



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

...mainly due to increases in food and transport prices.

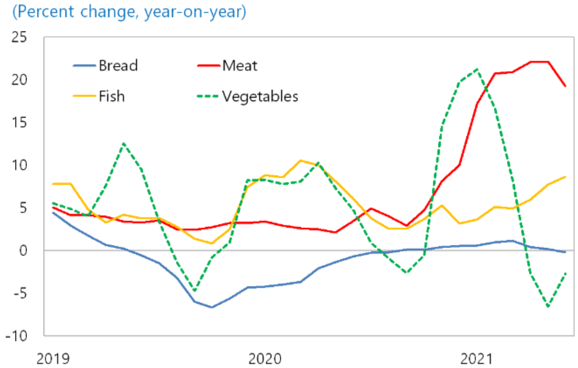
Contribution to Inflation
(In percent, year-on-year)



Sources: Haver Analytics; and IMF staff estimates.

Higher food prices have been driven by the adverse supply effects of typhoons (vegetables) and African Swine Fever.

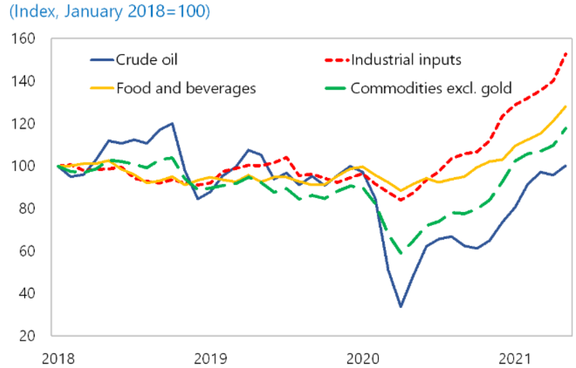
Food Prices
(Percent change, year-on-year)



Sources: Haver Analytics; and IMF staff estimates.

Global commodity prices also started increasing.

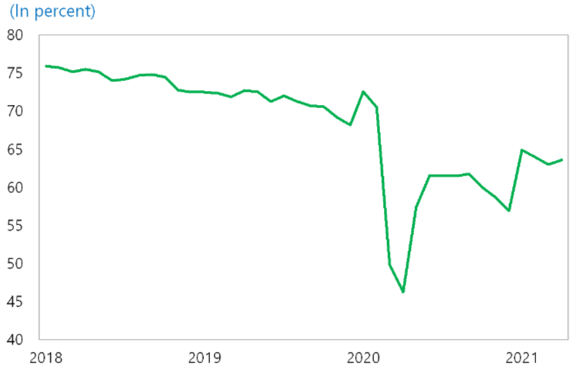
Global Prices
(Index, January 2018=100)



Sources: IMF, Global Commodity Prices; IMF staff estimates.

Capacity utilization has remained below pre-pandemic levels.

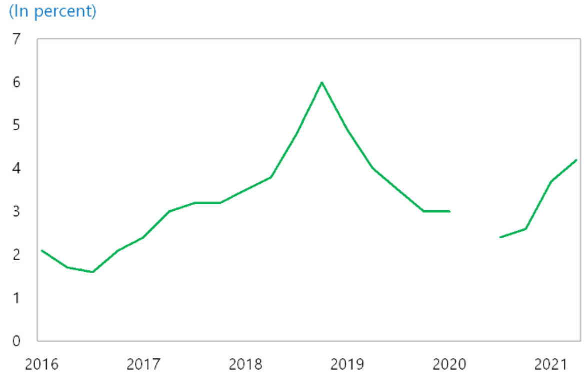
Manufacturing Capacity Utilization
(In percent)



Sources: Philippine Statistics Authority; and IMF staff estimates.

Short-term inflation expectations have edged up recently.

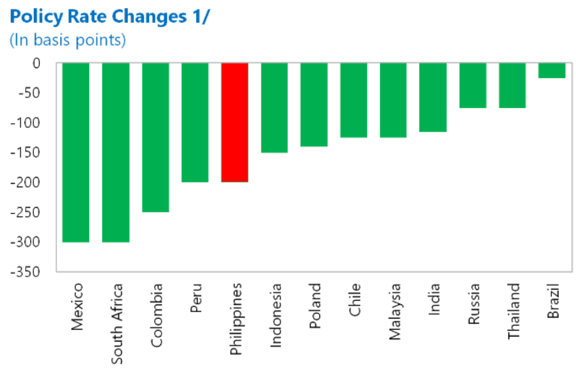
Business Inflation Expectations for Next Quarter
(In percent)



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

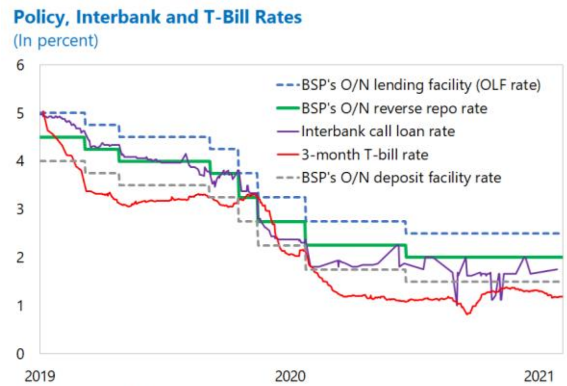
Figure 4. Monetary and Financial Conditions

The BSP has reduced the policy rate by a cumulative 200 basis points since the onset of the COVID-19 pandemic.



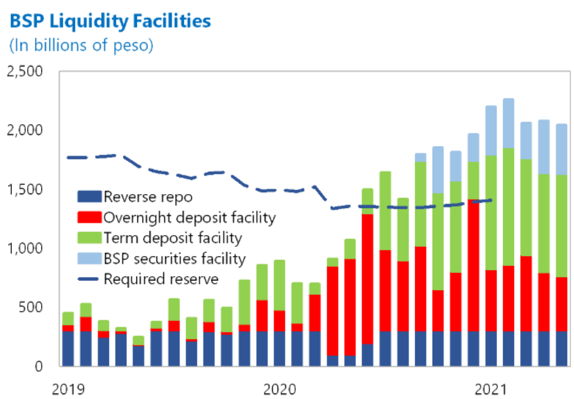
Sources: Haver Analytics; and IMF staff estimates.
1/ COVID-19 is the period January 2020 to June 25, 2021.

...other short-term interest rate declined by similar amounts.



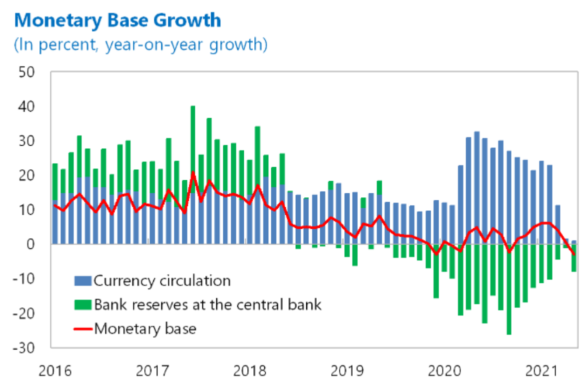
Sources: Bloomberg L.P.; and Haver Analytics.

The liquidity released from the reserve requirement reduction contributed to the increase in placements in the overnight and term deposit facilities...



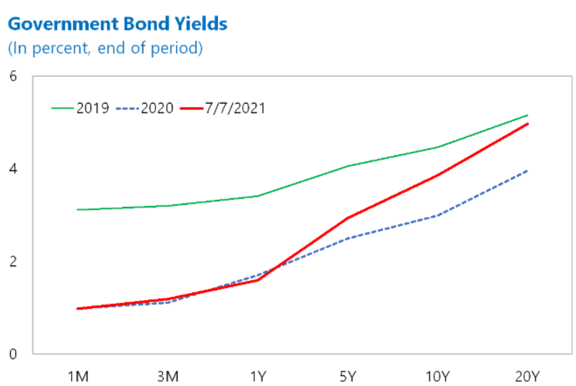
Sources: Haver Analytics; and CEIC Data Co. Ltd.

... and the monetary base increased in 2020 driven by higher currency in circulation.



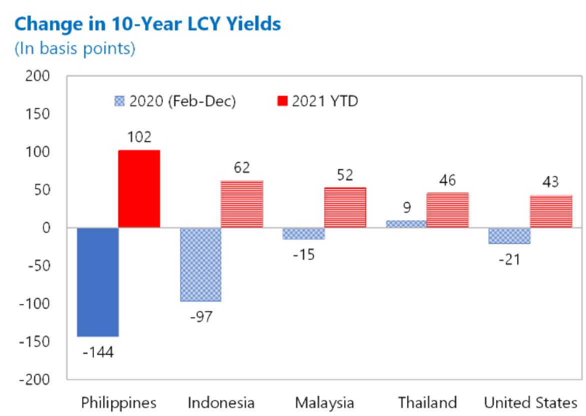
Sources: IMF, Monetary Financial Statistics; CEIC Data Co. Ltd.; and IMF staff estimates.

In 2021, yields have risen for longer maturity bonds...



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

...influenced by the rise in U.S. yields.

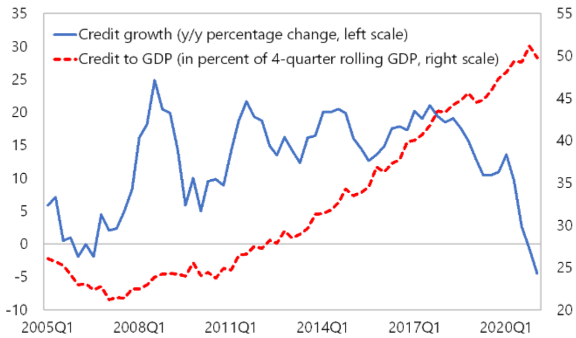


Sources: Haver Analytics and IMF staff estimates.

Figure 5. Macrofinancial Linkages

Credit growth has decelerated since 2018:H2…

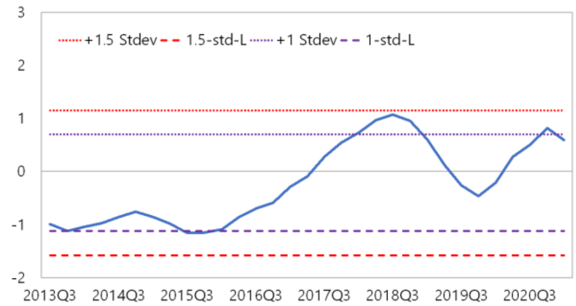
Bank Credit Growth and Credit-to-GDP Ratio 1/



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

…but the credit gap was positive in most of 2020 because of the contraction of GDP.

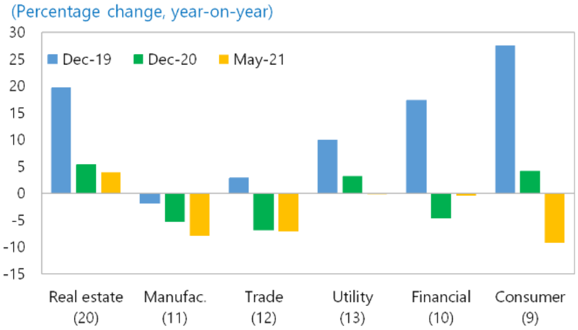
Credit-to-GDP Gap 1/
(In percent of GDP, 4-quarter moving average)



Sources: Bangko Sentral ng Pilipinas; and IMF staff estimates.
1/ Calculated using a one-sided Hodrick-Prescott filter with the smoothing parameter of 400,000. The sample gap average (2011:Q1-2019:Q4) is added to the thresholds.

Credit growth has declined in most sectors.

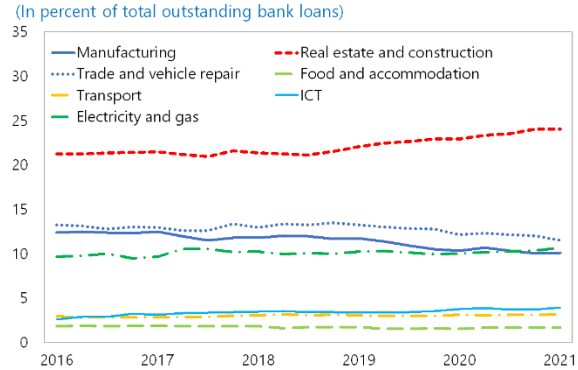
Universal and Commercial Banks: Loan By Sector 1/
(Percentage change, year-on-year)



Sources: CEIC Data Company Ltd; and IMF staff estimates.
1/ Figures in parantheses denote the share of respectives sectors in total bank loan outstanding as of end-May, 2021.

Corporate loans outstanding accounts for two-thirds of total loans, with real estate and construction loans gaining share…

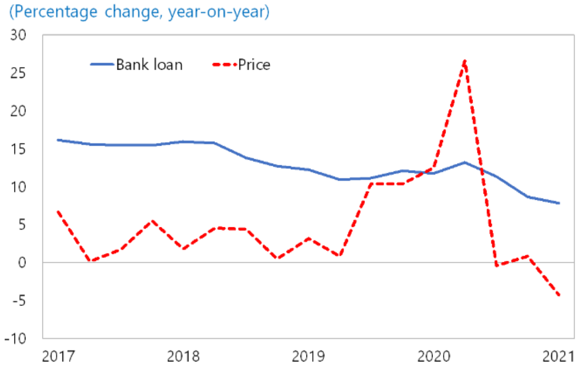
Share of Corporate Loan by Sector
(In percent of total outstanding bank loans)



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

…despite a large decline in real estate prices.

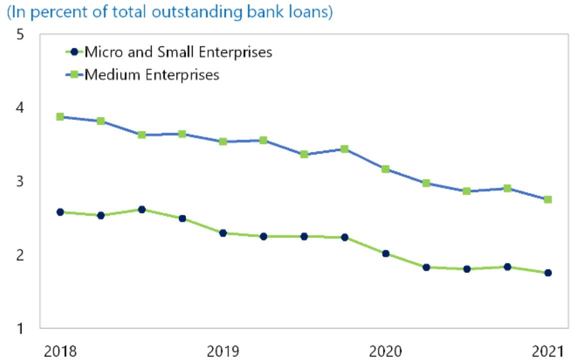
Residential Real Estate: Bank Loan and Price Growth
(Percentage change, year-on-year)



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

Share of bank loans to micro, small and medium enterprises continued to decline.

Loans of All Banks to Micro-Small and Medium Enterprises
(In percent of total outstanding bank loans)

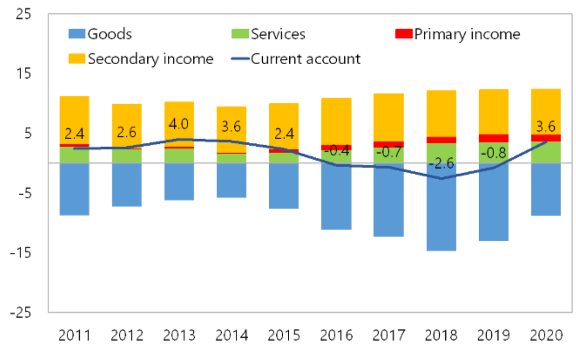


Sources: Bangko Sentral ng Pilipinas; and IMF staff estimates.

Figure 6. External Sector

The current account balance moved into surplus in 2020.

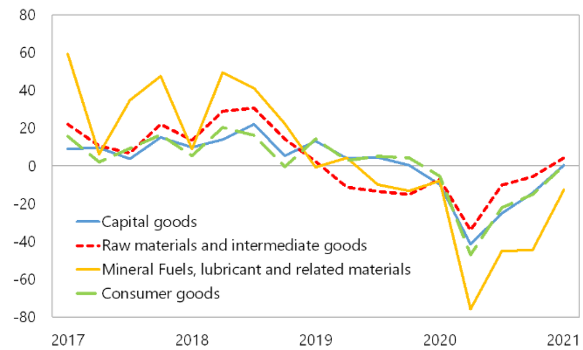
Current Account Balance
(In percent of GDP)



Sources: Haver Analytics; IMF staff estimates.

All import categories recorded decline in 2020.

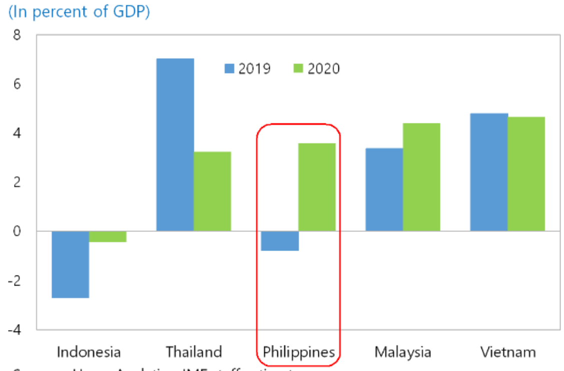
Imports of Goods
(US$ values, year-on-year growth percent change)



Sources: Haver Analytics; and IMF staff estimates.

The current account change in the Philippines in 2020 was larger than that in peers in the region.

