February 27, 2020
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/81-1

10:00 a.m., September 17, 2018

1. Philippines—2018 Article IV Consultation

Documents: SM/18/222 and Correction 1; and Correction 2; and Supplement 1

Staff: Breuer Mojoli, APD; Duttagupta, SPR

Length: 30 minutes

Executive Board Attendance

M. Furusawa, Acting Chair

Executive Directors	Alternate Executive Directors
	A. Nainda (AE), Temporary
	O. Diakite (AF), Temporary
	D. Vogel (AG), Temporary
	J. Shin (AP), Temporary
	B. Saraiva (BR)
	K. Lok (CC), Temporary
	T. Gonzalez (CE)
N. Horsman (CO)	
	O. Bayar (EC)
H. de Villeroché (FF)	
	P. Braeuer (GR), Temporary
	P. Dhillon (IN), Temporary
	P. Di Lorenzo (IT), Temporary
	Y. Saito (JA)
	M. Daïri (MD)
	P. Al-Riffai (MI), Temporary
	R. Doornbosch (NE)
	K. Virolainen (NO)
	S. Potapov (RU), Temporary
	R. Alkhareif (SA)
	E. Villa (ST)
	P. Inderbinen (SZ)
	T. Hemingway (UK), Temporary
	P. Pollard (US), Temporary

G. Bauche, Acting Secretary
J. Morco, Summing Up Officer
V. Sola, Board Operations Officer
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
Asia and Pacific Department: Luis Enrique Breuer Mojoli, Si Guo, S. Guo, P. Karam, Philippe D. Karam, Minsuk Kim, M. Kim, C. Rhee, Chang Yong Rhee. Communications Department: Ting Yan. Legal Department: Wolfgang Patrick Bergthaler, Gomiluk John Otokwala. Monetary and Capital Markets Department: M. Erbenova. Strategy, Policy, and Review Department: R. Duttagupta, Rupa Duttagupta, N. Sheridan, Niamh Mary Sheridan.

Executive Director: M. Raghani (AF). Alternate Executive Director: A. Castets (FF), L. Palei (RU), P. Sun (CC). Senior Advisors to Executive Directors: V. Djokovic (SZ), H. Etkes (NE), F. Fuentes (BR). Advisors to Executive Directors: A. Abdullahi (AE), K. Badsi (MD), J. Essuvi (AE), T. Gade (NO), G. Nadali (MD), Y. Naruse (JA), A. Sode (FF).

1. PHILIPPINES—2018 ARTICLE IV CONSULTATION

The staff representative from the Asia Pacific Department submitted the following statement:

The information below has become available following the issuance of the staff report (SM/18/222). It does not alter the thrust of the staff appraisal.

Headline CPI inflation picked up to 6.4 percent (y/y) in August from 5.7 percent in July, which brings the year-to-date average to 4.8 percent (y/y). Core CPI inflation rose to 4.8 percent (y/y) in August from 4.5 percent in July, resulting in a 3.7 percent (y/y) year to date average.

Since end-July, the peso has depreciated by 1.8 percent against the U.S. dollar, equity prices fell by 1.0 percent, and the 10 year government bond yield rose by 93 basis points. On a year-to-date basis, the peso has depreciated by 7.8 percent, equity prices fell by 12.9 percent, and the 10 year government bond yield rose by 177 basis points.

Gross international reserves increased from US$76.7 billion at end July to US$77.8 billion at end-August.

Ms. Villa submitted the following statement:

The Philippine Authorities wish to thank the IMF team, led by Mr. Luis Breuer, for their continued candid and constructive engagement. The Authorities were encouraged by the generally positive assessment of the Philippine domestic conditions, and took note of the variance in views, particularly on the risk of overheating as well as the appropriate timing of policy adjustments. The Authorities welcomed the analytical work presented by staff, including on the effects of the new Comprehensive Tax Reform Package and its first tranche, the Tax Reform for Acceleration and Inclusion (TRAIN-1); and the disaggregation of supply side and demand side inflation impulses. The Authorities will thoughtfully consider these as they refine policies, particularly in light of heightened global economic and financial uncertainty.

Recent Macroeconomic Developments

Supported by sound macroeconomic policies, the Philippines continues to be one of Asia’s best performing economies. Real GDP grew 6.7 percent in 2017 and 6.3 percent in H12018, bringing to 78 the number of consecutive quarters of positive economic growth. On the demand side, growth has increasingly been fueled by investments, while private and public consumption have been sustained. On the supply side, strong manufacturing and construction have been key growth drivers.

Fiscal performance has been strong. Revenues exceeded target by 8.1 percent in H12018, which provided space for expenditures to meet the target. Revenues generated from the recently implemented tax reform measures under TRAIN-1 exceeded projections by nearly 12 percent.

Inflation for the first eight months of the year averaged 4.8 percent (yoy), which is above the government's announced target range of 2-4 percent for the year. The main drivers of overall inflation are still supply side factors, relating to rising international oil prices, higher excise taxes, and weather-related supply disruptions. The Authorities have undertaken immediate measures to mitigate supply bottlenecks for rice and key products. In parallel, they are escalating reforms (such as the rice tariffication bill) to address medium-term supply-related issues.

While the peso has depreciated 6.6 percent in the first eight months of the year, it has maintained its external price competitiveness against baskets of currencies of trading partners. The recent movements in the currency have been influenced by shifts in market sentiment linked in turn to external developments, including those from tighter global financial conditions and market volatility in emerging markets, as well as the impending interest rate hikes by the Fed. At the same time, the depreciation of the peso appears to be driven mainly by the increase in dollar requirements due to the following fundamental factors: (1) sustained rise in the demand for imported goods (such as capital goods; intermediate and raw materials; and consumer goods); (2) residents' increasing direct and portfolio investments abroad; and (3) debt prepayments by the government and private corporations including payments of inter-company loans. Despite their consequent pressures on the local currency, the BSP welcomes these developments as they are indicative of robust economic expansion. Nonetheless, the peso is expected to remain broadly stable on account of the country's sound macroeconomic fundamentals – including robust GDP growth, strong and resilient banking system, and prudent fiscal position. Gross international reserves (GIR) at end August 2018 stood at US$77.8 billion, adequate for more than 7.5 months' import cover. The GIR will continue to be funded by steady BPO revenues and overseas workers' remittances.

The positive economic story in the Philippines is also underpinned by a stable and well-functioning banking system. Total assets of the banking system have continued to grow. System balance sheets remain strong, with CAR above regulatory standards and international norms at 14.5 percent on a solo basis and 15.1 percent on a consolidated basis. NPLs at end June 2018 stood at 1.3 percent, remaining well below the pre-GFC level of 4 percent. Credit growth at 19.6 percent continued to be directed towards the major production sectors of the economy.

Outlook, Risks and Strategic Policy Directions

Going forward, Authorities see sustained robust economic growth, driven by higher public spending on infrastructure through the "Build, build, build" program of the current administration, the sustained resurgence in manufacturing and growing foreign investments and tourism. Nevertheless, Authorities will review their economic growth projection of 7-8 percent over the medium term. Staff's projections are less optimistic. Staff see that maintaining fiscal stimulus at the planned 3.0 percent and 3.2 percent in 2018 and 2019, respectively, combined with strong private investment and consumption would feed into price and current account pressures.

Fiscal Policy

Authorities are keeping their expansionary fiscal policy, as originally programmed. While they have carefully considered the staff policy recommendation to keep a neutral fiscal stance to balance growth and stability, Authorities continue to see the imperative for stronger investment in infrastructure. They are mindful of the significant infrastructure gap that urgently needs to be filled to enable the country to sustain the momentum of economic growth. During the previous political administration, the priority was to strengthen governance reforms. With improvements in the procurement processes in place, Authorities can now ramp up infrastructure spending. Accelerated investments in social services, particularly education and social protection, are also urgently needed. Authorities are convinced that retaining these priorities will allow the country to capitalize on the Philippines' demographic advantages to drive the country towards upper-middle income status by 2022. Good revenue performance under TRAIN-1 is expected to be sustained, which should help build the necessary buffers for unforeseen slippages elsewhere.

Authorities positively acknowledge the Fund's recently concluded technical assistance through the Public Investment Management Assessment

(PIMA) which would help guide reforms to ensure that program prioritization, especially on infrastructure and social protection spending, maximizes the return on investment. For 2020 to 2022, the deficit target will revert to 3 percent of GDP, as the government remains committed to long-term fiscal sustainability. The debt-to-GDP ratio is expected to continue its downward trajectory in the medium-term from 42.1 percent in 2017 to 38.6 percent in 2022. A financing program that will continue to favor domestic borrowings will support this. Proactive liability management has decreased the burden of debt on the budget, creating more fiscal space to fund social commitments.

Monetary Policy

Authorities share staff's assessment that the less than benign external environment has complicated the conduct of monetary policy. Earlier this year, economic data suggested that an adjustment in policy rate was not warranted, as the uptick in prices was driven mainly by supply-side factors. Moreover, BSP forecasts then continued to show inflationary impulses as transitory and moderating to a target-consistent path in 2019. However, as international oil prices remained volatile and as the pace of policy normalization in AEs progressed, capital outflows from EMEs put significant pressure on the exchange rate. Authorities recognized that sustained pressure on the peso, along with the initial impact of TRAIN-1 on domestic prices and the broadening rise in prices, could adversely affect inflation expectations and trigger second round effects. Therefore, to prevent any de-anchoring of inflation expectations, the BSP raised its policy rate by a cumulative 100-basis points between May and August. With inflation in August tipping at 6.4 percent, the BSP maintains its strong commitment to weigh the need for further monetary policy action at its next policy meeting later this month. It has indicated clearly to the market that it is ready to undertake any follow-through action to safeguard the inflation target for 2019, including closely monitoring the possibility of demand-side pressures.

Part of staff argument for a neutral fiscal stance was to "limit overheating risks" and avoid "overburdening monetary policy." While Authorities are cognizant of elevated risks, they continue to see few signs of possible overheating in the economy. The recent output number remains in line with long-run trend, and credit conditions continue to be manageable. Monetary policy is vigilant with sufficient policy space to respond to ongoing price pressures. With technical assistance from the Fund, the BSP will also continue to enhance its monetary policy operations framework to sustain the effectiveness of monetary policy transmission. In addition, the BSP will keep pushing for the passage of amendments to the BSP Charter, which would further strengthen its ability to fulfill its mandate of price and financial stability.

Moreover, the BSP will continue to closely work with other government agencies and legislators towards the swift passage of laws that would lift the quantitative restrictions on rice, and thereby alleviate rice price pressures. House Bill 7735 (The Revised Agricultural Tariffication Act) was already approved by the House of the Representatives on 14 August 2018, while the Senate version of the Bill is pending before the Senate Committee on Agriculture and Food.

Financial System Stability and Inclusion Policies

Authorities welcome staff's assessment that the financial system is sound and that the BSP has appropriately implemented macroprudential policies to pre-empt the build-up of risks to financial stability. BSP regulations to safeguard the resilience of banks are in the pipeline. These include refinements to existing stress tests; introduction of a Debt-to-Earnings of Borrowers' Test (DEBT) and the Borrowers' Interconnected Index (BII); and the adoption of a countercyclical capital buffer (CCyB). Moreover, as regulator, the BSP supports responsible fintech innovation, given the latter's link to increased efficiencies and financial inclusion. The BSP has refined regulations to effectively respond to trends in digitization, fintech and technology-related risks. Among others, the BSP has updated the regulatory framework for money service businesses to enhance customer due diligence, established a framework for regulating virtual currency exchanges, and is in collaboration with co-regulators and the private sector on how best to benefit from pioneering technologies. The BSP has also piloted Regtech solutions to strengthen risk-based regulatory and supervisory activities. These pilots relate to handling consumer complaints and improving supervisory reporting.

Structural Reform Policy

Authorities are cognizant that while there have been inroads into poverty alleviation and improving inequality, much more could be done to attract investments to fuel economic growth, encourage enterprises to hire more workers, improve their competitiveness and thus deliver on social benefits. The policy thrusts of Authorities include:

Further liberalizing investment through shortening the list of foreign investments subject to restrictions. While the list is the shortest it has been in years, Authorities plan to further shorten it through executive orders and legislations.

Sustaining the implementation of TRAIN-1, which increased the disposable income of 99 percent of the working population. This is expected to help build a stronger middle class and lift one million Filipinos from poverty each year.

Rationalizing fiscal incentives and reducing CIT (both are under the second package of tax reforms (TRAIN-2), which is pending in Congress). This will create a level playing field for enterprises and attract new players to compete.

Further developing the domestic capital market so it can support and leverage on digital technology to promote financial inclusion, while ensuring cyber security risks are manageable.

Mr. Saraiva and Mr. Fuentes submitted the following statement:

We thank staff for the paper and Ms. Villa for her insightful statement. Economic activity in The Philippines have sustained a strong growth pace in recent years supported by solid fundamentals and prudent macroeconomic management. GDP growth rates are projected to remain above potential in 2018-19. However, uncertainty around global and domestic conditions affecting growth has risen, and timely policy responses are warranted to avoid overheating and spread the benefits of economic prosperity.

