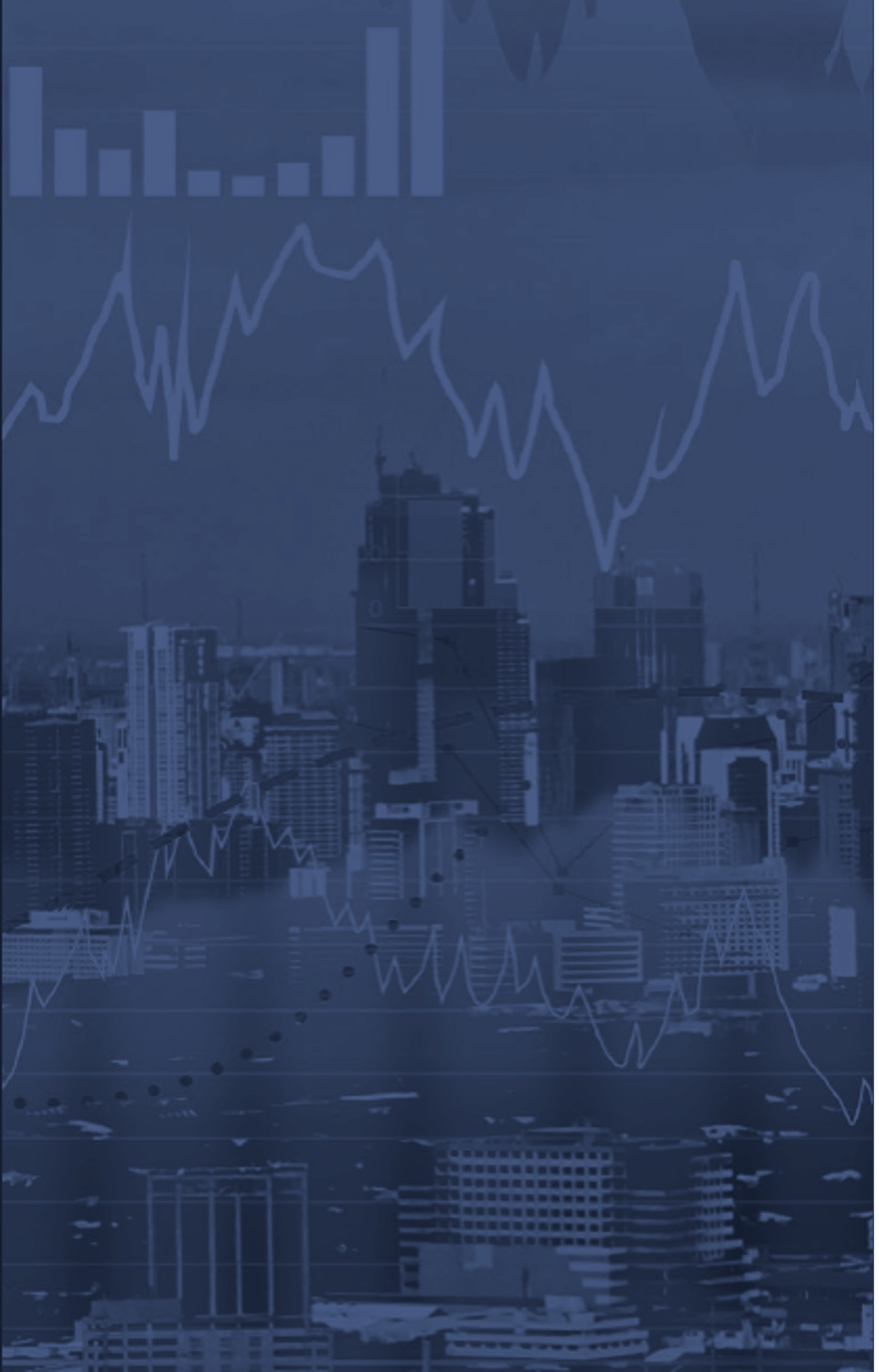

Philippine Institute for Development Studies

Macroeconomic Prospects of the Philippines in 2023: **Steering through Global Headwinds**

9 February 2023

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Steering through global headwinds – Outline

1. Macro performance in 2021 & 2022
2. Macro conditions going into 2023
3. Macro outlook for the year
4. Limiting factors, risks, and challenges
5. Policy priorities and proposals

❶ 2021-2022 macroeconomic performance

❶ 2021-2022 macroeconomic performance

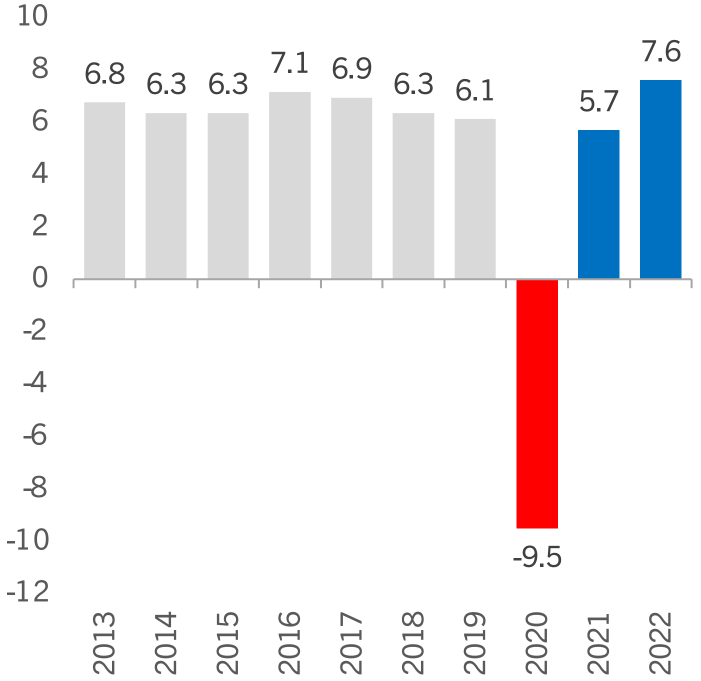
GDP growth recovered in 2021 and 2022

The lifting of pandemic restrictions, rise in vaccinations, and revival of public mobility fueled the rebound of GDP growth to 5.7% in 2021 and 7.6% in 2022.

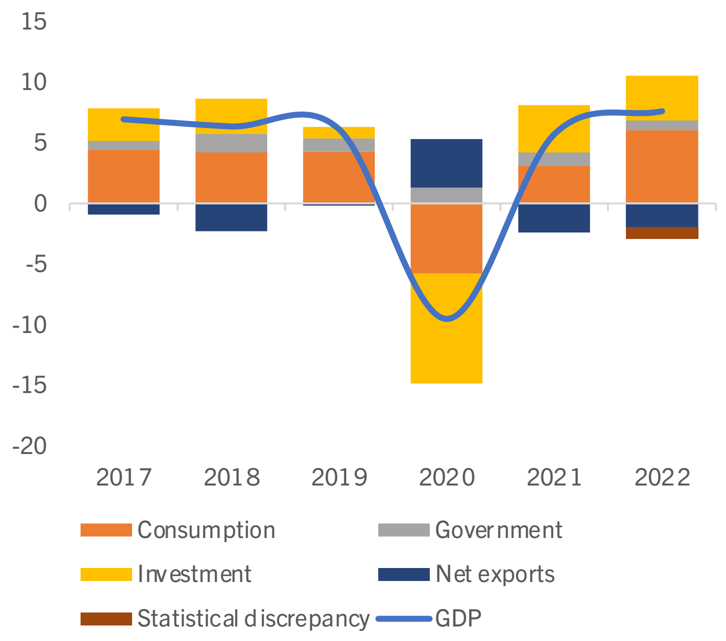
The resurgence of household consumption and investment spending drove GDP growth on the expenditure side…

…while the recovery of services and industrial output supported growth on the production side.

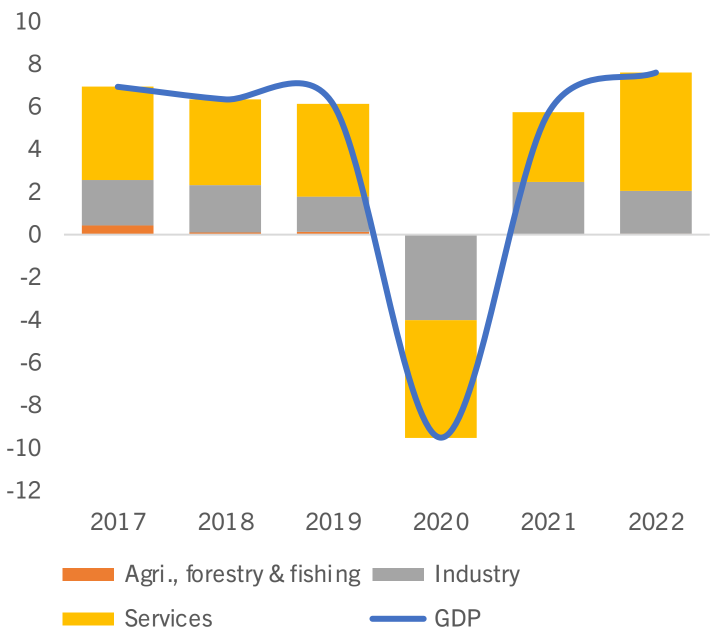
GDP growth (%)



