FISCAL RISKS STATEMENT

2018

Development Budget Coordination Committee

List of Acronyms and Abbreviations

AAIIBP	Al-Amanah Islamic Investment Bank of the Philippines
AFP	Armed Forces of the Philippines
ARI	Annual Regular Income
ARMS	Accounts Receivable Management System
AML	Anti-Money Laundering
ASEAN	Association of Southeast Asian Nations
BAC	Bids and Awards Committee
BCM	Business Continuity Management
BESF	Budget of Expenditures and Sources of Financing
BICRA	Bank Industry Credit Risk Assessment
BIR	Bureau of Internal Revenue
BLGF	Bureau of Local Government Finance
BOC	Bureau of Customs
BOT	Build-Operate-Transfer
BPF	Budget Priorities Framework
BPO	Business Process Outsourcing
BSC	Balanced Scorecard
BSF	Bond Sinking Fund
BPM	Business Process Management
BSFIs	BSP-Supervised Financial Institutions
BSP	Bangko Sentral ng Pilipinas
BTr	Bureau of the Treasury
CAR	Capital Adequacy ratio
CFT	Combating the Financing of Terrorism
CIIF	Coconut Industry Investment Fund
CL	Contingent Liability
CO	Capital Outlays
COA	Commission on Audit
CPCS	Compensation and Position Classification System
CPD	Continuous Professional Development
CSC	Civil Service Commission
CTRP	Comprehensive Tax Reform Program
DAP	Disbursement Acceleration Program
DBCC	Development Budget Coordination Committee
DBM	Department of Budget and Management
DENR	Department of Environment and Natural Resources
DepEd	Department of Education
DND	Department of National Defense
DOF	Department of Finance
DOH	Department of Health
DOJ	Department of Justice
DPWH	Department of Public Works and Highways
DRRM	Disaster Risk and Reduction Management
DSIB	Domestic Systemically Important Banks
eCar	Electronic Certificate Authorizing Registration
SRE	Statement of Receipts and Expenditures
EM	Emerging Markets

ENRDMT	Environment and Natural Resources Data Management Tool
EPP	Extended Payment Period
FATF	Financial Action Task Force
FCP	Financial Consumer Protection
FSS	Fiscal Sustainability Scorecard
FX	Foreign Exchange
FXD	Foreign Exchange Dealers
GAA	General Appropriations Act
GCG	Governance Commission for GOCCs
GDP	Gross Domestic Product
GFI	Government Financial Institutions
GIR	Gross International Reserves
GOCC	Government-Owned and Controlled Corporations
GNI	Gross National Income
HGC	Home Guaranty Corporation
ICC	Investment Coordination Committee
ICRS	Integrated Corporate Reporting System
IP	Interest Payments
IPP	Independent Power Producers
IPPA	Independent Power Producer Administration
IRC	Interest Rate Corridor
IRA	Internal Revenue Allotment
IRR	Implementing Rules and Regulations
IT	Information Technology
LCR	Liquidity Coverage Ratio
LGC	Local Government Code
LGU	Local Government Unit
LIBOR	London Inter-Bank Offer Rate
LSR	Locally-Sourced Revenues
LTOM	Local Treasury Operations Manual
LWUA	Local Water Utilities Administration
MB	Monetary Board
MC	Money Changers
MFA	Multi-Factor Authentication
MNFGC	Major Non-Financial Government Corporations
MOOE	Maintenance and Other Operating Expenditures
MPSA	Mineral Production Sharing Agreement
MRPAAO	Manual on Real Property Appraisal and Assessment Operations
MSB	Money Service Businesses
MWSS	Metropolitan Waterworks and Sewerage System
NDC	National Development Company
NEA	National Electrification Administration
NEDA	National Economic and Development Authority
NFA	Net Foreign Assets
NFA	National Food Authority
NG	National Government
NHA	National Housing Authority
NHIP	National Health Insurance Program
NIA	National Irrigation Administration
NLP	Net Lending Program

NPC	National Power Corporation
NPL	Non-Performing Loan
NRPS	National Retail Payment System
NSFR	Net Stable Funding Ratio
ODF	Overnight Deposit Facility
OF	Overseas Filipinos
OLF	Overnight Lending Facility
OPEC	Organization of the Petroleum Exporting Countries
PD	Past Due
PDP	Philippine Development Plan
PDNA	Post Disaster Needs Assessment
PES	Performance Evaluation System
PEZA	Philippine Economic Zone Authority
PHIC	Philippine Health Insurance Corporation
PIP	Public Investment Program
PNOC	Philippine National Oil Company
PPA	Philippine Ports Authority
PPP	Public-Private Partnership
PSA	Philippine Statistics Authority
PSALM	Power Sector Assets and Liabilities Management Corporation
QBs	Quasi-Banks
QMS	Quality Management Systems
QRF	Quick Response Fund
RATE	Run After Tax Evaders
RATS	Run After the Smugglers
RERBA	Real Estate, Renting and Business Activities
RMP	Risk Management Program
ROE	Return on Equity
RP	Repurchase
RPT	Real Property Tax
RRP	Reverse Repurchase
RTC	Remittance and Transfer Companies
SDA	Special Deposit Accounts
SDG	Sustainable Development Goals
SEAL	Standardized Examination and Assessment for Local Treasury Service
SFDRR	Sendai Framework for Disaster Risk Reduction
SMV	Schedule of Market Values
SSF	Securities Stabilization Fund
SUC	State Universities and Colleges
SSIs	Social Security Institutions
TDF	Term Deposit Facility
TIIDCORP	Trade and Investment Development Corporation of the Philippines
Transco	National Transmission Corportion
U/KB	Universal and Commercial Bank
VAT	Value Added Tax
VATAG	Value Added Tax Audit Group
VC	Virtual Currency
YoY	Year-on-Year
YTD	Year-to-Date

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I. INTRODUCTION

A. **The country's management of fiscal risks have significantly contributed to maintaining the growth momentum.** A concerted effort to cover and mitigate against emerging fiscal risks have added to the macro stability upon which growth and investor confidence has been anchored upon.

B. **The economy remained robust.** Growth was near the bottom of the assumed range for the period and characterized by low inflation and growing investment in capital goods.

C. **The Comprehensive Tax Reform Program (CTRP).** The NG is redesigning the country's tax system to be simpler, fairer and more efficient for all, while generating additional P133.8 billion revenues to support the government's push to accelerate infrastructure spending and human capital investments. Moreover, the BIR and the BOC remain committed in implementing rigorous tax administration and reforms to boost government revenues, including eliminating tax evasion and smuggling.

D. **The "Build! Build! Build!" Infrastructure Agenda of this Administration targets public spending on infrastructure projects to reach 8-9 trillion pesos or approximately USD 155.5 billion for the whole six-year term.** A new hybrid PPP model was adopted in order to achieve this. The government believes that this structure is the fastest and most cost-effective way of implementing a PPP. With respect to estimating NG's CL exposure in PPPs, a portfolio-level assessment of its PPP exposure was used, even capturing potential risks under the Build-Operate-Transfer-structured Independent Power Producer (BOT IPP) projects contracted in the 1990s, and other "legacy" projects.

E. **The NG debt continued to be sustainable over the medium term with declining debt-to-GDP ratio despite higher funding requirement to support investments that stimulate economic growth.** Furthermore**,** the structure and profile of the debt portfolio maintains a prudent exposure to market risks consistent with the Government's strategy and objectives. Interest payments as a percentage of expenditures sustain its downward trajectory owing to government's proactive liability management.

F. **The Philippine banking system maintained a solid performance as reflected by double-digit growth in deposits, assets and loan portfolio translating into improved asset quality, ample liquidity, sufficient capitalization and increased profitability.** The BSP continues to pursue proactive reforms aimed at promoting financial stability and greater financial inclusion, thereby ensuring the resilience of the financial system.

G. **The country's susceptibility to natural disasters remains to be a major source of fiscal risks.** And in order to mitigate disaster risks, the country's Disaster Risk and Reduction Management (DRRM), as guided by the Sendai Framework for Disaster Risk Reduction (SFDRR) 2015-2030 is put into effect. DRR policy directions will also align with the Philippine Development Plan (PDP) and relevant Sustainable Development Goals (SDGs).

II. MACROECONOMIC ASSUMPTIONS/PERFORMANCE

A. ASSUMPTIONS AND PERFORMANCE

1. **The economy remained robust and resilient in 2016 amidst external uncertainties, posting a full year growth in Gross Domestic Product (GDP) of 6.9 percent.** This figure is only slightly below the initial target of 7.0-8.0 percent, but is at the higher-end of the updated target (6.0 percent - 7.0 percent), and markedly higher than the 6.1 percent growth recorded in 2015.

Table 1. Philippines: Macroeconomic Performance for 2014-2016 and NG Budget Assumptions for 2017 [a/]
(in percent, unless otherwise specified)

Particulars	2014		2015		2016		2017	
	BESF	Actual	BESF	Actual	BESF	Actual	BESF	YTD
Real GDP growth	6.5-7.5	6.1	7.0-8.0	6.1	7.0-8.0	6.9	6.5-7.5	6.4 (H1 2017)
Inflation	3.0-5.0	4.1	2.0-4.0	1.4	2.0-4.0	1.8	2.0-4.0	3.1 (Jan-Aug)
364-day T-bill rate [b/]	2.0-4.0	1.8	2.0-4.0	2.1	2.0-4.0	1.8	2.5-4.0	3.0 (as of July)
6-month LIBOR	0.5-1.5	0.3	1.0-2.0	0.5	1.0-2.0	1.1	1.0-2.0	1.5 (as of July)
Exchange rate (PhP/US$1)	41.00 -43.00	44.4	42.00 -45.00	45.5	43.00 -46.00	47.49	45.00 -48.00	50.18 (Jan-Sep 25)
Dubai crude oil price *(US$/barrel)*	90.00-110.00	96.61	90.00-110.00	50.92	55.00 -75.00	41.27	40.00 -55.00	50.8 (Jan-Aug)
Goods exports growth [c/]	14.0	11.9	8.0	-13.3	6.0	-1.1	6.0	18.0 (Jan-Jun)
Goods imports growth [c/]	14.0	8.0	10.0	-1.0	12.0	17.7	10.0	15.2 (Jan-June)

a/ Macroeconomic assumptions adopted by the Development Budget Coordination Committee (DBCC), as published in the annual Budget of Expenditures and Sources of Financing (BESF) that the Executive branch submitted to the Congress for the preparation of the General Appropriations Act (GAA)
b/ Based on weighted average of primary market rates
c/ Based on the Balance of Payments and International Investment Position Manual, 6th Edition (BPM6) concept
Sources: NEDA, PSA, BTr, and BSP

Domestic demand (11.0 percent) was robust on account of upbeat household consumption (7.0 percent) and gains from investments (23.7 percent) in 2016. Further boosting domestic demand is the buoyant flow of remittances from abroad. Primary income from abroad managed to grow by 5.7 percent to contribute in the country's Gross National Income (GNI) growth of 6.7 percent in 2016.

The strong performance of the industry sector (8.4 percent) was supported by marked improvements in manufacturing (7.0 percent) following strong household consumption and better labor market conditions. The growth in service sector (7.4 percent) was steered by the robust performance of the real estate, renting and business activities and the financial sector. However, agriculture (-1.3 percent) remained vulnerable to extreme weather conditions. In particular, the lingering effects of El Nino and the damage from typhoons.

2. **Real GDP growth for the first half of 2017 registered at 6.4 percent, only slightly below the lower end of the full-year target of 6.5-7.5 percent for 2017.** Growth in the first semester of 2017 was slower relative to the performance in the same period a year ago (7 percent), as the impact of election spending wanes. Nonetheless, the Philippines remained as one of the best performing economies among its regional peers, second only to China (6.9 percent), but ahead of India (5.9 percent), Vietnam (5.7 percent), Malaysia (5.7 percent), Indonesia (5.0 percent), and Thailand (3.5 percent).

   Domestic demand (6.6 percent) remained firm, while external demand was stronger than expected, with the exports of goods and services expanding 20.0 percent. Industry (6.8 percent) and services (6.4 percent) continued to remain strong, supported by the rebound of agriculture and fishery (5.6 percent).

3. **Average inflation for 2016 increased but remained below the government target.** Headline inflation averaged 1.8 percent in 2016, slightly higher than the 2015 full-year average of 1.4 percent. However, this fell below the government target range of 3.0 percent ± 1.0 percentage point for the year.[1] The slightly higher inflation during the year was due to tighter food supply following weather-related supply disruptions as well as rising domestic pump prices caused by higher international oil prices.

   Headline inflation accelerated further in January – June 2017 to average 3.1 percent, attributed largely to tightness in domestic food supply, upward adjustments in petroleum prices and electricity rates, and increases in taxi and jeepney fares.

4. **Strong market demand for short-term government securities given a slower pace of US monetary policy tightening relative to initial expectations contributed to slightly lower domestic interest rates in 2016 relative to the previous year.** The 364-day Treasury bill rate averaged 1.8 percent in 2016 in the primary market, slightly below the 2.0 – 4.0 percent Budget of Expenditures and Sources of Financing (BESF) assumption for the year and lower than the 2.1-percent average in 2015. Meanwhile, average one-year Treasury bill rate in January – June 2017 offered by the Bureau of the Treasury increased to 2.8 percent.

