Republic of the Philippines
Development Budget Coordination Committee
Malacañang, Manila

Updates on the Mid-Year Report on the 2018 National Budget

November 22, 2018

The Development Budget Coordination Committee (DBCC) convened on October 16, 2018 to reassess the impact of recent developments in the macroeconomy and the fiscal sector. The Committee decided to revise the macreoeconomic assumptions and fiscal targets in view of the current inflation and interest environment, and recent local and global economic and financial developments.

Macroeconomic Assumptions

Growth

The growth target for 2018 was reduced from 7.0-8.0 percent to 6.5-6.9 percent taking into account the slower than expected growth in the first semester of the year, and the changes in the other macroeconomic assumptions and fiscal program.

With respect to the first semester performance, weaker external demand was the main drag on the economy, although there was also a slight weakening of household consumption, partly due to rising inflation. On the supply side, the slightly weaker performance of manufacturing and the almost stagnant agriculture were the main culprits.

The macroeconomic assumption for merchandise exports growth has been reduced to 2.0 percent, reflecting the more modest global growth outlook among others. The assumption for 2018 inflation has also been revised upwards to 4.8-5.2 percent, with the Dubai crude oil price assumption now at $70- 75/bbl, while the 364-day T-bill interest rate assumption has been increased to 4.4-4.6 percent. These increases are expected to negatively affect household consumption as well as investments.

The lower revenue program for 2018 has also resulted in a lower expenditure program. The lower spending on personnel services and MOOE are expected to reduce household and public consumption, offsetting the increase in investments from slightly higher capital outlay.

Moreover, the outlook for agriculture for the second half of the year has deteriorated. Based on standing crops, a contraction in *palay* and corn production is anticipated in the third quarter due to delayed plantings resulting from late release of irrigation water and late onset of rainfall[1]. In addition, the probability of a weak El Niño episode in the last quarter of 2018 until the first quarter of 2019 is rising[2].

Table 1. Selected Macroeconomic Indicators, 2018

Particulars	2018 DBCC Assumptions	
	Original[a/]	Revised[b/]
Growth Target (%)	7.0 - 8.0	6.5 - 6.9
Inflation (%)	2.0 – 4.0	4.8 – 5.2
Foreign exchange rate (₱/US$1)	48.00 – 51.00	52.00 – 53.00
Dubai crude oil price (US$/barrel)	45.00 – 60.00	70.00 – 75.00
364-day T-bill rate (%) [c/]	2.5 – 4.0	4.4 – 4.6
180-day LIBOR (%)	1.0 – 2.5	2.4 – 2.6
Goods exports growth (%) [d/]	7.0	2.0
Goods imports growth (%) [d/]	10.0	9.0

[a/] Based on FY 2018 BESF

[b/] Approved by the DBCC on October 16, 2018

[c/] Based on primary market rates

[d/] Based on Balance of Payments and International Investment Position Manual, 6th edition (BPM6)

Sources: DBM, NEDA, PSA, BTr, and BSP

[1] PSA, Rice and Corn Situation and Outlook, July 2018 Round

[2] NOAA Climate Prediction Center, El Niño Diagnostic Discussion, October 11, 2018

Inflation

Latest BSP forecasts indicate that inflation could average above the high-end of the inflation target range for 2018. The assessment of price and output conditions suggests that the risks to the inflation outlook remain weighted toward the upside in 2018 but downside risks to the outlook will dominate in 2019 – 2020. Additional wage adjustments and transport fare hikes, higher electricity rates, and faster-than-expected monetary policy normalization in advanced economies are the main upside risks to inflation. Meanwhile, the slower global economic growth due to protectionist policies in advanced economies and geopolitical tensions along with the proposed reform in the rice industry involving the replacement of quantitative restrictions with tariffs and the deregulation of rice imports continue to be the main downside risks to inflation.

Foreign Exchange Rate

The revised DBCC peso-dollar exchange rate assumption reflects the recent depreciation of the peso along with other emerging market currencies. On the domestic front, depreciation pressures could be attributed mainly to the wider trade deficit relative to a year ago, which reflected the government's accelerated implementation of its infrastructure program. On the external front, the sustained normalization of monetary policy by the US Fed as recovery of the US economy gains further traction as well as geopolitical tensions around the globe also posed depreciation pressures on the peso. Nonetheless, the peso market remains determined and is expected to draw its support from the country's firm macroeconomic fundamentals.

Dubai Crude Oil

Geopolitical tensions between the US and key oil producers, e.g., Iran and Venezuela, as well as production disruptions due to adverse weather conditions in the US contributed to increased prices and volatility in the global oil market. Forecasts by multilateral institutions also suggest that the 2018 oil prices would remain elevated as the global demand could outstrip supply for the year before gradually moderating over the medium-term.