GDP growth: Expenditure drivers (ppts)



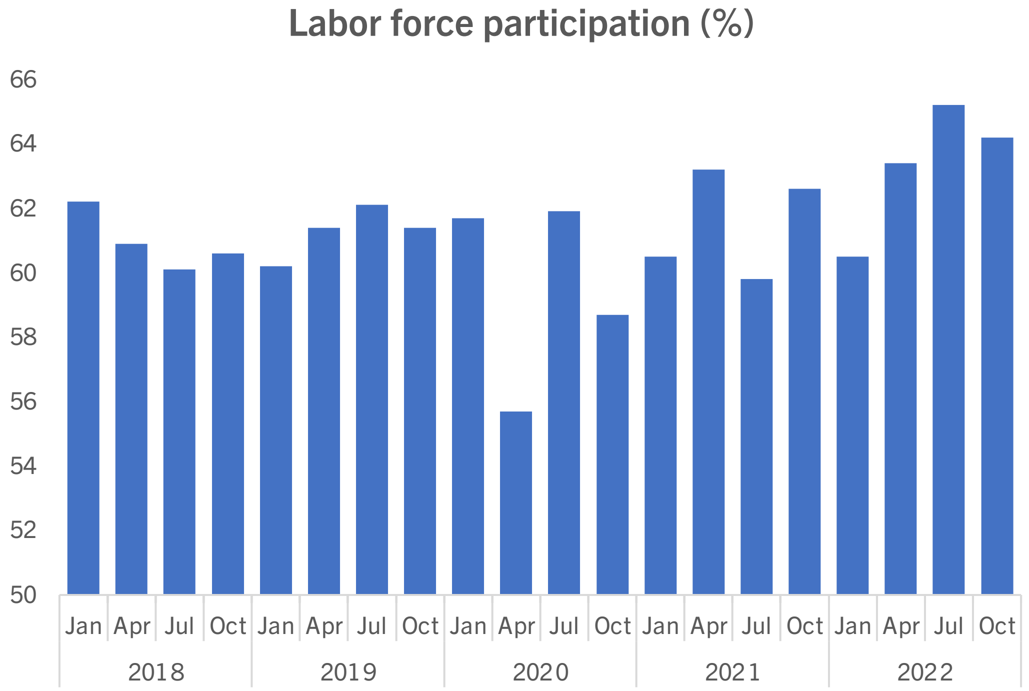
GDP growth: Industrial drivers (ppts)

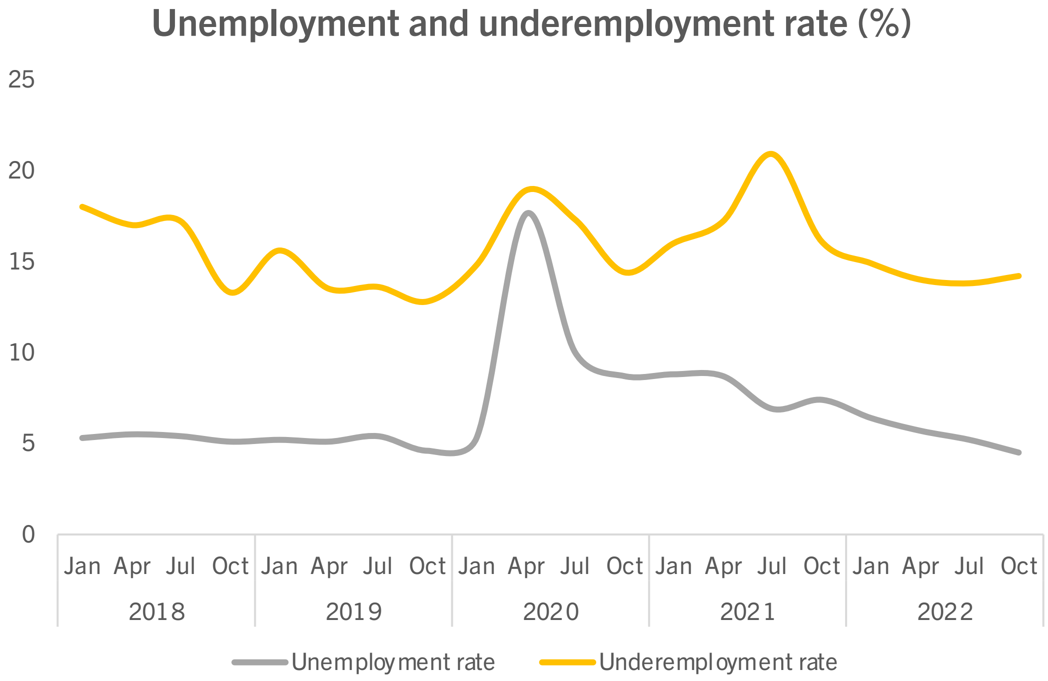


Economic reopening improved labor market conditions

Labor force participation rose to 61.5% in 2021 and 63.3% in 2022, above pre-pandemic levels (61.3% in 2019).

The unemployment rate fell to 8% in 2021 and 5.5% in 2022. However, underemployment remained high in 2021 (17.6%) before falling in 2022 (14.2%).



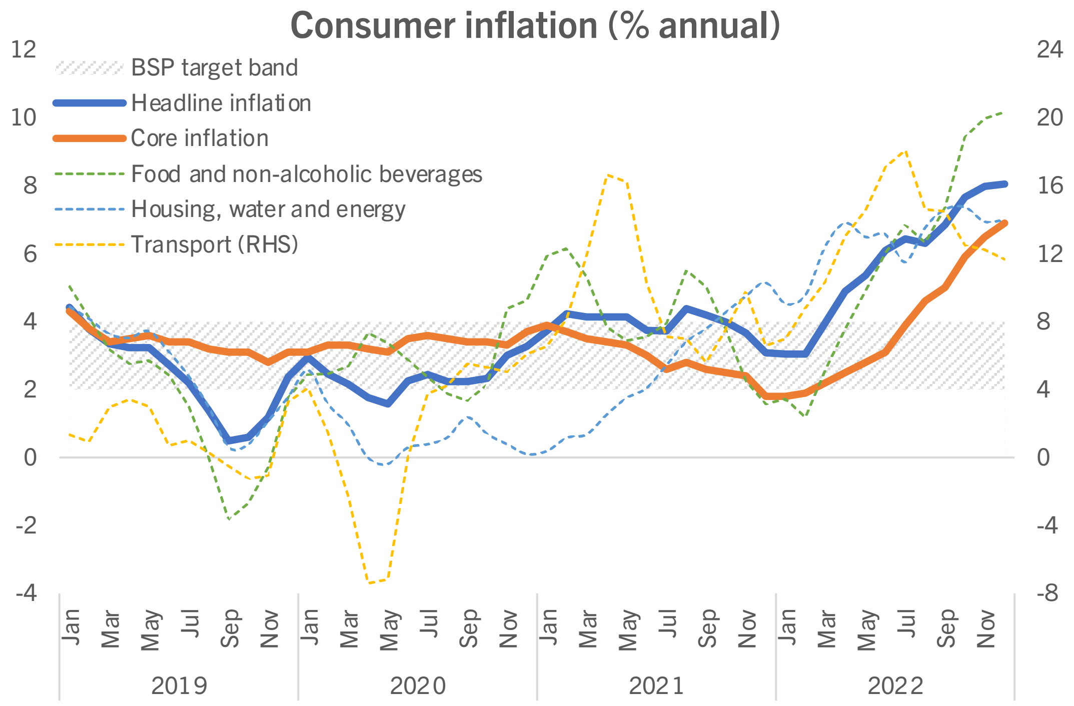


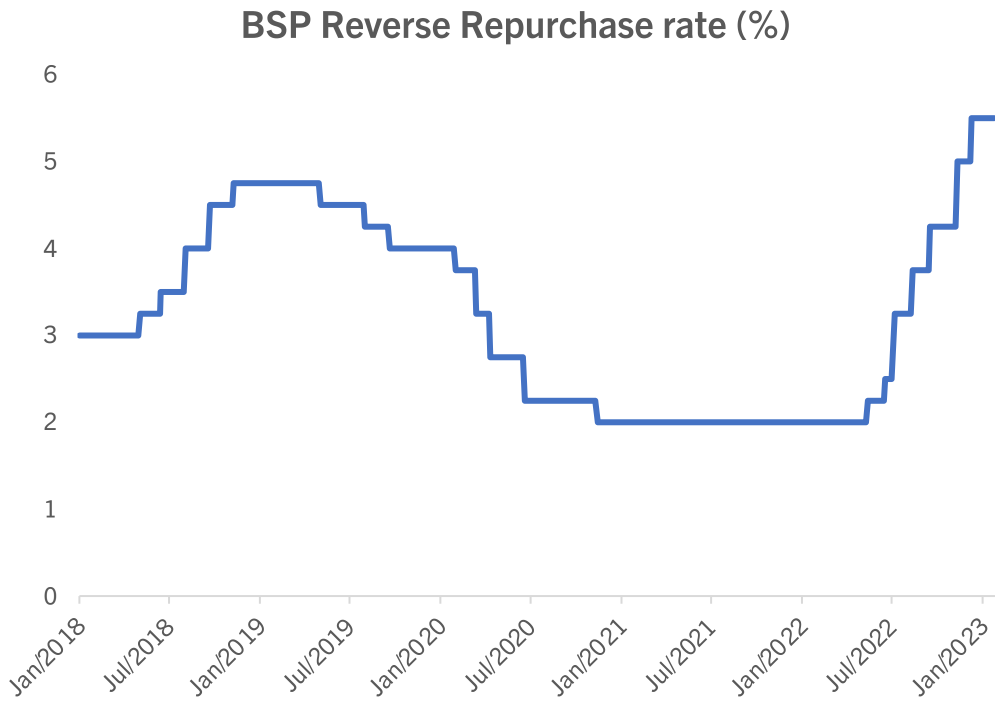
❶ 2021-2022 macroeconomic performance

Inflation accelerated and monetary policy tightened

From 3.9% in 2021, headline inflation steadily rose in 2022 due to high energy and food prices, peaking at 7.7% in Q4. Core inflation also rose in 2022, reaching 6.4% in Q4.

