Philippine Institute for Development Studies

Macroeconomic Prospects of the Philippines in 2023 & 2024: Prospects and Perils

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Margarita Debuque-Gonzales
Mark Gerald Ruiz
Ramona Maria Miral

Prospects and Perils — Outline

1. Macro performance in 2022 & 2023
2. Macro conditions going into 2024
3. Macro projections for the year
4. Risks and recommendations

❶ Macro performance in 2022 & 2023

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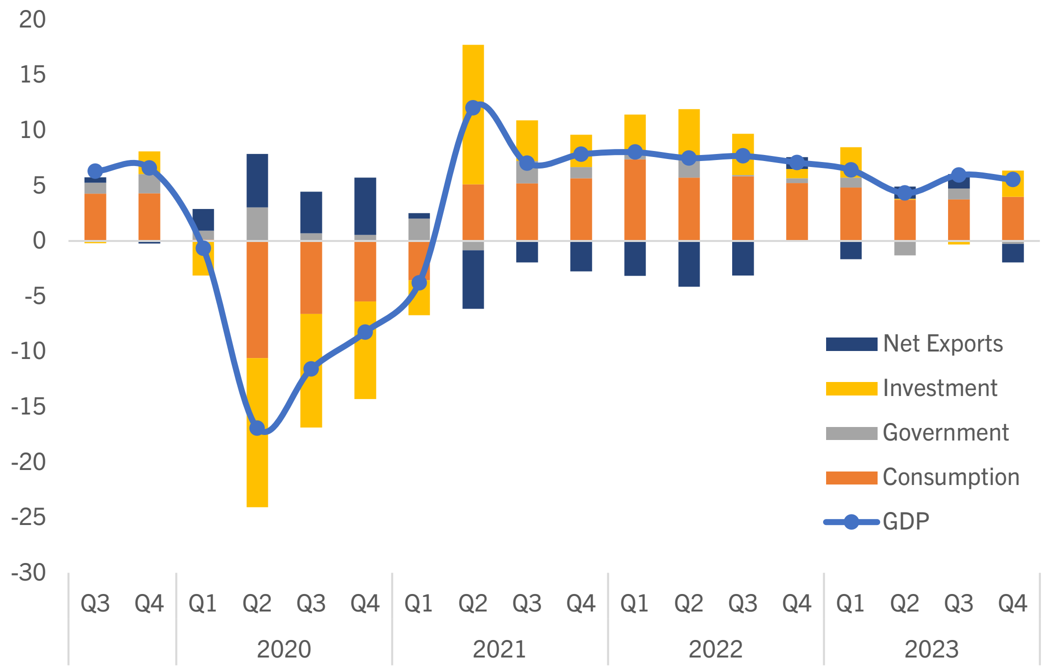
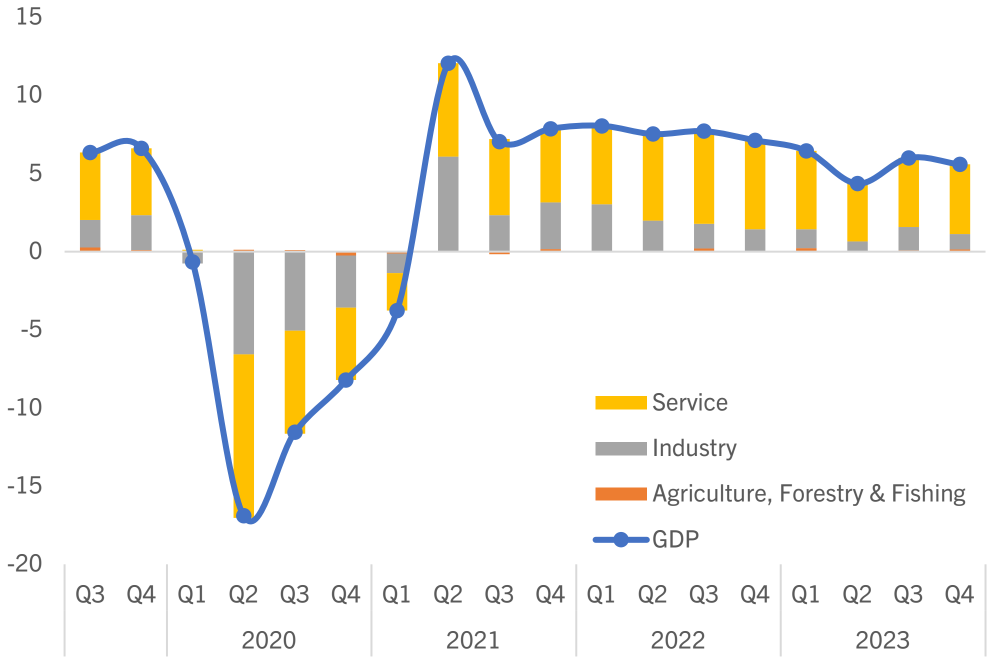
The economy's reopening supported economic activity in 2022, with some momentum maintained until the first quarter of 2023



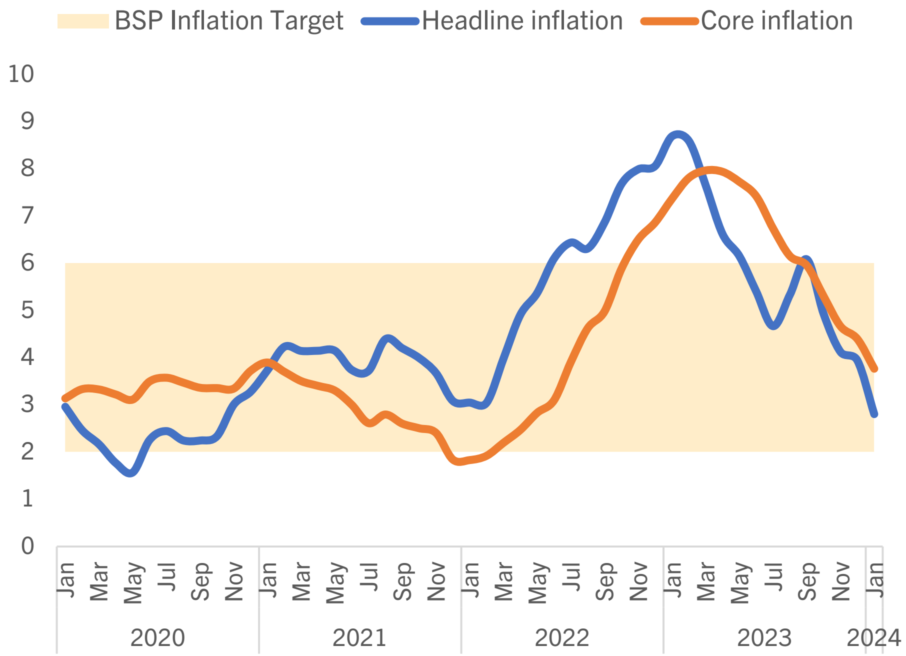
- Consumption (up 8.3%) and investment (13.8%) propelled growth on the spending side in 2022 (7.6%) but started to soften in the first half of 2023.
- A sharp reduction in public spending occurred in the second quarter of 2023 (-7.1%), pulling down overall growth.
- Trade deficit in goods and services continued to widen in 2022 as imports grew faster than exports during the recovery period, though this trend momentarily reversed.

