



The Philippines: A Fortified Economic Story

Philippine Economic Briefing

October 2011

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Executive Summary

A Fortified Economic Story



Healthy, Sustained and Inclusive Economic Growth

- The economy continues to expand at a healthy pace despite a challenging external environment. With a second quarter Gross Domestic Product (GDP) growth of 3.4 percent and a revised first quarter GDP growth of 4.6 percent, the first semester GDP growth for this year is 4.0 percent
- Growth in Q2 was led by household and government spending on the demand side, and by a strong turnaround of the agriculture sector as well as the modest expansion of the services sector on the supply side. Private construction grew at a robust 20.5% in the first half of 2011
- Current economic expansion is sustainable with growth in 2011 and 2012 expected to remain above the average of the last 10 years. The government forecasts growth rates between 4.5% and 5.5% for 2011 and between 5.0% and 6.0% for 2012
- Economic growth in the Philippines is becoming more inclusive with unemployment rate at a low 7.1% as of July and GDP Per Capita trending up towards the upper middle income threshold

Government Financial Strength: An Improving Profile

- The overall government financial strength of the Philippines has improved dramatically owing to a stronger government balance sheet and an extremely robust balance of payments
- Fiscal sustainability remains at the core of the government's economic policy making and is a commitment manifested at all levels of the Aquino administration
- The government balance sheet has been bolstered by shrinking and manageable public deficits, by a declining government debt burden and by a proactive liability management stance that has rebalanced public debt towards local obligations and has managed to extend maturities and cut servicing costs
- This progress has been achieved in the context of a strengthening balance of payments that has dramatically reduced the country's vulnerability to external shocks and has multiplied the availability of external resources transforming the Philippines into a net external creditor

Executive Summary

A Fortified Economic Story

Credible Monetary Policy and a Resilient Banking System

- Prudent monetary policy has kept inflation low and stable at 4.6% as of end-September 2011, within the target band of 3.0-5.0%. Headline inflation for the first nine months of 2011 averaged 4.3%
- BSP preemptively hiked policy rates to rein in inflation expectations and raised reserve requirements to manage liquidity generated by capital inflows
- Latest BSP forecasts show inflation staying within the target range for 2011
- The Philippines' banking system is sound and characterized by low NPLs and very strong prudential ratios

A Fortified External Position

- Gross international reserves expanded to a record US\$75.2 billion at end-September 2011 – these reserve holdings are equivalent to 10.5x the country's short-term external debt based on original maturity
- Remittances remain strong – expanding by 8.2% in 2010 and by 6.9% in the first eight months of 2011
- The Business Process Outsourcing (BPO) industry, one of the driving factors behind the improving net services trade balance, is growing at an average of 20% annually

Governance Reforms: Yielding Results, Strengthening the Social Contract

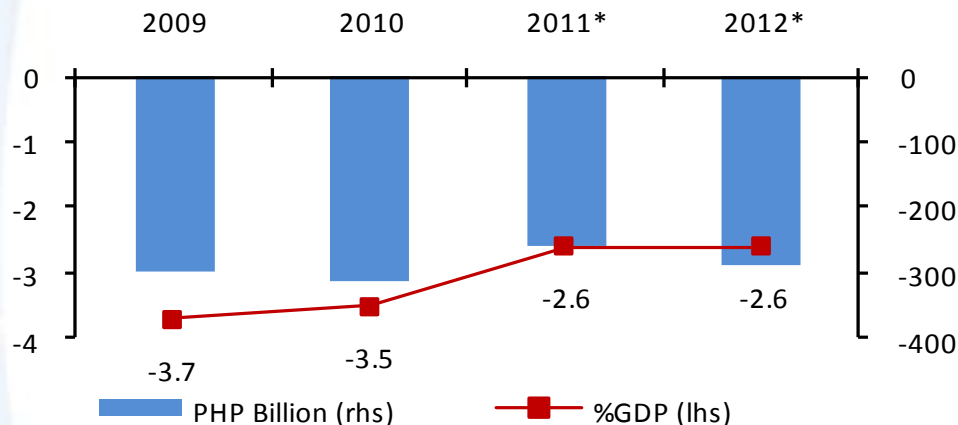
- The Aquino administration's governance reforms in the first 15 months in office have led to a ten-notch upgrade in the Philippines' ranking in the 2011-2012 WEF Global Competitiveness Report
- The Aquino administration has defined five areas of priority to strengthen the President's Social Contract
- These 5 areas drive the 2012 Budget and embody the ROP's commitment to lifting the poor from poverty through honest and effective governance

Executive Summary

A Fortified Economic Story: Concerns are being mitigated and strengths have been bolstered

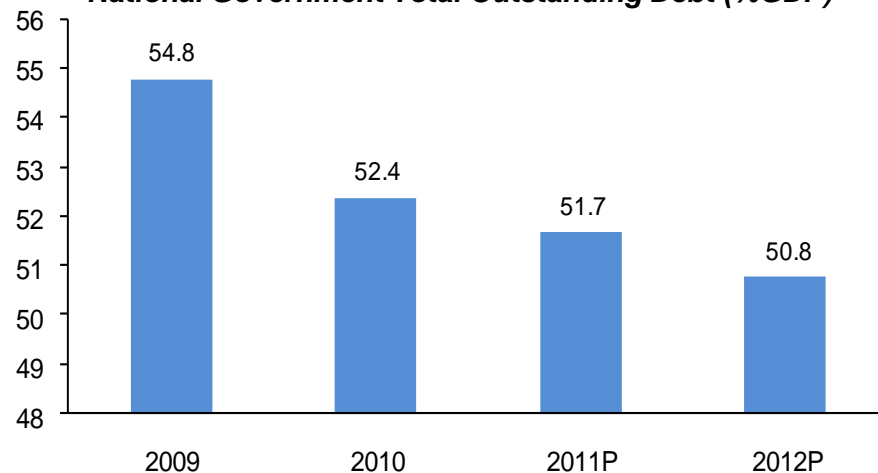
Deficits are manageable and shrinking

National Government Financial Position (%GDP and PHP bn)



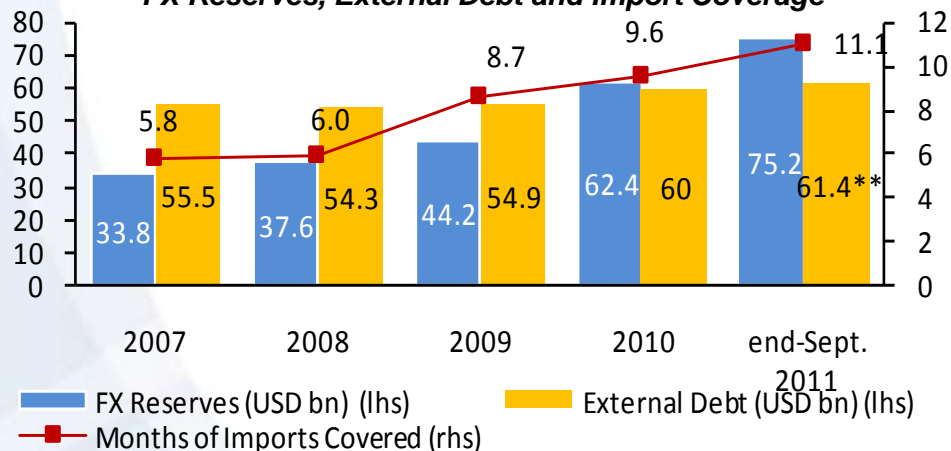
Government debt ratios are declining rapidly

National Government Total Outstanding Debt (%GDP)



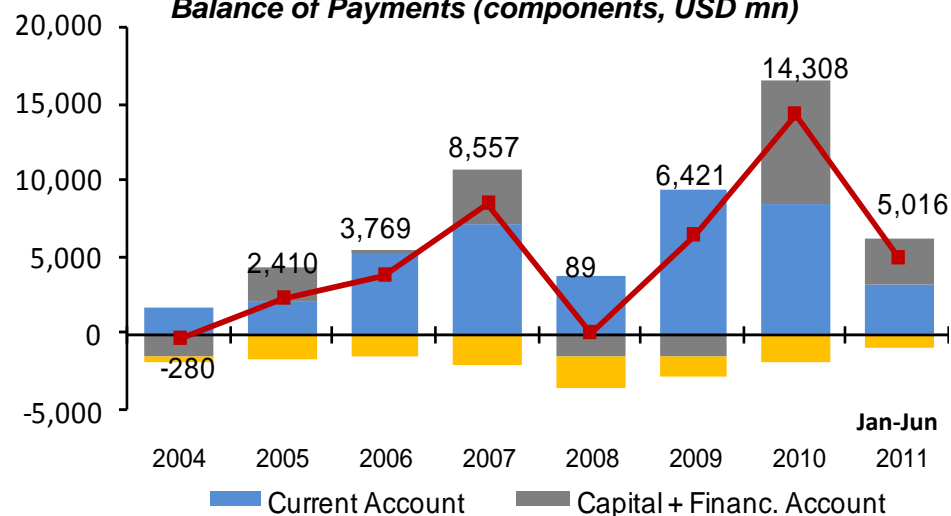
The Philippines is a net external creditor

FX Reserves, External Debt and Import Coverage



The Philippines enjoys a structurally positive BOP

Balance of Payments (components, USD mn)



*Revised outlook as of October 7, 2011

** As of 1H 2011

Source: Department of Finance (DOF), Bangko Sentral ng Pilipinas (BSP)

* Latest BOP position stood at US\$9.7 billion as of end-September 2011

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- 5 Governance Reforms: Strengthening the Social Contract

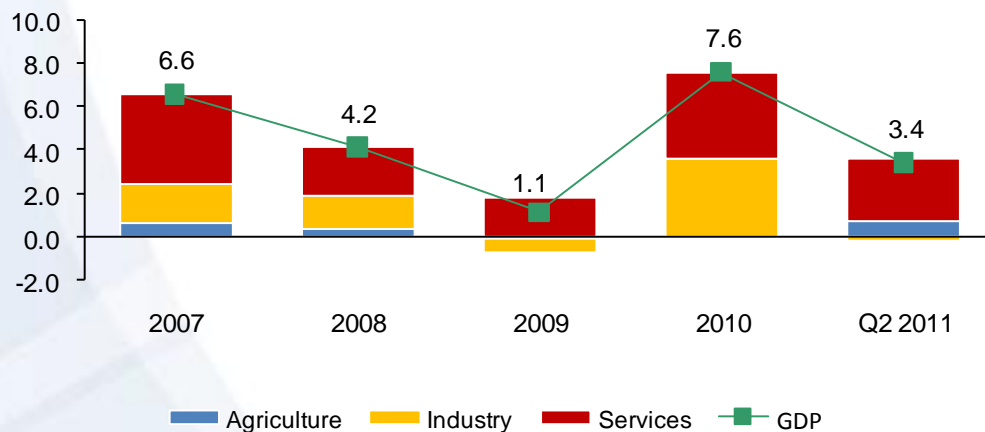
Healthy, Sustained and Inclusive Economic Growth

Healthy: The economy continues to expand despite a challenging external environment

- GDP grew by 4.0% in 1H2011
- Economic growth is becoming more broad-based
- Expansion was led by household and government consumption and by the agriculture and services sectors. Increases in capital formation was driven by higher private construction
- ROP is expected to sustain healthy expansion in 2011 and 2012

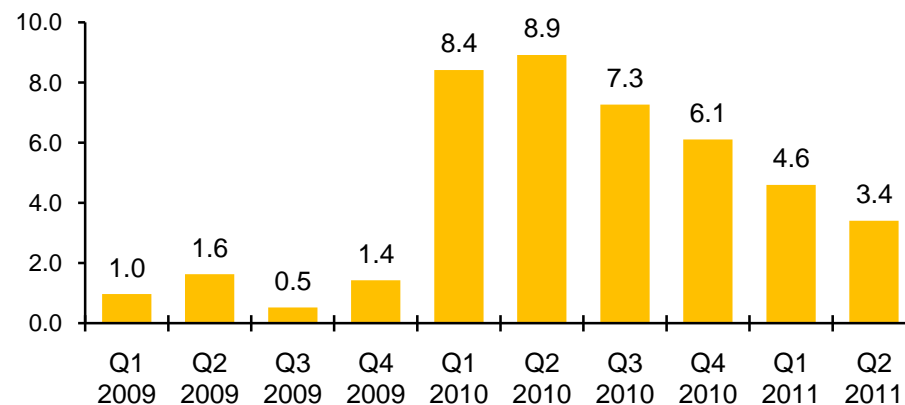
Economic growth is becoming more balanced

Contribution to GDP growth by industry origin (pct points)



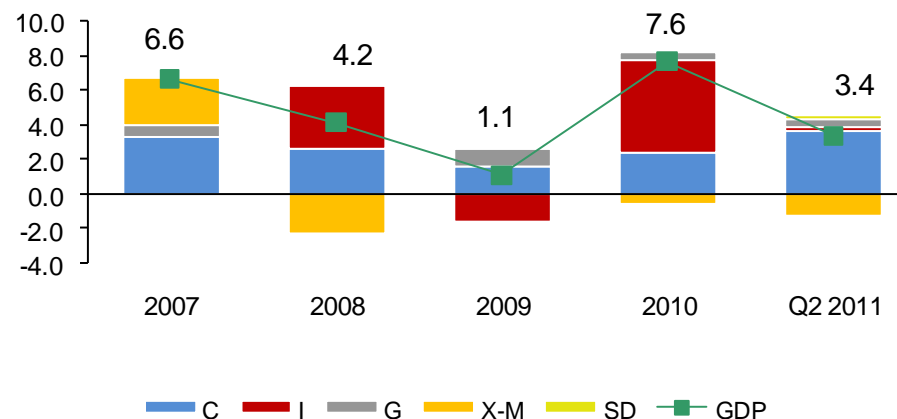
Economic growth remains healthy

GDP growth (y-o-y on a quarterly basis)