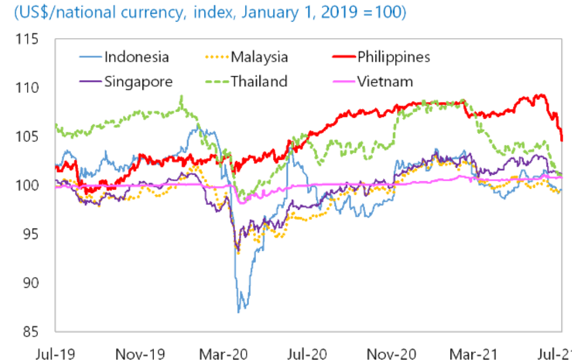
Current Account Balance
(In percent of GDP)



Sources: Haver Analytics; IMF staff estimates.

With the current account in surplus, the peso continued to appreciate in 2020.

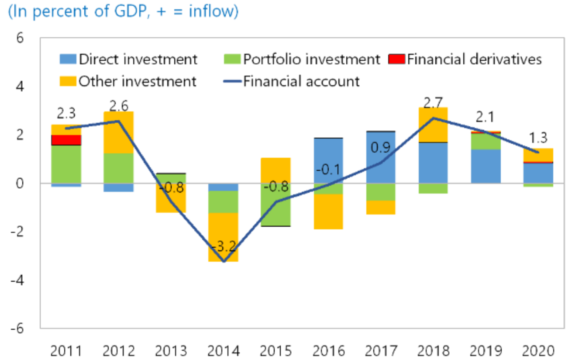
Exchange Rates
(US$/national currency, index, January 1, 2019 =100)



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

Net inflows in FDI and other investment were much larger than the small net outflows in portfolio investment in 2020.

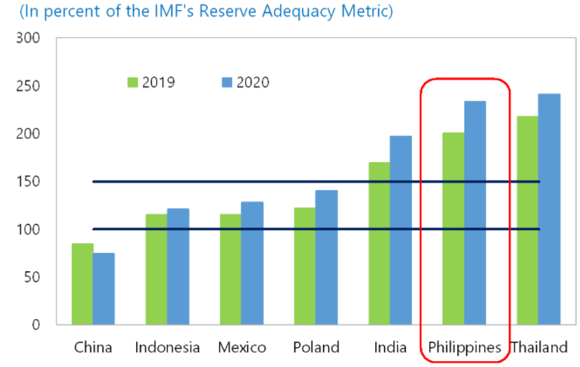
Capital Flows
(In percent of GDP, + = inflow)



Sources: Haver Analytics; IMF staff estimate.

The Philippines' foreign reserve increased to US$110 billion in 2020 and are well above the IMF's reserve adequacy metric.

Gross International Reserves
(In percent of the IMF's Reserve Adequacy Metric)

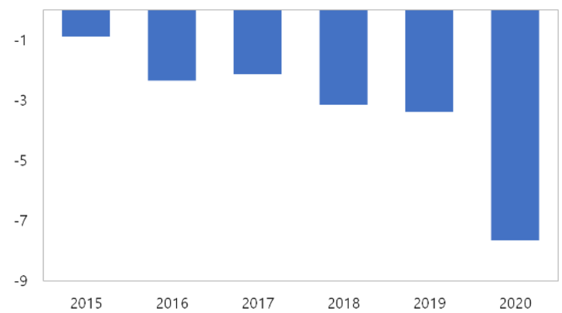


Sources: IMF, *International Financial Statistics*; and IMF staff estimates.

Figure 7. Fiscal Developments

The overall budget deficit widened in 2020…

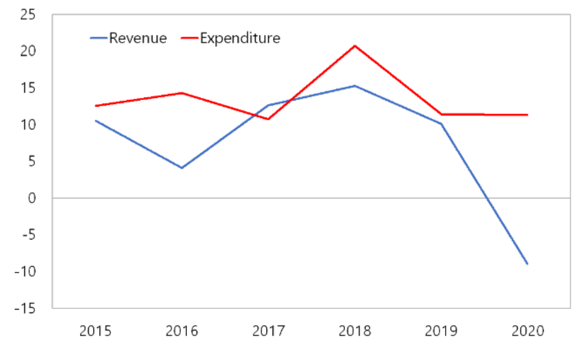
National Government Overall Balance 1/
(In percent of GDP)



Sources: Haver Analytics; and IMF staff estimates.
1/ Excluding privatization receipts.

… due to a fall in revenue and an increase in expenditure.

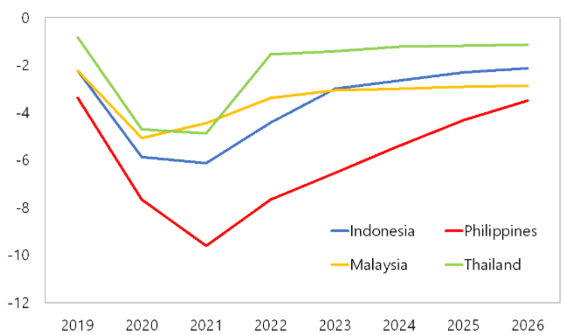
National Government Revenue and Expenditure Growth
(In percent, year-on-year)



Sources: Haver Analytics; and IMF staff estimates.

Philippines like most ASEAN peers will have a budget deficit increase in 2021…

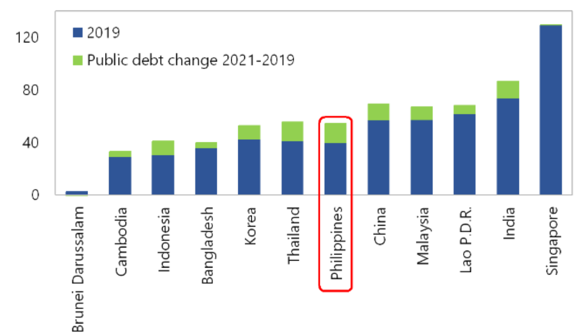
Fiscal Balance
(In percent of GDP)



Sources: IMF, World Economic Outlook; and IMF staff estimates.

…and its end-2021 debt-to-GDP ratio will remain comparable to its peers.

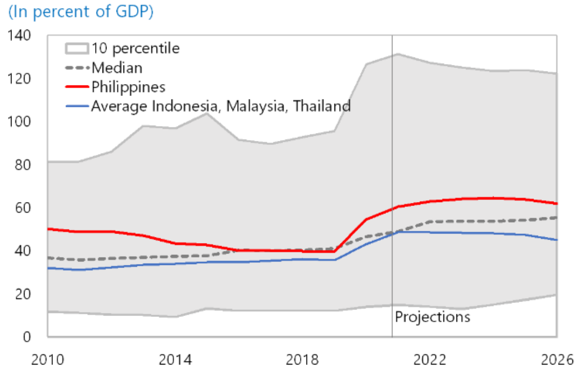
Public Debt
(In percent)



Sources: IMF, World Economic Outlook; and IMF staff estimates.

Philippines' debt-to-GDP ratio will remain similar to the median of the Asian EMs.

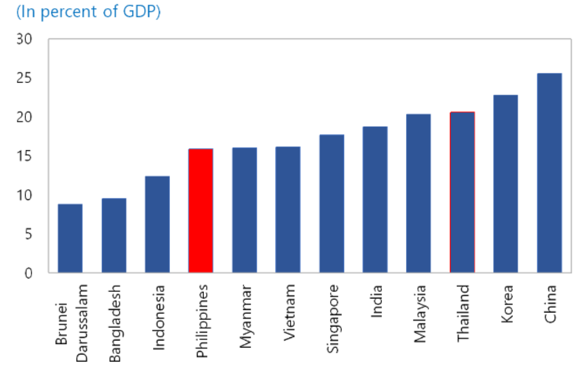
Government Debt over the Medium-Term
(In percent of GDP)



Sources: IMF, World Economic Outlook; and IMF staff estimates.

Boosting revenue mobilization is one option to rebuild fiscal space in the medium term.

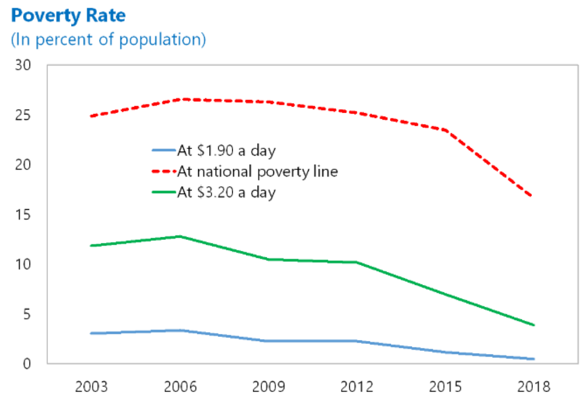
Government Revenue, 2020
(In percent of GDP)



Sources: IMF, World Economic Outlook; and IMF staff estimates

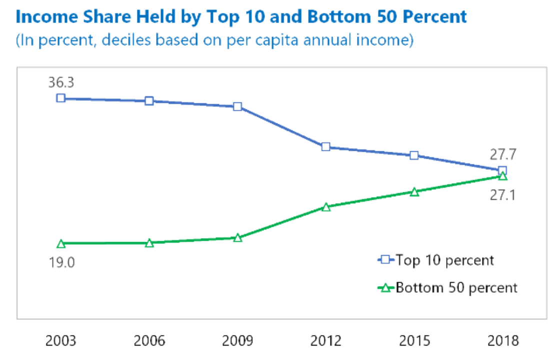
Figure 8. Poverty and Business Environment

Poverty was falling before the pandemic…



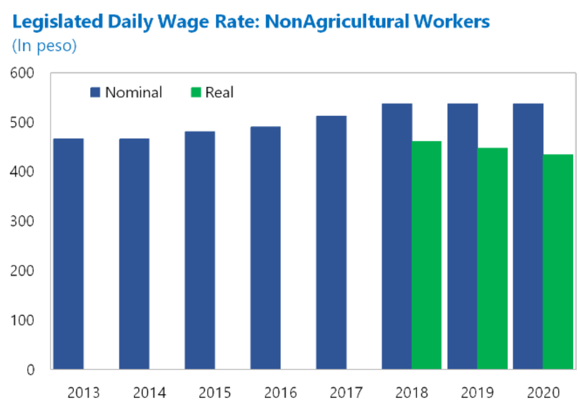
Source: World Bank, World Development Indicators via CEIC Data Co. Ltd.

…and inequality improved markedly…



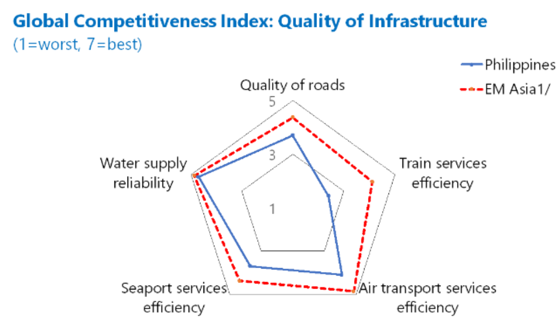
Sources: Philippines Statistics Authority, Family Income and Expenditure Survey; and IMF staff estimates.

…partly due to wage increases in those years, but wages have stagnated since 2019.



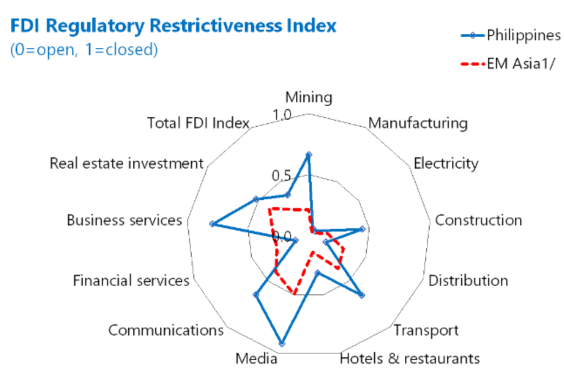
Source: Philippines Department of Labor and Employment via Haver Analytics.

Infrastructure gaps have contributed to a lack of high-quality non-agriculture jobs outside the national capital region.



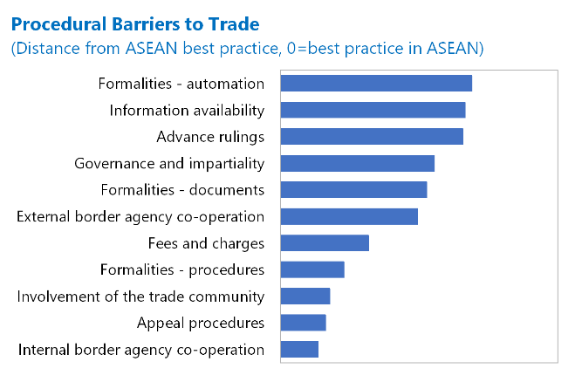
Sources: World Economic Forum, Global Competitiveness Report 2019 edition; and IMF staff estimates.
1/ Average of India, Indonesia, Malaysia, Thailand, and Vietnam.

Regulatory barriers remain high for inward FDI…



Sources: OECD, FDI Regulatory Restrictiveness Index, 2020; and IMF staff estimates.
1/ Average of India, Indonesia, Malaysia, Thailand, and Vietnam.

…and international trade.



Sources: OECD, Trade Facilitation Indicators, 2020; and IMF staff estimates.

Table 1. Philippines: Selected Economic Indicators, 2017–22

Demographic: Population (2020): 108.8 million; Life expectancy at birth (2018): 71
Poverty (percent of population): Below (2018) $1.90 a day: 2.7; Below the national poverty line (2018): 16.7
Inequality (2018, income shares): Top 10 percent: 33.5; Bottom 20 percent: 6.2
Business environment (2019 country ranking): Ease of doing business: 95 (out of 190); Starting a business: 171 (out of 190)
IMF quota: SDR 2,042.9 million
Main products and exports: electronics, agricultural products, and business process outsourcing

	2017	2018	2019	2020	2021 Proj.	2022 Proj.
	(Annual percentage change, unless otherwise indicated)					
National account						
Real GDP	6.9	6.3	6.1	-9.6	5.4	7.0
Consumption	6.0	6.8	6.3	-5.2	4.5	7.0
Private	6.0	5.8	5.9	-7.9	3.4	6.4
Public	6.5	13.4	9.1	10.5	9.9	9.6
Gross fixed capital formation	10.6	12.9	3.9	-27.5	5.6	10.3
Final domestic demand	7.1	8.2	5.7	-10.6	4.7	7.7
Net exports (contribution to growth)	-0.9	-2.3	-0.2	4.0	0.2	-1.4
Real GDP per capita	5.2	4.7	4.6	-10.8	3.8	5.4
Output gap (percent, +=above potential)	0.4	0.2	-0.1	-8.6	-3.9	-0.7
Labor market						
Unemployment rate (percent of labor force)	5.7	5.3	5.1	10.4	7.6	6.3
Underemployment rate (percent of employed persons)	16.1	16.4	13.8	16.2	…	…
Employment	-1.6	2.0	1.9	-6.1	5.2	3.2
Price						
Consumer prices (period average)	2.9	5.2	2.5	2.6	4.2	3.0
Consumer prices (end of period)	2.9	5.1	2.5	3.5	3.3	3.0
Core consumer prices (period average)	2.5	4.1	3.2	3.1	…	…
Residential real estate (Q4/Q4)	5.5	0.5	10.4	0.8	…	…
Money and credit (end of period)						
3-month PHIREF rate (in percent) 1/	3.3	6.5	3.1	1.3	…	…
Claims on private sector (in percent of GDP)	45.6	47.6	48.0	51.9	48.5	47.6
Claims on private sector	16.4	15.1	7.8	-0.6	1.0	8.0
Monetary base	13.7	6.4	-3.0	5.1	6.0	10.5
Broad money	11.3	9.0	9.8	8.6	6.2	9.1
Public finances (in percent of GDP)						
National government overall balance 2/	-2.1	-3.1	-3.4	-7.6	-9.6	-7.7
Revenue and grants	14.9	15.5	16.1	15.9	14.9	15.4
Total expenditure and net lending	17.1	18.7	19.5	23.6	24.5	23.1
General government gross debt	38.1	37.1	37.0	51.9	57.7	60.2
Balance of payments (in percent of GDP)						
Current account balance	-0.7	-2.6	-0.8	3.6	0.4	-1.8
FDI, net	-2.1	-1.7	-1.4	-0.8	-0.4	-0.9
Total external debt	22.3	22.8	22.2	27.2	25.0	24.4
Gross reserves						
Gross reserves (US$ billions)	81.6	79.2	87.8	110.1	103.6	98.3
Gross reserves (percent of short-term debt, remaining maturity)	419.3	364.9	398.3	552.6	508.3	459.0
Memorandum items:						
Nominal GDP (US$ billions)	328.5	346.8	376.8	361.5	400.6	433.6
Nominal GDP per capita (US$)	3,153	3,280	3,512	3,323	3,628	3,867
GDP (in billions of pesos)	16,557	18,265	19,518	17,939	19,390	21,320
Real effective exchange rate (2010=100)	103.4	100.5	105.4	111.5	…	…
Peso per U.S. dollar (period average)	50.4	52.7	51.8	49.6	…	…

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

1/ Benchmark rate for the peso floating leg of a 3-month interest rate swap.

