AMRO Country Report
ACR/23-10

AMRO Annual Consultation Report

The Philippines - 2023

ASEAN+3 Macroeconomic Research Office (AMRO)

November 2023

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 29 August to 8 September 2023 (Article 5 (b) of the AMRO Agreement). The AMRO Mission team was headed by Dr Runchana Pongsaparn. Members included Dr Heung Chun (Andrew) Tsang, Desk Economist on the Philippines; Dr Byunghoon Nam, Fiscal Specialist; Dr Ke Ji, Backup Economist; Ms Pim-orn Wacharaprapapong, Backup Economist; Ms Laura Grace Gabriella, Associate Economist; and Ms Sopheawattey San, Associate Economist. 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 2023 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 9, 2023.

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 maintained its robust growth momentum in the first three quarters of 2023, following a multi-decade high of 7.6 percent in 2022. Growth was supported by resilient household consumption with a strong recovery in the labor market, and was primarily driven by the services sector. GDP growth in 2023 is projected to moderate to 5.6 percent due to high base effects and weaker external demand, before edging up to 6.3 percent in 2024 as external demand recovers.

2. Overall labor market conditions continued to improve in H1 2023, following a strong rebound in 2022; however, the quality of jobs has worsened. Unemployment and underemployment rates are now below pre-pandemic levels; at the same time, total employment has surpassed pre-COVID levels. However, the increase in employment was concentrated in elementary low-paying jobs.

3. Inflation remained high in 2023, above the 2-4 percent target, driven by buoyant demand and supply shocks. Headline consumer price index (CPI) inflation is projected to increase to 6.0 percent in 2023 from 5.8 percent in 2022, and then moderate to 3.6 percent in 2024. Inflationary pressure will likely remain elevated as reflected in high core inflation. This is due to a positive output gap and second-round effects induced by increases in minimum wages and expectations of persistently high inflation.

4. On the external front, the expanded current account deficit was partly offset by net capital inflows. Furthermore, despite an increase in external debt from government borrowings in H1 2023, the share of external debt to GDP remains low compared with regional peers. The peso stabilized in H1 2023 after a sharp depreciation in 2022, while international reserves remained adequate to cover short-term external funding needs.

5. The Bangko Sentral ng Pilipinas (BSP) tightened monetary policy aggressively to address rising inflation. The central bank raised the policy interest rate by a cumulative 450 basis points (bps) between May 2022 and October 2023. After keeping the policy rate unchanged in four consecutive Monetary Board meetings, the Monetary Board took an off-cycle action to raise the policy rate by another 25 bps in October 2023 citing the need to prevent supply-side price pressures from inducing additional second-round effects and further dislodging inflation expectations. In addition to monetary policy tightening, non-monetary measures to ease food supply constraints have been implemented to help lessen upside risks to inflation.

6. The banking sector recorded improved profitability, ample liquidity and sufficient capital buffer. Liquidity in the banking system remains abundant, while bank lending has been resilient and supportive of economic activities, with a strong expansion in consumer loans. However, there remain pockets of vulnerabilities in both consumer and corporate loans that warrant close monitoring.

7. The fiscal position continued to improve in 2023, while the 2024 budget aims to continue reducing the fiscal deficit, guided by the Medium-Term Fiscal Framework (MTFF). The improved fiscal position is attributable to robust revenue collection and moderate expenditure. The fiscal stance is assessed to be countercyclical under a positive output gap.

8. The Philippine economic outlook is clouded by various risk factors and challenges. In the short term, high inflation, economic slowdown in major trading partners, and volatility in global financial markets along with tighter financial conditions could pose risks. Long-term growth potential is largely affected by the scarring effects of the pandemic, the pace of infrastructure

development, geopolitical risks, and economic losses from natural disasters that are being exacerbated by climate change.

9. At the current juncture, a tight monetary policy and contractionary fiscal stance form an appropriate policy mix amid the positive output gap and persistent inflationary pressure. Going forward, in light of increasing uncertainties, the policy mix should be flexible and data dependent. Meanwhile, the "all-of-government approach" to curb inflation, including the provision of targeted fuel and cash subsidies to the most vulnerable sectors, is welcomed. Macroprudential tools can also be used actively to address potential financial stability issues.

10. In the medium to long term, fiscal policy should strike a balance between restoring fiscal buffers and supporting sustainable growth, while fiscal consolidation should be underpinned by a strong commitment and anchored by fiscal rules and discipline. The establishment of the MTFF 2022-2028 is welcomed as it demonstrates a strong commitment to fiscal consolidation. Furthermore, fiscal reforms to address long-term fiscal burdens such as fiscal decentralization and Military and Uniformed Personnel (MUP) pension reforms, should be accelerated.

11. On the financial system, the authorities should continue to safeguard financial stability, and enhance financial resilience and inclusion. Close coordination among regulators is crucial in identifying, monitoring, and mitigating financial stability risks that might arise from non-financial corporates. Meanwhile, the authorities should continue to improve the liquidity management framework, develop the bond and repo markets, and continue to expand financial inclusion.

12. Overcoming the scarring effects of the pandemic, including by the formation and upgrading of human and physical/financial capital, is essential for strengthening long-term growth potential. The authorities could focus on upgrading and upskilling the workforce to embrace a more technology-driven economy and provide incentives to retain skilled labor in the country. Policies and measures to attract foreign investments and promote exports of both goods and services will also underpin long-term economic development.

13. Infrastructure investment should be stepped up through strategic prioritization among different sectors and effective utilization of various funding sources. To utilize available resources effectively, funding sources should be selected based on the nature of specific projects. In addition, public-private partnership (PPP) projects should be well designed and managed under a solid legal and policy framework.

14. The Philippines is establishing its first sovereign wealth fund, the Maharlika Investment Fund (MIF), aimed at maximizing financial returns while promoting socio-economic development. While the new MIF Act has laid down a strong legal framework, at the operational level, the authorities should clearly define its role in infrastructure investment with appropriate governance stipulated to avoid misuse of funds. The MIF should be run by professionals and the board should comprise independent directors.

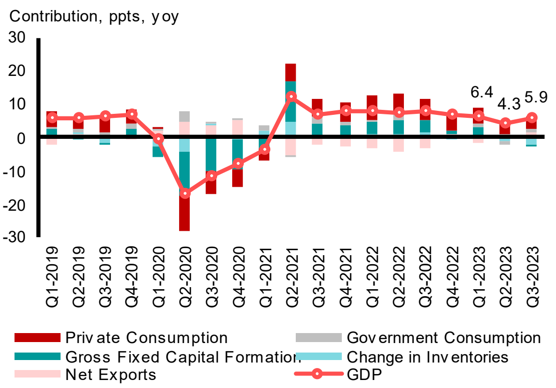
15. A comprehensive strategy, such as digitalization and development of a green economy, could enhance the country's competitiveness. AMRO supports the authorities' efforts in promoting economic and financial digitalization as part of the Philippine Development Plan (PDP) 2023-2028, and recognizes the progress made by the authorities in furthering payments digitalization and in promoting interoperability of domestic payments transactions. In addition, AMRO also recognizes the progress made in setting up a central bank digital currency (CBDC) and regional payment connectivity. In response to climate change risks, AMRO welcomes the authorities' formulation of a long-term national plan to address climate change issues supported by budget allocation and a legal framework.

A. Recent Developments and Outlook

A.1 Real Sector Developments and Outlook

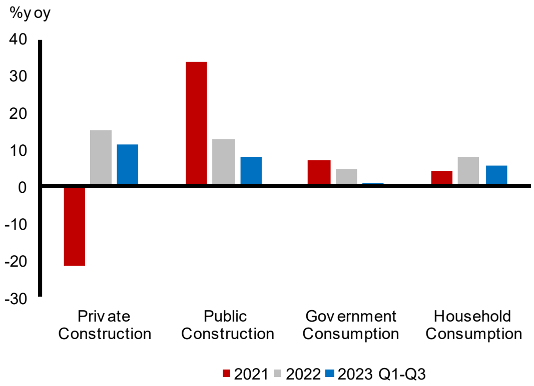
1. In the first three quarters of 2023, the Philippine economy maintained a robust growth momentum underpinned by strong domestic demand, following record growth in 2022. After COVID-19 containment measures eased, the growth rate registered a multi-decade high of 7.6 percent in 2022.[1] Robust growth was maintained in the first three quarters of 2023, albeit at a slower pace of 5.5 percent due to high base effects and weaker external demand (Figure 1). Domestic demand remained resilient from robust household consumption. Meanwhile, private and public construction (Figure 2) and durable equipment sustained their robust growth and played a major role in driving overall investment. Household consumption, government spending, public investment and the goods trade surpassed their pre-COVID levels in 2022, while private investment remained below pre-pandemic levels in the first three quarters of 2023.

Figure 1. Real GDP Growth by Expenditure



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

Figure 2. Public vs Private Demand

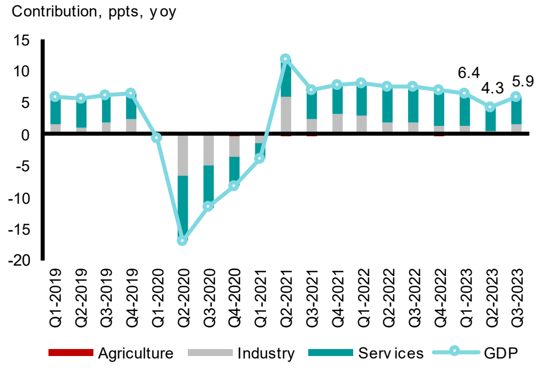


Source: PSA; AMRO staff calculations

2. On the production side, the services sector has been the primary driver of growth in the first three quarters of 2023, led by wholesale and retail trade (Figure 3). The recovery has been uneven. Certain sectors that have yet to attain their pre-pandemic levels have shown significant growth during the first three quarters of 2023, particularly transport and storage, accommodation, and food services, as well as other services, which have benefited from an investment rebound and robust post-pandemic consumption. While the services sector has been the major driver of growth, sustained expansion in manufacturing production and factory orders have also continued to support growth. The Philippine Institute of Supply Management (PISM) Purchasing Managers' Index (PMI) has shown sustained expansion in both manufacturing and services, remaining above the 50 no-change mark since February 2022, except in July 2023 when PMI was slightly below 50 (Figure 4).[2]

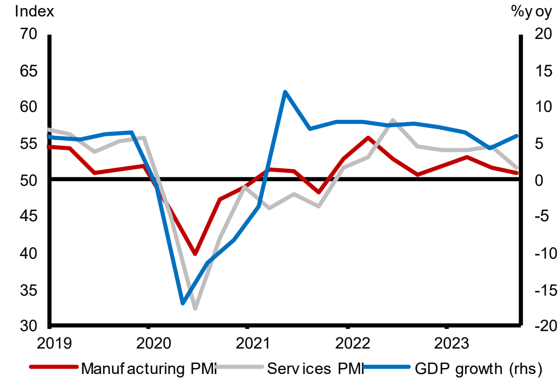
[1] AMRO staff estimates indicate that the negative output gap in 2020-21 turned positive in 2022 (based on the HP-filter approach).
[2] The S&P Global Philippines Manufacturing PMI has a similar result that the manufacturing sector has expanded since February 2022, except August 2023. In addition, the volume of production index for manufacturing showed a 5.7 percent increase in the first three quarters of 2023, primarily driven by the manufacture of food products and transport equipment.

Figure 3. Real GDP Growth and Sectoral Contribution



Source: PSA; AMRO staff calculations

Figure 4. PMI and GDP growth



Source: PSA; PISM; AMRO staff calculations

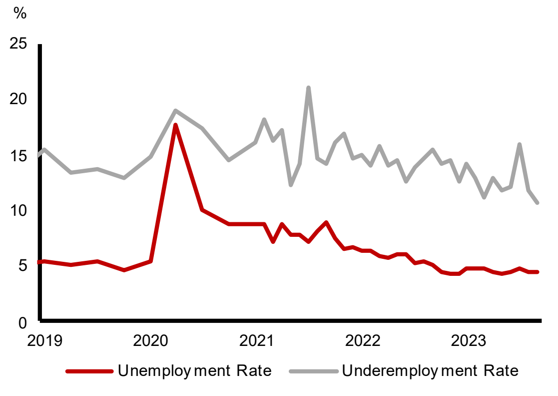
3. GDP growth is projected to moderate to 5.6 percent in 2023 before strengthening to 6.3 percent in 2024. The projected moderation in 2023 is due to high base effects and weaker external demand, while the upturn in 2024 is based on an expected recovery in external demand. However, domestic demand is anticipated to remain robust, supported by continued improvement in labor market conditions, lower inflation, robust overseas remittances, and higher government infrastructure spending. In addition, the external services sector, particularly tourism, which will benefit from the improving local tourism industry, ongoing marketing campaign (such as "Love the Philippines" campaign), and China's reopening, coupled with merchandise exports, which will rebound from 2024 onwards, are expected to boost the economy. Nonetheless, economic confidence is clouded by several risk factors as discussed in Section B.[3]

4. Overall labor market conditions continued to improve in 2023, following a strong rebound in 2022; however, the quality of jobs has worsened. The annual unemployment rate declined from 8.0 percent in 2021 to 5.4 percent in 2022 and dropped further to an average of 4.7 percent in the first three quarters of 2023 (Figure 5).[4] Similarly, the underemployment rate decreased from 17.6 percent in 2021 to 14.2 percent in 2022, followed by 14.3 percent in the first three quarters of 2023. Notably, both the unemployment and underemployment rates are now around pre-pandemic levels.[5] Furthermore, employment has surpassed pre-COVID levels, while the labor force participation rate is similar to pre-pandemic levels. While the labor market has shown significant improvement in quantity that supports the robust domestic consumption growth, the quality of jobs has deteriorated as the share of higher-income positions declined which could constrain the long-term growth potential. Compared with the pre-pandemic situation (Q1 2020), total employment increased by an average of 4.8 million in Q1 2023; however, the rise was concentrated in elementary jobs and

[3] According to the BSP's expectation surveys in Q3 2023. Specifically, business confidence has become less optimistic for Q3 2023 due to concerns about weather-related disruptions, high costs, elevated inflation and interest rates, and peso depreciation. Meanwhile, despite a significant improvement over the pandemic period due to the strong labor market recovery, consumer sentiment remained weak with concerns over the higher inflation, interest and unemployment rates, and a weaker peso.
[4] The average of the quarterly rounds (i.e., January, April, July and October) figures given the larger sample of households.
[5] The annual unemployment rate and underemployment rate were 5.1 percent and 13.8 percent, respectively in 2019.

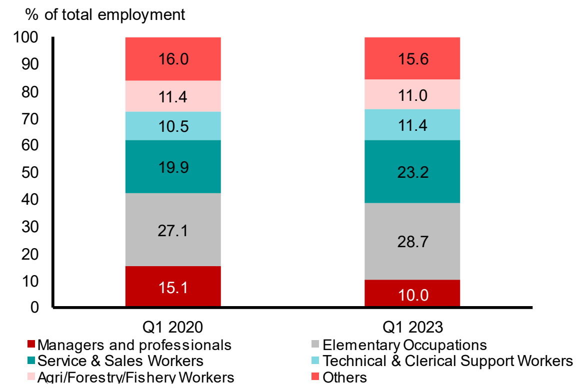
services and sales positions associated with low pay, while the share of managers and professionals declined from 15.1 percent in Q1 2020 to 10.0 percent in Q1 2023 (Figure 6).[6]

Figure 5. Unemployment and Underemployment



Source: PSA

Figure 6. Employment by Occupation

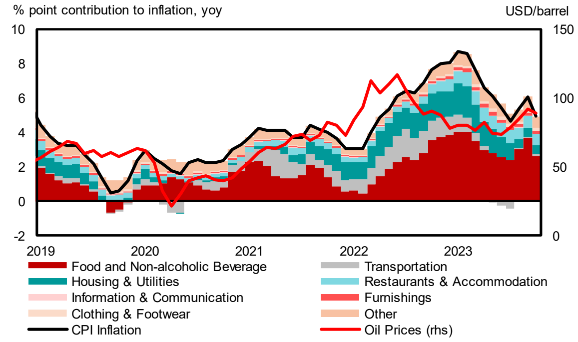


Source: PSA

5. Headline inflation surged in March 2022 and remained high, above the 2-4 percent target range, despite some moderation in H1 2023. Rising inflation in 2022 was mainly attributed to the spike in oil and food prices following the outbreak of the Ukraine crisis. In H1 2023, local supply constraints, particularly food supply, and domestic demand factors became the main drivers of inflation. The headline inflation rate declined to 4.9 percent year on year (yoy) in October 2023 from its peak of 8.7 percent in January, despite a rise in inflation during August and September due to supply-side pressures. A decline in inflation from the beginning of the year was due to a moderation in international commodity prices, as well as tighter fiscal and monetary measures by the Philippine authorities (Figure 7). In contrast, core inflation remained higher than the headline inflation at 5.3 percent in October 2023, though it had gone down from a peak of 8.0 percent in March 2023, indicating that inflationary pressures were widespread. Based on an AMRO study (Selected Issue 1 in the Annex), a combination of supply-side factors and demand-pull factors reflecting a positive output gap and second-round effects[7], contributed to the high and persistent core inflation.[8]

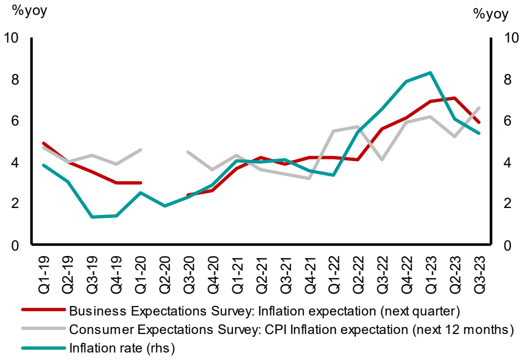
[6] In terms of the class of workers, the share of self-employment and unpaid family workers rose from 32.4 percent in Q1 2020 to 36.0 percent in Q1 2023, whereas the share of wage and salary workers fell from 64.7 percent to 61.5 percent over the same period.
[7] It is worth noting that inflation in the Philippines is relatively high compared with regional peers due to the absence of price subsidies. As a result, increases in commodity prices directly affect inflation without any buffering.
[8] According to AMRO's analysis, headline inflation was mainly driven by supply factors in 2022. However, in 2023, demand factors became the most important drivers of high inflation, particularly for core inflation. For headline inflation, supply factors drove 60 percent of inflation in 2022 and 33 percent between January and August 2023. The contribution of demand factors to headline inflation rose from 22 percent in 2022 to 43 percent between January and August 2023. Since there are ambiguous components, the sum of contributions from demand and supply factors is not equal to 100 percent.

Figure 7. Inflation by Components



Source: PSA; AMRO staff calculations

Figure 8. Inflation Expectations



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

6. Headline inflation is expected to gradually ease in Q4 2023 and 2024, primarily due to the high base effect and lower energy prices. In addition, a normalization in global supply-chain disruptions caused by pandemic lockdowns and heightened geopolitical tensions, and the recent stabilization of the exchange rate could provide some relief from inflationary pressures. Average headline CPI inflation is projected to rise from 5.8 percent in 2022 to 6.0 percent in 2023, and then moderate to 3.6 percent in 2024, which is just below the upper end of the inflation target range. Meanwhile, inflationary pressure will likely remain elevated on account of the positive output gap[9] and second-round effects, especially from increases in minimum wages and expectations of persistently high inflation (Figure 8).[10]

Authorities' Views

7. The authorities broadly agreed with AMRO staff's assessment of the inflation outlook, which was in line with the Development Budget Coordination Committee (DBCC)'s inflation assumption of 5.0 to 6.0 percent for 2023 and 2.0 to 4.0 percent from 2024 to 2028. Meanwhile, the BSP's latest inflation forecasts (as of 21 September 2023) were 5.8 percent, 3.5 percent and 3.4 percent for 2023, 2024 and 2025 respectively.

A.2 External Sector and the Balance of Payments

8. The external position was sound, as the current account deficit was partly offset by net capital inflows, while external debt remained low. The current account deficit rose from USD 5.9 billion in 2021 to USD 18.1billion in 2022, equivalent to 4.5 percent of GDP and stood at 4.0 percent of GDP in H1 2023 (Figure 9), driven mainly by the wider trade deficit in goods.[11] Meanwhile, trade in services have continued to improve since 2022 due to a rapid recovery in

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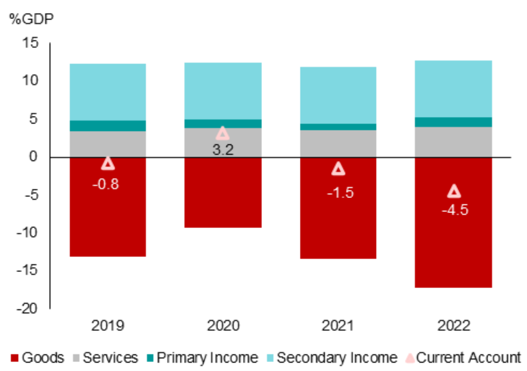
[9] AMRO staff estimates indicate that the output gap remains positive in 2023 and 2024. The widening of the output gap could drive headline and core inflation elevated at more than 5 percent in 2023.

[10] On second-round effects, wage hikes, such as the 7 percent increase in the minimum wage in Manila, and higher transport fares have contributed to inflationary pressures. Both businesses and consumers expected persistently high inflation, although the BSP and market economists forecasted a lower inflation rate in 2024. According to the BSP's expectation surveys in Q3 2023, businesses expected the inflation rate in Q3 2023, Q4 2023 and the next 12 months to average at 5.9 percent, 5.9 percent, and 5.7 percent, respectively. The average consumers' expectation of the inflation rate over the next 12 months was 6.6 percent.

[11] The deficit in goods trade reflects the Philippines' trade structure. Most of the exports consist of processing manufactures (around 80 percent of total exports), which rely on imports of raw materials and intermediate inputs. Meanwhile, the country also has 30 percent of imports in capital goods (e.g., machinery, equipment for infrastructure related investments) and 20 percent in consumer goods (e.g., food, durable goods).

revenues from tourism and business process outsourcing (BPO) (Selected Issue 2 in the Annex). The secondary income account also received higher inflows thanks to an improvement in remittances from overseas Filipino workers (Figure 10).[12] Net inflows of financial accounts rose from USD 6.4 billion (1.6 percent of GDP) in 2021 to USD 12.9 billion (3.2 percent of GDP) in 2022 and registered USD 8.4 billion in H1 2023, dominated by net inflows of other investment and direct investment (Figure 11).[13] However, FDI inflows declined from USD 12 billion in 2021 to USD 9.4 billion in 2022,[14] and dropped further by 20.4 percent (yoy) in H1 2023 to USD 3.9 billion. Total external debt of the Philippines edged up from 27 percent of GDP at end 2021 to 28.5 percent at end-June 2023 (Figure 12), stemming from an increase in government borrowing, but the share of external debt to GDP remains low compared with regional peers.[15]

Figure 9. Current Account Balance

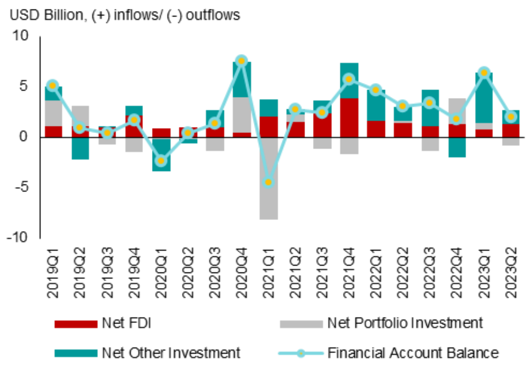


Source: BSP; AMRO staff calculations

Figure 10. Remittance

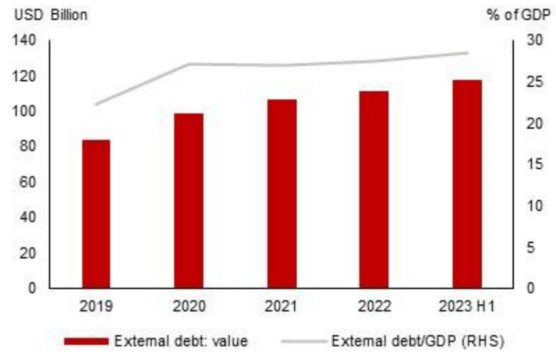
Source: BSP; AMRO staff calculations

Figure 11. Financial Account Flows



Source: PSA; AMRO staff calculations
Note: Other services include Professional, Scientific & Technical; Administrative & Support Services; Education; Human Health & Social Work; Arts, Entertainment & Recreation; and Other Services.

Figure 12. External Debt

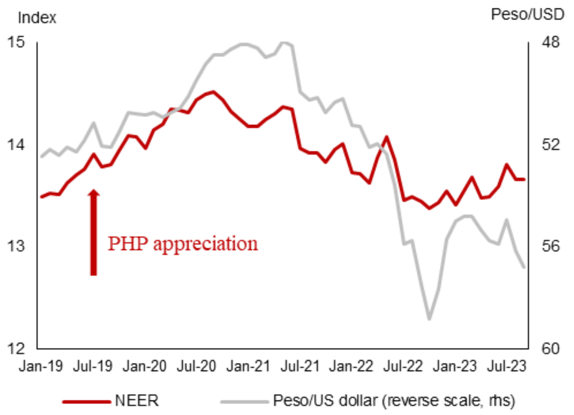


Source: BSP; AMRO staff calculations

[12] While the current account deficit will likely remain in the near term, markets are not showing notable concern over the twin deficits of the country as reflected by the stable credit outlook maintained by major rating agencies and continued portfolio investment inflows. Meanwhile, fiscal consolidation is underway and government bond yield spread with the US remains stable.
[13] Financial account inflows in H1 2023 were driven mainly by net inflows in other investment on account of foreign loans taken by the national government and residents' withdrawal of currency and deposits abroad. Portfolio investment reversed to net outflows in Q2 2023, due to residents' acquisition of foreign assets and non-residents' net selling of debt securities, which resulted in portfolio investment outflows in H1 2023.
[14] In 2022, FDI in the Philippines declined below pre-pandemic average levels. While FDI inflows also declined by 31 percent (Thailand), 27 percent (Malaysia), and 1 percent (Indonesia) year-on-year, the levels remained well above pre-Covid averages in Malaysia and Thailand.
[15] As of Q2 2023, external debt to GDP stands at 67 percent (Malaysia), 40 percent (Thailand, as of Q1 2023), and 29 percent (Indonesia), respectively.

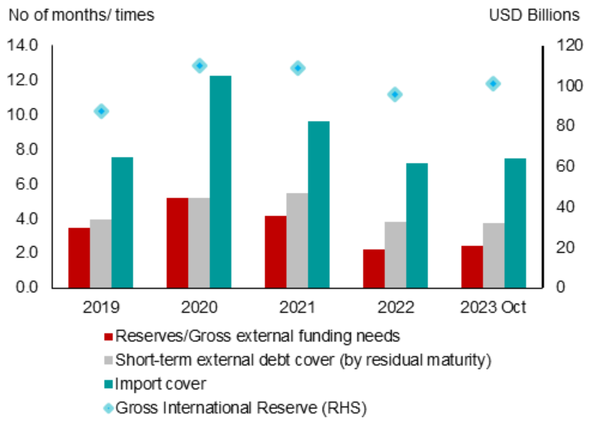
9. The Philippine peso stabilized in H1 2023 after a sharp depreciation in 2022, while international reserves remained adequate. The peso weakened 9.6 percent against the US dollar in 2022,[16] one of the largest movements among ASEAN-5 currencies[17], driven by both the broad US dollar strength and the widened current account deficit in 2022. The peso strengthened against the US dollar in H1 2023, supported by an improved outlook on the Philippine economy[18] and a moderation in the Federal Reserve's tightening pace, but depreciated in Q3 in line with regional currencies as the Federal Reserve was expected to keep interest rates higher for longer. In 2022, the peso weakened against the currencies of the Philippines' trading partners, as reflected in the nominal effective exchange rate (NEER) falling by 3.3 percent before recovering by 0.8 percent in the first nine months of 2023 (Figure 13).[19] The gross international reserves (GIR) declined from USD 108.8 billion at end-2021 to USD 96.1 billion at end-2022 reflecting the BSP's foreign exchange intervention, valuation loss, and the government's repayments of its foreign currency debt. The GIR rose to USD 101.1 billion at the end of October 2023, mainly on account of valuation gains from its foreign assets. The level of GIR is sufficient to cover short-term external funding needs at 3.7 times of short-term external debt, with an import coverage of 7.5 months as of October 2023 (Figure 14).

Figure 13. Exchange Rate Movement



Source: BSP; AMRO staff calculations
Note: An upward movement in the NEER means an appreciation in the peso

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.

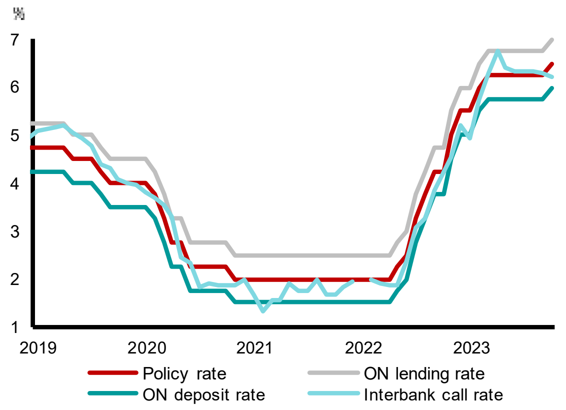
A.3 Monetary Conditions and the Financial Sector

10. The BSP tightened monetary policy aggressively to address rising inflation and raised the policy interest rate by a cumulative 450 basis points (bps) between May 2022 and October 2023. In Q1 2022, headline inflation began to rise above the inflation target range of 2-4 percent. The BSP's forecast suggested that inflation would remain above 4 percent on average for the year. Therefore, to anchor inflation expectations and prevent the

[16] Based on average USD/PHP exchange rate. The peso depreciated by 8.53 percent between end 2022 and 2021 if using the official closing rate from the BAP.
[17] ASEAN-5 comprise Indonesia, Malaysia, the Philippines, Singapore, and Thailand. The depreciation of peso was less than other Asian regional currencies: INR and TWD.
[18] This is reflected in improved risk sentiment from strong local economic data, China reopening, and an upgrade on credit rating outlook for the Philippines.
[19] However, the Real Effective Exchange Rate (REER) was broadly unchanged in 2022, as the nominal depreciation of the peso was offset by the higher inflation rate in the Philippines compared with other countries in the basket. Between January and September 2023, the REER rose 2.4 percent. NEER and REER series are from the BSP.

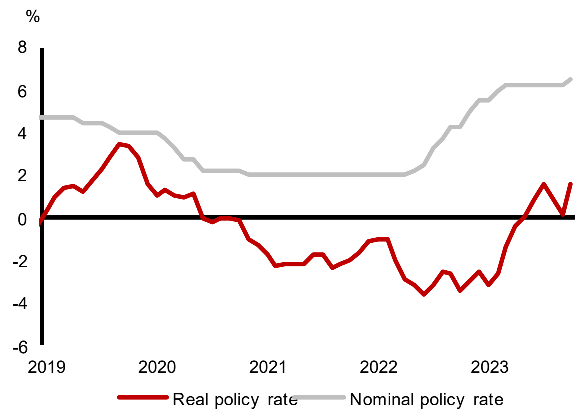
second-round price effects, the BSP started raising the policy rate by 25 bps in May 2022, followed by further increases totaling 400 bps until March 2023 before the policy rate hike was put on hold (Figure 15). The Monetary Board kept the policy rate unchanged through September 2023, following a trend decline in inflation that was due in part to non-monetary measures to ease food supply constraints. However, the Monetary Board took an off-cycle action to raise the policy rate by another 25 bps in October 2023 citing the need to prevent supply-side price pressures from inducing additional second-round effects and further dislodging inflation expectations. As of October 2023, with the policy rate at 6.50 percent and the latest inflation reading at 4.9 percent, the real policy rate has become positive at 1.60 percent after remaining in the negative territory between Q3 2020 and Q2 2023 (Figure 16).

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



Source: BSP

Figure 16. Real and Nominal Policy Rates

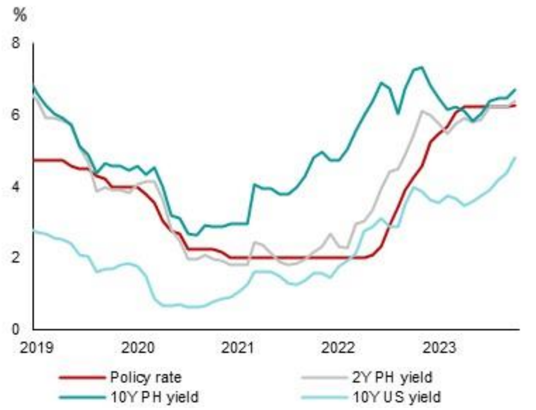


Source: BSP; PSA; AMRO staff calculations

11. While the interbank and bond markets have adjusted in line with policy rate hikes, the transmission to bank rates has been limited. Following a cumulative 450 bps policy rate tightening, the interbank call rate and two-year bond yield rose 433 bps and 337 bps, respectively (Figure 17).[20] However, the interest rates on current account and savings account (CASA) deposits of the Philippine banking system, which constitute 73.9 percent of total deposits, increased by only 47 bps. Meanwhile, time deposit rates showed a stronger passthrough of 386 bps, reflecting some competition for funding from small and medium-sized banks.[21] For lending rates, the low and high new loan rates[22] edged up 242 and 131 bps, respectively (Figure 18). Such limited transmission to lending rates is due to low and sticky funding cost from CASA deposits, robust competition among banks in large corporate loan segment, banks' initiatives to support some borrowers who have not fully recovered from the pandemic, and some lags in the repricing schedule of floating-rate loans. Looking ahead, lending rates could increase incrementally if firms' balance sheets improve, and the repricing becomes more complete.

