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Statement by Ms. Lim and Mr. Bautista on Philippines
Executive Board Meeting
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On behalf of the Philippine authorities, we thank staff for the insightful reports. Our authorities broadly share staff's views on the assessment of developments and challenges facing the economy. They also appreciate staff's policy recommendations, many of which are in line with the authorities' policy priorities and are currently being implemented.

Recent developments and outlook

The Philippines entered the pandemic with strong fundamentals characterized by broad monetary and external stability, resilient financial sector, favorable fiscal position, and prudent macroeconomic management. Nonetheless, the pandemic took a heavy toll on the economy with the marked contraction of domestic demand. The authorities accordingly employed a comprehensive set of policy support that put priorities on peoples' lives, health, and welfare, especially the poor and vulnerable.

The economy is recovering with the stabilization of infection and easing of mobility measures. Economic growth could return to its potential over the near term, with recovery strengthening in the second half of the year. Nonetheless, the authorities recognize the still-large uncertainties to the pace of recovery. The authorities have secured substantial contracts for vaccine supply for 70% of adult population, conducted information campaigns and pre-registration, and intensified implementation of prevent, detect, isolate, treat and recover (PDITR) strategy and vaccine rollout, particularly in high-risk areas and on economic frontlines. Local government units (LGUs) and highly productive large corporations are heavily involved in vaccination. The programs from 2021 and 2022 National Government (NG) budget as well as the measures from the *Bayanihan* II Law will help finance and ensure recovery. Meanwhile, monetary accommodation and supportive financial measures continue to work their way to the economy.

Recognizing that the pace of economic recovery hinges significantly on accelerated infrastructure investments, the authorities have strongly committed to full-scale uninterrupted implementation. The infrastructure program prioritizes crucial and shovelready projects that are responsive to the "new normal". The 2021 budget focuses on projects for addressing natural and human-induced calamities and disasters, health facilities, and standby fund for catastrophes and crises. To fast track the resolution of legal issues for the *Build Build Build* (BBB) program, 11 courts were designated by the Supreme Court to handle expropriation proceedings. The review of the Three-Year Rolling Infrastructure Program for 2022 include projects on transport, water, ICT, power, social, and others, with a number in advanced stages of preparation.

Meanwhile, inflation is expected at the high end of the 2-4% target at 3.9% for 2021, and to return to midpoint of target in 2022, with broadly balanced risks over the policy horizon, consistent with market expectation as of 12 May Monetary Board meeting. The transitory spikes observed from meat and transport prices will dissipate in the second half of the year, given measures to address the African swine fever in hogs, higher import quota and tariff reduction for meat, and easing of restrictions on the number of passengers for tricycle transport. The broadly muted inflation from the analysis of price dispersion and the still-significant economic slack will cushion the upside risks from global commodity price spillovers and interest rate.

Fiscal sector policies

The fiscal position remains sound and plays a significant role in regaining the economic potential. Targeted interventions helped in reducing the negative impact on income and employment. The fiscal sector also remains resilient despite the large deficit. The authorities underscore the need to restore confidence for economic growth to catch up and for employment to return to normal. Sustaining investments in infrastructure, health capacity, and more targeted social support, especially to address asymmetric impact of COVID-19 on labor, will provide the needed boost to the economy.

Past reforms that led to the historic reduction in debt-to-GDP provided adequate fiscal space for the authorities to respond to the pandemic. The budget deficit widened as expected in 2020 as revenues fell and expenditures rose. However, debt-to-GDP ratio remains manageable and falls within the middle of the country's peers in the region and below the IMF's debt sustainability threshold. The 2021 budget and extended use of 2020 budget are providing funds for the fiscal stimuli under *Bayanihan* I and II laws. The 2021 budget prioritizes: health-related spending to mitigate the impact of the pandemic; infrastructure projects to help stimulate economic rebound; and expenditure programs that support transition and adaptation to "new normal".