Healthy growth is being driven by consumer spending

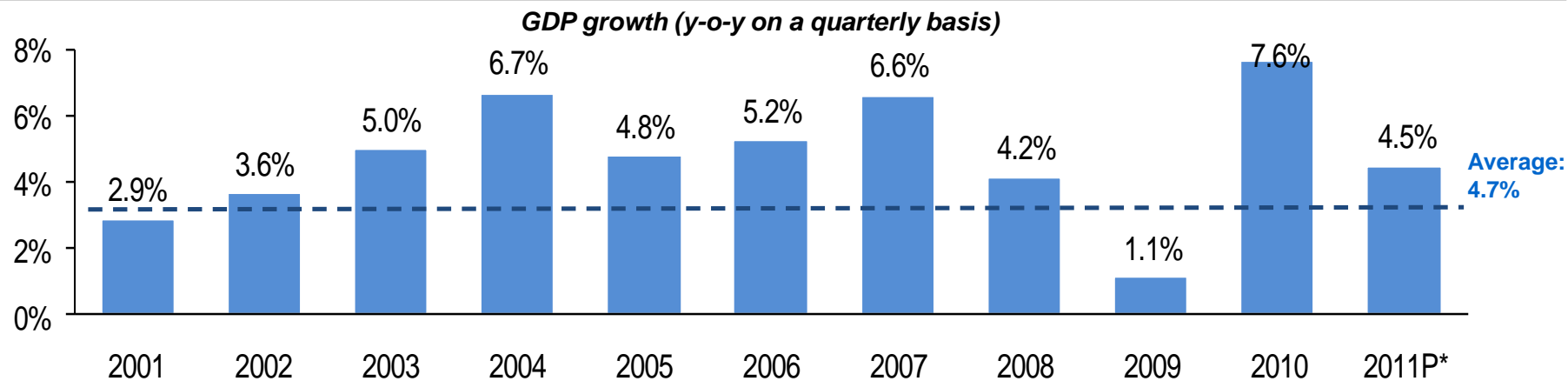
Contribution to GDP growth by expenditure (pct points)



Healthy, Sustained and Inclusive Economic Growth

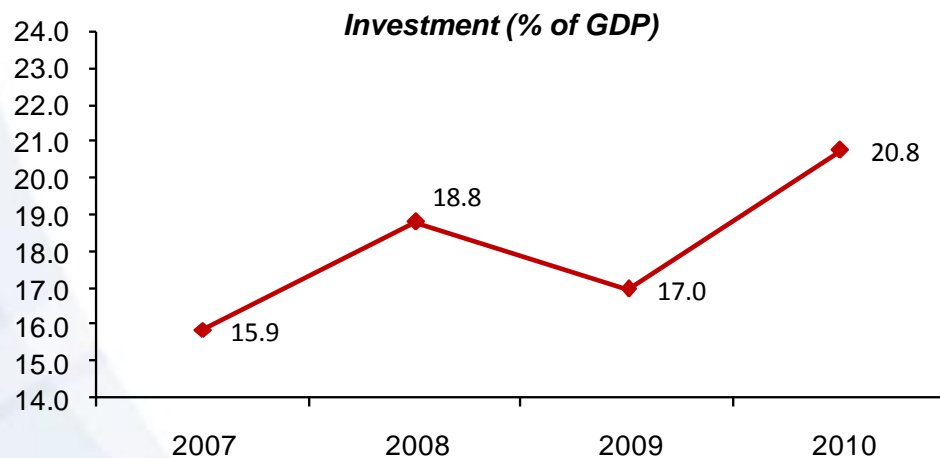
Sustained: The Philippines has a track record of economic growth even during extremely difficult conditions

A decade of rapid and sustained economic growth is set to continue







* Low-end of revised 2011 growth projection of 4.5-5.5 percent

Accelerating levels of investment should sustain healthy growth



Economic Growth Projections

	2011	2012
Official Assumptions 	4.5 - 5.5	5.0 - 6.0
 International Monetary Fund	4.7	4.9
 The World Bank	4.5	5.0
 Asian Development Bank <small>FIGHTING POVERTY IN ASIA AND THE PACIFIC</small>	4.7	5.1

Source: National Statistical Coordination Board (NSCB), Moody's, IMF, WB, and ADB

Healthy, Sustained and Inclusive Economic Growth

Sustained: Growth drivers remain intact despite an increasingly challenging environment

Growth Drivers: Supply Side

- **Agriculture** production will be supported by the strong prospect for palay production.
- **Other services and trade** will be supported by inbound tourists, the number of which is expected to rise, on the average, by 6.3 percent in 2011.
- **Mining** is expected to benefit further from high metal prices in the world market. The latest actual data and forecasts of commodity prices show average double-digit expansions of metals and minerals for FY 2011.
- **Real estate and private construction** will continue to remain upbeat given the bright prospects in the property market, in particular the office, residential, retail and hotel/leisure submarkets.
- **Public construction and government services** are likely to pick-up due to the accelerated spending plan of government implementing agencies and the Department of Budget and Management (DBM) for the rest of the year.
- As the inflation path remains consistent with the 3-5 percent inflation target for the year, the **transportation sector** will likely accelerate in the last two quarters of 2011.

Growth Drivers: Demand Side

- **Household consumption** will get a boost from the employment creation program, the continuing implementation of the conditional cash transfer program for the lower income deciles, the modest inflow of remittances, and the still well-anchored inflation expectations.
- **Investments** will continue to register positive increases given the bright outlook in the expansion plans of firms across the industry subsectors.

Risks and Challenges to Growth

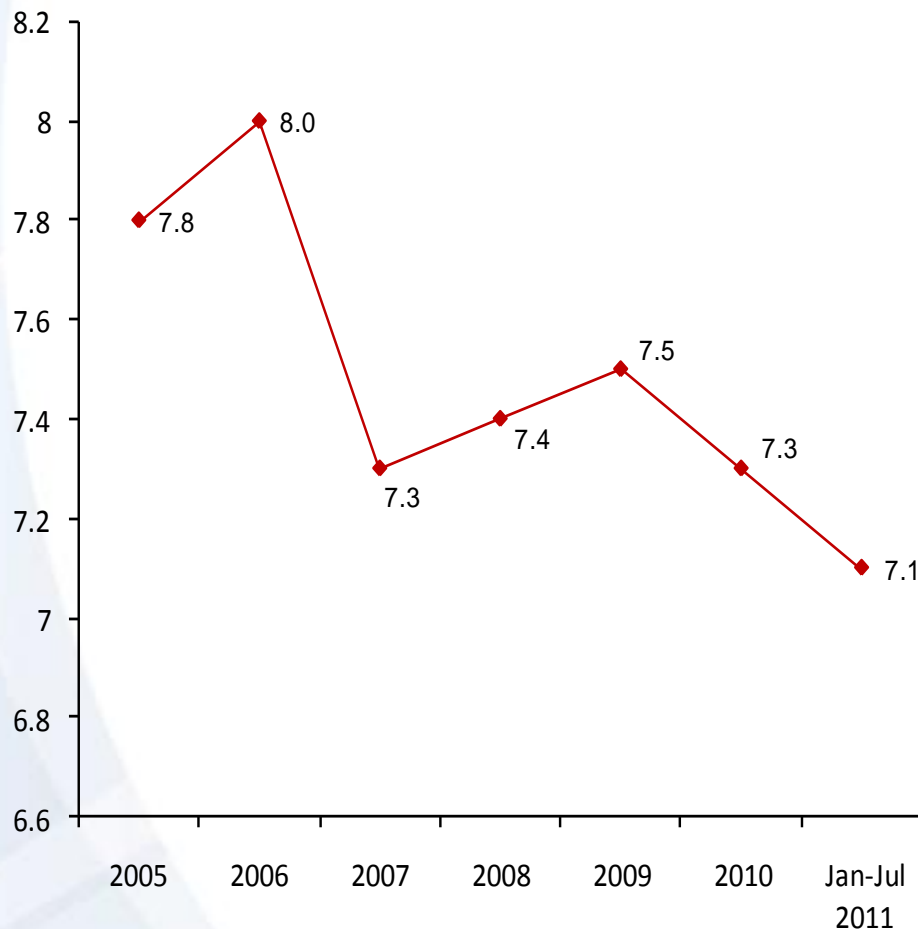
- **Uncertainty of external demand:** balance sheet problem and continuing weak consumption in the United States
- **Surge in capital inflows:** large capital inflows could pose challenges to liquidity and exchange rate management .
- **Protracted resolution of European debt crisis:** potential disruption to sovereign debt markets and global economic growth.

Healthy, Sustained and Inclusive Economic Growth

Inclusive: Economic growth is generating opportunities for all

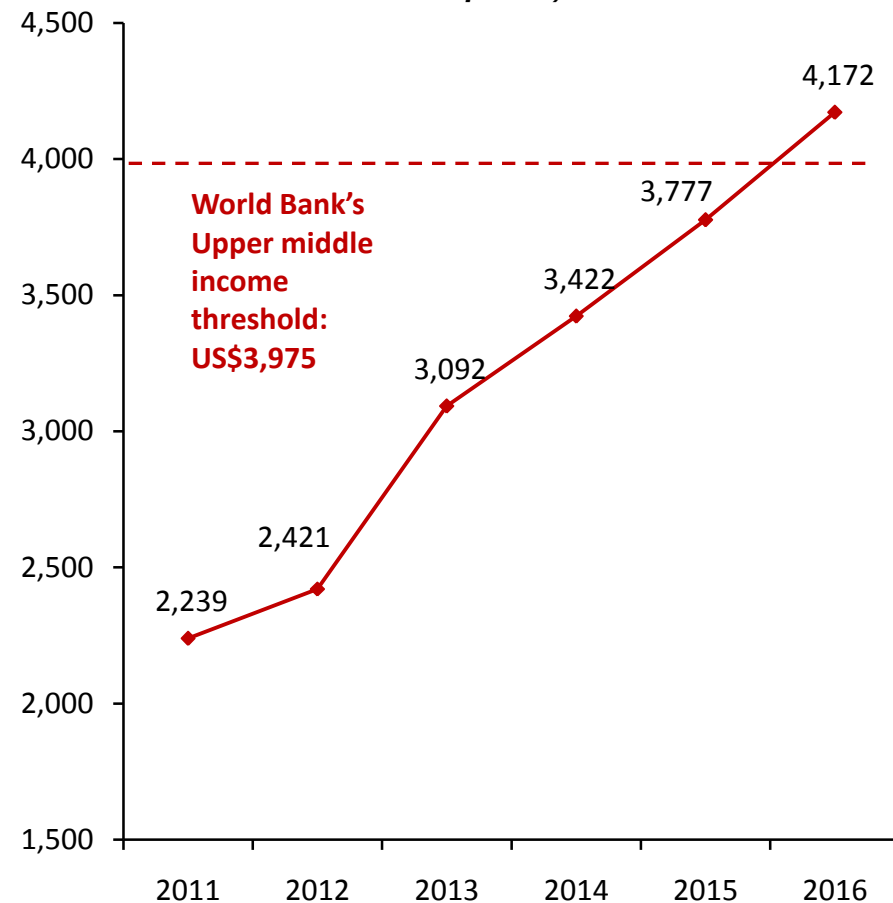
Unemployment has been consistently low and is declining

Unemployment rate (%)



The ROP is expected to cross the upper middle income threshold in the coming years

GDP Per Capita projections (Based on Government Assumptions)*



* GDP Per Capita calculation is based on low range budgeted nominal GDP, average range PHP/USD projection and IMF Population projections
Source: National Statistics Office (NS); IMF WEO April 2011; NEDA

Healthy, Sustained and Inclusive Economic Growth

Continued efforts to improve the business environment



Empowering the private sector through further business environment reforms

- **The Republic remains committed to making the business environment ever more predictable, reliable and efficient**
 - Upgrade the Business Name Registration System (BNRS); simplify business registration requirements and procedures.
 - DTI has successfully implemented measures to reduce business name registration to 15 minutes from 4-8 hours
 - There is ongoing integration of the Megalink Internet Payment Gateway (MIPG) in the BNRS as another payment option for the client in addition to the existing GCash
 - Streamline Business Permits and Licensing System (BPLS); simplify the minimum standards
 - Officially launched in August 6, 2010, the joint undertaking between DTI and DILG was able to set the following standards: unified business application form; 5 steps; <10 days for new; <5 days for renewals; and 2-5 signatories; 79 LGUS across all regions are now implementing BPLS reforms
 - Implement the Philippine Business Registry; provide single window online transaction processing system
 - Strengthen the National Economic Research and Business Assistance Center (NERBAC)
- **Develop Small and Medium Enterprises**
 - Capacitate small and medium enterprises (SME) by rewarding performers; make available training courses
 - Updates: The DTI has developed the SME Star Program which aims to support and strengthen the capabilities of MSMEs across the country; and recognize outstanding enterprises that have shown the most remarkable achievements in growing their businesses to globally competitive enterprises
 - Formulate the National SME Development Plan 2011-2016
 - Updates: THE MSME Development Plan 2011-2016 was crafted and approved by the MSME Development Council in May 2011. The Plan aims to address the key challenges and constraints that continue to prevent the MSME sector from realizing its full potential and boosting the country's industrial growth. To achieve this, the Plan lays out the overall framework to guide the formulation of action plans towards a more harmonized approach to MSME development. It was developed in close consultation with national, regional, and provincial stakeholders
 - Implement the Rural Micro-Enterprise Promotion Program (RuMEPP)
 - Updates: On its fourth year of implementation, RuMEPP continues to reduce rural poverty through increased economic development and job creation for poor rural households by promoting profitable and sustainable micro enterprises.