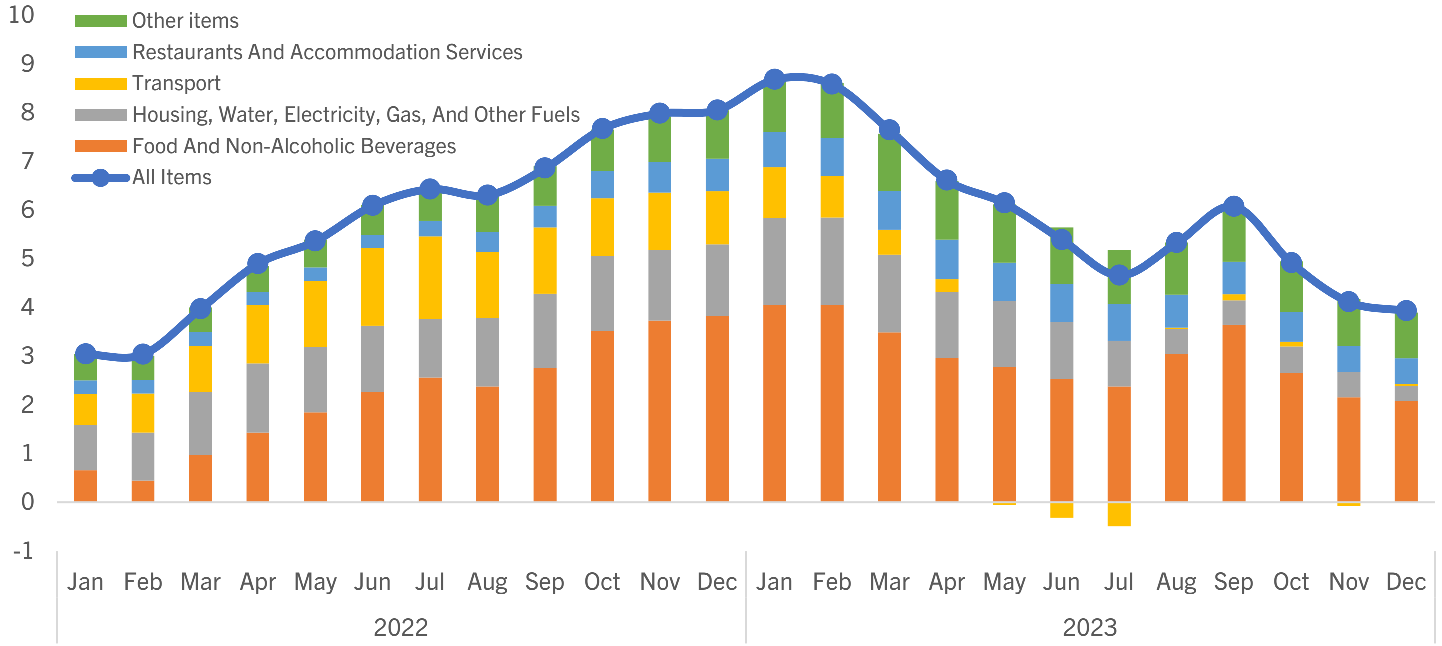


- Services (up 9.2%) powered growth on the production side, with industry (6.5%) continuing to provide support despite posting weaker growth.
- Services and industry decelerated in the first half of 2023, while growth in agriculture remained flat. Services trended upward in the second half.

❶ Macro performance in 2022 & 2023

Inflation rose throughout 2022, then peaked at 8.7 percent in January 2023

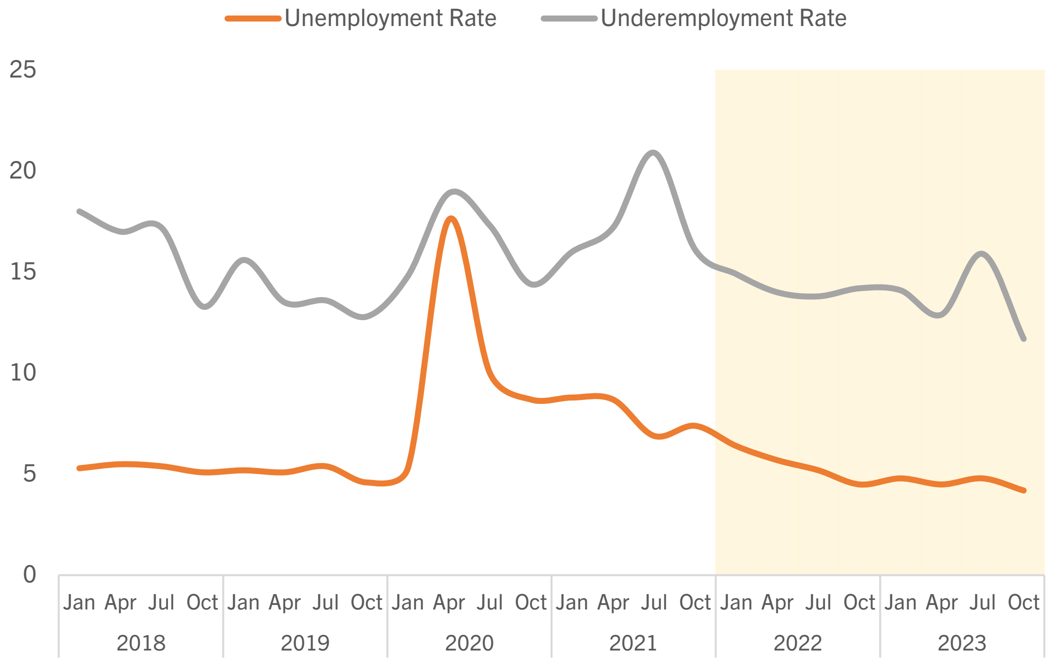


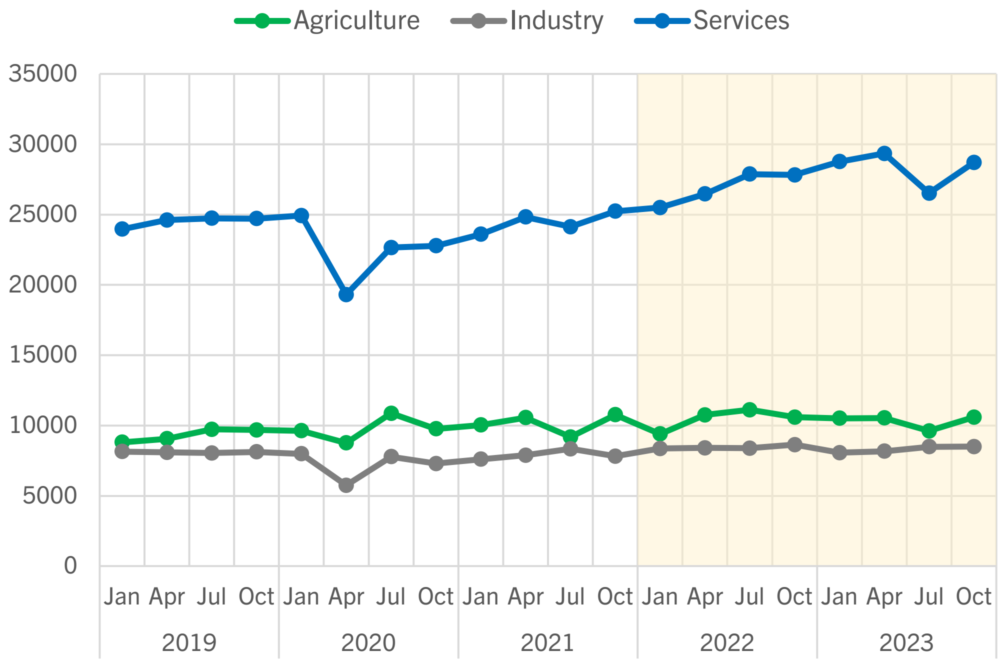


- Price pressures in food mainly propelled headline inflation. Next to food, housing and utilities were the second biggest contributors to headline inflation.
- In 2022, transport inflation rose by 12.9 percent on the back of gasoline and diesel prices, as global prices increased due to the Ukraine-Russia conflict.
- The upward trend in August to September of 2023 traces to inflation in food and non-alcoholic beverages.

➊ Macro performance in 2022 & 2023

Unemployment returned to pre-pandemic levels by the latter part of 2022 and remained below 5 percent in the first half of 2023



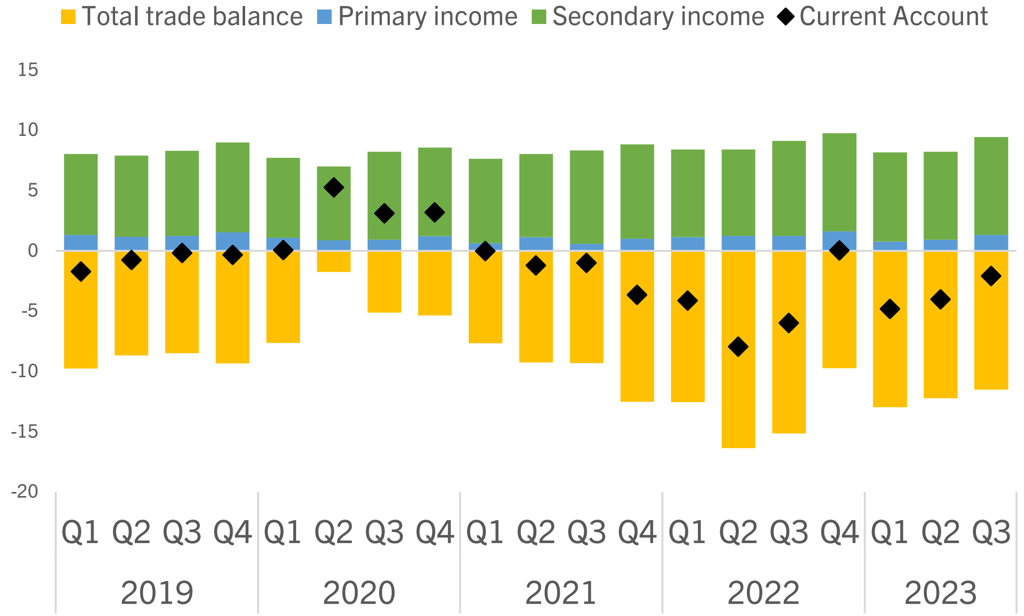


- Services continued driving overall employment, with the sector having a quarterly average of 26.9 million jobs in 2022.
- In 2023, employment in services rose from January to April. It shrank in July but recovered in the subsequent periods.