Incipient signs of overheating should be closely monitored. While the implementation of the Tax Reform for Acceleration and Inclusion (TRAIN) have prompted a one-time price increase in numerous goods and services, growth momentum continues to pressure domestic prices, driving inflation above the target range for 2018, and engendering higher inflation expectations. Moreover, tighter global monetary conditions and higher oil prices are contributing to widen domestic and external imbalances. Notwithstanding the timely response of the Bangko Sentral ng Pilipinas (BSP), which helped mitigate risks and limit second round effects, a more restrictive policy mix might be warranted to safeguard macroeconomic stability and medium-term growth sustainability, especially if no support comes from adjusting the fiscal stance.

We see merit in staff's recommendation for a neutral fiscal stance to balance growth and stability. The Philippine authorities have created enough fiscal space to support growth without altering public debt declining trajectory. Yet, focusing resources on infrastructure investment while restraining current spending could curb pressures on aggregate demand and circumvent further monetary tightening. Furthermore, cautious monitoring of the impact on revenue of the upcoming implementation of the second package of the TRAIN is necessary to prevent overshooting the targeted fiscal deficit. All in all, we commend authorities for their commitment to continue strengthening public expenditure management and implementing recommendations identified in technical assistance.

Focus on social protection is warranted to foster more inclusive growth and reduce inequality. Despite progress in poverty reduction in the last decade, rate decline in The Philippines has proceeded at a slower pace than its regional peers according to the World Bank. Thus, redirecting resources from nonpriority spending to expand the conditional cash transfer program and improve access to public services by low-income households could expedite social inclusion. We recall that the direct revenue impact of the TRAIN reform is regressive, asking for judicious spending decisions to maximize poverty reduction and lessen inequality. In addition, prevalent in-work poverty has been highlighted as a major challenge for poverty reduction and labor market dynamics. Consequently, further actions aimed at promoting job quality, investment in human capital and labor market flexibility, could help reduce inequality and sustain medium term growth.

The financial system remains sound despite rising downside risks. Financial indicators suggest banks are healthy and well-capitalized, with low nonperforming loans and limited exchange rate risk exposure. Credit growth to the private sector, however, continues to outperform nominal GDP, rising both household and corporate leverage. Accordingly, credit risk should be closely monitored as monetary conditions tighten, while timely information remains crucial to enable the BSP to perform its supervisory role. Against this background, we welcome the recent congressional decision to grant the BSP the authority to obtain information to safeguard the soundness of financial institutions. In this regard, we welcome the monetary authorities' efforts to enhance data compilation and availability.

Mr. Doornbosch and Mr. Etkes submitted the following statement:

We thank staff for the insightful report and Ms. Villa for an informative buff statement. The Philippine economy is enjoying high growth rates, yet inflation started to rise following the surge in oil prices. The fiscal policy is accommodative, and the authorities are increasing public investments, while the central bank raised its interest rates a few times to curb inflation. We support staff's advice to finetune the policy mix and continue raising the interest rate to support growth and price stability. We also broadly agree with staff's assessment and other recommendations and offer a couple remarks for emphasis.

The Philippine current account turned negative since 2016 as public investment increased and overall investment overtook saving. The increased investment seems warranted considering the reported poor state of the infrastructure as well as the infrastructure gap vis-à-vis peer countries. Part of the investments is undertaken as PPP and the authorities plan to amend the PPP law. In her buff statement, Ms. Villa thanks staff for the recently concluded technical assistance through the Public Investment Management Assessment (PIMA). We would appreciate if staff could provide some insights on the conclusions of the TA, and whether a Public-Private Partnership Fiscal Risk Assessment TA is also needed.

In 2017, the Philippines had about 2.3 million workers overseas, which is equivalent to 6 percent of the local work force. Remittances were equivalent to about 10 percent of GDP and are balancing most of the trade deficit in the BOP. Overseas employment and remittances also affect poverty and the gender gap as most of the Philippine overseas workers are women. Therefore, we believe that recent developments of overseas workers and remittances, and the impact of remittances on issues analyzed in the report, should be addressed in main sections of annual Article IV reports. For instance, while we commend staff's examination of trends in poverty and inequality (p.29) it would have been useful to also address the impact of remittances on poverty and inequality. Can staff provide estimates of the impact of remittances on inequality?

In this context, we appreciate the Philippines' innovative solution for smoothing cross boarder remittances. During the last year, the authorities turned the former Postal Bank into the governmentally owned Overseas Filipino Bank (OFB). According to public statements, the OFB's role is to provide financial products and services tailored to the requirement of overseas Filipinos. This public-sector experiment in cross border payments could be valuable for other countries, which suffer similar constraints due to withdrawal of CBR. We appreciate staff's comments on the effectiveness of this solution for making cross border payments and its implications for financial inclusion.

Mr. Meyer and Mr. Lieber submitted the following statement:

We thank Ms. Villa for her candid buff statement and staff for their concise report. We mostly concur with staff's policy recommendations. The Philippine economy maintains robust growth, mainly driven by strong investment. At the same time, inflation that has surpassed the BSP's target ceiling and rapid credit growth as well as volatile capital flows pose challenges going forward. On the external side, risks might inter alia emanate from the impact of higher U.S. interest rates and rising protectionism.

Supported by a sound macroeconomic policy mix, overall economic performance has been quite strong over the last years. However, despite strong growth rates, both poverty and inequality are still high by regional standards. Moreover, GDP per capita has been growing less than overall GDP and the (average) difference in respective growth rates over the last years is higher compared to Asian peers. The issue has also been raised in the context of previous Article IV consultations where staff has expressed the intention to cover GDP per capita developments in more detail in future reports. Against this backdrop, we would have welcomed a greater focus on these issues in the current report and would also appreciate further elaboration by staff on the effectiveness of recent reform measures that are aiming at making growth more inclusive.

We take note that, according to staff, demand as well as supply-side factors appear to have played a role with respect to high inflation rates as well as increasing government bond yields. In this context, we welcome the recent rise in the BSP's policy rate. At the same time, taking into consideration staff's estimate of the real interest rate to be close to zero and thus well below the estimated neutral rate, we see merit in staff's reasoning in favor of a further tightening of the monetary policy stance to prevent the economy from overheating.

The recent depreciation of the peso, mainly led by external developments, highlights the importance of exchange rate flexibility as a shock absorber. The ample degree of international reserves limits Philippines' vulnerabilities with respect to exchange rate shocks. Nonetheless, we concur with staff that foreign exchange intervention should be limited to smoothening excessive volatility.

On fiscal policy, we agree with staff that a shift to a neutral fiscal stance with a focus on well-targeted infrastructure and social spending would be desirable. While we welcome the authorities' implementation of the first package of the Tax Reform for Acceleration and Inclusion (TRAIN), we encourage the authorities to timely implement the second package of the tax reform. Any CIT rate reduction should be conditional on proportionate fiscal incentive consolidation to offset revenue losses.

We take note that staff points to a shift of government financing toward short-term debt. As shown in the DSA, staff expects a further increase in the share of short-term debt in total general government gross debt in the upcoming years. We would appreciate staff's comments on the reasons behind this development and possible risks emanating from the change in the maturity structure.

According to staff's assessment, increased corporate leverage and the pace of the credit-to-GDP increment point towards potential risks to financial stability. We therefore welcome the macroprudential policies proposed by the BSP, in particular plans on countercyclical capital buffers. In order to strengthen the BSP's financial stability mandate, staff rightly accentuates that the approval of the amendments to the BSP charter should be a priority. We welcome the authorities' initiatives to close existing data gaps, which might also help to better assess systemic issues stemming from conglomerate structures.

We support the proposed structural reform measures to improve the business environment. As staff rightly underlines, changes to the rice import quota system should be accompanied by measures aiming at minimizing the burden for the most vulnerable.

Finally, we echo staff's call to further strengthen the AML/CFT framework through an adjustment of the bank secrecy law and by making tax evasion a predicate crime. We take note of the authorities' efforts to create the Presidential Anti-Corruption Commission and would welcome staff's assessment of the specific design and effectiveness.

Mr. Alogeel and Mr. Rouai submitted the following statement:

We thank staff for their work and Ms. Villa for her informative buff statement. The Philippines economy continues to perform well and to bear the fruit of sound policies, registering high GDP growth, led by robust investment, and declining poverty and inequality. The external and fiscal positions are robust, with low current account and fiscal deficits, high international reserves, and a moderate and sustainable level of general government gross debt.

Medium-term prospects are also favorable despite the external risks noted in the RAM. However, we tend to agree with staff that a moderate growth trend is more realistic and we appreciate the indication in the buff that the authorities will review their economic growth projection of 7-8 percent over the medium term. As investment in infrastructure projects remains a pillar of growth, we encourage the authorities to address the impediments noted in Figure 8 to improve the business environment and support private investment. We also encourage staff to give due consideration to staff recommendation to adopt a neutral fiscal stance over 2018-19.

We note the rapid increase in inflation in August 2018 to 6.4 percent from 5.7 percent in July, largely above the 2-4 percent target band. In addition, Box 2 in the staff report indicates that inflation pressures are spreading from items directly affected by supply-side factors to a broader spectrum of the economy. Noting that in the staff statement, no reference is being made to a reassessment of staff appraisal and policy recommendations, we would appreciate if staff could indicate if this rapid increase in inflation may affect wages, inflation forecast for the year, and the pace and timing of policy recommendations, particular in view of the risk of the super typhoon Mangkhut impacting the corn and rice harvest? In any case, this increase reinforces the need for further monetary policy tightening, following recent increases in the policy rate by the BSP, to anchor inflation expectations and safeguard price stability.

Philippines' low exposure to external and FX-denominated financing is a helpful buffer against financial stability risks, particularly at this current juncture of high market volatility and tightening of financial conditions. However, as bank credit continues to outpace the rate of economic growth and the credit-to-GDP ratio is approaching early warning levels, we encourage the authorities to continue the implementation of macroprudential measures, address the data gaps noted by staff, and accelerate the proposed amendment to the BSP charter.

With these remarks, we wish the authorities further success.

Mr. Beblawi and Ms. Al-Riffai submitted the following statement:

We thank staff for their explanatory report and Ms. Villa for her informative buff statement. The Philippines maintained strong economic performance through sound policies and positive external environs, all of which have contributed to sturdy growth, low inflation, and a sound fiscal position. The economy's external position remains broadly in line with fundamentals and gross reserves remain ample. Nonetheless, short-term risks have emerged, including overheating and greater external uncertainty whilst the medium-term economic outlook remains favorable, allowing the authorities ample room to tackle the still elevated levels of poverty and inequality.

Through prudent fiscal management, sustained reforms, and a reduced need for gross financing and long-term adjustment, the authorities have successfully created some fiscal space. We positively note the government's tax reform program and efforts, specifically the effective implementation of its first phase, the Tax Reform for Acceleration and Inclusion (TRAIN), which has significant distributional impacts over the longer term. Though TRAIN is essential to finance the government's infrastructure investment projects, staff assesses that it is largely regressive which makes it necessary to allocate spending to promote more inclusive growth. To this end, we are pleased to note that the authorities agree to gradually expand social protection programs and further improve their public investment management practices as highlighted by the Fund's recent Public Investment Management Assessment.

Inflation is rising, spurred by adjustments in the excise taxes, the rise in global oil prices, a weaker peso, and above-trend growth. Though the authorities recently raised the policy rate by 100 bps to address rising price pressures, inflation is still projected to remain above target in 2018. Staff see need for further tightening to address the risk of overheating and prevent higher inflation, and greater downward pressure on the currency. However, the authorities, see few signs of possible overheating in the economy, contrary to staff's assessment. We would appreciate staff's clarification on why they see signs of overheating in the Philippines economy whereas the authorities don't. We agree with staff that the pace of monetary tightening should depend on evolving external and domestic conditions and note the authorities' willingness to take further actions to help ensure inflation expectations are well anchored and that the inflation target for 2019 is achieved. In addition to the ongoing efforts to address supply-side factors of inflation, it is equally important to monitor potential demand-side inflation pressures as well.

The financial sector is sound and well-capitalized. However, the rise in corporate loan exposure and large data gaps, both, within and outside the banking system hinder proper and timely analysis. We welcome the authorities' implementation of several macroprudential tools, which include revising the guidelines on liquidity risk management, and their plan to introduce a framework for implementing banks' countercyclical capital buffer, as well as other measures geared to manage further concerns of credit risk. To this end, we look forward to the early approval and adoption of the Bangko Sentral ng Pilipinas (BSP) charter which would further strengthen the BSP in its effort to safeguard the banking sector. Staff and the authorities diverge on their assessment of the banks' credit exposure. The authorities view that the growth of credit to GDP ratio is supported by the demand of a growing economy and that the tools in place are appropriate to safeguard financial stability. Staff comments are welcome. We encourage addressing the data gaps that exist across the financial sector to facilitate BSP's ability to effectively regulate, supervise, and monitor any emerging potential risks originating within the system.