Healthy, Sustained and Inclusive Economic Growth

Continued efforts to improve the business environment



Empowering the private sector through further business environment reforms

▪ **Develop Small and Medium Enterprises**

- One-Town-One- Product promoted countryside development by assisting micro, small, and medium enterprises in the production, promotion, and marketing of locally produced goods and services. DTI created a marketing platform that would facilitate e-transactions. In the first quarter of 2011, a total of 62 MSMEs were enrolled. A complimentary web-mail is being created to accommodate more MSMEs to join in the e-marketing initiative

▪ **Other Measures**

- Organize massive information campaign on the benefits of trade agreements
- Pursue productive collaboration with the Philippine Chamber of Commerce and Industry and other non-governmental organizations supportive of Department of Trade and Industry's international trade agenda
- Implement sector specific focused interventions; more inbound less outbound missions; selective trade fair participation
- Stricter implementation of product testing and compliance standards; database sharing with BOC and Bureau of Products Standards to ensure monitoring of incoming shipments that require an import commodity clearance

Public-Private Partnership Program to Help Provide the Foundations for Growth



President Benigno S. Aquino III: *“These projects will undoubtedly further stimulate our economy, which has already experienced unprecedented success in recent months.... We can expect thousands of jobs for our people, growth in our economy, and long-term, mutually beneficial partnerships with large corporations.” (7 March 2011)*

PPP Projects for 2011 Rollout

	Est. Project Cost (PhP Millions)
<p>Daang Hari-SLEX Link Road Project (DPWH) <i>The project is a new 4 km. 4-lane paved toll road that will pass through the New Bilibid Prison reservation that will connect Bacoor, Cavite to the South Luzon Expressway near through the Susana Heights toll Plaza. The new linkage will complement the Cavite-Laguna-east-west highway and will address requirement for additional access between Metro Manila and Cavite</i></p>	1,956.00
<p>NLEX-SLEX Connector (DPWH)^{1/} <i>The project involves the construction of 13.4 km. 4-lane elevated expressway over the Philippine National Railway (PNR) right of way which starts at Caloocan City and ends in Buendia, Makati City. The project aims to complete the north-south Luzon industrial beltway transport axis by connecting NLEX and SLEX. The project will help decongest Metro Manila traffic and provide 24-hour access to Manila ports</i></p>	20,181.00
<p>PPP for Classrooms Project (Department of Education) <i>The proposed PPP for Classrooms Project (PCP) is aimed at supplementing the current initiatives and programs of DepEd on classroom construction nationwide. The pilot project will cover regions such as Region III (Central Luzon) and Region IV-A Calamba-Laguna-Batangas- Rizal and Quezon or CALABARZON, which were projected to have an increasing trend in student population, and identified to have the highest classroom gap. Region 1 (Ilocos Norte) will also be covered in order to reach the 10,000-classroom target</i></p>	10,400.00
<p>Vaccine Self-Sufficiency Project (VSSP) Phase II <i>To accelerate progress in vaccine production in the Philippines, the Department of Health (DOH) will implement the Phase II of VSSP. VSSP II is expected to reduce overall Expanded Program of Immunization (EPI) vaccine procurement costs of finished vaccines with local formulation, filling, labeling and packaging of the following vaccines: Pentavalent (DPT-HepB-Hib, Diphtheria, Pertussis, Tetanus-Hepatitis B and Hemphylus Influenza B), Tetanus Toxoid (TT), Single HepB</i></p>	960.00
Total	33,497.00

^{1/} Unsolicited Project
 Source: Public-Private Partnerships (PPP) Center

Medium-Term Infrastructure Plan

Massive infrastructure build-up to support growth and increase competitiveness



Proposed Medium-Term Budget (From 2011 to 2016)

	<i>Est. Total (PhP Billions)</i>
Department of Public Works and Highways (DPWH) <i>Highways, Flood Control and Other Projects</i>	697.10
Department of Transportation and Communications (DOTC)	565.00
Major projects: 1. 11.7 km LRT 1 Baclaran to Cavite 2. LRT 2 Santolan, Pasig to Masinag 3. Antipolo extension rail projects 4. Re-configured North rail project 5. International airports in Puerto Princesa, Laguindingan, Misamis Oriental and Panglao, Bohol 6. Seaports in Davao 7. RORO projects linking China with either the Subic and Batangas ports	
Department of Agriculture (DA) <i>Irrigation, Production Support, Post-harvest and Other Infrastructure, Trading Center, Farm-to-Market Roads and PPP Support Fund</i>	241.20
Total	1,503.30

Promoting Rapid and Sustainable Growth

Disbursement acceleration plan for Q4 2011 to push economic growth in light of the global slowdown and onslaught of recent calamities



P72.11 billion Disbursement Acceleration Plan to support quick disbursing infrastructure and social services projects

- **Public Works:** The Department of Public Works and Highways will construct and rehabilitate P5.5 billion worth of roads, bridges, flood control and other projects, many of which have been damaged in the recent typhoons. These projects already have a completed program of work, and many are quick-disbursing projects below P40 million.
- **Agriculture and Agrarian Reform:** The Department of Agriculture (DA) will construct and rehabilitate P1.62 billion worth of irrigation, farm-to-market roads and other infrastructure. Additional funding requirements will also be released for the Mindanao Rural Development Project (P919 million) and the Agno River Integrated Irrigation Project (P411 million). Meanwhile, P1.29 billion will be released for the Agrarian Reform Communities Project 2 of the Department of Agrarian Reform (DAR). The Department of Budget and Management (DBM), in partnership with the National Statistics Office, DA and DAR will conduct a National Survey of Farmers and Fisherfolk (P625 million).
- **Support to LGUs:** A total of P6.5 billion will be provided to LGUs which are almost completely dependent on their Internal Revenue Allotment (IRA), for the construction of arterial roads that connect to national roads; rural electrification for barangays and sitios; and other priority projects that have economic impact, preferably directed to poor sectors and communities. This is being provided in light of the anticipated reduction in IRA in 2012. In addition, P750 million will be provided as development assistance to Quezon province in line with the settlement of National Power Corp. tax liabilities. Likewise, another P6.5 billion will be allocated for the various other programs and projects.
- **Housing, relocation and resettlement:** A total of P11.05 billion will be released to the National Housing Authority for various housing projects, including on-site housing development for families living along dangerous areas (P10 billion) and housing for Bureau of Fire Protection and Bureau of Jail Management and Penology personnel (P500 million). Government will also release P400 million to the Home Guarantee Corp. as equity infusion for its credit insurance and mortgage guaranty operations.

Promoting Rapid and Sustainable Growth

Disbursement acceleration plan for Q4 2011 to push economic growth in light of the global slowdown and onslaught of recent calamities



P72.11 billion Disbursement Acceleration Program to support quick disbursing projects

- **Healthcare:** To support premium subsidies for indigents under the National Health Insurance Program, P1.5 billion will be provided for the payment of obligations of the national government. The Department of Health will also have an additional P249 million for the hiring of nurses and midwives to be deployed to rural areas. Furthermore, P357 million will be provided for the upgrading of the physical plant and medical equipment of the Philippine Heart Center; P280 million for the renovation and purchase of equipment of the Philippine Children's Medical Center and P35 million for the pediatric pulmonary program of the Lung Center of the Philippines.
- **Railway Rehabilitation:** A total of P1.87 billion will be provided for the rehabilitation of Light Rail Transit (LRT) Lines 1 and 2, including the replacement of worn-out rails, repair and rehabilitation of trains and improvement of train station facilities. For the Metro Rail Transit (MRT), P4.5 billion has also been provided for the purchase of additional train cars.
- **Peace and Development:** To foster peace, development and reform in the Autonomous Region for Muslim Mindanao, government will implement a Comprehensive Peace and Development Intervention package, worth P8.59 billion. Meanwhile, the Payapa at Masaganang Pamayanan (PAMANA) program will be provided with an additional P1.82 billion for peace and development activities with the Cordillera People's Liberation Army and the Moro national Liberation Front; support for the Reintegration Program of former rebels of the New People's Army; among others.
- **Human resource development for Business Process Outsourcing (BPO) and other industries:** As the government, through TESDA and other agencies, partner with industry groups like the Business Process Association of the for human resource development, the government will provide P1.1 billion for the training of applicants, faculty-trainers and other activities.
- **Weather Forecasting:** A total of P425 million will be provided to improve the capacity of the Philippine Atmospheric, Geophysical and Astronomical Services Administration, particularly the enhancement of its Doppler radar network, as well as to establish National Meteorological and Climate Center with state-of-the-art information technology facilities.

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Government Financial Strength: An Improving Profile

The Philippines' creditworthiness is robust and continuously improving

Government Financial Strength

Enhanced and Improving Government Balance Sheet

- **Fiscal sustainability** is at the core of the economic agenda of the current administration
- **Government balances** have improved with manageable deficits and the government now runs a primary surplus
- **National Government debt** has declined from 74.4% of GDP in 2004 to 51.3% of GDP* as of June 2011 and is expected to dip below 50% by 2013
- **The share of domestic debt** has increased from 50.8% in 2003 to 57.6% as of July 2011, thanks to proactive liability management
- **Debt maturities as of July 2011** have been extended dramatically; 66.4% of domestic government debt is now long term. Short term debt amounts to only 12.6%. 100% of external debt is long term (by original maturity)
- **Cost of servicing debt** continues to fall with interest rates almost three times smaller than back in 2004
- **Proactive reform stance** to enhance tax collection, including the proposed bills on restructuring the excise tax on alcohol and tobacco products and or rationalizing fiscal incentives

Extremely Robust Balance of Payments

- **The Balance of Payments is structurally positive** thanks to consistent current account surpluses driven by growing remittances, strong BPO earnings and sustained exports receipts
- **The Stock of FX Reserves** is at a record high of US\$75.2bn as of end-September 2011. This level is more than adequate covering 11.1 months worth of imports of goods and payments of services and income. It is also equivalent to 10.5 times the country's short-term external debt on original maturity
- **Dramatic decline in external debt.** Total external debt is now 28.8% of GDP as of end-June 2011, a significant decline from a few years back when the external debt-to-GDP ratio went as high as 69%
- **ROP is now a net external creditor.** Total foreign assets are now more than US\$10bn larger than total external debt
- **PHP has a solid track record of stability.** Exchange rate stability has been maintained, even as the peso has retained its competitiveness

* Latest deficit to GDP data is as of June 2011

Government Financial Strength: An Improving Profile

Fiscal sustainability is at the core of the economic agenda of the Aquino administration



The government has a clear fiscal strategy for the medium-term

Continued Efforts to Improve Tax Administration and Implement Key Administrative Reforms

- Intensify tax compliance and enforcement measures: Run After The Smugglers (RATS), Run After Tax Evaders (RATE) and Revenue Integrity Protection Service (RIPS)
- Improve BIR taxpayer service and good governance: simplify forms; enhance internal audit system
- Improve BIR's organizational structure and management: enhance training for tax collectors; set key performance indicators and actual results; and, establish appropriate performance standards and evaluations
- Improve BOC process through development of transit module and National Single Window (NSW)
- Strengthen BOC's Valuation Reference Information System (VRIS) to ensure proper customs valuation and correct tariff classification
- Strengthen BOC's Post-Entry Audit Group (PEAG)

Tight Expenditure Discipline to Use Public Resources in the Most Efficient Manner

- Continue the Multi-Year Budgeting System to improve predictability of funding and integrate policy with resource allocation
- Promote transparency and accountability safeguards in the budget process
- Implement the Public Financial Management and the Government Integrated Financial Management Information System
- Finalize proposed fiscal incentives bill to remove redundant incentives to reduce fiscal costs
- Pursue the reversal of unnecessary tax exemptions to restore the integrity of revenues and make the system more efficient and equitable

Full Commitment to Maintain Sustainable Deficits and Healthy Public Finances

- Target budget deficit of 2% of GDP by 2013
- Continue Zero-based budgeting: across-the-board review of all budgets to cut waste
- Focus targeting of social programs to make sure funds go to those truly in need
- Advance Pay-Go legislation: A requirement that all new expenditure and revenue-eroding legislation would be matched with revenue-increasing measures
- Tighten implementation of procurement laws allowing greater scrutiny of all public procurement to cut waste

Prudent Debt Management

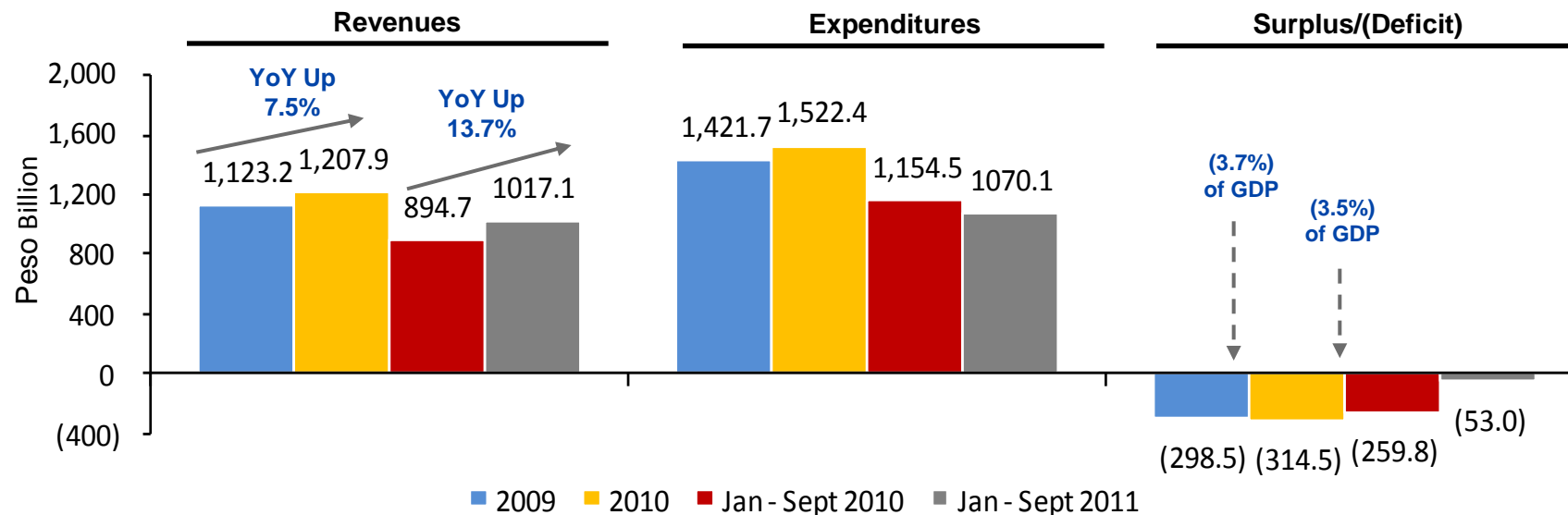
- Reduce the debt stock and debt service payments and lengthen the maturity profile where feasible through debt swaps and exchanges
- Continue with various initiatives to diversify the capital structure: examples already implemented include the Retail Treasury bond, Japanese Yen issue, Global Peso bond issues