The BSP maintained the policy rate at 2% throughout 2021 and most of 2022H1. To contain rising inflation, the policy rate was hiked 7 times from May 2022 to January 2023 by a total of 350 bps to 5.5%.





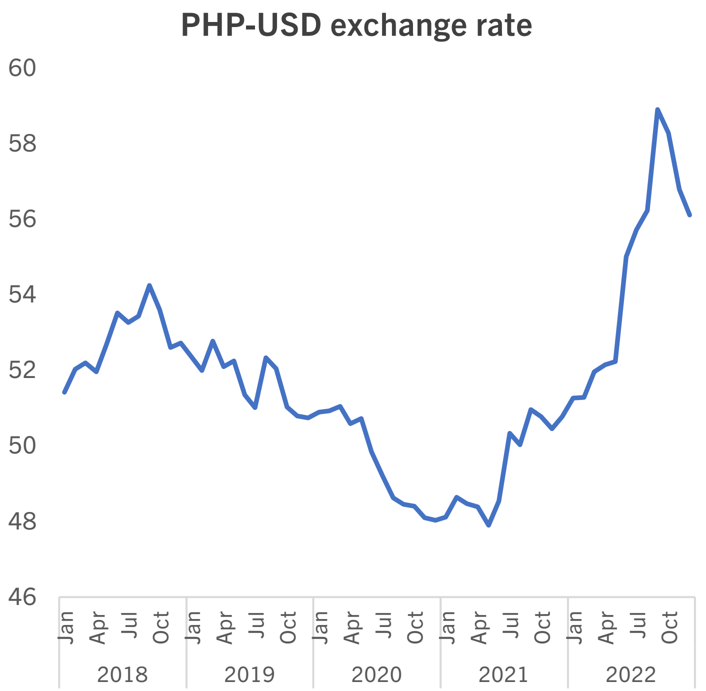
❶ 2021-2022 macroeconomic performance

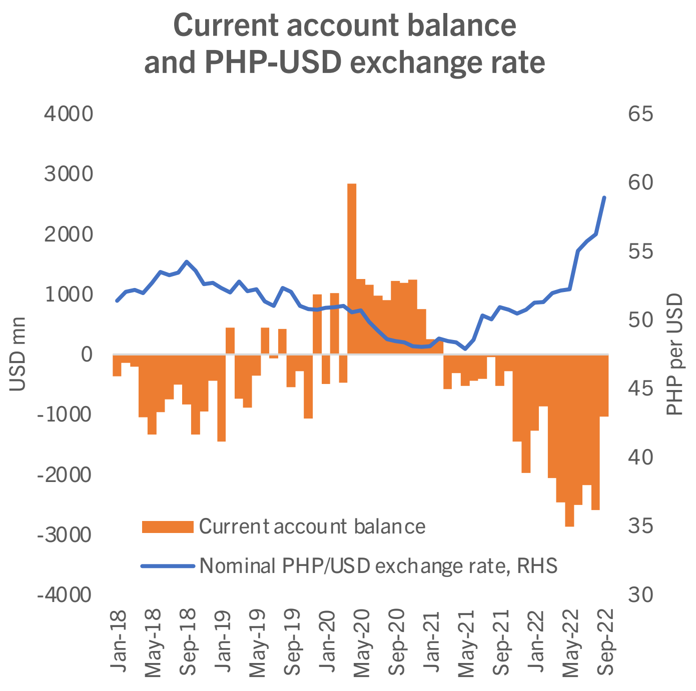
Philippine peso weakened on wider current account deficits and narrowing interest rate differentials

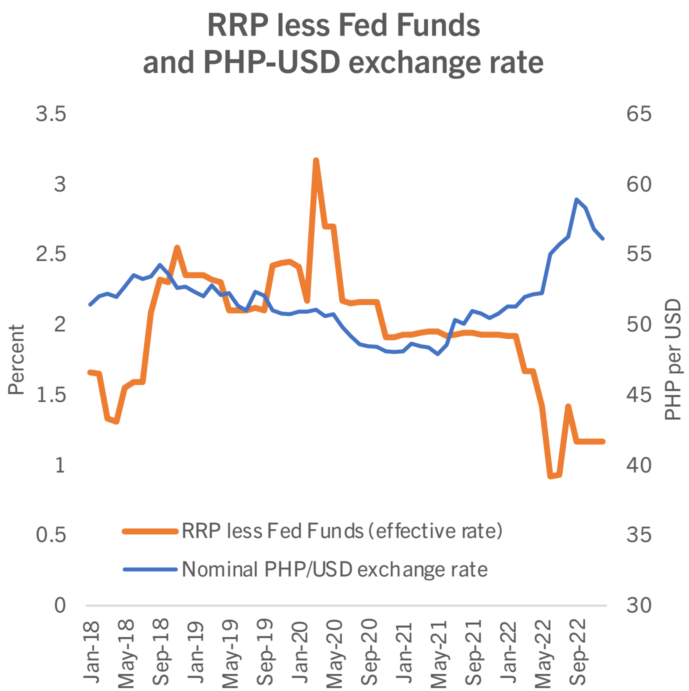
The peso began to weaken against the US dollar in mid-2021, falling by 4.6% in the last half of 2021, and by another 16% in Jan-Sep 2022, breaching P58/$ in Sep-Oct.

The current account swung back to deficit in 2021, which widened in 2022 due to strong import demand and higher commodity prices.

The gap between the US and PH policy rates abruptly narrowed in Q2 2022 due to aggressive US rate hikes to fight inflation.