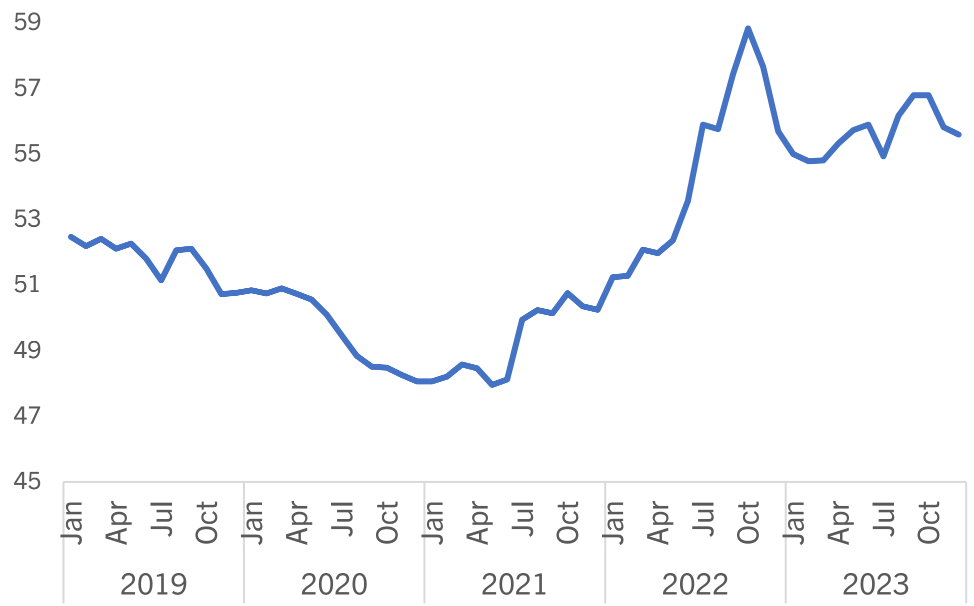
➊ Macro performance in 2022 & 2023

Overall external position turned from a USD 7.3 billion deficit in 2022 to a USD 3.7 billion surplus in 2023

- The current account deficit increased to USD 17.8 bn in 2022, from USD 5.9 bn in 2021, due to a wider trade deficit.
- The country's current account position has since improved, with lower trade deficit, and sustained remittances.

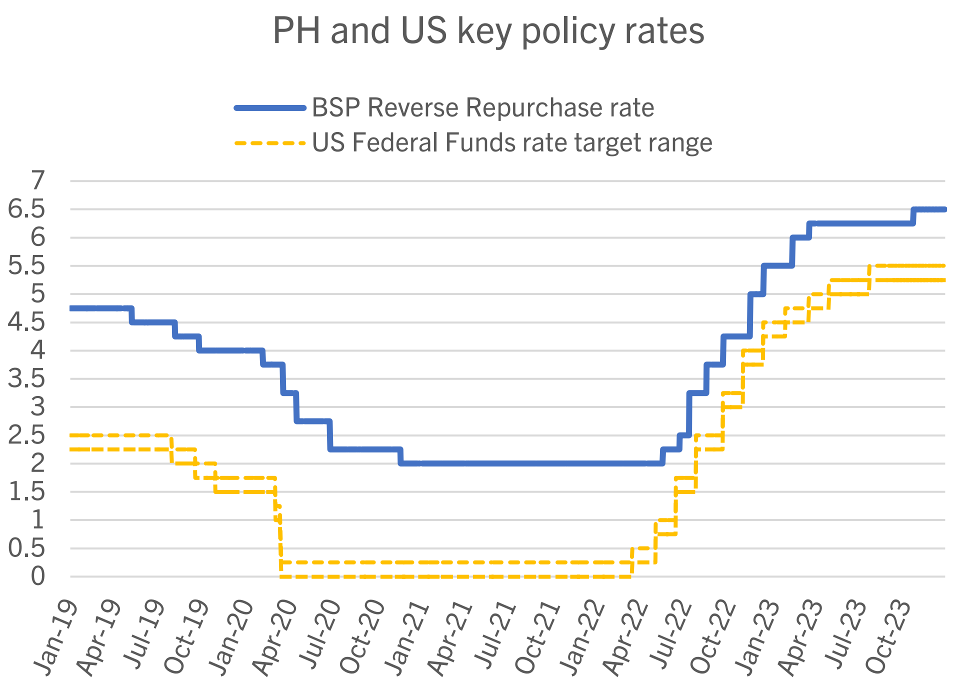


- The exchange rate averaged as much as 56.79 PHP/USD in September and October of 2022, then appreciated, averaging at 55.59 PHP/USD in December 2023.

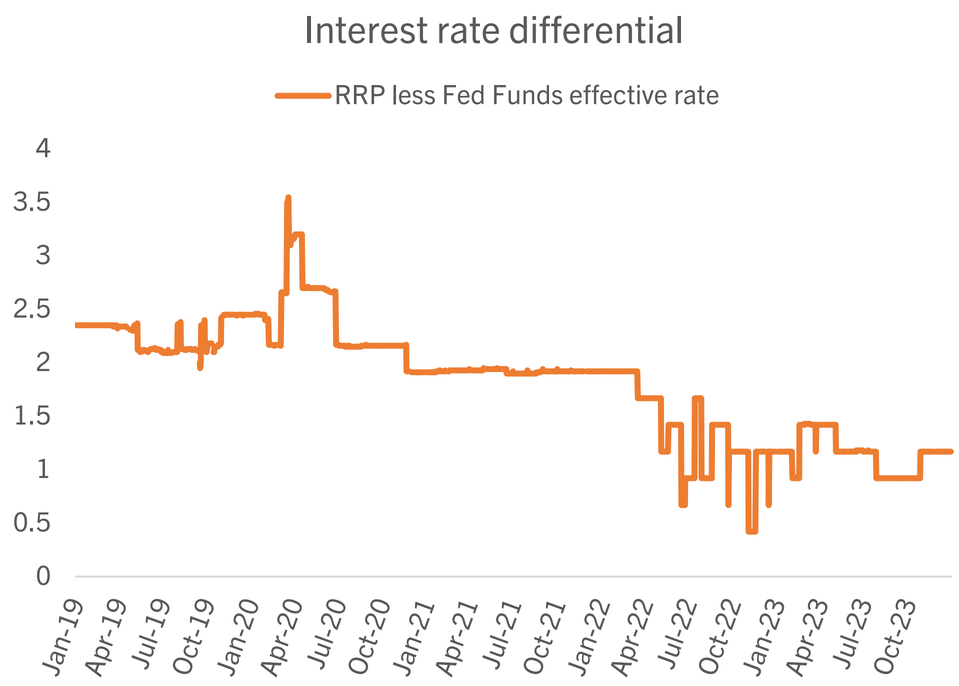


Monetary policy rates were momentarily held steady as inflation slightly eased

- Following the rate hikes from May 2022 to March 2023, BSP maintained the RRP at 6.25% before authorities decided on another 25-bps increase in October (6.5% at end-2023).



- The differential between Philippine and US key policy rates remained below 150 bps in the second half of 2023.

