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Macroeconomic Prospects of the Philippines in 2022–2023: Steering through Global Headwinds

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Philippine Institute for Development Studies

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Abstract

This paper, which will be released as the lead chapter of the *2021-2022 PIDS Economic Policy Monitor*, reviews the Philippines' macroeconomic performance in 2021 and the first half of 2022, analyzes recent developments and challenges shaping the economy's near-term outlook, and presents macroeconomic projections for 2022 and 2023. With the country's sustained economic reopening, the analysis suggests that GDP growth may grow by about 7.1 percent, but economic activity may weaken in 2023 as the global economic environment deteriorates. Inflation will likely continue to be elevated in 2022 but may still fall within the central bank's target range in 2023. The economic outlook features significant challenges and downside risks, including persistently high inflation, an uncertain business environment, and a possible downturn in the world's major economies. The paper ends by outlining what the authors believe should count among government's key priorities in steering the economy through these headwinds.

Keywords: Philippine economy, growth, inflation, forecast

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Macroeconomic Prospects of the Philippines in 2022–2023:
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Margarita Debuque-Gonzales, John Paul P. Corpus, and Ramona Maria L. Miral*

1. Introduction

The Philippine economy managed to grow by 5.7 percent in 2021 despite waves of COVID-19 cases, as the government relaxed pandemic-related restrictions and ramped up vaccinations. Both private consumption and investment began to recover as community mobility steadily improved, with consumers returning to retail establishments and recreation centers by the last quarter of the year. The reopening also brightened labor market outlook, with unemployment slowly declining though still elevated compared to pre-pandemic levels.

In last year's *PIDS Economic Policy Monitor* (2021), we forecast "a rough recovery" from the pandemic crisis considering intermittent quarantines in key economic regions and weak business and consumer confidence, among other factors, though supported by an expected revival of remittances and election spending. We anticipate further rough sailing this year and the next, as the country faces a new set of headwinds, with inflation becoming a global issue and leading to widespread monetary tightening, which presages a broad slowdown. Financial volatility in advanced countries has been spilling over to emerging market economies, increasing the complexity of issues and challenges faced by local policymakers in these places.

In this chapter, we assess the prospects of the Philippines under the current world and domestic economic environment. We first examine the country's performance in 2021 and the first half of 2022, then discuss the evolving macroeconomic outlook. For the latter, we analyze current macro conditions then present our own macro projections, as well as the consensus projections, while also considering the limiting factors, risks, and challenges. We close by outlining what we propose should (also) be policy priorities of the (new) government.

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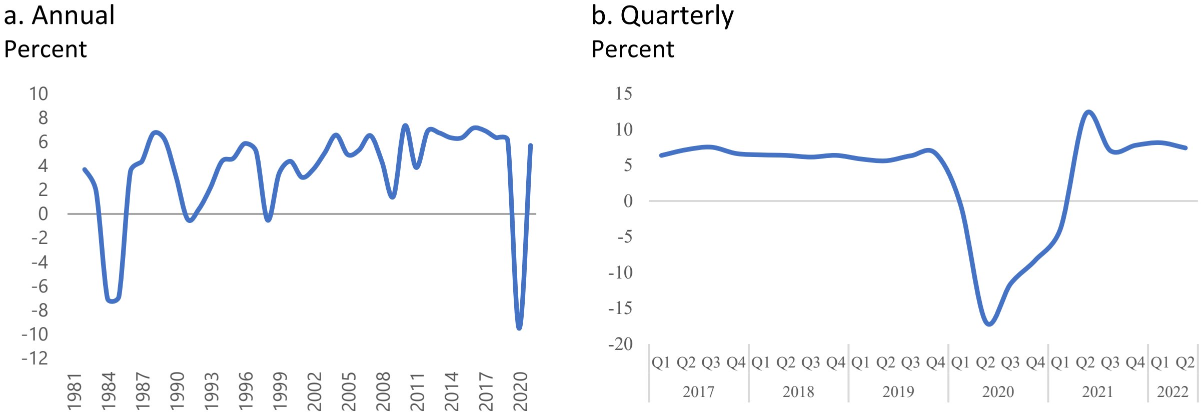
2. Macroeconomic performance in 2021 and H1 2022

2.1. GDP growth

Despite facing COVID-19 outbreaks, growth recovered to 5.7 percent in 2021 as pandemic-related restrictions eased and vaccinations gained pace (Figure 2.1). The momentum for reopening was disrupted as lockdowns were reinstated to stem COVID-19 waves that peaked in Q2 and Q3, the latter fueled by the virus's Delta variant (Figure 2.2a). Their effects, however, were softened by a shift to more targeted and less stringent containment measures, with authorities rolling out a more permissive alert level system of restrictions starting late Q3. Meanwhile, following a slow start due to procurement issues, vaccinations accelerated in H2, with 49.6 million Filipinos or about 45 percent of the population having received the full dose by end of 2021 (Figure 2.2b). These factors, combined with the ebb of the Delta wave and a rise in mobility particularly in Q4, lifted growth to 7.4 percent in H2. A steep but short-lived Omicron wave in January 2022 threatened the recovery, but the subsequent lowering of alert levels, lifting of more pandemic restrictions, normalizing public mobility (Figure 2.2c), and increased immunity due to rising (albeit plateauing) full vaccine coverage (about 71 million or 64% of the population by end-June 2022), helped GDP expand by 7.7 percent in H1 2022.

Figure 2.1. GDP growth



a. Annual

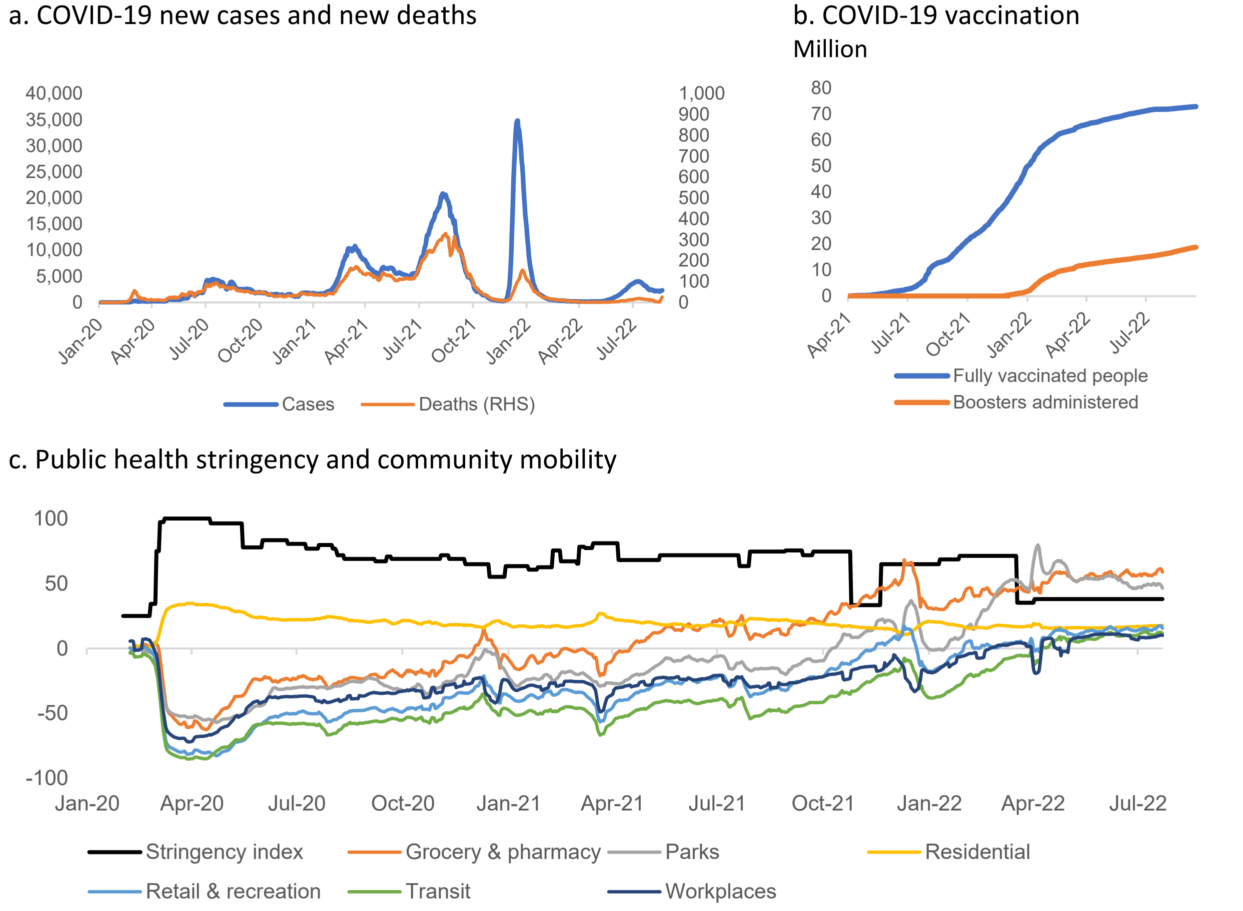
Percent

b. Quarterly

Percent

Source: CEIC Database (2022a).

Figure 2.2. COVID-19 pandemic indicators



a. COVID-19 new cases and new deaths

b. COVID-19 vaccination

c. Public health stringency and community mobility

Note: The stringency index measures the strictness of "lockdown style" policies that restrict people's behavior.
Source: CEIC Database (2022g, h, p, y).

On the demand side, improved investment and consumption spending propelled GDP growth (Figure 2.3a). After contracting by a third in 2020, investment expanded by 20.3 percent in 2021, owing largely to a pickup in public construction and outlays on durable equipment.[1] Faster inflation, high unemployment, and lingering public health restrictions weighed on household consumption, which nonetheless grew by 4.2 percent. Consumption growth was aided by higher spending on necessities such as food, miscellaneous goods and services, health, education, and housing and utilities. Spending on transportation and non-essentials such as recreation and restaurants and hotels also rose but remained significantly lower than pre-pandemic levels. Government consumption, meanwhile, grew at a slower rate of 7.9 percent from 10.5 percent in 2020. Consumption and investment continued to drive the recovery in H1 2022, expanding by 9.3 percent and 20.5 percent, respectively.

Net exports dampened growth as imports recovered faster than exports. Exports grew by 8 percent on the back of strong growth in merchandise exports (11.6%), particularly electronics. With the country remaining closed to foreign tourists throughout 2021, travel exports continued to contract, tempering growth in service exports (2.5%). Meanwhile, stronger domestic demand

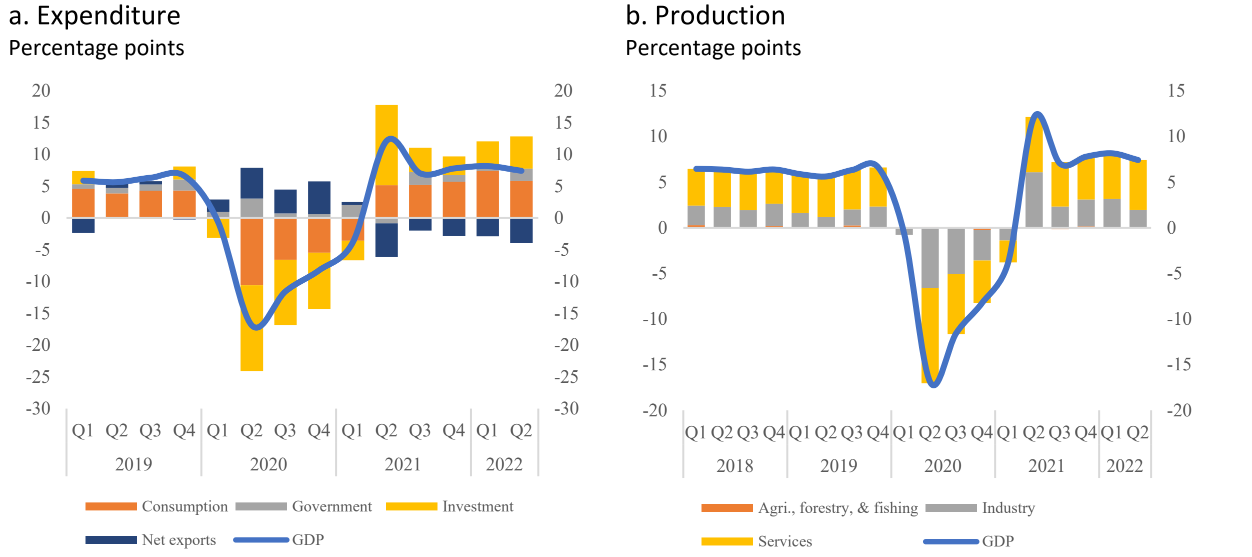
[1] Smaller net inventory withdrawals (-80.4%) accounted for a little under half of investment growth in 2021.

caused imports to rise by 13 percent, owing primarily to increased shipments of electronics, fuel, medicinal and pharmaceutical products (likely due to COVID-19 vaccine orders), and transport equipment. In H1 2022, import growth continued to outpace export growth (14.5% vs. 7.3%).

On the production front, the economy expanded on gains in services and industrial output (Figure 2.3b). Services grew by 5.4 percent, with wholesale and retail trade, finance and insurance, and professional and business services being the main drivers. Output from high-contact services such as transport and storage, accommodation and food services, and arts and recreation also managed to improve but only partially recovered from the steep declines they suffered in 2020. Meanwhile, industrial output rose by 8.5 percent thanks primarily to a rebound in manufacturing, particularly of food and electronics. Construction output also increased but remained well below pre-pandemic levels. Services and industry continued to power the recovery in H1 2022, expanding annually by 8.7 percent and 8.3 percent, respectively.

Agriculture continued to contract on lower livestock output. Despite modest growth in crops and other agricultural subsectors, overall agricultural output dipped by 0.3 percent in 2021 as livestock output fell for a second year in a row (down 17% in 2021) due to the African Swine Fever. In H1 2022, agricultural output grew by a faint 0.2 percent as a large decline in sugar output (down 22.6%)—attributed by authorities to Typhoon Odette and unfavorable weather conditions[2]—weighed on the sector's performance.

Figure 2.3. Drivers of GDP growth



a. Expenditure
Percentage points

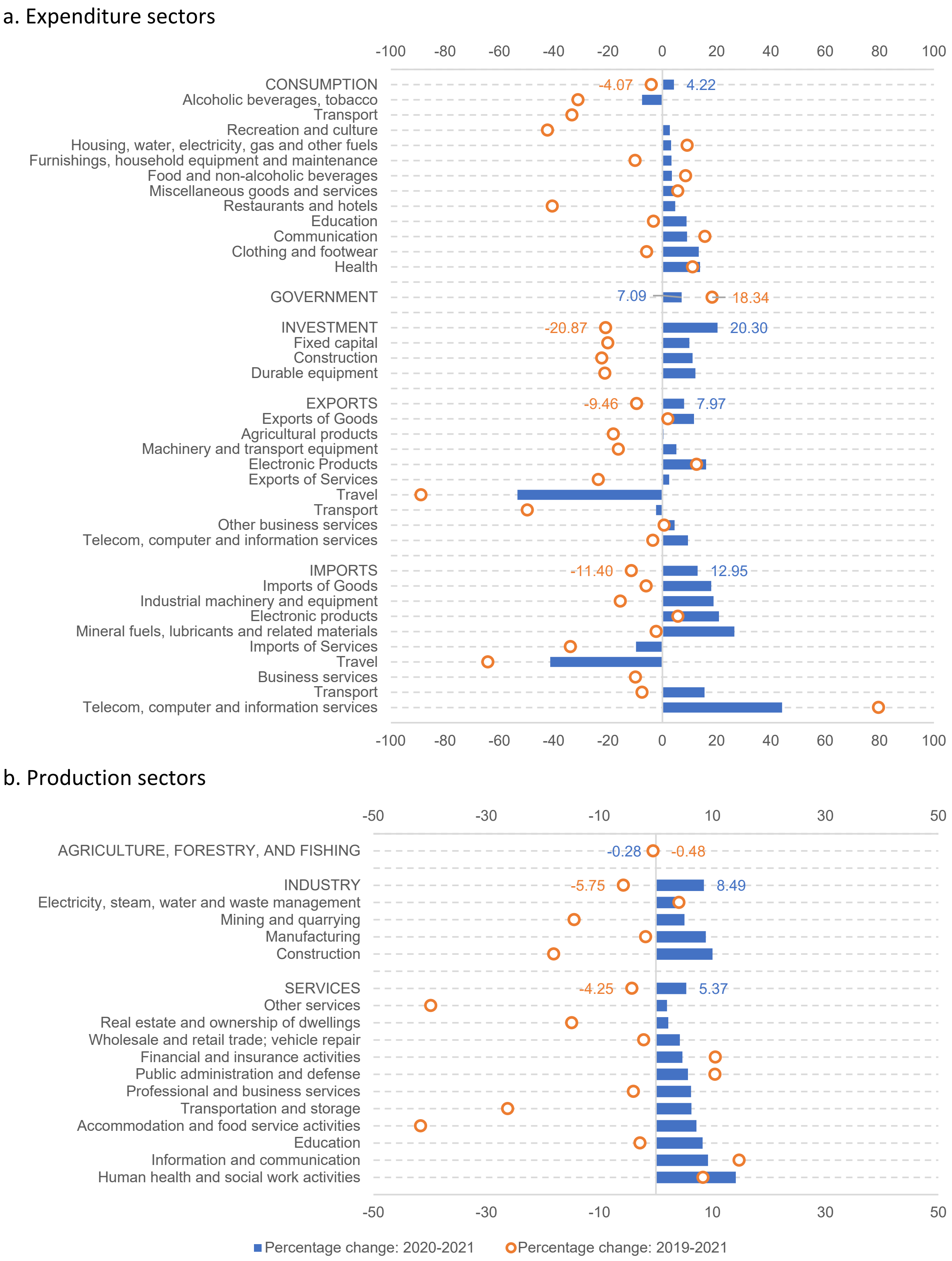
b. Production
Percentage points

Source: Authors' computation using CEIC Database (2022n, o).

[2] Typhoon Odette struck central Philippines—including Western Visayas, the country's main sugar producing region—as a Category 2-3 typhoon in December 2021.

Figure 2.4. Growth in economic sectors

Percentage change



a. Expenditure sectors

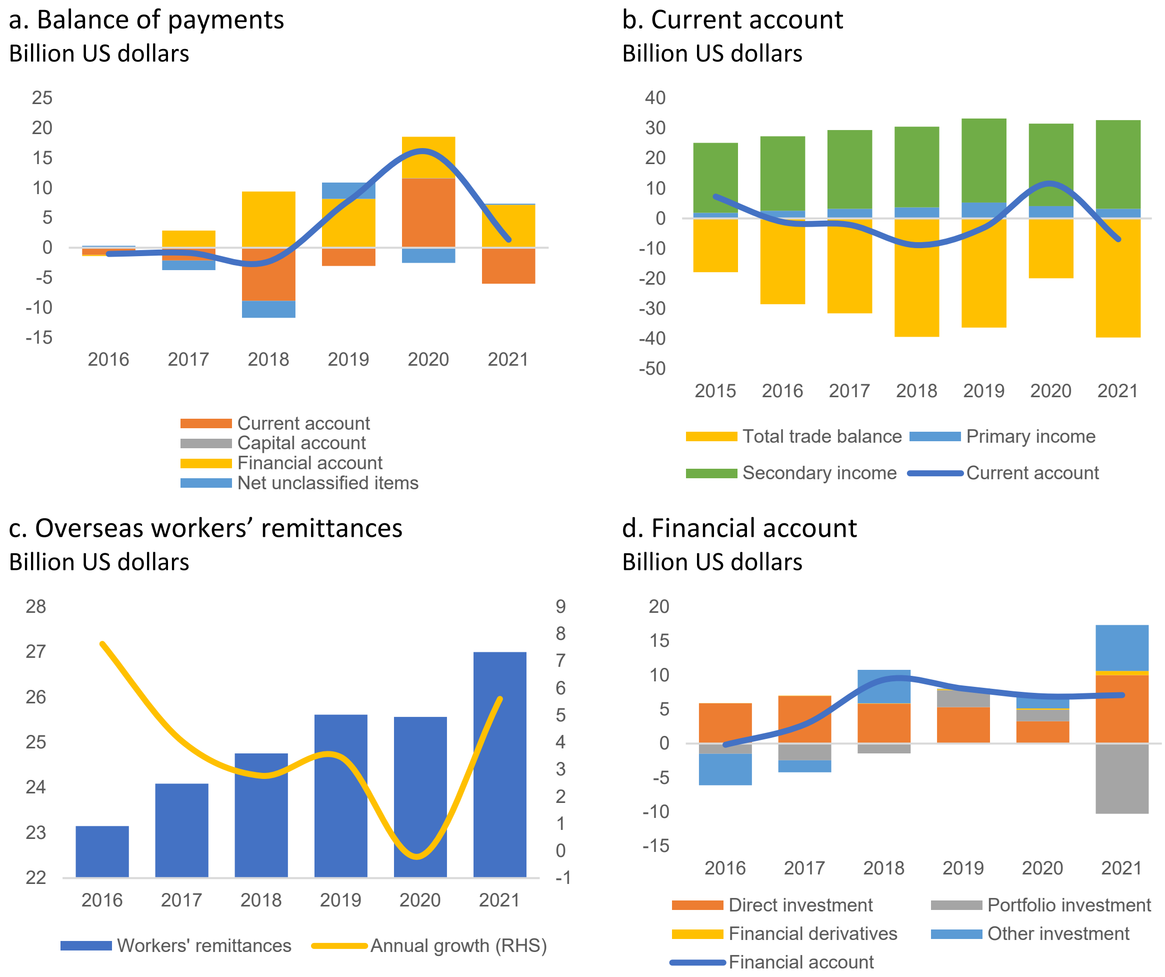
b. Production sectors

Source: Authors' computation using CEIC Database (2022n, o).

