FOR INFORMATION

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To: Members of the Executive Board

From: The Secretary

Subject: **Philippines—Assessment Letter for the Asian Development Bank and the World Bank**

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Questions:	Mr. Helbling, APD (ext. 36051)

***If the authorities consent to the publication of this assessment, it may be published by the AsDB or the World Bank.**

Philippines—Assessment Letter for the Asian Development Bank and the World Bank
April 6, 2020

Recent Developments, Outlook, and Risks

Context: **The Philippines has been hit by the COVID-19 pandemic from a strong initial position**. Structural reforms and prudent macroeconomic policies in recent years have supported sustained, strong GDP growth and macroeconomic stability, and have helped in containing vulnerabilities. At the conclusion of the Article IV consultation in late January 2020, real GDP growth was expected to strengthen further to 6.3 percent in 2020 and inflation to be well within the target range of 2–4 percent. The current account deficit was projected to increase to 2.3 percent of GDP from 0.1 percent in 2019, reflecting increased infrastructure investment. Gross international reserves of US$87.8 billion at end-2019 amounted to 200 percent of the IMF's reserve adequacy metric. The banking system was well capitalized and liquid.

The COVID-19 pandemic is exerting pressures on the economy. Travel restrictions, which have been in place since early February and tightened over time, have led to sharply lower tourist arrivals. The introduction of enhanced community quarantine on the Luzon island, including Metro Manila, on March 16 has led to significant disruption to economic activity.[1] At the same time, global financial turmoil has resulted in tighter external financial conditions for the Philippines. However, the peso exchange rate has remained broadly stable, as have gross international reserves (US$87.6 billion at end-February 2020).

A significant negative economic impact of the COVID-19 pandemic is expected. In the context of the related global recession, real GDP growth in 2020 is now expected to drop to 0.6 percent, lower than the 1.1 percent recorded in the global financial crisis. The virus outbreak is assumed to peak in the second quarter, leading to a gradual recovery in the second half of 2020. With economic policies mitigating the impact of COVID-19 and base effects, growth is projected to rebound to 7.6 percent in 2021. Lower activity and oil prices are expected to reduce headline inflation to 1.7 percent in 2020 before rebounding about 3 percent by end-2021. At 2.3 percent of GDP, the current account deficit in 2020 is broadly unchanged from earlier projections, with weaker exports and remittances offset by lower imports.

Downside risks are large. The risks to this near-term outlook are larger than usual. The virus outbreak could be broader or longer lasting than expected, both globally and locally, which could lead to more social distancing measures and even a contraction in activity in 2020 and a delayed recovery, despite expected stronger policy response in such circumstances. Constraints on timely and adequate policy support could lead to increases in poverty and insolvencies among businesses and households, delaying the recovery and resulting in long-term scarring effects on tourism and supply chains. There are also downside risks to external demand, external financial conditions, and remittances.

Policy Framework and Settings

The authorities have taken swift actions to mitigate the impact of COVID-19. Measures have included macroeconomic policy actions and health policy interventions. Meanwhile, structural reforms

[1] The IMF's policy tracker provides a detailed description of the authorities' policy response to COVID-19: https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19.

continue, with several landmark reforms being implemented, including rice tariffication, a national digital ID, ease of doing business, and BSP charter amendments.

The budget deficit will increase temporarily with the Covid-19 pandemic. Prior to the outbreak of COVID-19, the fiscal deficit target for 2020−22 was set at 3.2 percent of GDP, which implied a moderate reduction from the 3.5 percent deficit recorded in 2019 but nevertheless supportive of the government's medium-term growth agenda. However, with the COVID-19 shock, a larger fiscal deficit is both expected and desirable, as weaker economic activity leads to lower revenue while rising demand for social protection, including unemployment benefits, increases expenditure.

The fiscal policy response to the pandemic has been targeted. The government announced a PHP 27.1 billion fiscal package (about 0.2 percent of 2019 GDP) on March 16, which includes purchase of COVID-19 testing kits and health equipment, social protection for vulnerable workers—including those in the informal sector who have been hard hit—and retraining programs for displaced workers; and support to the tourism and agriculture sector. In addition, financial assistance will be provided to affected SMEs and vulnerable households through specialized microfinancing loans and loan restructuring. The government is also preparing to launch a PHP 200 billion cash aid program (about 1.1 percent of 2019 GDP) for 18 million low-income households, with a transfer of PHP 5,000−8,000 a month per household for a period of two months.

Timely deployment of these measures, reinforced by further fiscal support, will be critical for their effectiveness. The immediate priority is to contain the rapid spread of virus and its health impact, and to provide vital income support to the vulnerable. Given its low level of public debt (about 39 percent of GDP), the Philippines has considerable fiscal space to use to counter the impact of COVID-19 aggressively while maintaining debt sustainability.

The monetary policy stance is now accommodative. The BSP has promptly reduced its policy rate twice in 2020 by a cumulative 75 bps to 3.25 percent. Moreover, a 200 bps reduction of the reserve requirement ratio for banks (to 12 percent) became effective on March 30. The BSP has indicated its readiness to take further actions as needed given the considerable monetary policy space it still has. Furthermore, its plans to purchase PHP 300 billion worth of government securities (about 1.6 percent of 2019 GDP) to support the government's programs to counter the impact of COVID-19. The authorities should continue to let the exchange rate move as a shock absorber in line with underlying fundamentals. FX intervention should be used, as needed, to mitigate disorderly market conditions.

