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Macroeconomic Outlook of the Philippines in 2023–2024: Prospects and Perils

Margarita Debuque-Gonzales, Mark Gerald C. Ruiz, and Ramona Maria L. Miral

CONTACT US:

RESEARCH INFORMATION DEPARTMENT
Philippine Institute for Development Studies

18th Floor, Three Cyberpod Centris - North Tower
EDSA corner Quezon Avenue, Quezon City, Philippines

publications@pids.gov.ph
(+632) 8877-4000

https://www.pids.gov.ph

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Abstract

This paper, which will be released as the lead chapter of the *2022–2023 PIDS Economic Policy Monitor*, examines the economic performance of the Philippines for 2022 and the first half of 2023. It presents conditions shaping the global and regional outlook, projections on growth and consumer prices, and prospects coming into 2024. Carried by post-pandemic momentum but moderated by continued headwinds, the economy grew by 7.6 percent in 2022. For 2023, GDP growth is expected to weaken to 5.2 percent, and inflation is estimated to average at about 6 percent. As for 2024, growth is anticipated to register between 5.5 to 6 percent, while inflation is expected to fall to the center of the target band. These projections consider the steady stream of income from abroad, an improved jobs picture, benign financial conditions, a less restrictive public budget, and a possible resurgence and/or rising business expectations in some sectors. On top of the issues listed in the previous edition, the current one draws attention to risks related to inflation, the country's fiscal position, and the newly created national investment fund.

Keywords: Philippine economy, growth, inflation, forecast

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Macroeconomic Outlook of the Philippines in 2023–2024: Prospects and Perils

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1. Introduction

Fueled by wider reopening of the economy but tempered by inflationary and global pressures, growth in the Philippines for 2022 was recorded at 7.6 percent. The year saw a return to workplaces and schools and continued recovery of industries that had suffered during the COVID-19 pandemic, such as recreation and tourism.

In last year's *PIDS Economic Policy Monitor* (Debuque-Gonzales et al 2022b), we predicted that recovery from the pandemic in 2023 would involve "steering through global headwinds," including the risk of global stagflation, where high inflation combines with sluggish growth. With further reopening of the Philippine economy, output has managed to grow by 5.5 percent in the first half of the year, though a downtrend seems imminent—GDP grew by 6.5 percent in the first quarter and by just 4.3 percent in the second, largely due to a sharp decline in government spending, but with consumption growth also slowing from 6.4 to 5.5 percent during the period. We thus expect output to grow by 5.2 percent growth this year, which is well within our original estimated range of 4.5 to 5.5 percent. However, we expect inflation to average outside of the target range, at about 6 percent, because of several supply-side surprises in the second half of the year.

We continue to anticipate a challenging macroeconomic climate in 2024. Yet despite sustained global risks, we expect the country's GDP to grow between 5.5 to 6 percent next year, and inflation to fall to 3 percent. This chapter spells out the basis for these forecasts and flags some immediate and longer-term risks. Section 2 reports on the trends in key macroeconomic indicators and provides fiscal and monetary policy updates. Section 3 presents our macroeconomic outlook, starting with a summary of global, regional, and domestic conditions; and ending with the authors' projections for growth and headline inflation. Section 4 concludes by identifying policy-related risks and providing some (hopefully) useful insights and recommendations.

2. Macroeconomic performance in 2022 and January to June 2023

2.1. GDP growth

A reopening of the economy supported economic activity in 2022, with some momentum maintained until the first quarter of 2023 (Figures 1 and 2). GDP grew by 7.6 percent annually in 2022, up from 5.7 percent in 2021, as mobility restrictions were lifted, and economic activity boosted by the national elections in May (Figure 2a). Government offices already began operating at full workforce capacity by March of 2022, while businesses began to issue return-to-office orders. Schools in Metro Manila also started to shift from online to face-to-face classes by August that year. Although the country entered 2023 with some momentum from the reopening, high inflation (which peaked at 8.7 percent in January of 2023) and interest rates (with average lending rates exceeding 6 percent by the third quarter of 2022), tracing partly to the monetary tightening needed to control inflation, increasingly weighed down demand. GDP grew by 5.3 percent annually in the first half of 2023, but the numbers already reflected a weakening—from 6.4 percent growth in the first quarter to 4.3 percent in the second, because of a drop in public spending (Figure 2b).

Consumption and investment propelled growth on the spending side last year but started to soften by the first half of 2023 (Figures 1.2c and 1.2d). Consumption, which grew by 8.3 percent in 2022 (from 4.2 percent in 2021), was mainly driven by spending on food and non-alcoholic beverages (5.7 percent), restaurants and hotels (28.0 percent), and transport (16.6 percent). The latter two sectors, together with recreation (which also rebounded, by 25.6 percent), suffered the sharpest downturns during the pandemic. Consumer demand rose by 6 percent in the first half of 2023, though this corresponded to a deceleration from 6.4 percent in the first quarter to 5.5 percent in the second. Investments still managed to rise by 13.8 percent in 2022, from 20 percent in 2021, but its growth declined to 5.4 percent in the first half of 2023 as global and domestic outlook worsened. Among the major demand components, only capital spending, particularly on durable equipment and construction, has not fully recovered from the COVID-19-induced economic downturn, and remains below pre-pandemic levels in real terms.

Government spending growth decelerated to 4.9 percent in 2022, from 7.2 percent in 2021, in line with the normalization of the economy, then slipped to negative territory (-1.4 percent) in the first half of 2023. A sharp reduction in public spending occurred during the second quarter of 2023 (-7.1 percent), pulling down overall growth. Finance and budget authorities have partially attributed the decline to unreleased checks, particularly for the social and infrastructure programs.[1] In August, budget authorities reported government underspending of about PHP 170.5 billion (about 0.8% of 2022 GDP), which they traced to "ongoing procurement and implementation of government programs, as well as right-of-way acquisition issues that cause significant delays in infrastructure spending" (DoF 2023b). This prompted the budget department to issue a circular requiring government agencies to submit "catch-up" plans to facilitate budget execution for the remainder of the year.

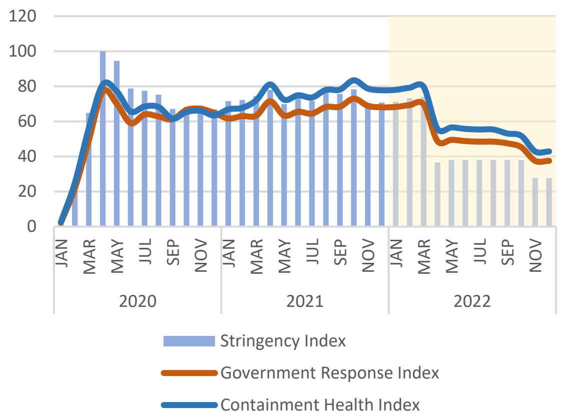
[1] This was reportedly due to unfinished registration and validation of beneficiaries, apart from various procurement, implementation, and payment issues.

The trade deficit in goods and services continued to widen in 2022 as imports grew faster than exports (13.9 percent versus 10.9 percent) during the recovery period, though this trend has started to reverse. High import growth last year traced in large part to global oil disruptions, especially with the escalation of the Russia-Ukraine conflict that began in late February. The fuel bill, which expanded by 23.9 percent in 2022, contributed to the rise in imports. Travel, transportation, and business spending meanwhile drove the services side, rebounding by 69.8 percent, 44.0 percent, and 39.5 percent, respectively. While exports grew at a slower pace in the first quarter of 2023 than during the same period in 2022 (4.1 percent versus 4.9 percent, respectively), import growth slowed further during the same period (from 14.5 percent to 0.4 percent), as investment and global trade activity weakened. This served to narrow the trade gap.

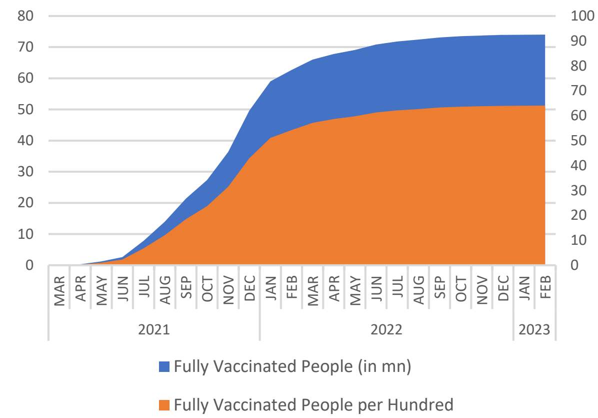
Services powered growth on the production side last year, with industry continuing to provide support despite posting weaker growth (Figure 2e and 2f)**.** Services grew by 9.2 percent in 2022, up from 5.4 percent in 2021, with wholesale and retail trade (up 8.7 percent) contributing the most to the expansion. A post-2020 recovery was seen in accommodations and food (32.1 percent) and transportation and storage (23.9 percent). Industry output grew by 6.5 percent in 2022, down from 8.5 percent in 2021, but bolstered by a rise in construction (12.1 percent). Growth in agriculture, forestry, and fishery meanwhile turned slightly positive during the year (up 0.5 percent, from -0.3 percent in 2021) despite damage from typhoons, with recoveries seen in livestock and poultry. Livestock had come from a low base because of bouts with African swine fever, which troubled the pork industry in past years. Services and industry decelerated in the first half of 2023, while growth in agriculture remained flat.

Figure 1. Developments in 2022 and 2023

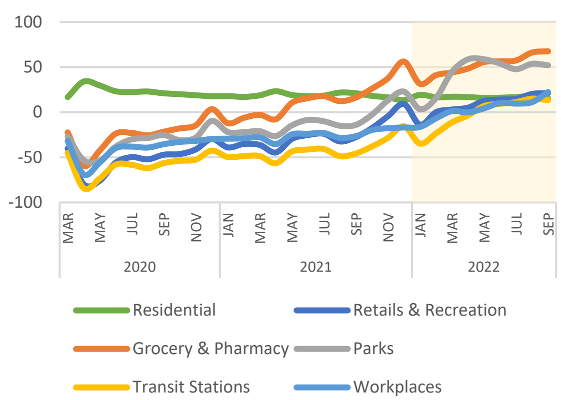
a. OxCGRT COVID-19 response indicators[2]



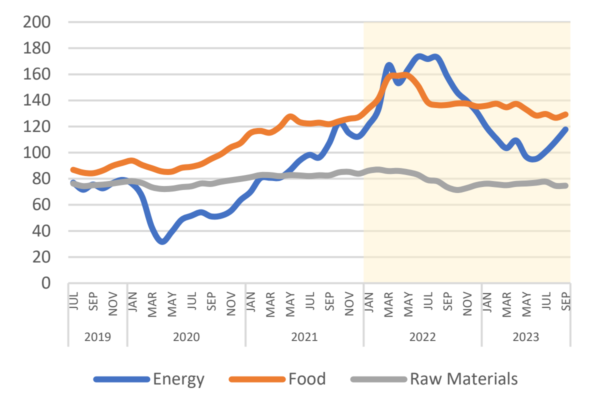
b. Vaccination rates



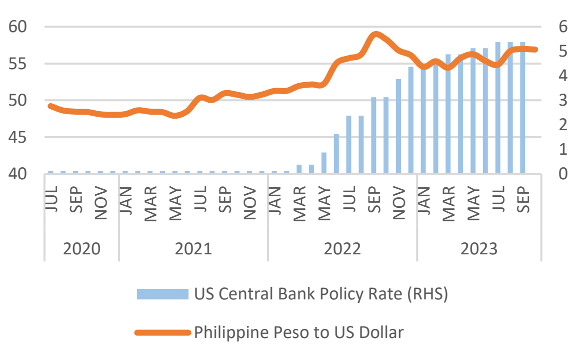
c. Google Mobility indicators[3]



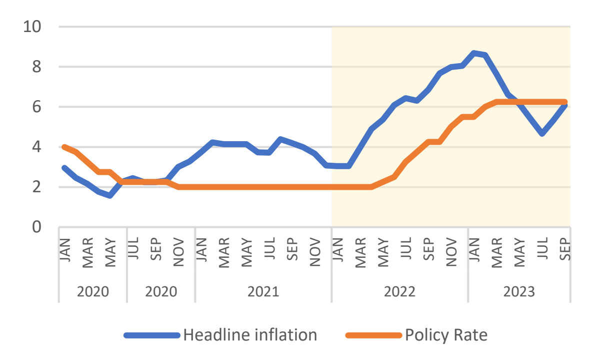
d. World Bank price indices



e. US policy rate and PHP/USD exchange rate



f. BSP policy rate and headline inflation (%)

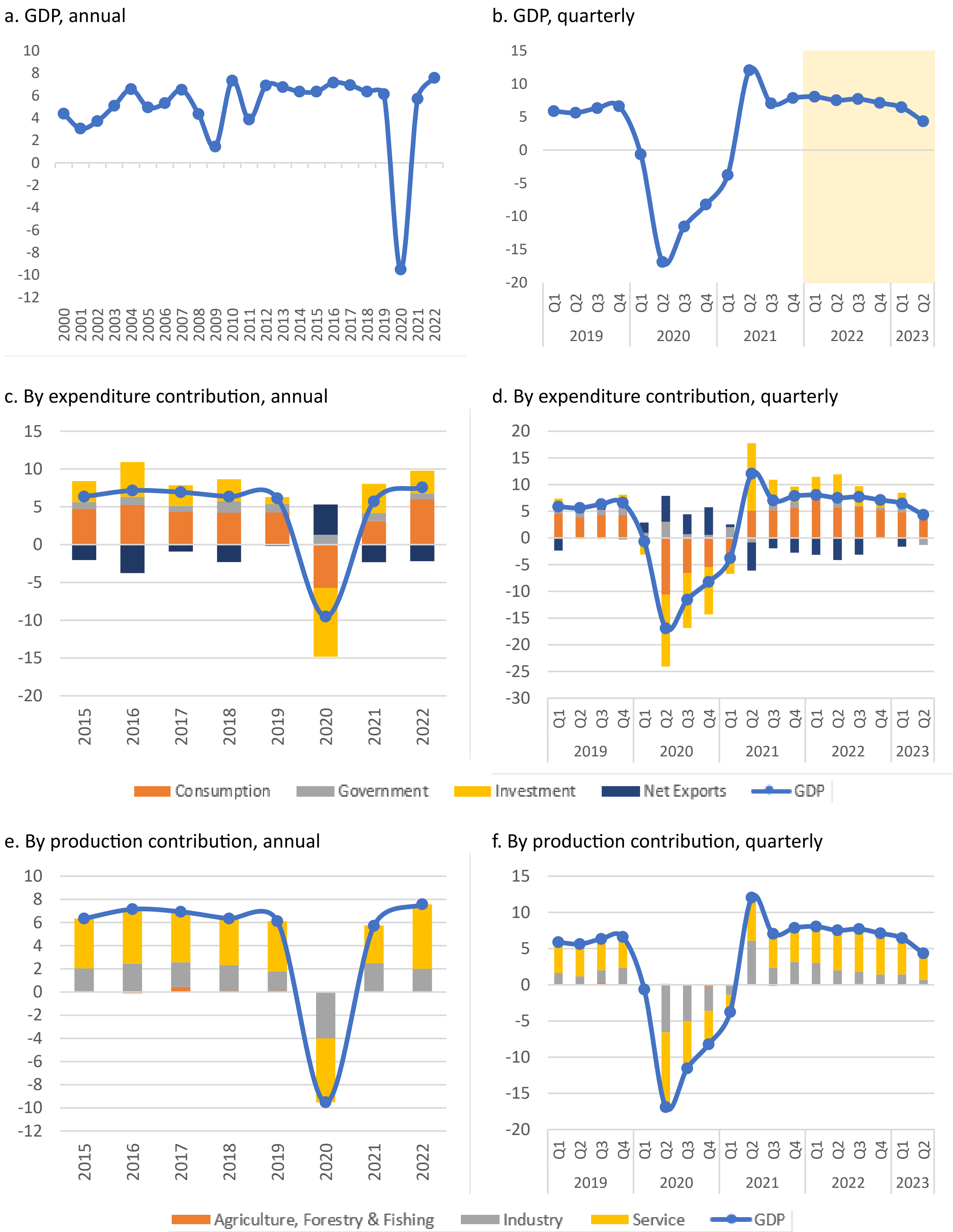


Source: Bangko Sentral ng Pilipinas; Blavatnik School of Government, University of Oxford; Google; International Monetary Fund; Our World in Data; Philippine Statistics Authority; World Bank via CEIC Data (2022a, b; 2023c, j, m, u, v, ae)

[2] The Oxford COVID-19 Government Response Tracker summarizes the response of governments to the COVID-19 pandemic. The Government Response Index is an overall measure. The Containment Health Index keeps track of "lockdown-style" policies in combination with preventive response, such as testing and vaccination. The Stringency Index meanwhile focuses on "lockdown-style" policies.

[3] Google Mobility measures the change in footfall from a baseline date in March 2020. It is based on users' location data.

Figure 2. GDP growth (in percent)



Source: Authors' computations; Philippine Statistics Authority via CEIC Data (2023k)

2.2. Inflation

Inflation rose in the first months of 2022, then peaked at 8.7 percent in January 2023 (Figure 3)**.** Core inflation increased faster than headline inflation in March 2023, suggesting a broader range of price increases. The headline rate declined to 5.4 percent in June 2023.

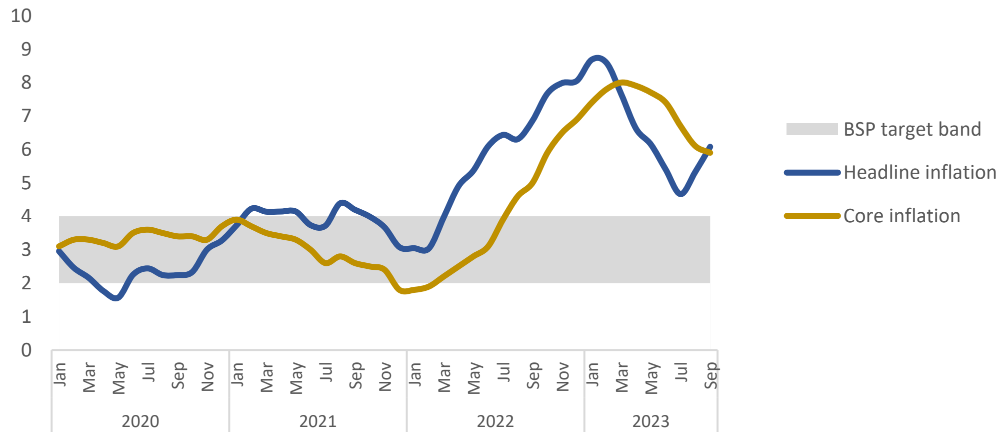
Headline inflation has been driven mainly by price pressures in food. In 2022, meat, fish, and cereal which covers rice[4] and corn, pushed up inflation, growing by 7.6 percent, 6.6 percent, and 3.6 percent respectively. Sugar prices increased by 38.8 percent but had a smaller impact on the CPI because of its smaller weight in the consumer basket. The surge in sugar prices came after a drop in domestic output due to Typhoon Rai and La Nina (SRA Circular No. 28, 2022). In the first half of 2023, vegetables, cereal, and fish prices similarly drove inflation, increasing by 21.4 percent, 5.5 percent, and 7.4 percent, respectively.

Next to food, housing and utilities had the second biggest contribution to headline inflation. Fees rose by 6.4 percent and 7.2 percent in 2022 and the first half of 2023. These rates were held up by electricity, gas, and other fuels which grew by 15.9 percent and 10.4 percent in the same periods. Rental prices followed, registering rates of 2.4 percent and 5.4 percent. Meanwhile, transport inflation rose by 12.9 percent in 2022 on the back of gasoline and diesel prices (up 31.2 and 65.4 percent, respectively), as global energy prices increased due to the Ukraine-Russia conflict (Figure 4). Restaurants and accommodation businesses raised fees during the first half of 2023, pushing up inflation of related services to 8.2 percent.

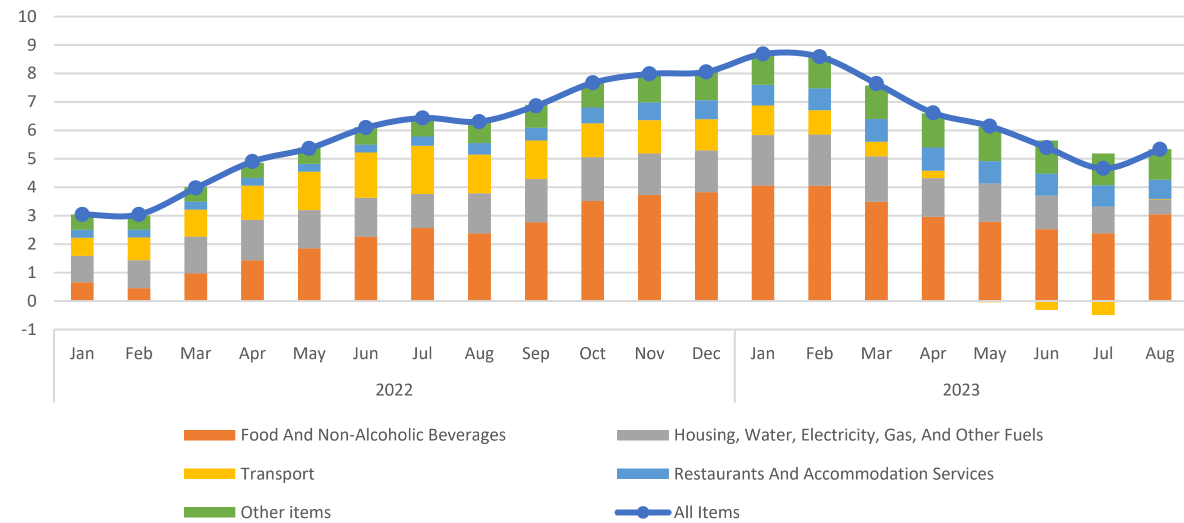
[4] Rice inflation became more prevalent in the latter part of the year. See Figure 5 and Section 3.