The Philippines' recent strong growth trends have not translated into significant reductions in poverty and inequality, thus highlighting the necessity of maintaining the reform momentum to foster more inclusive growth. We are thus pleased to note the authorities' reform progress to date, including easing the restrictions on foreign investment, switching to a tariff-based system for rice imports, and the proposed legislation that revenue from these tariffs be utilized to support farmers to further enhance their productivity and competitiveness.

We wish the Philippines authorities further success in their stabilization and reform efforts.

Mr. de Villeroché, Mr. Castets and Mr. Sode submitted the following statement:

We thank staff for an insightful report and Ms. Villa for her comprehensive buff statement. We commend the authorities for the continuous good performance of the Philippines economy and their sound economic management. Nonetheless, the authorities should step up their efforts unleash the growth potential of the country and to reduce the high levels of poverty and inequality which remain elevated compared to regional peers. As rightly identified by the authorities, resolving the longstanding infrastructure gap will be key. In parallel, further efforts are warranted on the structural front to improve the business climate, position the economy in high-productivity sectors and create better-paid jobs. While we agree with the thrust of staff appraisal, we would like to emphasis the following points.

On the fiscal front, the envisioned increased in government deficit to finance public investment should be conditional on a strict selection of projects to maximize the impact on potential growth. Given the relatively low track-record in term of public investment implementation, it will be key to improve public investment management along the lines suggested by IMF technical assistance. Could staff comment the authorities plan to use "hybrid" PPP and whether there exist good international practices in this domain? Moreover, while we commend the authorities for their ongoing tax reforms, the medium tax to GDP ratio will remain very low compared to peers. This indicates further room for domestic revenue mobilization which would help finance additional social and investment spending. Could staff elaborate on the prospect to further raise public revenues and whether the authorities consider additional DRM measures beyond the TRAIN program?

Monetary authorities should remain vigilant and be ready to implement further tightening if inflation picks up. Increased caution is notably warranted about inflation pressures potentially coming from the planned expansionary fiscal policy, from depreciation of the currency or from a desanchoring of expectations due to ongoing supply-side factors. We commend the authorities for their commitment to maintain a flexible exchange rate regime and their plan to improve the monetary framework. Regarding financial stability, closing the existing data gap is an absolute priority and the authorities should step up their effort in this direction. We also encourage the authorities to strengthen their macroprudential toolkit.

On the structural front, we commend the authorities for the reforms undertaken and in preparation - notably the national digital strategy - but encourage them to be more ambitious. The relatively low level of income per capita and relatively high levels of inequality and poverty mean that the Philippines have not yet fully reaped the potential offered by international trade and a dynamic regional outlook. Contrary to most neighbors, the transition from an agricultural economy has not been accompanied by a significant development of the manufacturing sector. Moreover, unemployment is high, and most workers are in low-paid service-sector job. We agree with staff that labor market reform could help create more and better jobs and wonder how staff assesses the executive order signed in May 2018 that tightens regulations on short-term employment contracts? Given the reported weakness of the business climate, notably regarding the market-access of foreign firms, we encourage the authorities to accelerate reforms in this domain by lifting existing restrictions. Improving the efficiency of the public sector will also be key to strengthen medium growth. In this regard, could staff comment on how it envisions the implementation of the Fund's new governance framework for the Philippines?

Mr. Virolainen and Mr. Gade submitted the following statement:

We thank staff for their report and Ms. Villa for her informative buff statement. With the help of sound policies and a favourable external environment, the Philippine economy has been one of the strong economic performers in recent years with high and stable growth, low inflation, and no major economic or financial imbalances. This solid performance is likely to continue if the authorities calibrate the policy mix to mitigate the overheating tendencies in the economy. In addition, we support staff's focus on the need to address poverty, inequality, and inclusion for sound and balanced long-term growth. We broadly agree with the staff appraisal and provide the following comments for emphasis.

The policy mix needs to be calibrated to mitigate the overheating tendencies in the economy. While the fiscal position appears sound, the deficit is increasing and the planned and projected fiscal stimulus for 2018 and 2019, combined with strong consumption and investment growth, and an overall positive output gap, comes with some risks of jeopardizing the high and stable growth performance of recent years. We support staff's recommendation of a neutral fiscal stance - centered on infrastructure investment and social spending, while the overall responsibility for stable inflation falls on the The Bangko Sentral ng Pilipinas (BSP). We strongly support the approval of the proposed amendments to the BSP charter, which, inter alia, would improve BSP's ability to control inflation. Recent global financial market volatility and its differentiated impact across countries show the importance of strong and credible institutions.

The financial system appears sound with well-capitalized banks, but the rise in corporate leverage on the back of low debt financing costs calls for continuous monitoring. The ratio of FX debt vs. local debt appears balanced, banks are reasonably capitalized, non-performing loans (NPLs) are low, and specific provisions to NPLs appear prudent. That said, the pace of credit growth and leverage need close monitoring, and we agree with staff that the counter-cyclical capital buffer should not be zero in an upturn with overheating tendencies in the economy. The amendment to the BSP charter would also be important to improve the monitoring and mitigation of financial risks.

The external sector analysis shows low vulnerability and that the Philippine economy is well-positioned to manage the effects of global financial tightening. The current account deficit is relatively small for a fast-growing economy, and the expected widening of the current account deficit is driven by a continued rise in capital goods imports, financed by FDI. We do not see this as posing any major risks. With a sound composition of foreign liabilities, a flexible exchange rate, and ample foreign reserves, we believe that the Philippine economy is well-positioned to manage the financial volatility as global financial conditions are expected to tighten further in the years ahead. We would, however, have appreciated more details on the impact of global trade tensions on the Philippine economy via the external sector. Finally, we appreciate that staff presents the current account gap and the REER gap as ranges, and with an understandably wider range for the REER gap.

We welcome the improvements in inequality over the recent years, but continued efforts are needed to bring down the relatively high levels of both poverty and inequality more forcefully. The poverty rate is moderately dropping, and it is positive to see that the poverty headcount ratio has not increased substantially through the upturn, as can be observed in some peers. Also, income inequality is lower but remains high compared to peers. We think the upturn provides a good backdrop for structural policies that more forcefully lower poverty and inequality as well as support greater inclusion. Since this is an important theme across the Fund, we would have appreciated a more dedicated analysis and recommendations from staff.

Finally, we encourage the authorities to consent to publication of the Article IV report.

Mr. Saito and Mr. Naruse submitted the following statement:

We thank the staff for the comprehensive reports and Ms. Villa for her informative statement. We welcome the fact that the Philippines has been one of Asia's strong performers over the past years, supported by sound policies and a favorable external environment. However, the country faces important challenges, including rising inflation, high credit growth, and persistent poverty and inequality. Going forward, we encourage the authorities to continue their efforts to balance growth and stability objectives, while fostering inclusion. As we agree with the thrust of the staff's appraisal, we will limit our comments to the following points:

Fiscal Policy

We observe that on current policies, fiscal policy would be expansionary in 2018-2019, with a fiscal impulse of 0.5 percent of GDP in 2018 and 0.2 percent of GDP in 2019. In the meanwhile, given the closed output gap, we encourage the authorities to review the staff's advice on the neutral fiscal stance to balance growth and stability objectives. In this regard, we take note of the staff's view that the neutral stance could be achieved by intensifying efforts on the revenue side and containing nonpriority spending, such as new hiring of public sector employees and non-urgent capital projects. Do staff think that the authorities could secure enough budget for priority infrastructure and social programs by cutting nonpriority spending?

On the revenue side, we welcome the effective implementation of the Tax Reform for Acceleration and Inclusion (TRAIN) since January 2018, which is expected to generate about 0.5 percent of GDP additional revenue in 2018 from excise tax increases, VAT base broadening, and administrative measures. At the same time, we note with concern that the TRAIN is regressive, with most of the revenue raised from consumption taxes. Given still high poverty and inequality, we support the importance of targeted public investment in physical and human capital. Moreover, we welcome the fact that the House of Representatives approved the second package of tax reforms. At the same time, we agree with the staff's view that any CIT rate reduction should be conditional on proportionate fiscal incentive consolidation to offset revenue losses.

On the spending side, we agree with the need for reallocating resources from nonpriority spending to social spending in order to effectively reduce poverty. Also, we agree with the importance of public expenditure management, such as selection and prioritization of capital projects, periodic review of ongoing programs and projects, and contingent liability management and oversight over the PPP.

Lastly, we are pleased to see that the Philippines' general government gross debt remains moderate and sustainable at 40 percent of GDP as of end-2017. We are encouraged by the staff's expectation that prudent fiscal management and strong growth are expected to reduce the general government gross debt-to-GDP ratio from 40 percent of GDP in 2017 to 36.5 percent in 2023. It is also encouraging that total external debt in the Philippines is expected to be sustainable with a relatively low share of foreign currency-denominated debt, in line with the authorities' debt management policy.

Monetary and Exchange Rate Policy

The recent tightening of monetary policy shows the Bangko Sentral ng Pilipinas's (BSP's) strong commitment to ensuring macroeconomic stability. Yet, the BSP should look to tighten monetary policy further. Given the positive output gap, rising inflation and inflation expectations, and high and sustained credit growth, we concur with staff that the BSP's recent decisions to raise its policy rate were appropriate. At the same time, we note the projection that inflation is projected at above the 4 percent upper target bound in 2018 and stay in the upper half of the target band (3–4 percent) during 2019–2020. We also note the staff's estimation that the real policy rate is below the neutral policy rate. Furthermore, we would like to encourage the authorities to monitor carefully the possibility of demand side pressures, further rising inflation expectations, and second-round effects, in addition to supply-side pressures. In this regard, we agree that further monetary policy tightening to anchor inflation expectations is needed. The exact pace of monetary tightening should depend on evolving external and domestic conditions.

We agree with the staff's appraisal that exchange rate flexibility should continue to support the economy's ability to adapt to external shocks. It is encouraging that reserves as of end-2017 were about eight months of imports, or about 204 percent of the IMF's reserve adequacy metric, and both approaches indicate that the reserves level is ample. The development in 2018 does not change the assessment, and we appreciate the staff's recent update that gross international reserves increased from US$76.7 billion at end-July to US$77.8 billion at end-August. We observe that staff assess that with international reserves more than adequate, the authorities should continue with the policy of allowing the exchange rate to move freely in line with market forces, while limiting foreign exchange intervention to avoid disorderly market conditions. While we agree with the staff's recommendation, we wonder why ample international reserves warrant the flexible exchange rate (para 21). We would welcome the staff's justification.

Financial Sector Policy

We welcome the fact that the financial system appears sound. We take note of the staff's assessment that banks' high capitalization and stable nonperforming loans, and low exposure to external and FX-denominated financing provide some buffer against financial stability risks. Also, we commend that the BSP has implemented macroprudential tools to pre-empt the buildup of risks to financial stability. We commend the BSP's efforts to revise its guidelines on liquidity risk management, implement targeted macroprudential policies to stem excessive credit growth in specific sector, and adopt the Net Stable Funding Ratio to enhance banks' ability to absorb liquidity stress.

Having said that, we are concerned that corporate leverage has increased. We note that the authorities think that new bank credit mostly directed to productive sectors. We would appreciate the staff's assessment on this authorities' view. While the pace of credit growth has slowed recently, we share the concern that the credit-to-GDP gap has widened, approaching early warning levels. Related to this, we note that the BSP plans to introduce the framework for implementing banks' countercyclical capital buffer (CCyB). In this regard, we agree with the need for clear communication with market participants, including on the methodology and comprehensive set of indicators that will be used to calibrate the CCyB.

Lastly, we note that financial intermediation by nonbank financial institutions is small but has grown rapidly in recent years. We also take note of the staff's assessment that data gaps exist to identify and monitor emerging systemic risks outside the banking system. Therefore, we encourage the authorities' efforts to strengthen the financial stability mandate of the BSP through an amendment to the BSP Charter which will grant the authority to obtain data and information.

Structural Reform

We support the authorities' efforts to sustain the reform momentum for fostering inclusive growth and attracting investments. We welcome the fact that a reform bill has been submitted to Congress, which would replace the current quota-based system for rice imports with one based on tariffs (35 percent). We agree with the need to support the affected small farmers. Therefore, we are pleased to see the authorities' intension that the proceeds from tariffs will be utilized to provide additional resources to farmers to further enhance productivity and competitiveness. Moreover, we agree with the importance of promoting competition by opening new sectors of the economy to foreign investment. In this light, as the authorities' statement mentions, we welcome the authorities' efforts to further liberalize investment through shortening the list of foreign investments subject to restrictions. Lastly, we note that the Ease of Doing Business Law has been implemented since May 2018, which requires all local government units to streamline procedures and shorten the processing time for government transactions. We hope that this could improve the business environment.