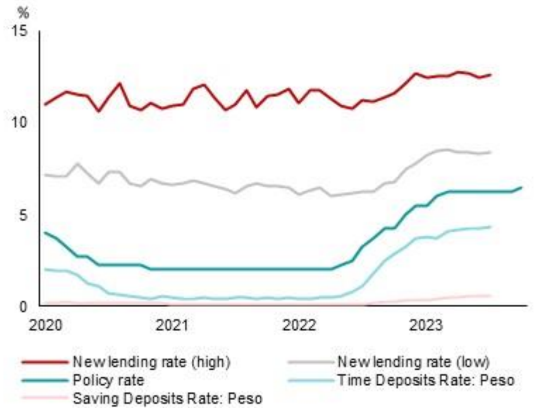
[20] Changes in interbank call rate and two-year bond yields are between April 2022 and October 2023. The interbank call rate is from the BSP, while the two-year bond yield is based on Tullett Prebon Information/Haver Analytics.
[21] Deposit rates data are from the BSP database. Changes are between April 2022 and July 2023.
[22] The high and low rates are from the BSP. They refer to the averages of the highest and the lowest effective lending rates of banks, respectively. Latest data is as of July 2023.

Figure 17. Philippines Government Bond Yields



Source: BSP; Haver analytics

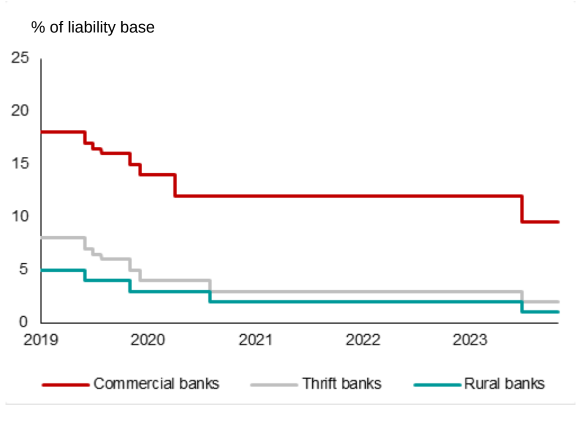
Figure 18. Lending and Deposit Rates of the Philippine Banking System



Source: BSP; CEIC

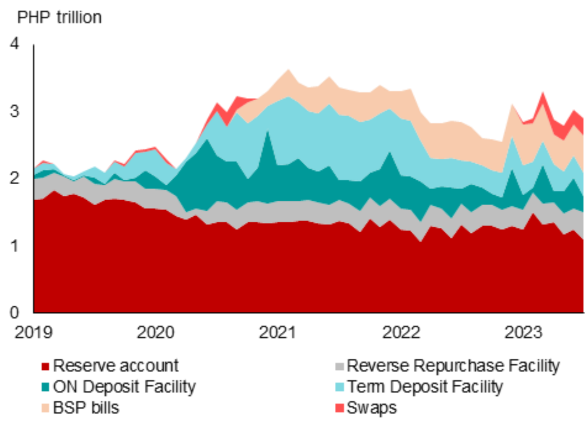
12. Liquidity in the banking system remains abundant. Excess liquidity in the banking system, excluding required reserves, averaged around PHP 1.6 trillion in 2022 and 2023, more than triple the average of PHP 492 billion in 2019. The increase was driven by the BSP's purchase of government securities in 2020 and reserve requirement relaxations during the pandemic (Figure 19). The liquidity level has proven sufficient to support the banking system, as indicated by the orderly functioning of the money market. The BSP manages excess liquidity through a mix of absorption tools, namely reverse repurchase agreement (RRP), issuance of BSP securities, term deposit facility, (occasionally) foreign exchange swaps, as well as the overnight lending and deposit facilities (Figure 20). Moreover, in 2023, the BSP introduced several changes to the open market operations (OMOs) framework to improve its effectiveness.[23] (Box A provides further details of OMOs in the Philippines.)

Figure 19. Reserve Requirement Ratio



Source: BSP

Figure 20. BSP's Excess Liquidity Absorption Outstanding

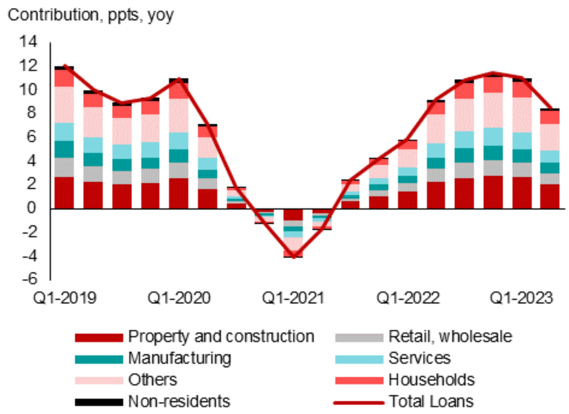


Source: BSP

[23] In May 2023, the BSP moved the auction time of the RRP facility to the morning session to promote interbank lending activities. Then, in early June, the BSP announced cuts to the RRR, as part of its ongoing reform toward a more market-based liquidity management framework, and to stabilize liquidity conditions upon the expiration of regulatory relief measures. Finally, in late June, the BSP introduced a new 56-day BSP bill as an additional liquidity absorption instrument.

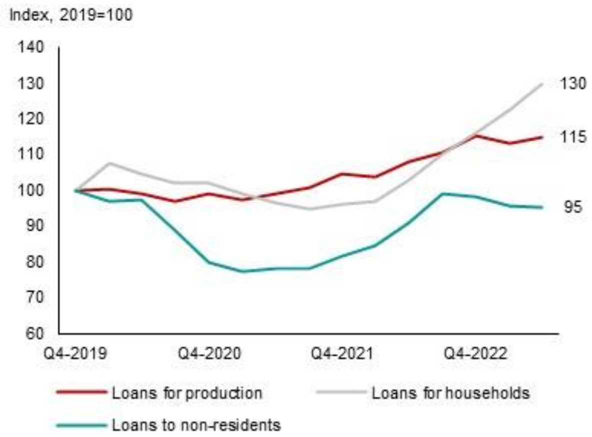
13. Bank lending in the Philippine banking system has been resilient and has provided support for economic activities, with a strong expansion in consumer loans. Loans increased by 8.1 percent (yoy) in August 2023, lower than the 11.3 percent increase in 2022 (Figure 21). In August 2023, corporate[24] and household loans grew by 4.8 percent and 30.5 percent, respectively, and both have rebounded to their pre-pandemic levels (Figure 22). Corporate loans account for 81 percent of total loans as of August 2023, and the main drivers of corporate loan growth are utilities, real estate activities, and wholesale/retail trade loans. Most of the corporate loans are used for working capital, and it is likely that corporate loan growth will slow down further due to higher interest rates and a delay in borrowing in anticipation of a decline in lending rates. On the other hand, household loan growth is primarily driven by credit card loans. Banks, especially the largest ones, are exploring opportunities to expand their loan portfolios, particularly in the consumer lending sector.

Figure 21. Banking System Loans by Sector



Source: BSP; AMRO staff calculations

Figure 22. Banking System Loan Recovery



Source: BSP; AMRO staff calculations

14. However, there remain pockets of vulnerabilities in both consumer and MSME loans that warrant close monitoring. Although the banking sector's nonperforming loan (NPL) ratio continued to decline from its peak of 4.51 percent in August 2021 to 3.4 percent in Q2 2023, the NPL ratio remains above the pre-pandemic level of 2.0 percent. Meanwhile, the ratios of past due loans and restructured loans declined from their peaks in mid-2021, at 5.4 percent and 3.0 percent of total loans, respectively, to 4.1 percent and 2.5 percent in Q2 2023 (Figure 23).

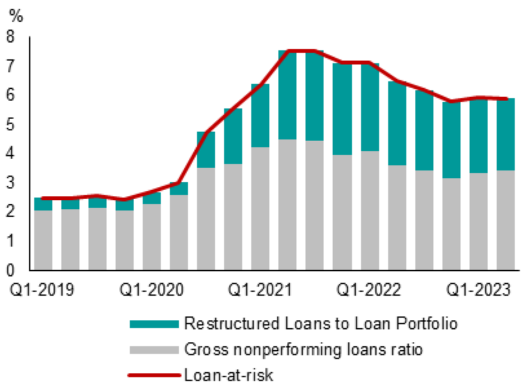
- **On the corporate side**, a corporate debt-at-risk[25] assessment has revealed an increase in the share of debt with an interest coverage ratio (ICR) of less than 1.25 during the pandemic. However, this number has been declining since then (Figure 24), indicating that forbearance measures have helped ease financial distress within the corporate sector. Nevertheless, debt-at-risk remains concentrated within specific types of firms and sectors. In particular, MSMEs contribute the most to firms-at-risk, while

[24] Large corporations make up more than 95 percent of new loans, whereas micro, small and medium enterprises (MSMEs) constitute less than 5 percent of new loans to the private sector.
[25] Debt-at-risk is defined as the debt of financially stressed borrowers. Debt-at-risk does not correspond directly to nonperforming loans; rather, it is the debt that could come under strain or could potentially become nonperforming.

most of the debt-at-risk originates from the retail and wholesale, property, and construction sectors (Selected Issue 3). Nevertheless, MSME loans comprised only about 3.6 percent of the banking system's total loans as of end-June 2023.

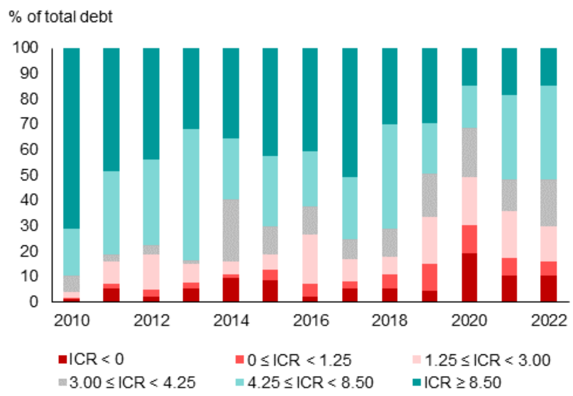
- **On the consumer side**, consumer loan portfolio continued to report a higher NPL ratio, at 6.3 percent, compared with other loan types, despite a decline from 8.1 percent in June 2022 due to the economic recovery and the banking system's efforts to manage risks through prudent credit underwriting, collection, remediation, and workout (Figure 25). Consumer loans' NPLs contributed as much as 35.1 percent of overall NPLs in Q2 2023, even though consumer loans constitute only 20 percent of the banking system's loan outstanding. Auto loans and mortgages have relatively high NPL ratios of 6.9 percent and 7.6 percent, respectively, in Q2 2023 (Figure 26).

Figure 23. Banking System's Loan-at-Risk



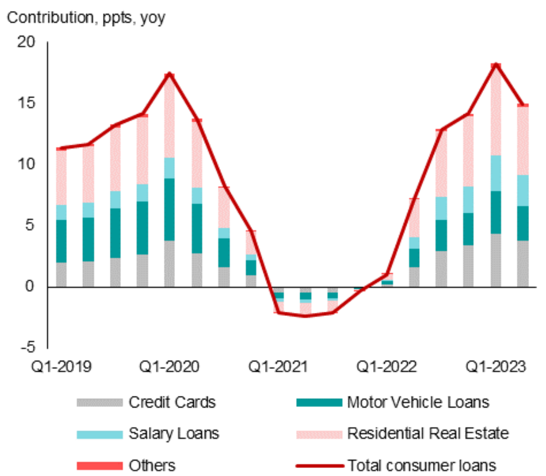
Source: BSP; AMRO staff calculations

Figure 24. Proportion of Total Debt by ICR



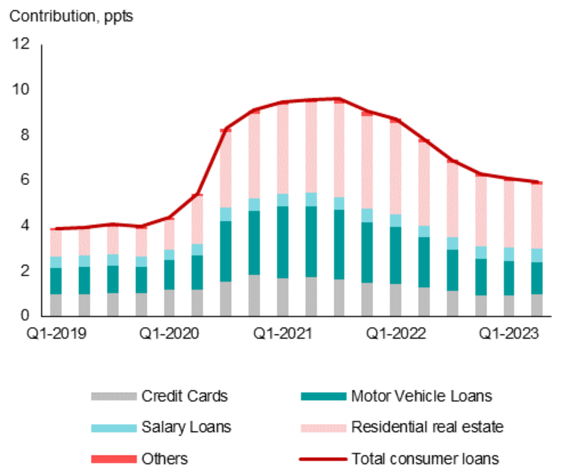
Source: Orbis Moody's; AMRO staff calculations

Figure 25. Banking System's Consumer Loan Growth



Source: BSP; AMRO staff calculations

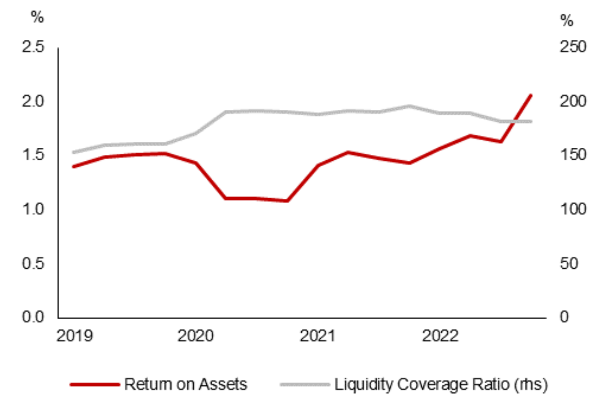
Figure 26. Banking System's Consumer Loan NPL Ratio



Source: BSP; AMRO staff calculations

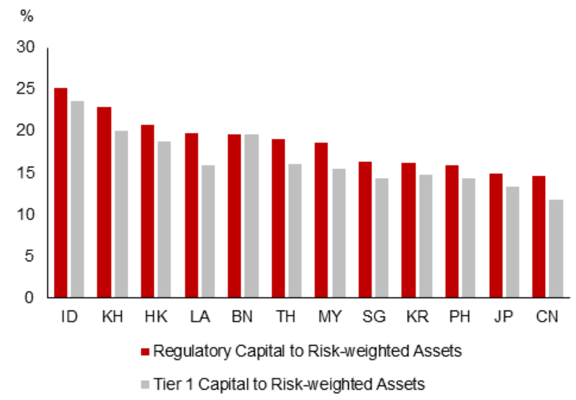
15. The overall banking sector has recorded improved profitability and sufficient liquidity and capital buffers. As of end June 2023, most regulatory relief measures related to COVID-19 to facilitate lending and support the banking sector during the pandemic[26] had ended. The net interest margin improved from 3.47 percent in 2021 to 3.98 percent in Q2 2023, and return on assets (ROA) rose from 1.12 percent in 2021 to 1.56 percent in Q2 2023. The liquidity coverage ratio (LCR) for the universal and commercial banks (UKBs) remained comfortable at 185.7 and 185.4 percent in Q4 2022 on solo and consolidated bases, respectively (Figure 27). In terms of capital buffer, the overall banking system maintained a sufficient capital adequacy ratio (CAR) of 16.0 percent in Q1 2023 (Figure 28), well above the regulatory minimum of 10 percent. However, there is a dispersion of CARs across banks, from 20 percent to below 13 percent. In a volatile global financial market, capital is subject to both credit risks and market risks, with 28 percent of the banking system's assets in debt securities. Nevertheless, a large proportion of debt securities are held to maturity and the possibility of fire sale is small, given ample liquidity in the system (Box B provides an interest-rate-risk stress test on Philippine banks).

Figure 27. ROA and LCR



Source: IMF via Haver Analytics; AMRO staff calculations

Figure 28. CAR & Common Equity Tier 1 (CET1)



Source: IMF via Haver Analytics; AMRO staff calculations
Note: Latest available data.
ID = Indonesia, KH = Cambodia, HK = Hong Kong, LA = Lao PDR, BN = Brunei, TH = Thailand, MY = Malaysia, SG = Singapore, KR = Korea, PH = Philippines, CN = China, JP = Japan, and VN = Vietnam.

16. The property sector saw elevated vacancies in some segments, but the risk to the banking sector should be limited. Demand for office space has weakened because of the post-COVID work-from-home trend and muted demand from offshore gaming operators.[27] Likewise, the demand for residential condominiums has been subdued on account of higher mortgage rates. As such, the vacancy rates for office spaces and residential condominiums in Metro Manila posted 18.4 percent and 17.2 percent, respectively, in Q2 2023,[28] compared with 5 percent and 10 percent pre-pandemic. The government's commitment to build six million homes over the next 6 years, while helpful for expanding home ownerships, could add to the stock of vacant homes. If the vacancy rate remains elevated for an extended period, it may

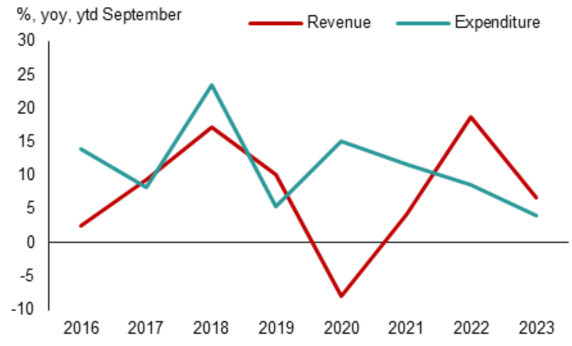
[26] These measures include raising the single borrower's limit (SBL) for all banks from 25 percent to 30 percent in March 2020 (extended four times until June 30, 2023). Moreover, the BSP reduced reserve requirements for UKBs from 12 percent to 9.5 percent in June 2023. In May 2020, the BSP reminded banks and quasi-banks to utilize capital conservation buffer (CCB) and Liquidity Coverage Ratio (LCR) buffers during the crisis, allowing UKBs to draw down their 2.5 percent minimum CCB and banks to access liquid assets to meet liquidity demands, even if the LCR falls below 100 percent. The BSP also allowed banks and quasi-banks to use loans to MSMEs and large enterprises (LEs) that had been critically affected by the COVID-19 pandemic as an alternative to comply with the reserve requirements (RR), which has been extended three times since the measure was introduced on 24 April 2020 for MSME loans and 29 May 2020 for loans to eligible LEs. These measures aimed to enhance lending and flexibility in the banking sector during the pandemic. For UKBs, the said relief measure already ended on 30 June 2023 while thrift banks, rural banks, and cooperative banks can still use their outstanding MSME and LE loans as of June 30, 2023 as alternative compliance with the reserve requirement until the said loans are fully paid, but not later than December 31, 2025, subject to certain conditions.
[27] The Philippine authorities have been clamping down on illegal activities associated with offshore gaming industry.
[28] Based on Colliers Quarterly Report on Metro Manila real estate markets as of 27 July 2023.

lead to property price corrections and weigh on the financial health of vulnerable developers. However, based on AMRO's corporate debt-at-risk analysis, the proportion of vulnerable developers or firms-at-risks in the real estate sector constitutes only 10 percent of the sector's total assets. Therefore, although the overall real estate activities account for 19 percent of the banking system's lending, the direct spillovers to banks from a property downturn should be limited.

A.4 Fiscal Sector

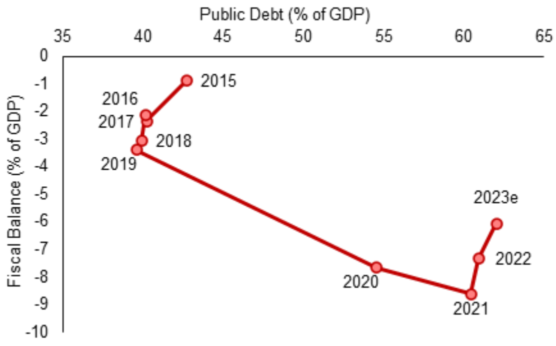
17. The fiscal position continued to improve in 2023, attributable to robust revenue collection and moderate expenditure. Fiscal revenue increased by 6.8 percent in the first nine months of 2023, compared to the same period in 2022 (Figure 29). Income tax led a rise in tax revenue, reflecting the strong economic recovery since 2022, while consumption tax and customs duties also increased robustly. On the other hand, total expenditure rose 4.1 percent in the same period (Figure 29), despite buoyant disbursement of capital expenditure, mainly due to a decline in transfers to local government units (LGUs).[29] With solid revenue performance and moderate expenditure, the fiscal deficit in 2023 is expected to fall to 6.0 percent of GDP in 2023 from 7.3 percent of GDP in 2022, based on AMRO staff estimates. National government debt is projected to inch up to 62.0 percent of GDP in 2023 from 60.9 percent of GDP in 2022 (Figure 30).

Figure 29. Changes in Revenue and Expenditure



Source: Bureau of the Treasury; AMRO staff estimates

Figure 30. Fiscal Balance and Government Debt



Source: Bureau of the Treasury; AMRO staff estimates

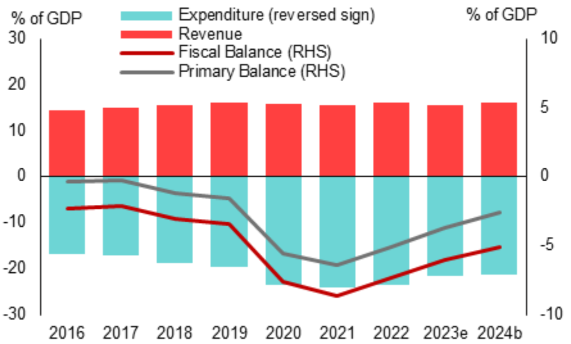
18. The 2024 budget aims to continue reducing the fiscal deficit, guided by the Medium-Term Fiscal Framework (MTFF). The fiscal deficit is budgeted to decline further to 5.1 percent of GDP in 2024 (Figures 31, 32). The revenue is expected to grow by 13.9 percent, as supported by tax reform measures, such as the passage of the Passive Income and Financial Intermediary Taxation Bill, the imposition of value-added tax (VAT) on digital service providers, as well as excise tax on single-use plastic bags, sweetened beverages, and junk food (Figure 33).[30] Disbursements are also planned to increase by 7.9 percent in 2024, with priorities on expenditure items that promote economic growth, including infrastructure projects. The fiscal stance in 2024 is assessed to be countercyclically contractionary under a positive output gap (Figure 34). Over the medium term, the government plans to gradually reduce the

[29] Total transfers to LGUs declined sharply largely due to the lower national tax allotment (NTA) shares of LGUs in 2023. This resulted from the lower actual tax revenue in 2020, which was the basis for the determination of 2023 NTA.

[30] Package 1 (TRAIN), package 1+ (tax amnesty), package 2 (CREATE), and package 2+ (sin tax) of the Comprehensive Tax Reform Program (CTRP) are already effective. The remaining packages, such as package 3 (real property valuation) and package 4 (passive income and financial tax) are pending at the Senate. In addition, the government proposed a tax on single-use plastic bags, VAT on nonresident digital service providers, excise tax on pre-mixed alcohol, sweetened beverages and junk food, rationalization of the mining fiscal regime, motor vehicle road users' tax, and the Ease of Paying Tax bills.

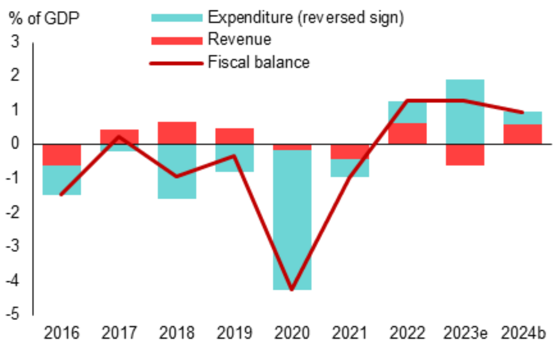
fiscal deficit to 3.0 percent of GDP, and national government debt to 51.1 percent of GDP, by 2028.

Figure 31. Fiscal Balance



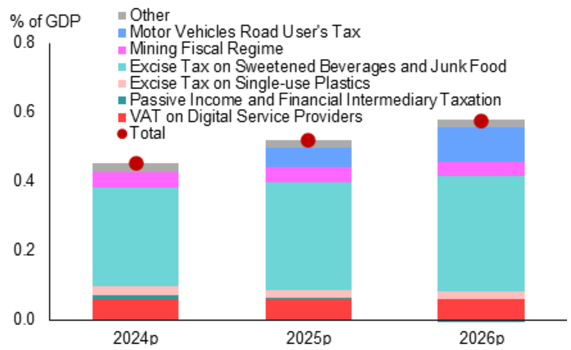
Source: Bureau of the Treasury; AMRO staff estimates

Figure 32. Change in Fiscal Balance



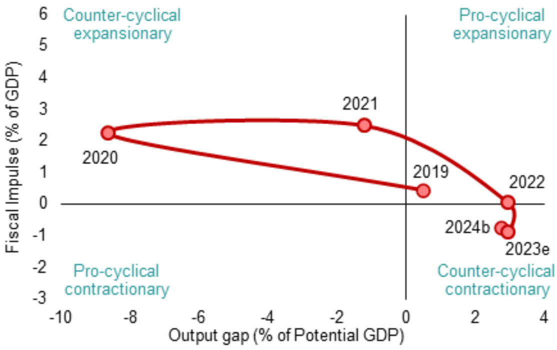
Source: Bureau of the Treasury; AMRO staff estimates

Figure 33. Impact of Tax Reform Measures



Source: Department of Budget and Management; AMRO staff estimates

Figure 34. Fiscal Impulse and Output Gap

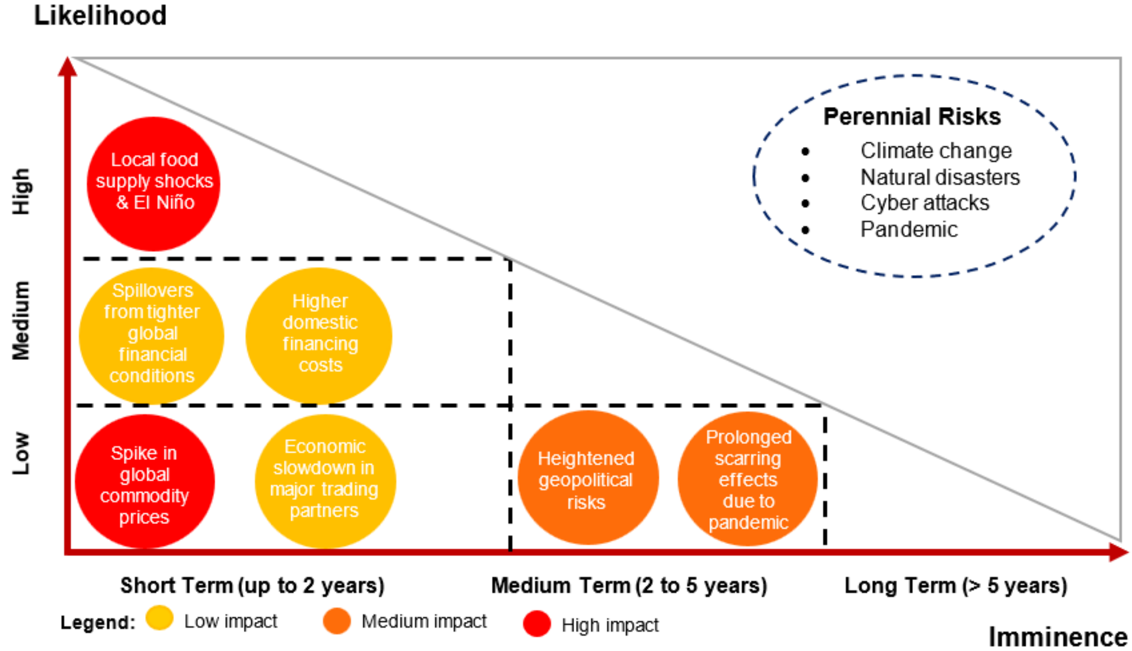


Source: Bureau of the Treasury; Department of Budget and Management; AMRO staff estimates

B. Risks, Vulnerabilities and Challenges

19. The Philippine economic outlook is clouded by various risk factors and challenges. In the short term, growth prospects are relatively robust, but the country could be adversely affected by high inflation, especially due to local supply shocks in the food sector. Additionally, an economic slowdown in major trading partners and volatility in the global financial market, along with tighter financial conditions, also pose risks. Looking at the longer term, growth potential will largely hinge on the scarring effects of the pandemic, the pace of infrastructure development, geopolitical risks, and natural disasters. These factors underscore an urgent need for action to foster resilient, sustainable, and inclusive long-term growth.

Risk Map: The Philippines



Source: AMRO staff compilation.

B.1 Near-term Risks to the Macro Outlook

20. Risks to inflation are skewed to the upside from both domestic and external factors, and high inflation could take a toll on growth. Specifically, high food and oil prices have reduced households' ability to afford discretionary items and hence dampened household consumption. Moreover, higher inflation could increase the risk of a slowdown in private consumption. Key risk factors to inflation are:

- **Local supply shocks:** Local supply disruptions, such as those caused by typhoons and other natural disasters, can lead to a shortage in consumer goods. El Niño as well as outbreaks of bird flu and swine flu could further exacerbate the shortage of local food.
- **Global supply shocks:** The ongoing Ukraine crisis could disrupt the global supply of commodities, leading to another spike in energy, fertilizer, and food prices. Meanwhile, Saudi Arabia's production cuts aiming at "balancing oil markets" could also put pressure on the international energy prices. These will exert upward pressure on inflation in the Philippines.

21. Headwinds from a further slowdown in global economic growth will pose challenges to the Philippines in the near term. In particular, China's economic recovery could fall short of expectations should sluggish consumption and property sector weakness persists. Also, growth in the U.S. and Europe could slow more than expected if elevated inflation leads to a further tightening of monetary policy. These developments can result in negative spillovers to the Philippine economy through their impacts on merchandise and service trade, tourist arrivals, overseas remittances, as well as foreign investment inflows.

22. Tighter financial conditions will lead to higher funding costs for the government and pose challenges for corporate and households:

- **From the external spillovers:** The Philippines' long-term government bonds are affected by U.S. Treasury (UST) bonds through return, interest rate shock and volatility spillovers.[31] Tighter financial conditions abroad, especially in the U.S., will trigger a rise in the Philippine government bond yields, which tend to be highly correlated with the UST yields.[32] Low turnover in the secondary market and a concentrated investor base can exacerbate bond market volatilities in such a rising interest rate environment. Furthermore, during periods of heightened risk aversion and peso depreciation, government bonds could be subject to rollover and foreign exchange risks, as 17.3 percent of government debt are held by private non-residents and almost all this debt is in foreign currency.[33]
- **On the domestic side**: The BSP policy rate hikes have been transmitted into higher interbank rates, short-term treasury bill and bond yields,[34] and, to a lesser extent, bank lending rates. The domestic financial condition will tighten further if the central bank raises the policy rate again due to higher inflation. The higher borrowing costs will lead to a higher interest burden for the government and potential difficulties in servicing debts for some firms.[35] As corporates account for 85 percent of the banking system's loans, defaults among these borrowers can have a material impact on banks' balance sheet. Meanwhile, household loans, especially in the residential real estate sector, could face higher interest costs, potentially straining debt repayment capacity. Although this may have only a limited impact on banks' stability given the small size of household loans in the banks' loan portfolio, a high debt servicing burden and defaults can weigh on households' consumption, leading to a slowdown in private consumption.

B.2 Longer-term Challenges and Vulnerabilities

23. Scarring effects caused by the pandemic can reduce growth potential. Pandemic scarring is estimated to have lowered the Philippines' potential growth from 6.2 percent to about 6.0 percent.[36] Specifically, lower job quality and a slow recovery in investment are the major scarring effects in the Philippines. Although the labor market has rebounded faster than expected since 2022, job quality has deteriorated, with a lower share of high-skilled jobs.[37] Furthermore, a sharp drop in investment during the pandemic has reduced capital formation

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[31] See Tsang, A., M.S. Yiu and H.T. Nguyen (2021), "Spillover across Sovereign Bond Markets between the US and ASEAN4 Economies," *Journal of Asian Economics*, 76, Article 101343, and AMRO Working Paper: WP/20-04.
[32] AMRO staff's estimate shows that the 10-year UST yield is the most important driver of the 10-year Philippine bond yield. The sensitivity of the 10-year Philippine bond yield to a 100-bps change in 10-year UST is 80 bps. This is based on a simple linear regression that regresses the monthly change in the 10-year Philippine government bond yield on the monthly changes of the policy rate, the CPI, the 10-year US Treasury yield, and first lags of these variables.
[33] However, since most of this is in the medium- to long-term tenors, the impact from currency repricing will only be felt over time.
[34] The coupon rates of treasury bills and bonds have risen since 2022 in line with the policy rate hikes. While the long-term rates increased and the short-term rates remained stable until Q3 2022, the long-term rates gradually came down and the short-term rates rose sharply thereafter.
[35] Based on AMRO study (Box A), a 2-percent increase in lending rates could lead to a 4.8 percentage-point rise in debt-at-risk.
[36] 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). The latter figure is close to the lower bound of the authorities' target of 6.0 – 7.0 percent for 2023. 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.
[37] The job quality deterioration, partly reflecting lower labor productivity, could be explained by an unwanted structural shift in the labor market. For example, there was a return to low-productivity pursuits in agriculture. See Esguerra, E. and Jandoc, K., "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: Bangko Sentral ng Pilipinas.

and long-term growth potential. For instance, developing a digital economy is essential to improve the growth potential, and this can materialize only by upgrading labor skills and attracting substantial investment.

