AMRO Country Report
ACR/24-11

AMRO Annual Consultation Report

The Philippines - 2024

ASEAN+3 Macroeconomic Research Office (AMRO)

December 2024

Acknowledgments

1. This Annual Consultation Report on the Philippines has been prepared in accordance with the functions of AMRO to monitor and assess the macroeconomic status and financial soundness of its members; identify relevant risks and vulnerabilities; report these to member authorities; and if requested, assist them in mitigating these risks through the timely formulation of policy recommendations. This is being done in accordance with Article 3 (a) and (b) of the AMRO Agreement.

2. This Report is drafted on the basis of the Annual Consultation Visit of AMRO to the Philippines from August 27 to September 6, 2024 (Article 5 (b) of the AMRO Agreement). The AMRO Mission team was headed by Dr Runchana Pongsaparn. Members included Dr Jinho Choi, Deputy Mission Chief, Dr Heung Chun (Andrew) Tsang, Desk Economist on the Philippines; Ms Pim-orn Wacharaprapapong, Backup Economist; Ms Chunyu Yang, Fiscal Specialist; Ms Sopheawattey San, Associate; and Ms Su Su Hlaing, Associate. AMRO Director Dr Kouqing Li and Chief Economist Dr Hoe Ee Khor also participated in key policy meetings with the authorities. This AMRO Annual Consultation Report on the Philippines for 2024 was peer-reviewed by a group of economists from AMRO's Country Surveillance, Financial Surveillance, and Fiscal Surveillance teams; endorsed by the Policy and Review Group; and approved by Dr. Hoe Ee Khor, AMRO Chief Economist.

3. The analysis in this Report is based on information available up to November 7, 2024.

4. By making any designation of or reference to a particular territory or geographical area, or by using the term "member" or "country" in this Report, AMRO does not intend to make any judgments as to the legal or other status of any territory or area.

5. On behalf of AMRO, the Mission team wishes to thank the Philippine authorities for their comments on this Report, as well as their excellent meeting arrangements and hospitality during our visit.

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Executive Summary

1. The Philippine economy grew steadily at 5.8 percent in the first three quarters of 2024, driven by robust domestic demand and export recovery. The growth momentum was mainly supported by a recovery in public consumption and construction investment, as well as an improvement in exports of goods and services. On the production side, growth was primarily driven by the construction and services sectors.

2. The labor market continued to be strong, which helped boost domestic consumption; however, the underemployment rate remained elevated, albeit declining. The unemployment rate continued to improve and the level of employment has surpassed pre-pandemic levels. The lower share of higher-income positions and the high underemployment rate could constrain the country's long-term growth potential.

3. Inflation continued its declining trend from 2023. The moderation of supply-push factors, particularly a decrease in global commodity prices, combined with the government's direct measures and tight monetary policy, has driven down headline inflation. However, demand-pull factors, such as the positive output gap and second-round effects, have kept core inflation above 3 percent in the first half of 2024. Nonetheless, core inflation eased below 3 percent from July 2024 onwards.

4. The fiscal position continued to improve in 2024, supported by a significant increase in revenue despite higher fiscal expenditure. The increase in expenditure was mainly due to higher capital outlay, maintenance and other operating expenses, allotments to local government units (LGUs), and interest payments, while the rising revenue was driven largely by higher value-added tax (VAT) and nontax revenue.

5. On the external front, the balance of payments (BOP) registered a surplus in H1 2024, while external debt remained low. Specifically, the current account improved with a narrowing merchandise trade deficit; at the same time, net financial account inflows increased. Meanwhile, international reserves remained sufficient. However, the Philippine peso weakened against the U.S. dollar and in nominal effective terms during the year.

6. As inflation remained elevated, albeit easing, the Monetary Board maintained the policy rate at 6.50 percent in the first half of 2024 and delivered two 25-basis-point rate cuts since August. With inflation on a declining trend, the Bangko Sentral ng Pilipinas (BSP) has signalled that a calibrated shift to a less restrictive monetary policy stance will be appropriate going forward. The BSP has also announced a reduction in the reserve requirement ratio effective in late October 2024, which would release more liquidity into the banking system.

7. The banking system remains sound, while bank loans continued to grow moderately. The banking system has ample liquidity, robust profitability and high capital buffers. Amid high interest rates, overall loan growth has remained moderate, driven largely by lending to the household segment, which were particularly pronounced in unsecured segments such as credit card loans and salary-based general consumption loans.

8. The Philippine economy is expected to grow by 5.8 percent in 2024 and 6.3 percent in 2025. The pick-up in growth is driven by higher government spending as well as an upturn in external demand and strengthening domestic demand. Private consumption is anticipated to grow faster in the rest of the year, supported by strong labor market conditions, lower inflation and robust overseas remittances. With the start of the monetary policy easing cycle, private investment sentiments are expected to improve.

9. Headline consumer price index (CPI) inflation is projected to decline to 3.2 percent in 2024 from 6.0 percent in 2023, and maintain at 3.2 percent in 2025. While upside risks such as wage increases and local food supply shocks remain, the decline in headline inflation is expected to continue in the second half of 2024 due to lower commodity prices of fuel and food, and tariff cuts on imported rice.

10. The growth prospects of the Philippines could be subject to several risks. Higher inflation could dampen consumption, and the economy could be challenged by a potentially sharp slowdown in major trading partners. Heightened geopolitical risks could increase the likelihood of global supply disruptions and further global economic fragmentation. Over the long term, the country's potential growth could be constrained by insufficient infrastructure investment, vulnerabilities to climate change, and prolonged scarring effects caused by the COVID-19 pandemic.

11. The current fiscal-monetary policy mix is appropriate and can be adjusted further to support economic growth while rebuilding policy buffers. As inflation will continue to ease within the target band, there is room to adopt a less restrictive monetary policy stance if current growth trends continue. However, if supply-side risks emerge, a whole-of-government approach should be taken to address inflationary pressures.

12. While the need for strategic adjustments in medium-term fiscal policy to support the economy is recognized, fiscal consolidation should be accelerated when conditions allow. The government is likely to continue its medium-term fiscal consolidation plan at a slower pace to better support economic growth. However, it would be prudent to quicken the pace of fiscal consolidation if conditions allow, as restoring fiscal space remains critical to build greater resilience to external shocks amid elevated uncertainty. The authorities should continue to carry out further revenue mobilization, efficiency improvement, and long-term fiscal reforms to ensure fiscal sustainability.

13. Overall financial stability remains sound; at the same time, a more active use of macroprudential toolkits could be considered to mitigate the financial stability risks. Some signs of vulnerabilities have emerged in certain areas, such as the household and property sectors, which warrant close monitoring. Meanwhile, the authorities should strengthen the institutional framework to safeguard financial stability and deepen the bond and repo markets.

14. On structural issues, the government should implement measures on labor upskilling and reskilling in a timely manner to raise labor productivity. In particular, the government should collaborate closely with industries and training providers to formulate training frameworks and implement plans to ensure that the supply of skilled labor matches industry demand. More efforts should also be made to attract foreign direct investments (FDIs) and to encourage technological transfers.

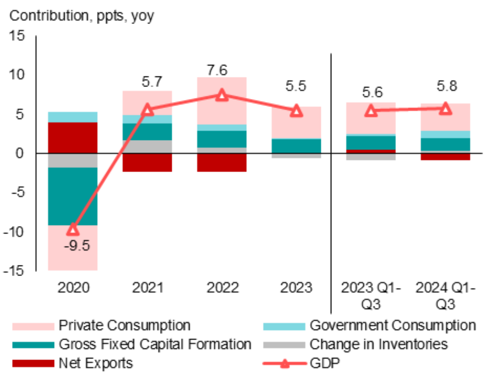
15. Furthermore, a comprehensive strategy for enhancing the country's competitiveness is crucial to bolster economic growth potential. The strategy should include raising infrastructure investment, continuing digitalization and developing a sustainable economy. Specifically, sufficient infrastructure investment with a rigorous selection of projects is required to address the need for sustainable long-term growth. At the same time, the Philippines should take the opportunity to attract more FDIs to develop a sustainable economy, given that it is already on the right track to address vulnerabilities arising from climate change.

A. Recent Developments and Outlook

A.1 Recent Developments

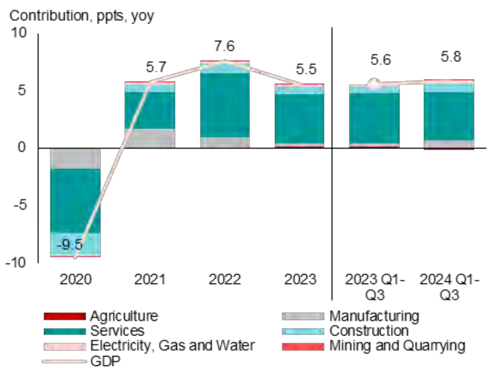
1. The Philippine economy grew steadily in the first three quarters of 2024, led by robust domestic demand and export recovery, with the services sector remaining the main driver of growth. GDP growth picked up to 5.8 percent year on year (yoy) in Q1-Q3 2024, after slowing to 5.5 percent in 2023 from a multi-decade high of 7.6 percent in 2022. The higher growth was mainly supported by a recovery in public consumption and construction investment, as well as an improvement in exports of goods and services (Figure 1).[1] Household consumption, underpinned by a strong labor market and robust remittances, continued to expand, but at a slower pace due to the lagged impact of high inflation. Private investment is gradually rebounding but has yet to reach pre-pandemic levels, partly due to weak investment sentiment amid high interest rates.[2] On the production side, GDP growth in Q1-Q3 2024 was driven mainly by the construction and service sectors (Figure 2), particularly financial services and retail and wholesale trade.

Figure 1. Real GDP Growth by Expenditure



Source: Philippine Statistics Authority (PSA); AMRO staff calculations

Figure 2. Real GDP Growth and Sectoral Contribution



Source: PSA; AMRO staff calculations

2. The labor market continued to be strong, which helped support robust consumption in Q1-Q3 2024; however, the underemployment rate remained elevated, albeit declining. The unemployment rate continued to improve, from 4.5 percent in September 2023 to 3.7 percent in September 2024 (Figure 3).[3] Meanwhile, employment surpassed the January 2020 pre-pandemic level by 5.2 million. However, the new hires were concentrated in elementary low-paying jobs, while employment of managers and professionals decreased by 1.4 million, from 15.2 percent of total employment in January 2020 to 10.2 percent in September 2024 (Figure 4).[4] The underemployment rate is still elevated, but it has generally declined over the

[1] According to AMRO's estimate of import-adjusted GDP, after netting out imports from each expenditure component, value-added exports contributed 1.3 percentage points out of the Q1-Q3 2024 growth of 5.8 percent, following private consumption's contribution of 2.7 percentage points.

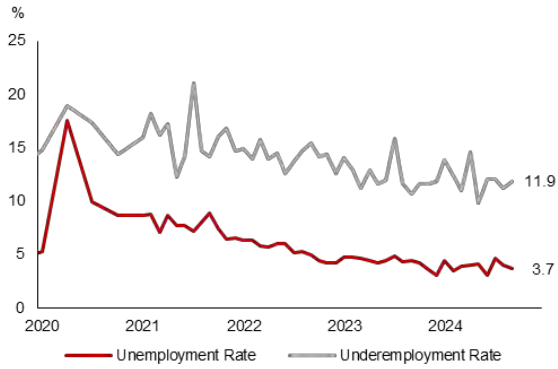
[2] According to AMRO's staff analysis (Gabriella, L. G., 2023. Decoding Corporate and MSME Debt-at-Risk in the Philippines, AMRO's 2023 Annual Consultation Report on the Philippines), high interest rates could significantly increase firms-at-risk (firms have an interest coverage ratio (ICR) lower than 1.25) and the debt-at-risk (debts with interest coverage ratios (ICRs) lower than 1.25 and/or debt service ratios (DSRs) lower than 1.0) of corporates.

[3] The pre-pandemic unemployment rate was 5.1 percent in 2019 on average.

[4] In terms of the class of workers, the share of self-employment and unpaid family workers in total employment rose from 34.8 percent in January 2020 to 36.1 percent in September 2024, whereas the share of wage and salary workers fell from 65.2 percent to 63.9 percent over the same period.

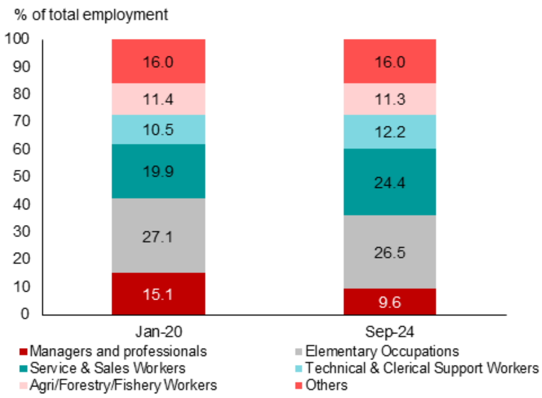
past two years. However, the most recent rate increased from 10.7 percent in September 2023 to 11.9 percent in September 2024.[5]

Figure 3. Unemployment and Underemployment



Source: PSA

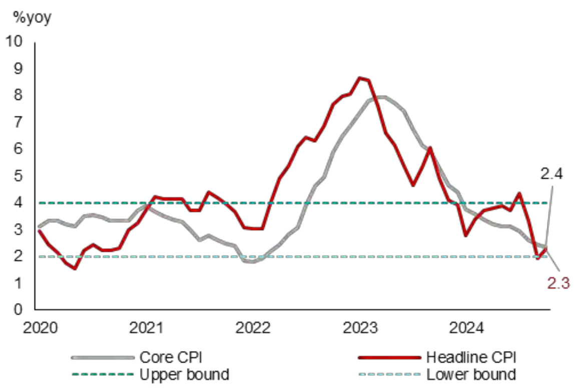
Figure 4. Employment by Occupation



Source: PSA

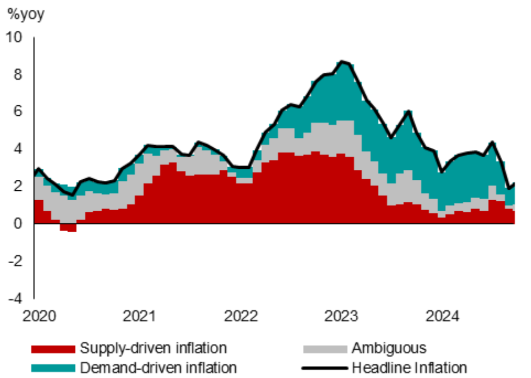
3. In the first ten months of 2024, inflation broadly continued its downtrend from 2023. The headline inflation rate had fallen within the target range of 2-4 percent since December 2023 and recorded 2.3 percent (yoy) in October 2024, far below its peak of 8.7 percent in January 2023 (Figure 5). The disinflation process was driven by a moderation in global commodity prices, administrative measures such as tariff cuts on food items,[6] and a fall in core goods and services inflation. Core inflation dropped from a peak of 8.0 percent in March 2023 to 2.4 percent in October 2024 (Figure 5). The moderation of supply-push factors has driven down the headline inflation rate, while demand-pull factors, such as the positive output gap and second-round effects,[7] have kept core inflation hovering above 3 percent in the first half of 2024. Nonetheless, core inflation eased further from July 2024 onwards (Figure 6).[8]

Figure 5. CPI Inflation



Source: PSA; AMRO staff calculations

Figure 6. Drivers of Inflation



Source: PSA; Bangko Sentral ng Pilipinas (BSP); AMRO staff calculations

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[5] The underemployment rate is comparable to its pre-pandemic level, when it was at an average of 13.8 percent in 2019.

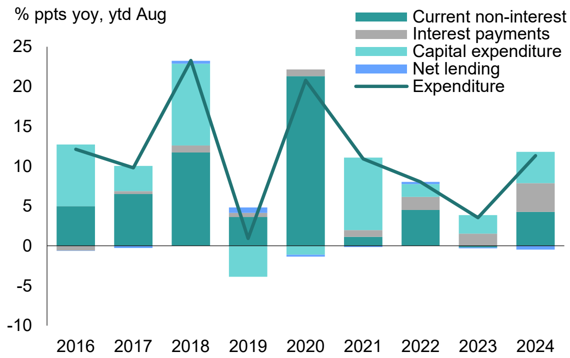
[6] See Executive Order No. 62 for a tariff reduction on rice: https://www.officialgazette.gov.ph/2024/06/20/executive-order-no-62-s-2024/.

[7] It is worth noting that inflation in the Philippines is high compared with regional peers due to the absence of general price subsidies. As a result, increases in commodity prices directly affect inflation without any buffering.

[8] According to AMRO's staff analysis (see Tsang, A. and Wacharaprapapong, P., 2023. Drivers of Philippine Inflation, AMRO's 2023 Annual Consultation Report on the Philippines, for the methodology), headline inflation was mainly driven by demand factors in 2023 and 2024, while core inflation was roughly equally driven by demand and supply factors. For headline inflation, supply factors drove 28 percent of inflation in 2023 and 24 percent between January and October 2024. The contribution of demand factors to headline inflation rose from 48 percent in 2023 to 62 percent between January and October 2024. Since there are ambiguous components, the sum of contributions from demand and supply factors is not equal to 100 percent.

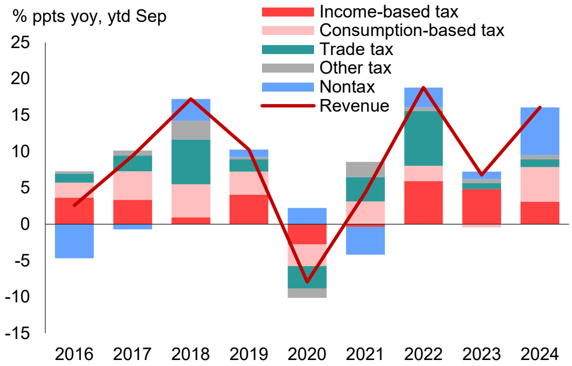
4. Although fiscal expenditure climbed significantly in the first nine months of 2024, the fiscal position continued to improve, supported by robust increases in revenue. From January to September 2024, fiscal expenditure rose by 11.6 percent (yoy), much higher than the 4.1 percent increase in the same period in 2023. This increase was mainly due to higher capital outlay, maintenance and other operating expenses, allotments to local government units (LGUs)[9] and interest payments (Figure 7).[10] Meanwhile, fiscal revenue grew by 16.0 percent from January to September (ytd, yoy), up from the 6.8 percent increase in the same period in 2023, led mainly by higher value-added tax (VAT)[11] and nontax revenue (Figure 8).[12] In contrast, income tax grew moderately[13] and excise tax declined.[14] As a result, the fiscal deficit in the first nine months of 2024 registered PHP970.2 billion, below the programmed PHP1,067.1 billion, indicating an improvement in the fiscal position.

Figure 7. Changes in Expenditure



Source: Department of Budget and Management; AMRO staff calculations

Figure 8. Changes in Revenue



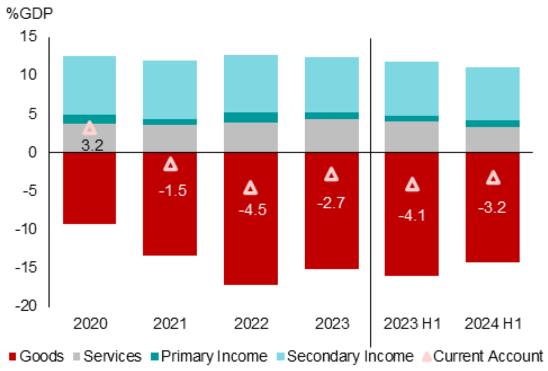
Source: Bureau of the Treasury; AMRO staff estimates

5. The current account deficit improved further in H1 2024, mainly due to a narrowing merchandise trade deficit as well as increases in primary and secondary income. The current account deficit fell to 3.2 percent of GDP in H1 2024 from 4.1 percent in H1 2023 (Figure 9). The merchandise trade deficit improved reflecting an upturn in electronic product exports and a decline in imports. Primary income rose, boosted by bigger receipts from residents' investments abroad, while secondary income benefited from robust growth in remittances from overseas Filipino workers (Figure 10; see also Box A, which summarizes the latest developments of remittances to the country). However, the surplus in services trades contracted in H1 2024 due to higher spending from outbound tourism, which outweighed

[9] The national tax allotment (NTA) share of LGUs in 2024 and 2023 are based on the tax revenue in 2021 and 2020, respectively. A lower tax base in 2020 resulted in LGUs' lower NTA share in 2023, while economic recovery in 2021 boosted their NTA share in 2024. Therefore, the allotment to LGUs in H1 2024 is higher than H1 2023.
[10] The primary reason for increasing interest payments is the reissuance of sizable short-term government bonds issued during the pandemic, which currently face higher interest rates.
[11] VAT revenue in 2023 underperformed relative to the budget, largely due to revised filing requirements for VAT returns. Beginning January 1, 2023, VAT-registered taxpayers are required to file only quarterly, not monthly, VAT returns. As a result, VAT for transactions made in October and November, which were previously supposed to be filed within Q4 2023, were instead submitted in Q1 2024, leading to revenue that was lower in 2023 and higher in 2024 than it would have been without the changes in the VAT filing schedule.
[12] In 2023, nontax revenue more than doubled the budget due to higher dividends from state-owned enterprises (SOEs). In the first nine months of 2024, nontax revenue continued increasing, surpassing the same period in 2023 by 62.8 percent, driven by higher dividend remittances, interest on advances from government-owned and controlled corporations (GOCCs), and the national government's share from the Philippine Amusement and Gaming Corporation (PAGCOR) income. Noticeably, the dividend rate of GOCCs was adjusted from 50 percent to 75 percent of their earnings in April 2024, pushing up nontax revenue.
[13] The latest data shows income tax grew modestly by 8.4 percent yoy in the first nine months in 2024, possibly due to a base effect, as growth was 14.1 percent during the same period in 2023 because of strong economic recovery and the Bureau of Internal Revenue's (BIR) efforts on enhancing tax compliance (https://www.dof.gov.ph/bir-ramps-up-tax-compliance-and-enforcement-drives-in-2023-results-in-higher-collection-performance/).
[14] The latest data on excise tax shows a 0.4 percent yoy decline in the first nine months in 2024, continuing the downward trend from 2023, which saw a 4.9 percent decrease during the same time. According to the Department of Finance (DOF), the decline is primarily due to reduced tobacco tax collections, which account for the largest share of excise tax. Consumption has shifted from traditional tobacco to electronic cigarettes, but the latter are mostly traded in the informal sector, making tax collection difficult.

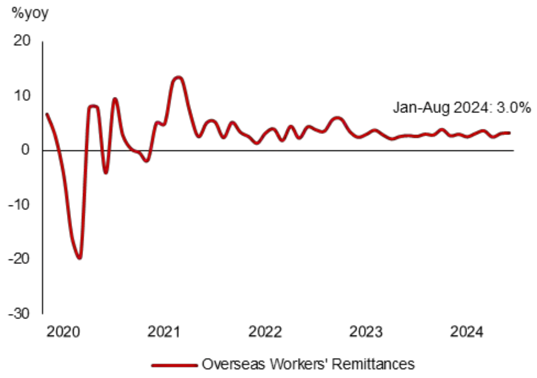
increased receipts from business process outsourcing (BPO) and weaker-than-expected inbound tourism.[15]

Figure 9. Current Account Balance



Source: BSP; AMRO staff calculations

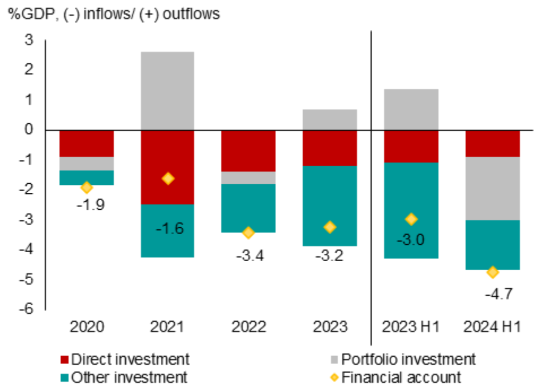
Figure 10. Personal Remittances



Source: BSP; AMRO staff calculations

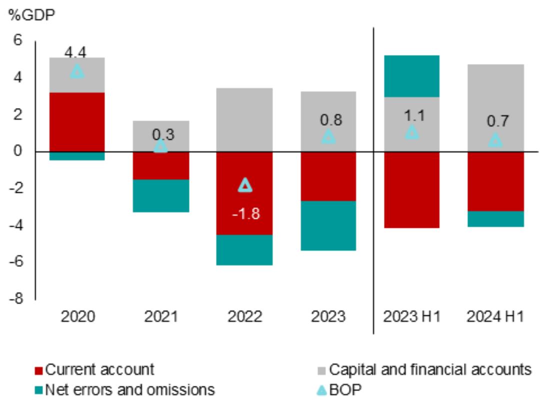
6. The balance of payments (BOP) registered a surplus in H1 2024 as the financial account's net inflows offset the current account deficit, while external debt remained low. The financial account continued to register net inflows, which rose to USD10.5 billion in H1 2024, equivalent to 4.7 percent of GDP, from USD6.2 billion in H1 2023, or 3.0 percent of GDP, driven by the reversal of the portfolio investment account from net outflows to net inflows reflecting a shift to risk-on sentiments among global investors[16] but partly offset by lower net inflows registered in the direct investment and other investment accounts (Figure 11).[17] Together with the narrowing current account deficit, the BOP posted a surplus of USD1.4 billion in H1 2024, equivalent to 0.7 percent of GDP and down from USD2.3 billion, or 1.1 percent of GDP, in H1 2023 (Figure 12). Meanwhile, the total external debt of the Philippines remained low at 28.9 percent of GDP as of end-June 2024, up slightly from 28.7 percent at end-2023.

Figure 11. Financial Account Flows



Source: BSP; AMRO staff calculations

Figure 12. Balance of Payments



Source: BSP; AMRO staff calculations

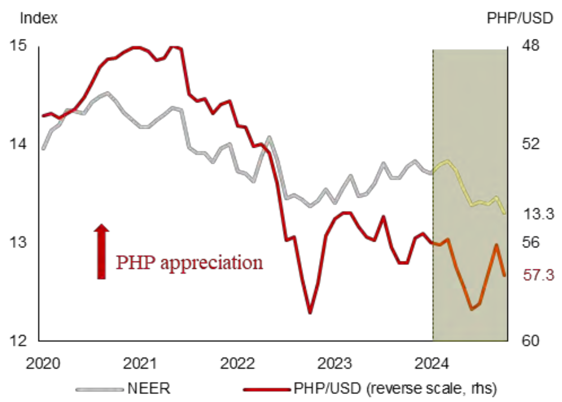
[15] The Department of Tourism had set an annual target of receiving 7.7 million international visitors in 2024. However, only 3.0 million international visitors, including overseas Filipinos, arrived in H1 2024, less than 40 percent of the target, despite continued growth in the receipts from inbound tourists. The weak recovery in Chinese tourists was the main cause of the missed expectations. Chinese tourists have recovered to only 20 percent of pre-pandemic levels, while tourists from other countries have returned to about 80 percent.

[16] In H1 2024, portfolio investment reversed to net inflows, mainly due to nonresidents' net buying of debt securities and, to a lesser extent, inflows from residents' net withdrawal of USD644 million from their investments in foreign portfolio assets (a reversal from the outflows of residents' net placements of USD3.2 billion).

[17] The fall in net direct investment inflows was due to growth in residents' net investments in foreign financial assets outpacing that of FDI, although FDI rose by 7.9 percent yoy in H1 2024. Specifically, equity FDIs mainly came from the United Kingdom, Japan, and the United States. Meanwhile, the lower net inflows in other investments were mainly attributed to a decline in residents' net withdrawals of currencies and deposits abroad.

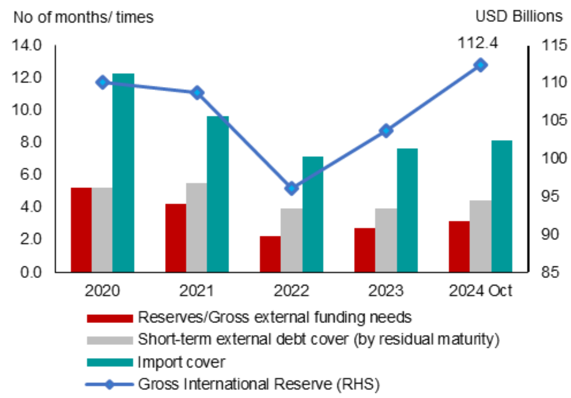
7. The Philippine peso weakened in 2024, while international reserves remained sufficient. As of end-October 2024, the peso had depreciated by 4.6 percent against the U.S. dollar on a year-to-date basis, after a 1.0 percent appreciation in 2023 (Figure 13). The nominal effective exchange rate (NEER) also fell by 3.2 percent on a year-to-date basis, after appreciating by 1.5 percent in 2023.[18] The depreciation was driven by a combination of external factors, mainly broad U.S. dollar strength and geopolitical risks, and market expectation of a policy rate cut by the BSP. The depreciation pressures have diminished since August, when the U.S. Federal Reserves signaled the start of a monetary policy easing cycle. Gross international reserves (GIR) increased from USD103.8 billion at end-2023 to USD112.4 billion as of end-October 2024 (Figure 14), reflecting higher U.S. dollar deposits of the government from its global bond issuance,[19] upward valuation adjustments in the BSP's gold holdings, and net income from the central bank's investments abroad. The GIR is adequate based on international metrics, sufficient to cover 8.1 months' worth of imports and 4.5 times of the country's short-term external debt based on residual maturity.

Figure 13. Exchange Rate Movement



Source: BSP; AMRO staff calculations
Note: The shaded area refers to the exchange rate movement in 2024.

Figure 14. International Reserves

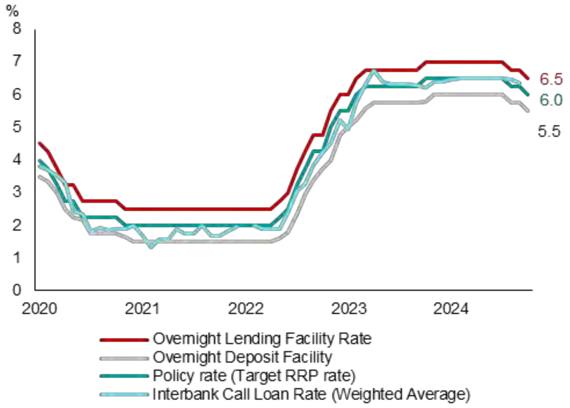


Source: BSP; AMRO staff calculations
Note: Import cover refers to the number of months of average imports of goods and payment of services and primary income.