Figure 3. Inflation (in percent)

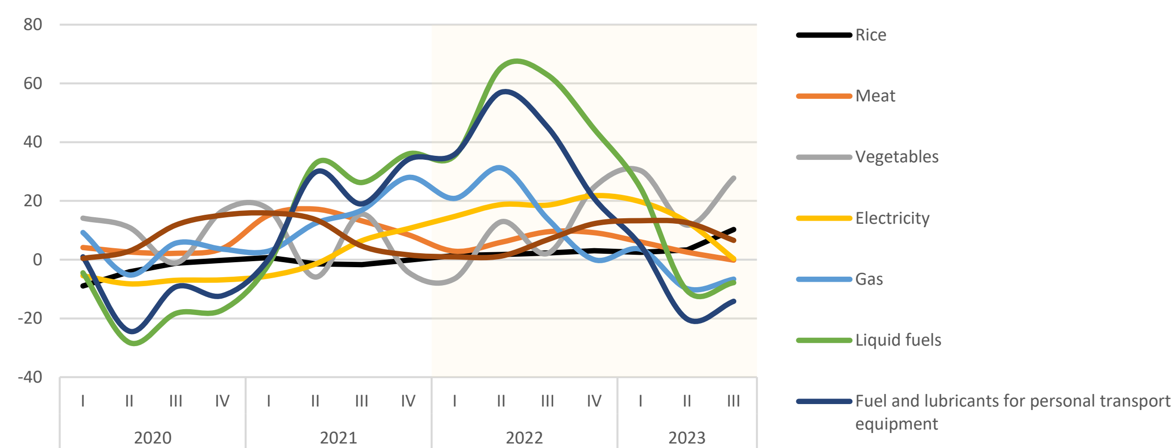
a. Headline and core inflation



b. Drivers of headline inflation



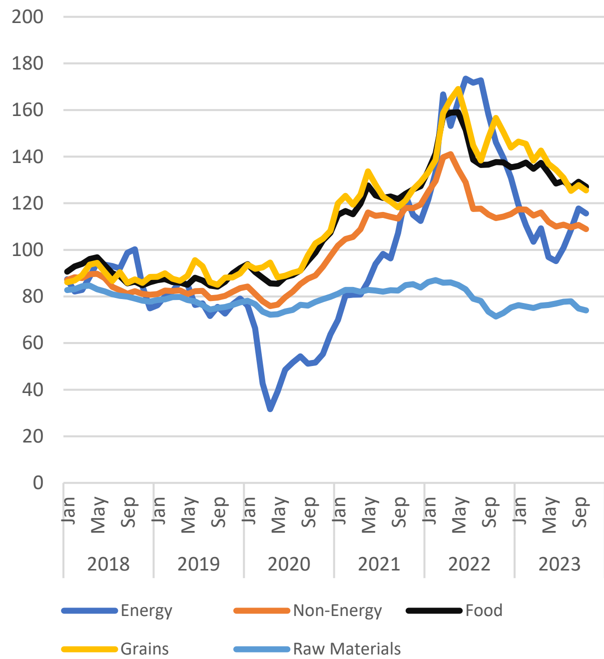
c. Inflation of key items



Source: Authors' computations; Philippine Statistics Authority via CEIC Data (2023e, f, m, o)

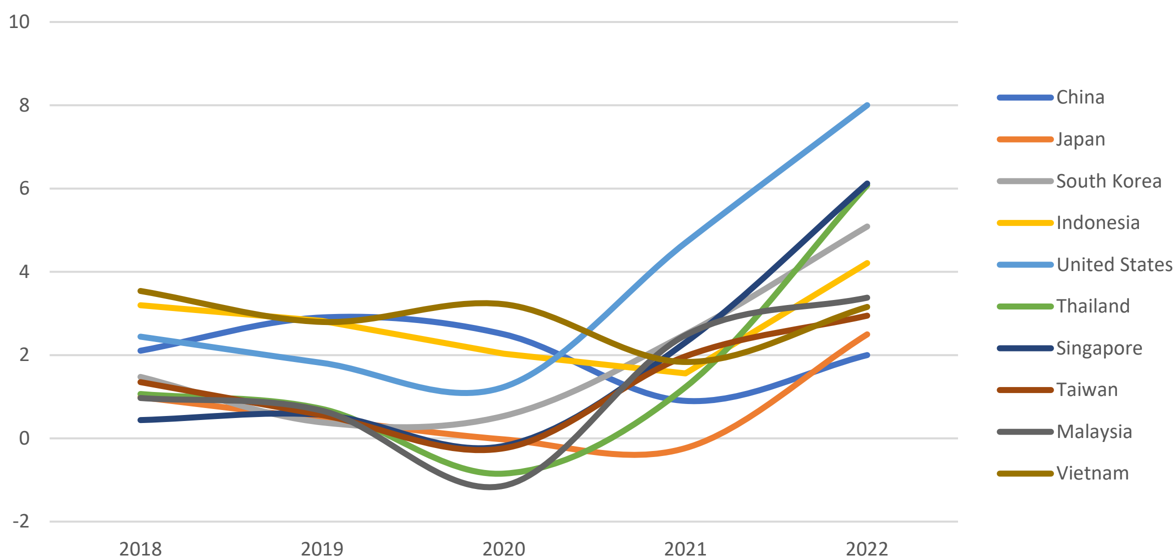
Figure 4. World inflation

a. World Bank price indices



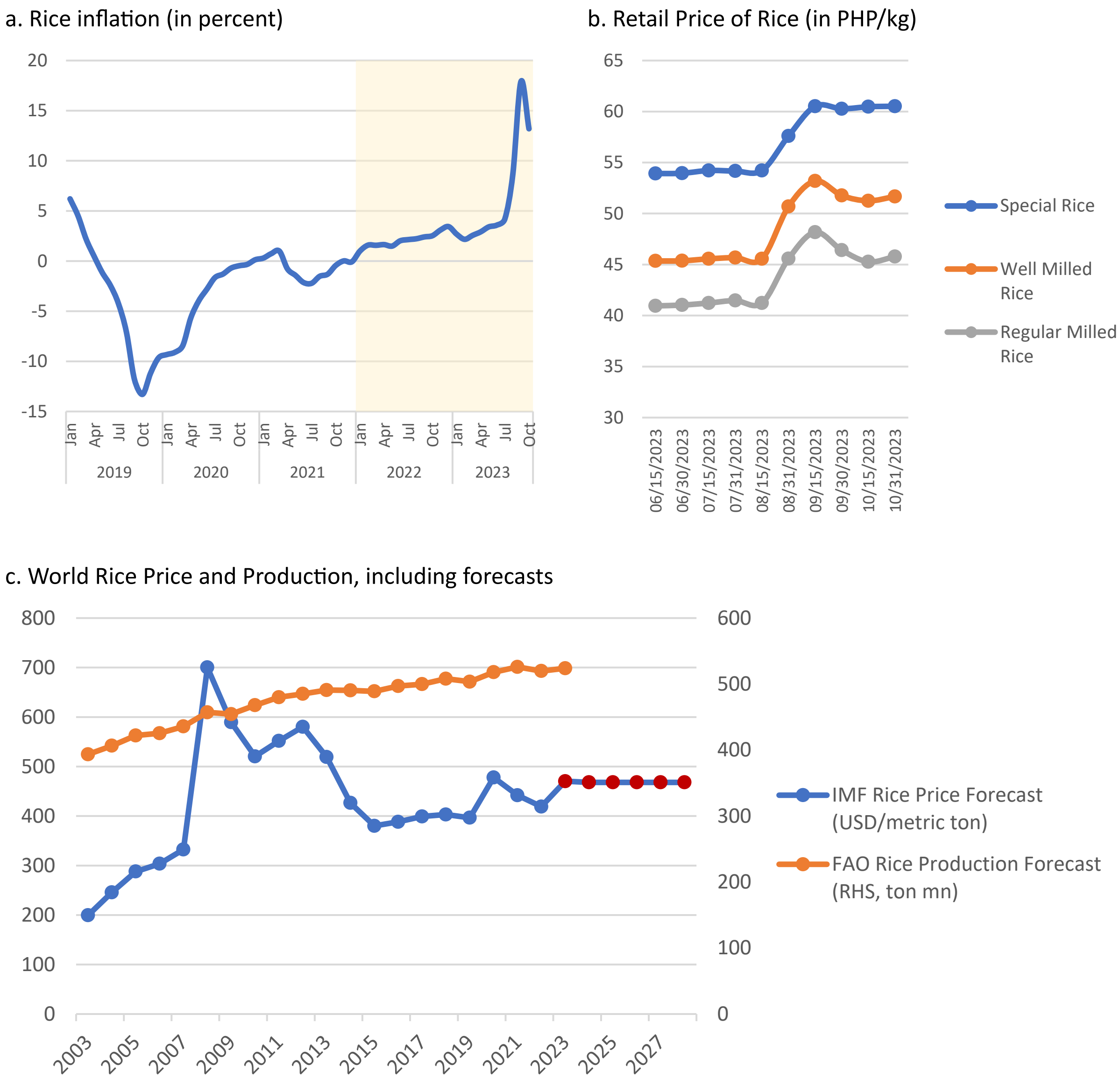
b. Dubai oil price (USD per barrel)

c. Inflation in top import sources (in percent)



USD = United States dollar
Source: International Monetary Fund and World Bank via CEIC Data (2023c, g), CEIC Data (2023d)

Figure 5. Rice inflation



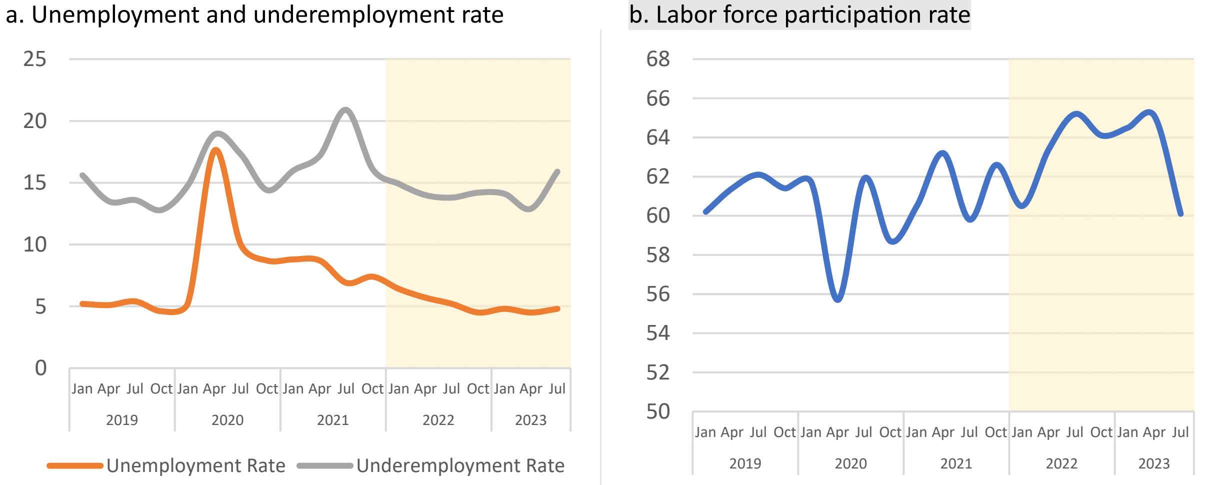
Source: Philippine Statistics Authority, International Monetary Fund, and Food and Agriculture Organization via CEIC Data (2023e, y, z, aa)

2.3. Employment

Based on quarter-end data, unemployment normalized to pre-pandemic levels by the latter part of 2022, remaining below 5 percent in the first half of 2023 (Figure 6)**.** Underemployment similarly eased in 2022, registering an average of 14.2 percent. It rose to 15.9 percent in July 2023, reflecting an increase in the number of employed and unemployed seeking more working hours. Labor force participation meanwhile grew to an average of 63.3 percent in 2022 before descending to 60.1 percent in July 2023, suggesting some worker discouragement during the period.

Figure 6. Labor market situation (in percent)

a. Unemployment and underemployment rate b. Labor force participation rate



Source: Philippine Statistics Authority via CEIC Data (2023p, ac, ad)

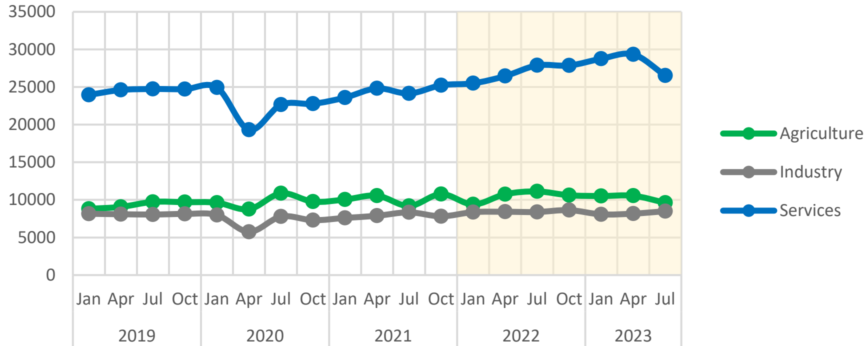
Services continued to drive overall employment, with the sector having a quarterly average of 26.9 million jobs in 2022 (Figure 7). Wholesale and retail trade regularly accounted for the majority of service workers. Figures for employment in high-contact work, notably in accommodation and food services and transport and storage, have already reverted to pre-pandemic levels. Meanwhile, employment in education improved beginning July 2022, reflecting students' return to schools.

In 2023, employment in services rose from January to April but shrank in July.[5] The number of jobs in wholesale and retail trade, public administration and defense, accommodation and food services, and education, albeit rising in April, receded in July. Industry rose on the back of about an additional 500,000 jobs in construction. Agricultural employment, like services, declined in the first half of 2023.

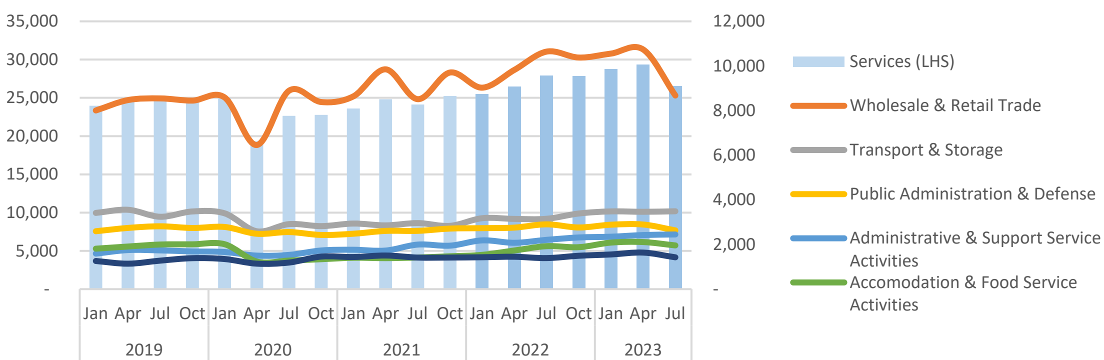
[5] Employment figures for services recovered in October, registering 28.7 million jobs.

Figure 7. Employment by class, in thousands

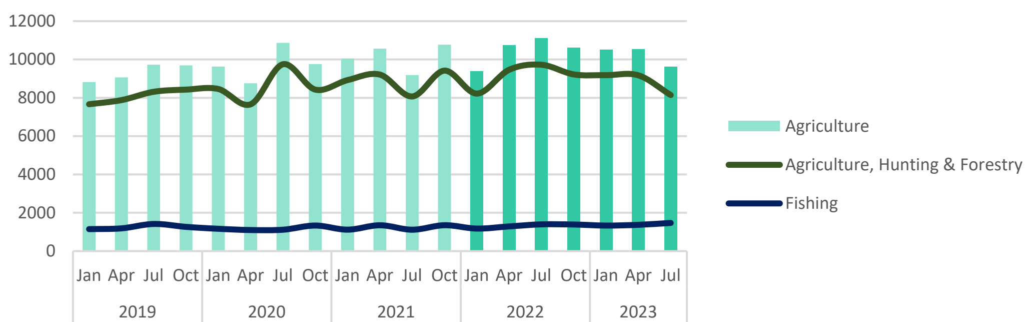
a. Employment by sector



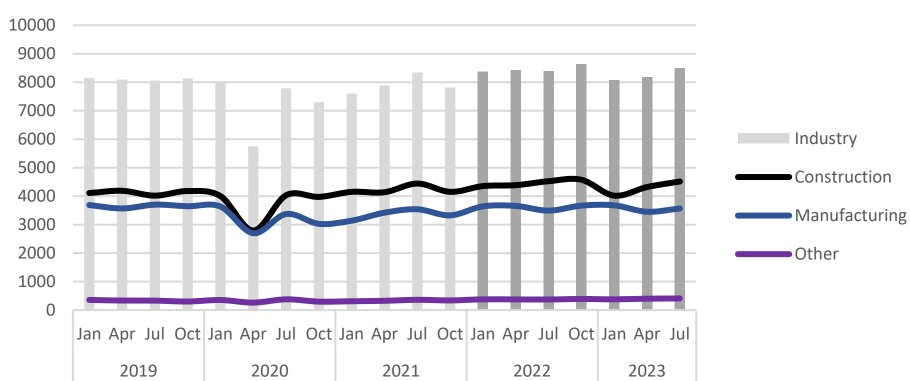
b. Employment in Services



c. Employment in Agriculture



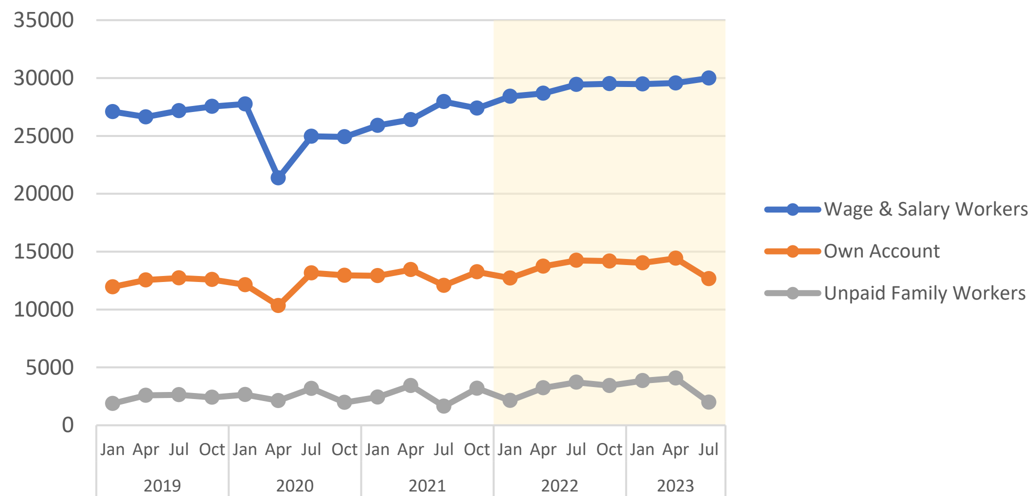
d. Employment in Industry



Source: Philippine Statistics Authority via CEIC Data (2023i)

There have been signs lately that the quality of jobs has improved (Figure 8). The number of wage and salary workers, who account for the majority in the workforce, has mostly grown since 2022. It visibly edged up in July 2023 at the same time the number of unpaid family workers and workers with their own accounts noticeably declined. The latter covers self-employed individuals as well as business owners who hire employees.