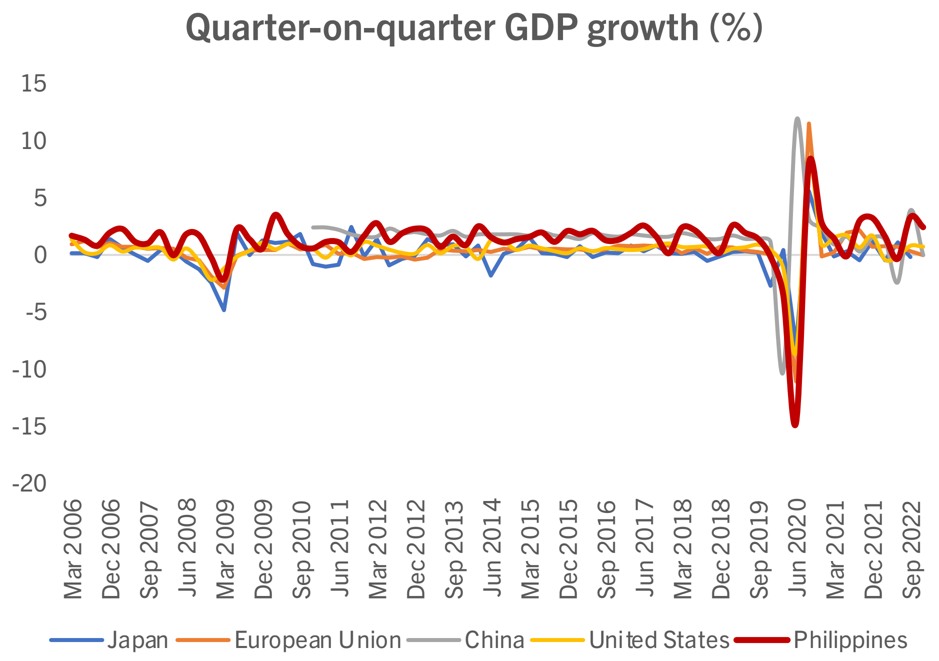


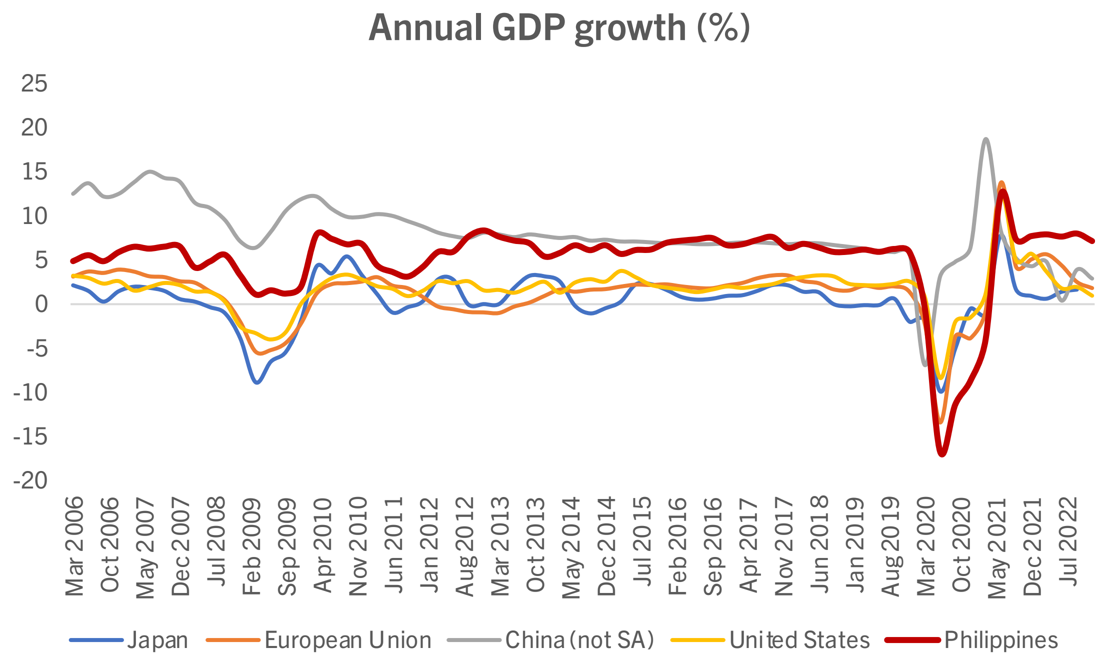


❷ Macroeconomic conditions going into 2023

Major economies have slowed down

- Output growth forecasts for advanced economies—notably for the US, Japan, and key countries in the euro area—were revised down substantially last year.
- The US posted two consecutive quarter-on-quarter GDP declines during the first half of 2022, with growth remaining weak until yearend. US labor markets however remain relatively tight.
- GDP growth in China, which accounts for 15.5% of Philippine exports, fell again to a historic low of 0.4% annually in Q2 2022, rebounded in Q3 (3.9%) but weakened in Q4 (0.0%). A real estate crisis adds to the negative outlook.





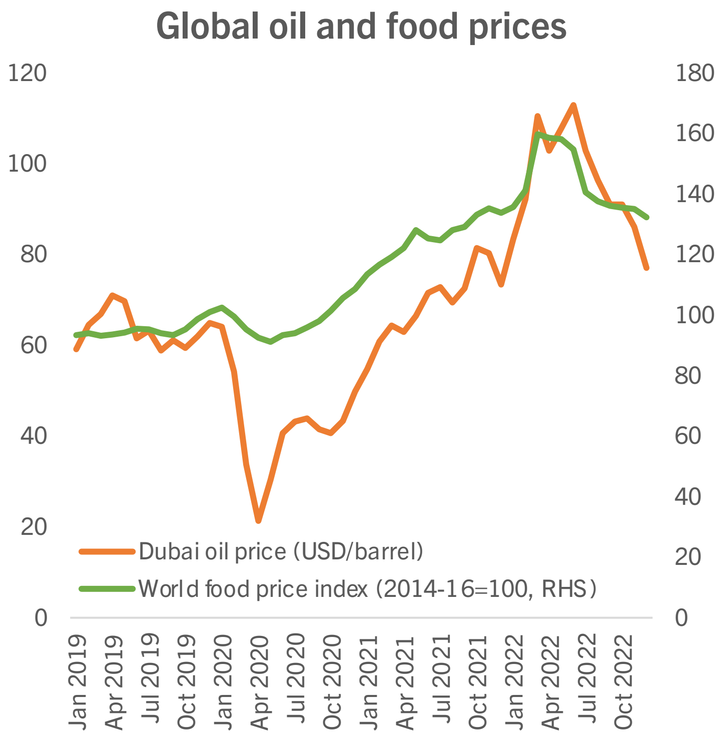
❷ Macroeconomic conditions going into 2023

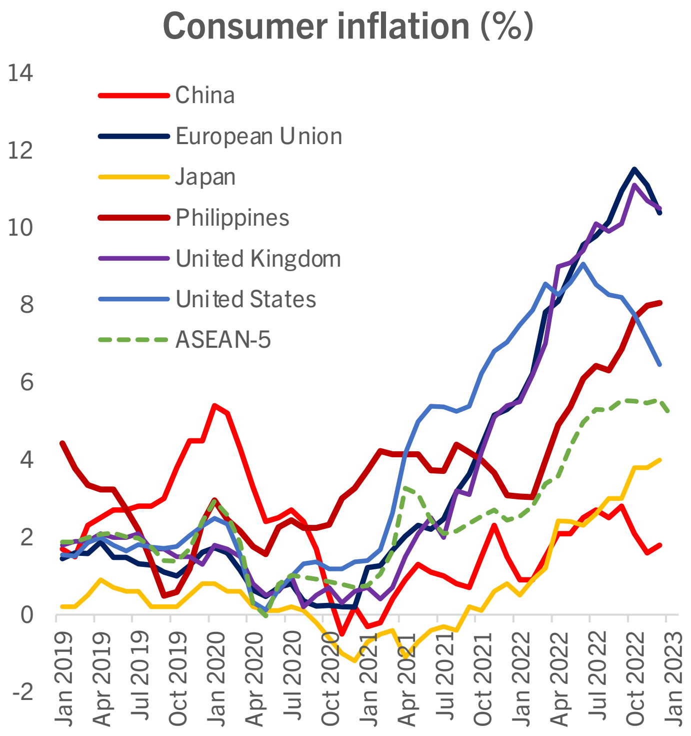
Inflation has become a major concern across countries, leading to monetary tightening globally

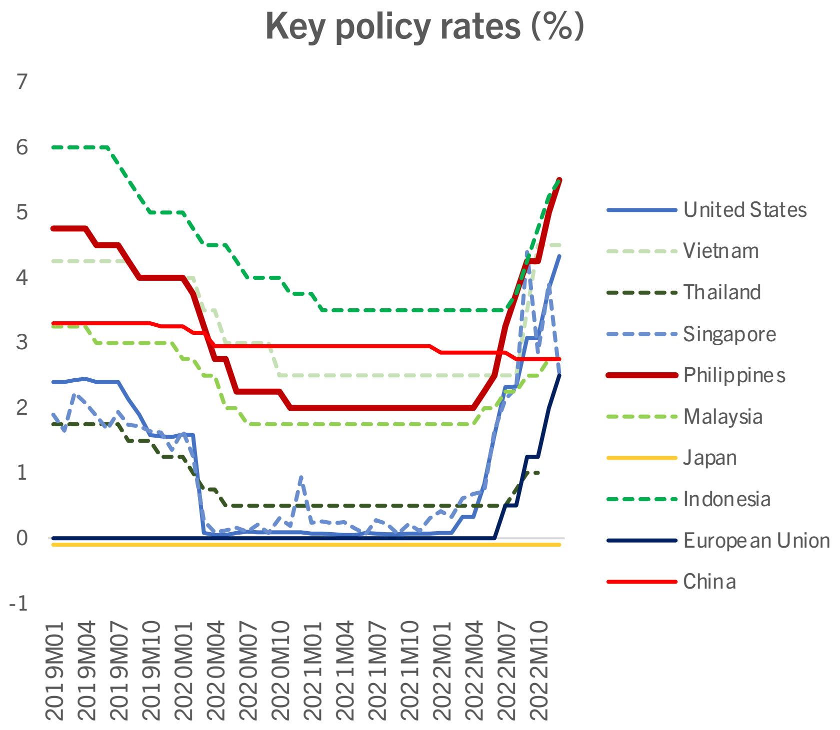
Global oil and food prices surged following the Russian invasion of Ukraine, peaking in Q2 2022 and softening since.

Higher food and energy prices and the rebound of aggregate demand stoked inflation across the world.

Central banks have responded by hiking interest rates, ending the period of easy monetary policy that prevailed since the start of the pandemic.