2.2. External sector

The Philippines' external position weakened as the current account returned to deficit. The balance of payments (BOP) surplus shrank to just USD 1.3 billion in 2021 from USD 16 billion in 2020 due to a wider trade deficit (Figure 2.5a). Strong import growth and higher global energy prices combined to widen the trade gap, pulling the current account balance from a surplus of USD 11.6 billion in 2020 to a deficit of USD 6 billion in 2021 (Figure 2.5b). The larger trade deficit was partly tempered by overseas worker remittances, which grew by 5.6 percent to USD 29.4 billion (Figure 2.5c). Meanwhile, the financial account recorded a surplus of USD 7.1 billion (Figure 2.5d) due to large net inflows of direct investment (USD 10 billion)—driven by foreign direct investment in the form of intercompany borrowings (USD 7.5 billion) (BSP 2022a)—and other investment (USD 6.7 billion). These inflows were partially offset by significant net portfolio investment outflows (USD 10.2 billion) stemming from higher outward debt acquisition by the central bank and other sectors, coupled by a large decline in debt incurrence by the government compared to 2020. In H1 2022, the BOP sank to a deficit of USD 3.1 billion as the country's rising import bill swelled the current account deficit to USD 12 billion (nearly 9 times larger than in H1 2021).

Figure 2.5. Balance of payments components



a. Balance of payments
Billion US dollars

b. Current account
Billion US dollars

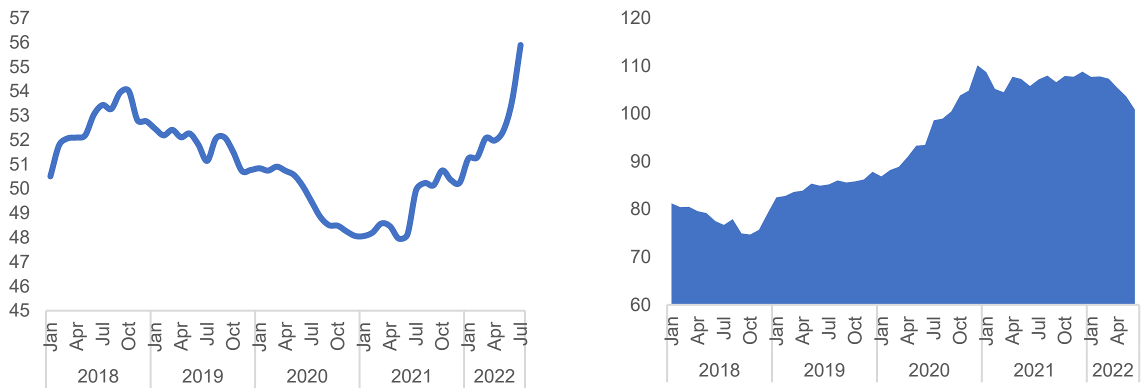
c. Overseas workers' remittances
Billion US dollars

d. Financial account
Billion US dollars

Source: CEIC Database (2022b).

The weaker external position contributed to peso depreciation and lower foreign exchange reserves. Strong import demand and anticipation of US monetary policy normalization weakened the peso, falling to an average of PHP 50/dollar in December 2021 from PHP 48.1/dollar from the previous year (Figure 2.6a). The peso further slipped to an average of PHP 53.6/dollar in June 2022 as the dollar strengthened following three rate hikes by the US Federal Reserve from March to June totaling 150 basis points. Meanwhile, gross international reserves (GIR) stood at USD 108.8 billion in end-December 2021, down by 1.2 percent annually due to the government's foreign currency debt payments and downward revaluation of the BSP's foreign currency and gold holdings (Figure 2.6b). Reserves slid further to USD 100.9 billion by end-June 2022.

Figure 2.6. Gross international reserves and exchange rate



a. Peso-US dollar exchange rate
Pesos per US dollar (monthly average)

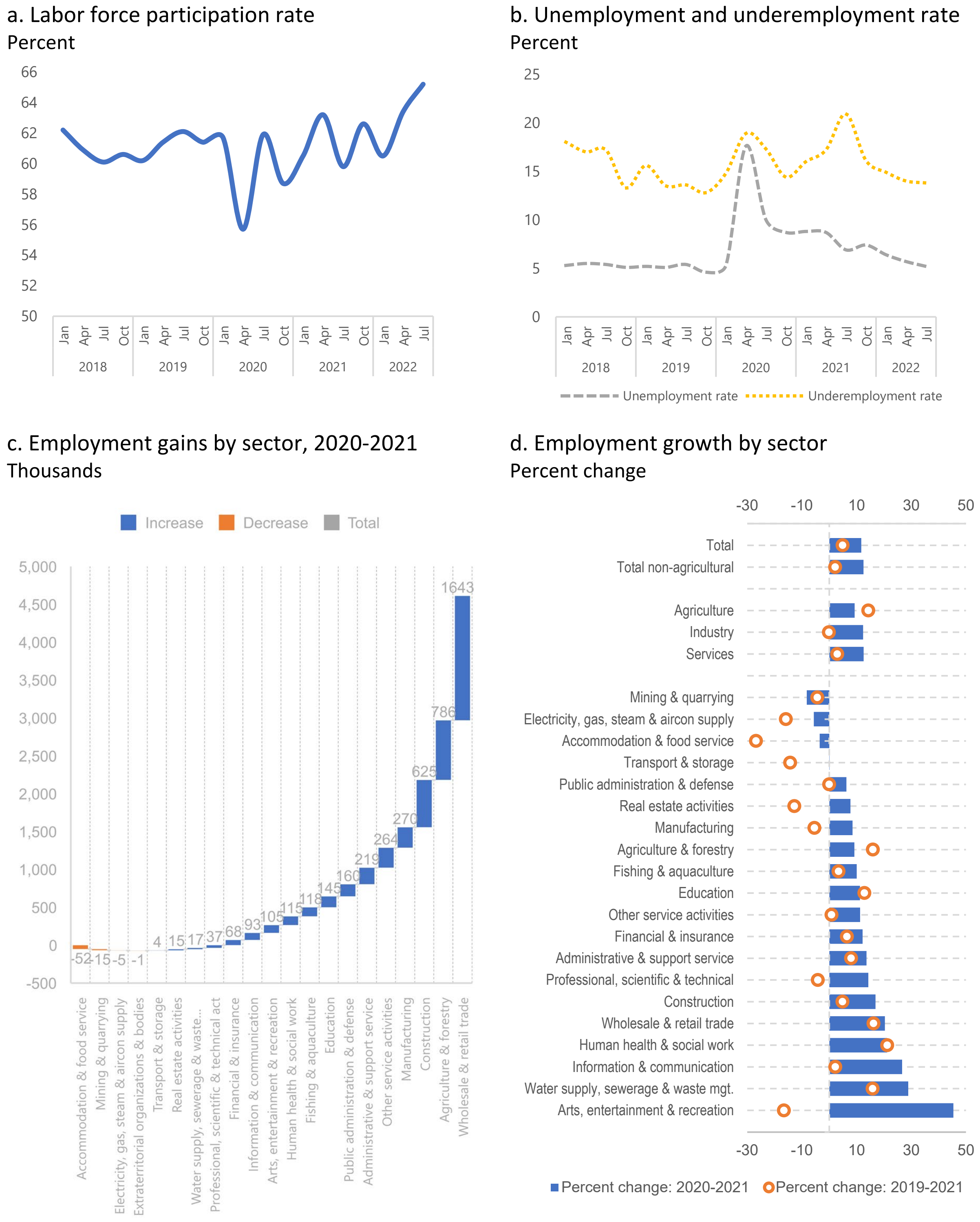
b. Gross international reserves
Billion US dollars

Source: CEIC Database (2022q, z).

2.3. Labor market

The economy's reopening improved labor market conditions, but unemployment and underemployment remained high. Full-year labor force participation (63.3%) and employment (43.9 million) both recovered in 2021 to surpass 2019 levels (Figure 2.7a). The economy added 4.9 million jobs during the year, mostly in the services sector particularly in wholesale and retail trade (Figure 2.7c). However, employment remained below pre-COVID levels in several sectors, notably manufacturing and high-contact services such as transportation, accommodation and food services, and recreation (Figure 2.7d). The uneven job growth contributed to elevated joblessness, which exceeded 2019 levels despite having moderated since 2020 (7.8% in 2021 and an average of 6.1% in H1 2022) (Figure 2.7b). High underemployment (15.9% in 2021 and an average of 14.3% in H1 2022) also persisted.

Figure 2.7. Labor market situation



a. Labor force participation rate
Percent

b. Unemployment and underemployment rate
Percent

c. Employment gains by sector, 2020-2021
Thousands

d. Employment growth by sector
Percent change

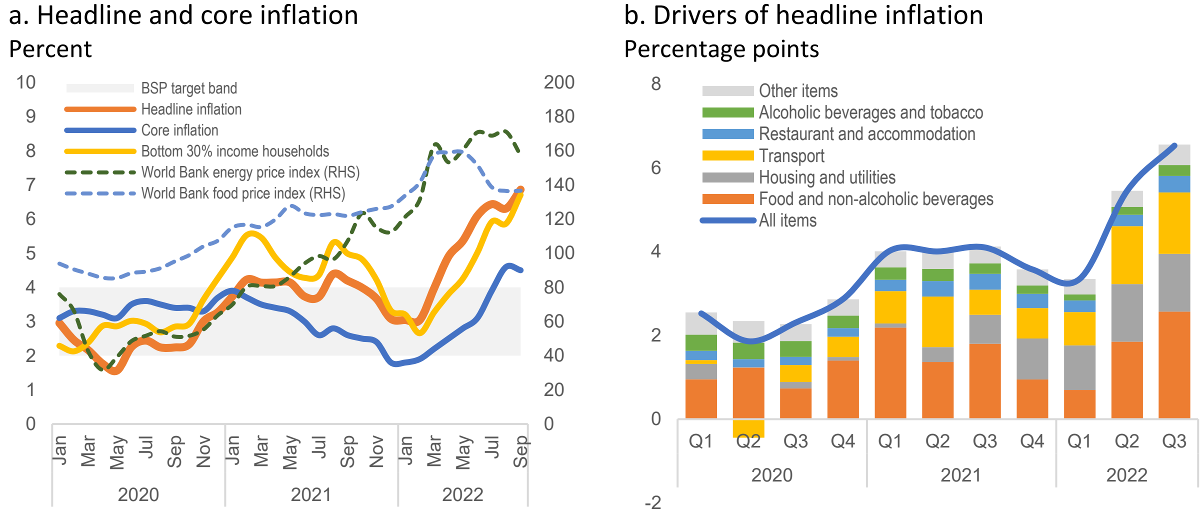
Source: CEIC Database (2022u, ae), authors' computation using CEIC Database (2022j).

2.4. Inflation

Headline inflation increased to 3.9 percent in 2021 on higher food and energy prices (Figure 2.8). From an average of 2.4 percent in 2020, inflation hovered around 4 percent in the first three quarters of 2021 before easing to 3.6 percent in Q4. Meat prices were on average 13.4 percent higher than the previous year due largely to tight pork supply brought on by the continuing African Swine Fever. To address high meat prices, the government imposed a 60-day price ceiling on pork and chicken products in Metro Manila in Q1[3]. Tariff rates for pork and rice were also temporarily reduced under Executive Orders (EOs) 134 and 135, both issued in May 2021. Prices of fish and vegetables rose in some months due to adverse weather conditions. Meanwhile, prices of transport fuel and cooking gas climbed (by an average of 20.8% and 15.1%, respectively) as world energy prices surged owing to the rebound in global energy demand. Inflation in electricity rates also picked up in the second half of the year (averaging 8.5% in H2) due to higher generation and transmission charges.[4]

Consumer prices rose sharply in Q2-Q3 2022. After softening to 3 percent in January-February 2022 owing to a slowdown in food prices, inflation climbed to 5.5 percent in Q2 and 6.5 percent in Q3. A surge in global energy prices following the Russian invasion of Ukraine in late February triggered a sharp acceleration in transport fuel and household gas prices in Q2 (by 57.1% and 31.2%, respectively) which slightly moderated in Q3. During the same quarters, electricity rates increased by 18.7 percent, while food inflation picked up owing to faster inflation in various food products, including meat, cereals (rice and corn) and cereal products, vegetables (in Q2), and sugar (in Q3). Core inflation rose to 4.3 percent in Q3, indicating the spread of price pressures to other consumer items.

Figure 2.8. Inflation



a. Headline and core inflation

Percent

b. Drivers of headline inflation

Percentage points

Note: World Bank commodity price indices are based in 2012 (=100).
Source: CEIC Database (2022r, t, ah), authors' computation using OpenStat (2022).

[3] The price of chicken also rose as consumers substituted chicken for pork.

[4] Gas supply restrictions from the Malampaya gas field to gas-fired power plants and peso depreciation also contributed to higher power charges.

2.5. Fiscal policy

Government expenditure rose by 10.6 percent in 2021 to reach PHP 4.68 trillion (24.1% of GDP), owing mainly to the recovery of infrastructure spending (Figure 2.9a). Infrastructure and capital outlays climbed to 4.6 percent of GDP after falling in 2020 due to lockdowns and budget reallocations towards the pandemic response. Maintenance spending dipped to 4.6 percent of GDP absent a repeat of the nationwide cash relief to low-income families carried out in 2020, but it remained elevated overall relative to pre-COVID levels due to spending on various pandemic-related measures, including COVID-19 vaccine procurement and administration in the health sector, flexible learning programs in the education sector, and OFW repatriation and emergency employment programs in the labor sector. Emergency cash transfers in 2021 occurred at a smaller scale (during strict lockdowns in NCR-Plus in April and in Metro Manila, Bataan, and Laguna in August),[5] but these, alongside higher internal revenue transfers, nonetheless buttressed transfers to local government units (LGUs) to 3.5 percent of GDP. Higher government spending was enabled by the extended availability of funds from Bayanihan 2 (until mid-2021) and the continuing 2020 budget (until end-2021), in addition to the PHP 4.5-trillion 2021 budget.

Revenues grew by 5.2 percent to PHP 3.01 trillion (15.5% of GDP) in 2021 as tax collections recovered amid the revival of economic activity and trade (Figure 2.9b). After falling in 2020, tax revenues rebounded in 2021 by 9.5 percent (to 14.1 % of GDP) on higher internal revenue and customs collections (up 6.5% and 19.7%, respectively). Lower corporate income tax collections (down P35.2 billion or 7%) following corporate tax cuts under the CREATE Law (Corporate Recovery and Tax Incentives for Enterprises Act, or RA no. 11534)[6] played a part in tempering growth in domestic tax revenues, while peso devaluation and higher prices of imports including oil contributed to the strong upturn in customs collections.[7] Despite gains in tax collection, overall revenue growth was blunted by a large decline in non-tax revenues (down 25.2%) as dividend receipts from government corporations normalized after the record levels reached in 2020.[8]

The fiscal deficit swelled to PHP 1.67 trillion (8.6% of GDP) in 2021, leading to higher borrowing and government debt (Figure 2.9c). The deficit is about 10 percent lower than the target (equivalent to 9.3% of GDP) as revenues exceeded and expenditures fell below program (by 4.3% and 1.3%, respectively). The government raised PHP 2.58 trillion in financing, of which PHP 2.2 trillion was obtained through domestic issuances of medium- and long-term Treasury bonds. Higher borrowing pushed national government debt as a share of GDP to rise to 60.4 percent, the highest level in 15 years (Figure 2.9d). The debt portfolio remained largely composed of domestic and long-term debt (69.7% and 69.6%, respectively).

[5] NCR-Plus consists of Metro Manila and the provinces of Bulacan, Cavite, Laguna, and Rizal. The cash aid amounted to PHP 1,000 per person or up to PHP 4,000 per family, smaller than the assistance provided under the Bayanihan 1 Social Amelioration Program (SAP) in 2020 (either PHP 5,000 or PHP 8,000 per family). The government released PHP 22.9 billion in funds for the April round of the cash transfers (using leftover funds from Bayanihan 2), and another PHP 11.3 billion for the August round (using savings from the continuing 2020 budget). LGUs were tasked with aid distribution this time around, rather than Department of Social Welfare and Development (DSWD) as with the SAP in 2020.

[6] In 2021, the government's projected revenue losses from CREATE amount to PHP 138.2 billion for 2021 and PHP 118.8 billion for 2022 (DBCC 2021, p. 17).

[7] Also contributing were lower excise tax collections from petroleum products (down P20.2 billion or 73.3%) due to the temporary shutdown and registration of Petron's Bataan refinery—the country's only remaining refinery—as a locator of the Bataan freeport area. Collection of petroleum excise taxes has since shifted from the Bureau of Internal Revenue (BIR) to the Bureau of Customs (BOC) (DBM 2022a). This, in turn, helped boost the BOC's excise tax collections in 2021 (up PHP 35.3 billion or 27%).

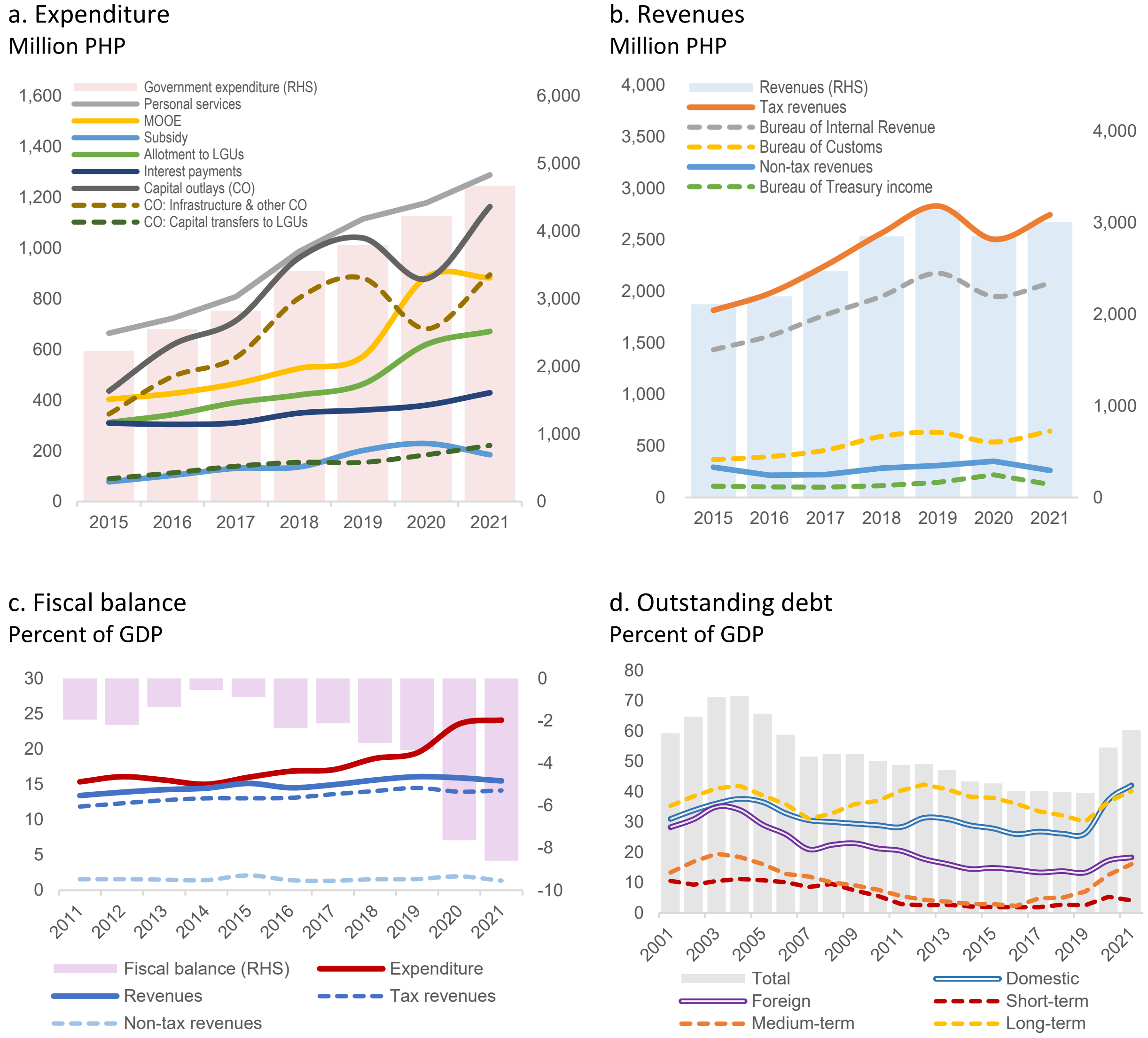
[8] Dividend remittances of government-owned and controlled corporations to the Treasury in 2020 reached PHP 135 billion, which was used to help fund the government's pandemic response.