2/ IMF definition. Excludes privatization receipts and includes deficit from restructuring of the previous Central Bank-Board of Liquidators.

Table 2. Philippines: National Government Cash Accounts, 2017–22

(In percent of GDP, unless otherwise indicated

	2017	2018	2019	2020	2021 Proj.	2022 Proj.
Revenue and grants	14.9	15.5	16.1	15.9	14.9	15.4
Tax revenue	13.6	14.0	14.5	14.0	14.0	14.7
Net income and profits	6.2	5.7	5.9	5.8	5.9	6.4
Excises	1.6	2.1	2.3	2.4	2.4	2.5
VAT	4.2	4.2	4.2	3.7	3.8	3.7
Tariffs	0.4	0.4	0.4	0.4	0.4	0.5
Other 1/	1.2	1.6	1.7	1.7	1.5	1.6
Nontax revenue	1.3	1.5	1.6	2.0	0.9	0.8
Expenditure and net lending	17.1	18.7	19.5	23.6	24.5	23.1
Current expenditures	12.8	13.4	14.0	18.5	19.0	17.1
Personnel services	4.9	5.4	5.7	6.6	6.7	6.3
Maintenance and operations	2.8	2.9	2.9	4.9	4.9	3.0
Allotments to LGUs	2.4	2.3	2.4	3.5	3.4	4.4
Subsidies	0.8	0.7	1.0	1.3	1.2	0.7
Tax expenditure	0.1	0.1	0.1	0.2	0.1	0.1
Interest	1.9	1.9	1.8	2.1	2.7	2.7
Capital and equity expenditure	4.3	5.3	5.3	4.9	5.3	5.8
Capital expenditure	4.3	5.3	5.3	4.8	5.0	5.8
Equity	0.0	0.0	0.0	0.1	0.3	0.0
Net lending	0.0	0.0	0.1	0.1	0.1	0.1
Balance	-2.1	-3.1	-3.4	-7.6	-9.6	-7.7
On the authorities' presentation 2/	-2.1	-3.1	-3.4	-7.6	-9.6	-7.7
Financing	2.1	3.1	3.4	7.6	9.6	7.7
External financing (net)	0.2	1.0	0.9	3.3	1.9	2.1
Domestic financing (net)	3.0	1.8	1.8	8.2	7.7	5.6
Change in cash (negative=accumulation)	-1.1	0.2	0.6	-3.9	0.0	0.0
Privatization	0.0	0.1	0.0	0.0	0.0	0.0
Memorandum items:						
Cyclically-adjusted primary balance 3/	-0.3	-1.3	-1.5	-3.7	-6.0	-4.8
Structural primary balance 3/	-0.3	-1.3	-1.5	-3.6	-5.9	-4.7
Gross financing requirement 4/	6.1	6.9	8.4	13.6	16.9	15.6
National government gross debt 5/	40.2	39.9	39.6	54.6	60.5	62.9
Domestic	26.8	26.2	26.3	37.3	42.3	44.0
External	13.4	13.8	13.3	17.3	18.2	18.9
GDP (in billions of peso)	16,557	18,265	19,518	17,939	19,390	21,320

Sources: Philippine authorities; and IMF staff projections.

1/ Includes other percentage taxes, documentary stamp tax, and non-cash collections.

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

3/ In percent of potential GDP. Compared to the cyclically-adjusted balance, the structural balance also controls for the effect of cyclical fluctuations of the peso on revenue.

4/ Defined as the sum of deficit, amortization of medium- and long-term debt, and the stock of outstanding short-term debt.

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

Table 3. Philippines: General Government Operations, 2017–22 1/

(In percent of GDP, unless otherwise indicated)

	2017	2018	2019	2020	2021 Proj.	2022 Proj.
Revenue	18.7	19.3	20.0	20.6	19.7	20.5
Taxes	14.5	14.9	15.4	15.1	15.2	15.8
Taxes on income, profits, and capital gains	6.2	5.7	5.9	5.8	5.9	6.4
Taxes on goods and services	6.8	7.4	7.7	7.4	7.4	7.5
Taxes on international trade and transactions	0.4	0.4	0.4	0.4	0.4	0.5
Taxes not elsewhere classified	1.2	1.4	1.4	1.5	1.4	1.5
Social contributions	2.2	2.2	2.4	2.7	2.8	3.0
Grants	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue	2.0	2.1	2.2	2.8	1.7	1.6
Total expenditure	19.1	20.9	21.7	26.4	27.3	26.4
Expense	14.4	15.2	15.9	21.1	21.8	19.9
Compensation of employees 2/	4.9	5.4	5.7	6.6	6.7	6.3
Purchases/use of goods and services 2/	2.8	2.9	2.9	4.9	4.9	3.0
Interest 2/	1.6	1.7	1.6	1.8	2.4	2.4
Social benefits	2.3	2.4	2.6	3.0	3.2	3.3
Expense not elsewhere classified	2.8	2.8	3.1	4.8	4.6	5.0
Net acquisition of nonfinancial assets	4.6	5.7	5.7	5.3	5.5	6.4
Net lending/borrowing	-0.4	-1.6	-1.7	-5.7	-7.6	-5.9
Memorandum items:						
Primary balance	1.3	0.1	-0.1	-3.9	-5.1	-3.5
General government gross debt 3/	38.1	37.1	37.0	51.9	57.7	60.2
Domestic	24.8	23.4	23.6	34.6	39.6	41.3
Foreign	13.4	13.8	13.3	17.3	18.2	18.9
GDP (in billions of peso)	16,557	18,265	19,518	17,939	19,390	21,320

Sources: Philippine authorities; and IMF staff projections.

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

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

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

Table 4. Philippines: Depository Corporation Survey, 2017–21 1/

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

	2017	2018	2019	2020	2021:Q1
Total					
Net foreign assets	4,403	4,461	4,858	6,096	6,082
Net domestic assets	8,083	9,149	10,092	10,138	10,081
Net claims on nonfinancial public sector	1,994	2,249	2,711	3,456	3,543
Claims on private sector	7,551	8,687	9,363	9,308	9,167
Net claims on other financial corporations	921	1,084	1,192	1,101	1,088
Broad money	12,486	13,610	14,950	16,234	16,163
National currency	10,636	11,643	12,976	14,211	14,150
Foreign currency	1,851	1,968	1,974	2,023	2,012
Bangko Sentral ng Pilipinas					
Net foreign assets	4,004	4,089	4,399	5,303	5,234
Net domestic assets	-864	-746	-1,157	-1,901	-1,943
Claims on private sector	0	0	0	0	0
Net claims on financial corporations	-384	-231	-734	-1,910	-2,010
Monetary base	3,136	3,338	3,238	3,402	3,291
Currency in circulation	1,267	1,490	1,679	2,039	1,890
Other depository corporations liabilities	1,867	1,847	1,559	1,363	1,401
Other liquid liabilities	3	5	4	0	…
Other depository corporations					
Net foreign assets	400	372	459	793	889
Net domestic assets	11,034	12,000	13,091	13,708	13,680
Net claims on nonfinancial public sector	1,935	2,034	2,478	2,710	2,986
Claims on private sector	7,551	8,687	9,363	9,308	9,184
Net claims on financial corporations	3,401	3,424	3,771	4,608	4,561
Liquid liabilities	11,434	12,373	13,550	14,131	…
Memorandum items:					
Broad money (percent change, year-on-year)	11.3	9.0	9.8	8.6	6.3
Claims on private sector (percent change, year-on-year)	16.4	15.1	7.8	-0.6	-3.5
Broad money (in percent of GDP)	75.4	74.5	76.6	90.5	83.4
Claims on private sector (in percent of GDP)	45.6	47.6	48.0	51.9	47.3
Nominal GDP	16,557	18,265	19,518	17,939	4,346

Sources: Philippines authorities; IMF, *International Financial Statistics;* and IMF staff projections.

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

Table 5. Philippines: Balance of Payments, 2017–22

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

	2017	2018	2019	2020	2021 Proj.	2022 Proj.
Current account balance	-2.1	-8.9	-3.0	13.0	1.5	-7.7
Trade balance of goods and services	-31.5	-39.4	-36.3	-18.8	-32.6	-44.6
Goods	-40.2	-51.0	-49.3	-31.8	-47.3	-60.7
Exports, f.o.b.	51.8	52.0	53.5	47.4	52.9	58.5
Imports, f.o.b.	92.0	102.9	102.8	79.3	100.2	119.2
Services	8.7	11.6	13.0	13.1	14.7	16.1
Receipts	34.8	38.4	41.3	31.4	36.5	41.2
Payments	26.1	26.8	28.2	18.3	21.7	25.0
Primary income, net	3.2	3.7	5.3	4.4	5.9	7.1
Receipts from resident workers abroad	7.9	8.3	8.8	8.6	8.8	9.3
Secondary income, net	26.2	26.8	27.9	27.4	28.1	29.7
Recepits from nonresident workers remittances	24.1	24.8	25.6	25.6	26.3	27.8
Payments	0.7	0.8	0.8	0.9	0.9	1.0
Capital account	0.1	0.1	0.1	0.1	0.1	0.1
Financial account 1/	-2.8	-9.3	-8.0	-4.6	7.1	-3.6
Direct investment	-7.0	-5.8	-5.3	-3.0	-1.5	-3.8
Portfolio investment	2.5	1.4	-2.5	0.5	6.0	-0.3
Financial derivatives	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2
Other investment	1.7	-4.9	-0.1	-1.9	2.8	0.7
Errors and omissions	-1.6	-2.8	2.7	-1.6	-1.6	-1.6
Overall balance	-0.9	-2.3	7.8	16.0	-7.2	-5.6
Memorandum items:						
Nominal GDP (US$ billions)	328	347	377	361	401	434
Current account (in percent of GDP)	-0.7	-2.6	-0.8	3.6	0.4	-1.8
Short-term debt (original maturity)	14.3	16.1	17.2	14.2	14.7	15.7
Short-term debt (residual maturity)	19.5	21.7	22.1	19.9	20.4	21.4
Gross reserves	81.6	79.2	87.8	110.1	103.6	98.3
External debt (US$ billions)	73.1	79.0	83.6	98.5	100.2	106.0
External debt (in percent of GDP)	22.3	22.8	22.2	27.2	25.0	24.4

Sources: Philippine authorities; and IMF staff projections.

1/ An increase in either assets or liabilities is positive and a decrease is negative. Net investment is assets minus liabilities. A negative financial account balance means that the change in liabilities is greater than the change in assets.

Table 6. Philippines: Medium-Term Outlook, 2020–26

(In percent of GDP, unless otherwise indicated)

	2020	2021 Proj.	2022 Proj.	2023 Proj.	2024 Proj.	2025 Proj.	2026 Proj.
GDP and prices							
Real GDP (percent change)	-9.6	5.4	7.0	6.8	6.5	6.5	6.5
CPI (percent change, annual average)	2.6	4.2	3.0	3.0	3.0	3.0	3.0
GDP by expenditure							
Consumption (percent change)	-5.2	4.5	7.0	6.1	5.6	5.5	5.6
Private	-7.9	3.4	6.4	5.7	5.1	4.9	5.0
Public	10.5	9.9	9.6	8.0	8.0	8.0	8.0
Gross fixed investment (percent change)	-27.5	5.6	10.3	14.2	13.8	13.4	12.4
Net exports (contribution to growth)	4.0	0.2	-1.4	-1.7	-1.7	-1.7	-1.7
Investment and saving							
Gross investment	17.4	17.5	18.2	20.2	22.0	23.8	25.5
Private	12.9	12.6	12.8	14.9	16.9	19.0	21.0
Public	4.5	4.9	5.4	5.3	5.1	4.8	4.5
National saving	21.0	17.8	16.4	18.4	20.2	22.1	23.7
Private	21.8	20.1	16.5	17.8	18.6	19.7	20.9
Public	-0.8	-2.3	-0.1	0.6	1.6	2.3	2.9
Public finances							
National government balance	-7.6	-9.6	-7.7	-6.5	-5.4	-4.3	-3.5
Total revenue	15.9	14.9	15.4	15.5	16.0	16.2	16.3
Total expenditure and net lending	23.6	24.5	23.1	22.1	21.4	20.5	19.7
General government gross debt	51.9	57.7	60.2	61.6	61.9	61.1	59.3
Current account	3.6	0.4	-1.8	-1.8	-1.8	-1.8	-1.8
Reserves (US$ billions)	110.1	103.6	98.3	93.9	89.8	86.3	83.2
Reserves/short-term liabilities 1/	552.6	508.3	459.0	417.7	381.3	350.1	322.5
Total external debt	27.2	25.0	24.4	23.9	23.5	22.9	22.4
Monetary sector							
Claims on private sector 2/	51.9	48.5	47.6	48.6	49.9	51.2	52.6
Claims on private sector (percent change) 2/	-0.6	1.0	8.0	11.6	12.1	12.1	12.0

Sources: Philippine authorities; and IMF staff projections.

1/ Remaining maturity basis.

2/ Based on the depository corporations survey. In addition to universal and commercial banks, it includes thrift banks, rural banks, non-stock savings and loan associations and non-banks with quasi-banking functions.

Table 7. Philippines: Financial Soundness Indicators, 2017–21

(In percent)

	2017	2018	2019	2020	2021:Q1
Capital adequacy					
Regulatory capital to risk-weighted assets	14.4	14.9	15.2	16.3	16.6
Regulatory Tier-1 capital to risk-weighted assets	12.7	13.3	14.0	15.3	15.7
Capital to total assets	10.0	10.7	11.0	11.1	11.3
Nonperforming loans net of provisions to capital	3.1	3.5	4.6	6.2	8.3
Net open position in foreign exchange to capital	7.9	4.7	5.8	3.7	3.5
Gross asset position in financial derivatives to capital	1.6	1.8	1.2	1.5	1.3
Gross liability position in financial derivatives to capital	0.0	0.1	0.4	0.1	0.1
Asset quality					
Nonperforming loans to total gross loans	1.6	1.7	2.0	3.5	4.2
Specific provisions to nonperforming loans	66.9	63.2	58.0	65.9	59.8
Earnings and profitability					
Return on assets	1.3	1.3	1.5	1.1	1.4
Return on equity	13.6	12.7	13.9	9.7	12.6
Interest margin to gross income	73.9	75.2	74.0	73.9	73.5
Trading income to gross income	4.3	3.2	7.8	12.1	9.0
Noninterest expenses to gross income	60.9	62.2	58.7	52.9	54.3
Personel expenses to noninterest expenses	36.6	35.4	34.5	35.6	34.4
Liquidity and funding					
Liquid assets to total assets	32.9	32.6	32.1	35.5	33.3
Liquid assets to short-term liabilities	51.8	50.7	48.8	53.5	51.4
Non-interbank loans to customer deposits	0.8	0.8	0.9	0.8	0.8
Sensitivity to market risk					
Foreign currency denominated loans to total loans	11.1	10.9	10.7	10.6	10.9
Foreign currency denominated liabilities to total liabilities	20.2	20.1	19.6	17.5	16.6
Real estate markets					
Residential real estate loans to total loans	7.2	7.1	7.3	8.0	8.2
Commercial real estate loans to total loans	14.1	12.3	13.2	14.0	14.2

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

Table 8. Philippines: Indicators of External Vulnerability, 2017–22

(In percent of GDP, unless otherwise indicated)

	2017	2018	2019	2020	2021 Proj.	2022 Proj.
External indicators (including external liquidity)						
Gross international reserves (US$ billions, end of period)	81.6	79.2	87.8	110.1	103.6	98.3
Maturing short-term debt (US$ billions)	14.3	16.1	17.2	14.2	14.7	15.7
Amortization of medium and long-term debt (US$ billions)	4.8	5.2	5.6	4.8	5.7	5.7
Net FDI inflows (in BPM6, US$ billions)	-7.0	-5.8	-5.3	-3.0	-1.5	-3.8
FX deposits residents (US$ billions)	39.5	40.2	41.5	45.6	...	...
Total gross external debt	22.3	22.8	22.2	27.2	25.0	24.4
Fiscal indicators						
National government overall balance	-2.1	-3.1	-3.4	-7.6	-9.6	-7.7
National government cyclically-adjusted primary balance	-0.3	-1.3	-1.5	-3.7	-6.0	-4.8
Net debt denominated in FX or linked to the exchange rate (in percent of total)	30.8	33.1	32.9	31.1	30.1	30.4
Short-term net general government debt (original maturity, in percent of total)	4.7	6.8	6.4	9.7	9.8	10.0
Amortization of total general government debt	4.5	5.0	5.2	8.8	8.5	8.9

Sources: Philippine authorities; and IMF staff estimates.

Appendix I. Impact of COVID-19 on the Philippines' Labor Market[1]

1. **The COVID-19 pandemic caused a global health crisis, which has rapidly transformed into economic and labor market shocks**. The measures used to contain the spread of the virus have impacted activity and employment in all sectors of the Philippines' economy, albeit to differing degrees. An analysis of job separations and findings using the Labor Force Survey (LFS) data shows that COVID-19 had large effects on employment, with considerable heterogeneity across economic sectors, population segments, and geographical regions.