Mr. Leipold and Mr. Di Lorenzo submitted the following statement:

We thank staff for the insightful report and Ms. Villa for the well-written buff. We agree with the thrust of the staff's appraisal and offer some points for emphasis.

High inflation is the main downside domestic risk and monetary policy should act accordingly. Monthly inflation on an upward trend and the risk of unanchoring expectations require staying firmly on the current tightening path. Ample policy space provides scope to move the current rates closer to the neutral level, even after the recent rate hikes. A contribution to disinflation could furthermore come from the planned liberalization of the protected rice market in line with WTO rules, a welcome development at a time of rising global trade tensions. Exchange rate flexibility has served the economy well and should remain in place as an important stabilizer in case recent pressures on emerging markets were to intensify. Large reserves can be mobilized to smooth excessive volatility. As regards external risks, we were struck by the absence of any direct reference to China and a possible slowdown in its economic growth. Preliminary elaborations of the quantitative impact of a such a slowdown, also in case of a trade war "shock", as recently defined by the MD, would be welcome.

In addition to fighting inflation, a tighter monetary stance is also needed to tame rapidly growing corporate leverage. Addressing data gaps in this area is of paramount importance, not only – as stated in the report – to properly assess risks from outside the banking system, but also to strengthen supervision capacity, for instance on currency and concentration risks. We therefore strongly share staff's view that the proposed amendments aimed at strengthening the central bank's ability to obtain these data are a priority.

Tax and spending reforms can help to implement development goals without overheating the economy. Fiscal targets have been overperforming through an effective tax and budget management, contributing to a steady decrease in the public debt-to-GDP ratio. Even though this overperformance might continue also in 2018 and 2019, consideration should be given to staff's warnings on the risks stemming from an overly loose fiscal stance. In the authorities' investment drive it would therefore be appropriate to prioritize high-multiplier projects. Closing the investment gap with peers while preserving fiscal sustainability would require additional resources and addressing investment management constraints. The analysis of the distributional effects of different spending plans provide strong indication of the positive effects on output and wealth inequality of targeted investments in infrastructures. At the same time, it would have been interesting if conditional cash transfers to the poorest family (rather than an equally distributed lump-sum) had been assumed in the alternative scenario. Conditional transfers can also help to cushion in the short term the effect of the regressive tax reforms until positive effects of investments materialize. Noting the acceleration in the rate of potential output growth, we wonder how much of this estimation reflects the sizeable public investment effort and how much the population growth rate.

Mr. Inderbinen and Mr. Djokovic submitted the following statement:

We welcome the continued strong economic performance of the Philippines. Growth rates are impressive, also in regional comparison; the fiscal deficit has declined; government debt-to-GDP is moderate and on a downward trajectory; and international reserves remain at a comfortable level. However, as staff reports, the risks to the outlook are clearly on the downside. We note the differences between the authorities and staff on the cyclical position of the economy and the appropriateness of policy adjustment. We are grateful to staff for the good report, and also thank Ms. Villa for her clear and comprehensive buff.

Adjustment of the fiscal stance would be warranted. We acknowledge the Philippines' sizable infrastructure and social spending needs. We also note the commendable fiscal adjustment and the reduction in public debt achieved over the last decade. But the planned increase in the headline deficit will put additional pressure on monetary policy and increase the risks of an overheating. Staff make a good case for adjustment, which is rendered all the more convincing by the uncertain external outlook. We also concur on expenditure prioritization and tax incentive streamlining. The Philippines would benefit from further PFM and PIM reforms and we encourage authorities to build on the findings of recent Fund TA.

The BSP should be on the guard against increasing inflationary pressure. Against the backdrop of exchange rate depreciation and accelerating inflation, the recent tightening of the monetary stance was certainly warranted. We take good note that the BSP stands ready to take further action to maintain price stability. Removing monetary accommodation will be even more important if fiscal expansion continues. We welcome the ongoing work to further strengthen the monetary policy framework, and we encourage the authorities to advance with legislation to update the BSP Charter.

Vigilance is required against the build-up of financial sector risks. Banks are well capitalized, and the ratio of NPLs in the system remains low, as emphasized in the buff. However, credit to the economy has continued to grow rapidly, and is increasingly also being provided by non-banks. And, as staff indicate, corporate debt is on the increase. We thus welcome the macro-prudential measures taken by the authorities, as well as their consideration of further instruments, including a counter-cyclical buffer.

We encourage the authorities to strengthen their AML/CFT regime, building on the improvements made over the past years. We also take good note of the authorities' priority to advance the digitalization of the financial sector, as well as the measures taken by BSP to adapt the regulatory framework to fintech. Does the authorities' regulatory response include provisions to mitigate the integrity risks associated with fintech?

We welcome the decline in inequality and poverty. However, poverty remains high, also in regional comparison. Continued reforms are thus called for to promote inclusive growth. Removing barriers to investment and fostering competition would be helpful to that end. We note that the restrictions on FDI have been eased over the past years, and we are encouraged by the authorities' intentions to further liberalize the regime. The business environment would benefit from reducing non-tariff barriers to trade, as well as labor market rigidities. Could staff elaborate on the expected effects of the Ease of Doing Business Law?

Mr. Armas and Mr. Vogel submitted the following statement:

We thank staff for an insightful report and Ms. Villa for her helpful buff statement. We broadly agree with the thrust of the staff appraisal.

We welcome the Philippines' positive performance in recent years. The Philippines continues to be one of Asia's best performing economies, as pointed out by Ms. Villa, and high GDP growth rates continue to be robust. At the same time, the country faces substantial challenges considering the much less benign external scenario, particularly for emerging economies, and the Philippines' own problems, such as relatively high poverty rates and inequality.

We understand the authorities' position regarding the need for uninterrupted investment in infrastructure investment, although we find merit in the staff's recommendation to undertake a neutral fiscal stance. Although the country has some fiscal space, reflected for instance in its relatively low public debt-to-GDP ratio, emerging economies seem to have started a new phase with more economic and financial constraints, which would require additional caution. Staff's advice with regards to taxes and expenditures is timely. We agree with Mr. Villeroché, Mr. Castets and Mr. Sode that “the envisioned increased in government deficit to finance public investment should be conditional on a strict selection of projects to maximize the impact on potential growth”. Furthermore, we note the staff´s assessment that there is room to gradually expand social protection by reallocating resources from nonpriority spending. Could staff provide more details about nonpriority spending?

While we share the BSP´s recent decision to raise its policy rate, we would like to have a further explanation from staff on the differences of views between staff and the authorities on the overheating risks. In particular, what is the assessment of the current economic cycle in terms of output gap and labor market indicators? What is the estimation of current inflation expectation based on the indicators mentioned in paragraph 19? We also agree with staff on the importance of maintaining flexibility in the exchange rate system.

As previously noted, reducing poverty and inequality are critical challenges for the country. While we understand that what appears in paragraph 29 of the staff report does not constitute an exhaustive list, we believe that many more initiatives and ideas are needed to have a strong answer to this challenge.

With these comments, we wish Philippines and its people every success in their future endeavors.

Mr. Gokarn and Mrs. Dhillon submitted the following statement:

We thank staff for insightful report and Ms. Villa for the candid buff statement.

Philippines is one of the most dynamic economies in the East Asia and remains a consistent growth performer. Backed by sound economic fundamentals, growth at 6.7 percent in 2017 was anchored in strong exports, investment and demand. The economy is projected to continue its expansionary path and grow at 6.5 and 6.7 percent in 2018 and 2019. Nevertheless, challenges remain from rising inflation, higher oil prices and intensification of global trade tensions. Going forward, we expect the authorities to build on the economic dynamism and continue the current growth trajectory with an ambitious investment and social protection agenda. We broadly agree with the thrust of the staff report and would like to offer the following points for emphasis.

On the fiscal side, we note that the authorities are keeping their expansionary fiscal policy even as the staff recommends a neutral fiscal stance to balance growth and stability. Even as we acknowledge the priority for pro-growth spending on investment and social protection, we urge the authorities to remain mindful of the caution emphasized by the staff on overburdening monetary policy and containing inflationary pressures. Moreover, a balanced focus on revenue side dynamics and reallocating spending from non-priority programs should be adopted to develop buffers and to meet unexpected episodes, including those emerging from global financial conditions.

We agree that monetary policy tightening to anchor inflation expectations is needed. BSP's recent decisions to increase the policy rates and readiness to take further action to safeguard price stability are encouraging. Staff has indicated that the main risks to the inflation outlook would include additional upward adjustments of minimum wages, transport fares, and electricity rates. With inflation in August tipping at 6.4 percent, follow-through action to safeguard inflation targets by addressing demand-side pressures may be warranted. Have staff discussed a roadmap with the authorities on this?

The financial sector is sound and further macroprudential measures for financial stability should continue. We positively note that BSP regulations to safeguard the resilience of banks are in the pipeline and BSP has refined regulations to effectively respond to trends in digitization, fintech and technology-related risks. However, historic low borrowing costs have powered credit growth and corporate leverage has risen even as data gaps hinder a substantive analysis. But the authorities view the domestic banks' credit exposure as firmly supported by demands of a growing economy, with appropriate tools in place to safeguard financial stability. We invite staff comments.

Finally, Philippines must maintain the reform momentum for investment competitiveness and make productive investment in physical and human capital for inclusive growth. To this end, we welcome the steps taken on liberalizing investment and developing the capital market. In recent years, Philippines has made great strides in delivering inclusive growth and reducing poverty and efforts to achieve shared prosperity should continue. To conclude, we join staff in urging Philippines for a strengthened AML/ CFT Framework.

With these remarks, we wish the authorities the best in their endeavors.

Mr. Raghani, Mr. Nguema-Affane and Mr. Lopes Varela submitted the following statement:

We thank staff for their comprehensive report and Ms. Villa for her informative buff statement.

The Philippine economy has continued to grow strongly, supported by solid domestic demand and its outlook remains broadly favorable. However, some challenges may represent risks to the short-term outlook, notably accelerating inflation, less favorable external policy environment, and high level of poverty and inequality. Going forward, policy actions should thus continue to focus on striking the right balance between fiscal sustainability and growth, preserving financial resilience, and pursuing reforms to promote more inclusive and durable growth.

We commend the authorities' sound macroeconomic policies that led to the decline of the public debt from 52.4 percent of GDP in 2016 to 40 percent of GDP in 2017. We share the view that moving to a neutral fiscal stance would be appropriate given expected positive output gap. In this regard, while we welcome the authorities' envisioned plan to reduce infrastructure gaps and boost social spending in 2018-2019, we agree that this could be achieved through neutral fiscal measures to preserve fiscal sustainability, notably by improving revenue collection and restraining expenditures, as advised by staff.

We take note of the authorities' planned tax reform to make the system more efficient and transparent, including streamlining tax incentives and lowering the corporate income tax (CIT) rate from 30 to 25 percent. We would appreciate staff comments on the timeline for the implementation of the proposed CIT rate and its repercussions on growth. Would the intended cuts in tax incentives offset possible revenue's losses from reducing CIT?

The tightening of monetary stance is in our view appropriate and should be maintained to lower inflation and anchor inflationary expectations within the range target, especially in light of second-round effects expected from supply side pressures. The authorities should remain vigilant to source of pressures stemming from demand-side, including the rising wage pressure, and may need to tighten further the monetary stance to adapt to market expectations and inflation target. The authorities' commitment in this regard, as indicated in Ms. Villa's buff statement is welcome. We also take note of the staff's assessment that external position is in line with fundamentals.

We take note that the financial system remains sound. We welcome the launch of the Electronic Information Sharing project aimed to tackle current data gaps and the progress made in strengthening BSP's macroprudential and surveillance. However, we encourage the authorities to closely monitor risks associated with rising corporate leverage to ensure financial stability further. Besides, swift actions for the approval of the proposed amendments to the BSP charter should be considered.

We welcome the authorities' continuous commitment to advance their structural reform agenda. Easing restrictions on foreign investment, replacing the rice import quota, and financial inclusion initiatives are very positive developments that would undoubtedly foster infrastructure and private investment, and improve competitiveness. However, further steps to promote inclusive growth and reduce poverty will be of great importance. We thus agree with staff on the need to improve the business environment, notably by accelerating labor market reforms, investing in human and physical capital.

Mr. Sun and Ms. Lok submitted the following statement:

We thank staff for the comprehensive report and Ms. Villa for the informative buff statement. Supported by sound policies and a favorable external environment, the Philippine economy has continued to perform strongly over the years. Looking ahead, a more uncertain global economic and financial outlook calls for greater efforts to maintain a well-balanced and prudent policy mix to sustain the Philippines' growth momentum. We broadly agree with staff's appraisal and would like to make the following comments for emphasis.