8. As inflation remained elevated albeit easing, the Monetary Board maintained the policy rate at 6.50 percent in H1 2024 and delivered two 25-basis-point rate cuts since August. A forceful monetary policy tightening during 2022 and 2023 that brought the policy rate to a 17-year high, together with other direct measures under a whole-of-government approach, has helped bring headline inflation back to the BSP's inflation target of 2-4 percent. Hence, after maintaining the policy rate at 6.50 percent through H1 2024, the Monetary Board cut the policy rate by 50 basis points in total during the meetings in August and October (Figures 15, 16). Looking ahead, the central bank forecasts risk-adjusted inflation to reach 3.1 and 3.3 percent in 2024 and 2025, respectively, and expects downside risks to inflation in 2024 from the impact of the lower rice import tariffs that started from July. Therefore, the central bank has signaled that a calibrated shift to a less restrictive monetary policy stance will be appropriate going forward.

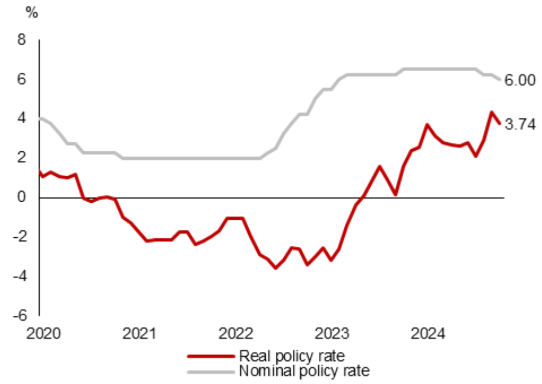
[18] Meanwhile, the real effective exchange rate (REER) fell by 2.72 percent in the first ten months of 2024 after recording a 3.49 percent increase in 2023 due to the high inflation rate in the Philippines compared with its trading partners. Both the NEER and REER series are from the BSP.
[19] The country issued USD2 billion of fixed-rate global bonds in May 2024, including a 10-year bond and a 25-year bond. The 25-year bond was issued under a sustainable finance framework.

Figure 15. BSP Interest Rate Corridor and Short-term Market Rate



Source: BSP

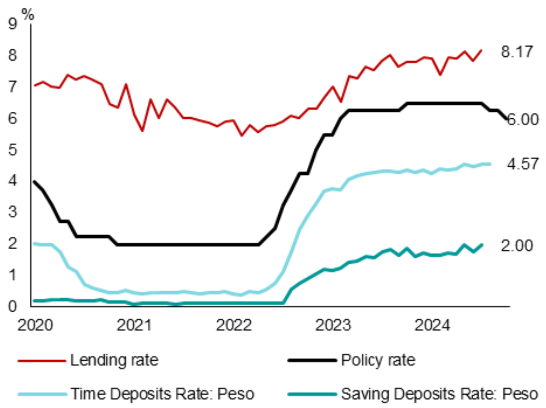
Figure 16. Real and Nominal Policy Rates



Source: BSP; PSA; AMRO staff calculations

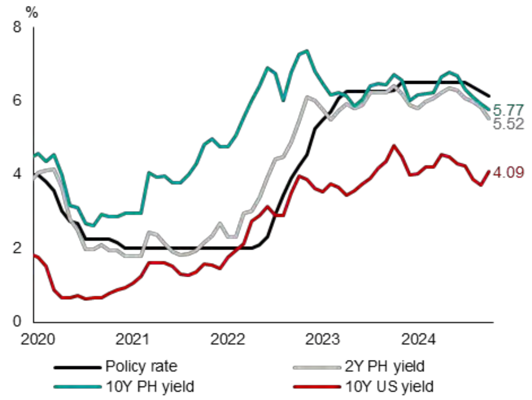
9. **The moderate increase in commercial bank rates reflected lagged transmission from policy rate hikes in previous years, while movements in government bond yields reflected external and domestic factors.** In 2024, the interbank call rate moved in line with the policy rate. As of end-July 2024, commercial bank lending rates, savings deposit rates and term deposit rates rose 22 bps, 28 bps and 18 bps, respectively, compared with 126 bps, 52 bps and 67 bps in 2023 (Figure 17). The Philippine government bond yields at two and 10-year tenors rose 19 bps and 28 bps, respectively, between December 2023 and July 2024, reflecting higher U.S. Treasury bond yields in the first half of the year and expectations of higher government borrowings. However, government bond yields trended down from August onwards, on the back of monetary policy easing in the Philippines and the U.S. (Figure 18). Annex 1 provides further discussions on the degree of monetary policy transmission to bank rates.

Figure 17. Lending and Deposit Rates of Philippine Banking System



Source: BSP; CEIC

Figure 18. Philippine Government Bond Yields

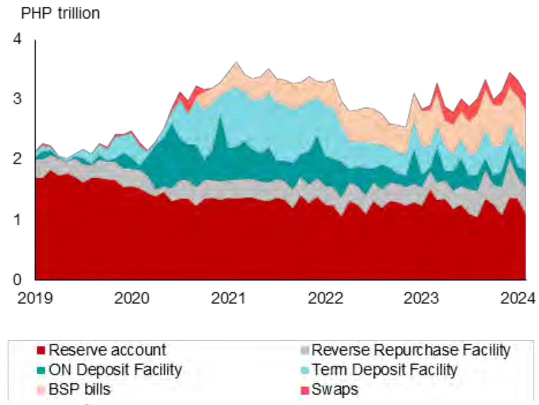


Source: BSP; Haver Analytics

10. **Liquidity in the banking system continues to be ample.** Total outstanding placements in BSP liquidity facilities, comprising a reverse repurchase facility, term deposits, BSP securities and overnight deposits, averaged PHP1.6 trillion in 2023. The amount was more than thrice the average volume of PHP496 billion that the central bank absorbed in 2019 (Figure 19). At such a level, liquidity is ample in the banking system. The BSP has announced a cut in reserve requirement ratio (RRR) from 9.5 percent to 7.0 percent, effective in October 2024, as part of its continuing efforts to reduce distortions in the financial system. The RRR

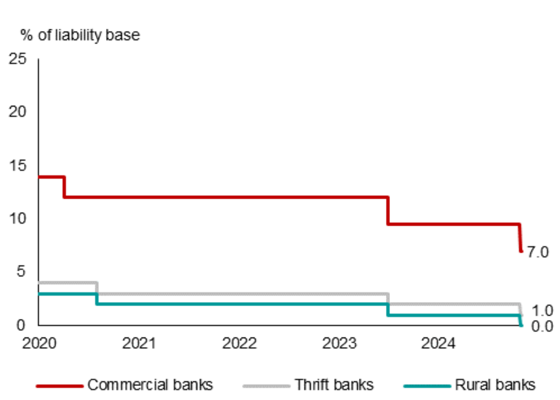
cut will release more liquidity into the banking system (Figure 20) and reduce the cost of funds as required reserves are interest free. The BSP has also indicated an intention to mop up the excess liquidity through a mix of absorption tools.[20]

Figure 19. Outstanding Amount of BSP's Excess Liquidity Absorption



Source: BSP

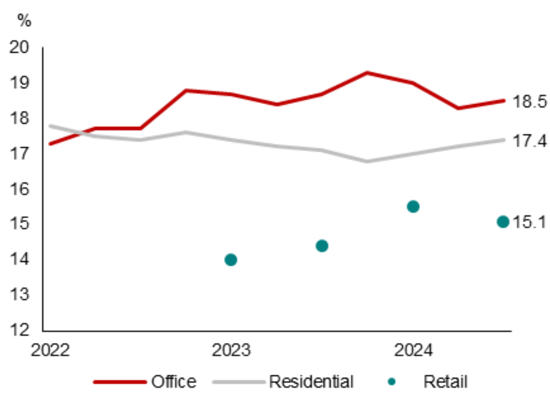
Figure 20. Reserve Requirement Ratio



Source: BSP

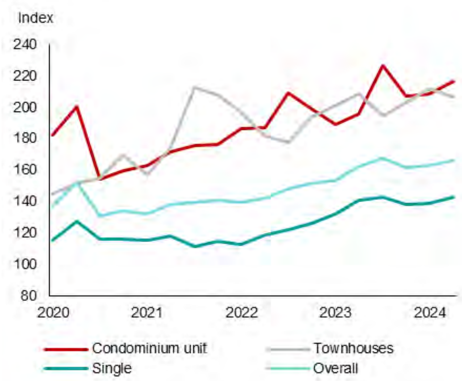
11. Supply overhang in the property sector, particularly in Metro Manila, remains elevated especially in the office market. The office market recorded a vacancy rate of 18.5 percent in Q3 2024,[21] significantly above the pre-pandemic 3-5 percent. The slowdown in office space demand can be attributed to: (i) non-renewal of pre-pandemic leases; (ii) rightsizing of the outsourcing sector including the impact of regulatory developments on two legislations awaiting to be signed in line with work-from-home arrangements and tax issues; and (iii) the total ban on Philippine Offshore Gaming Operator (POGO) activities announced in July 2024 that will lead to the departure of its foreign operators in the near term. For residential properties, the vacancy rate was also elevated at 17.4 percent in Q3 2024 (Figure 21). High mortgage rates continue to weigh on demand, especially in the affordable and middle segments of the housing market. In terms of prices, average office rents declined in 2024 as developers offered discounts to tenants to fill vacancies. Residential prices also moderated, recording a slower annual growth of 2.7 percent in Q2 2024, compared with 14 percent in Q2 2023 (Figure 22).

Figure 21. Property Sector Vacancy Rates



Source: Colliers; CEIC

Figure 22. Residential Property Prices

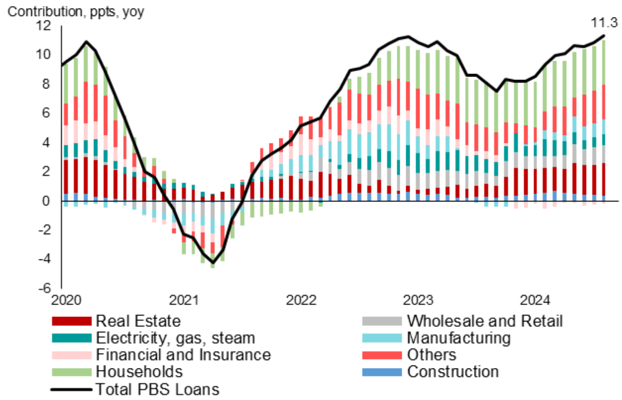


Source: BSP; Haver Analytics

[20] The absorption tools include reverse repurchase agreements (RRPs), issuance of BSP securities, a term deposit facility, foreign exchange swaps and an overnight deposit facility.
[21] According to Colliers data.

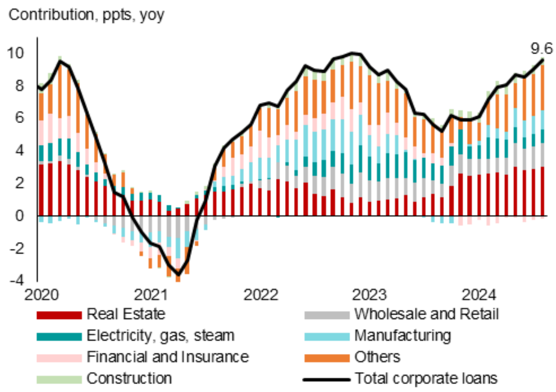
12. Amid high interest rates, total loans in the Philippines' banking system grew at a solid pace, and loan growth in the household segment remained strong. Total bank lending[22] grew at 11.3 percent (yoy) in August 2024, higher than the 8.2 percent in December 2023, led mainly by loans to the real estate, household consumption, and wholesale and retail sectors (Figure 23). Bank lending to residents for production grew at 9.6 percent in August 2024, compared with 5.6 percent in 2023, but remained below the pre-pandemic average[23] of 13.8 percent, attributable to weaker domestic demand and banks' tighter lending standards due to a deterioration in borrowers' profiles and banks' lower risk tolerance (Figure 24). Meanwhile, loans for household consumption (excluding mortgage loans), which are mostly unsecured, increased by 22.0 percent in August 2024 compared with 24.6 percent in December 2023, mainly due to credit card, motor vehicle and other consumer loans. This strong growth in loans for household consumption can be attributed to both strong household spending on credit and banks shifting to consumer lending, given low penetration rates and high interest rates.

Figure 23. Total Philippine Banking System (PBS) Loans by Sectors



Source: BSP; AMRO staff calculations
Note: PBS refers to Philippine banking system.

Figure 24. Contribution of Growth in Bank Lending to Residents for Production



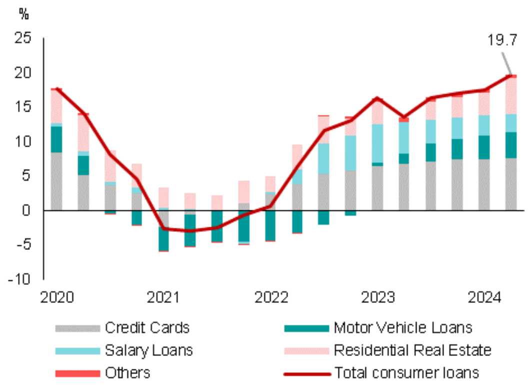
Source: BSP; AMRO staff calculations

13. Strong growth in consumer loans, including mortgage loans, was largely driven by the rapid expansion of unsecured loans. Consumer loans maintained a strong growth rate of 19.7 percent at the end of Q2 2024, compared with 17.0 percent in Q4 2023 (Figure 25). The increase was particularly pronounced in riskier unsecured segments, with credit card loans and salary-based general consumption loans expanding at 28.8 percent and 20.5 percent, respectively. Residential mortgage lending, which at 37 percent accounts for the largest share of total consumer loans, grew by 13.5 percent at the end of Q2 2024 compared with 7.0 percent in Q4 2023. Meanwhile, consumer non-performing loans (NPLs) increased by 11.4 percent (yoy) at the end of Q2 2024, up from 3.2 percent in 2023. NPLs among credit card loans and salary loans grew significantly at 55.2 percent and 45.7 percent, respectively. However, the overall consumer NPL ratio remained stable at 5.8 percent at the end of Q2 2024, supported by strong credit growth. In Q2 2024, the NPL ratios for credit card and salary loans rose to 4.6 percent and 5.9 percent respectively, an uptick from 4.0 percent and 5.1

[22] Total loans outstanding to resident net of the BSP reserve repurchase agreement.
[23] Average yoy growth during 2015 – 2019.

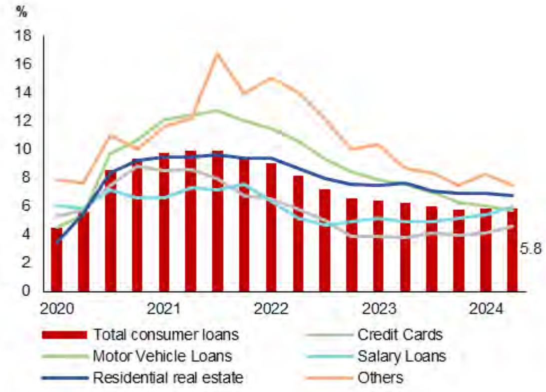
percent in Q4 2023, while the NPL ratio for mortgage loans marginally declined to 6.7 percent from 6.9 percent in Q4 2023 (Figure 26).

Figure 25. Contribution of Consumer Loans



Source: BSP; AMRO staff calculations

Figure 26. Consumer Loans' NPL Ratio by Type



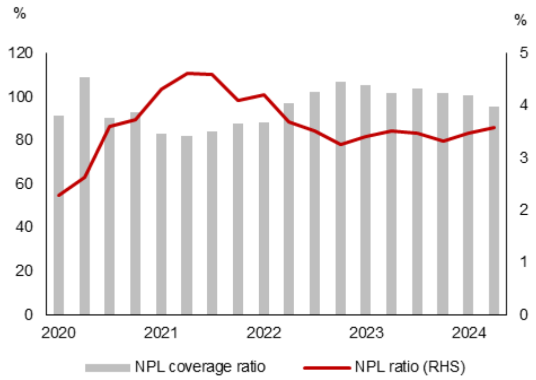
Source: BSP; AMRO staff calculations

14. Despite a slight decline in credit quality, the banking system remains resilient, with ample liquidity, robust profitability and high capital buffers. Liquidity buffers remain adequate, reflected in the high liquidity coverage ratio and net stable funding ratio, both exceeding 100 percent. Meanwhile, the overall NPL ratio went up slightly to 3.7 percent in August 2024 from 3.3 percent at the end of 2023.[24,25] The NPL coverage ratio also declined from 101.7 percent at the end of 2023 to 94.1 percent as of August 2024 (Figure 27). The net interest margin slightly improved to 4.3 percent in Q2 2024 from 4.1 percent at the end of 2023, driven by loan expansion to corporations and households, the repricing of lending rates, and higher returns on investment in securities. Return on assets (ROA) remained stable at around 1.5 percent in Q2 2024, comparable to end-2023 but surpassing pre-pandemic levels, while return on equity (ROE) registered 12.1 percent in Q2 2024, slightly down from 12.3 percent at the end of 2023. As of end-Q2 2024, the banking system was maintaining a capital adequacy ratio (CAR) of 16.1 percent on a solo basis, higher than the BSP's minimum regulatory requirement of 10 percent (Figure 28).

[24] Thrift banks (TBs) and rural and cooperative banks (RCBs) can still use their outstanding loans to micro, small and medium enterprises (MSMEs) and large enterprises (LEs) as alternative compliance with the reserve requirements until such loans are fully paid, but not later than December 31, 2025, subject to conditions. The outstanding MSME and LE loans of TBs and RCBs as of June 2023 that became past due; non-performing loans; and extended, renewed or restructured loans are no longer eligible as alternative compliance with the reserve requirements. Likewise, new MSME and LE loans granted by banks after June 30, 2023, are ineligible as alternative compliance with the reserve requirements.

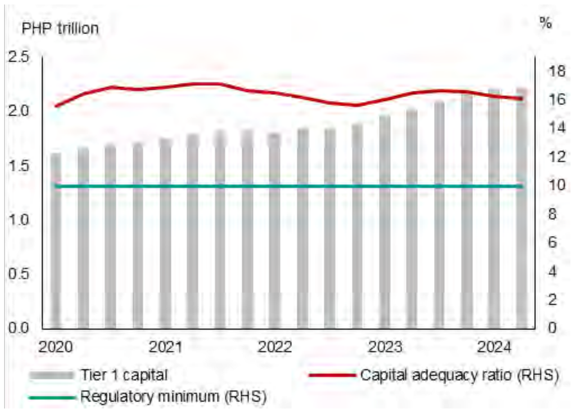
[25] The NPL ratio net of interbank loans (IBLs) varies across different segments of the market and banking groups. The NPL ratio of consumer loans registered 5.8 percent as of Q2 2024, trending down compared with 6.3 percent in Q2 2023. Digital banks exhibited the highest NPL ratio, of 12.1 percent in August 2024, followed by RCBs and TBs, while universal and commercial banks (UKBs) had a lower NPL ratio of 3.4 percent in August 2024.

Figure 27. Banking System NPL Ratio and NPL Coverage Ratio



Source: BSP; AMRO staff calculations

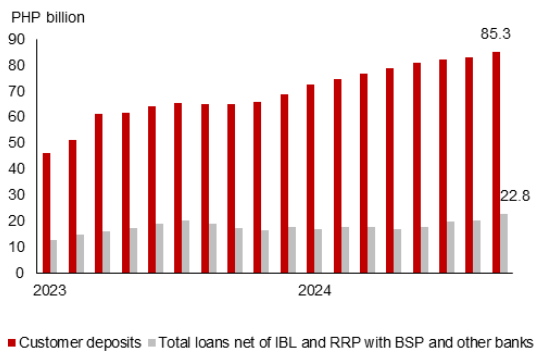
Figure 28. Banking System Capital Adequacy Ratio and Tier-1 Capital



Source: BSP; IMF via Haver Analytics; AMRO staff calculations
Note: Latest available data of tier 1 capital was obtained up to Q1 2024.

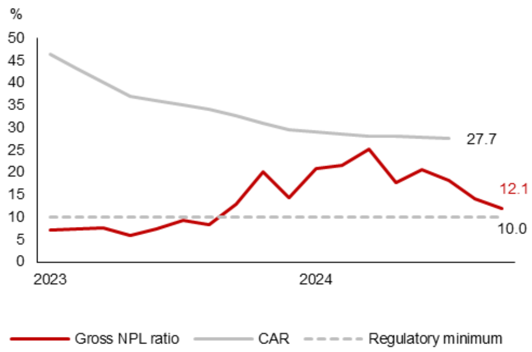
15. Digital banks in the Philippines have shown fast expansion in the past few years, but there is still room for improvement in their operations. As of August 2024, digital banks[26] accounted for 0.4 percent of total assets in the banking system and had expanded their customer deposits by 29.8 percent yoy, while their total credit grew by 12.4 percent yoy (Figure 29). With high exposure to unsecured loans and subdued credit growth, the NPL ratio remained elevated at 12.1 percent in August 2024 despite a slight decline from 14.5 percent at end-2023. As of Q2 2024, digital banks had made losses as reflected in negative ROA and ROE of 7.9 percent and 55.6 percent, respectively. This has put some pressure on capital buffers as the CAR decreased from 29.6 percent in Q4 2023 to 27.7 percent in Q2 2024, albeit still way above the minimum capital requirement (Figure 30).

Figure 29. Digital Bank Customer Deposits and Loans



Source: BSP
Note: IBL refers to interbank loans and RRP refers to reverse repurchase.

Figure 30. NPL Ratio and Capital Position



Source: BSP

[26] The BSP has authorized a total of six digital banks to operate in the Philippines, namely GoTyme Bank Corporation, Maya Bank, Inc., Overseas Filipino Bank, Inc. (a subsidiary of Land Bank), Tonik Digital Bank, Inc., UnionDigital Bank, Inc., and UNObank, Inc. In 2021, the BSP imposed a moratorium on applications for digital banking licenses. It issued a press release to lift the moratorium starting January 1, 2025, and to allow a maximum of 10 digital banks to operate domestically. The country will therefore accommodate four additional licensees that are either new banks or conversions from existing players.

Authorities' View

16. Due to different views on output gap estimates and underlying drivers of inflation, the authorities assessed that the decline in core inflation was attributable to the negative output gap. In addition to easing international commodity prices and direct measures, core goods and services inflation also fell, which contributed to a moderation in headline inflation. The decline in core inflation can be accounted for by limited demand-based inflationary pressure from the negative output gap as estimated by the BSP. Meanwhile, supply-side factors continued to drive inflationary pressure, with more than a third of the headline CPI inflation in October 2024 attributable to rice inflation. The contribution from supply-side factors would be much larger if other volatile food and energy components, such as electricity and fuel costs, were taken on board.

17. On property sector trends, the authorities expect the office space vacancy rate to normalize over the next few years. According to the BSP, traditional firms and those in information technology and business process management (IT-BPM) are expected to take up the slack as POGOs vacate office spaces. In view of this expectation, vacancy rates are projected to decline by 2025 and 2026 with sustained demand from IT-BPM firms.

18. The BSP recognized that digital banks, as start-up companies and new entrants to the banking industry, would encounter challenges in posting profits, especially at the start of their operations. Nonetheless, the BSP's performance review of the six licensed digital banks revealed positive performance, with growth in balance sheets that was primarily supported by strong deposit bases. Moreover, these digital banks contributed to financial inclusion as they could reach broader customer bases through retail deposit products and loans, offering flexibility through alternative credit-scoring models. Additionally, digital banks continue to maintain ample capital buffers to support their operations, with CARs that are significantly higher than minimum regulatory requirements.

A.2 Outlook

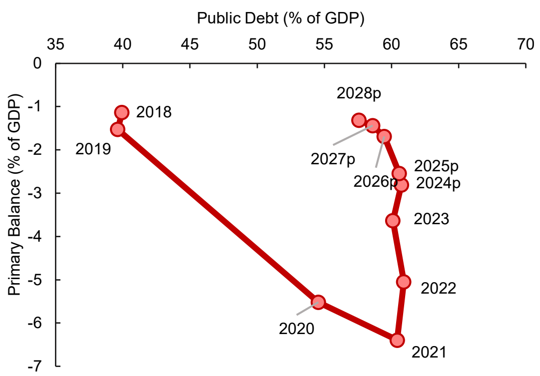
19. GDP growth is expected to improve from 5.5 percent in 2023 to 5.8 percent in 2024, and to accelerate to 6.3 percent in 2025.[27] The upturn in 2024 is based on higher government spending, particularly in infrastructure. Although private consumption showed signs of moderation in the first half of 2024, it picked up in Q3 and is expected to maintain the momentum in Q4, supported by strong labor market conditions, lower inflation and robust overseas remittances. Private investment sentiments also may improve in the monetary policy easing cycle.[28] Meanwhile, strong performance in the exports of IT-BPM, as well as the improving merchandise exports could also support the growth. The S&P Global Philippines Manufacturing Purchasing Managers' Index (PMI) shows that the manufacturing sector has expanded since September 2023.[29]

[27] Correspondingly, the output gap is expected to be positive in 2024 and 2025. The output gap is estimated by using 1-sided Hodrick–Prescott (HP) filter on quarterly GDP data.
[28] According to the BSP's expectation surveys in Q3 2024. Specifically, business confidence in the quarter became more optimistic due to improving demand, easing inflation, and expanding and improving business operations. Meanwhile, consumer sentiment had improved with better labor market conditions.
[29] The Philippine Institute of Supply Management (PISM) PMI showed similar results, but registered a temporary contraction in July 2024 after staying above the 50 no-change mark since August 2023. Meanwhile, the volume of production index for manufacturing showed a 1.0 percent increase in January-September 2024, primarily driven by the manufacture of electrical equipment and coke and refined petroleum products.

20. Inflation is expected to stay broadly within the target range in the second half of 2024 through 2025, benefiting from the continued easing of global commodity prices and government measures. Headline inflation will likely continue to slow down in the second half of 2024 amid lower commodity prices, particularly for food and energy, and tariff cuts on imported rice from July, although upside risks remain, such as wage increases and local food supply shocks. Headline inflation is expected to fall within the inflation target range in 2024 and 2025. Specifically, average inflation is projected to be 3.2 percent in 2024, and maintain at 3.2 percent in 2025. Meanwhile, inflationary pressure will likely remain moderate due to a positive output gap[30] and second-round effects, following increases in minimum wages and persistently high inflation expectations.[31]

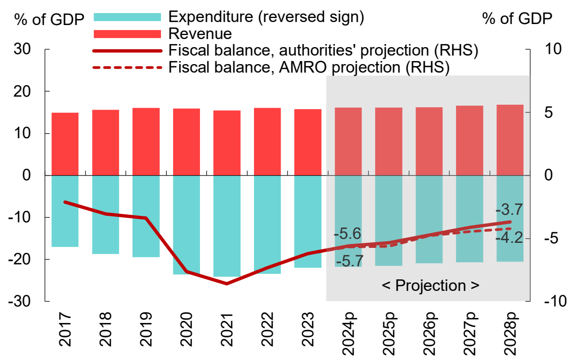
21. The fiscal stances in 2024 and 2025 are expected to be neutral,[32] with a continued reduction in the fiscal deficit. AMRO projects that the fiscal deficit will narrow from 6.2 percent of GDP in 2023 to 5.7 percent in 2024 and 5.6 percent in 2025, supported by robust revenue collection despite higher expenditure. Moving forward, the fiscal balance is expected to gradually decline to 4.2 percent of GDP by 2028. Notwithstanding, according to AMRO's debt sustainability analysis (Appendix 5), public debt is projected to increase slightly from 60.1 percent of GDP in 2023 to 60.7 percent in 2024, due to the government's sustained funding needs and higher debt servicing costs.[33] However, it is expected to gradually decrease to 57.6 percent of GDP in 2028, on account of improved fiscal positions and robust economic growth (Figure 31).

Figure 31. Primary Balance and Government Debt



Source: Bureau of the Treasury; AMRO staff calculations and projections

Figure 32. Fiscal Balance



Source: Bureau of the Treasury; AMRO staff estimates

22. Over the medium term, the government will continue its fiscal consolidation plan, but at a slower pace to better support economic growth. Initially, under a medium-term fiscal framework (MTFF) announced in 2022, the government planned to gradually reduce the fiscal deficit to 3.0 percent of GDP, and to cut government debt to 51.1 percent of GDP, by

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[30] AMRO staff estimates indicate that the output gap will remain positive in 2024 and 2025, bearing in mind that the estimates are subject to a certain degree of uncertainty. However, the narrowing output gap could help maintain headline and core inflation at around 3 percent, in the middle of the target range.

[31] On the second-round effects, wage hikes, such as the 5.7 percent increase in the Manila minimum wage in July, have contributed to inflationary pressures. Both businesses and consumers had expected that inflation would be persistently higher than the target range, although inflation expectations have since eased. Meanwhile, the BSP and market economists have forecasted a lower inflation rate in 2024. According to the BSP's expectation surveys in Q3 2024, businesses projected the inflation rate in the next 12 months to average 4.4 percent, whereas the average consumers' expectation was 5.9 percent.

[32] AMRO evaluates the fiscal stance primarily based on the fiscal impulse, measured by changes in the structural primary balance, and also considers the change in primary expenditure as a percentage of GDP as a supplementary measure.

[33] In contrast, financing needs in 2023, which were elevated by the primary deficit, were partially offset through redemptions by the Bond Sinking Fund (BSF) and real GDP growth. This allowed the government to lower its bond issuances to about PHP2.6 trillion in 2023 from PHP3.0 trillion in 2022, with public debt declining to 60.1 percent of GDP in 2023 from 60.9 percent in 2022.