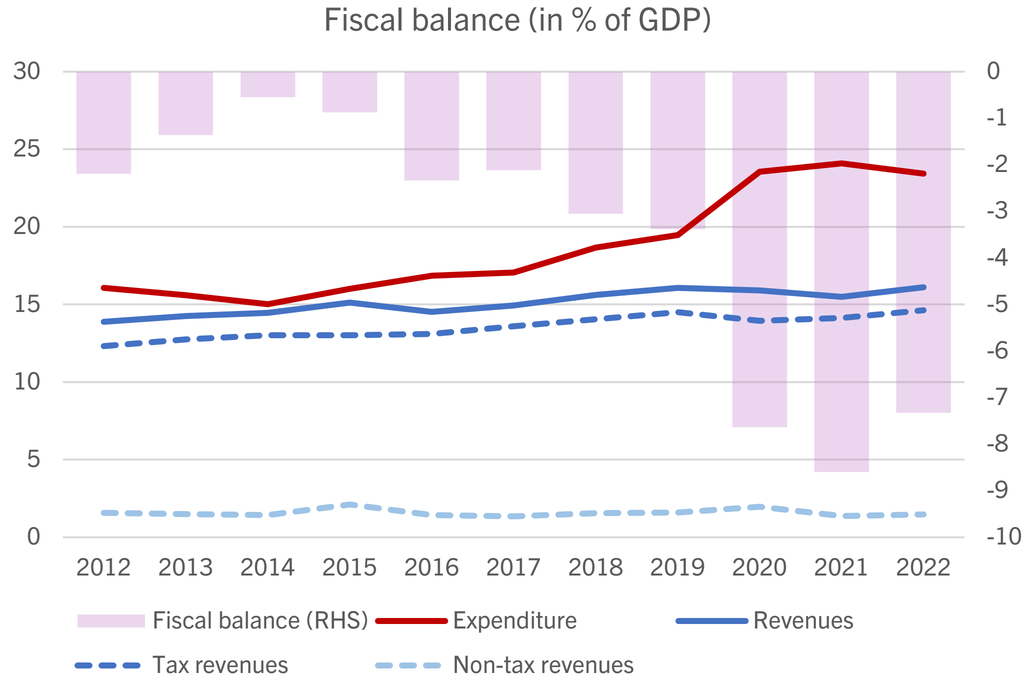


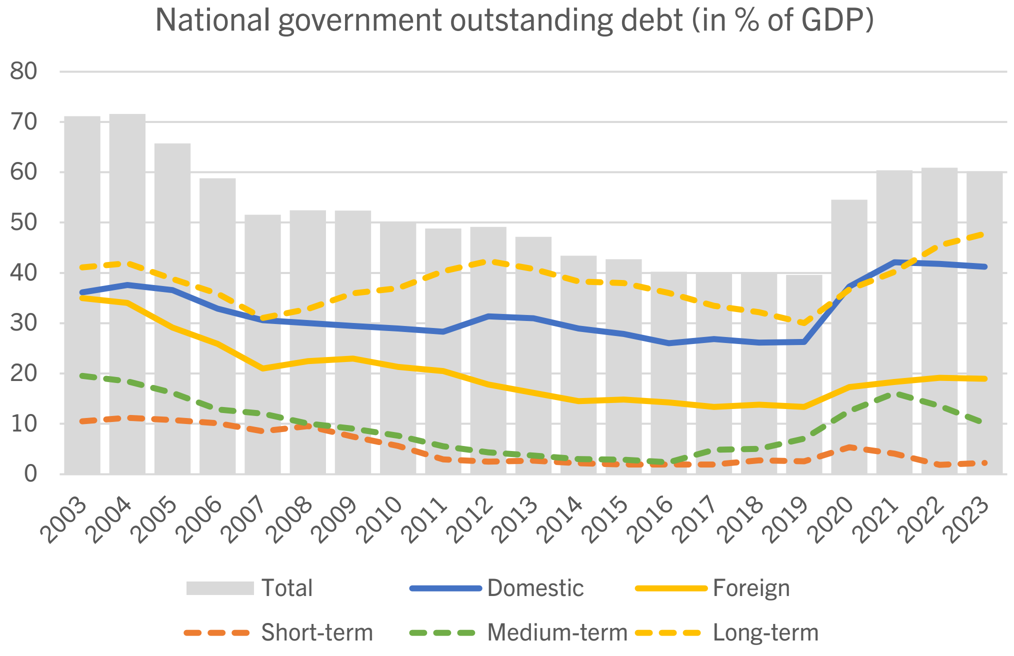
- The reserve requirement ratios (RRR) against selected peso deposit and deposit substitute liabilities were cut by the BSP in June 2023. There was simultaneous unwinding of some pandemic relief measures.

Lower fiscal deficit on the back of lower-than-programmed disbursements and higher revenue

- Fiscal deficit slightly narrowed to 7.3% of GDP in 2022.
- Q1 to Q3 (Jan to Sep) 2023 fiscal deficit was 5.7% of GDP, lower than the 6.5% recorded deficit in the same period in 2022

- Outstanding NG debt remained at about 60% of GDP in 2023; 79.4% of this were in long-term tenors, and 68.5% comprising domestic debt.





❷ Macro conditions going into 2024

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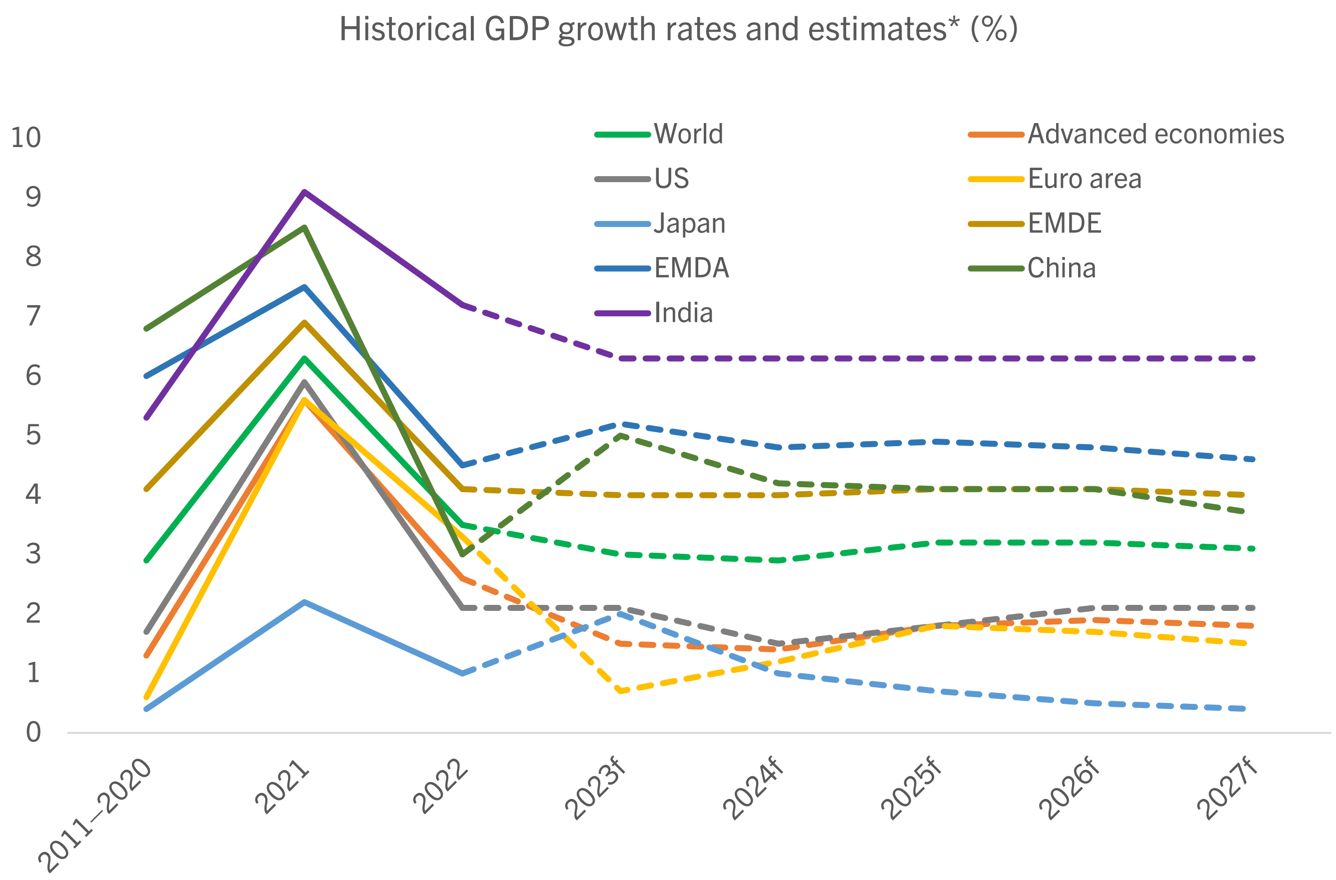
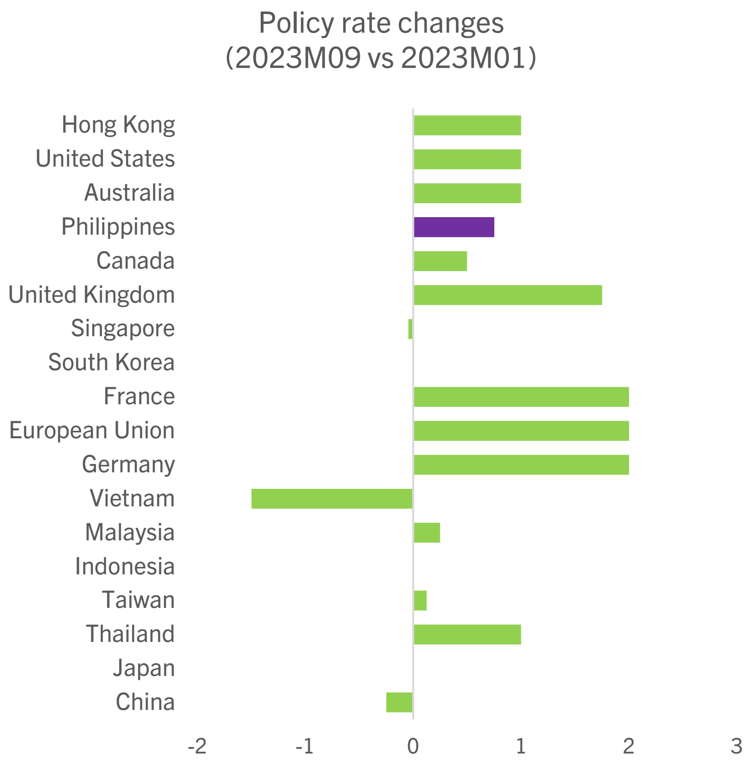
Global macroeconomic outlook remains uncertain