The fiscal stance is rightly focused on infrastructure investment and social spending. We take positive note from the buff statement that improved procurement processes are in place for infrastructure spending. Overall, public infrastructure expenditure should build on strong governance, and be effectively prioritized and managed, such that its benefits to the economy can be maximized. Well-targeted social spending, in turn, would help ensure that these benefits are able to reach all parts of society. Going forward, noting staff's concern that the current fiscal plan may feed into price pressures, we encourage the authorities to stay vigilant and adjust as needed to minimize risks of overheating. Meanwhile, we look forward to further progress in the authorities' tax reforms to help enhance efficiency and effectiveness of the country's tax system.

The recent monetary tightening by the Bangko Sentral ng Pilipinas (BSP) is appropriate and should help anchor inflation expectations. We welcome the BSP's strong commitment to ensure macroeconomic stability and ongoing efforts to enhance monetary policy operation and transmission. As latest figures suggest continued inflationary pressures, the BSP should stand ready to take further tightening action as needed.

The Philippine financial system remains sound and the BSP's use of macroprudential measures have helped prevent the buildup of risks to financial stability. With an increasingly uncertain global financial environment, continued vigilance is warranted, and the approval of the proposed amendments to the BSP charter would strengthen the BSP's ability to safeguard overall financial stability. Could staff share on what communication issues were raised by the banking industry regarding the counter cyclical capital buffer proposal, and how the issues are being addressed?

We support the authorities' structural reforms, such as further liberalization of foreign investment and replacement of the rice import quota system, which will help improve the Philippines' business environment and competitiveness while increase inclusiveness. Digitalization presents an opportunity for the authorities to enhance efficiency in the economy and support financial inclusion. To fully reap the benefits of digitalization, it is important to create an enabling environment with appropriate investments in human and physical capital. Equally important is the mitigation of associated risks. Balancing between the two goals requires a comprehensive digital strategy, and we welcome the authorities' priorities as set out in Box 5. We encourage staff to continue to monitor the developments of the Philippine digital economy, and provide advice and support, where appropriate.

We wish the authorities every success in their policy endeavors.

Ms. Horsman, Ms. McKiernan and Mr. Hart submitted the following statement:

We thank staff for a clear and concise report, and Ms. Villa for a helpful buff. Both documents highlight the Philippines' robust growth, strong buffers, relatively low vulnerability to external volatility, as well as the authorities' commitment to sound macroeconomic policies. Regarding the latter, we welcome that there has been progress across the board on the recommendations from the 2017 AIV report, and a relatively close alignment on current policy priorities. With this in mind, we offer the following comments.

The Philippines appears to be in a good position to weather external shocks. Public and external debt levels are low and declining under the baseline, with limited FX exposures. A flexible exchange rate and ample reserves will contribute to the economy's resilience.

Macro-financial risks also appear relatively contained, an effort supported by recent and prospective macroprudential reforms. However, we take note of the growing credit gap. While there may not be evidence of a sector-specific boom, this warrants careful monitoring. Closing data gaps would also help support strengthened supervision of systemic risks.

We support the authorities' plans to increase public investment infrastructure and social support. Taking advantage of the Philippines' demographic dividend will require significant further investment in infrastructure (which is still low by regional standards). We note that the authorities are relying primarily on domestic financing sources for this effort, while investments from abroad are primarily in the form of FDI, both of which should reduce financing risks. Poverty and inequality remain pressing challenges, so we support an increase in well-targeted social spending, including for women and girls.

Partially offsetting this higher public spending with more robust revenues is appropriate. We welcome early signs that the authorities' initial tax reform package (TRAIN-1) is overperforming, with a follow-up package in the pipeline. We also appreciate staff's efforts to look at the distributional effects of TRAIN, but question the decision to use an "unproductive redistribution" scenario as the only comparator. Since the latter seems out of step with the authorities' stated intentions, we wonder whether a less extreme, higher-probability scenario could have been more useful for decision-makers. Staff comments would be welcome.

The recent surge in inflation may warrant a monetary response. Staff's helpful analysis of underlying inflation trends suggests that this may not simply reflect temporary factors. We encourage the central bank (BSP) to remain vigilant in keeping inflation expectations well-anchored, and welcome indications that they stand ready to take further action. We also support the proposed amendments to the BSP's Charter.

Finally, we encourage the authorities to maintain momentum on their structural reform agenda to foster inclusive growth. We noted with interest the government's digital strategy and welcomed its emphasis on financial inclusion and investing in people.

Mr. Johnston and Mr. Shin submitted the following statement:

We thank staff for their comprehensive set of reports on the Philippines and Ms. Villa for the informative buff statement. The Philippine economy has maintained strong growth momentum in recent years and is expected to continue its high growth trajectory of above 6 percent over the medium term. But risks are tilted to the downside with rising inflation and tighter global financial condition, in addition to challenges for still persistent poverty and inequality. We broadly agree with the staff assessment and have the following comments for emphasis and clarification.

Given recent signs of overheating, the policy mix of neutral fiscal stance and monetary tightening seems to be warranted. Despite the recent interest rate hike, high credit growth approaching early warning levels and fiscal easing could adversely affect inflation expectations and trigger second round effects. We also see the risk of further peso depreciation in case of continued monetary policy normalization of major central banks, which might add pressure with its pass-through effect on already high inflation that has surpassed the BSP's target ceiling. In this regard, we suggest the authorities carefully consider staff's recommendation of a more balanced policy direction for growth and stability and make adjustments in a gradual manner.

In face of growing external uncertainty, capital movement and volatility need to be closely monitored. The escalation of trade tensions, compounded with global liquidity tightening, could deliver a shock especially to small and open emerging markets economies, raising the concerns over broader contagion effect. Despite sufficient foreign reserves and relatively low external financing, a more cautious approach and contingency plan would be needed in managing the capital flows and foreign liabilities, as investor sentiments could change and reverse rapidly. Have staff done some work on the effect of peso depreciation in case of capital reversal on debt burden or inflation? Were there any specific backgrounds for shorter term structure in government financing this year?

While keeping a neutral stance and improving efficiency, fiscal policy should focus on improving the quality of infrastructure and welfare system. We concur that significant need to fill the gap for infrastructure and social protection exists, given the Philippines' still low overall public investment level compared to Asian peers. However, this spending needs to be matched by additional revenue mobilization in line with the authorities' ongoing Comprehensive Tax Reform Package to prevent the possible overheating and preserve the financial stability. Also, we suggest the authorities fully utilize the lessons from recently concluded technical assistance through PIMA to ensure program prioritization and maximize the return on investment.

Structural reforms to improve the business environment is key to tackle poverty and raise growth potential in the longer term. We welcome the authorities' plan to further liberalize foreign investment through shortening the negative list subject to restrictions. Furthermore, reducing the overall state control and regulation would help create quality jobs in the private sector and improve productivity. Further developing the domestic capital market would also be necessary to lower the financing costs and better support the national infrastructure initiative.

Mr. Bayar and Mr. Hagara submitted the following statement:

We thank staff for their report and Ms. Villa for her informative buff statement. The Philippines' economic growth has remained robust, led by strong public investment and a favorable external environment. Nevertheless, to sustain these solid growth rates over the medium term; the increasing signs of the economy's overheating, including rising core inflation and inflation expectations, increasing capacity utilization, a wider current account deficit and broad-based high credit growth, warrant caution and a tighter policy mix. We broadly concur with staff's appraisal and would like to add the following points.

Expansionary policy should be avoided at the current stage, while rebalancing towards a more growth-friendly and efficient fiscal mix should continue. Owing to prudent fiscal policy, the public debt-to-GDP ratio has been reduced by around 30 percentage points compared to the beginning of 2000s, and put on a sustainable declining path. Nevertheless, the economy at the current juncture does not need further stimulus, and against a global backdrop that is increasingly epitomized by downside risks, we strongly encourage the authorities to reconsider their fiscal expansion plans by containing non-priority spending and continue to build fiscal buffers. We welcome the authorities' tax reform plans, intending to further simplify the tax system and streamline the tax incentives, which allows reducing the CIT rate in a budget neutral way. Similarly, there is scope to reallocate expenditures from non-priority arrears towards more spending on the Philippines' developmental needs in education and healthcare as well as to better targeted social transfers. We wonder, in this regard, whether the very high volatility in the fixed capital formation figures is a consequence of an underlying fiscal policy choice. Staff comments are welcome.

We concur with staff that further monetary tightening is needed to anchor inflation expectations and the flexible exchange rate should remain the economy's main defense to external shocks. Inflation acceleration above the BSP's target - partly on the back of supply-side factors, rising inflation expectations and core inflation - calls for the authorities' vigilant approach. The real interest rate seems to be below the neutral rate, also pointing to the need for further monetary policy tightening. The appropriately high level of Philippines' international reserves is welcome and we agree with staff that the foreign exchange interventions should be limited to cases of excessive market volatility smoothing.

While the financial sector seems sound with low non-performing loans, the longer-lasting strong credit growth requires the authorities to be alert. Leverage of listed corporates increased rapidly in 2016 amid strong credit growth, while data gaps prevent effective monitoring and identification of risks by the BSP. Against that backdrop, amendments to the BSP charter, addressing data gaps, as well as stepping up the macroprudential framework and measures in a forward-looking manner seem warranted.

Mr. Palei and Mr. Potapov submitted the following statement:

We thank staff for the insightful report and Ms. Villa for her informative buff statement. In the face of the challenging external environment, the Philippine economy demonstrated resilience and continued strong growth. The growth rates of around 6.5 percent over the recent years were among the fastest in the Asian region. This favorable growth performance is supported by continued robust private demand and increased public spending. Despite these positive developments, the Philippine authorities continue to face deeply rooted structural deficiencies, such as high poverty and inequality, poor infrastructure, and relatively low human capital. These challenges are exacerbated by a less benign external environment, including tighter financial conditions, portfolio outflows, sustained pressures on the peso, and higher oil prices. We broadly agree with staff's appraisal and would limit our comments to the following points.

According to the staff analysis, with output growth at 6.5 percent and inflation exceeding the 4 percent upper target bound, the economy is already above its potential. Moreover, external vulnerabilities of the economy can be exacerbated by the prospects of gradually rising global interest rates and abrupt changes in investors' risk appetite. To preserve buffers against possible adverse shocks and limit overheating risks, we support staff's advice to adjust fiscal policy to a neutral stance over 2018-19, implying a smaller fiscal deficit than currently projected in the baseline scenario. Enhancing tax revenue mobilization and containing nonpriority spending would be necessary to support pro-growth infrastructure investment and expansion of social protection. On the revenue side, staff highlighted potential yields from streamlining tax incentives and enhancing the VAT refund system. On the expenditures side, there is scope to strengthen public investment management, as well as rationalize unconditional cash transfers. In this respect, we welcome the authorities' assurances that many of these measures are already under implementation or consideration. It is encouraging that the recently implemented tax reforms under TRAIN-1 have already started to bear fruit.

Bringing inflation under firm control is the authorities' key priority. Against the background of elevated risks to the inflation outlook, the BSP has rightly started tightening of monetary policy in May this year. The surge in headline CPI inflation in August together with rising inflation expectations may point to the need of further actions on this front. At the same time, we agree with staff that the pace of monetary tightening should depend on evolving external and domestic conditions. It is also encouraging that the risks of external shocks to the Philippine economy are mitigated by substantial foreign exchange reserves.

While the financial system remains robust, credit growth and concentration risks in conglomerates warrant the authorities' close attention. We note that the BSP has managed to slow down credit growth from 19.6 percent in 2014 to 16.6 percent in 2017 by introducing macroprudential measures. However, in 2018 credit growth is expected to jump to around 20 percent (y/y). Although sector-specific credit boom indicators do not yet raise an alarm, the credit-to-GDP gap continues to rise, approaching the early warning levels. In this context, we welcome the recent BSP's additional macroprudential measures, as well as its plans to introduce a framework for countercyclical capital buffers. We also encourage the authorities to accelerate the initiatives aimed at closing data gaps in order to strengthen monitoring of emerging systemic risks inside and outside of the banking system.

Implementation of structural reforms is critical to reducing poverty and inequality, strengthening private sector development, and improving the business environment. Philippines's low ranking in the 2018 Doing Business Database points to the scope for more ambitious structural reforms. We welcome the authorities' focus on competition, labor market regulation, financial market development, and public finances. Over the recent years, the authorities have made important progress in improving export diversification, as reflected in the index of exports complexity. Further opening of the economy to foreign investment will help foster its competitive edge.

With these remarks, we wish the Philippine authorities success.

Mr. Gonzalez submitted the following statement:

We would like to thank staff for their insightful report and Ms. Villa for an informative buff statement.

We are pleased to see Philippines' robust performance. With growth continuing its upward trend and close to potential, unemployment cut by half and inflation close to BSP's target band—albeit slightly above—the country has managed to sustain an impressive performance for over a decade and become one the strongest economies in emerging Asia. Beyond favorable external conditions, authorities have played a critical role in supporting these outcomes by taking a longer-term view and focusing their policy on strengthening the economy. Furthermore, the outlook is favorable as risks remain tilted to the downside and the country seems to have the necessary tools to maintain performance and deal with domestic and external risks.