5. **Expectation of a steeper trajectory of foreign interest rates due to the eventual policy rate hikes by the US Federal Reserve contributed to the increase in the 180-day London Inter-Bank Offer Rate (LIBOR).** The average 180-day LIBOR rose to 1.1 percent in 2016 from the 0.5-percent average in 2015, well within the BESF assumption of 1.0 – 2.0 percent for

[1] An Open Letter to the President was published on January 20, 2017 explaining the factors behind the deviation of inflation from the target for 2016. This is in accordance with the accountability and transparency procedure under the BSP Inflation Targeting framework. Available online at www.bsp.gov.ph/monetary/open_2016.asp.

2016. Meanwhile, the average 6-month LIBOR in the first six months of 2017 rose to 1.4 percent.

6. **The peso depreciated against the US dollar in 2016 primarily due to the impact of US Fed rate hike in December 2016, further US Fed rate increases as well as concerns over China's economic slowdown.** The peso-dollar exchange rate averaged USD/PHP 47.49 in 2016, a more depreciated level than the USD/PHP 43.00 – 46.00 BESF assumption for the year and the 2015 average of USD/PHP 45.50. Meanwhile, the peso settled at an average of USD/PHP 49.92 in January - June 2017, outside the BESF FX assumption range of USD/PHP 45.00 – 48.00. The US Fed rate hikes in March and June 2017 as well as market concerns on the recent widening of the country's current account deficit contributed to peso depreciation during the review period. The current account deficit position signals the country's higher propensity to import as the country gears up for higher growth momentum.

7. **Average Dubai crude oil declined further in 2016 to US$41.27 per barrel, from US$50.92 in the previous year and was below the BESF assumption for the year of US$55 – US$75 per barrel.** Crude oil prices remained generally subdued in early 2016 due largely to the sustained glut in the global oil supply. Crude oil prices rebounded in late 2016 following an agreement among major oil-producing countries to reduce production in an effort to stabilize oil prices,[2] although the increase in prices was not enough to offset the substantial decline during the year.

   Crude oil prices increased in the first half of 2017, driven mainly by the strong compliance among members of the Organization of the Petroleum Exporting Countries (OPEC) with agreed targets for reducing output despite rising commercial crude stockpiles as well as higher active rig counts and capital expenditure from oil companies in the US. Dubai crude oil price averaged US$51.44 per barrel in January – June 2017 from US$36.80 per barrel in the same period in 2016, within the DBCC assumption of US$40.00 – US$55.00 per barrel.

8. **Amid the generally weak demand in advanced and major emerging economies coupled with softening of commodity prices, goods exports contracted by 1.1 percent in 2016 to US$42.7billion from the US$43.2 billion in 2015.** [3] This developed as the decline in shipments of manufactured goods and mineral products negated the growth in exports of sugar products, fruits and vegetables, and coconut and other agro-based products. Exports of manufactured goods declined by 0.5 percent due largely to lower shipments of machinery and transport equipment, non-consigned electronics, garments, and chemicals due to the continued sluggish demand from the country's major trading partners.

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[2] The deal is estimated to reduce OPEC production by 1.2 million barrels per day (b/d) from global supply. Nonetheless, the upward momentum was slightly tempered by doubts among market analysts given OPEC's history of noncompliance with production quotas.

[3] Based on revised 2016 Balance of Payments (BOP) report released by the BSP on 15 September 2017.

In the first six months of 2017, exports of goods grew by 18.0 percent to US$24.0 billion from the comparable 2016 level of US$20.3 billion. Exports growth was driven primarily by the 12.1 percent increase in outbound shipments of manufactured goods, contributing 10.3 percentage points to the 18.0 percent year-on-year expansion of total goods exports. Higher exports of manufactures were largely driven by non-consigned electronics, machinery and transport equipment, processed food and beverages, and garments. Other exports such as mineral products and coconut products likewise recorded significant year-on-year growth rates of 87.7 percent and 78.2 percent, respectively.

9. **Meanwhile, goods imports in 2016 rose by 17.7 percent to US$78.3 billion,[4] reversing the slight contraction in 2015, and surpassing the 12.0 percent growth projection for the year.** The expansion in total imports was driven mainly by the purchases of capital goods, and raw materials and intermediate goods, which increased by 47.5 percent and 21.8 percent, respectively. This outturn pointed to the continued expansion in the domestic economy's capital formation and production. Imports of consumer goods likewise rose by 30.1 percent on account mainly of higher importation of durable goods, notably passenger cars and motorized cycles (by 65.7 percent).

For the first half of 2017, imports of goods amounted to US$43.4 billion, posting a 15.2 percent increment relative to US$37.7 billion in the same period last year. The year-on-year expansion was boosted primarily by increased imports of raw materials and intermediate goods (by 16.8 percent), mainly supported by materials and accessories used for manufacture of non-consigned electronics. Imports of mineral fuels and lubricants grew by 30.7 percent, buoyed by the hike in global oil prices which averaged about US$51.32 per barrel in the first half of 2017, from an average of US$36.75 per barrel in the comparable period in 2016.

B. MACROECONOMIC OUTLOOK AND RISKS

10. **The latest Bangko Sentral ng Pilipinas (BSP) assessment of the price and output conditions on the global and domestic fronts suggests continued upside risks to the inflation outlook.** The risks to future inflation appear to be tilted toward the upside. The impact of the government's fiscal reform program and the pending petitions for adjustments in electricity rates are the main upside risks to inflation. Meanwhile, the slower global economic growth due to policy uncertainty in advanced economies and geopolitical tensions continues to be the main downside risk to inflation. Going forward, the BSP will continue to monitor evolving economic conditions to ensure price and financial stability conducive to sustainable economic growth.

[4] Ibid.

11. **The timing and pace of policy normalization in the US could influence trends in the peso-dollar exchange rate.** Tighter monetary conditions due to faster-than-expected interest rate hikes by the US Federal Reserve could trigger further portfolio rebalancing, resulting in tighter financial market conditions as well as exchange rate pressures in emerging markets, including the Philippines. Subsequent interest rate hikes by the US Federal Reserve could likewise contribute to higher domestic and foreign interest rates in 2017 and 2018.

12. **The potential shift to inward-looking trade and investment policies in the United States could have an important impact on overseas remittances, business process management (BPM), trade and foreign exchange (FX).** Changing policies in US tax laws, labor/immigration laws, and financial and business regulations may contribute to near-term policy uncertainty. The extent of the effects of this change in policies for the Philippines will depend mainly on the following channels: (1) overseas Filipino (OF) remittances - tighter immigration policies could affect OF remittances from the US which account for about 33.1 percent of total OF remittances in January-June 2017; (2) BPM industry - bringing jobs back to the US may impact on the Philippines' BPM sector which caters mostly to US companies; (3) external trade – US renegotiation or withdrawal from free trade agreements could affect the Philippines indirectly; and (4) foreign exchange – short-term volatilities may continue to arise from perceived policy uncertainties.

III. FISCAL PERFORMANCE

A. REVENUE PERFORMANCE

13. **For 2016, the National Government (NG) incurred a fiscal deficit of P353.4 billion, 190.4 percent higher than the deficit in 2015.** This was attributed to the higher expenditure growth resulting from the new administration's initiative to boost public spending. As percent of Gross Domestic Product (GDP), the deficit in 2016 reached 2.4 percent almost triple the 0.9 percent achieved in 2015.

14. **Total revenue collection grew by 4.1 percent.** This is far lower than the collection growth in 2015 which included the one-time transfer of the Coco Levy Assets worth P62.5 billion to the General Fund. Exclusion of the said transfer will expand the revenue growth to 7 percent. Of the total revenues, 90 percent came from tax revenues and the remainder from non-tax sources and privatization.

15. **Tax effort increased slightly to 13.7 percent, a 0.1 percentage point increment over the 2015 tax effort of 13.6 percent.** January to December tax revenues reached P1,980.4 billion, P164.9 billion higher than the 2015 full year tax collection of P1,815.5 billion registering growth of 9.1 percent.

16. **Bureau of Internal Revenue (BIR) collections amounted to P1, 567.2 billion registering a higher growth of 9.3 percent compared to the 7.4 percent growth in 2015, and achieved 96.7 percent of its target for 2016**. BIR tax effort maintained the 10.8 percent achieved in 2015. Incremental collections from the sin tax law contributed a total of P67.5 billion. Stronger tax administration and various reforms contributed to higher collection performance.

17. **Revenue from the Bureau of Customs (BOC) continuously grew achieving 97 percent of its target for 2016.** Total collection reached P396.4 billion, 7.8 percent higher than its collection in 2015 due to higher collections on non-oil, and excise tax on account of higher imports and motor vehicle collection. The BOC collections grew despite the continuous drop in oil price which affected its Value Added Tax (VAT) collection, lower collection from duties affected by lower average tariff rate, and the increasing percent of non-dutiable value of imports to total value of imports brought about by the free trade agreement. The conduct of successful public auction of confiscated and abandoned goods amounting to P1 billion contributed to growth of non-traditional revenue collection.

18. **Non-tax collections reached P214.9 or P15.8 billion lower than 2015.** Growth in collection declined due to an P8.3 billion lower Treasury income from Bond Sinking Fund /Securities Stabilization Fund (BSF/SSF) investments and NG deposits as the Treasury rationalized the level of the BSF. Lower collection in guarantee fee and dividend remittance further contributed to the decline in non-tax revenue. Similarly, other existing non-tax revenue collection, which includes Malampaya Royalties, also

registered a huge decline of P10.9 billion from last year. However, Fees and Charges grew by P3.4 billion or 9.4 percent higher but still not enough to compensate the decline in collection of the Treasury Income and the other existing non-tax revenues.

19. **Total privatization proceeds amounted to P657 million.** The privatization proceeds decreased by 99 percent year-on-year because of the Coco Levy proceeds amounting to P62.8 billion in 2015. Privatization collections came from sale and other modes of disposition of government assets.

REVENUE PROGRAM

20. **The 2017 revenue target is expected to achieve a 10.52 percent growth with the continued implementation of reforms and higher tax administration efficiency by the collection agencies**. The proposed budget targets a deficit of 3 percent of GDP. This is slightly higher than the previous years' fiscal gap but is expected to translate into substantial infrastructure programs and human capital expenditure.

21. **The passage of the proposed tax reform program (CTRP) will help cushion the potential negative impact of the emerging risks on revenue and any adverse effect of global economic downturns.** The 2018 revenue target (BESF) incorporated the impact of the proposed tax reform measure. An expected amount of P133.8 billion will be collected from the Comprehensive Tax Reform Program. The estimated higher yields from this program will enable the government accelerate its infrastructure spending and human capital investments. Higher public spending, in turn, will help make our GDP growth rate more robust.

Table 2. Philippines: Revenue Program, 2015-2022
(In billion pesos, unless otherwise specified)

Particulars	2015 Actual	2016 Actual	2017 Assessment	2018	2019	2020	2021	2022
Total Revenues	2,109.0	2,195.9	2,426.9	2,840.5	3,244.0	3,637.6	4,018.8	4,504.0
% of GDP	15.8%	15.2%	15.3%	16.3%	16.9%	17.3%	17.4%	17.8%
Tax Revenues	1,815.5	1,980.4	2,258.4	2,671.7	3,073.0	3,468.3	3,850.4	4,337.2
% of GDP	13.6%	13.7%	14.2%	15.3%	16.0%	16.5%	16.7%	17.1%
BIR	1,433.3	1,567.2	1,782.8	2,005.0	2,308.1	2,614.9	2,912.7	3,306.2
BOC	367.5	396.4	459.6	637.1	732.8	818.8	900.3	990.5
Other Offices	14.6	16.8	15.9	29.7	32.1	34.7	37.5	40.5
Non-Tax Revenues	230.7	214.8	166.5	166.8	169	167.3	166.3	164.8
Privatization	62.8	0.7	2.0	2.0	2.0	2.0	2.0	2.0
Expenditures	2,230.6	2,549.3	2,909.0	3,364.1	3,819.7	4,271.3	4,715.7	5,271.8
Surplus/(Deficit)	-121.7	-353.4	-482.1	-532.6	-575.7	-633.7	-696.9	-767.9
% of GDP	-0.9%	-2.4%	-3.0%	-3.0%	-3.0%	-3.0%	-3.0%	-3.0%

**Note: BIR and BOC FY2015 & 2016 Collections are Net of tax refund.

TAX ADMINISTRATION AND REFORMS

22. **Rigorous tax administration and reforms continue to boost revenues.** Higher tax administration efficiency contributed significantly in raising the tax efforts of the revenue collection agencies. Thus, tax administration and governance reforms continues to be implemented to sustain growth in collection, enhanced transparency, and eliminate tax evasion and smuggling.

23. **The BIR stays committed to continue implementing administrative measures and initiatives to achieve its target.** The Bureau's robust revenue performance were attributed to the following initiatives:

    a. Continued pursuit of tax fraud cases through the Run After Tax Evaders (RATE) program. A total of 71 cases were filed at the Department of Justice (DOJ) with estimated tax liabilities of P9,760.93 million.

    b. Strengthened the Oplan Kandado Program wherein non-compliant business establishments were temporarily closed. Total of 81 establishments were closed with collections amounting to P134.03 million.

    c. Other initiatives like the deployment of Accounts Receivable Management System (ARMS) to additional regional sites; institutionalized the VAT Audit Group (VATAG) in the regional offices to maximize the effectiveness of the VAT Audit Program; and the full implementation of the Electronic Certificate Authorizing Registration (eCAR) System, among others.