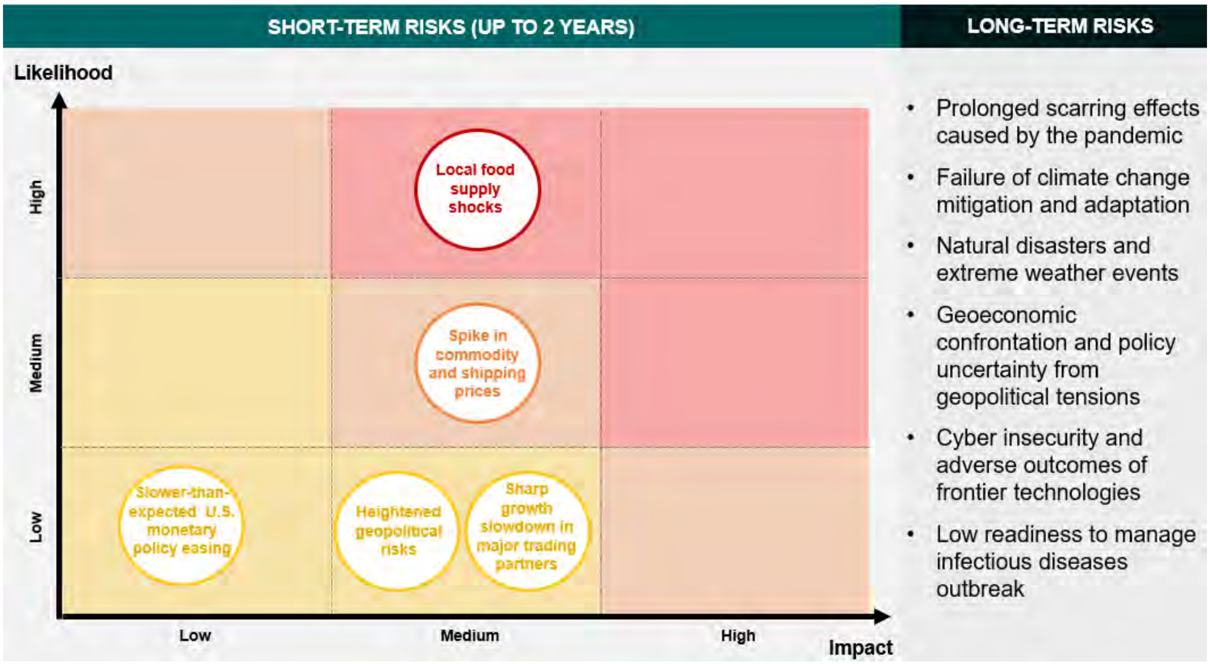
2028. However, in March and June 2024, the Development Budget Coordination Committee (DBCC) recalibrated the government's medium-term fiscal program, signaling a slower pace of consolidation. These adjustments are reflected in the Budget of Expenditures and Sources of Financing (BESF) 2025, released in July 2024, under which the government now plans to gradually reduce the fiscal deficit from 5.6 percent of GDP in 2024 to 3.7 percent in 2028 (Figure 32), and to cut government debt from 60.6 percent of GDP in 2024 to 56.3 percent by 2028. The slower pace of consolidation is based on the lower but more realistic GDP growth target of 6.0 – 7.0 percent in 2024 and on more attainable revenue growth assumptions, while higher levels of expenditure are projected to better support economic growth.

Authorities' Views

23. The authorities broadly agreed with AMRO's assessment of the growth and inflation outlook, despite holding different views on output gap estimates. According to the BSP's forecast, inflation is expected to hover within the target range from 2024 to 2026. The output gap turned negative in 2024 due to tightened financial conditions and is expected to remain so until 2025. With regard to inflationary expectations, the results of an external forecasters survey in October 2024 suggested that analysts expected inflation to stay at 3.4 percent, within the target range, over the policy horizon for the full year of 2024. Risks are broadly balanced with a view that local inflation will likely trend lower in the rest of the year. Mean inflation forecasts for 2025 and 2026 are slightly lower at 3.0 and 3.2 percent, respectively.

B. Risks, Vulnerabilities and Challenges

Risk Map: The Philippines



Source: AMRO staff compilation

B.1 Short to Medium-term Risks

24. Philippine growth prospects, particularly private consumption, are clouded by the risk of high food inflation. Specifically, high food prices have already dampened growth in households' real consumption of food, but households still had to spend more on food in nominal terms due to higher prices.[34] Higher costs of basic needs would further reduce households' ability to afford discretionary items and hence constrain household consumption. The upside risks of high inflation could increase if there were to be a sharp depreciation of the peso caused by external shocks. Domestic food prices could also surge because of local supply disruptions caused by typhoons, flooding and other natural disasters, which could be exacerbated by the impending La Niña phenomenon.[35]

25. The Philippine economy could be derailed by a sharp slowdown in major trading partners in the near term. According to AMRO's estimate of import-adjusted GDP, after netting out imports from each expenditure component, exports make up a significant component that drives overall growth – with value-added exports contributing 1.7 percentage points out of the 2023 growth of 5.5 percent, following private consumption' contribution of 3.0 percentage points.[36] Therefore, a slowdown in major trading partners, such as the U.S., Europe, and China, could pose negative spillovers to the Philippine economy through their impacts on merchandise and services trade, tourist arrivals, overseas remittances, and foreign investment inflows.

26. Heightened geopolitical risks could bring both short-term and long-term challenges to the Philippines. In the near term, further escalation of disputes between the Philippines and China in the West Philippine Sea (South China Sea) could reduce trade, investment, and tourist arrivals from China. Meanwhile, a worsening of geopolitical tensions in other regions, such as Ukraine and the Middle East, could raise the risk of global supply shocks, like sharp spikes in commodity prices and shipping costs, and cause another round of upward pressures on inflation. Over the longer term, the persistent and intensified geopolitical tensions between China and the U.S. could lead to global economic fragmentation, causing substantial uncertainties and eroding market sentiments, which would adversely affect foreign investments in the region. Nevertheless, the Philippines' closer ties with the U.S. and other advanced economies may bring opportunities in terms of higher trade and FDIs.

27. A slower-than-expected monetary policy easing in the U.S. compared to market expectations can trigger a peso depreciation and an increase in Philippine government bond yields. Even though the Federal Reserves already started cutting the federal funds rate in September, there remain uncertainties in the pace of further easing for the rest of this year and into 2025. As a result, the pace of U.S. monetary policy easing still warrants close

[34] In the first three quarters of 2024, household consumption of food and non-alcoholic beverages rose by 6.3 percent in nominal terms, but registered only 1.3 percent growth in real terms, continuing the situation of large difference between nominal and real growth in 2023, when nominal growth for the whole year of 2023 was 8.2 percent and real growth, 0.5 percent. This reflects that the high food inflation has dampened household consumption of food, spending more in nominal value while consuming the same amount as before.
[35] The authorities have forecast a 71 percent chance of a La Niña forming from September to November (PAGASA ENSO Alert System Status). A World Bank study suggested that La Niña contributed slight economic benefits to agriculture (Sutton, W. R., Srivastava, J. P., Rosegrant, M. W., Valmonte-Santos, R., and Ashwill, M., 2019. Striking a balance: Managing El Niño and La Niña in Philippines' agriculture. Washington, DC: World Bank.). However, the authorities expected the 2024-25 La Niña to prolong the drought season in 2024 (Philippine News Agency, 2024. La Niña to prolong drought; 13 to 16 typhoons to hit PH in Q4) and bring more typhoons to the country by the end of the year toward early 2025 (SunStar, 2024. PH to experience more tropical storms due to La Niña).
[36] Using conventional calculations,net exports contributed nearly zero percent to Philippine GDP in 2023. However, the share of the external sector in the Philippines is not as large as other economies in the region. The Philippines' share of exports to import-adjusted GDP was 25.1 percent in 2023, lower than Singapore (64.9 percent), Vietnam (53.1 percent), Malaysia (38.8 percent) and Thailand (38.7 percent), and similar to Indonesia (22.6 percent).

monitoring, as a slower-than-expected pace can trigger renewed peso depreciations. Although a weaker peso would benefit earners of foreign income such as overseas Filipino workers (OFWs) and exporters, and the Philippines faces limited risk from external debt, large depreciations can exert upward pressures on the prices of imported goods. Higher import prices can cause significant burdens on importers and manufacturers, and potentially consumers if the higher prices are passed on (Box B provides the latest AMRO estimates of exchange rate pass-through).[37] Moreover, slower U.S. monetary policy easing can contribute to an increase in the Philippine government bond yields, which are highly correlated with U.S. Treasury yields. This will raise the government's funding costs.

B.2 Longer-term Challenges and Vulnerabilities

28. Long-term potential growth could be constrained by prolonged scarring effects caused by the pandemic. A slow labor force upgrade, lower labor productivity due to low-quality jobs,[38] and a muted recovery in private investment stemming from weaker balance sheets, are the major scarring effects in the Philippines. These conditions have lowered the potential growth rate (Annex 2 gives a detailed analysis of the scarring effects).[39] An upgrade to a digital economy could lift its growth potential. However, this requires labor skill and productivity upgrades, as well as more investments. For instance, the IT-BPM industry, as the leading service-exporting sector in the country, has a shortage of skilled labor. With the increasing use of artificial intelligence (AI), the Philippines' comparative advantage in IT-BPM could be quickly eroded if the industry cannot keep pace with the technological developments due to its failure in attracting further investment and upskilling the labor force.

29. Insufficient infrastructure investment is a drag on Philippine growth potential.[40] Without sufficient infrastructure investment, the country's competitiveness will be hampered. Infrastructure investment and capital stock declined in the previous two decades before an uptick in the late 2010s. Together with low investment efficiency, this has led to low infrastructure quality in the country. Compared with peer middle-income country groups, Philippine transport infrastructure, especially road infrastructure, is identified as the weakest area.[41] The lack of development in this aspect has constrained post-COVID recovery in tourism and FDI. Inadequate transport infrastructure development restricts connectivity for the flow of tourists and goods, which will continue to lower growth potential in tourism and manufacturing export sectors.

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[37] The Asian Development Bank Institute (ADBI) has found that a 1 percent peso NEER depreciation over a month leads to a 0.7 percentage point increase in PPI after one year. However, the pass-through to CPI is lower at 0.06 percentage point (Beirne, J., N. Renzhi, and P. Panthi, 2023. "Exchange Rate Pass-Through in Emerging Asia and Exposure to External Shocks." ADBI Working Paper 1379. Tokyo: ADBI). Separately, a BSP study has found that a 1 percent peso depreciation against the U.S. dollar over a quarter causes a 0.06 percentage point increase in CPI inflation in the long term, defined as around one year (BSP, 2022. "An Updated Estimate of the Exchange Rate Pass-Through to Domestic Prices in the Philippines." Monetary Policy Report – November 2022, BSP). AMRO has found that, by updating the same model specification in BSP (2022) using data up to Q2 2024, a 1 percent peso depreciation causes a 0.1 percentage point increase in CPI inflation in the long term.

[38] The job quality deterioration, partly reflecting lower labor productivity, could be explained by an unwanted structural shift in the labor market. For example, agriculture saw a return to low-productivity pursuits. See Esguerra, E. and Jandoc, K., (2023). "Labor Productivity, Structural Change, and COVID-19," Labor market implications of the COVID-19 pandemic in the Philippines, Canlas, Dante B. (ed.), Malate, Manila, Philippines: BSP.

[39] Pandemic scarring is estimated to have lowered the Philippines' trend growth from 6.2 percent to about 6.0 percent. The trend growth is based on the estimated trend from 1998 to 2019 (6.2 percent), and from 1998 to 2023 (about 6.0 percent). Similarly, the World Bank estimates that the pandemic could lower the Philippines' long-term growth potential from above 6.0 percent pre-pandemic to an average of 5.7 percent in 2020-2029.

[40] See Nam, B., 2023. Infrastructure Investment in the Philippines: Challenges and Policy Considerations, AMRO's 2023 Annual Consultation Report on the Philippines.

[41] The assessment is based on the Global Competitiveness Index 2019, published by the World Economic Forum. According to the World Competitiveness Report 2024 published by the Institute of Management Development (IMD), the Philippines ranked below 55th in various infrastructure aspects among 67 economies.

30. With its geographic location which makes it highly exposed to natural disasters relative to the rest of the world,[42] the Philippines is very vulnerable to the threats of extreme weather and climate change. Huge long-term social and economic costs could result from the physical damage and losses caused by climate change, such as more severe damage inflicted by typhoons, floods and rising sea levels.[43] Without timely and sufficient adaptation measures to mitigate the physical impacts of climate change, the growing costs of such damage could become a major burden on fiscal resources, a drag on growth, and pose risks to the financial stability of the Philippines. In addition, transition risks need to be addressed to avoid or minimize losses in carbon-intensive energy sectors, such as utilities, transport and industries, and in carbon-intensive productive assets.[44]

C. Policy Discussions and Recommendations

C.1 Calibrating Macroeconomic Policy to Rebuild Policy Buffer

31. The current fiscal-monetary policy mix is appropriate and can be adjusted further to support economic growth while rebuilding policy buffers. Easing inflationary pressures provides room to gradually cut the policy rate closer to a neutral level and make the monetary policy stance less restrictive. Meanwhile, the positive output gap[45] provides a window of opportunity for fiscal normalization, where fiscal policy space can be rebuilt.

- **From a fiscal perspective, given the elevated debt post-pandemic, fiscal consolidation could be accelerated to restore policy space if conditions allow**. In particular, while prioritizing the need for infrastructure spending to enhance long-term growth potential, the authorities could restore fiscal space by reducing the fiscal deficit when feasible, to ensure fiscal sustainability and prepare for unforeseen risks amid elevated uncertainty.
- **With inflation hovering in the upper half of the target band, a restrictive monetary policy stance is appropriate,** but there is room to dial back some tightness in light of easing inflationary pressure. Forceful monetary policy tightening during 2022-2023 has raised the real interest rate to an exceptionally tight level compared with the neutral rate.[46] As year-to-date inflation has returned to the upper half of the target range, the BSP has room to gradually adjust the policy rate to a moderately restrictive stance. This will lend some support to private investment and allow the BSP to rebuild space for renewed policy rate hikes if inflationary risks were to reemerge.

[42] The World Risk Report 2024 ranks the Philippines as the country most prone to disaster risks. The high disaster risk is associated with very high exposure, vulnerability and susceptibility and a severe lack of coping capacities, which are mainly due to cyclical extreme events such as typhoons. See Bündnis Entwicklung Hilft and the Institute for International Law of Peace and Armed Conflict (IFHV), 2024. World Risk Report 2024 – Disaster Risk and Diversity. Berlin: Bündnis Entwicklung Hilft. Separately, the United Nations' Index for Risk Management (INFORM) ranks the Philippines as having the world's 28th highest risk of climate change. In addition, the Notre Dame Global Adaptation Initiative (ND-GAIN) 2022 ranked the Philippines as the 79th most vulnerable country (or the 109th least vulnerable country out of 187 nations) and the 131st most ready country out of 192 nations. The Philippines' high exposure and vulnerability to extreme weather and climate change due to its geographic location affected its ND-GAIN vulnerability index. The country's location within the so-called typhoon belt puts it among the countries most frequently hit by cyclones. Each year, 19 to 20 cyclones enter the Philippine Area of Responsibility, and seven to nine of these storms typically make landfall. The ND-GAIN concluded that the high vulnerability and low readiness scores of the Philippines signaled both a great need for investment and innovations to improve readiness and a great urgency for action.

[43] For example, from 2003 to 2022, losses and damage incurred by disasters amounted to PHP702.96 billion (USD12.89 billion), of which about 96 percent arose from climate-related hazards. According to the World Bank Country Climate and Development Report 2022, climate-related hazards can cause losses of 3.2 to 7.6 percent of GDP per year by 2030, and between 5.7 and 13.6 percent by 2040.

[44] However, there is less concern for transition risk and climate change mitigation due to the Philippines' relatively low emissions, comprising 0.48 percent of global emissions in 2023 (Emissions Database for Global Atmospheric Research Community GHG Database, 2024).

[45] Based on AMRO staff estimates, the current output gap is about 2.3 percent, subject to estimation uncertainties.

[46] AMRO estimates that real interest in the Philippines has surpassed the neutral rate (r-star) since Q3 2023, and in Q2 2024 the real interest rate remained at one of the tightest levels compared with the past four hiking cycles since 2010. Similarly, the BSP estimates the nominal neutral rate at 4.6 percent, confirming that the current policy rate is tight.

- **The authorities should continue to use a whole-of-government approach to address inflation as supply-side risks remain.** In particular, in response to food price shocks, supply-side measures such as the reduction in rice and other food tariffs,[47] and fuel subsidies to affected groups like farmers and public transport drivers, could play a crucial role in containing the pass-through and mitigating the impact of supply shocks on inflation.

32. The authorities should stand ready to support the economy if significant downside risks to growth materialize. The authorities' data-dependent approach to the formation of economic policy is welcomed in the current environment of heightened uncertainty. Should significant downside risks to growth materialize, triggering a marked deterioration in the growth outlook, the BSP could cut the policy rate to a less restrictive stance in support of economic growth. The moderate fiscal space[48] available also provides some room for fiscal policy to mitigate the risks and support the economy.

33. The exchange rate should continue to be determined by the market. The peso may continue to experience high volatility amid uncertainties over monetary policy decisions both at home and abroad, the global growth outlook, and geopolitical concerns. Against this backdrop, the peso should continue to be determined by the market and serve as a shock absorber for the economy. Judicious foreign exchange interventions should be employed from time to time to address excessive volatility.

Authorities' Views

34. The authorities broadly agreed with AMRO's recommendations on policy directions, notwithstanding differences in assessments of the current policy stance. On the monetary policy front, while AMRO was of the view that the current real interest rate was exceptionally tight compared with the neutral rate, the BSP assessed that its monetary policy stance was tight but not exceptionally tight. The assessments differed due to different estimates of the neutral interest rate, which is subject to a high degree of uncertainties. With regard to the whole-of-government approach, the authorities have proposed an extension of the Rice Competitiveness Enhancement Fund (RCEF) until 2031. The proposal was made as part of ongoing deliberations on the amendment of the Rice Tariffication Law (RTL) to enhance local rice production and address the needs of rice farmers.[49]

C.2 Accelerating the Pace of Fiscal Consolidation

35. While AMRO acknowledges the need for strategic adjustments in medium-term fiscal policy, it remains prudent to accelerate fiscal consolidation if conditions permit. Revisions to the fiscal projections contained in the Medium-Term Fiscal Program (MTFP) in 2024 have led to a slower pace of consolidation, which will provide room for increased spending on infrastructure investment to enhance support long-term growth. However,

[47] Under the whole-of-government approach, the authorities established the Inter-agency Committee on Inflation and Market Outlook (IAC-IMO), through Executive Order (EO) No. 28, series of 2023, to closely monitor food and non-food inflation drivers and provide timely policy advice, such as changes in import tariffs to curb inflation. See NEDA (2023), National Economic and Development Authority Year-End Press Chat.

[48] The assessment of moderate fiscal space is based on the AMRO Policy Perspectives Paper, ASEAN+3 Fiscal Policy Report 2024: Transitioning to Fiscal Normality.

[49] The Bicameral Conference Committee Report or the reconciled version of Senate Bill (SB) No. 2779 and House Bill (HB) No. 10381 was ratified by the Senate and the House of Representatives on September 25, 2024 but still needs to be enrolled. The proposed RCEF annual allocation of the joint Bicameral Report was PHP 30 billion, from the current allocation of PHP 10 billion. It was also proposed for the RCEF to be extended until 2031.

restoring fiscal space is critical to ensure fiscal sustainability and prepare for unforeseen risks amid elevated uncertainty. It can be accelerated by continuing to enhance revenue mobilization and improve spending efficiency. If higher revenue is achieved due to better-than-expected economic growth, the authorities should consider using the additional revenue to speed up fiscal consolidation. Meanwhile, the authorities' frequent revisions of the fiscal projections may hinder the establishment of a consistent and credible public debt management strategy, while undermining investor confidence. Therefore, it is worth noting that disciplined fiscal management is vital for maintaining macro-fiscal stability and improving credibility in the markets. In this context, it is worth considering the establishment of legally binding fiscal rules[50] with resilience and flexibility against shocks through escape clauses or other designs, to safeguard fiscal discipline in the long run.

36. More revenue mobilization is crucial to ensure fiscal sustainability. The Philippines still has room to improve revenue collection, judging by taxation efforts and value-added tax (VAT) C-efficiency.[51] In this regard, AMRO welcomes the authorities' proposed tax reforms, such as VAT on nonresident digital service providers (DSPs),[52] a revision to the mining tax regime,[53] a motor vehicle user's charge (MVUC)[54] and a tax on single-use plastic bags.[55] Timely approval and implementation of these reforms would help achieve the revenue target, as shown in the FY2025 budget proposal (Figure 33), which projects a robust growth rate in the next three years. In addition, various measures supporting revenue mobilization could be considered.

- Additional revenue-generating measures, such as broadening the tax base through fiscal digitalization, and further improvements to personal and corporate income tax would be welcomed.
- Periodic reviews of tax incentives,[56] along with systematic monitoring and transparent assessment, are required to limit excessive generosity of incentives and ensure the tax incentive system aligns with developments in the economic and policy environment.
- Additionally, the passage of the Ease of Paying Taxes Act is a positive step, while efforts to improve tax administration and tackle implementation challenges should continue, especially by further digitalizing and harmonizing the tax collection systems.

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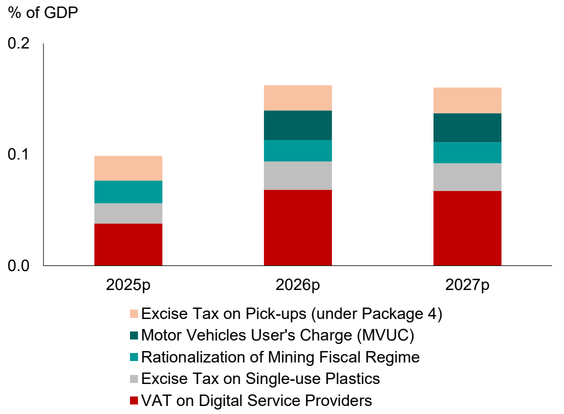
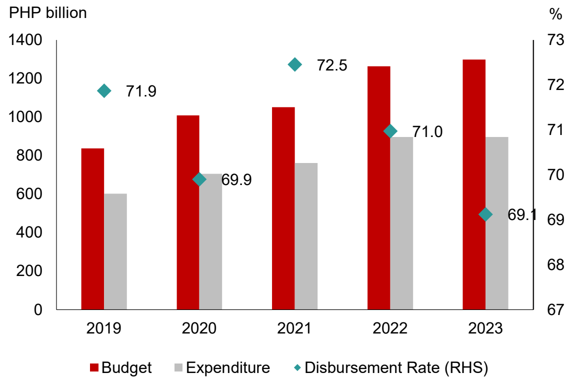
[50] Fiscal rules can be established in various forms – public debt rules, budget balance rules, expenditure rules, or a combination of these rules. See ASEAN+3 Fiscal Policy Report 2024 (Box D)
[51] According to the WoRLD database, the Philippines' VAT C-efficiency was 39 percent in 2021, lower than the pre-pandemic 42 percent.
[52] The VAT on Digital Services or Republic Act (RA) No. 12023 was signed into law on October 2, 2024 to clarify 12 percent VAT on nonresident digital services consumed in the Philippines. The government clarified that this measure would not impose a new tax but merely clarify the imposition of 12 percent VAT is also applied to non-resident digital services providers to ensure the fairness between local and foreign digital services providers while expanding the VAT base. The government has estimated that tax revenue could increase by 0.07 percent of GDP.
[53] This reform aims to impose a four-tier, margin-based royalty ranging from 1.5 percent to 5 percent on income derived from mining operations outside of mineral reservations, and to levy a windfall profit tax of 1.5 percent to 10 percent based on profit margins. The IMF has estimated that tax revenue could increase by 0.05 percent of GDP. This proposal is pending in the Senate.
[54] The MVUC, otherwise known as the road user tax, is a charge imposed through vehicle registration fees and penalties for overloading. For example, passenger cars of up to 1,600 kg in gross vehicle weight must pay PHP2,080 in 2024, PHP2,560 in 2025, and PHP3,040 in 2026; from 2027 onwards, the increase would be 5 percent annually. The IMF has estimated that tax revenue could increase by 0.05 percent of GDP. This proposal is pending in the Senate.
[55] A fee of PHP100 would be levied on firms for every kilogram of single-use plastics that they produce or import, and it would rise by 4 percent annually starting in 2026. The government has estimated that tax revenue could increase by 0.01 percent of GDP in the first year, and by 0.04 percent of GDP in the fifth year. This proposal is pending in the Senate.
[56] The total size of investment tax expenditure is 2.5-3.0 percent of GDP. The Philippines has implemented tax exemption, tax rate reduction and trade tax reduction. Among these measures, import VAT exemption contributes around two-thirds of total tax expenditure. In terms of sector, tax incentives are concentrated in manufacturing (70 percent), followed by services (21 percent). See https://www.amro-asia.org/wp-content/uploads/2021/10/Policy-Considerations-in-Using-Tax-Incentives-for-Foreign-Investment-1.pdf.

Figure 33. Impact of Tax Reform Measures



Source: Department of Budget and Management; AMRO staff estimates

Figure 34. LGU Budget, Expenditures, and Disbursement Rate



Source: Bureau of Local Government Finance (BLGF) via Department of Finance (DOF)
Note: Disbursement rate means total expenditures over total budget.

37. Reallocating resources to align with government priorities is crucial for improving spending efficiency and economic growth. It is commendable that the authorities are ensuring adequate spending on infrastructure, which will enhance the country's growth potential going forward. The authorities should continue selecting projects based on rigorous cost-benefit analysis and conduct proactive monitoring and regular reviews during the management stage, to ensure that the pace of infrastructure investment aligns with the government's capabilities and economic needs. Meanwhile, as LGUs now enjoy a larger share of tax revenue following the Mandanas-Garcia Supreme Court Ruling,[57] timely and targeted capacity building could enhance their effective use of funds (Figure 34). The national government's roles in steering and coordination should be enhanced,[58] and performance-based budgeting and fiscal discipline for LGUs could be introduced to ensure their expenditures align with national goals and to address the issue of LGUs' persistent underspending.[59] Furthermore, reviewing the current formula for LGUs' shares of the National Tax Allocation (NTA) to base it on more recent tax revenue, rather than the three-year lag currently used, could help stabilize fiscal resources for the national government's priorities, especially given the need for fiscal consolidation or, when necessary, countercyclical policy. Such rebasing may require legal amendments.

38. Long-term fiscal sustainability should be ensured by remaining vigilant to potential fiscal risks and continuing fiscal reforms. It is crucial to ensure that contingent liabilities to the government during the implementation of public-private partnership (PPP) projects are assessed, monitored and managed by key stakeholders such as the Department of Finance (DOF), National Economic and Development Authority (NEDA) or PPP Center, as they may pose hidden long-term fiscal risks to the national government.[60] The proposed reform plan for the Military and Uniformed Personnel (MUP) pension scheme based on bills currently being

[57] The ruling said that starting 2022, the base from which LGUs' shares of the NTA were determined would be based on all national taxes, rather than national internal revenue taxes only.
[58] The Public Financial Management (PFM) Reforms Roadmap 2024-2028, presented to the President by the PFM Committee on September 17, 2024, may serve an important role to transform how public funds are managed, ensuring greater accountability, efficiency and transparency in the allocation and use of resources across government agencies.
[59] LGUs' budget usage has ranged from 74 percent to 77 percent in the past five years. As a result, LGUs have accumulated a budget surplus on average as they receive allocations from the national government and collect local taxes, such as real estate and business taxes. LGUs have retained all the surpluses for use later.
[60] Currently, for the national projects, several frameworks were used to implement PPP projects without oversight from DOF, NEDA, nor PPPC. For local government projects, LGUs have the autonomy to implement their own PPPs. The LGUs would only have to secure approval for local PPPs if they would require undertakings from the NG.

deliberated in Congress[61], which applies only to new entrants, provides limited relief from the potential fiscal burden. Further reforms or discussions are warranted to address concerns about growing fiscal spending. Pension reforms under the Social Security System (SSS) and Government Service Insurance System (GSIS) should also be reviewed periodically. Such review includes verifying that the actuarial valuations of these schemes are conducted in line with the latest regulatory standards and industry best practices, and ensuring that the pension liabilities are sufficiently funded.

Authorities' Views

39. The authorities view the Medium-Term Fiscal Framework (MTFF) as a guiding tool for fiscal policy. The MTFF was adopted by Congress and is subject to review and/or updating every three years. Meanwhile, the Medium-Term Fiscal Program (MTFP) serves as the operating mechanism of the MTFF. It contains fiscal projections based on approved macroeconomic parameters and growth targets and is regularly updated to account for developments in the macro-fiscal environment. While the fiscal projections might differ in nominal values for every update, they consistently align with the MTFF targets. Moreover, the country's fiscal discipline is enforced by market mechanisms. If the government were to exceed deficit targets, the market would penalize it by widening credit spreads, which would serve as a deterrent to irresponsible spending. Not enforcing strict fiscal rules reflects the country's aim of providing flexibility, given changing market and economic conditions.

C.3 Safeguarding Financial Stability and Developing Financial Markets

40. AMRO commends the BSP's efforts in enhancing its macroprudential monitoring framework along with the implementation of prudential instruments to safeguard financial stability. The BSP has used a set of tools to assess financial stability, including market sentiment models as part of its intertemporal analysis of macro-financial risks.[62] To limit banks' exposure to concentration risk, the BSP has issued a Framework for Large Exposures Monitoring Threshold, which imposes a threshold of 25 percent in tier 1 capital on all universal and commercial banks (UKBs) and their subsidiary banks as well as quasi-banks on both solo and consolidated bases. This measure aims to identify, monitor, and control large exposures to protect these entities' solvency from maximum possible losses in the event of sudden counterparty failure. Amid the economic recovery, the BSP also lowered the single-borrower limit from 30 percent to 25 percent in December 2023 to contain potential concentration risks in the banking sector.