We broadly agree with the analysis presented but note some key differences between authorities and staff. Staff's estimate of a positive output gap, rising inflation and inflation expectations, and credit rising faster than economic growth are all consistent with an economy beginning to overheat. This should be given special attention since policy continues to be supportive of expansion and private demand shows no signs of abating. Yet, authorities are reported not seeing significant evidence of overheating and are confident they will be able to cope with the identified external risks without major changes in policy. Could staff provide more detail on these differences and on the implications they see for macroeconomic performance if the current policy mix is not adjusted as advised in the report?

On the fiscal side, greater prudence seems a more appropriate course of action. In the next two years, authorities are planning a fiscal impulse of 0.5 and 0.2 percent of GDP, respectively, to support infrastructure and social spending plans. This impulse comes after the policy decisions of the past decade effectively lowered public debt to GDP by more than 12 percentage points and helped open significant space to increase spending. We find ourselves, however, in agreement with staff's recommendation of following a neutral stance since it will not imply sacrificing key infrastructure investment, it will put less pressure on monetary policy to deal with signs of overheating, while still leaving room to lower nonpriority spending. It will also preserve a valuable tool if adverse and larger-than-expected shifts occurred in the external environment.

Furthermore, the report identifies several areas that could support key spending while preserving the existing fiscal space—including the planned tax reform, spending relocation and public expenditure management. Could staff provide additional information on these and specify the impact they would have—especially tax reform—on fiscal balances?

On the monetary side, we acknowledge that the recent rise in inflation has been caused mainly by supply-side factors, although we see a case for re-anchoring expectations through a less accommodative monetary policy. We are pleased to see monetary authorities' strong willingness to undertake further action, commitment to a flexible exchange rate, and the apparent strength of the banking system. We wonder, however, to what extent the reported "lack of timely data that has hampered BSP's ability to identify and monitor emerging systemic risks outside the banking system and formulate more targeted policy measures" is masking a more accurate understanding of the true state of financial system risks and the need for more urgent actions. Staff's comments are welcome.

Finally, we see the structural reforms going in the right direction to improve the business sector environment and strengthen the economy, and would like to commend authorities for their efforts in pursuing inclusive growth and in committing to the strong policy framework that has helped sustain such a strong performance.

Ms. Pollard and Ms. Svenstrup submitted the following statement:

The Philippine economy continues to experience strong economic performance, with robust growth and a sound fiscal position. Yet, rising domestic and external risks, particularly the possibility of tightening global financial market conditions, underscore the importance of a well-calibrated policy mix. Further policy effort is also needed to address poverty and inequality. We generally agree with staff's analysis and recommended policies and provide the following comments for emphasis.

The authorities' reform efforts and sound fiscal management have helped reduce public debt to a more sustainable level and finance growth-enhancing infrastructure initiatives. We concur with staff that a neutral fiscal stance is warranted to lessen the burden on monetary policy and preserve buffers in the context of emerging vulnerabilities, assuming that planned adjustment measures do not negatively impact growth. We agree in principle that the planned tax incentive reform, enhancement of the VAT refund system, and strengthening of the international taxation framework will help achieve this goal. However, it was not clear to us if staff are proposing further measures beyond those listed in Table 10. Further, while we appreciated Box 1 on the distributional impacts of TRAIN, we would have valued a similar discussion of any additional recommended adjustment policies, including distributional impacts and political/technical feasibility. Staff comments would be welcome.

A sound public investment management framework will also be necessary to prioritize projects and streamline the infrastructure investment plan, and we are pleased to see that staff recently completed a PIMA. Could staff share some of the key findings of the PIMA, including areas of deficiency and planned reforms?

Given the rise in inflation, the BSP's recent rate hike was sensible. Although we note that supply-side factors have been driving higher inflation to date, we urge the BSP to continue vigilantly monitoring the situation and to stand ready to tighten further if needed. Exchange rate flexibility should continue to be the main shock absorber, particularly given the country's comfortable reserves position. Further, we welcome recent domestic capital market enhancements and market and FX liberalization reforms, which will help strengthen monetary operations.

The Philippine financial system appears to be sound and well-capitalized. Nonetheless, given the infrastructure investment drive, it will be important for the authorities to better understand – in part with better data – and closely monitor rising corporate leverage. We also agree with staff that the approval of the BSP's charter and further efforts to ensure the proper macroprudential tools should be priorities.

Finally, we broadly agree with staff's recommended structural policies to improve the business environment and make growth more inclusive. In particular, further easing of restrictions on foreign capital and operators are critical to increased private sector dynamism and create jobs.

Mr. Daïri and Mr. Badsi submitted the following statement:

We thank staff for the well-written report and Ms. Villa for her informative statement.

The Philippine economy continues to perform strongly, with high economic growth, low inflation, and declining unemployment. While increasing somewhat in 2017, the current account deficit remained low and was mainly financed by FDI, international reserves are more than adequate, the fiscal position remained strong, and public debt is moderate. This performance owes much to sound policy implementation, supported by a favorable external environment. While the outlook is for continued strong performance, risks are skewed to the downside, in view of recent acceleration of inflation, high credit growth, and a less favorable and uncertain global environment. We concur with the thrust of the staff appraisal.

We commend the authorities for their prudent fiscal management that helped bring down the public debt to more sustainable levels. We encourage them to give consideration to staff call for a neutral fiscal stance to support monetary policy in containing inflation, while creating room for increased social spending and improving spending prioritization. Maybe the authorities could consider maintaining their fiscal deficit targets only to the extent that progress is made in reducing inflationary pressures. Staff may wish to comment. Stepping up the implementation of the planned tax incentive reform and improving tax administration will be important, and we agree with staff that a reduction in corporate tax rates should be offset by gains from the tax incentive reform.

While the supply side measures implemented by the authorities should help ease inflationary pressures, we welcome recent increases in policy rates and the BSP’s readiness to take further action as needed to contain inflationary expectations. We commend the authorities for the progress made in implementing the interest corridor system. We agree that the external position is broadly in line with fundamentals and desirable policies. While continued exchange rate flexibility will be helpful, the impact on inflation of sustained pressures on the peso should be carefully monitored.

The banking sector is sound and well capitalized, with low NPLs, although increased corporate leverage requires close attention. We welcome the implementation of macroprudential tools aimed at safeguarding financial stability and call on the authorities to speed up the approval of the proposed amendments to the BSP charter. We commend the authorities for the progress made in supporting responsible fintech innovation and upgrading the regulatory framework, as highlighted by Ms. Villa.

The need of deep structural reforms to promote inclusive growth, address high poverty and reduce inequality is key. We take positive note of the progress made in improving the business climate and look forward to further shortening of the Foreign Investment Negative List along with the adoption by Congress of the reform bill to replace the quota-based system for rice imports with tariffs. We commend the authorities for the recent adoption of the law on the ease of doing business, which aims at streamlining administrative procedures, as well as for their efforts in fighting corruption.

With these remarks, we wish the Philippine authorities continued success.

The Acting Chair (Mr. Furusawa) expressed his sympathy for the loss of life caused by typhoon Mangkhut.

Mr. Saito made the following statement:

We thank the staff for the comprehensive report and Ms. Villa for her informative statement. I would also like to express our sympathy to those affected by the recent typhoon.

Turning to recent economic performance, we are pleased to see that the Philippines continue to be one of Asia's best performing economies, with 78 consecutive quarters of positive growth, according to Ms. Villa's buff statement. As we have issued a gray statement, I would like to offer three comments for emphasis.

First, on fiscal policy, we note that the authorities are mindful of the need for infrastructure spending. However, given the closed output gap, we concur with the staff that the neutral fiscal stance is warranted to lessen the burden of monetary policy. To this end, intensifying efforts on the revenue side and containing non-priority spending would be needed. At the same time, we underscore the importance of strengthening public investment management in line with the Fund's technical assistance (TA).

Second, on monetary policy, we support the central bank's recent decisions to raise its policy rate. However, inflation is projected to remain above the target, and the real policy rate is still below the neutral rate. While we note that supply-side factors have been a driving force so far, we encourage the authorities to monitor carefully demand-side inflation pressures, inflation expectations, and second-round effects of supply shocks and to stand ready to tighten monetary policy if needed.

Finally, on the financial sector, we note with concern that corporate leverage has increased and the credit-to-GDP gap has widened, approaching the early warning levels, according to the staff report. We commend that the Bangko Sentral ng Pilipinas (BSP) has implemented macroprudential tools, and we look forward to seeing the successful introduction of the framework for countercyclical capital buffers. That being said, together with addressing excessive credit growth, to vitalize investment in growth sectors is also a critical issue. The staff's written responses to technical questions suggest that the bank loans are well diversified, but they did not mention credit quality or whether credit is allocated to the productive sectors. We would like to ask the staff on whether bank loans are directed to growth sectors and contribute to the enhanced productivity.

Mr. Virolainen made the following statement:

I would also like to express our sympathies to the authorities for the recent events. I thank the staff for the good report and Ms. Villa for her informative buff statement. We issued a gray statement, so I will just highlight a few issues for emphasis.

We commend the authorities for the solid economic performance in recent years with high and stable growth, low inflation, and no major imbalances. In view of the strong consumption and investment growth and overall positive output gap, we urge the authorities to consider adjusting fiscal policy toward a more neutral stance while continuing to support infrastructure investment and social spending.

With rising inflation, we also see merit in the staff's recommendation to further tighten the monetary policy stance to prevent the economy from overheating.

We take positive note of the fact that the external sector analysis indicates relatively low vulnerabilities. The Philippines should thus be well positioned to manage the impacts of global financial tightening. A flexible exchange rate supports the ability to adapt to external shocks. The financial system appears to be sound with well-capitalized banks, but the rise in corporate leverage calls for careful monitoring. We ask the authorities to implement the proposed amendments to the BSP charter to improve the monitoring and safeguarding of financial stability risks.

Finally, we welcome the improvements in inequality over the recent years, but further efforts are needed. The current upturn provides an opportune moment to implement further structural reforms to more forcefully lower poverty and inequality, as well as support greater inclusion.

Mr. Bayar made the following statement:

We would like to join previous Directors in expressing our condolences to the people of the Philippines and our deepest sympathy for those who are affected. We hope that the people and the government of the Philippines will be able to recover as soon as possible.

On the Article IV consultation, we thank the staff for the informative set of papers and answers to our technical questions and Ms. Villa for her helpful buff statement. The Philippines’ economic performance has remained remarkably strong over an extended period of time. Owing to the authorities’ sound policies and favorable external environment, the Philippines experienced a long track record of robust growth with sustained price stability. The public debt has been significantly reduced, and the country has accumulated adequate reserve buffers. Against these buffers, while we understand the authorities’ comfort about the strength of the economy and the buffers they have built over time, we still would encourage them to err on the side of caution in an environment that is increasingly more challenging for emerging market economies. Currently, the Philippines’ economy does not need additional macroeconomic stimulus, and there are some nascent signs of overheating. Against rising inflation expectations, further increase of policy rates toward this neutral level seems warranted. We support the authorities’ focus on structural reforms to sustain high growth rates beyond the medium-term horizon. The planned budget-neutral shift toward a more growth-friendly tax mix is also welcome.

Finally, the authorities should focus also on the prioritization of investment spending, as well as increased use of well-targeted social transfers. With those remarks, we would like to express our best wishes and good luck to the authorities in their endeavors.

Mr. Inderbinen made the following statement:

I would like to join the Acting Chair and Directors in expressing our sympathy with the authorities over the damage and loss of life caused by the typhoon that has hit the northern Philippines two days ago. We thank the staff for the good documents and Ms. Villa for her candid buff statement, and we are also grateful to the staff for the written responses.

In our gray statement, we commended the authorities on the good economic performance with high growth, reduced public debt, and ample buffers on the monetary side. On fiscal policy, we also acknowledge the substantial adjustment that has been achieved over the last decade. However, like the staff, we see the need to shift to a more neutral stance, as also emphasized by Mr. Virolainen.

We note the differences between the staff and the authorities, and maybe the staff could elaborate on where the differences primarily lie. Is it primarily on diagnostics, on the phase of the cycle in which the economy is at, or is it more of a difference in the policy response that is called for, and the compatibility of this response with the authorities' important infrastructure agenda?

We also are not quite clear on how large the differences are, with the staff reporting in paragraph 18 of the report that the authorities were open "to review" the advice that they were giving; but the buff statement, on the other hand, underlined that the expansionary fiscal stance will be maintained. The staff's comments would be appreciated.

On the financial sector, we are grateful for the answer to the question we asked on the inclusion of provisions to mitigate integrity risks and the authorities' plan to advance with digitalization; and like others, we encourage further progress in strengthening the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime, building on the achievements the authorities have made over the past years. With that, we wish the authorities well.

Mr. de Villeroché made the following statement:

I thank the staff for the report and for the answers to our written questions. We commend the authorities for the recent economic performance and their sound macroeconomic management. While important progress has been made in recent years, the economic potential of the Philippines remains largely untapped, and further efforts are needed to reduce poverty and inequality.