Figure 8. Employment by sectors, in thousands



Source: Philippine Statistics Authority via CEIC Data (2023h)

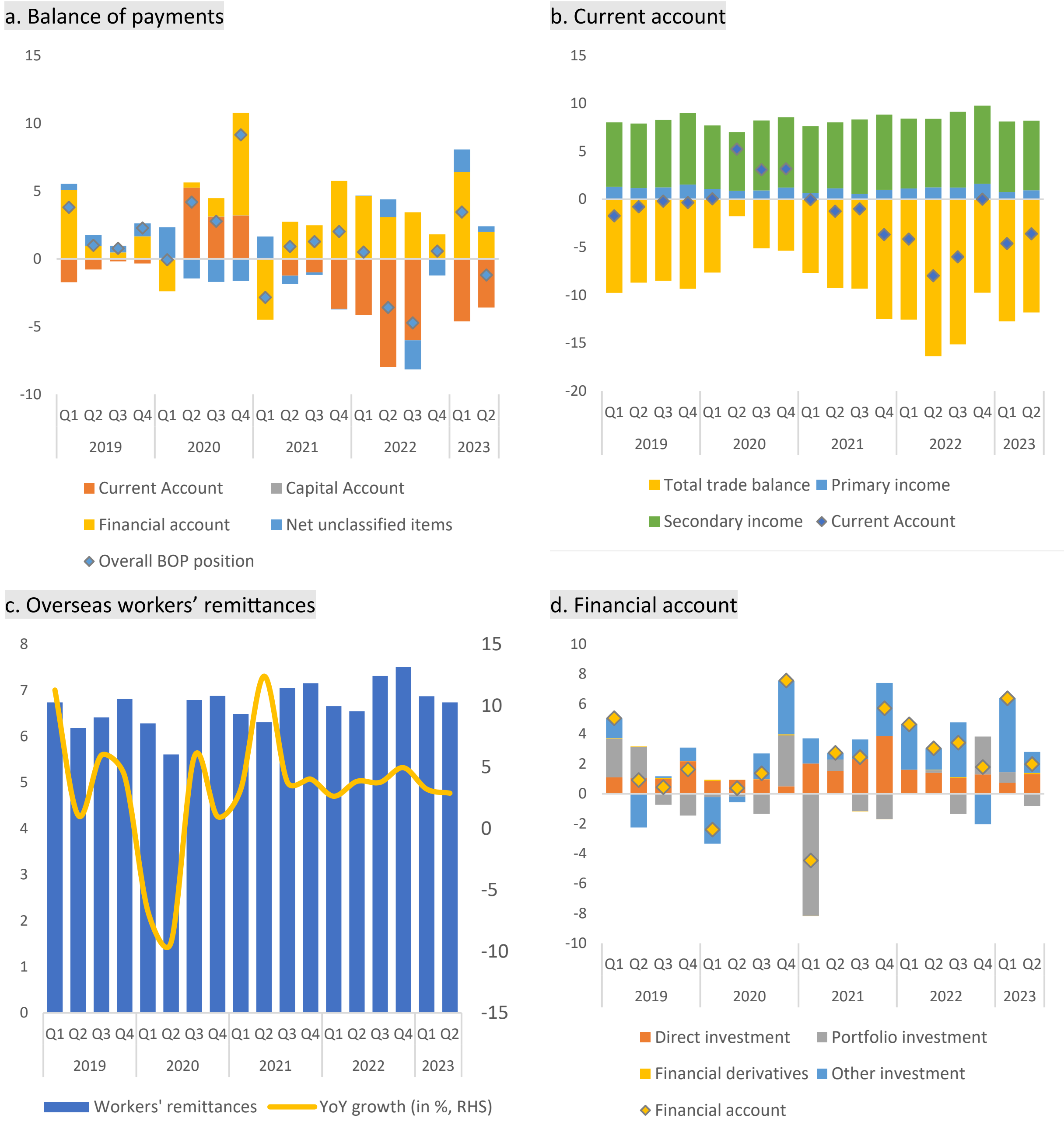
2.4. Balance of payments

The current account deficit increased to USD 17.8 billion in 2022, from USD 5.9 billion in 2021, brought about by a wider trade deficit (Figure 9b)**.** The continued growth in imports (20.3%) outpaced the growth of the country's exports (12.2%), driven largely by the post-pandemic momentum of the economy with people buying and spending more, which compelled an increase as well in the importation of goods, and an increase in world fuel prices. This was slightly countered by the strong numbers in services exports. The current account position has since improved in the first half of 2023, with a lower deficit of USD 8.2 billion versus USD 12.1 billion during the same period in the previous year owing largely to a lower trade deficit. Moreover, primary income net receipts for 2022 increased from USD 3.3 billion to USD 5.2 billion with receipts increasing by 11.1 percent and payments declining by 6.9 percent. Secondary income also rose, with remittances amounting to about USD 28 billion, though annual growth of the latter slowed from 5.6 percent in 2021 to 3.8 percent for 2022.

The balance of payments of the Philippines correspondingly turned from a surplus of USD 1.3 billion in 2021 to a USD 7.3 billion deficit in 2022 (Figure 9a). A higher deficit on goods trade outweighed the net receipts from service exports and from remittances, despite net inflows from direct and portfolio investments. The BoP for the period of January to June 2023 was slightly better, amounting to USD 2.3 billion in the first six months of 2023, compared to a USD 3.1 billion deficit during the same period in 2022. The Philippines is forecasted to attain a better external position in 2023, on account of a smaller current account deficit. For 2024, the BSP sees a small surplus in the overall balance of payments, with the expectation of an improved financial account (BSP 2023a).

Gross international reserves settled at USD 96.1 billion in December 2022 at end-of-period (Figure 10)**.** This presents an 11.6-percent annual decline from end-2021. The country's foreign reserves slid to USD 93 billion in September 2022, but the amount has increased since. It rose to about USD 101.8 billion in April 2023, but dipped to USD 99.4 billion by the end-June 2022. The peso sharply depreciated against the dollar beginning 2021, and until October 2022, when it reached PHP 58.8/USD. The peso appreciated in succeeding months on the back of higher remittances and a slightly better trade balance during the latter part of 2022. The peso-dollar exchange rate averaged at 55.9 in June 2023.

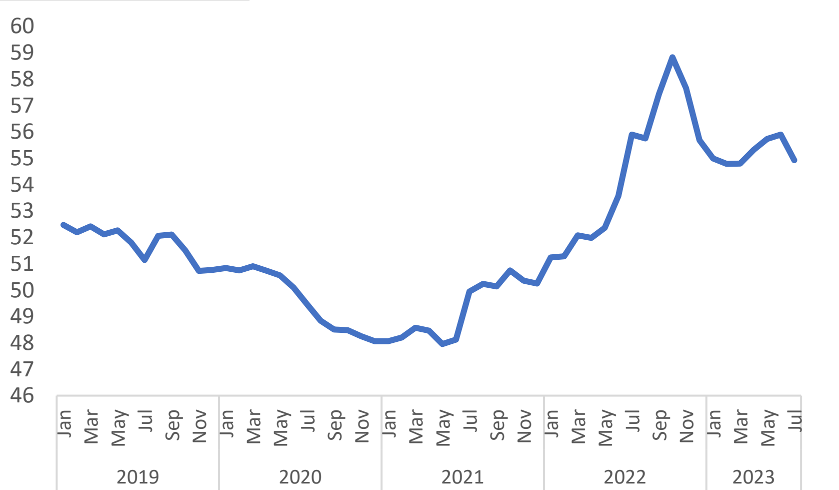
Figure 9. Balance of payments and components (in USD billions)



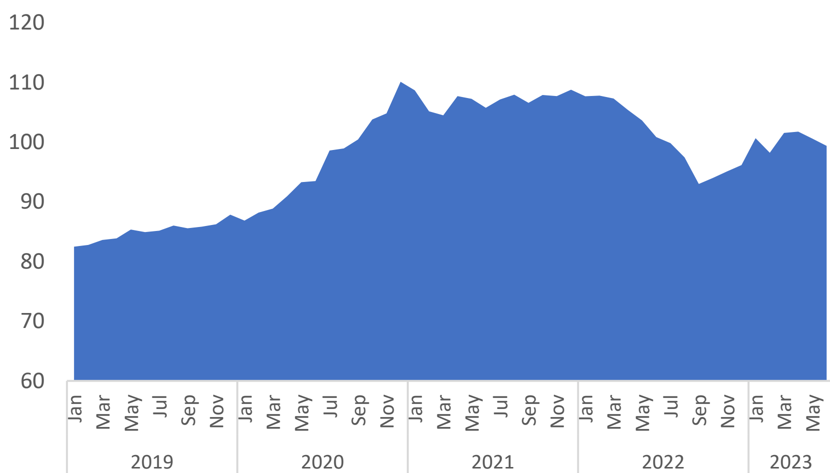
GDP = gross domestic product; BOP = balance of payments; RHS = right-hand side
Source: Bangko Sentral ng Pilipinas via CEIC Data (2023a)

Figure 10. Gross international reserves and exchange rate (PHP per USD monthly average)

a. Peso-USD exchange rate



b. Gross international reserves (in USD billions)



USD = United States Dollar

Source: Bangko Sentral ng Pilipinas via CEIC Data (2023l, u)

2.5. Fiscal developments

Government expenditure as a ratio of GDP dipped from 24.1 percent in 2021 to 23.4 percent in 2022 (Figure 11). Weak spending performance in the early part of 2022 traced to delays in spending for infrastructure programs as well as restricted capital and maintenance spending because of the national elections. Infrastructure and other capital outlays grew by14.2 percent annually in 2022, slower than the 31.4 percent growth in 2021. Personnel services (PS) still grew by 7.1 percent due partly to the implementation of the third tranche of the Salary Standardization Law of 2019. Moreover, following the utilization of DepEd and CHED for scholarship programs and other subsidies, maintenance and other operating expenses (MOOE) amounted to PHP 879.3 billion in 2022, but translated to a 0.4 percent annual decline (DBCC 2023b). Spending in 2022, the first year of the devolution transition[6], also included a higher allotment to LGUs (up by PHP 157.6 billion) on account of their higher share in the National Tax Allotment (NTA). Meanwhile, government underspending was notable in the first half, significantly slowing down to 0.4 percent year-on-year growth, from 8.9 percent previously, because of procurement-related difficulties and lower-than-programmed disbursements (DBCC 2023c). PS and MOOE from January to June 2023 slowed down to just 1.5 and 0.5 percent growth, respectively, while infrastructure and other capital outlays grew by 6.2 percent with the implementation of DOTr and DPWH projects. Furthermore, allotment to LGUs in the first half of this year decreased by 14.4 percent compared to the first half of 2022, given their lower NTA for 2023[7].

The reopening of the economy contributed to higher tax revenues in 2022. The increase in economic activity helped raise total revenues in 2022 to about 16.1 percent of GDP, with corresponding improvement in tax effort (the ratio rising from 14.1% to 14.6%). Tax revenues in 2022 were higher by 17.4 percent compared to 2021, due to higher collections from net income and profits, sales taxes and licenses, and taxes on international trade and transactions. The Bureau of Internal Revenue (BIR) collected PHP2.3 trillion, slightly lower than its target, while the Bureau of Customs (BOC) collected better than expected (at PHP 862.4 billion) because of higher oil prices and increased imports of sweetened beverages, tobacco, and rice. For January to June 2023, revenue grew by 7.7 percent year-on-year, a slower pace compared to the 15.9 percent growth during the same period last year. Improved tax administration in the BOC and increased collections from net income and profits by the BIR were tempered by lower than anticipated revenues from VAT, excise taxes, and other domestic taxes. This resulted in tax revenue growing by 8.2 percent year-on-year for the first half of 2023, a slowdown compared to the 14.7 percent growth recorded last year.

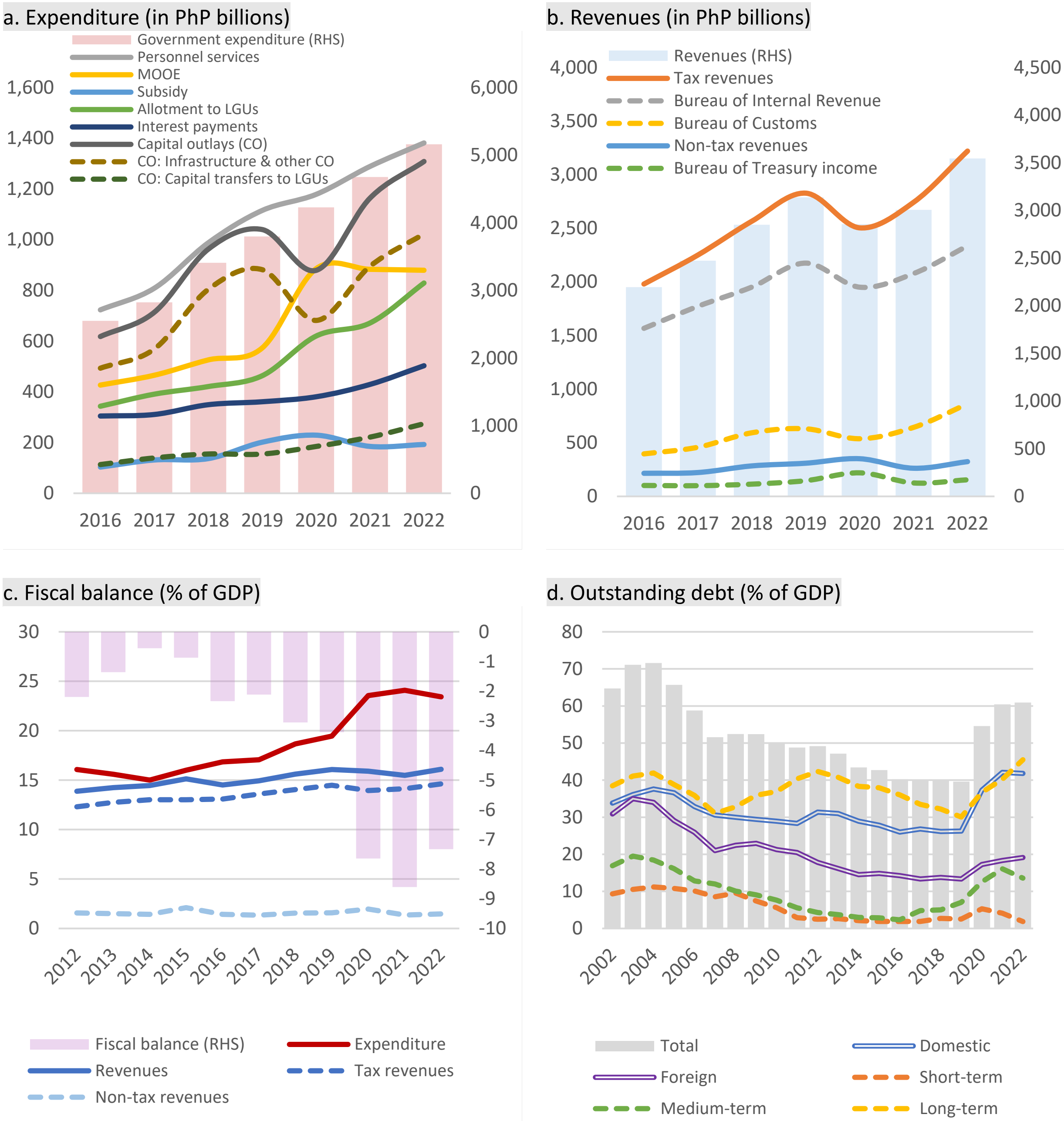
The country's fiscal deficit narrowed slightly from 8.6 percent in 2021 to 7.3 percent of GDP in 2022. Expenditures as a ratio of GDP dipped from 24 percent in 2021 to 23.4 percent in 2022, while revenues stood at 16.1 percent in 2022, up from 15.5 percent in 2021. In terms of financing, gross borrowings by the government amounted to PHP 2.16 trillion in 2022. The debt-to-GDP ratio saw a 0.5 percentage point increase, from 60.4 to 60.9. By end-2022, NG debt consisted largely of domestic issuances (about 68.6 percent of the total, or about PHP 9.2 trillion). Moreover, most of

[6] The implementation of Executive Order No. 138 s. 2021, mandating full devolution of certain functions of the executive branch to LGUs, has been temporarily postponed by the current administration amid the review for possible amendments.
[7] The NTA is based on the third preceding year, which for the case of FY 2023 is 2020—when lockdown measures led to a drastic reduction in revenues.

the borrowings had long maturities (74.7 percent of total outstanding debt). In the first six months of 2023, the fiscal deficit was recorded at 4.8 percent of GDP, lower compared to the 6.5 percent deficit in the same period last year, as revenue grew more (7.7%) compared to the meek growth in spending (0.4%). As the latter was mostly due to lower disbursements, the catch-up plan may still spur spending in the latter half of the year across projects and activities of government agencies including infrastructure (DBCC 2023e).

Debt sustainability analysis shows that the debt-to-GDP ratio will likely peak at 64.2 in 2025 (Figure 12a). This assumes the economy will grow by 5.2 percent in 2023 and post higher growth (about 6%) thereafter, and with the primary deficit at normal levels. Excluding cash buffers from the fiscal program (Figure 12c), the trajectory follows a lower path that hovers near the 60 percent ratio and is projected to be well below this benchmark in the medium term. Furthermore, it can be noted from the Budget of Expenditures and Sources of Financing (BESF) tables for 2024 that the government expects relatively higher budgetary change in cash from its fiscal program in the coming years, projected at PHP 863.8, 794.9, and 913.7 billion for the years 2024 to 2026 (DBM various years) representing liquidity that may also be used to repay the debt.

Figure 11. National government fiscal performance

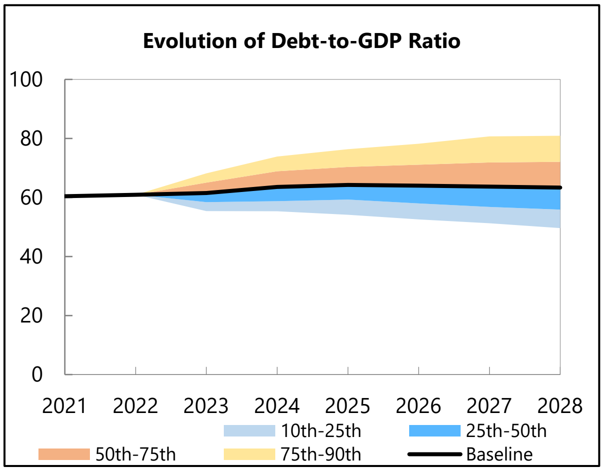


PHP = Philippine peso; RHS = right-hand side; MOOE = maintenance and other operating expenses; LGUs = local government units; GDP = gross domestic product

Source: Bureau of Treasury via CEIC Data (2023r, s)

Figure 12. Debt sustainability analysis

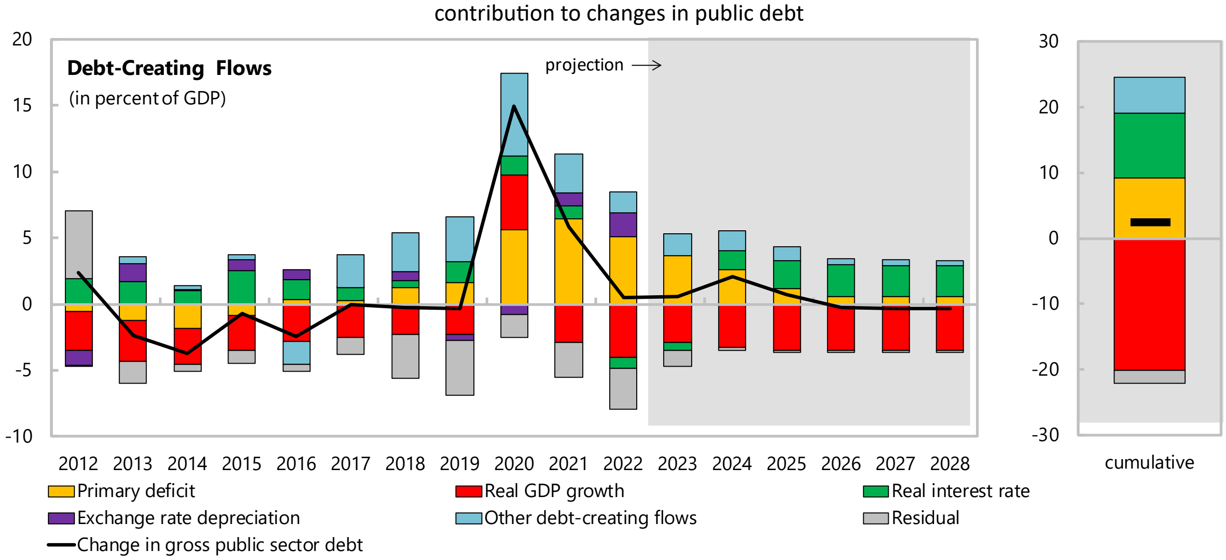
a. DSA fan chart, 2021 to 2028.



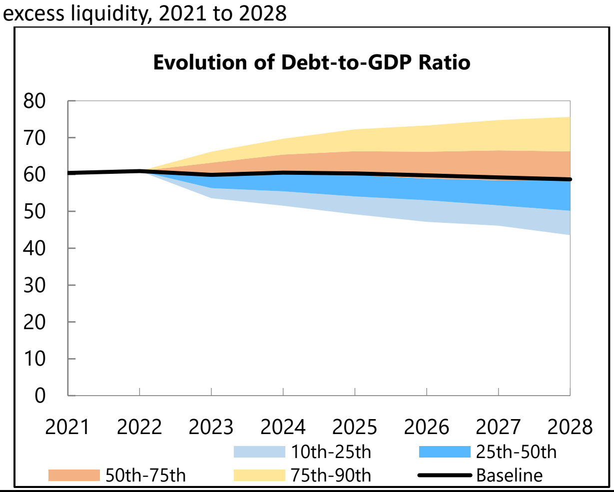
b. DSA – Baseline scenario: debt, economic, and market indicators

	Actual			Projections						As of July 01, 2023		
	2012-2020	2021	2022	2023	2024	2025	2026	2027	2028	Sovereign spreads		
Nominal gross public debt	44.1	60.4	60.9	61.5	63.6	64.2	64.0	63.7	63.4	Bond spread (bp)		94
Public gross financing needs	5.5	12.6	10.9	10.1	12.9	11.2	10.9	10.1	10.8	5Y CDS (bp)		77
Real GDP growth (in percent)	4.8	5.7	7.6	5.2	5.8	6.0	6.0	6.0	6.0	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	1.8	23	5.5	5.6	3.0	3.0	3.0	3.0	3.0	Moody’s	Baa2	Baa2
Nominal GDP growth (in percent)	6.7	8.1	13.5	11.1	9.0	9.2	9.2	9.2	9.2	S&Ps	BBB+	BBB+
Effective interest rate (in percent)	5.4	4.4	4.3	4.7	5.7	6.8	7.2	7.1	7.2	Fitch	BBB	BBB

contribution to changes in public debt



c. DSA fan chart excluding the excess liquidity, 2021 to 2028



	2021	2022	2023	2024	2025	2026	2027	2028
NG debt/GDP	60.4	60.9	59.9	60.5	60.3	59.8	59.2	58.7

Source: Authors' calculations using the IMF-DSA template.