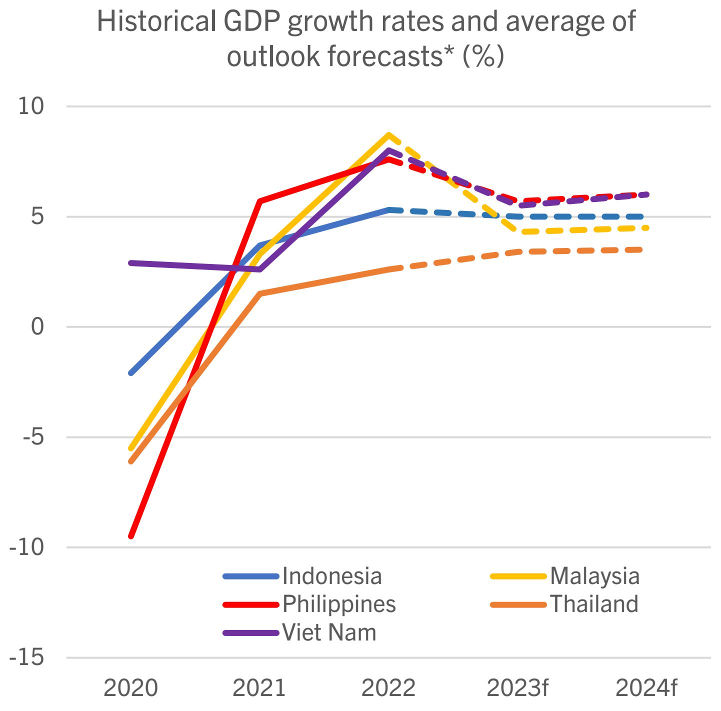


*Forecasted figures are from the October 2023 edition of the IMF WEO

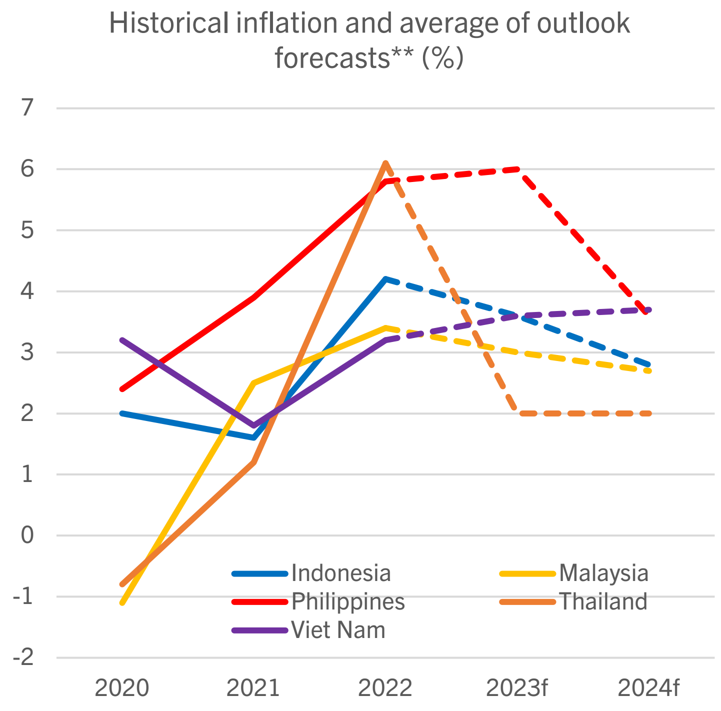
- Global economic recovery from the COVID-19 pandemic continued despite geopolitical and commodity price shocks, but the macro-economic outlook remains uncertain in 2024.
- Inflation has decelerated globally but remains high among EMDEs except in Asia, according to the IMF.
- The growth in trade is expected to experience a significant slowdown globally – from 5.1 percent in 2022 to 0.9 percent in 2023 – but may soon recover.

ASEAN-5 output is similarly anticipated to slow in the near term





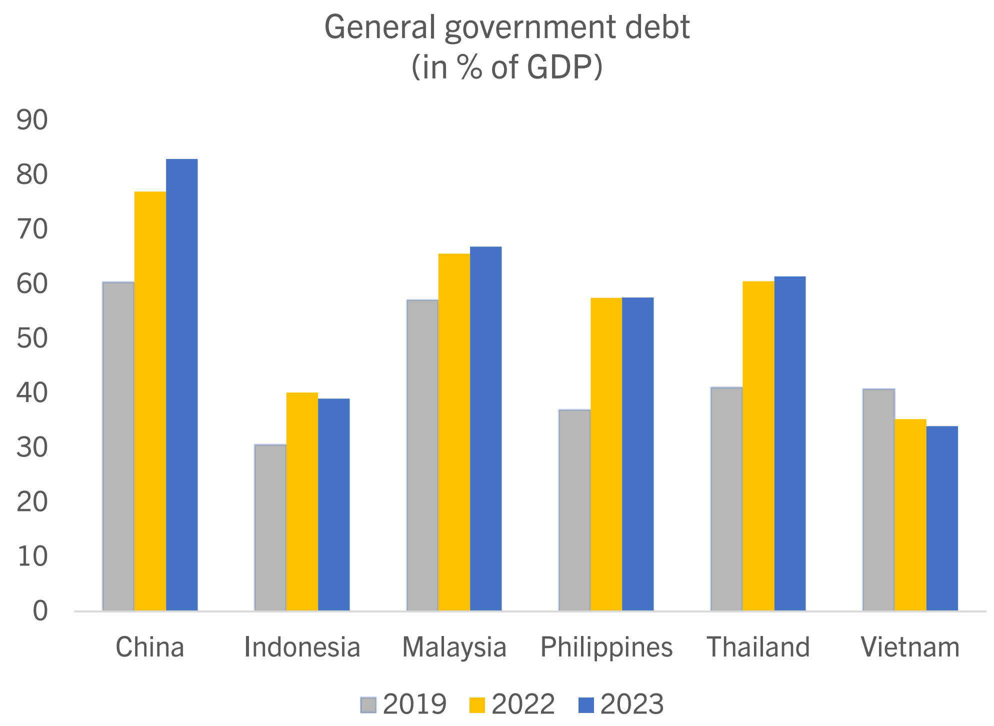
* Derived from the Sep 2023 ed of ADB ADO, Jun 2023 ed of WB GEP, and Oct 2023 ed of IMF WEO