41. While overall financial stability remains sound, signs of vulnerabilities are present in certain areas, which warrant close monitoring. With the overall NPL ratio still above pre-pandemic levels, asset quality should be keenly watched, while sufficient buffers should continue to be maintained to safeguard the soundness of the banking system. In particular, rapid growth in consumer lending, which may be viewed favorably from the financial access angle, may need close attention as a rise in the NPL ratio, especially in the unsecured segment,

[61] HB No. 8969, entitled *Military and Uniformed Personnel Pension System Act*, was approved on final reading in the House of Representatives on September 26, 2023. The counterpart bill in Senate, SB No. 2501, entitled *An Act Providing New Separation, Retirement and Pension System for the Military and the Uniformed Personnel*, is pending second reading.
[62] A market sentiment model is developed to help analyze changing investment behavior driven by shifting perceptions and tolerance of risks in the bonds and equities markets. Investors' heightened risk perception coupled with low risk tolerance could prompt global investors to retreat from investments, such as those in emerging markets, perceived to be of higher risk.

could signal a deterioration in households' debt serviceability.[63] At the same time, supply overhang in the real estate sector remains elevated, while loans to real estate sector account for 20.3 percent of total credit. Therefore, maintaining vigilance over banks' exposure to the real estate sector and leveraged companies is warranted because policy actions may be needed to mitigate potential risks.[64]

42. In the medium term, the BSP should consider more active use of macroprudential toolkits to help address potential financial stability issues, should they emerge. A broad-based macroprudential tool including a countercyclical capital buffer (CCyB) is in place, but it is set at zero (0 percent). If a less restrictive monetary policy gives rise to excessive overall credit growth, the BSP should be ready to recalibrate the CCyB to reflect its risk-based considerations to preserve banking-sector resilience and build policy buffers, which can be used in the event of adverse shocks. A more sector-specific macroprudential tool, such as the debt service ratio (DSR), could be considered to address potential risks arising from greater household debt. The implementation of such a policy would require comprehensive and granular information on borrowers, which highlights the importance of credit data availability to support policy formulation and decisions.[65]

43. The institutional framework that safeguards financial stability should continue to be enhanced, including the surveillance of non-financial and financial conglomerates, the bank resolution framework and credit data availability.

- **AMRO supports the commitment of the Financial Stability Coordination Council (FSCC) and the Financial Sector Forum (FSF) to strengthening the supervision of financial conglomerates.** However, given that both financial and non-financial corporates are integral parts of conglomerates, close collaboration and information sharing among agencies is crucial in the surveillance of conglomerates to enable a more comprehensive assessment of systemic risks and interconnectedness across different players and sectors.
- **The establishment of a technical working group to carry out groundwork for the development and operationalization of the resolution framework is welcomed.** Strengthened collaboration between the BSP and Philippine Deposit Insurance Corporation (PDIC) would also be important to ensure timely and orderly resolution in case of a bank failure.
- **To enable a more thorough credit risk assessment, the authorities should strengthen and streamline the credit data system, especially for households and SMEs.** High-quality credit data is crucial to the assessment of new borrowers' creditworthiness, and thus it is instrumental to achieving the right balance between financial inclusion and financial stability. The Credit Information Corporation collects and disseminates credit data from both bank and non-bank lenders, but data quality, and by extension usability, needs to be improved. At the same time, the BSP is setting

[63] Although consumer loan penetration remained low at 10.9 percent of GDP as of Q1 2024, these loans are inherently more susceptible to repayment issues during an economic downturn, as consumers typically have less financial cushion compared with larger corporate borrowers. According to TransUnion's Consumer Pulse survey of 944 adults conducted from May 1-10, 2024, 44 percent of respondents expressed concerns about their ability to fully pay bills and loans, marking an increase from the previous year. This financial strain has influenced spending behaviors, with 47 percent of respondents cutting back on discretionary expenses and 52 percent expecting higher bills and loan repayments.
[64] Based on AMRO's corporate debt-at-risk analysis, 16 percent of companies in the property and construction sectors had an interest coverage ratio (ICR) lower than 1.25 in 2023 and are considered as "firms-at-risk". In addition, the two sectors make up 24 percent of bank loans. See Gabriella, L. G., 2023. Decoding Corporate and MSME Debt-at-Risk in the Philippines, AMRO's 2023 Annual Consultation Report on the Philippines.
[65] The BSP issued a circular entitled "Comprehensive Credit and Equity Exposures (COCREE) Report" in 2021 to capture granular borrower and counterparty information related to all credit and equity exposures by BSP-Supervised Financial Institutions (BSFIs). The information shall cover UKBs and their TBs, non-bank financial institutions with quasi-banking functions (NBQBs), trust corporation subsidiaries, and digital banks.

up a new Credit Information Management System to collect credit information from financial institutions under its supervision. The Philippine Open Finance Pilot, which focuses on MSME borrowers, offers another option for credit data sharing using application programming interface (API) technologies. While these initiatives are welcome, the multiple credit data systems should be consolidated and streamlined in the medium term to enhance efficiency and ensure a level playing field for all lenders.

44. The authorities should continue to develop the bond and repo markets to strengthen liquidity and resilience.

- **In the domestic government bond market, more can be done to improve market liquidity so as to support price discovery and market resilience.** First, a reduction in the withholding tax rates on interest income from government securities will improve the attractiveness of the Philippines' government bonds, especially to nonresident investors, whose participation in the local currency bond market remains at a low 3 percent.[66] Second, the proposed establishment of defined-contribution private pension funds under the Capital Market Development Act will increase participation from long-term institutional investors. Third, the number of government securities and benchmark tenors should be consolidated further to facilitate more robust secondary market trading that will strengthen price discovery. Finally, a more active repo market will enhance the liquidity of government bonds.
- **In the repo market, the BSP's plan to implement deliverable GMRA-based repo transactions will support market liquidity.** Activities in the repo market have thus far been constrained, largely due to the absence of a standard legal agreement and difficulties in conducting same-day collateral settlement, which have given rise to legal uncertainties and high transaction costs. In 2024, the BSP is set to adopt the Global Master Repurchase Agreement (GMRA)[67] as a legal standard, and to operationalize deliverable repo for its reverse repurchase (RRP) window. Once the changes are made, liquidity in the repo market is expected to improve. Finally, consolidation of the number of government securities will also ease the collateral management burden on repo transactions. A deep and liquid repo market will serve as a first line of defense for the banking system in times of liquidity stress.
- **The corporate bond market should be strengthened.** The Philippines' corporate bond market remains small, at 6 percent of GDP in 2023, compared with Thailand's 27 percent and Malaysia's 54 percent. The market is also dwarfed by the government local currency bond market, which was equivalent to 40 percent of GDP. The Financial Stability Coordination Council (FSCC) recognizes the potential of an active corporate bond market as both a funding source for borrowers and an investment alternative for investors, and has pledged to support development of the market. To this end, the authorities should establish a road map to develop both the supply and demand sides of the market, and to tackle any gaps in the market infrastructure.

Authorities' Views

45. The BSP affirms its efforts to develop the bond and repo markets. To support development of the domestic corporate bond market, the BSP is actively pushing for the

[66] The current withholding tax rate is as high as 20 percent for residents and 30 percent for nonresidents.
[67] GMRA is a standard legal agreement for repo transactions published by the International Capital Market Association (ICMA).

inclusion of Republic of the Philippines bonds in the global bond index. Initiatives toward this end include ensuring a highly liquid money market that would strengthen the benchmark yield curve. On September 30, 2024, the BSP announced the joint initiatives with the Bankers Association of the Philippines (BAP) to create the enhanced peso interest rate swap (IRS) overnight reference rate (ORR) based on the BSP's variable overnight reverse repurchase (RRP) rate and expand the government security (GS) repo market which would deepen liquidity in GS secondary trading and provide an alternative benchmark for loan rates.

46. BSP points to the regulatory safeguard in place to limit banks' exposure to real estate sector. Prudential measures are in place to limit exposures to the commercial real estate sector – 25 percent real estate loan (REL) limit of UKBs – and assess solvency of banks should a downturn in the property sector occurs, through the quarterly real estate stress test (REST). As of June 2024, real estate exposures of UKBs, on aggregate and at an individual level, remained below the 25 percent REL limit, while results of the REST as of 30 June 2024 show that banks have sufficient capital to absorb a 25 percent write-off in commercial real estate loans and real estate investments.

C.4 Expediting Structural Reforms for Long-term Growth Potential

47. The government should implement its labor policy in a timely manner, with a particular focus on upskilling and improving job quality to overcome the scarring effects of COVID-19. Upskilling the workforce to embrace a more technology-driven economy is essential in the longer term to improve the country's productivity and competitiveness. The authorities have published the National Technical Education and Skills Development Plan (NTESDP) 2023-2028 to enhance labor training, which is a step in the right direction. However, a clear implementation plan to increase investment in education and training should be in place. In pursuit of its goal of developing a digital and technology-driven economy, the authorities have introduced plans to facilitate labor upskilling. [68] However, the existing vocational education and training programs[69] mainly focus on increasing employability, which may not be sufficient to upgrade labor quality to meet the needs of a technology-driven economy. Therefore, the government should collaborate closely with industries and training providers to formulate training frameworks and implement the plans to ensure that the supply of skilled labor matches industry demand.

48. In an increasingly competitive environment, further efforts and measures will be needed to attract FDIs and to ensure knowledge transfer. The Philippine authorities have made commendable efforts to reduce restrictions on FDI through legislation.[70] More needs to be done to attract and benefit from foreign investment, such as improving the general business environment[71] for FDI, and working with FDI to encourage knowledge transfers to locals from FDI operations. In addition to overseas investment promotions, the authorities should expedite the

[68] The country has three new laws to enhance the workforce and industries, focusing on digital skills, creative sectors and overall employment generation. These laws are the Philippine Digital Workforce Competitiveness Act, Philippine Creative Industries Development Act, and Trabaho Para sa Bayan Act. Meanwhile, in anticipation of the opportunities and challenges presented by the growing use of AI, the Department of Trade and Industry (DTI) launched the National AI Strategy Roadmap 2.0 (NAISR 2.0) and the Center for AI Research (CAIR) on July 5, 2024, to drive innovation, help upskill and reskill the workforce, bolster the economy and improve lives through strategic AI adoption.
[69] Examples include the Technical Education and Skills Development Authority's (TESDA) technical and vocational education and training (TVET) programs and the Department of Labor and Employment's (DOLE) JobStart Philippines Program.
[70] Examples include amendments to the Retail Trade Liberalization Act, the Public Service Act and the Foreign Investments Act. Specifically, the amended Retail Trade Liberalization Act has relaxed requirements for foreign retail enterprises; the amended Public Service Act has removed foreign ownership restrictions in key sectors; and the amended Foreign Investments Act now allows international investors to set up and fully own domestic enterprises, including MSMEs, in the Philippines.
[71] The Philippines' competitiveness ranked 52nd out of 67 economies in 2023 and 2024, down from 45th in 2020, as challenges offset improvements in 2024, according to IMD's World Competitiveness Report. The country's lower ranking was mainly due to its weaker position in infrastructure.

implementation of investment projects to ensure that planned investments are realized. In April 2024, the Philippines issued a joint statement with the U.S. and Japan on cooperation among the three countries, including the launch of the Luzon Economic Corridor,[72] providing support to Philippine economic development through an Open Radio Access Network (RAN)[73] and the U.S. CHIPS and Science Act,[74] and expanding their cooperation in civil-nuclear capacity building[75] and the deployment of clean energy technologies.[76] The country should take the opportunity to attract more FDIs and technological transfers, such as under the CHIPS and Science Act framework,[77] through the trilateral agreement.

49. Sufficient infrastructure investment with rigorous selection is required to address the need for sustainable long-term growth. The government has realized the need for infrastructure development and intensified its developmental efforts through the Build Better More (BBM) program to address infrastructure gaps. Some progress has been made in improving the funding for infrastructure investment in 2024.[78] In particular, the approval of a public-private partnership (PPP) code in early 2024 is welcomed as it is a step toward better coordination between public and private stakeholders. The new code is expected to contribute to reducing risks related to PPP projects by clarifying the processes and providing a unified legal framework for all PPPs at the national and local levels.[79] In late 2023, the country founded its first sovereign investment fund, the Maharlika Investment Fund (MIF). Then in early 2024, the MIF management body, Maharlika Investment Corporation (MIC), said it would invest in domestic infrastructure, renewable energy and sustainable copper mining, and planned to announce the details later in the year. While AMRO welcomes the MIF's investment to meet the country's long-term infrastructure development needs, the MIF should clearly define its role in infrastructure investment and establish an appropriate governance structure that is professional, transparent and accountable to avoid misuse of funds.[80] Meanwhile, further infrastructure development will be needed for tourism, digitalization and agriculture to enhance potential growth and food security in the medium to long term. At the same time, infrastructure projects must be subject to strategic prioritization and rigorous selection, efficient implementation, strict adherence to project timelines, and improved project governance. Attempts to carry out many projects simultaneously could delay implementation and lead to cost overruns.

50. AMRO welcomes recent progress in promoting digitalization across different platforms. In terms of digital infrastructure, the rollout of a national identity system known as

[72] The Luzon Economic Corridor is expected to support connectivity between Subic Bay, Clark, Manila and Batangas by increasing joint investments in infrastructure projects, such as railroads, port modernization, clean energy and semiconductor supply chains. Investments in labor deployments, agribusiness and civilian port upgrades will also take place at Subic Bay.
[73] The U. S. and Japan agreed to provide at least USD8 million to set up Open RAN field trials and a Manila-based Asia Open RAN Academy. The agreement aims to create a secure, reliable and trusted information communications technology ecosystem in the Philippines, with possible commercial value.
[74] Through the CHIPS and Science Act's International Technology Security and Innovation Fund, the U.S. will provide funding to help the Philippines to develop and expand the Philippine semiconductor workforce, in order to strengthen the global supply chain.
[75] Japan and the U.S. will further cooperate with the Philippines to expand the Philippines' civil-nuclear workforce and capacity through trilateral cooperation in a civil nuclear energy program.
[76] The three countries will expand trilateral cooperation in the development of clean energy technology, including renewable energy projects such as solar and wind power, to support the Philippines' energy needs and energy transition.
[77] In early 2024, the Philippines became one of seven countries chosen by the U.S. as a partner under the CHIPS and Science Act. Under this act, the U.S. government has allocated USD500 million to the International Technology, Security, and Innovation (ITSI) Fund, which will be spent over the next five years in the partner countries. The CHIPS Act aims to diversify the U.S. semiconductor supply chain by strengthening the sector in partner countries, making them more conducive for U.S. companies to invest in.
[78] Ongoing projects under the BBM program in 2024 include 134 in physical connectivity, 29 in water resources, nine in agriculture, five in health and three in digital connectivity.
[79] In addition, the authorities approved the New Government Procurement Act in July 2024 to enhance transparency and accountability in government procurement processes and expedite procurement activities to 60 days from 90 days, from the opening of bids to the awarding of contracts.
[80] Besides PPP and MIF, the Philippines could fund infrastructure projects from sources such as the government budget, official development assistance (ODA) and FDI.

PhilSys ID is recognized as facilitating digitalization in the Philippines. It had issued national IDs to more than 55 million people by July 2024, about half of the population. Meanwhile, the government is currently implementing the Philippine Public Financial Management (PFM) Reforms Roadmap 2024 – 2028, including a strategic plan to expedite digitalization of government transactions. On financial digitalization, the country's digital payment has achieved the 50 percent target[81] stated in the Digital Payments Transformation Roadmap 2020-2023. The BSP is preparing a new road map for 2024-2026 to update the overall plan for financial digitalization. On wholesale central bank digital currency (CBDC), the pilot initiative, Project Agila, will be concluded by the end of 2024, and the results of the assessment will serve as a guide for a possible launch of wholesale CBDCs in the Philippines.[82] Finally, notable progress has been observed on the multilateral payment connectivity front as the BSP formally announced its continued participation in the next phase of Project Nexus[83] in July 2024, to develop a common cross-border payment platform with Bank Negara Malaysia, the Monetary Authority of Singapore, the Bank of Thailand and the Reserve Bank of India.[84] The project is facilitated by the Bank for International Settlements (BIS).[85]

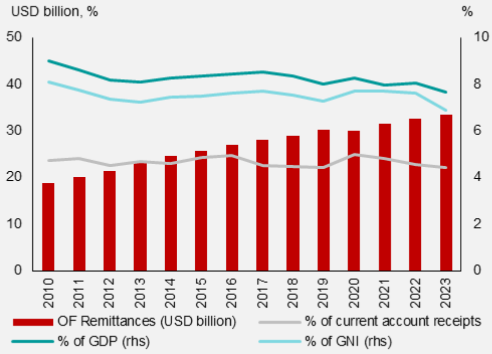
51. With regard to climate change risks, the Philippines is on the right track to address vulnerabilities arising from climate change while taking the opportunity to attract more FDIs to develop a sustainable economy. The authorities have done well in formulating long-term national plans, such as the Philippine National Adaptation Plan (PNAP) and the Philippine Development Plan (PDP),[86] to address climate change issues and strengthen the country's disaster resilience.[87] In 2024, the BSP and the SEC issued the country's version of a green finance taxonomy which was developed under the auspices of the Financial Sector Forum, providing better standards to classify sustainable finance domestically. Investments related to climate change are augmented by the budget and loans from international organizations.[88] In particular, expenditure related to climate change will increase by 123 percent to PHP1 trillion in the 2025 budget. To raise new funding for sustainable investments, the authorities have been promoting and attracting FDIs on renewable energy,[89] as well as green FDIs in various sustainable industry systems (Appendix 6 Climate Clipboard has more details on the Philippines' climate change responses).

[81] In 2023, the share of digital payment transactions reached 52.8 percent of total monthly retail payments.
[82] Project Agila is testing wholesale CBDC technology for round-the-clock interinstitutional fund transfers by assigned participants in a sandbox environment. According to BSP Governor Eli Remolona, by the end of Project Agila's pilot run, the central bank and the banking sector would have assessed the possible launch of a wholesale CBDC across the whole country. Upon completion of the requisite sandbox and pilot tests and the subsequent assessment, wholesale CBDC could be expected to be issued, in coordination with the payment industry, to commercial banks and other financial institutions to settle interbank payments, securities transactions and cross-border payments. Six financial institutions are participating in the pilot project, namely BDO Unibank Inc., China Banking Corp., Land Bank of the Philippines, Rizal Commercial Banking Corporation, Union Bank of the Philippines and Maya Philippines Inc.
[83] Nexus is a BIS Innovation Hub project that seeks to enhance cross-border payments by connecting multiple domestic instant payment systems (IPS) globally.
[84] The cooperation with the Indian central bank seeks to expand the potential user base to India's Unified Payments Interface (UPI), the world's largest IPS.
[85] Bank Indonesia will participate with special observer status in Nexus.
[86] In the Nationally Determined Contribution (NDC) submitted to the UN in 2021, the Philippine government has committed to reducing greenhouse gas emissions by 75 percent, of which 2.71 percent is "unconditional" and 72.29 percent is "conditional," compared with projected business-as-usual emissions from 2020 to 2030. It will achieve this committed reduction by making the transition to cleaner energy sources while reducing reliance on coal and oil. More importantly, the country's main concern is to adapt to the physical risks of climate change. To this end, it formulated a Philippine National Adaptation Plan (NAP), focusing on the four priority areas of food security, water sufficiency, ecosystem and environmental stability, and human security. Furthermore, the authorities have included an accelerated climate change agenda in the Philippine Development Plan (PDP) 2023-2028. Specifically, the government committed to strengthening delivery on key climate actions and disaster resilience.
[87] To mitigate the impacts of disaster risk, the authorities have created several funds, such as the People's Survival Fund (PSF) to grant technical and financial assistance to help local communities implement adaptation measures; the National Disaster Risk Reduction and Management Fund (NDRRMF) to provide relief and rehabilitation to calamity-affected communities and areas to facilitate a return to normalcy as quickly as possible; and the Local Disaster Risk Reduction and Management Fund (LDRRMF), which requires local governments to set aside 5 percent of their budgets as a local calamity fund, of which 30 percent shall be allocated as a Quick Response Fund (QRF) or a standby fund for relief and recovery programs.
[88] For example, the Philippines is included in the ADB's Country Partnership Strategy (CPS) and the World Bank's Country Partnership Framework (CPF), to receive funding to cover resilience to climate change, environment and disaster risk management.
[89] The Implementing Rules and Regulations (IRR) of the 2008 Renewable Energy Act has been amended to allow 100 percent foreign ownership in the investment of renewable energy, such as solar, wind, hydro and ocean power or tidal energy sources. The amendment aims to encourage foreign investment in developing renewable energy.

Box A. Overseas Filipino (OF) Remittances: Trends Before and After the Pandemic[90]

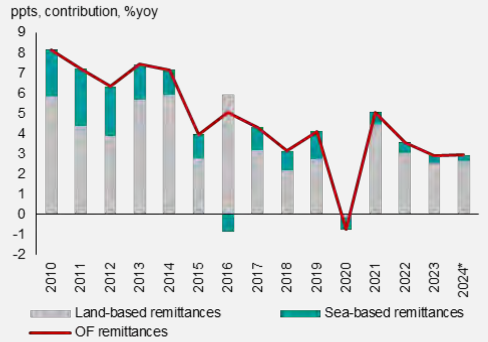
Remittances from overseas Filipinos (OFs) have been a major source of the Philippines' external earnings. OF remittances, mainly sent by overseas Filipino workers (OFWs),[91] have accounted for 22-25 percent of total current account receipts since 2010 (Figure A1), which together with the services trade surplus offset merchandise trade deficits. OF remittances were equivalent to around 8 percent of GDP and 7 percent of gross national income (GNI), a major source of external income to support the country's private consumption and economic growth. Except for a one-off modest drop in 2020 at the peak of the pandemic, OF remittances grew steadily at 3-5 percent each year from 2015 (Figure A2), mainly driven by land-based remittances. The following review looks at the characteristics and contributions of OF remittances.

Figure A1. Importance of OF remittances



Source: Bangko Sentral ng Pilipinas (BSP); Philippine Statistics Authority (PSA); AMRO staff calculations
Note: OF Cash Remittances cover those which are remitted through the Philippine banking system by OFs who may be working/staying abroad on a temporary basis and those who have already migrated.

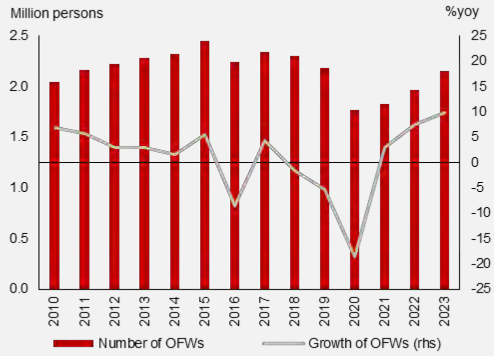
Figure A2. Growth of OF remittances



Source: BSP; AMRO staff calculations
Note: 2024 figures are year-to-date figures from January-August.

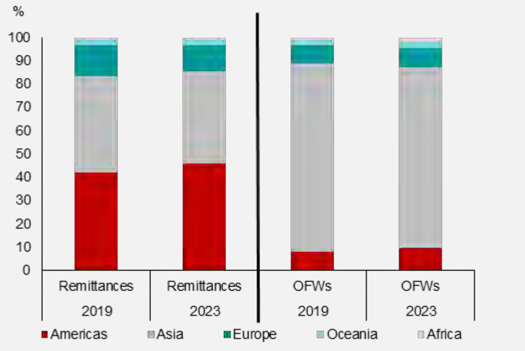
Despite the drop in 2020, OF remittances in 2021 surpassed pre-pandemic levels. The number of OFWs and OF remittances fell in 2020 due to COVID-19. However, as travel restrictions were relaxed, the deployment of OFWs and remittances started recovering in 2021. The number of OFWs in 2023 had rebounded close to pre-pandemic levels (Figures A2, A3).[92]

Figure A3. Number of OFWs



Source: Survey on Overseas Filipino Workers (SOF), PSA; AMRO staff calculations
Note: SOF estimates cover overseas Filipinos whose departure occurred within the last five years and who are working or had worked abroad during April to September of the survey year.

Figure A4. Remittances and OFWs by Continent

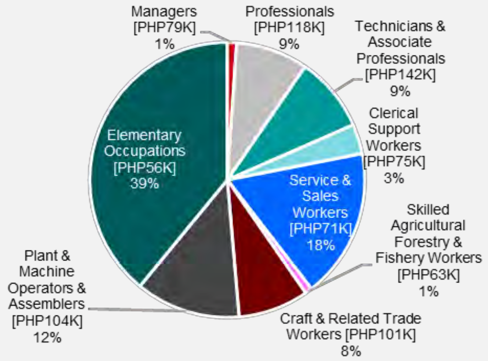


Source: BSP; SOF, PSA; AMRO staff calculations
Note: Remittance data is from the BSP. OFW data is from the SOF and PSA.

[90] This box was prepared by Andrew Tsang, Senior Economist, and Su Su Hlaing, Associate.
[91] Besides OFWs, OFs include Filipinos who have migrated abroad. OF remittances also include i) other household-to-household transfers between Filipinos who have migrated abroad and their families in the Philippines, and ii) capital transfers between resident and non-resident Filipino households. According to 2023 BOP statistics, around 97 percent of OF remittances were workers' remittances.
[92] Deployment statistics from the Department of Migrant Workers (DMW) suggested that deployment numbers increased and registered a historical high in 2023. However, DMW recorded a significant drop of 74.1 percent in OFW deployment in 2020, larger than the 18.6 percent found in the SOF conducted by the PSA, which is inconsistent with the 0.8 percent fall in OF remittances recorded by the BSP.

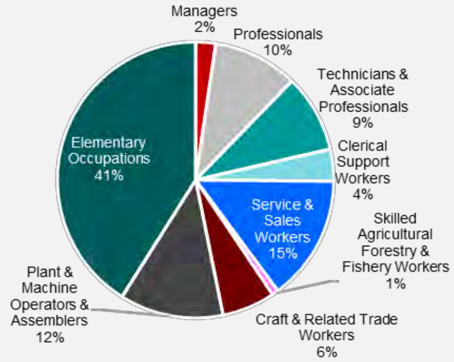
Focusing on OFW remittances, the increase in remittances could be attributed to more OFWs working in countries with higher OFW incomes. Compared with 2019, the share of OFWs working in the Americas, mainly Canada and the U.S., increased in 2023, and more remittances came from American countries (Figure A4). According to the Survey on Overseas Filipino Workers (SOF) by the Philippine Statistics Authority (PSA), the highest average OFW remittances originated in the Americas. The shares of OFWs working in Asia and their remittances fell. On the other hand, despite slight changes among the proportions of OFWs by occupation, their composition by income group is similar before and after the pandemic (Figures A5, A6).[93] The increase in remittances is less likely to be due to changes in the composition of OFW occupations.

Figure A5. OFWs and Average Cash Remittances by Occupation (2019)



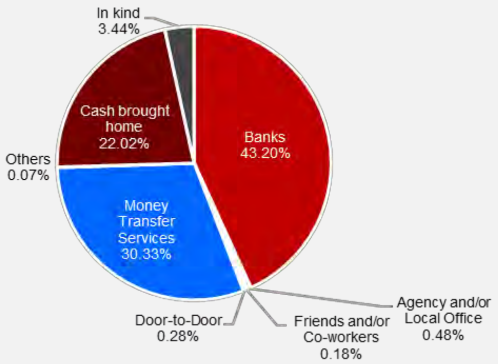
Source: SOF, PSA; AMRO staff calculations
Note: The average cash remittances by occupation are shown in brackets, and the average cash remittance in 2019 was PHP74,000.

Figure A6. OFWs by Occupation (2023)



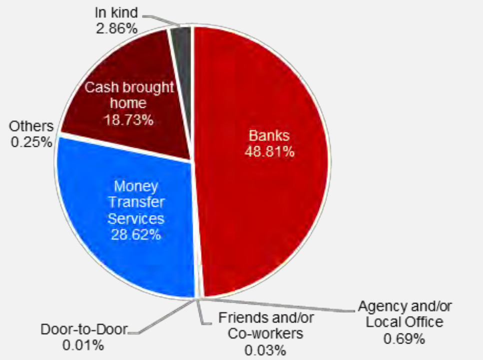
Source: SOF, PSA; AMRO staff calculations
Note: From 2020, average remittances by occupation have been excluded from the SOF.

Figure A7. OFW Remittances by Mode (2019)



Source: SOF, PSA; AMRO staff calculations
Note: The SOF data only covers OFW remittances. The SOF broadly categorizes remittances sent by OFWs as "cash sent" (cash remittances), "cash brought home," and "in kind." In particular, "cash sent" is further divided into remittances sent in cash through different modes: banks, agencies and/or local offices, friends and/or co-workers, door-to-door, money transfer services, and others.

Figure A8. OFW Remittances by Mode (2023)



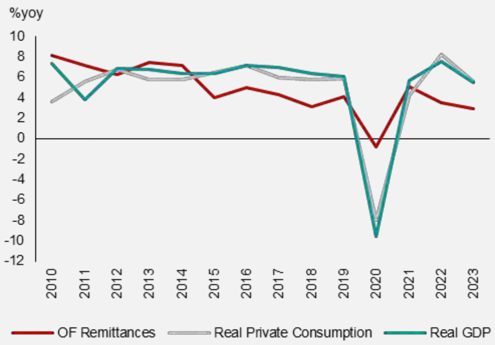
Source: SOF, PSA; AMRO staff calculations

[93] In the high-remittance groups, managers and professionals increased by 2 percentage points (ppts), but craft and related trade workers fell by 2 ppts. In the mid- and low-remittance groups, clerical support workers and elementary occupations rose by 3 ppts, while services and sales workers dropped by 3 ppts.

Regarding the OFW remittance channels, the share of remittances sent through formal channels, namely banks and money transfer services, increased from 73.5 percent in 2019 to 77.4 percent in 2023.[94] In particular, nearly half of the remittances (48.8 percent) were transferred via banks, higher than the 43.2 percent in 2019 (Figures A7, A8). The share of remittances sent through money transfer services, cash brought home and contributions in kind fell. The higher share of remittances sent through banks may be due to the lower cost of accessing banking services through digital banking and the country's efforts to raise financial inclusion.