2.6. Monetary developments

After much tightening in 2022, key policy rates were held steady in Q2 2023, as inflation slightly eased. In 2022, the central bank implemented a string of monetary policy increases, as inflation accelerated. Table 1 shows that from 2 percent at the start of the year, the overnight reverse repurchase rate (RRP) was raised by a total of 350 basis points (bps) by yearend (25 bps in May, 25 bps in June, 75 bps in July, 50 bps in August, 50 bps in September, 75 bps in November, and 50 bps in December). This continued until the early part of 2023 when the monetary authority decided to raise the interest rate by 25 bps in February and again in March. The rate was then (temporarily) maintained at 6.25 percent due to inflation showing a slight deceleration.

The differential between Philippine and US key policy rates declined in 2022, settling within a limited (but lower) band beginning the second half of 2022. It virtually matched policy rate hikes implemented by the Federal Reserve during the period—even when the latter raised its target range by 75 bps in November 2022 and by another 50 bps a month after[8]— keeping the interest rate differential within 90 to 150 bps (compared to above 150 bps previously). The differential held steady at 117 bps by the end of the first half of 2023.

Reserve requirement ratios (RRR) against selected peso deposit and deposit substitute liabilities were cut by the BSP in June 2023. This included a 200 bps reduction for universal and commercial banks (U/KBs), 200 bps for digital banks, and 100 bps for thrift banks, rural banks, and cooperative banks. RRRs for non-bank financial institutions with quasi-banking functions (NBQBs) against deposit substitutes were also trimmed by 250 bps (BSP 2023b).[9] Coinciding with

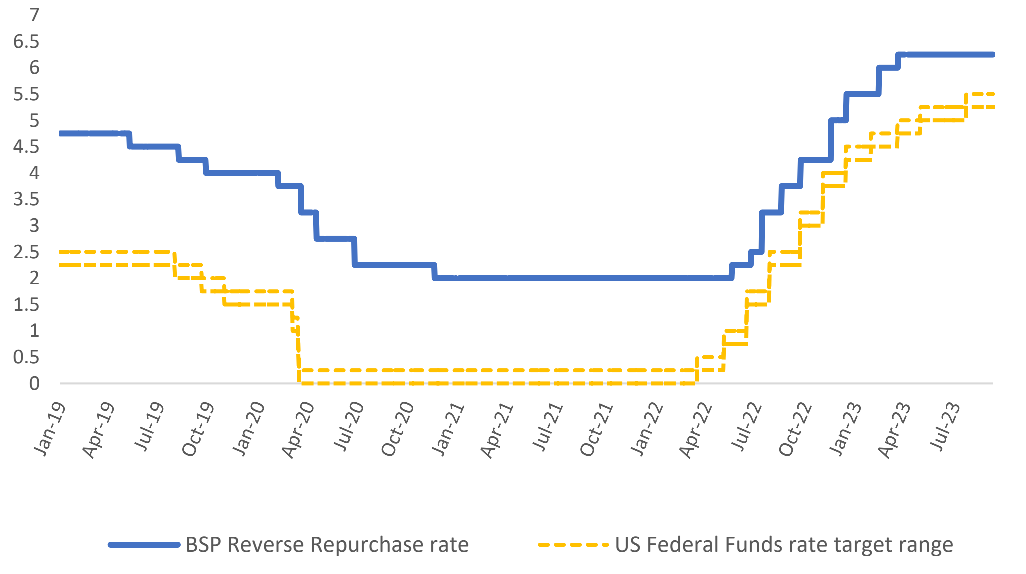
[8] The US Federal funds rate target range had been gradually rising since 2022 to also temper the effects of rapid inflation. From a range of 0.0 to 0.25 percent, interest rates had been increased since March by a total of 4.25 ppts to end 2022 at the 4.25 to 4.5 percent range. Further tightening was seen in the first half of 2023 with hikes of 0.25 ppts in February, in March and again in May. The Federal Reserve remains hawkish, maintaining the 5.25 to 5.5 percent range since.

[9] The RRR for U/KBs and NBQBs now stand at 9.5 percent, 6.0 percent for digital banks, 2.0 percent for thrift banks, and 1.0 percent for rural and cooperative banks.

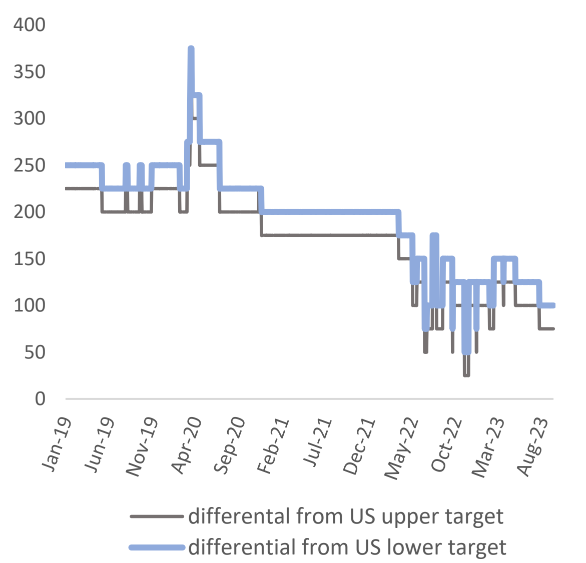
this policy was the removal of some pandemic relief measures, specifically with respect to banks counting the loans to MSMEs and large enterprises as an alternative to comply with the reserve requirements. The removal of this regulatory relief was aimed at restoring the reserve requirement as an instrument for managing liquidity in the financial sector (BSP 2023c).

Figure 13. Philippine and US key policy rates

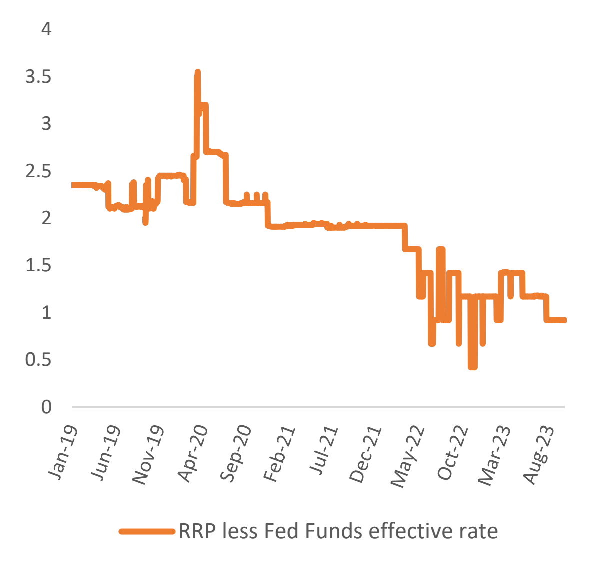
a. BSP reverse repurchase rate (RRP) and US Federal Funds rate



b. Differential of BSP RRP and US Federal Funds target range (in basis points)



c. Interest rate differential of BSP RRP rate and US Federal Funds effective rate (in percent)



US = United States; BSP = Bangko Sentral ng Pilipinas

Source: Bangko Sentral ng Pilipinas and United States Federal Reserve via CEIC Data (2023b, af)

Table 1. Monetary policy decisions on the overnight repurchase facility

Date	Interest rate	Policy decision and associated considerations
Feb 17 2022	2.00	Maintained; due to manageable inflation and emerging uncertainty in domestic and global growth.
Mar 24 2022	2.00	Maintained; to sustain the momentum of the economy, on the face of increasing uncertainty.
May 19 2022	2.25	25 bps increase; to restrain the second-round effects and temper the expectations on inflation.
Jun 23 2022	2.50	25 bps increase; to ensure macroeconomic stability in light of rising commodity prices as well as headwinds to domestic economic growth.
Jul 14 2022*	3.25	75 bps increase; given the urgent need to address the inflation situation amid the ongoing normalization of monetary policy settings.
Aug 18 2022	3.75	50 bps increase; with continued inflationary pressures projected to go beyond the inflation target over the policy horizon.
Sep 22 2022	4.25	50 bps increase; due to inflation still expected to surpass the target range and prevent further price pressures.
Nov 17 2022	5.00	75 bps increase; due to expectations of higher inflation along with the adverse effects of upside risks, and increased likelihood of further second-round effects.
Dec 15 2022	5.50	50 bps increase; as inflation remains high and broad-based; in addition to heightened inflation expectations.
Feb 16 2023	6.00	50 bps increase; due to inflation showing a sharp rise in January, that is projected to remain high.
Mar 23 2023	6.25	25 bps increase; due to persistent inflationary pressures and to preserve the buffer in consideration of external spillovers and continued uncertainty.
May 18 2023	6.25	Maintained; as inflation reflects a gradual return within the target range, allowing for further assessment of macroeconomic and financial conditions given the tighter global financial conditions.
Jun 22 2023	6.25	Maintained; due to inflation demonstrating a continued gradual return within target and to stave off buildup of potential financial imbalances.

* off-cycle meeting
Source: BSP (2022, 2023g)

3. Macroeconomic outlook

3.1. Macro conditions

Global economic recovery from the COVID-19 pandemic continued despite geopolitical and commodity price shocks, but the macroeconomic outlook remains uncertain this year and the next. GDP growth is generally expected to slow in 2023, especially with lagged effects of monetary policy tightening materializing, and will continue be unremarkable in 2024 (Table 1.1). Among the major economic partners of the Philippines, the US may perform better than anticipated this year, but growth may still weaken in the next couple of years (at still below 2%). In contrast, Japan and countries in the Euro area will likely see slower growth than anticipated this year, but with similarly weak prognosis in the medium term. Among the large developing economies, China will grow faster this year versus a year ago but may continue to face domestic headwinds, from a real estate crisis and diminished business and consumer confidence. Growth of emerging and developing economies (EMDEs) is expected to be resilient and remain at about 4 percent in the short to medium term.

Inflation has decelerated globally but remains high among EMDEs except in Asia (IMF 2023b). Inflation in advanced economies (both headline and core) is expected to decline from 7.3 percent in 2023 to about 4.5 percent in 2024 and further to below 4 percent in the medium term. It is expected to go down from 9.8 percent to 8.5 percent then remain above 5 percent among EMDEs during the same period but remain consistently below 3 percent in developing Asia. These forecasts are in line with a projected decline in world oil prices. Non-OPEC (Organization of the Petroleum Exporting Countries) members are set to increase oil production, helping offset lower supply from key oil-producing economies, primarily Saudi Arabia and Russia (IMF 2023c). However, volatilities in food and energy prices due to recent developments in addition to the Russian invasion of Ukraine, particularly the Israel-Hamas war, continue to pose upside risks (WB 2023a).

Growth in trade may see a significant slowdown globally, from 5.1 percent in 2022 to 0.9 percent in 2023, but may soon recover. This projection hinges on reduced demand, the appreciation of the US dollar, and increased trade restrictions. Goods trade is expected to decline by 0.3 percent this year but rise by 3.2 percent in 2024. On the other hand, services trade is poised to register strong growth for 2023, but momentum is seen to slightly wane for the latter end of this year albeit still expected to perform better than trade in goods (WTO 2023). Prolonged geopolitical conflicts, among many factors, may be anticipated to significantly impact international trade, with escalations likely to disrupt growth.

Table 2. World outlook in short to medium term

	2011-2020	2021	2022	2023f	2024f	2025f	2026f	2027f
Output (annual % change)								
World	2.9	6.3	3.5					
GEP (Jun 2023)				2.1 (3.0)	2.4 (3.0)	3.0		
WEO (Oct 2023)				3.0 (2.7)	2.9 (3.2)	3.2 (3.4)	3.2 (3.3)	3.1 (3.2)
Advanced economies	1.3	5.6	2.6					
GEP (Jun 2023)				0.7 (2.2)	1.2 (1.9)	2.2		
WEO (Oct 2023))				1.5 (1.1)	1.4 (1.6)	1.8 (1.9)	1.9 (1.9)	1.8 (1.7)
US	1.7	5.9	2.1					
GEP (Jun 2023)				1.1 (2.4)	0.8 (2.0)	2.3		
WEO (Oct 2023)				2.1 (1.0)	1.5 (1.2)	1.8 (1.8)	2.1 (2.1)	2.1 (1.9)
Euro area	0.6	5.6	3.3					
GEP (Jun 2023)				0.4 (1.9)	1.3 (1.9)	2.3		
WEO (Oct 2023)				0.7 (0.5)	1.2 (1.8)	1.8 (1.9)	1.7 (1.7)	1.5 (1.5)
Japan	0.4	2.2	1.0					
GEP (Jun 2023)				0.8 (1.3)	0.7 (0.6)	0.6		
WEO (Oct 2023)				2.0 (1.6)	1.0 (1.3)	0.7 (0.9)	0.5 (0.5)	0.4 (0.4)
EMDE	4.1	6.9	4.1					
GEP (Jun 2023)				4.0 (4.2)	3.9 (4.4)	4.0		
WEO (Oct 2023))				4.0 (3.7)	4.0 (4.3)	4.1 (4.3)	4.1 (4.3)	4.0 (4.3)
EAP	6.2	7.5	3.5					
GEP (Jun 2023)				5.5 (5.2)	4.6 (5.1)	4.5		
EMDA	6.0	7.5	4.5					
WEO (Oct 2023)				5.2 (4.9)	4.8 (5.2)	4.9 (5.3)	4.8 (5.2)	4.6 (5.1)
China	6.8	8.5	3.0					
GEP (Jun 2023)				5.6 (5.2)	4.6 (5.1)	4.4		
WEO (Oct 2023)				5.0 (4.4)	4.2 (4.5)	4.1 (4.6)	4.1 (4.6)	3.7 (4.6)
India	5.3	9.1	7.2					
GEP (Jun 2023)				6.3 (7.1)	6.4 (6.5)	6.5		
WEO (Oct 2023)				6.3 (6.1)	6.3 (6.8)	6.3 (6.8)	6.3 (6.5)	6.3 (6.2)
Consumer prices (Annual % change)								
World	3.5	4.7	8.7	6.9 (6.5)	5.8 (4.1)	4.6 (3.6)	4.2 (3.4)	3.9 (3.3)
Advanced economies	1.4	3.1	7.3	4.6 (4.4)	3.0 (2.4)	2.2 (2.0)	2.0 (1.9)	2.0 (1.9)
EMDE	5.2	5.9	9.8	8.5 (8.1)	7.8 (5.3)	6.2 (4.6)	5.7 (4.4)	5.2 (4.3)
EMDA	3.6	2.2	3.8	2.6 (3.6)	2.7 (2.8)	2.9 (2.8)	2.9 (2.8)	2.8 (2.8)
World trade volume (annual % change)	2.6	10.9	5.1	0.9 (2.5)	3.5 (3.7)	3.7 (3.7)	3.6 (3.6)	3.5 (3.5)
World prices (USD, annual % change)								
Oil	-2.9	65.8	39.2	-16.5 (-12.9)	-0.7 (-6.2)	-4.9 (-4.9)	-4.3 (-3.9)	-3.9 (-3.1)
Nonfuel primary commodities	-0.1	26.7	7.9	-6.3 (-6.2)	-2.6 (-0.7)	-0.1 (-0.4)	0.2 (0.2)	0.4 (0.2)

GEP = Global Economic Prospects; WEO = World Economic Outlook; US = United States; EMDE = emerging market and developing economies; EAP = East Asia and Pacific; EMDA = emerging and developing Asia; USD = United States dollar; f = forecast
Note: Numbers in parenthesis are forecasts from year-ago editions (i.e. June 2022 and October 2022)
Source: International Monetary Fund (2022, 2023c); World Bank (2022, 2023b)

ASEAN-5 output is similarly anticipated to slow in the near term, as lagged effects of monetary policy rate hikes play out and governments continue with their fiscal consolidation efforts. Economies in the region, except for Thailand, benefited from a sharp recovery from the pandemic in 2022 and may face slower growth in 2023, with prospects not expected to improve much in 2024 for most countries**.** In the Philippines, post-pandemic momentum is seen to weaken, with economic growth expected to decline to slightly below the 6-to-7-percent target of the government this year. Medium-term growth of the country is projected at about 6 percent, falling below pre-pandemic assessments of the country's potential performance (which hovered around 6.5%).

Price pressures are seen to ease in most countries in ASEAN-5 in 2023 as tightening policies take effect. The majority in the region will likely see their headline inflation at below 4 percent this year and the next. However, in the Philippines, inflation is forecast to inch up from 5.8 percent in 2022 to about 6 percent in 2023, still outside of the inflation target band (3% +/- 1 percentage point), before easing to about 3.6 percent in 2024. The country's core inflation has fallen, indicating some easing of inflationary pressures, though the headline rate has begun to rise again (Figure 1.3a). Recent price pressures in the country have been mostly on the agricultural supply side, due to increases in food costs, particularly of rice and vegetables (Figures 1.3b, 1.3c, and 1.5).[10]

[10] Rice inflation became a concern in the third quarter of 2023 as prices grew by 17.9 percent in September. A price cap was imposed on regular milled and well-milled rice in September (EO 39 s. 2023). This was however lifted after nearly a month. Export bans on rice were seen in some economies. India has imposed a ban on broken rice (since September 2022) and on non-basmati white rice exports (since July 2023). Bangladesh also has a standing export ban on aromatic rice (since June; from Sharma 2023, and Kashem and Ali 2022).

Table 3. Output projections for major ASEAN developing economies

	2020	2021	2022	2023f	2024f	2025f	2026f	2027f
GDP (annual % change)								
Indonesia	-2.1	3.7	5.3	**5.0**	**5.0**			
ADO (Sep 2023)				5.0 (5.0)	5.0			
GEP (Jun 2023)				4.9 (5.3)	4.9 (5.3)	5.0		
WEO (Oct 2023)				5.0 (5.0)	5.0 (5.4)	5.0 (5.3)	5.0 (5.2)	5.0 (5.1)
Malaysia	-5.5	3.3	8.7	4.3	4.5			
ADO (Sep 2023)				4.5 (4.7)	4.9			
GEP (Jun 2023)				4.3 (4.5)	4.2 (4.4)	4.2		
WEO (Oct 2023)				4.0 (4.4)	4.3 (4.9)	4.4 (4.4)	4.4 (4.4)	3.9 (3.9)
Philippines	-9.5	5.7	7.6	**5.7**	**6.0**			
ADO (Sep 2023)				5.7 (6.3)	6.2			
GEP (Jun 2023)				6.0 (5.6)	5.9 (5.6)	5.9		
WEO (Oct 2023)				5.3 (5.0)	5.9 (6.0)	6.1 (6.0)	6.2 (6.0)	6.3 (6.0)
Thailand	-6.1	1.5	2.6	**3.4**	**3.5**			
ADO (Sep 2023)				3.5 (4.2)	3.7			
GEP (Jun 2023)				3.9 (4.3)	3.6 (3.9)	3.4		
WEO (Oct 2023)				2.7 (3.7)	3.2 (3.6)	3.1 (3.3)	3.0 (3.2)	3.0 (3.0)
Viet Nam	2.9	2.6	8.0	**5.5**	**6.0**			
ADO (Sep 2023)				5.8 (6.7)	6.0			
GEP (Jun 2023)				6.0 (6.5)	6.2 (6.5)	6.5		
WEO (Oct 2023)				4.7 (6.2)	5.8 (6.6)	6.9 (6.7)	6.8 (6.7)	6.8 (6.8)

ASEAN = Association of Southeast Asian Nations; GDP = gross domestic product; ADO = Asian Development Outlook; GEP = Global Economic Outlook; WEO = World Economic Outlook; f = forecast
Notes:
(1) Top-line forecasts are averages of projections from the September 2023 issue of the Asian Development Bank (ADB)'s ADO; the June 2023 issue of the World Bank (WB)'s GEP, and the October 2023 issue of International Monetary Fund (IMF)'s WEO.
(2) Numbers in parenthesis are forecasts from year-ago editions (i.e., September 2022, June 2022, and October 2022)
Sources: ADB (2022, 2023); IMF (2022, 2023c); World Bank (2022, 2023b)

Table 4. Inflation forecasts for major ASEAN developing economies

	2020	2021	2022	2023f	2024f	2025f	2026f	2027f	2028f
CPI (annual % change)									
Indonesia	2.0	1.6	4.2	3.6	2.8				
WEO (Oct 2023)				3.6 (5.5)	2.5 (3.2)	2.5 (3.0)	2.5 (3.0)	2.3 (3.0)	1.6
ADO (Sep 2023)				3.6 (5.1)	3.0				
Malaysia	-1.1	2.5	3.4	3.0	2.7				
WEO (Oct 2023)				2.9 (2.8)	2.7 (2.4)	2.3 (2.4)	2.1 (2.4)	1.8 (2.5)	1.9
ADO (Sep 2023)				3.0 (2.5)	2.7				
Philippines				6.0	3.6				
WEO (Oct 2023)	2.4	3.9	5.8	5.8 (4.3)	3.2 (3.1)	3.0 (3.0)	3.0 (3.0)	3.0 (3.0)	3.0
ADO (Sep 2023)				6.2 (4.3)	4.0				
Thailand				2.0	2.0				
WEO (Oct 2023)	-0.8	1.2	6.1	1.5 (2.8)	1.6 (1.5)	1.9 (2.3)	2.0 (2.0)	2.0 (2.0)	2.0
ADO (Sep 2023)				2.5 (2.7)	2.3				
Viet Nam				3.6	3.7				
WEO (Oct 2023)	3.2	1.8	3.2	3.4 (3.9)	3.4 (3.5)	3.4 (3.5)	3.4 (3.5)	3.4 (3.5)	3.4
ADO (Sep 2023)				3.8 (4.0)	4.0				

ASEAN = Association of Southeast Asian Nations; CPI = consumer price index; WEO = World Economic Outlook; ADO = Asian Development Outlook; f = forecast
Note: Numbers in parenthesis are forecasts from year-ago editions (i.e., October 2022, and September 2022)
Source: ADB (2022, 2023); IMF (2022, 2023c)

Monetary policies in most developing Asian economies tightened further during the year, but monetary easing in the region may be expected by 2024. Thailand steadily raised its policy rate during the first 3 quarters of 2023, while the Philippines and Malaysia followed through with a few more hikes sometime during that period (Figure 14). China and Vietnam, however, cut their policy rates by 25 and 150 basis points, respectively, to provide stimulus to their slowing economies. Others in the region may follow suit as macroeconomic prospects weaken, yet their actions will also depend on domestic price conditions and the decisions of the US Fed, given the latter's impact on key variables. Financial conditions in the Philippines had been surprisingly resilient until early 2023 despite last year's sharp monetary tightening based on a broad financial conditions index (FCI). Positive readings of the Philippine FCI in the fourth quarter of 2022 suggest looser financial conditions than the normal level historically (>1 standard deviation by January 2023), though the index has since trended down.[11] The latter movement indicates tighter financial conditions this year, constraining economic activity. Conditions may tighten even further with an additional policy rate increase of 25 bps in October 2023, an off-cycle action that puts the overnight repurchase rate at 6.50 percent. This was done to prevent supply-side price pressures and inflation expectations from exacerbating second-round effects (BSP 2023d).