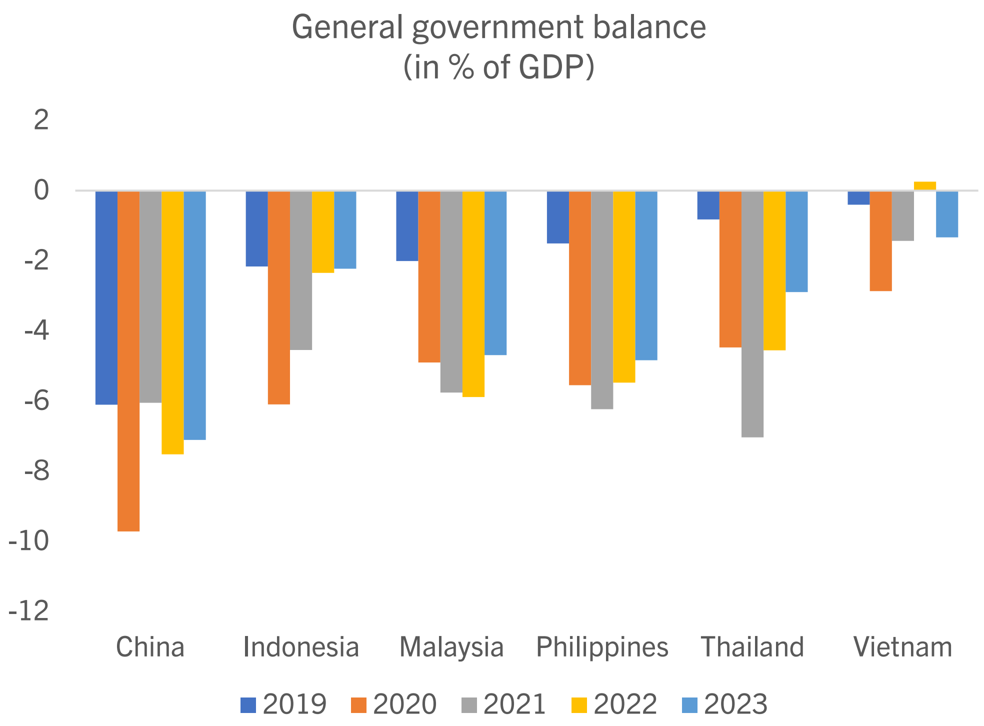


** Derived from the Sep 2023 ed of ADB ADO and Oct 2023 ed of IMF WEO

- ASEAN-5 output is similarly anticipated to slow in the near term, as the lagged effects of monetary policy rate increases play out and governments continue with their fiscal consolidation efforts.
- Monetary policies in most developing Asian economies tightened further in 2023, but monetary easing in the region may be expected by 2024.

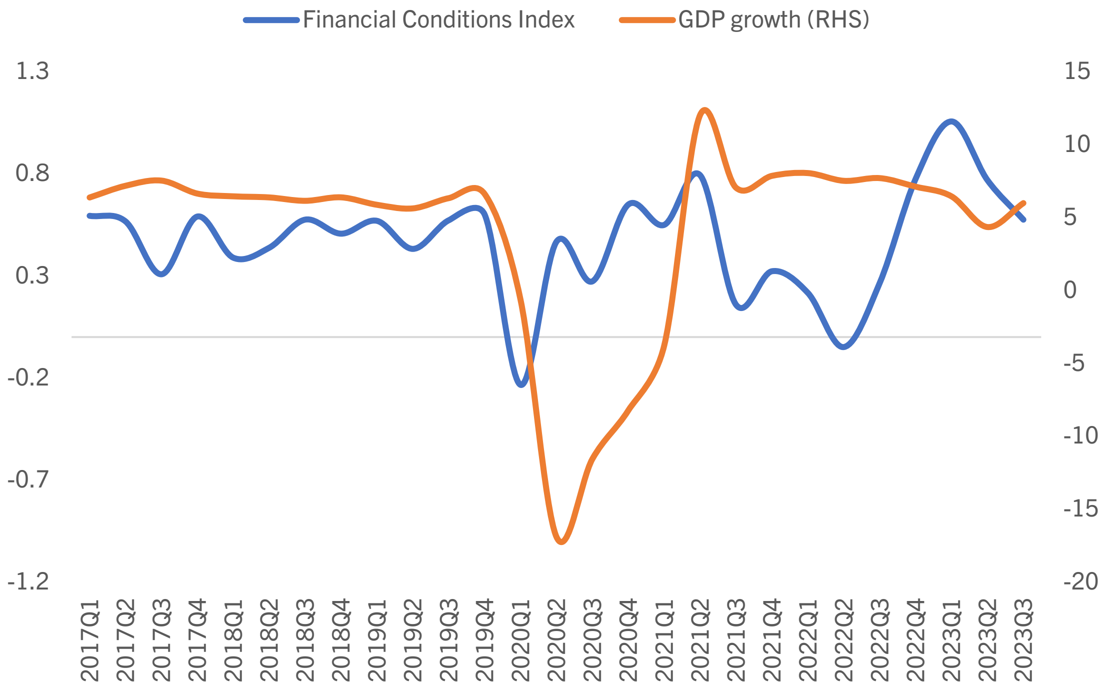
Countries in developing Asia will continue to face limited fiscal space in the near term

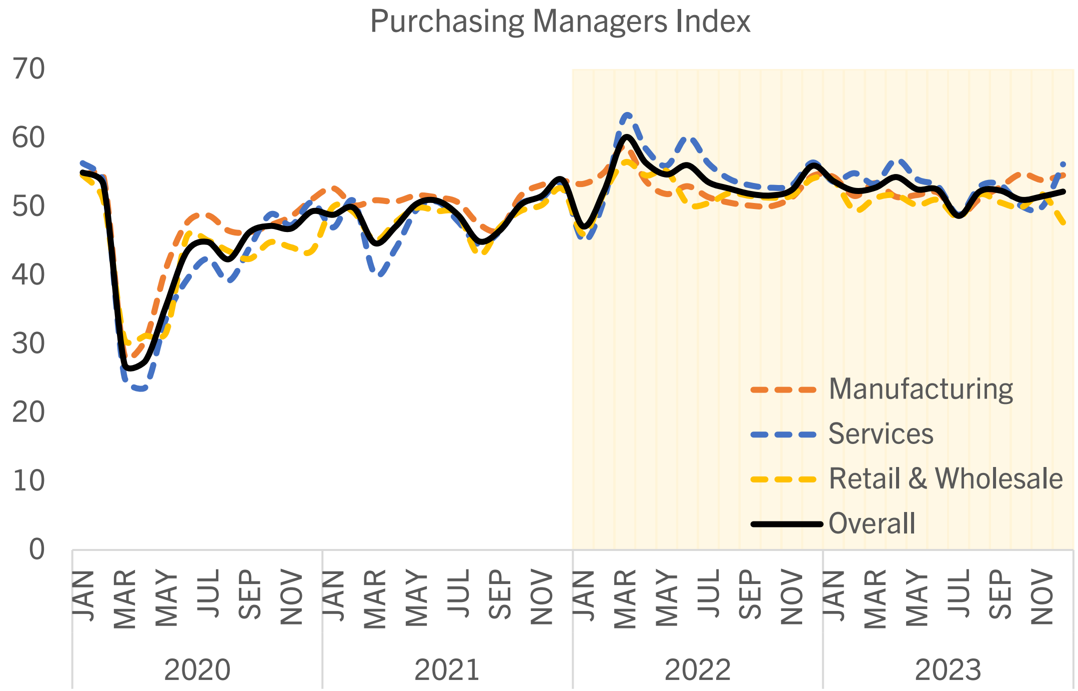




- Deficits and debt ratios have climbed in the region because of the public health measures and fiscal stimulus that had to be launched during the COVID-19 pandemic.
- Since then, deficits have been brought down in the region, with substantial fiscal consolidation observed in Indonesia and Thailand.

Philippine financial conditions tightening





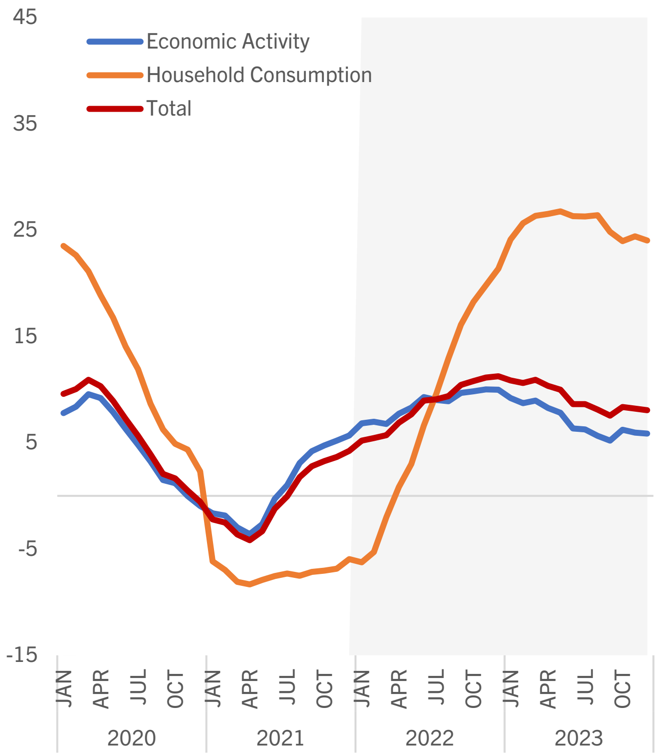
- Financial conditions in the Philippines had been surprisingly resilient until early 2023 despite sharp monetary tightening, based on a broad financial conditions index (FCI).
- The subsequent downtrend indicates tighter financial conditions, thus constrained economic activity.