24. **BOC intensified its tax enforcement and anti-smuggling activities.** As of end 2016, the Bureau was able to resolve 90 cases under the Run After The Smugglers (RATS) program. Of these cases, 42 were completed with its findings or recommendations approved while 47 are still pending approval, with 1 case returned for reinvestigation. These cases stemmed from anonymous complaints against BOC personnel as well as against other entities who had various transactions with the Bureau.

    A total of 413 Alert/Hold Orders and 56 requests for "Special Stop" were issued by the Bureau's Intelligence Group for the year 2016 against various shipments nationwide suspected to have the following violations: misdeclaration, misclassification, undervaluation, lack of import permits from the appropriate government regulatory agencies, intellectual property rights and other customs offences. These anti-smuggling and border security activities generated a total of P1.1 billion for the government coffers.

25. **The Department of Finance (DOF) strongly pushes the passage of the CTRP.** The proposed tax reform program is expected to raise revenue, achieve the medium-term revenue program necessary to implement the government's social agenda and undertake infrastructure projects necessary to stimulate the economy making it more competitive, strengthen

domestic demands, promote inclusive growth for poverty reduction, and immune the country from the adverse impact of global economic slowdown.

Should the proposed tax reform program not be passed, our budget deficit is estimated to be at 3.8 percent of GDP by 2018.

B. EXPENDITURE PERFORMANCE

26. **The actual NG spending in 2016 amounted to P2,549.3 billion, growing 14.3 percent year-on-year.** This was faster than the 12.6 percent spending growth in 2015.

Government spending was mainly driven by strong infrastructure and other capital expenditures which reached P493.0 billion compared to the P345.3 billion in 2015. This includes projects of the DPWH (widening, repair and rehabilitation of national roads); DND-AFP (modernization program); DOH (acquisition of medical equipment and health facilities), DepEd and some SUCs (construction, repair and rehabilitation of educational facilities).

Higher subsidies to government corporations, such as the Philippine Health Insurance Corporation (PHIC) for premium subsidies and senior citizens under the National Health Insurance Program (NHIP), and National Irrigation Administration (NIA) for its irrigation projects have also contributed to the increased spending in 2016.

27. **The National Government posted an underspending of 96.3 billion, or a deviation of 3.6 percent from the disbursement program of P2,645.6 billion.** Among the expenditure items where sizeable underspending was still recorded are maintenance and other operating expenditures (MOOE), infrastructure and other capital outlays (CO), and interest payments (IP):

a. Maintenance and other operating expenditures were below the program level by 11.1 percent mainly due to procurement issues such as delays and failed biddings, and the election ban in the early part of 2016.

b. Infrastructure on the other hand failed to meet the program by 7.5 percent or around P40.1 billion because of the difficulties encountered in procurement.

c. Savings in interest payments amounting to around P23.5 billion continued to be a source of underspending.

The significant improvement in underspending can be attributed to increased provision for subsidy of around P32.5 billion or more than 46.0 percent of the program, tax expenditures of P3.9 billion or 32.9 percent, and equity of around P3.1 billion or 35.8 percent.

Outlook for 2017

28. **Disbursements in the first few months of 2017 is expected to be moderate partly due to the base effect considering the frontloading made in the same period in 2016.** However, spending is expected to rack up in the succeeding months starting in the summer season towards the end of the year.

    To help the agencies obligate their budget faster, the Department of Budget and Management (DBM) has comprehensively released P1,643.9 billion or 83.5 percent of the total P1,968.8 billion agency-specific budget in January 3, 2017 – the first working day of the year. This is part of the Department's GAA-as-an-Allotment Order policy and is supported by the comprehensive release of cash requirements for the first semester to ensure efficient and timely implementation of government programs and projects.

29. **Furthermore, the revised Implementing Rules and Regulations (IRR) of the Procurement Law or R.A. No. 9184 has been issued in late 2016.** The revision aims to fast-track the bidding process and streamline the documentary requirements to avoid procurement problems and the delays in program/project implementation. Training and capacity building of Bids and Awards Committee (BAC) personnel also started last year and currently still ongoing for some line agencies, Government-Owned or Controlled Corporations (GOCCs) and Local Government Units (LGUs) to support the implementation of the revised IRR. This should facilitate the procurement activities of agencies this year and hopefully improve their budget utilization.

Sources of Fiscal Risks

30. **The absorptive capacity of departments and agencies continue to pose as one of the major sources of fiscal risks.** During the period 2012-2015, the rate of underspending averaged 9.0 percent, peaking at 13.3 percent in 2014 and slightly decreasing to 12.8 percent in 2015. Measures have been put in place to curb agency underspending but have not significantly addressed the issue. Although underspending had decreased to 3.6 percent in 2016, this was mainly attributed to the accelerated spending during the election year.

    It was found out that a big chunk of agency underspending is attributed to structural weaknesses in program/project preparation and implementation. In particular, the following reasons were cited:

    a. Agency planning remains weak resulting in poor program/project design;

    b. Difficulties in the procurement process, which include frequent bidding failures, numerous changes in contract specifications, weak capacity or lack of manpower to handle procurement;

c. Bottlenecks in program/project implementation, which include issues on right-of way, LGU support and coordination, claims and billing preferences of suppliers and contractors, among others.

31. **The peace and order situation continues to hamper development in the countryside.** For years, the government has been allotting significant amount of funds for infrastructure projects and social programs in the southern part of the Philippines but sustained insurgencies caused by militant and terrorist groups have slowed socioeconomic progress in the region. Crises such as the siege of Marawi City have caused the non-implementation of government programs and projects programmed for the fiscal year. In such cases, available funds have been realigned to augment existing activities that are more urgent and requires additional funding.

Risk Mitigating Measures

32. **The DBM is working with both Houses of Congress for the enactment of the Budget Reforms Bill**. It is intended to reform the budgeting process by enforcing greater accountability in public financial management (PFM), promoting fiscal sustainability, strengthening congress' power of the purse, instituting an integrated PFM system, and increasing budget transparency and participation, and for other purposes. This Bill has 7 Key Features, summarized as follows:

    a. Fiscal Responsibility – The Bill will ensure that fiscal policies will be supportive of the development goals identified in the AmBisyon Natin 2040, representing the long-term vision and collective aspiration of the Filipino people in the next 25 years, translated into appropriate and responsive fiscal strategies. The progress and outturns will be assessed against the targets set under these strategies, which will be presented in the Annual Financial Report and Year-End Report and the results will form part of the inputs to the planning and budgeting cycle.

    b. Financial Management – In addition to institutionalizing the reforms that were already introduced to improve financial resources management such as the Treasury Single Account, the Bill will also set in place a budget management environment conducive to faster, more accountable, transparent and credible budget execution. With the shift from a 2-year validity to a 1-year appropriation period, as well as the shift from budgeting obligations to budgeting for cash, greater discipline will be imposed on agencies in managing their budgetary funds such that delivery of goods and services is expected within the year. This calls from better planning, programming, procurement and coordination capacities in agencies, especially for multi-year contracts which the other sections in the Bill aims to do.

       DBM is introducing the concept of the extended payment period (EPP) to allow agencies up to 3 months after the budget year to pay off the goods and services delivered during the budget year.

c. Planning, Budgeting and Performance – The Budget Priorities Framework (BPF) presented to the President and Cabinet serves as a guide in the formulation of the budget for the following year. The BPF emphasizes the fiscal policy direction as envisioned in the PDP and discusses the latest medium-term fiscal strategy in consideration of recent macroeconomic and fiscal developments. It contains both aggregate and agency budget ceilings, and the projection or budgetary estimates for the next two-years. It also provides the government with the information of available fiscal space which will fund the expenditure priorities of the government (i.e., priority programs and projects) consistent with both the PDP and PIP (Public Investment Program).

d. Congress' Power of the Purse – The Bill will strengthen the Congressional power of the purse which provides that only the Congress may increase appropriations but subject to the availability of funds as certified by the Bureau of the Treasury. Moreover, lump sum funds and special purpose funds will be limited to the Calamity Fund, Contingent Fund, and Statutory Shares of LGUs. More restrictions will be imposed on the Unprogrammed Fund from allocation to its usage. Allocation to the Fund will not exceed 2 percent of the appropriations law, and cannot be used if there is a risk of breaching the deficit target. Special Accounts in the General Fund and other Special Funds will have a sunset provision, which requires the review of these funds every three years for possible termination.

   The Bill also provides a definition of savings consistent with the Supreme Court's ruling on the Disbursement Acceleration Program (DAP) case.

e. Accountability – The creation of the Office of the Comptroller General is aimed at strengthening the public financial accountability. The Comptroller General will formulate measures for the implementation of internal controls and appropriations reporting by agencies; enforce accounting and auditing rules and regulations being promulgated by the Commission on Audit (COA); and enforce agency compliance with required reports and consolidates accounts for reporting to the President, Congress and COA, among others.

f. Transparency and Participation – The DBM promulgates a calendar of disclosure which requires among others the publication of the People's Budget to ensure transparency. Moreover, the Bill will institutionalize participatory mechanisms to enjoin civil society organizations, academe, and experts in all phases of the budget process.

g. Enforcement and Implementation – Finally, the Bill provides sanctions and penalties to ensure strict compliance to the requirements provided in the Bill. These include non-approval of request for release of allotments, and disallowance of expenditures, among others.

IV. PUBLIC DEBT

33. **The sustainability of National Government debt has steadily improved.** The end-Dec 2016 debt-to-GDP ratio of 42.1 percent shows a significant decline from 44.7 percent the year before. And despite the rise to 42.5 percent as of June 2017 owing to frontloading of NG borrowing, the year-end projection maintains a sustained improvement in debt sustainability. Furthermore, the structure and profile of the debt portfolio maintains a prudent exposure to market risks consistent with the Government's strategy and objectives.

Table 3. Philippines: National Government Debt Indicators, 2015- Q2 2017
(in percent, unless otherwise specified)

Particulars	2015	2016	Q2 2017
National Government Debt			
% of GDP	44.7	42.1	42.5
% Share			
Domestic	65.2	64.6	65.2
External	34.8	35.4	34.8
Interest Payments			
% of revenues	14.7	13.9	12.9
% of expenditures	13.9	11.9	11.4

Source: BTr

34. **The currency mix indicates moderate exposure to adverse adjustments in foreign exchange market**. Based on value, the currency breakdown of NG debt has remained relatively stable despite recent foreign exchange movements. The share of local currency denominated obligations has stayed at 67% of the total due to the steady redenomination of outstanding liabilities in line with the borrowing program.

35. **Borrowing costs have remained manageable.** The weighted average interest rate (WAIR) of outstanding total debt has remained low and stable at 4.90 percent from 4.99 percent at the beginning of the year. Over the same period, the WAIR for both domestic and foreign borrowing has gone down to 5.17 percent and 4.40 percent as of end-June 2017 from 5.24 percent and 4.54 percent, respectively.

36. **The debt structure maintains minimal exposure to unfavorable swings in interest rate.** Only 8.51 percent of the total debt portfolio is subject to resetting which limits the sensitivity of interest payments to volatile market conditions.

37. **As a result, debt servicing flows have concurrently improved.** Interest Payments (IP) as of end-June 2017 eased to 12.9% of revenues and 11.4% of expenditures, from 14.0% and 12.6% the year before, respectively.

38. Average maturity (residual) remains at comfortable levels. The average maturity of NG debt is 9.96 years, reaching the upper bound of the medium term strategic target, with domestic and external debt having residual maturities of 8.19 and 12.43 years, respectively. Furthermore, short term debt (maturing in one 1-year) makes up a mere 7.38% of the total debt portfolio as of end-June 2017.

39. Guaranteed debt[5] has declined. The Government has taken a proactive stance in managing its exposure to guaranteed debt from state owned enterprises. Latest figures indicate the level holding steady at 3.5% of GDP from 4% in 2015. Furthermore, the end-June level indicates a 4% drop from the beginning of the year.