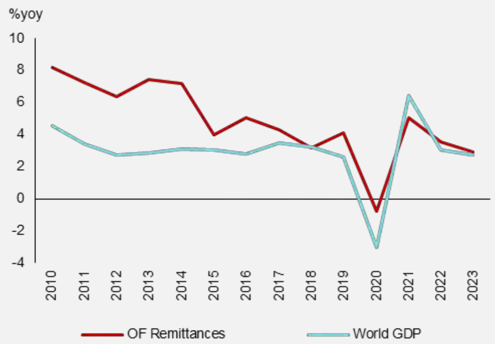
As a major source of external and household income, OF remittances also act as a stabilizer of the economy because of their countercyclical nature. A previous AMRO study (Choo & Oeking, 2020)[95] confirmed that remittances provided a very stable form of external income in terms of volatility, including during past crises. However, there was only weak evidence regarding the countercyclicality of remittances in migrant home economies, including the Philippines (Oeking, 2020).[96] Since OF remittances behave countercyclically, the funds did not decline as much as private consumption and GDP did in 2020, and have supported the economic rebound since 2021 (Figure A9).[97] Nevertheless, OF remittances also show pro-cyclicality with respect to the host economy, posting lower amounts during a cyclical downturn in world GDP (Figure A10).

Figure A9. OF Remittances, Real Private Consumption and Real GDP



Source: BSP; PSA; AMRO staff calculations

Figure A10. OF Remittances and World GDP



Source: BSP; Oxford Economic Forecasting (OEF); AMRO staff calculations
Note: The World GDP is OEF's World GDP in national currency.

The authorities have actively formulated various policies to protect OFWs' labor conditions in host countries and to provide training for their upskilling, which would boost remittances. In principle, the Philippine government does not promote OFW deployment; thus, it aims at Filipinos working abroad becoming "a choice rather than a necessity." However, given the reality that OFWs have contributed to the Philippine economy, the government seeks to protect OFW labor conditions and provide job training for upskilling and reskilling. Specifically, increasing the deployment of OFWs in higher-income occupations could boost remittances, which prompted the authorities to actively formulate policy measures to train OFWs in higher-income occupations in health care and education. Going forward, upskilling and reskilling could be expanded to other occupations.[98]

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[94] The SOF data only covers OFW remittances. Official OF remittance statistics compiled by the BSP classify remittances sent through the banking system (banks and money transfer services) as "cash remittances," which make up around 90 percent of personal remittances, a higher share than what the SOF has found for the OFW remittances. The remaining 10 percent of official OF remittances are transferred through informal channels, such as cash brought home and contributions in kind, that would likely be difficult to capture in officially recorded flows and are lower than the SOF statistics.
[95] Choo, E. and OeKing, A., 2020. "Coming Home: Are Remittances in the ASEAN+3 Another Victim of the Pandemic?", AMRO Analytical Note, December 3, 2020.
[96] OeKing, A., 2021. "COVID-19's Impact on Overseas Remittances to the Philippines", Annual Consultation Report 2020, AMRO.
[97] According to the BSP's Consumers' Expectation Survey, the remittances were mainly used in private consumption, particularly for food and other household needs, as well as in education.
[98] The government has also created the Trabaho Para sa Bayan (TPB) Plan. This national employment generation and recovery master plan aims to address unemployment, underemployment and informal work arrangements while improving the employability and competitiveness of Filipino workers through upskilling and reskilling initiatives. It will also provide support for MSMEs and industry stakeholders.

Box B. Exchange Rate Pass-through of the Peso to Consumer Price Inflation[99]

The impact of the peso exchange rate depreciation on consumer price inflation in the Philippines has raised some concerns. In the second quarter of 2024, the Philippine peso depreciated by 3.6 and 1.1 percent against the U.S. dollar and in nominal effective terms, respectively. This was primarily due to expectations of delayed rate cuts by the U.S. Federal Reserve, which affected the overall sentiment of regional currencies. Peso depreciation directly raises import prices in pesos, which will ultimately be passed through to higher consumer prices. The current box estimates the degree of exchange rate pass-through (ERPT) in the Philippines and examines its development.

ERPT is estimated using the quarterly model in BSP (2022):[100]

$$\Delta \ln(CPI_t^{PH}) = c + \sum_{j=0}^{2} \beta_{1,j}\Delta \ln(ER_{t-j}^{PH}) + \sum_{k=1}^{6} \beta_{2,k}\Delta \ln(CPI_{t-k}^{PH}) + \sum_{l=0}^{2} \beta_{3,l}\Delta \ln(PR_{t-l}^{PH}) + \beta_4\Delta \ln(CPI_t^{World}) + \beta_5 Output\ Gap_t + \varepsilon_t \qquad \text{(B1)}$$

where
CPI_t^{PH} is the Philippine CPI at quarter *t*, seasonally adjusted;
ER_t^{PH} is the peso exchange rate, which is measured as either the bilateral rate against the U.S. dollar (PHP/USD) or the nominal effective exchange rate (NEER);
PR_t^{PH} is the Philippine policy rate;
CPI_t^{World} is the world CPI, constructed by the weighted average of CPI inflation by using the trade weight of the top 12 trading partners of the Philippines;
$Output\ Gap_t$ is the estimated output gap;
$\sum \beta_{1,j}$ is the short-run ERPT, that is, the percentage point (ppt) change subject to a 1 percent increase in the *ER* (PHP/USD depreciation or NEER appreciation);
$\sum \beta_{2,k}$ is inflation persistence, while the implied one-year ERPT is calculated by $\sum_{m=0}^{3}(\sum \beta_{1,j} \sum \beta_{2,k}^{m})$.

Table B1 presents the estimation results using different exchange rate variables, namely PHP/USD and the NEER. The quarterly models are estimated using data samples from Q1 2002 to Q2 2024, and insignificant lagged variables are dropped.

Table B1. Estimated Coefficients and ERPT Using Different Exchange Rate Variables

	PHP/USD	NEER
Short-run ERPT	0.046*	-0.071*
Inflation persistence	0.539***	0.562***
Policy rate	-0.386**	-0.312
World inflation	0.857***	0.830***
Output gap	-0.018	-0.021
(Implied) 1-year ERPT	**0.091**	**-0.147**

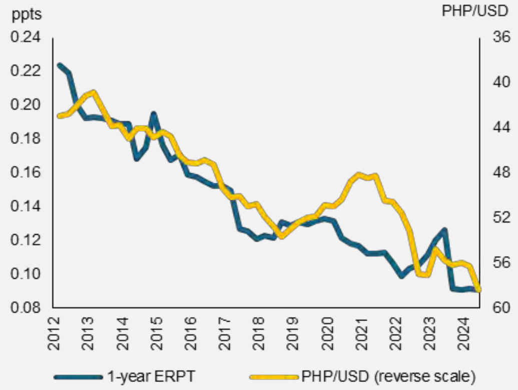
Source: BSP; PSA; Haver Analytics; AMRO staff estimates
Note: A higher (lower) PHP/USD (NEER) represents depreciation.

The estimation results suggest that ERPT in the Philippines remains relatively small. A depreciation of 1 percent of the average peso exchange rate against the U.S. dollar in a quarter would raise the inflation rate by 0.046 ppts in a quarter, and the accumulated effect in one year would increase to 0.091 ppts. The ERPT of a 1 percent NEER depreciation is larger at 0.071 ppts in a quarter and 0.147 ppts in a year, as the NEER is more stable than the bilateral exchange rate against the U.S. dollar. The findings from this study is consistent with those of other scholars who have found that the pass-through effects is quite small in most EMs whose inflation is low and well anchored. Beirne *et al*. (2023) also found that the Philippines' ERPT to consumer prices is smaller than regional peers.

[99] This box was prepared by Andrew Tsang, Senior Economist.
[100] BSP, 2022. "An Updated Estimate of the Exchange Rate Pass-Through to Domestic Prices in the Philippines." Monetary Policy Report – November 2022.

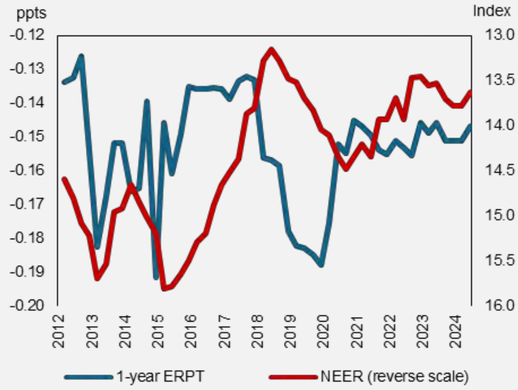
Using recursive regression, ERPT estimates generally decreased over time. The initial sample of the recursive regression ranges from Q1 2002 to Q4 2011, and the regression window is expanded by one observation until the estimation sample covers the full sample period from Q1 2002 to Q2 2024. In general, the one-year ERPT fell over time alongside the depreciation trend of the peso exchange rate (both PHP/USD and the NEER) in the last decade (Figures B1, B2), indicating that the marginal impact of a 1 percent peso depreciation on CPI inflation becomes smaller as the currency weakens. According to the literature, the exchange rate pass-through to consumer prices could be effectively reduced by a credible monetary policy framework that supports well-anchored inflation expectations and other structural improvements related to external trade (Ha *et al*., 2019).[101]

Figure B1. 1-year ERPT and PHP/USD



Source: BSP; AMRO staff estimates
Note: ERPT is estimated using the model with PHP/USD.

Figure B2. 1-year ERPT and NEER



Source: BSP; AMRO staff estimates
Note: ERPT is estimated using the model with NEER.

The Philippines' ERPT to consumer prices is relatively small, while other factors could have greater influence on CPI inflation. Thus, given the downward trend of the peso exchange rate, ERPT has been diminishing over the past decade. Looking forward, the peso may continue to experience high volatility amid uncertainties again due to local and external risks. Such limited pass-through will lessen the impact of peso volatility on inflation.

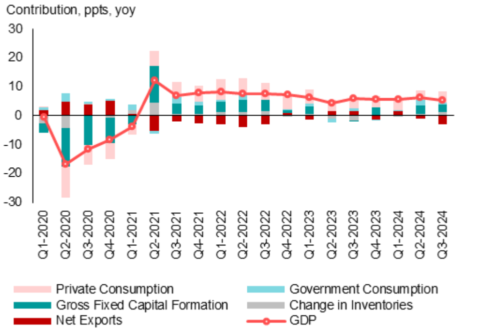
[101] Ha, J., Stocker, M., Yilmazkuday, H., (2019). "Inflation and Exchange Rate Pass-Through," Policy Research working paper, No. WPS 8780 Washington, D.C.: World Bank Group. Meanwhile, Ha *et al.* (2019) listed other structural factors for the falling exchange rate passthrough, such as the degree of competition among importing and exporting firms, the frequency of price adjustments, the composition of trade, the level of participation in global value chains, the share of trade invoiced in foreign currencies, and the use of currency hedging instruments, etc.

Appendices

Appendix 1. Selected Figures for Major Economic Indicators

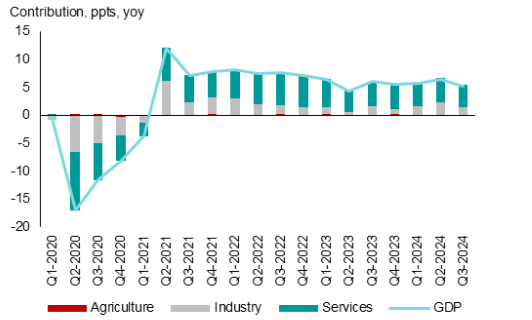
Figure 1.1 Real Sector

Economic growth was robust in Q1-Q3 2024, mainly driven by an uptick in public consumption and investment.



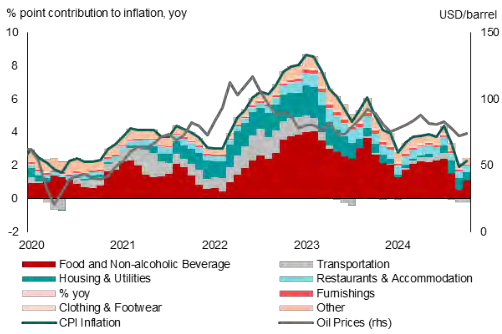
Source: PSA; AMRO staff calculations

By sector, services remained the main contributor of growth.



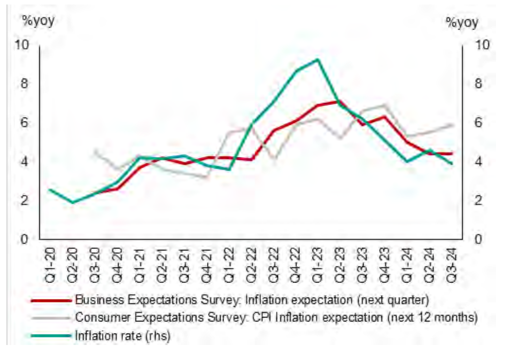
Source: PSA; AMRO staff calculations

The easing of inflation was broad-based, with supply shocks occasionally raising food prices again.



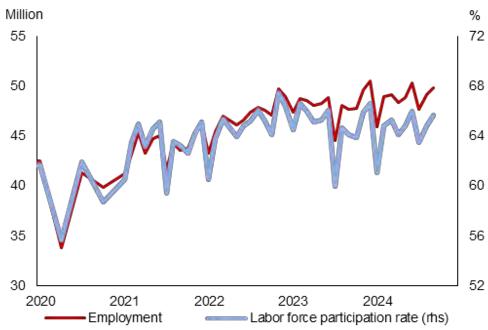
Source: PSA; AMRO staff calculations

Inflation expectations have generally declined in line with actual inflation.



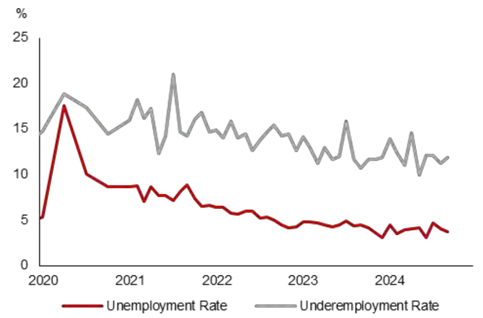
Source: PSA; BSP; AMRO staff calculations

Employment has surpassed pre-COVID levels.



Source: PSA

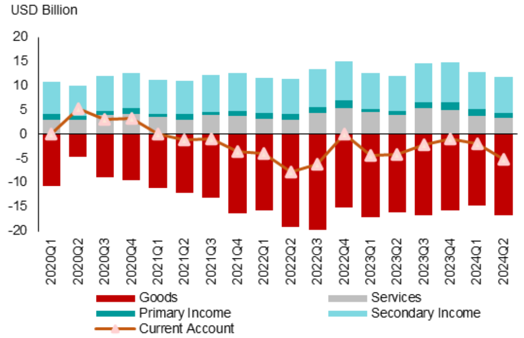
Unemployment rate stayed around pre-pandemic lows and underemployment remained elevated.



Source: PSA

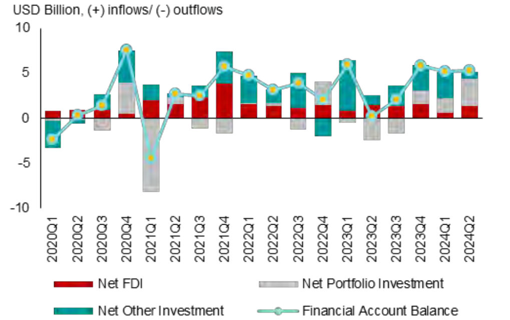
Figure 1.2 External Sector

The current account deficit improved in H1 2024 with a narrowed trade-in-goods deficit.



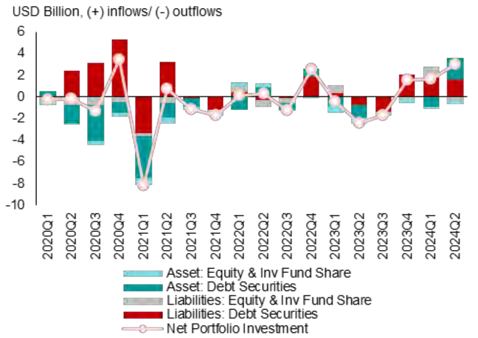
Source: BSP; AMRO staff calculations

The capital account continued to record inflows in H1 2024.



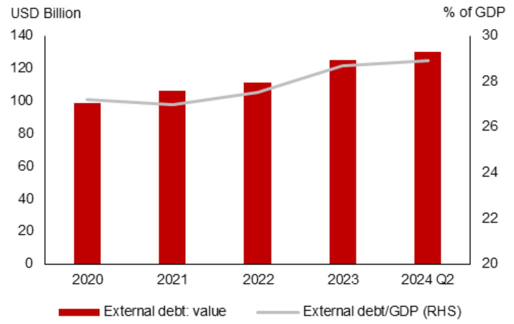
Source: PSA; AMRO staff calculations

Portfolio investments registered net inflows in H1 2024.



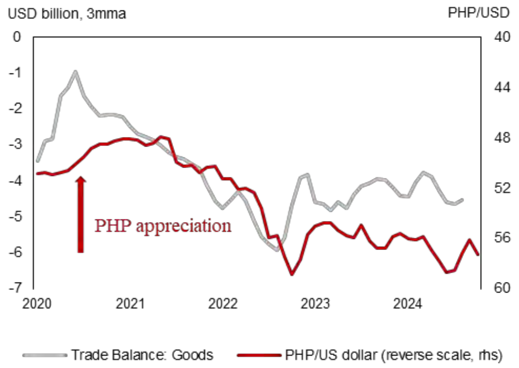
Source: BSP; AMRO staff calculations

External debt rose but remained low.



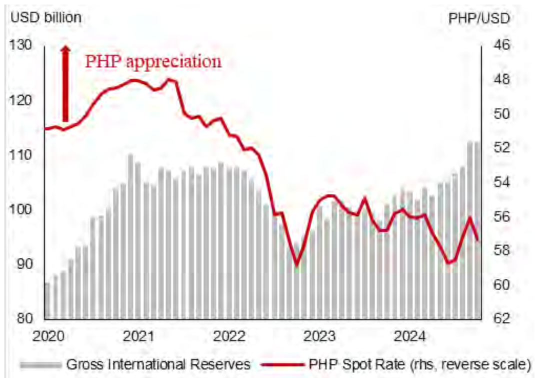
Source: BSP

The peso rebounded against the U.S. dollar in Q3 2024, before depreciated in October.



Source: BSP; AMRO staff calculations

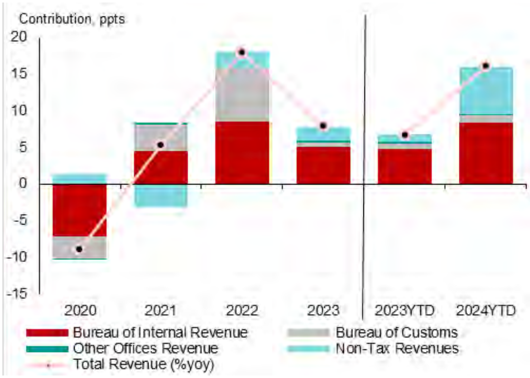
International reserves rose in 2024 and stayed at USD112.4 billion in October.



Source: BSP

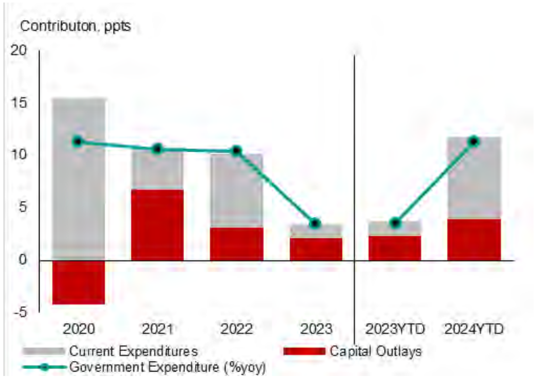
Figure 1.3 Fiscal Sector

In Jan-Sep 2024, revenue continued to grow robustly by 16.0 percent, backed by strong economic growth…



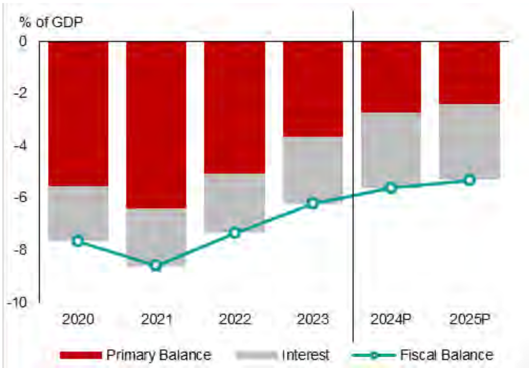
Source: BTr, AMRO staff estimates
Note: The YTD data in the chart is from Jan-Sep.

…while disbursement picked up by 11.6 percent with buoyant capital outlays and increased allotments to LGUs.



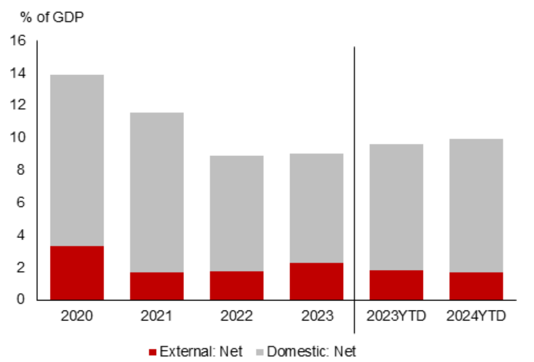
Source: DBM; AMRO staff estimates
Note: The YTD data in the chart is from Jan-Aug.

The fiscal deficit is expected to be smaller in 2024 and 2025.



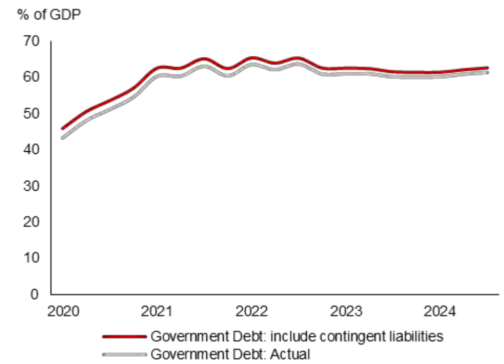
Source: BTr; AMRO staff estimates
Note: "P" means authorities' projections.

The government continued to finance the deficit by issuing bonds, but on a smaller scale in Q1-Q3 2024.



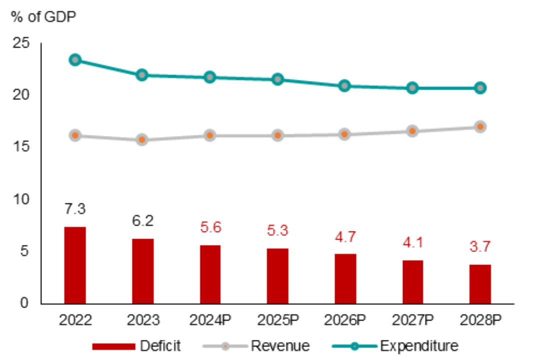
Source: BTr; AMRO staff estimates
Note: The YTD data in the chart are from Q1-Q3.

Accordingly, the government debt ratio has stabilized since 2022.



Source: BTr; AMRO staff estimates

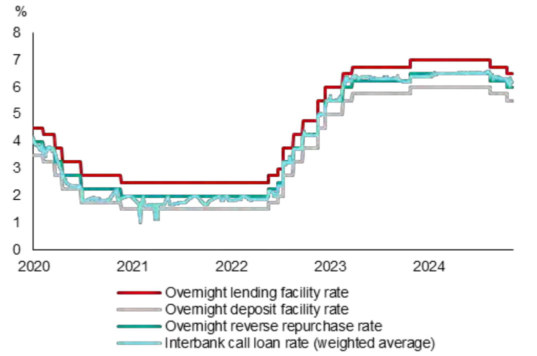
Fiscal consolidation was revised to take a slower pace in the government's latest medium-term fiscal framework.



Source: DBM; AMRO staff estimates
Note: "P" means authorities' projections.

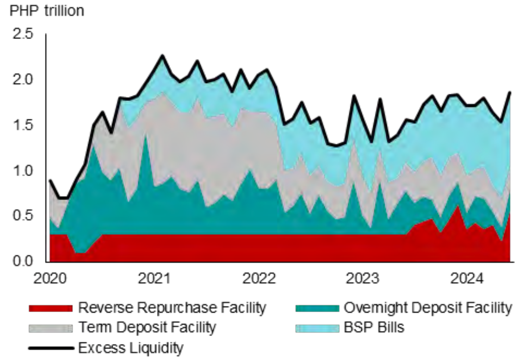
Figure 1.4 Monetary and Financial Conditions

The BSP started to cut the policy rate in August 2024.



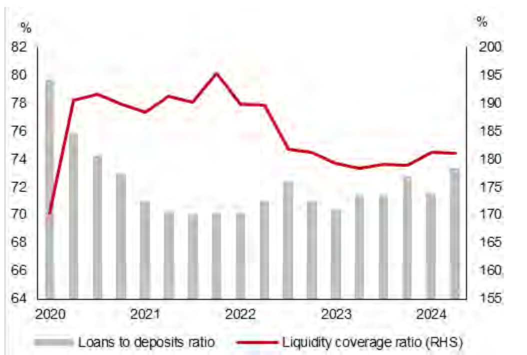
Source: BSP

Liquidity remained ample in the interbank market…



Source: BSP

Liquidity was also ample in the banking system…

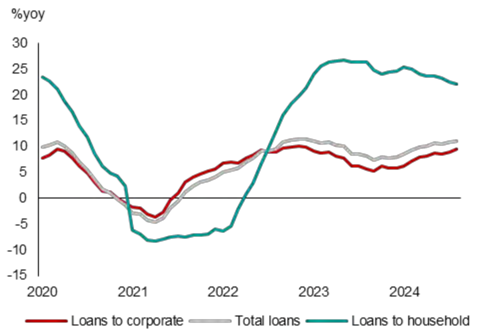


Source: BSP and IMF
Note: Loan to deposit ratio is defined as gross total loans to total deposit liabilities. The liquidity coverage ratio series is from IMF's Financial Soundness Indicators.

… as well as in the broader financial system.

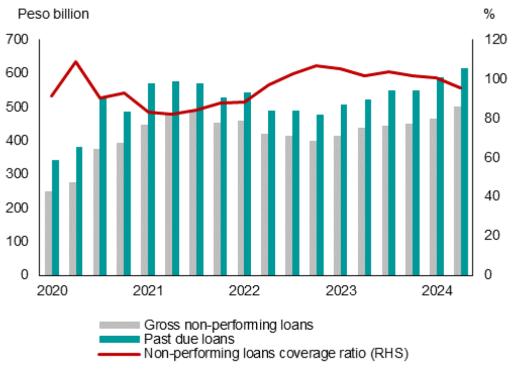
Source: BSP

Bank loans picked up steadily, with growth in household loans still strong at around 20 percent.



Source: BSP
Note: The loans are outstanding loans of the Philippines banking system, net of reverse repurchase (RRP) placements with the BSP.

Asset quality should be monitored as NPLs and past-due loans gradually picked up.



Source: BSP

Appendix 2. Selected Economic Indicators for the Philippines

	2020	2021	2022	2023	Projection 2024	Projection 2025
Real sector and prices	(in percent change, unless specified)					
Real GDP	-9.5	5.7	7.6	5.5	5.8	6.3
Private consumption	-8.0	4.2	8.3	5.6	5.0	6.0
Government consumption	10.5	7.2	5.1	0.6	5.5	4.2
Gross fixed capital formation	-27.3	9.8	9.8	8.2	6.7	7.0
Exports of goods and services	-16.1	8.0	11.0	1.4	4.5	5.5
Imports of goods and services	-21.6	12.8	14.0	1.0	4.2	5.5
Prices						
Consumer price inflation (period average 2018=100)	2.4	3.9	5.8	6.0	3.2	3.2
Core inflation (period average 2018=100)	3.4	3.0	3.9	6.6	2.9	3.0
GDP deflator	1.7	2.3	5.5	4.6	2.8	2.2
External sector	(in billions of U.S. dollars, unless specified)					
Current account balance	11.6	-5.9	-18.3	-11.8	-12.2	-12.5
(in percent of GDP)	3.2	-1.5	-4.5	-2.7	-2.6	-2.4
Goods trade balance	-33.8	-52.8	-69.7	-65.9	-68.0	-71.7
Services trade balance	13.9	14.0	15.9	18.7	18.9	20.8
Primary income, net	4.1	3.3	4.9	4.4	5.1	5.8
Secondary income, net	27.4	29.5	30.6	31.0	31.8	32.7
Financial account balance	-6.9	-6.4	-13.9	-14.1	-14.0	-15.2
Direct investment, net	-3.3	-9.7	-5.6	-5.2	-7.9	-10.2
Portfolio investment, net	-1.7	10.2	-1.7	3.0	-0.6	-0.6
Financial derivatives, net	-0.2	0.0	0.0	-0.1	-0.1	-0.1
Other investment, net	-1.8	-7.0	-6.5	-11.7	-5.4	-4.3
Error and omission	-2.5	0.8	-2.9	1.4	0.0	0.0
Overall balance	16.0	1.3	-7.3	3.7	1.8	2.8
Gross international reserves (end-period)	110.1	108.8	96.1	103.8	110.6	110.4
Total external debt (percent of GDP)	27.2	27.0	27.5	28.7	29.3	29.1
Short-term external debt (percent of total)	14.4	14.2	14.9	13.6	13.6	13.6
Fiscal sector (National Government)	(in percent of GDP)					
Government revenue	15.9	15.5	16.1	15.7	16.1	16.0
Government expenditure	23.5	24.1	23.4	21.9	21.7	21.6
Fiscal balance	-7.6	-8.6	-7.3	-6.2	-5.7	-5.6
Primary balance	-5.5	-6.4	-5.0	-3.6	-2.8	-2.5
Government debt	54.6	60.4	60.9	60.1	60.7	60.6
Monetary sector	(in percent change, end-period unless specified)					
Domestic credit	4.7	8.2	12.7	9.3	10.0	10.5
Of which: Private sector	-0.2	3.8	11.1	9.1	9.5	10.0
Broad money (M4)	8.7	8.0	8.0	7.4	7.5	8.0
M1	21.2	13.6	6.8	3.7	4.5	6.0
Memorandum items:						
Exchange rate (peso per USD, average)	49.6	49.3	54.5	55.6	-	-
Exchange rate (peso per USD, eop)	48.0	50.8	56.1	55.6	-	-
Gross domestic product at current price (In trillions of pesos)	18.0	19.4	22.0	24.3	26.4	28.7
Gross domestic product at current price (In billions of U.S. dollar)	361.8	394.1	404.4	437.1	465.1	510.3
GDP per capita (in U.S. dollar)	3,318.2	3,576.9	3,639.5	3,904.6	4,122.1	4,486.3

Source: Philippine authorities; AMRO staff estimates

Appendix 3. Balance of Payments

	2019	2020	2021	2022	2023
	(in millions of U.S. Dollars, unless specified)				
Current Account (I)	-3,047	11,578	-5,943	-18,261	-11,817
Goods	-49,312	-33,775	-52,806	-69,701	-65,899
Exports	53,477	48,212	54,228	57,710	55,394
Imports	102,788	81,987	107,034	127,412	121,293
Services	13,039	13,866	14,039	15,895	18,699
Exports	41,264	31,822	33,570	41,122	48,320
Imports	28,225	17,956	19,531	25,226	29,621
Primary Income	5,276	4,101	3,323	4,949	4,432
Receipts	13,402	11,594	11,832	13,024	16,363
Payments	8,125	7,492	8,509	8,076	11,931
Secondary Income	27,949	27,386	29,501	30,596	30,951
Receipts	28,746	28,240	30,452	31,378	32,043
Payments	797	854	950	781	1,092
Capital Account (II)	127	63	80	23	67
Receipts	147	88	99	86	81
Payments	20	25	19	62	14
Financial Account (III)(+ indicates inflows)	8,034	6,906	6,433	13,885	14,068
Net Acquisition of Financial Assets	-7,297	-13,286	-10,261	-2,533	-4,700
Net Incurrence of Liabilities	15,331	20,192	16,694	16,419	18,769
Direct Investment	5,320	3,260	9,732	5,631	5,211
Net Acquisition of Financial Assets	-3,351	-3,562	-2,251	-3,861	-3,905
Net Incurrence of Liabilities	8,671	6,822	11,983	9,492	9,116
Portfolio Investment	2,474	1,680	-10,237	1,684	-3,005
PI:Net Acquisition of Financial Assets	-2,402	-6,567	-7,809	281	-3,636
PI:Net Incurrence of Liabilities	4,876	8,246	-2,428	1,402	632
Financial Derivatives	173	199	-49	48	115
Net Acquisition of Financial Assets	874	796	449	632	779
Net Incurrence of Liabilities	-701	-596	-498	-584	-664
Other Investment	67	1,767	6,987	6,523	11,747
OI:Net Acquisition of Financial Assets	-2,417	-3,953	-649	415	2,062
OI:Net Incurrence of Liabilities	2,484	5,720	7,636	6,108	9,684
Net unclassified items (V)	2,729	-2,526	774	-2,911	1,354
Overall BOP (I+II+III+V)	7,843	16,022	1,345	-7,263	3,672
Change in Reserve Assets	7,843	16,020	1,345	-7,246	3,681
Memorandum items:					
Current Account (% GDP)	-0.8	3.2	-1.5	-4.5	-2.7
Gross International Reserves	87,840	110,117	108,794	96,149	103,753
Import cover	7.6	12.3	9.7	7.2	7.6
Changes in gross reserves	8,646	22,278	-1,323	-12,645	7,604
Nominal GDP (USD billion)	377	362	394	404	437

Source: Philippine authorities; AMRO staff calculations
Note: Import cover is defined as number of months of average imports of goods and payment of services and primary income that can be financed by reserves.