- On average, PMI readings declined in 2023 from 2022. Values hovered over the critical value of 50, implying expansion.
- Readings briefly went below 50 in July 2023, both in the overall index and in its components. Such activity suggests contraction.
- More recently, the PMI index for Retail & Wholesale fell below the critical mark.

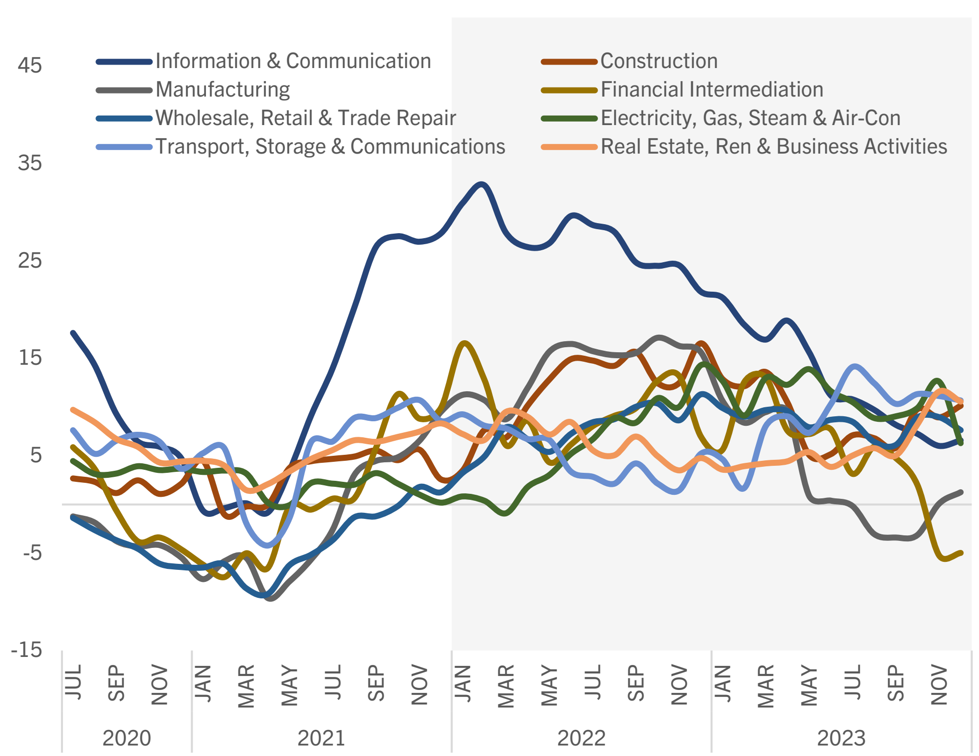
Demand for loans moderate in 2023

- After gathering pace in 2022, demand for loans started to moderate in 2023.

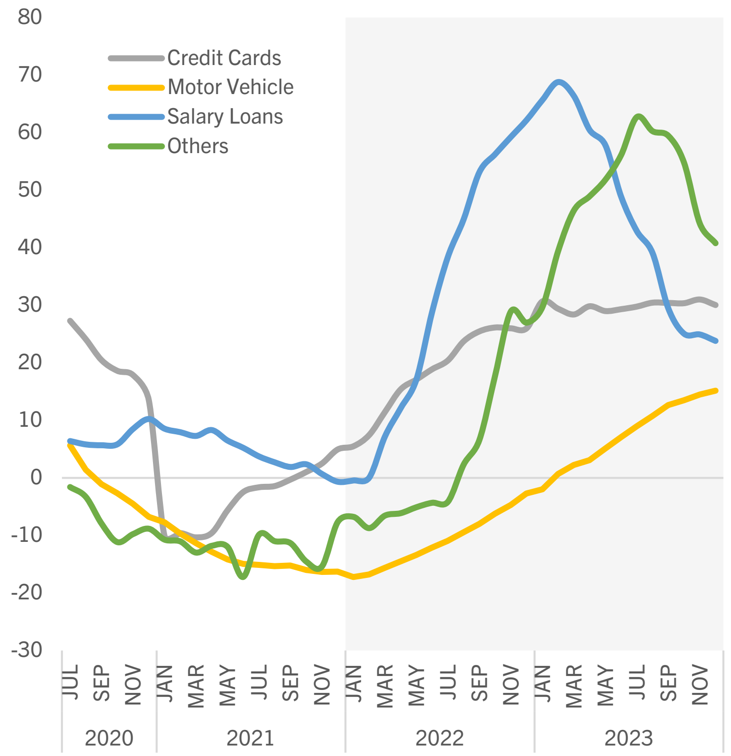
Loan growth (annual % change)



Production loan growth (annual % change)



Household loan growth (annual % change)

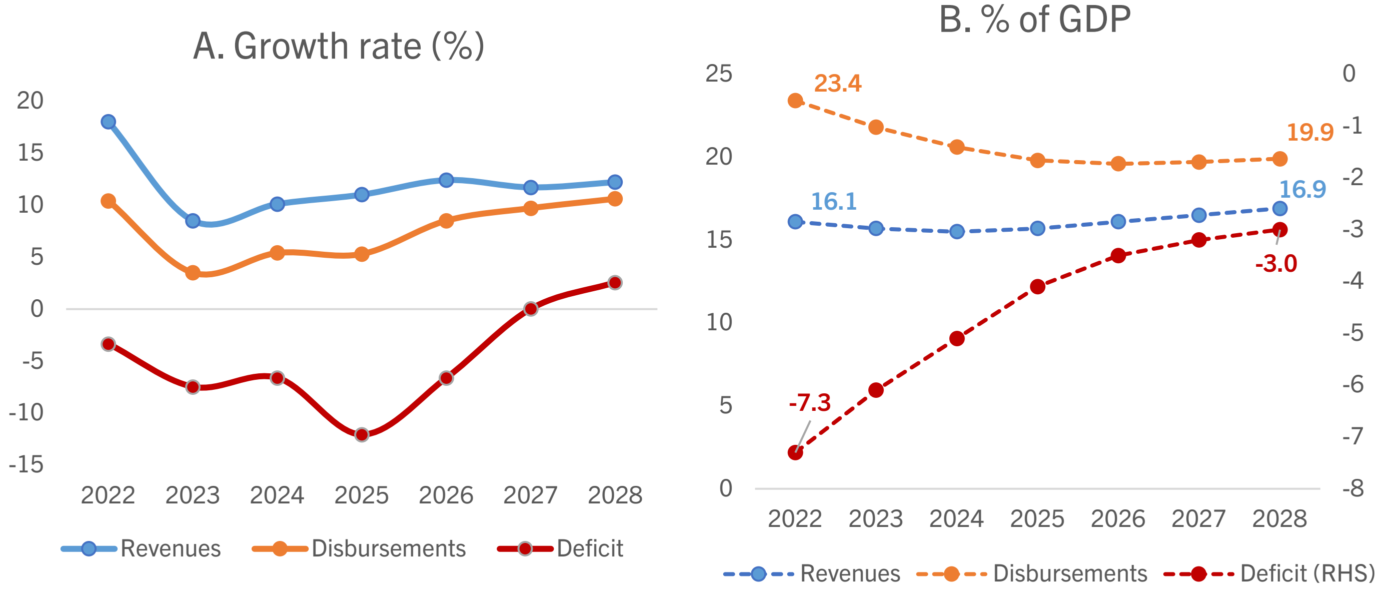


❷ Macro conditions going into 2024

The government will continue to pursue deficit reduction in the medium-term

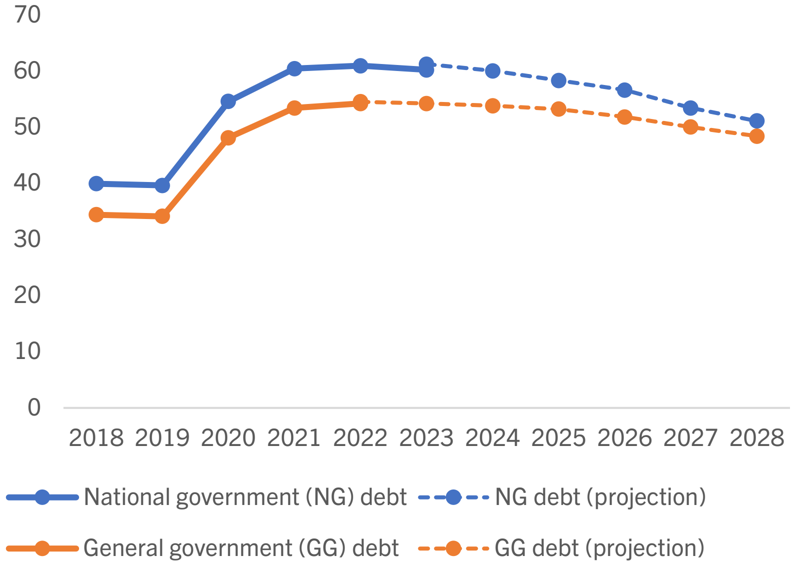
The Development Budget Coordination Committee (DBCC) projects the deficit-to-GDP ratio in 2024 at 5.1% and is targeting 3.0% fiscal deficit in 2028.