24. The pace of infrastructure development is one of the key challenges facing the Philippine economy (please refer to Selected Issue 4 in the Annex for a detailed discussion). Infrastructure development is important for enhancing growth potential and reducing poverty. However, infrastructure investment in the Philippines has been lagging behind regional peers, resulting in weak competitiveness.[38] Compared with middle-income country groups, the Philippine transportation infrastructure, especially road infrastructure, is identified as the weakest area, followed by information and communications technology (ICT) and utility infrastructures.[39]

25. Heightened geopolitical tensions can bring about both challenges and opportunities to the Philippines. The geopolitical tensions between China and the U.S. could persist and intensify over the medium to long term, leading to fragmentation of the global economic system. This can result in both headwinds and tailwinds for the Philippines. On one hand, substantial uncertainties brought by geoeconomic fracturing could erode market sentiment and hold back foreign investment in the country. On the other hand, the reconfiguration of supply chains, such as "China Plus One," could be advantageous to the Philippines especially in investment and trade, provided the infrastructure gap is closed, labor quality is enhanced, and the business environment is improved to attract industry relocation to the country.

26. As one of the most disaster-prone countries, the Philippines faces increasing social and economic costs due to global climate change. The impact of climate change has become more severe due to environmental degradation caused by rapid socio-economic development in the absence of adequate mitigating environmental plans. The Philippines is particularly affected by the physical risks of climate change and needs to take adaptation measures to mitigate the impacts. In terms of acute risks, tropical cyclones continue to cause numerous deaths and extensive damage in the country,[40] while flooding due to heavy rainfall also significantly affects various regions.[41] Sea level rise poses a chronic risk of flooding that would lead to huge economic losses resulting from widespread population resettlement and extensive reconstruction efforts. These physical risks will likely be exacerbated by climate change. Thus, the rising costs of these risks could become a major burden on fiscal resources and jeopardize financial stability, underscoring an urgent need for climate change adaptation in the Philippines.[42]

[38] See Nam B. 2023. "Public Infrastructure Investment and Macroeconomic Impact in ASEAN+3 Economies." AMRO Analytical Note, for a comparison of infrastructure stock, investment and competitiveness among ASEAN+3 economies.
[39] The assessment is based on the Global Competitiveness Index 2019, published by the World Economic Forum.
[40] According to the United Nations Office for the Coordination of Humanitarian Affairs (OCHA), 18 tropical cyclones entered the Philippines' Area of Responsibility in 2022, and five made landfall. In particular, Typhoon Paeng caused at least 156 deaths. According to Situational Report No.30 of the National Disaster Risk Reduction and Management Council (NDRRMC), the damage of Typhoon Paeng to infrastructure and agriculture amounted to PHP5.7 billion and PHP7.1 billion, respectively. In addition, in December 2021, Typhoon Odette/Rai brought massive destruction to the Philippines, where a response was needed until 2022.
[41] Between December 2022 and February 2023, a series of floods, caused by heavy rain, severely affected central and southern parts of the Philippines (including Misamis Occidental, Misamis Oriental, and some parts of Mindanao).
[42] Conversely, the Philippines' relatively low emissions have resulted in less concern for transition risk and climate change mitigation.

C. Policy Discussions and Recommendations

C.1 Calibrating Macroeconomic Policy in Response to Evolving Economic Situation

27. At the current juncture, a tight monetary policy and contractionary fiscal stance form an appropriate policy mix against the backdrop of a positive output gap and persistent inflationary pressure. The BSP's monetary policy tightening between 2022 and October 2023 has been timely and necessary, as inflation was also demand-driven according to AMRO's findings. According to AMRO's baseline projections, the output gap is expected to remain positive while inflation should gradually return to its target band in 2024, which suggests that the current tightened monetary policy stance is appropriate. The policy rate can be maintained at the current level[43] to keep monetary policy tight, as it is above the neutral rate[44] and the projected decline in inflation will keep the policy rate positive in real terms. On the fiscal side, given the positive output gap in 2023 and 2024, tight fiscal policy would not only lower fiscal deficit in line with the government's fiscal consolidation efforts, but also help contain aggregate demand and rein in inflation.

28. Going forward, in light of increasing uncertainties, the policy mix should be flexible and data dependent. Authorities should be vigilant in monitoring the evolving economic situation under high uncertainties, particularly with respect to price and growth developments. In a risk scenario of prolonged inflation at a level higher than the target range,[45] there may be a need for additional monetary policy tightening. However, the decision should take into account the delayed transmission of past tightening, and the impact of additional rate hikes on financial stability – in particular, the financial health of vulnerable borrowers such as households and MSMEs. In a different risk scenario, if downside risks were to result in a sharp and persistent economic slowdown in the coming quarters, monetary policy easing in coordination with a reallocation of budgetary funds to support vulnerable groups could be warranted. In that way, fiscal policy can provide support without derailing the fiscal consolidation plan.

29. Meanwhile, the "all-of-government approach" to curb inflation is welcomed as supply-side factors also contribute to inflation dynamics. This comprehensive strategy encompasses both monetary measures and non-monetary supply side measures.[46] On short-term non-monetary measures, the authorities have rightly decided to encourage more food imports as the main response. However, the authorities should strive to reduce import restrictions further and move toward a more market-oriented approach to food importation. At the same time, local production of food has been hampered due partly to low productivity, leading to higher costs of production and a need for protectionist measures, which, in turn, could intensify the impact of local supply shocks. The authorities should also take structural measures to improve the productivity of the agricultural sector, such as considering agrarian land ownership reforms, increasing investments in rural area infrastructure, and providing

[43] AMRO's Taylor Rule model suggests that the current level of policy rate of 6.50 percent is appropriate, based on the 2023 GDP growth and inflation projections of 5.6 percent and 6.0 percent respectively.
[44] Based on a historical average.
[45] In particular, inflationary pressure remains elevated from persistently high level of core inflation in 2023. Also, inflation expectations from certain surveys have not been well-anchored. For example, inflation expectations from customer and business surveys have continued to increase, according to the BSP's expectation surveys in Q3 2023 (see Footnote 10).
[46] Non-monetary measures can play a significant role in curbing high inflation that is due to the upward supply-driven price shock. Moreover, the policy mix could vary according to the persistence of the shock. Non-monetary tools such as lowering excise tax and granting direct subsidies could suffice to deal with temporary shocks, while for persistent shocks, monetary policy tightening could be warranted to avoid second-round effects.

more financial and technical support to the agricultural sector,[47] in order to enhance food security of the country. Lastly, to alleviate the impact of high inflation, the authorities are encouraged to provide targeted subsidies to lower-income groups and people heavily affected by high prices, as the total amount of targeted subsidies should be relatively small and will not undermine fiscal sustainability.[48]

30. Moreover, macroprudential tools can be used actively to address financial stability issues as part of a policy package. The BSP has in place macroprudential tools, such as the countercyclical capital buffer (CCyB), which can be used in a time-varying and countercyclical manner to address potential vulnerabilities. Additional macroprudential tools such as the debt-service-ratio (DSR) may also be considered to ensure appropriate lending standards in light of more intensive competition in the consumer loan segment. In view of high NPLs which are pandemic-related, banks are encouraged to help households and MSMEs in distress to restructure their debts. The active use of macroprudential tools to address financial stability risks will allow further flexibility for monetary policy to focus on price stability and growth objectives.

Authorities' Views

31. The authorities emphasized that, although the fiscal stance in 2024 would be countercyclical, it remains supportive of growth. The contractionary fiscal policy stance is mainly due to normalization following fiscal expansion during the pandemic. However, the fiscal policy envisages attaining short-term macro-fiscal stability while remaining supportive of economic recovery and promoting medium-term fiscal sustainability, as committed by the government under the Medium-Term Fiscal Framework (MTFF).

32. The authorities also provided further clarification on related policies regarding imports of agricultural goods. As part of the government's effort to fast-track official processes for clearances of agricultural goods, the Bureau of Internal Revenue (BIR) in March 2023 issued Revenue Memorandum Circular (RMC) No. 31-2023, which removed the required issuance of Authority to Release Imported Goods (ATRIG) on fertilizers and feed ingredients, to minimize import processing time.

C.2 Supporting Sustainable Development While Ensuring Fiscal Sustainability

33. Medium-term fiscal policy should strike a balance between restoring fiscal buffer and supporting sustainable growth and development. Rebuilding the fiscal buffer is crucial to ensure fiscal sustainability and prepare for unforeseen risk events amid elevated uncertainties. Disciplined fiscal management is also critical in maintaining a good sovereign credit rating, which is an important factor in determining financing costs in the capital markets, for not only the government but also the private sector. At the same time, fiscal policy is expected to play an important role in enhancing growth potential through investment in

[47] The lack of comparative advantages in local food production could be traced back to several underlying factors, such as the scattered ownership of land, low technology, a lack of financing, and weak transportation infrastructure.
[48] To protect the vulnerable sectors, the Department of Social Welfare and Development (DSWD) has disbursed a total of PHP18.4 billion under the first and second tranches of the Targeted Cash Transfer (TCT) Program in 2022. For the third tranche in 2023, the DSWD is aiming to distribute grants to about 7.6 million beneficiaries, instead of the originally targeted 9.3 million beneficiaries due to budgetary constraints. Moreover, the National Government, through the Department of Budget and Management (DBM), has allotted a total of PHP 4 billion as fuel subsidies for the transport and agriculture sectors in 2023.

infrastructure, human capital development, and digitalization. Fiscal policy should also take the lead in strengthening social protection and provide proper incentives/support to address structural issues, such as climate change. While fiscal consolidation should be at the center of the medium-term fiscal policy, continuing and emerging fiscal needs should be addressed by reprioritizing and restructuring existing spending programs and reallocating the restructured fiscal resources toward national priorities.

34. Fiscal consolidation should be underpinned by strong commitment and specific targets/measures, anchored by fiscal rules and discipline. The establishment of the MTFF 2022-2028 is welcomed as it demonstrates a strong commitment to fiscal consolidation, thereby improving the credibility and accountability of the government. Given significant spending needs for sustainable development, the fiscal consolidation objective to gradually reduce the fiscal deficit and government debt, as well as adopt measures focusing on enhancing revenue collection, seem reasonable. The proposed tax reform measures should be implemented effectively to achieve the desired outcomes, while additional revenue-enhancing measures, especially the broadening of tax base through fiscal digitalization, should be continued.[49] In addition, AMRO recommends that the authorities consider introducing fiscal rules to instill discipline in fiscal policy, so as to ensure its continuity and independence regardless of political changes. The fiscal rules will help set a debt-to-GDP ratio limit over the medium-to-long term and guide operational targets, such as fiscal balance and spending. The specific design of fiscal rules should strike a balance between flexibility, simplicity, and enforceability.[50]

35. Accelerating fiscal decentralization and reallocating fiscal resources will serve the growing spending needs while maintaining fiscal sustainability. Reallocation of fiscal resources is essential to fit existing and emerging spending needs, given the constraints of fiscal consolidation. Resources can be secured through devolution and reassignment of functions across different levels of government, coupled with the restructuring of spending programs. The resources that are freed up can then be reallocated to new spending priorities.

- **The devolution of functions to LGUs, following the Mandanas-Garcia Supreme Court Ruling, should be completed effectively.**[51] The Mandanas Ruling increased the National Tax Allocation (NTA) received by LGUs, implying that the national government (NG) is left with less resources to spend on its programs. LGUs should fully assume responsibility for basic public services and facilities in accordance with the increased resources. Encouraging the national and local governments to prepare and implement the comprehensive devolution transition plan (DTP) will support the smooth and effective devolution of functions. To ensure the quality of public services and the local fiscal programs are aligned with national priorities, the authorities should continue with capacity development and technical assistance for LGUs, while enhancing the steering and coordination roles, and strengthening the monitoring and performance review processes. In addition, the formula on which the distribution of the

[49] Despite the relatively high VAT rate of 12 percent, the VAT C-efficiency (defined as actual VAT revenue / (statutory VAT rate x consumption)) is the lowest in the region due to the narrow tax base and weak tax administration. See the Annual Consultation Report on the Philippines 2021.

[50] See Davoodi, Hamid, Paul Elger, Alexandra Fotiou, Daniel Garcia-Macia, Andresa Lagerborg, Raphael Lam, and Sharanya Pillai. 2022. "Fiscal Rules Dataset: 1985-2021", International Monetary Fund, Washington, D.C, for the detailed discussion.

[51] The Mandanas-Garcia Supreme Court Ruling, which broadened the base from which the NTA shares of LGUs are determined, has significantly increased allotments to LGUs and reduced the fiscal resources available to the national government (NG) since 2022. For fiscal sustainability, devolved functions under the local government code (LGC) should be fully and permanently turned over by national government agencies (NGAs) to LGUs.

shares of individual LGUs is based, could be revised, considering the varying fiscal needs across regions.[52] Meanwhile, the government may need to consider revising the tax base from which the NTA shares of LGUs are determined, from the third fiscal year (FY) preceding the current FY to the current FY, to avoid a situation where the national government is required to make a big transfer to LGUs when the economy is in a downturn and revenue collection is weak, and countercyclical policy becomes necessary.

- **At the same time, the national government should also consider restructuring spending programs while enhancing spending efficiency.** The assessment, which should be on a zero basis, will help identify fiscal programs that are less effective, persistently underspent, and have achieved their intended objectives. In addition, public finance management (PFM) could be strengthened by using performance-based budgeting and introducing fiscal discipline. Persistent underspending of LGUs should also be addressed to warrant the nationwide fiscal policy planned for the fiscal year.[53] Further reassignment of functions across different levels of government could be discussed based on the characteristics of functions (e.g., beneficiaries, spillover effect, and economies of scale) and the capacity and resources of respective governments.
- **The reallocation of resources should be aligned with national priorities.** Full devolution and reassignment of functions, as well as restructuring of spending programs, will free up fiscal space for the national government, which can be redirected toward the national priority programs. Incorporating the strategic resource allocation plan (e.g., by sector and function) in the Medium-term Fiscal Program will better serve the national development plan. Specific design of priority programs, including infrastructure and social protection, should take into account their medium- to long-term implications on the economy and fiscal burden.

36. Fiscal reforms to address long-term fiscal burdens should be tackled as early as possible to avoid sharper and more painful adjustments later. Although population aging in the Philippines is still at an early stage, there are concerns about the growing fiscal burden from the Military and Uniformed Personnel (MUP) pension scheme, and the financial sustainability of the Social Security System (SSS) and the Government Service Insurance System (GSIS).[54] The AMRO mission welcomes the government's discussion on MUP pension reforms, and recommends completing it without delay by considering fiscal sustainability, income support, and equity across different pension systems.[55] In the longer-term perspective, the SSS and GSIS pension reforms should also be reviewed to enhance their financial sustainability.

[52] Currently, the distribution of the shares of individual provinces, cities, and municipalities is based on a formula factoring in population (50 percent), land area (25 percent) and equal sharing (25 percent). The formula could be more sophisticated, taking into account the factors affecting the fiscal needs of LGUs, such as fiscal self-sufficiency, the demographic structure (old-age and school-age population), industrial structure, basic infrastructure development, poverty rate, as well as the newly devolved functions.

[53] LGUs' budget utilization has ranged from 74 percent to 77 percent in the past five years. As a result, LGUs have incurred a budget surplus on average as they receive allocations from NG and collect local taxes, such as real estate and business taxes. LGUs have retained all the surpluses for use later.

[54] The previous pension system for MUP collapsed due to mismanagement, and the current MUP pension scheme is expected to pose a massive fiscal burden in the medium to long term. According to the Bureau of Treasury, MUP pension spending is expected to increase from PHP125 billion in 2022 to PHP240 billion by 2028 and PHP1.5 trillion by 2040.

[55] The main reform measures under discussion are as follows: (i) contribution from both MUP and the government (currently no contribution from MUP); (ii) no automatic promotion to the next rank upon retirement (currently automatic promotion); (iii) no automatic indexation to the salary of active personnel of the same rank (currently automatic indexation); (iv) minimum pensionable age at 57 years old (currently no minimum age); (v) professional management of the pension fund by GSIS.

Authorities' Views

37. The government is committed to fiscal consolidation by publishing the MTFF. The MTFF serves as a blueprint to reduce fiscal deficit, promote fiscal sustainability, and enable robust economic growth. The published six-year MTFF guides the macroeconomic and fiscal policies of the government and contains concrete fiscal targets and explicit measures. It was also adopted by both Houses of Congress through a concurrent resolution in 2022. The MTFF includes medium-term macroeconomic and fiscal targets, including a 3 percent deficit-to-GDP ratio by 2028 and a national government debt-to-GDP ratio of less than 60 percent by 2025. The targets cannot be revised unless deemed necessary based on an interim review scheduled in 2025.

38. The implementation of the Mandanas-Garcia Supreme Court Ruling aims to achieve full and smooth devolution of functions. The government has been conducting a study defining the functions and services that should be retained with the NG and those that should be devolved to LGUs based on their absorptive capacities. To enable LGUs to assume the devolved functions and services, the NGAs have been supporting the capacity building of LGUs. In particular, the Department of the Interior and Local Government-Local Government Academy (DILG-LGA), in coordination with NGAs, will spearhead the integrated capacity development program and technical assistance. Also, NGAs and LGUs have been directed to prepare and implement the DTP to ensure a smooth implementation of the full devolution of basic services and facilities. Meanwhile, the government has been conducting research to address issues related to the NTA shares of LGUs, including changing the tax base from which these shares are determined, and revising the formula for allocating NTA shares across different LGUs.

C.3 Safeguarding Financial Stability While Enhancing Financial Resilience and Inclusion

39. Close coordination among regulators is crucial in identifying, monitoring and mitigating potential financial stability risks that might arise from large conglomerates. While banks and financial markets have large exposure to conglomerates, the conglomerates are not subject to regulatory oversight, which prevents regulators from conducting a thorough risk assessment. That said, a coordinated effort has been made in identifying and assessing potential risks of spillovers by a timely sharing of information across regulatory agencies.[56] The Financial Stability Coordination Council (FSCC)[57] and the Financial Sector Forum (FSF)[58] have served as a coordination platform to share information, conduct regular consolidated monitoring, and discuss potential coordinated measures as well as actions to address conglomerates' vulnerabilities which could help prevent systemic risk events.

[56] The BSP, Securities and Exchange Commission (SEC), Insurance Commission (IC), and Philippine Deposit Insurance Corporation (PDIC) under the auspices of the Financial Sector Forum (FSF) signed a Memorandum of Understanding on the establishment of a supervisory college in 2022. The Supervisory College serves as a forum to facilitate cooperation and coordination on the supervision of financial conglomerates. The FSF completed comprehensive risk assessments of two financial conglomerates through the Supervisory College in August 2022 and February 2023. Another financial conglomerate is subject to ongoing inter-agency cross-sectoral review.
[57] The FSCC, which is an interagency body composed of FSF member agencies, is tasked with mitigating systemic risks that threaten the stability of the overall financial system.
[58] The FSF is a voluntary interagency body with representatives from the BSP, SEC, IC, and PDIC. It provides an institutionalized framework for consultation, coordination, and exchange of information relative to the supervision and regulation of the financial system.

40. On the financial system, authorities should continue to improve the liquidity management framework, as well as develop the bond and repo markets.

- **Liquidity management framework:** The BSP has made commendable progress in improving open market operations since adopting an interest rate corridor system in 2016. Further progress could be made in several areas: 1) The reserve requirement ratio (RRR) should be reduced further. At 9.5 percent, the RRR remains higher than in other countries with similar interest rate corridors and could have a distortionary impact on the system. 2) When the RRR is lowered, absorption capacity through other instruments must be enhanced[59] to avoid excess liquidity exerting downward pressure on interest rates. 3) The BSP should continue to promote interbank lending activities through its OMOs, such as by limiting OMO access to a subset of counterparties which could then serve as market makers.
- **Bond and repo market development:** Authorities should continue to improve the functioning and liquidity of these key markets. In the government bond market, where banks account for half of bond holdings and nearly 90 percent of market turnover, a broader investor base will improve market resilience and price discovery. Hence, the authorities should reduce withholding tax rates on interest income from government securities to encourage more investment by nonbank players, including non-residents.[60] Moreover, the proposed establishment of defined-contribution private pension funds under the Capital Market Development Act will increase the demand for bonds from long-term institutional investors. On the repo market, the legal and operational framework should be strengthened. At present, the absence of a standard legal agreement and difficulties in same-day collateral settlement are giving rise to legal uncertainties and high transaction costs on repo transactions. Hence, the BSP should consider adopting the Global Master Repurchase Agreement (GMRA)[61] to establish a legal standard. Also, the central bank should promote deliverable repo transactions, especially for its own RRP operations. Finally, further consolidation in the number of government securities can also ease the collateral management burden.

41. In the longer term, the authorities should continue to expand financial inclusion, which is key to inclusive development and poverty reduction. According to the BSP's 2021 Financial Inclusion Survey, 44 percent of adults remained without a formal account.[62] About half of adult savers kept their savings at home, and more than half of borrowers obtained loans from informal sources. The majority of the underserved could be found in the lower-income group, MSMEs, and the agricultural sector. Key impediments to financial inclusion included insufficient savings, the lack of required identification documents, the absence of personal financial data for credit assessment, limited understanding of financial products, and inadequate physical and IT infrastructures in remote areas. Authorities should promptly address these gaps, including through speeding up the issuance of national IDs, improving the functioning of credit bureau by enhancing data interconnectivity and consistency or introducing alternative credit data. The BSP can also provide incentives for banks to expand digital banking services to the underserved population.

[59] For example, the BSP can expand the size of RRP operations and increase BSP bill supply, in consultation with the Bureau of Treasury (BTr) and in line with investors' demand.
[60] Currently withholding tax rate is as high as 20 percent for residents and 30 percent for non-residents.
[61] GMRA is a standard legal agreement for repo transactions published by the International Capital Market Association (ICMA).
[62] Account ownership covers all types of transaction accounts (in a bank, e-money issuer, cooperative, microfinance institution) that can be used to save money, transfer funds, and send or receive payments and remittances.

C.4 Expediting Structural Reforms for Sustainable Growth and Development

42. Strengthening the medium- to long-term economic growth potential requires overcoming the scarring effects of the pandemic and formulating a long-term development strategy. Specifically, the formation and upgrading of human, physical and financial capital are essential for reducing the scarring effects. Given the improved employment situation, the focus of human capital policy should shift from job creation to job (quality) improvement. Moreover, upgrading and upskilling the workforce to embrace a more technology-driven economy is essential in the longer term to improve productivity and competitiveness. The authorities also recognized the needs for investments in education and training to improve labor quality, and for action plans to implement the related policies. The authorities could implement plans to retain skilled labor in the country, such as providing incentives to skilled labor to work locally instead of moving abroad and incentives to encourage firms to recruit more local skilled labor to improve competitiveness. Meanwhile, the implementation of policies and measures to attract investments, particularly foreign investments, and to promote exports constitutes another driver of long-term economic development. These policies could include implementing new investment legislations, easing market entry requirements, and promoting the ease of doing business environment. Furthermore, the government can enhance the country's growth potential and competitiveness through infrastructure investment, digitalization, and developing a green economy.[63]

43. The authorities should continue the efforts to promote foreign investment and ensure policy consistency to boost investor confidence. The Philippine authorities have made commendable efforts, notably on the legislative and administrative front,[64] to improve efficiency and the general business environment for FDI. These efforts should continue and be followed up by effective implementation. While FDI inflows have decelerated year to date, total approved foreign investments in H1 2023 have increased by 9 percent (yoy),[65] indicating increasing interest from foreign investors. In addition to the overseas investment promotion endeavors, the authorities should expedite the implementation of these investment projects, and to ensure policy consistency to boost investor confidence in general.

44. The Philippines could benefit by strengthening its commitment to free trade and regional integration against growing uncertainties arising from geopolitical tensions and fragmentation. A strong commitment to free trade and expanded Free Trade Agreement (FTA) networks with trading partners can help mitigate uncertainties and build market confidence. Indeed, the Philippines' ratification of the Regional Comprehensive Economic Partnership (RCEP) in June 2023 is a strong signal of its endorsement of free trade and multilateralism amid stronger regional economic ties. The RCEP along with other FTAs can be a catalyst to expand international trade and attract foreign investment.[66] These FTAs pose considerable opportunities that the country can exploit to boost tourism and broaden services

[63] In early 2023, the government approved the Philippine Development Plan (PDP) 2023-2028. The PDP set the direction for the Philippines to work towards becoming an upper-middle income country by 2025, considering its economic development with concerns about social development and protection, disaster resilience, digital transformation, among others..
[64] For example, amendments to the Retail Trade Liberalization Act and the Public Service Act, and the Foreign Investments Act.
[65] Total approved foreign investment in H1 2023 recorded PHP 467 billion, up by 9 percent (yoy) according to PSA data.
[66] For instance, see Quimba, F, et al., 2021, "Who Benefits from RCEP? Application of Trade Policy Tools", PIDS Discussion Paper Series 2021-35

trade.[67] Unlike its neighbors, the Philippines tourism industry is very much driven by domestic tourism and it has much potential to attract foreign tourists to expand the tourism industry.[68] In order to do so, the authorities can leverage FTAs, via foreign investment and participation, to speed up the implementation of the National Tourism Development Plan, particularly on enhancing accessibility, connectivity, facilities, and productivity.

45. Infrastructure investment should be stepped up through strategic prioritization among different sectors and effective utilization of various funding sources (Selected Issue 4 in the Annex)**.** Given the inadequate and weak infrastructure stock, extensive infrastructure investment is required in the medium term to support growth and sustainable development.[69] To address the infrastructure gap, the government has intensified its infrastructure development efforts through the Build Better More (BBM) program, which superseded the previous Build Build Build (BBB) program. The infrastructure projects will be funded from various sources, including the government budget, official development assistance (ODA), public-private partnership (PPP), the Maharlika Investment Fund (MIF), and foreign direct investment (FDI).

- **Strategic prioritization of infrastructure projects is essential, given limited resources.** The priorities of infrastructure projects should closely align with the national development plan and the projects should be complemented by other development projects and policy measures, such as industrial parks and economic zones, to create synergy. The authorities should identify and prioritize the strengthening of weak infrastructure which is a drag on national/regional development and people's livelihoods, as well as projects that can potentially promote economic growth with high spillover and network impact. Moreover, it is better to focus on completing the priority infrastructure projects, rather than implementing many projects simultaneously, to avoid delays and cost overruns.
- **For effective utilization of available resources, funding sources should be selected based on the nature of specific projects.** For example, a PPP model is suitable for large-scale transportation infrastructure projects if the upfront costs are expected to be recovered by user tolls/fees and/or regular payments by the government over the life of the contract. In general, a well-designed PPP contract offers advantages over public procurement in terms of mobilizing private financial resources and know-how, promoting efficiency and improving service quality. On the other hand, the government should continue to provide basic transportation infrastructure for universal access (e.g., farm-to-market roads, detours to highways). In addition, the role of MIF in funding infrastructure investment, compared to other funding sources, should be clearly defined to prevent confusion and duplication, which may lead to inefficiency in investment.
- **PPP projects should be well designed and managed under a sound legal and policy framework.** First, PPP projects should undergo a feasibility study with the same standards as public investment projects. That is, the PPP should not be used as a means to circumvent budgetary review. Second, the government should share risks fairly between public and private parties to provide the right incentives while minimizing

[67] See Rivera, J and Tullao, T., 2022, "How Can the Philippines Seize Opportunities in Services Trade under RCEP?". PIDS Policy Notes
[68] According to the Department of Tourism (DOT), revenue from international tourists was PHP368 billion while revenue from domestic tourism was PHP 1.6 trillion in 2022.
[69] According to NEDA, 3,770 infrastructure priority programs and projects, with an indicative total investment requirement of PHP17.3 trillion over the medium term, are deemed responsive to the requirement for infrastructure for the PDP 2023-2028.

contingent liabilities to the government. The authorities should be mindful that poorly designed PPP contracts, with minimum income guarantees under optimistic demand and revenue assumptions, may result in cost overruns and a need for fiscal support. Third, PPPs require a well-established legal and policy framework that clearly articulates the appraisal, approval, monitoring, review and resolution processes. The newly proposed PPP Law 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.

46. The Philippines is establishing its first sovereign wealth fund, known as the Maharlika Investment Fund (MIF), primarily aimed at maximizing financial returns while at the same time promoting socio-economic development. AMRO recognizes the authorities' ambition to step up investments in infrastructure, long-term development, and sustainable growth. The new MIF Act has laid down a strong legal framework defining the fund's objectives, sources of funding, investment guidelines, and governance structure, all of which are crucial for the successful establishment of a national investment fund (please refer to Box C for further details). However, at the operational level, it is essential for the authorities to closely monitor the MIF and its management body, the Maharlika Investment Corporation (MIC), to ensure that the objectives are achieved, the country's long-term development needs are met, and the governing law is strictly adhered to. Moreover, the MIF's role in infrastructure investment should be clearly defined with appropriate governance to avoid misuse of funds. With regard to the MIF's funding sources, as the initial funding will come from the national government and related agencies including the BSP, the relevant parties must conduct due diligence in assessing the potential impact of their contributions on the financial health of these agencies. Finally, drawing on international experiences, the MIF should be run by professionals and the board should comprise independent directors to ensure that the Fund adheres to its investment objectives.

47. AMRO supports the authorities' efforts in promoting economic and financial digitalization as part of PDP 2023-2028. Despite lagging behind its peers, the Philippines has made substantial progress in digitalizing the economy since the pandemic. The roll-out of the National ID (PhilSys ID) system has facilitated digitalization in the Philippines. An e-government program has been introduced to improve government services, particularly "One Digitized Government" program.[70] On financial digitalization, the BSP launched Digital Payments Transformation Roadmap 2020-2023 in 2020 to outline the overall plan for financial digitalization, and progress has been satisfactory. A new roadmap is expected to be announced early next year. The digital banking landscape has expanded with six digital banks established, and 289 FinTech companies as of December 2022. In regulating digital banks, AMRO supports the BSP's prudent approach to move gradually and carefully in order to avoid systemic risks. (Please refer to Selected Issue 5 in Annex for further details of the digitalization in the Philippines.)

[70] The e-government program is spearheaded by the Department of Information and Communications Technology (DICT), which has developed a number of e-government initiatives, particularly "One Digitized Government" program, to improve government services. Other initiatives include i) Electronic Business Permits and Licensing System (eBPLS), ii) Online Payment System (OPS), iii) Integrated Government Philippines (iGovPhil), iv) Philippine National Public Key Infrastructure (PNPKI), and v) Citizen's Charter program.

48. Progress has been made in the areas of central bank digital currency (CBDC) and regional payment connectivity. The BSP has conducted studies on CBDC since 2020. In 2022, the BSP launched a pilot initiative called Project Agila to create its own wholesale CBDC, and the results of the assessment will serve as a guide for a possible launch of wholesale CBDCs in the Philippines. Project Agila is expected to run until 2024.[71] To foster and enhance bilateral and multilateral payment connectivity, the ASEAN-5 members (Indonesia, Malaysia, the Philippines, Singapore, and Thailand) signed the Memorandum of Understanding (MOU) on Cooperation in Regional Payments Connectivity (RPC) in November 2022. Consistent with the MOU objectives, some ASEAN Member States (AMS) are exploring multilateral payment connectivity via instant payment systems, by collaborating on Project Nexus of the Bank for International Settlements Innovation Hub (BISIH).

49. In response to climate change risks, the Philippines has formulated a long-term national plan to address climate change issues supported by budget allocation and a legal framework. AMRO welcomes the authorities' inclusion of an accelerated climate change agenda in PDP 2023-2028.[72] In 2024, PHP 543.4 billion will be allocated to national government agencies (NGAs) for climate change-related programs and projects. Out of the allocation, 69 percent is for adaptation and 31 percent for mitigation. The authorities have established a Sustainable Finance Roadmap, outlining a plan to secure funding through sustainable financing instruments (SFIs) to support sustainable development and climate change goals. The BSP has issued regulatory guidelines on sustainable finance for banks.[73] The BSP also launched its 11-point Sustainable Central Banking (SCB) Strategy in late 2022, to promote "sustainability" in the financial system (please refer to Climate Clipboard for the Philippines in Appendix 6).[74]

[71] On 31 August 2023, the BSP's Monetary Board approved the selection of Hyperledger Fabric as the technology which will be used for sandbox tests and building CBDC prototypes for Project Agila. The next phases of Project Agila from Q4 2023 to Q1 2024 will involve testing the wholesale CBDC technology for 24/7 inter-institutional fund transfers in a sandbox environment.