Government Financial Strength: An Improving Profile

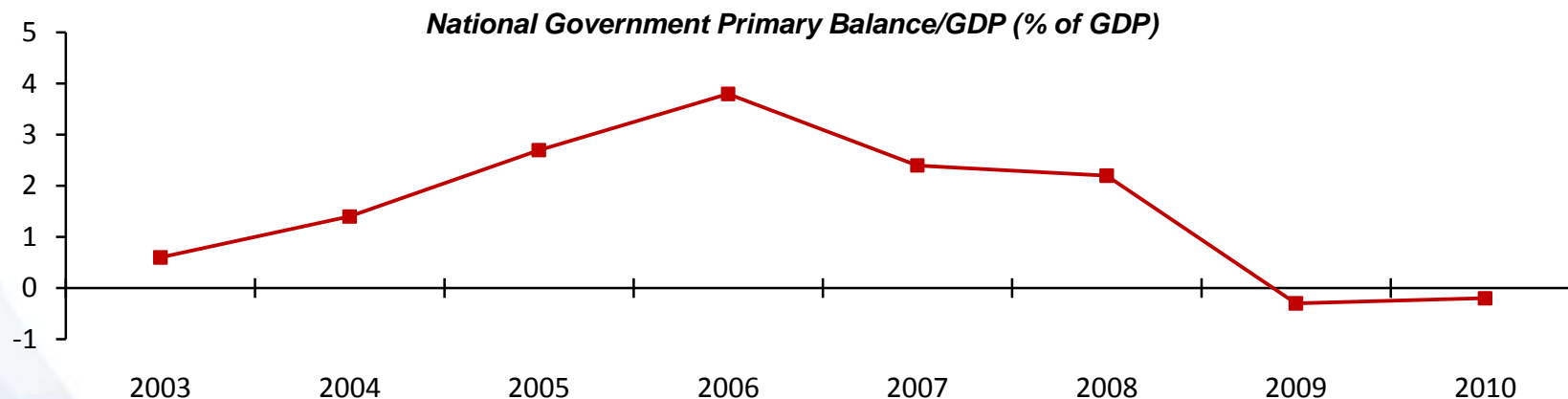
Fiscal performance remained strong through the financial crisis and further strengthens under the Aquino Administration

National Government deficit from Jan – Sept 2011 much better than program at P52.99 billion;

Strong fiscal position provides enough fiscal space to support growth in 2H 2011



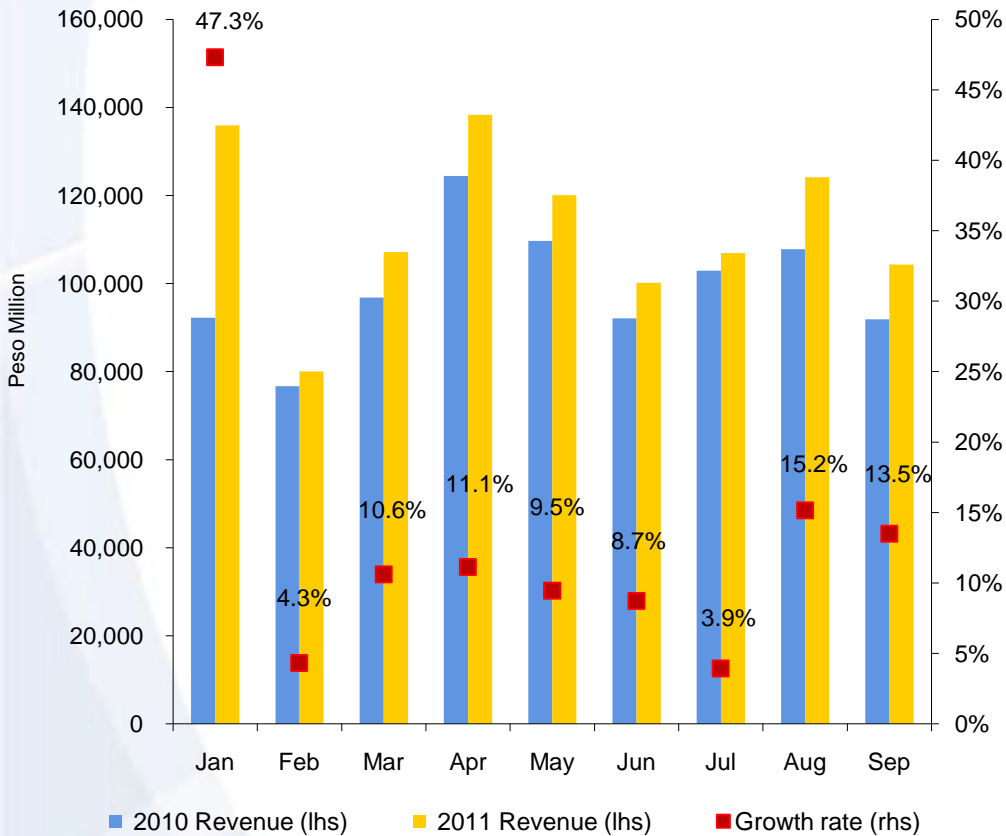
The Philippines' primary balance provides flexibility to deal with global economic and financial uncertainties



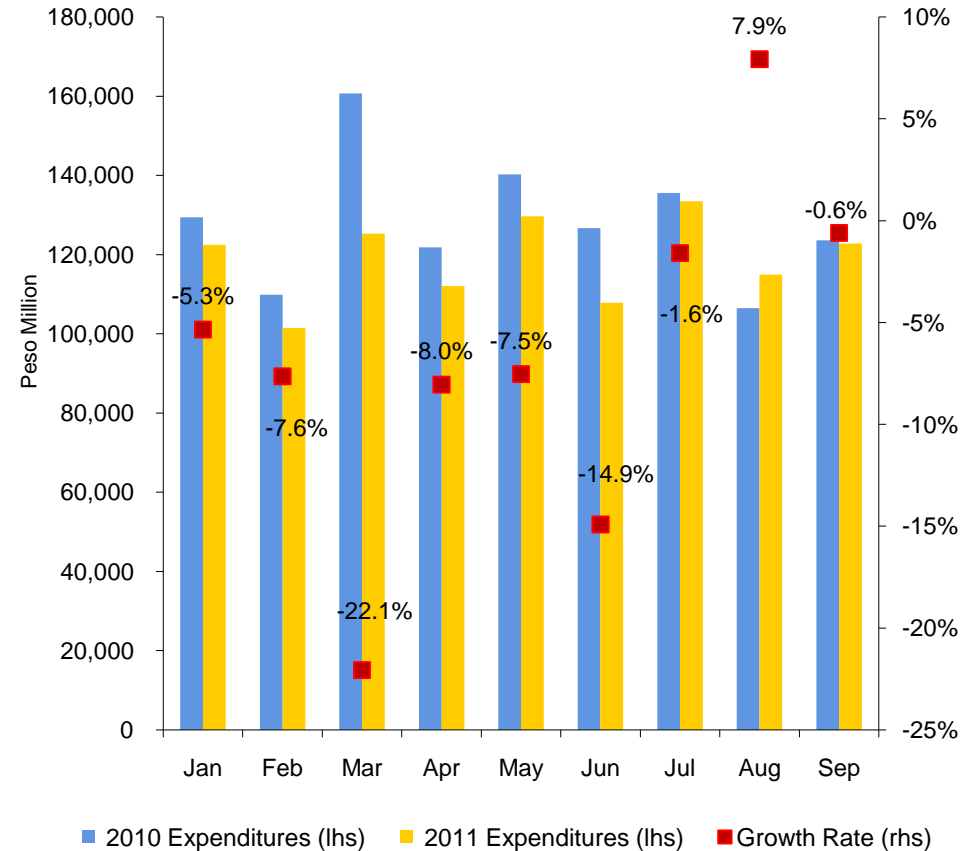
Government Financial Strength: An Improving Profile

Fiscal consolidation on track in 2011 underpinned by strong revenue collection and tight expenditure discipline

Firm tax administration measures push revenues higher in 2011



Careful review of programs ensures productive expenditures



Source: Department of Finance

Government Financial Strength: An Improving Profile

Keeping the deficit within manageable levels is a fundamental goal of the government



The proposed budget for 2012 cuts the deficit to 2.6% of GDP

2012 National Government Fiscal Program (PHP bn)

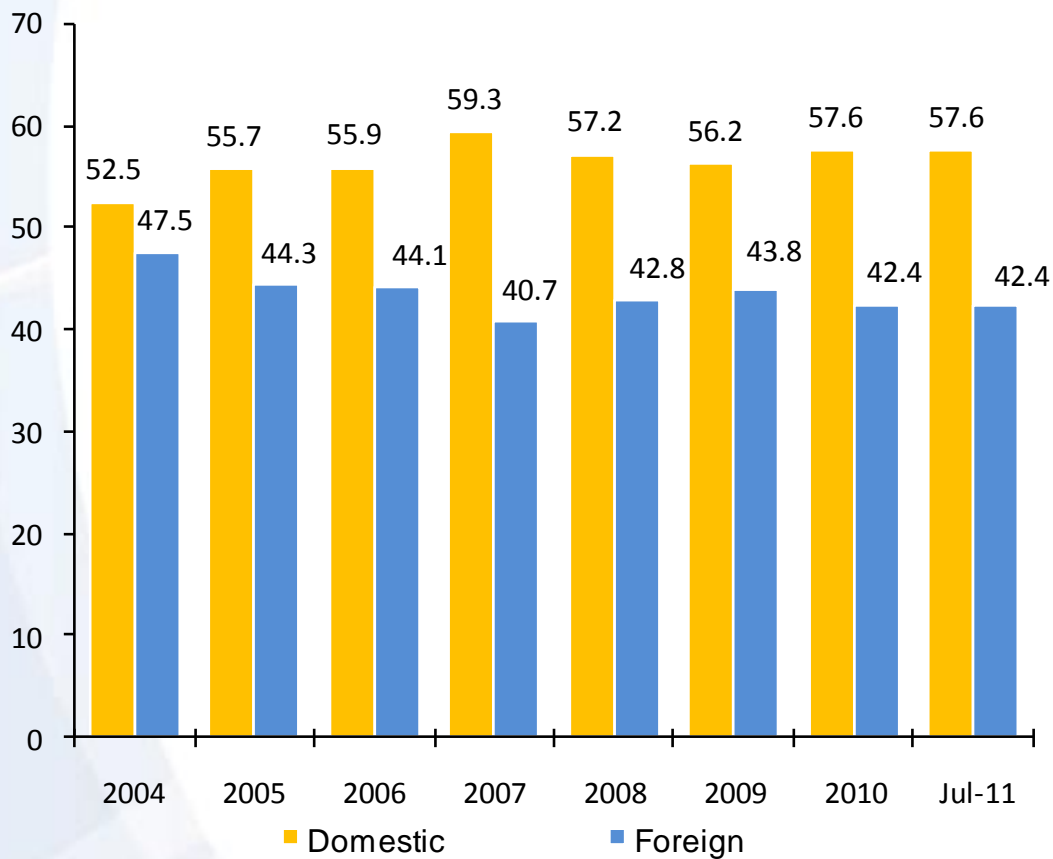
	2010 Actual	2011 Outlook	2012 Outlook	Growth Rate (2012/2011)
Total Revenues	1,207.9	1,357.3	1,513.2	
<i>% of GDP</i>	<i>13.4%</i>	<i>13.8%</i>	<i>13.9%</i>	<i>11.5%</i>
Tax Revenues	1,093.6	1,225.1	1,391.1	13.6%
Bureau of Internal Revenue	822.6	935.5	1,051.2	12.4%
Bureau of Customs	259.2	276.4	325.8	17.9%
Other Offices	11.8	13.2	14.1	7.0%
Non-Tax Revenues	114.3	132.2	122.1	-7.6%
Bureau of the Treasury	54.3	70.0	51.8	-26.1%
Others	60.0	62.2	70.4	13.1%
Expenditure	1,522.4	1,617.9	1,833.3	
<i>% to GDP</i>	<i>16.9%</i>	<i>16.4%</i>	<i>16.9%</i>	<i>13.3%</i>
Current Operating Expenditures	1,229.8	1,329.3	1,444.5	8.7%
Capital Outlay	283.3	260.5	365.8	40.4%
Surplus / (Deficit)	-314.4	-260.7	-320.1	
<i>% of GDP</i>	<i>-3.5%</i>	<i>-2.6%</i>	<i>-2.6%</i>	<i>22.8%</i>

Government Financial Strength: An Improving Profile

Debt ratios have come down substantially and should drop further

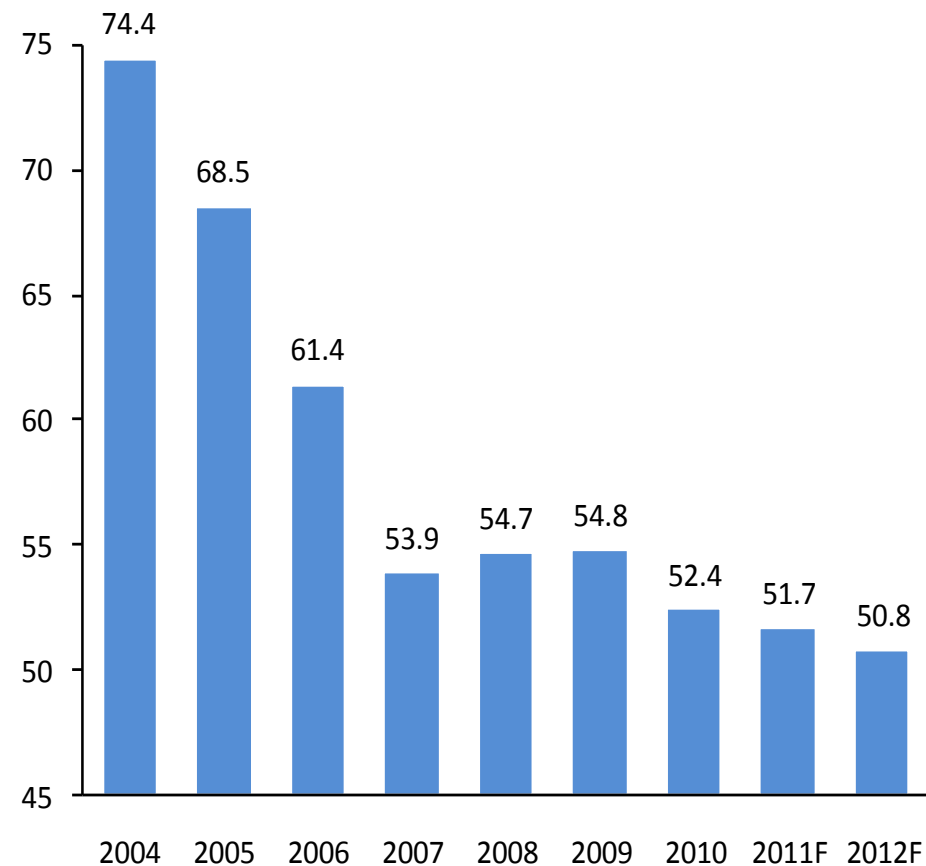
Debt composition continues to be rebalanced towards domestic sources