Table 1. Summary of Labor Market Stocks and Transition Rates

	2017	2018	2019				2020			Year-On-Year Percent Change 2020		
			Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q1	Q2	Q3
Labor Market Stocks												
Employment (% of Working-Age Population)	57.7	57.7	57.1	58.2	58.7	58.6	58.4	45.9	55.8	2%	-21%	-5%
Of which: Agricultural employment share (in percent)	25.4	24.3	21.6	21.7	22.9	22.8	22.6	25.9	26.3	2%	19%	15%
Non-employment (in percent of working-age population)	42.3	42.3	42.9	41.8	41.3	41.4	41.6	54.1	44.2	-3%	29%	7%
Of which: Unemployment (in percent)	3.5	3.2	3.2	3.2	3.4	2.8	3.3	9.8	6.2	4%	208%	85%
Of which: Nonparticipation (in percent)	38.8	39.1	39.7	38.7	37.9	38.6	38.3	44.3	38.1	-4%	14%	1%
Labor Market Transition Rates												
EN (agricultural to non-employed)	0.07	0.07	0.08	0.09	0.07	0.06	0.07	0.16	0.05	-12%	85%	-29%
EN (non-agricultural to non-employed)	0.05	0.05	0.06	0.05	0.05	0.04	0.05	0.21	0.05	-14%	350%	-4%
NE (non-employed to agricultural)	0.03	0.03	0.03	0.02	0.02	0.02	0.01	0.01	0.03	-53%	-44%	42%
NE (non-employed to non-agricultural)	0.08	0.09	0.09	0.10	0.07	0.06	0.03	0.02	0.14	-63%	-79%	106%

Notes: (1) the working-age population represents those with age 15 and above ; (2) for the EN rates, the underlying sample contains matched records that start with employed in the past quarter; the dependent variable takes 1 when an EN transition occurs and 0 when the worker remains employed. Likewise, the sample for NE rates consists of those who are non-employed in the past quarter; the variable takes 1 if the worker is employed in the survey quarter and 0 otherwise. To calculate the EN rates (NE rates) for agricultural and non-agricultural workers respectively, we further classify each sample based on whether the worker is employed in the agricultural sector before non-employment (after non-employment); (4) we do not model or include in the empirical baseline the EE transitions since agricultural (non-agricultural) workers only switch to non-agricultural (agricultural) employment through job-to-job transitions with an average probability of 3.2% (0.9%) during 2017Q1-2020Q3, and such transitions did not spike during the pandemic.

Source: Philippines Statistics Authority, Labor Force Survey.

2. **The pandemic triggered a short-lived but sharp decrease in employment in 2020:Q2**. As shown in Table 1, employment saw a significant decline to 45.9 percent during 2020:Q2, even though most of the decline was immediately reversed as employment rose to 55.8 percent in 2020:Q3, which was just 3 percentage points below the pre-pandemic level.[2] These drastic changes in employment were accompanied by corresponding adjustments in non-employment.[3] Following the jumps in both unemployment and nonparticipation in 2020:Q2, non-participation seemed fully recovered in 2020:Q3, but unemployment remained twice as high as its pre-pandemic level. In terms of sectoral performance, with most non-agricultural employment following the same

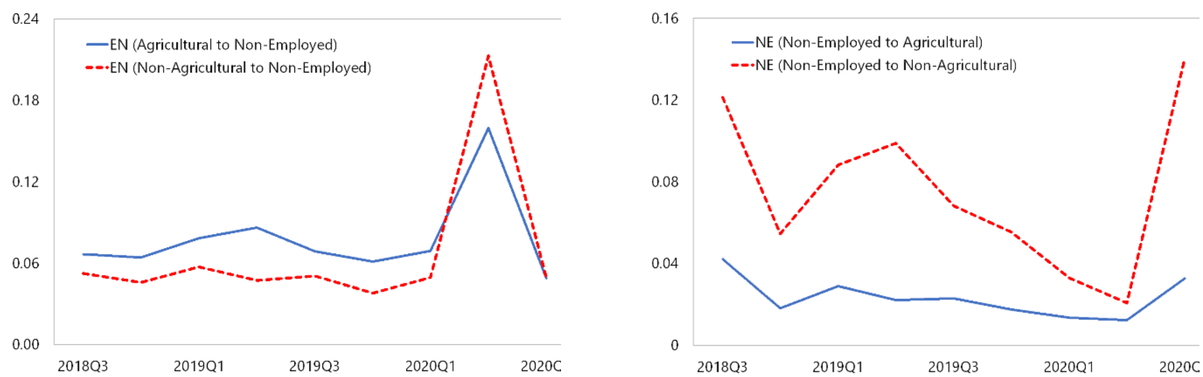
[1] Prepared by Eugenio Cerutti and Yiliang Li.

[2] For reference, employment, unemployment, and non-participation are measured in percentages of the working-age population in the Philippines (i.e., population with age of 15 and above).

[3] Non-employment includes both unemployment and non-participation. In the Philippines, unemployment refers to those not being in employment, being available for work, and seeking a job, whilst nonparticipation refers to those not being in employment, being unable to work or not actively searching for jobs.

general pattern, the agricultural sector's experience was different, with its employment share increasing during the pandemic, and interrupting, at least temporarily, a long-term declining trend observed in the Philippines for the last 15 years. This transitory evolution towards employment in agriculture seems consistent with a notion of geographical dispersion and lower risks of infection in agriculture.

Figure 1. Job Separation (EN) and Finding (NE) Rates During the Pandemic



Source: Philippines Statistics Authority, Labor Force Survey.

3. The transient rise in agricultural employment share during 2020:Q2 was primarily driven by non-agricultural workers separating more often from jobs than their peers in agriculture. The job separation rates—capturing the movements from Employment to Non-employment (EN)—for both agricultural and non-agricultural workers increased dramatically in 2020:Q2 (see left hand side panel of Figure 1).[4] Notably, in terms of year-on-year growth, the non-agricultural workers' job separation rate quadrupled and reached 0.21, implying that roughly one in every five non-agricultural workers separated from his/her employer during that quarter. With the rates of hiring—capturing the movements from Non-employment to Employment (NE)—in both agriculture and non-agriculture being timid and similarly low, the greater job separation rate in non-agriculture triggered a significant increase in agricultural employment share during 2020:Q2. While the job separation rates declined to similar levels for both agricultural and non-agricultural workers in 2020:Q3, there was a significantly larger rebound of the job finding rate in non-agriculture than in agriculture (see right hand side panel of Figure 1). This significant rebound in the non-agriculture finding rate coincided with the easing of containment measures and policy stimulus in 2020:Q3, and it was particularly strong in the construction and trade and repair sectors.

4. The worsening labor market conditions for non-agricultural workers in 2020:Q2 were not restricted to any single administrative region, but evident across the entire Philippines. As shown in the top right panel of Figure 2, the largest increases in job separation rates for

[4] The survey question in the LFS asking each worker's employment status in the past quarter does not distinguish unemployment from non-participation. This leads us to group them together and study the labor market behaviors by the non-employed in general.

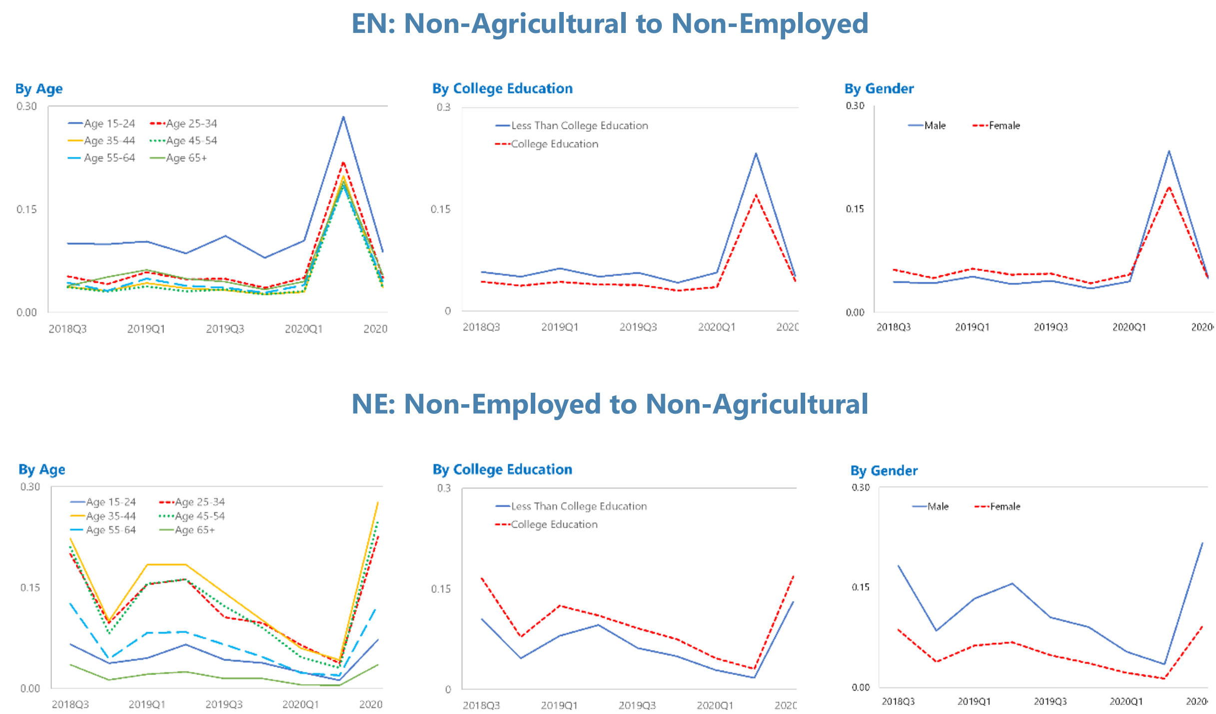
non-agricultural workers during 2020:Q2 were in Zamboanga Peninsula (1,336 percent, year-on-year), Bangsamoro Autonomous Region in Muslim Mindanao (992 percent, year-on-year), and Cordillera Administrative Region (784 percent, year-on-year). As for the National Capital Region (Metro Manila), its job separation rate for non-agricultural workers tripled (year-on-year) during 2020:Q2. In terms of the evolution of job finding rates in non-agriculture, as shown in the bottom right panel of Figure 2, all administrative regions experienced a sharp fall in 2020:Q2, but they recovered substantially in 2020:Q3, particularly in the cases of Ilocos Region, Metro Manila, and Calabarzon as they achieved the highest job finding rates that quarter.

Figure 2. Job Separation (EN) and Finding (NE) Rates, by Region, 2018:Q3-2020:Q3

Source: Philippines Statistics Authority, Labor Force Survey.

5. **The young and less educated non-agricultural workers were more adversely affected by the pandemic than their peers in terms of job separation rates during 2020:Q2, and those that were middle-aged and educated recovered more quickly in terms of job finding rates during 2020:Q3**. In addition, across genders, although males in non-agricultural sectors suffered proportionally more from a higher job separation rate in 2020:Q2, they recuperated more swiftly from the pandemic thanks to a greater rebound in job finding rate (see Figure 3).

Figure 3. Job Separation (EN) and Finding (NE) Rates Outside Agriculture, 2018:Q3-2020:Q3

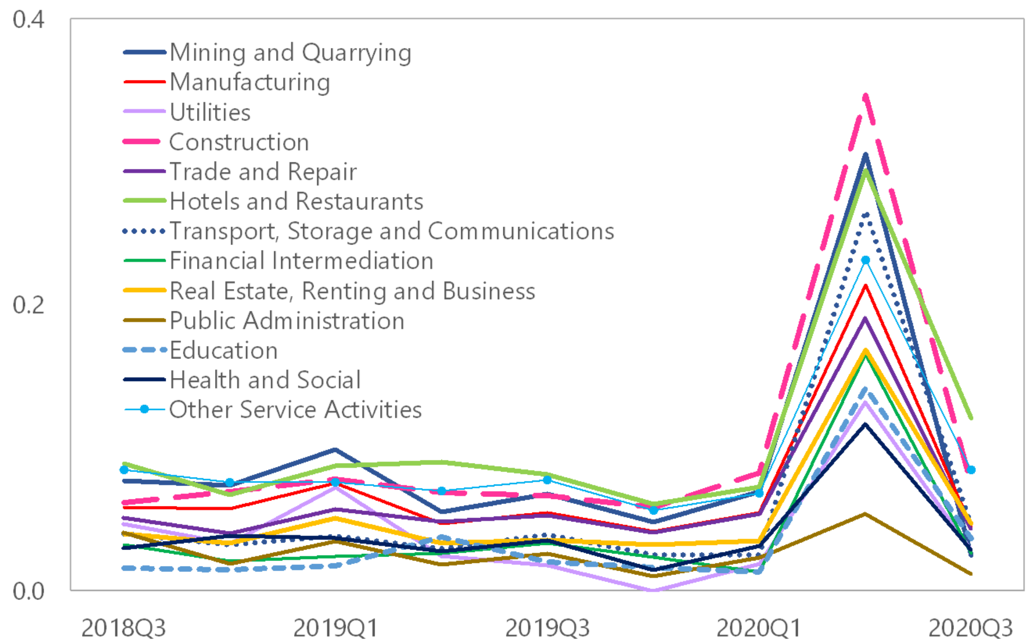


Source: Philippines Statistics Authority, Labor Force Survey.

6. Across non-agricultural sectors, as shown in Figure 4, all the job separation rates rose significantly during 2020:Q2, with construction, mining and quarrying, hotel and restaurants, and transport, storage and communications suffering the most. Here, it is worthwhile to highlight that, although lower than in 2020:Q2, some sectors like hotel and restaurants as well as construction continued registering relatively high job separation rates during 2020:Q3.

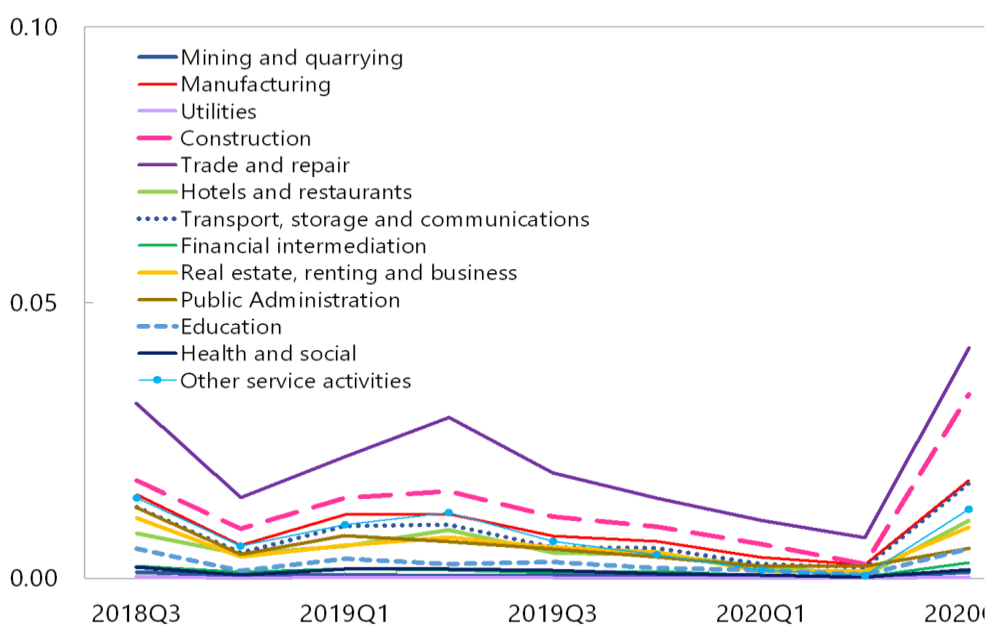
7. Moreover, as shown in Figure 5, non-employed workers also faced heightened difficulty in finding jobs in non-agricultural sectors during the peak of the pandemic. They all registered negative, year-on-year growth in job finding rates in 2020:Q2. In some sectors, notably utilities, mining and quarrying, health and social, and financial intermediation, job finding rates remained lackluster and did not recover in 2020:Q3.

Figure 4. Job Separation (EN) Rates Across Non-agricultural Industries, 2018:Q3-2020:Q3



Source: Philippines Statistics Authority, Labor Force Survey.

Figure 5. Job Finding (NE) Rates Across Non-agricultural Industries, 2018:Q3-2020:Q3



Source: Philippines Statistics Authority, Labor Force Survey.

8. The analysis indicates that the pandemic triggered asymmetric impacts on the labor markets in the Philippines, highlighting the importance of targeted responses. The authorities' targeting of specific economic sectors and population segments through fiscal policy aims to (at least partially) offset the magnitude of the asymmetric impacts. More generally, a well-functioning labor market is crucial to reduce the scarring effects of the pandemic through sectoral reallocations. The analysis of pre-pandemic labor trends in the Philippines (see Cerutti and Li, 2021) indicates that investments in infrastructure and education would play an important role in improving labor reallocations, and they need to be taken into consideration for a long-lasting recovery of labor productivity and employment. [5]

[5] E. Cerutti and Y. Li, 2021, "The Agricultural Exodus in the Philippines: Are Wage Differentials Driving the Process?," IMF Working Paper (forthcoming).