[72] Specifically, the government committed to strengthening delivery on key climate actions and disaster resilience, and "toward an upper middle-income and low-carbon development, and a climate-smart and climate-resilient Philippines" by 2028. The government also 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 in the Nationally Determined Contribution (NDC) submitted to the UN in 2021. This reduction will be achieved by making the transition transitioning to cleaner energy sources, while reducing reliance on coal and oil.

[73] These include i) Sustainable Finance Framework (2020), ii) Environmental and Social Risk Management Framework (2021), iii) Guidelines on the Integration of Sustainability Principles in Investment Activities of Banks (2022), and iv) Guidance on the Implementation of the Environmental and Social Risk Management (ESRM) System (2022).

[74] The SCB strategy requires the BSP to i) conduct a comprehensive climate vulnerability assessment, ii) enhance banks' mandatory disclosures of climate-related financial risks, iii) issue guidance on mandatory climate stress testing by banks, iv) integrate environmental and social (E&S) risk into prudential practices, v) incorporate climate change impact in monetary policy analysis, vi) consider incentive schemes for green lending promotion, vii) include sustainability considerations in its portfolio and risk managements, viii) develop a task force for inclusive green finance, ix) include climate-related financial disclosures in its Annual Report, x) adopt sustainable practices, and xi) roll out a capacity-building program for all staff.

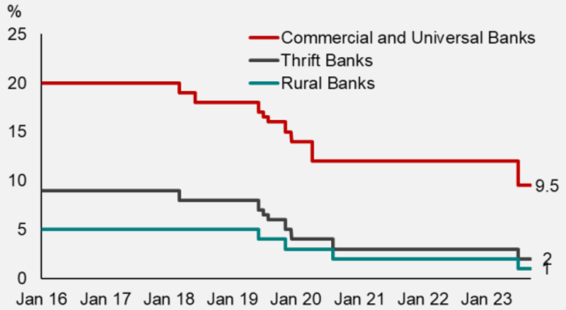
Box A. Recent Developments in BSP's Open Market Operations[75]

The BSP adopted an interest rate corridor (IRC) system in 2016 to strengthen monetary policy transmission to short-term money market interest rates.[76] Since then, the BSP has constantly refined the system to enhance its effectiveness, such as by introducing new absorption tools. During 2022-2023, several important adjustments were also made to improve monetary policy transmission and support market developments.

1. **Reduction of Reserve Requirement Ratio (RRR)**. The RRR is employed as a liquidity absorption tool alongside OMOs such as the overnight reverse repurchase (RRP) facility, the term deposit facility (TDF), and the BSP securities. But unlike these OMOs, required reserve balances do not earn interests, causing a distortionary effect on banks' balance sheets. The RRR also lacks flexibility and limits the role of market participants in active liquidity management. Recognizing such drawbacks, the BSP has committed to reducing the role of the RRR and has been cutting the ratio since 2018. In June 2023, the BSP delivered the latest round of such cuts, bringing the RRR from 12 percent to 9.5 percent for commercial and universal banks, from 3 percent to 2 percent for thrift banks, and from 2 percent to 1 percent for rural banks (Figure A1). Not only did these cuts further the central bank's commitment to switch to a more market-based liquidity management, but they also helped stabilize the domestic liquidity conditions after alternative RRR compliance modes expired.[77] At their current levels, the RRRs have been slashed by more than half the ratios in 2017.

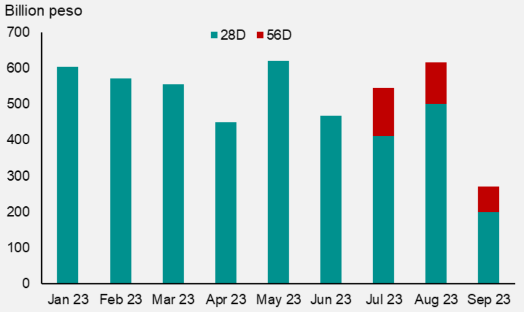
2. **Introduction of 56-day BSP Bills.** Concurrent with the RRR cuts, the BSP introduced a new liquidity absorption instrument, the 56-day BSP Bills (Figure A2). These added to the 28-day Bills that have been in the toolkit since 2020, and will expand the central bank's capacity to mop up excess liquidity, including reserves to be released from the RRR cuts. Although market demand in the first three months of auctions was weaker than that for the 28-day Bills, it is expected to pick up over time as investors become more familiar with the new instrument. To ensure a balanced supply of short-term bills and avoid competing with the government's bill issuances, the BSP and the Bureau of Treasury (BTr) regularly coordinate their issuance plans through meetings of the BSP-BTr Liquidity Management Committee.

Figure A1. Reserve Requirement Ratio (RRR)



Source: BSP; CEIC

Figure A2. Issuance of 56-day BSP Bills



Source: BSP; AMRO staff calculations

[75] This box was prepared by Pim-orn Wacharaprapapong, Economist.
[76] More information on the BSP's Interest Rate Corridor is on the BSP website: https://www.bsp.gov.ph/Price%20Stability/IRC.pdf
[77] Between April 2020 and June 2023, banks were allowed to use loans to MSMEs and large companies to satisfy the RRR in place of the actual reserve balance. The allowance was part of COVID-era relief measures.

3. Improvements in operational procedures for the reverse repurchase facility.

- **A variable-rate auction has been adopted, and an auction-implied overnight RRP rate will serve as the formal operational target.**[78] Previously, the RRP employed fixed-rate, fixed-volume auctions, whereby the BSP fixed the offer sizes and all accepted bids were paid the policy rate. The BSP recognizes the need to strengthen the role of the market mechanism in these auctions, so that RRP can better meet liquidity management demands and the resulting interest rates can truly reflect prevailing liquidity conditions. Hence, the auction format has been changed to that of a variable-rate auction, in which counterparts submit bids for both the amount of funds and the interest rates at which they are willing to lend to the BSP. Bids are then awarded according to their interest rates. The average rate of successful bids constitutes a new operational target, the overnight RRP (ON RRP) rate. With signals from the ON RRP rate, the BSP can effectively adjust its liquidity management operations to steer the rate toward the policy rate set by the Monetary Board.

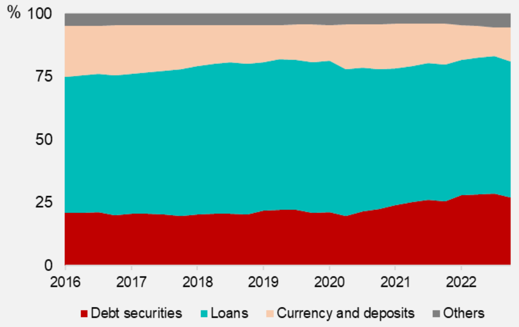
- **The auction time was shifted from the late afternoon to the morning to promote active liquidity management and interbank market activities.** Prior to the adjustment, the availability of the RRP facility at 4.30pm-5.00pm meant that banks with excess liquidity can wait until late afternoon to place the funds with the BSP, earning interest at the policy rate. Such a risk-free backstop reduced the need for banks to conduct active liquidity management throughout the day, and dampened activities in the interbank market. By moving RRP auctions to an earlier part of the day, the BSP hopes to encourage banks to become more active in this regard; banks would need to project how much excess liquidity they want to place with the RRP in the morning, and if any unexpected shortfall in cash flows arise during the rest of the day, they can make the necessary adjustments in the interbank market to avoid facing penalty rates at the BSP's end-of-day standing facilities, which are available until 5.30pm.

Box B. Debt Securities Holding of Philippine Banks and Implication of Interest Rate Risks on Capital Buffer[79]

The Philippine banking system invests close to 30 percent of assets in debt securities, the highest share among ASEAN-5 countries. Pre-pandemic, debt securities holdings of the Philippine banking system were broadly stable at around 20 percent of total assets, which was already high compared with regional peers. During the pandemic, the share rose further from 21 percent in June 2020 to more than 28 percent in June 2023 (Figures B1 and B2). Such a high proportion far exceeded those of regional peers, for instance Thailand and Malaysia, whose holdings of debt securities averaged at 11 percent and 21 percent of total assets, respectively (Figure B3). In terms of different bank types, debt securities holdings are higher among universal and commercial banks, which tend to be larger banks with broader business mandates. Nevertheless, the securities holdings of thrift banks and rural banks are also significant, at 14.5 percent and 16.6 percent, respectively (Figure B4).

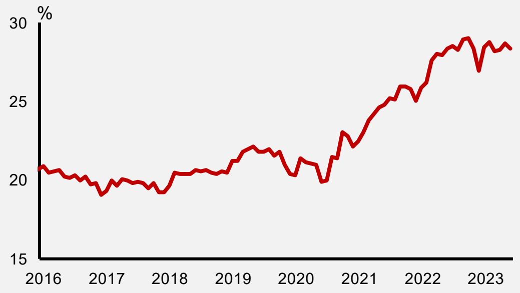
[78] More information can be found on the BSP website: https://www.bsp.gov.ph/SitePages/MediaAndResearch/MediaDisp.aspx?ItemId=6836
[79] This box was prepared by Pim-orn Wacharaprapapong, Economist.

Figure B1. Banking System Assets



Source: BSP

Figure B2. Banking System's Debt Holdings to Total Assets

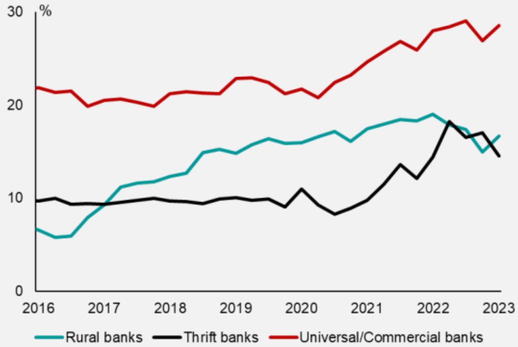


Source: BSP

Figure B3. Share of Debt Securities to Total Banking System Assets

Source: CEIC; AMRO staff calculations

Figure B4. Share of Debt Securities Holdings by Bank Type



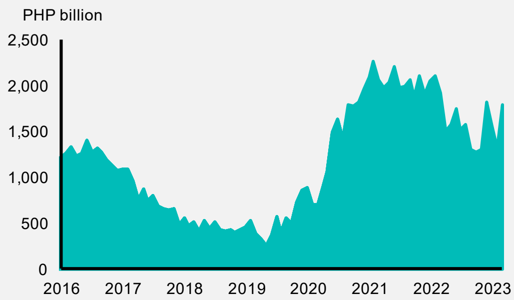
Source: BSP

The rise in the banking system's debt securities investment was supported by an increase in banking system liquidity. After a temporary dip in debt securities investment amid the flight-to-cash episode at the dawn of the pandemic (Figure B2), the banking system's investment in debt securities started to climb from Q3 2020 onwards. In addition to improved bond market conditions, higher liquidity in the banking system contributed to the rise in securities holdings. First, the loan-to-deposit ratio declined sharply from 80.2 percent in December 2019 to a trough of 69.4 percent in February 2022 (Figure B5), following a slowdown in loan growth at the height of the pandemic. Moreover, excess liquidity in the interbank market rose to a peak in Q1 2021 on account of the BSP's purchases of government securities in 2020 and relaxations of the RRR between April 2020 and June 2023 (Figure B6). Higher liquidity from deposits and central bank operations may have driven banks' appetite for debt securities investment. More recently, however, as demand for loans picked up and the interbank market's excess liquidity declined, the share of debt securities holding has tapered off.

Figure B5. Loan-to-Deposit Ratio

Source: BSP

Figure B6. Excess Liquidity in Interbank Market



Source: BSP; AMRO staff calculations

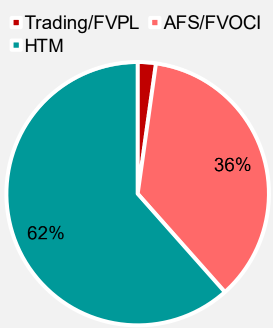
Large holdings of debt securities could subject banks to potential risks from changes in bond yields due to mark-to-market losses, but such risks are limited in the case of the Philippines.

When bond yields rise and the value of debt securities falls, banks will incur losses on the segment of debt securities holdings that are subject to mark-to-market valuations, namely securities held in the trading and available-for-sale portfolios. If large enough, these mark-to-market losses can have an impact on banks' capital positions. For the Philippines' banking system, this risk is partly mitigated because more than half of debt securities are held under amortized costs (Figure B7). Nonetheless, these amortized-cost securities will also be subject to market valuations if banks are forced to liquidate them, for example, in a liquidity run similar to the case of the Silicon Valley Bank. However, the likelihood of such severe liquidity shortage is low in the Philippine case, thanks to ample liquidity.

AMRO conducted a stress test to assess the impact of higher bond yields on banks' capital positions. The stress test comprises 19 banks, which account for more than 90 percent of the Philippines' banking system assets. It considers two adverse scenarios: (1) a 150bps upward shift in the government bond yield curve, which is equivalent to 1 standard deviation of annual yield changes;[80] and (2) a 300bps upward shift in the yield curve, or 2 standard deviations. The changes in yields affect only the price of bonds in trading and available-for-sale portfolios of the banks.

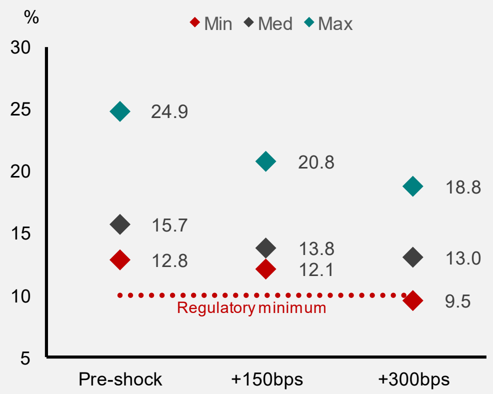
The stress test shows that although most banks will maintain sufficient capital under stressed scenarios, a few are vulnerable to extreme yield changes. Prior to the shocks, the total capital adequacy ratio (CAR) of banks under this exercise ranged between 12.8 percent and 24.9 percent, compared to the regulatory minimum of 10 percent. Given a shock of a 1-standard deviation yield increase, the CAR of all banks will remain above the regulatory minimum. However, in a more extreme scenario in which yields surge by 2 standard deviations, three banks will see their CARs fall near or below the regulatory minimum, with the lowest CAR at 9.5 percent (Figure B8). These are banks with larger shares of debt securities holdings, higher portions of trading and available-for-sale portfolios, or lower levels of the pre-shock CAR.

Figure B7. Share of Debt Securities Portfolios



Source: BSP

Figure B8. CAR Under Risk Scenarios



Source: BSP; AMRO staff calculations

The stress test serves as a reminder that although Philippine banks' capital positions remain sufficient, tail-event interest rate shocks could put some of them under pressure. Despite recent stabilization in government bond yields, there remains a risk of higher interest rates, given lingering upside risks to inflation, both in the Philippines and globally. Thus, both banks and regulators should continue to be vigilant in managing interest rate risks and ensuring that the capital buffers are sufficient to withstand adverse scenarios.

[80] The standard deviation is based on daily changes of 10-year Philippine government bond yields over 2016-2023.

Box C. Maharlika Investment Fund (MIF)[81]

This year, the Philippines is establishing its first sovereign wealth fund, Maharlika Investment Fund (MIF). The legislation of the Maharlika Investment Fund Act (MIF Act) has been completed.[82] The corporate vehicle of the MIF, Maharlika Investment Corporation (MIC), will be set up in 2023, and the fund is expected to start operating in early 2024. This box will outline the MIF's main features, assess its benefits and potential risks, as well as discuss the international best practices pertaining to the successful management of a sovereign wealth fund.

The MIF is primarily aimed at maximizing financial returns and promoting socio-economic development, under a strong legal framework laid down in the MIF Act. Table C1 summarizes the main features of the MIF, including its objectives, sources of funding, investment guidelines, and governance structure. These features are clearly defined in the MIF Act, and they are crucial for the success of the new sovereign wealth fund.

Table C1. Main Features of the MIF

	Features of the MIF (Section of the MIF Act in parentheses)
Main purposes	The objective of the MIF is to promote socio-economic development. This will be achieved by making strategic and profitable investments in key sectors to preserve and enhance the long-term value of the fund. (***Sec. 13***)
Funding sources	The initial funding is PHP 500 billion (5 billion shares) 75% of the shares are common shares, which are open to subscription by only the government and its agencies, *of which*: ➢ the national government: 10%, funding sources are BSP dividends, PAGCOR revenues; DOF-PMO properties and privatization proceeds; other sources such as royalties, etc., ➢ the Land Bank: 10%, ➢ the Development Bank of the Philippines (DBP): 5% 25% of the shares are preferred shares, which both the government and private investors can subscribe to. Public funding channels including the Social Security System (SSS), Government Service Insurance System (GSIS), Philippine Health Insurance Corporation (PhilHealth), Home Development Mutual Fund (Pag-ibig Fund), Overseas Workers Welfare Administration (OWWA), and Philippine Veterans Affairs Office (PVAO) Pension Fund are prohibited from contributing to the MIF. Any increase in MIF capitalization requires going through the legislative process in Congress. (***Sec. 6, 7 & 51a***)
Investment & Usages	The MIC Board of Directors shall formulate written investment policies and allowable investments which include: - Financial investments such as cash, currencies, tradable commodities, fixed-income instruments, corporate bonds, equities, joint ventures, real estate, loans and guarantees, etc. - Infrastructure projects that are directed toward the fulfillment of national priorities. - Programs and projects contributing to sustainable development and other investments with sustainable and developmental impacts. (***Sec. 14 – 17***)
Governance	The MIF Act defines the composition, powers, functions, quorum, and meetings of the MIC Board of Directors, as well as the duties and qualifications of top management, the risk management committee, and the advisory body, which is composed of government officials. Specifically, the MIC Board of Directors shall have nine members: - comprising i) the Secretary of Finance (Chairperson), ii) the MIC President and CEO (PCEO, Vice-Chairperson), iii) the Land Bank President and CEO, iv) the DBP President and CEO, v) two full-time regular directors appointed by the President of the Philippines, and vi) three independent directors from the private sector. (***Sec. 20 – 28***)

[81] This box was prepared by Andrew Tsang, Economist.
[82] The Maharlika Investment Fund Act (MIF Act) was signed by President Ferdinand Marcos Jr. on July 18, 2023, and the Bureau of the Treasury (BTr) issued the implementing rules and regulations (IRR) of the Act on August 28, 2023. The implementation of its IRR was suspended on October 18, 2023. Nonetheless, the administration is committed for the law to be operational by the end of the year.

In contrast to sovereign wealth funds in most other countries, the MIF is essentially a national investment fund that will invest mainly within the country.[83] A sovereign wealth fund is a state-owned investment fund comprising money generated by the country. Typical sovereign wealth funds often invest overseas using the funds derived from i) surplus revenue from oil and other industries that deal with natural resources, as in the case of the United Arab Emirates' Abu Dhabi Investment Authority, or ii) fiscal surpluses as in the case of Singapore's Government Investment Corporation. However, the MIF is a national investment fund mainly investing within the country to support national development strategies, similar to the Indonesia Investment Authority, and Temasek Holdings.

Expected benefits from the newly established MIF: i) enhancing investment capital: the MIF is poised to serve as a long-term source of investment capital that will foster economic growth and job creation; ii) promoting infrastructure development: the MIF can be used to finance various infrastructure projects, such as roads, bridges, and airports, improving connectivity and enhancing the country's attractiveness to investors; iii) boosting foreign investment: by attracting foreign investment, the MIF can draw in fresh capital and technology. In particular, the Fund could complement other recent reforms to attract foreign investment, such as amendments to the Foreign Investments Act to allow foreign investors to set up and fully own firms in some sectors like renewable energy.

However, there could be potential risks associated with the operations of MIF. First, there could be a risk in terms of governance, especially if the fund's role in infrastructure investment is not clearly defined, which could lead to misuse of funds and lack of accountability. Second, given the MIF has to ensure long-term value and promote socio-economic development, there could be a risk that the different goals might be at odds with each other in some investments, for instance, there could be a trade-off between the rate of return and the public good nature of certain projects. Third, funds contributed by the government agencies could crowd out planned expenditure in other areas. Finally, although the contributions to the MIF's capital from government financial institutions (GFIs) are relatively small compared with the size of their investible funds, there could be some impact on the institutions' financial position in the event of losses.[84]

With a strong legal framework, the MIF has the potential to be a successfully managed national investment fund. Based on the literature,[85] several criteria for a successfully managed sovereign wealth fund are outlined in Table C2, which can be used as a benchmark against which the MIF is assessed. Compared against such criteria, the MIF Act has broadly fulfilled all aspects. However, the MIF's success would also depend on the actual implementation of the law and whether the fund is operated with a robust risk management framework, taking cognizance of the potential risks and governance concerns addressed earlier.[86] Moreover, the MIF should have clear guidelines on the types of assets in which it can invest. With regards to investments in infrastructure projects, a rigorous due diligence and risk assessment process is crucial for optimizing the risk-return profile of infrastructure investments.

[83] As in other sovereign wealth funds, the MIF will also compile with the Santiago Principles. The Santiago Principles consist of 24 generally accepted principles and practices to promote transparency, good governance, accountability, and prudent investment practices among sovereign wealth funds. The Principles are focused on adherence to a sound investment and risk management framework driven by economic and financial considerations.

[84] For instance, the Land Bank's investment in the MIF accounts for only 3.7 percent of its investible funds, while the DBP's investment is equivalent to about 3.0 percent of its investible funds. These investments are reasonable and would least likely crowd out other lending obligations that these GFIs need to fulfill under their respective mandates. Nevertheless, the relevant parties must duly assess the potential impact of their contributions on the financial health of these agencies.

[85] For example,

Al-Hassan, A., Papaioannou, M., Skancke, M. and Sung, C.C. (2013), "Sovereign Wealth Funds: Aspects of Governance Structures and Investment Management," IMF Working Paper, WP/13/231.

Milken Institute (2023), "Best Practices of Sovereign Wealth Funds: The Case for The Philippines."

Wagner, D. (2014), "Sovereign wealth funds: Investment objectives and asset allocation strategies," Journal of Governance and Regulation, Vol 3, 10.22495/jgr_v3_i2_p4.

Yin, Wei (2017), "Sovereign wealth fund investments and the need to undertake socially responsible investment," International Review of Law, Volume 2017, Issue 1, https://doi.org/10.5339/irl.2017.9.

[86] According to the MIF Act, the MIF will be implemented by a professional and independent body with expertise in finance, economics, and investments, among other disciplines, and with sufficient financial reporting, auditing, and transparency mechanisms.

Table C2. Criteria of a Successfully Managed Sovereign Wealth Fund

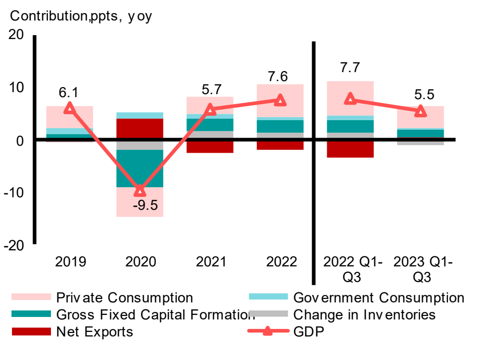
Criterion	Description	Can MIF fulfill the criterion?
Clear Objectives and Mandate	A clear and well-defined mandate is essential to ensure the sovereign wealth fund aligns with the country's economic and developmental goals.	The objectives of MIF are clearly stated in the MIF Act (***Sec. 13***).
Contribution to Economic Development and Diversification with Long-Term Orientation	A well-designed sovereign wealth fund can contribute to economic diversification and development, generating returns over the long term.	Included in the MIF Act (***Sec. 14***)
Adherence to Ethical and Environmental Standards	Ethical investment and environmental, social and governance (ESG) factors are increasingly relevant to sovereign wealth funds.	Included in the MIF Act (***Sec. 14(k)***)
Avoidance of Political Interference	Political interference in investment decisions can undermine the financial performance and credibility of sovereign wealth funds.	The MIC Board of Directors is mainly composed of officials and directors appointed by the President of the Philippines, but the management is made up of professionals. (***Sec. 20 – 25***)
Professional Management and Governance	Professional management and governance are crucial for effective decision-making, maximizing returns and ensuring the fulfillment of the investment objective without misuse of funds. The required conditions include: - A competent and independent board - Professional fund managers - Transparency and accountability - Proper risk management and diversification	Included in the MIF Act - Board of Directors and professional fund managers (***Sec. 20 – 25***) - Transparency, particularly since the MIC is required to report regularly to the Joint Congressional Oversight Committee (***Sec. 38 – 43***) - Risk management (***Sec. 26***)

Appendices

Appendix 1. Selected Figures for Major Economic Indicators

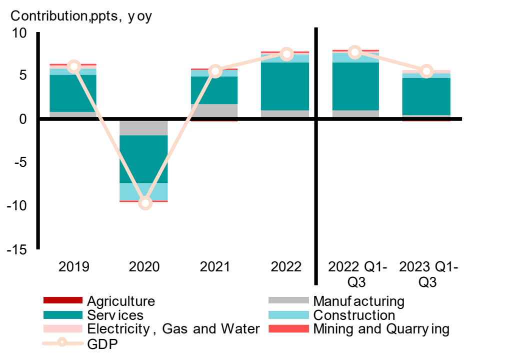
Figure 1.1 Real Sector

Economic growth was robust and mainly driven by private consumption.



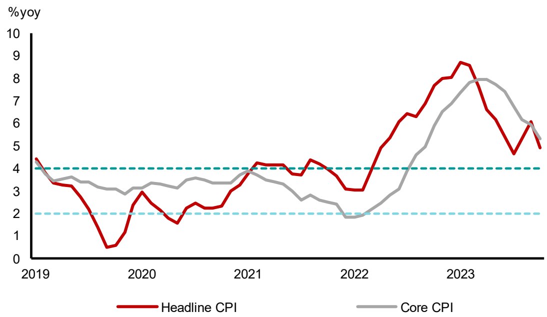
Source: PSA; AMRO staff calculations

By sector, services led the recovery.



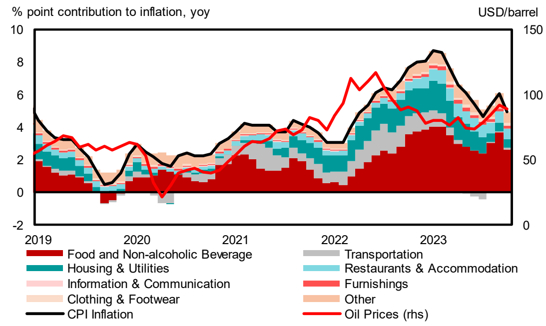
Source: PSA; AMRO staff calculations

Inflation rose above the target range, with core inflation higher than headline inflation.



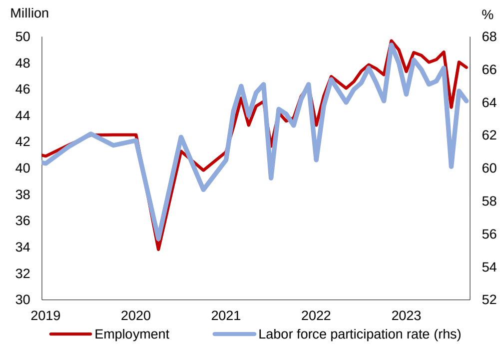
Source: PSA; AMRO staff calculations

Inflation is broad-based, although some easing has occurred in 2023.



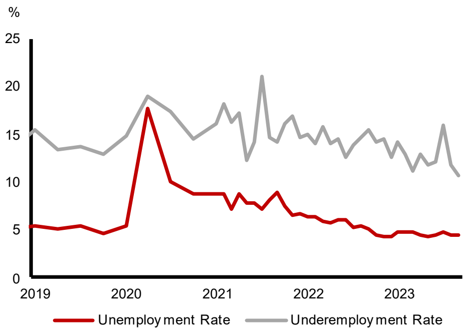
Source: PSA; AMRO staff calculations

Employment has surpassed pre-COVID levels…



Source: PSA

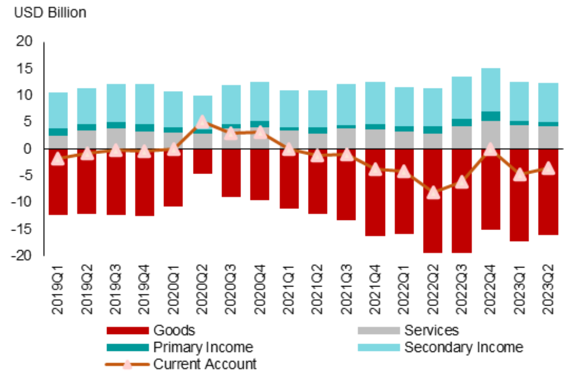
…while the unemployment and underemployment rates stayed around the pre-pandemic lows.



Source: PSA

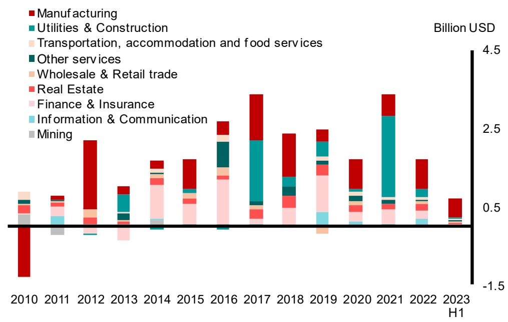
Figure 1.2 External Sector

The current account registered a deficit from a large trade-in-goods deficit.



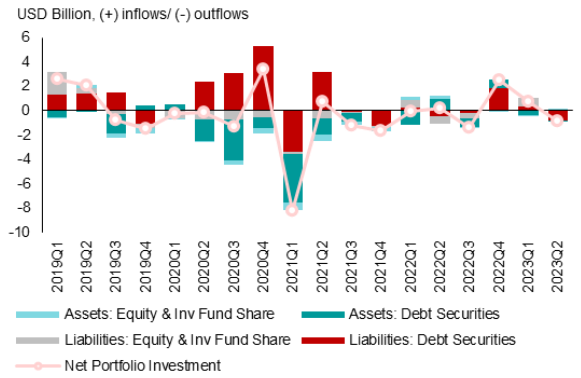
Source: BSP; AMRO staff calculations

FDI inflows declined across sectors.



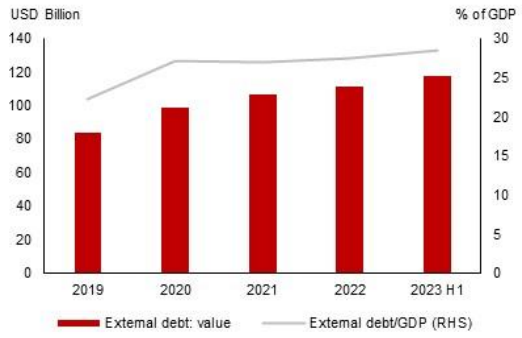
Source: PSA; AMRO staff calculations

Portfolio investments registered net outflows in H1 2023



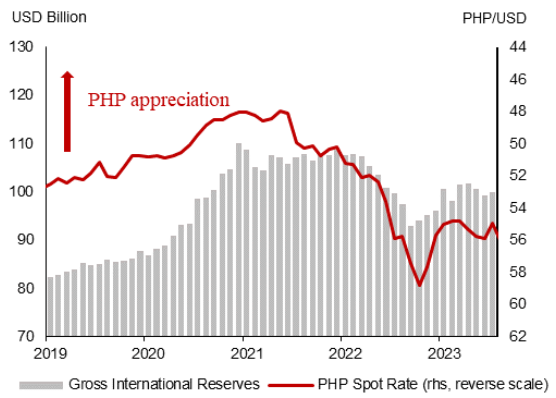
Source: BSP; AMRO staff calculations

External debt rose but remained low.



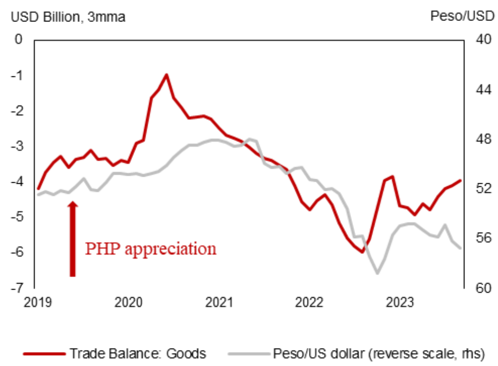
Source: BSP

International reserves remained adequate at around USD 100 billion.