Modernization of tax and customs administration is underway to improve revenue collection. The Department of Finance continues to work on modernizing tax administration, making tax compliance easier, adopting digital technology, and enhancing service efficiency. Measures to enhance tax administration has digitalization at its backbone. Online system for tax filing and collections have been put in place, which encouraged taxpayers' compliance to filing, and significantly contributed to revenue collections. Other ongoing reforms include property valuation and financial institutions taxes, tax on gambling (e.g., POGOs), change in fiscal regime in mining, development of corporate pension linked to the national identification system, and issuance of green bonds.

Customs administration is also being modernized along with the automation of systems, improving border protection capability, operationalization of the Customs Operations Center, and establishment of the Customs Training Institute. The roll-out of real-time GPS-based monitoring of cargoes, the inventory management system for monitoring real-time movements of imported goods and raw materials and the fuel marking system also generated additional revenues.

The authorities have been enhancing budget execution with focus on raising implementation capacities, addressing bottlenecks as well as enhancing procurement rules, transparency, and accountability. To further improve disbursements, the Department of Budget and Management will be completing its shift to cash budget system. A budget modernization bill aims to institutionalize public financial management. In addition, the oversight of government accounts is being strengthened along with the deployment of integrated financial management information system, oversight internal audit standards, and institutionalization of public participation in the budget process. Technical assistance from multilateral agencies improved the evaluation and management of public investments and helped in capacity building of government agencies on project development and implementation. The use of digital technology for online blacklisting, e-bidding, and tracking; and institutionalizing budget and treasury management system helped simplify and modernize the procurement system.

The authorities acknowledge that greater empowerment of LGUs will support the further devolution of functions and help in recovery efforts. In this context, the authorities will provide guidelines on funding for LGUs in the 2022 budget. Relatedly, an Executive Order on the mechanism of devolution transition plans, creation of a time-bound growth enhancement fund, and updating of regional plan, investment program and budget framework, is ready for signature by the President. To ensure efficient and effective use of the budget, the authorities are preparing the standards for delivery, and they will provide the needed technical and management assistance, build capacity, and monitor the use of the LGUs budget, especially in the implementation of infrastructure projects.

The authorities underscore the need for balancing fiscal prudence and recovery through adjustments in spending for targeted stimulus, where possible. Social protection programs will be strengthened to alleviate immediate concerns on unemployment and poverty, while the continued strong push for infrastructure programs should create jobs and enhance the long run economic potential, thereby preventing further scarring effects. Measures under the proposed *Bayanihan* III bill are being carefully assessed to ensure availability of revenues that could be sourced from government corporations and identified savings from the budget. Meanwhile, the 2022 budget will have at its core the pandemic response and economic recovery objectives.

As embodied in the medium-term fiscal program, the authorities concur with staff's view and fully commit to adopt a fiscal consolidation strategy that would help gradually

bring deficit ratio to GDP to pre-COVID-19 levels. This strategy will ease the country's debt and allow for gradual rebuilding of fiscal space as the economy recovers and expands, and revenue collections strengthen. The fiscal strategy will balance the support to economic recovery and the priority measures to protect livelihoods.

Monetary policies

The authorities' monetary actions and various liquidity-enhancing measures helped in lowering the cost of funds, ensure orderly and favorable market conditions, and maintain confidence in the banking system. In response to the pandemic, the authorities reduced its policy rate in 2020 by a cumulative 200 bps to two percent and lowered the reserve requirement ratio by 200 bps to 12 percent. Consistent with the provisions under the Bangko Sentral ng Pilipinas (BSP) Charter, the BSP provided provisional advances to the NG in the form of a repurchase agreement in March 2020 and direct provisional advances in January 2021, the latter maturing in July 2021. The BSP Charter provides that advances to the NG shall not, in aggregate, exceed 20 percent of the average annual income of the borrower for the three preceding fiscal years and shall be repaid before the end of three months extendible by another three months as the Monetary Board may allow. In addition, the *Bayanihan* II Law authorizes the BSP to make additional direct provisional advances to the NG, provided that such advances shall not, in their aggregate, exceed 10 percent of the average annual income of the national government for fiscal years 2017-2019.