Revenue growth (15.9%) outpaced spending growth (8.9%) in H1 2022. Tax revenues during the period rose by 14.7 percent year-on-year. Customs revenues notably increased by 31.5 percent as the government reaped a larger windfall from a weakening peso and surging oil prices. On the spending front, allotments to LGUs in H1 grew by 23 percent (PHP 80 billion) as the Mandanas-Garcia Supreme Court ruling—which expands LGUs' share of tax revenues to all taxes collected by the national government[9]—took effect. Infrastructure spending and government employee salary hikes also contributed to spending growth. In addition, the government released funds for cash assistance to vulnerable sectors to cushion the impact of rising fuel and consumer prices, including PHP 2.5 billion for fuel subsidies to public utility vehicle (PUV) drivers, PHP 500 million for fuel discounts to farmers and fisherfolk, and PHP 6.1 billion (as of end-June 2022) for cash assistance to poor and low-income families.[10]

[9] The Supreme Court ruling changed revenue sharing with LGUs by including national taxes (with some exclusions allowed by law) in the base for determining the internal revenue allotment and has necessitated a devolution of some fiscal responsibilities of the national government to LGUs. The National Tax Allotment (NTA) of LGUs is set to increase by PHP 239.8 billion (over 1% of GDP) to a total PHP 959 in 2022, or nearly a fifth of the national budget.

[10] The Department of Transportation's Fuel Subsidy Program, which rolled out in March 2022, provides fuel vouchers worth PHP 6,500 to over 377,000 PUV drivers nationwide. The Department of Agriculture's Fuel Discount to Farmers and Fisherfolk program, which also began distribution in March 2022, provides PHP 3,000 in fuel discount cards to corn farmers and fishers who own fuel-based farm and fishing machinery. Meanwhile, the government's Targeted Cash Transfers program (with DSWD as the main implementer) aims to provide 12.4 million poor and low-income families with monthly cash assistance worth PHP 500 per family for six months (or PHP 3,000 per family in total), subject to fund availability. Distribution of the initial PHP 6.1 billion released in June 2022 started in July. Another PHP 4.13 billion was released for the program in August 2022.

Figure 2.9. National government fiscal performance


a. Expenditure

Million PHP

b. Revenues

Million PHP

c. Fiscal balance

Percent of GDP

d. Outstanding debt

Percent of GDP

Source: CEIC Database (2022v, w).

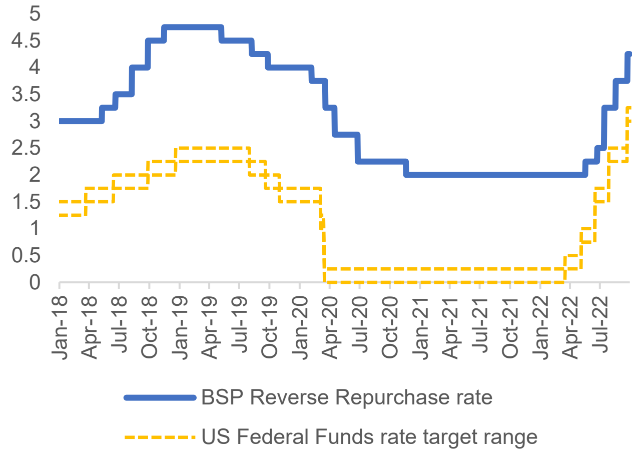
2.6. Monetary policy

The Bangko Sentral kept monetary policy accommodative and continued to provide the government with liquidity support. Viewing inflationary pressures in 2021 as manageable, monetary authorities held the key policy rate (overnight reverse repurchase rate or RRP) at its record low level of 2 percent throughout the year to continue to boost demand and support the economy's recovery (Figure 2.10). Cuts in banks' reserve requirement ratios from 2020 were similarly preserved. To help finance the government amid weakened revenue collection, the central bank granted fiscal authorities' request for three provisional advances on top of the two it had given in 2020. BSP made the advances in January 2021 and July 2021, each worth PHP 540 billion, and in January 2022, worth PHP 300 billion. The government settled these obligations in July 2021, December 2021, and May 2022, respectively.

Monetary policy tightened in Q2 and Q3 2022 to tame inflation. With the economy strengthening and full-year inflation expected to breach the BSP's target in 2022 (and remain elevated in 2023), the central bank pivoted to inflation stabilization. It raised the key policy rate by a total of 225 basis points starting May to reach 4.25 percent by the end of September 2022. The rate hikes were meant to anchor inflation expectations and curb the spread and entrenchment of inflationary pressures, which have started to manifest in minimum wage hikes in June and higher public transport fares in October.[11] The reversal of benign monetary conditions that prevailed in the first two years of the pandemic is in sync with the policy tightening pursued by central banks globally to combat soaring inflation (see section on macroeconomic outlook).

Figure 2.10. Philippine and US key policy rates

Percent



Source: CEIC Database (2022c, af).

[11] Minimum wage increases ranging from PHP 3 to PHP 110 took effect in 16 regions in June 2022 (and in BARMM in July 2022) (DOLE 2022). Wage hikes in some regions are to be implemented in tranches. Meanwhile, the LTFRB in September 2022 approved fare hikes for jeepneys, buses, taxis, and Transportation Network Vehicle Services (TNVS), effective October 4, 2022 (Mendoza 2022).

3. Macroeconomic outlook and risks

3.1. Macro conditions — foreign and local

The global economic environment has deteriorated. Outlook for the world economy, which has barely recovered from the COVID-19 pandemic, is seen to be "gloomy and uncertain" (IMF 2022c), with the risk of "global stagflation"—defined as high inflation combined with sluggish growth—rising (WB 2022b). Major factors undermining global prospects include high inflation in the US and major economies in Europe and anticipated strong monetary tightening; a downturn in China due to continuous mobility restrictions and a worsening real estate crisis; and negative spillovers of the Russian invasion of Ukraine. With tighter financial conditions and lower household purchasing power, world output is expected to grow by about 3 percent in 2022 and 2023, down from previous (i.e., year-ago) GDP growth projections of well above 4 percent and 3 percent, respectively (Table 3.1).

Table 3.1. World outlook in the short to medium term

	2010-2019	2020	2021	2022f	2023f	2024f	2026f
Output (annual % change)							
World	3.7	-3.0	6.0				
GEP (Jun 2022)				2.9 (4.3)	3.0 (3.1)	3.0	
WEO (Oct 2022)				3.2 (4.9)	2.7 (3.6)	3.2 (3.4)	3.3 (3.3)
Advanced economies	2.0	-4.4	5.2				
GEP (Jun 2022)				2.6 (4.0)	2.2 (2.2)	1.9	
WEO (Oct 2022)				2.4 (4.5)	1.1 (2.2)	1.6 (1.7)	1.9 (1.6)
US	2.3	-3.4	5.7				
GEP (Jun 2022)				2.5 (4.2)	2.4 (2.3)	2.0	
WEO (Oct 2022)				1.6 (5.2)	1.0 (2.2)	1.2 (1.7)	2.1 (1.7)
Euro area	1.4	-6.3	5.2				
GEP (Jun 2022)				2.5 (4.4)	1.9 (2.4)	1.9	
WEO (Jul 2022)				3.1 (4.3)	0.5 (2.0)	1.8 (1.6)	1.7 (1.4)
Japan	1.2	-4.6	1.7				
GEP (Jun 2022)				1.7 (2.6)	1.3 (1.0)	0.6	
WEO (Oct 2022)				1.7 (3.2)	1.6 (1.4)	1.3 (0.8)	0.5 (0.5)
EMDE	3.6	-2.0	6.6				
GEP (Jun 2022)				3.4 (4.7)	4.2 (4.4)	4.4	
WEO (Oct 2022)				3.7 (3.6)	3.7 (2.9)	4.3 (2.7)	4.3 (2.6)
EAP	n.d.	1.2	7.2				
GEP (Jun 2022)				4.4 (5.3)	5.2 (5.2)	5.1	
EMDA	7.0	-0.6	7.2				
WEO (Oct 2022)				4.4 (6.3)	4.9 (5.7)	5.2 (5.6)	5.2 (5.3)
China	7.7	2.2	8.1				
GEP (Jun 2022)				4.3 (5.4)	5.2 (5.3)	5.1	
WEO (Oct 2022)				3.2 (5.6)	4.4 (5.3)	4.5 (5.2)	4.6 (4.9)
India	6.9	-6.6	8.7				
GEP (Jun 2022)				7.5 (7.5)	7.1 (6.5)	6.5	
WEO (Oct 2022)				6.8 (8.5)	6.1 (6.6)	6.8 (6.3)	6.5 (6.1)
Consumer prices (annual % change)							

World	3.5	3.2	4.7	8.8 (3.8)	6.5 (3.3)	4.1 (3.2)	3.4 (3.1)
Advanced economies	1.5	0.7	3.1	7.2 (2.3)	4.4 (1.9)	2.4 (2.0)	1.9 (1.9)
EMDE	5.2	5.1	5.9	9.9 (4.9)	8.1 (4.3)	5.3 (4.1)	4.4 (3.9)
EMDA	3.8	3.1	2.2	4.1 (2.7)	3.6 (2.7)	2.8 (2.7)	2.8 (2.7)
World trade volume (annual % change)	4.6	-7.8	10.1	4.3 (6.7)	2.5 (4.5)	3.7 (3.8)	3.6 (3.6)
World prices (USD, annual % change)							
Oil	3.2	-31.7	65.9	41.4 (-1.8)	-12.9		
Nonfuel primary Commodities	1.7	6.5	26.3	7.3 (-0.9)	-6.2		

Dev. ASEAN-5 = Indonesia, Malaysia, Philippines, Thailand, and Viet Nam; EAP = East Asia and Pacific; EMDA = emerging and developing Asia; EMDE = emerging market and developing economies; GDP = gross domestic product; GEP = Global Economic Prospects; US = United States; USD = United States dollar; WEO = World Economic Outlook

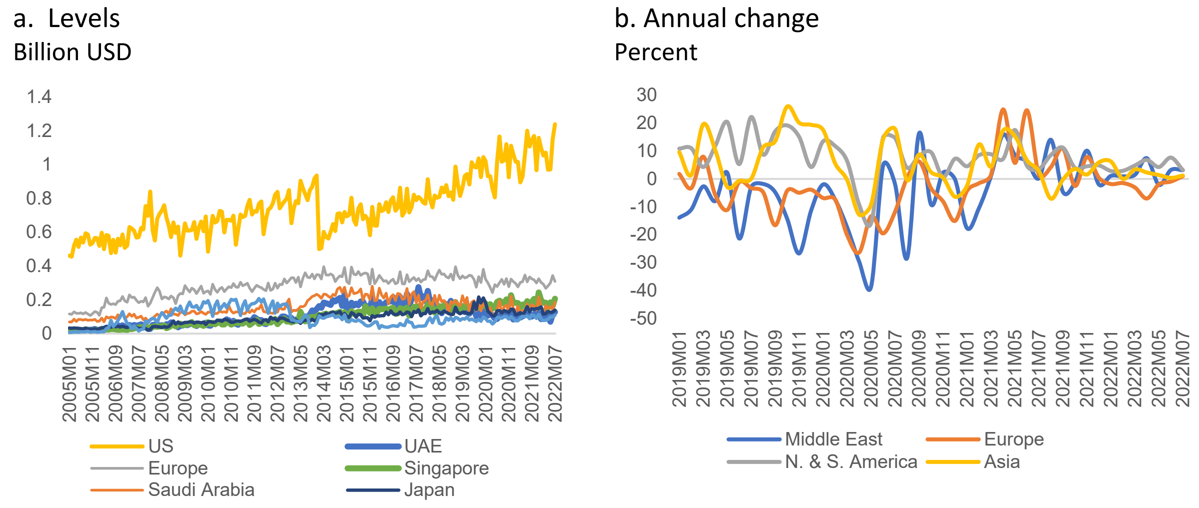
Note: Numbers in parentheses are forecasts from year-ago editions (i.e., Jun 2021 and Oct 2021).

Sources: IMF (2021b, 2022b), WB (2021, 2022b).

The Philippines' main economic partners have weakened. Output growth forecasts for advanced economies for 2022, notably for the US, Japan, and key countries in the euro area, have been revised down substantially over the past year but remain positive (Table 3.1). The US and Japan together account for close to a third of Philippine exports (15.9 and 14.4 percent, respectively, in 2021) and, together with Europe, are a rich source of workers' remittances (Figure 3.1a).[12] Although the US posted two consecutive quarter-on-quarter GDP declines during the first half of 2022 (Figure 3.2a), matching one of the common criteria for a technical recession, US labor markets have been tight with unemployment back to pre-pandemic levels—3.7 percent in August 2022, after spiking to 14.7 percent in April 2020. Robust US employment should help sustain overall Philippine remittance growth albeit at relatively low levels (Figure 3.1b). GDP growth in China, which accounts for 15.5 percent of Philippine exports and over a fifth of imports, has again fallen to a historical low of 0.4 percent annually in Q2 2022 (Figure 3.2b), after experiencing a 6.9 percent drop in Q1 2020, due to further lockdowns under a zero-COVID-19 strategy. A deepening property crisis is adding to the negative outlook for China, with GDP growth forecasts of above 5 percent (5.5 percent and 5.3 percent, on average, for 2022 and 2023) revised down to about 3.8 percent and 4.8 percent.

[12] Cash remittances are remittances sent through the local banking system. Those reported as coming from the US may include inflows originating from elsewhere in the world that simply passed through US correspondent banks or money couriers with main offices located in the US.

Figure 3.1. Overseas cash remittances



a. Levels

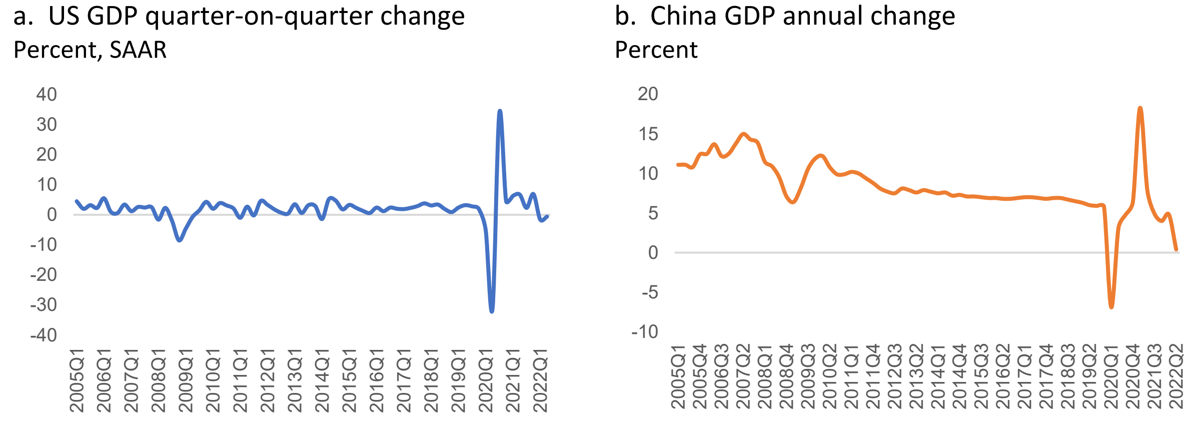
Billion USD

b. Annual change

Percent

Source: CEIC Database (2022x), authors' computation.

Figure 3.2. US and China GDP growth



a. US GDP quarter-on-quarter change

Percent, SAAR

b. China GDP annual change

Percent

SAAR = seasonally adjusted annual rate

Source: CEIC Database (2022e, ag).

Inflation has become a major issue across countries, leading to monetary tightening globally. Inflation forecasts have risen across world regions due to a combination of factors—including supply-chain shortages and expansionary policies in some economies—from 3.8 percent to 8.8 percent on average for 2022 and from 3.3 percent to 6.5 percent for 2023 (Table 3.1). Revisions have been sharp for advanced and emerging market and developing economies (EMDEs), though less so for developing Asian countries. Many central banks have correspondingly raised policy rates, led by the US Federal Reserve, which raised the federal funds rate by 300 basis points between September and January 2022 (Figures 3.3a and 3.3b).

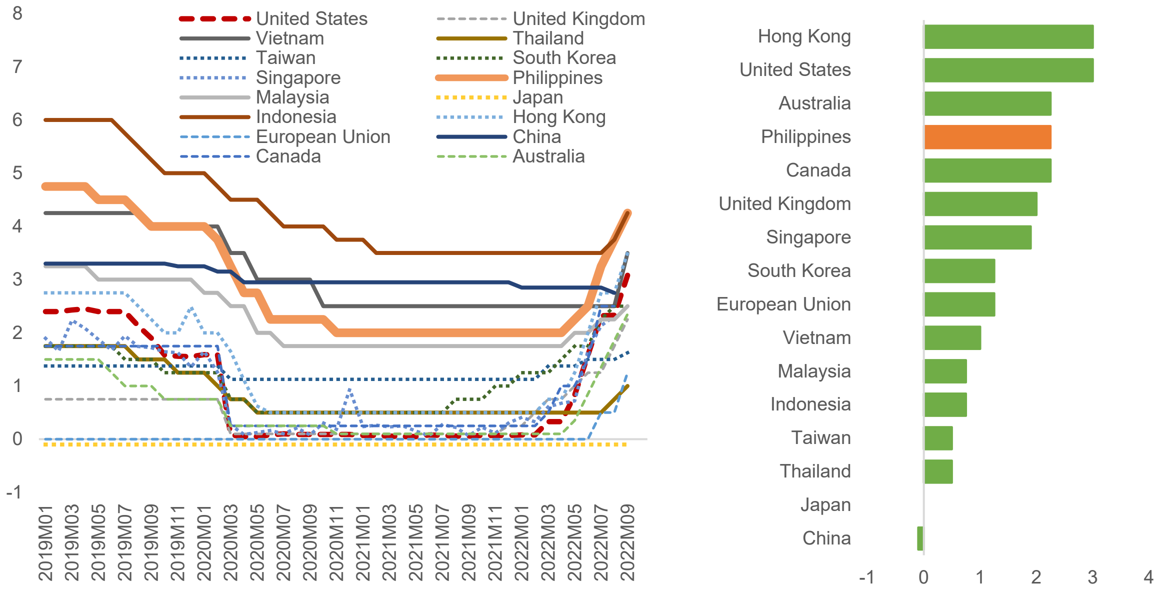
However, movements in key commodity prices, a significant contributor to inflation in many countries, have seemed to soften. The trajectory for world food prices rose beginning June 2020 (Figure 3.4a), steepened in 2022 as the Russia-Ukraine conflict put pressure on cereal prices, then declined by the second half of the year, as grain exports resumed in Ukraine and prospects for grain production improved in North America and Russia (UN News 2022). Oil prices evolved following a similar timeline, rising steadily as demand recovered by mid-2020, then further accelerating during the first half of 2022 as geopolitical tensions rose, before bending in July 2022 as tighter financial conditions fueled expectations of slower world growth (Figure 3.4b).

Financial conditions have been particularly restrictive for EMDEs. Monetary tightening abroad and at home has led to higher interest rates in these countries, even as weaker currencies and wider funding spreads have pushed up the cost of external borrowing (IMF 2022c). Lower risk appetites and expectations of further interest rate increases in advanced economies have negatively affected emerging markets, raising financing risks and debt vulnerabilities. Risk-off sentiment together with expectations of lower profits of firms on account of higher costs have pushed down equity prices, while higher interest rates along with lower tax revenues have pushed up sovereign bond yields.[13] Although financial stability risks have risen in the current environment, investors are still able to differentiate among emerging markets, benefiting those with better inflation outlooks and monetary conditions, and lower exposures to commodity markets (IMF 2022c).