DBCC medium-term fiscal program, December 2023



The country's outstanding NG debt recorded at 60.2 % of GDP in 2023, lower than the 61.2% projection in the 2022-2028 MTFF.

Projected path of national and general government debt (% of GDP)



❸ Macroeconomic outlook for 2024

GDP will likely grow between 5.5 to 6 percent in 2024

	2021	2022	2023	2024f
Actual	5.7	7.6	5.6	
Credit raters (Moody's, Fitch, and S&P forecast average)			5.5 (5.9)	**5.9**
ADB			5.7 (6.3)	**6.2**
AMRO			5.9 (6.3)	**6.5**
IMF			5.3 (5.0)	**5.9**
World Bank			6.0 (5.6)	**5.9**
PIDS authors			5.2 (4.5 to 5.5)	**5.5 to 6.0**
DBCC			6.0 to 7.0 (6.5 to 8.0)	**6.5 to 8.0**

Figures in parentheses are previous-year forecasts.

Inflation reached 6 percent on average in 2023, and is expected to fall within target range in 2024

	2021	2022	2023	2024f
Actual	3.9	5.8	6.0	
Credit raters (Moody's, Fitch, and S&P forecast average)			5.9 (4.6)	**3.4**
ADB			6.2 (4.3)	**4.0**
AMRO			5.5 (4.0)	**3.8**
IMF			5.8 (4.3)	**3.2 (3.1)**
PIDS authors			6.0 (3.5 to 4.5)	**3.0**
DBCC			5.0 to 6.0 (2.5 to 4.5)	**2.0 to 4.0 (2.0 to 4.0)**

Figures in parentheses are previous-year forecasts.

❹ Risks and recommendations

Several policy priorities and proposals from the previous edition remain relevant

- Control inflation without harming growth.
- Smooth exchange rate volatility but maintain flexibility.
- Rebuild fiscal space to promote fiscal sustainability while protecting those at risk.
- Prepare for financial tightening and uncertainty through vigilant and strategic monitoring.
- Address pandemic scars through infrastructure and human capital investment, the latter in education and health care.
- Continue the policy momentum to encourage investment, especially foreign direct investment (FDI), to sustain growth.

Inflation risk

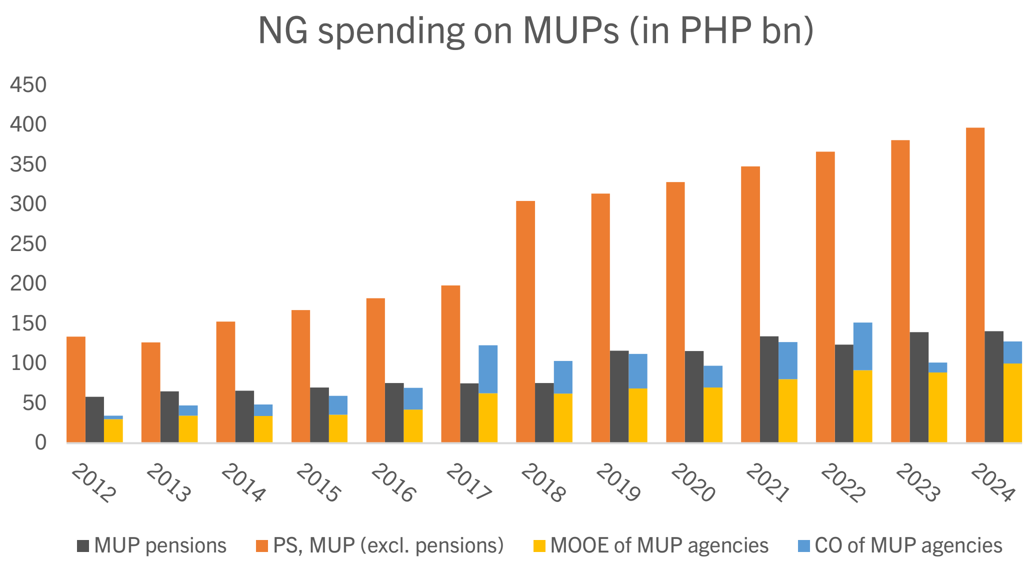
- Decisions on managing inflation should be solely that of the monetary authority, which should remain independent, if the inflation targeting framework is to remain credible.
    - ✓ Temptation to prioritize concerns apart from inflation should be resisted, particularly when inflation expectations are not yet fully under control, given the importance of price stability in protecting the purchasing power of consumers, especially the poorest ones.
- As inflation threats remain, there is continued need for high-frequency monitoring and a calibrated response to price developments.
- The government is urged to utilize every weapon in the arsenal to control inflation, particularly those that work through the supply side, such as easing import restrictions on agriculture products that may face shortages and instituting a better system for anticipating and addressing these shortages.
- We continue to advise against inflation-related policies that may have (costly) unintended consequences.

Risk of stalled fiscal policy reform

- The Medium-term Fiscal Framework (MTFF) outlines additional sources of revenues that may be expected from future legislative measures.
- Having a sound and credible plan remains critical in shaping market perceptions about the country's debt limits and hence essential to keeping financing costs down.
- While it may not be feasible to immediately aim for a low debt ratio, we highlight the importance of a solid medium-term to long-term fiscal consolidation plan.
- Ideally, this should have estimates of net gains (from both the revenue and non-interest spending side) large enough to make an impact on the country's fiscal health.

Military and uniformed personnel (MUP) pension scheme still a fiscal risk

- The current MUP pension scheme is a non-contributory, defined-benefit system, with no corresponding assets currently—i.e., it is completely funded by the national government, with related spending carved out from the public budget. It features automatic indexation of pensions.
- MUP pensions have typically exceeded the cost of supporting the active military, in terms of MOOE and CO of MUP agencies. Arrears already accumulated to PHP 57 billion as of 2021, with unmet payments also tracing to the salary adjustments several years earlier (DBCC 2022).
- Removing automatic indexation of retirement pay to the salary of active personnel can lop off PHP6.6 trillion from the system's unfunded liabilities, according to computations by the GSIS study.
- Who among the MUP will bear the brunt of the fiscal adjustment should be carefully considered. Need an equitable framework.



Risks related to the national investment fund

- Background

The Maharlika Investment Fund (MIF) was established "to promote economic growth and social development" by "investing national funds and coordinating and strengthening the investment activities of the country's top-performing government financial institutions" (RA 11954, Section 2).

It aimed to "promote socioeconomic development" by "making strategic and profitable investments in key sectors" to meet the following goals (RA 11954, Section 13):

- to preserve and enhance the long-term value of the fund;
- to obtain an optimal absolute return and achieve financial gains on investments; and
- to satisfy various requirements (liquidity, safety/security, and yield) to "ensure profitability."

Risks related to the national investment fund

- The government's intentions and fundamental goals and ways of meeting these goals are not (yet) as clear as those of its regional neighbors. Need to cohesively frame investment beliefs and strategic vision for the fund to have sufficiently clear mandates.

- While national investments should match the requirements of national development, as what the government ideally strives for when crafting the public budget, the likelihood of turning a profit may be higher if investment decisions are kept free of political complexities and patronage. Fund success consequently hinges on finding ways to settle this conflict.

- Making it work: The MIF should further clarify its role and find ways to handle multiple objectives. To protect the fund, the government is well advised to follow what has already worked in many cases for different types of sovereign funds. The MIF's adherence to the Santiago Principles is a good starting point. To build the fund's credibility, which will be from scratch, the most important task today entails appointing a truly independent board and professional management team, to embody good governance, minimize the risk of political interference, and make sure the goals of the fund are met.

Clear mandates, professional management, and transparent performance benchmarks needed in the management of the Maharlika Investment Fund

- Making it work: With the country's fiscal position still just recovering from the pandemic crisis, economic managers must ensure that establishing the MIF will not draw from already scarce state funds. The government must also ensure that GFIs' funding contributions do not fuel uncertainty and harm the country's overall financial stability.

- The most beneficial role the MIF can play is if it can help pull in new capital from multilaterals, other sovereign funds, and other large institutional investors, even private funds, particularly in areas that need development such as infrastructure.

- Establishing a credible return benchmark that cannot be used to mask poor performance (possibly from fund misuse and corruption) will be an important challenge for the MIF and our economic managers who head it. The fund should be continuously monitored by the public.

Thank you!

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