Medium Term Outlook and Risks

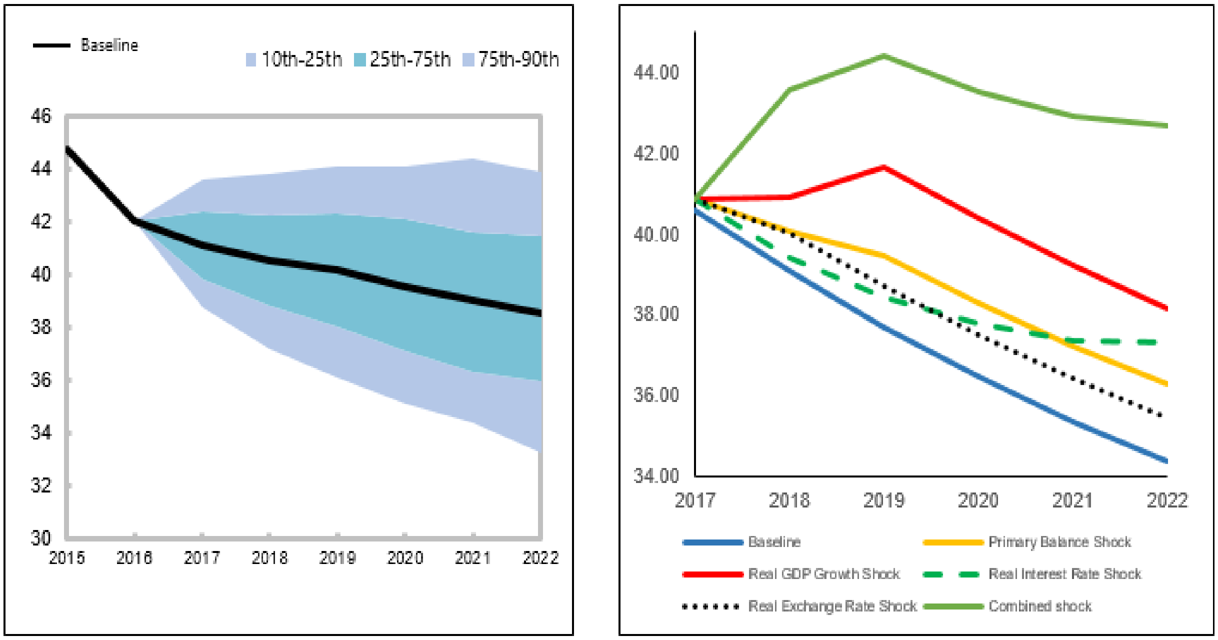
40. Debt sustainability remains intact over the medium term. The fiscal program projects a continued improvement in debt sustainability even with the higher funding requirement stemming from the Government's push to increase investments in infrastructure and key social welfare services.

41. A debt sustainability analysis (DSA) projects NG debt to GDP ratio remaining within prudent levels. Using the baseline assumptions, the IMF DSA framework indicates a more pronounced decline in the debt-to-GDP ratio, decreasing to 38.5 percent at the end-of-2022. On the other hand, there is a 90% probability that debt-to-GDP ratio will settle below 43.9 percent by 2022 and 50% likelihood to stay between the range of 36 percent to 41.4%. The DSA shows that NG debt continues to demonstrate resilience against various macroeconomic shocks, and despite higher funding requirement over the medium-term.

42. DSA scenario analysis indicates shocks having transitory effects on debt levels before settling into a higher albeit still sustainable path. Real GDP growth shocks (1 percentage deviation against the baseline assumption) at the start of the period produced the largest variance against baseline figures resulting to an almost 2.3 percentage point increase for the end-of-2022 debt ratio. Meanwhile, real exchange rate depreciation of 15%, based on historical levels, have a more muted effect of 0.4 percentage point increase in line with the continued redenomination of outstanding debt in favor of the local currency. Lastly, rising interest rates would have a compounding effect on debt payments expectedly causing a divergent path vis-à-vis the initial baseline debt trajectory.

[55] Includes NG guarantee and NG assumed GFI guarantee only. Excludes obligations arising from BOTs, IPPS and equivalent projects.

Figure 1. Debt Sustainability Analysis



Source: BTr staff estimates

43. **The sensitivity analysis of NG Debt to changes in interest and foreign exchange rates shows that the debt portfolio remained resilient against market shocks.** Table 4 presents the limited impact of changes in interest and foreign exchange rates to NG debt service over the medium-term.

    a. A 1-peso depreciation leads to a smaller increment of P1.8 billion in interest payments compared to the previous estimate of P2.0 billion in the 2017 FRS. However, there is a significant increase in the impact on principal payments amounting to P3.0 billion from the previous assessment of P1.6 billion. This highlights the effect of improving borrowing costs for foreign debt as well as the effect of liability management exercises carried out by the Government.

    b. Meanwhile, a 100 basis point increase in interest rates translates to a P10.5 billion increase in IP for 2018, up from the previous projection of P8.2 billion mostly due to floating rate foreign debt and rolling over of amortizing foreign debt payments.

44. **The Government's prudent and proactive stance in managing government debt over the past decade have resulted in improvement in debt sustainability and various cost-risk indicators.** This suggests that the Government needs to maintain its efforts in monitoring and managing the risks inherent in the debt portfolio, and be ready to navigate various macroeconomic shocks that may affect the sustainability of government debt over medium to long-term.

Table 4. Philippines: Sensitivity of Debt Service Flows

Particulars	2017 in PHP Millions	2017 Increase in IP Budget (%)	2018 in PHP Millions	2018 Increase in IP Budget (%)	2019 in PHP Millions	2019 Increase in IP Budget (%)	2020 in PHP Millions	2020 Increase in IP Budget (%)
Interest Rate Sensitivity (1ppt increase)								
Domestic Interest Rate								
Floating interest rate								
Rolled-over fixed rate[1/]	3,213.80	0.96%	4,065.77	1.21%	4,437.87	1.33%	4,933.91	1.47%
Foreign Interest Rate								
Floating interest rate	4,968.09	1.48%	5,683.85	1.70%	6,391.33	1.91%	7,173.24	2.14%
Rolled-over fixed rate	0.00	0.00%	1.34	0.00%	102.60	0.03%	173.38	0.05%
Rolled-over debt amortization	727.20	0.22%	732.60	0.22%	737.73	0.22%	561.83	0.17%
Foreign Exchange Rate Sensitivity (1 peso depreciation)								
Outstanding								
Of which against the US$	34,745.55		35,803.34		36,819.98		38,657.42	
Of which against the Euro	620.75		573.99		526.97		483.98	
Of which against the JPY	8,437.12		7,882.90		7,328.21		5,663.92	
Interest Payments								
Of which against the US$	1,762.23	0.53%	1,672.95	0.50%	1,524.56	0.46%	1,453.81	0.43%
Of which against the Euro	10.57	0.00%	9.33	0.00%	8.10	0.00%	7.00	0.00%
Of which against the JPY	128.73	0.04%	118.12	0.04%	107.92	0.03%	70.16	0.02%
Principal Amortization								
Of which against the US$	2,245.73		2,364.21		2,989.36		2,424.56	
Of which against the Euro	46.65		46.75		47.02		42.99	
Of which against the JPY	549.56		554.22		554.69		1,664.29	
Combined interest rate shock and FX depreciation2/								
Total	10,810.61	3.23%	12,283.96	3.67%	13,310.12	3.97%	14,373.32	4.29%
Domestic	3,213.80	0.96%	4,065.77	1.21%	4,437.87	1.33%	4,933.91	1.47%
Foreign	7,596.81	2.27%	8,218.19	2.45%	8,872.24	2.65%	9,439.41	2.82%

Source: BTr staff estimates

Notes:

Based on outstanding as of June 2016. Assumes roll-over in the same currency and interest rate structure for debt maturing within the projection

1/ Includes CBOL bonds maturing 2019.

2/ Includes domestic and foreign

V. MONETARY PERFORMANCE

45. **Domestic liquidity or M3 grew by 13.3 percent as of end-June 2017, faster than the 12.4 percent expansion recorded in the same period in 2016.** The continued increase in money supply remained consistent with the robust expansion in domestic demand.

46. **Demand for credit remains the principal driver of money supply growth.** Domestic claims grew by 15.4 percent in June 2017, faster than the 14.3-percent growth in May due largely to sustained growth in credit to the private sector. Growth in bank loans has remained strong on account of lending to key production sectors such as real estate activities; electricity, gas, steam and airconditioning supply; manufacturing; wholesale and retail trade, repair of motor vehicles and motorcycles; and information and communication.

47. Meanwhile, net claims on the central government grew by 14.0 percent as of end-June 2017, slower compared to the 25.6 percent growth in the same period a year ago, as a result of withdrawals by the National Government of its deposits with the BSP.

48. Net foreign assets (NFA) in peso terms grew by 2.8 percent year-on-year in June 2017 from 4.6 percent in the previous month. Foreign exchange inflows coming mainly from overseas Filipinos' remittances and business process outsourcing receipts continued to be the drivers behind the increase in the BSP's NFA position. Meanwhile, the NFA of banks expanded due to the growth in banks' foreign assets resulting from higher loans and investments in marketable debt securities.

49. **Bank lending sustains its expansion.** Outstanding loans of commercial banks, net of reverse repurchase (RRP) placements with the BSP, grew by 19.0 percent in June 2017 from 17.6 percent in June 2016. Likewise, bank lending inclusive of RRPs increased by 18.3 percent in June 2017 from 16.1 percent in the previous year.

a. Bank loans for production activities—which comprised 88.5 percent of banks' aggregate loan portfolio, net of RRP — grew by 17.9 percent in June from 17.6 percent in May. The growth in production loans was driven primarily by increased lending to the following sectors: real estate activities (17.8 percent); electricity, gas, steam and airconditioning supply (24.9 percent); manufacturing (11.6 percent); wholesale and retail trade, repair of motor vehicles and motorcycles (11.6 percent); and information and communication (35.5 percent).

b. Loans for household consumption increased by 22.5 percent in June 2017 from 23.6 percent in May due to the expansion in credit card loans and other types of household loans as well as sustained growth in auto loans and salary-based general purpose loans.

50. **Since the adoption of the interest rate corridor (IRC) system in June 2016, the Monetary Board (MB) has maintained its key monetary policy settings up to June 2017.**

On June 3, 2016, the BSP formally shifted its monetary operations framework to an IRC system for guiding short-term market rates towards the BSP policy interest rate to help improve the transmission of monetary policy. The IRC system consists of the rates on the following instruments: standing liquidity facilities (namely, the overnight lending facility (OLF) and the overnight deposit facility (ODF)); the overnight RRP facility; and term deposit auction facilities (TDFs).

The interest rates for the standing liquidity facilities form the upper and lower bound of the corridor while the overnight RRP rate is set as the middle of the corridor. The repurchase (RP) and special deposit account (SDA) windows were replaced by the standing OLF and ODF, respectively. Meanwhile, the RRP facility was modified to an auction-based facility offering an overnight RRP tenor. In addition, the TDFs serve as the main tool for absorbing the bulk of system liquidity.

Consequently, the interest rate corridor was set at 3.5 percent in the OLF, 3.0 percent in the overnight RRP facility, and 2.5 percent in the ODF. It should be noted that the shift to the IRC system did not represent a change in the BSP's stance of monetary policy. The IRC reforms are primarily operational changes.

51. **The policy decisions of the MB were based on the BSP's assessment of inflation dynamics and the risks to the inflation outlook over the policy horizon.** The MB observed that the balance of risks surrounding the inflation outlook remains tilted toward the upside. While there may be potential transitory impact of the proposed tax reform program, the social safety nets are expected to mitigate the resulting inflationary pressures. The long-run effects on productivity will improve overall supply and further dampen inflation. Meanwhile, prospects for the global economy have improved, but risks to external demand remain tilted to the downside.

    Nonetheless, the BSP emphasized that while global economic conditions remain challenging, prospects for domestic economic activity continue to be firm owing to buoyant consumer and business sentiment, ample liquidity, and sustained credit growth.

52. **In its policy pronouncements, the BSP has emphasized that its assessment of the inflation environment remains manageable, despite upside risks to the inflation outlook.** Latest baseline forecasts continue to be within the target range of 3.0 percent ± 1 percentage point for 2017-2019. Looking ahead, the BSP noted that it will remain vigilant against any risks to the inflation outlook and will adjust its policy settings as needed to ensure that future inflation remains consistent with the medium-term target while being supportive of sustainable economic growth.

EXTERNAL SECTOR

53. **Amid soft global demand, the country's external sector remains a pillar of strength for the Philippine economy. It has helped shield the economy and the domestic financial markets against recent financial market volatilities.** The country's current account had been in surplus for 13 consecutive years up to 2015, supported by the sustained increase in OF remittances, as well as in business process outsourcing (BPO) revenues and tourism receipts. The recent reversal of the current account to a small deficit of 0.3 percent of GDP or US$954 million in 2016, and 0.2 percent of GDP or US$234 million in the first half of 2017 is attributed mainly to the significant growth of goods imports relative to exports, which resulted in a widening of the trade-in-goods deficit. Strong growth were particularly recorded for capital goods and raw materials and intermediate goods. This reflects primarily the continued robust expansion of the domestic economy.

Meanwhile, remittances from OF workers continue to flow in from various geographical locations globally. For the period January to June 2017, cash remittances from OFs amounted to US$13.8 billion, which represents a 4.7 percent year-on-year growth rate, higher than the 4.0 percent projection for the year.

54. **Nonetheless, gross international reserves (GIR) remain ample at US$81.3 billion as of end-June 2017, able to support 8.5 months' worth of imports of goods and payments of services and primary income, and cover 5.6 times the level of short-term external debt based on original maturity and 3.8 times based on residual maturity**. This enables the BSP to, if necessary, participate in the foreign exchange market to ensure orderly conditions and smoothen volatility.

55. **The country's external indebtedness has declined relative to the size of the economy.** The favorable external sector position is also manifested through improvements in the country's external liability management as exhibited by sustained drop in the Philippines external debt ratios. The country's external debt-to-GDP ratio has decreased from 60.2 percent in 2004 to 24.5 percent in 2016 and 23.5 percent in the first half of 2017.