Figure 3.3. Policy rates and rate changes

a. Policy rates
Percent

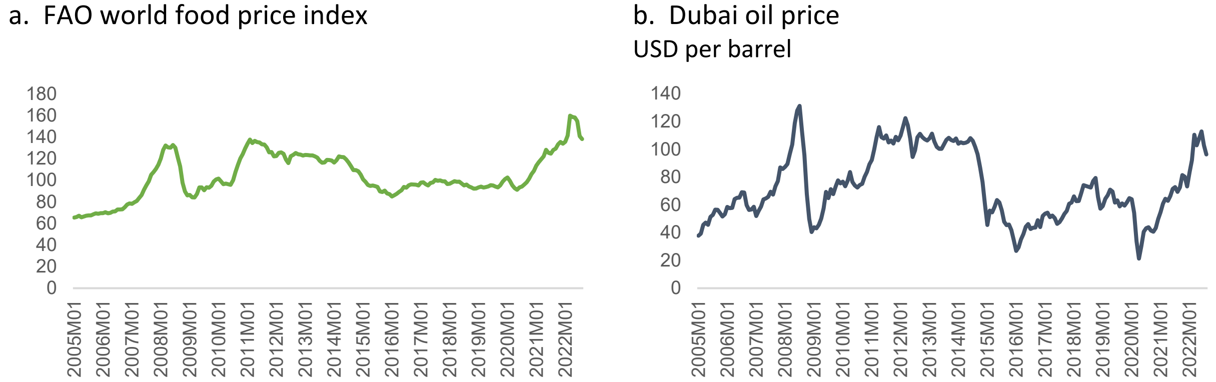
b. Policy rate changes, 2022M09 vs M01
Percentage points



Source: CEIC Database (2022aa), authors' computation.

[13] The Global Financial Stability Update (in IMF 2022c) released in July 2022 reports that about a third of emerging market borrowers had bonds that were trading with yields of greater than 10 percent.

Figure 3.4. World food and fuel prices



a. FAO world food price index

b. Dubai oil price

USD per barrel

Source: CEIC Database (2022i, m).

Like many countries in developing Asia, the Philippines will see higher GDP growth and inflation in 2022, but both indicators are expected to decelerate in 2023. The country's output growth is projected to rise by around 5.7 percent to 6.5 percent in 2022 and about 5 percent to 6.3 percent in 2023 (Tables 3.2a and 3.2b). Forecasters lowered their projections for Philippine growth for 2023, but no special reason was offered for the revisions aside from a deterioration of the external environment. Similarly, inflation in the Philippines is anticipated increase to about 5.3 percent in 2022 but decline to 4.3 percent in 2023.

Monetary conditions will likely remain tight as the country's central monetary authority strives to contain inflation, and in doing so, address a rapidly depreciating peso. Tailing the US Fed, the BSP has already raised the key policy rate by 225 basis points to 4.25 percent, placing it among the highest in the Asian region and significantly above key foreign rates (Figures 3.3a and 3.3b). However, US financial markets expect the Fed to continue raising the FFR to around 4.25 to 4.5 percent by end-2022, with the rate possibly peaking at 4.5 to 4.75 percent in Q1 2023 (Ghosh 2022). This increases the likelihood of further policy rate hikes in the Philippines. Small open economies in Asia typically have domestic monetary policies that are strongly linked with that in the US (e.g., see Debuque-Gonzales and Gochoco-Bautista 2017).

Table 3.2a. Output projections for major ASEAN developing economies

	2019	2020	2021	2022f	2023f	2024f	2026f
GDP (ann. % change)							
Indonesia	5.0	-2.1	3.7				
ADO (Sep 2022)				5.4 (4.8)	5.0		
GEP (Jun 2022)				5.1 (5.0)	5.3 (5.1)	5.3	
WEO (Oct 2022)				5.3 (5.9)	5.0 (6.4)	5.4 (5.6)	5.2 (5.2)
Malaysia	4.4	-5.5	3.1				
ADO (Sep 2022)				6.0 (6.1)	4.7		
GEP (Jun 2022)				5.5 (4.2)	4.5 (4.4)	4.4	
WEO (Oct 2022)				5.4 (6.0)	4.4 (5.7)	4.9 (5.3)	4.4 (5.0)
Philippines	6.1	-9.5	5.7				
ADO (Sep 2022)				6.5 (5.5)	6.3		
GEP (Jun 2022)				5.7 (5.9)	5.6 (6.0)	5.6	
WEO (Oct 2022)				6.5 (6.3)	5.0 (7.0)	6.0 (6.7)	6.0 (6.5)
Thailand	2.2	-6.2	1.5				
ADO (Sep 2022)				2.9 (3.9)	4.2		
GEP (Jun 2022)				2.9 (5.1)	4.3 (4.3)	3.9	
WEO (Oct 2022)				2.8 (4.5)	3.7 (4.0)	3.6 (3.6)	3.2 (3.6)
Vietnam	7.2	2.9	2.6				
ADO (Sep 2022)				6.5 (6.5)	6.7		
GEP (Jun 2022)				5.8 (6.5)	6.5 (6.5)	6.5	
WEO (Oct 2022)				7.0 (6.6)	6.2 (6.8)	6.6 (7.0)	6.7 (6.9)

ADO = Asian Development Outlook, GDP = gross domestic product, GEP = Global Economic Prospects, WEO = World Economic Outlook.

Note: Numbers in parentheses are forecasts from year-ago editions (i.e., Sep 2021, Jun 2021, and Oct 2021).

Sources: ADB (2021, 2022), IMF (2021b, 2022b), WB (2021, 2022b).

Table 3.2b. Inflation forecasts for major ASEAN developing economies

	2019	2020	2021	2022f	2023f	2024f	2027f
CPI (ann. % change)							
Indonesia	2.8	2.0	1.6				
WEO (Oct 2022)				4.6 (2.8)	5.5 (3.2)	3.2 (3.0)	3.0 (3.0)
ADO (Sep 2022)				4.6 (2.7)	5.1		
Malaysia	0.7	-1.1	2.5				
WEO (Oct 2022)				3.2 (2.0)	2.8 (2.0)	2.4 (2.0)	2.4 (2.0)
ADO (Sep 2022)				2.7 (2.3)	2.5		
Philippines	2.4	2.4	3.9				
WEO (Oct 2022)				5.3 (3.0)	4.3 (3.0)	3.1 (3.0)	3.0 (3.0)
ADO (Sep 2022)				5.3 (3.5)	4.3		
Thailand	0.7	-0.8	1.2				
WEO (Oct 2022)				6.3 (1.3)	2.8 (1.1)	1.5 (1.6)	2.0 (1.9)
ADO (Sep 2022)				6.3 (1.0)	2.7		
Vietnam	2.8	3.2	1.8				
WEO (Oct 2022)				3.8 (2.3)	3.9 (3.2)	3.5 (4.0)	3.5 (4.0)
ADO (Sep 2022)				3.8 (3.5)	4.0		

CPI = consumer price index.

Note: Numbers in parentheses are forecasts from year-ago editions (i.e., Sep 2021, Jun 2021, and Oct 2021)

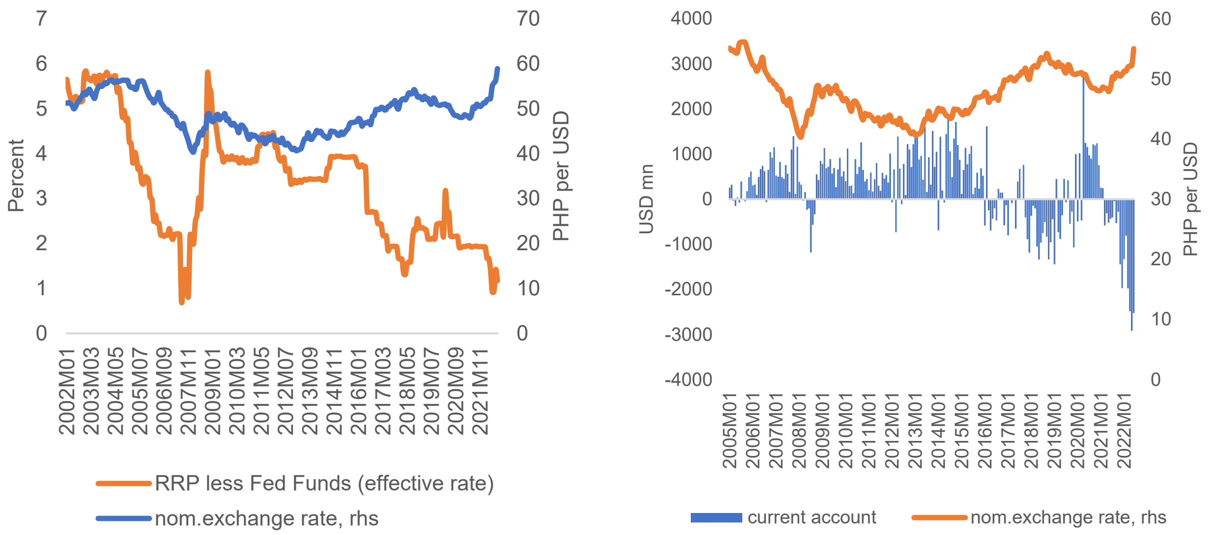
Sources: ADB (2021, 2022), IMF (2021b, 2022b).

Exchange rate volatility has become a key consideration in the near term. Aside from fueling uncertainty, the worry is that large and sudden exchange rate depreciation can significantly add to inflation risk, despite low estimates of the effect of changes in the relative value of the domestic currency on inflation (the exchange rate pass-through or ERPT) overall. In a SEACEN working paper, Delloro et al. (2017) find evidence of asymmetry in the ERPT, with negligible results for appreciation episodes but statistically significant outcomes for depreciation episodes.[14] For an inflation targeter, this implies the need for closer monitoring of inflation risk when peso depreciation shocks tend to be large. Gross international reserves have continually decreased from USD 108.8 billion in December 2021 to USD 97.4 billion in August 2022 reflecting balance-of-payments shortfalls and some foreign exchange intervention to smooth peso volatility. However, they remain at healthy levels and are still able to cover about 7.8 months of imports, the same reading as prior to the pandemic, in end-2019, when import cover was about 7.6 months.

A narrowing interest rate differential and current account deficits have triggered the recent sharp depreciation of the peso. The gap between the US and Philippine policy rates (the FFR and RRP rate, respectively) abruptly narrowed by the middle part of 2022, from 167 basis points in end-April to 92 basis points by end-June, as the US Fed began to aggressively tighten monetary policy to fight domestic inflation, while the BSP likewise considered mainly domestic price (and economic) conditions (Figure 3.5a). The interest rate differential partly recovered when a series of policy rate hikes were implemented by the BSP, though as noted earlier, more policy rate increases are expected from the US Fed. Meanwhile, exceptionally large current account deficits were observed from April to June of 2022 (the last available data point), which contributed to peso weakening (Figure 3.5b). As previously mentioned, these deficits were mainly driven by higher commodity prices and a resumption of domestic demand, including for capital goods, which accounted for the country's strong import growth. This trend likely explains why the peso's depreciation has been stronger than other regional currencies even though the country had more evenly matched movements in the FFR and had the highest interest differential (Figure 3.6a and 3.6b). With the abovementioned forces still in play, the exchange rate continued to rapidly accelerate in the second half of 2022 (approaching 60 pesos per dollar by end-September).

[14] For peso appreciation, the long-run ERPT is statistically insignificant for the pre-inflation-targeting (pre-IT) and IT periods (1982Q2–2001Q4 and 2002Q1–2016Q4, respectively). For peso depreciation, the ERPT parameters are statistically significant—with CPI inflation tending to rise with an increase in the nominal peso-dollar rate—at 0.59 for the pre-IT period and 0.18 for the IT period.

Figure 3.5. Factors driving the exchange rate



a. Interest rate differential

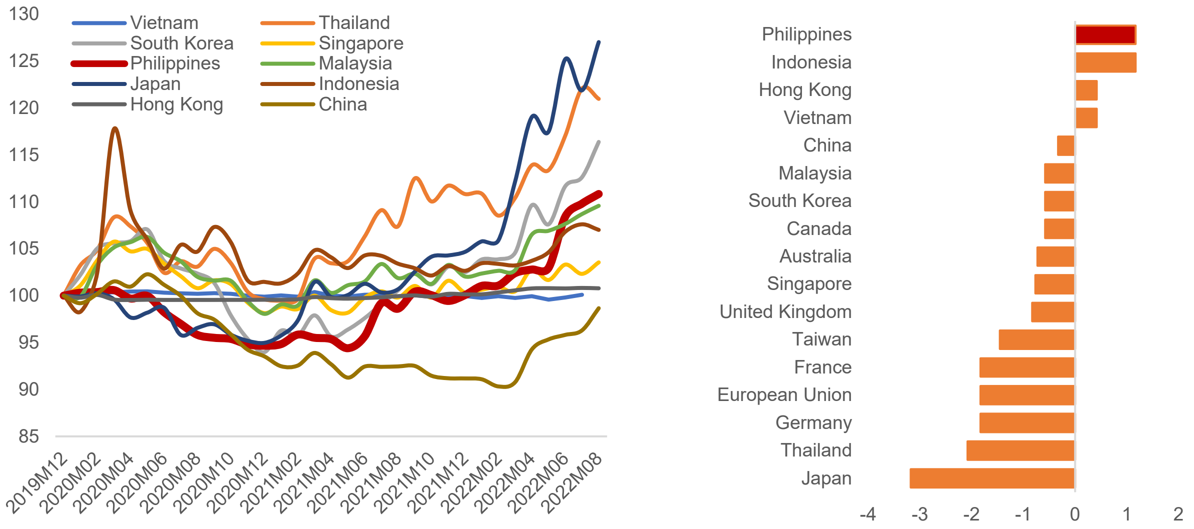
b. Current account

Sources: CEIC Database (2022b, z, aa) and authors' computation using CEIC Database (aa).

Figure 3.6. Asian currency movements and interest differentials

a. Exchange rates
Domestic currency per USD, 2019M12=100

b. Interest rate differentials
Policy rate less effective FFR (Aug/Sep 2022), percentage points



FFR = Federal Funds Rate.
Sources: Authors' computation using CEIC Database (2022k, aa).

Financial conditions in the country have declined in the past year in line with tighter monetary policy and higher domestic currency risk. The latest estimate of the Philippine financial conditions index (FCI) produces a negative reading for June 2022, indicating financial conditions that are worse than the normal level historically, given the stage in the business cycle (Figure 3.7a).[15] This index summarizes indicators of various financial markets, including interest rates and spreads, asset values, credit quantities and liquidity, and measures of financial stress and risk (Debuque-Gonzales 2020a, see Appendix 1). Policy rate hikes in May and June 2022 (25 bps each) largely explain the deterioration of the FCI, with larger consecutive RRP rate increases (75 bps in July and 50 bps each in August and September) and expectations of more rate hikes likely to further tighten financial conditions and keep the FCI in negative territory. Financial conditions had earlier collapsed at the onset of the COVID-19 pandemic and stringent public health restrictions in March 2020 but subsequently improved on the back of aggressive loosening of monetary policy.

Fiscal policy has also become less expansionary, following the government's medium-term fiscal plan, though unexpected revenue gains have seemingly allowed greater room for spending. Government expenditures have so far risen by 8 percent (January to August 2022) versus the planned 6 percent for the whole year under the medium-term fiscal program (Table 3.3), while revenues have so far expanded by 18.1 percent, almost double the targeted 9.9 percent. As noted earlier, a bonanza in customs collections tracing to higher import prices and peso depreciation helped boost government revenues during the period. Public spending is scheduled to grow by less than 3 percent in 2023, though the proposed national budget, which is anchored on the government's 8-point agenda (Box 1), pencils in a 4.9-percent expansion.[16] Fiscal authorities hope to bring the budget deficit down to 3 percent by the end of the current administration and the national government debt-to-GDP ratio to below 60 percent by 2025 (Figure 3.8). In a previous analysis on debt sustainability, we forecast the debt ratio to rise to 66.8 percent of GDP in 2024 and eventually dip to 65.7 percent by 2026 (Debuque-Gonzales, et al. 2022), though these projections assumed maintenance of ample cash reserves (up to 6 percent of GDP). However, these estimates were also made before the emergence of strong global headwinds and have yet to reflect the impact of likely growth deceleration, higher interest rates, and peso depreciation, which are all debt-creating, and higher inflation, which may or may not be debt-reducing.[17] Nevertheless, based on preliminary estimates, we may yet expect the peak to occur around 2024 or 2025.

While a partial reopening of the economy has lifted aggregate demand, some important leading indicators have begun to signal a deceleration of activity (see Appendix 2). On the hopeful side, less stringent public health policies and increased vaccinations, including boosters, have allowed normalization of activity at transit stations, workplaces, and retail and recreation establishments, while banks' easing of lending standards has fostered recovery of credit demand for households as well as for firms.[18] On the less optimistic side, purchasing managers indexes (PMIs), which are based on surveys that try to capture the extent of new product orders in various

[15] An FCI of zero means the financial system is operating at its historical average, consistent with the stage of the business cycle.

[16] The 2023 General Appropriations bill is still being deliberated in Congress, though a realigned version has already been passed by the Lower House on third and final reading.

[17] Higher inflation can lower the real interest rate and the real debt burden, but it can also spur domestic currency depreciation and increase the nominal value of foreign-currency debt.

[18] Some of the production loan activity may be due to precautionary borrowing, however, in anticipation of rising interest rates under monetary tightening, while household loans have been mostly driven by salary loans.

sectors, have been declining,[19] while business confidence as measured by various business expectations surveys has started to wane.

Box 3.1. 2022-2028 Eight-point socioeconomic agenda and medium-term fiscal framework

Eight-point Socioeconomic Agenda. The Eight-Point Socioeconomic Agenda of the Marcos, Jr. administration was unveiled by the country's economic managers on July 26, 2022, one day after the new president's first State of the Nation Address. The agenda seeks to respond to the risks facing the country—including high inflation, lingering effects of the pandemic, and an uncertain global political economy—and steer the economy back to a high growth path.

- Protect purchasing power and mitigate socioeconomic scarring by ensuring food security, reducing transport and logistics costs, and reduce energy costs to families;
- Reduce vulnerability and mitigate scarring from the COVID-19 pandemic by tackling health, strengthening social protections, and addressing learning losses;
- Ensure sound macroeconomic fundamentals by enhancing bureaucratic efficiency and sound fiscal management and ensuring a resilient and innovative financial sector;
- Create more jobs by promoting trade and investments, improving infrastructure, and achieving energy security;
- Create quality jobs by increasing employability, encouraging research and development and innovation, enhancing digital economy;
- Create green jobs by pursuing green economy and establishing livable and sustainable communities;
- Uphold public order and safety, peace, and security; and
- Ensure a level playing field by strengthening market competition and reducing barriers to entry and limits to entrepreneurship.

Medium-Term Fiscal Framework. The 2022-2028 Medium-Term Fiscal Framework (MTFF), which contains the new administration's fiscal strategy, was announced to the media by the Secretary of Finance on July 8, 2022. It presents the government's headline macroeconomic and fiscal objectives, namely:

- Achieving real GDP growth of 6.5-7.5 percent in 2022 and 6.5-8 percent in 2023-2028;
- Cutting the poverty incidence to 9 percent by 2028;
- Reducing the fiscal deficit to 3 percent of GDP by 2028;
- Bringing the debt-to-GDP ratio below 60 percent by 2025; and
- Reaching upper middle-income country status.

On the fiscal front, the MTFF presents a framework for fiscal consolidation while promising that fiscal policy will be supportive of employment growth. The framework aims to:

- Decelerate expenditure growth from 10.6 percent in 2021 to 6 percent in 2022 and 2.6 percent in 2023, before ramping it up again in 2024, reaching 11.5 percent in 2028;
- Bring down expenditure effort from 24.1 percent in 2021 to within 20-21 percent in 2024 to 2028;
- Maintain infrastructure spending at 5-6 percent of GDP from 2023 to 2028;
- Grow revenues annually by an average of 11.9 percent from 2023 to 2028;
- Raise revenue effort from 15.2 percent in 2022 to 17.6 percent in 2028; and
- Improve tax effort from 14.5 percent in 2022 to 17.1 percent by 2028.

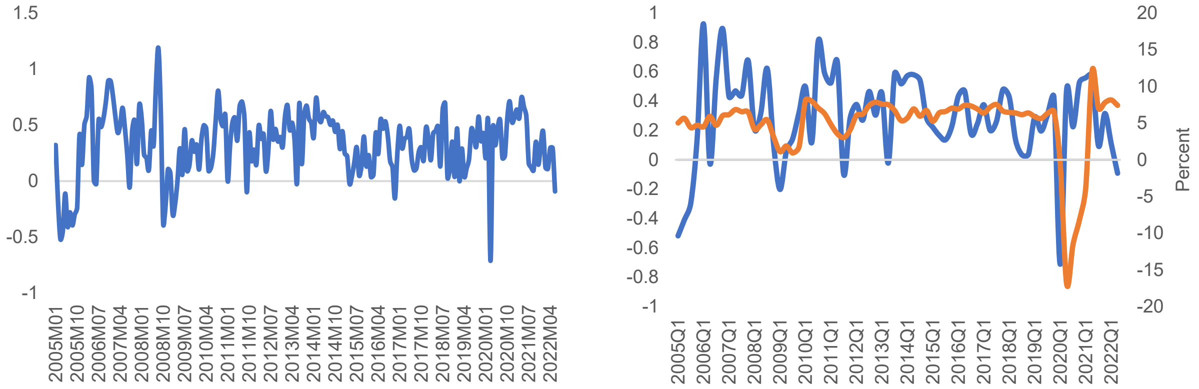
The MTFF outlines the following measures to achieve its revenue targets:

- Impose value-added tax (VAT) on digital service providers;
- Improve income taxation of digital content creators;
- Impose excise tax on single-use plastics;
- Pursue two remaining components of Duterte administration's tax reform package (on real poverty valuation and assessment and passive income and financial intermediary taxation); and
- Pursue tax administration reforms in the BIR and BOC.