Source: BSP

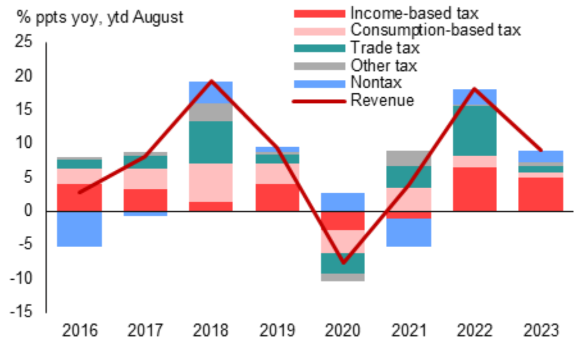
The peso broadly stabilized against the U.S. dollar in 2023.



Source: BSP; AMRO staff calculations

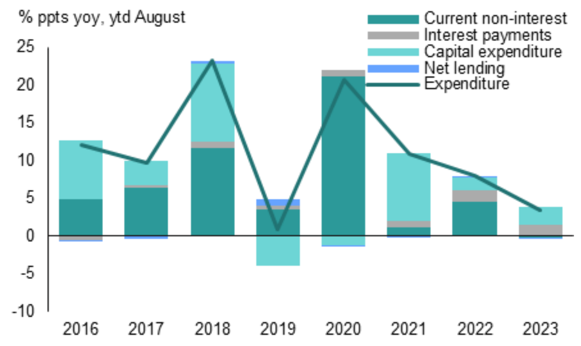
Figure 1.3 Fiscal Sector

In 2023, revenue continued to grow robustly, backed by a strong economic rebound…



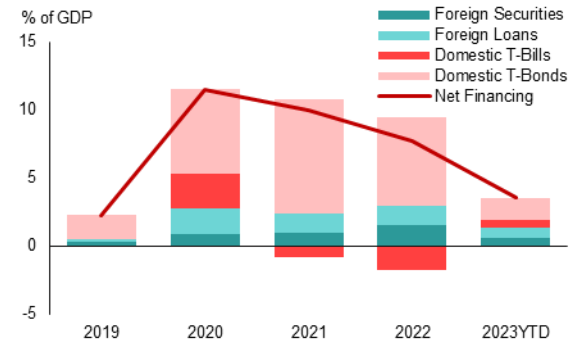
Source: BTr, AMRO staff estimates

…while disbursement moderated despite buoyant capital outlays, due to a decline in allotments to LGUs.



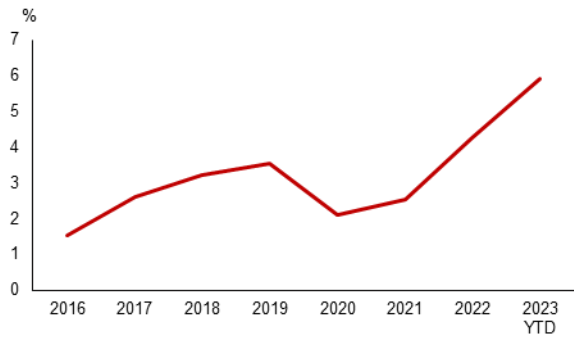
Source: DBM; AMRO staff estimates

As of September 2023, the government financed the deficit mainly by issuing domestic bills and bonds.



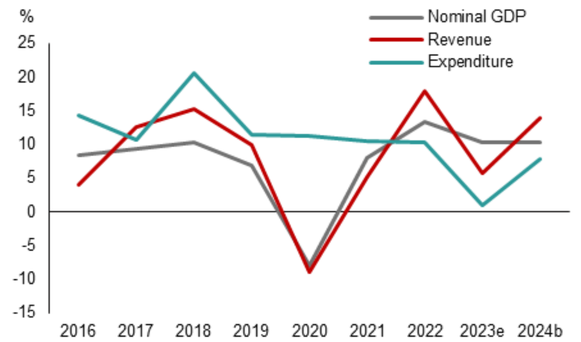
Source: BTr; AMRO staff estimates

Amid policy rate hikes, the average financing cost of newly issued bonds has risen sharply.



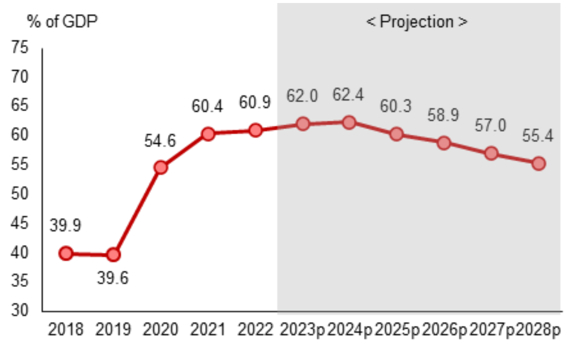
Source: BTr; AMRO staff estimates

The fiscal deficit is budgeted to narrow in 2024, attributable to strong revenue collection offsetting the pick-up in expenditure growth…



Source: DBM; AMRO staff estimates

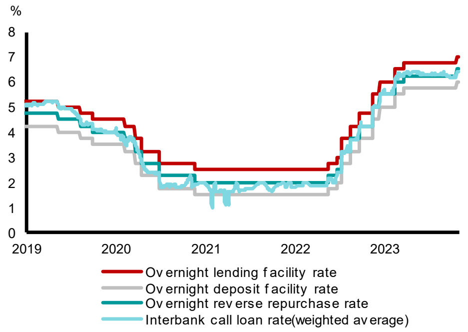
…and is projected to continue declining to the pre-pandemic level by 2028, which will stabilize the debt-to-GDP ratio at below 60 percent.



Source: DBM; AMRO staff estimates

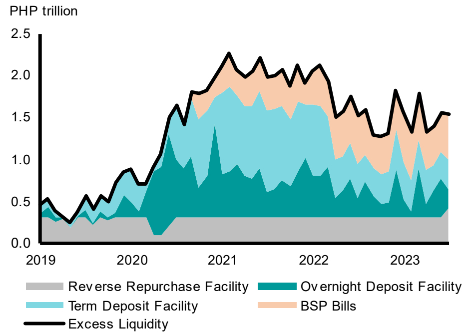
Figure 1.4 Monetary and Financial Conditions

The BSP started to raise the policy rate in May 2022.



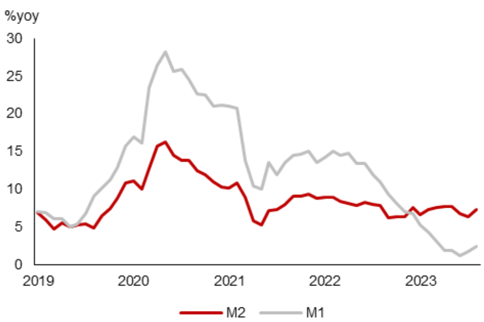
Source: BSP

Liquidity was still ample in the interbank market…



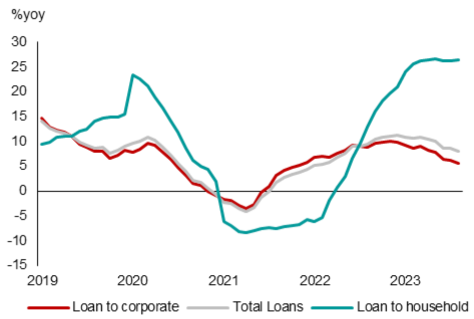
Source: BSP

…and in the banking system as a whole.



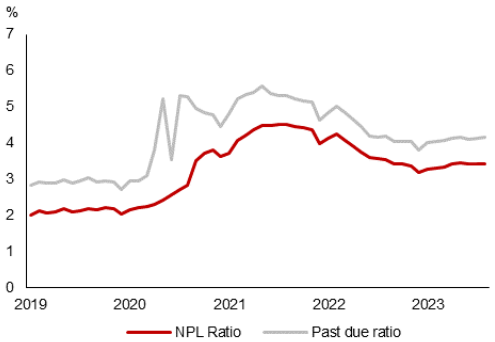
Source: BSP

Bank loans have picked up steadily, with growth in household loans accelerating recently.



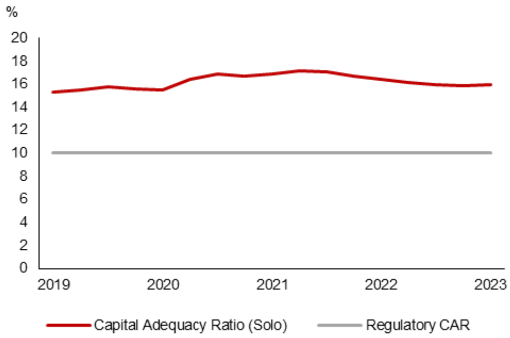
Source: BSP
Note: The loans are outstanding loans of the Philippines banking system, net of reverse repurchases (RRP) placements with the BSP.

Banks' asset quality has improved since 2022.



Source: BSP

Overall banking sector's capital position remains strong in 2023.



Source: BSP

Appendix 2. Selected Economic Indicators for the Philippines

	2019	2020	2021	2022	Projection	
					2023	2024
Real sector and prices	(in percent change, unless specified)					
Real GDP	6.1	-9.5	5.7	7.6	5.6	6.3
Private consumption	5.9	-8.0	4.2	8.3	5.6	6.5
Government consumption	9.1	10.5	7.2	4.9	1.5	3.5
Gross fixed capital formation	3.9	-27.3	9.8	9.7	6.7	7.0
Exports of goods and services	2.6	-16.1	8.0	10.9	2.7	8.0
Imports of goods and services	2.3	-21.6	12.8	13.9	1.0	8.0
Prices						
Consumer price inflation (period average 2018=100)	2.4	2.4	3.9	5.8	6.0	3.6
Core inflation (period average 2018=100)	3.4	3.4	3.0	3.9	6.6	3.6
GDP deflator	0.7	1.7	2.3	5.5	4.3	2.3
External sector	(in billions of U.S. dollars, unless specified)					
Current account balance	-3.0	11.6	-5.9	-18.1	-15.4	-15.7
(in percent of GDP)	-0.8	3.2	-1.5	-4.5	-3.5	-3.3
Goods trade balance	-49.3	-33.8	-52.8	-69.7	-72.3	-77.3
Services trade balance	13.0	13.9	14.0	15.9	19.9	23.2
Primary income, net	5.3	4.1	3.3	5.2	5.6	6.1
Secondary income, net	27.9	27.4	29.5	30.5	31.4	32.3
Financial account balance	-8.0	-6.9	-6.4	-12.9	-11.2	-11.8
Direct investment, net	-5.3	-3.3	-9.7	-5.4	-5.6	-6.7
Portfolio investment, net	-2.5	-1.7	10.2	-1.3	-2.6	-2.9
Financial derivatives, net	-0.2	-0.2	0.0	0.0	-0.1	-0.1
Other investment, net	-0.1	-1.8	-7.0	-6.2	-2.8	-2.2
Error and omission	2.7	-2.5	0.8	-2.0	0.0	0.0
Overall balance	7.8	16.0	1.3	-7.3	-4.1	-3.8
Gross international reserves (end-period)	87.8	110.1	108.8	96.1	98.0	94.2
Total external debt (percent of GDP)	22.2	27.2	27.0	27.5	23.5	21.1
Short-term external debt (percent of total)	20.6	14.4	14.2	14.9	14.9	14.9
Fiscal sector (National Government)	(in percent of GDP)					
Government revenue	16.1	15.9	15.5	16.1	15.5	16.4
Government expenditure	19.5	23.5	24.1	23.4	21.5	21.4
Fiscal balance	-3.4	-7.6	-8.6	-7.3	-6.0	-5.0
Primary balance	-1.5	-5.5	-6.4	-5.0	-3.7	-2.4
Government debt	39.6	54.6	60.4	60.9	62.0	62.4
Monetary sector	(in percent change, end-period unless specified)					
Domestic credit	10.7	4.7	8.2	12.8	10.3	11.0
Of which: Private sector	7.8	-0.2	3.8	11.0	8.0	8.5
Broad money (M4)	9.8	8.7	8.0	7.8	7.5	8.4
M1	15.7	21.2	13.6	6.8	3.0	5.0
Memorandum items:						
Exchange rate (peso per USD, average)	51.8	49.6	49.3	54.5	-	-
Exchange rate (peso per USD, eop)	50.7	48.0	50.8	56.1	-	-
Gross domestic product at current price (In trillions of pesos)	19.5	18.0	19.4	22.0	24.2	26.4
Gross domestic product at current price (In billions of U.S. dollar)	376.8	361.8	394.1	404.3	434.5	475.3
GDP per capita (in U.S. dollar)	3,515.1	3,331.4	3,573.0	3,618.3	3,703.3	3,990.6

Source: Philippine authorities; AMRO staff estimates

Appendix 3. Balance of Payments

	2018	2019	2020	2021	2022
	(in millions of U.S. Dollars, unless specified)				
Current Account (I)	-8,877	-3,047	11,578	-5,943	-18,116
Goods	-50,972	-49,312	-33,775	-52,806	-69,682
Exports	51,977	53,477	48,212	54,228	57,726
Imports	102,949	102,788	81,987	107,034	127,408
Services	11,608	13,039	13,866	14,039	15,879
Exports	38,397	41,264	31,822	33,570	41,127
Imports	26,789	28,225	17,956	19,531	25,248
Primary Income	3,669	5,276	4,101	3,323	5,225
Receipts	11,999	13,402	11,594	11,832	13,149
Payments	8,330	8,125	7,492	8,509	7,924
Secondary Income	26,818	27,949	27,386	29,501	30,462
Receipts	27,607	28,746	28,240	30,452	31,244
Payments	788	797	854	950	782
Capital Account (II)	65	127	63	80	0
Receipts	103	147	88	99	91
Payments	38	20	25	19	91
Financial Account (III)(+ indicates inflows)	9,332	8,034	6,906	6,433	12,896
Net Acquisition of Financial Assets	-7,522	-7,297	-13,286	-10,261	-2,630
Net Incurrence of Liabilities	16,855	15,331	20,192	16,694	15,526
Direct Investment	5,833	5,320	3,260	9,732	5,380
Net Acquisition of Financial Assets	-4,116	-3,351	-3,562	-2,251	-3,986
Net Incurrence of Liabilities	9,949	8,671	6,822	11,983	9,366
Portfolio Investment	-1,448	2,474	1,680	-10,237	1,309
PI:Net Acquisition of Financial Assets	-4,740	-2,402	-6,567	-7,809	310
PI:Net Incurrence of Liabilities	3,292	4,876	8,246	-2,428	1,000
Financial Derivatives	53	173	199	-49	48
Net Acquisition of Financial Assets	679	874	796	449	632
Net Incurrence of Liabilities	-626	-701	-596	-498	-584
Other Investment	4,894	67	1,767	6,987	6,158
OI:Net Acquisition of Financial Assets	654	-2,417	-3,953	-649	415
OI:Net Incurrence of Liabilities	4,240	2,484	5,720	7,636	5,744
Net unclassified items (V)	-2,826	2,729	-2,526	774	-2,042
Overall BOP (I+II+III+V)	-2,306	7,843	16,022	1,345	-7,263
Change in Reserve Assets	-2,305	7,843	16,020	1,345	-7,246
Memorandum items:					
Current Account (% GDP)	-2.6	-0.8	3.2	-1.5	-4.5
Gross International Reserves	79,193	87,840	110,117	108,794	96,149
In months of imports of goods and services	7.3	8.0	13.2	10.3	7.6
Changes in gross reserves	-3,994	8,646	22,278	-1,323	-12,645
Nominal GDP (USD billion)	347	377	362	394	404

Source: Philippine authorities; AMRO staff calculations

Appendix 4. Statement of National Government Operations

	2018	2019	2020	2021	2022
	(In percent of GDP, unless specified)				
Government Revenue	15.6	16.1	15.9	15.5	16.1
Tax Revenue	14.0	14.5	14.0	14.1	14.6
Bureau of Internal Revenue (BIR)	10.7	11.1	10.9	10.7	10.6
Net Income & Profits	5.7	5.5	5.8	5.9	5.6
Excise Tax	1.6	1.5	1.6	1.6	1.4
Sales Taxes & Licenses	2.5	2.4	2.6	2.7	2.6
Others	0.9	0.8	0.8	0.9	0.9
Bureau of Customs (BOC)	3.2	3.2	3.0	3.3	3.9
Other Offices	0.1	0.1	0.1	0.1	0.1
Non Tax & Grant	1.6	1.6	2.0	1.4	1.5
Government Expenditure	18.7	19.5	23.5	24.1	23.4
Current Operating Expenditures	13.4	14.0	18.5	18.0	17.4
Personal Services	5.4	5.7	6.6	6.6	6.3
Maintenance and Other Operating	2.9	2.9	4.9	4.5	4.0
Subsidy	0.7	1.0	1.3	1.0	0.9
Allotment to LGUs	2.3	2.4	3.5	3.5	3.8
Interest Payments	1.9	1.8	2.1	2.2	2.3
Tax Expenditure	0.1	0.1	0.2	0.2	0.2
Capital Outlays	5.3	5.3	4.9	6.0	5.9
Infrastructure & Other Capital Outlays	4.4	4.5	3.8	4.6	4.6
Equity	0.0	0.0	0.1	0.2	0.0
Capital Transfers to LGUs	0.8	0.8	1.0	1.1	1.2
Net Lending	0.0	0.1	0.1	0.1	0.1
Government Balance	-3.1	-3.4	-7.6	-8.6	-7.3
primary balance	-1.1	-1.5	-5.5	-6.4	-5.0
Government Financing	4.3	4.5	13.9	11.6	8.9
External: Net	1.0	0.9	3.3	1.7	1.8
External: Gross	1.7	1.6	4.1	2.9	2.4
Project Loan	0.2	0.3	0.3	0.6	0.5
Program Loans	0.0	0.0	0.0	0.0	0.0
Global Bonds	0.6	0.4	1.4	0.8	1.1
Amortization	0.6	0.7	0.8	1.2	0.6
Domestic: Net	3.2	3.5	10.6	9.9	7.2
Domestic: Gross	3.5	3.6	11.1	10.4	7.5
Treasury Bills: Net	1.0	0.0	2.6	-0.8	-1.8
Retail Treasury Bonds	0.7	1.2	4.6	4.2	2.1
Fixed Rate Treasury Bonds	1.6	2.4	3.9	6.5	5.4
Amortization	1.7	1.8	2.5	2.8	2.8
Memorandum items:					
Government Debt	39.9	39.6	54.6	60.4	60.9
Domestic	26.2	26.3	37.3	42.1	41.8
Foreign	13.8	13.3	17.3	18.3	19.1
Short-term(% of Total)	6.8	6.4	9.8	6.8	3.1
Medium-term (% of Total)	13.5	17.8	23.0	23.6	22.3
Long-term (% of Total)	79.8	75.9	67.3	69.6	74.7
Nominal GDP (Trillion, PHP)	18.3	19.5	18.0	19.4	22.0

Source: Philippine authorities; AMRO staff calculations

Appendix 5. Debt Sustainability Analysis[87,88]

The public debt-to-GDP ratio is projected to gradually decline after peaking in 2024, and gross financing needs (GFNs) are also expected to fall (Table 5.1). The projected average economic growth rate from 2024 to 2028 is 6.2 percent, in line with the potential growth path. The effective interest rate is expected to rise gradually until 2026, reflecting increased costs of new borrowings due to policy rate hikes in 2022-2023, but stabilize thereafter. The fiscal deficit as a percentage of GDP is projected to continue to fall to pre-pandemic levels by 2026, backed by robust revenue growth, benefiting from implemented and anticipated tax reform measures, and modest spending expansion after normalization. Strong real GDP growth will lead to a reduction in the debt ratio, offsetting the contribution from the primary deficit and real interest rate (Figure 5.1 Panel A). Despite a continuous reduction in the primary deficit, the GFN-to-GDP ratio will remain higher than the pre-pandemic level 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) finds the overall risk of public debt sustainability to be low (Figure 5.4). The public debt-to-GDP ratio and the GFN as a percentage of GDP remained below their corresponding thresholds in the past five years and are projected to stay lower than the thresholds in the baseline and all stress test scenarios over the projection period (Figure 5.2). Moreover, market perception of sovereign risk continues to be low, as indicated by the EMBI spread. Although the share of debt held by non-residents and debt in foreign currency exceed the lower early warning benchmarks, the rollover risk is relatively contained, as the share of concessional loans remains high, amounting to 14 percent of total debt. However, considering the sizable current account deficit, more attention should be paid to external financing requirements (Figure 5.3).

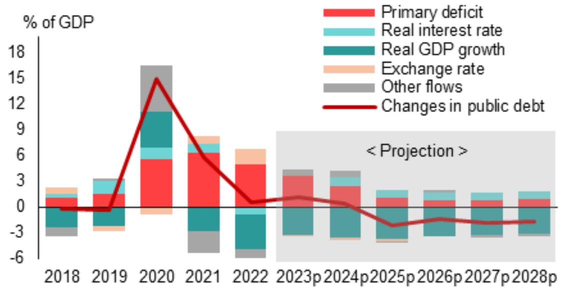
Table 5.1. Macroeconomic and Fiscal Indicators

	2018	2019	2020	2021	2022	2023p	2024p	2025p	2026p	2027p	2028p
Macroeconomic indicators (Percent)											
Real GDP growth	6.3	6.1	-9.5	5.7	7.6	5.6	6.3	6.5	6.2	6.0	6.0
GDP deflator	3.7	0.7	1.7	2.3	5.5	4.3	2.3	2.8	2.7	2.7	2.7
Effective interest rate	5.2	4.9	4.9	4.4	4.3	4.3	4.4	4.5	4.5	4.5	4.4
Fiscal indicators (Percent of GDP)											
Revenue	15.6	16.1	15.9	15.5	16.1	15.5	16.4	16.5	16.7	17.0	17.3
Expenditure	18.7	19.5	23.5	24.1	23.4	21.5	21.4	20.2	20.0	20.2	20.5
Fiscal balance	-3.1	-3.4	-7.6	-8.6	-7.3	-6.0	-5.0	-3.7	-3.2	-3.2	-3.3
Primary balance	-1.1	-1.5	-5.5	-6.4	-5.0	-3.7	-2.4	-1.2	-0.8	-0.8	-0.9
Public debt	39.9	39.6	54.6	60.4	60.9	62.0	62.4	60.3	58.9	57.0	55.4
Gross financing needs	5.1	5.9	10.9	12.6	10.7	9.9	9.7	8.1	7.5	7.4	7.3

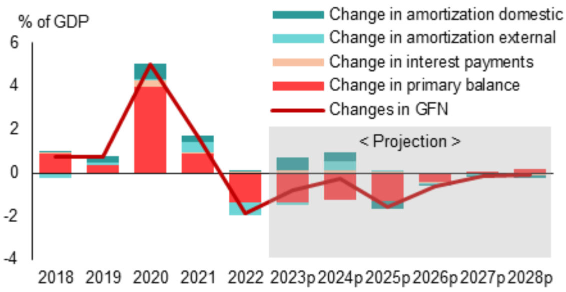
Source: Department of Budget and Management; AMRO staff estimates

Figure 5.1. Public Debt and GFN Dynamics

Panel A. Contribution to Changes in Public Debt



Panel B, Contribution to Changes in GFN

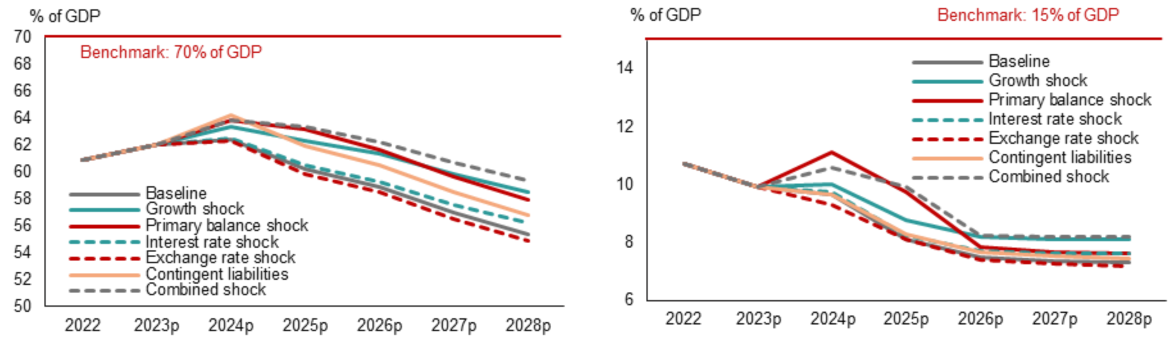


Source: Department of Budget and Management; AMRO staff estimates

[87] Prepared by Byunghoon Nam, Senior Economist
[88] Public DSA for the Philippines covers national government debt. As of end-2022, general government debt was at 51.3 percent of GDP, while national government debt amounted to 60.9 percent of GDP.

Figure 5.2. Macro-Fiscal Stress Test

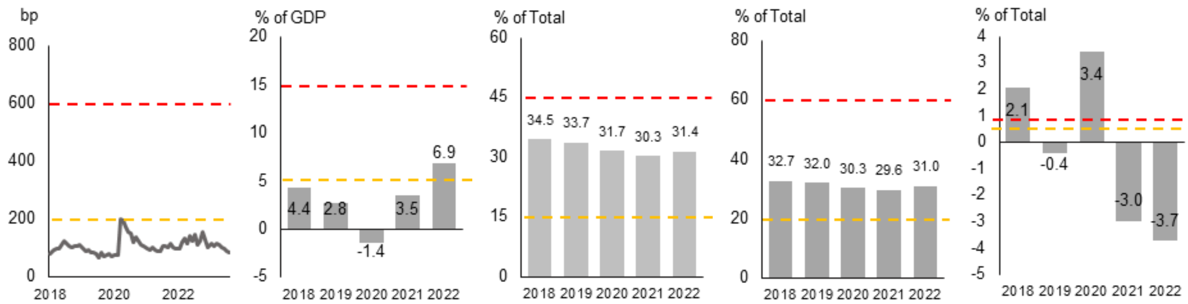
Panel A. Stress Test for Public Debt | Panel B. Stress Test for GFN



Note: The scenarios for the stress test are as follows: 1) Real GDP growth shock: one standard deviation or –1.0 percentage point shock to 2024 and 2025; 2) Primary balance shock: one standard deviation or –1.5 percent of GDP shock to 2024 and 2025; 3) Interest rate shock: +1 percentage point shock from 2024; 4) Exchange rate shock: one-time +5 percentage points shock in 2024; 5) Contingent liability shock: one-time 1.8 percent of GDP shock in 2024, by recognizing the existing contingent liabilities as of end-2022; 6) Combined shock: a combination of growth (half size), primary balance (half size), interest rate, and exchange rate shocks.
Source: Department of Budget and Management; AMRO staff estimates

Figure 5.3. Debt Profile Vulnerabilities

EMBI Global Spread | External Financing Requirement | Public Debt held by Non-residents | Public Debt in Foreign Currency | Change in Short-term Debt



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: Department of Budget and Management; AMRO staff estimates

Figure 5.4. Heatmap of Public Debt Sustainability

		2018	2019	2020	2021	2022	2023p	2024p	2025p	2026p	2027p	2028p
Public Debt												
Gross Financing Needs												
Debt Profile	Market Perception of Sovereign Risk											
	External Financing Requirement											
	Public Debt Held by Non-residents											
	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; 2) 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

Appendix 6. Climate Clipboard—Risks, Responses, and Opportunities[89]

A. Physical risks

Sources of risk	Potential macro-financial impact
• Tropical cyclones (acute) • Floods (acute) • Sea-level rise (chronic) **Exposure** • Largely exposed or substantial exposure to physical risks. • The Philippines topped the 2023 World Risk Index (WRI) with the highest exposure to disaster risks (46.86) among 193 countries • The Philippines ranked 113th out of 182 countries in the 2022 Notre Dame-Global Adaptation Index (ND-GAIN)	• From 2003 to 2022, losses and damage incurred from disasters amounted to PHP702.96 billion (USD12.89 billion), of which about 96% were caused by climate-related hazards, according to the PSA. • During 2011-2020, the agricultural sector sustained total losses and damage of PHP295 billion, according to the Department of Agriculture. • According to the World Bank Country Climate and Development Report 2022, the Philippines' average estimated losses (in terms of GDP per year) from climate-related hazards can be between 3.2% and 7.6% by 2030, rising to between 5.7% and 13.6% by 2040. • Large-scale climate-related hazards could inflict destabilizing losses on the insurance industry and other financial intermediaries with direct and indirect exposure to affected industries.

B. Transition risks

Sources of risk	Potential macro-financial impact
• Policy changes • Technological changes needed for a shift to a green economy • Changes in public sentiment **Exposure** • Relatively limited exposure to transition risks at present. • Despite increasing GHG emissions, the Philippines makes up only 0.39 percent of the world's total GHG emissions.	• Losses in carbon-intensive energy sectors, such as utilities, transportation, and industrial sector. • Revaluation or repricing of carbon-sensitive assets entails losses for investors holding these assets which, if not addressed, could lead to systemic risks in the financial system. • Productivity changes. • Sovereign credit rating downgrade.

C. Adaptation response framework and strategies

National framework	Key initiatives/strategies	Estimated financing needs and sources	
• The Philippine National Adaptation Plan (NAP) is under the National Climate Change Action Plan 2011-28 (2011) ➢ The NAP focuses on four thematic priority areas in making climate change adaptation responses to ○ food security ○ water sufficiency ○ ecosystem and environmental stability ○ human security • Philippines Development Plan (PDP) 2023-2028 (2023)	• The People's Survival Fund (PSF) ➢ provides technical and financial assistance 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 stand-by fund for relief and recovery programs. • Energy Resiliency Roadmap ➢ includes nuclear energy and increasing renewable energy targets under a clean energy scenario. • Formulation of Energy Resiliency Standards ➢ complements the programs, strategies and activities on climate change adaptation and disaster risk reduction. • Infrastructure projects ➢ include infrastructure repairs (50% of public infrastructure spending) and climate change-resilient infrastructure, such as prevention of overflowing water.	• The annual cost of adapting to climate-related hazards over 2020-2059 is USD 4.2 billion (Source: United Nations - Economic and Social Commission for Asia and the Pacific, UN-ESCAP) **Domestic** • 2024 National Government (NG) Budget: PHP374.9 billion (69% of total climate change expenditures of PHP 543.4 billion) • 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	
• National Framework Strategy on Climate Change 2010-2022 (2010) • National Climate Change Action Plan 2011-2028 (2011) ➢ covers areas like sustainable energy • Philippine Energy Plan 2020-2040 (2020) • PDP 2023-2028 (2023) **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.	• Banning new coal-fired power plants from October 2020 • Phasing out unabated coal power generation in the 2040s (or as soon as possible thereafter) • Promoting energy efficiency and conservation via campaigns and implementation of energy usage standards • Developing sustainable energy: ➢ The Philippines has fully opened its renewable energy sector to foreign ownership through Circular No. 2022-11-0034 • Four strategic energy transition initiatives: ➢ reliable and clean power ➢ a smart and green grid system ➢ port build-up to support offshore wind development ➢ voluntary coal plant retirement and/or re-purposing	• Potential investment in energy systems over 2020-2050 is USD200 - 300 billion, or USD 6.7 - 10 billion per annum (Source: Asia Investor Group on Climate Change) **Domestic** • 2024 NG Budget: PHP168.6 billion (31% of total climate change expenditures of PHP 543.4 billion)	 **External** • ADB's Climate Change Action Program, Subprogram 1: USD250 million from ADB's ordinary capital resources • Global Environment Facility

[89] Prepared by Andrew Tsang, Economist, Pim-orn Wacharaprapapong, Economist, Sopheawattey San, Associate Economist.