VI. FINANCIAL SECTOR

56. **The Philippine banking system maintained a solid performance as reflected by double-digit growth in deposits, assets and loan portfolio translating into improved asset quality, ample liquidity, sufficient capitalization and increased profitability.** The BSP continues to pursue proactive reforms aimed at promoting financial stability and advancing financial inclusion, thereby ensuring the resilience of the financial system.

Performance of the Banking System[6]

57. **Banks' risk-taking activities are funded by stable deposit and capital base.** The banking system's funding base was supported by deposit inflows and the build-up of capitalization. In particular, deposits, which are primarily peso-denominated and sourced mostly from resident individual depositors, increased by 14.1 percent to P11,013.1 billion. Banks' capital accounts also went up by 11.0 percent to P1,691.9 billion. The overall capitalization of the banking system remains strong as the capital adequacy ratio (CAR)[7] of universal and commercial banks (U/KBs) stood at 15.0 percent on solo basis and 15.8 percent on consolidated basis as of end- March 2017, which were well above the 10 percent BSP regulatory threshold and the 8 percent international minimum.

58. **Resources of banks were mainly allocated to lending activities.** The total assets of the banking system, which is mainly channelled to loans, grew year-on-year (YoY) by 13.5 percent to P14,236.4 billion. Loan portfolio, which expanded by 18.0 percent to P8,020.2 billion, is broad-based and diversified. By economic sector, real estate activities had the largest loan intake at 17.3 percent.[8] Despite the continued asset growth, loan quality of the banking system remained satisfactory as the non-performing loan (NPL) ratio stood at 1.9 percent, considerably better than the 16.9 percent NPL ratio as of end-December 2001 which was the highest recorded NPL ratio after the Asian financial crisis.

59. **Banks maintained ample liquidity to meet their operational requirements and related funding needs.** Despite the moderated growth in financial assets, banks were still building up their liquid assets in the form of cash and due from BSP and other banks. As liquid assets[9] grew by 8.3 percent to P5,546.1 billion, the banking system's liquid assets-to-deposits ratio was registered at 50.4 percent.

[6]Based on Philippine banking system data as of end- June 2017 unless otherwise stated
[7]Under the Basel III framework
[8]The other economic activities with double-digit percent loan shares were wholesale and retail trade (11.7 percent), manufacturing (11.1 percent), and loans to individuals for consumption purposes (10.5 percent).
[9]Sum of cash and due from banks and financial assets, net (excluding equity investments)

60. Banks have consistently posted a positive net income on the back of strong core revenues. Net income continued its uptrend as annualized net profit rose by 8.3 percent to P157.1 billion in June 2017, primarily fueled by the hike in interest-based revenues derived from lending to the corporate and consumer sectors. Accordingly, sustained profitability provided better returns to shareholders as return to equity (ROE) was maintained at 10.5 percent and the cost-to-income ratio declined to 64.2 percent.

61. International credit rating agencies continue to view the Philippine banking system as a source of sovereign strength. The Philippine banking system is one of the only two systems in the Emerging Markets (EM) in Asia-Pacific that earned a stable outlook for 2017 from Fitch Ratings in its December 2016 report.[10] The outlook of the Philippine banking system was likewise stable in the October 2016 report of Moody's.[11] Meanwhile, Standard & Poor's retained in April 2017 the Bank Industry Credit Risk Assessment (BICRA) score for the Philippines at '7', with '1' being the highest assessment and '10' being the lowest.[12]

Risks from the Banking Sector

62. Exposures of the NG to the banking sector remain minimal. As of end-June 2017, the Philippine Government's exposure to the banking system was mostly in the form of deposits totaling P1,294.3 billion,[13] which made up 11.8 percent of the P11,013.1 billion total deposit liabilities of the banking system. Meanwhile, the paid-in capital stock contribution of the NG in government banks (i.e., Land Bank of the Philippines- LBP, Development Bank of the Philippines-DBP and Al-Amanah Islamic Investment Bank of the Philippines-AAIIBP) was reported at P38.7 billion.[14]

63. The NG extends guarantees to government banks and GOCCs, as well as counter-guarantees to other government corporations. The notional amount of guarantees (i.e., FX cover) extended by the NG on foreign currency denominated borrowings of government banks from multilateral lenders is estimated at US$1.2 billion (or P59.1 billion) as of end-December 2016. Peso-denominated borrowings of government banks amounting to P5.9 billion for re-lending to priority sectors/projects are likewise guaranteed by the NG.

As of end-June 2017, bank loans granted to GOCCs to the extent guaranteed by the NG summed up to P168.1 billion. Meanwhile, real estate mortgage loans to the extent guaranteed by Home Guaranty Corporation (HGC) stood at P131.3 billion while loans to the extent guaranteed by Trade

[10] "2017 Outlook: Asia-Pacific Banks: Asset-Quality Risks Weigh on Sector Outlooks", www.fitchratings.com

[11] "Banking System Outlook - the Philippines: Robust Fundamentals Drive Stable Outlook", www.moodys.com

[12] "Ratings on the Republic of the Philippines Affirmed At 'BBB/A-2'; Outlook Stable", www.standardandpoors.com

[13] This is higher than the P1,132.5 billion deposits of the Philippine Government as of end- June 2016, which represented 11.7 percent of the P9,652.6 billion total deposit liabilities of the banking system.

[14] Based on bank-submitted Financial Reporting Package (FRP)

and Investment Development Corporation of the Philippines (TIDCORP) were reported at P1.5 billion. These exposures totaling P132.8 billion are counter-guaranteed by the NG since the obligations incurred by both HGC and TIDCORP are fully guaranteed by the NG as embodied in their respective Charters.

Challenges Faced by the Philippine Banking Industry

64. **Challenges in the short term faced by the banking industry stem from financial market volatilities.** The lingering uncertainties in advanced economies may affect capital flows resulting in volatilities in exchange rates and interest rates. These volatilities may cause pressures on banks' proprietary positions and balance sheets of the corporate borrowers of banks, which in turn may affect the banks' loan portfolio. The real estate sector and consumer finance, which are driving loan growth, are sensitive to tighter financial conditions.

65. **In the medium term, banks face challenges from competition and financial technology.** Banks may have to reassess their business models and competitive advantage to preserve their market share amid competition resulting from globalization and non-bank activities. Moreover, banks must be able to keep up with fast-paced innovations in financial technology which adapts to the preferences of consumer clientele on how they wish to be served.

66. **Moving forward, the industry should also be vigilant against the consequences of de-globalization, asynchronous monetary policies in advanced economies, heightened cyber-security and geopolitical risks.**

Risk Mitigation Measures

67. The BSP has instituted significant policy reforms to uphold good governance and align regulations and risk management practices with evolving trends and international standards consistent with its commitment to promote dynamic and stable, yet inclusive banking system.

    a. **Promoting deeper culture of good governance.** In line with the BSP's thrust to promote banks' effective operational risk management framework, the outsourcing guidelines were revised in 2016 to ensure that banks have in place appropriate processes, procedures and information systems that can adequately identify, monitor and mitigate operational risks arising from outsourced activities. The banks' board of directors and senior management shall be responsible in ensuring that outsourced activities are conducted in a safe and sound manner and in compliance with applicable laws, rules, and regulations.

    b. **Enhancing risk management standards.** The guidelines on managing liquidity and information technology (IT) risks were likewise enhanced to align with international standards and evolving trends in the global financial system. In particular, the BSP introduced the Liquidity Coverage Ratio (LCR) standards, a key component of the Basel reforms. Moreover, the BSP released to the industry the discussion paper on the Net Stable Funding Ratio (NSFR) last December 2016. The NSFR aims to ensure that banks have adequate long-term stable funding in contrast to the LCR which focuses on short-term funding adequacy. These two prudential standards comprise the Basel III Liquidity Standards which were issued in response to the noted deficiencies during the most recent global financial crisis.

With regard to IT risk, the BSP recently approved the issuance of pioneering guidelines on social media risk management that advocate responsible use of social media by BSP Supervised Financial Institutions (BSFIs). Likewise, the BSP issued guidelines on business continuity management (BCM) which requires BSFIs to adopt a cyclical, process-oriented BCM framework. Furthermore, in order to promote a secure digital financial services environment, the BSP amended the IT risk management guidelines to mandate BSFIs to adopt multi-factor authentication (MFA) techniques for certain transactions. This is in response to the increasing propensity and sophistication of cyber-attacks involving fund transfers, payments and other transactions via online channels.

c. **Strengthening bank's capital.** The BSP set up minimum standards for domestic systemically important banks (DSIBs) in coming up with their respective concrete and reasonable recovery plans. The supervisory policies and process for DSIBs are aimed at further strengthening the implementation of the DSIBs framework in line with the BSP's efforts to ensure the resilience of banks to withstand shocks, and thus foster stability in the financial system.

d. **Instituting financial stability mechanisms.** In order to timely identify and mitigate the build-up of system-wide risks, the BSP institutionalized macro-financial surveillance measures. Among these measures are the new prudential reporting requirement on repurchase transactions and the amendments to the regulatory definitions of past due (PD) and NPL to align with predominant global conventions (effective 1 January 2018).

   The BSP has also entered into a cross-border liquidity arrangement with the Bank of Japan which can be utilized as a liquidity buffer during emergency situations.

e. **Enhancing supervisory oversight on non-bank entities.** In light of the important role of pawnshops in building a more inclusive financial system, the BSP adopted a new supervisory framework to strengthen the governance and market conduct of these entities. Pawnshop operators are now subject to stricter fit and proper rules and applicable standards of corporate governance and financial consumer protection (FCP), particularly on disclosure and transparency standards.

The BSP recently adopted the enhanced oversight framework (i.e., network-based regulatory approach) for money service businesses (MSBs) which are comprised of Remittance and Transfer Companies (RTCs),[15] Money Changers (MCs) and Foreign Exchange Dealers (FXDs). Regulations governing the operations of virtual currency (VC) exchanges that facilitate the conversion of any VC into fiat currency or vice versa were likewise developed. This new framework classifies VC exchanges as RTCs, thereby subjecting the former with the basic requirements applied to the latter including compliance with anti-money laundering (AML) regulations.

f. **Protecting financial integrity and promoting increased transparency.** The BSP approved the amendments to AML regulations as part of its efforts to enhance integrity in the banking system and strengthen controls against money laundering and terrorist financing. This is to align the BSP regulations with the latest Revised IRR of the AML Act, as amended;[16] and the latest Financial Action Task Force (FATF) Recommendations and Guidance Papers, particularly on applying a risk-based approach to Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) standards and striking balance between financial integrity and financial inclusion. The enhanced regulations also recognized the use of technology in the conduct of customer identification.

   Moreover, to promote greater disclosure and transparency to the public, BSP guidelines on the submission of Annual Reports of banks and quasi-banks (QBs) were enhanced to ensure that proper disclosure is made on all significant matters including financial condition, performance, ownership and governance.

g. **Promoting financial inclusion and consumer education.** Towards inclusive growth, the BSP, on its part, is continuously pursuing reforms that will bring the financial products/services more accessible to Filipinos and relevant sectors. In particular, the guidelines on agricultural value chain financing were adopted. Moreover, the BSP now allowed the conversion of microfinance-oriented banks/branches to regular banks/branches and expanded the allowable services of micro-banking offices. The BSP also recently issued the regulation allowing banks to use third party cash agents as cost-efficient service delivery channels. With cash agents, banks will be able to strategically leverage on innovative digital banking solutions to onboard clients and expand its market. In addition, the BSP issued new rules that reduce the Know-Your-Customer (KYC) requirements for certain low-risk accounts. The use of technology for face-to-face contact requirements is now allowed to facilitate frictionless customer on-boarding.

[15]This include remittance agents, remittance platform providers and e-money issuers.
[16]This took effect on 7 January 2017.

With the vision of enabling Filipinos to make electronic payments to any transaction account in a convenient, affordable and secure manner, the BSP undertook policy initiatives and brokering changes in the industry through the National Retail Payments System (NRPS).[17]

In order to serve and protect consumer welfare, the BSP also introduced cooling-off provisions regarding the right of BSFI clients to cancel their investment contracts without penalty, thereby giving them the opportunity to reconsider their long-term investment decisions. The BSP also laid down revised guidelines governing fees on dormant deposit accounts and other retail bank products and services.

68. While the Philippine financial system is currently in a position of strength, the BSP will continue to strengthen its supervisory framework as well as pursue proactive prudential reforms which are aimed at: promoting financial transparency; improving risk management standards; fostering accelerated capital market development; broadening access to financial services that would result into a more competitive banking system; and advancing financial inclusion and consumer education. The BSP shall also collaborate with other financial regulators, if necessary, in safeguarding the stability and ensuring the resilience of the financial system.

[17]The BSP, together with industry stakeholders, launched the NRPS framework on 9 December 2015. The Charter creating the Payment System Management Body under the NRPS framework and the Expression of Interest for the establishment and operationalization of two Automated Clearing Houses were signed on March 31, 2017.