Sources: Mercado (2022b), DBCC (2022a).

[19] The S&P Global Philippines manufacturing PMI has trended down from above 54 in April 2022 to below 51 in July, though it turned up slightly in August, to 51.2. PMIs from the BSP reflect a similar trend, with indexes for manufacturing and retail and wholesale trade reaching their post-pandemic peak in March 2022 (at above 55) before falling close to 51.4 and 50.5, respectively. With a PMI reading of below 50 presaging a contraction, the decline in manufacturing PMIs signifies a further weakening of export growth, which had already dropped to 1 percent annually in June 2022.

Figure 3.7. Financial conditions and growth in the Philippines



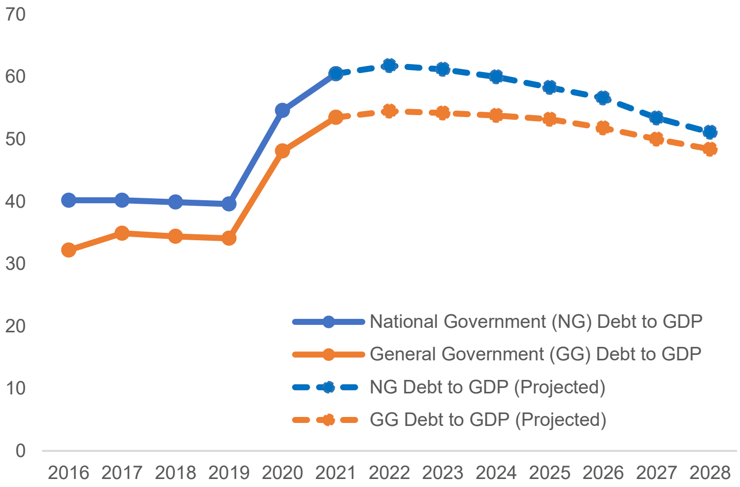
a. Philippine financial conditions index (monthly)

b. Financial conditions and GDP growth (quarterly)

Note: Note: A value of 0 for the FCI means financial conditions are at average levels of liquidity, stress, and risk, consistent with real activity and inflation levels. A value of -1 suggests worse financial conditions than the average historically by 1 standard deviation; the reverse holds for a value of 1.
Sources: CEIC Database (2022a); authors' computations.

Figure 3.8. Medium-term debt to GDP ratio

Percent of GDP



Note: The debt-to-GDP path may be updated at the beginning of the (next) 20th Congress to reflect current economic conditions and developments.
Source: DBCC (2022), as approved on 8 July 2022.

Table 3.3. Medium-term fiscal program
In billion PHP

Particulars	2021	2022	2023	2024	2025	2026	2027	2028
	Actual	Program	Projections					
Revenues	3,005.5	3,304.1	3,632.9	4,062.6	4,576.8	5,155.3	5,821.4	6,589.0
% of GDP	15.5%	15.2%	15.3%	15.6%	16.0%	16.5%	17.0%	17.6%
Growth rate	5.2%	9.9%	10.0%	11.8%	12.7%	12.6%	12.9%	13.2%
Disbursement	4,675.6	4,954.6	5,085.8	5,402.0	5,759.7	6,249.6	6,916.0	7,711.7
% of GDP	24.1%	22.9%	21.4%	20.7%	20.2%	20.0%	20.2%	20.6%
Growth rate	10.6%	6.0%	2.6%	6.2%	6.6%	8.5%	10.7%	11.5%
Surplus / Deficit	-1,670.1	-1,650.5	-1,452.9	-1,339.4	-1,182.8	-1,094.3	-1,094.6	-1,122.7
% of GDP	-8.6%	-7.6%	-6.1%	-5.1%	-4.1%	-3.5%	-3.2%	-3.0%
Memo Item: Nominal GDP	19,410.6	21,672.8	23,755.2	26,065.8	28,578.8	31,266.7	34,207.4	37,424.7
Infrastructure Program[1] **% of GDP**	1,123.6 5.8%	1,199.5 5.5%	1,180.2 5.0%	1,297.2 5.0%	1,423 5.0%	1,644.1 5.3%	1,945.5 5.7%	2,327.7 6.2%

1 Indicative and subject to updating. Projections pertain to disbursements from NG infrastructure, infrastructure subsidy/equity to GOCCs, and transfers to LGUs intended for infrastructure activities. Includes payables from current year's budget and prior years' obligations.
Source: DBM (2022b).

3.2. Macro projections

GDP growth will likely be closer to 7.1 percent in 2022 owing to a sustained reopening of the economy during the year (Table 3.4a). The new administration early on said it will try to minimize lockdowns and focus instead on strengthening the COVID-19 vaccination program, particularly by intensifying the rollout of booster shots (GOVPH 2022). The education department announced resumption of in-person classes in all schools by November 2022, though private schools are provided the option to continue implementing blended and distance learning. Fuller reopening of schools would mean greater catchup spending and sharper recovery of related sectors that had been held down by school closures, such as transport. The steady flow of remittances and BPO receipts, increasing further in peso terms on account of recent strong exchange rate depreciation, provides additional support to aggregate spending in the immediate horizon.

Nonetheless, the country's GDP growth will tend to slow in 2023. Economic activity in the Philippines may be heavily weighed down by simultaneous monetary tightening across the world; heightened risks of a sharp slowdown of major economic partners, mainly the US and China (the latter due to a zero-COVID policy); and restrictive financial conditions that confront most EMDEs, especially higher financing risks and debt burdens.[20] While output expanded by 7.4 percent annually in Q2 of 2022, seasonally adjusted GDP shrunk by 0.11 percent quarter on quarter during the period, indicating possible weakening of economic momentum. In constructing a small macroeconometric model for the Philippines, we find that a global downturn transmits to the economy primarily through a drop in exports (and imports, though to a lesser extent) and weaker investment spending (Debuque-Gonzales and Corpus 2022). *Given the "gloomy and uncertain" outlook for the world economy, we present a forecast range for Philippine growth in 2023, which we expect to decelerate to between 4.5 to 5.5 percent.* Projections incorporating the Philippine FCI, which is tightly linked to GDP growth particularly at important turning points (Figure 3.7b) and

[20] See section on macro conditions.

which has turned negative as of the last update (June 2022), indicate a slower GDP expansion of about 4.7 percent in the coming year. However, catchup spending in services, especially in tourism, and stronger deployment of overseas Filipino workers may bolster growth.

Table 3.4a. Growth projections for the Philippines

		2010-2019	2020	2021	2022f	2023f
GDP (annual % change)		6.4	-9.5	5.7		
International financial institutions						
Asian Development Outlook (Sep 2022)					6.5 (5.5)	6.3
Global Economic Prospects (Jun 2022)					5.7 (5.9)	5.6 (6.0)
World Economic Outlook (Oct 2022)					6.5 (6.3)	5.0 (7.0)
Private sector						
FocusEconomics (Oct 2022)					6.6 (6.8)	5.7
Of which:						
Capital Economics					6.5 (11.0)	6.0
Fitch Solutions					6.6 (6.9)	6.2
Kiel Institute					6.7 (8.0)	5.0
Moody's Analytics					6.8 (6.4)	6.4
Oxford Economics					6.2 (7.4)	4.4
Philippine Equity Partners					6.5 (7.1)	5.5
GlobalSource Philippines					6.3 (6.5)	5.0
Government						
DBCC projection					6.5 to 7.5 (7.0 to 9.0)	6.5 to 8.0
Authors' projection					7.1 (6.5)	4.5 to 5.5

Note: Numbers in parentheses for international financial institutions are forecasts from year-ago editions (i.e., Sep 2021, Jun 2021, and Oct 2021). Numbers in parentheses for the private sector and DBCC are corresponding forecasts from FocusEconomics (October 2021) and the *PIDS Economic Policy Monitor 2020-2021* (Debuque-Gonzales et al. 2021).
Sources: ADB (2021, 2022), DBCC (2022b), Debuque-Gonzales et al. (2021), FocusEconomics (2021, 2022), IMF (2021b, 2022b), WB (2021, 2022b).

While inflation will likely be 5.7 percent on average in 2022 due to large supply shocks in commodities, it can still return to within the official target band (3 percent +/- 100 basis points) in 2023 (Table 3.4b). Price pressures may persist for the time being, as the effects of regional (minimum) wage and transport fare increases, and sharp peso depreciation continue to ripple forward. Other sources of pressure include supply issues in the agriculture and energy sectors, which may push up food and electricity prices, respectively.[21] However, recent softening

[21] These include higher fertilizer costs, shortages of certain farm products, and continued threat of the African swine flu on hog farms in the agriculture sector; and possible termination of supply contracts by a private company in the power sector, as the regulator has denied its petition for a price increase, which may force the main electric distribution utility company in the country to obtain likely higher-cost power from other sources.

of world food and fuel prices with the lifting of supply constraints and deepening fears of a global slowdown are strong indicators that domestic inflation may also soon decline. In our small macroeconometric model, where the price block draws elements from the BSP's workhorse models for inflation targeting, we find the strongest determinants to be domestic (retail) rice and world oil prices. The series of policy rate hikes that began in May 2022 may also take time to work in terms of bringing down consumer prices, with the estimated lag of monetary policy in the Philippines—the time it takes for a policy change to impact inflation—estimated to lie anywhere between 5 to 7 quarters (Tuaño-Amador 2003; Guinigundo 2005) though more recent estimates lie closer to 4 quarters (e.g., Debuque-Gonzales 2020b).[22] *Projections based on the Philippine FCI indicate that inflation will likely fall to the upper bound of the official target range in 2023.*

Table 3.4b. Inflation projections for the Philippines

	2010-2019	2020	2021	2022f	2023f
CPI (annual % change)	3.0	2.4	3.9		
International financial institutions					
Asian Development Outlook (Sep 2022)				5.3 (3.5)	4.3
World Economic Outlook (Oct 2022)				5.3 (3.0)	4.3
Private sector					
FocusEconomics (Oct 2022)				5.3 (3.0)	4.1
Of which:					
Capital Economics				5.0 (2.0)	2.5
Fitch Solutions				5.6 (3.4)	4.5
Kiel Institute				4.3 (2.7)	3.7
Moody's Analytics				5.3 (3.5)	5.0
Oxford Economics				5.8 (3.1)	4.2
Philippine Equity Partners				5.5 (3.0)	3.9
GlobalSource Philippines				5.5 (3.5)	4.2
Government					
DBCC projection				4.5 to 5.5 (2.0 to 4.0)	2.5 to 4.5
Authors' projection				5.7 (3.0)	3.5 to 4.5

Note: Numbers in parentheses for international financial institutions are forecasts from year-ago editions (i.e., Sep 2021 and Oct 2021). Numbers in parentheses for the private sector and government are corresponding forecasts from FocusEconomics (October 2021) and the *PIDS Economic Policy Monitor 2020-2021* (Debuque-Gonzales et al. 2021).
Sources: ADB (2021, 2022), DBCC (2022b), Debuque-Gonzales et al. (2021), FocusEconomics (2021, 2022), IMF (2021b, 2022b).

So far, the macroeconomic outlook of the private sector remains optimistic. Table 3.5, which contains the latest FocusEconomics (October 2022) consensus forecasts,[23] shows that GDP growth in the near to medium term is projected to average around 6 percent, with investment expected to grow robustly, by more than 9 percent. Inflation, on the other hand, is anticipated to quickly return

[22] These are all pre-pandemic estimates, however, and it remains to be seen if the relevant mechanisms of the economy have changed.

[23] These forecasts reflect the views of various banks, financial institutions, and financial research forms on trends in the Philippine economy.

to and stay within the BSP's target band. The fiscal deficit is forecast to taper to 3.7 percent by 2026, in line with the government's medium-term fiscal program (Table 3.3), but national government debt is not seen to fall below the indicative cap of 60 percent in the medium-term horizon. As we noted earlier, under the new administration's Medium-Term Fiscal Framework (Box 1), debt is slated to decline to below 60 percent by 2025. Private forecasters expect the country's current account deficit to taper and settle at around 2 percent of GDP, resuming an increase in the country's international reserves. The exchange rate meanwhile is expected to remain above PHP 50 per dollar until 2026.

Table 3.5. Consensus forecasts for the Philippines: Key macroeconomic variables

	2019	2020	2021	2022f	2023f	2024f	2025f	2026f
Real sector								
GDP (annual % change)	6.1	-9.5	5.7	6.6	5.7	6.0	6.2	6.4
Private consumption (annual % change)	5.9	-8.0	4.2	7.0	5.1	5.5	5.8	6.1
Fixed investment (annual % change)	3.9	-27.3	9.9	14.0	9.3	9.2	9.3	9.4
Unemployment rate (% of active population)	5.1	10.4	8.0	6.1	5.6	5.5	5.5	5.5
Fiscal balance (% of GDP)	-3.4	-7.6	-8.6	-7.3	-6.0	-5.2	-4.4	-3.7
Public debt (% of GDP)	39.6	54.6	60.4	62.6	62.9	62.1	61.0	60.0
Monetary/financial sector								
Inflation (CPI, annual % change, aop)	2.4	2.4	3.9	5.3	4.1	3.5	3.2	2.9
Policy rate (%, eop)	4.0	2.0	2.0	4.29	4.25	4.17	4.17	4.17
91-day Treasury bill (%, eop)	3.00	1.02	1.13	2.23	2.78	3.18		
10-year bond yield (%, eop)	4.45	3.02	4.82	6.38	6.05	6.07	6.02	5.96
Stock market index, PSEi (annual % change)	4.7	-8.6	-0.2					
Exchange rate (peso per USD, eop)	50.6	48.0	51.0	56.0	54.8	53.8	52.9	52.0
External Sector								
Current account balance (% of GDP)	-0.8	3.2	-1.5	-4.2	-3.4	-2.9	-2.6	-2.3
Merchandise Trade Balances (in USD bn)	-40.7	-24.6	-42.2	-53.5	-54.2			
Merchandise Exports (in USD bn)	70.9	65.2	74.7	77.7	80.0	87.6		
Merchandise Imports (in USD bn)	111.6	89.8	116.9	131.2	134.3			
International reserves (USD billion)	87.8	110.1	108.8	106.0	111.0	114.2	116.4	118.5
External debt (in USD)	83.6	98.5	106.4	110.3	113.5	119.0	125.5	132.1

Source: FocusEconomics (October 2022).

3.3. Limiting factors, risks, and challenges

Inflation will be a major limiting factor in the near term. Higher consumer prices have reduced the purchasing power of households, further lowering their (real) incomes coming out of the pandemic, while higher input costs are pressuring businesses, especially those with already thin profit margins and low net worth. This may continue to dampen both private consumption and investment appetite. The latest Family Income and Expenditures Survey (FIES) reveals an increase in the proportion of poor Filipinos in 2021 (Box 2), likely due to employment and income losses during the pandemic but also a period when the inflation measure for poor households (bottom 30% in terms of income) outstripped headline inflation (Figure 2.8). Monetary tightening to control inflation, however, works essentially by reducing aggregate demand, thus further constraining growth.

Risk aversion will likewise be a key consideration. The country recently launched important structural reforms aiming to encourage private investment (Box 3), especially foreign direct investment (FDI), but the policy changes may not bear fruit immediately. The business environment has become more challenging, as financing and other business costs rise, and the world outlook darkens. Domestic uncertainty has also not diminished as pandemic effects linger and potential investors take time to gain deeper insight on the possible outcomes under a new political leadership. This naturally holds true as well for financial market investors.

The economy faces both upside and downside risks. On the upside, economic activity may turn out to be stronger than anticipated on account of resilient remittances and BPO receipts and possible revival of tourism. Remittances had been able to buck a world recession in 2009, when the global financial crisis spread to the real economy, owing to the strength of sea-based remittances. Today, strong demand for healthcare and other service workers, the latter as more countries start to reopen (especially their tourism sectors), are expected to support remittance inflows, while emergent demand for digital workers may bolster the performance of BPOs (Bernardo and Tang 2022). World commodity prices have also begun to decline, lowering the risk of global stagflation. Biggest downside risks include an abrupt drop in global financial conditions, as monetary authorities in advanced economies aggressively raise interest rates; a recession or sharp downturn in the US or China; and a protracted Russia-Ukraine conflict. These are apart from the continued threat of a new COVID-19 variant leading to another surge of infections and the usual risks faced yearly by the Philippines such as typhoons and other natural disasters.

Under the current environment, the government may have limited scope to launch a strong macroeconomic response to counter a downturn. The central bank remains constrained by the issue of high domestic inflation. Sharp peso depreciation due to wider interest differentials and large current account deficits also limit monetary authorities' ability to maintain an accommodative policy stance.[24] Domestic financial conditions have begun to worsen as a result. Fiscal deficits and increasing public debt after the pandemic, meanwhile, have narrowed fiscal space, pressing government to start on a fiscal consolidation path. Lower expected growth, higher interest rates, and domestic currency depreciation all contribute to greater uncertainty in public debt management.

[24] This is reflective of the trilemma or the impossible trinity in economics (based on Mundell-Fleming analyses), which states that it is impossible to simultaneously have full control of monetary policy, a fixed/stable exchange rate, and free capital movement (i.e., no capital controls).

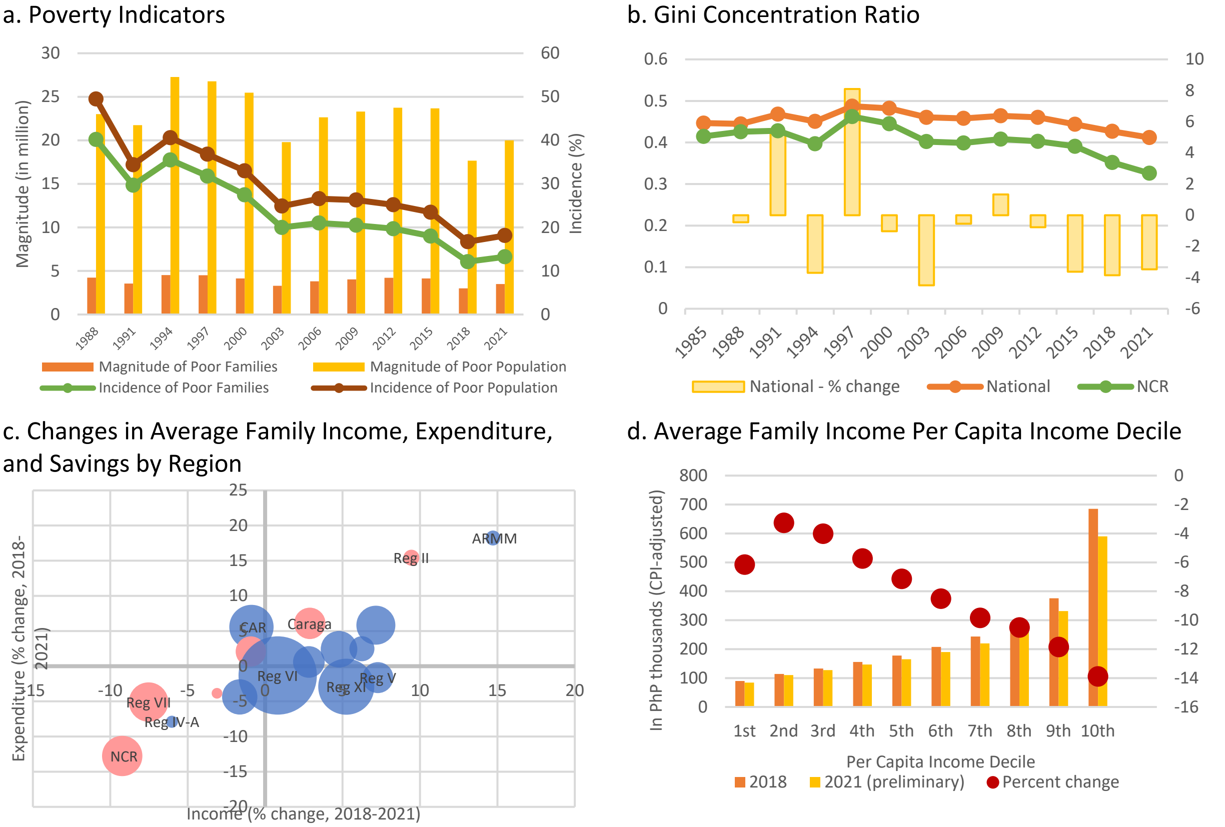
For the longer term, policy challenges include addressing the economic scars from the COVID-19 crisis and encouraging new drivers of growth. Economic scarring refers to possible damage to the country's supply potential (on human and/or physical capital) and include productivity losses due to business closures, de-skilling of workers resulting from prolonged unemployment, and disruptions in job training and planned investment (e.g., Boissay and Rungcharoenkitkul 2020, Eichengreen 2020). Since controlling the COVID-19 virus required intermittent shutdowns of high-contact sectors and a continuous quarantine in key regions, pandemic scarring has seemingly occurred, with output in certain sectors still far below pre-pandemic levels, especially in services (Figure 3.11). Supposing some of the output losses become permanent, new areas of growth will have to come up to close the gap and bring the economy back to its original output path.