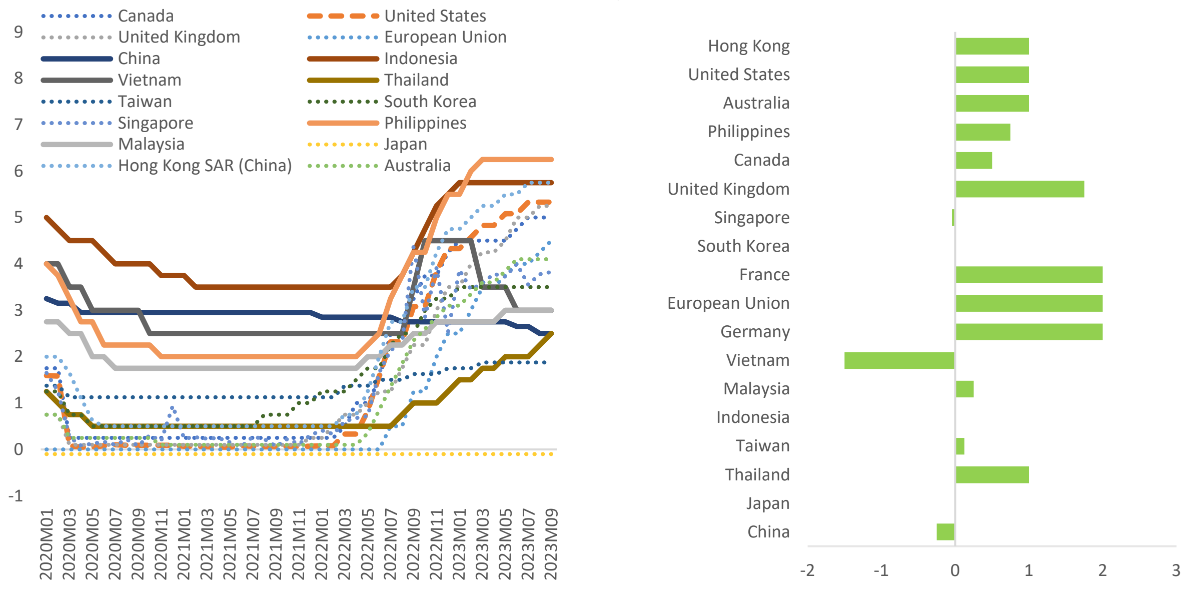
Countries in developing Asia will continue to face limited fiscal space in the near term. Like elsewhere in the world, deficits and debt ratios have climbed in the region because of the public health and fiscal stimulus programs that had to be launched during the COVID-19 pandemic (Figure 16 and 17). The rise had been especially pronounced in the Philippines and Thailand, though much of the increase in debt in the former had been due to government efforts to build a cash buffer as defense against the uncertainty created by the pandemic (Debuque-Gonzales et al 2022a). High debt levels may constrain public investment, while the likely increase in interest rates may limit private investment. Deficits have been brought down in the region, with substantial fiscal consolidation observed in Indonesia and Thailand.

[11] The FCI 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 2020, see Appendix). It is measured relative to a country's stage in the business cycle.

Figure 14. Policy rates and rate changes

a. Policy rates (in percent)

b. Policy rate changes, 2023M09 vs M01 (percentage points)

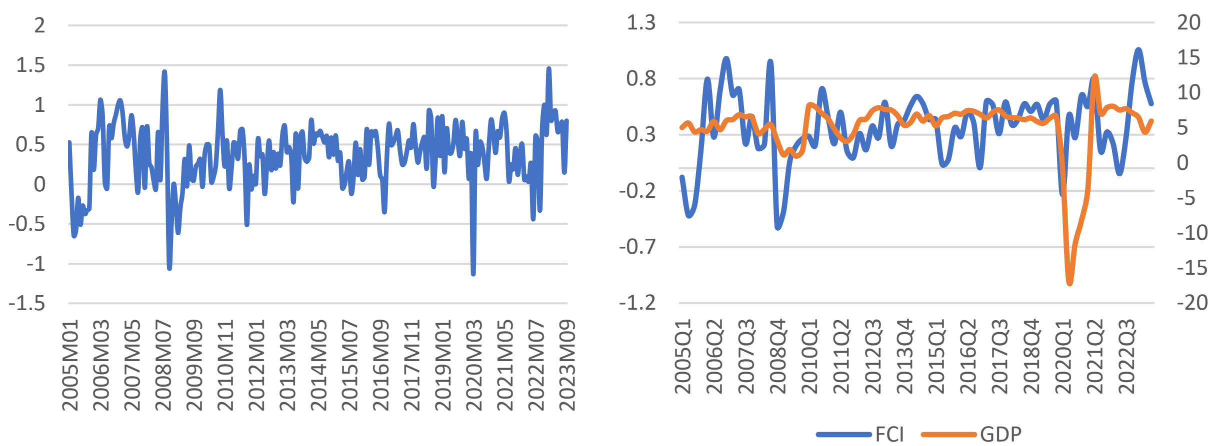


Sources: Authors' computations using CEIC Data (2023w)

Figure 15. Financial conditions and GDP growth

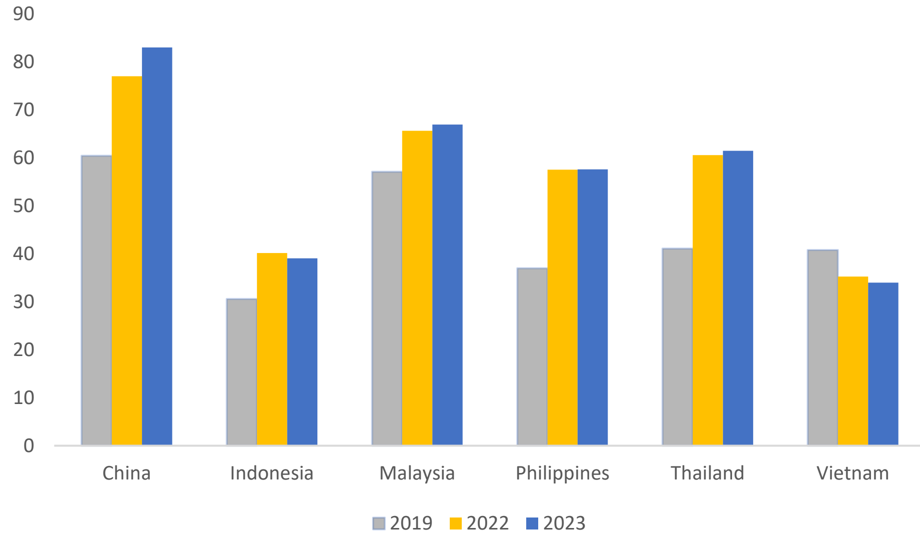
a. FCI

b. FCI and Quarterly GDP



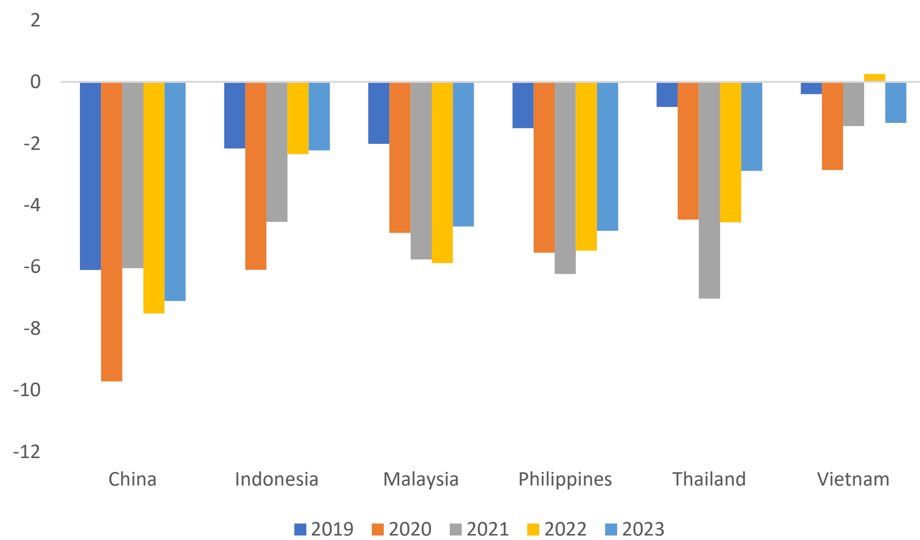
Source: Philippines Statistics Authority via CEIC Data (2023k), authors' computations

Figure 16. ASEAN-5 plus China general government debt (in percent of GDP)



Source: IMF (2023c).

Figure 17. ASEAN-5 plus China general government balance (in percent of GDP)



Note: Computed as general government total revenue less total expenditure.
Source: IMF (2023c).

3.2. Macro projections

We expect GDP growth to slow to 5.2 percent in 2023, which is well within our forecast range for the year (at about 4.5 to 5.5 percent). In line with previous expectations, monetary tightening and fiscal constraints due to a rising debt burden, and a generally "gloomy and uncertain" outlook for the world economy, with many countries battling high inflation and experiencing a slowdown, has constrained consumer and government spending this year. An unexpected escalation of supply-side inflation contributes as well to the mix, dampening our already (relatively) pessimistic (i.e., lower-than-consensus) projections. However, as also previously noted, catchup spending in services, particularly tourism, and stronger deployment of overseas Filipino workers, which provides support to international remittances, has helped bolster economic growth.[12]

GDP will likely grow between 5.5 to 6 percent in 2024. Consumption may still support growth despite weak global economic prospects, given the steady flow of remittances from abroad; increased wages, which may partially offset lost purchasing power; and an improved jobs picture, with an increase in wage and salary employees. Financial conditions have also not worsened (yet) as one might expect amid monetary tightening, with macro conditions set to further improve with declining inflation and some credit easing next year. While this year's public budget had been on a consolidation path, programmed to grow by just 5.5 percent annually (DBCC 2023d), the 2024 budget is set to grow at a less restrictive pace of about 9.5 percent (DBM 2023a). On the production side, apart from continued resilience of services, possible upsides would include resurgence in certain sectors, such as construction, given the current momentum, and rising business expectations in some industries, like in utilities and agriculture, where firms have reported expansion plans in the next 12 months (BSP 2023d). The downside would be if external conditions worsen more than expected.

Inflation will likely reach 6 percent on average in 2023, then decline to within target range (3% +/- 1 percentage point) in 2024. A spike in retail rice prices last September combined with an upward climb in gasoline prices and minimum wage, transport fare, and power rate hikes have kept the headline rate high this year, but easing pressures on both commodities combined with base effects will eventually bring inflation down next year. The impact of additional policy rate hikes this year will also continue to be felt in 2024, with the estimated lag of monetary policy in the country estimated to be anywhere between 4 to 7 quarters Tuaño-Amador 2003; Guinigundo 2005; Debuque-Gonzales 2020). However, there is still risk of rice prices remaining high (and inflation averaging at the upper end of the band), with the uncertain duration of India's export ban and the El Nino phenomenon still exerting upward pressure. Thailand, which already experienced a drought in the latter part of this year, expects rice prices to continue climbing next year as dryness persists. Moreover, as previously mentioned, renewed geopolitical conflicts may lead to large volatilities in commodities prices, which could disturb the downward trend in global inflation.

[12] While figures have yet to reach 2019 levels, tourist arrivals grew by 165.3 percent in June 2023. DOT reports tourism revenues of PHP 212 billion for January to July, 502.2 percent higher than in the same period last year (Ivana 2023). 1.96 million OFWs were meanwhile deployed in 2022, with remittances growing by 3.6 percent.

Table 5. Growth projections for the Philippines

	2011-2020	2021	2022	2023f	2024f
GDP (annual % change)	4.7	5.7	7.6		
International institutions					
ASEAN+3 Regional Economic Outlook (Oct 2023)				5.9 (6.3)	6.5
Asian Development Outlook (Sep 2023)				5.7 (6.3)	6.2
Global Economic Prospects (Jun 2023)				6.0 (5.6)	5.9 (5.6)
World Economic Outlook (Oct 2023)				5.3 (5.0)	5.9 (6.0)
Credit rating agencies					
Moody's Analytics (Oct 2023)				5.2 (6.4)	5.3
Fitch Solutions (Aug 2023)				5.9 (6.2)	6.6
S&P Global Ratings (Nov 2023)				5.4 (5.2)	5.9
Government					
DBCC projections				6.0 to 7.0 (6.5 to 8.0	6.5 to 8.0 (6.5 to 8.0)
Author's projections				5.2 (4.5 to 5.5)	5.5 to 6.0

GDP = gross domestic product; DBCC = Development Budget Coordination Committee; f = forecast
Note: Numbers in parenthesis for international institutions are forecasts from year-ago editions (i.e. October 2022, September 2022, June 2022, and October 2022). Numbers in parenthesis for credit raters Fitch Solutions and S&P Global Ratings are forecasts taken from year-ago editions (August 2022, and November 2022) while the numbers in parenthesis for Moody's Analytics are year-ago forecasts taken from *FocusEconomics* (October 2022 edition). Numbers in parenthesis for DBCC and the authors' projection are from the *PIDS 2022-2023 Economic Policy Monitor* (PIDS 2022).
Source: ADB (2022, 2023), AMRO (2022, 2023b), DBM (various years), Fitch Solutions (2022, 2023), FocusEconomics (2022), IMF (2022, 2023c), Moody's Analytics (2023), S&P Global Ratings (2022, 2023), World Bank (2022, 2023b)

Table 6. Inflation projections for the Philippines

	2011-2020	2021	2022	2023f	2024f
CPI (annual % change)	2.9	3.9	5.8		
International institutions					
ASEAN+3 Regional Economic Outlook (Oct 2023)				5.5 (4.0)	3.8
Asian Development Outlook (Sep 2023)				6.2 (4.3)	4.0
World Economic Outlook (Oct 2023)				5.8 (4.3)	3.2 (3.1)
Private sector					
Moody's Analytics (Oct 2023)				6.0 (5.0)	3.2
Fitch Solutions (Aug 2023)				5.7 (4.5)	3.6
S&P Global Ratings (Nov 2023)				5.9 (4.3)	3.4
Government					
DBCC projections				5.0 to 6.0 (2.5 to 4.5)	2.0 to 4.0 (2.0 to 4.0)
Authors' projections				6.0 (3.5 to 4.5)	3.0

CPI = consumer price index; DBCC = Development Budget Coordination Committee; f = forecast
Note: Numbers in parenthesis for international institutions are forecasts from year-ago editions (i.e. October 2022, September 2022, and October 2022). Numbers in parenthesis for the credit raters Fitch Solutions and S&P Global Ratings are forecasts taken from year-ago editions (August 2022, and November 2022) the numbers in parenthesis for Moody's Analytics are year-ago forecasts taken from *FocusEconomics* (October 2022 edition). Numbers in parenthesis for DBCC and the authors' projection are from the *PIDS 2022-2023 Economic Policy Monitor* (PIDS 2022).
Source: ADB (2022, 2023), AMRO (2022, 2023b), Fitch Solutions (2022, 2023), FocusEconomics (2022), IMF (2022, 2023c), Moody's Analytics (2023), S&P Global Ratings (2022, 2023)

4. Risks and recommendations

In last year's *PIDS Economic Policy Monitor* (Debuque-Gonzales et al 2022), we highlighted several policy priorities and proposals that may be considered by the (then) new leadership. These included, to wit: controlling inflation without harming growth; smoothing exchange rate volatility, but maintaining flexibility; rebuilding fiscal space to promote fiscal sustainability, while protecting those at risk; preparing for financial tightening and uncertainty through vigilant and strategic monitoring; addressing pandemic scars through infrastructure and human capital investment, the latter in education and health care; and continuing the policy momentum to encourage investment, especially foreign direct investment (FDI), to sustain growth. These remain highly relevant and should be pursued.

However, under the current macroeconomic scenario, there are three possible sources of policy uncertainty that need to be reiterated and/or emphasized. We discuss each set below:

- **Inflation-related risks.** The first set includes those related to possible mixed messaging and missed timing in monetary policymaking. It bears repeating that decisions on managing inflation should be solely that of the monetary authority, which should remain independent, if the inflation targeting framework is to remain credible. The temptation to prioritize concerns apart from inflation should be resisted, particularly when inflation expectations are not yet fully under control, given the importance of price stability in protecting the purchasing power of consumers, especially the poorest ones. Food inflation, in particular, has been shown to significantly worsen living standards and increase poverty in the Philippines, hurting the weakest segments of society (e.g., Son 2008, Fujii 2011).

  The central bank has been quite responsive to rapidly changing information, from both domestic and foreign sources. Yet as inflation threats remain, we continue to propose high-frequency monitoring and a calibrated response to price developments that carefully considers the nature of shocks, estimated pass-throughs, and policy lags to ensure that monetary decisions are always well-timed. We also continue to caution against inflation-related policies that could have unintended (costly) consequences. In our set of proposals last year, we already warned that while the temptation to impose price controls (and other untargeted measures) may be high, such a policy distorts markets, possibly leading to "excess demand, supply rationing, and even a black market" or a generally unruly outcome—as recent experience has quite vividly confirmed (Debuque-Gonzales et al 2022b).

  Meanwhile, we urge the government to make use of every weapon in the arsenal to control inflation, particularly those that work through the supply side, such as easing import restrictions on agriculture products that may face shortages and instituting a better system for anticipating and addressing these shortages. The central bank, for instance, has pushed for the extension of an executive order that temporarily reduces most-favored nation tariff rates of meat, corn, and rice (BSP 2023i, DoF 2023d).[13] This could help raise supply in lean times and contain food inflation. As we repeatedly emphasize, subsidies are ideally targeted to sectors directly hurt by these measures as well as to the poorest consumers.

[13] Temporary tariff reductions under Executive Order 10 of 2023, which is likewise an extension of EO 171 of 2022, are set to expire on December 31, 2023.

- **Fiscal risks.** The second set pertains to the threat of stalled fiscal policy reforms. We previously flagged the need for details in the country's medium-term fiscal framework (MTFF), which has so far been well received, particularly on the additional revenues that may be expected from future legislative measures and the timing of these deficit-reducing measures. Having a sound and credible plan remains critical in shaping market perceptions about the country's debt limits and hence essential to keeping financing costs down. Although our debt sustainability analysis generates still relatively benign results, and while the Philippine economy has been among the fastest growing in the region, it may be hard to generate the speed of growth needed to quickly climb out of debt, given narrower fiscal space and current weak macroeconomic prospects globally.