VII. OTHER CONTINGENT CENTRAL GOVERNMENT OBLIGATIONS

A. Government Owned and Controlled Corporations (GOCCs)

69. The DOF continues its various fiscal reforms to enhance financial discipline and better resource management among GOCCs. The Implementing Rules and Regulations (IRR) of R.A. 7656 (GOCC Dividend Law) was revised to simplify the assessment of dividends with the use of Corporate Income Tax Returns as the primary documentary base, and promote more transparent computation and efficient administration of dividend assessments.

The DOF Circular on Authorized Government Depository Banks was also amended to streamline approval process for authorized depository banks consistent with thrust of government to expedite delivery of services. The amendment likewise aims to further strengthen sound and efficient management of the financial resources of the Government.

70. The fourteen major non-financial government corporations (14 MNFGCs) improved its surplus in 2016 of about 88.86 percent more than previous year's financial performance. Compared with the 2015 surplus of P2.78 Billion, the increase in the surplus primarily emanated from National Food Authority's (NFA) lower importation and as an outcome of the buffer stocking made in 2015 in preparation for the supposedly severe impact of El Niño in the rice production and less intervention by NFA in the local procurement with the favorable market condition; improvement of Power Sector Assets and Liabilities Management Corporation (PSALM) brought about by lower fuel related costs, build-up of payables and lower interest payments; and Philippine National Oil Company's (PNOC) lower dividend payment in 2016. The additional dividend of PNOC in 2015 is a result of the recognition of gain from sale of banked gas and other extraordinary dividend.

Other GOCCs that also contributed to the financing surplus were National Power Corporation (NPC), National Transmission Corporation (Transco), Philippine Ports Authority (PPA), Metropolitan Waterworks and Sewerage System (MWSS), National Development Company (NDC) and Local Water Utilities Administration (LWUA). The combined surpluses of these GOCCS more than offset the increase in deficit position of the National Electrification Administration (NEA) and National Housing Authority (NHA).

For the years 2017 and 2018 the financial outlook of the 14 MNFGCs will be a significant reduction of the surplus it attained in 2016. The decrease in 2017 surplus was brought about by: PSALM's lower Universal Charge (UC) collection and Independent Power Producer Administration (IPPA) generation payment from Unified Leyte, and tax subsidy released in 2016 for VAT deficiency in 2012; NFA's higher importation and local procurement for buffer stocking; and higher expenditures of NPC due to increase in fuel cost and dividend arrears payable. In 2018, the minimal reduction in surplus was due to increase in anticipated capital expenditure of NFA with the construction of Central Office building and warehouse and build up of inventory; and conservative projected UC collection pending decision by the

Energy Regulatory Commission (ERC) on PSALM's various outstanding applications.

71. Social Security Institutions (SSIs) and Government Financial Institutions (GFIs) continued to post positive cash flows, mainly due to earnings derived from their diversified portfolio investments. Taken together, SSIs and GFIs posted a combined cash surplus of P87.93 billion for the year 2016 and contributed to the improvement of the overall public sector financial position.

Table 5. Philippines: Consolidated Public Sector Financial Position, 2015 – 2018
(As percent of GDP, unless otherwise specified)

Particulars	Actual		Program	
	2015	2016	2017	2018
Consolidated public sector financial position	1.02	-0.15	-1.10	-0.90
Non-financial public sector financial position	-0.85	-2.19	-2.90	-2.90
Financing position of 14 major MNFGCs	0.02	0.17	0.02	0.02
in billion pesos	2.78	24.93	3.87	2.66
Financing position of GFIs	0.10	0.11	0.08	0.08
in billion pesos	13.80	15.48	12.16	14.20
Financing position of SSIs	0.46	0.50	0.48	0.48
in billion pesos	60.64	72.44	75.40	84.66

72. SSIs are in the bracket of large government corporations in terms of assets and revenue size. Given the magnitude of funds they manage, they have been operating at positive returns. Part of their strategic objectives include: maintain their financial viability, achieve funds perpetuity and promote the welfare of their members.

73. In 2016, SSIs surplus improved by 16.29 percent from the previous year's P60.64 billion, mainly due to higher member's contribution including NG share with the implementation of the 1st tranche of the Modified Salary increase for civilian personnel, alongside with the growth of membership by 10 percent and increased subsidy to Phil Health. SSIs will continue to be in surplus in 2017 and 2018. However, increase in the projected surplus in 2017 will be minimal mainly due to: higher benefit pay-outs (mainly due to the health care provisions of Phil Health), moderate income from investments and higher provision for operating expenses to expand their operations locally and overseas. In 2018, surplus will slightly improve despite the increase in pension pay-outs by SSS and Phil Health bearing another substantial expenditure for the delivery of health care services to its members.

74. GFIs perform their unique functions aligned with the economic roadmap of the government. GFIs surplus in 2016 amounted to P15.48 billion which is higher by P1.69 billion compared to 2015. The GFIs' major revenue drivers are their improved performance with regards to their favorable lending activities, gain on sale of properties, lower financial charges and recovery of advances on guaranteed loans. They provide financing/credit facilities which can be accessed readily by the priority sectors of the government at concessional terms.

Table 6. Philippines: Liabilities of the Government Corporate Sector and 14 Major Non-Financial Government Corporation (MNFGCs), 2015
(in billion pesos, unless otherwise specified)

Particulars	Total Liabilities	% of GDP
TOTAL GOCCs	4,122.36	28.47%
Share of 14 MNFGCs (%)	33.65%	
TOTAL 14 MNFGCs	1,387.30	9.58%
NPC	13.89	0.10%
PSALM	722.57	4.99%
TransCo	145.23	1.00%
NFA	171.63	1.19%
LRTA	66.24	0.46%
NIA	120.6	0.83%
HGC	25.22	0.17%
PNR	27.39	0.19%
MWSS	13.17	0.09%
PPA	9.88	0.07%
NEA	32.03	0.22%
LWUA	8.23	0.06%
NHA	16.52	0.11%
NDC	4.51	0.03%
PNOC and Subsidiaries	8.99	0.06%
PEZA	1.2	0.01%

Source: 2015 COA Audited Reports, comprising 135 GOCCs
1/ Excluding Bangko Sentral ng Pilipinas
2/ NPC, TransCo and PSALM are counted as one

The GFIs projected cash surplus in 2017 will be slightly lower than 2016 but will slightly improve in 2018. In consideration of the BASEL III Leverage ratio framework, LBP was given relief in 2017 dividend remittance for its 2016 Net Income while P2.0 Billion equity to DBP was proposed under the 2018 budget to DBP.

75. Total liabilities of the government corporate sector in 2016 amounted to P4.12 trillion based on the 2016 COA audited reports (Table 6). The liabilities of the 14 MNFGCs of P1.39 Trillion accounted for 33.65 percent of the total liabilities or equivalent to 9.58 percent of GDP.

Table 7. Philippines: Outstanding Government Guaranteed Debt to GOCCs, 2016
(in billion pesos)

Particulars	Amount	% of GDP
MNFGCs		
PSALM	238.21	1.65%
NFA	131.84	0.91%
LRTA	4.14	0.03%
MWSS	9.16	0.06%
PPA	3.73	0.03%
LWUA	2.92	0.02%
PNR	1.56	0.01%
NPC	0.65	0.00%
PEZA	0.1	0.00%
NEA	0	0.00%
GFIs/SSIs		
DBP	56.31	0.39%
LBP	23.04	0.16%
TIDCORP	0.48	0.00%
SBGFC	1.14	0.01%
NHMFC	11.63	0.08%
Others		
AFAB	0.04	0.00%
BCDA	20.26	0.14%
SBMA	5.48	0.04%
MIAA	2.72	0.02%
NLRC (NORTHRAIL)	1.03	0.01%
PDA	0.13	0.00%
TIEZA	0.25	0.00%
TOTAL	514.8	3.56%

Source: DoF

76. The borrowings of the GOCCs were mostly covered by NG guarantees through the respective charter of the GOCCs or RA 4860, as amended (Foreign Borrowing Act) (Table 7). The Government had extended guarantees to GOCCs' obligations in order to support the bankability of their investment, or to comply with the requirement of the lending institutions: bilateral or multilateral institutions. The outstanding guaranteed debt of all GOCCs declined to 3.56 percent of GDP in 2016 compared to 4.11 percent in 2015.

77. In addition to guarantee on GOCCs' borrowings, the National Government had provided performance undertakings on GOCCs' obligations under BOT schemes. These were the case of the various power projects of the NPC/PSALM and the Casecnan Multi-Purpose Project of the NIA. The total guarantees for these contractual obligations of NIA and PSALM were estimated at P254.333 billion as of 2016.

NG has a net lending program (NLP) for GOCCs which extends advances for the debt servicing of the guaranteed GOCCs' obligations to avoid defaulting on guaranteed commitments (Table 7). The National Government will advance only the repayment of guaranteed obligations or relent loans of a GOCC if there is clear indication of GOCC's insufficient funds to pay the maturing obligations after due evaluation. Policy initiatives were undertaken through more prudent fiscal management reducing the yearly advances to GOCCs.

Table 8. Philippines: Outstanding NG Advances to GOCCs, 2015 – 2016
(in billion pesos)

Particulars	2015	2016
Of the 14 MNFGCs		
NIA[2/]	58.91	61.19
LRTA	34.27	36.3
PNR	23.36	23.97
NEA	20.25	18.19
NPC/PSALM[3/]	20.5	30.81
NFA	24.01	26.79
NDC	4.891	3.79
HGC	11.65	11.85
MWSS	-	2.89
Other GOCCs	30.32	31.35
TOTAL	228.16[1/]	247.14[1/]

1/ Includes interest on NG advances
2/ Represents Casecnan-related accounts
3/ Includes Casecnan-related accounts
Source: BTr. Includes interest on NG advances; excludes CB BOL.

78. The budgetary supports to GOCCs are extended to the priority programs of the government such as health insurance, irrigation and rehabilitation and restoration of calamity-affected areas. (Table 7). The budgetary flows to the GOCCs are offset by the revenues remitted to the national treasury in the form of dividend, other fees and other form of shares in GOCC revenue. GOCCs contribute P58.63 billion in the revenue generation effort of the government as its total remittances represent 27.29 percent of total non-tax revenues in 2016. Out of the total revenue for GOCCs, dividend remittance to the National Government of 55 GOCCs amounting to P27.7 Billion in 2016 decreased by 17.1 percent or P5.7 Billion as compared to 2015 dividend remittance. The biggest remittances came from Land Bank of the Philippines (LBP), Development Bank of the Philippines (DBP), Philippine

Deposit Insurance Corporation (PDIC), Philippine Ports Authority (PPA), Philippine Amusement and Gaming Corporation (PAGCOR), Manila International Airport Authority (MIAA), and Philippine Reclamation Authority (PRA) which represent 82.96 percent of the total GOCCs dividend remittance in 2016.

Table 9. Philippines: Net Budgetary Flows to GOCCs, 2015- 2016
(as percent of GDP, unless otherwise specified)

Particulars	2015	2016
I. NG Flows from GOCCs	**0.46**	**0.4**
(in billion pesos)	**61.04**	**58.63**
Dividend	0.25	0.19
Interest on NG Advances	0	0
Guarantee Fees Collected	0.03	0.01
Forex Risk Cover Fee	0.01	0.01
NG Share on Net Income	0.16	0.18
Airport Terminal Fee	0	0.01
II. NG Flows to GOCCs	**0.66**	**0.9**
(in billion pesos)	**88.48**	**130.17**
Subsidy[a/]	0.59	0.71
Equity	0.01	0.08
Net Lending	0.07	0.11
NET NG FLOWS (I-II)	-0.21	-0.49
In billion pesos	-27.43	-71.54

a/ Excludes tax subsidy – because of its neutral effect since it is considered as both revenue and expenditure of the government

Source: BTr

Current Progress of Governance Commission for GOCCs (GCG) Mandates

79. **With the new administration onboard, the Governance Commission continued the streamlining of the GOCC Sector by recommending 5 GOCCs for abolition and/or privatization to the Office of the President in the early parts of 2017.** From 157 in 2011, only 123 GOCCs remain to be going concerns for the Governance Commission in 2017. This figure includes the additional 20 Coconut Industry Investment Fund (CIIF) Companies declared as GOCCs last February 2016. For the previously approved abolitions and privatizations, the Commission continued to oversee the implementation of the liquidation process to ensure that all progressions are in accordance with law.

80. **Investment in programs and projects for economic growth and development through GOCCs amounted to P87.12 Billion for 2016.** This program fund was mostly used for the implementation of universal healthcare to senior citizens and indigent families, housing and resettlement

programs, electrification of Sitios and other missionary areas, food security and stabilization programs, and coconut planting programs.

81. GCG continued to implement the Performance Evaluation System (PES) using the Balanced Scorecard (BSC) and Quality Management Systems (QMS), including the transition to ISO 9001:2015 in all GOCCs to inculcate innovation, efficiency, and evidence-based governance through linking regular strategy and operations review to social impact, stakeholders' feedback, and other financial and operational indicators.

82. **Further, the GCG commenced its implementation of Executive Order No. 203 which adopted the Compensation and Position Classification System (CPCS) for the GOCC Sector.** This will standardize the compensation structure among all GOCCs and make it competitive with the private sector doing comparable work in order to attract, retain, and motivate a corps of competent civil servants to provide a world-class quality of public service. It is noteworthy, however, that the funds for the implementation of the compensation adjustments within GOCCs depends on their financial capability and their corporate operating budgets.