Box 3.2. Worsening poverty, lower inequality

The 2021 edition of the Family Income and Expenditure Survey (FIES) confirms that the pandemic worsened poverty. Following periods of declining rates starting in 2006, the latest figures show a reversal. Incidence among families increased from 12.1 percent in 2018 to 13.3 percent in 2021, equivalent to about 500,000 more poor families. Incidence among population likewise increased from 16.7 percent to 18.1 percent[25], equivalent to about 2.32 million more poor individuals (Figure 3.9a). The average income meanwhile fell from PHP 313,348.33 to PHP 307,195.71 and the average expenditure, from PHP 238,640.92 to PHP 228,799.67.

Regions and income deciles were affected differently. Families in more urban locations NCR, Central Visayas, and CALABARZON saw the greatest drop in income, at -9.23, -7.53, and -6.02 percent, respectively. Savings similarly tumbled in NCR (-12.92 percent) and Central Visayas (-7.53 percent). Meanwhile, income fell across all deciles, with the largest contraction registered in the highest-earning group at -6.17 percent. Weaker impact was felt in lower income groups[26] (Figure 3.9c and 3.9d). Such dynamics are reflected in the Gini Concentration Ratio, which implies lower inequality. Readings declined, from 0.43 in 2018 to 0.41 in 2021[27] (Figure 3.9b).

Figure 3.9. Family Income and Expenditure Survey



a. Poverty Indicators

b. Gini Concentration Ratio

c. Changes in Average Family Income, Expenditure, and Savings by Region

d. Average Family Income Per Capita Income Decile

Negative and positive changes in savings are represented by red and blue bubbles, respectively. Sizes correspond to magnitude of changes.

Source: CEIC Database (2022l), authors' computation.

[25] This does not fall within 15.5 to 17.5 percent, the target range for poverty incidence set in the Enhanced Philippine Development Plan.

[26] This is partially an effect of the Social Amelioration Program (SAP). A simulation by Reyes et al (2022) shows that SAP was effective in alleviating poverty incidence by about 3.4 percent among families.

[27] A score of 0 represents perfect income equality. 1 meanwhile implies perfect inequality.

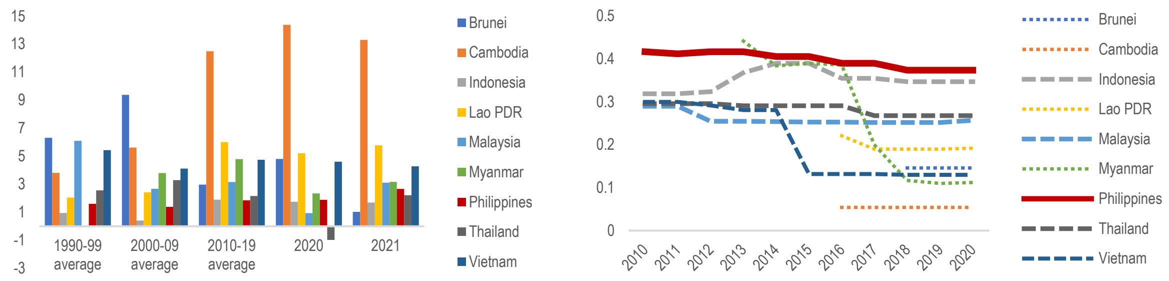
Box 3.3. Reforms to boost foreign direct investment

Foreign direct investment inflows to the Philippines as a percentage of GDP have perennially lagged those of its neighbors (Figure 3.10a). A contributing factor is the country's regulatory environment for foreign direct investment (FDI), which has been among the most restrictive in developing Southeast Asia (Figure 3.10b).

Figure 3.10. Foreign direct investment in developing Southeast Asia

a. FDI inflows
Percent of GDP

b. OECD FDI regulatory restrictiveness index
0 = open; 1 = closed



Note: The OECD's FDI regulatory restrictiveness index captures restrictions in four areas: foreign equity restrictions, discriminatory screening or approval mechanisms, restrictions on key foreign personnel, and operational restrictions.
Source: FDI data from UNCTAD (2022); FDI regulatory restrictiveness index from OECD (2022).

In 2021 and 2022, laws were passed cutting the corporate income tax and loosen longstanding restrictions to foreign investment. The government expects these reforms to boost FDI and help the country's economic recovery.

- Republic Act (RA) no. 11534, or the Corporate Recovery and Tax Incentives for Enterprises (CREATE) Act (signed March 26, 2021), lowers the corporate income tax from 30 percent to 25 percent for foreign and domestic corporations with net taxable income exceeding P5 million. The law also rationalizes fiscal incentives provided to firms registered to investment promotion agencies, providing longer but time-bound incentives to those located in less developed areas and those engaged in more sophisticated sectors.
- RA no. 11595 (signed December 10, 2021), which amends the Retail Trade Liberalization Act (RTLA) of 2000, relaxes restrictions to foreign participation in the retail trade sector. The law eliminates pre-qualification requirements for foreign-owned enterprises to engage in retail trade other than the minimum paid-up capital, which is lowered from USD 2.5 million (P137.5 million) to P25 million.[28]
- RA no. 11647 (signed March 2, 2022), which amends the Foreign Investment Act of 1991, allows greater foreign engagement in micro and small-scale enterprises (MSEs). The law lowers the paid-up capital threshold for foreign participation in MSEs (in sectors not covered by the RTLA and other laws) from USD 500,000 (P27.5 million) to USD 200,000 (P11 million), and further to USD 100,000 (P5.5 million) under certain conditions.[29]
- RA no. 11659 (signed March 21, 2022), which amends the Public Service Act of 1936, relaxes foreign investment restrictions in public services. The law effectively confines the application of foreign equity limits to public services that are public utilities (up to 40% under the Constitution), which are narrowed down to just six sectors,[30] or critical infrastructure (up to 50%), involving services vital to national security such as telecommunications. This enables full foreign ownership in public services that fall under neither category, including shipping, airlines, and railways.

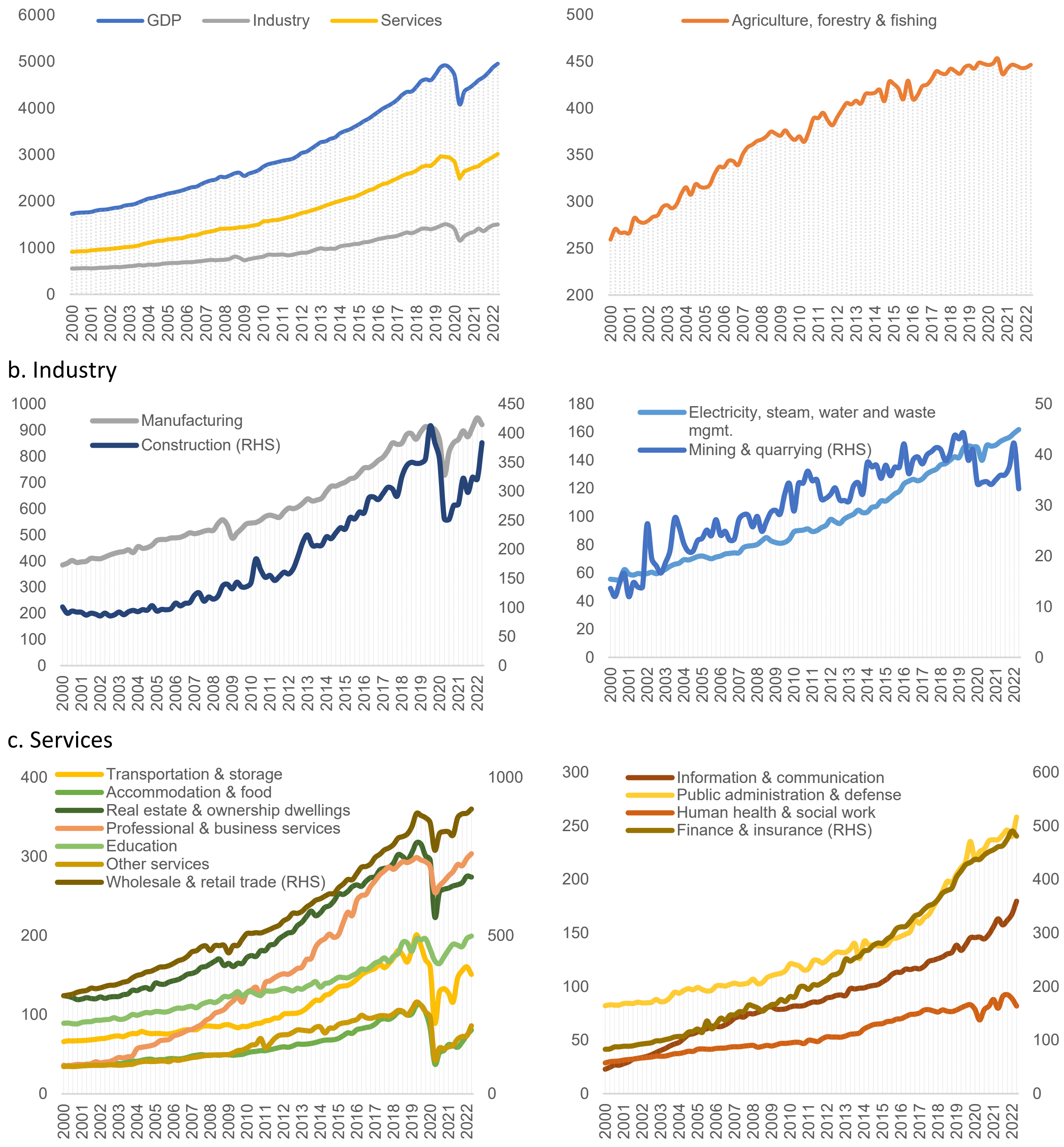
[28] The law also removes the requirement for retailers with more than 80 percent foreign equity to publicly offer a minimum of 30 percent of their equity through the stock exchange within eight years of starting operations.

[29] Namely, if the enterprise involves advanced technology, or is a startup, or if a majority (but not less than 15) of its direct employees are Filipinos.

[30] Namely, electricity distribution and transmission, petroleum and petroleum products pipeline transmission, water pipeline distribution, wastewater and sewerage, seaports, and public utility vehicles.

Figure 3.11. Seasonally adjusted real GDP

Billion PHP, 2018 prices



a. Main sectors

b. Industry

c. Services

Source: CEIC Database (2022ac).

4. Policy priorities and proposals

The new administration has released its 8-point Agenda and Medium-Term Fiscal Framework (MTFF), providing a coherent basis for government programs (Box 1). The 8-point socio-economic agenda focuses on protecting the purchasing power of Filipinos; reducing vulnerability and mitigating economic scarring from the pandemic; ensuring macroeconomic fundamentals; creating jobs (especially quality jobs and green jobs); maintaining safety and security; and leveling the playing field by strengthening market competition and reducing barriers to entry of firms. This agenda provides the foundation for the *Philippine Development Plan 2023 to 2028*, which is currently being prepared by the National Economic and Development Authority (NEDA). The MTFF, meanwhile, proposes measures to enhance the fairness and efficiency of the country's tax system and promote solid fiscal management for sustainable growth (Diokno 2022).

Our macroeconomic analysis suggests the country will enter another period of rough sailing given global headwinds, where the new government's commitment to its socio-economic agenda will be tested. To aid in their maneuvering, and to end this chapter, we list the following policy priorities and proposals, which have benefits cutting across different horizons:

- **Control inflation without harming growth.** This is a near-term priority. Aside from driving macroeconomic instability, high inflation also tends to worsen poverty and income distribution. Taming rapid inflation is also notoriously difficult and may be extremely costly. While a strong policy reaction is needed to prevent persistently high inflation, this naturally stifles economic recovery.

  Minimizing the cost of battling inflation will, more than ever, entail careful calibration of responses—especially considering the nature of price shocks (whether temporary or permanent), and estimated pass-throughs and monetary policy lags—and a clear and coherent communications strategy in relaying policy objectives to the public. Uncertainty about the nature of inflation will require close monitoring of domestic and world prices, including consensus forecasts, and the different factors driving domestic and world economic activity.

  Looking beyond the present episode, the central bank's monitoring toolset would ideally include higher-frequency surveys to gauge inflation expectations of households (Adrian 2022) and businesses (Candia et al. 2021).[31] More up-to-date information would give policymakers a clearer picture of inflation trends and allow early detection of risks, such as possible de-anchoring of inflation expectations or triggering of wage-price spirals.[32]

  In trying to soften the blow of inflation on the consumer, the temptation to impose price controls and untargeted subsidies may be high currently, but such measures tend to be costly (adding to fiscal deficits and public debt) and leads to excess demand, supply

[31] The BSP's consumer and business expectations surveys, which include inflation expectations (for the current and next quarter and the next 12 months), are conducted on a quarterly basis.

[32] Based on the available indicators, such attention to detail will show that producer prices and core prices (excluding volatile price items) have inched down, based on the latest updates. As we note in the discussion of consensus forecasts, the private sector still sees inflation falling within the target band by 2023, which means inflation expectations remain anchored as of early October.

rationing, and even a black market.[33] Targeting support to low-income households hurt by price increases remains to be the better option for the country.

There are also supply-side solutions for taming inflation, though these may take longer to implement and take effect. They include structural reforms to expand supply, either by increasing productivity, which raises potential output, and/or removing supply constraints. The former would be through investments in better education and digital infrastructure. The latter meanwhile includes easing import restrictions, for instance, agriculture products that may face shortages.[34] Such reforms should be implemented immediately.

- **Smoothen exchange rate volatility but maintain flexibility.** Sharp peso depreciation makes the fight against inflation even more difficult.[35] It may also have negative effects on balance sheets, particularly for firms that have taken on a large amount of (unhedged) dollar-denominated debt, contributing to financial tightening. More generally, high exchange rate volatility heightens business uncertainty, with the increase in transactions costs having a well-known negative effect on the growth of small open economies in the longer run, with trade and investment as the main channels.

  Avoiding severe exchange rate fluctuations should clearly be a priority. However, the appropriate response must again depend on the nature of the exchange rate shock as well as its impact on the monetary and financial sectors. If the depreciation is due to fundamental factors (e.g., an appreciating US dollar and rapidly rising US interest rates, and current account deficits due to relative price shocks) and financial markets are not in turmoil, the correct strategy would be to simply adjust monetary policy to keep within inflation targets and allow the exchange rate to serve its role as automatic shock absorber.[36]

  Significant exchange rate intervention, which requires drawing down foreign reserves, may be warranted in certain situations, when domestic currency depreciation is already interfering with the central bank's goals. As Gopinath and Gourinchas (2022) likewise note, there is a role for *temporary* interventions when "currency movements substantially raise financial stability risks and/or significantly disrupt the central bank's ability to maintain price stability."

  Temporary intervention is deemed appropriate when there are acute disturbances in the foreign exchange market that in turn destabilize other financial markets (e.g., by raising risk premia) and trigger macroeconomic instability, or worse, lead to large corporate defaults that could fuel and amplify a financial crisis. It is also applicable in the unique case where large exchange rate depreciations, which are more likely to occur in shallow

[33] This also has a distributional angle as price controls support not just poor households and small businesses but also deep-pocketed individuals and firms.

[34] For example, passage of a law that removed quantity restrictions on rice imports and replaced the quotas with tariffs (RA 11203 or the Rice Tariffication Law) led to a softening of rice prices after it was implemented in March 2019, helping bring down headline inflation, which breached the official target in 2018 (averaging at 5.2% for the whole year). Rice accounts for 8.87 percent of the CPI index. EO 171, issued in May 2022, also extended the validity of EOs 134 and 135 (until end-2022) which lowered the tariff rates for pork and rice, respectively.

[35] Gopinath and Gourinchas (2022) state that, on average, the estimated pass-through of a 10-percent dollar appreciation into inflation is 1 percent, with pressures tending to be greater for emerging market economies.

[36] Letting the exchange rate depreciate, for instance, naturally reduces imports (and encourages exports), helping bring down trade deficits and prevent accumulation of external debt. Like other price controls, exchange rate intervention may not be beneficial if made permanent, as it serves to distort price signals and impede efficient allocation of resources.

currency markets, succeed in de-anchoring inflation expectations, or where monetary policy may not be enough to stabilize prices. Such a strategy allows a country to preserve its foreign reserves—i.e., to be used only when necessary, or minimally. Similarly, the use of capital controls must be carefully considered and only briefly applied under rare circumstances.

As of time of writing, the country's gross international reserves had already fallen by over 14 percent since end-2021, though they remain slightly above pre-pandemic levels. The central bank cited the need to prevent a buildup of inflationary pressures as reason for the intervention. Monetary authorities recently bared several non-monetary tools they were prepared to use to lower exchange rate volatility and meet "legitimate demand" for foreign currency (mainly, for international trade). These include liquidity management tools for FX such as a US dollar repo facility, an exporters' dollar and yen rediscount facility, and an enhanced currency rate risk protection program (CRRP) that aimed to ease demand pressures in the FX spot market.[37] Swap arrangements were also available that could provide short-term FX liquidity support when needed, including one with the Bank of Japan and another with ASEAN+3 countries under the Chiang Mai Initiative.

In all cases, clear, calm, and coherent communication of policy goals and direction will be needed, especially as the level of appreciation of complex issues regarding the exchange rate may be different for the public and financial markets. Central bank independence and transparency should also be maintained to build confidence in the ability of monetary authorities to maintain sound policy as well as strengthen control over inflation expectations.

- **Pursue fiscal sustainability but protect those at risk.** While there is a need to rebuild fiscal space because of the rising debt burden, priority should also be granted to protecting those most at risk from the lingering effects of the COVID-19 crisis and elevated inflation. Households still reeling from the harsh effects of the pandemic are the same ones now suffering from consumer price increases, and likely the same ones to be hurt by monetary tightening. However, fiscal policy should also not overturn inflation goals.

  Conflicting objectives may be met through well-designed and well-targeted fiscal support, notably by continuous improvement of the country's social protection program. For instance, direct transfers that are more efficiently delivered to poor households may provide relief without jeopardizing fiscal targets. Thus, ongoing development of a digital delivery system for social protection (digital IDs and stronger digital data governance and digital payment systems) stands out as an important achievement, as it widens the reach of government, allowing it to include poor households that were previously denied social services because of the lack of an ID (Varghese and Elfayez 2022). Government may similarly provide well-targeted financial support to alleviate the burden of badly hit sectors in special cases, such as during periods of steep oil price hikes, but only temporarily.

[37] Similarly, to help contain inflation, they also turned to operational tweaks to strengthen liquidity management, by allowing trust entities' unit investment trust funds (UITFs) that have minimal foreign participants to invest in central bank-issued securities traded in the secondary market. As in the case of the enhanced CRRP, a similar strategy as the current one was already used in the past, with monetary authorities garnering a fair amount of success from the policy innovation.

In past studies on debt sustainability (Debuque-Gonzales et al. 2022), we emphasized the need for a sound medium- to long-term fiscal consolidation plan to attain debt sustainability, but also to give the economy time and room to recover from the pandemic shock. We argued that immediately aiming for a low debt ratio (i.e., closer to the pre-pandemic rate of about 40 percent of GDP for national government debt) may not be feasible, which remains the case today, as the need for fiscal support may continue as the economy enters another rough period.

While the MTFF has offered initial comfort to financial markets, there may eventually be greater demand for policy details. Providing a sound and credible plan will be crucial, as market expectations shape perceived debt limits and the corresponding fiscal space. The fiscal plan should include specifics on the prioritization of public spending; the additional revenues that may be expected from *future* legislative measures, which should be large enough to move the needle on deficits and debt; and the timing of these deficit-reducing measures, some of which may be made conditional on economic recovery.

As also noted by other observers (e.g., IMF 2021a), additional fiscal measures are needed in view of pandemic scarring, the recent corporate tax cut (under the CREATE law), and the implications of the Mandanas-Garcia ruling, which has raised the amount apportioned to LGUs. The latter development has added uncertainty to the spending plans of government, while raising concerns that larger fiscal support may eventually undercut the financial viability of LGUs. This is another area where greater clarity on the implementation of policy is needed, on account of numerous issues that must ideally be settled before a full devolution of functions from the national government to local governments takes place.[38]

- **Prepare for financial tightening and uncertainty.** Financial tightening in advanced economies can be expected to spill over to EMDEs. In the Philippines, higher US interest rates have pushed up domestic interest rates while also triggering sharp peso depreciation. The combination has led to a sudden decline in financial conditions (Figure 3.7).