364-day T-bill Rate

Higher domestic interest rate assumption for 2018 reflects the increase in the average 364-day T-bill rate during the auctions offered by the Bureau of the Treasury (BTr) thus far this year. The rise in domestic interest rates reflected mainly the monetary policy actions by the BSP and the US Fed. Going forward, trends in the domestic T-bill market will continue to be influenced by the emerging fiscal position of the NG given the approved tax reform vis-a-vis the commitment to sustain the infrastructure program, the future monetary policy actions of the BSP and the US Fed, and domestic liquidity conditions.

180-day LIBOR

Policy rate hikes by major central banks contributed to the rise in foreign interest rate in 2018. Upward adjustments in the target federal funds rate by the US Fed largely influenced the rise in LIBOR. Moreover, the Bank of Canada, Bank of England, Reserve Bank of India, and Bank Indonesia raised their respective policy rates in 2018. The revised LIBOR assumption for 2018 is likewise in line with recent available LIBOR futures data as well as expectations of one more policy rate hike by the US Fed for the remainder of the year.

Exports

Growth assumption for goods exports for 2018 was revised downward to 2.0 percent from 9.0 percent, mainly reflecting the significant upward revision made by the PSA in the 2017 actual trade-in-goods data, which resulted in a higher base of comparison for the 2018 projection. Apart from base effect, the synchronized recovery in trade and investment in 2017 may have taken a pause owing to the heightened uncertainty emanating particularly from protectionist policies in major economies, which are key trading partners for the Philippines. International investors and the business sector may have decided to take on a wait-and-see stance amid rising trade tensions and tighter financial conditions. Unfavorable domestic production conditions were also seen as contributing to the slowdown of agro-based export products for 2018. For instance, supply disruptions and other weather-related disturbances may result to lower exports of sugar, fruits, coconut products, and fish. Nonetheless, the government continues to see support from semiconductor exports, which account for more than 40.0 percent of total goods exports, as indicated by continued double-digit growth in world semiconductor sales. Moreover, the Semiconductor and Electronics Industries in the Philippines (SEIPI) targets electronics exports to grow by 5.0 - 6.0 percent in 2018 on the back of increased global demand and innovation.

Imports

The imports growth assumption for 2018 is projected to be lower than the earlier estimate due to base effect. However, its nominal level in 2018 could be slightly higher-than-previously expected reflecting the continued upward trend in global oil prices pushing up the oil import bill; the increased importation of certain agricultural products aimed at curbing inflation; as well as the significant expansion in imports of raw materials and capital goods in the first half of 2018, consistent with the rise in investments, supported by Foreign Direct Investments (FDI) and government's commitment to push its massive infrastructure agenda.

Fiscal Targets

For 2018, revenues are estimated to be at P2,819.7 billion given the efficiency of collecting agencies, also in consideration of the emerging macroeconomic indicators, as well as the status of the remaining packages of the Tax Reform for Acceleration and Inclusion (TRAIN) Law. The 2018 projected revenues were adjusted downward from its original level of P2,846.3 billion due to the non-implementation of the Fuel Marking and E-receipts under the TRAIN Package 1A amounting to P26.6 billion.

Table 2. Fiscal Targets, 2018 (In billion pesos)

Particulars	2018 DBCC Assumptions			Variance	
	Original[a/]	Revised[b/]			
		Amount	% of GDP[c/]	Amount	%
Revenues	2,846.3	2,819.7	16.1	(26.6)	(0.9)
Disbursements	3,370.0	3,346.5	19.1	(23.5)	(0.7)
Surplus/(Deficit)	(523.7)	(526.8)	(3.0)	(3.1)	0.6

[a/] Based on FY 2018 BESF

[b/] Approved by the DBCC on October 16, 2018

[c/] Nominal GDP: 17,510,534 million

Source: DBM, DOF and NEDA

Likewise, disbursements were revised downward from P3,370.0 billion to P3,346.5 billion considering the decline in expected revenues. Expenditures will be prioritized for mandatory items, payment for completed infrastructure projects and actual goods delivered and services rendered, and for grants and subsidies under the TRAIN social mitigating measures.

The 3.0 percent of GDP deficit will therefore be maintained, minimizing the country's exposure to foreign exchange volatility, higher foreign and domestic interest rates, as well as impact of greater global economic uncertainty. This strategy will help the government improve overall macroeconomic stability and attain fiscal sustainability over the medium-term.▪