Appendix II. Risk Assessment Matrix[1]

	Source of Risks	Likelihood	Expected Impact	Policy Recommendation
Global	**Unexpected shift in the COVID-19 pandemic**			
	• Prolonged pandemic 1/	Medium	**High.** Larger economic scarring effects including from higher structural unemployment and persistent underinvestment; a decline in capital inflows, leading to currency depreciation; deterioration of bank assets; and higher poverty rate.	Fiscal stance should remain accommodative to provide (i) support for the health sector, including vaccine procurement and delivery; (ii) short-term income support for hard-hit households and sectors; and (iii) spending increase on social protection. Monetary policy could be loosened further if inflation expectations remain well-anchored. Markets should be kept liquid. The exchange rate should remain flexible and market driven.
	• Faster containment 2/	Medium	**Medium-High**. Investment and employment recover; capital inflows resume, leading to currency appreciation and easier domestic credit conditions.	Fiscal policy should be supportive until a recovery is firmly underway, including by social spending and infrastructure investment. Once the recovery is underway, a gradual withdrawal of fiscal support would help to rebuild fiscal space. Monetary policy should be on hold or gradually tightened in line with the inflation outlook. Pandemic-related regulatory relief measures should expire.
	• Asynchronous progress 3/	Medium	**Medium**. Higher volatility in global financial markets leads to higher volatility in currency and capital flows.	Expedite inoculation to reach herd immunity. Exchange rate should remain flexible and market driven. Government support for viable firms should be considered. Closely monitor financial markets to ensure stability.
	Sharp rise in global risk premia exposes financial and fiscal vulnerabilities. 4/	Medium	**High**. Lower GDP growth; larger economic scarring effects; a decline in capital inflows, leading to currency depreciation and tightening of domestic credit conditions.	The exchange rate should act as a shock absorber while foreign exchange interventions should counter disorderly market conditions. Increase infrastructure investment and social spending if domestic demand weakens significantly. Address banking sector difficulties and ensure markets are liquid. Provide targeted support to viable firms, while facilitating the exit of unviable ones for efficient reallocation of resources.
	Accelerating de-globalization 5/	Medium	**Medium**. Weaker exports; reduced FDI inflows; increased uncertainty leading to weaker investment.	Accelerate trade integration efforts within the ASEAN region and pursue new, high-quality regional trade agreements. Implement structural reforms to reduce trade cost, attract FDI, promote competition and financial deepening.
Domestic	**Sharper deterioration in banks' asset quality and funding positions**. The quality of bank assets deteriorates more than expected as supportive and forbearance measures are unwound. Disruptions to economic activity caused by the resurgence in COVID-19 cases raises uncertainty and further weakens the balance sheet position of banks.	Medium to High	**High**. Lower GDP growth; larger economic scarring effects; a decline in capital inflows, leading to currency depreciation and tightening of domestic credit conditions.	Potential solvency and capital adequacy issues should be recognized and addressed upfront. Accelerate reforms on bank resolution and crisis management. Banks should increase provisioning against credit losses even under the relaxed loan standards, which would be critical for banks' ability to weather the deterioration in asset quality.
	Natural disasters Major natural disasters (e.g., typhoons, volcano eruptions and/or earthquakes) disrupt economic activity and affect sentiment, resulting in higher fiscal expenditure.	High	**Medium–High**. Disruption in economic activity in the affected region; poor agriculture production; damage to properties; and higher food inflation, with larger impact on low-income households in rural areas.	Targeted assistance to affected groups and sectors. If the economy slows significantly, provide relief to banks in affected regions, while monitoring credit risk. Prioritize public investment in disaster-resistant infrastructure and sustainable growth.

[1] The disease proves harder to eradicate (e.g., due to new virus strains, short effectiveness of vaccines, or widespread unwillingness to take them), requiring costly containment efforts and prompting persistent behavioral changes rendering many activities unviable. For countries with policy space, prolonged support—while needed to cushion the economy—exacerbates stretched asset valuations, fueling financial vulnerabilities. For those with limited space, especially EMs, policy support is insufficient.
[2] Pandemic is contained faster than expected due to the rapid production and distribution of vaccines, boosting confidence and economic activity.
[3] Limited access to, and longer-than-expected deployment of, vaccines in some countries—combined with dwindling policy space—prompt a reassessment of their growth prospects (for some Emerging and Frontier Markets triggering capital outflows, depreciation and inflation pressures, and debt defaults).
[4] A reassessment of market fundamentals (e.g., in response to adverse COVID-19 developments) triggers a widespread risk-off event. Risk asset prices fall sharply and volatility spikes, leading to significant losses in major nonbank financial institutions. Higher risk premia generate financing difficulties for leveraged firms (including those operating in unviable activities) and households, and a wave of bankruptcies erode banks' capital buffers. Financing difficulties extend to sovereigns with excessive public debt, leading to cascading debt defaults.
[5] Despite renewed efforts to reach multilateral solutions to existing tensions, geopolitical competition leads to further fragmentation. Reshoring and less trade reduce potential growth.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Appendix III. External Sector Assessment

The Philippines external position in 2020 was stronger than the level implied by fundamentals and desirable policies. The external position strengthened in 2020, owing importantly to the impact of the large fiscal expansions in other major, mostly advanced, economies compared to the Philippines relatively smaller fiscal response to the pandemic. In staff's view, the strength of the external position is expected to moderate as the economic recovery takes hold. The assessment remains subject to considerable uncertainty around the resolution of the COVID-19 pandemic and its implications for economic activity, imports, and fiscal policies.

Foreign Asset and Liability Position

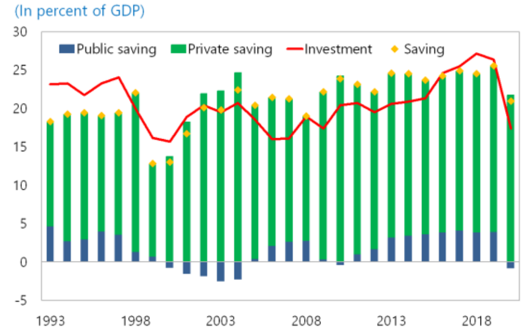
1. *Background*. The net international investment position (NIIP) narrowed to minus 6 percent of GDP by end-2020, compared to minus 10 percent of GDP by end-2019. The narrowing reflected the current account surplus and valuation effects (a decline in equity prices lowered the value of the net external equity liabilities). External assets and liabilities amounted to 65 percent and 70 percent of GDP, respectively, at end-2020. Foreign reserves held by the BSP accounted for about 47 percent of the total external assets. Key components of external liabilities included FDI (28 percent of GDP) and portfolio investment (25 percent of GDP). Total external debt increased to 27 percent of GDP in 2020 from 22 percent in 2019, as public external debt increases to 16 percent of GDP in 2020 from 11 percent of GDP in 2019.

2. *Assessment*. The low level and the composition of the NIIP and external debt indicate that the Philippines' external position is sustainable and entails relatively low vulnerabilities. FX reserves are substantially larger than short-term external liabilities, and FDI accounts for a sizeable share of liabilities. While external debt ratio (27.2 percent of GDP) increased moderately in 2020, the debt service ratio[1] declined to 6.3 percent, from 6.7 percent in 2019, as medium and long-term share of total debt increase to 86 percent in 2020 from 79 percent in 2019.

Current Account

3. *Background*. The current account balance (CA) in the Philippines turned around from an average deficit of 1.1 percent of GDP in 2016–19 to a surplus of 3.6 percent of GDP in 2020. The turnaround in 2020 mainly reflects the narrowing deficit in the trade balance for goods, which, in turn, mainly reflects the sharp import compression due to the contraction in domestic

Saving and Investment Balance
(In percent of GDP)



Sources: Philippines Statistics Authority; and IMF staff estimates.

[1] Ratio of debt service burden (principal and interest payments after rescheduling) to exports of goods and receipts from services and income.

demand in the pandemic. Other balances (services, primary and secondary income) changed relatively little. From a saving-investment (S-I) balance perspective, the rising current account surplus reflects the impact of sharply lower investment, partly offset by a substantial decline in public savings, given the fiscal response to the pandemic and revenue declines.

4. *Assessment*. The standard EBA model implies that the current account in 2020 was stronger than the balance implied by medium-term fundamentals and desired policies. However, the CA gap broadly matches the identified policy gap, which, in turn, was mainly driven by the relatively less expansionary fiscal stance in the Philippines compared to trading partners, notably advanced economies. Going forward, the envisaged increase in public investment spending, the economic recovery, and structural reforms to improve the business environment should result in an investment rebound and an increase in the investment ratio in the Philippines. As domestic demand recovers, imports are also expected to rebound, and staff projects a substantial narrowing in the current account surplus in 2021 and a return to current account deficits in the medium-term. The policy gap is also expected to narrow in 2021. The 2021 budget plans for a more expansionary fiscal stance in the Philippines compared to 2020, while the stance in other countries is expected to be less expansionary.

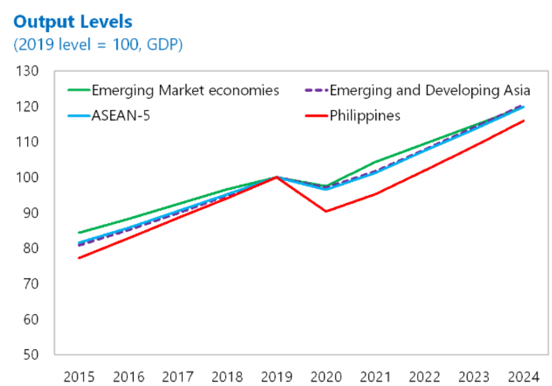
Philippines: Model Estimates for 2020

(In percent of GDP)

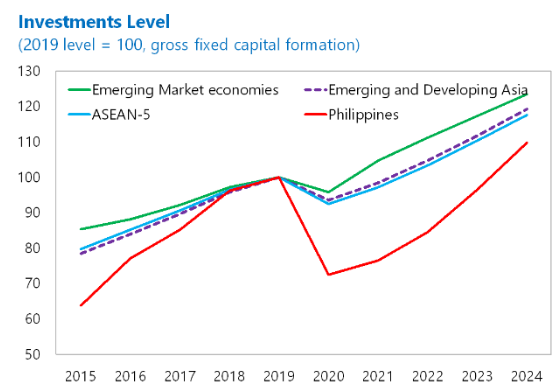
	CA Model	REER Level Model	REER Index Model
CA Actual	3.6		
Cyclical contributions	2.0		
COVID-19 adjustment 1/	0.2		
Adjusted CA	**1.4**		
CA Norm	**-0.7**		
CA Gap	**2.2**		
Policy Gap	2.4		
Elasticity	**-0.2**		
REER Gap	**-11**	**17**	**11**

Source: IMF staff estimates.

1/ Adjustments for oil, tourism, medical goods, and tradable goods are 0.5, -0.1, -0.1 and 0.0, respectively



Sources: IMF, World Economic Outlook; and IMF staff estimates.



Sources: IMF, World Economic Outlook; and IMF staff estimates.

Real Exchange Rate

5. *Background*. The peso appreciated by 6.1 percent in real effective terms in 2020, and by 4.2 percent in nominal effective terms. The appreciation is consistent with a large surplus in the current account balance on account of the COVID-19 shock and continued capital inflow recorded in 2020.

6. *Assessment*. The real effective exchange rate (REER) gap in 2020 implied by the REER Index model was 11 percent, while the gap implied by the EBA REER level models was 17.0 percent. Both models thus suggest that the REER in 2020 was stronger than the level implied by fundamentals and desirable policies. In contrast, the CA model (with COVID-19 adjustors) implied a gap of −11 percent suggested a weaker REER.

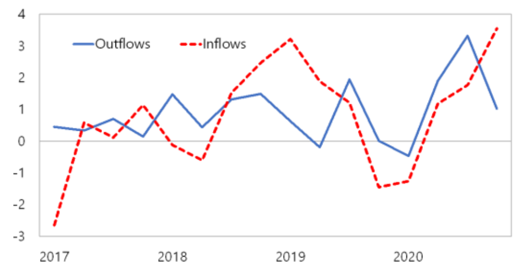
Capital and Financial Accounts

7. *Background*. There were large net FDI inflows (1.4 percent of GDP) and portfolio inflows (0.7percent of GDP) in 2019. With the economy contracting, net FDI inflows declined to 0.8 percent of GDP in 2020 and net portfolio investments turned to slight outflow (0.1 percent of GDP). On other investments, there was large capital inflow (0.5 percent of GDP) from government borrowing in the response of the COVID-19 crisis, while they are almost neutral in 2019 (0.02 percent of GDP inflow).

8. *Assessment*. As a small open economy, the Philippines is exposed to cross-border capital flow volatility. Despite the economic downturn and global financial market turmoil in parts of the year, net capital inflows into the Philippines remained sizeable in 2020. Portfolio outflows and inflows declined in the first quarter of 2020, but rebounded subsequently. This pattern seems consistent with increased risk aversion due to the pandemic and increased funding needs of the government and corporates.

Portfolio Investments 1/

(In billions of U.S. dollar)



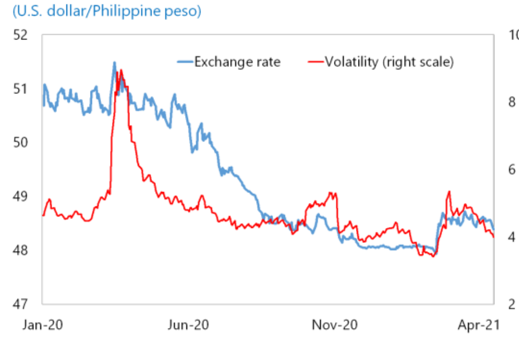
Sources: Haver Analytics; and IMF staff estimates.
1/ Portfolio outflows and inflows reflect the net acquisition of foreign portfolio assets and net issuance of domestic liabilities to nonresidents, respectively.

FX Intervention and Reserves Level

9. *Background*. The exchange rate is classified as floating. The value of the Philippine peso is determined in the interbank foreign exchange market. The BSP intervenes in the spot and forward markets but intervention data are not published and not available to staff. The BSP intervenes to smooth excess exchange rate volatility. The peso appreciated in effective terms through much of 2020.

Exchange Rate and Volatility

(U.S. dollar/Philippine peso)



Source: Bloomberg L.P.

10. *Foreign reserves*. Gross reserves were about US$110.1 billion (about 30 percent of GDP) at end-2020, substantially above end-2019 levels (US$87.8 billion).The increase in in the stock of gross reserves in 2020 reflected both valuation changes, mainly from a revaluation of the BSP's gold stock, and the accumulation of reserves. The latter, in turn, reflected BSP's leaning against the wind in the face of peso appreciation amid pandemic-related exceptional balance of payments strength and increased deposits of the national government with the BSP from higher external loan proceeds. Going forward, foreign reserves in percent of the adequacy metric are expected to decrease, as domestic FX market conditions will normalize in the recovery.

11. *Assessment*. Reserves as of end-2020 were about 12.6 months of imports, or about 237 percent of the IMF's reserve adequacy metric. Both approaches indicate that reserves are ample. While the FX interventions implied by the accumulation of reserves in 2020 was not warranted from a reserve adequacy angle, they appear appropriate. They slowed the likely temporary appreciation of the peso in a shallow FX market amid a larger COVID-19-induced economic downturn and higher uncertainty in the Philippines than in other countries. The currency appreciation last year could not have been addressed through a different macroeconomic policy mix. However, further buildup of foreign reserves would not be helpful as the economic recovery strengthens.

Appendix IV. Public and External Debt Sustainability Analysis

The Philippines' general government gross debt is estimated to have increased by about 15 ppts, reaching about 52 percent of GDP as of end-2020 due to the pandemic related spending and contraction in output. In the baseline, the debt-to-GDP ratio is projected to peak at about 62 percent in 2024 and then decline over the medium term with a reduction in budget deficits and growth recovery. The general government debt-to-GDP ratio is most vulnerable to a growth shock, followed by real interest rate and primary balance shocks. External debt stood at 27.2 percent of GDP as of end-2020 and is projected to decline to below 23 percent in the medium term. However, debt dynamics are sensitive to large peso depreciation and current account balance deterioration.

A. Background and Realism of Key Assumptions

1. **Baseline projections are predicated on fiscal consolidation and sustainable macroeconomic performance over the medium term**. After a 9.6 percent output contraction in 2020, real GDP growth is projected to rise to 5.4 percent in 2021 and converge to 6.5 percent over the medium term. As the temporary shocks in 2021 dissipate, headline inflation will return close to the midpoint of the target band at 3 percent. The national government deficit will reach 9.6 percent of GDP in 2021 but decline to 3.5 percent of GDP in the medium term on the back of post-pandemic fiscal consolidation. After a sharp turnaround to a 3.6 percent of GDP surplus in 2020 largely as a result of import compression, the current account balance is projected to narrow to 0.4 percent in 2021 and stabilize at a deficit of 1.8 percent over the medium term.