Appendix 4. Statement of National Government Operations

	2019	2020	2021	2022	2023
	(In percent of GDP, unless specified)				
Government Revenue	16.1	15.9	15.5	16.1	15.7
Tax Revenue	14.5	14.0	14.1	14.6	14.1
Bureau of Internal Revenue (BIR)	11.1	10.9	10.7	10.6	10.4
Net Income & Profits	5.9	5.8	5.4	5.6	5.8
Excise Tax	1.6	1.6	1.6	1.4	1.2
Sales Taxes & Licenses	2.7	2.6	2.6	2.6	2.5
Others	0.9	0.8	1.0	0.9	0.9
Bureau of Customs (BOC)	3.2	3.0	3.3	3.9	3.6
Other Offices	0.1	0.1	0.1	0.1	0.1
Non Tax & Grant	1.6	2.0	1.4	1.5	1.6
Government Expenditure	19.5	23.5	24.1	23.4	21.9
Current Operating Expenditures	14.0	18.5	18.0	17.4	16.0
Personal Services	5.7	6.6	6.6	6.3	5.9
Maintenance and Other Operating	2.9	4.9	4.5	4.0	3.8
Subsidy	1.0	1.3	1.0	0.9	0.7
Allotment to LGUs	2.4	3.5	3.5	3.8	2.9
Interest Payments	1.8	2.1	2.2	2.3	2.6
Tax Expenditure	0.1	0.2	0.2	0.2	0.1
Capital Outlays	5.3	4.9	6.0	5.9	5.8
Infrastructure & Other Capital Outlays	4.5	3.8	4.6	4.6	5.0
Equity	0.0	0.1	0.2	0.1	0.1
Capital Transfers to LGUs	0.8	1.0	1.1	1.2	0.9
Net Lending	0.1	0.1	0.1	0.1	0.1
Government Balance	- 3.4	- 7.6	- 8.6	- 7.3	- 6.2
primary balance	- 1.5	- 5.5	- 6.4	- 5.0	- 3.6
Government Financing	4.5	13.9	11.6	8.9	8.5
External: Net	0.9	3.3	1.7	1.8	1.8
External: Gross	1.6	4.1	2.9	2.4	2.3
Project Loan	0.3	0.3	0.6	0.5	0.6
Program Loans	0.4	2.1	0.9	0.6	0.8
Global Bonds	0.4	1.4	0.8	1.1	0.7
Amortization	0.7	0.8	1.2	0.6	0.5
Domestic: Net	3.5	10.6	9.9	7.2	6.7
Domestic: Gross	3.6	11.1	10.4	7.5	6.7
Treasury Bills: Net	0.0	2.6	- 0.8	- 1.8	0.5
Retail Treasury Bonds	1.2	4.6	4.2	3.8	1.0
Fixed Rate Treasury Bonds	2.4	3.9	6.5	5.4	4.8
Amortization	1.8	2.5	2.8	2.8	3.4
Memorandum items:					
Government Debt	39.6	54.6	60.4	60.9	60.1
Domestic	26.3	37.3	42.1	41.8	41.2
Foreign	13.3	17.3	18.3	19.1	18.9
Short-term(% of Total)	6.4	9.8	6.8	3.1	3.7
Medium-term (% of Total)	17.8	23.0	23.6	22.3	16.8
Long-term (% of Total)	75.9	67.3	69.6	74.7	79.4
Nominal GDP (Trillion, PHP)	19.5	18.0	19.4	22.0	24.3

Source: Philippine authorities; AMRO staff calculations

Note: 1) The tax expenditures pertain to tax expenditure subsidies granted to government agencies/units/instrumentalities, different from the general concept of tax expenditures. 2) Net lending represents advances by the NG for the servicing of government guaranteed corporate debt during the year, net of repayments on such advances, and includes loan proceeds from program loans relent to government corporations. 3) Short-term debts are borrowings payable within one year; medium-term debts are borrowings payable within 1-5 years; long-term debts are borrowings payable more than 5 years.

Appendix 5. Debt Sustainability Analysis[102,103]

The public debt-to-GDP ratio is projected to gradually decline to 57.6 percent by 2028 after peaking at 60.7 percent in 2024, with gross financing needs (GFNs) also expected to decrease (Table 5.1). The projected average economic growth rate from 2024 to 2028 is 6.2 percent, aligning with the potential growth trajectory. The effective interest rate is expected to rise gradually until 2026 and stabilize after 2027, driven by the higher coupon rates from sizable issuances of Treasury bonds and rollovers since the pandemic, as well as the ongoing increase in the effective interest rate of existing debt until more of it switches to lower rates. The fiscal deficit as a percentage of GDP is expected to continue narrowing, supported by robust revenue growth from ongoing and anticipated tax reform measures, as well as improved tax administration, despite increased spending to stimulate economic growth. Strong real GDP growth will help to reduce the debt ratio, offsetting the effects of the primary deficit and the real interest rate (Figure 5.1 Panel A). However, despite a steady reduction in the primary deficit, the GFN-to-GDP ratio will remain above pre-COVID levels due to the repayment of Treasury bonds that were issued in large amounts during the pandemic (Figure 5.1 Panel B).

A standard debt sustainability analysis (DSA) indicates that the overall risk to public debt sustainability is low (Figure 5.4). The public debt-to-GDP ratio and the GFN as a percentage of GDP have remained below their respective thresholds over the past five years, and are projected to stay below these thresholds in the baseline and all stress test scenarios throughout the projection period (Figure 5.2). Additionally, market perception of sovereign risk is also low, as evidenced by the EMBI spread. While the share of debt held by nonresidents and debt in foreign currencies exceed the lower early warning benchmarks, the rollover risk remains relatively contained, as the share of concessional loans remains high, amounting to 17.5 percent of total debt. However, given the sizable current account deficit, closer attention should be paid to external financing requirements (Figure 5.3).

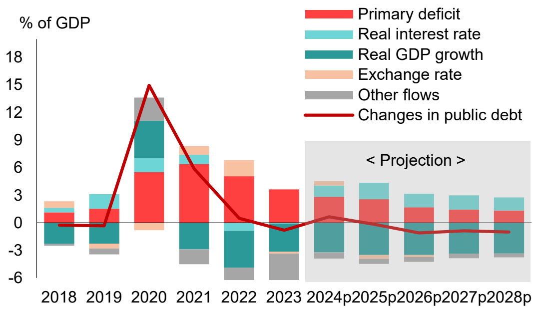
Table 5.1. Macroeconomic and Fiscal Indicators

	2018	2019	2020	2021	2022	2023	2024p	2025p	2026p	2027p	2028p
Macroeconomic indicators (Percent)											
Real GDP growth	6.3	6.1	-9.5	5.7	7.6	5.5	5.8	6.3	6.3	6.2	6.2
GDP deflator	3.7	0.7	1.7	2.3	5.5	4.6	2.8	2.2	2.8	2.6	2.6
Effective interest rate	5.2	4.9	4.9	4.4	4.3	4.7	5.2	5.5	5.6	5.5	5.4
Fiscal indicators (Percent of GDP)											
Revenue	15.6	16.1	15.9	15.5	16.1	15.7	16.1	16.0	16.0	16.0	16.2
Expenditure	18.7	19.5	23.5	24.1	23.4	21.9	21.7	21.6	20.8	20.5	20.4
Fiscal balance	-3.1	-3.4	-7.6	-8.6	-7.3	-6.2	-5.7	-5.6	-4.8	-4.5	-4.2
Primary balance	-1.1	-1.5	-5.5	-6.4	-5.0	-3.6	-2.8	-2.5	-1.7	-1.4	-1.3
Public debt	39.9	39.6	54.6	60.4	60.9	60.1	60.7	60.6	59.5	58.6	57.6
Gross financing needs	5.1	5.9	10.9	12.6	10.7	10.0	10.5	9.8	9.0	8.6	8.3

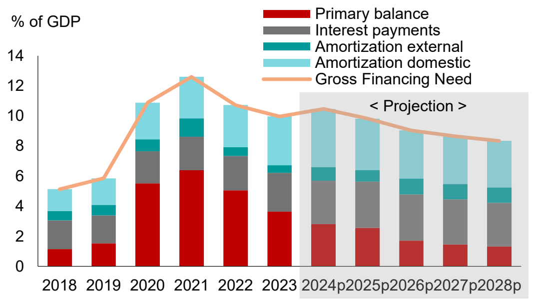
Source: Department of Budget and Management (DBM); AMRO staff estimates

Figure 5.1. Public Debt and GFN Dynamics

Panel A. Contribution to Changes in Public Debt



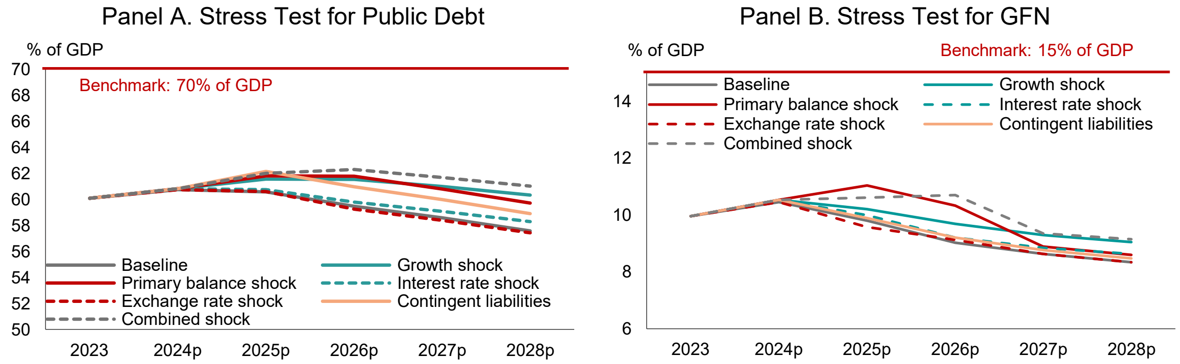
Panel B, Contribution to GFN Levels



Source: DBM; AMRO staff estimates

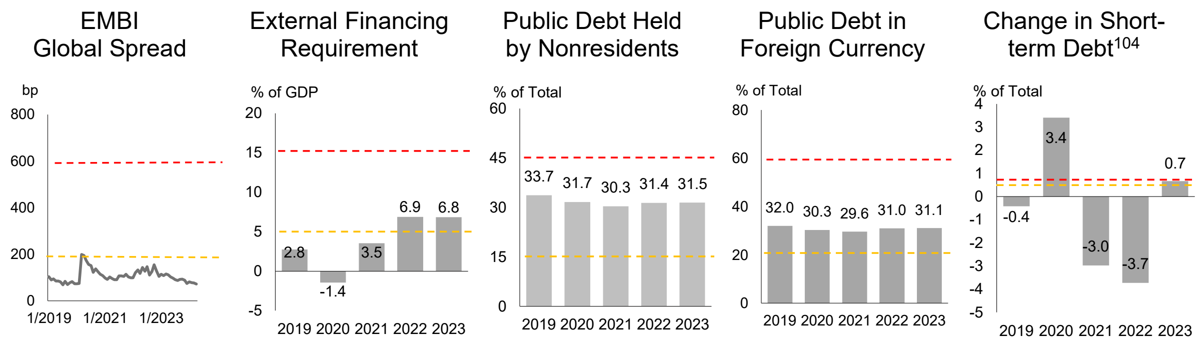
[102] Prepared by Chunyu Yang, Economist.
[103] Public DSA for the Philippines covers national government debt.

Figure 5.2. Macro-fiscal Stress Test



Note: The scenarios for the stress test are as follows: 1) Real GDP growth shock: one standard deviation or a -1.0 percentage point shock to 2025 and 2026; 2) Primary balance shock: one standard deviation or a -1.1 percent of GDP shock to 2025 and 2026; 3) Interest rate shock: a +1 percentage point shock from 2025; 4) Exchange rate shock: a one-time +5 percentage point shock in 2025; 5) Contingent liability shock: a one-time 1.5 percent of GDP shock in 2025; 6) Combined shock: a combination of growth (half size), primary balance (half size), interest rate and exchange rate shocks.
Source: DBM; AMRO staff estimates

Figure 5.3. Debt Profile Vulnerabilities



Note: 1) — — — Lower early warning (50 percent of the benchmark), — — — upper early warning (75 percent of the benchmark); 2) External financing requirements = current account deficit + amortization of public external debt + amortization of private external debt; 3) Short-term debt is based on the original maturity.
Source: DBM; AMRO staff estimates

Figure 5.4. Heatmap of Public Debt Sustainability

		2018	2019	2020	2021	2022	2023	2024p	2025p	2026p	2027p	2028p
Public Debt												
Gross Financing Needs												
Debt Profile	Market Perception of Sovereign Risk											
	External Financing Requirement											
	Public Debt Held by Nonresidents											
	Public Debt in Foreign Currency											
	Change in Short-term Debt Share											

Note: For Public Debt and Gross Financing Needs, the cell is highlighted in green if the benchmark is not exceeded under all shocks or the baseline, yellow if exceeded under any specific shock but not the baseline, and red if exceeded under the baseline. For Debt Profile, the cell is highlighted in green if the country value is less than the lower early warning benchmark, red if it exceeds the upper early warning benchmark, and yellow if it lies between the lower and upper early warning benchmarks.
Source: AMRO staff estimates

[104] Although the share of short-term debt increased in 2023, this may reflect the authorities' strategy to shorten the duration amid a high interest rate environment. However, the size of short-term debt in 2023 remained smaller than in 2020 and 2021.

Appendix 6. Climate Clipboard – Risks, Responses and Opportunities[105]

A. Physical risks

Sources of risk	Potential macro-financial impacts
• Increased temperature and drought (chronic) • Sea level rise and extreme sea levels (chronic) • Extreme precipitation (acute) • Extreme winds and tropical cyclones (acute) **Exposure** • The Philippines is largely or substantially exposed to physical risks • Topped the 2024 World Risk Index with the highest exposure to disaster risks among 193 countries • Ranked as having the world's 28th highest risk of climate change on the UN Index for Risk Management (INFORM) • Ranked 115th out of 187 countries in the 2022 Notre Dame-Global Adaptation Index (ND-GAIN)	• Extreme weather events and natural disasters resulted in damage and losses worth PHP24.49 billion in 2023. • In 2024, combined damage and losses brought about by the southwest monsoon and Typhoon Carina reached PHP4.73 billion. • Average estimated losses from climate-related hazards can be between 3.2% and 7.6% of GDP per year by 2030, rising to between 5.7% and 13.6% by 2040, according to the World Bank Country Climate and Development Report 2022. • Large-scale climate-related hazards could inflict destabilizing losses on insurance and other financial intermediaries with direct and indirect exposure to affected industries.

B. Transition risks

Sources of risk	Potential macro-financial impacts
• Policy changes • Technological changes needed for the shift to a green economy • Changes in public sentiment **Exposure** • Relatively limited exposure to transition risks at present • Despite increasing greenhouse gas (GHG) emissions, the Philippines makes up only 0.48 percent of the world's total GHG emissions.	• Losses in carbon-intensive energy sectors, such as utilities, transport and industrial sector • Revaluation or repricing of carbon-sensitive assets entails losses to investors holding these assets, which, if not addressed, could lead to systemic risks in the financial system. • Productivity changes

C. Adaptation response framework and strategies

National framework	Key initiatives/strategies	Estimated financing needs and sources	
• National Adaptation Plan (NAP, 2024) ➢ The NAP guides the identification and implementation of science-based adaptation measures across eight priority sectors: (a) agriculture, fisheries and food security; (b) water resources; (c) health; (d) ecosystems and biodiversity; (e) cultural heritage, population displacement and migration; (f) land use and human settlements; (g) livelihoods and industries; and, (h) energy, transport and communications.	• The People's Survival Fund (PSF) ➢ provides technical and financial assisstance to enable local communities to implement adaptation measures. • National Disaster Risk Reduction and Management Fund (NDRRMF) ➢ provides relief and rehabilitation to calamity-affected communities and areas to facilitate a return to normalcy as quickly as possible. • Local Disaster Risk Reduction and Management Fund (LDRRMF) ➢ requires local governments to set aside 5% of their budgets as a local calamity fund, of which 30% shall be allocated as a Quick Response Fund (QRF) or standby fund for relief and recovery programs. • Formulation of Energy Resiliency Standards ➢ complements the programs, strategies and activities on climate change adaptation and disaster risk reduction. • Infrastructure projects ➢ include infrastructure repairs (half of public infrastructure spending) and climate change-resilient infrastructure, such as prevention of overflowing water.	• Annual cost of adapting to climate-related hazards over 2020-2059 is USD4.2 billion (Source: United Nations - Economic and Social Commission for Asia and the Pacific, UN-ESCAP) **Domestic** • 2025 National Government (NG) Budget: PHP889.7 billion (87% of total climate change expenditures of PHP1.02 trillion) • Local government units, the private sector, and individuals who support adaptation initiatives	 **External** • Asian Development Bank (ADB): Country Partnership Strategy (CPS) for 2018-2023 • World Bank: Country Partnership Framework (CPF) for 2019-2023, covering resilience to climate change, environment, and disaster risk management

D. Mitigation response framework and strategies

National framework	Key initiatives/strategies	Estimated financing needs and sources	
• Philippine Energy Plan 2020-2050 (2024) ➢ outlines sector-specific strategies to decarbonize the country's energy system. • Nationally Determined Contribution Implementation Plan (NDCIP) (2024) ➢ reduce/avoid emissions from 5 sectors: agriculture, waste, industrial process & product use, transport, and energy. **Nationally Determined Contribution (NDC)** • Economy-wide emission reduction of 75% from the business-as-usual scenario by 2030, of which ➢ 2.71% is an unconditional reduction using nationally mobilized resources. ➢ 72.29% is a conditional reduction subject to support from developed countries. **Long-term commitment** • No net-zero target	• Raise the share of renewable energy in the power generation mix to 41.45% by 2030 and 56.92% by 2040 • Banned new coal-fired power plants from October 2020 • Phase out unabated coal power generation by the 2040s, or as soon as possible thereafter • Promote energy efficiency and conservation via campaigns and implementation of energy usage standards • Adopt a four-point strategy to achieve high clean energy usage: ➢ Accelerate deployment of renewable energy projects ➢ Build and/or develop a green and smart transmission system ➢ Build and/or expand the necessary port infrastructure to support marine-based energy resource development projects ➢ Provide an avenue for voluntary early decommissioning and/or repurposing of existing coal-fired power plants	• Potential investment in energy systems over 2020-2050 is USD200 billion to USD300 billion (Source: Asia Investor Group on Climate Change) • Investment requirements to deliver the country's NDC targets are around USD73 billion (PHP4.1 trillion, NDCIP) **Domestic** • 2025 NG Budget: PHP130.0 billion (13% of total climate change expenditures of PHP1.02 trillion) • NG's environmental, social and governance (ESG) bonds and banks' sustainable bonds	 **External** • ADB's Climate Change Action Program, Subprogram 1: USD250 million from ADB's ordinary capital resources • Global Environment Facility

[105] Prepared by Andrew Tsang, Senior Economist.

E. Enabling regulations for climate resilience

E.1. Legal framework	E.3. GHG accounting framework	E.5. Sustainable finance frameworks
• Climate Change Act (2009) • National Framework Strategy on Climate Change (NFSCC) (2010) • National Climate Change Action Plan (NCCAP) 2011-2028 (2011) • Climate Change Act (2012), governing Climate Change Commission (CCC) and climate change regulations	• The Philippine Greenhouse Gas Accounting and Reporting Program (PhilGARP) ➢ aims to help businesses in the Philippines prepare GHG inventories, identify GHG reduction opportunities, and participate in programs and projects to reduce GHG emissions.	• The Securities and Exchange Commission (SEC) has released guidelines on issuing green, social, and sustainability bonds under ASEAN Bond Standards. ➢ Guidelines for the issuance of green bonds in the Philippines (2018) ➢ Guidelines for the issuance of social bonds in the Philippines (2019) ➢ Guidelines for the issuance of sustainability bonds in the Philippines (2019) ➢ Rules on Sustainable and Responsible Investment Funds (2022) ➢ Guidelines on the Issuance of Sustainability-Linked Bonds under the ASEAN Sustainability-Linked Bond Standards in the Philippines (2023) ➢ Adoption of the ASEAN Sustainable and Responsible Fund Standards (ASEAN SRFS) (2023) • The BSP has introduced guidelines for banks to incorporate sustainability principles into their corporate and risk governance and operations. ➢ Sustainable Finance Framework for Banks (2020) ➢ Environmental and Social Risk Management Framework (2021) ➢ Guidelines on the Integration of Sustainability Principles in Investment Activities of Banks (2022) ➢ Guidance on the Implementation of the Environmental and Social Risk Management (ESRM) System (2022) ➢ Recognition of Sustainable Finance as an eligible mode of compliance with mandatory credit to agriculture, fisheries and rural development (2022) ➢ Grant of Additional Single Borrower's Limit for Financing Eligible Projects and Zero Percent Reserve Requirement Rate Against Sustainable Bonds (2023) ➢ Issuance of the Philippine Sustainable Finance Taxonomy Guidelines for Banks (2024)
E.2. Fiscal framework	**E.4. Carbon pricing and taxation frameworks**	
• Department of Budget and Management (DBM) and CCC Joint Memorandum Circular (JMC) (2015) ➢ The CCC and DBM work together to develop a climate change expenditure tagging (CCET) system ➢ The CCC is mandated to (i) evaluate and approve NG institution-tagged climate change budgets, and (ii) strengthen the capacities of National Government Agencies (NGAs), State Universities and Colleges (SUCs), and Government-Owned and Controlled Corporations (GOCCs) to undertake CCET. ➢ Government agencies and other public instrumentalities are required to identify and tag climate-related programs and projects in their budget, as reflected in the agency request, the National Expenditure Program, and the General Appropriations Act.	• The Department of Finance (DOF) and other government agencies, with the support of the World Bank, have been conducting a study on carbon pricing instruments (CPI). • The Department of Environment and Natural Resources (DENR) works with the United Nations Development Programme (UNDP) to establish a regulatory framework for carbon trading. • The DENR has been developing a carbon credit program through reforestation projects using the Guidelines on the Establishment of the Carbon Accounting, Verification, and Certification System for Forest Carbon Projects. • The NG collects energy taxes through excise taxes on fuels and electricity consumption. • Two measures qualify as subsidies on energy use based on the OECD's Taxing Energy Use for Sustainable Development classification: ➢ a fuel cash card program for operators of public utility jeepneys to offset the cost of higher excise taxes; and, ➢ direct NG budgetary support to the National Power Corporation.	

E.6. Financial system

Initiatives	Guidelines	Status
1. Taxonomy	• Philippine Sustainable Finance Taxonomy Guidelines (SFTG) (2024)	• The BSP, in collaboration with the industry, is developing guidance on the integration of the taxonomy in the banks' credit risk management cycle and on the related reporting tool. • The SFTG will be reviewed and updated periodically to capture developments in sustainable finance.
2. Risk management assessment	• The BSP's Sustainable Finance Framework requires banks to develop and implement an environmental and social risk management system (ESRMS) that is commensurate with the size, nature and complexity of their operations. ➢ For example, banks must have in place the tools for monitoring and identifying risks and integrate environmental and social risks into stress testing.	• The BSP will develop climate risk stress testing guidelines in collaboration with the industry to better equip banks in managing exposures to climate and environment-related risks. • The BSP issued complementary guidelines which required banks to incorporate environmental and social (E&S) factors in their credit (lending and investing activities) and operational risk management systems. • The BSP issued Memorandum No. M-2022-042 providing sample approaches/methodologies for climate stress testing/scenario analysis of banks.
3. Climate-related financial disclosure	• SEC's Sustainability Reporting Guidelines for listed firms. • BSP's requirement for banks to disclose environmental and sustainability risks in their annual reports starting in 2023.	• The BSP's ESG Supervision and Surveillance Group, in coordination with supervising departments, is assessing banks' sustainability disclosures in the 2023 Annual Report.
4. Capacity building	• The BSP, SEC and Inter-agency Technical Working Group on Sustainable Finance (the Green Force). • The BSP articulated its 2024-2029 Enterprise Strategy to strengthen response to climate and nature concerns.	• The BSP, SEC, and the Green Force, in partnership with local and international organizations, are providing training and seminars to both regulators and private entities. • The BSP created a Sustainability Office to promote sustainability in the BSP's policy formulation and advocacy, and operations. The ESG Supervision and Surveillance Group was also created to lead the development and implementation of enabling policies and regulations for the financial sector on sustainability/sustainable finance, as well as oversee the continued awareness and capacity building initiatives of the sector in this area.
5. Regulatory incentives	• Measures to incentivize banks to finance green or sustainable projects, including transitional activities targeting decarbonization	• The BSP is considering additional potential measures to incentivize banks to promote green lending, such as the use of preferential rediscount rates or provision for higher loan values.

F. Potential opportunities from the low-carbon transition

• Enhancing energy security by using a larger share of renewable energy resources ➢ Opening renewable energy to full foreign ownership (Department of Energy (DOE) Circular No. 2022-11-0034)	• Electric vehicles (EVs) ➢ The Philippines has a vast supply of the required rare earth minerals necessary to produce EV batteries. ➢ A Green Lane for Strategic Investments, such as EV infrastructure.

Source: National authorities; media reports; AMRO staff

Appendix 7. Data Adequacy for Surveillance Purposes: A Preliminary Assessment

Surveillance Areas	Data Availability(i)	Reporting Frequency/Timeliness(ii)	Data Quality(iii)	Consistency(iv)	Others, if Any(v)
National Accounts	Available	Quarterly data for the expenditure and production approaches is available with a normal time lag of two months after the reference quarter	-	-	-
Balance of Payments (BoP) and External Position	Available	BoP data is available quarterly with a normal time lag of two months and three weeks after the reference month. External debt data is available with a normal time lag of two months and three weeks after the reference quarter	-	-	-
State Budget and Government/ External Debt	Available	Central government budget and public finance data is available on a monthly basis with a normal time lag of one to two months after the reference month. Date for central government domestic and foreign debt outstanding is available monthly with a normal time lag of one month after the reference month	-	-	-
Money Supply and Credit Growth	Available	Money supply data is available on a monthly basis with a normal time lag of one month after the reference month. Bank loan data is available quarterly with a normal time lag of two-and-a-half to three months after the reference quarter	-	-	-
Financial Sector Soundness Indicators	Available	Quarterly indicators are available with a time lag of one quarter	-	-	-
SOE Statistics	SOE statistics have yet to be made available on a frequent basis	-	-	-	-

Notes:
1. Data availability refers to whether the official data is available for public access by any means.
2. Reporting frequency refers to the time interval between the publishing of the available data. Timeliness refers to how up to date the published data is relative to the publication date.
3. Data quality refers to the accuracy and reliability of the available data after taking into account the data methodologies.
4. Consistency refers to both internal consistency within the data series itself and its horizontal consistency with other data series of either the same or different categories.
5. Other criteria might apply, if relevant. Examples include but are not limited to potential areas of improvement in data adequacy.