The BSP also purchased government securities in the secondary market to support the smooth functioning of the domestic bond market. The outright purchase of government securities (GS) is part of the BSP's open market operations toolkit but has not been activated given ample financial system liquidity. The BSP will further refine the conduct of monetary operations, which include outright GS transactions, during regular and crisis periods. The authorities pointed out that the advances are temporary and for emergency use related to the pandemic. Moreover, the NG intends to reduce its reliance on temporary and short-term advances from the BSP. Measures are being considered to raise additional revenues and financing, including new taxes from gaming operations, privatization, dividend collections from government-owned and controlled corporations, and increase issuance of government securities.

The authorities share staff's view that the current monetary policy setting is appropriate and should remain accommodative given the nascent recovery of domestic demand. The current monetary policy should remain until signs of sustained recovery are clear and in line with price and financial stability. Most of the risks to inflation come from the supply side and inflation projection is seen to be within target in 2021 and 2022, consistent with market expectations. Demand side price pressures remain largely subdued with generally stable core inflation and still weak credit. These emphasize that domestic demand still requires both fiscal and monetary policy support under strong coordination. The BSP will continue to preserve supportive liquidity conditions prior to eventually scaling back monetary interventions.

The authorities understand the limits of monetary policy in the context of the present shock and are mindful of the need to preserve central bank credibility and guard against narrowing policy space. Consistent with the BSP Charter and the *Bayanihan* II Law, the authorities stand ready to provide policy support, as necessary. When recovery becomes self-sustaining, the BSP will implement a well-communicated strategy for unwinding of policy stimulus, while ensuring sustainability of economic recovery and guarding against emerging threats to price and financial stability.

Further reforms are ongoing to improve monetary operations and enhance the transmission mechanism in terms of more market-based implementation of monetary policy by expansion of market participation, improving the ability to respond to fluctuations in liquidity conditions, expanding the toolkit for injecting liquidity into the financial system, and strengthening the operational readiness in responding to various financial market developments via strategies on the current BSP holdings of government securities.

External sector policies

The authorities remained of the view that the country's external sector position is broadly in line with the medium-term macroeconomic fundamentals and remains favorable after the brief volatility and as trade suffered a setback in 2020. The external sector is showing signs of recovery. The relative strength of the Peso against the US dollar is due to a combination of factors. The Philippines stands out among emerging economies with strong BOP in 2020. The stringent lockdowns caused the demand for foreign exchange to decline markedly with exports and remittances remaining moderate. Firms and exporters can borrow from the international market and issue debts. Meanwhile, the government has continued market access to financing while imports demanded less foreign exchange.

The authorities continue to embark on improving the investment climate and expanding trade opportunities. Domestic ratification processes are underway for the Regional Comprehensive Economic Partnership among ASEAN Member States and its FTA partners - South Korea, India, China, Japan, Australia, and New Zealand. Moreover, the Philippines is now delisted from the USTR list on protection of intellectual property rights. The 12th Regular Foreign Investment Negative List due for submission to the President by Q4 of 2021 will help ease some barriers and encourage greater foreign investments in: the practice of professions; cooperatives; ownership of private lands; operation of public utilities; retailing of rice and corn; construction or repair of public works where the structures to be built require the application of advanced techniques and/or technologies; and educational institutions.

The authorities remain committed to a flexible or a market-determined exchange rate system, anchored on the constitutional mandate to maintain price stability. It is also consistent with the monetary policy of inflation targeting, which demands a disciplined commitment to participate in the foreign exchange market only under well-defined circumstances, such as when there is a need to smooth out exchange rate volatility, which can threaten the inflation target. The authorities have also combined foreign exchange intervention and monetary measures with market-based foreign exchange regulations to ensure stability in the foreign exchange market. The BSP has been keeping foreign exchange regulations responsive through the liberalization of foreign exchange rules with appropriate safeguards and continues to have recourses and measures to cushion sharp peso movements.

The authorities believe that the current reserves accumulation is prudent and appropriate in the face of risks from the challenging economic environment and other transitory non-fundamental factors, which call for reserve build-up for liquidity buffer for precautionary use. The authorities noted that the build-up in gross international reserves was due to other several factors, including the large reduction in imports and relatively still growing remittances. The increase was also attributed to the borrowings of the NG to raise funds and valuation gains of gold assets. Part of the reserves will be eventually drawn down once spending of the NG accelerates and economic activity normalizes.