Moving Forward in Pursuit of GCG Mandates

83. GCG is currently studying the rationalization of 13 GOCCs through abolition, decoupling of regulatory and commercial functions and privatization this 2017.

84. The GCG also promotes the adoption of the ISO 9001:2015 among all GOCCs, which will pave way for the development of quality systems that emphasizes the role of governing board and management team in the achievement of the GOCC's performance measures and targets.

85. Relative to the PDP 2017 to 2022, GCG commits to continue reviewing the mandate and performance of GOCCs under its jurisdiction, and determine actions that must be undertaken to promote Competitive Neutrality in the country.

86. GCG also targets to roll out uniform standards and methodologies for GOCC Customer Stakeholders Satisfaction Survey and Policies and Programs for Enterprise Risk Management System for GOCCs.

87. Establish a Memorandum of Agreement with the DOF and DBM for inter-agency cooperation.

88. Roll-out of the improved Integrated Corporate Reporting System (ICRS) that will enable faster correlation and disaggregation of data as well as the identification of trends in support of the policy-making and oversight functions not only of GCG but also DOF, DBM, and COA. The public portal will also serve as an online central repository for all information on GOCCs open to the general public.

89. Develop a talent pool of professionals and create board profiles per GOCC in a way that will allow the nomination for board directorship of individuals with known expertise in the industries or areas where the GOCCs are classified.

90. Lastly, although the CPCS has been approved and rolled out, no GOCC could implement the CPCS due to the various requirements that GOCCs must first meet. On another note, NG Agencies already implemented E.O. No. 201 or the SSL IV, which modified their salary schedule. Therefore, the GCG plans to propose an interim measure for GOCC officers and employees to likewise enjoy compensation adjustments, until such time that the GOCCs can fully comply with the requirements of the CPCS and implement the same.

B. PUBLIC PRIVATE PARTNERSHIPS (PPPs) AND OTHER CONTINGENT LIABLITIES (CL)

91. As of end-May 2017, the government's PPP portfolio has grown to 15 awarded projects and a total project cost of P 317.11 billion. Three other projects have so far been approved by the NEDA Board and are in the bidding stage, and an additional five unsolicited projects are currently under evaluation by the implementing agencies and the Investment Coordination Committee (ICC).

92. The "Build! Build! Build!" Infrastructure Agenda of this Administration targets public spending on infrastructure projects to reach 8-9 trillion pesos for the whole six-year term. To achieve this, the government has adopted a new hybrid PPP model, where it finances the construction of big-ticket projects and bids out the operation and maintenance phases to the private sector. The government believes that this structure is the fastest and most cost-effective way of implementing a PPP.

93. Using a portfolio-level assessment of its PPP exposure, the government estimates its CL exposure in PPPs, even capturing potential risks under the BOT IPP projects contracted in the 1990s, and other "legacy" projects. Briefly, the valuation methodology factors in project cost and implementation status to estimate a project's cost of failure. The CL value is adjusted by the probability of failure using a localized failure rate and the presence of risk metrics to classify the project as low, medium, high, or very high risk.

94. A stock estimate of the government's contingent liabilities arising from PPPs for 2017 is P 262 billion, a 26-billion peso decrease from the previous figure. This is due to a large number of projects, a significant chunk of which are comprised of the BOT IPPs, being in the tail-end of their operations stages, where cost of failure is expected to have steadily gone lower. Flow estimate, on the other hand, is estimated at P 25 billion.

Table 10. Philippines: List of Awarded Projects

Awarded Projects	NEDA Board Approved Project Cost (PHP billion)	NEDA Board Approved Project Cost (USD billion)[18]	Implementing Agency
Daang Hari-SLEX Link Road (Muntinlupa-Cavite Expressway)[19]	2.23	0.04	DPWH
PPP for School Infrastructure Project Phase I[20]	9.89	0.20	DepEd
Automatic Fare Collection System	1.72	0.03	DOTr
NAIA Expressway Project[21]	17.93	0.36	DPWH
PPP for School Infrastructure Project Phase II[22]	3.86	0.08	DepEd
Mactan-Cebu International Airport Passenger Terminal Building	17.52	0.35	DOTr
Metro Manila Skyway Stage 3[23]	37.43	0.75	TRB
Southwest Integrated Transport System Project	2.50	0.05	DOTr
MRT Line 7 Project	69.30	1.39	DOTr
Bulacan Bulk Water Supply Project	24.41	0.49	MWSS
Civil Registry System Information Technology Project	1.59	0.32	PSA
LRT Line 1 Cavite Extension and O&M[24]	64.9	1.30	DOTr
Cavite-Laguna (CALA) Expressway[25]	35.43	0.71	DPWH
South Integrated Transport System Project[26]	5.20	0.10	DOTr
NLEx-SLEx Connector Road	23.20	0.46	DPWH

95. **Since 2014, the government has continuously provisioned for potential claims made against existing PPP projects.** The GAA FY 2017 included a provision of P 29 billion for the Risk Management Program under the "Unprogrammed Fund" of the budget. To date, no disbursements have been made from the Risk Management Program (RMP).

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[18] USDPHP 50

[19] Original project cost approved by the NEDA Board on July 8, 2011 was P1.956 billion. The cost increased to P2.23 billion due to the payment for the advance works improvements amounting to P0.050 billion as approved by the ICC-CC on November 29, 2011 and Variation Cost amounting to P0.223 billion.

[20] Approved Budget Ceiling (ABC) of the Build-Lease-Transfer contract is P16.43 billion

[21] Original project cost approved by the NEDA Board on May 30, 2012 was P15.86 billion; the cost increased to P17.93 billion due to the Variation Order

[22] The original project cost approved by the NEDA Board on November 29, 2012 was P13.14 billion. However, only two out of the five contract packages were successfully procured amounting to P3.86 billion

[23] Project cost is based on the final Engineering Design as approved by the Toll Regulatory Board

[24] Project cost is inclusive of the P19.83 billion ODA component

[25] Project cost does not include the approved minimum bid price amounting to P20.105 billion

[26] Project cost includes the cost of the C5-FTI-Skyway Connector Road (access ramp) of P1.20 billion, and cost of land

C. LOCAL GOVERNMENT UNITS (LGUs)

Risks/Challenges

96. **Local governments affected by the cancellation, closure and suspension order of the Department of Environment and Natural Resources (DENR) to the mining firms, have an estimated revenue loss of P899.35 million.** Of this, P821.13 million are estimated revenues of 16 cities and municipalities affected by mines closure and suspension while P78.22 million are from cancellation of the mineral production sharing agreement (MPSAs). Revenue collections from mining firms account for large percentage of the affected LGUs' total revenues, particularly for low income class LGUs, as these firms pay large amounts of taxes to their localities. Given this, the affected LGUs should find alternative revenue source, as they are likely to lose as much as 50 percent of their annual income.

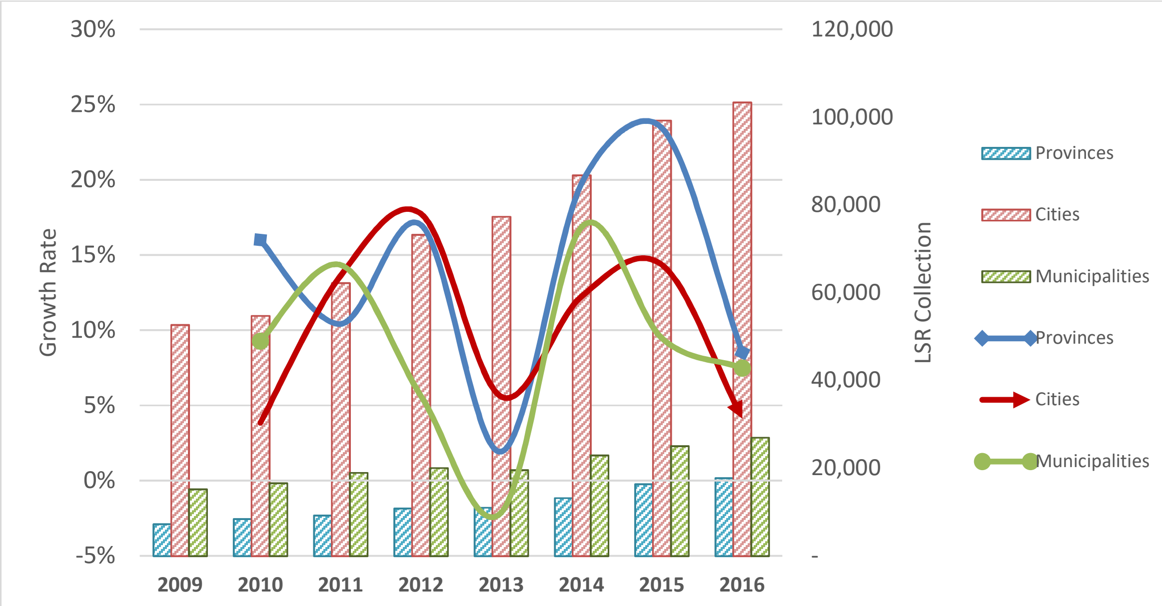
97. **Slow-down in growth of the own-source revenues of the local government units.** Although the revenues are increasing in nominal values, the growth rate have declined in 2016. Significant slowdown in the own-source revenues can be observed among provinces, from 28 percent in 2015 to 10 percent in 2016, and among cities from 12 percent in 2015 to 9 percent in 2016. This is brought about by the decline in the growth of business tax collections to only 9 percent; which still remained as the main source of local revenues of the LGUs at 43 percent.

    If this continues, local revenues will be overshadowed by the growth of NG revenues, which means LGUs will continue rely on the national transfers for the delivery of public goods and services.

98. **Absorptive capacities of the local government units needs improvement with the growing LGU surplus.** While having more fiscal space is desirable to support local development projects and activities, this is also an indication of low absorptive capacity. Local government surplus reached P138.63 billion in 2016 from P45.59 billion in 2009, with an increase of almost 200 percent.

    For 2016, around 93 percent of LGUs have surplus. Of the P138.63 billion, 62 percent can be attributed to first income class LGUs, particularly the cities. Given this, there might be a need to revisit the IRA distribution formula to take into account disparities in revenue potential of LGUs in line with their expenditure needs.

Figure 2. Locally-sourced revenues by LGU Type

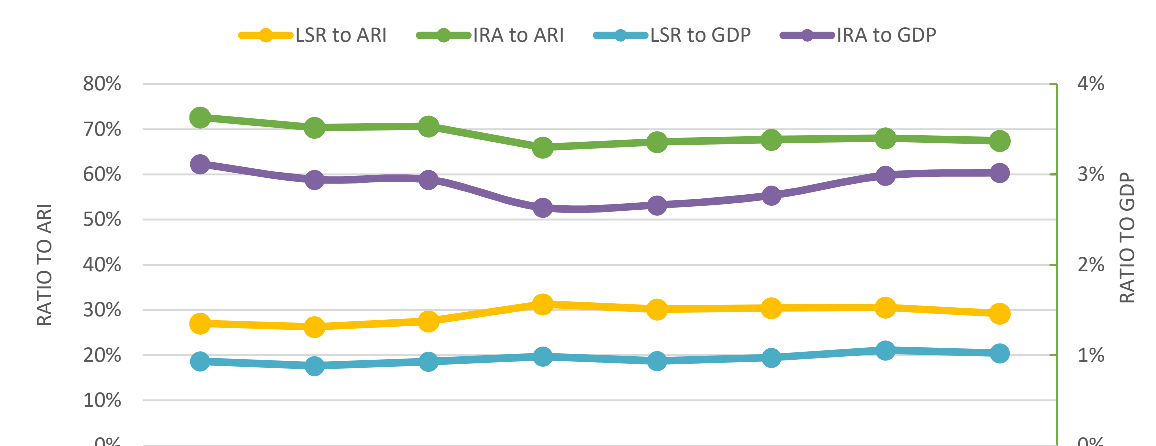


99. **Overall, local government units remain dependent on internal revenue allotment (IRA) at 71 percent.** LGUs, in aggregate terms, continue to rely on NG transfers, particularly the IRA for 71 percent of their income, to deliver mandated services and enhance local development. In most cities, local revenues provide a sizeable share of the regular income, at 50 percent, with around 47 percent IRA dependence. However, in provinces and municipalities, dependence on IRA is at 82 and 80 percent, respectively, given the low economic development and limited resource mobilization capacity. Overall, IRA, still considerably supports most of the budgetary requirements of LGUs, and positively contributes to allowing LGUs to invest on programs and projects that should improve local growth and development. Without IRA, low income LGUs cannot function effectively.

100. **Utilization of IRA for local development projects is relatively low compared to the statutory limitation prescribed in the LGC[27] of 1991.** Section 287 of the LGC provides that 20 percent of the IRA should be allocated for local development projects. However, data shows that in 2016, only 16 percent of the IRA were utilized by LGUs for the purpose prescribed by law. Consequently, the fund is not being optimized to address the developmental needs of LGUs, particularly in the realization of the goals for social development of the community.