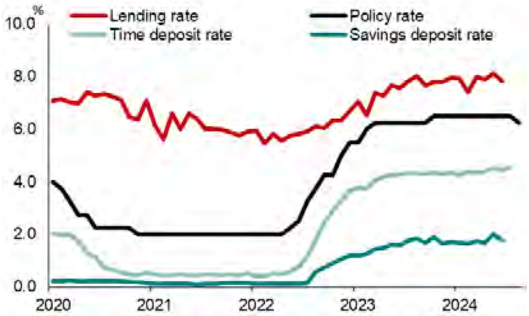
Source: AMRO staff compilation. This preliminary assessment will form the “Supplementary Data Adequacy Assessment” in the EPRD Matrix.

Annexes: Selected Issues

1. A Closer Look at Monetary Policy Transmission to Bank Lending Rates[106]

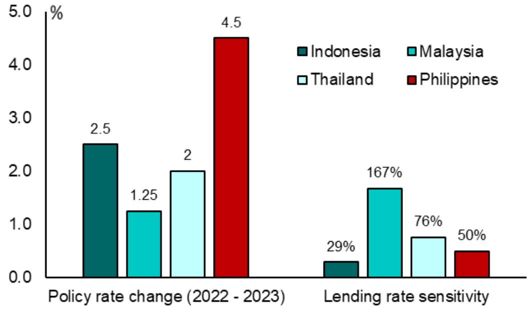
In 2022-2023, Bangko Sentral ng Pilipinas (BSP) tightened monetary policy forcefully by raising the policy interest rate by 450 basis points to fight off inflation. The magnitude of the increase was large compared with peer countries such as Indonesia, Malaysia and Thailand. However, only half of the total change was reflected in the actual bank lending rate (Figures A1.1, A1.2). Such a weak pass-through may hinder monetary policy effectiveness, given the bank-based nature of the Philippine financial system. This selected issue attributes the causes of such limited pass-through to an abundance of low-cost funding and the lack of consumer credit data, then discusses policy options to strengthen the pass-through.

Figure A1.1. Policy and Bank Rates



Source: BSP; CEIC

Figure A1.2. ASEAN-4 Lending Rate Sensitivity

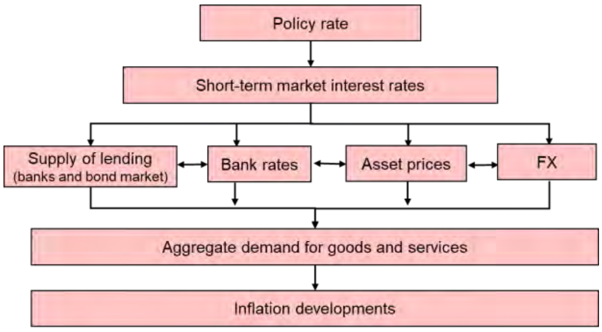


Source: Central banks; CEIC; AMRO calculations
Note: Lending rate sensitivity is the change in the average lending rate divided by the change in the policy rate between the first hike and three months after the last hike in each respective country.

1. **Effective monetary policy implementation requires a robust transmission of the policy rate to the interest rates in the broader economy.** When the BSP adjusts its policy rate, known as the target reverse repurchase (RRP) rate, it should lead to corresponding changes in the short-term market interest rates at which banks lend or borrow funds from one another (Figure A1.3). These market interest rates influence asset prices, such as stock indices, bond yields and exchange rates. They also feed into bank funding costs, which are the basis for the pricing of bank deposit and lending rates. The bank rates and asset prices that consumers and firms face affect their demand for goods and services, and ultimately, domestic prices. In the Philippines, since bank funding is the largest formal financing source for the private sector, the sensitivity of bank lending rates to the policy rate is central to monetary policy effectiveness. In the following sections, the strength of each link is examined one at a time.

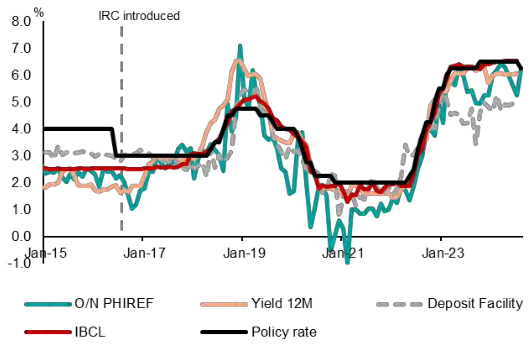
[106] This selected issue was prepared by Pim-orn Wacharaprapapong, Economist.

Figure A1.3. Monetary Policy Transmission Channels



Source: AMRO illustration
Note: The figure displays channels that are relevant to this selected issue. It omits some channels, such as the expectations channel.

Figure A1.4. Policy and Short-term Market Rates



Source: BSP; Bloomberg; Haver Analytics; AMRO calculations

A Fair Transmission from the Policy Rate to Money Market Rates

2. The first link in the transmission – from the policy rate to short-term market rates – worked well in some markets. Movements of the interbank call loan rate (IBCL), which is the overnight unsecured borrowing rate, and the short-term government bond yields have been well anchored to the policy rate since the establishment of the Interest Rate Corridor (IRC) in 2016.[107] Before the IRC, insufficient liquidity absorption led IBCL and one-year yields to trade significantly below the policy rate (Figure A1.4). However, after the IRC was put in place, the BSP introduced new liquidity absorption tools such as the term deposit facility and the issuance of BSP securities, and these short-term market rates began moving more in line with the policy rate. Correlations between the policy rate and the IBCL rose from 63 percent during 2010-2016 to 99 percent during 2017-2024. Similarly, correlations between the policy rate and the one-year yield improved from 38 percent to 94 percent.

3. However, the interest rate in the foreign exchange swap market is more volatile and often trades below the policy rate. Banks use FX swaps to borrow or lend peso liquidity using the U.S. dollar as collateral. Therefore, the implied peso interest rate derived from FX swaps, called the Philippine Interbank Reference Rate (PHIREF),[108] depends on not only domestic interest rate conditions but also U.S. dollar funding conditions. This is why the PHIREF trades on average 64 bps lower than the policy rate[109] and experience higher volatilities compared with the IBCL (Figure A1.4). Between April 2022 and October 2023, the PHIREF climbed 322 bps compared with 450 bps in the policy rate. The PHIREF's volatilities and deviations from the policy rate can dilute monetary policy signals, given that FX swaps remain the most active interbank market in the Philippines[110] due to higher liquidity and more familiarity among participants compared with the repo market.

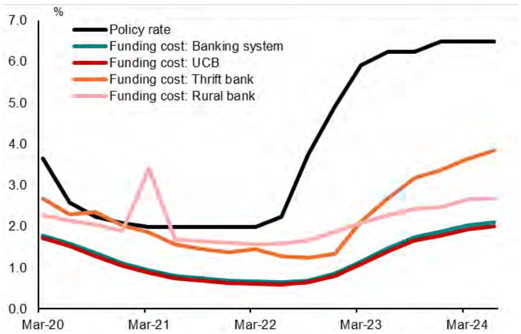
[107] See BSP Press Release: BSP Implements Interest Rate Corridor (IRC) System in Q2 2016 at https://www.bsp.gov.ph/SitePages/MediaAndResearch/MediaDisp.aspx?ItemId=3991
[108] The Philippine Interbank Reference Rate (PHIREF) is the implied peso rate derived from FX swap transactions using USD LIBOR or USD SOFR.
[109] Data from 2017 to 2024.
[110] BSP data shows that average daily volumes of transactions in 2024, as of August 15, are as follows: FX swaps PHP37.7 billion, IBCL PHP10.4 billion, repo PHP1.4 billion.

Disconnect Between Market Rates and Bank Funding Costs

4. Short-term market rates are only partially reflected in bank funding costs. Following the 450 bps increase in the policy rate and the comparable changes in many short-term market rates, the average funding costs of the banking system rose by less than 30 percent of that amount[111] (Figure A1.5). The changes were most muted at universal and commercial banks (UKBs), the key players in the system.

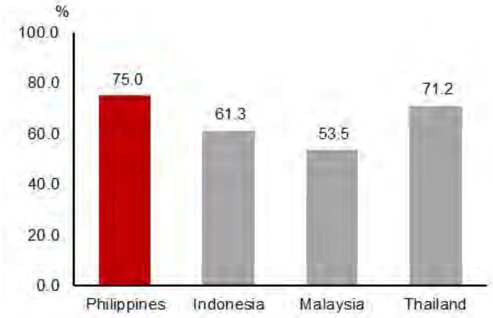
5. The muted changes in bank funding costs are a result of the large low-cost deposit funding in the banking system. Demand & negotiable order of withdrawal (NOW) and savings deposits in the Philippines constitute on average 75 percent of the deposit base, higher than current and savings (CASA) deposits in Malaysia's 53 percent, Indonesia's 61 percent and Thailand's 71 percent (Figure A1.6). Notably, when the policy rate rose to a 17-year high, the average NOW and savings deposit ratio fell by 6.9 percent between 2022 and the first half of 2024,[112] suggesting some stickiness in the deposit base. Because NOW and savings deposits are held for transactional purposes, they pay lower interest rates than term deposits (Figure A1.1), and thus help keep banks' funding costs low. The savings deposit rate is also less sensitive to policy rate changes. During the latest policy rate hiking cycle, the savings deposit rate rose by only 34 percent of the policy rate hike, compared with 83 percent in the term deposit rate.[113] To be sure, from a bank's perspective, a high NOW and savings ratio supports profitability. However, from a monetary policy perspective, it limits the degree of policy transmission to bank rates and then to the economy overall.

Figure A1.5. Average Bank Funding Costs



Source: BSP; CEIC

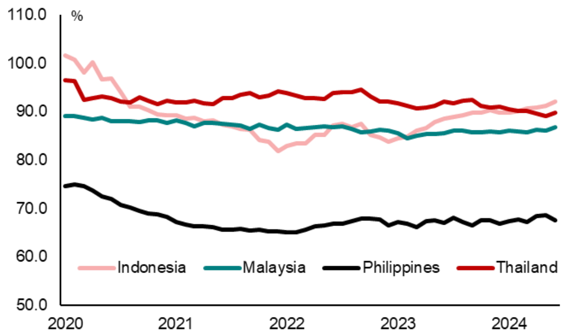
Figure A1.6. CASA Deposit Ratio (5-year Average)



Source: Central banks; CEIC; AMRO calculations
Note: Average for the periods of Jan 2020 – Jun 2024. For the Philippines, the figure refers to the demand and negotiable order of withdrawal (NOW) and savings deposits.

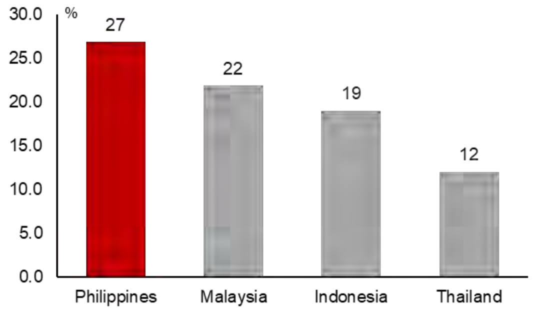
[111] The change in average bank funding costs between the first policy rate hike to three months after the last rate hike, to allow for lagged effects.
[112] CASA ratio averaged at 81 percent in 2022, and 76 percent in H1 2024.
[113] Deposit rate sensitivity is measured as the change in average deposit rates divided by the change in the policy rate between the first rate hike and three months after the last rate hike, to account for transmission lags.

Figure A1.7. Loan-to-Deposit Ratios



Source: Central banks; CEIC; AMRO calculations
Note: The loan-to-deposit ratios in this chart are defined as loans and receivable - others, net of amortization divided by deposit liabilities, to provide a consistent comparison of loan-to-deposit ratios among peer countries.

Figure A1.8. Proportion of Bank Securities Holding to Total Assets



Source: IFS; CEIC; AMRO calculations

6. The large surplus liquidity in the banking system also limits the rise in bank funding costs. The Philippine banking system has ample liquidity. The series of Reserve Requirement Ratios (RRR) cuts also released more liquidity into the banking system and lowered banks' costs of funds. Excess liquidity is also reflected by the loan-to-deposit (L/D) ratio, which is markedly lower than in ASEAN-4 peers (Figure A1.7). The low L/D ratio shows that most banks have a sizable buffer of idle liquidity, and hence have no need to compete for deposits by using more attractive rates. This is particularly true for UKBs, which are big banks with larger deposit bases.[114] This is why UKBs have kept their funding costs lower than rural and thrift banks. The low L/D ratio may reflect some combination of a lack of profitable lending opportunities and low-risk appetite among banks. Indeed, Philippine banks hold more government securities as a share of total assets compared with their counterparts in other ASEAN-4 countries (Figure A1.8).

Constrained Linkage from Bank Funding Costs to Lending Rates

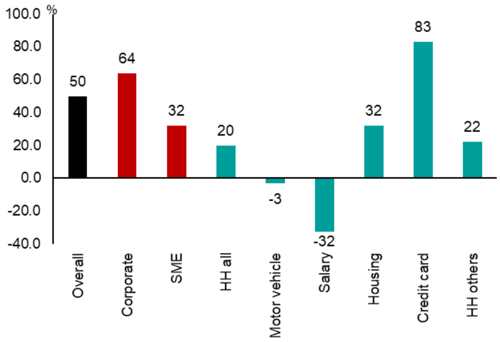
7. The pass-through to bank lending rates was constrained and differs across loan types. After the policy rate was raised by 450 bps, the average effective lending rate rose by 224 bps, a pass-through of 50 percent. However, behind this average number, the degree of pass-through varies across loan types. It is strongest for corporate loans, at 64 percent, followed by SME loans at 32 percent, and household loans at 20 percent (Figure A1.9). Furthermore, among household loan types, the pass-through differs markedly, from positive for credit card[115] and housing loans, to negative for salary and motor vehicle loans. At the outset, it may appear counterintuitive that corporates that generally have lower credit risks experience a sharper rise in their borrowing costs than SMEs or households. AMRO's interviews with banks shed some light on this puzzle.

8. Household loan rates are less sensitive to the policy rate because they are dominated by credit risk premiums. In simple terms, bank loan rates comprise bank funding costs plus the risk premium of the borrowers and the bank's profit margins. Based on AMRO's interviews with banks, the credit risk component in household loan rates tends to be large, dwarfing any changes in funding costs that can be influenced by the policy rate. This is why

[114] The average L/D ratio during 2022-2024 for UKBs, thrift banks and rural banks are 66.2 percent, 83.2 percent and 79.0 percent, respectively. Moreover, 65 percent of bank deposits are concentrated in the five largest banks, which are all UKBs.
[115] The larger increase in the credit card loan rate was in part a result of the lifting of the credit card interest rate ceiling in January 2023 from 24 percent to 36 percent.

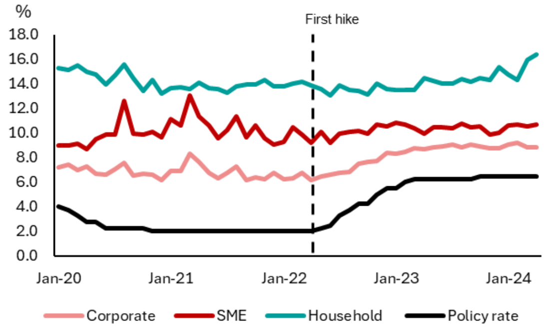
household rates were elevated and kept steady through the policy rate cutting and hiking cycles (Figure A1.10).

Figure A1.9. Sensitivity of Bank Lending Rates to Policy Rate in 2022-2024



Source: BSP; Haver Analytics; AMRO calculations
Note: The rates shown are the average between effective high rates and effective low rates. The changes are between Apr 22 and Jan 24, between the first hike and three months after the last rate hike. HH denotes households.

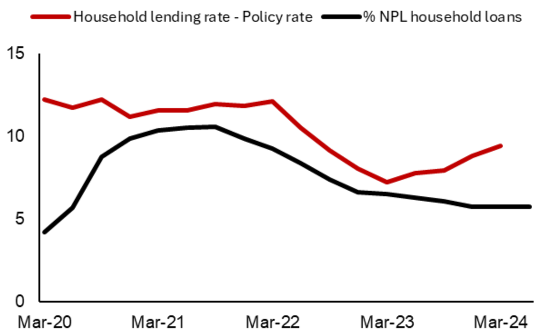
Figure A1.10. Effective Lending Rates



Source: BSP; Haver Analytics; AMRO calculations
Note: The effective rates shown are the average between effective high rates and effective low rates.

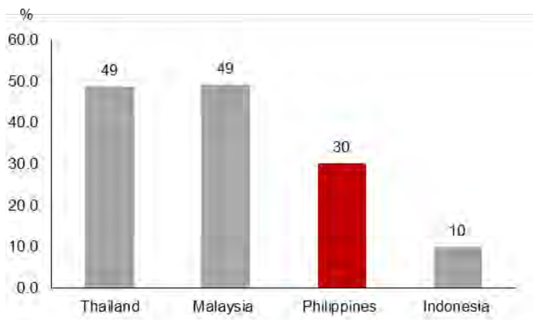
9. Banks cited insufficient household credit data as the reason for the large and persistent credit risk premium. The Credit Information Corporation (CIC) is responsible for collecting the credit data of all borrowers from both bank and non-bank lenders. However, the data is not fully usable or reliable due to problems with quality and coverage. For example, borrowing records are often incomplete, sometimes because different types of identity documents were used for different loans. Entries from different lenders could also be submitted in different formats. The absence of comprehensive and reliable credit information hinders lenders' ability to accurately assess and price the credit risk of household borrowers. The assessment is even more challenging for new borrowers who do not have any prior records. Only a quarter of individuals have access to formal credit,[116] presenting a significant challenge to lenders. As a result, banks tend to attach a large credit risk premium to household lending rates to ensure an adequate buffer. Indeed, the lending rate sometimes deviates from the actual credit risk trend, as measured by the non-performing ratio of household loans (Figure A1.11).

Figure A1.11. Household Credit Risk Premium and NPLs



Source: BSP; CEIC; Haver Analytics; AMRO calculations
Note: Household lending rate is the average effective rate.

Figure A1.12. Share of Investment Funds Outstanding to Total Deposits



Source: AIMC; SC Malaysia; OJK; BSP; AMRO calculations
Note: Investment funds outstanding include unit trust funds, mutual funds and private provident funds. Data for the Philippines is estimated from the liabilities of trust funds by banks and non-bank institutions.

[116] Statistics as of 2021 based on the BSP's 2022 Annual Report National Strategy for Financial Inclusion.

Policy Discussions

Given these findings, three policy priorities can be identified to strengthen the linkage between the policy rate and bank lending rates, and to advance financial development overall.

10. First, the BSP should continue to develop a liquid repo market to serve as the core interbank funding market with a stronger link to the domestic policy rate. The repo market offers an alternative for secured interbank borrowing with more stable pricing, in place of FX swaps. To strengthen the repo market, once the BSP establishes a standard GMRA contract and adopts deliverable repos in its RRP window,[117] it should strongly encourage market participants to follow suit. Next, the authorities should establish standard pricing conventions for collateral securities that market participants can also adopt. Furthermore, the BSP can consider limiting RRP access to a subset of market makers to promote interbank repo activities, at least in the short term. Finally, the BSP's plan to develop an overnight reference rate based on overnight RRP rates as a replacement of the PHIREF is also welcome.

11. Second, although stable bank funding is important for banking system resilience, the deposit market has room for more competition to enhance sensitivity to the policy rate. The BSP can start, as part of promoting financial inclusion and literacy, by increasing awareness and availability of savings alternatives to CASA, including higher-yielding term deposits and capital market investments, such as unit investment trust funds. At present, outstanding investment funds amount to only 30 percent of bank deposits in the Philippines, compared with 50 percent in Malaysia and Thailand (Figure A1.12). To promote more investment, tax incentives for the Personal Equity Retirement Account (PERA) can be expanded beyond retirement savings to cater for other investment goals.[118] Finally, although private entities are already offering investment products, a government-run alternative similar to Malaysia's PNB[119] can take the lead in offering products to underserved groups. The increase in investment in the capital market will not only benefit monetary policy transmission, but also boost household savings and deepen the domestic capital market.

12. Finally, the quality and availability of household credit data must be strengthened. The existing system of household credit data needs improvements to allow lenders to better assess credit risks and price loans. First, the data should be more complete, encompassing all financial footprints at bank and non-bank lenders. Second, the accuracy of the data must be improved. Third, alternative data such as payments to utility companies or online shopping platforms can be added to the credit profile, subject to appropriate data privacy and protection standards. Such improvements in the credit data will not only benefit policy rate transmission, but also provide opportunities to households with a good credit history to access finance at more reasonable costs.

[117] A reverse repurchase (RRP) operation is one of the BSP's monetary policy instruments, in which the central bank sells government securities to banks with a commitment to buy them back at a future date. Currently, securities are not actually transferred due to operational constraints, but the BSP plans to deliver securities by the end of 2024.
[118] PERA is a voluntary retirement savings program that offers investors income tax credit of 5 percent of their annual PERA contributions. The maximum annual contribution eligible for the tax credit is PHP100,000. PERA contributions can be withdrawn upon reaching the age of 55 or in the event of death.
[119] Permodalan Nasional Berhad (PNB) is a government-linked investment company in Malaysia.

2. Scarring Effects of COVID-19 and Post-pandemic Philippine Economic Recovery[120]

The Philippine economy was severely affected by the COVID-19 pandemic. The disruptions caused by harsh lockdowns, impaired the balance sheets of firms, reduced investment, and interruptions in global supply chains had weakened the country's economic fundamentals and lowered its potential growth after the pandemic. This selected issue estimates the pandemic-related scarring effects on the Philippines and suggests that the country's potential growth has been lowered by about 1.69 percentage points, the average of 2022 to 2024, dampened by slower growth in physical capital stock, total factor productivity (TFP) and human capital compared with the pre-pandemic period.

Introduction

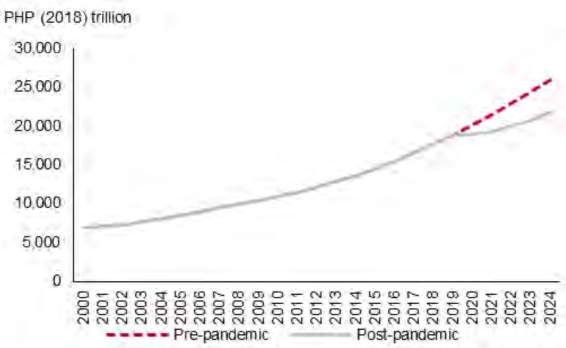
1. Philippine growth was dragged down by the outbreak of the COVID-19 pandemic, and some segments of the economy have not recovered their pre-pandemic levels yet. Strict pandemic-related restrictions, a sharp reduction in investment, and global supply chain interruptions hit the services-based Philippine economy hard, resulting in a 9.5 percent contraction in 2020. Although the economy has experienced a strong post-pandemic recovery since its re-opening in 2022, private investment in H1 2024 has not yet returned to levels recorded before COVID-19. The value-added of some industries, such as accommodation and food services activities, real estate, and construction, were also below their pre-pandemic levels. The slower recovery in specific sectors could partly reflect the scarring effects of the COVID-19 pandemic. Against this backdrop, the current study seeks to estimate how COVID-19's scarring effects have affected production factors and potential growth in the Philippines in the post-pandemic period of 2022 to 2024.[121] This study also discusses the implications of the scarring effects on long-term growth potential.

COVID-19 Scarring Effects on Philippine Growth Potential

2. Results of the estimation suggest that the Philippines' potential growth was lowered during and after the pandemic. To estimate potential output, this study employs an augmented Cobb-Douglas production function approach, which enables the estimation and decomposition of the scarring effects into production factors, such as labor, human capital, physical capital and total factor productivity (TFP). Box A2.1 details the methodology and data sources.[122] The results show that the estimated potential output in the post-pandemic period of 2022-2024 (actual scenario) fell below the pre-pandemic trend (counterfactual scenario) (Figure A2.1). Potential growth, defined as the growth rate of potential output, fell to an average of 5.4 percent for 2022-24 from the average of 6.2 percent for 2017-19.[123] This finding is lower than the potential growth of the pre-pandemic trend (Figure A2.2). Lower potential growth in 2022-24 could be explained by the scarring effects, which is estimated by the difference in potential growth between the actual outcome and the pre-pandemic trend under the counterfactual scenario.

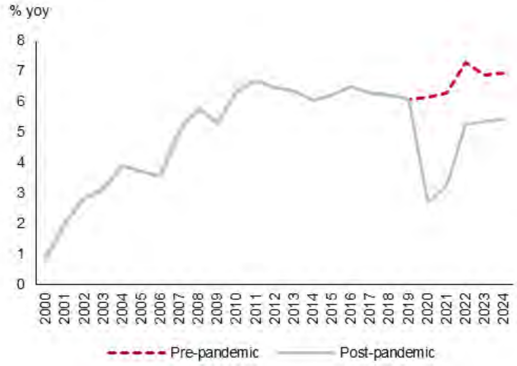
[120] Prepared by Andrew Tsang, Senior Economist; and Sopheawattey San, Associate.
[121] Given the economy was sharply distorted during the pandemic period of 2020-2021, this study focuses only on the post-pandemic period. The actual data is obtained only until H1 2024, and H2 2024 figures are AMRO's forecasts.
[122] The methodology is the same as that used by Choi *et al*. (2021) for estimating potential growth.
[123] The estimated potential output grew by a low 3.0 percent during the pandemic in 2020-2021.

Figure A2.1. Potential Output



Source: Philippine Statistics Authority (PSA), Penn World Table (PWT); United Nations Development Programme (UNDP); AMRO staff calculations
Note: 2024 figures are forecasts.

Figure A2.2. Potential Growth



Source: PSA, PWT; UNDP; AMRO staff calculations
Note: Potential growth is defined as the growth in potential output. 2024 figures are forecasts.

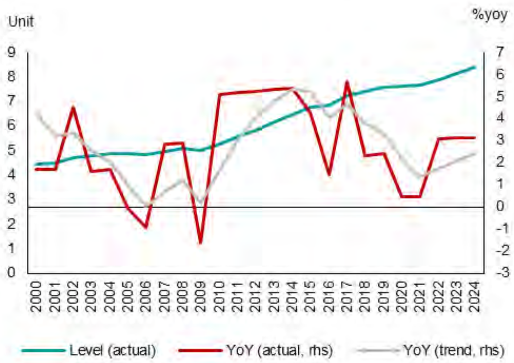
Assessing Key Drivers of Philippine Potential Growth

3. **Philippine employment dropped sharply in 2020 due to the strict lockdown, but has recovered rapidly since 2021 and surpassed pre-pandemic levels.** Total employment declined by 6.1 percent from 41.9 million people in 2019 to 39.4 million in 2020, while the labor force participation rate fell to 59.5 percent in 2020 from 61.3 percent, reflecting the effects of the various community quarantine restrictions, business closures and physical distancing measures (Figure A2.3). The lockdown pushed the unemployment rate to its highest, of 17.6 percent in Q2 2020. In particular, high-contact sectors, medium-skill occupations and in-wage jobs were more vulnerable at the onset of the pandemic.[124] However, employment has bounced back strongly since 2021 and surpassed its pre-pandemic level. Nevertheless, job quality remained weak, reflecting the double-digit underemployment rate, lower numbers of managerial and professional workers, and a higher share of self-employed workers, which would lower the TFP and will be discussed below.

Figure A2.3. Growth of Employment and Labor Force

Source: PSA; AMRO staff calculations
Note: 2024 figures are forecasts.

Figure A2.4. Human Capital Stock Estimates



Source: PSA; PWT; UNDP; AMRO staff calculations
Note: 2024 figures are forecasts.

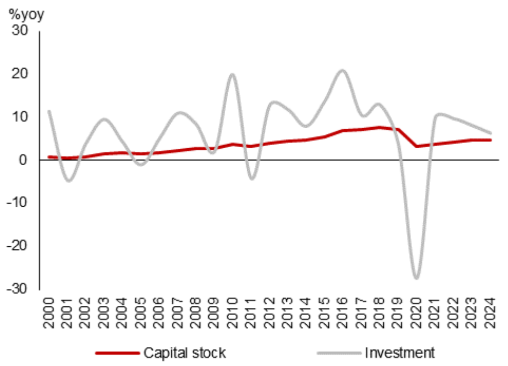
4. **Human capital stock, measured by expected years of schooling and its returns, grew slower during the pandemic compared with pre-COVID levels, largely due to the suspension of face-to-face schooling.** Human capital, which enhances labor productivity, is built through improvements in health and education, contributing to the accumulation of

[124] Debuque-Gonzales, Margarita; Epetia, Ma. Christina F.; Corpus, John Paul P. 2023. "Effects of the COVID-19 Pandemic on Employment and Wages in the Philippines," PIDS Discussion Paper Series, No. 2023-10, Philippine Institute for Development Studies (PIDS), Quezon City.

skills, knowledge and experience over a person's lifetime (World Bank Group, 2023). Growth in the Philippines' human capital decreased significantly in 2020-2021, primarily driven by the lower returns on education due to the pandemic, before recovering gradually from 2022 (Figure A2.4). However, post-pandemic human capital growth is slower than the pre-pandemic period, partly due to the high learning losses during the pandemic,[125] while the digital divide has exacerbated the difficulties of low-income students' access to education.[126]

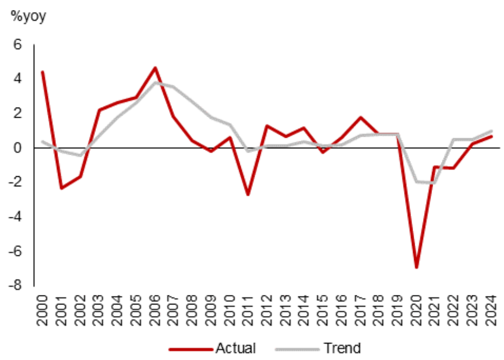
5. **Physical capital stock in the Philippines was severely affected by the pandemic, and its growth momentum is still weaker than the pre-pandemic period due to firms' impaired balance sheets and weak sentiment.** The accumulation of physical capital stock decelerated during the pandemic because of a sharp decline of 34 percent in investment in 2020. It has since shown only gradual recovery over the past three years (Figure A2.5). Firms' balance sheets weakened due to losses incurred during the pandemic. According to AMRO (2024b), the share of debt-at-risk,[127] mainly due to those losses, in the Philippines' non-financial corporates (NFCs) increased significantly from around 40 percent to above 70 percent in 2021,[128] although it has slowly declined since 2022. Meanwhile, the stock of FDI decreased by 21.3 percent in 2020 as foreign investors delayed projects and repatriated profits to manage the financial impacts of the pandemic on their operations. Nevertheless, the post-pandemic investment growth rate remains lower than the pre-pandemic period, although there is a procyclical nature of investment. The weak sentiment in private investment and FDI has slowed the accumulation of capital stock.