<table>
<tr><th colspan="3">E. Enabling regulations for climate resilience</th></tr>
<tr><th>E.1. Legal framework</th><th>E.3. GHG accounting framework</th><th>E.5. Sustainable finance frameworks</th></tr>
<tr>
<td>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</td>
<td>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.</td>
<td rowspan="3">The Securities and Exchange Commission (SEC) has issued guidelines on the issuance of 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 introduced guidelines for banks to incorporate sustainability-principles into their corporate and risk governance and operations.
Sustainable Finance Framework for Banks (2020)
Environment 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 eligible mode of compliance with the mandatory credit to agriculture, fisheries and rural development (2022).
Three-year transition period (effective May 16, 2023) for banks to submit transition plans that align with the BSP's sustainability guidelines to BSP.
As of July 13, 2023, a cumulative USD3.55 billion of the Philippines' sovereign sustainable bonds were issued.
As of June 30, 2023, Philippine companies had issued USD10.02 billion (or 25%) of ASEAN-labelled green, social and sustainability (GSS) bonds.</td>
</tr>
<tr><th>E.2. Fiscal framework</th><th>E.4. Carbon pricing and taxation frameworks</th></tr>
<tr>
<td>Department of Budget and Management (DBM) and CCC Joint Memorandum Circular (JMC) (2015)
The CCC and DBM work together to develop the climate change expenditure tagging (CCET) system
The CCC is mandated to (i) evaluate and approve national government institutions-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 PAPs in their budget, as reflected in the Agency Request, National Expenditure Program, and the General Appropriations Act.</td>
<td>Carbon pricing instruments such as carbon taxation and emission trading schemes are under consideration by DOF/parliament. The studies/initiatives include:
World Bank (WB) Partnership for Market Implementation
United Nations Office for Project Services (UNOPS) Southeast Asia Energy Transition Partnership Project
Legislation of emission trading system (ETS), under Senate's consideration
The National Government (NG) collects energy taxes through excise taxes on fuels and electricity consumption. Fuel excise taxes, an implicit form of carbon pricing, cover 52.4 percent of emissions in 2021, unchanged since 2018.
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,
direct budgetary support to the National Power Corporation from NG.</td>
</tr>
</table>

<table>
<tr><th colspan="3">E.6. Financial system</th></tr>
<tr><th>Initiatives</th><th>Guidelines</th><th>Status</th></tr>
<tr><td>1. Taxonomy</td><td>The Philippine Sustainable Finance Taxonomy Guidelines (under public consultation)</td><td>The Philippine Sustainable Finance Taxonomy Guidelines are being developed by the Financial Sector Forum (FSF), which comprises the BSP, Insurance Commission, and SEC. The proposed guidelines are for comments until October 6, 2023, supplemented by public consultations scheduled in October – November 2023.</td></tr>
<tr><td>2. Risk management assessments</td><td>The BSP's Sustainable Finance Framework requires banks to develop and implement an environmental and social risk management system (ESRMS) that is commensurate to 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.</td><td>The BSP will provide guidelines on the scenarios that should be used in climate stress testing.
Moreover, the BSP issued complementary guidelines which require banks to incorporate environmental and social (E&S) factors in their credit (lending and investing activities) and operational risk management systems.</td></tr>
<tr><td>3. Climate-related financial disclosure</td><td>Sustainability Reporting Guidelines for listed companies
Requirement for banks to disclose environmental and sustainability risks in their annual reports.</td><td>The SEC is revising the sustainability reporting guidelines to improve reporting quality and ensure consistency.
BSP will update its disclosure requirements considering the latest issuance of the IFRS Sustainability Disclosure Standards.</td></tr>
<tr><td>4. Capacity building</td><td>The BSP, SEC and Inter-agency Task Force on Green Finance.</td><td>The BSP, SEC, and Inter-agency Task Force on Green Finance, in partnership with local and international organizations, are providing training and seminars for both regulators and private entities.</td></tr>
<tr><td>5. Regulatory incentives</td><td>Recognition of sustainable finance as an eligible mode of compliance with the mandatory credit to agriculture, fisheries, and rural development.
Measures to incentivize banks to finance green or sustainable projects, including transitional activities to decarbonization.</td><td>The BSP is considering potential measures to incentivize banks to promote green lending such as the use of preferential rediscount rates or provision for higher loan values</td></tr>
<tr><th colspan="3">F. Potential opportunities from the low-carbon transition</th></tr>
<tr><td colspan="2">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)</td><td>Electric vehicles (EVs)
The Philippines has a vast supply of the required rare earth minerals necessary to produce EV batteries.</td></tr>
</table>

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. Drivers of Philippine Inflation[90]

An in-depth understanding of inflation dynamics and underlying drivers would have important policy implications for the Philippine economy. This selected issue explores the relative contribution of demand and supply factors in driving inflation dynamics. The findings suggest that high inflation in 2022 was mainly driven by supply factors, while demand factors have become more dominant in 2023. Over the decade, demand and supply factors have played broadly equal roles in driving core inflation. A policy mix of both demand-side and supply-side measures will be necessary to help curb inflationary pressure.

Background

1. **High inflation has been a major concern for Philippine policymakers since early 2022 due to its adverse impact on purchasing power and consumption.** The Philippine headline inflation rate surged from 3.0 percent year on year in February 2022 to a peak of 8.7 percent in January 2023, before gradually slowing to 5.3 percent in August 2023. Among the major components of the consumer price index (CPI), food, transportation, and utilities have been the key drivers since 2022, contributing to the surge in inflation in 2022 and gradual slowdown in 2023 (Figure 7 in the main report). The development is mostly consistent with the movement of international commodity prices, particularly international oil and food prices, which sharply increased in early 2022 due to supply chain disruptions caused by the Ukraine Crisis and gradually fell from late 2022 as the supply chain disruptions eased. This study assesses the contribution of supply and demand factors in driving inflation and provides policy recommendations about addressing high inflation.

Decomposing Inflation Components by Various Drivers

2. **This study applies the Federal Reserve (Fed)'s framework in Hale Shapiro (2022) to decompose inflation by different drivers.** The method essentially provides a historical decomposition of CPI components by regrouping different driving factors. Specifically, the method classifies the sub-components of the CPI into supply- versus demand-driven categories/external- versus domestic-driven categories, then aggregates sub-components in the same category by applying CPI weights to the year-on-year inflation of sub-components. In this study, we classify inflation by four categories:

- **Demand-driven inflation:** Contributed by the positive output gap and second-round effects, such as wage hikes.
- **External-supply-driven inflation:** Mainly driven by surges in foreign prices, such as international commodity prices, partly due to global supply chain disruptions and depreciation of the local currency.
- **Domestic-supply-driven inflation:** Mainly caused by local supply shocks, such as typhoons, El Niño, animal diseases, and other natural disasters, while the low productivity of local supply due to structural issues[91] could also be a constraint.

[90] This selected issue was prepared by Andrew Tsang and Pim-orn Wacharaprapapong, Economists.
[91] For instance, the weak agricultural productivity in the country is due to the scattered ownership of land, lack of financing, low technology, and weak transportation infrastructure (from farms to markets).

- **Ambiguous components**: Could contribute to either demand or supply factors.

The methodology can be applied to headline inflation, core inflation, and specific inflation such as food inflation. Details of the classification method are presented in the Appendix.

3. According to our estimation results, inflation is mainly being driven by demand factors in 2023. Consistent with the global supply chain disruptions in 2022, the external-supply-driven components of inflation, together with the ambiguous components, could account for most of Philippine inflation in 2022. However, the demand factors, mainly due to the positive output gap, have become the main driver in 2023 (Table A1.1).[92] The results are consistent across all types of inflation – headline, core, and food – with details as follows.

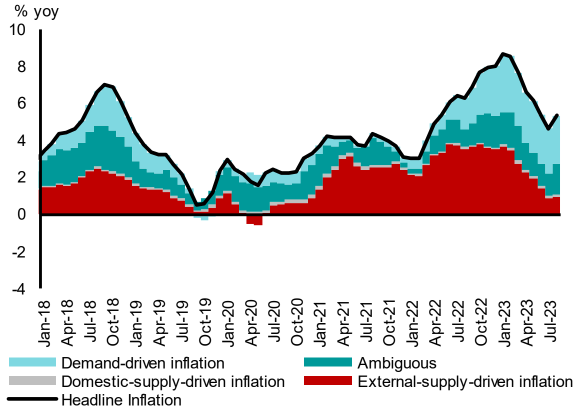
- **Headline Inflation:** The high inflation in 2022 was driven by supply factors, while the demand factors became the main driving force in 2023 as the supply factors eased. The persistence of high inflation is mainly driven by demand factors (Figure A1.1).
- **Core Inflation:** Excluding selected volatile food and energy components, core inflation, accounting for around 70 percent of the CPI index, was mainly driven by demand factors. Supply factors also have contributed considerably throughout the sample (Figure A1.2).
- **Food inflation:** With regards CPI food components, demand factors drove the recent food inflation episode; however, supply and ambiguous components have always played an important role in driving food price inflation. In particular, during the COVID-19 pandemic, food inflation was largely driven by supply and ambiguous components (Figure A1.3).

Table A1.1 Drivers of Core Inflation

		2022	2023*
Headline inflation	Supply	60%	33%
	Demand	22%	43%
Core inflation	Supply	39%	38%
	Demand	39%	42%
Food inflation	Supply	22%	6%
	Demand	43%	64%

Source: PSA; Haver; AMRO staff calculations
Note: Given that there are ambiguous items, the sums of contributions by demand factors and those by supply factors are not equal to 100%. 2023 figures are until August.

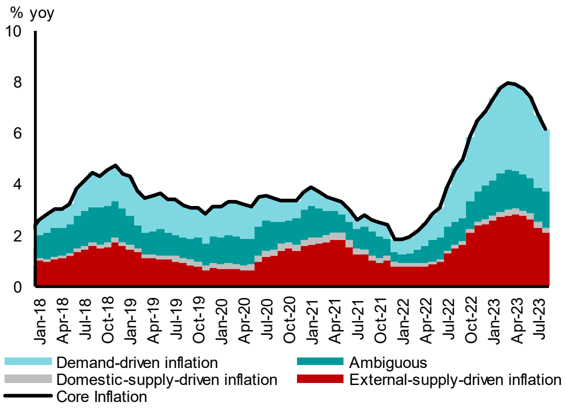
Figure A1.1 Drivers of Headline Inflation



Source: PSA; Haver; AMRO staff calculations

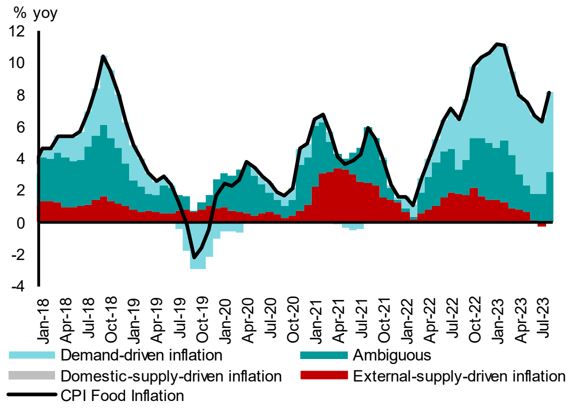
[92] In an AMRO's analytical note (del Rosario, Diana, and Wynn, Michael (2023), "Food for Thought: Fertile Ground for ASEAN+3 Inflation?" AMRO. https://amro-asia.org/food-for-thought-fertile-ground-for-asean3-inflation/), an alternative method (sign-restricted VAR with two variables: output gap and inflation rate) was used to estimate the contribution of demand and supply shocks. The Analytical note's results are generally consistent with our results such as the finding that recent headline inflation was from the demand side; and that supply and ambiguous components are playing a major role in food inflation, although differences were found during some periods.

Figure A1.2 Drivers of Core Inflation



Source: PSA; Haver; AMRO staff calculations

Figure A1.3 Drivers of Food Inflation



Source: PSA; Haver; AMRO staff calculations

Policy Mix for Addressing Inflation Risks

4. Given that Philippine inflation is driven by both demand and supply factors, a combination of policies from both aspects is required. To contain the latest demand-driven headline inflation, tightened demand-side policies are appropriate. However, supply-side measures should also be used to curb the high core and food inflation, particularly when supply shocks occur. The authorities have realized the need for a policy mix of combining both demand and supply-side policies. Specifically, the Philippine authorities introduced the "all-of-government" approach, which involves taking both monetary and non-monetary measures, in early 2023. They have also set up an Inter-Agency Committee on Inflation and Market Outlook (IAC-IMO) to continuously monitor commodity prices, assess the supply-demand situation, and provide timely recommendations to bring inflation back within the target range.

5. The empirical results show that inflation in recent months has been demand-driven, justifying the current demand-side policies. In particular, with significant inflationary pressures coming from the demand side this year, the tightening stance in both monetary and fiscal policy is warranted. Monetary policy has been tightening until recently. The BSP's decision to raise the policy rate from 2.00 to 6.25 percent, starting in May 2022, was timely and appropriate. Going forward, the BSP should maintain a hawkish bias and stand ready to tighten the policy rate further if inflation becomes more persistent than expected. Meanwhile, the ongoing fiscal consolidation also complements the tightening monetary policy stance in curbing high inflation.

6. However, given that the supply factors also contribute a large share of Philippine inflation as well, supply-side policies should be considered. At the heart of this consideration are measures to curb high food inflation, which is the most important component of the Philippine CPI inflation.[93] In particular, prices of key food items such as rice, onions, sugar, eggs and pork have surged to unprecedented levels due to a shortage of domestic supply. Thus, in the short term, the government can provide targeted subsidies and relax import restrictions as follows:

- **Subsidies can help mitigate the adverse impacts of high inflation**. To alleviate the impact of high inflation, particularly those caused by external supply shocks, existing

[93] The food inflation accounts for 34.8 percent of headline CPI and largely affects the living costs of the public.

subsidies have targeted lower-income groups and those heavily affected by high inflation.[94] Such targeted subsidies are appropriate as they can help mitigate the adverse impact of inflation on vulnerable groups without undermining fiscal sustainability.

- **Import restrictions should be relaxed to allow more imports of food.** This is particularly useful for easing short-term price pressures caused by local supply constraints, in which the importation of selected products is necessary to bridge the gap between domestic production and consumption demand. For example, when the import tariff rates on rice, pork, and corn were lowered,[95] and the import permits for pork and sugar were expanded, food inflation moderated in the first half of 2023. These relaxations should remain in place as needed subject to developments in domestic supply and prices. At the operational level, effective and timely implementation is key to bringing down prices:
    - ➢ First, the decisions on import tariffs, which rest with the IAC-IMO and the President, must be timely, based on sufficient data and accurate projections of potential shortages.
    - ➢ Second, the government should speed up the administrative processes required for importations to ensure fast-tracked shipments. Digital technology can be used to simplify processes such as import permit approvals and goods clearance.
    - ➢ Third, a comprehensive price monitoring system should be in place to ensure that retail prices decline in line with more import supplies.
    - ➢ Ultimately, the authorities should strive to reduce import restrictions further and move towards a more market-oriented approach to food importation.

7. In the long term, the country should promote a stronger agricultural sector and a more resilient domestic food supply chain to reduce fluctuations in food prices, and ensure food security. Over more than a decade, the growth of the Philippines' agricultural sector has lagged that of the overall economy, which is driven mostly by the services sector. While the annual growth rate of the whole economy averaged 5 percent over the past 10 years, growth of the agriculture, fishery and forestry sectors averaged merely 1.2 percent. The lagging growth reflects many challenges that the agricultural sector faces, including low yields, erratic weather conditions, insufficient access to finance, and inadequate infrastructure. Tackling these challenges requires a strong partnership between the public and private sectors on the following fronts:

- **First, land consolidation is necessary to promote higher yields.** The average farmer holds only 1.3 hectares of land.[96] Thus, they cannot achieve economies of scale and made the necessary productivity-enhancing investment in inputs and mechanization. Thus, the government is committed to promoting farmland consolidation through contiguous farming that allows smallholder farmers to combine their resources and boost

[94] For instance, to mitigate the impact of high oil prices, the authorities set up a Pantawid Pasada Program to subsidize public transport drivers. The government also provides fuel and fertilizer subsidies to farmers and fisherfolks to ensure unimpeded agricultural production and fishing operations.
[95] Specifically, the 2022 reduced Most Favored Nation (MFN) tariff rates on rice, corn, and pork provided under Executive Order (EO) 171 have been extended until 31 December 2023 through the issuance of EO 10 on 29 December 2022:
- Rice – from 40 percent to 35 percent for in-quota and from 50 percent to 35 percent for out-quota
- Corn – from 35 percent to 5 percent for in-quota and from 50 percent to 15 percent for out-quota
- Pork – from 30 percent to 15 percent for in-quota and from 40 percent to 24 percent for out-quota

On the other hand, lowered MFN tariffs on the mechanically deboned meat (MDM) of chicken and turkey at 5 percent were extended until December 31, 2024, through the issuance of EO 13 on January 13, 2023.
[96] Data from the Philippines Statistics Authority's 2012 Census of Agriculture and Fisheries.

aggregate productivity. The consolidation and clustering of farmlands is part of a plan to improve the agricultural sector under the Philippine Development Plan (PDP) 2023-2028.

- **Second, greater access to financing will help farmers scale up operations and manage cash flows amid uncertainties from weather conditions and animal diseases.** As of May 2023, lending to the agricultural sector accounted for only 2.5 percent of total bank lending to economic activities. The BSP's financial inclusion survey also reveals that financial inclusion remains relatively low in agriculture compared with other sectors.[97] Without access to loans or insurance, farmers will be constrained in their investment and cashflow management, especially in the event of shocks. Recognizing the importance of financial inclusion to farmers' productivity, among others, the government has enacted "The Agriculture, Fisheries, and Rural Development Financing Enhancement Act of 2022" to finance activities that shall enhance productivity and increase the income of an agricultural and fisheries household, thereby promoting agricultural sector productivity and competitiveness, as well as sustainable development of rural communities. The major features of the law include the expansion of the scope of rural community beneficiaries and the activities for agriculture, fisheries and rural development (AFRD) financing, introduction of new modes of compliance and the removal of the distinction on the credit allocation of fifteen percent (15%) to agriculture and ten percent (10%) to agrarian reform beneficiaries. In addition to this, digital banking platforms can play a key role in boosting access to this target group.
- **Third, modern farming and digital technology will boost productivity.** Government investment is needed to spearhead research, development, and funding of smart farming technology, such as disease-resistant or climate-tolerant seeds, pest control tools and water irrigation systems. Moreover, digital technology can be adopted to increase efficiency, such as by using sensor-based or precision agriculture. Digital platforms can also connect farmers directly to consumers by facilitating marketing, delivery and payment.
- **Lastly, improved physical connectivity is crucial for food supply management.** The archipelagic geography and frequent natural disasters have meant slow and costly transportation between farms and markets. Thus, the country needs to expand and upgrade physical connectivity via multiple modes of transportation to speed up food logistics and reduce waste. Besides transportation routes, improved post-harvest and storage facilities, particularly cold chain[98] will also help.

Reference:

Hale Shapiro, Adam (2022), "A Simple Framework to Monitor Inflation," Federal Reserve Bank of San Francisco Working Paper No. 2020-29. https://doi.org/10.24148/wp2020-29

NEDA (2023), Philippine Development Plan 2023-2028. https://pdp.neda.gov.ph/philippine-development-plan-2023-2028

[97] According to the BSP's 2021 Financial Inclusion Survey, farmers and workers in the agricultural sector had the highest financial exclusion level, of 73 percent in 2021.
[98] A cold chain is a temperature-controlled supply chain comprising refrigerated production, storage, and distribution facilities supported by equipment that can constantly maintain the required low-temperature range.

Box A1.1 Details of the Methodology for CPI Component Classification

To classify components of the Philippine CPI into supply- versus demand-driven categories an external- versus domestic-driven categories, we apply the Fed's framework in Hale Shapiro (2022) to classify the 185 sub-categories of the Philippine CPI (the third level of sub-categories). The classification is based on the results of the following equation:

$$\Delta \ln (P_{it}) = c + \sum_{j=1}^{12} \beta_j \Delta \ln (FP_{t-j}) + \beta_{13} OutputGap_{t-1} + \beta_{14} \Delta \ln (P_{it-1}) + \varepsilon_{it} \qquad \text{(A1.1)}$$

where P_{it} is the monthly price index for sub-category *i* of the Philippine CPI at time t, FP is foreign prices, represented by the IMF's International Commodity Price Index (the IMF's International Food Price Index is applied to food sub-categories), $OutputGap$ is the output gap, defined as (Actual GDP – Potential GDP)/Potential GDP, in which the Potential GDP is estimated by applying a one-sided HP filter to quarterly GDP, and the quarterly output gap series is converted into monthly series using interpolation. All series are seasonally adjusted, and the sample period is from January 2010 – August 2023, depending on data availability.

External-domestic classification

- This classification was not discussed in Hale Shapiro (2022). In this study, we apply Equation A1.1 and classify external/domestic-driven inflation components by using the following criteria.
  - **External-driven inflation components**: a positive sign for the sum of the coefficients of all lagged foreign prices, with F-statistics < 0.1.
  - **Domestic-driven inflation components**: include all components not classified under external-driven inflation components.
- Foreign prices are proxied by the IMF's International Commodity Price Index (U.S. dollar-denominated) (IMF's International Food Price Index for food inflation) multiplied by the peso-U.S. dollar exchange rate. Alternative proxies, including i) the IMF's International Commodity Price Index (U.S. dollar-denominated), ii) trade-weighted foreign CPI inflation, and iii) trade-weighted foreign CPI inflation divided by the Philippine NEER, generate similar results.

Demand-supply classification

- In addition, according to Hale Shapiro (2022), supply and demand-driven categories could be classified based on the signs of the price and quantity equations for each component in the PCE deflator index. To decompose the Philippine CPI, the data on quantities of goods transacted are not available, so the output gap is used in Equation A1.1, and the following criteria are applied:
  - **Supply-driven inflation components**: components classified as external-driven inflation, and/or negative sign for output gap, with *t*-statistics < -1
  - **Demand-driven inflation components**: components classified as domestic-driven inflation, and positive sign for output gap, with *t*-statistics > 1
  - **Ambiguous components**: components which cannot be classified as supply- or demand-driven components.

2. Philippines' Services Sector Developments and Intersectoral Linkages[99]

The services sector has been a major contributor to economic growth in the Philippines and understanding its role and dynamics can have important policy implications for the country's growth strategy. This selected issue explores major services industries and their inter-sectoral linkages using the input-output table. The findings suggest that enhancing productivity of the services sector and strengthening intersectoral linkages are both crucial for sectoral development and broader economic growth.

Background

1. The services sector has been the principal growth engine in the Philippines. The sector accounted for 61 percent of GDP and contributed 74 percent of GDP growth in 2022, while providing around 60 percent of total employment. In addition, services exports have also been a key contributor to the country's external income, which recorded a surplus of around 4 percent of GDP in 2022. Beyond its direct contributions to economic growth, the services sector is also a crucial node connecting and supporting various other sectors along the domestic supply chain. To better understand the services sector, this selected issue utilizes the Philippine input-output (IO) table to assess the importance of key sectors and related intersectoral linkages for sectoral and broader economic development, and discusses policy considerations.

Services industries

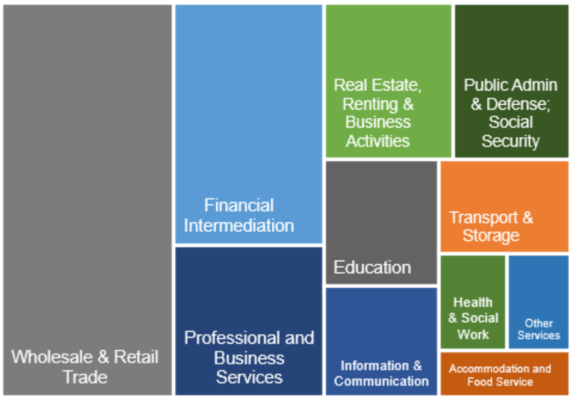
2. Business and travel-related services are the key components in both services exports and the domestic economy. In the domestic economy, wholesale & retail trade, financial services, professional and business services, ICT, transport, and storage are among the major components based on the production side of GDP (Figure A2.1). As for services exports, tourism related (travel and transport) and BPO services (other business services, telecommunications, and ICT services) together make up 85 percent of services exports (Figure A2.2). Business services (including BPO) and travel related industries (transport and accommodation) are the common critical components, which not only generate export revenue but also exert positive spillovers to related sectors via domestic supply chains.

3. The services sector has considerable growth potential, especially in tourism and BPO industries.[100] The tourism industry, in particular the international inbound tourism, has significant potential to expand further. Despite rapid recovery in tourist arrivals, the revenue from international tourists is still small relative to the domestic tourism market.[101] Compared with the ASEAN peers, the international tourism market in the Philippines is small.[102] The BPO industry is another segment that has recorded remarkable growth since the pandemic and will likely expand robustly going forward. This is partly because the Philippines enjoys a comparative advantage, notably in its young and dynamic labor force and English proficiency, in addition to the enabling policy support from the government.[103] The BPO sector will continue

[99] This selected issue was prepared by Ke Ji, Economist.
[100] The BPO industry, also referred as IT-BPM (business process management), in the Philippines consists of traditional call centers and more complex services such as healthcare information management, software, game development, and animation.
[101] According to the Department of Tourism (DOT), revenue from international tourists reached PHP368 billion in 2022, while revenue from domestic tourism recorded PHP 1.6 trillion.
[102] Foreign tourist arrivals in 2019, before the pandemic, totaled 8.2 million in the Philippines, compared with 16 million in Indonesia, 26 million in Malaysia, 40 million in Thailand, and 15 million in Singapore.
[103] For instance, tax incentive packages provided by the Board of Investments (BOI) and the Philippine Economic Zone Authority (PEZA).

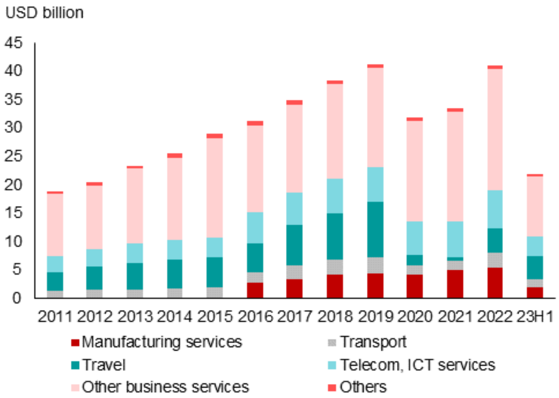
to grow given the ongoing trend of digitalization and steady rise in external demand for IT-BPM services for cost optimization.[104]

Figure A2.1 Services Sector Composition in Domestic Economy



Source: PSA; Haver; AMRO staff calculations
Note: Area size reflects respective production of real GDP in 2022.

Figure A2.2 Services Exports Composition



Source: BSP; Haver; AMRO staff calculations
Note: BPO related sectors are Other business services and Telecom, ICT services. Other business services cover technical, trade-related, and other business services; R&D; professional and management consulting services, and technical services. Others include maintenance & repair; construction services; financial services; personal, cultural and recreational services; and government services.

Input-output Analyses and Intersectoral Linkages

4. This study applies a standard input-output analysis using the official IO table of the Philippines.[105] The method entails deriving respective multipliers for each sector based on transformed IO table — the Leontief inverse matrix where each element (i, j) represents the total output required from sector i for every unit of final demand in sector j, including both direct and indirect impacts from intersectoral flows.[106] Based on the Leontief inverse matrix, this study employs two sets of indicators to characterize the economic impact from the changes in final demand in respective sectors and the intersectoral linkages (Table A2.1). The multipliers measure the sensitivity of the economy to changes in the final demand of each sector, in terms of total output and value-added, thereby shedding light on which sectors should be further developed to generate broader economic growth. Relatedly, the import multiplier, on the other hand, identifies the required foreign inputs corresponding to changes in one sector's final demand, or the leakage into other economies. Finally, backward linkage captures the demand linkage with respect to the output needed from other industries, while forward linkages show supply-side linkages regarding output supplied to other industries (Miller & Blair 2009).

5. Based on output multipliers, tourism-related, ICT, and financial services can provide a greater-than-average boost to the total output. In particular, the tourism-related sectors (transportation, accommodation, and food services) have higher-than-average output multipliers, indicating that expansion in the final demand of those sectors can bring about higher total output of the economy considering direct and indirect effects (Figure A2.3). This is followed by information and communication (ICT) and financial services. The output

[104] See The Philippine IT-BPM Industry Roadmap 2028 by the IT and Business Process Association of the Philippines (IBPAP).
[105] The analysis is based on the official input output table 2018 released by the PSA.
[106] See for instance ADB (2022) for a detailed definition and formula for the multipliers, and AMRO (2020) Annex 1 for an example on the tourism sector in the Lao PDR.

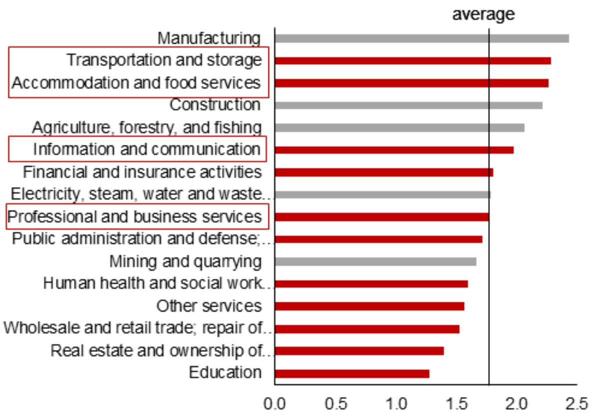
multiplier of professional and business services, which covers BPO sectors, is on par with the industry average, while the rest of the services categories fall below the industry average.

Table A2.1 Multiplier and linkage indicators

	Indicators	Description
Multipliers	Simple output multiplier	It measures the direct and indirect effects of one unit value of final demand from one industry on total output. The output multiplier for sector j is the sum of column j of the Leontief Inverse Matrix.
	Value-added multiplier	It measures the total value-added generated in the economy (i.e. excluding intermediate inputs) due to a unit value change of final demand for one sector. It is calculated by the vector of value-added coefficient times the Leontief Inverse Matrix.
	Import multiplier	It measures the amount of imports required to meet one unit change in the final demand of each sector. It is calculated by the share of imports times the Leontief Inverse Matrix.
Intersectoral linkages	Backward linkage	It shows the demand amount from other industries, captured by the respective column coefficients of the Leontief Inverse Matrix.
	Forward linkage	It shows how much an industry output is demanded by other industries, captured by respective row coefficients of the Leontief Inverse Matrix.

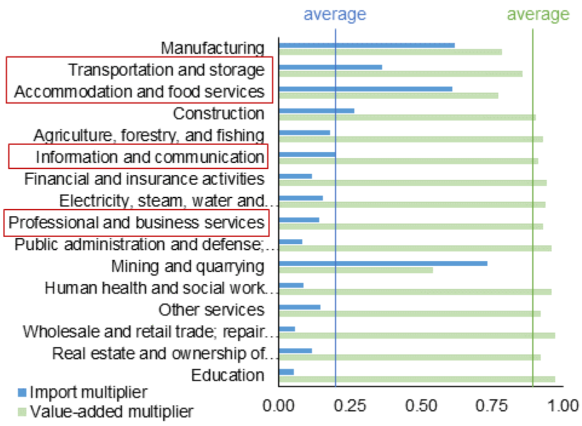
6. However, tourism related sectors have lower value-added multipliers and higher import multipliers. Figure A2.4 shows that despite being a stronger driver of total output, the value-added multiplier effect of tourism related sectors is below the industry average, suggesting a relatively weaker driver of GDP compared with other industries. Meanwhile, the import multipliers or the leakage to other economies are higher, in part due to higher reliance on imported goods and services. BPO related sectors (professional and business services, and ICT) as well as other major services sectors show higher a value-added multiplier effect and lower leakage to other economies.

Figure A2.3 Output Multiplier by Industry



Source: PSA; AMRO staff calculations
Note: The red bars represent services sectors. Tourism (Transportation, accommodation and food services) and BPO related sectors (professional and business services, and ICT) are highlighted in red frame.

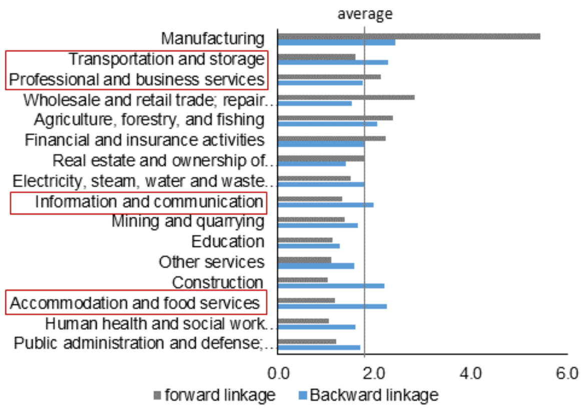
Figure A2.4 Import and Value-added Multipliers



Source: PSA; AMRO staff calculations
Note: Tourism (Transportation, accommodation and food services) and BPO related sectors (professional and business services, and ICT) are highlighted in red frame.

7. Tourism-related sectors show stronger backward linkages, while wholesale and retail trade and financial services have higher forward linkages. Notably, tourism-related sectors show a higher reliance on other industries, particularly on manufacturing, agriculture, and utilities (electricity, water, and waste management), in addition to other major services sectors as reflected by the higher backward linkages (Figure A2.5 and A2.6). For instance, transportation has a high backward linkage to the manufacturing sub-category of coke and refined petroleum products, while both accommodation and food services rely heavily on food products as well as chemical products. This implies that an expansion in tourism will boost upstream sectors, but at the same time its development also depends on the supply capacity of those sectors. In fact, manufacturing and utilities are critical backward linkages for many major services sectors.[107] As for forward linkages, services sectors appear to provide crucial inputs to other segments of the economy, especially wholesale and retail trade, financial services, and professional and business services (Figure A2.5).

Figure A2.5 Backward and forward linkages



Source: PSA; AMRO staff calculations
Note: Industry average is 1.8 for both forward and backward linkages. Tourism (Transportation, accommodation and food services) and BPO related sectors (professional and business services, and ICT) are highlighted in red frame.

Figure A2.6 Tourism related sector's backward linkages

Source: PSA; AMRO staff calculations

Policy considerations

8. The productivity of services sectors needs to be enhanced so as to contribute to quality economic development. As shown in the multiplier analysis, while having high output multipliers, services sectors — especially tourism-related sectors — can have low value-added multiplier effect on the economy. This indicates a need to improve productivity and increase value-added content in services in addition to expanding the market and strengthening infrastructure. As highlighted in the new National Tourism Development Plan 2023-2028[108] to diversify the tourism portfolio, the tourism industry can benefit from expanding medical and wellness tourism to generate higher value-added. For the IT-BPM industry, productivity will also need to be enhanced to remain competitive amid the challenges and

[107] For instance, BPO related industries — information and communications, professional and business services — have high backward linkages to the manufacturing sub-category of computers, electronic and optical products. This is also the case for financial services.
[108] The NTDP 2023-2028 was approved in March 2023.

evolving dynamics in the industry. This can benefit from an increase in foreign investment and higher education in ICT and BPO-related fields (Fermo et al., 2021).