  In an earlier paper, we computed the country's fiscal gap, which measures the adjustment needed over a specified time horizon to achieve a particular fiscal target, and found that to bring the debt ratio back to pre-pandemic levels after a decade (i.e., to 40% of GDP by 2031) would require annual primary balance adjustments ranging from 1.4 to 3.4 percent of GDP, in the most optimistic to the most pessimistic scenarios, respectively (Debuque-Gonzales et al 2022). Assuming a longer time horizon (2 decades, or until 2041) and a central scenario of about 6 percent GDP growth and moderate real interest rates, however, would still require annual adjustment of about 1 percent of GDP (>PHP 200 billion). We then concluded that while it may not be feasible to immediately aim for a low debt ratio, the findings highlight the importance of a solid medium-term to long-term fiscal consolidation plan. Such a plan logically should have estimates of net gains (from both the revenue and non-interest spending side) large enough to make an impact on the country's fiscal health.[14]

  An example of a fiscal risk[15] that must eventually be addressed emanates from the current military and uniformed personnel (MUP) pension system. The DBCC (2022b) in the *Fiscal Risks Statement 2023* placed the inability to reform MUP pensions in its list of threats to the country's fiscal position, along with possible policy discontinuity from a change in administration and negative fiscal and economic impacts of national disasters.

  The current MUP pension scheme is a non-contributory, defined-benefit system, with no corresponding assets currently—i.e., it is completely funded by the national government, with related spending carved out from the public budget.[16] The scheme is unique in that, upon retirement, pensions are automatically computed from the base pay of MUP one rank higher and then automatically indexed to the salary of that (higher) rank in the active service (Box

[14] The 2022-2028 MTFF (DBCC 2022a) outlines the following revenue measures: VAT on digital service providers, improved income taxation of digital content creators, excise tax on single-use plastics, the remaining components of the previous administration's tax reform package (reforming real property valuation and assessment and passive income and financial intermediary taxation or PIFITA), and tax administration reforms. It aims to raise the tax-to-GDP ratio from 14.5 percent in 2022 to 17.1 percent in 2028 (and the revenue-to-GDP ratio from 15.2 to 17.6 percent). Pending bills may impact revenues from the following sources: PIFITA (originally designed to be a revenue-neutral package); VAT on digital transactions; excise taxes on single-use plastics, pre-mixed alcohol beverages, sweetened beverages and junk food; and reforms in the fiscal regime for mining. According to the DOF proposal, the excise tax on sweetened beverages, the motor vehicle road user's tax, and the mining fiscal regime may generate revenues worth about 0.3 to 0.4 percent of GDP if the expected 2025 implementation comes through (DoF 2023a).
[15] Another fiscal risk is managing the decentralization process. As the outcome of the Mandanas-Garcia ruling affects the fiscal space, multilateral observers have noted the importance of realistic transition plans in order to capacitate LGUs toward ensuring no diminution in the devolved public services as well as enhancing accountability (IMF 2023a). However, the current administration is reviewing possible amendments to EO 138, with some government officials recommending to extend the transition period from 2024 to 2027, which would give those affected more time to prepare for the change (DBM 2023b).
[16] The precursor was a contributory retirement and benefit system that failed in the aftermath of the Asian Financial Crisis, with the collapse also attributed to financial mismanagement (Diokno 2013).

1.1).[17] Thus, broad salary increases would naturally have a substantial impact on MUP liabilities under this arrangement, directly worsening fiscal deficits.

Unsurprisingly, total funding requirements of the MUP pension system doubled after salary increases implemented beginning 2018.[18] This figure approximates the amount needed to cover future MUP obligations—the present value of future benefits plus accrued liabilities—or quite simply, the unfunded liabilities of the pension scheme.[19] In an actuarial study using end-2019 data, the Government Service Insurance System (GSIS) estimated this amount for the *existing* members and pensioners to be about PHP 9.6 trillion, up from about PHP 4.8 trillion previously (DoF 2021).[20] Finance officials claim the number has since risen to about PHP 14 trillion (CNN Philippines 2023).

Box 1.1 further shows how annual MUP pensions have typically exceeded the cost of supporting the active military, in terms of maintenance and other operating expenses (MOOE) and capital outlays (CO) of MUP agencies, though not of personnel services (PS). Moreover, arrears of the MUP pension scheme had already accumulated to PHP 57 billion as of 2021, with unmet payments also tracing to the salary adjustments several years earlier (DBCC 2022b). Although spending on MUP pensions averaged at just about half a percentage point of GDP in the last couple of years (after reaching a high of about 0.7% of GDP in 2021), a sudden escalation is projected in the coming decade, but assuming the recent pace of salaries will continue (Salceda 2021, DoF 2023c).

The Senate and the House have different versions of the MUP reform bill, though both have endorsed mandatory contributions by *new* MUP pensioners (in some form) paired with sizable contributions by government, in line with the administration's proposals. They seemingly agree as well on the computation for monthly retirement pay,[21] creation of separate trust funds for the armed forces and the uniformed services, and retirement age (at 57 years). However, despite the urgency of the issue, who among the MUP will bear the brunt of the fiscal adjustment should be a matter of vigorous debate.

Lawmakers will ultimately have to create an equitable framework that shows the value placed by government both on the services offered by the MUP to the country, by offering them a secure retirement, and the country's protection from escalation of fiscal risk. It will be quite difficult to achieve the latter, however, without altering the existing MUP pension system's original components. Removing automatic indexation of retirement pay to the salary of active personnel, particularly, can lop off PHP6.6 trillion from the system's unfunded liabilities, according to computations by the same GSIS study mentioned above, bringing the figure down

[17] There is also no required age to be eligible for pensions for as long as one actively served a full 20 years.
[18] These were stipulated in Joint Resolution No. 1 (Authorizing the increase in base pay of the MUP in the government, and other purposes) approved by Congress, dated 1 January 2018. See also National Budget Circular No. 574, series of 2018, dated 11 January 2018.
[19] One can think of it as the size of the fund one must create *today* to fund all these obligations.
[20] This assumes a 7-percent interest rate (based on the 10-year Treasury note at end-2010) and annual 10-percent salary increases (based on the historical rate of change for unformed personnel). The time horizon for calculating the present value of future benefits, however, was not specified. Active members and pensioners are based on lists provided by the Armed Forces of the Philippines, the Philippine National Police (PNP), the Bureau of Fire Protection (BFP), the Bureau of Jail Management and Penology (BJMP), the Philippine Coast Guard (PCG), the National Mapping and Resource Information Authority (NAMRIA), and the Bureau of Corrections (BuCor).
[21] Equivalent to 50 percent of the base pay and longevity pay of the permanent grade last held by the personnel in case of 20 years in active duty, increasing by 2.5 percent for every year of active duty rendered beyond 20 years to a maximum of 90 percent for 36 years of active duty and over.

to much more manageable levels (about PHP 3 trillion). This feature, which exacerbates deficits, will eventually require tweaking to permanently fix the system down the road. We recommend doing so sooner rather than later.

Box 1. Military and uniformed personnel pensions

A comparison of the different pension schemes highlights the non-contributory aspect of military pensions which the government appropriates for in the national budget. Another critical component in the discussion of pension reform is the automatic indexation to the next rank higher provided to MUP upon retirement. The current pension scheme for GSIS, SSS, and MUPs can be summarized as follows:

Comparison of MUP and civilian pension schemes

	Contribution	Eligibility	Basic monthly pension Computation
GSIS	21% of pay (9% for member, and 12% for government agency)	At least 15 years of service; at least 60 years of age; and is not receiving a monthly pension benefit from permanent total disability	BMP = RAMC x (2.5% x RCS)
SSS	14% (4.5% employee and 9.5% employer)	At least 120 monthly contributions prior to semester of retirement; at least 60 years old	Highest result of the following: 1. PHP 300 + 20% of the AMSC + 2% of the AMSC for each CYS in excess of 10 years 2. 40% of the AMSC 3. PHP 1200 if the member has at least 10 CYS and PHP 2,400 if at last 20 CYS + PHP 1,000 additional benefit and 13th month pension payable every December
MUP pensions	100% provided by NG	20 years of active service, and compulsory upon reaching 30 years of service	(Base pay of the next grade higher than the grade last held + longevity pay) x 2.5% x years of active service

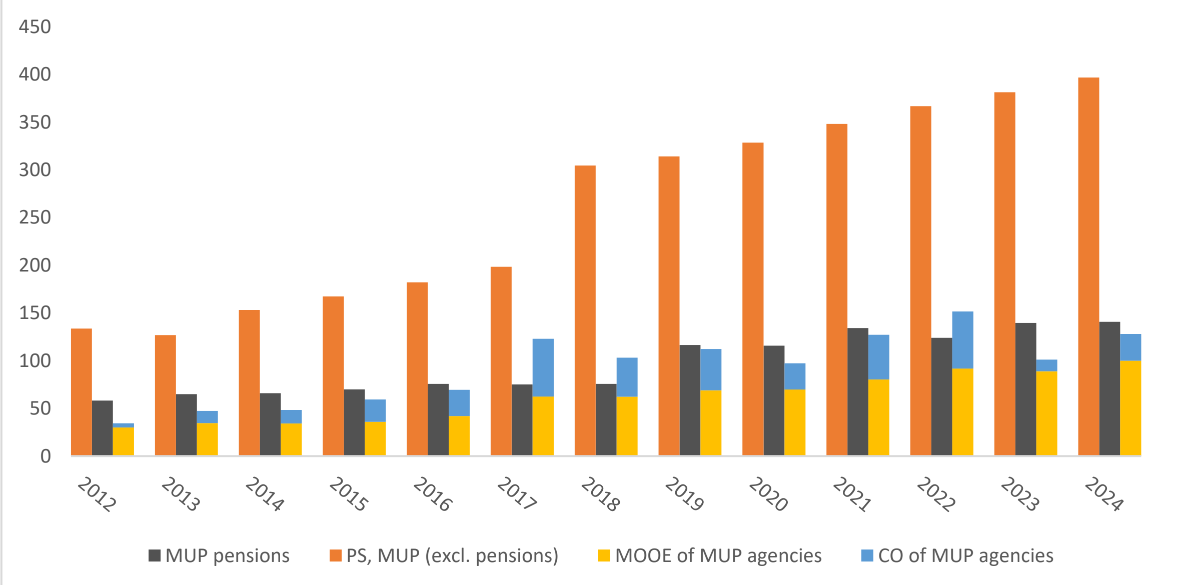
GSIS=Government Service Insurance System; SSS=Social Security System; MUP=Military/uniformed personnel; NG=national government; RAMC=revalued average monthly compensation for the last 36 months) plus PHP 700. RCS=record of creditable service; CYS=creditable years of service; AMSC=average monthly salary credit for the last 60 months

Note: Before 2023, SSS contributions were at 13 percent (4.5% employee and 8.5% employer). Longevity for MUP pension computed as 10 percent of base pay for every five years of service.

Source: GSIS (n.d., 2010), SEPO (2012), SSS (n.d., 2019).

MUP pensions have typically exceeded the combined outlay for maintenance and other operating expenses (MOOE) and capital outlays (CO). MUP pensions within the last decade reached 0.7 percent of GDP in 2021, with the biggest annual growth seen in 2019 following the implementation of the increase in salaries of military and uniformed personnel for 2018 and 2019. A noticeable annual change can be observed for the MOOE in 2017, attributable to significant additions to repairs and maintenance, intelligence expenses, and supplies and materials.

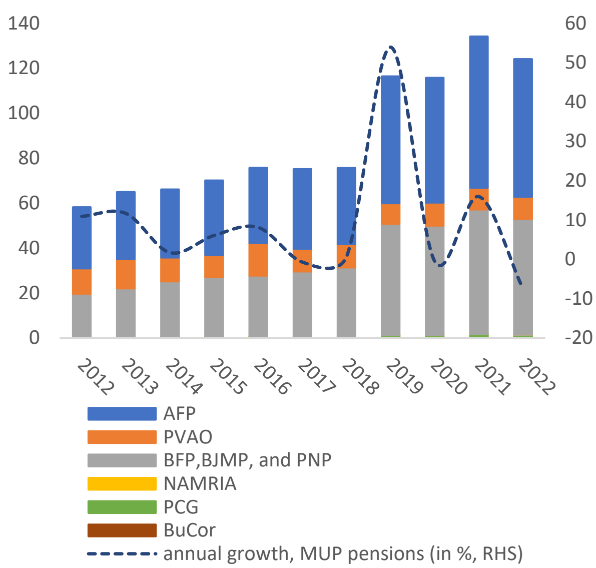
National government expenditure for MUP pensions (in PHP billion)



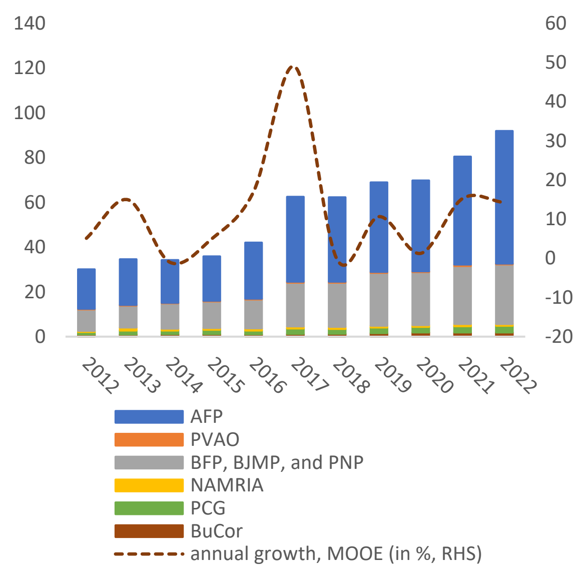
PS=personnel services, MOOE=maintenance and other operating expenditures; CO = capital outlay; MUP=Military/uniformed personnel
Note: 2023 and 2024 are programmed and proposed appropriations by the national government as of writing, respectively. Personnel services of military/uniformed personnel include basic pay, other compensation common to all, other compensation for specific groups, police benefits, and other benefits.
Source: DBM (various years).

Looking at the 2022 distribution of total MUP pensions, the AFP takes about 49.4 percent of the total, while the BFP, BJMP and PNP under the Department of Interior and Local Government (DILG) account for 41.6 percent. A small decline is seen in the annual growth spending for these pensions in 2022, while the MOOE of the MUP agencies recorded a slight slowdown.

MUP pensions, by agency (in PHP billion)



MOOE of MUP agencies (in PHP billion)



PS=personnel services, MOOE=maintenance and other operating expenditures; CO = capital outlay; AFP = Armed Forces of the Philippines; PVAO = Philippine Veterans Affairs Office; BFP = Bureau of Fire Protection, BJMP = Bureau of Jail Management and Penology; PNP = Philippine National Police; NAMRIA = National Mapping and Resources Information Authority; PCG = Philippine Coast Guard; BuCor=Bureau of Corrections; RHS = right-hand side.
Source: DBM (various years).

- **Sovereign investment risks.** The idea of a sovereign fund was floated late November last year, the relevant bill signed into law in July this year, and the implementing rules and regulations completed by November 2023 (see Box 1.2). The Maharlika Investment Fund (MIF) was established "to promote economic growth and social development" by "investing national funds and coordinating and strengthening the investment activities of the country's top-performing government financial institutions" (RA 11954, Section 2). It aimed to "promote socioeconomic development" by "making strategic and profitable investments in key sectors" to meet the following goals (RA 11954, Section 13):
    i. to preserve and enhance the long-term value of the fund;
    ii. to obtain optimal absolute return and achieve financial gains on investments; and
    iii. to satisfy various requirements (liquidity, safety/security, and yield) to "ensure profitability."

  Moreover, "in pooling the investible funds from the government GFIs and channeling them to diversified financial assets and development projects," it hoped to contribute to "a prudent and transparent management of the government resources." Apart from the national government, mainly through dividends from the Bangko Sentral ng Pilipinas or BSP (PHP 50 billion), the initial contributors are the government financial institutions (GFIs)—namely, the Landbank of the Philippines or LBP (PHP 50 billion) and the Development Bank of the Philippines or DBP (PHP 25 billion).

  The MIF is now on the verge of joining a new breed of "sovereign wealth funds" (SWFs) ironically not built on surpluses, earning it widespread criticism from the outset.[22] Undeterred by the Malaysian experience with 1Malaysia Development Berhad (1MDB) and the scandal surrounding that state fund, such arrangements began to be established around the mid-2010s by governments of developing countries that had substantial current account deficits or external debt, as they attempted to invigorate their economies in a global slowdown (Milhench 2017). Most hoped to attract external capital through sovereign funds, in many cases by leveraging profitable state-owned companies and other assets.[23]

  India's National Investment and Infrastructure Fund (NIIF), which was launched in 2015, appeared to be a standout in the group. It then hoped to bankroll projects by drawing co-investors from other SWFs and pension funds, and seemingly succeeded in doing so. It has been able to attract large institutional investors with global portfolios, often receiving positive reviews from industry observers (e.g., Rundell [2023], who called it "a poster child of development finance").

  In 2021, Indonesia also introduced a sovereign development fund called the Indonesia Investment Authority (INA), which was partly modeled after the NIIF and built to draw FDI into the country (Tang 2022). INA was launched in the middle of a pandemic yet showed moderate success. It entered USD 28 billion in (non-binding) investment agreements with other

[22] The main criticisms against the MIF revolved around the perceived unclear rationale for the fund; its apparent lack of additionality, in terms of resources as well as in the country's mix of institutions; its inappropriateness considering the country's deficits and debt; and the fiscal and monetary risk of such a fund, with the central bank as the national government's main source of contributions to the fund, and more fundamentally, with the country's weak rule of law and poor governance conditions. These came from various sources including statements by the Foundation for Economic Freedom and prominent business and civil society groups, Fabella (2023), and Abrenica et al. (2023), the latter penned by professors and lecturers at the UP School of Economics.
[23] Among the countries that had launched or planned to launch a sovereign fund during the period included India, Turkey, Romania, and Bangladesh. The latter deviated from the group, as it intended to seed its fund by tapping its international reserves.

SWFs by the first half of 2023, from a USD 5-billion seeding, though with the Indonesian government still the only investor as of end-2022 (Ruehl 2023, Guild 2023).[24]

With a newly installed CEO, the completion of the Maharlika Investment Corporation's (MIC's) nine-person board (three of whom must be independent) and expected initial capital of about USD 2.25 billion (based on current exchange rates), the Philippines has followed suit.[25] However, the government's intentions and fundamental goals, and ways of meeting these goals, are not (yet) as clear as those of its regional neighbors. Hopefully, the MIF's leaders can still cohesively frame their investment beliefs and strategic vision for the fund, for the latter to have sufficiently clear mandate/s.

Unlike traditional (surplus-derived) SWFs, the new funds mentioned that have emerged are typically not designed to meet specific macroeconomic goals (such as preventing inflation and excessive exchange rate appreciation that may weaken competitiveness of sectors) apart from attracting capital, and they generally have dual or even multiple purposes, combining various developmental and financial goals. They most certainly do not preclude domestic investment, in what has been considered by some as best practice for SWFs and are thus exposed to the associated risks to public financial management, which tend to worsen with multiple objectives.[26]

One can expect such funds to be a constant source of conflict, as strategic goals and commercial interests do not always naturally align.[27] While national investments should match the requirements of national development, as what the government ideally strives for when crafting the public budget, the likelihood of turning a profit may be higher if investment decisions are kept free of political complexities and patronage. Fund success consequently hinges on finding ways to settle this conflict.

While differences with other state funds make the MIF a unique experiment on development financing, the government is well advised to follow what has already worked in many cases, for different types of sovereign funds. The MIF's adherence to the Santiago Principles, which is meant to ensure a "transparent and sound governance structure" based on "adequate operational controls, risk management, and accountability," is a good starting point, provided such principles are followed (Box 1.3). To build the fund's credibility, which will be from scratch, the most important task today entails appointing a truly independent board and professional management team, to embody good governance, minimize the risk of political interference, and make sure the goals of the fund are met. Anything less would place the fund at a disadvantage.

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[24] At end-2022, INA held mainly cash (USD 1.5 billion) and equity stakes in two profitable state-owned banks (USD 4.3 billion).

[25] The Milken Institute (2023), in a Financial Innovations Lab study, states however that the Philippine government began considering an SWF as early as 2013, with a feasibility study by the Department of Finance leading to the filing of a Senate bill in 2016. This was reportedly followed by a proposal to the Office of the President in 2020 to establish a Philippine Investment Authority. Plans for setting up a SWF were then revived in 2022, after the elections and under the new administration.

[26] The default recommendation for traditional SWFs is to invest the money abroad rather than at home. This is to support macroeconomic goals as well as to lower the associated public spending risk. Domestic investment is discouraged, as SWFs are extrabudgetary funds that operate outside of the budget process, and thus investing them domestically could weaken public financial management systems and lead to poor decisions (Bauer 2015).

[27] This has been the case even with the NIIF, where fund leadership and government have at times clashed over investment choices, and resource allocation (e.g., Singh and Batia 2022).

The MIF should also clarify its role and find ways to handle multiple objectives. "Strategic and profitable" investments in key sectors "to promote socioeconomic development" denote conflicting objectives that may be difficult to reconcile. Other sovereign development funds have resolved this by adopting dual or even multiple investment structures (Milken Institute 2023).[28] The strategy adopted, however, would have to differ depending on the type of fund (i.e., in risk tolerance and expected returns), and so too the needed expertise, with firewalls ideally built between these funds.