Share of Dom. and For. Debt by Creditor (as % of Total NG Debt)



NG Debt/GDP ratio is on a steep declining path

Proposed Debt Path 2011-2012 (% of GDP)

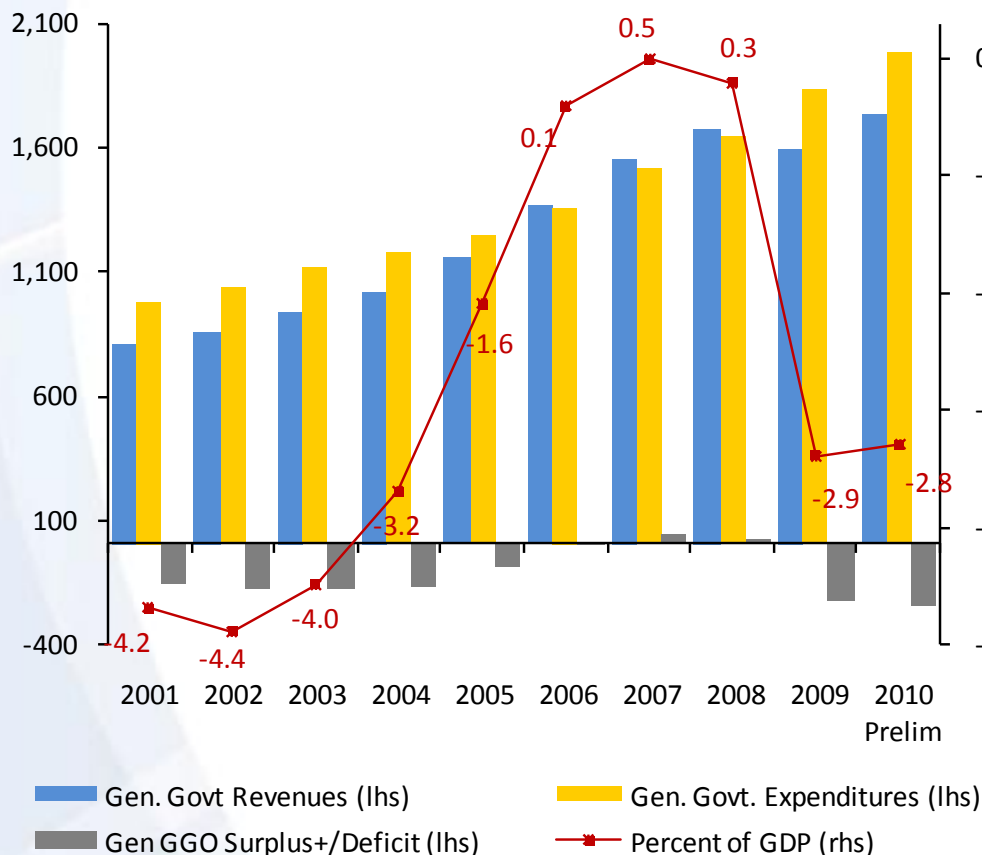


Government Financial Strength: An Improving Profile

Government deficit and debt continue to improve on general government basis

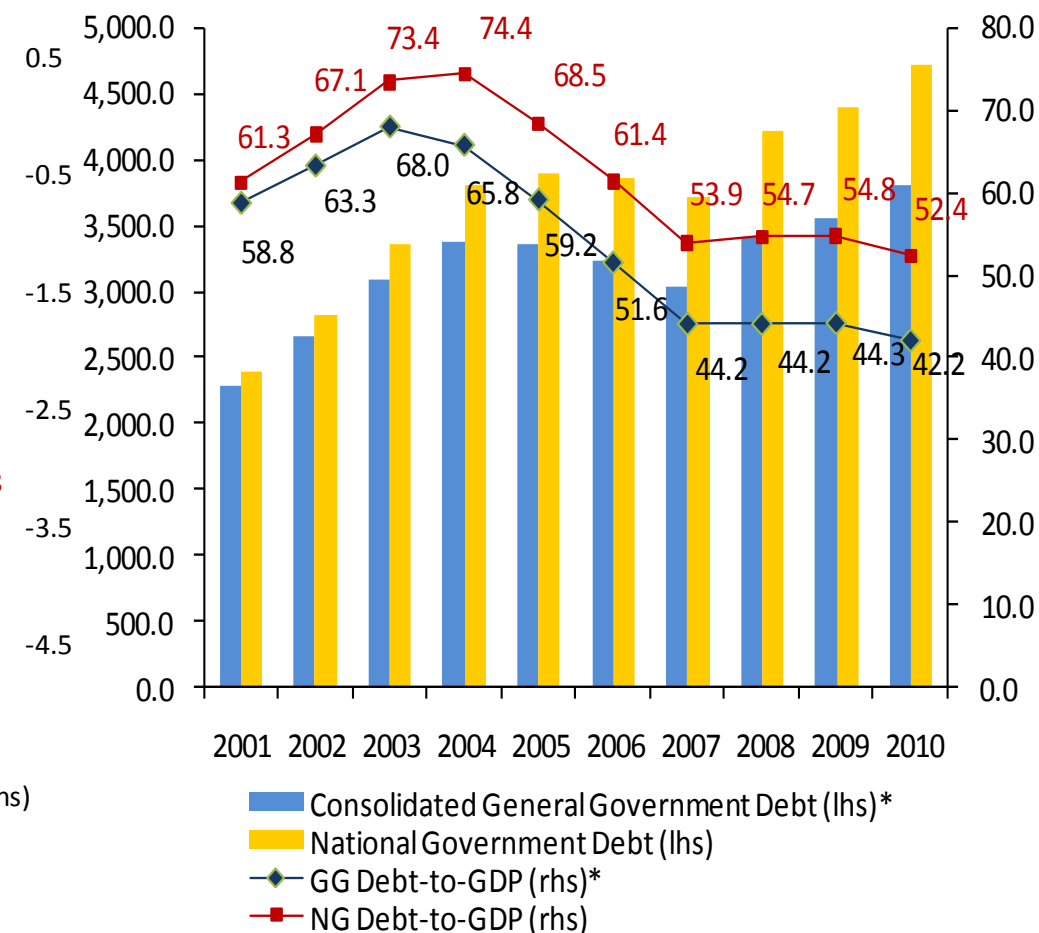
Healthy general government operations supported by LGU and SSI surpluses

in PHP bn; as % of GDP



General Government Debt/GDP in 2010 is about 10 percentage points lower than National Government Debt/GDP

in PHP bn; as % of GDP



Government Financial Strength: An Improving Profile

Proactive liability management has reduced the exposure to external financing sources

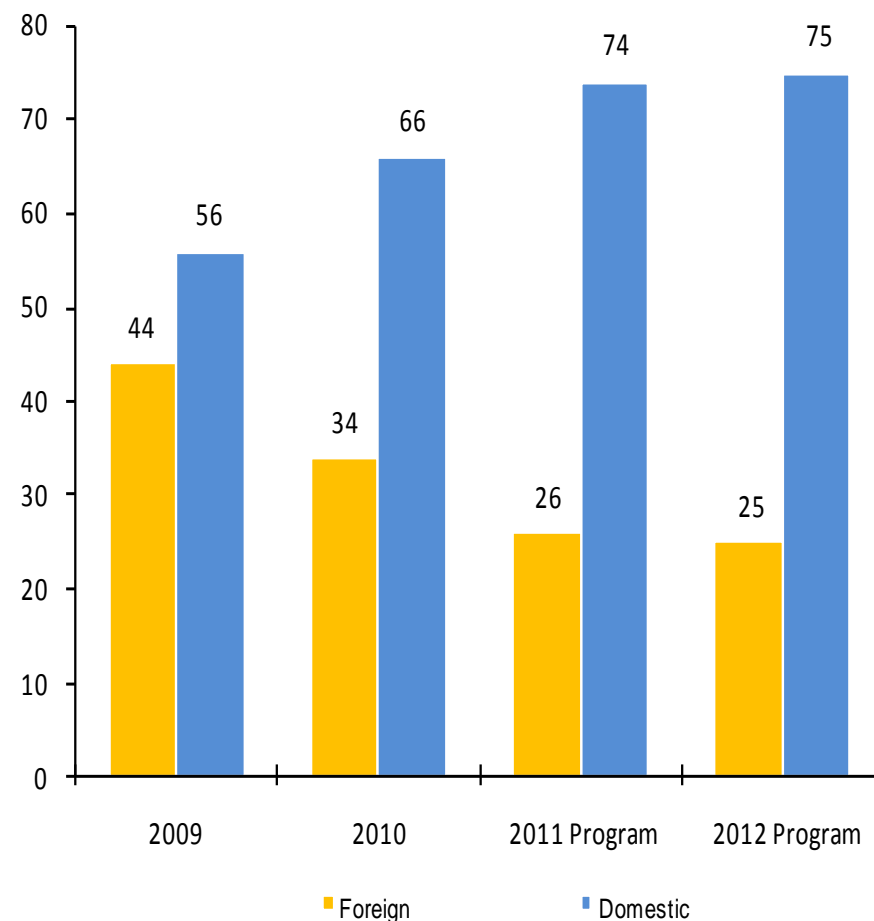
ROP faces decreasing financing needs in 2011 and 2012

NG Financing Program (PHP bn)

	2010 Actual	2011 Program	2012 Program
Net Financing	351.6	309.3	298.8
External (Net)	133.0	48.1	108.9
<i>External (Gross)</i>	<i>257.4</i>	<i>191.8</i>	<i>174.8</i>
Less: Amortization	124.3	143.7	65.8
Domestic (Net)	218.6	261.2	189.9
<i>Domestic (Gross)</i>	<i>489.8</i>	<i>546.3</i>	<i>529.5</i>
Less: Amortization	271.2	285.1	339.6
Gross Financing Mix	100%	100%	100%
Foreign	34%	26%	25%
Domestic	66%	74%	75%

Prudent financing strategies minimize FX risk and increase self-sufficiency

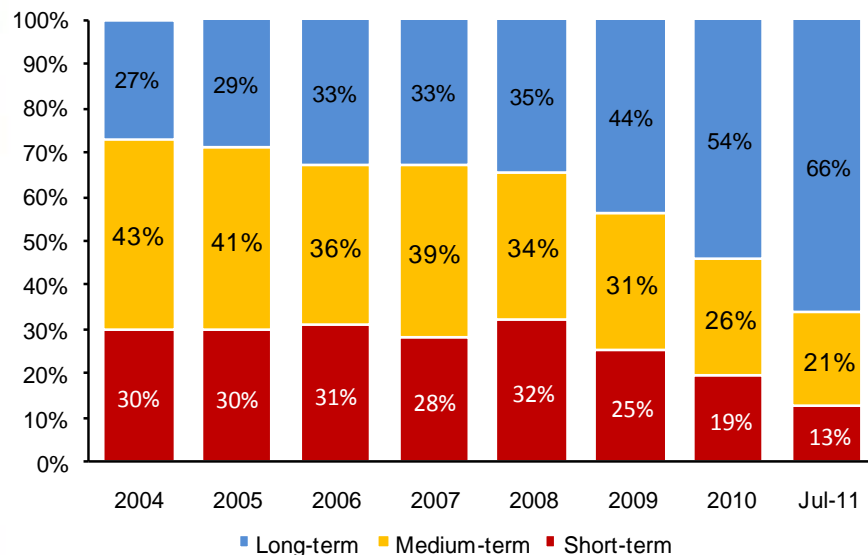
Domestic and Foreign Financing Prog. (% of total financing)



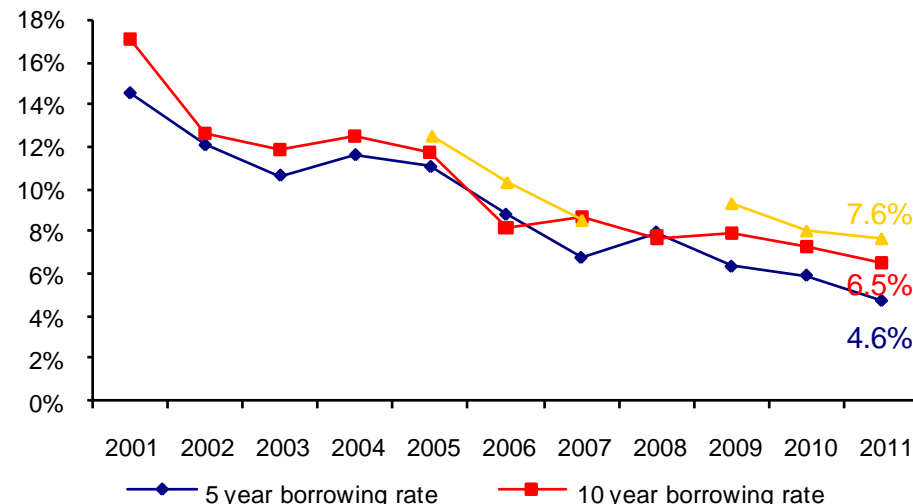
Government Financial Strength: An Improving Profile

Proactive liability management has extended maturities and has lowered costs

Lengthening domestic debt maturities



Declining local borrowing rates



Note: Weighted average annual yields of Philippine government securities

Landmark liability management transactions

Issuance of 25-year Global Peso Notes

- Improved currency composition of NG debt and reduced foreign exchange risk
- Priced at a 23% discount to the local benchmark thereby reduces borrowing cost
- Further build up the GPN yield curve in support of other borrowers particularly for infrastructure projects

Bond Exchange

- Achieved a maturity and duration extension of 9.1 years and 5.3 years, respectively
- Generated NPV savings of about US\$5.6M and cash interest savings of US\$69.6M per annum
- Approx. US\$1.7M of bonds maturing from 2011-2017 were retired in the exchange

Issuance of 15-year \$1.5 billion bond in March

- Priced at 99.495 with a coupon of 5.5% to yield 5.55%
- Demonstrated strong global appetite for exposure to the Philippines' credit