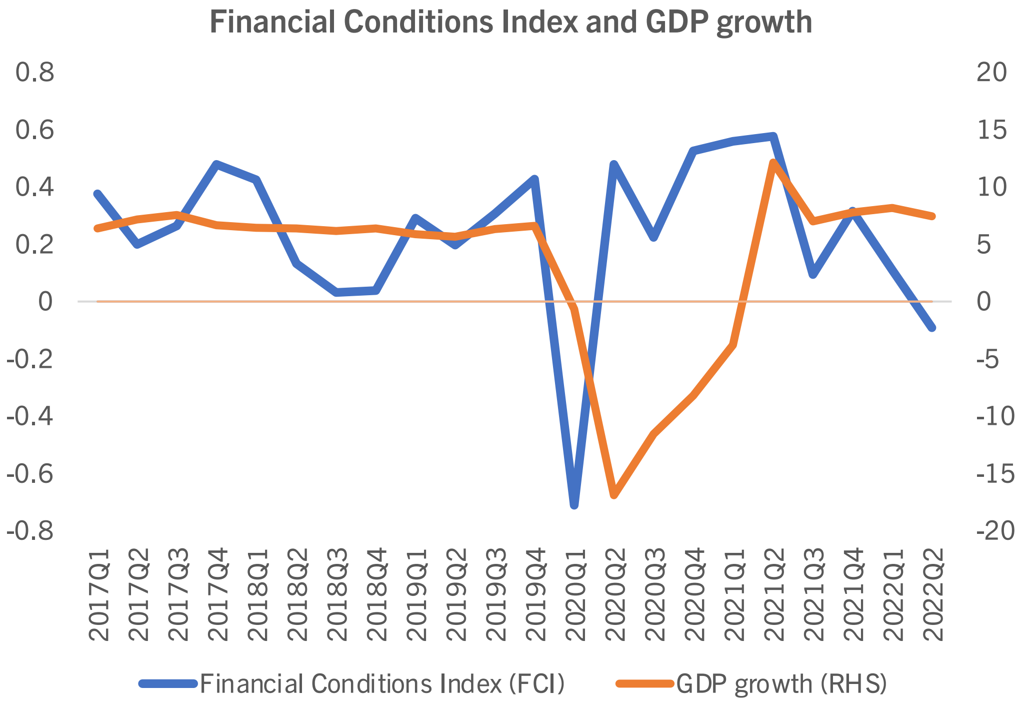


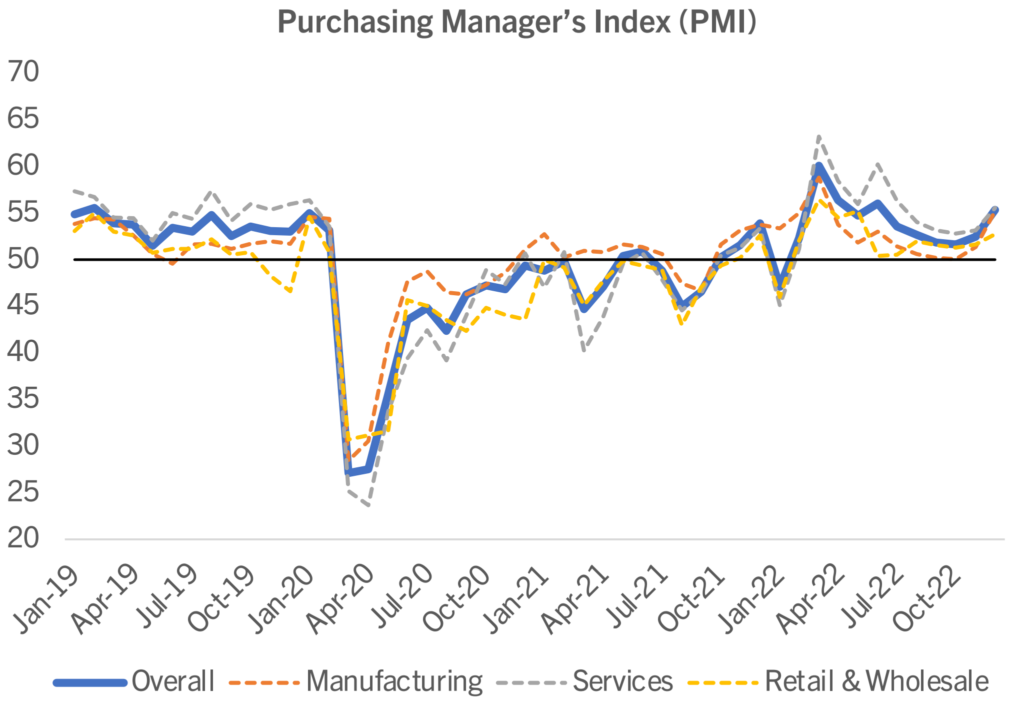
❷ Macroeconomic conditions going into 2023

Domestically, financial conditions have declined, although high frequency indicators suggest further economic expansion

Financial conditions in the country have worsened in line with tighter monetary policy and higher domestic currency risk. Expectation of more rate hikes are likely to keep financial conditions tight.

The expansion in economic activity as measured by the Purchasing Manager's Index appeared to slow down beginning in March 2022, but picked up again by November 2022.

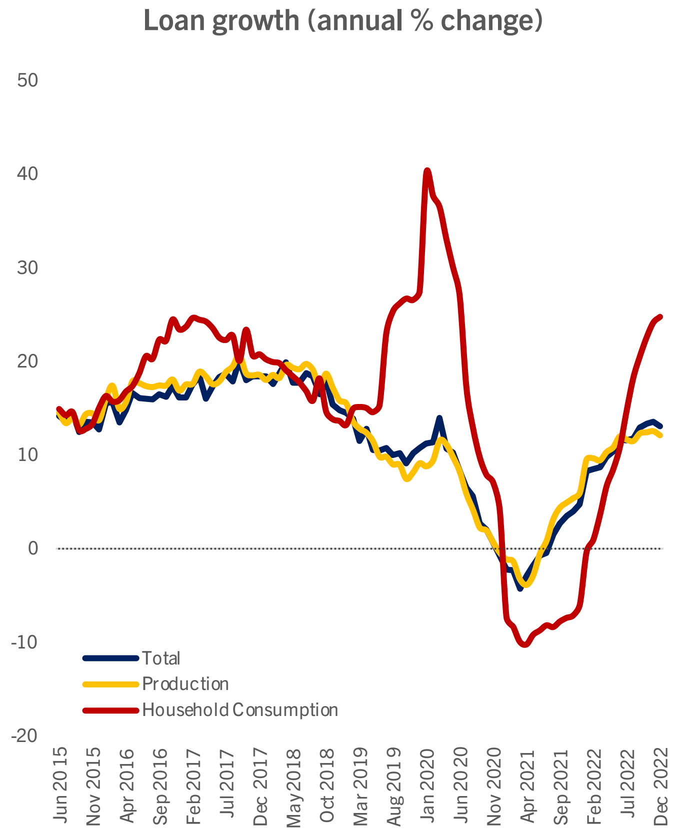


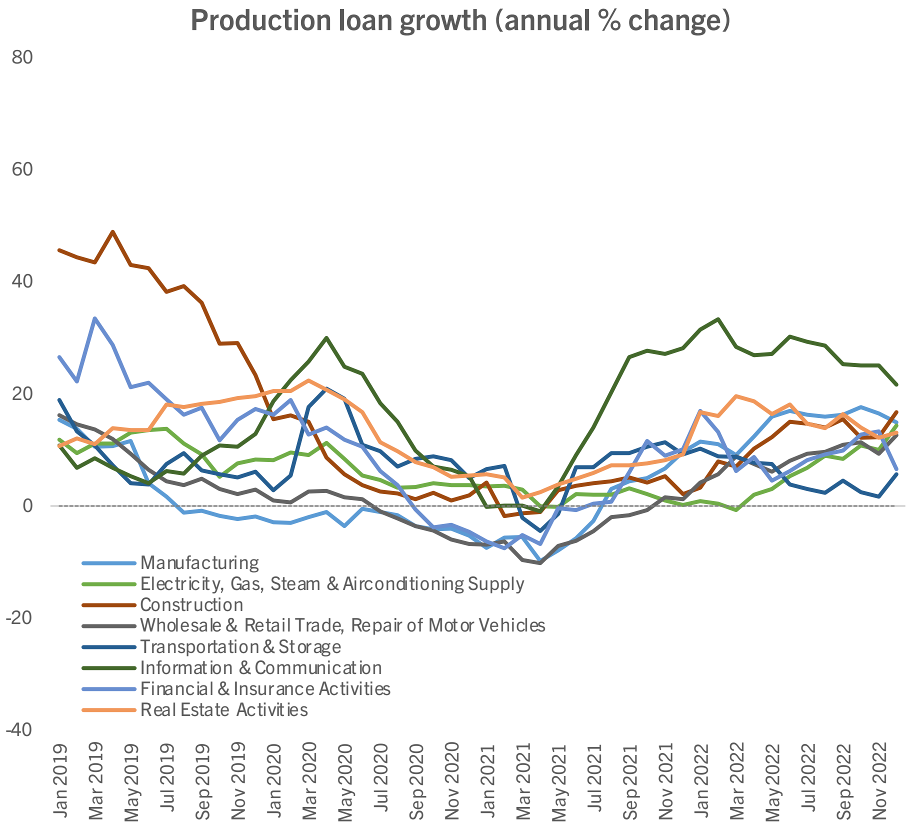


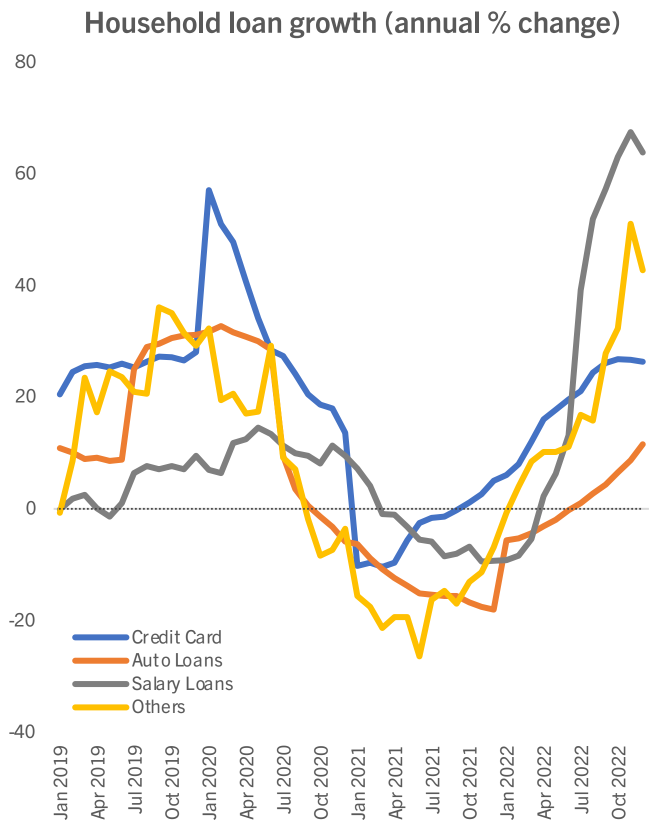
❷ Macroeconomic conditions going into 2023

Demand for loans continued to grow

Household loans exhibited high growth, likely fueling consumption. With a high-interest rate regime, this is expected to slow down.