With the country's fiscal position still just recovering from the pandemic crisis, economic managers need to make sure that the establishment of the MIF will not draw from already scarce state funds.[29] The Asean+3 Macroeconomic Research Office or AMRO (2023), a regional macroeconomic surveillance organization, has cited this as a "potential risk," noting how government agencies' contribution to the fund's capital "could crowd out planned expenditure in other areas."[30] AMRO additionally noted that, while the GFI's contributions are small in relation to the size of their investible funds (less than 4%), these could still impact their financial positions if losses occur.[31]

This latter funding source, which accounts for 60 percent of the seed capital, is what makes the MIF a unique experiment.[32] State-owned development banks are stand-alone entities, have their own (development) mandates, and like any state-owned company, ideally operate at arm's length from government. Indeed, in managing national wealth, it has usually been a choice among state-owned entities including SWFs, development companies, and development banks, with the latter considered a better channel for domestic investment (e.g., Bauer 2015).[33]

The GFIs have now, in effect, turned over some control of their portfolio to the MIC, another state-owned corporation, albeit minimally and with board representation in the fund. Turning over the assigned contributions to the MIF implies a reduction in the lending capacity of these banks, presumably by a certain multiple of the amount (if capital is not correspondingly increased). At least one may fail to meet minimum capital requirements because of the contributions, as well as breach limits prescribed by the MIF law itself, with investments likely

[28] NIIF, for instance, has a Master Fund for investment in infrastructure, a Fund of Funds managed by fund managers with good track records, and a Strategic Opportunities Fund which provides long-term capital to strategic sectors that can drive economic growth.
[29] Apart from BSP dividends amounting to PHP 50 billion issued during the first two (fiscal) years of effectivity of the MIF law, other national government (NG) contributions include 10 percent of NG's share from PAGCOR income and 10 percent of gaming revenues of other government-owned gaming operators and/or regulators, both for a period of 5 years, plus privatization of state assets and other sources (e.g., royalties and special assessments).
[30] This is also true for GFIs. The LBP, for example, was exempted from remitting dividends (from last year's earnings) to the national government (NG) to help preserve its capital. By law, government owned and controlled corporations are required to remit at least 50 percent pf their earnings to the NG.
[31] Around 3.7 and 3% percent of the investible funds of the LBP and DBP, respectively (AMRO 2023).
[32] Tapping into GFIs' investible funds and BSP dividends has been the result of a difficult search for seed capital for the MIF. Proposed funding sources initially included the country's foreign exchange reserves and contributions from the Social Security System and the Government Service Insurance System (GSIS). These were all met with strong public criticism and eventually dropped. The initial target had been to create a PHP 275-billion fund.
[33] Banks also have a known function and ability to screen and monitor their loans (e.g., Diamond 1984).

exceeding one-fourth of its net worth.[34] The government must take precautions so that these events do not fuel uncertainty and harm overall financial stability.[35]

The most beneficial role the MIF can play is if it can help pull in new capital from multilaterals, other sovereign funds, and other large institutional investors, even private funds, particularly in areas that need development such as infrastructure. There are opportunities, for instance, in green investment, where demand is currently rising owing to climate-change-related goals.[36]

Some observers have noted, for instance, the advantage of inviting multilaterals to invest early in the setting up of the MIF, to benefit from their knowledge and governance inputs from the beginning and over the long term, thus enhancing fund credibility and governance quality and further unlocking capital from private investors (e.g., Bernardo 2023). The fund can also participate in public-private partnerships (PPP), under transparent and competitive bidding processes, to develop key infrastructure needed by the country as well as generate much-needed investment, to achieve both strategic and profit-oriented goals.[37]

In the end, success of the MIF will depend on whether it has, in fact, enhanced capital (and use of capital), boosted infrastructure development, fostered FDI, and promoted economic growth. All while also turning in a profit, or otherwise proving itself viable. It will be—and should be—highly monitored by the public, as these funds are now beyond the usual (budgetary) controls, with strategic decisions affecting the entire country now largely up to the MIC's board.[38]

This again underscores the need for clear mandate/s and suitable and transparent performance benchmarks. These may be difficult to establish, however, especially for development projects, as results may not readily appear in the fund's balance sheet—returns may not be financial, or may take years to materialize, demanding a longer-term horizon for assessing fund performance. Clearly, establishing a credible return benchmark that cannot be used to mask poor performance (possibly from fund misuse and corruption) will be an important challenge for the MIF and our economic managers who head it.

[34] Critical for these GFIs with respect to their participation in the fund is to sustain sufficient capital. The 2022 annual report of the Land Bank of the Philippines (LBP) reported a capital adequacy ratio (CAR) of 14.4 percent and Common Equity Tier 1 (CET 1) of 13.9 percent (LBP 2023). Considering the PHP 50 billion contribution to the MIF, the CAR and CET 1 of LBP goes down to 10.7 and 10.2 percent. On the other hand, the Development Bank of the Philippines (DBP) had a CAR of 12.6 percent and a CET 1 of 11.7 percent (DBP 2023). Netting out the PHP 25 billion to the MIF, the CAR and CET 1 declines to 8.3 and 7.4 percent, well below the minimum requirement of the BSP. Furthermore, as of June 2023, the PHP 50 billion contribution of LBP to the fund is 21 percent of its total equity while the PHP 25 billion on the part of DBP is equivalent to 30 percent, beyond the 25 percent limit set in RA 11954 (BSP 2023f, h).

[35] For instance, according to some legal opinions, the MIC board itself can opt to accept staggered contributions from the GFIs. This loosens the constraints to lending of these banks and matches the timeline of investment funds of similar size, which may take several years to deploy. This is typically the case for large infrastructure projects.

[36] Moreover, diluting government's share to less than 50 percent would allow for greater operational flexibility. The NIIF is 49-percent-owned by the Indian government, considered the right balance for providing sovereign comfort to investors as well as the discipline required to successfully run a sovereign development fund (Rundell 2023, Singh and Batia 2023)

[37] As of time of publishing this edition, the newly appointed president of the MIC announced the fund's interest in participating in private-sector-led PPP projects meant to create high-quality infrastructure following the enactment of the PPP law (Simeon 2023). He also proposed the role of the MIC as a "co-grantor" allowing it to manage PPP projects experiencing delays to help speed up the process.

[38] The MIC board consists of: (a) the Secretary of Finance as Chairperson in an ex-officio capacity, (b) the President and CEO of the MIC as Vice-Chairperson, (c) the President and CEO of the Land Bank of the Philippines, (d) the President and CEO of the Development Bank of the Philippines, (e) two Regular Directors, (f) and three Independent Directors from the private sector.

Box 2. Maharlika Investment Fund at a glance

Created under RA No 11954, which was signed in July 18, 2023, the Maharlika Investment Fund (MIF) is geared towards socio-economic development through the pooling and redirection of funds from government financial institutions (GFIs) as well as contributions from the National Government and other sources into investments for optimal returns and economic development. The management shall adhere to the Santiago Principles, detailed in Box 3.

Objectives

- Rechanel investible funds from GFIs into diversified financial assets and development projects
- Earn returns; promote long-term value; maintain standards of liquidity, safety, and yield
- Achieve socio-economic development

Funding

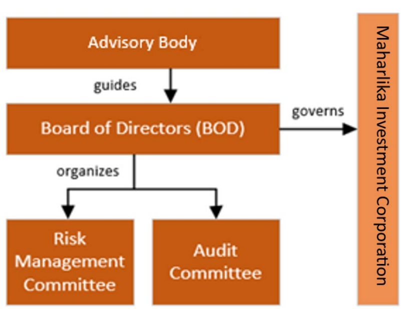
Authorized capital stock PHP 500 bn (5 bn shares)	
Common shares (3.75 bn) PHP 375 bn	Preferred shares (1.25 bn) PHP 125 bn
To be subscribed by the National Government, its agents or instrumentalities, including GOCCs or GFIs With PHP 125 bn initially subscribed by	To be made available for subscription by the National Government, its agencies or instrumentalities, GOCCs or GFIs; reputable private financial institutions, except SSS, GSIS, PhilHealth, Pag-IBIG Fund, OWWA, and PVAO Pension Fund

Land Bank	PHP 50 bn
Dev't Bank	PHP 25 bn
Nat'l Gov't	PHP 50 bn

Contributions from the National Government shall be sourced from:

- BSP dividends
- Government share in PAGCOR
- DOF Privatization and Management Office (PMO)
- Other sources based on the fiscal regime to be implemented by the National Government

Governance



- The **Board of Directors** shall govern the Fund. It shall consist of the Secretary of Finance, sitting in an ex officio capacity; President and Chief Executive Officer (PCEO) as Vice-Chairperson; President and CEO of the Land Bank; President and CEO of the Development Bank; two Regular Directors; and three Independent Directors from the Private Sector.
- The **Advisory Body** shall guide the Board of Directors on investment and risk management. It shall consist of the DBM and NEDA secretaries and the Treasurer of the Philippines.
- The **Risk Management Committee** shall implement suitable actions to maintain the balance between risk and reward in business endeavors.
- The **Audit Committee** shall supervise internal and external audits. It shall recommend an independent auditor.
- The **Joint Congressional Oversight Committee** shall monitor and evaluate the implementation of RA 11954.

Investments

3. Adherence to **Limitations and Safeguards** shall ensure sound management.

2. Business decisions are to be guided by the **Investment Policy**.

1. The **Nature of Investments** to be made under the Fund are:
- Cash, foreign currencies, metals, and other tradeable commodities
- Fixed income instruments
- Domestic and foreign corporate bonds
- Listed or unlisted equities
- Islamic investments
- Joint ventures or co-investments, mergers and acquisitions
- Mutual and exchange-traded funds invested in underlying assets
- Real estate and infrastructure projects
- Programs and projects for sustainable development
- Loans and guarantees to, or participation into joint ventures or consortiums with Filipino and foreign investors
- Other investments with sustainable and developmental impact

Prohibited Investments: Areas explicitly prohibited under existing laws and conventions

Investment Policy:
- Balance between risk and return of overall portfolio
- Investment policies
- Risk management
- Performance standards
- International best practices
- Rules and regulations where investments are domiciled
- Procedural framework and cooperation among investors
- Procedure for assessing, deploying, and liquidating investments
- Disclosure and transparency mechanism
- ESG standards
- All other matters for compliance with MIF objectives

Limitations and Safeguards:
- Subject to investment policies, guidelines, and risk management limits and procedures, approved by the Board of Directors, guided by the Advisory Body
- Fund activities shall be made public

Source: Implementing Rules and Regulations of the Maharlika Investment Fund Act of 2023

Box 3. The Santiago Principles

1	The **legal framework** for the SWF should be sound and support its effective operation and the achievement of its stated objective(s).
2	The **policy purpose** of the SWF should be clearly defined and publicly disclosed.
3	Where the SWF's activities have significant direct domestic **macroeconomic implications**, those activities should be closely coordinated with the domestic fiscal and monetary authorities, so as to ensure consistency with the overall macroeconomic policies.
4	There should be clear and publicly **disclosed policies, rules, procedures, or arrangements** in relation to the SWF's general approach to funding, withdrawal, and spending operations.
5	The **relevant statistical data** pertaining to the SWF should be reported on a timely basis to the owner, or as otherwise required, for inclusion where appropriate in macroeconomic data sets.
6	The **governance framework** for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.
7	The **owner** should set the objectives of the SWF, appoint the members of its governing body(ies) in accordance with clearly defined procedures, and exercise oversight over the SWF's operations.
8	The **governing body(ies)** should act in the best interests of the SWF, and have a clear mandate and adequate authority and competency to carry out its functions.
9	The **operational management** of the SWF should implement the SWF's strategies in an independent manner and in accordance with clearly defined responsibilities.
10	The **accountability framework** for the SWF's operations should be clearly defined in the relevant legislation, charter, other constitutive documents, or management agreement.
11	An **annual report and accompanying financial statements** on the SWF's operations and performance should be prepared in a timely fashion and in accordance with recognized international or national accounting standards in a consistent manner.
12	The SWF's operations and financial statements should be audited annually in accordance with recognized international or national **auditing standards** in a consistent manner.
13	**Professional and ethical standards** should be clearly defined and made known to the members of the SWF's governing body(ies), management, and staff.
14	**Dealing with third parties** for the purpose of the SWF's operational management should be based on economic and financial grounds, and follow clear rules and procedures.
15	SWF operations and activities in host countries should be conducted in compliance with all applicable **regulatory and disclosure requirements** of the countries in which they operate.
16	The governance framework and objectives, as well as the manner in which the SWF's management is **operationally independent** from the owner, should be publicly disclosed.
17	**Relevant financial information** regarding the SWF should be publicly disclosed to demonstrate its economic and financial orientation, so as to contribute to stability in international financial markets and enhance trust in recipient countries.
18	The SWF's **investment policy** should be clear and consistent with its defined objectives, risk tolerance, and investment strategy, as set by the owner or the governing body(ies), and be based on sound portfolio management principles.
19	*The SWF's investment decisions should aim to maximize **risk-adjusted financial returns** in a manner consistent with its investment policy, and based on economic and financial grounds.*
20	The SWF should not seek or take advantage of privileged information or inappropriate influence by the broader government in **competing with private entities**.
21	SWFs view **shareholder ownership** rights as a fundamental element of their equity investments' value.
22	The SWF should have a framework that identifies, assesses, and manages the **risks of its operations**.
23	The assets and investment performance (absolute and relative to benchmarks, if any) of the SWF should be measured and reported to the owner according to **clearly defined principles or standards**.
24	A process of **regular review** of the implementation of the GAPP should be engaged in by or on behalf of the SWF.

Source: International Working Group of Sovereign Wealth Funds (2008)

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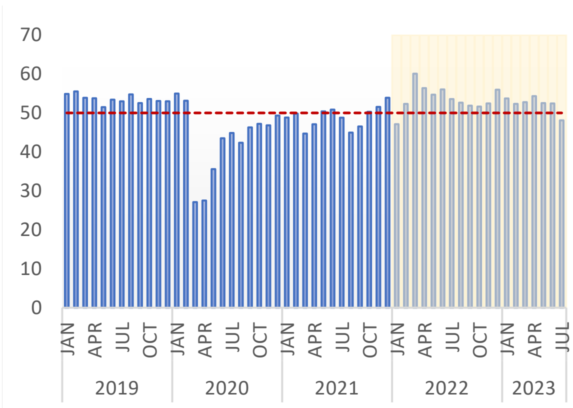
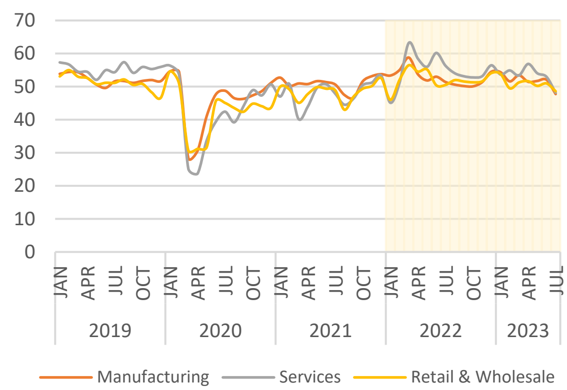
6. Appendix

6.1. Leading indicators

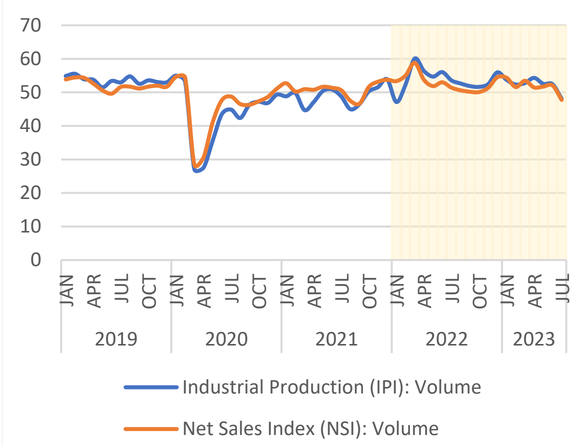
Appendix Box 1. Production activity

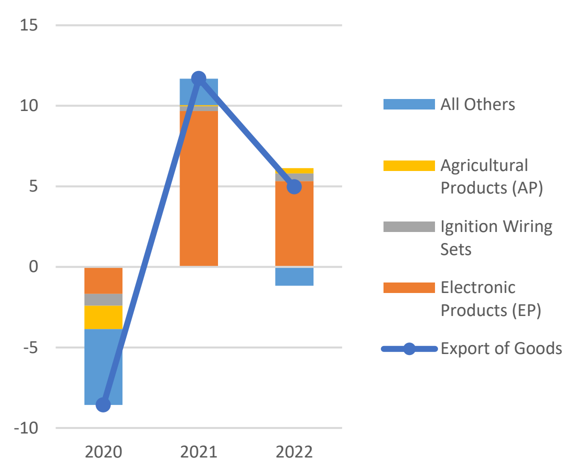
Healthier **Purchasing Managers Index (PMI)**[39] scores in 2022 suggest improvement in economic activity. Unlike the previous year, continuous expansion was observed, with only the January score falling below the critical level of 50. The highest reading was recorded in March, and the lowest in October. So far, 2023 has been registering generally lower scores, dipping below the critical value in July.





As with PMI, readings of **Industrial Production and Net Sales (Volume) Indices**[40] hit the highest point in March and lowest in October. Growth in **Export of Goods**, which slowed down in 2022, was meanwhile driven by Electronic Products, followed by Ignition Wiring Sets and Agricultural Products.





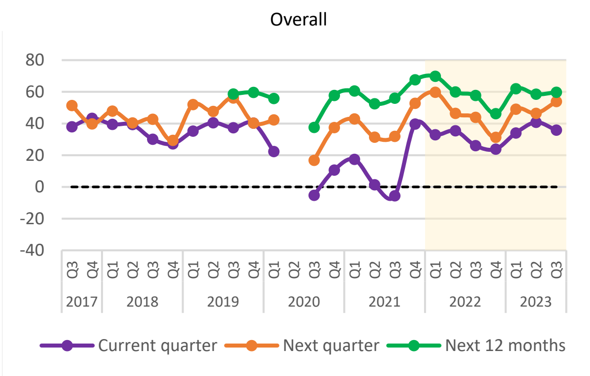
Sources: Philippine Statistics Authority via CEIC Data (2023k, n, t, x)

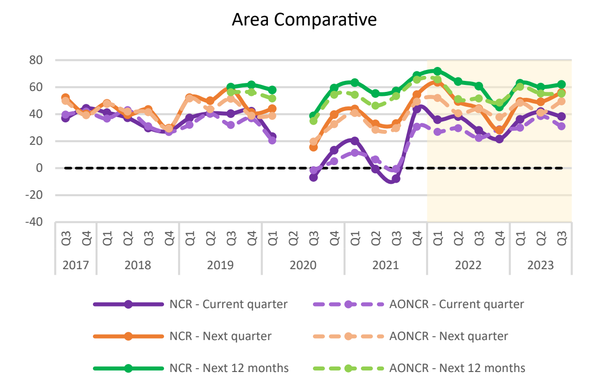
[39] This index from the Philippine Institute for Supply Management (PISM) is used in gauging economic activity. It is based on a survey of purchasing executives on current market conditions. Scores above 50 indicate an expansion while those below indicate a contraction.
[40] These indicators are based on findings of the Monthly Integrated Survey of Selected Industries. Both are comparisons with values from base year 2018.

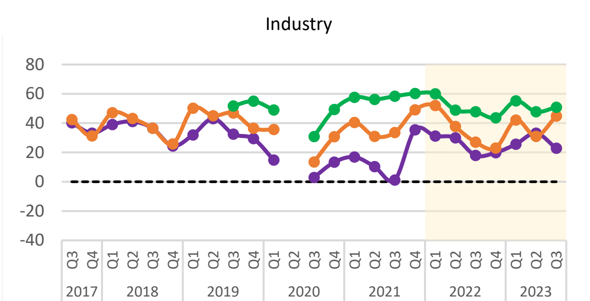
Appendix Box 2 Business Expectations Survey (BES) [41, 42]

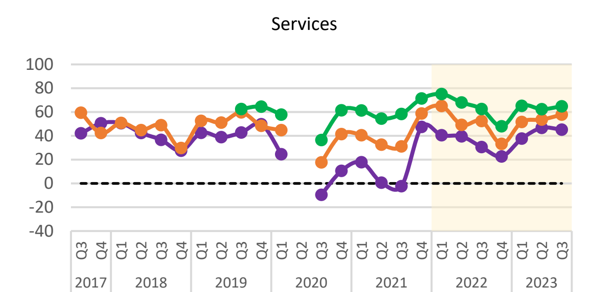
Results of the **Business Expectations Survey (BES)** reflect an early boost and sequent slump in 2022. Overall outlook among firms for all periods (current quarter, next quarter, next 12 months) was more positive, rising in the first half due to the relaxation of pandemic restrictions and reopening of the economy, increase in demand, and election spending. The fourth quarter slump is attributed to higher inflation, peso depreciation, weaker demand, higher costs of production, and higher interest rates.

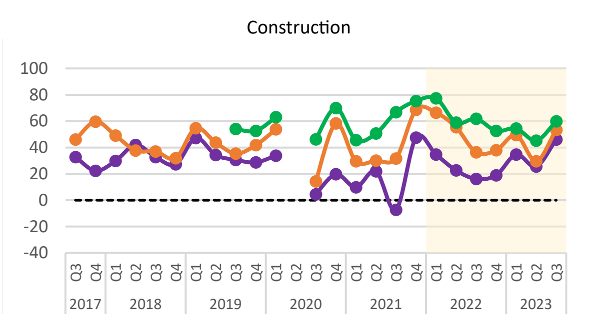
Business views for the current quarter were more positive in the first half of 2023. The outlook for future periods turned less upbeat in the second quarter, due to stronger inflation, higher interest rates, and weaker demand, as well as seasonal and climate challenges.