Debt buy back in October

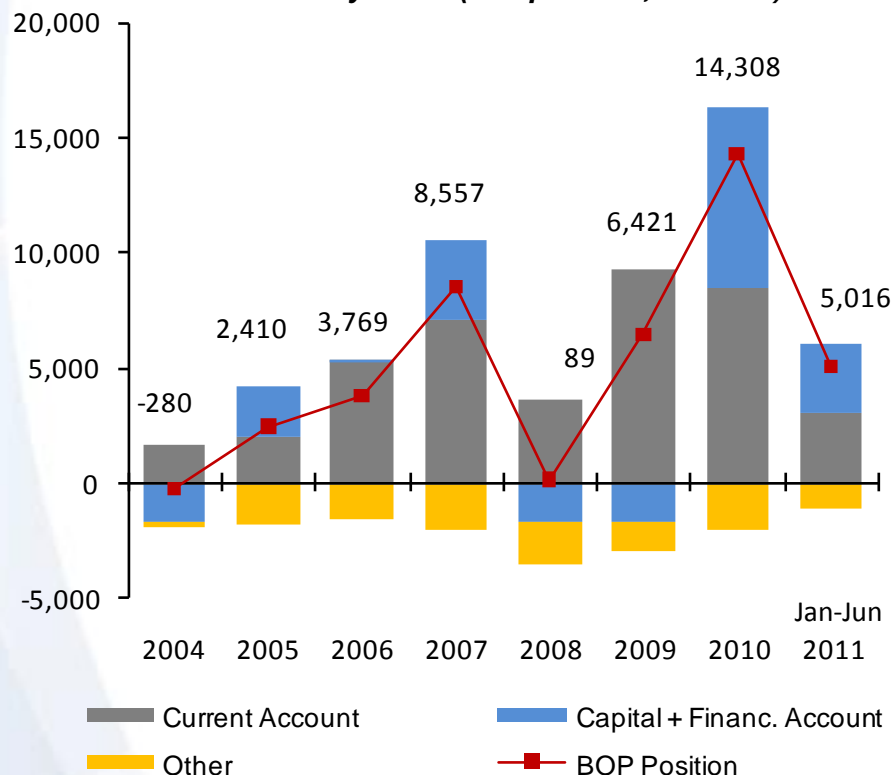
- The Republic recently bought approximately US\$1.3 billion of its foreign currency debt which yielded approximately US\$63M in interest savings per annum
- In line with the government's on-going objective to rebalance debt portfolio in favor of local currency while extending maturities and reducing cost

Government Financial Strength: An Improving Profile

A strong balance of payments promotes a stable currency environment and facilitates a healthy buildup of FX resources

The Philippines enjoys a structurally positive BOP

Balance of Payments (components, USD mn)

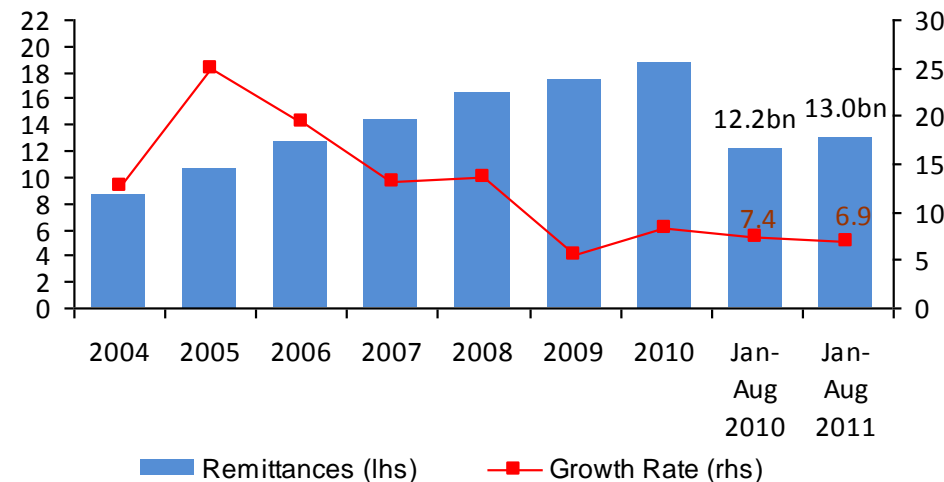


* Latest BOP position stood at US\$9.7 billion as of end-September 2011

Source: Bangko Sentral ng Pilipinas, National Statistical Coordination Board

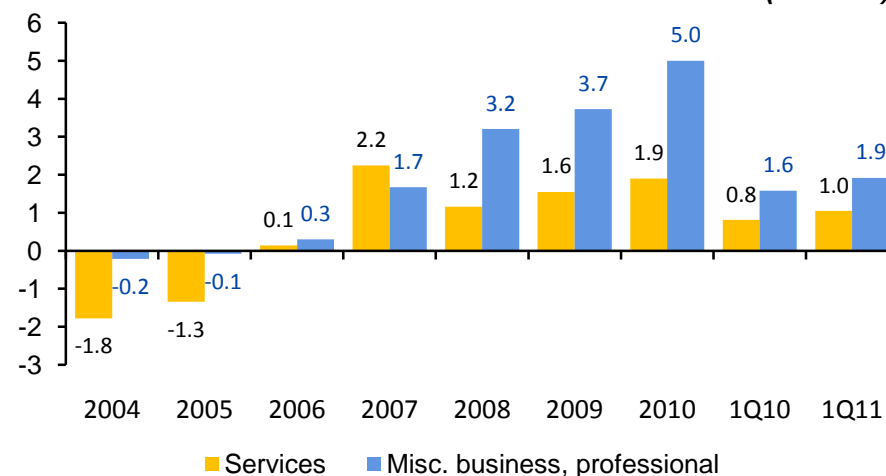
Remittances continue to rise

Overseas Filipinos' Remittances (USD bn and % Growth)



BPO continues to grow quicker than the net services balance

Net Services Trade Balance and BPO Net Balance (USD bn)



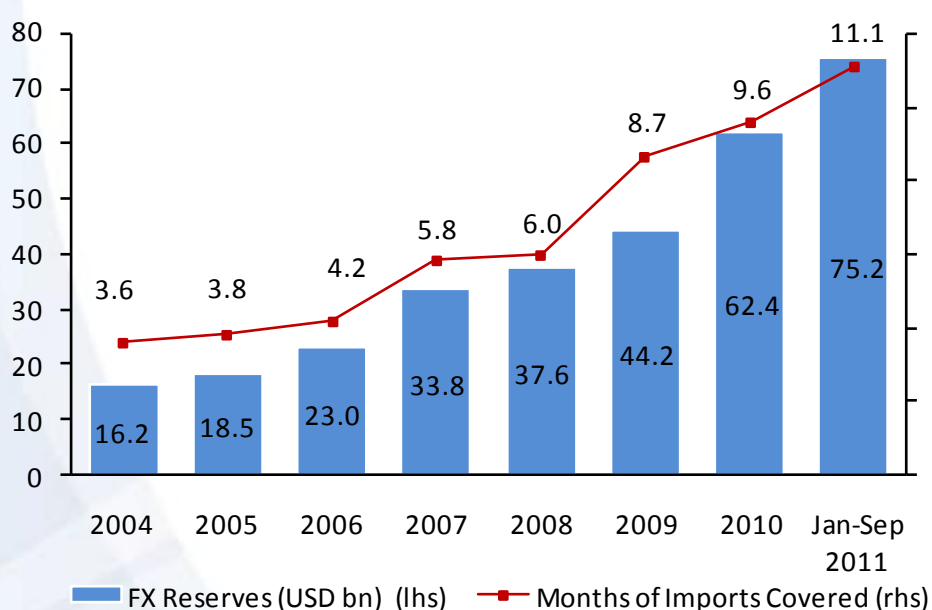
Government Financial Strength: An Improving Profile

International reserves levels continue to soar providing an ample buffer against external shocks

- Gross international reserves expanded to a record US\$75.2 bn as of end-September 2011, much higher than the ROP's external debt of US\$61.4 billion.
- Large stockpile of international reserves provide a healthy buffer against external shocks – reserve holdings can cover 10.5x the country's short-term external debt on original maturity and 11.1 months of imports
- Growing international reserves are structural in nature and are supported by strong remittance flows, robust business process outsourcing (BPO) industry receipts and increasing tourism revenues

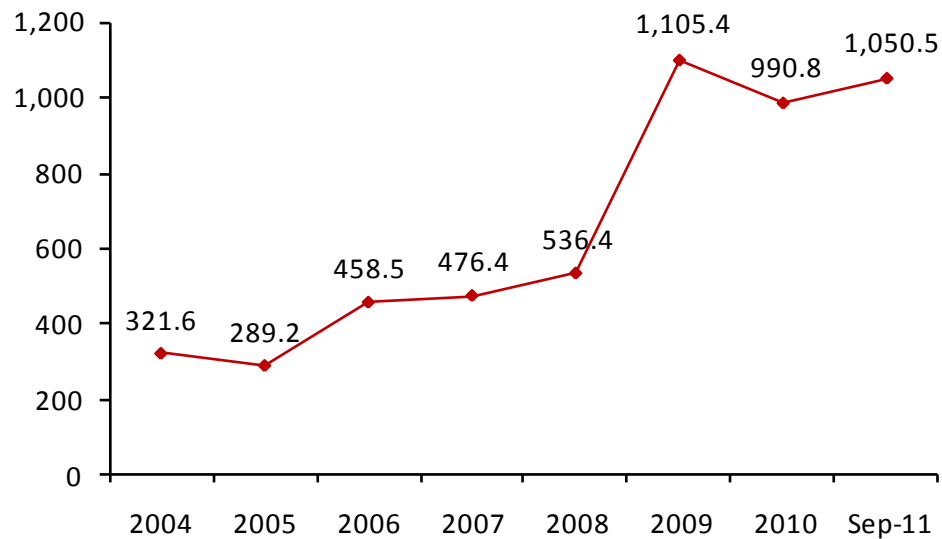
Soaring FX reserves have fortified the economy's buffers

Gross International Reserves (USD bn and Import Coverage)



Reserve coverage ratios are at all time high

Short-Term External Debt Cover (Original Maturity)

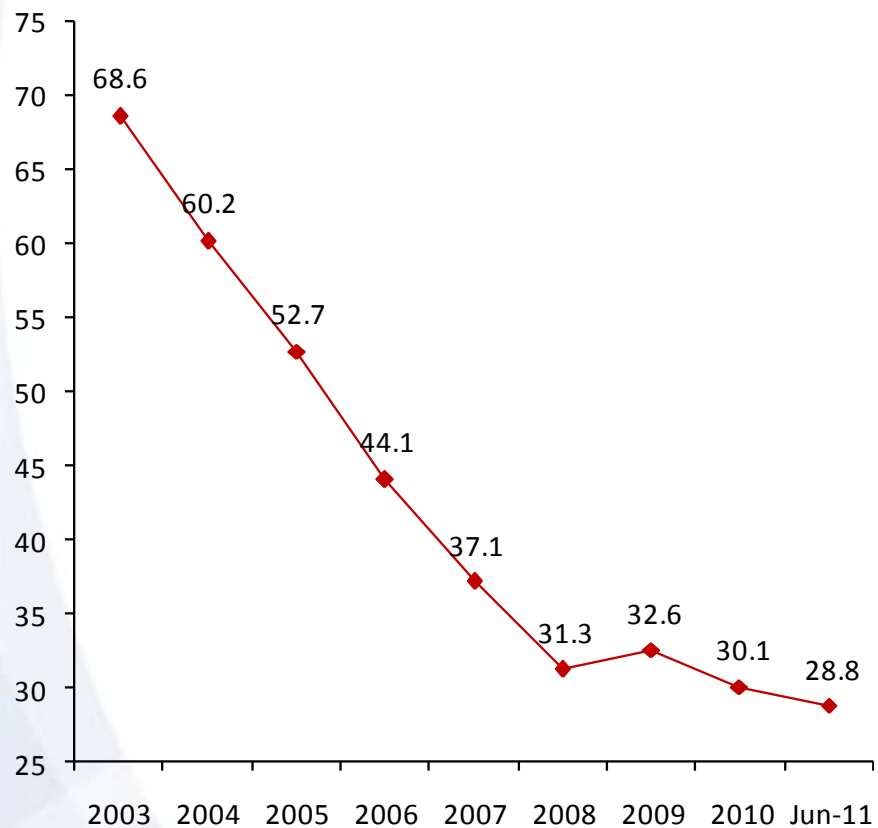


Government Financial Strength: An Improving Profile

External debt service and interest payments are very manageable

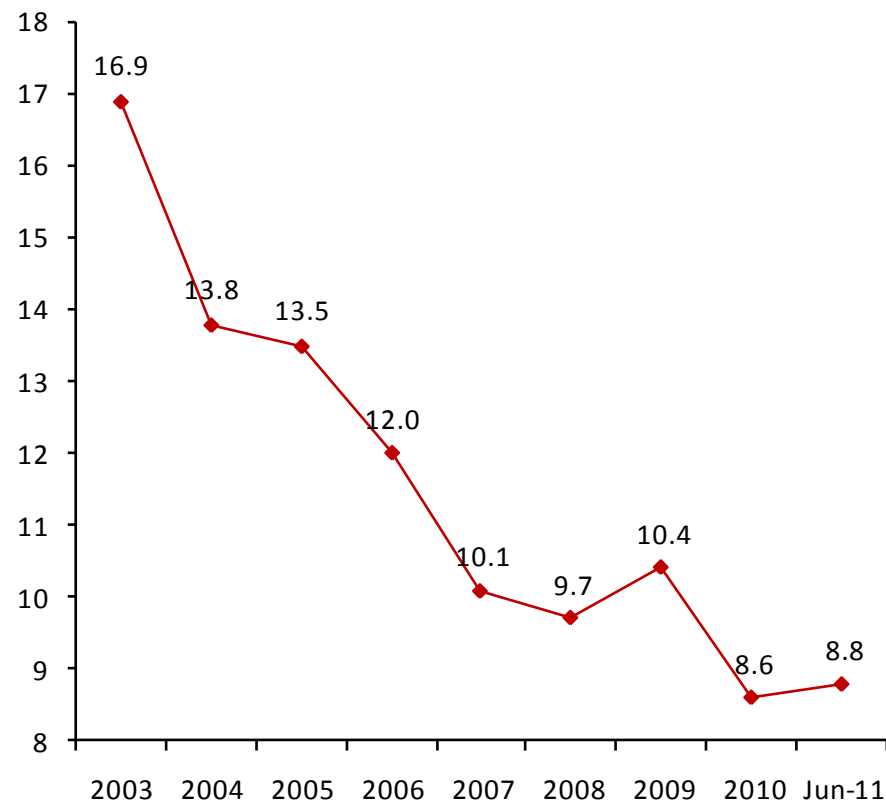
External debt- to-GDP has been cut by half in six years