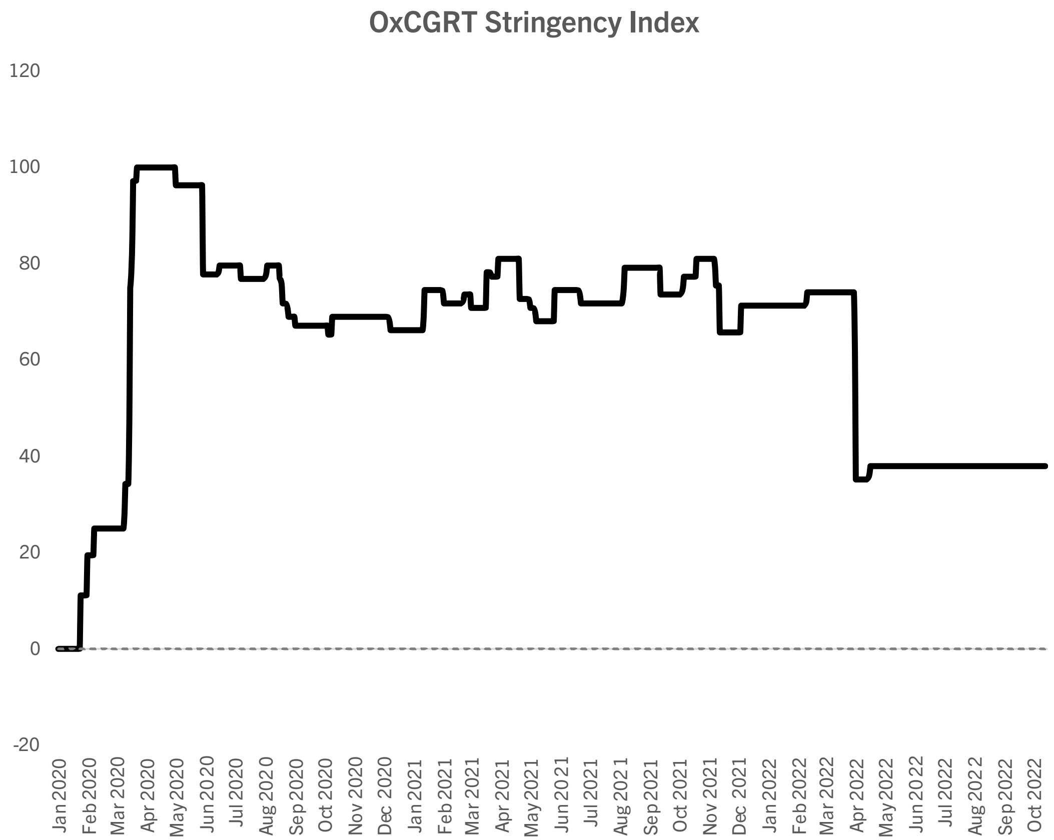


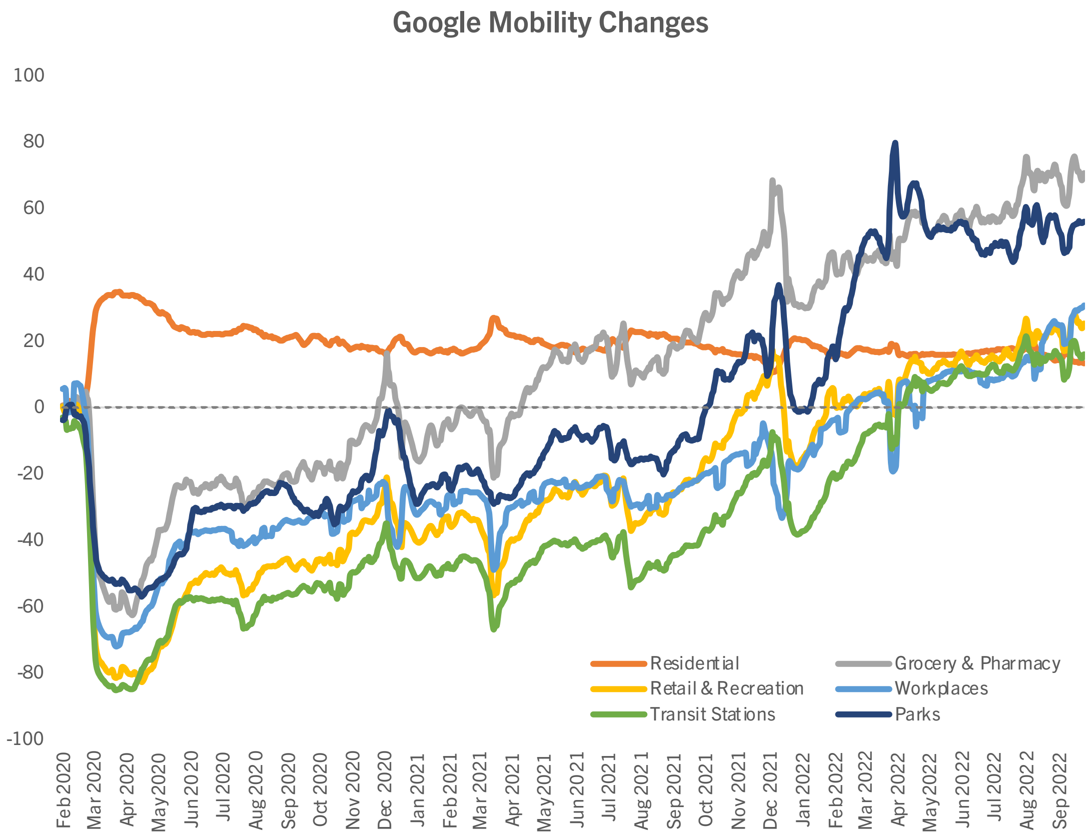


❷ Macroeconomic conditions going into 2023

Mobility across location types have normalized

Containment measures were eased in 2022. Footfall in workplaces and transit stations have returned to pre-pandemic levels. Activity in places of retail and recreation continued to increase.





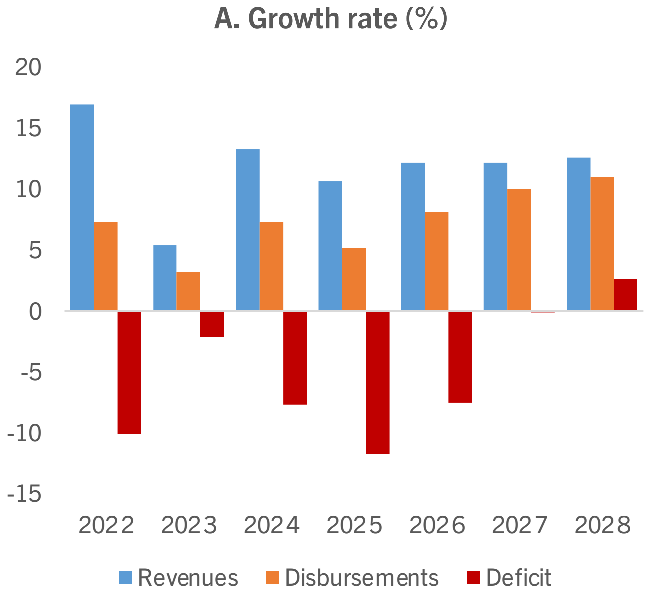
❷ Macroeconomic conditions going into 2023

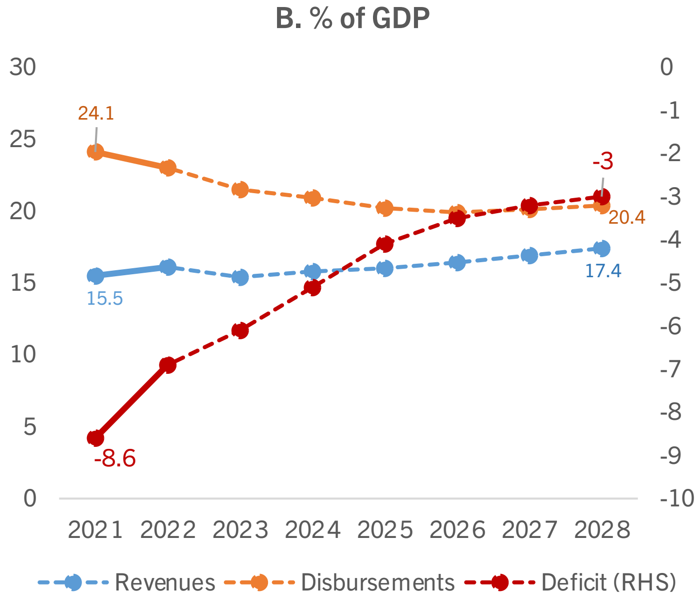
Fiscal policy has become less expansionary