I would like to stress the following points. On fiscal policy, while we welcome the authorities' plan to increase infrastructure and social spending, the funding of such needs should be ensured for enhanced tax revenues. We see a need to go beyond the ongoing tax reform and to plan a medium-term strategy to increase public revenue and improve the efficiency of the tax administration.

On structural reforms, while we commend the authorities for their ambitious digital plan, we encourage them to be more ambitious as regards openness and trade policy. Given the buoyant regional trade environment, the Philippines could be much more integrated into global and regional value chains. In this regard, it is notably necessary to step up efforts to open the economy to foreign investment, notably by reducing the Foreign Investment Negative List.

Finally, on governance, we encourage the authorities to fully implement the Ease of Doing Business Law and the Philippine Competition Act. Building on these important milestones, it is important to go further by improving administrative efficiency and reducing corruption. We expect that the rollout of the Fund's enhanced governance framework will enrich the policy dialogue with the authorities in this domain next year.

The staff representative from the Asia Pacific Department (Mr. Breuer), in response to questions and comments from Executive Directors, made the following statement:[1]

I thank Directors for their questions. On the question about credit growth, while credit growth is supportive of economic growth, it needs to be watched carefully because it has been rapid for a number of years. Credit allocation is diversified, asset quality remains very good, with low nonperforming loans that stand at 1.3 percent of total loans. We also gathered some anecdotal information while on mission and in meetings with banks and corporates that the increase in recent corporate borrowing from the domestic banking sector was to reduce external liabilities, so this is probably good; but in light of experience of other countries, we are monitoring credit growth quite closely.

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

In terms of the views of the authorities versus the staff, there is a significant amount of agreement, including on the diagnosis of inflation and on the importance of adapting monetary policy to better anchor inflationary expectations. The staff believes that fiscal policy should also play a role in containing inflation while the authorities give more priority to completing the infrastructure projects that were initiated. It might well be that by the end of the year, the outcome of the fiscal deficit is somewhere in between what the staff is suggesting and what the authorities are targeting for two reasons. First, tax collections are doing well; and second, project execution has improved substantially in the Philippines, but it is not at 100 percent. There might be some margin on the spending side.

The staff representative from the Strategy, Policy, and Review Department (Ms. Duttagupta) noted that the staff was considering corrections to the staff report: on paragraphs 26 and 27 on page 12; on a table on page 31; and on paragraph 11 on page 8. The corrections were being considered under the Transparency Policy, and fell under the categories of factual errors and/or evident ambiguity.

Mr. Daïri made the following statement:

I join the Chairman and other Directors in expressing our sympathies and condolences to the Filipino people.

We raised a question in our gray statement about the difference between the staff's recommendation and the authorities' projections for the budget for 2008-19. We indicated that since the debt is moderate, maybe there should be some flexibility in the staff's advice. If there is progress on inflation and if inflation is doing better than expected, maybe the staff could consider that the deficit could go up to what the authorities would like to see, because they obviously did not want to reduce public investment, and they are right about that. Of course, if overheating risks are confirmed, there is no such margin for maneuver. But if they are not confirmed and if things improve on the inflation side, maybe the authorities will be right to stick to their investment and budget deficit plans.

Ms. Villa made the following concluding statement:

I thank Directors for their thoughtful gray statements, and on behalf of my authorities, we appreciate deeply their words of sympathy. We also appreciate their interventions on the staff report. We greatly value this, and I shall faithfully convey them to my authorities.

The Philippine Article IV staff report last came to the Board for discussion two years ago, almost to the date, September 14, 2016. Since then, the Philippines has continued to strengthen domestic policy frameworks, taking careful consideration of Fund advice. On fiscal policy, the authorities have implemented the Fund's recommendations, including raising the fiscal target to 3 percent and increasing capital outlays for infrastructure. We have also since then put into effect the Tax Reform for Acceleration and Inclusion (TRAIN), the first in a series of measures under a comprehensive tax reform program. Revenue overperformance, however, caused the actual deficit to fall short of the target. The actual outturn in 2017 was 2.2 percent instead of 3 percent.

We have also completed a Public Investment Management Assessment (PIMA), which should in time capacitate national and regional authorities to rightly prioritize infrastructure and social spending to get the most bang from the buck, so to speak. The procurement process in the Philippines continues to be refined. The PIMA-related TA is a significant part of this refinement. As Mr. Sun and Ms. Lok, Mr. de Villeroché, Mr. Castets, and Mr. Sode pointed out in their gray statements, the fiscal stance of the country is rightly focused on infrastructure and social spending, which must be built on a strong governance structure.

In the last two years, the Philippines has, with TA from the Fund, introduced the interest rate corridor, subsequently refining its operations therewith allowing the BSP to reduce its reserve requirements, which are among the highest in the region. Together with improvements in the domestic capital market, which were also conceptualized with TA from the Fund, the reduction in reserve requirements paves the way for more market-based monetary operations.

Also, in the last two years, the BSP set up a financial stability department, now called the Office of Systemic Risk Management. This office has provided the academic underpinnings for the macroprudential measures that the BSP has thus far adopted, as well as those in the pipeline that I mentioned in my buff statement. The BSP, in collaboration with other financial regulators, is working to improve data capture to address gaps in financial and regulatory data. During all this time, the economy continued to expand in a non-inflationary environment. Potential output has subsequently risen. External debt sustained its downward trajectory with the current account turning to a deficit, reflecting a growing economy.

Today, however, we find ourselves in an environment that is less favorable than that two years ago. The authorities are cognizant that these uncertain times and elevated volatility cannot be faced with a business-as-usual attitude, thus, my authorities welcome the engagement with the Fund through the Article IV process. The analytical work presented by Mr. Breuer's team was high-quality and refreshing, providing authorities with new perspectives.

While there may be differences in the appreciation of the impact of certain risks on the domestic economy, and therefore the timing of policy actions, my authorities will continue to take Fund advice thoughtfully into their regular assessment of macroeconomic developments and their impact on both fiscal and monetary policies. We assure the Board that as we review our economic growth targets, their comments shall be considered based on the imperatives of keeping the momentum of economic growth, stabilizing inflation, and maintaining fiscal sustainability.

As many Directors noted, the Philippines has a large infrastructure gap. By its nature, filling infrastructure gaps has a long gestating process, often requiring lumpy investments. Therefore, policymakers need to take a policy horizon that goes beyond one or two years. A medium-term perspective that is well communicated and does not switch gears too often also engenders stability to investors. My authorities are acutely aware that if the Philippines wishes to truly go beyond being aspirational with regard to enlarging the economic pie and raising the quality of life for more, policies must be crafted with a correct balance between capital and social spending in the context of a resource envelope that will maintain the downward debt trajectory.

My authorities shall therefore pursue subsequent packages of TRAIN. We would rather minimize the need for borrowed stimulus for expanding our productive capacity. With a good balance of tax policy and public spending, we expect to address such a large infrastructure gap while maintaining good debt metrics. We shall continue to keep our ears close to the ground for any additional threat to price inflation and undertake strong monetary action and timely non-monetary measures as well to keep inflation expectations anchored to the government target, ensure the equanimity of the foreign exchange market, stabilize the peso, and minimize the pass through to inflation. This monetary direction, coupled with appropriate micro and macroprudential measures, should address any financial stability concerns and limit the risk of potential overheating.

Our real estate sector remains promising given the persistently large demand for residential housing supported by a young demographic advantage. Our current and trade positions, while showing some shortfalls, remain manageable. Our imports to sustain growth and capital transactions mostly for debt repayments and outward investment to increase our foreign assets are the main factors behind the deficit in the overall balance of payments. The authorities believe that the deficit can continue to be financed by net inflows of foreign investment and portfolio investments on top of the regular support from both remittances and business process outsourcing revenues. The peso remains flexible, allowing for effective management of external domestic shocks, and our reserves continue to be more than adequate. Macro-fundamentals have been sustained with strong support from healthy financial intermediation.

Finally, we shall continue to strengthen the regional financial cooperation to achieve greater resiliency in the face of mostly external challenges to our public policy, particularly in light of deepening trade and financial links with our neighbors.

As I end, I wish to express on behalf of my authorities our sincere appreciation to the Fund team, the mission chief, Mr. Breuer, his calm and well-composed deputy mission chief, Mr. Karam, and their talented specialists Mr. Kim and Mr. Guo. This is a good team that meshed skill and professionalism with candor, diplomacy, and sincerity, key elements that ensure that the Fund fulfills its role of a trusted outside advisor. I thank Mr. Breuer for his leadership. We look forward to building on this collaboration in the years to come.

The Acting Chair (Mr. Furusawa) noted that the Philippines is an Article VIII member, and no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for the strong economic performance owing to sound macroeconomic management and continued reforms to promote inclusive growth. Directors noted that short-term risks have increased from rising inflation and a less favorable external environment, and underscored the need to adjust the policy mix to address these risks. Nonetheless, the medium-term economic outlook remains favorable, placing the Philippines in a good position to tackle still-elevated poverty and inequality.

Directors broadly urged the authorities to consider adjusting the fiscal stance over 2018-2019 to continue to support pro-growth infrastructure investment and social spending while containing nonpriority spending, in order to avoid overburdening monetary policy. They stressed the importance of careful selection and management of infrastructure projects to maximize their impact on growth.

Directors supported the authorities' reforms to make tax incentives more effective in achieving national policy goals and improve economy-wide productivity. Enhancing the VAT refund system and strengthening the international taxation framework will also be steps in the right direction. Directors suggested complementing these reforms with enhanced social protection.

Directors welcomed recent decisions of the Bangko Sentral ng Pilipinas (BSP) to increase the policy rate and its announced readiness to take further actions to safeguard price stability. In this context, they recommended carefully monitoring both supply-and demand-side pressures. They also welcomed the BSP's decision to delay the bank reserve requirement cuts until inflation expectations are more firmly anchored. Directors supported the authorities' policy of allowing the exchange rate to move freely in line with market forces, while limiting foreign exchange intervention to address disorderly market conditions. They welcomed the recent launch of national retail payment systems and the progress made with domestic capital market and FX liberalization reforms.

Directors noted that the financial system appears sound. They welcomed the BSP's recent macroprudential measures to safeguard financial stability against systemic risks and noted the need for continued vigilance. While the pace of credit growth has slowed recently, the credit-to-GDP gap has widened. In this regard, Directors supported the BSP's plan to introduce a countercyclical buffer for banks and underscored the need to close data gaps on nonbank financial institutions and conglomerates. Directors encouraged the approval of the amendments to the BSP charter.

Directors welcomed the progress made by the authorities on structural reforms and encouraged them to deepen the reform efforts in seeking broader economic benefits. They supported the authorities' plan to replace the rice import quota system with one based on tariffs, while emphasizing the need to support small farmers affected by the reform. Directors noted the need to promote competition by opening new sectors of the economy to foreign investment, improve the business environment through better infrastructure, create more and better jobs through investment in human capital and labor market reforms, and modernize the bank secrecy legal framework.

It is expected that the next Article IV consultation with the Philippines will be held on the standard 12-month cycle.

APPROVAL: March 5, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook and Risks

1. Preliminary elaborations of the quantitative impact of a such a slowdown, also in case of a trade war "shock", as recently defined by the MD, would be welcome.

- While the impact of a China growth slowdown through the trade channel alone is expected to be limited, with an estimated growth elasticity of about 0.25, the impact could be magnified by weaker confidence and tighter financial market conditions. Assuming China's policy response under this scenario and some spillovers through non-trade channels, we expect the Philippines' growth to drop by 0.1 ppt in 2019 in response to a 0.2 ppt drop in China.

2. We would appreciate staff's clarification on why they see signs of overheating in the Philippines economy whereas the authorities don't.

- Staff's emphasis is on higher overheating risks, as a result of adjustments in excise taxes, rise in global oil prices, weaker peso, and above trend growth. The sustained increase in core inflation in recent months suggests broadening price pressures amid robust domestic demand.

3. We wonder, in this regard, whether the very high volatility in the fixed capital formation figures is a consequence of an underlying fiscal policy choice. Staff comments are welcome.

- Growth in fixed capital formation in Philippines has been especially volatile since the global financial crisis. This is partly due to the lumpy nature of flagship infrastructure projects, the increase in public investment in the run up to the Presidential Election in 2016, and the resumption of the infrastructure push under the current administration's "Build, Build, Build" program.

4. Authorities are reported not seeing significant evidence of overheating and are confident they will be able to cope with the identified external risks without major changes in policy. Could staff provide more detail on these differences and on the

implications they see for macroeconomic performance if the current policy mix is not adjusted as advised in the report?

- If no adjustment in policy is undertaken, inflation expectations will become harder to rein and may lead to higher inflationary wage pressure. Furthermore, an expansionary fiscal policy could exacerbate inflation risk and lead to a larger current account deficit at a time when global financial conditions are tightening.