B. Debt Sustainability

2. **Public debt in the Philippines will peak in 2024 before decreasing gradually in the baseline scenario (under current policies)**. Large fiscal deficits in the near term are expected to increase the general government gross debt-to-GDP ratio from 37 percent of GDP in 2019 to a peak of about 62 percent in 2024. The subsequent decline would be led by a significant reduction in the primary budget deficit, which staff assess as achievable based on historical trends. The gross financing needs will accordingly increase to an average of about 13.7 percent of GDP in 2021–23, and fall below 12 percent of GDP in the medium term. The debt composition is projected to be broadly stable, with relatively low shares of foreign currency-denominated debt, in line with the authorities' debt management policy.

3. **Alternative scenarios suggest that staff's baseline is conservative by historical standards**. Under the historical scenario, the debt path would fall faster than in the baseline, reflecting the pre-pandemic prudent fiscal management and strong GDP growth. However, the constant primary balance scenario suggests the debt path would be higher than in the baseline, reflecting the fiscal expansion in 2020 and the assumption of no post-pandemic fiscal consolidation resulting in average gross financing needs over 18 percent of GDP for the projection period. A growth shock would temporarily increase the debt ratio to a peak of 64 percent of GDP in 2024.

4. **External debt is also deemed sustainable**. The baseline external debt-to-GDP ratio is expected to fall to below 23 percent of GDP in 2025, from 27.2 percent in 2020. The historical scenario suggests that staff's baseline is conservative, and debt dynamics appear resilient to various shocks including to interest rates, growth, and the current account. A one-time depreciation of 30 percent in 2021 would raise the debt ratio to about 38 percent of GDP in 2021 before slightly declining over the medium term.

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

(In percent of GDP, unless otherwise indicated)

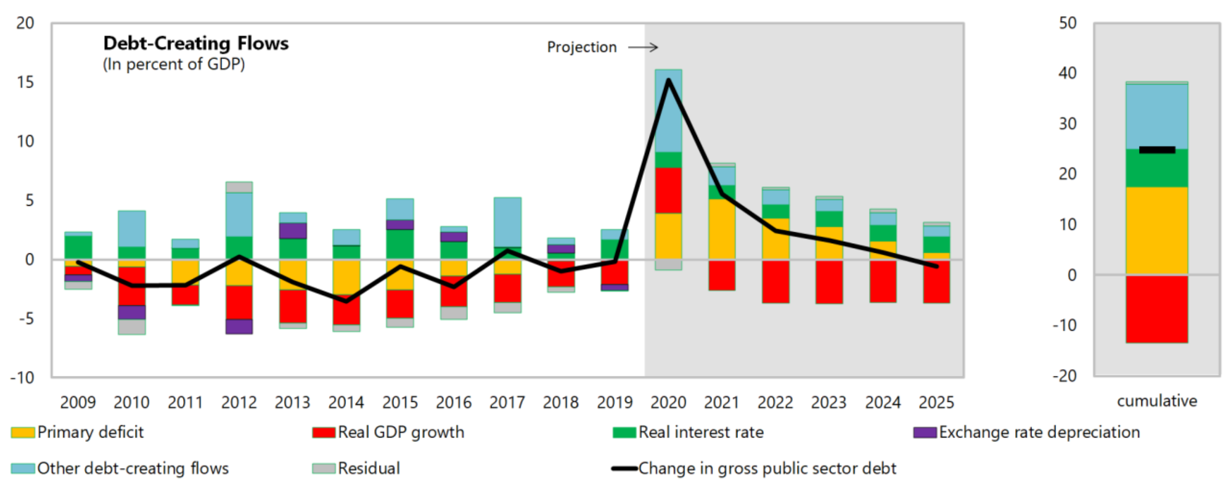
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2009-2017 [2/]	2018	2019	2020	2021	2022	2023	2024	2025
General government gross debt	43.1	37.1	37.0	51.9	57.7	60.2	61.6	61.9	61.1
General government gross financing needs	7.8	5.2	5.4	10.1	15.6	12.8	12.8	12.2	11.7
Real GDP growth (in percent)	5.9	6.3	6.1	-9.6	5.4	7.0	6.8	6.5	6.5
Inflation (GDP deflator, in percent)	2.3	3.7	0.7	1.6	2.6	2.8	2.5	2.5	2.5
Nominal GDP growth (in percent)	8.4	10.3	6.9	-8.1	8.1	10.0	9.5	9.1	9.1
Effective interest rate (in percent) [4/]	5.6	4.8	4.6	4.7	5.0	5.0	5.0	5.0	5.0
General government net debt [5/]	37.5	34.4	34.1	49.0	54.8	57.2	58.7	59.0	58.2

As of June 15, 2021		
Sovereign Spreads		
EMBIG (bp) 3/		90
5Y CDS (bp)		43
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BBB+	BBB+
Fitch	BBB	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2009-2017	2018	2019	2020	2021	2022	2023	2024	2025	cumulative	debt-stabilizing primary balance [10/]
Change in general government gross debt	-1.3	-1.0	-0.2	14.9	5.9	2.4	1.4	0.3	-0.8	24.1	
Identified debt-creating flows	-0.8	-0.5	-0.1	16.1	5.2	2.2	1.4	0.3	-0.8	24.3	
Primary deficit	-1.8	-0.1	0.1	3.9	5.1	3.5	2.8	1.5	0.6	17.5	-1.4
Primary (noninterest) revenue and grants	17.7	19.3	20.0	20.6	19.7	20.5	20.7	21.4	21.6	124.6	
Primary (noninterest) expenditure	15.8	19.2	20.1	24.6	24.9	24.0	23.5	22.9	22.2	142.1	
Automatic debt dynamics [6/]	-0.8	-0.9	-1.0	5.1	-1.5	-2.6	-2.5	-2.3	-2.4	-6.1	
Interest rate/growth differential [7/]	-0.8	-1.7	-0.5	5.1	-1.5	-2.6	-2.5	-2.3	-2.4	-6.1	
Of which: real interest rate	1.5	0.5	1.6	1.3	1.1	1.1	1.3	1.4	1.3	7.5	
Of which: real GDP growth	-2.4	-2.2	-2.1	3.9	-2.6	-3.7	-3.7	-3.7	-3.7	-13.5	
Exchange rate depreciation [8/]	0.0	0.7	-0.5	…	…	…	…	…	…	…	
Other identified debt-creating flows	1.8	0.6	0.9	7.0	1.6	1.3	1.0	1.1	0.9	12.9	
Privatization proceeds (negative)	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
GG Accumulation of liquid assets	1.7	0.6	0.8	7.0	1.6	1.3	1.0	1.1	0.9	12.9	
Residual, including asset changes [9/]	-0.5	-0.5	-0.1	-1.2	0.6	0.2	0.1	0.0	0.1	-0.2	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ EMBIG.

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

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

6/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

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

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

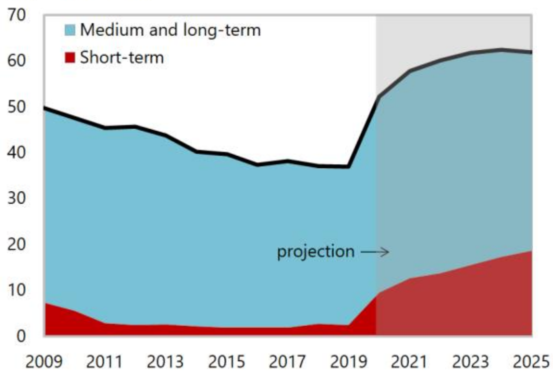
9/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

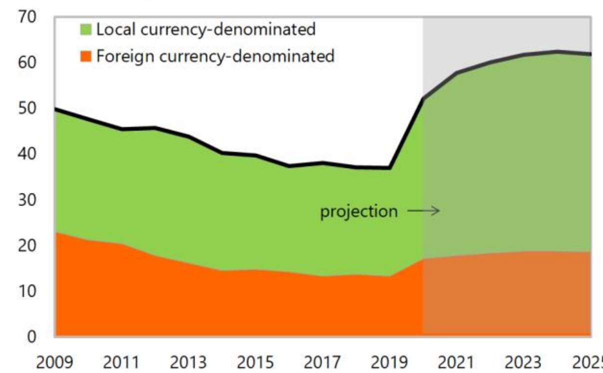
Figure 2. Philippines—Public DSA—Composition of General Government Gross Debt and Alternative Scenarios

Composition of General Government Gross Debt

By Maturity
(in percent of GDP)



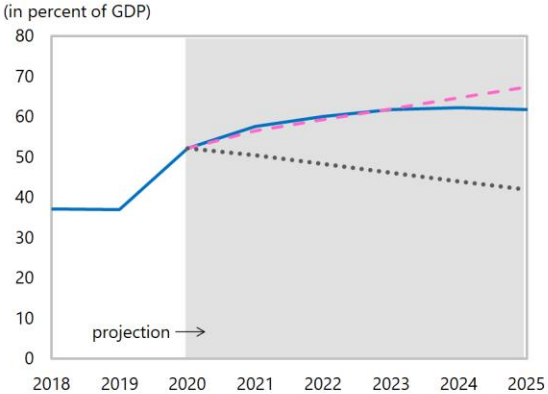
By Currency
(in percent of GDP)



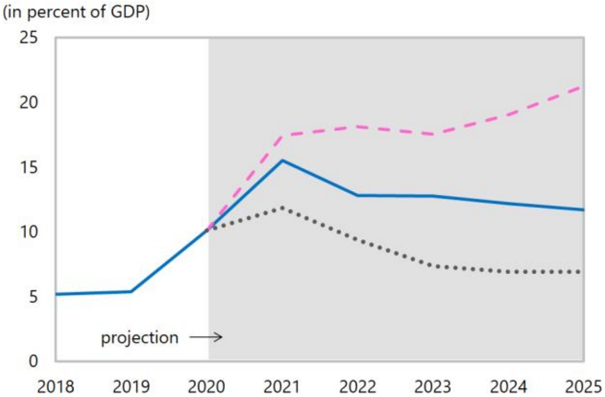
Alternative Scenarios

Baseline   Historical   Constant Primary Balance

General Government Gross Debt
(in percent of GDP)



General Government Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-9.6	5.4	7.0	6.8	6.5	6.5
Inflation	1.6	2.6	2.8	2.5	2.5	2.5
Primary Balance	-3.9	-5.1	-3.5	-2.8	-1.5	-0.6
Effective interest rate	4.7	5.0	5.0	5.0	5.0	5.0
Constant Primary Balance Scenario						
Real GDP growth	-9.6	5.4	7.0	6.8	6.5	6.5
Inflation	1.6	2.6	2.8	2.5	2.5	2.5
Primary Balance	-3.9	-3.9	-3.9	-3.9	-3.9	-3.9
Effective interest rate	4.7	5.0	4.9	4.7	4.8	4.8

Historical Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-9.6	6.4	6.4	6.4	6.4	6.4
Inflation	1.6	2.6	2.8	2.5	2.5	2.5
Primary Balance	-3.9	1.6	1.6	1.6	1.6	1.6
Effective interest rate	4.7	5.0	4.9	4.7	4.9	4.8

Source: IMF staff.

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

(External debt, in percent of GDP)

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

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

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

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

4/ One-time real depreciation of 30 percent occurs in 2021.

Table 1. Philippines—External Debt Sustainability Framework, 2015–2025

(In percent of GDP, unless otherwise indicated)

		Actual							Projections						
	2015	2016	2017	2018	2019			2020	2021	2022	2023	2024	2025	Debt-stabilizing non-interest current account 6/
1 Baseline: External debt	25.3	23.5	22.3	22.8	22.2			27.2	25.0	24.4	23.9	23.5	22.9	-1.9
2 Change in external debt	-0.8	-1.8	-1.2	0.5	-0.6			5.1	-2.2	-0.6	-0.5	-0.5	-0.5	
3 Identified external debt-creating flows (4+8+9)	-2.9	-2.5	-2.3	0.0	-2.9			-1.5	-2.0	-0.4	-0.4	-0.4	-0.6	
4 Current account deficit, excluding interest payments	-3.2	-0.4	-0.1	1.7	0.0			-4.2	-1.1	1.1	1.1	1.2	1.1	
5 Deficit in balance of goods and services	5.8	8.9	9.6	11.3	9.6			5.2	8.1	10.3	10.3	10.2	10.2	
6 Exports	23.6	23.2	26.4	26.1	25.1			21.8	22.3	23.0	23.7	24.4	24.9	
7 Imports	29.4	32.2	36.0	37.4	34.8			27.0	30.4	33.3	34.0	34.6	35.1	
8 Net non-debt creating capital inflows (negative)	0.2	-1.9	-2.3	-1.4	-1.9			-0.1	-0.3	-0.5	-0.7	-0.8	-0.9	
9 Automatic debt dynamics 1/	0.1	-0.2	0.1	-0.3	-1.0			2.8	-0.6	-1.0	-0.9	-0.8	-0.8	
10 Contribution from nominal interest rate	0.8	0.8	0.8	0.8	0.8			0.6	0.7	0.7	0.6	0.6	0.6	
11 Contribution from real GDP growth	-1.6	-1.7	-1.6	-1.3	-1.3			2.2	-1.3	-1.6	-1.5	-1.4	-1.4	
12 Contribution from price and exchange rate changes 2/	0.8	0.8	0.9	0.2	-0.5			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	2.1	0.7	1.1	0.5	2.3			6.6	-0.2	-0.2	-0.1	0.0	0.1	
External debt-to-exports ratio (in percent)	107.2	101.1	84.4	87.4	88.3			125.0	112.2	106.3	101.0	96.3	92.2	
Gross external financing need (in billions of US dollars) 4/	12.0	20.9	21.4	28.3	24.7			9.1	18.5	28.0	29.8	31.5	33.0	
in percent of GDP	3.9	6.6	6.5	8.2	6.6			2.5	4.6	6.5	6.4	6.3	6.1	
Scenario with key variables at their historical averages 5/						10-Year Historical Average	10-Year Standard Deviation	27.2	24.2	20.2	16.4	12.8	9.4	-1.1
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	6.3	7.1	6.9	6.3	6.1	6.4	1.0	-9.6	5.4	7.0	6.8	6.5	6.5	
GDP deflator in U.S. dollars (change in percent)	-3.1	-3.0	-3.6	-0.7	2.4	1.5	4.9	6.1	5.2	1.1	0.9	0.9	0.9	
Nominal external interest rate (in percent)	3.3	3.3	3.4	4.0	3.9	3.7	0.3	2.7	2.9	2.9	2.9	2.8	2.8	
Growth of exports (U.S. dollar terms, in percent)	-4.1	2.3	17.2	4.3	4.8	8.5	9.2	-16.8	13.3	11.6	11.0	10.4	9.8	
Growth of imports (U.S. dollar terms, in percent)	2.3	13.7	15.3	9.8	1.0	9.9	8.0	-25.5	24.9	18.4	9.9	9.4	8.9	
Current account balance, excluding interest payments	3.2	0.4	0.1	-1.7	0.0	2.4	2.4	4.2	1.1	-1.1	-1.1	-1.2	-1.1	
Net non-debt creating capital inflows	-0.2	1.9	2.3	1.4	1.9	0.8	1.0	0.1	0.3	0.5	0.7	0.8	0.9	

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

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

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

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

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

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

Appendix V. Key FSAP Recommendations[1]

1. **Strengthening the bank resolution framework is urgent, given the downside risks to bank health**. The authorities should immediately start streamlining the prompt corrective action (PCA) framework and working on resolvability assessments and resolution planning for individual banks, starting with the Domestic Systemically Important Banks (D-SIBs).

2. **There is a strong case to amend the unusually stringent bank secrecy laws to allow financial sector regulators and law enforcement authorities full and direct access to depositor information**. The bank secrecy law is a long-standing bottleneck limiting effective prudential supervision and resolution activities, the Philippine Deposit Insurance Corporation (PDIC)'s ability to ensure the timely reimbursement of depositors, and hampering the effectiveness of the anti-money laundering and combating the financing of terrorism (AML/CFT) framework. In addition, these laws have wider negative financial stability, developmental, financial integrity and reputational implications.

3. **Powers and conglomerate supervision should be enhanced**. Conglomerate supervision should be strengthened by increasing powers to obtain information from banks' affiliates; supervising all related financial institutions under a regulated financial holding company; enhancing regulatory powers and standards for transferring significant ownership, controlling interest, and assessing beneficial owners' suitability; enhancing sectoral and group-wide supervision with closer cross-agency collaboration; appointing the BSP as the lead supervisor for financial conglomerates; setting large exposure and reporting requirements on both solo and consolidated bases; and, enhancing related party transaction reporting and monitoring.