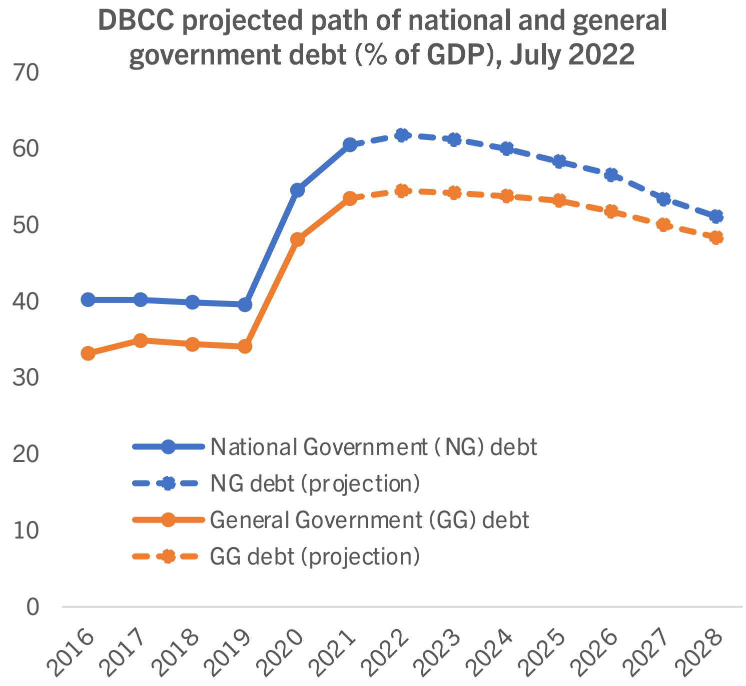
Based on the government's medium-term fiscal program, spending is set to grow by less than 3% in 2023. Fiscal authorities hope to bring the budget deficit from 8.6% of GDP in 2021 to 3% of GDP in 2028…

…and the debt-to-GDP ratio to below 60% by 2025 from a projected peak of 61.8% in 2022.

DBCC medium-term fiscal program, December 2022







❸ Macroeconomic outlook for 2023

❸ Macroeconomic outlook for 2023

GDP growth will tend to slow down in 2023

	2020	2021	2022	2023f
Actual	-9.5	5.7	7.6	
FocusEconomics (private sector forecast average)	-7.0	4.6 (7.3)	6.6 (6.8)	**5.7**
ADB	-7.3	4.5 (6.5)	6.5 (5.5)	**6.3**
IMF	-8.3	4.7 (7.4)	6.5 (6.3)	**5.0**
World Bank	-6.9	5.4 (5.3)	5.7 (5.9)	**5.6**
PIDS authors	-9.5	5.4 (6.0)	7.1 (6.5)	**4.5 to 5.5**
DBCC	-8.5 to -9.5	4.0 to 5.0 (6.5 to 7.5)	6.5 to 7.5 (7.0 to 9.0)	**6.5 to 8.0**

Figures in parentheses are previous-year forecasts (e.g., computed in October 2021 for year 2022).

❸ Macroeconomic outlook for 2023

Inflation may fall in the upper bound of the official target range in 2023

	2020	2021	2022	2023f
Actual	2.6*	4.4*	5.8	
FocusEconomics (private sector forecast average)	2.4	4.1 (2.9)	5.3 (3.0)	**4.1**
ADB	2.4	4.1 (2.6)	5.3 (3.5)	**4.3**
IMF	2.4	3.4 (3.0)	5.3 (3.0)	**4.3**
PIDS authors	2.6	4.3 (3.0)	5.7 (3.0)	**3.5 to 4.5** **
DBCC	2.4 to 2.6	2.0 to 4.0 (2.0 to 4.0)	4.5 to 5.5 (2.0 to 4.0)	**2.5 to 4.5**

Figures in parentheses are previous-year forecasts (e.g., computed in October 2021 for year 2022).

*Prior to rebasing. **Likely revision.

❹ Limiting factors, risks, and challenges

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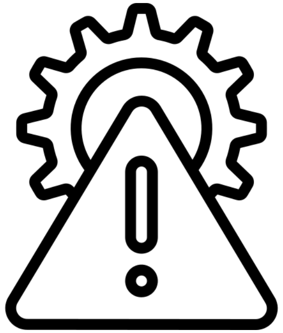
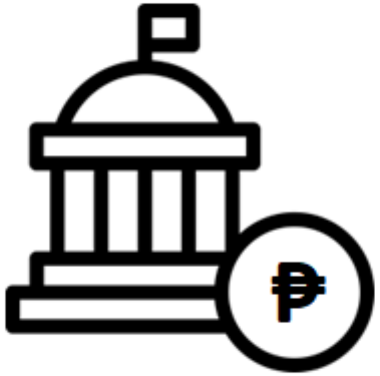
High inflation, risk aversion, and constrained policy space are key limiting factors

Higher consumer prices have reduced the purchasing power of households, while higher input costs are pressuring businesses especially those with already thin margins and low net worth. This may continue to dampen private consumption and investment appetite.



The business environment has become more challenging due to higher financing and business costs and economic uncertainty. Businesses are still recovering from the pandemic and may be more cautious given a new political leadership. Recent reforms to liberalize investment may take time to bear fruit.



Policy space to counter an economic slowdown is limited. The central bank is constrained to keep monetary policy tight to fight inflation. Meanwhile, the rise in fiscal deficits and public debt due to the pandemic has pressed the government to pursue fiscal consolidation.

Upside and downside risks

Upside

- Economic activity may be stronger than anticipated due to resilient remittances and BPO receipts, and possible revival of tourism
- Word commodity prices have started to decline

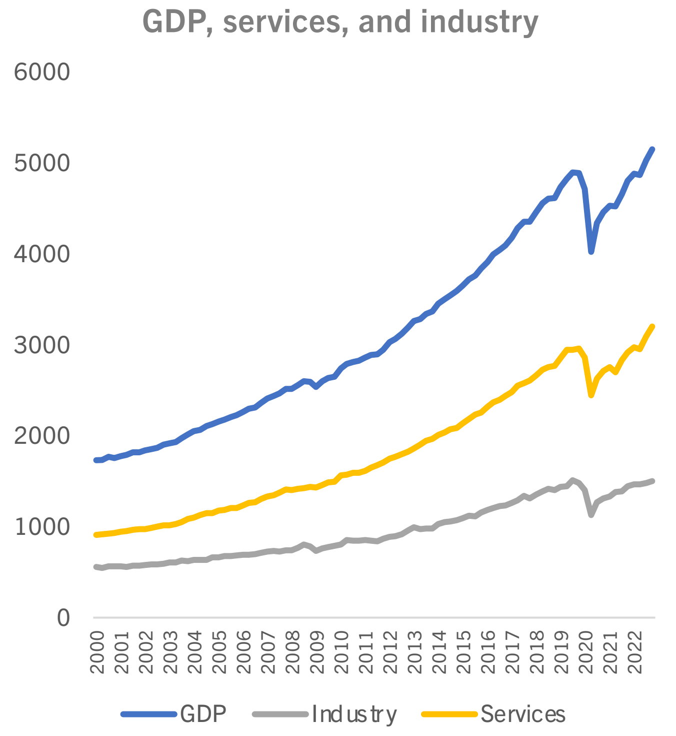
Downside

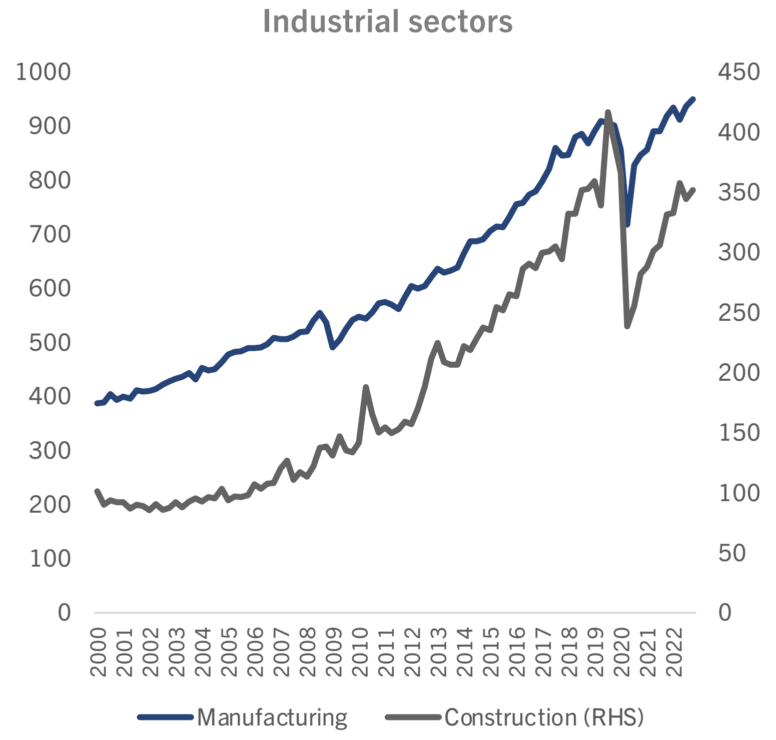
- Drop in global financial conditions with continued monetary tightening in advanced economies
- Recession in the US or China
- Protracted Russia-Ukraine conflict