Financial sector policies

The Philippine banking system remains on strong footing with sustained growth in assets, deposits, and capital, as well as positive net profit, stable capital and liquidity buffers, and ample loan loss reserves. Its resources continued to expand to support the country's financing needs. Meanwhile, the impact of the pandemic on the banking system characterized by the expected weakening of asset quality, has been manageable. Banks proactively recognized provisioning since the start of 2020 in anticipation of the adverse impact of the pandemic on their loan portfolio.

The comprehensive prudential reforms and implementation of regulatory and operational relief measures have generally supported the resilience of banks and risk management. The time-bound measures included: regulatory relief measure that enables banks to grant equivalent financial relief to their borrowers or restructure loan accounts; incentivized lending to sustain the post-crisis operations of enterprises; continued access to credit/financial services; use of information technology for financial transactions during quarantine; and supported continued delivery of financial services to enable consumers to complete financial transactions during quarantine. For its part, the Securities and Exchange Commission (SEC) provided issuances on extension of filing of reports and simplified onboarding of procedures for low-risk accounts for AML/CFT purposes.

The authorities note that banks entered this pandemic with ample capital and liquidity buffers, allowing them to withstand short-term liquidity shocks while providing adequate stable funding for the medium-term. Meanwhile, other sources of financing, notably corporate bonds, have remained relatively active due to low interest rate environment. The authorities have also extended and further enhanced the operational relief measures to provide financial institutions with flexibility in managing their operations and ensuring continuous delivery of financial services amid the pandemic.

Banks that avail themselves of the credit-related regulatory relief measures are required to report actual past due and NPLs and allowance for credit for losses in their prudential reports. Thus, the published industry statistics of banks present the true state of health of the banking system. The expiry of these relief measures was timed to coincide with the full operationalization of the Financial Institutions Strategic Transfer (FIST) Act at end-December 2021. This approach is meant to bridge transition between the crisis-oriented temporary relief measures and the long-term permanent resolution mechanism afforded under the FIST Law. Meanwhile, the window of the staggered booking of allowance for credit losses was allowed to lapse on 8 March 2021. This relief measure recorded utilization by a few small banks which were allowed to stagger booking of allowance for credit losses below the maximum period of five years. In evaluating applications for relief, the BSP considered the results of stress testing exercises in determining any conditions on the approval. Banks applying for relief measures may be restricted from making dividend or other forms of profit distributions. The restriction applies automatically to banks that utilize their capital conservation buffers and may be imposed on banks that have reached their internal capital targets. Existing regulations also allow the BSP to limit or prohibit dividend declaration, as necessary. The authorities are confident that dividend prohibition can be handled on a case-by-case basis, considering that banks have individual capital triggers provided in their internal capital adequacy assessment process, stress testing results and risk assessment, among others.

The authorities also adopted prudential regulations to ensure effective supervision of the banking sector. Prior to the onset of the pandemic, the BSP already adopted the following Basel capital and liquidity standards: amendments to the capital requirements which provide for higher-quality capital and additional minima requirements; liquidity coverage ratio; net stable funding ratio; leverage ratio; and the framework for DSIBs. The authorities implemented the Supervisory Assessment Framework (SAFr) in January 2021, which puts emphasis on a bank's financial stability impact, bank's business model and overall risk profile. With this, the BSP has a better hand in evaluating the overall safety and soundness of banks. The BSP has also continued to strengthen consolidated supervision where banks belonging to one conglomerate structure are handled by one department. While each financial institution within the conglomerate is assessed individually, focus is given on the effectiveness of the governance process across the group. The Financial Conglomerate Supervision Committee, under the auspices of the Financial Sector Forum (FSF)[1] is tasked to strengthen conglomerate supervision and assessment of risk concentrations. The work of this Committee included the development of the guidelines on related party transactions that were adopted by the FSF member agencies for their respective supervised institutions. The FSF is currently working on the finalization of the memorandum of agreement (MOA) on the formation of supervisory colleges to effectively conduct groupwide risk assessment and discuss cross-cutting issues. In addition, a bill has been filed in Congress to provide a window to look into potential issues using fraudulent transactions in deposit.