[27] Local Government Code of 1991

Figure 3. LSR[28] and IRA share to ARI[29] and GDP



	2009	2010	2011	2012	2013	2014	2015	2016
LSR to ARI	27%	26%	27%	31%	30%	30%	31%	29%
IRA to ARI	73%	70%	71%	66%	67%	68%	68%	67%
LSR to GDP	0.94%	0.89%	0.93%	0.99%	0.94%	0.97%	1.06%	1.02%
IRA to GDP	3.1%	2.9%	2.9%	2.6%	2.7%	2.8%	3.0%	3.0%

101. **Local government units' estimated foregone real property tax (RPT) revenues from non-updating of Schedule of Market Values (SMVs) is at least P11.57 billion.** As of June 2017, a total of 142 or 63 percent of the provinces, cities and the lone municipality in Metropolitan Manila are using outdated SMVs, thus undermining their potential to generate own-source revenues as mandated to them by law. The annual local revenue could increase by up to P25.75 billion if RPT collection efficiency is optimized using updated SMVs, which could be used to finance the basic services for local constituencies and reducing their dependence on national transfers.

102. **Issuance of Executive Order No. 19 granting reduction and condonation of real property taxes and interests/penalties assessed in the power generation facilities of independent power producers (IPPs) under build-operate transfer contracts with government-owned or –controlled corporations would result to revenue loss on RPT collections.** Under EO No. 19, the real property tax are computed based on assessment level of 15 percent and fair market value of 2 percent, and IPPs are relieved from payment of fines, penalties and interests on power generation facilities. Since RPT is second major source of local revenues, this policy risks affected LGUs for a significant decline in their revenue. This would also impact the education sector since the Special Education Funds are provided under the RPT collections. Approximately, there will be an estimated P9.08 billion revenue loss in the said collections that may affect the barangays, municipalities, provinces and the local school board.

[28] Locally-Sourced Revenue (LSR) = RPT (GF) + Tax on Business + Other Taxes + Regulatory Fees (Permit and Licenses) + Service/User Charges (Service Income) + Income from Economic Enterprises (Business Income)
[29] Annual Regular Income (ARI) = LSR + IRA (CY) + Other Shares from National Tax Collections + Interest Income

Risk Mitigation Measures

103. **Institute reforms in real property valuation and assessment in the Philippines.** The proposed Valuation Reform Act (VRA) primarily aims to establish unified standards and processes to govern the valuation of real property in the country, thereby enhancing the LGUs capacity to generate local revenues from real property. This will ensure a rationalized real property valuation transcending political boundaries and promote genuine fiscal autonomy of local governments to provide basic services to their constituency. The potential LGU gains from the impact of VRA will result to an estimated P41.33 billion increase in local tax collections.

     If fully enforced and properly administered, real property tax offers a progressive and stable sources of revenues that can be shared among the LGUs and the Local School Board, to finance the provision of basic services and education needs to the LGUs constituencies, thereby improving the service delivery to the public.

104. **Develop the implementing mechanisms and procedures for the establishment of the idle land inventory and the imposition of idle land tax in all LGUs.** The tax on idle land is an ad valorem tax that is levied annually on the assessed value of real property that remains uncultivated and unimproved by a property owner. LGU revenues from RPT are estimated to increase by 20 percent from the imposition and efficient collection of idle land taxes.

105. **Improve local revenues through amendments of provisions in the Local Government Code (LGC) of 1991.** The review and amendment of the LGC of 1991 is long overdue given the recent progress in local governance reforms. With the proposed amendments, local governments will be given sufficient local fiscal autonomy particularly on tax assignments per LGU level and a greater flexibility in adjusting the tax rates, to be able to increase the potential of LGUs' own revenue sources. This could likewise mitigate the economic disparities brought about by the difference in the LGUs development level and natural resource endowment.

106. **Professionalization of local treasurers through the Standardized Examination and Assessment for Local Treasury Service (SEAL) Program.** The new policy of the DOF requires a three-level competency certification, in coordination with the Civil Service Commission (CSC), to promote the continuous professional development (CPD) of the local treasury service and to develop a corps of competent and qualified local treasury officials who demonstrate and perform their functions with the highest degree of excellence, integrity, professionalism, and ethical orientation.

107. **Intensive and closer LGU fiscal monitoring and performance evaluation by the Bureau of Local Government Finance (BLGF) through standardized reporting tools and metrics.** These includes a) electronic Statement of Receipts and Expenditures (eSRE); b) Local

Government Units Fiscal Sustainability Scorecard (LGU FSS); c) Environment and Natural Resources Data Management Tool (ENRDMT) and d) Local Finance Portal. These tools could serve as a basis to further improve the financial management of local governments for them to become self-reliant and less dependent on national government subsidies. In addition, it could provide specific areas for improvement, e.g. increase collection from other revenue source, improve the capacity of local treasurers, and enhance systems.

108. **Updating of key local finance manuals to take into account innovations and new policies, laws, jurisprudence, and other developments in local finance, i.e.** a) Local Treasury Operations Manual (LTOM); b) Manual on Real Property Appraisal and Assessment Operations (MRPAAO); c) Local Resource Mobilization Manual; d) Manual for the Preparation of the Statement of Receipts and Expenditures (SRE) for LGUs and e) User and Systems Manual on Environment and Natural Resource Development Management Tool (ENRDMT); and f) Philippine Valuation Standards (PVS).

D. NATURAL DISASTERS

Impacts of Natural Disasters

109. **Three (3) major typhoons were recorded in 2016 namely Typhoon Ferdie, Typhoon Lawin, and Typhoon Nina.** The table below shows the summary of damages and losses including the total damages and losses as percent (%) of GDP based on the figures from the Post Disaster Needs Assessment (PDNA) reports.

110. **Typhoon Ferdie inflicted total damages and losses of approximately P457 million in the Province of Batanes.** About 43 percent of total damages affected the Infrastructure Sector, specifically on rural and tourism infrastructures and public sector facilities. Significant damage was also noted on livestock, equipment, and post production facilities. Out of the total losses of P133.20 million, the Productive Sector incurred the most substantial loss at P109 million.

111. **Typhoon Lawin recorded total damages and losses of around P20.455 billion.** The highest damage was recorded in housing structures and education facilities (e.g., elementary and secondary school rooms, and classrooms furniture). Moreover, damages in roadways resulted in isolation of families, closure of several barangays including road access to work, schools and livelihood, and higher transportation cost. In terms of losses, the Productive Sector documented most losses which can be attributed to foregone revenues in agriculture, particularly, high value crops such as vegetables and rice, livestock and poultry.

Table 11. Philippines: Impact of Major Typhoons in 2016

Disaster/Event (Dates of Occurrence)	Affected Regions	Total Damages (PhP Mn)	Total Losses (PhP Mn)	Total Damages & Losses (PhP Mn)	Total Damages & Losses as % of GDP
Typhoon Ferdie (September 2016)	Region II (Batanes)	323.98	133.20	457.18	0.003
Typhoon Lawin (October 2016)	Region II (Cagayan, Isabela, Quirino, Nueva Vizcaya)	15,887.04	4,567.96	20,455.00	0.141
Typhoon Nina[30] (December 2016)	Subtotal	10,520.19	15,784.82	26,305.01	0.182
	CALABARZON	21.82	-	21.82	
	MIMAROPA	1,299.32	811.127	2,110.44	
	BICOL REGION	9,199.05	14,973.70	24,172.75	

Note: Total Damages and Losses as % of GDP are NEDA-RDS estimates
Source: Post Disaster Needs Assessment (PDNA) reports

112. **Among the three major typhoons, Typhoon Nina recorded the highest damages and losses worth P26.305 billion, 92 percent of which is inflicted in Bicol Region at P24.173 billion.** The Social Sector, particularly housing, recorded the highest damage estimates, followed by agriculture and fisheries (i.e., damage in agricultural inputs and assets). In terms of losses, the Productive Sector recorded the highest foregone revenue due to production losses in agriculture and fisheries (e.g., coconut and rice).

113. **In order to mitigate disaster risks, the country's Disaster Risk and Reduction Management (DRRM), as guided by the Sendai Framework for Disaster Risk Reduction (SFDRR) 2015-2030 is put into effect.** The Framework has four priorities of actions, namely: (a) understanding disaster risk, (b) strengthening disaster risk governance to manage disaster risk, (c) investing in DRR for resilience, and (d) enhancing disaster preparedness for effective response and to "Build Back Better" in recovery, rehabilitation, and reconstruction. DRR policy directions will also align with the PDP and relevant Sustainable Development Goals (SDGs).

114. For FY 2018, the National Disaster Risk Reduction and Management Fund (NDRRMF) is allocated with P25 billion for aid, relief, and rehabilitation services to communities/areas affected by natural calamities, epidemics, and other catastrophes. Of this amount, around P6.5 billion is allocated to the Quick Response Fund (QRF), while P1 billion is allocated to the People's Survival Fund.

[30] Data from acquired from CALABARZON are not yet official.

Annex A: Technical Notes and Assumptions Used in CL Estimation

1. Projects under implementation – those where contingent liabilities could potentially materialize – were considered. Based on information provided by the PPP Center, there were 14 projects under implementation as of April 11, 2016. Projects likely to be awarded by end of 2016 were not included in the initial computation since costs associated with those projects have yet to be finalized when the computation was made.

2. Projects were categorized based on their status description. Theoretically, project status would give a rough estimate of a project's CL value. In coming up with the base CL valuation, the following formulas were used:

   For awarded projects:
   $$CL = \text{Project Cost} * 20 \text{ percent}$$

   For projects under construction:
   $$CL = \text{Project Cost} * 110 \text{ percent} * \text{Completion }\%$$

   For operational projects:
   $$CL = \text{Project Cost} * (110 \text{ percent} - 33 \text{ percent}) * \%\text{ Concession Period Elapsed}$$

Project	NEDA Board Approved Cost[1]	Status	Completion (%)	Concession Period	Start Date	CL Value[1]
PSIP Phase 2[2]	3.13	Awarded				0.63
LRT 1	64.90	Awarded		32		12.98
Southwest ITS	2.50	Awarded		35		0.50
CALAX	35.43	Awarded		35		7.09
South ITS	5.20	Awarded		35		1.04
Bulacan Bulk	24.41	Awarded		30		4.88
MRT Line 7 Project	69.30	Awarded		25		13.86
NAIAX	17.93	Construction	72.69	30		14.34
PSIP Phase 2[1]	10.01	Construction	76.20			7.63
MCIA	17.52	Construction	12.48	25		2.41
MMS Stage 3 Project	37.43	Construction	9.66	30		3.98
Daang Hari	2.23	Operational		30	2015	0.06
PSIP Phase 1	9.89	Operational		10	2015	0.76
AFCS	1.72	Operational		10	2015	0.13
MPOC	5.61	Terminated		25		0.00
TOTAL						70.29

[1] *In PHP Billion*

[2] *Total NEDA Board Approved Cost for PSIP Phase 2 is P13.14 billion*

The percentages were based on Castalia's estimate. In the case of operational projects, 33 percent was subtracted from the multiplier to factor in cost of re-concession for the acquired value of assets.

3. A trigger rate was used as a multiplier to capture a CL's probability of occurrence. Projects that have yet to reach financial close were assumed to have a basic CL trigger rate of 25 percent, while projects in construction and in early operation stages were assumed to have a trigger rate of 37.5 percent. The computation also made several risk assumptions. Adjustments of 5 percent were made based on the following additional risks:

    a.) Major liability in USD (+5%)
    b.) Unsolicited procurement (+5%)
    c.) Demand risk (+5%)
    d.) Availability payment scheme (-5%)

Project	Cost[3]	CL Value	Trigger Rate (%)	Major Liability in USD	Unsolicited Procurement	Demand Risk	Availability Payment (%)	TOTAL RISK (%)	Adjusted CL Value
PSIP Phase 2	3.13	0.63	25.00	No	No	No	Yes	20.00	0.13
LRT 1	64.90	12.98	25.00	No	No	No	No	25.00	3.25
Southwest ITS	2.50	0.50	25.00	No	No	No	Yes	20.00	0.10
CALAX	35.43	7.09	25.00	No	No	Yes	No	30.00	2.13
South ITS	5.20	1.04	25.00	No	No	No	Yes	20.00	0.21
Bulacan Bulk	24.41	4.88	25.00	No	No	No	No	25.00	1.22
MRT Line 7 Project	69.30	13.86	25.00	No	Yes	No	Yes	25.00	3.47
NAIAX	17.93	14.34	37.50	No	No	Yes	No	42.50	6.09
PSIP Phase 2	10.01	7.63	37.50	No	No	No	Yes	32.50	2.48
MCIA	17.52	2.41	37.50	No	No	No	No	37.50	0.90
MMS Stage 3	37.43	3.98	37.50	No	No	Yes	No	42.50	1.69
Daang Hari	2.23	0.06	37.50	No	No	Yes	No	42.50	0.02
PSIP Phase 1	9.89	0.76	37.50	No	No	No	Yes	32.50	0.25
AFCS	1.72	0.13	37.50	No	No	Yes	No	42.50	0.06
MPOC	5.61	0.00					0.00		0.00
TOTAL		70.29							22.00

[3] *NEDA Board Approved Cost*

4. The proposed amount was raised to P30 billion, incorporating a buffer to cover for liabilities arising from legacy projects and projects likely to be awarded by end of 2016.