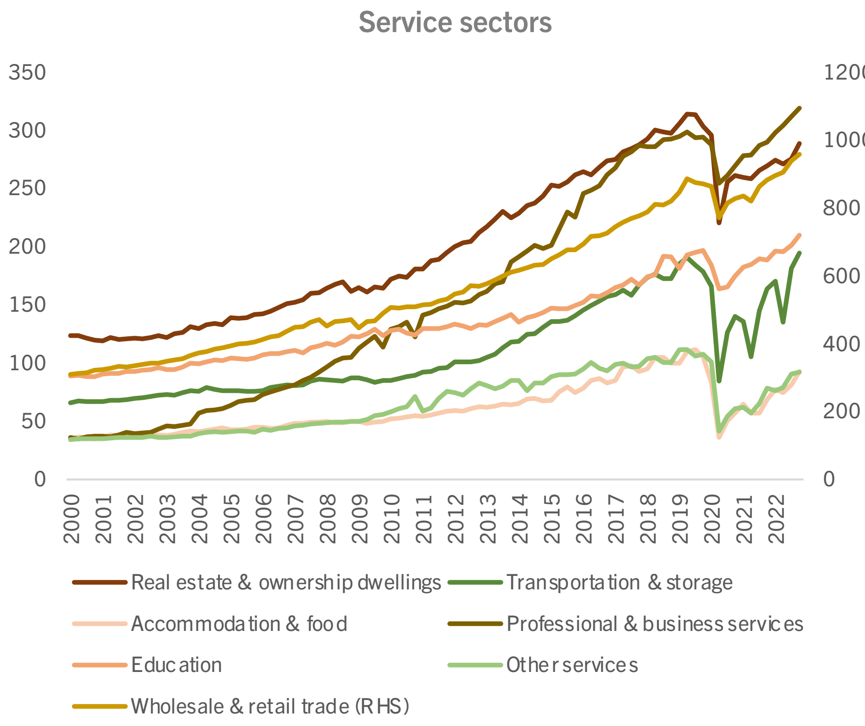
❹ Limiting factors, risks, and challenges

Economic scarring from the pandemic

Many sectors of the economy have suffered enduring losses in physical and human capital due to business closures and prolonged unemployment caused by pandemic lockdowns and restrictions. Output in some sectors are still below pre-pandemic levels. New areas of growth must open to help bring the economy to its pre-pandemic path.







❺ Policy priorities and proposals

Control inflation without harming growth

- Inflation must be controlled as it creates instability and worsens poverty, but this should be done without stifling the economic recovery.
    - Carefully calibrated responses and a coherent public communications strategy are required.
    - Higher frequency surveys on household and business expectations can help with early detection of inflation risks.
- To help cushion the effects of inflation on poor households, targeted support is better than price controls or untargeted subsidies.
- Supply-side reforms to raise productivity (e.g., investment in education and infrastructure) and remove supply constraints (e.g., easing import restrictions when needed) must be implemented.

Smoothen exchange rate volatility

- Sharp peso depreciation must be avoided as it makes the fight against inflation more difficult, may harm balance sheets of firms, and heightens business uncertainty.
- However, policy response should depend on nature of exchange rate movement.
  - If depreciation is due to fundamental factors and financial markets are stable, the correct strategy is to adjust monetary policy to keep within inflation targets and allow the exchange rate to serve its role as an automatic shock absorber.
  - Temporary exchange rate interventions, however, are warranted when FX market disturbances trigger financial or macroeconomic instability and threaten to set off corporate defaults or a financial crisis.

Pursue fiscal sustainability but protect those at risk

- While fiscal space must be rebuilt, the government should protect those suffering from elevated inflation and the pandemic's lingering effects.
- Targeted support to poor households or sectors can provide relief without undermining fiscal targets.
- To foster credibility, the Medium-Term Fiscal Framework should provide specifics on public spending prioritization; future legislative measures (in terms of size/sufficiency of new revenue sources); and the timing of these reforms.
- The Mandanas-Garcia ruling has added uncertainty to the government's spending plans.
  - Greater clarity on policy implementation is needed before moving ahead with full devolution.

Prepare for financial tightening and uncertainty

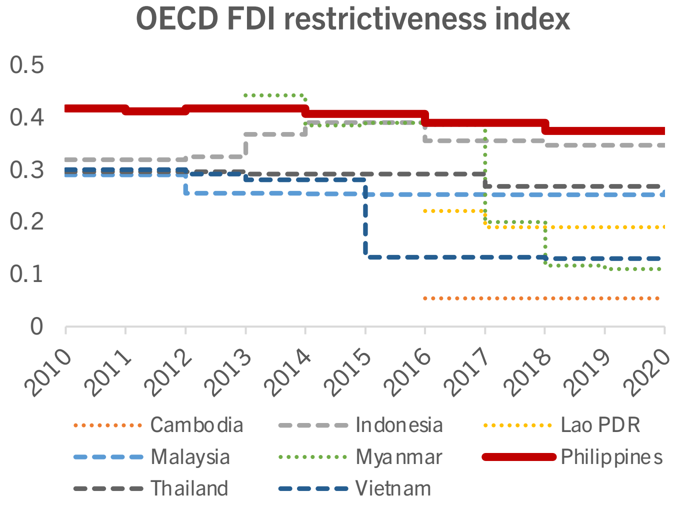
- Financial tightening in advanced economies spill over to EMDEs such as the Philippines and can multiply financial risks.
- Financial regulators should stay vigilant of threats to financial stability through close monitoring of banks (through various asset quality and capital adequacy indicators).
- Financial authorities should also monitor conglomerates associated with banks, including offshore and foreign currency borrowing of non-financial firms.
- To preserve financial stability, the central bank could consider using its powers to gather information from broad economic sectors and close important data gaps.

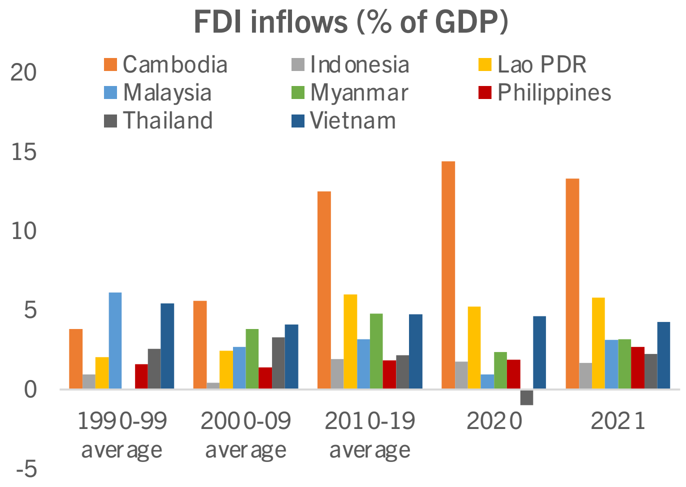
Address the pandemic scars

- Productivity losses from the COVID-19 crisis must be reversed.
- The government should continue its prioritization of infrastructure spending, which helps address scarring by enhancing the country's physical capital, boosting long-term growth, while also having short-run multiplier effects.
    - High-potential areas include infrastructure for more efficient trade, better digital connectivity, and clean energy, especially where private sector participation is viable (with financial risks to government carefully controlled).
- The government should also continue human capital investments in education, social protection, and public healthcare.

❺ Policy priorities and proposals

Continue policy momentum on investments





- With one of the strictest regulatory regimes for foreign direct investment (FDI) in Southeast Asia, the Philippines has perennially lagged its neighbors in attracting FDI.
- The past administration bequeathed the country with laws that have loosened long-standing restrictions to FDI, boosting the country's investment competitiveness.
- The government should continue to remove impediments to FDI by addressing the country's inadequate infrastructure, expensive power, slow internet connectivity, regulatory inconsistencies, and concerns about government corruption.

Recent policy reforms on foreign direct investment

RA 11595 of 2021, amending the 2000 Retail Trade Liberalization Act. *Relaxes restrictions to foreign participation in the retail trade sector.*

RA 11647 of 2022, amending the 1991 Foreign Investment Act. *Allows for greater foreign participation in micro and small-scale enterprises.*

RA 11659 of 2022, amending the 1936 Public Service Act. *Enables full foreign ownership in public services that are not public utilities or critical infrastructure.*

Steering through Global Headwinds in 2023
Summing up

- Macro outlook in 2023
  - Challenging times for the Philippine economy and the rest of the world.
  - Economic growth to moderate in 2023.
  - Headline year-on-year inflation may stay elevated.
- Policy recommendations:
  - Pursue balanced macro management.
  - Address pandemic scars.
  - Continue policy momentum on investments, particularly FDI.

Thank you!

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