External Debt-to-GDP ratio (%)



External debt service ratio keeps strengthening

Debt Serv. /Exports of Goods and Rcpts. from Serv. and Income (%)

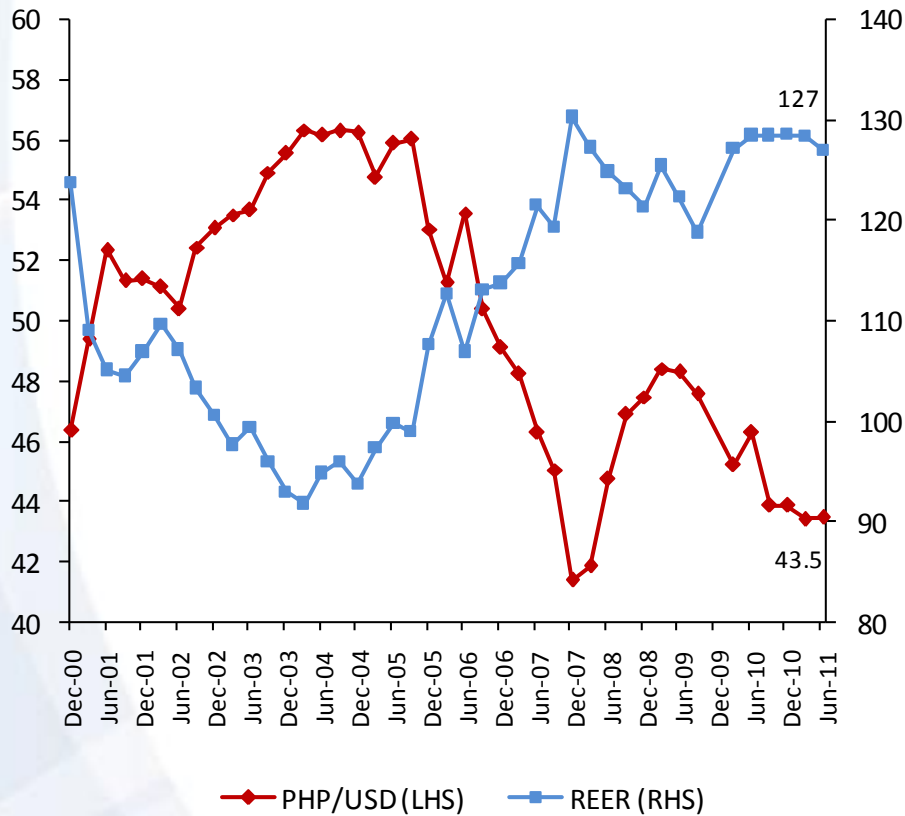


Government Financial Strength: An Improving Profile

Reduced likelihood of destabilizing depreciation bolsters the Philippines' creditworthiness

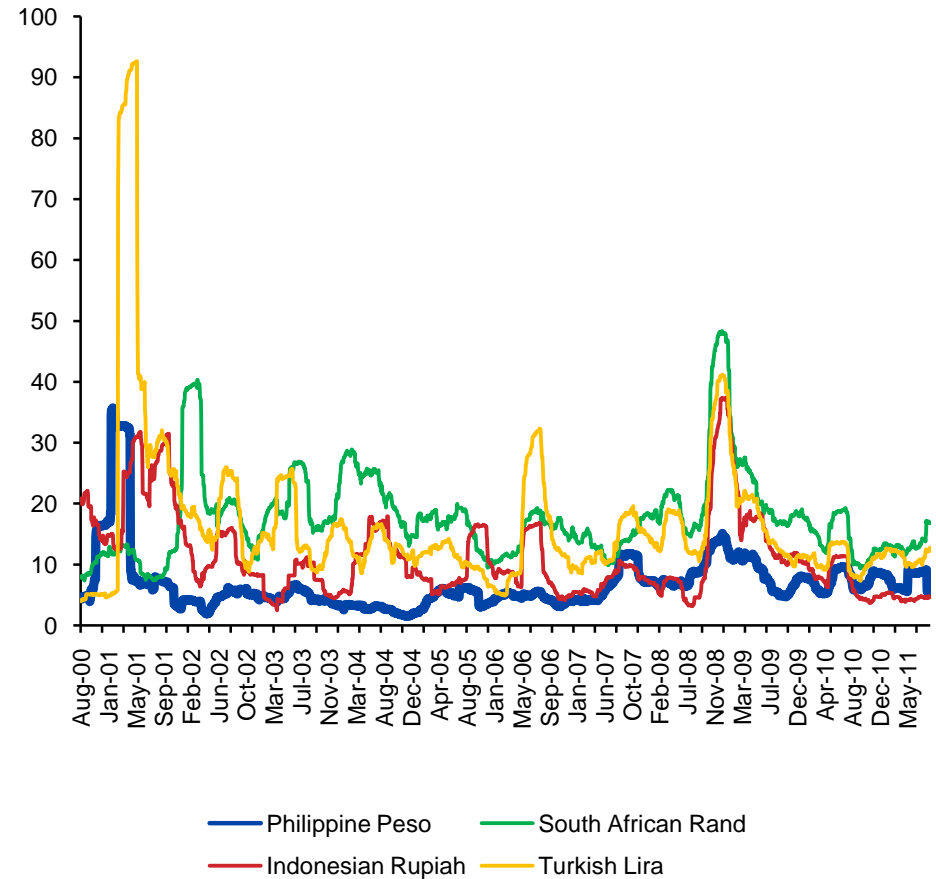
The Peso has strengthened both vis-à-vis the USD and on a real effective exchange rate basis

*PhP per USD and REER**



Peso substantially more stable compared to peer currencies

Three Months Realized Volatility



* Effective exchange rate based on Bank for International Settlement (BIS) figures
Source: Bangko Sentral ng Pilipinas, Bank for International Settlements; Bloomberg

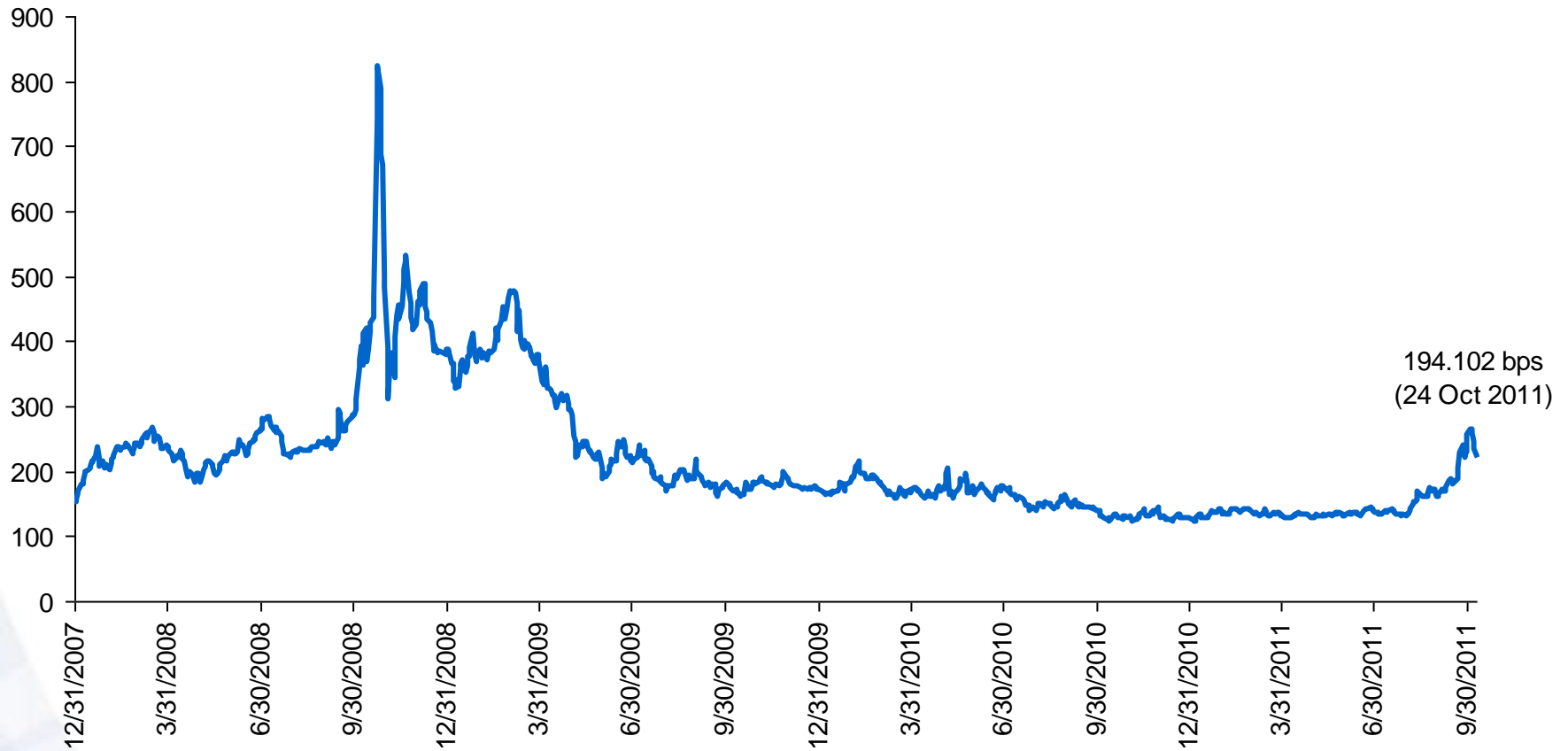
Government Financial Strength: An Improving Profile

Market validation of the country's credit strengths



The Philippines 5-Year CDS had dropped from a high of 824.78 on 24 October 2008 reflecting the markets' increasing confidence on ROP's creditworthiness

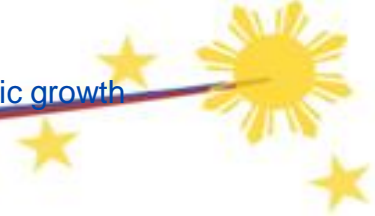
5-Year Sovereign CDS



- 1 **Executive Summary: A Fortified Economic Story**
- 2 **Healthy, Sustained and Inclusive Growth**
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- 4 **Credible Monetary Policy and a Resilient Banking System**
- 5 **Governance Reforms: Strengthening the Social Contract**

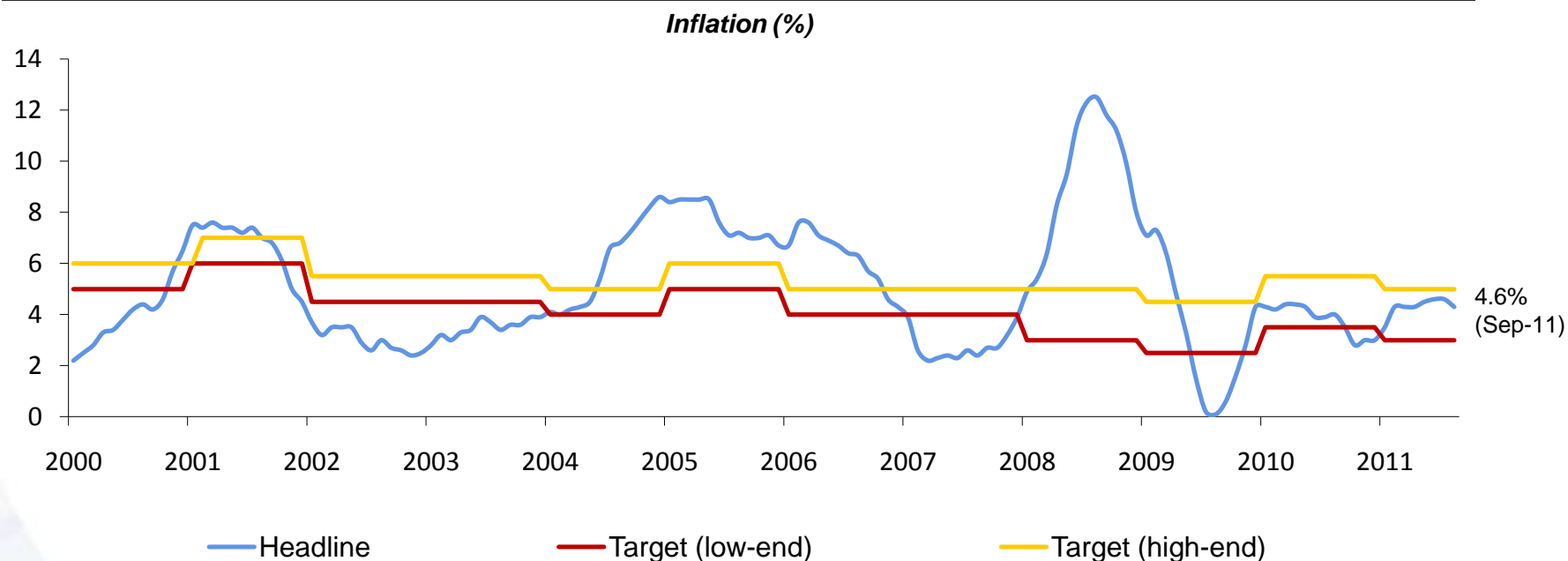
Effective Monetary Policy – Supportive and Stable

The Philippines strikes a delicate but effective policy balance between policy accommodation in support of economic growth and controlling inflation



- Prudent monetary policy has kept inflation low and stable at 4.6% as of end-September 2011, within the target band of 3.0-5.0%. Headline inflation for the first nine months of 2011 averaged 4.3%
- BSP preemptively hiked policy rates to rein in inflation expectations and raised reserve requirements to manage liquidity generated by capital inflows
- Latest BSP forecasts show inflation staying within the target range for 2011
- Upside risks to inflation include continuous large capital inflows and further uptick in oil and non-oil commodities (e.g. food)