Figure A2.5. Investment and Capital Growth



Source: PSA; PWT; AMRO staff calculations
Note: 2024 figures are forecasts.

Figure A2.6. TFP Estimates



Source: PSA; PWT; UNDP; AMRO staff calculations
Note: 2024 figures are forecasts.

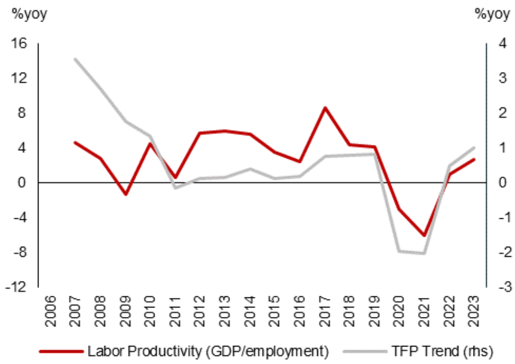
6. **Estimates in this study indicate that TFP experienced a decline during the COVID-19 pandemic, although there has since been a recovery (Figure A2.6).** Using the production function approach, TFP represents the portion of residuals from potential growth that traditional factors of production cannot account for. In this context, a narrative approach drawing on local news sources and relevant literature (Box A2.2) helps identify key drivers of the decline in TFP during the pandemic, attributing part of the pandemic's lasting effects on

[125] A report from the Congressional Policy and Budget Research Department shows an estimated loss of 0.61 in learning-adjusted years of schooling (LAYS) in the Philippines, more than the average LAYS loss of 0.37 in ASEAN member states. By ADB estimates, students in Asia who were affected by school closures were estimated to have potentially lost about USD180 of annual income due to COVID-19, with some regions experiencing higher percentage declines than others; for example, East Asia saw USD771 less in annual earnings due to protracted school closures.
[126] The digital divide in the Philippines exacerbated inequalities in access to education. Students from low-income families, especially in rural areas, were less likely to have access to the necessary technology for remote learning. UNECSO *et al.* (2021) highlighted that many students lacked internet access, computers or even reliable electricity, further widening the gap between the ones who could continue learning and those who could not. This disparity in access is expected to result in a lower return on education for students from disadvantaged backgrounds, as their interrupted education would hinder their future earnings potential.
[127] AMRO (2024) defines firms that have debts with interest coverage ratios (ICRs) lower than 1.25 and/or debt service ratios (DSRs) lower than 1.0 as debt-at-risk firms, or financially stressed borrowers.
[128] According to the criterion of DSRs lower than 1.0.

TFP to temporary factors, such as reduced productivity. Indeed, the movement and growth in TFP estimates are qualitatively similar to those of the conventional labor productivity measure, defined as GDP divided by the number of employments (Figures A2.7, A2.8).

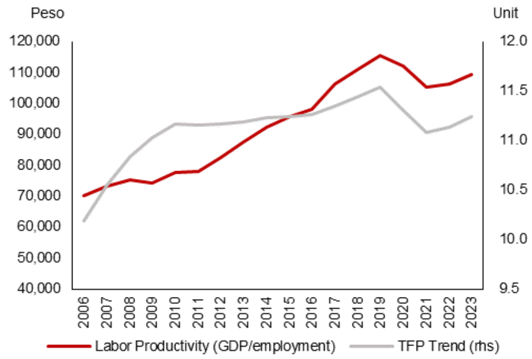
- Temporary decline in productivity: This is reflected in the deteriorated job quality. The pandemic's negative effects on health and well-being came at a significant cost and affected post-pandemic labor productivity recovery. Long-term productivity losses due to the direct and indirect health impacts of COVID-19 are estimated at PHP2.3 trillion (PDIS, November 2021). Meanwhile, the share of wage and salary workers and employers among the employed stayed at 63.8 percent in July 2024, lower than the 65.2 percent in January 2020. The share of vulnerable employment, including self-employment and unpaid family work, is still higher than in the pre-pandemic period and remains above 30 percent, although it has gradually improved in recent years.[129] While the government offers a range of skill training programs, the quality of job creation still lags behind due to poor institutional coordination, fragmented program design and weak monitoring systems, limiting their overall effectiveness in addressing labor market needs.

Figure A2.7. Labor Productivity and TFP



Source: PSA, PWT; UNDP; AMRO staff calculations

Figure A2.8. Growth in Labor Productivity and TFP



Source: PSA, PWT; UNDP; AMRO staff calculations

Additionally, in the long run, COVID-19 has exacerbated the influence of structural issues on TFP.

- COVID-19 reinforced the impact of structural issues: The pandemic not only highlighted but also reinforced existing structural issues in the Philippine economy. The country's reliance on outdated infrastructure and inefficient logistics networks became more apparent as supply chains were disrupted (UNCTAD, 2021). The pandemic has delayed infrastructure upgrading. Although the authorities have worked to improve the infrastructure, domestic infrastructure development is still hindered in the post-pandemic period[130] by a challenging business environment, deficiencies in planning, coordination, and financing, as well as a decline in private-sector participation in infrastructure projects.

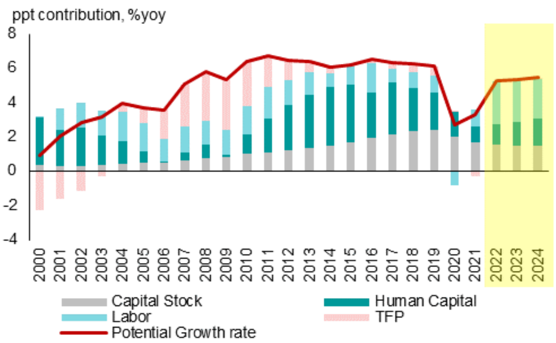
Sources of Scarring Effects on Philippine Potential Growth

[129] The share of vulnerable employment rose from 32.4 percent in 2019 to 34.6 percent in 2020 and has gradually improved to 32.9 in 2024 (year-to-date).

[130] Compared with peer economies in the region, investment in infrastructure in the Philippines has been relatively low, resulting in low capital stock (AMRO, 2023). The Philippines ranked below 55th in different infrastructure aspects among 67 economies in the World Competitiveness Report 2024 published by the IMD.

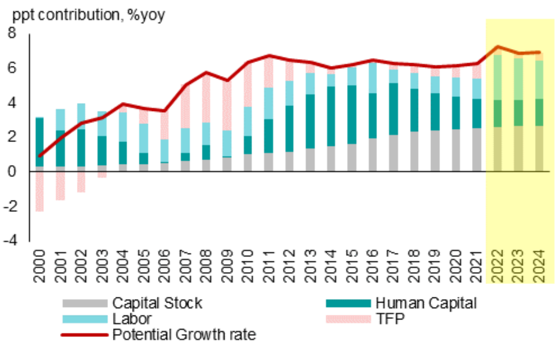
7. The empirical results suggest that two-thirds of COVID-19's scarring effects on the Philippines' potential growth are attributable to slower growth in physical capital, with the remainder due to weaker TFP and human capital. Following Jackson and Lu (2023), the scarring effects are estimated by comparing the differences in potential growth between the actual scenario (Figure A2.9) and the counterfactual scenario that assumes the pre-pandemic trend (Figure A2.10). Thus, the drop in potential growth could be further decomposed into the contributions of different factors of production (Box A2.1 gives details of the methodology). Our decomposition analysis, as summarized in Figure A2.11, indicates that the scarring effects have reduced post-pandemic Philippine potential growth by 1.69 percentage points on average for 2022-2024, mainly because of the lower growth in physical capital stock (1.12 percentage points), TFP (0.39 percentage points) – presumably due to temporary productivity drops, underutilization and efficiency loss – and human capital (0.17 percentage points) attributed to lower returns on education caused by the pandemic.

Figure A2.9. Potential Growth with Scarring Effects (Actual Scenario)



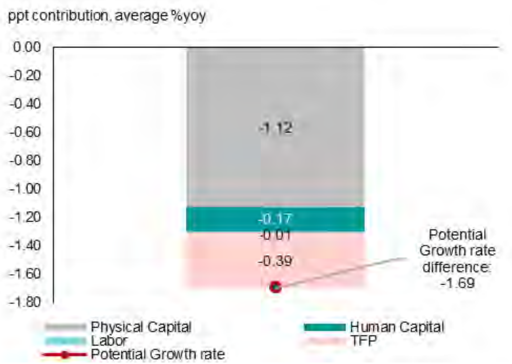
Source: PSA; PWT; UNDP; AMRO staff calculations
Note: The shaded area represents the post-pandemic period of 2022-2024. 2024 figures are forecasts.

Figure A2.10. Potential Growth without Scarring Effects (Counterfactual: Pre-pandemic Trend)



Source: PSA; PWT; UNDP; AMRO staff calculations
Note: The shaded area represents the post-pandemic period of 2022-2024. 2024 figures are forecasts.

Figure A2.11. Contribution to Scarring Effects in Post-pandemic Period (Average for 2022-2024)



Source: PSA; PWT; UNDP; AMRO staff calculations
Note: 2024 figures are forecasts.

Implications for Long-term Philippine Growth

8. This study identifies the sources of scarring effects that lowered potential growth in the post-pandemic period, shedding light on policy suggestions to improve long-term potential growth. The slower growth in physical capital stock, human capital and TFP mainly drove the Philippines' lower post-pandemic potential growth. Therefore, to reduce the impact of the scarring effects on long-term growth potential, the economy should attract more investment, improve access to financing especially for MSMEs, upgrade productivity, improve job quality and upskill the labor force. In particular, the following areas could be considered:

- Attracting more investment: The authorities should strategically attract foreign direct investment requiring technology and knowledge, and the country should seize the opportunity to draw more FDIs and technology transfer under the framework of the trilateral agreement with the U.S. and Japan. Ways of attracting more investment include building better infrastructure,[131] continuing regulatory framework reform, fostering a competitive business environment, promoting digitalization and innovation, and developing a sustainable economy.

- Improving access to financing for MSMEs: The authorities should introduce measures to help businesses, especially MSMEs, repair their balance sheets and improve their access to funding, which will help them address existing vulnerabilities and initiate new investments. In the short term, such measures may include incentives for temporary loan restructuring, which should help distressed firms to repair their balance sheets (AMRO, 2024a). In the longer term, the government should improve the funding environment for MSMEs. AMRO welcomes the BSP's active initiatives to improve MSME access to bank financing. For instance, the authorities' new Philippine Open Finance Pilot, which focuses on MSME borrowers and offers an option for credit data, is also the step in the right direction to enhance MSMEs' financial access.

- Upgrading productivity and improving job quality: The authorities should implement policies to upgrade labor productivity and create more quality jobs. To achieve this, policies should focus on diversifying the economy by incentivizing investment in high-productivity sectors, such as manufacturing, digital services, and agribusiness. The development of these sectors will lead to the creation of more formal and stable jobs. Furthermore, additional efforts are needed to attract foreign investment and ensure that it promotes innovation and R&D, which can drive the growth of knowledge-based industries while facilitating the transfer of skills and knowledge to the local workforce, further stimulating quality job creation.[132]

- Upskilling the labor force: The authorities should expand the existing technical and vocational education framework, such as the Technical Education and Skills Development Authority's (TESDA) technical and vocational education and training (TVET) programs. Particularly, the scope of training should be expanded from employability to more technology upgrading. Additionally, expanding digital skills training programs will help workers in sectors affected by automation and artificial intelligence (AI) make the transition to new roles within the digital economy. Such an initiative should include promoting digital literacy at all levels of education and providing resources for lifelong learning and adult education. Moreover, the government should collaborate closely with industries and training providers, such as universities and training institutions, to formulate training frameworks and implement plans to ensure the supply of skilled labor aligns with industry demand and that job matching is provided to students after the training.

[131] Infrastructure investment can also directly increase GDP. A rise in public investment would result in a 9.5 percent cumulative increase in real GDP relative to the steady state after 15 years, while improving public investment efficiency to about 85 percent would increase output by 2.1 percentage points after 15 years (Komatsuzaki, 2019).

[132] Revitalizing the agricultural sector is equally important and can be achieved through investments in modern farming techniques, improved market access, and financial support for smallholder farmers. Such initiatives will enhance productivity and create employment opportunities.

Box A2.1. Estimation of Potential Growth and Scarring Effects

Estimating potential output and potential growth

This study applies growth accounting by assuming the augmented Cobb-Douglas production function, and uses HP-filtered factors of production to estimate potential output and potential growth (growth of potential output).

The augmented Cobb-Douglas production function is used, as human capital is separately added to the conventional Cobb-Douglas production function, which covers only labor, physical capital and total factor productivity.

$$Y_t = A_t K_t^{1-\alpha}(L_t H_t)^{\alpha}$$

$$H_t = exp(\varphi_t S_t)$$

where
Y_t represents GDP in year t;
A_t, total factor productivity (TFP);
K_t, physical capital stock;
L_t, the labor component;
H_t, the human capital per worker;
α, the income share of labor;
(1 – α), the income share of capital;
φ_t, the return on education; and
S_t, expected years of schooling.

Remarks:

i. H_t is defined as a function of expected years of schooling (S_t) and the return on education (φ_t);
ii. The augmented Cobb-Douglas production function applies the Cobb-Douglas function's standard assumption with constant income shares over time for labor (with human capital, α) and capital ($1 - \alpha$).

The potential level of employment, human capital stock, physical capital stock and TFP are inserted into the above augmented Cobb-Douglas production function to estimate potential output and growth. The potential levels of these factors of production are derived by applying the one-sided Hodrick-Prescott (HP) filter on the original series. For potential TFP growth, the rolling five-year average growth of potential TFP is used.

Finally, potential GDP growth, defined as the growth of potential output, is estimated as potential TFP growth plus the weighted sum of the growth in potential employment, potential human capital stock and potential physical capital stock.

Estimating scarring effects

Following Jackson and Lu (2023), scarring effects are defined as the differences in potential growth between the counterfactual scenario of potential output in the COVID-19 pandemic that assumes the pre-pandemic trend:

$$Y_{pre,t} = A_{pre,t} K_{pre,t}^{1-\alpha}\left(L_{pre,t} H_{pre,t}\right)^{\alpha}$$

and the actual outcome of potential output in the pandemic:

$$Y_{c,t} = A_{c,t} K_{c,t}^{1-\alpha}\left(L_{c,t} H_{c,t}\right)^{\alpha}$$

Take the log-difference of the above equations, the sources of scarring effects (differences in potential growth) can be further decomposed by the output deviation based on the estimated production function under two scenarios.

$$\Delta y_t = \Delta a_t + (1-\alpha)\Delta k_t + \alpha \Delta l_t + \alpha \Delta h_t$$

Data sources

1. Employment: PSA's official data

2. Human capital stock:

a. Expected years of schooling: UNDP data
b. Return on education: Until 2019, Psacharopoulos and Patrinos (1994, 2004, 2018) applied linear interpolation and extrapolation to 1988, 1998 and 2000 figures. Assuming no increases during the pandemic period of 2020-2021.

3. Physical capital stock: The data used in this study is constructed by applying the perpetual inventory method (PIM), using 1980 capital stock figures in the Penn World Tables (PWT) 10.1 database as the initial capital stock, gross fixed capital formation in the PSA's official National Account data, and depreciation data in PWT.

4. Labor income share: The labor income share (α) is assumed to be two-thirds of the total income, reflecting the labor-intensive services and manufacturing sectors in the country.

5. TFP: Derived as the difference between observed real GDP and the weighted sum of employment, human capital and physical capital, the last of which is known as Solow residual. Potential TFP is derived by applying the one-sided HP filter. The rolling five-year average growth of potential TFP is used to estimate potential TFP growth until 2021 while assuming a slight increase in 2023-2024 to be consistent with the economic recovery.

Box A2.2. Selected Local News and Literature on the Impact of COVID-19 on TFP

News and literature about employment
About 4.5 million Filipinos lost their jobs in 2020.[133] The unemployment rate stood at 10.3%, the highest in 15 years, the government reported, due to the COVID-19 pandemic and the lockdown shuttering thousands of businesses. But as quarantine restrictions were lifted and the economy reopened to allow workers to return to their jobs, the jobless rate also eased to 8.7% in October, National Statistician Dennis Mapa said on December 3, 2020. He cited the latest preliminary results of the Philippine Statistics Authority's quarterly labor force survey. (https://www.straitstimes.com/asia/se-asia/philippines-suffers-worst-job-losses-in-15-years-due-to-covid-19-and-lockdown)
As the country's unemployment rate continues to drop, the Philippine government remains committed to invigorating investments and implementing key reforms to sustain the positive momentum of the labor market and create more quality jobs for Filipinos, the National Economic and Development Authority said on July 8, 2024. As reported by the Philippines Statistics Authority, the May 2024 Labor Force Survey showed that the unemployment rate had dropped to 4.1%, a decrease from 4.3% in the same month last year. The increase in total employment for May 2024, reaching 48.9 million jobs – up 605,000 from the previous year – was primarily driven by expansion in the industry (+1.2 million) and services (+982,000) sectors. Construction and manufacturing also grew significantly, adding 745,000 and 347,000 jobs, respectively. This growth can be attributed to the implementation of several flagship programs and projects under the Marcos administration. (https://neda.gov.ph/investments-key-labor-market-reforms-to-boost-job-quality-for-filipinos-neda/)
A report from the Ateneo Center for Economic Research and Development shows that, by education level, the increase in the number of unemployed in terms of percentage growth was highest among people with only elementary or no education (336%), those with only junior high school education (275%), and those with senior high school education (262%), compared with people who had at least some college education (157%). The same is indicated by looking at employment loss by sector, which shows the highest decline in employment in wholesale and retail trade and repair of motor vehicles (a loss of two million jobs), construction (-1.4 million jobs), and transport and storage (-1 million jobs). Based on previous data, about half of the people employed in these three sectors belong to the poorest 50% of households, which means their income situation is precarious and they are vulnerable to any loss of income. In an ongoing study, using Monte Carlo simulations, the Ateneo center estimated that if 8.4 million self-employed workers and "non-regular" workers became jobless during the lockdown months, and if employment recovery was gradual such that only two-thirds of the 8.4 million were able to recover their jobs by the end of the year, poverty incidence would go up by 5.7 percentage points from the pre-COVID baseline, equivalent to an additional 1.4 million poor households, or 7.5 million poor individuals. (Ducanes, G. M. 2020. "A Closer Look at the Impact of COVID-19 and the Lockdown on Employment and Poverty," *Policy Brief*, June 2020, Ateneo Center for Economic Research and Development, Ateneo De Mainly University)
The pandemic has affected employment in the Philippines and reversed some gains, wiping out 1.7 million wage and salary jobs in the 12 months to January 2021. In contrast, employment in the informal sector rose by about 435,000. The pandemic could create long-lasting effects on employment. Put simply, this temporary large shock to the economy might produce a persistently lower employment rate even after the economy has started to grow again. This phenomenon is known as hysteresis in employment. There are three transmission channels of the pandemic on modern employment. First, the number of jobseekers will be higher, including people who have lost their jobs, school dropouts and new entrants to the labor market. The longer laid-off workers and new labor market entrants remain unemployed, the more likely they would become less employable in the future because of lost skills. Second, the pandemic has triggered a large reallocation of jobs across sectors. While job losses have occurred across most sectors, the hardest-hit are businesses dependent on personal contact, such as accommodation, food services, transport and recreational services. In contrast, the sectors that recover quickly and present positive job growth are those that tend to absorb a lower share of labor, such as communications and technology and several higher-skilled services. While a portion of these jobs will return as the economy bounces back, we expect this change in the employment composition to persist in the medium to long term. This divergence will increase skill mismatches in the labor market, as workers do not switch easily between sectors given differences in required skills and experiences. Third, companies are modifying their business models to rely more on technology, thereby reshaping their workforces and the types of skills demanded. Digital transformation and remote working will transform jobs, facilities, processes and skill needs, including skills required for higher value-added services. These will further exacerbate the skill mismatch in the labor market. (https://blogs.adb.org/blog/philippines-covid-19-employment-challenge-labor-market-programs-to-rescue)

News and literature about human capital loss
Learning poverty – the share of 10-year-old children who cannot read and understand a simple story – in the Philippines was estimated at 69.5% in 2019 and is expected to rise further due to the pandemic. School closures and long-term learning loss are also likely to affect the

[133] Some of these individuals may have only entered the labor force in 2020.

children's economic potential and productivity in adulthood, thus undermining the country's competitiveness. It is estimated that due to learning losses, average annual earnings per student will decrease by USD893-USD1,137 (in 2017 PPP$), equivalent to a loss of USD16,287-USD20,752 (in 2017 PPP$) in the present value of individual lifetime earnings.
(World Bank Group. 2021. *Philippine Basic Education System: Strengthening Effective Learning During the COVID-19 Pandemic and beyond*.)

According to World Bank Senior Adviser for Education Harry Patrinos in February 2024, for every week of school closure, learning levels decline by almost 1 percent, so "20 weeks closed translates to losing almost a year's worth of learning."
(https://www.pids.gov.ph/details/news/press-releases/covid-19-school-closures-led-to-significant-learning-losses-says-world-bank-expert)

Learning poverty, as defined by the World Bank, means being unable to read and understand a simple text or story by age 10. A 2019 pre-pandemic World Bank study put the Philippines' learning poverty at 69.5%. In 2021, however, it increased to 91%, meaning nine out of 10 Filipino children under the age of 10 were unable to read a simple text. This makes the Philippines the country with the highest level of learning poverty in East Asia and the Pacific region, according to the World Bank.
(World Bank, (2022). *Philippines' Learning Poverty Brief*.)

A bill on Academic Recovery and Accessible Learning (ARAL) was approved and aims to establish a national learning intervention program. The bill will establish well-systematized tutorial sessions and well-designed intervention plans that provides learners with optimal time to master essential learning competencies and make up for learning losses. It will focus on essential learning competencies in language and mathematics at grades 1-10 and in science at grades 3-10. The ARAL program shall also focus on strengthening the numeracy and literacy skills of kindergarteners. It covers public school learners who did not enroll at the start of the 2020-2021 school year, and those who are below minimum proficiency levels as required in language, mathematics and science. Private school learners may also avail themselves of the interventions provided under the program.
(https://legacy.senate.gov.ph/lisdata/4014737372!.pdf)

World Bank simulations in 2020 expected to see a global loss of 0.9 learning-adjusted years of schooling (LAYS), driving down the global average from 7.8 LAYS to 6.9 LAYS. Under this scenario, a typical student would lose USD25,000 in lifetime earnings in present value terms, while the current generation of students could lose an estimated USD16 trillion in earnings. Given that duration of school closures, learning poverty was expected to increase by 10 percentage points, reaching 63%. In a pessimistic scenario, learning poverty is expected to increase to as much as 70% in low and middle-income countries.
(UNESCO, UNICEF and World Bank. 2021. *The state of the global education crisis: A Path to Recovery*, a joint UNESCO, UNICEF and World Bank Report.)

A report from the Congressional Policy and Budget Research Department shows an average estimated loss of 0.37 in the LAYS of ASEAN member states (AMS), thereby indicating a 4.31% decline from the 2020 baseline AMS LAYS average of 8.55 years. Myanmar, Malaysia and the Philippines all have greater respective LAYS losses, of 0.77, 0.67 and 0.61 years, than the AMS average. On the other hand, Singapore, Brunei Darussalam and Vietnam have the least LAYS losses, of 0.10, 0.15 and 0.20, respectively.
Studies have established that a person's annual earnings increased by 9.7% on average for every additional year of schooling. However, school closures put this potential on hold and even adversely affected most students. The report shows that in AMS, the potential earning losses per student per year is an estimated USD173, a 1.9% decline from the 2020 baseline earnings potential. Malaysia and Myanmar are estimated to lose 6.4% and 7.6%, respectively, more than thrice and about four times the AMS' 1.9% average decline. Indonesia and the Philippines, meanwhile, trail at 3.8%. The annual earnings per student of the other AMS are estimated to dip by less than 2%, with Singapore reflecting the least drop, of 0.9%.
The report also shows the AMS learning poverty rates in 2019 and 2021, indicating an average increase of 26 percentage points due to school closures at the height of the pandemic. Lao PDR, Cambodia, the Philippines and Myanmar are assessed to have very high learning poverty rates in 2021, ranging from 89% to 98%. Cambodia and Malaysia posted spikes of 39% and 30%, respectively, in learning poverty rates, way above the AMS average hike of 26%. Singapore and Vietnam not only have the lowest AMS learning poverty rates, of 3% and 2%, respectively, but were unaffected at all during the 2019 and 2021 reference periods, even under the pandemic.
(Congressional Policy and Budget Research Department. 2022. "The Cost of Learning Loss from the COVID-19 Pandemic," *Fact in Figure*, May 2022, No 32.)

By the ADB's estimates, students in Asia who were affected by the closures of their schools potentially lost about USD180 of annual income due to COVID-19, with some regions experiencing higher percentage declines than others. For example, East Asia saw USD771 less in annual earnings due to protracted school closures.
(https://www.adb.org/sites/default/files/publication/692111/ado2021-special-topic.pdf)

News and literature about lower labor income

Households continued to experience income losses. One in four household heads were still without work in December 2020 despite a rebound in employment. Job recovery among female household heads was not on par with their male counterparts. The share of female heads working in December was 66 percent, about 6 percentage points less than March, which was before the pandemic. While employment improved slightly, the usual working arrangements had not resumed. Resumption of work (one in four household heads) was nearly the same as the pre-COVID rate in March. The share of household heads employed in the services sector rebounded to 46%, slightly higher than the pre-COVID level of 43%. About three in five household heads with non-agriculture jobs reported they had returned to their usual working arrangements, an increase from only a third in August.
(https://thedocs.worldbank.org/en/doc/ab24c2a718fb53a344c5942d236b2fe6-0070062021/original/Philippines-COVID-19-High-Frequency-Survey-Household-Results-Slides.pdf)

The decrease in income, or worse, the loss of income, of millions of Filipino workers translate to a higher poverty incidence as well as subsistence incidence in the country. Poverty incidence, according to the PSA, is the proportion of Filipinos whose per capita income is insufficient to meet their basic food and non-food needs, while subsistence incidence is the proportion of Filipinos whose income is not enough to cover even basic food needs. Poverty incidence in the first semester of 2021 was estimated at 23.7%, equivalent to 26.14 million Filipinos, while those in subsistence incidence registered 9.9%, or 10.94 million Filipinos. While the pandemic affected all workers, it also exposed the vulnerability of some sectors. The jobs of vulnerable workers are unstable, lack formal work arrangements, and do not have social or legal protections, thus their incomes are usually low. They are also described as having a higher risk of getting injured, harmed or ill as a result of working in a more dangerous setting. These workers are usually associated with the informal economy, which the International Labour Organization (ILO) defines as independent, self-employed small-scale producers and distributors of goods and services. A 2020 study by the ILO on the impact of COVID-19 on the labor market of the Philippines revealed that people working in manufacturing, transport and storage, accommodation and food services activities, arts, entertainment and recreation and tourism had a higher risk of being displaced.
(Ronahlee A. Asuncion. 2022. "Mitigating the Covid-19 Pandemic Impact on the Philippine Labor Market," *Japan Labor Issues*, vol.6, no.40, pp. 75-85)

News and literature about productivity, underutilization and efficiency

The Philippines' public infrastructure investment is lower than its neighbors. The persistently low public investment has resulted in low public capital stock relative to other ASEAN countries. In the baseline scenario, which models the Duterte administration's infrastructure scale-up plan and comprehensive tax reform, the increase in public investment results in a 9.5% cumulative increase in real GDP relative to the steady state after 15 years. If no further tax reform takes place after the legislation that was passed in December 2017, the same public investment infrastructure increase would need to be financed by running higher deficits. Sustained output growth is realized in this alternative scenario as well, but the size is smaller due to the negative effects of higher borrowing costs from greater public debt. Separately, improving public investment efficiency has substantial additional benefits. Eliminating half of the inefficiency would lead to an additional 2.1 percentage points in real GDP.
(Komatsuzaki, T. 2019. "Improving Public Infrastructure in the Philippines," *Asian Development Review*, vol. 36, no. 2, pp. 159-184)

	One quarter of total employment in the Philippines is likely to be disrupted by the impact of COVID-19 on the economy and labor market, either through decreased earnings and working hours or a complete job loss. This translates to about 10.9 million workers. Women account for 38% of the jobs at risk of COVID-19 disruption. The sectors facing a medium risk of job disruption are those that are temporarily halted by the lockdown but may recover after a transition period. These include water supply and waste management activities; construction; wholesale and retail trade; information and communication; financial and insurance activities; real estate activities; and professional and scientific services. (https://www.ilo.org/sites/default/files/wcmsp5/groups/public/@asia/@ro-bangkok/@ilo-manila/documents/publication/wcms_762209.pdf)
	The Department of Labor and Employment has generated more than half of its job generation goals under the National Employment Recovery Strategy (NERS). The NERS program seeks to generate one million jobs from the private sector and 200,000 jobs from the government sector. It started operations in May 2021, in an effort to precipitate the recovery of the labor market by creating a policy environment that encouraged generation of, and improved access to, employment, livelihoods and training opportunities; improvement of the employability, wellness and productivity of workers; and provision of support to existing and emerging businesses. The strategy will be implemented until 2022 in response to the effects of the pandemic. (https://www.bworldonline.com/economy/2021/10/11/402790/dole-says-employment-program-has-put-780000-to-work/)
	Informal-sector workers who have temporarily lost their livelihoods due to stepped-up community quarantine in Luzon can apply for the Department of Labor and Employment's temporary employment program. The department has set aside PHP180 million in an emergency employment program under Tulong Pangkabuhayan sa Displaced/Underprivileged Workers (TUPAD), which will be offered to 16,000 informal-sector workers. (https://www.gmanetwork.com/news/topstories/nation/730280/temporary-jobs-offered-by-dole-for-workers-displaced-due-to-luzon-quarantine)

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