Regulatory relief aims to support access to credit and provide relief. The BSP has relaxed rules to allow banks to provide financial support to their borrowers while they experience temporary income losses, through temporary grace periods for loan payments or loan restructuring. These measures are expected to play a crucial role in cushioning the macroeconomic and financial impacts of the pandemic, although further measures might be needed. The authorities are closely monitoring the health of the financial system, including both the U.S. dollar and peso liquidity, during this period of increased risks.

IMF Relations

The Philippines is on a standard 12-month Article IV consultation cycle. The 2019 Article IV consultation was concluded by the IMF Executive Board on January 27, 2020.

Philippines: Selected Economic Indicators

Demographic: Population (2018): 106.6 million; Life expectancy at birth (2017): 69
Poverty (2015, percent of population): Below $1.90 a day: 6.1; Below the national poverty line: 21.6
Inequality (2015, income shares): Top 10 percent: 34.8; Bottom 20 percent: 5.7
Business environment (2019 country ranking): Ease of doing business: 95 (out of 190); Starting a business: 171 (out of 190)
IMF quota: SDR 2,042.9 million
Main products and exports: electronics, agriculture products, and business process outsourcing

	2016	2017	2018	2019	2020 Proj.	2021 Proj.
	(Annual percentage change, unless otherwise indicated)					
National account						
Real GDP	6.9	6.7	6.2	5.9	0.6	7.6
Consumption	7.4	5.9	6.5	6.4	3.6	7.5
Private	7.1	5.9	5.6	5.8	1.7	7.1
Public	9.0	6.2	13.0	10.5	15.2	9.4
Gross fixed capital formation	26.1	9.4	12.9	1.5	0.3	14.6
Domestic demand	11.7	6.8	8.2	5.1	2.8	9.3
Net exports (contribution to growth)	-4.9	-0.7	-2.8	0.5	-2.4	-2.8
Real GDP per capita	5.1	5.0	4.6	4.3	-0.9	5.9
Output gap (percent, +=above potential)	0.1	0.4	0.2	-0.1	-3.2	-0.7
Labor market						
Unemployment rate (percent of labor force)	5.5	5.7	5.3	5.1	6.2	5.3
Underemployment rate (percent of employed persons)	18.3	16.1	16.4	13.9	...	...
Employment (percent change)	4.7	-1.6	2.0	2.9	0.4	3.4
Non-agriculture daily wages (Q4/Q4) 1/	2.1	4.3	4.9	0.0	...	...
Price						
Consumer prices (period average, 2012 basket)	1.3	2.9	5.2	2.5	1.7	2.9
Consumer prices (end of period, 2012 basket)	2.2	2.9	5.1	2.5	2.6	3.0
Core consumer prices (period average, 2012 basket)	1.5	2.5	4.1	3.2	...	...
Residential real estate (Q4/Q4) 2/	3.3	5.7	0.6	10.4	...	...
Money and credit						
3-month PHIREF rate (percent, end of period) 3/	2.0	3.3	6.5	3.1	...	...
Claims on private sector (percent of GDP)	44.8	47.8	49.9	50.3	50.2	48.9
Claims on private sector (percent change)	16.6	16.4	15.1	7.7	2.3	7.9
Public finances (in percent of GDP)						
National government overall balance 4/	-2.4	-2.2	-3.3	-3.5	-5.0	-4.6
Revenue and grants	15.2	15.6	16.3	16.9	15.7	16.2
Total expenditure and net lending	17.6	17.9	19.6	20.4	20.8	20.8
General government gross debt	39.0	39.9	38.9	38.6	42.9	42.9
Balance of payments (in percent of GDP)						
Current account balance	-0.4	-0.7	-2.7	-0.1	-2.3	-2.2
FDI, net	-1.9	-2.2	-1.8	-1.2	-0.6	-1.7
Gross reserves (US$ billions)	80.7	81.6	79.2	87.8	83.6	85.3
Gross reserves (percent of short-term debt, remaining maturity)	418.2	419.3	364.5	417.9	383.1	367.8
Total external debt	24.5	23.3	23.9	23.7	24.5	23.4
Memorandum items:						
Nominal GDP (US$ billions)	304.9	313.6	330.9	359.4	360.9	405.8
Nominal GDP per capita (US$)	2,953	2,989	3,104	3,319	3,281	3,631
GDP (in billions of pesos)	14,480	15,808	17,426	18,613	19,056	21,101
Real effective exchange rate (2005=100)	108.2	103.4	100.5	105.3	...	...
Peso per U.S. dollar (period average)	47.5	50.4	52.7	51.8	...	...

Sources: Philippine authorities; World Bank; and IMF staff estimates and projections.

1/ In National Capital Region.
2/ Latest observation as of 2019:Q3.
3/ Benchmark rate for the peso floating leg of a 3-month interest rate swap. Latest observation as of December 2019.
4/ IMF definition. Excludes privatization receipts and includes deficit from restructuring of the previous Central Bank-Board of Liquidators.