4. **The macroprudential policy framework should be further strengthened**. The BSP should enhance collaboration within to strengthen essential financial stability monitoring functions, including macro scenario stress tests of banks. The decision-making processes should reflect monetary policy, supervisory, and macroprudential perspectives given their interlinkages. The macroprudential toolkit should be expanded beyond the countercyclical capital buffer (CCyB), and the BSP should establish operational procedures in setting macroprudential policies. The influence of the inter-agency Financial Stability Coordination Council (FSCC) could be elevated with a comply-or-explain mechanism and by providing financial stability objectives to supervisors of nonbank financial institutions.

5. **Financial sector regulators need to continue building capacity to better understand and manage climate and environmental risks**. The Philippines is highly exposed to physical (typhoon) risks. The FSAP climate change bank solvency stress test indicated the relevance of physical risks for financial stability, though they are not systemic unless extreme tail events—once in 250–500 years—materialize. The BSP has recently undertaken steps to support the integration of these risks in supervision, and should continue efforts to improve information collection, monitoring of risk metrics, and building stress test capacity.

[1] IMF, 2021, Philippines—Financial System Stability Assessment, IMF Country Report No. 21/74.

Table 1. Key Recommendations	
Recommendation	**Timing 1/**
Macroprudential Policy and Systemic Risk Monitoring Framework	
Limit bank dividend distributions while downside risks remain high and be ready to take additional measures to strengthen banks' capital if the risks materialize to continue providing credit to the economy (FSCC members, BSP).	ST
Enhance collaboration within the BSP to conduct essential macroprudential risk analyses, including macro scenario stress tests, and assure a balanced decision-making process (BSP).	MT
Strengthen the influence of FSCC decisions by adding a comply-or-explain mechanism and providing sectoral regulators with a financial stability objective (FSCC members).	MT
Expand macroprudential policy toolkit and establish operational procedures to set them in a more systemic risk-based manner (BSP).	MT
Financial Sector Supervision	
Lapse or limit the use of issued regulatory forbearance measures (BSP).	ST
Enhance regulatory powers and standards regarding transfer of significant ownership or controlling interest and to assess the suitability of beneficial owners of banks (BSP, DoF).	ST
Strengthen sectoral supervision, appoint the BSP as the lead supervisor of financial conglomerates and conduct more frequent and comprehensive risk-assessment of FCs (BSP, IC, SEC, FSF).	ST
Update the large exposure requirements (to be applicable on a solo and consolidated level) and enhance large and related party exposure reporting requirements (BSP).	ST
Amend the bank secrecy laws to enhance supervision powers, strengthen AML/CFT effectiveness, and cooperation with foreign authorities (BSP, SEC, IC, AMLC and DoF).	MT
Provide the power to the BSP to insert a regulated Financial Holding Company into a mixed conglomerate and obtain information from the wider group (BSP, DoF).	MT
AML/CFT	
Make legislative amendments to (i) designate tax crimes as predicate ML offenses; and (ii) establish a comprehensive legal framework for targeted financial sanctions against proliferation financing (AMLC, DoF).	ST
Strengthen risk-based AML/CFT supervision (including sanctioning procedures) for high-risk sectors, such as banks, casinos, money value transfer service providers (BSP, AMLC, PAGCOR).	ST
Enhance the accuracy and availability of beneficial ownership information of companies (SEC).	MT
Crisis Management, Resolution, and Safety Net	
Ensure timely corrective actions and resolution of weak banks (BSP, PDIC).	ST
Implement resolvability assessments and resolution plans, starting with D-SIBs (PDIC, BSP).	ST
Make the legal framework for ELA more specific regarding the conditions under which it can be provided and avoid assistance without collateral (BSP).	ST
Designate and provide the PDIC with powers to act as resolution authority (PDIC, BSP, DoF).	MT
Expand and operationalize bank resolution tools (particularly P&A) beyond liquidation (PDIC).	MT
Climate Change, Environment Risks and Supervision	
Improve information collection, monitoring of risk metrics, and stress test capacity for climate change and environmental risks (BSP).	MT
1/ Short-term (ST) = within one year; medium-term (MT) = one to three years.	

Appendix VI. Integration of IMF Capacity Development Assistance and Surveillance

Capacity development (CD) in the Philippines will focus on strengthening institutional capacity to address the fallout from the pandemic, in line with surveillance priorities. The deep economic contraction in 2020 and slow recovery have increased risks to the banking system and the corporate sector. Policy responses to the pandemic have diminished the country's policy buffers and their unwinding in due course will also likely pose difficult challenges. The Fund's CD should therefore focus on enhancing the Philippines' capacity to manage macroeconomic and financial risks, revenue mobilization, and public financial management, execute a well-calibrated exit strategy, and rebuild policy buffers.

- *Central bank communication*: following the recent CD on monetary policy communication, further assistance is likely to be needed in central bank communication, including on the BSP's exit strategy and on communicating when a broader set of instruments is used.

- *Bank regulation and supervision*: the BSP has launched major initiatives to strengthen its supervisory framework in response to the pandemic and recommendations of the recently concluded FSAP. Fund CD in conglomerate supervision has helped close some important gaps and should continue as needed.

- *Bank resolution, crisis management, and corporate restructuring*: the FSAP has highlighted the potential stress facing the banking and corporate sectors and Fund CD assistance may be needed to enhance the capacity in addressing this challenge.

- *Financial stability*: building on the recent training on financial market analysis, more advanced training and technical assistance would help strengthen the BSP's capacity in the analysis of financial stability and macro-prudential policies.

- *Anti-money laundering and combating the financing of terrorism (AML/CFT)*: The Fund staff stands ready to offer targeted CD to enhance overall AML/CFT effectiveness and support the country's exit of the Financial Action Task Force (FATF) list to complement ongoing assistance from other capacity development providers.

- *Revenue mobilization and public financial management*: public debt has risen sharply as a result of the pandemic, approaching just above the government's indicative threshold of 60 percent of GDP. To rebuild policy buffers, the authorities are strengthening capacity in tax policy design, revenue administration, and expenditure management.

- *Debt management and capital market development*: elevated public debt heightens the need to strengthen the capacity in debt management and to accelerate capital market development to ensure stable domestic financing. The authorities have expressed interest in continued Fund CD in these two areas.

- *Public investment management*, including for government-owned and controlled corporations (GOCCs): building on the Fund's CD in Public Investment Management Assessment (PIMA) and financial oversight of GOCCs, further assistance would help the authorities to improve efficiency in infrastructure investment and minimize contingent liabilities.

- *Digital economy*, including fintech, and possibly central bank digital currencies. The BSP has recently created a new Payments and Currency Management Sector and a Research Academy. Fund CD could be valuable for building capacity in the new sector and the academy.

INTERNATIONAL MONETARY FUND

PHILIPPINES

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 8, 2021

Prepared By	Asia and Pacific Department

CONTENTS

FUND RELATIONS

(As of May 31, 2021)

Membership Status: Joined December 27, 1945; Article VIII

General Resources Account

	SDR Millions	Percent of Quota
Quota	2,042.90	100.00
IMF holdings of currency (holdings rate)	1,493.05	73.08
Reserve tranche position	550.01	26.92
Lending to the Fund New Arrangements to Borrow	9.72	

SDR Department

	SDR Millions	Percent of Allocation
Net cumulative allocation	837.96	100.00
Holdings	856.19	102.17

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

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

Projected Payments to Fund: None

Exchange Arrangement

The de jure exchange rate arrangement is classified as *free floating*, while the de facto arrangement is classified as *floating*. The value of the Philippine peso is determined in the interbank foreign exchange market; the Bangko Sentral ng Pilipinas (BSP) intervenes in the spot and forward markets to smooth undue short-term volatility in the exchange rate. The Philippines maintains an exchange system that is free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions except for exchange restrictions maintained for security reasons and notified to the Fund pursuant to Executive Board Decision 144-(52/51).

Article IV Consultation

Philippines is on the standard 12-month cycle. The Executive Board Meeting for the 2019 Article IV consultation was held on January 27, 2020 (IMF Country Report No. 20/36).

Financial Sector Assessment Program (FSAP)

The work of the 2021 FSAP was conducted from June 2019 and during the COVID-19 outbreak, with virtual missions concluding on October 20, 2020. The findings were presented to the Executive Board and concluded on March 5, 2021 (IMF Country Report No. 21/74). The previous FSAP Update was published on April 7, 2010 (IMF Country Report No. 10/90).

Resident Representative

A Resident Representative has been stationed in Manila since January 1984. Mr. Yongzheng Yang has been the Resident Representative for the Philippines since September 2017.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

- World Bank: http://financesapp.worldbank.org/en/countries/Philippines/.
- Asian Development Bank: https://www.adb.org/countries/philippines/main.

STATISTICAL ISSUES

(As of June 24, 2021)

I. Assessment of Data Adequacy for Surveillance
General: Data provision to the Fund has some shortcomings but is broadly adequate for surveillance.
National accounts: The Philippine Statistics Authority (PSA) has rebased the national accounts from 2000 to 2018 and adopted the 2008 System of National Accounts. The results, disseminated in 2020, reflect continued strides by the authorities on improving data quality. Work is underway to improve (i) the accuracy of the GDP volume measures; (ii) the coverage of the public corporations sector; (iii) the accuracy of the quarterly GDP data; (iv) the adoption of benchmark techniques to reconcile quarterly and annual national accounts estimates; and (v) the development of high-frequency indicators of economic activities. **Price statistics**: In March 2018, the PSA introduced a rebased consumer price index (CPI). The updated CPI is compiled using weights based on the 2012 Family Income and Expenditure Survey. Data from the 2013 Commodity and Outlet Survey were used to augment the provincial market baskets. The CPI data is classified according to the internationally recommended *Classification of Individual Consumption by Purpose (COICOP)* for the classification of all items. In 2021, the PSA updated the reference period of the producer price index (PPI) to 2018, with weights from the 2018 Census of Philippine Business and Industry. The PSA is working to expand PPI coverage to the services sectors.
External sector statistics (ESS): The BSP completed the balance of payments compilation based on the sixth edition of the *Balance of Payments and International Investment Position Manual* framework in March 2014, and that of the international investment position (IIP) in September 2014. Steps have been taken to improve the quality of balance of payment statistics. The authorities have introduced new data sources; however, there are several compilation issues. The main challenges are: (i) under-coverage in data on goods imports of transactions related to shuttle trade, imports of cars, e-commerce, imports by individuals within the allowed threshold for imports without declaration; (ii) estimation of remittances data using an outdated model; (iii) underestimation of current and capital transfers; and (iv) significant inconsistencies in direct investment data registered in balance of payments and IIP as they are compiled using different data sources.
Monetary and financial statistics: The authorities report monthly monetary statistics for the central bank and other depository corporations with a lag of less than two months, using the standardized report forms for publication in the *International Financial Statistics (IFS)*. In October 2019, the BSP started the publication of the Other Financial Corporations (OFCs) Survey, after a joint effort between the Insurance Commission, SEC, GOCs, and BSP, supported by an IMF's Statistics Department technical assistance program. These data, together with a full financial corporations survey, are now being disseminated through *IFS*. Philippines reports data on several series and indicators of the Financial Access Survey, including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the United Nations to monitor Target 8.10 of the Sustainable Development Goals. **Financial sector surveillance**: The authorities report all 12 core financial soundness indicators (FSIs), 9 of the 13 encouraged FSIs for deposit takers, and 2 FSIs for real estate markets—on a quarterly basis—for posting on the IMF's FSI website with one quarter lag.
Government finance statistics (GFS): Provision of fiscal data is broadly adequate for surveillance. Philippines report data for the budgetary central government in the GFSM 2014 format. Major areas for improvement include regular production of quarterly GFS, expanding the sector coverage of GFS beyond the budgetary central government on a higher frequency, reporting of financial balance sheets, and enhancing published data on public debt.

II. Data Standards and Quality	
Philippines subscribed to the Special Data Dissemination Standard (SDDS) in August 1996 and met SDDS specifications in January 2001.	A data ROSC was published in August 2004.

Philippines: Table of Common Indicators Required for Surveillance

(As of June 17, 2021)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items: Data Quality—Methodological Soundness[8]	Memo Items: Data Quality—Accuracy and Reliability[9]
Exchange rates	6/17/2021	6/17/2021	D	D	D	O	O
International reserve assets and reserve liabilities of the monetary authorities[1]	5/2021	6/2021	M	M	M	LO	LO
Reserve/base money	5/2021	6/2021	D	W	W	O, LO, LO, LNO	LO, O, O, O, LO
Broad money	4/2021	5/2021	M	M	M		
Central bank balance sheet	3/2021	5/2021	M	M	M		
Consolidated balance sheet of the banking system[2]	4/2021	5/2021	M	M	M		
Interest rates[3]	6/17/2021	6/17/2021	D	D	D	O	O
Consumer price index	5/2021	6/2021	M	M	M	O, O, O, O	O, LO, O, LO, LO
Revenue, expenditure, balance and composition of financing[4]—general government[4]	2018	6/2021	A	A	A	LO, LO, O, O	LO, LO, LO, LO, LO
Revenue, expenditure, balance and composition of financing[4]—central government	4/2021	5/2021	M	M	M		
Stocks of central government and central government-guaranteed debt[5]	4/2021	5/2021	M	M	M	LNO	LNO
External current account balance	6/2021	3/2021	M	M	M	O, LO, LO, LO	LNO, LO, O, LO, LO
Exports and imports of goods and services	4/2021	6/2021	M	M	M		
GDP/GNP	Q1:2021	05/2021	Q	Q	Q	LO, LO, O, LO	LNO, LNO, O, LO, O
Gross external debt	Q1:2021	6/2021	Q	Q	Q	O	O
International investment position[6]	Q4:2020	4/2021	Q	Q	Q	O	O

[1] Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but 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] Foreign, domestic banks, and domestic nonbank financing
[3]. Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7]Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); Not Available (NA).
[8] Reflects the assessment provided in the data ROSC or the Substantive Update (published on August 25, 2004 and based on the findings of the mission that took place during September 1–16, 2003) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, 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 Rosemary Lim, Executive Director for the Philippines; and Dennis Bautista, Advisor to Executive Director
July 23, 2021

On behalf of the Philippine authorities, we thank staff for the insightful reports. Our authorities broadly share staff's views on the assessment of developments and challenges facing the economy. They also appreciate staff's policy recommendations, many of which are in line with the authorities' policy priorities and are currently being implemented.

Recent developments and outlook

The Philippines entered the pandemic with strong fundamentals characterized by broad monetary and external stability, resilient financial sector, favorable fiscal position, and prudent macroeconomic management. Nonetheless, the pandemic took a heavy toll on the economy with the marked contraction of domestic demand. The authorities accordingly employed a comprehensive set of policy support that put priorities on peoples' lives, health, and welfare, especially the poor and vulnerable.

The economy is recovering with the stabilization of infection and easing of mobility measures. Economic growth could return to its potential over the near term, with recovery strengthening in the second half of the year. Nonetheless, the authorities recognize the still-large uncertainties to the pace of recovery. The authorities have secured substantial contracts for vaccine supply for 70% of adult population, conducted information campaigns and pre-registration, and intensified implementation of prevent, detect, isolate, treat and recover (PDITR) strategy and vaccine rollout, particularly in high-risk areas and on economic frontlines. Local government units (LGUs) and highly productive large corporations are heavily involved in vaccination. The programs from 2021 and 2022 National Government (NG) budget as well as the measures from the *Bayanihan* II Law will help finance and ensure recovery. Meanwhile, monetary accommodation and supportive financial measures continue to work their way to the economy.

Recognizing that the pace of economic recovery hinges significantly on accelerated infrastructure investments, the authorities have strongly committed to full-scale uninterrupted implementation. The infrastructure program prioritizes crucial and shovel-ready projects that are responsive to the "new normal". The 2021 budget focuses on projects for addressing natural and human-induced calamities and disasters, health facilities, and standby fund for catastrophes and crises. To fast track the resolution of legal issues for the *Build Build Build* (BBB) program, 11 courts were designated by the Supreme Court to handle expropriation proceedings. The review of the Three-Year Rolling Infrastructure Program for 2022 include projects on transport, water, ICT, power, social, and others, with a number in advanced stages of preparation.

Meanwhile, inflation is expected at the high end of the 2-4% target at 3.9% for 2021, and to return to midpoint of target in 2022, with broadly balanced risks over the

policy horizon, consistent with market expectation as of 12 May Monetary Board meeting. The transitory spikes observed from meat and transport prices will dissipate in the secondhalf of the year, given measures to address the African swine fever in hogs, higher import quota and tariff reduction for meat, and easing of restrictions on the number of passengers fortricycle transport. The broadly muted inflation from the analysis of price dispersion and the still-significant economic slack will cushion the upside risks from global commodity price spillovers and interest rate.

Fiscal sector policies

The fiscal position remains sound and plays a significant role in regaining the economic potential. Targeted interventions helped in reducing the negative impact on income and employment. The fiscal sector also remains resilient despite the large deficit. The authorities underscore the need to restore confidence for economic growth to catch up and for employment to return to normal. Sustaining investments in infrastructure, health capacity,and more targeted social support, especially to address asymmetric impact of COVID-19 on labor, will provide the needed boost to the economy.