9. Developing the services sector is not just about the sector itself. It is also crucial to strengthen intersectoral linkages and productivity of upstream industries. First, services sectors can have high import multipliers, indicating high leakage to foreign inputs despite an expansion in demand. This suggests that the Philippines should also improve domestic supply quantity and quality. In particular, the food services[109] industry shows a high import multiplier due to a heavy reliance on imported inputs. Second, services sector development also hinges on the supply capacity of their upstream sectors, or backward linkages. In particular, manufacturing and utilities are among the common critical sectors that major services sectors depend on. This will require effective implementation of the manufacturing roadmap laid out in the PDP 2023-2028, to expand the domestic production base, improve competitiveness, and upgrade the value chain[110]. Finally, strengthened intersectoral linkages will also facilitate the services sector in supporting downstream industries. In this regard, efforts in increasing internet coverage and speed, promoting digitalization and connectivity, and improving efficiency should be expedited, in line with the government's endeavor to step up infrastructure investment in the country and close the infrastructure gap as discussed in Section C of this report.

Reference:

Fermo, Laura, et al, (2021), Labor Productivity, Real Wages in Services and the Growth in the Philippine IT-BPM Sector, BSP Discussion Paper Series No.9.

Miller, R. and P. Blair. (2009). Input–Output Analysis: Foundations and Extensions. Second edition. Cambridge: Cambridge University Press.

[109] This is a sub-category under Accommodation and food service activities.
[110] This includes, for instance, to enhance competitiveness of food manufacturing and processing, and lowering energy cost in general.

3. Decoding Corporate and MSME Debt-at-Risk in the Philippines[111]

Over the past decade, the Philippines' non-financial corporate (NFC) debt has been one of the fastest growing in the ASEAN+3 region. Although the overall size of NFC debt remains small, tighter financial conditions have raised concerns over the financial position of NFCs. This selected issue explores how the risk levels of different firms and sectors have evolved over time and assesses the impact of interest rate hikes on firms-at-risk and debt-at-risk based on a stress testing exercise. The outcome of the exercise identifies pockets of vulnerabilities in the corporate sector.

Background

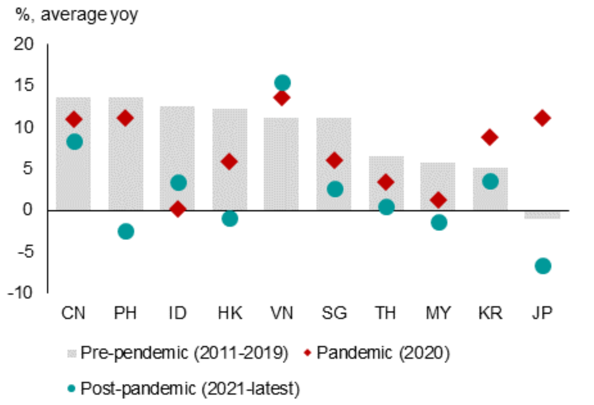
1. **Non-financial corporate (NFC) debt in the Philippines was among the fastest growing in the region before the pandemic.** Between 2011 and 2019, NFC debt in the Philippines grew 13.6 percent (yoy) on average, among the fastest growth rates in ASEAN+3 economies (Figure A3.1). During the pandemic, NFC debt increased further due partly to the need for working capital while profitability was hard hit by the pandemic, especially in transportation, property and business services (Figure A3.2). After the pandemic, there are signs of deleveraging as reflected in a contraction in corporate debt, although the contraction was smaller than the speed of deleveraging in household and financial corporation debt (Figure A3.3).

2. **Although the Philippines' corporate debt to GDP ratio appears modest compared with the regional average, NFCs rely heavily on bank funding, and the banking system could be affected if debt distress occurs.** Corporate debt, though rapidly increasing, stands at about 50 percent of GDP compared with an average of 75 percent of GDP among ASEAN countries. The corporate debt is concentrated in a few sectors, notably property and construction, manufacturing, and utilities. Moreover, there is a significant reliance on long-term debt across these sectors (Figure A3.5). Most of the firms source their funds from the domestic market, through either the banking sector or the bond markets. However, the local currency (LCY) corporate bond market makes up only about 7 percent of GDP (Figure A3.4). Given the shallowness of the local bond market, there is a considerable tilt toward bank borrowing, which is reflected in corporate loans having a large share, of 69 percent of total loans,[112] equivalent to about 40 percent of GDP. During the pandemic, companies' heavy reliance on banks was pivotal in sustaining their funding and liquidity. As banks have substantial loan exposure to corporates, the impact of corporate distress might have a direct impact on the financial system. That said, prevalent cross-shareholdings between banks and corporations also accentuate macro-financial linkages, strengthening the potential for a systemic impact (Lim and Woodruff 1998).

3. **In light of recent tighter financial conditions, this study assesses the extent to which the high-interest-rate environment could exert additional pressure on debt-at-risk and how companies' cash buffers could help absorb interest rate shocks**. The study explores firm-level data across the listed, unlisted, and delisted companies as well as across sectors, and suggests some policy recommendations.

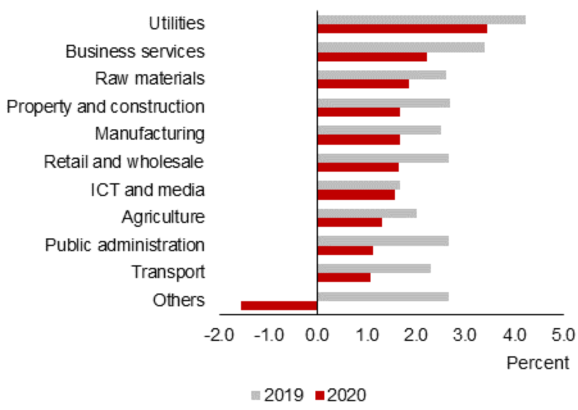
[111] Prepared by Laura Grace Gabriella, Associate Economist.
[112] Banking sector loans to production, excluding loans to financial activities and mortgage loans.

Figure A3.1 ASEAN+3: Corporate Debt Growth



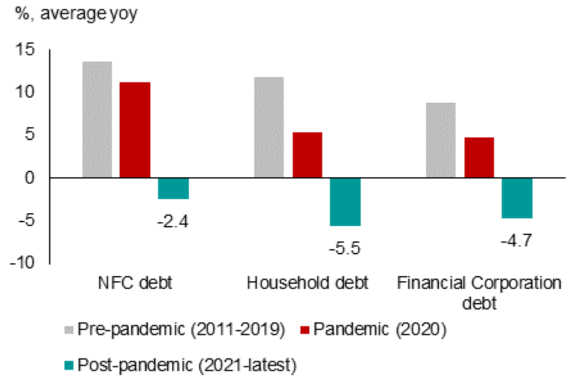
Source: Institute of International Finance (IIF); AMRO staff calculations
Note: PH = Philippines, ID = Indonesia, VN = Vietnam, SG = Singapore, TH = Thailand, and MY = Malaysia.

Figure A3.2 Median ROA of Corporate by Sector



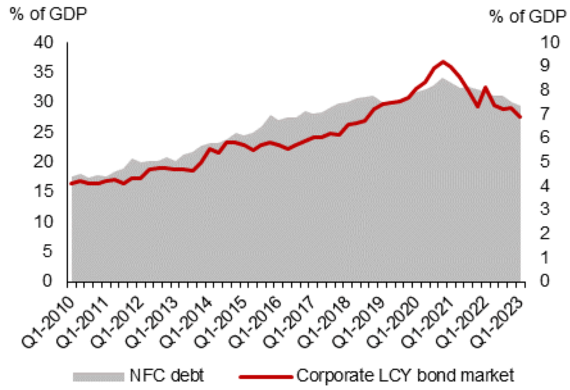
Source: Orbis Moody's; AMRO staff calculations

Figure A3.3 Private Sector Debt Growth



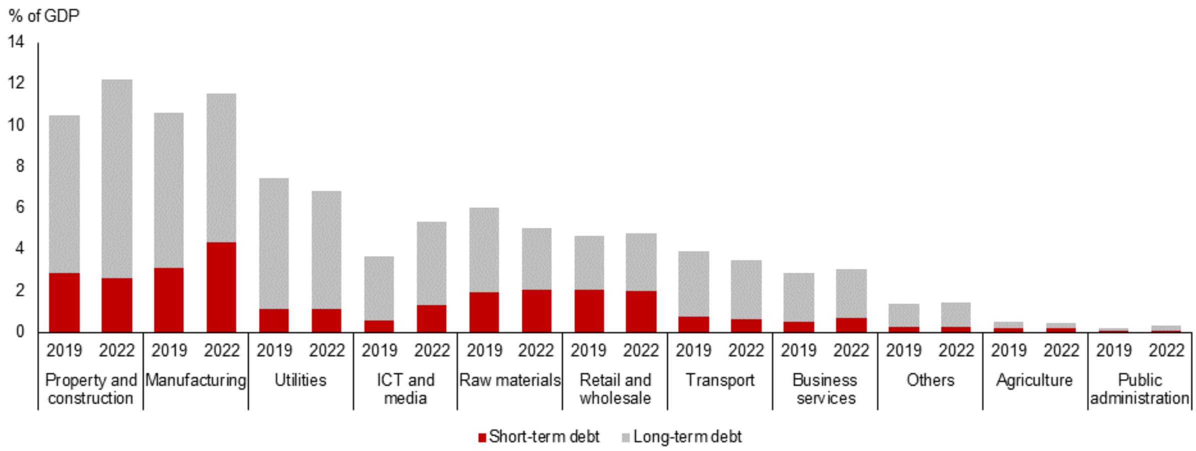
Source: IIF; AMRO staff calculations

Figure A3.4 NFC Debt and Corporate LCY Bond Market



Source: IIF; ADB AsianBonds; AMRO staff calculations

Figure A3.5 Corporate Debt across Sectors by Maturity



Source: Orbis Moody's; AMRO staff calculations.

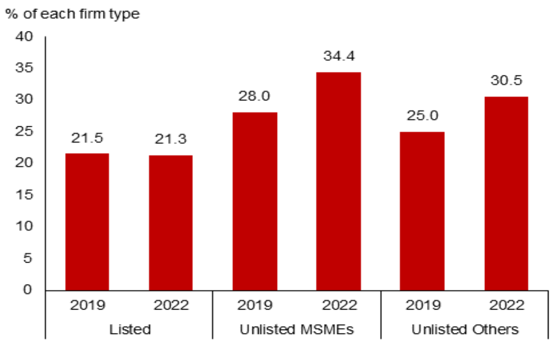
Corporate Firms-at-risk and Debt-at-risk[113]

4. To assess the degree of vulnerability in the corporate sector, this study utilizes firm-level data across firm types and sectors, and defines the degree of vulnerability according to firms' interest coverage ratio (ICR). A firm is considered 'at risk' if the ICR falls below 1.25.[114] The findings on firms-at-risk are as follows:

a. **By firm type**: Most notably, MSMEs demonstrated a higher degree of vulnerability than other firm types, with 34.4 percent of these firms categorized as being at risk. In a temporal comparison with the pre-pandemic period, the proportion of firms-at-risk for listed companies was stable, but both unlisted MSMEs and other unlisted categories registered a considerable increase in their risk quotient between 2019 and 2022 (Figure A3.6).

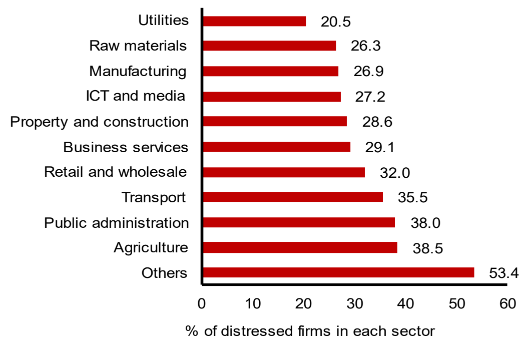
b. **By sector:** A sectoral breakdown reveals the Others category, comprising tourism-related businesses such as restaurants, hotels and travel agencies, as bearing the highest share of at-risk firms (Figure A3.7). Under a more granular breakdown, the firms-at-risk data for MSMEs and unlisted others indicates that the proportion of firms-at-risk in the Others category has declined compared with 2020. Meanwhile, the Public Administration sector, which includes healthcare-related firms, presented the highest risk among MSMEs (Figures A3.8 and A3.9).

Figure A3.6 Firms-at-risk by Firm Type



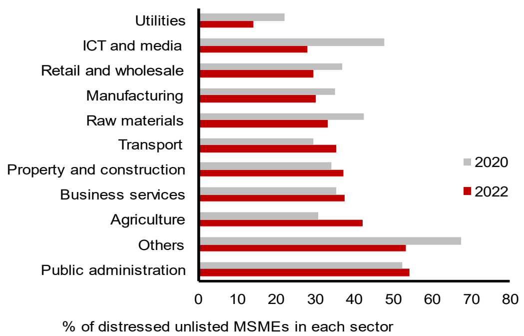
Source: Orbis Moody's; AMRO staff estimates

Figure A3.7 Firms-at-risk by Sector (2022)



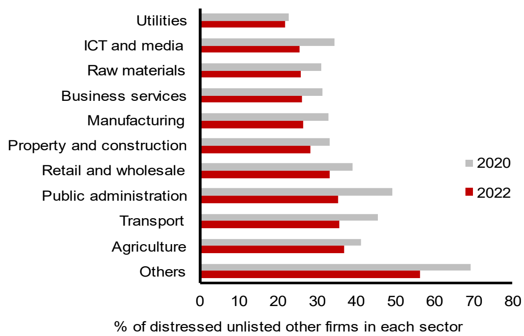
Source: Orbis Moody's; AMRO staff estimates

Figure A3.8 Unlisted MSME Firms-at-risk by Sector (2020 and 2022)



Source: Orbis Moody's; AMRO staff estimates

Figure A3.9 Unlisted Other Firms-at-risk by Sector (2020 and 2022)



Source: Orbis Moody's; AMRO staff estimates

[113] This assessment utilizes a sample of 6,349 firms, comprising 191 listed firms, 1,228 unlisted MSMEs, 4,918 unlisted other firms, and 12 delisted firms. All the balance sheet information is sourced from Orbis Moody's and spans the period from 2010 to 2022. Where 2022 data is unavailable, the information is supplemented with 2021 data. Debt-at-risk is defined as debt held by corporates with an ICR below 1.25. The ICR is calculated as earnings before interest, taxes, depreciation and amortization (EBITDA) divided by the corporate's interest expenses.

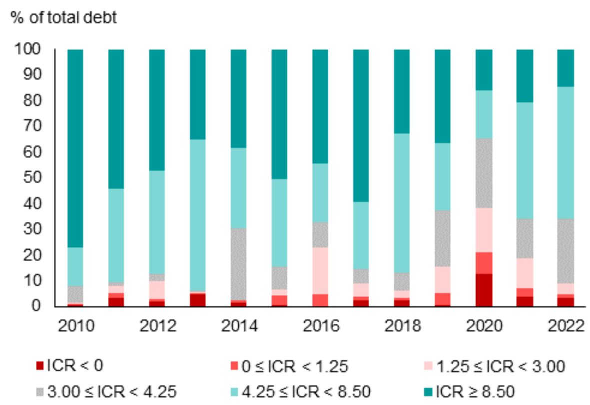
[114] Companies with an ICR below 1.25 are viewed as being at risk, in line with the Damodaran (2016) classification, which equates companies with ICRs under 1.25 to S&P ratings of CCC or lower.

5. The debt-at-risk analysis sought to identify debt with an ICR below 1.25 as a proportion of total debt, and the findings indicate the following:

a. **By firm type:** Over the past decade, the proportion of debt-at-risk for listed companies has been under 5 percent. However, there was a surge in 2020, which was subsequently reversed in 2021 (Figure A3.10). In contrast, MSMEs consistently exhibited a larger share of debt-at-risk, often exceeding 30 percent. This proportion saw a decline in 2020 but rebounded in 2021 (Figure A3.11).

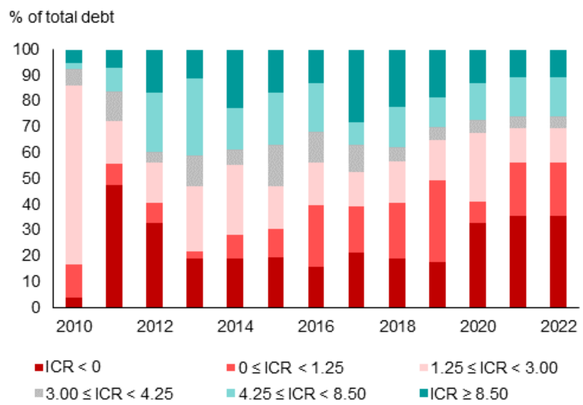
b. **By sector:** At the sectoral level, retail and wholesale, property and construction, and transport were sectors with the highest proportion of debt-at-risk (Figure A3.12). When focusing on MSMEs, retail and wholesale, business services, and manufacturing emerge as the most vulnerable sectors (Figure A3.13).

Figure A3.10 Debt-at-risk of Listed Companies



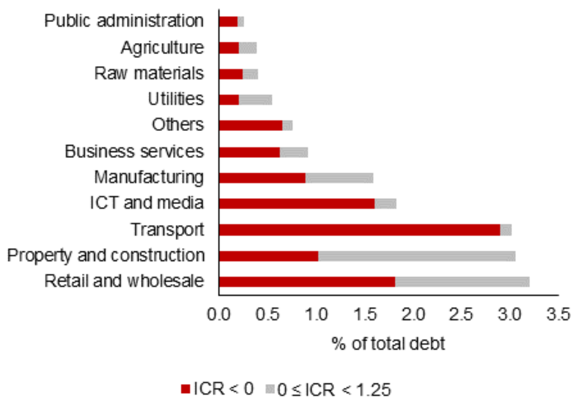
Source: Orbis Moody's; AMRO staff estimates

Figure A3.11 Debt-at-risk of MSMEs



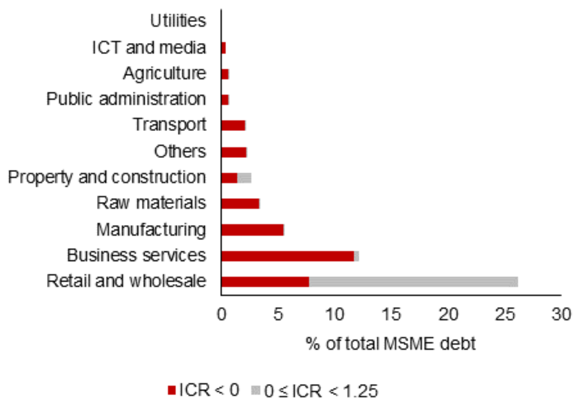
Source: Orbis Moody's; AMRO staff estimates

Figure A3.12 Overall Debt-at-risk by Sector (2022)



Source: Orbis Moody's; AMRO staff estimates

Figure A3.13 MSME Debt-at-risk by Sector (2022)



Source: Orbis Moody's; AMRO staff estimates

Stress Test on Debt-at-risk from Interest Rate Hikes

6. Stress tests were conducted under three different scenarios, both with and without additional cash buffers.[115] In the baseline scenario, the interest rate increased by 200 bps,

[115] In a scenario without a cash buffer, companies repay their debt using operational income. On the other hand, in a scenario with a cash buffer, companies need to use cash and cash equivalents to supplement the payments because there is no haircut due to asset liquidation. The ICR is calculated by adding cash and cash equivalents to EBITDA, then dividing by the corporation's interest expenses.

which is roughly the average rise in bank lending rates (paragraph 11 in the main report). Moreover, additional stress scenarios were introduced that had incremental interest rate hikes of 50 bps, 100 bps, and an increase equivalent to 2 standard deviations, comparable to an additional 150 bps. The stress test results are then presented in terms of both firms-at-risk and debt-at-risk. For sectors that appear vulnerable, the stress test results are also described in details.

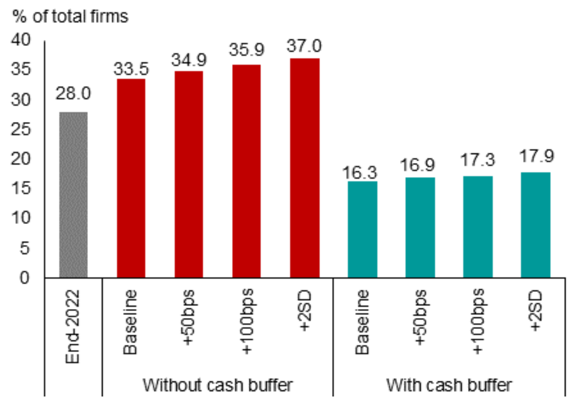
a. On aggregate, the stress test could raise the proportion of firms-at-risk from 28 percent to as much as 38 percent of total firms, with most of the vulnerable firms in the 'Unlisted Other' category. An incremental increase in the proportion of firms-at-risk was observed under each additional scenario. In the most severe scenario, available cash buffers could reduce the number of firms-at-risk to only 18 percent of total firms (Figure A3.14A).

b. The stress tests demonstrate a progressive increase in debt-at-risk across the scenarios. The baseline scenario could lead to a rise in debt-at-risk from 14 percent to 18 percent. While the incremental hikes of 50 bps and 100 bps would result in a gradual increase in debt-at-risk, the hike of 2 standard deviations (2SD) would cause a sharper rise in the proportion of debt-at-risk (Figure A3.14B).

c. Delving deeper into the debt-at-risk across sectors, the stress tests indicate that firms in each sector exhibit varying degrees of sensitivity to interest rate shocks (Figure A3.15). The retail and wholesale sector might see a significant jump from 28 percent to 43 percent. Property and construction would experience a moderate impact, with debt-at-risk rising from 12 percent to 17 percent in the most severe scenario. Business services also displayed sensitivity to interest rate hikes, jumping from 14 percent to 25 percent. In contrast, transportation, which already has a high proportion of debt-at-risk, showed less sensitivity to larger interest rate shocks, with debt-at-risk remaining steady at around 48 percent.

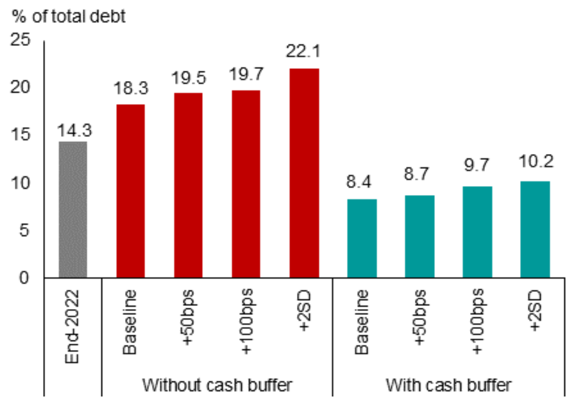
Figure 3.14 Stress Test Results

A. Firms-at-Risk



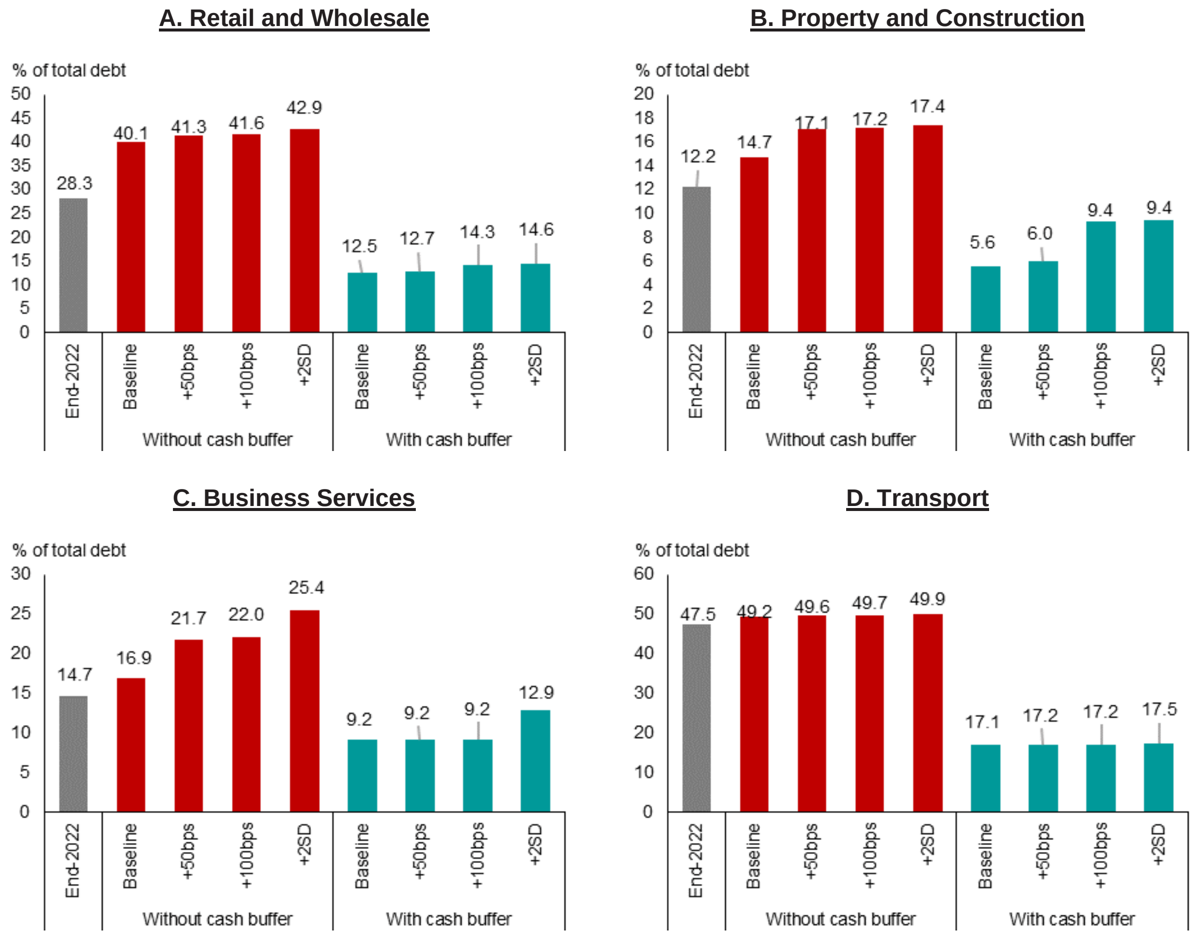
Source: AMRO staff estimates

B. Debt-at-risk



Source: AMRO staff estimates

Figure 3.15 Stress Test Results by Sector: Debt-at-Risk



Source: AMRO staff estimates

Policy Recommendations

7. Based on the results of the stress tests, the implication of interest rate hikes on corporate distress varies across firm types and sectors. While there are pockets of vulnerabilities, the likelihood of potential systemic risks is somewhat limited as the impact of additional interest rate hikes on overall debt-at-risk appears incremental. Nonetheless, policy recommendations could be made in the areas of corporate sector monitoring, transparency, and risk management, as follows:

a. **Enhance regulatory oversight:** The Securities and Exchange Commission (SEC), as the primary regulatory body for corporations, could strengthen the monitoring framework further, especially for companies with high debt exposure. This may require additional resources to enable the SEC to perform this task more effectively, in addition to overseeing registration processes, reviewing and approving the registration statement of companies for listing in the stock market, and facilitating information disclosure among others.

b. **Utilize digital data collection for risk monitoring:** The SEC has stepped up efforts to adopt digital technology to enhance the ease of doing business, including processing of applications for registration (SEC-ESPARC) and payment (SEC-eSPAYSEC), which has proven beneficial for investors and capital market institutions. The SEC has also collected companies' financial statements online (SEC-eFAST); however, the information is now being utilized for market decision-making rather than for risk monitoring by the SEC. Therefore, digital methods should be further adopted for risk monitoring purposes. A digital platform can offer more timely, accurate, and exhaustive data, leading to improved risk assessment and decision-making.

c. **Promote hedging practices**: Corporates should be well-informed and encouraged to use hedging instruments, especially in a volatile economic environment. This can help mitigate potential losses and lessen the impact of volatile financial markets on the balance sheet. Hedging could be done to cover interest rate risks, for example, by using interest rate swaps, and to cover foreign exchange risk by using foreign exchange derivatives.

d. **Deepen the bond market:** A well-functioning bond market can provide the corporate sector with an alternative source of financing. This will require a broader investor base to help improve market resilience and price discovery (paragraph 40 in the main report gives specific policy recommendations on bond market development).

Reference

Damodaran, Aswath. 2016. "Podcast Valsession7." Stern School of Business, New York University, New York. https://pages.stern.nyu.edu/~adamodar/New_Home_Page/valquestions/syntrating.htm

Lim, Cheng Hoon and Charles Woodruff. 1998. "Managing Corporate Distress in the Philippines: Some Policy Recommendation." IMF Working Paper No. 98/138. https://www.imf.org/en/Publications/WP/Issues/2016/12/30/Managing-Corporate-Distress-in-the-Philippines-Some-Policy-Recommendations-2748

4. Infrastructure Investment in the Philippines: Challenges and Policy Considerations[116]

Given the importance of infrastructure for sustainable development, it is imperative to identify the factors underpinning the slow pace of infrastructure development in the Philippines and discuss policy options for efficient and effective infrastructure investment. This selected issue assesses the state of infrastructure in the Philippines based on various measures and provides policy recommendations to enhance infrastructure investment in terms of both quantity and quality.

Background

1. **Infrastructure investment is important for promoting economic growth and reducing the poverty rate.** In the near term, public infrastructure investments can boost aggregate demand and crowd in private investments, contributing to robust economic growth. Economic development theory suggests that accumulated infrastructure stock is an important factor for production and contributes to higher productivity growth. In particular, in emerging economies and low-income developing countries with a large infrastructure gap, infrastructure investment is even more critical to enhancing their growth potential for sustainable development and poverty reduction.[117]

2. **A slow pace of infrastructure development is one of the key challenges facing the Philippines.** Infrastructure development in the Philippines has been lagging behind peer economies. To address the infrastructure gap, the Build! Build! Build! (BBB) program was launched in 2017, superseded by the Build Better More (BBM) program in 2022. Infrastructure flagship projects (IFPs) under the BBM program have been and will be implemented by various funding sources, including the government budget, official development assistance (ODA), and public-private partnership (PPP). Nevertheless, expanding public infrastructure investment from the government budget would be challenging, given fiscal consolidation needs in the post-pandemic era. Against this backdrop, this selected issue aims to assess the state of infrastructure development in the Philippines and suggest policy considerations for effective and efficient infrastructure investment, in four aspects: (i) strategic prioritization of infrastructure projects; (ii) role-sharing between the public and private sectors; (iii) addressing factors that impede infrastructure development; (iv) expanding public infrastructure spending while maintaining debt sustainability.

Infrastructure Investment, Capital Stock, Quality, and Efficiency

3. **Compared to peer economies in the region, infrastructure investment in the Philippines has been relatively low, consequently resulting in low capital stock.**[118] Infrastructure investment as a percentage of GDP had declined in the past two decades before showing an uptick in the late 2010s (Figure A4.1). Consequently, infrastructure capital stock has continued to decline. In per capita terms, the Philippines has posted one of the lowest infrastructure stock in the ASEAN+3 region (Figure A4.2). However, the government has ramped up public infrastructure spending since 2016 and plans to maintain it at 5-6 percent of

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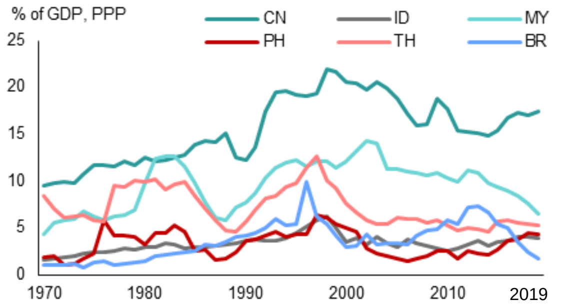
[116] This selected issue was prepared by Byunghoon Nam, Senior Economist.
[117] Please see ADB (2017) and the reference therein.
[118] Since infrastructure investment and cumulated stock data is not readily available for most countries, public and public-private partnership (PPP) investment and capital stock are used as proxies. Public capital investment is measured by the gross fixed capital formation (GFCF) of the general government. PPP investments in emerging economies and low-income developing countries are based on the World Bank's Private Participation in Infrastructure (WB PPI) database. Since the WB PPI database provides the total value of PPP investment commitments at contract signature or financial closure, annual PPP investments are derived by spreading the value of PPP project commitments over five years. See Nam (2023) for the methodology.