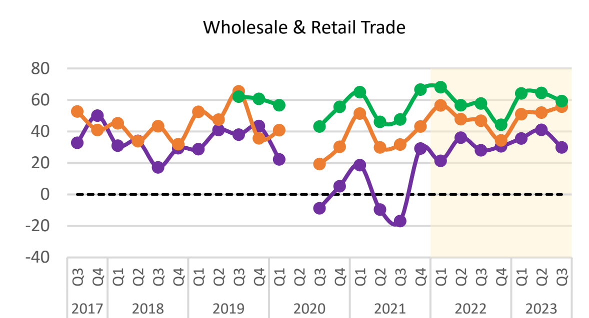












Source: Bangko Sentral ng Pilipinas (2023d)

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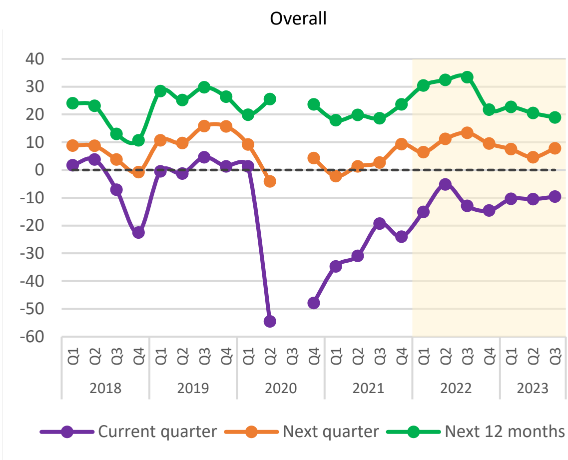
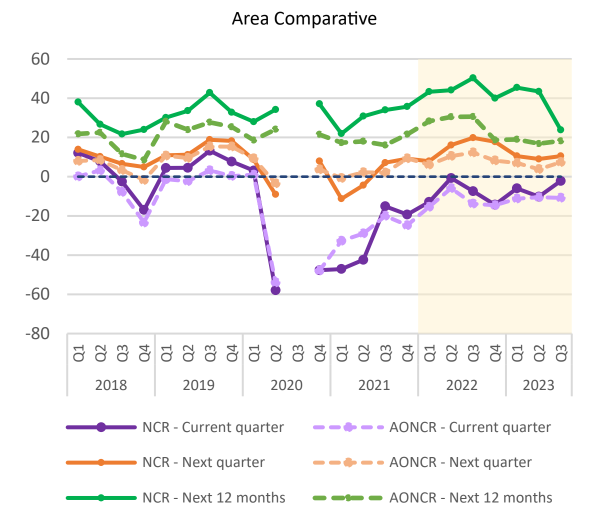
[41] The BES is a quarterly study of the central bank that analyzes the outlook of firms on business indicators, such as the macroeconomy, own operations, expansion plans, and select economic indicators.
[42] Reports use a diffusion index (DI) approach. As such, positive (negative) scores imply that respondents with a positive (negative) outlook outnumber those with a negative (positive) outlook.

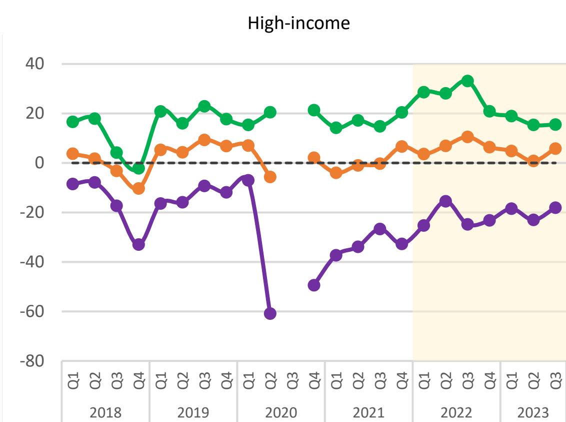
Appendix Box 3. Consumer Expectations Survey (CES)[43, 44]

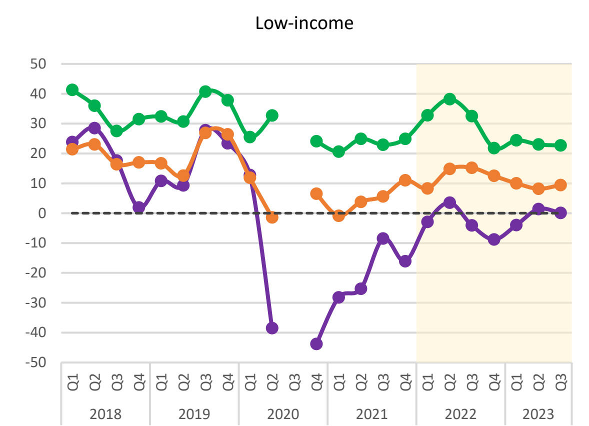
The **Consumer Expectations Survey (CES)** shows that, although views for the current quarter in 2022 remain more pessimistic, they improved from 2021. Views for the next quarter and the next 12 months have also improved and remain more positive. Mid-year peaks are attributed to better work opportunities and pandemic recovery as well as expectations of good governance. Pessimism in the fourth quarter was due to inflation, low income, and fewer work opportunities.

Figures for the first half of 2023 point to weaker pessimism for the current quarter. Outlook for future periods meanwhile turn less optimistic due to inflation, lower income and unemployment, and government policies, among others.









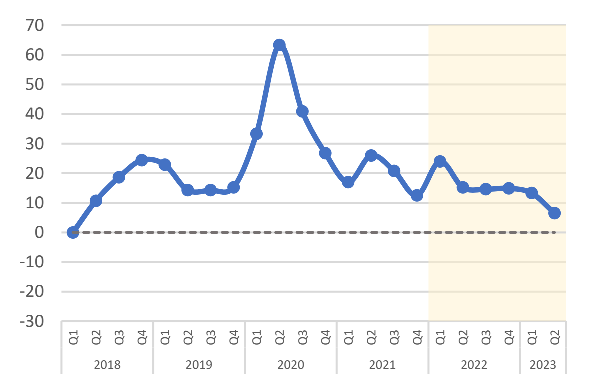
Source: Bangko Sentral ng Pilipinas (2023e)

[43] The CES is a quarterly survey that examines consumer outlook on indicators, such as economic condition, family financial situation, and family income; buying conditions, savings, loans, remittances; and macroeconomic indicators.
[44] Reports use a diffusion index (DI) approach. As such, positive (negative) scores imply that respondents with a positive (negative) outlook outnumber those with a negative (positive) outlook.

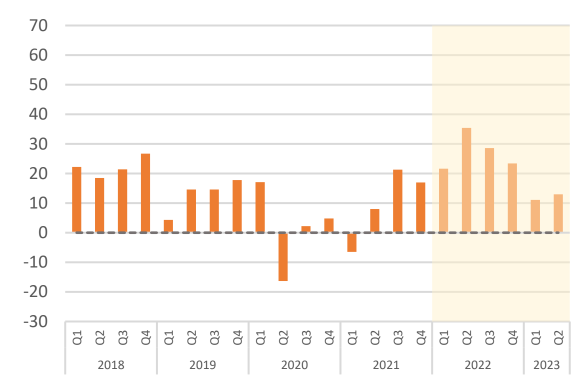
Appendix Box 4. Senior Bank Loan Officers' Survey (SLOS) [45, 46]

Positive diffusion index (DI) scores on the **Senior Bank Loan Officers' Survey (SLOS)** indicate a net tightening of lending terms in 2022. Following a surge (24.0 points) in the first quarter, the score declined in the second quarter (15.2 points) and stabilized for the remainder of the year. Overall demand meanwhile saw a gradual decline. Net tightening persists in 2023 albeit the index score is lower in the second quarter. Demand score correspondingly increased.

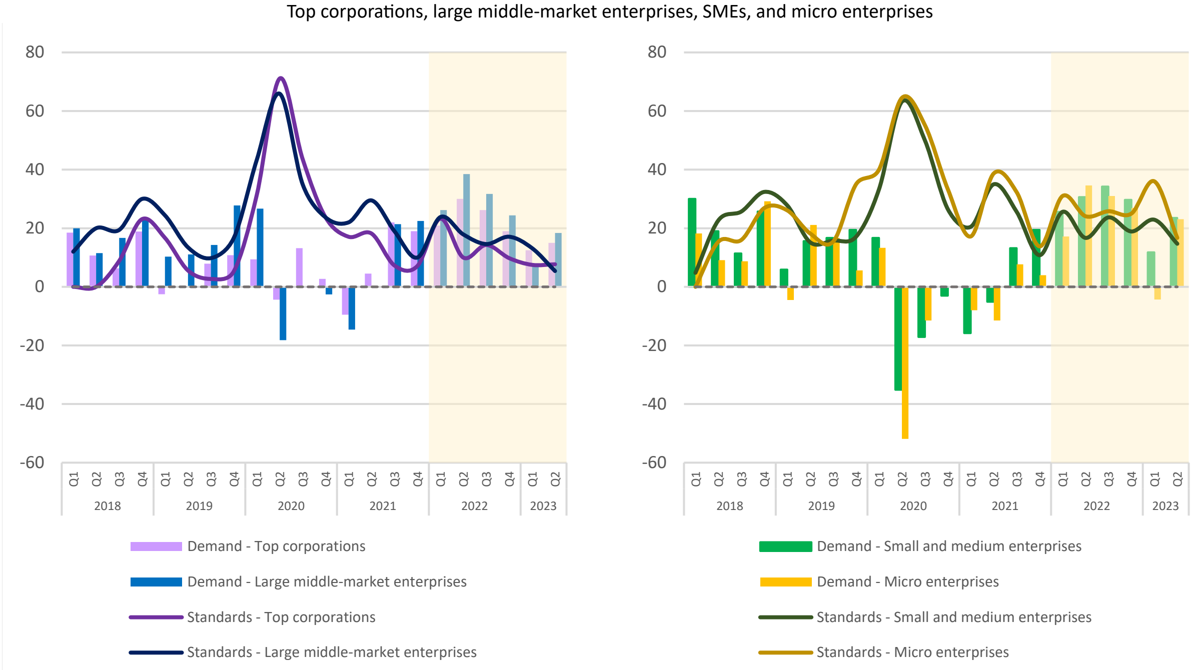
Overall standards



Overall demand



Top corporations, large middle-market enterprises, SMEs, and micro enterprises



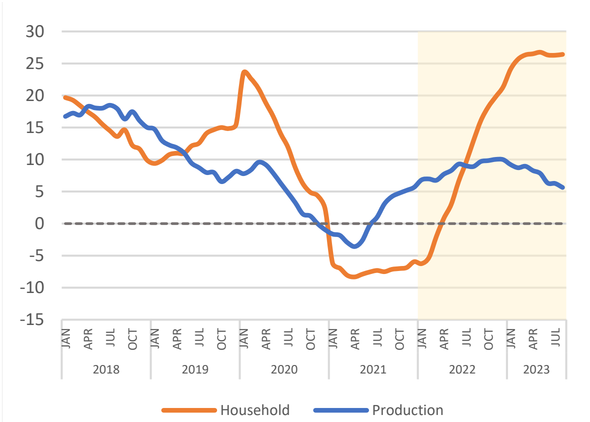
Source: Bangko Sentral ng Pilipinas via CEIC Data (2023ab)

[45] Conducted on a quarterly basis, the SLOS gauges credit activity based on lending behavior data collected from banks.
[46] In describing standards, a positive diffusion index (DI) implies net tightening, meaning more banks are tightening than easing lending terms. A negative score implies net easing. In describing demand, a positive score indicates a net increase in loan demand. A negative score implies a net decrease.

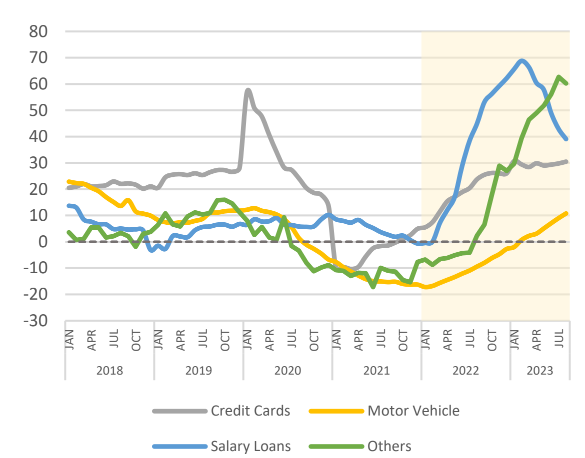
Appendix Box 5. Loan activity

Loan activity in production continued to gather pace in 2022. Faster growth was seen in Information & Communication, Construction, Manufacturing, and Financial Intermediation. Household loan activity meanwhile accelerated, driven by increased demand across all components. In 2023, activity among households plateaued while production posted a slowdown.

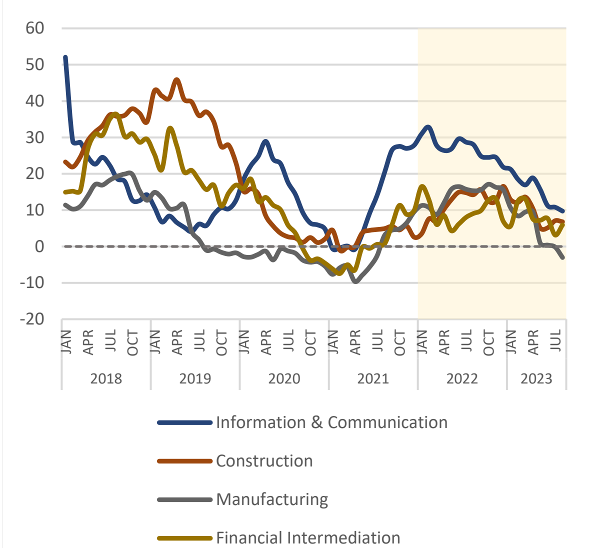
Loans



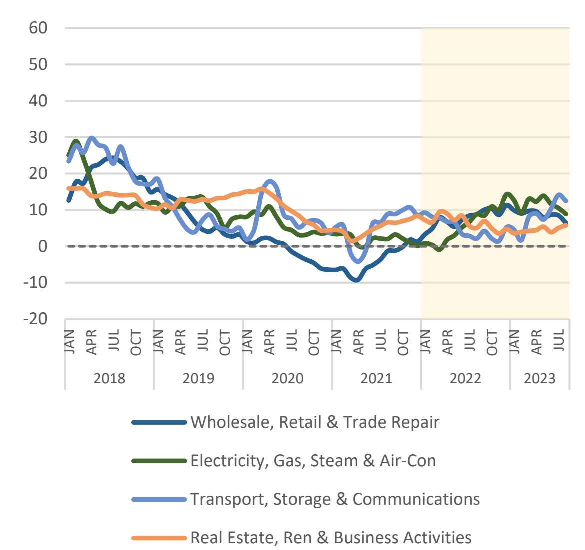
Household loans



Production loans



Production loans

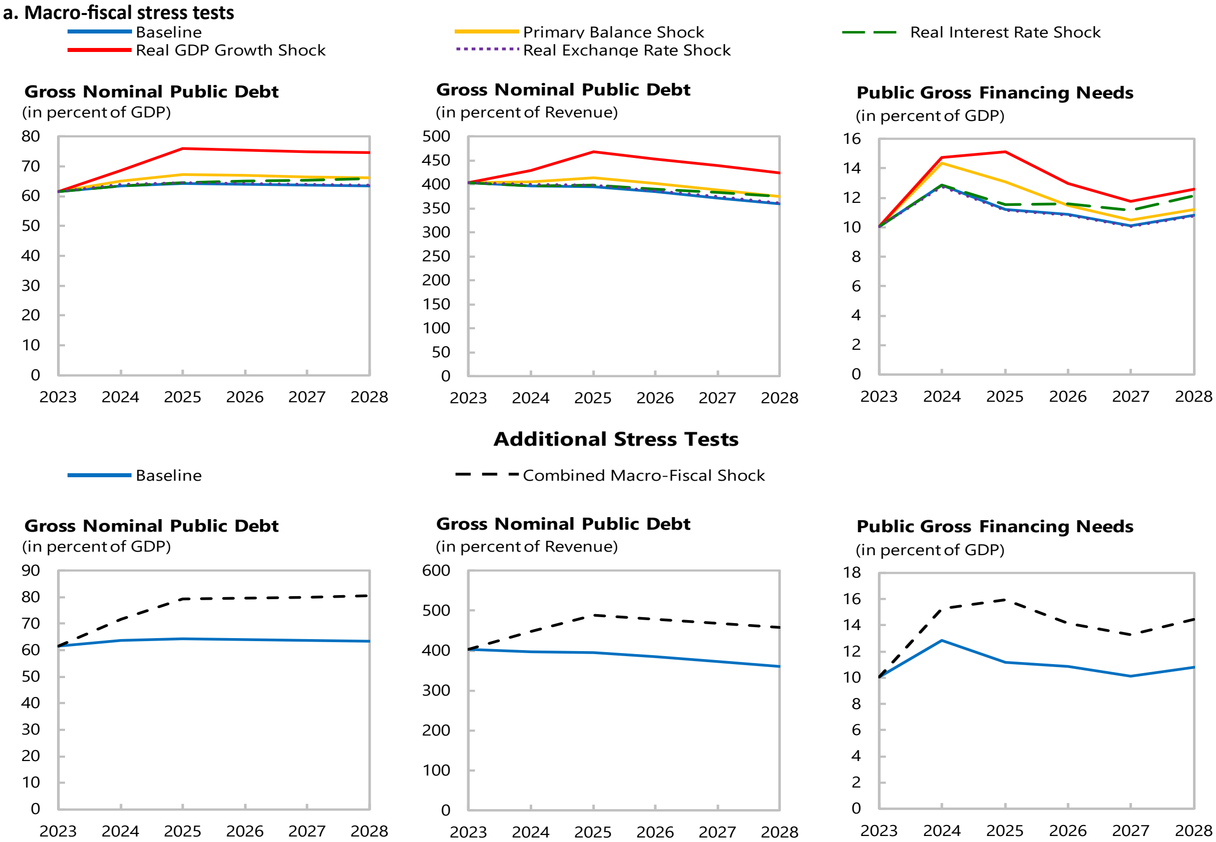


Source: Bangko Sentral ng Pilipinas via CEIC Data (2023q)

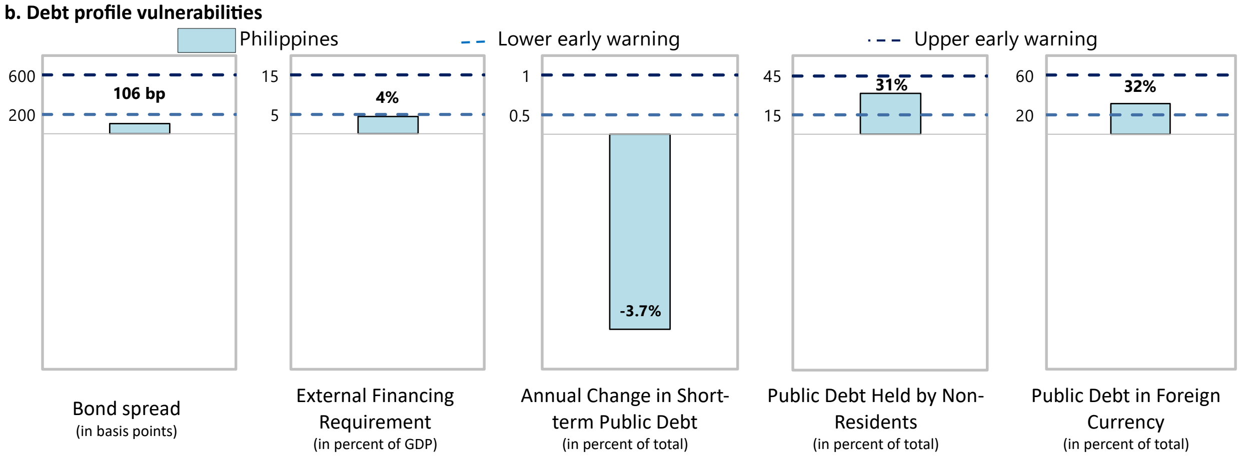
6.2. DSA stress tests and debt profile vulnerabilities

The stress tests reveal that a real GDP growth shock, such as sizeable disruptions that would again force the economy to contract, is expected to adversely affect the debt ratio the most. This is followed by a primary balance shock, which would come should there be a significant need for spending such as a severe El Niño, large-scale cost-of-living support measures, or contingent liabilities (social security institutions and MUP pensions). Significant loss of revenue widening the primary deficit would also affect the country's fiscal position.

a. Macro-fiscal stress tests



b. Debt profile vulnerabilities



Note: EMBIG bond spread
Source: Authors' calculations using the IMF-DSA template.

6.3. Financial Conditions Index

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.[47] The least squares estimator $\hat{F}_t$ solves the problem: $min_{\lambda_t, F_t} \sum_{i,t} (\hat{v}_{it} - \lambda_i' F_t)^2$. The $\hat{F}_t$ 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.

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