The authorities underscore its commitment toward the timely implementation of the International Co-operation Review Group (ICRG) action plans to address strategic anti-money laundering and counter-terrorism financing (AML/CTF) deficiencies of the country. A number of the Mutual Evaluation Report recommended actions have largely been addressed. Given the recent identification of the Philippines as "Jurisdiction under Increased Monitoring" with serious AML/CTF deficiencies, the relevant government and law enforcement agencies' sustained pledge to implement the remaining 18 action plans within

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[1] FSF is a voluntary inter-agency body comprised of the BSP, SEC, Insurance Commission (IC), and Philippine Deposit Insurance Corporation (PDIC).

the prescribed timelines will be essential to the country's removal from such list. The authorities are confident that the country would be removed from the FATF watch list given the current actions to address the remaining issues.

The authorities are continuously improving the regulation of the financial system by expanding the macroprudential toolkit and strengthening bank resolution framework to help enhance its resilience. While enhancements in the regulatory policies and supervisory practices towards strengthening the bank resolution framework are ongoing, the authorities underscore that banks which are under the Prompt Corrective Action Framework do not pose systemic risk to the Philippine financial system. The authorities are closely monitoring banks' asset quality along with the developments in the real sector, cross-border borrowings, the non-corporates bond issuances, and amounts under forbearance needed for supervisory assessment and development of corresponding supervisory plan.

Structural reforms

The authorities agree with the staff view on the need to advance the structural reforms for economic sustainability and green recovery over the medium to long term. Related to this, several laws have been passed. The Corporate Recovery and Tax Incentives for Enterprises (CREATE) law will improve investments by lowering corporate income tax rate by five to 10 percentage points and rationalizing tax incentives. The FIST Law would facilitate resolution of NPLs and distressed assets to improve banks' balance sheet and encourage lending. The authorities are also closely monitoring various proposed bills, such as the Government Financial Institutions Unified Initiatives to Distress Enterprises for Economic Recovery (GUIDE) bill, which will allow GFIs to invest in strategically important companies facing temporary solvency issues, and the amendments to the PDIC Charter on bank resolution. The President has also certified the following priority bills: Amendments to the Public Service Act, which redefines the coverage of public utility to effectively remove foreign equity restrictions; Amendments to the Foreign Investment Act, to relax restrictive provisions on FDIs and facilitate entry of new players; and Amendments to the Retail Trade Liberalization Act, which relaxes barriers to foreign investments in the retail sector.

The authorities are strongly stepping up the implementation of various climate change management framework and plans for adaptation, mitigation, and disaster risk-reduction, with more aggressive target, and thrust to explore new renewable energy (RE) technologies along with consumer protection policies. Energy conservation and efficiency in government and the private sector is being implemented along with green buildings and energy labeling. Efforts are ongoing to mainstream climate change and disaster resilience in sustainable finance, and local and international collaborations. Investments on climate change mitigation include registrations for RE and battery energy storage, and conversion of biomass waste for aviation fuel. The energy innovation landscape is exploring various energy sources, such as hydrogen, expanded solar rooftop, tidal energy, and offshore wind. Use of biodegradable plastic from local commodities is also promoted. The authorities' investments on green recovery, particularly on climate change adaptation and mitigation, are well in place and tagged for identification in both the 2021 budget and upcoming 2022 budget.

Strong efforts to improve governance are aimed at improving the conduct of business, reducing red tape, and enhancing delivery of services. In this context, the authorities have applied technology to: streamline efforts to eliminate inefficiencies; improve and simplify business processes and requirements on licenses, registrations, renewal, and handling of complaints and resolutions; and establish an electronic data system on business-related transactions that are linked to government agencies. Meanwhile, LGUs are also implementing electronic Business One-Stop Shop for online applications, digital payment options, and issuance of electronic versions of permits, licenses, or clearances. A web-based platform for real-time public access to management system and regulations is expected to go live by Q4-2021. Moreover, the launching of Go SmARTApp will harmonize the existing systems of government agencies to simplify government transactions and doing business in the country. The national identification system has been rolled out and targets 50 million registration by 2021. This system is useful for planning and budgeting and will simplify transactions and facilitate social services delivery.