5. What is the assessment of the current economic cycle in terms of output gap and labor market indicators?

- We assess the output to be slightly above potential as of Q2, and labor market indicators to be steadily strengthening, with unemployment at 5.4 percent (5.7 percent in 2017).

Monetary Policy and Inflation

6. Noting that in the staff statement, no reference is being made to a reassessment of staff appraisal and policy recommendations, we would appreciate if staff could indicate if this rapid increase in inflation may affect wages, inflation forecast for the year, and the pace and timing of policy recommendations, particular in view of the risk of the super typhoon Mangkhut impacting the corn and rice harvest?

- Staff did not revise the inflation forecast based on August data, considering some base year effects (e.g. electricity price) which affected the y/y measure of inflation. In addition, the 3m/3m seasonally adjusted headline and core inflation measures do not point to a persistent and sequential trend in core inflation, albeit they remain high. Going forward, staff will pay close attention to sustained increases in core inflation and broadening price pressures, amid resilient aggregate demand conditions, signs of further erosion of economic slack, and rising wage demand pressures and inflation expectations.

- It is too early to assess the likely impact of Mangkhut on crop losses and waves of responses. However, immediate reforms for reducing food prices are due to be implemented, including releasing rice from the National Food Authority (NFA) warehouses to the market and authorizing additional rice imports.

7. ***With inflation in August tipping at 6.4 percent, follow-through action to safeguard inflation targets by addressing demand-side pressures may be warranted. Have staff discussed a roadmap with the authorities on this?***

- Staff discussed the need to maintain a tightening bias against signs that inflationary pressures had broadened. There was agreement with the authorities that favorable conditions from sustained domestic growth suggest that tightening should not lead to a significant slowdown of growth momentum and that the pace of tightening should depend on domestic and external developments.

8. ***What is the estimation of current inflation expectation based on the indicators mentioned in paragraph 19?***

- Survey-based measures of inflation expectations show they remain elevated. The median forecast from private sector economists, as reported in the *BSP's July survey*, rose to 4.7 percent for 2018 (up from 4.5 percent from the June survey), 3.9 percent for 2019 (up from 3.7 percent), and remain elevated through 2020 at 3.8 percent. The 2018-2019 inflation expectations are similar to the August Consensus Economics expectations.

Fiscal Policy and Tax Reform

9. ***Noting the acceleration in the rate of potential output growth, we wonder how much of this estimation reflects the sizeable public investment effort and how much the population growth rate.***

- The medium-term potential growth estimates fully reflect the projected public investment increase under the baseline (rising from 4.5 percent of GDP in 2017 to 6 percent in 2023) and an expected annual population growth of about 2 percent.

10. ***Do staff think that the authorities could secure enough budget for priority infrastructure and social programs by cutting nonpriority spending? Could staff provide more details about nonpriority spending?***

- The national government may have a margin in spending of around 1.0 percent of 2018 GDP. These are mostly expenditures linked to "Special Purpose Funds," which are budget items allocated for specific purposes, such as budgetary support to government corporations, miscellaneous government employee benefits, and capital projects undertaken by local governments.

11. Could staff comment the authorities plan to use "hybrid" PPP and whether there exist good international practices in this domain?

- The Philippine government's use of hybrid PPP is mainly to shorten construction time and lower project costs. Based on past experience, the government believes that traditional PPP projects tend to be slow in getting off the ground and this does not meet the urgent need to improve the country's infrastructure. Moreover, the authorities hope to reduce construction costs by making greater use of official development assistance and other forms of low-cost external financing, in addition to increased revenue from tax reforms. International experience suggests that hybrid PPP can be a useful model when low-cost public financing is available, and a adequate regulatory framework is in place to ensure efficient maintenance and operation by the private sector of public infrastructure projects.

12. Could staff elaborate on the prospect to further raise public revenues and whether the authorities consider additional DRM measures beyond the TRAIN program?

- Beyond the planned measures under the TRAIN program, DRM could be further enhanced by addressing inefficient tax collection, including through capacity development and additional staffing in the tax collection agencies, and modernization of the tax framework aimed to prevent profit shifting and base erosion.

13. As shown in the DSA, staff expects a further increase in the share of short-term debt in total general government gross debt in the upcoming years. We would appreciate staff's comments on the reasons behind this development and possible risks emanating from the change in the maturity structure.

Were there any specific backgrounds for shorter term structure in government financing this year?

- The increase in short-term public debt aims at completing a risk-free yield curve and support capital development. If kept moderate, rollover risks should be manageable.

14. We would appreciate if staff could provide some insights on the conclusions of the TA, and whether a Public-Private Partnership Fiscal Risk Assessment TA is also needed.

Could staff share some of the key findings of the PIMA, including areas of deficiency and planned reforms?

- Key findings include: (1) making project appraisal and selection more comprehensive, including stricter review of right of way issues; (2) fostering effective competition in the procurement process, including through more stringent sanctions on anti-competitiveness bidding practices; and (3) strengthening ex-ante fiscal assessment of infrastructure projects. Additional TA, including on P-FRAM, would respond to the authorities' request.

15. We would appreciate staff comments on the timeline for the implementation of the proposed CIT rate and its repercussions on growth. Would the intended cuts in tax incentives offset possible revenue's losses from reducing CIT?

- The authorities' objective is to offset the revenue loss from a lower CIT rate through streamlining of tax incentives. The reform package is still under discussion in Congress. The House bill (approved) proposes to gradually reduce the CIT rate starting in 2021, resulting in an estimated revenue loss of about 0.35 percent of 2018 GDP. The Senate bill under discussion aims to reduce the CIT rate by 5 ppt immediately in 2019, with the tax incentive rationalization starting in 2021. This proposal would result in about 0.7 percent revenue loss. As assessed by previous IMF TAs, we expect the growth impact of the reform to be positive and significant over the medium term given the current inefficiency of the tax system.

16. We also appreciate staff's efforts to look at the distributional effects of TRAIN, but question the decision to use an "unproductive redistribution" scenario as the only comparator. Since the latter seems out of step with the authorities' stated intentions, we wonder whether a less extreme, higher-probability scenario could have been more useful for decision-makers. Staff comments would be welcome.

While we appreciated Box 1 on the distributional impacts of TRAIN, we would have valued a similar discussion of any additional recommended adjustment policies, including distributional impacts and political/technical feasibility.

- The scenarios aim to be illustrative and focus on the merit of targeted productive investment in the long term. Unfortunately, the complexity of the model makes it difficult to analyze the transition paths under different scenarios, which could be important for policy formulation in the short term. That said, we would note that the model results are highly linear. This allows a linear combination of these two "extreme" scenarios to approximate alternative scenarios consisting of both productive investment and redistribution.

17. The report identifies several areas that could support key spending while preserving the existing fiscal space—including the planned tax reform, spending relocation and public expenditure management. Could staff provide additional information on

these and specify the impact they would have—especially tax reform—on fiscal balances?

- The tax reform program is projected to generate about 1.0-1.2 percent of GDP of additional revenue over the medium term (Table 10), most of which would be used to finance infrastructure projects and the remainder to support poor households, including through unconditional cash transfers. The medium term fiscal balance is expected to remain at or slightly below 3 percent of GDP, with a higher share of government spending allocated to infrastructure and social measures.

18. It was not clear to us if staff are proposing further measures beyond those listed in Table 10. Staff comments would be welcome.

- Many important elements of the measures listed in Table 10 are still under discussion in the government and Congress. Staff aims to contribute to this discussion by providing views on some issues, such as the sequencing of the CIT rate cut and tax incentive rationalization. Some recommendations benefited from recent TA.

External Sector

19. While we agree with the staff's recommendation, we wonder why ample international reserves warrant the flexible exchange rate (para 21). We would welcome the staff's justification.

- Staff recommends that the exchange rate be allowed to continue to move in line with market forces to allow the economy to adjust to external shocks such as higher oil prices and tighter external financial conditions. International reserves could be used to prevent disorderly market conditions.

20. Have staff done some work on the effect of peso depreciation in case of capital reversal on debt burden or inflation?

- The impact of peso depreciation on debt burden would be moderate due to the relatively low level of external debt. The BSP's estimates of peso passthrough to inflation is about 0.14.

Macrofinancial Linkages

21. We note that the authorities think that new bank credit mostly directed to productive sectors. We would appreciate the staff's assessment on this authorities' view.

The authorities view that the growth of credit to GDP ratio is supported by the demand of a growing economy and that the tools in place are appropriate to safeguard financial stability. Staff comments are welcome.

But the authorities view the domestic banks' credit exposure as firmly supported by demands of a growing economy, with appropriate tools in place to safeguard financial stability. We invite staff comments.

- A breakdown of the share of banks' total loans to sectors shows a well-diversified portfolio geared at predominantly production sectors. Furthermore, prudential/supervisory measures to curb excessive exposure in the real estate sector have been geared at alleviating concerns of rising exposures (i.e., REST test). Other tools and measures include putting in place guidelines on Credit Risk Management Practices, adopting Basel III reforms (minimum leverage ratio, financial institutions liquidity-enhancing measures), a supervisory framework for D-SIBs, as well as proposing a new 'Borrowers Interconnectedness Index' which aims at assessing concentration of the systemic importance of conglomerates in the banking system.

22. Could staff share on what communication issues were raised by the banking industry regarding the counter cyclical capital buffer proposal, and how the issues are being addressed?

- The BSP has invited the Bankers Association of the Philippines (BAP) to comment on the proposed CCyB. The BSP's Office of Systemic Risk Management maintains an open dialogue with the BAP on systemic risks confronting the industry. Staff understands that BAP has the view that bank capital is already adequate. Discussions are ongoing.

Structural Reform

23. Could staff elaborate on the expected effects of the Ease of Doing Business Law?

- The law, if effectively implemented, would significantly reduce government's processing time for business permits, making it easier to start new businesses. This would be achieved by imposing strict limits on the maximum number of days for granting permits and introducing electronic processing systems. The law also introduces a "zero-contact" policy, strictly limiting government officials' contact with any permit applicants.

24. We agree with staff that labor market reform could help create more and better jobs and wonder how staff assesses the executive order signed in May 2018 that tightens regulations on short-term employment contracts?

- The repeated use of temporary contracts, including to avoid paying benefits to workers, is not optimal, and the intention of the executive order to prohibit the practice is understandable. However, the elimination of repeated use of "temporary" contracts should be complemented with greater flexibility in terminating the contracts of workers with "regular" status. This will help maintain the flexibility of the labor market and promote job creation.

Inclusive Growth Policy

25. We would appreciate further elaboration by staff on the effectiveness of recent reform measures that are aiming at making growth more inclusive.

- The direction of recent reforms is broadly in line with inclusive growth objectives, although their effectiveness would largely depend on implementation. Progress seems somewhat mixed based on our preliminary assessment, with some areas making good advances, such as financial inclusion and capital market reforms, while others could be accelerated, such as the rice import system reform.

26. Can staff provide estimates of the impact of remittances on inequality?

- While we do not have recent quantified estimates, anecdotal evidence and staff's past analysis (IMF Country Report No.13/103) show that remittances play an important role in smoothing household consumption in the Philippines, especially for poor households with limited access to financial services. Remittances do not appear to affect income inequality significantly.

27. We appreciate staff's comments on the effectiveness of this solution [turning the former Postal Bank into the government-owned Overseas Filipino Bank to provide financial services tailored to the need of overseas Filipinos] for making cross border payments and its implications for financial inclusion.

- The Overseas Filipino Bank (OFB) was launched early this year and is not yet fully operational—hence, it is too early to assess results. The OFB is designed to cater the financial service needs of overseas Filipino workers and plans to provide a wider range of financial products than commercial banks.

Governance and AML/CFT

28. ***Does the authorities' regulatory response include provisions to mitigate the integrity risks associated with fintech?***

- Yes. An example is the BSP's recent establishment of a framework for regulating virtual currency (VC) exchanges and similar entities operating in the Philippines. VC exchanges are classified as Remittance and Transfer Companies (RTCs) under the new BSP framework for money service businesses subject to registration, minimum capital, internal controls, regulatory reports and compliance with the AML rules and regulations.

29. ***In this regard, could staff comment on how it envisions the implementation of the Fund's new governance framework for the Philippines?***

- The centralized process to identify and assess the nature and severity of governance weaknesses under the new Framework for Enhanced Fund Engagement started to be implemented for countries with policy consultation meetings/missions starting in Q3:2018. For Philippines, the mission and discussion with the authorities took place prior to Q3:2018 and as such, the new framework has not been applied at this point. As we implement this new framework, The Philippines would be guided by the framework for the next Article IV and this assessment would guide the coverage of governance and corruption in the next staff report.

30. ***We take note of the authorities' efforts to create the Presidential Anti-Corruption Commission and would welcome staff's assessment of the specific design and effectiveness.***

- It is too soon to assess the work of the Commission since it is new—established in October 2017. It focuses on investigating administrative cases primarily graft and/or corruption of high-level government officials appointed by the President. Five Cabinet officials have been investigated over graft allegations.