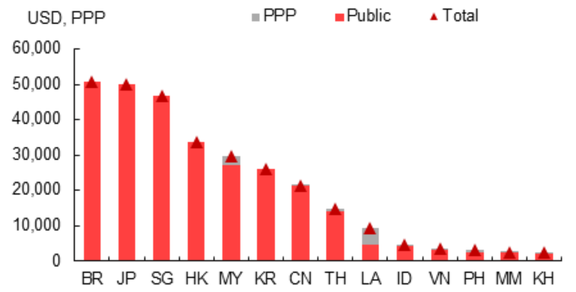
GDP over the medium term. As a result, the share of infrastructure outlays in total fiscal expenditure is expected to reach almost 30 percent by 2028 (Figure A4.3). On the other hand, the Philippines has actively utilized the PPP scheme to develop infrastructure, compared to other regional peers (Figure A4.4).[119] PPP investment has been the highest in the electricity sector (60 percent of total investment), followed by water and sewerage, roads, airports, railways, and seaports.

Figure A4.1 Infrastructure Investment: Selected ASEAN+3 Economies



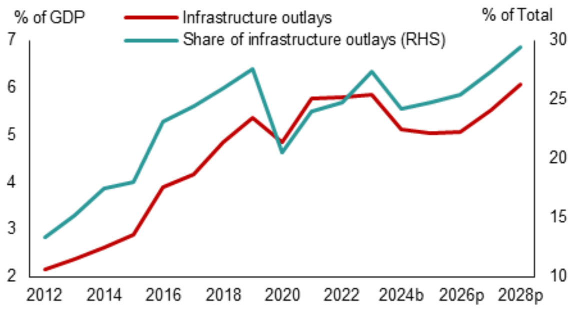
Source: IMF Investment and Capital Stock Database (ICSD); AMRO staff estimates

Figure A4.2 Infrastructure Stock per Capita: ASEAN+3 Economies



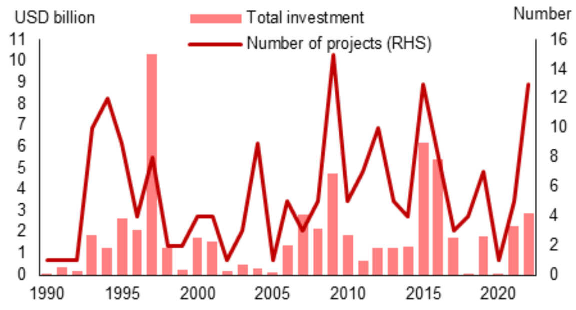
Source: IMF ICSD; AMRO staff estimates
Note: Infrastructure stock per capita is as of 2019.

Figure A4.3 Capital and Infrastructure Outlays



Source: Department of Budget and Management; AMRO staff estimates
Note: The share of infrastructure outlays is computed by infrastructure outlays / total expenditure.

Figure A4.4 PPP Projects



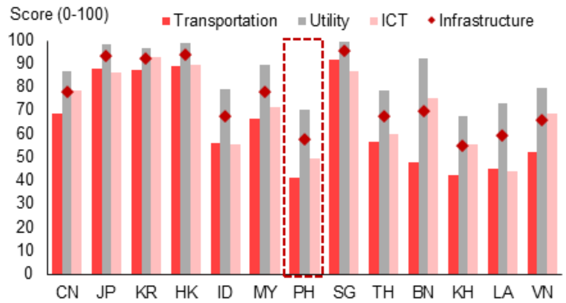
Source: World Bank, Private Participation in Infrastructure (WB PPI)
Note: The total value of PPP investments is based on the commitments at contract signature or financial closure.

4. Low infrastructure investment and stock, together with inefficient investment, have led to low infrastructure quality in the country. Infrastructure quality, as measured by the Global Competitiveness Index (GCI) of the World Economic Forum (WEF), is assessed to be low, mainly due to low investment in the previous two decades, as discussed earlier (Figure A4.5). Transportation infrastructure is the weakest sector, followed by ICT and utility sectors. A strong participation of PPP projects in the electricity and water/sewerage sectors seems to have helped maintain the quality of utility infrastructure, compared to other sectors.[120] Infrastructure quality depends not only on the size of the infrastructure investment, but also on the efficiency of those investments. Plotting infrastructure quality against infrastructure capital stock per capita demonstrates the efficiency of the infrastructure investment (Figure A4.6). The efficiency gap can be measured conceptually by the vertical distance from the

[119] As of 2019, the share of PPP in infrastructure capital stock in the Philippines was 18.4 percent, compared to 10.2 percent in Indonesia, 7.8 percent in Malaysia, 6.0 percent in Thailand, and 7.3 percent in Vietnam.
[120] The transportation infrastructure score reflects road connectivity, quality of road, railway density, efficiency of train services, air connectivity, efficiency of air transport services, liner shipping connectivity, and efficiency of seaport services. The utility score reflects electricity access, electricity supply quality, exposure to unsafe drinking water, and reliability of water supply. The ICT score reflects mobile telephone/broadband subscription, fixed broadband subscription, fibre internet subscription, and internet users.

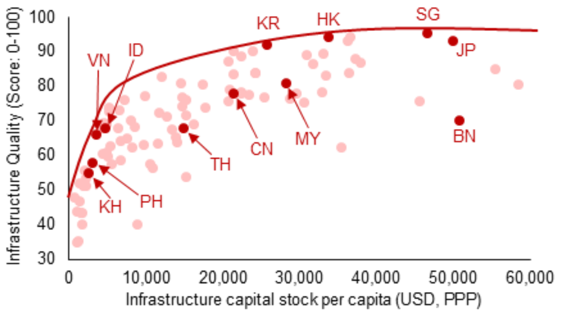
efficiency frontiers at each infrastructure capital per capita level. In the case of the Philippines, there exists an efficiency gap, albeit not large, suggesting room to improve the efficiency of infrastructure investment.

Figure A4.5 Infrastructure Quality



Source: WEFGCI 2019

Figure A4.6 Infrastructure Stock per Capita and Infrastructure Quality

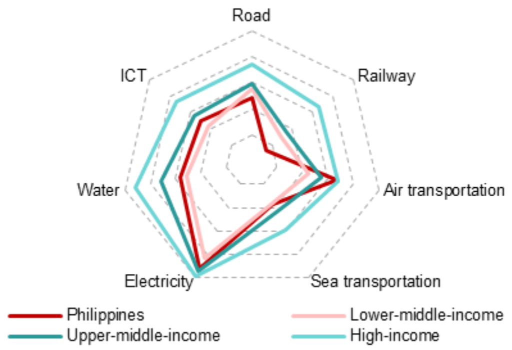


Source: IMF ICSD; WEF, GCI 2019; AMRO staff estimates
Note: The figure shows the infrastructure quality and stock per capita of 96 countries, comprising advanced economies, emerging market economies, and low-income developing countries across all continents.

Strategic Prioritization of Infrastructure Investment

5. Given limited resources, the authorities should prioritize infrastructure projects. Project priority should align with the national development plan. Close integration of the projects with other development initiatives, such as special economic zones and industry clusters, will create synergy. In addition, the authorities should identify and prioritize weak infrastructure that is a drag on national/regional development and people's livelihoods. To equip the country with quality infrastructure comparable to upper-middle-income countries, more investment is required, especially in water, railway, and road infrastructure (Figure A4.7). Different industrial landscapes and infrastructure needs across regions should also be taken into account. At the same time, strategic investment in projects that can promote economic growth with high spillovers and network impacts would also foster national development.

Figure A4.7 Infrastructure Quality Comparison



Sources: WEF, GCI 2019

Role-sharing Between Public and Private Sectors

6. The government plans to boost infrastructure investment through strong public and private engagement. The Philippines Development Plan 2023-2028 focuses on strategies to boost the infrastructure drive by (i) maintaining annual fiscal spending on infrastructure at 5 – 6 percent of GDP in the medium term; (ii) promoting PPP with the advanced legal framework (PPP Law); and (iii) undertaking reforms to raise investments. Infrastructure flagship projects (IFPs) under the BBM program will be implemented in various sectors with various funding sources. Physical connectivity will be the focus, followed by water resources and agriculture (Table A4.1). ODA and the government budget will still be the primary funding sources, while PPP will contribute to a substantial share of investment financing (Table A4.2).

Table A4.1 IFPs by Sector and Stage

	Number
Total	197
Physical Connectivity	122
Water Resources	44
Agriculture	15
Health	6
Digital Connectivity	5
Power and Energy	1
Other	4

	Number
Total	197
Completed	1
Ongoing	71
Approved	29
For government approval	8
Under project preparation	53
Pre-project preparation	35

Source: National Economic and Development Authority (NEDA)

Table A4.2 IFPs by Funding Source

	Number	Cost (PHP billion)
Total	197	8,739
ODA	76	4,593
Government budget	62	1,447
PPP	47	2,301
ODA/PPP	1	65
Government budget/PPP	1	94
TBD	8	204

Source: NEDA
Note: PPP includes supplemental toll operation agreements and the port terminal management regulatory framework.

7. To better utilize the available funding sources for overall infrastructure development, role-sharing between the public and private sectors should be discussed.

- The waning nature of infrastructure as public goods has enabled private participation. The rationale behind the provision of infrastructure by the government is based on the concept of public goods (non-rivalry, non-excludability) and market failures (externality, natural monopoly). Private participation in infrastructure development has been growing as the externality and monopolistic power of infrastructure or public services are increasingly being addressed by market pricing and institutions (e.g., tolls and charging fees), technological competition (e.g., mobile services, renewable energy), and regulatory frameworks. Nonetheless, the government still needs to take the lead in providing infrastructure so that there can be universal access to basic infrastructure and public services (e.g., education, basic transportation).

- The suitability of the government or PPP in providing specific projects and services depends on their characteristics. For example, PPP is suitable for large-scale transportation infrastructure projects if the upfront costs are expected to be recovered by user tolls/fees and/or regular payment by the government over the life of the contract. In general, a well-designed PPP contract offers advantages over public procurement in terms of mobilizing private financial resources and know-how, promoting efficiency, and improving service quality. On the other hand, the government should continue to provide basic transportation infrastructure (e.g., farm-to-market roads, detours to highways), of which costs should be funded by taxes. Another example is that mobile services and electricity generation by renewable energy can be operated by the private sector under the oversight of the authorities, while the overall telecommunication and electricity distribution should be managed by the government to guarantee universal access and fair prices.

8. Benefits from the role-sharing between the public and private sectors are warranted if the PPP is well designed and managed under a sound legal and policy framework.

- First, PPP projects should undergo a feasibility study and subject to the same standards as for public investment projects. That is, PPP should not be a means to circumvent budgetary review. Low-quality and/or less-prioritized projects that would otherwise be excluded from the public investment plan should not be considered for PPP.

- Second, the government should share risks efficiently between public and private parties to provide the right incentives while minimizing contingent liabilities to the government. The authorities should be mindful that poor PPP contract design with minimum income guarantees under optimistic demand and revenue assumptions may result in additional fiscal costs.

- Third, PPPs require a well-established legal and policy framework that clearly articulates the appraisal, approval, monitoring, review, and resolution processes. The newly proposed PPP law is expected to provide a comprehensive legal framework for PPP in the Philippines.

- Lastly, solicited PPP is preferable to unsolicited PPP. Unsolicited proposals may carry potential benefits in identifying and assessing new projects, and in providing innovative solutions to challenges. However, given that unsolicited proposals by nature do not originate as a part of the government's plans, the proposed projects may not be sufficiently linked to national/regional/sectoral plans that are based on social and economic needs. Moreover, the government may incur additional fiscal costs and contingent liabilities if the unsolicited projects have not been adequately assessed through a cost-benefit analysis or assessed for the associated risks. The lack of transparency and competitiveness in the procurement process may also result in low value for money and invite opportunities for corruption. Thus, it is recommended to prioritize solicited projects, while approving unsolicited proposals only if they are well aligned to national plans and the potential risks are contained by legal and policy arrangements.[121]

Addressing the Factors Impeding Infrastructure Development

9. In addition to physical infrastructure investment, infrastructure quality is driven by various factors that affect investment efficiency. The Global Infrastructure Hub provides scores for eight drivers of infrastructure quality: governance, regulatory framework, permits, planning, procurement, activity, financial market, and funding capacity. 41 individual metrics for the eight drivers are selected regarding their linkages to efficient and effective infrastructure (Table A4.3).[122]

Table A4.3 Drivers of Infrastructure Quality

	Definition	Metric
Governance	Governance, institutions (including rule of law, corruption prevention), and legal environment required to support infrastructure investment	Recovery rate, Rule of law, Post-completion reviews, Shareholder governance, Political stability and absence of violence score, Infrastructure or PPP agency
Regulatory Framework	The extent to which regulation, openness to investment, and competition frameworks support infrastructure delivery	Regulatory quality, Strength of insolvency framework, Prevalence of foreign ownership, Product market regulatory score and network sectors, Effect of taxation on incentives to invest, Investment promotion agency
Permits	The efficiency of planning and licencing procedures for the issuance of permits and acquisitions of land required for development	Cost to start a business, Quality of land administration, Time required to start a business, Registering property, Dealing with construction permits
Planning	A government's ability to plan, coordinate, and select infrastructure projects	Preparation of PPPs, Published infrastructure plan, Published project pipeline, Economic analysis assessment, Market sounding and/or assessment, Environmental impact analysis

[121] See World Bank (2017), "Policy Guidelines for Managing Unsolicited Proposals in Infrastructure Projects."
[122] See Deloitte (2020) for the detailed methodology.

	Definition	Metric
Procurement	The extent to which procurement processes and bid management frameworks are standardized, transparent, and non-onerous to bidders	Published infrastructure procurement guidelines, Transparency in public procurement, Procurement of PPPs, PPP contract management, Average procurement duration
Activity	The extent and nature of recent infrastructure investment activity and extent of private sector involvement over the last five years, relative to the size of the economy	Infrastructure investment, Value of closed PPP infrastructure deals, Private infrastructure investment, Value of close infrastructure deals with foreign equity sponsorship
Financial Market	Strength and capability of local financial markets	Financial depth, Domestic credit to private sector, Stocks traded, Financing through local equity market, Financial stability
Funding Capacity	Stability and sustainability of the government's fiscal management	Summary credit rating, GDP per capita, Long term GDP growth trend, Gross government debt

Source: Global Infrastructure Hub

Figure A4.8 Strength of Infrastructure Driver

Sources: Global Infrastructure Hub

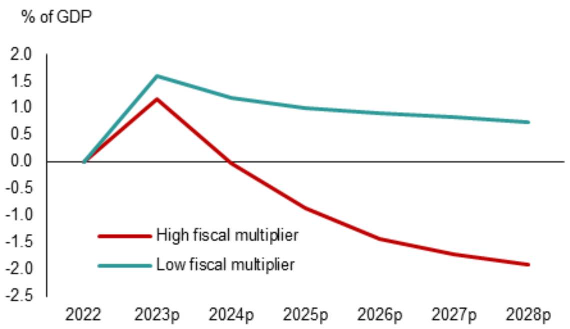
10. The assessment finds that the Philippines has strength in planning and regulatory framework, but weakness in permits and governance, compared to the upper-middle-income countries (Figure A4.8). [123] The weakness in governance stems from low recovery rates (making it difficult/expensive to obtain capital for infrastructure investments), high perception of the likelihood of political instability and uncertainty (discouraging long-term investment), and weak rule of law. Permits scored low in most metrics due to the low quality of land administration, the long time needed to register a property, and the long time and high costs to start a business. The procurement score is comparable to the average of upper-middle-income countries, but there is room for improvement in terms of transparency in public procurement and the average procurement duration. The bottom line is that the Philippines has strong planning capacity and tools, but needs to improve the overall business environment and governance structure and the institutions to support infrastructure investment.

Expanding Public Infrastructure Spending while Maintaining Debt Sustainability

11. Expanding public infrastructure spending worsens government debt sustainability in the short term but could improve debt dynamics over the medium to long term as it crowds in private investment and generates revenue. More public infrastructure spending will naturally lead to increases in the fiscal deficit and government debt in the short term, which may cause the government's fiscal consolidation plan to go off-track. On the other hand, theoretically, infrastructure investment will boost aggregate demand through the fiscal multiplier, and by crowding in private investment, given the highly complementary nature of infrastructures such as transportation, utilities, and ICT with manufacturing and other industries. Moreover, higher infrastructure stock will increase the overall productivity of the economy over the long term. Higher economic growth will then generate more fiscal revenue and reduce the government debt as a share of GDP over time. In this regard, it is vital to understand the impact of infrastructure investments on the economy and debt dynamics.

[123] See https://infracompass.gihub.org/ind_country_profile/phl/

Figure A4.9 Government Debt-to-GDP Ratio In Response to Public Investment Spending



Sources: Department of Budget and Management; AMRO staff estimates
Note: The figure represents the differences between the debt-to-GDP ratio without additional public investment (baseline) and the debt-to-GDP ratio with an additional two percent of GDP of public investment.

12. Investment efficiency is critical in order that public infrastructure spending can improve infrastructure while maintaining debt sustainability. Inefficiencies in the investment process, such as poor project selection, implementation, and monitoring, can result in only a fraction of public investment translating into productive infrastructure, limiting long-term output gains. Many empirical studies find larger multipliers in advanced economies than in emerging and developing economies, mainly due to investment quality and institutional efficiency.[124] Given that the fiscal multiplier, together with the elasticity of revenue to output, is a key variable that determines debt dynamics over time, we simulate the effect of an increase in public infrastructure spending on the debt-to-GDP ratio over the medium term with different assumptions of fiscal multiplier and its persistency.[125] Specifically, scenario 1 assumes the fiscal multiplier based on a bucket approach, suggested by Batini et al (2014), with persistent effects over four successive years, while scenario 2 assumes the half size and duration of the fiscal multiplier of scenario 1. The rationale behind the two alternative scenarios is that efficient investment will have a higher and more persistent fiscal multiplier than inefficient investment. The simulation results show that scenario 1 (efficient investment) will eventually see a reduced debt ratio compared to the baseline, while scenario 2 (inefficient investment) will end up with a higher debt ratio (Figure A4.9).

Conclusions

13. Infrastructure investment needs could be fulfilled through strategic resource allocation and role-sharing between the public and private sectors. Expanding and upgrading infrastructure is critical for sustainable growth and development in the Philippines. In the course of fiscal consolidation, setting strategic priorities will help maximize the benefits given limited fiscal resources. PPP can supplement public infrastructure spending through efficient role-sharing between the public and private sectors and improvement of the PPP design, management, and legal framework.

14. The expansion of infrastructure investment should be accompanied by the enhancement of investment quality. With an already-strong planning capacity for infrastructure development, the authorities are recommended to continue enhancing those factors identified as weak, such as permits, governance, and procurement. Considering that the macroeconomic and fiscal impacts of public infrastructure spending depend largely on investment efficiency, the authorities should pay more attention to strengthening public finance management (PFM) to increase infrastructure spending while ensuring fiscal sustainability.

[124] See IMF (2014) and Komatsuzaki (2019) among others.
[125] See Nam (2023) for the methodology.

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5. Digitalization of the Philippine Economy[126]

The recent development of digital infrastructure has paved the way for the Philippines to adopt digitalization – not only in the financial system but also in other sectors of the economy. Despite these developments, the Philippines has yet to catch up with its ASEAN peers in some areas. This selected issue aims to take stock of digitalization in the Philippines, and discusses the opportunities, challenges, and possible policy directions.

Background

1. An improved digital infrastructure over the past few years has allowed the Philippines to catch up with its ASEAN peers in some areas of digitalization, while in others, it is still lagging behind.[127] The roll-out of the National ID (PhilSys ID) system has facilitated digitalization. Furthermore, with increasing affordability of smartphones[128] and availability of faster internet connections,[129] more Filipinos have been able to access the internet[130] and take advantage of digital services. However, although the Philippines' mobile phone and internet access has caught up with its ASEAN peers (Table A5.1), the country is still lagging behind in various digital indicators, such as digital transformation and trade, digital government, and digital security (Table A5.2).

Table A5.1 Mobile Phone and Internet Access in ASEAN-5 and Vietnam

	Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam
Mobile phone ownership (%)	66	97	79 (2019)	89	87	77
Mobile-cellular subscriptions per 100 inhabitants	134	141	146 (2022)	147	169	139
Mobile-cellular network coverage (%)	98	98	99	100	99	100
Individuals using the internet (%)	62	97	89 (2022)	97 (2022)	85	74
Households with internet access at home (%)	82	95	77 (2022)	99 (2022)	89	81
Active mobile-broadband subscriptions per 100 inhabitants	115	125	141 (2021)	147	112	88

Source: Digital Development Dashboard of International Telecommunication Union, OoKla, PSA, National Telecommunications Commission
Note: All the numbers in the table are in 2021 except those stated otherwise in the parenthesis.

Table A5.2 Ranking of Digital Development in ASEAN-5 and Vietnam

	Digital Transformation and Digital Trade (2022)	Digital Government (2022)	Digital Security (2021)
Indonesia	59	77	24
Malaysia	36	53	5
Philippines	71	89	61
Singapore	2	12	4
Thailand	46	55	44
Vietnam	62	86	25
	Out of 131 countries	Out of 193 countries	Out of 182 countries

Source: Portulans Institute, United Nations E-Government Knowledgebase, International Telecommunication Union.

[126] Prepared by Andrew Tsang, Economist, and Tolakham Vann, Associate Economist.
[127] Digitalization of the economy is defined as transforming economic activities into digital forms.
[128] Mobile phone ownership was 79.01 percent (2019 data) and there were 146 mobile-cellular subscriptions per 100 inhabitants (2022 data).
[129] Mobile-cellular network coverage was 98.8 percent (2023 data), with an average broadband downloading speed of 50.29 Mbps (2022 data).
[130] The data shows 89.3 percent of individuals with internet access, 76.9 percent of households with internet access at home (2022 data), and 141 active mobile-broadband subscriptions per 100 inhabitants (2021 data).

Key Areas of Development in Digitalization

2. Trade and transactions: Digital trades and transactions thrived during the pandemic and have become part of Filipinos' daily lives. The digital economy[131] in 2022 contributed 9.4 percent to GDP and amounted to PHP2.08 trillion, an increase of 11 percent over the previous year.[132] The estimated number of employed people in the digital economy was 6.05 million in 2022, making up 13.2 percent of total employment. A report by Google, Temasek and Bain & Company estimated the gross merchandise value of e-commerce, transport and food delivery, online travel, and online media in the Philippines at around USD20 billion in 2022, equivalent to about 5 percent of GDP, and a 20 percent increase over the previous year.[133]

3. Financial system: Financial digitalization has progressed well with rapidly growing digital payments, the creation of digital banks, and processes in central bank digital currency (CBDC) and cross-border payment connectivity. The BSP launched Digital Payments Transformation Roadmap 2020-2023 in 2020 to outline the overall plan for financial digitalization, aiming to digitalize 50 percent of payments in terms of volume by 2023. As of end-2022, digital payments accounted for 42.1 percent of the total volume of payments.[134] Furthermore, the digital banking landscape has expanded with six digital banks and 285 FinTech companies providing innovative solutions in areas such as payments, lending, digital banking, and insurance, among others.[135] At the same time, the BSP took a cautious approach and imposed a two-year moratorium on electronic money issuer (EMI) licensing starting from 16 December 2021, allowing the BSP to rigorously monitor the EMI sector and prevent the misuse of e-money licenses. To develop a CBDC, in 2022 the BSP launched Project Agila, a pilot initiative to create its own wholesale CBDC that was expected to run until 2024.[136] For cross-border payment connectivity, the Philippines signed a Memorandum of Understanding (MOU) on Cooperation in Regional Payments Connectivity (RPC) with Indonesia, Malaysia, Singapore, and Thailand in November 2022.

4. Government: The government has taken initiatives to digitalize operations to increase the efficiency and transparency of public services, resource allocation and revenue collection while trying to capture potential tax revenues from the digital economy sector. The authorities introduced e-Government Master Plan (EGMP) 2022 to serve as the blueprint for a harmonized government information system. This plan outlines the Department of Information and Communications Technology's (DICT) intent to develop e-government systems through the digital transformation of basic services that cut across the whole-of-government

[131] The PSA defines digital economy as a broad range of activities including the utilization of information and knowledge as factors in production, information networks as a platform for action and how the information and communication technology (ICT) sector stimulates economic growth. The digital economy is composed of digital transactions covering digital-enabling infrastructure, e-commerce, and digital media and content.
[132] Of the total amount of digital transactions in 2022, digital-enabling infrastructure made up the largest share, amounting to PHP 1.60 trillion or 77.2 percent.
[133] The gross merchandise value of e-commerce in 2022 was USD14 billion, making up 3.5 percent of GDP. According to an alternative source, the U.S. International Trade Administration (2022), the Philippines' e-commerce market recorded USD17 billion of sales in 2021 and had 73 million active users.
[134] Digital payments such as PESONet and InstaPay have been growing significantly in terms of both the volume and value of transactions. In 2022, PESONet posted a transaction value and volume of PHP 6.4 trillion (around 12 percent of the value of digital payments) and 84.8 million transactions, which were five times and seven times, respectively, the value and volume in 2019, before the pandemic. Likewise, InstaPay increased significantly from 34 million transactions and PHP258.7 billion in value in 2019 to 548.7 million transactions and PHP3.5 trillion in 2022, accounting for around 7 percent of the value of digital payments.
[135] According to the 2023 Fintech Philippines Report, https://fintechnews.ph/wp-content/uploads/2023/08/Fintech-Philippines-Report-2023.pdf. Other areas include wealth management, property, RegTech, financial aggregators, cryptocurrency, crowdfunding, remittances, and e-wallets.
[136] On August 31, 2023, the BSP's Monetary Board approved the selection of Hyperledger Fabric as the technology which would be used for sandbox tests and building a CBDC prototype under Project Agila. The next phases of the project, from Q4 2023 to Q1 2024 will involve testing the wholesale CBDC technology to conduct round-the-clock 24/7 inter-institutional fund transfers in a sandbox environment.

approach.[137] The goal is to achieve "One Digitized Government" for the country. On the other hand, as the digital economy expands, close monitoring and regulation of digital service transactions is needed, including imposing taxes on these transactions to generate revenue. The House of Representatives approved a 12 percent value-added tax (VAT) on digital services in 2021. The Department of Finance (DOF) estimated that PHP10.66 billion of annual revenue could be generated from VAT on digital service transactions.

Opportunities and Challenges

5. The digitalization of the Philippine economy has brought forth a number of opportunities for the people and the government. First, financial inclusion has been enhanced through the use of digital ID, making it convenient for Filipinos to access digital services, such as digital banking and financial services. Second, electronic platforms and markets have not only created job opportunities but have also facilitated the flow of goods and services, especially during and after the pandemic. Furthermore, on the fiscal front, digitalization has enabled the government to collect taxes more efficiently and generate additional tax revenue from digital service providers. In addition, the delivery of government services has improved and become more efficient and transparent. In a nutshell, the digital transformation is poised to have a positive impact on the people's lives and the overall growth of the economy.

6. Nevertheless, several obstacles and issues need to be addressed. First, the digital infrastructure is still lagging behind. Despite the growth of e-commerce in the Philippines, challenges persist, pertaining to logistics and delivery, payment systems, and internet connectivity in some areas. Particularly in rural and remote regions, reliable and high-speed internet connections are often lacking, hindering digital inclusion and economic development. Furthermore, soft infrastructure is inadequate, as reflected in the labor force's digital skill gaps, people's resistance to digital transformation, and regulatory gaps and loopholes. In particular, regulations should be updated to keep up with the relentless development of technology, such as artificial intelligence (AI), blockchain, the Internet of Things (IoT) and big data.

7. As digitalization progresses, the country is also becoming more vulnerable to cyber threats, prompting more concerns about data privacy and cybersecurity. The Philippines is viewed as a vulnerable target. Kaspersky reported an increase of 432.75 percent in web threat attempts to Philippine-based websites, which brought the country from fourth place globally in 2021 to being the second most attacked nation in cyberspace in 2022. The Philippine National Computer Emergency Response Team (NCERT) handled 3,470 incidents from 2020 to February 28, 2023, and monitored 57,400 threats during the same period.[138] The country also ranks 45th among 175 countries on the 2023 National Cybersecurity Index (NCSI) of the eGov Academy.[139]

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[137] A number of initiatives to improve government services are being developed, including an Electronic Business Permits and Licensing System (eBPLS), Integrated Government Philippines (iGovPhil), and Philippine National Public Key Infrastructure (PNPKI). On the fiscal front, the government has also digitalized its operations through Electronic Filing and Payment System (eFPS), Electronic Receipt and Invoicing System (eRIS), Electronic Budget System (EBS), Government Integrated Financial Management Information System (GIFMIS) and so on.
[138] The top three monitored threats are malware or malicious code at 48.9 percent, data leakage at 12.5 percent, and compromised websites at 12.4 percent. And these threats often targeted government emergency response systems at 61 percent.
[139] In most of these rankings, the country received a good mark in cybersecurity policy, having adopted various laws related to cybersecurity and cybercrime, such as RA 10175 or the Cybercrime Prevention Act of 2012, and RA 9775 or the "Anti-Child Pornography Act" to name a few.

Policy Implications

8. While the Philippines has made notable progress in digitalization in recent years, gaps remain in the regulatory and policy landscape that warrant attention. To ensure a smooth digitalization process, the authorities should prioritize further development of digital infrastructure, the upgrading and upskilling of the workforce's digital skills, and the strengthening of the regulatory framework. The authorities have initiated various policies to promote digitalization, as outlined in Table A5.3, which is a step in the right direction. Nevertheless, developing and implementing appropriate regulations in a timely manner can be challenging due to rapid technological development, which often outpaces the regulatory development process. At the same time, to encourage further use of digitalization, appropriate regulations need to be in place to safeguard consumers from digital threats and vulnerabilities.

Table A5.3 Major Policy Initiatives to Digitalize the Economy

Policy Initiative	Details
PDP 2023-2028	Digitalization is one of the underlying themes. The plan highlights promoting digitalization to modernize agriculture and agribusiness to improve the efficiency of agri-food systems and the interoperability of AFF information systems by harnessing Fourth Industrial Revolution technologies, such as big data, block chain and Internet of Things. Digital connectivity will also be enhanced even in hard-to-reach places through the operationalization of the National Broadband Program, which aims to accelerate the deployment of fiber optic cables and wireless technologies across the country.
DICT's Four Priority Areas for Digitalization	DICT aims to bridge the digital divide, enhance workforce skills, and upgrade digital infrastructure through four priority areas: (1) digital innovation and inclusion; (2) digital governance; (3) digital workforce competitiveness; and (4) digital infrastructure and cybersecurity.
National Innovation Agenda and Strategy Document (NIASD) 2023-2034	The NIASD is the country's 10-year blueprint for improving innovation governance. It outlines the agenda vision, long-term goals, and strategies to achieving a smart and innovative society. To set up a dynamic innovation ecosystem innovation infrastructure will be improved, in which physical and digital structures, equipment, and tools shall be accessible and available to translate ideas into innovation.
DBM's 2022-2026 Digital Transformation Roadmap	The Department of Budget and Management (DBM) launched a Digital Transformation Roadmap (2022-2026) to support President Marcos' Executive Order No. 29, requiring all government agencies to adopt an Integrated Financial Management Information System (IFMIS) as part of his administration's digitalization efforts. The roadmap aims to improve digital efficiency and future-proof the bureaucracy, especially in fiscal management. It also seeks to improve digital payments, which constituted 42 percent of total retail payments in 2022 and are on track to reach the BSP's 50 percent target.
Digital Technology and Digital Skills Roadmap (RA 11927)	The roadmap provides for national directions in digital technology and digital entrepreneurship that aim to upskill, re-skill and train the Filipino workforce to address digital skills gaps.
Philippine Creative Industries Development Plan (RA 11904)	The plan outlines comprehensive digital acceleration of creative industries, provides creative businesses with access to digital services and training platforms, and offers financial and technical support to aid them in the development and creation of digital platforms and innovations.
BSP's Digital Payments Transformation Roadmap 2020-2023	The objectives of the roadmap are to digitalize 50 percent of total retail payment volumes and cover 70 percent of Filipino adults in financial inclusion Measures by 2023. The roadmap is anchored in three pillars: (i) digital payment streams; (ii) digital finance infrastructure; and (iii) digital governance and standards.
National Strategy for Financial Inclusion (NFSI) 2022-2028	The NFSI aims to improve financial inclusion, while a digital infrastructure is one of the main development areas.
E-Government Master Plan under the proposed E-Government Act	The plan aims to establish a digitally empowered government, providing secure citizen-centered services and utilizing open data for economic growth.
National Cybersecurity Plan 2023-2028	The plan aims to strengthen the security and resilience of the Philippine cyberspace by partnering and collaborating with the private sector. Under NCSP 2028, two significant laws must be legislated to strengthen cybersecurity. These are the National Cybersecurity Act and the Critical Information Infrastructure Protection Law.

AMRO
ASEAN +3 MACROECONOMIC RESEARCH OFFICE

Address: 10 Shenton Way, #15-08
MAS Building, Singapore 079117
Website: www.amro-asia.org
Tel: +65 6323 9844
Email: enquiry@amro-asia.org

LinkedIn | Twitter | Facebook