  Financial risks can multiply in such a scenario. Although higher interest rates normally imply wider profit margins for financial institutions, an economic slowdown may offset this by raising default probabilities and reducing new loans. Higher funding costs may burden private borrowers, especially those already weakened by the COVID-19 crisis, making it difficult for them to meet payments and curtailing credit demand. Declines in the domestic currency add to the precarious mix. In Southeast Asia, the World Bank (2022a) mentions firms in Indonesia, the Philippines, and Vietnam as being "particularly vulnerable

[38] Full devolution is set to occur in a phased manner, with support provided for capacity development. An executive order (EO 138) was issued in July 2021 on the full devolution of some functions of the executive branch to local governments and the creation of a Committee on Devolution. Both national government agencies and LGUs have been asked to put together detailed transition plans. A Growth Equity Fund has also been set up for LGUS needing the most assistance (namely, the poor, disadvantaged, and lagging LGUs) in the implementation of devolved functions and services, including of infrastructure projects. As of time of writing, the timeline for the devolution of some functions has been extended to 2027 from 2024.

to exchange rate depreciations," with at least three-fifths of their maturing debt (consisting of syndicated loans and bonds) denominated in foreign currency.[39]

Higher interest rates and lower tax revenues under a sluggish economy may also worsen fiscal accounts and hamper fiscal sustainability. Notably, the link between sovereign debt markets and domestic financial systems in developing Asia has intensified during the pandemic, as commercial banks along with central banks provided the financing needs of governments during the time (World Bank 2022a). This suggests even stronger transmission of risks from sovereign bonds to bank balance sheets in the post-pandemic period.

In an uncertain environment, financial regulators will need to stay vigilant and guard against possible threats to financial stability that could set off an adverse macro-financial feedback loop. They must continue to ensure that banks are strong enough to deal with corporate difficulties, by closely monitoring bank asset quality and capital adequacy indicators.[40] The Philippine banking system so far remains healthy in this regard, with still quite low non-performing loan (NPL) levels, ample loan loss reserves, and strong capital and liquidity buffers.[41]

Financial authorities must not just closely monitor the banks, however, but also the conglomerates banks are associated with. The IMF (2021a) attributes the limited rise in NPLs during the pandemic to the resilience of conglomerate businesses that are tightly linked with large banks in the country, apart from improvements in banks' risk management owing to past crises and proactive loan restructuring. Thus, keeping track of conglomerates, including offshore and foreign currency borrowing of their non-financial firms, is also vital to maintaining financial stability, given possible lagged effects of the pandemic and subsequent global and domestic financial tightening.[42]

To lessen the uncertainty, it may be beneficial to start monitoring financial stability from a larger (macroprudential) perspective, for instance through the conduct of macro-scenario stress testing of banks, as suggested by specialized observers (e.g., IMF 2022a). This would entail examining the effects of relevant macro scenarios, making sure to include macro-financial feedback effects when assessing the stability of financial institutions. It may be

[39] BSP data show external debt of the private non-banking system rose sharply (by 22.4 percent) from USD 20.687 billion in 2019 to USD 25.315 billion in 2021, and further to USD 27.674 billion in June 2022, and is now equivalent to about a fourth of total external debt. In contrast, external debt of the banking system dropped by 13.8 percent from USD 22.637 billion in 2019 to USD 19.506 billion in 2021, to 16.641 in June 2022.

[40] Close attention should still be placed on the impact of removal of regulatory forbearance measures—including delayed NPL recognition and staggered provisioning (up to a maximum of 5 years subject to approval)—which were put in place during the pandemic bus subsequently extended, although loans placed under these measures remain small. A law, however, is already in place—i.e., the Financial Institutions Strategic Transfer (FIST) Act of 2021 patterned after the Special Purpose Vehicle Act of 2002—that incentivizes banks and other financial institutions to offload their nonperforming loans and other nonperforming assets to newly formed private asset management companies called FIST corporations. This helps remove the attached risk from balance sheets of financial institutions to free up capital and improve liquidity and lending capacity.

[41] The gross NPL ratio rose from 3.04 percent of total loans by end-December 2019 to 3.63 percent during the same period in 2020 and further to 3.97 percent by end-2021. It has since dipped to 3.53 percent in end-August 2022. Loan loss reserves grew from 1.89 percent of total loans by end-December 2019 to 3.38 percent by end-2020, subsequently remaining at around 3.5 percent. The capital adequacy ratio remained above minimum thresholds set by the BSP (10 %) and the Bank for International Settlements (8%), at 16.17 on a solo basis in end-June 2022, up from 15.61 percent in end-December of 2019.

[42] The task of currently lies with the Financial Conglomeration Supervision Committee of the Financial Sector Forum (FSF), which is a voluntary inter-agency body comprising the BSP, SEC, Insurance Commission, and PDIC. Policymakers may need to find ways to bolster this arrangement.

high time also to use the powers under the new central bank act to gather information from broader economic sectors (e.g., the real estate sector) in addition to leveraging data from other government institutions (e.g., from the SEC) to close data gaps for financial stability. Lawmakers may also start reconsidering amendment of stringent bank secrecy laws for financial stability purposes.

- **Address the pandemic scars.** Sector shutdowns, business closures, prolonged unemployment, and disruptions in education, training, and investment during the COVID-19 crisis may have undermined the economy, reducing long-term growth potential. These productivity losses need to be immediately reversed. The government's prioritization of infrastructure in public spending despite narrowing fiscal space is therefore most welcome. Such investments not only help address the economic scarring by enhancing the country's physical capital and opening new growth areas, but also have short-run multiplier effects that help support near-term growth. High-potential areas include infrastructure for more efficient trade, better digital connectivity, and clean energy, where private sector participation may be viable (with financial risks to government carefully controlled). Other ways to respond to pandemic scars may be through greater investments in education, to develop the country's workforce; in social protection, particularly in improving service delivery, to shield the country's human capital; and in the public healthcare system to help prevent, or at least lessen the severity of, another pandemic crisis in the future.

- **Finally, continue the policy momentum on investments.** The past administration bequeathed the country with several policy reforms that allow greater competition and boost investment competitiveness (Box 3). By loosening stringent rules on FDI, these structural changes may be the key to revitalizing the economy by creating better jobs and improving incomes, opening new growth areas, and reducing debt worries, lowering the risk of painful fiscal consolidation in succeeding years.

  The new leadership banked on these recent reforms in overseas trips to attract business capital into the country. However, much still needs to be done to assuage investors' concerns. The lack of growth drivers today should only strengthen policymakers' resolve to remove major disincentives to FDI. Impediments often cited include inadequate infrastructure, expensive power, slow internet connectivity, regulatory inconsistencies, and corruption (International Trade Administration 2022). Local business leaders have echoed similar hopes under the newly elected government, urging it to prioritize accountability and transparency and to eliminate corruption, citing the latter as the top risk to economic recovery (Calonzo 2022).

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6. Appendices

6.1. Financial Conditions Index[43]

To compute a high-frequency (monthly) FCI for the Philippines, a technique based on Hatzius et al. (2010) is adopted. This method condenses information from a large dataset to a few summary variables (common factors or principal components). This technique differs from standard principal component analysis (PCA) by allowing for unbalanced panels (time series with different beginning and ending dates), a useful feature that lengthens data history and broadens data coverage. To ensure that the FCI holds unique information about the future state of the economy, the method is applied to financial shocks obtained by first eliminating cyclical influences from the financial variables.

The following common factor model is applied:

$$v_{it} = \lambda_i' F_t + u_{it}$$

where F_t is a $k \times 1$ vector of unobserved financial factors capturing the common variation among the different financial indicators; and v_{it} is the error term (i.e., the financial shock corresponding to variable i) in a regression of the ith financial variable X_{it} on a vector of macroeconomic variables Y_t comprising output growth and inflation. The error term u_{it} is unrelated to both F_t and Y_t and assumed to be uncorrelated (or weakly correlated) across variables.

With an unbalanced panel, F_t is computed iteratively using least squares estimation.[44] The least squares estimator $\widehat{F}_t$ solves the problem: $min_{\lambda_t, F_t} \sum_{i,t}(\hat{v}_{it} - \lambda_i' F_t)^2$. The $\widehat{F}_t$ computed from a one-factor model represents the financial conditions index (FCI) adopted in this chapter.

Prior to estimation, all financial variables (49 in total comprising yields, spreads, asset prices, credit quantities, liquidity measures, and financial stress and risk indicators) are transformed as needed (such as for stationarity) and normalized (demeaned and divided by their standard deviations) to make sure measurement units and data fluctuations do not unduly influence the extracted common factors. They are then regressed against current and two lagged values of log changes in prices (as measured by CPI) and economic output (as proxied by an industrial production index) to obtain the corresponding financial shock.

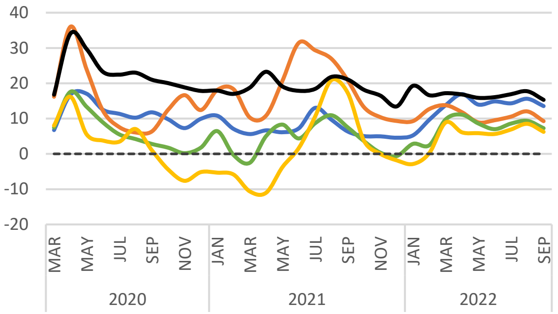
[43] This appendix is lifted in full from Debuque-Gonzales (2020, p.56).

[44] This is performed using MATLAB codes from Debuque-Gonzales and Gochoco-Bautista (2017).

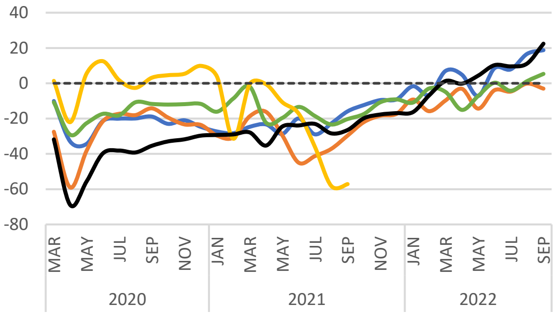
6.2. Leading indicators

Box 6.1. Community mobility

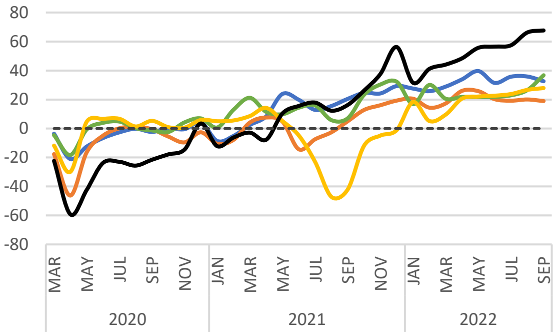
Residential. Google Mobility[45] data indicate prolonged stay-at-home behavior among Filipinos despite relaxed restrictions into 2022.



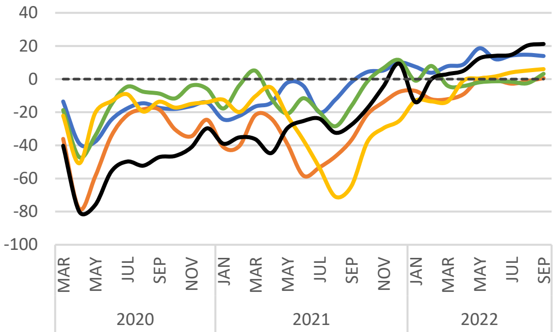
Workplaces. Activity normalized in 2022, reflecting return-to-office orders in both public and private sectors. As with other locations, slight plateauing registers midyear.



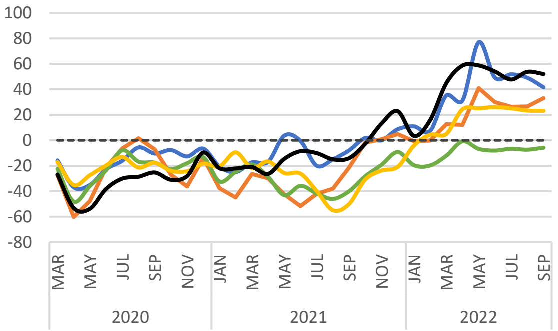
Groceries and Pharmacies. Among non-residential locations, these were the earliest to recover from the initial shock. The Omicron variant prompted a dip in January 2022.



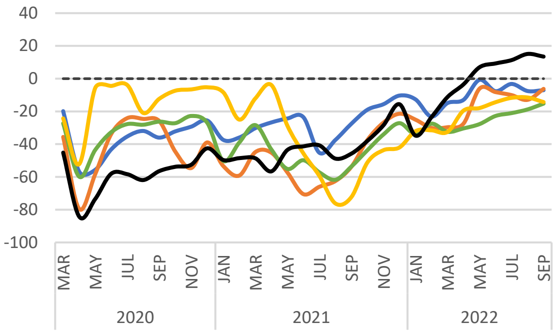
Retail and Recreation. Visits to places of retail and recreation saw a return to pre-pandemic levels in the fourth quarter of 2021.



Parks. Compared to places of retail and recreation, movement in parks normalized sooner, crossing to pre-crisis levels by the second half of 2021.



Transit Stations. With restrictions on intrazonal and interzonal transport lifted, activity in stations reverted to pre-pandemic figures in the second quarter of 2022.

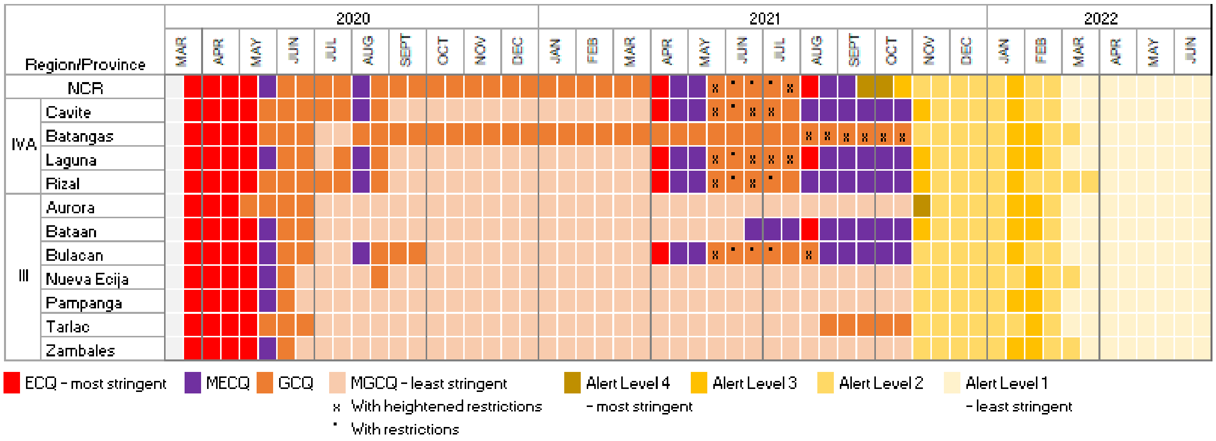


Source: Authors' computation using CEIC Database (2022p).

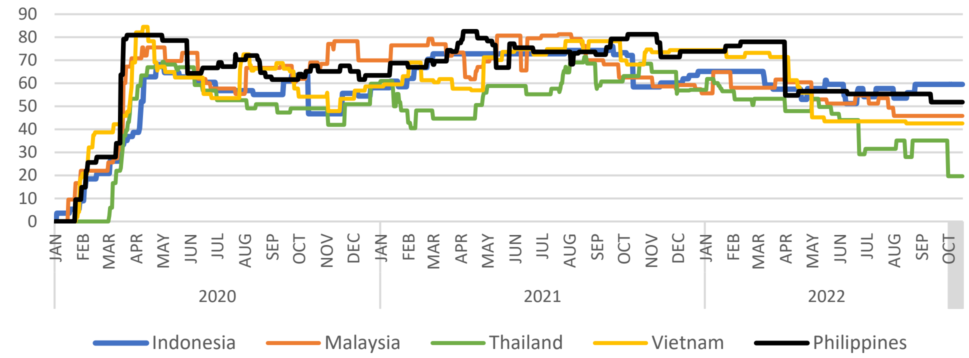
[45] The points are monthly averages of data from users whose Location History settings were switched on. They consider visits and length of stay compared to the baseline during the five-week period from January 3 to February 6, 2020. The charts cover data from February 15, 2020 to September 30, 2022 only.

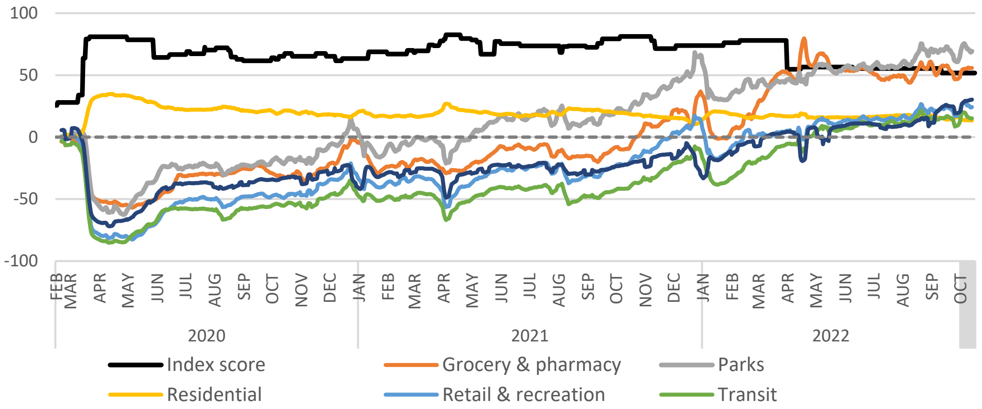
Box 6.2. Policy stringency

Community Quarantines. A new quarantine classification system was enforced in September 2021, consisting of only enhanced community quarantine (ECQ) and general community quarantine (GCQ). The latter was further categorized into Alert Levels 1 to 4. The table below shows the gradual loosening of restrictions across the National Capital Region and Regions IV-A and III, which register over half of the economic activity in the country.



Containment Health Index & Community Mobility. The Containment Health Index considers government policies, such as vaccine rollouts, contact tracing, requirements for protective coverings, limitations on gatherings, and travel restrictions. Readings show that for some periods, the Philippines had the heaviest measures among five Southeast Asian countries. By around April, however, scores had fallen to below 60, while mobility outside residences increased. (For details on the the Stringency Index, which focuses mobility restrictions, see Section 2.1.)

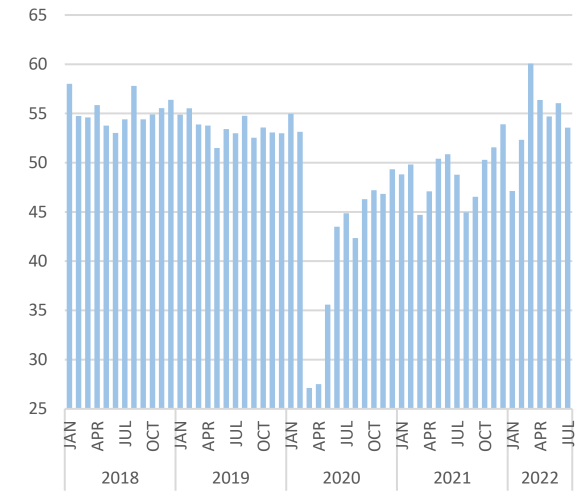


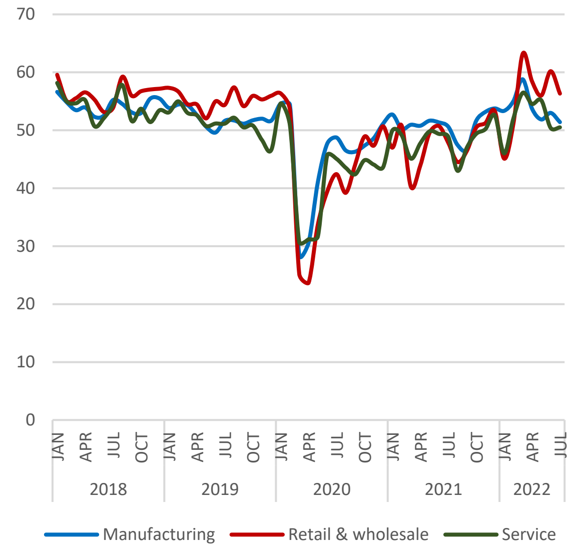


Source: Aning (2022), CEIC Database (2022p, y), Corrales (2022), Debuque-Gonzales et al. (2021), Debuque-Gonzales (2022), Fernandez (2022a, b), Galvez (2022), Mercado (2022).