Past reforms that led to the historic reduction in debt-to-GDP provided adequate fiscal space for the authorities to respond to the pandemic. The budget deficit widened as expected in 2020 as revenues fell and expenditures rose. However, debt-to-GDP ratio remains manageable and falls within the middle of the country's peers in the region and below the IMF's debt sustainability threshold. The 2021 budget and extended use of 2020 budget are providing funds for the fiscal stimuli under *Bayanihan* I and II laws. The 2021 budget prioritizes: health-related spending to mitigate the impact of the pandemic; infrastructure projects to help stimulate economic rebound; and expenditure programs that support transition and adaptation to "new normal".

Modernization of tax and customs administration is underway to improve revenue collection. The Department of Finance continues to work on modernizing tax administration,making tax compliance easier, adopting digital technology, and enhancing service efficiency.Measures to enhance tax administration has digitalization at its backbone. Online system for tax filing and collections have been put in place, which encouraged taxpayers' compliance to filing, and significantly contributed to revenue collections. Other ongoing reforms include property valuation and financial institutions taxes, tax on gambling (e.g., POGOs), change in fiscal regime in mining, development of corporate pension linked to the national identification system, and issuance of green bonds.

Customs administration is also being modernized along with the automation of systems, improving border protection capability, operationalization of the Customs Operations Center,and establishment of the Customs Training Institute. The roll-out of real-time GPSbased monitoring of cargoes, the inventory management system for monitoring real-time movements of imported goods and raw materials and the fuel marking system also generated additional revenues.

The authorities have been enhancing budget execution with focus on raising implementation capacities, addressing bottlenecks as well as enhancing procurement rules, transparency, and accountability. To further improve disbursements, the Department of Budget and Management will be completing its shift to cash budget system. Abudget modernization bill aims to institutionalize public financial management. In addition, the oversight of government accounts is being strengthened along with the deployment of integrated financial management information system, oversight internal audit standards, and institutionalization of public participation in the budget process. Technical assistance from multilateral agencies improved the evaluation and management of public investments and helped in capacity building of government agencies on project development and implementation. The use of digital technology for online blacklisting, e-bidding, and tracking; and institutionalizing budget and treasury management system helped simplify and modernize the procurement system.

The authorities acknowledge that greater empowerment of LGUs will support the further devolution of functions and help in recovery efforts. In this context, the authorities will provide guidelines on funding for LGUs in the 2022 budget. Relatedly, an Executive Order on the mechanism of devolution transition plans, creation of a time-bound growth enhancement fund, and updating of regional plan, investment program and budget framework, is ready for signature by the President. To ensure efficient and effective use of the budget, the authorities are preparing the standards for delivery, and they will provide the needed technical and management assistance, build capacity, and monitor the use of the LGUs budget, especially in the implementation of infrastructure projects.

The authorities underscore the need for balancing fiscal prudence and recovery through adjustments in spending for targeted stimulus, where possible. Social protectionprograms will be strengthened to alleviate immediate concerns on unemployment and poverty, while the continued strong push for infrastructure programs should create jobs and enhance the long run economic potential, thereby preventing further scarring effects. Measures under the proposed *Bayanihan* III bill are being carefully assessed to ensure availability of revenues that could be sourced from government corporations and identified savings from the budget. Meanwhile, the 2022 budget will have at its core the pandemic response and economic recovery objectives.

As embodied in the medium-term fiscal program, the authorities concur with staff's view and fully commit to adopt a fiscal consolidation strategy that would help gradually bring deficit ratio to GDP to pre-COVID-19 levels. This strategy will ease the country's debt and allow for gradual rebuilding of fiscal space as the economy recovers and expands, and revenue collections strengthen. The fiscal strategy will balance the support to economic recovery and the priority measures to protect livelihoods.

Monetary policies

The authorities' monetary actions and various liquidity-enhancing measures helped in lowering the cost of funds, ensure orderly and favorable market conditions, and maintain confidence in the banking system. In response to the pandemic, the authorities reduced its policy rate in 2020 by a cumulative 200 bps to two percent and lowered the reserve requirement ratio by 200 bps to 12 percent. Consistent with the provisions under the Bangko Sentral ng Pilipinas (BSP) Charter, the BSP provided provisional advances to the NG in the form of a repurchase agreement in March 2020 and direct provisional advances in January 2021, the latter maturing in July 2021. The BSP Charter provides that advances tothe NG shall not, in aggregate, exceed 20 percent of the average annual income of the borrower for the three preceding fiscal years and shall be repaid before the end of three months extendible by another three months as the Monetary Board may allow. In addition,the *Bayanihan* II Law authorizes the BSP to make additional direct provisional advances to the NG, provided that such advances shall not, in their aggregate, exceed 10 percent of the average annual income of the national government for fiscal years 2017-2019.

The BSP also purchased government securities in the secondary market to support the smooth functioning of the domestic bond market. The outright purchase of government securities (GS) is part of the BSP's open market operations toolkit but has not been activated given ample financial system liquidity. The BSP will further refine the conduct of monetary operations, which include outright GS transactions, during regular and crisis periods. The authorities pointed out that the advances are temporary and for emergency use related to the pandemic. Moreover, the NG intends to reduce its reliance on temporary and short-term advances from the BSP. Measures are being considered to raise additional revenues and financing, including new taxes from gaming operations, privatization, dividend collections from government-owned and controlled corporations, and increase issuance of government securities.

The authorities share staff's view that the current monetary policy setting is appropriate and should remain accommodative given the nascent recovery of domestic demand. The current monetary policy should remain until signs of sustained recovery are clear and in line with price and financial stability. Most of the risks to inflation come from the supply side and inflation projection is seen to be within target in 2021 and 2022,consistent with market expectations. Demand side price pressures remain largely subdued with generally stable core inflation and still weak credit. These emphasize that domestic demand still requires both fiscal and monetary policy support under strong coordination. TheBSP will continue to preserve supportive liquidity conditions prior to eventually scaling backmonetary interventions.

The authorities understand the limits of monetary policy in the context of the present shock and are mindful of the need to preserve central bank credibility and guard against narrowing policy space. Consistent with the BSP Charter and the *Bayanihan* II Law, the authorities stand ready to provide policy support, as necessary. When recovery becomes self-sustaining, the BSP will implement a well-communicated strategy for unwinding of policy stimulus, while ensuring sustainability of economic recovery and guarding against emerging threats to price and financial stability.

Further reforms are ongoing to improve monetary operations and enhance the transmission mechanism in terms of more market-based implementation of monetary policy by expansion of market participation, improving the ability to respond to fluctuations in liquidity conditions, expanding the toolkit for injecting liquidity into the financial system, and strengthening the operational readiness in responding to various financial market developments via strategies on the current BSP holdings of government securities.

External sector policies

The authorities remained of the view that the country's external sector position is broadly in line with the medium-term macroeconomic fundamentals and remains favorable after the brief volatility and as trade suffered a setback in 2020. The external sector is showing signs of recovery. The relative strength of the Peso against the US dollar is due to a combination of factors. The Philippines stands out among emerging economies with strong BOP in 2020. The stringent lockdowns caused the demand for foreign exchange to decline markedly with exports and remittances remaining moderate. Firms and exporters can borrow from the international market and issue debts. Meanwhile, the government has continued market access to financing while imports demanded less foreign exchange.

The authorities continue to embark on improving the investment climate and expanding trade opportunities. Domestic ratification processes are underway for the Regional Comprehensive Economic Partnership among ASEAN Member States and its FTA partners **-** South Korea, India, China, Japan, Australia, and New Zealand. Moreover, the Philippines is now delisted from the USTR list on protection of intellectual property rights. The 12th Regular Foreign Investment Negative List due for submission to the President by Q4 of 2021 will help ease some barriers and encourage greater foreign investments in: the practice of professions; cooperatives; ownership of private lands; operation of public utilities;retailing of rice and corn; construction or repair of public works where the structures to be built require the application of advanced techniques and/or technologies; and educational institutions.

The authorities remain committed to a flexible or a market-determined exchange rate system, anchored on the constitutional mandate to maintain price stability. It is also consistent with the monetary policy of inflation targeting, which demands a disciplined commitment to participate in the foreign exchange market only under well-defined circumstances, such as when there is a need to smooth out exchange rate volatility, which canthreaten the inflation target. The authorities have also combined foreign exchange intervention and monetary measures with market-based foreign exchange regulations to ensure stability in the foreign exchange market. The BSP has been keeping foreign exchange regulations responsive through the liberalization of foreign exchange rules with appropriate safeguards and continues to have recourses and measures to cushion sharp peso movements.

The authorities believe that the current reserves accumulation is prudent and appropriate in the face of risks from the challenging economic environment and other transitory non-fundamental factors, which call for reserve build-up for liquidity buffer for precautionary use. The authorities noted that the build-up in gross international reserves was due to other several factors, including the large reduction in imports andrelatively still growing remittances. The increase was also attributed to the borrowings of the NG to raise funds and valuation gains of gold assets. Part of the reserves will be eventually drawn down once spending of the NG accelerates and economic activity normalizes.

Financial sector policies

The Philippine banking system remains on strong footing with sustained growth in assets, deposits, and capital, as well as positive net profit, stable capital and liquidity buffers, and ample loan loss reserves. Its resources continued to expand to support the country’s financing needs. Meanwhile, the impact of the pandemic on the banking system characterized by the expected weakening of asset quality, has been manageable. Banks proactively recognized provisioning since the start of 2020 in anticipation of the adverse impact of the pandemic on their loan portfolio.

The comprehensive prudential reforms and implementation of regulatory and operational relief measures have generally supported the resilience of banks and risk management. The time-bound measures included: regulatory relief measure that enables banks to grant equivalent financial relief to their borrowers or restructure loan accounts; incentivized lending to sustain the post-crisis operations of enterprises; continued access to credit/financial services; use of information technology for financial transactions during quarantine; and supported continued delivery of financial services to enable consumers to complete financial transactions during quarantine. For its part, the Securities and Exchange Commission (SEC) provided issuances on extension of filing of reports and simplified onboarding of procedures for low-risk accounts for AML/CFT purposes.

The authorities note that banks entered this pandemic with ample capital and liquidity buffers, allowing them to withstand short-term liquidity shocks while providing adequate stable funding for the medium-term. Meanwhile, other sources of financing, notably corporate bonds, have remained relatively active due to low interest rate environment. The authorities have also extended and further enhanced the operational relief measures to provide financial institutions with flexibility in managing their operations and ensuring continuous delivery of financial services amid the pandemic.

Banks that avail themselves of the credit-related regulatory relief measures are required to report actual past due and NPLs and allowance for credit for losses in their prudential reports.Thus, the published industry statistics of banks present the true state of health of the banking system. The expiry of these relief measures was timed to coincide with the full operationalization of the Financial Institutions Strategic Transfer (FIST) Act at end-December 2021. This approach is meant to bridge transition between the crisis-oriented temporary relief measures and the long-term permanent resolution mechanism afforded underthe FIST Law. Meanwhile, the window of the staggered booking of allowance for credit losses was allowed to lapse on 8 March 2021. This relief measure recorded utilization by a few small banks which were allowed to stagger booking of allowance for credit losses below the maximum period of five years. In evaluating applications for relief, the BSP considered the results of stress testing exercises in determining any conditions on the approval. Banks applying for relief measures may be restricted from making dividend or other forms of profit distributions. The restriction applies automatically to banks that utilize their capital conservation buffers and may be imposed on banks that have reached their internal capital targets. Existing regulations also allow the BSP to limit or prohibit dividend declaration, as necessary. The authorities are confident that dividend prohibition can be handled on a case- by-case basis, considering that banks have individual capital triggers provided in their internal capital adequacy assessment process, stress testing results and risk assessment,among others.

The authorities also adopted prudential regulations to ensure effective supervision of the banking sector. Prior to the onset of the pandemic, the BSP already adopted the following Basel capital and liquidity standards: amendments to the capital requirements which provide for higher-quality capital and additional minima requirements; liquidity coverage ratio; net stable funding ratio; leverage ratio; and the framework for DSIBs. The authorities implemented the Supervisory Assessment Framework (SAFr) in January 2021, which puts emphasis on a bank’s financial stability impact, bank's business model and overall risk profile. With this, the BSP has a better hand in evaluating the overall safety and soundness of banks. The BSP has also continued to strengthen consolidated supervision where banks belonging to one conglomerate structure are handled by one department. While each financial institution within the conglomerate is assessed individually, focus is given on the effectiveness of the governance process across the group. The Financial Conglomerate Supervision Committee, under the auspices of the Financial Sector Forum

(FSF)[1] is tasked to strengthen conglomerate supervision and assessment of risk concentrations. The work of this Committee included the development of the guidelines on related party transactions that wereadopted by the FSF member agencies for their respective supervised institutions. The FSF is currently working on the finalization of the memorandum of agreement (MOA) on theformation of supervisory colleges to effectively conduct groupwide risk assessment and discuss cross-cutting issues. In addition, a bill has been filed in Congress to provide a window to look into potential issues using fraudulent transactions in deposit.

The authorities underscore its commitment toward the timely implementation of the International Co-operation Review Group (ICRG) action plans to address strategic anti-money laundering and counter-terrorism financing (AML/CTF) deficiencies of the country. A number of the Mutual Evaluation Report recommended actions have largely beenaddressed. Given the recent identification of the Philippines as "Jurisdiction under Increased Monitoring" with serious AML/CTF deficiencies, the relevant government and law enforcement agencies' sustained pledge to implement the remaining 18 action plans within the prescribed timelines will be essential to the country's removal from such list. Theauthorities are confident that the country would be removed from the FATF watch list given the current actions to address the remaining issues.

The authorities are continuously improving the regulation of the financial system by expanding the macroprudential toolkit and strengthening bank resolution framework to help enhance its resilience. While enhancements in the regulatory policies and supervisory practices towards strengthening the bank resolution framework are ongoing, the authorities underscore that banks which are under the Prompt Corrective Action Framework do not pose systemic risk to the Philippine financial system. The authorities are closely monitoring banks' asset quality along with the developments in the real sector, cross-border borrowings, the non-corporates bond issuances, and amounts under forbearance needed for supervisory assessment and development of corresponding supervisory plan.

Structural reforms

The authorities agree with the staff view on the need to advance the structural reforms for economic sustainability and green recovery over the medium to long term. Related to this, several laws have been passed. The Corporate Recovery and Tax Incentives for Enterprises (CREATE) law will improve investments by lowering corporate income tax rate by five to 10 percentage points and rationalizing tax incentives. The FIST Law wouldfacilitate resolution of NPLs and distressed assets to improve banks' balance sheet and encourage lending. The authorities are also closely monitoring various

[1] FSF is a voluntary inter-agency body comprised of the BSP, SEC, Insurance Commission (IC), and Philippine Deposit Insurance Corporation (PDIC).

proposed bills, such as the Government Financial Institutions Unified Initiatives to Distress Enterprises for Economic Recovery (GUIDE) bill, which will allow GFIs to invest in strategically important companies facing temporary solvency issues, and the amendments to the PDIC Charter on bank resolution. The President has also certified the following priority bills: Amendments to the Public Service Act, which redefines the coverage of public utility to effectively remove foreign equity restrictions; Amendments to the Foreign Investment Act, to relax restrictive provisions on FDIs and facilitate entry of new players; and Amendments to the Retail Trade Liberalization Act, which relaxes barriers to foreign investments in the retail sector.

The authorities are strongly stepping up the implementation of various climate change management framework and plans for adaptation, mitigation, and disaster risk- reduction, with more aggressive target, and thrust to explore new renewable energy (RE) technologies along with consumer protection policies. Energy conservation and efficiency in government and the private sector is being implemented along with green buildings and energy labeling. Efforts are ongoing to mainstream climate change and disaster resilience in sustainable finance, and local and international collaborations. Investments on climate change mitigation include registrations for RE and battery energy storage, and conversion of biomass waste for aviation fuel. The energy innovation landscape is exploring various energy sources, such as hydrogen, expanded solar rooftop, tidal energy, and offshore wind. Use of biodegradable plastic from local commodities is also promoted. The authorities' investments on green recovery, particularly on climate change adaptation and mitigation, are well in place and tagged for identification in both the 2021 budget and upcoming 2022 budget.

Strong efforts to improve governance are aimed at improving the conduct of business, reducing red tape, and enhancing delivery of services. In this context, the authorities have applied technology to: streamline efforts to eliminate inefficiencies; improve and simplify business processes and requirements on licenses, registrations, renewal, and handling of complaints and resolutions; and establish an electronic data system on business-related transactions that are linked to government agencies. Meanwhile, LGUs are also implementing electronic Business One-Stop Shop for online applications, digital payment options, and issuance of electronic versions of permits, licenses, or clearances. A web-based platform for real-time public access to management system and regulations is expected to go live by Q4-2021. Moreover, the launching of Go SmARTApp will harmonize the existing systems of government agencies to simplify government transactions and doing business in the country. The national identification system has been rolled out and targets 50 million registration by 2021. This system is useful for planning and budgeting and will simplify transactions and facilitate social services delivery.