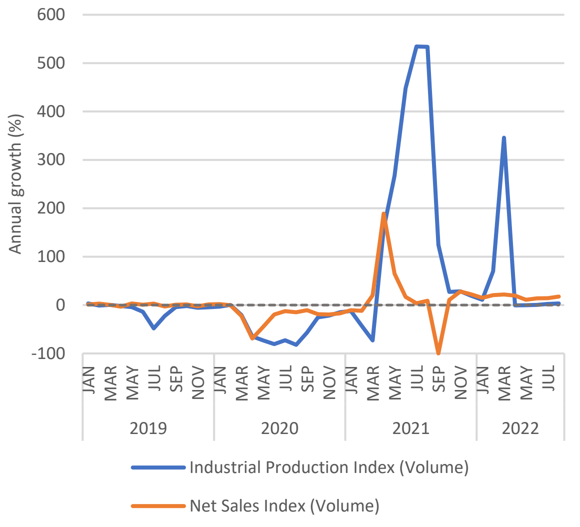
Box 6.3. Production activity

Purchasing Managers Index (PMI)[46]. The PMI for the Philippines fell below the critical value of 50 from July to September in 2021 and in January of 2022. More stable readings above 50 were recorded in the following months, most noticeably in March with 60.1 points, the highest since May 2014. However, a general downtrend followed in May and July, when PMI readings were 54.7 and 53.6 points, respectively. Similar patterns can be observed in PMIs for Manufacturing, Retail & Wholesale, and Service. Export growth has correspondingly declined.

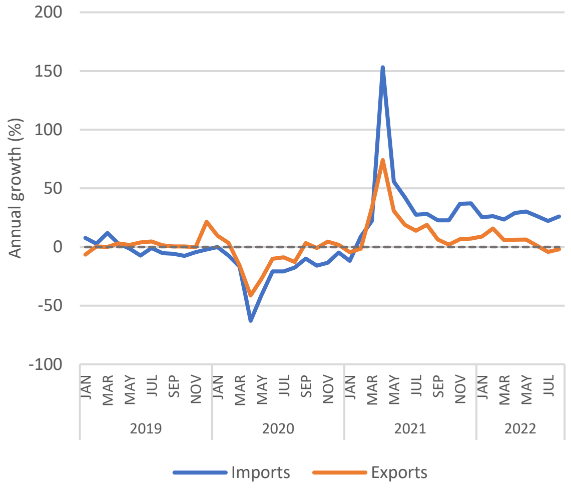




Industrial Production and Net Sales Volume



Imports and Exports

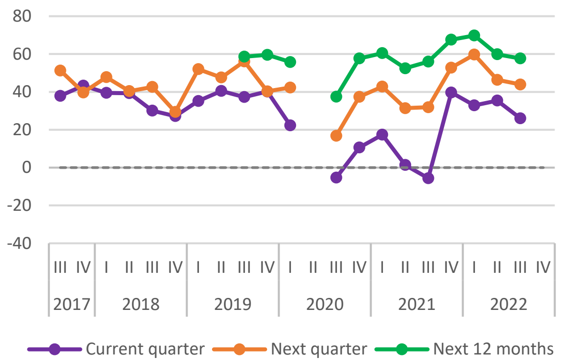


Source: CEIC Database (2022n, s, ab).

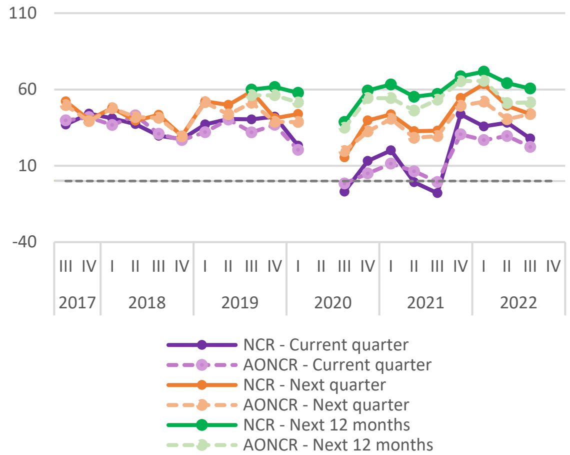
[46] The Purchasing Managers Index (PMI) considers variables such as business output, new orders, and exports. Readings above 50 suggest expansion while those below indicate contraction.

Box 6.4. Business expectations survey

Results of the Business Expectations Survey[47] indicate generally improved sentiments from 2020 to 2021 and 2021 to the first three quarters of 2022. Optimism was attributed to the relaxation of pandemic restrictions and the reopening of the economy. The spread of the Delta variant and the mobility restrictions only temporarily dampened prospects in the third quarter of 2021. Elections-related spending bolstered views in the second quarter of 2022. Views for future periods however have become relatively bleaker, with firms citing the increasing cost of production, weaker demand, fuel prices, and depreciating peso as reasons for the weaker outlook (BSP 2022b).

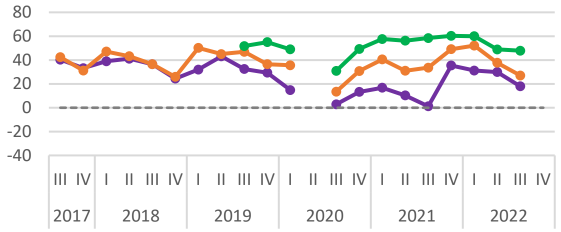


Overall

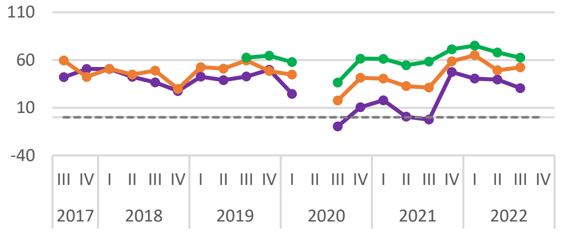


Area Comparative

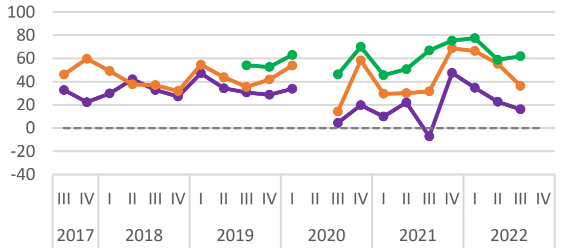
Between the first two quarters of 2022, business confidence weakened across all sectors except Wholesale & Retail Trade. Fringe effects of the pandemic, a drop in consumer demand, and cost of materials were cited as causes (BSP 2022b).



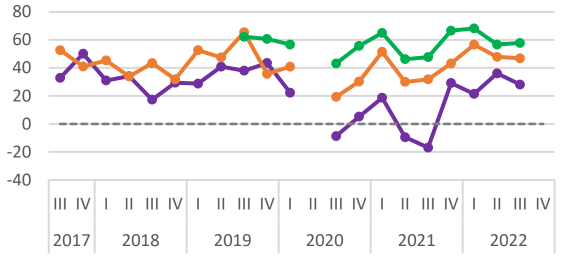
Industry



Services



Construction



Wholesale & retail trade

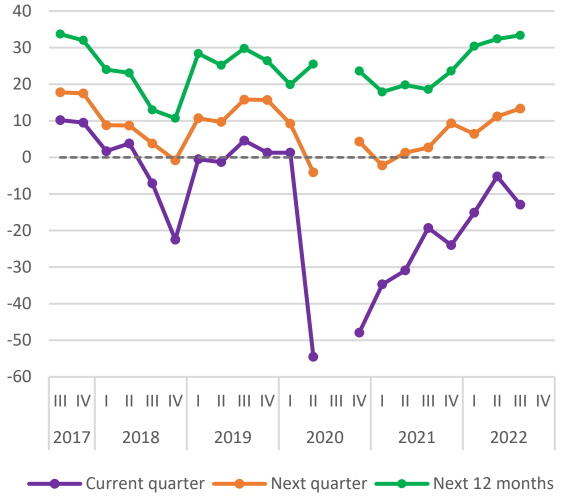
Sources: CEIC Database (2022d), BSP (2022b).

[47] A positive (negative) reading indicates that respondents with a positive (negative) outlook outnumbered those with a negative (positive) outlook.

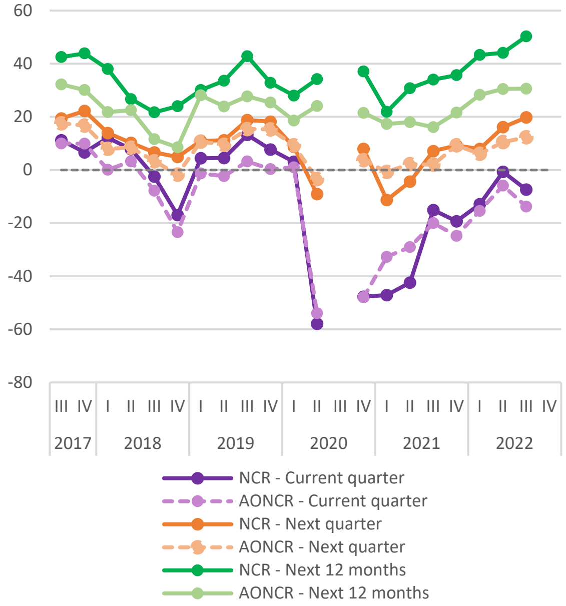
Box 6.5. Consumer expectations survey

The Consumer Expectations Survey[48] suggest a general improvement in current-quarter sentiments, from 2020 to 2022. Values however remain negative. Sentiments for the succeeded periods are more upbeat. Pessimism in the third quarter has been ascribed to the increasing cost of goods, low income, and lack of jobs (BSP 2022c).

Overall

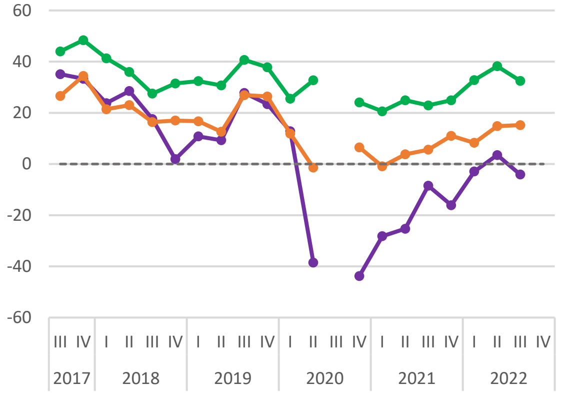


Area Comparative

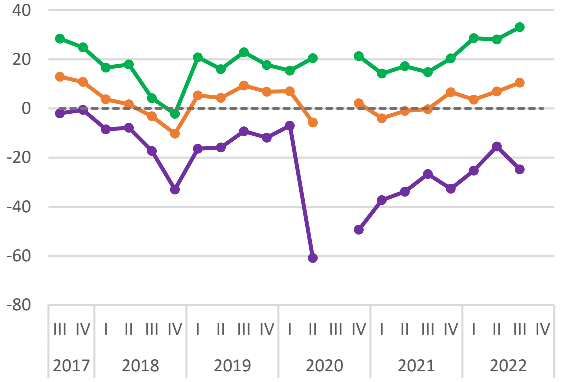


High-income households[49] show more optimistic current-quarter views in the second quarter of 2022. Low-income households consistently have more pessimistic views.

High-income



Low-income



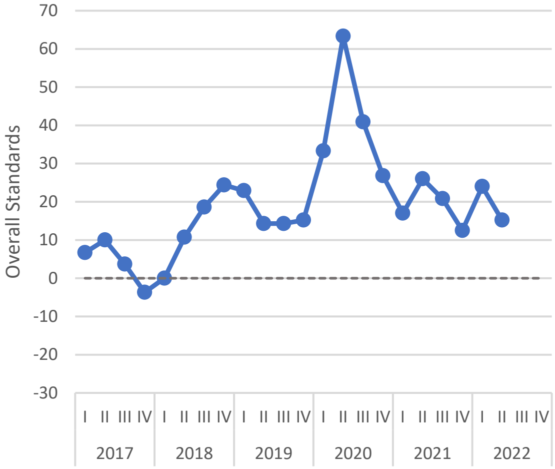
Sources: CEIC Database (2022f), BSP (2022c).

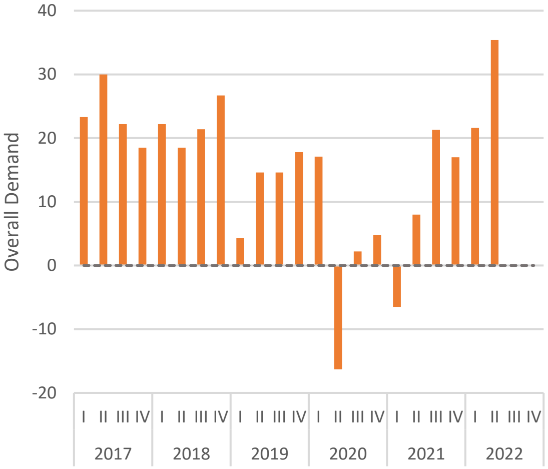
[48] A positive (negative) reading indicates that respondents with a positive (negative) outlook outnumbered those with a negative (positive) outlook.

[49] High-income pertains to households with monthly income greater than PHP 30,000 while low-income refers to households with monthly income less than PHP 10,000.

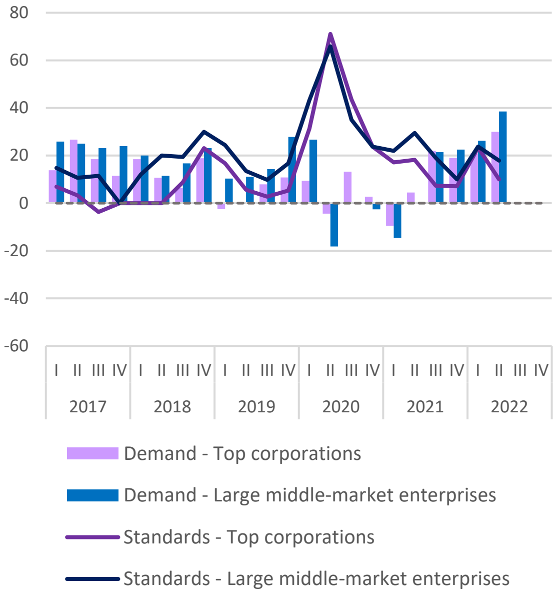
Box 6.6. Credit standards and demand for loans or credit lines

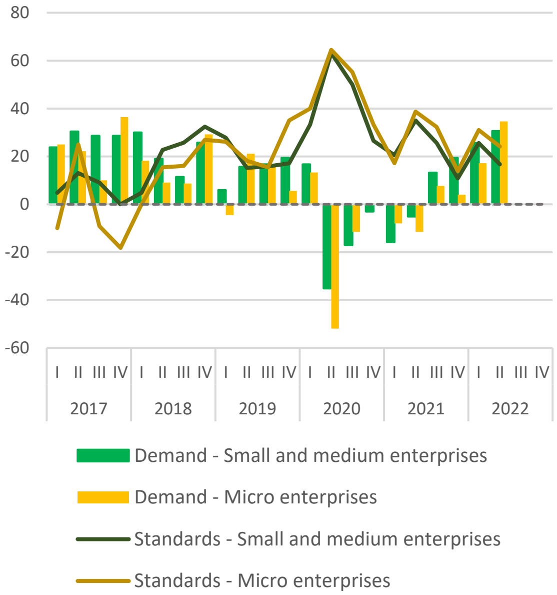
Senior Loan Bank Officers' Survey[50]**.** Results imply a general net easing of lending terms from the onset of the pandemic in the second quarter of 2020. Overall demand correspondingly grew, with a notable surge of 13.8 points from the first to second quarter of the 2022.





Top Corporations, Large Middle-Market Enterprises, Small and Medium Enterprises, Micro Enterprises. Net easing of standards was seen across the board. Demand among top corporations rose in the second quarter of 2021. Improvement among large middle-market enterprises, small and medium enterprises, and micro enterprises registered in the following quarter. Demand among all types continued to grow in the first two quarters of 2022.



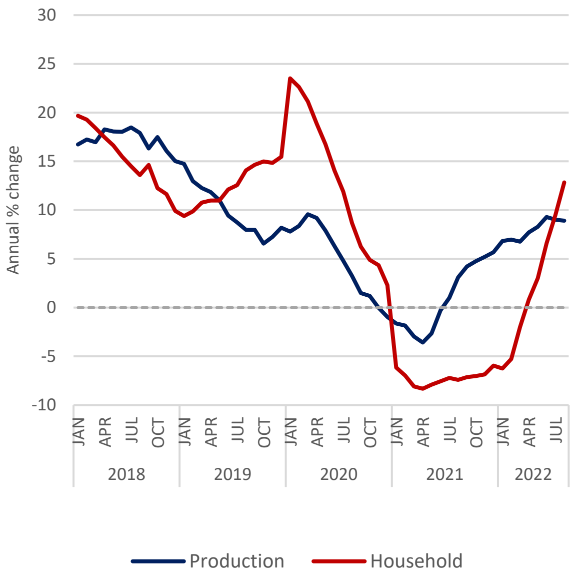


Source: CEIC Database (2022ad).

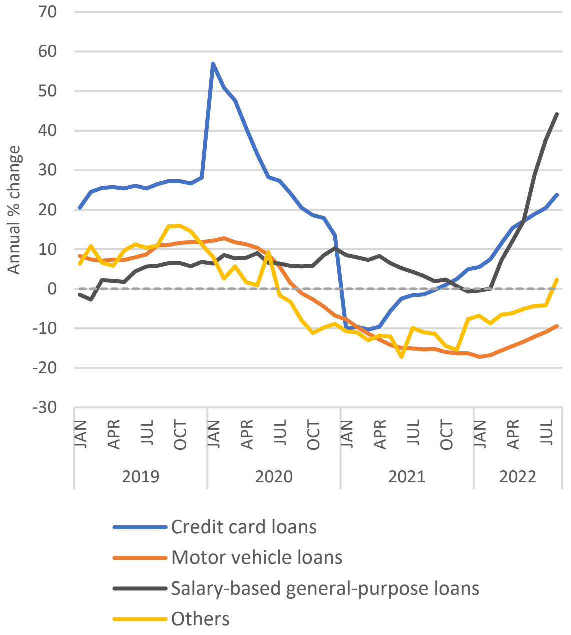
[50] For standards, a positive diffusion index indicates a "net tightening" of credit standards (i.e., more banks tightening than easing), while a negative index indicates "net easing." For demand, a positive diffusion index indicates a net increase in loan demand (i.e., more banks reporting an increase than a decrease in demand), while a negative reading indicates a net decrease.

Box 6.7. Loan activity

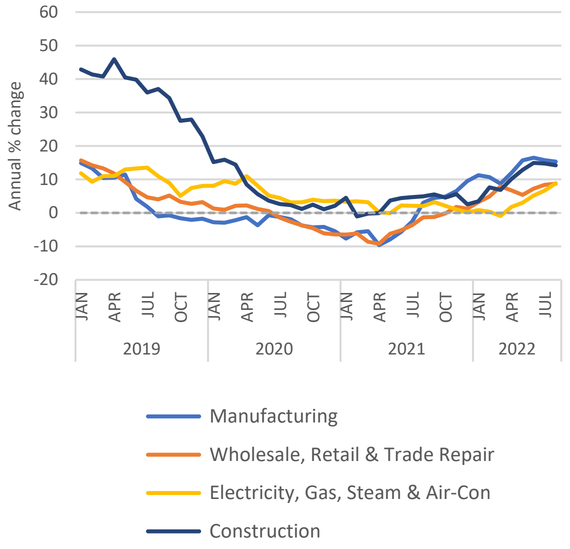
Loans by Type. Coming from low demand in 2020, production loans exhibit improved growth from April 2021. Household consumption loans stagnated in 2021. Demand surges in 2022.



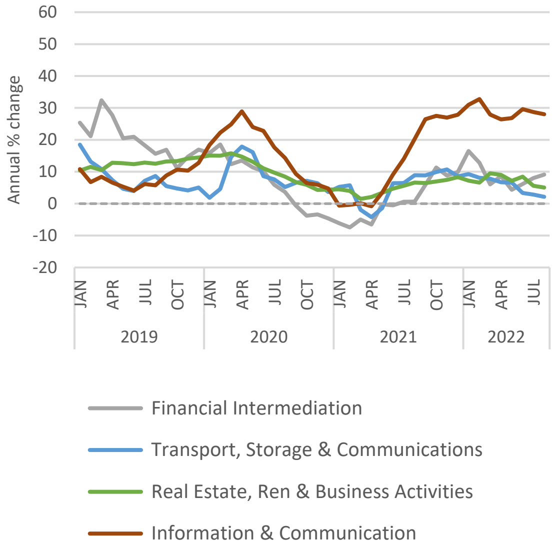
Household Loans. Salary-based general-purpose and credit card loans drive growth in household loans.



Production Loans by Economic Activity. Acceleration in the first months of 2022 was recorded in manufacturing; wholesale, retail & trade repair; electricity, gas, steam & airconditioning; and construction.



Slowdowns were posted in financial intermediation and transport, storage, & communications. Information & communication stagnates but remains relatively healthy.



Source: BSP (2022d).