Inflation remains well-contained within targets

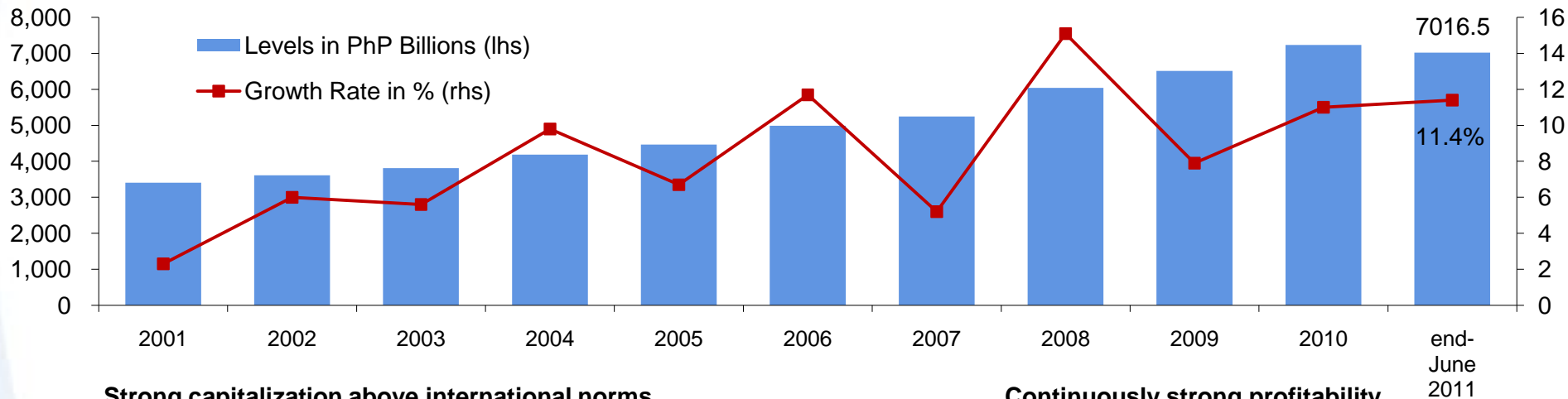


Maturing Banking Sector Continues to Perform Well

The risk of a banking crisis is minimal due to demonstrated resilience as well as healthy levels of growth and capitalization

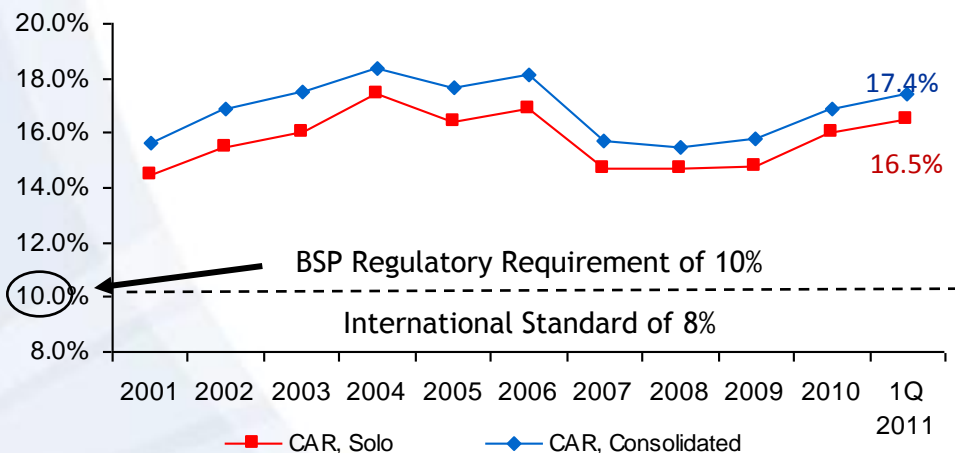
Solid asset growth in line with economic expansion

Philippine Banking System Asset Size and Asset Growth



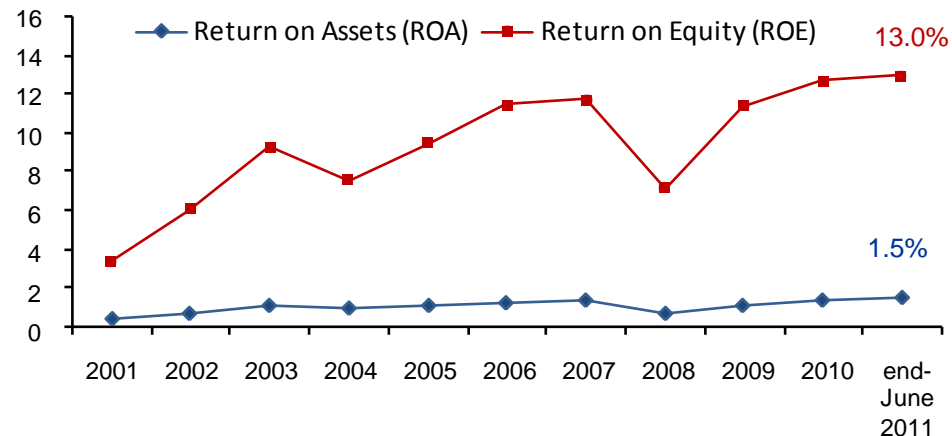
Strong capitalization above international norms

Capital Adequacy Ratio (%)



Continuously strong profitability

Return on Equity (%) and Return on Assets (%)

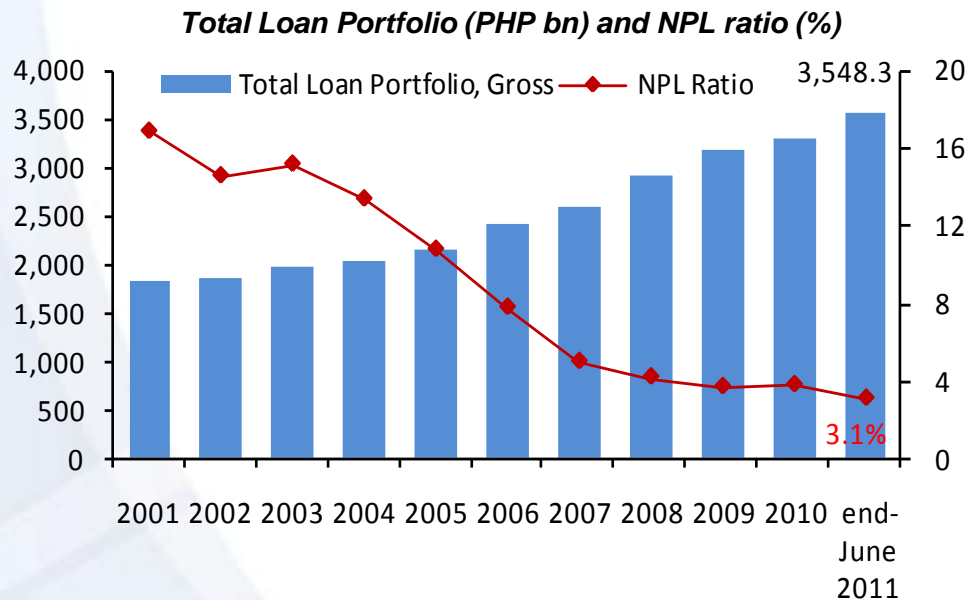


Improving Asset Quality

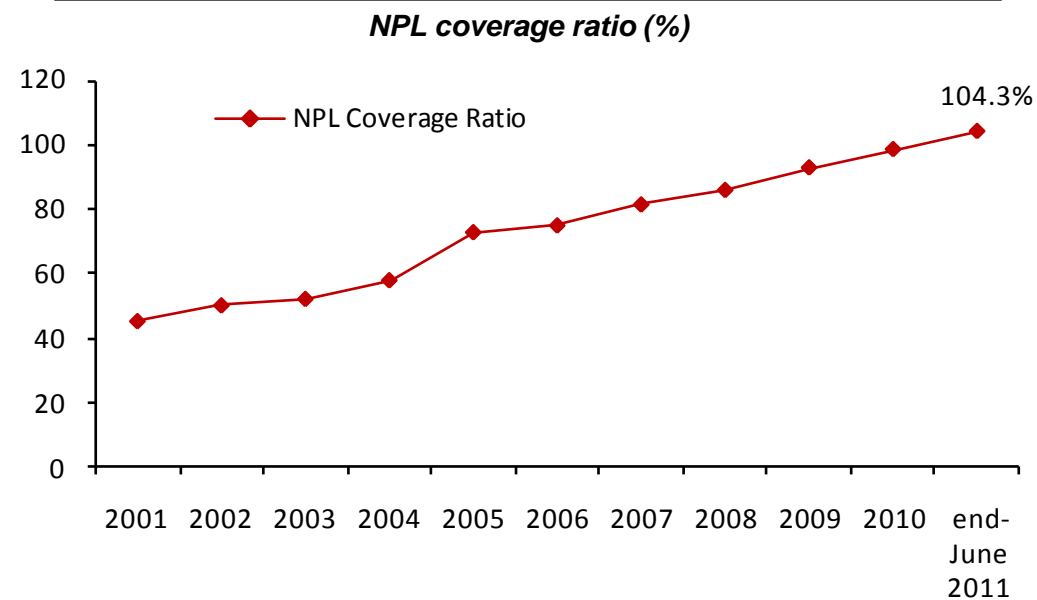
Strong asset quality underpins the health of the Philippines' banking system

- The resilience demonstrated by the Philippine banking system is highlighted by the decrease in system-wide nonperforming loans (NPL) even at the heart of the global financial crisis
- Total loan portfolio continues to grow while NPL ratio continue to improve
- Improving asset quality helps minimize the risk of a potential banking-system led crisis
- NPL coverage ratios have strengthened as insurance against potential future asset deterioration, and underpin the conservative nature of the banking system

System-wide NPL level has shown sustained improvement vis-à-vis the growing loan portfolio of Philippine banks



While NPLs have shrunk, NPL coverage ratios have strengthened



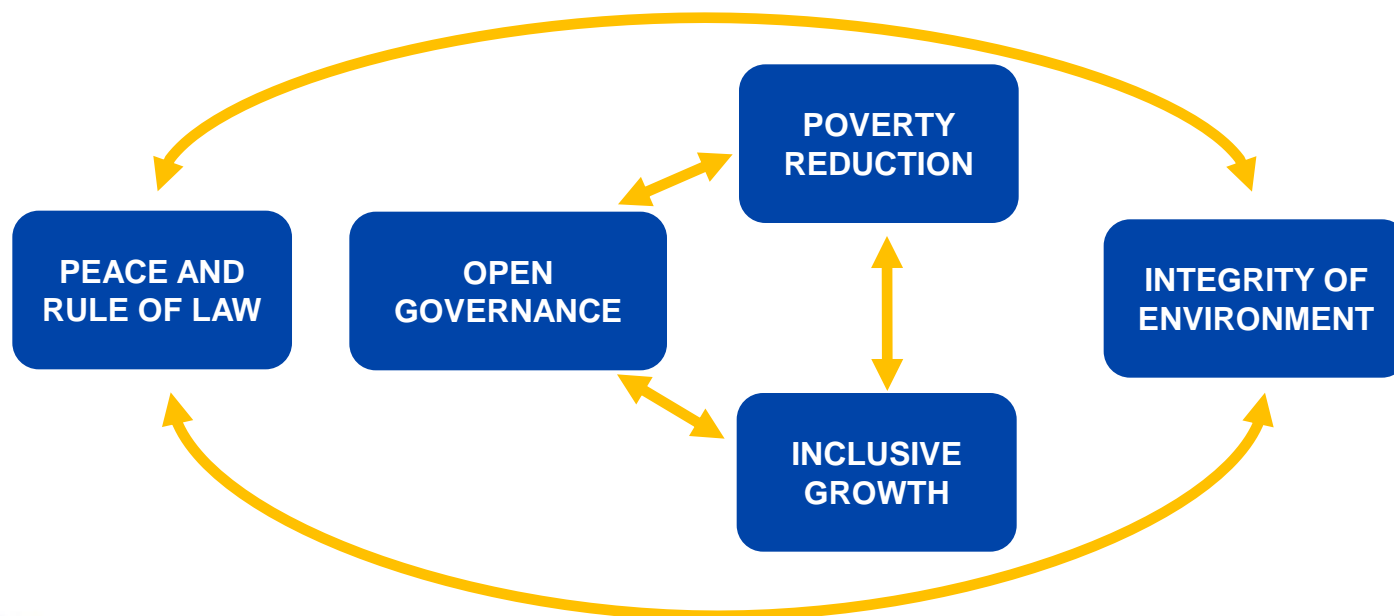
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Governance Reforms: Strengthening the Social Contract

Daylight in governance remains the overarching principle of the Aquino Administration

President Aquino issued on May 13, 2011 Executive Order No. 43, defining five areas of priority of the Social Contract. These five areas drive the 2012 Budget and embody the ROP's commitment to lifting the poor from poverty through honest and effective governance:

- Anti-Corruption and Transparent, Accountable and Participatory Governance
- Poverty Reduction and Empowerment of the Poor and Vulnerable
- Rapid, Inclusive, and Sustainable Economic Growth
- Just and Lasting Peace and Rule of Law
- Integrity of the Environment and Climate Change Adaption and Mitigation



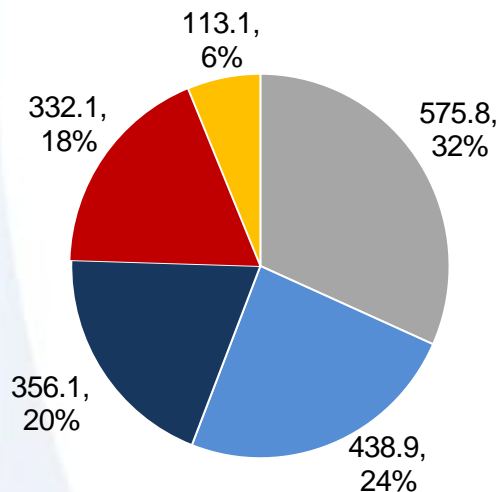
Governance Reforms: Funding

The efforts to enhance governance go beyond words and they are clearly reflected in the 2012 Budget

Reforms in governance are at the core of economic policy making and the budget is the financial translation of the country's social contract

Proposed 2012 Budget Allocation*

(PHP Bn, %)



- Social Services
- Econ. Services
- Debt Burden
- General Public Service
- Defense

Budget Allocations by the Five Priority Areas, FY 2011 and 2012

	Levels (PHP Mn)		% of Budget		Growth (%)
	2011	2012	2011	2012	
Anti-Corruption and Transparent, Accountable and Participatory Governance	18,846	29,012	1.1	1.6	53.9
Poverty Reduction and Empowerment of Poor and Vulnerable	318,494	368,769	19.4	20.3	15.8
Rapid, Inclusive and Sustainable Economic Growth	191,754	247,109	11.7	13.6	28.9
Just and Lasting Peace and Rule of Law	182,001	196,805	11.1	10.8	8.1
Integrity of the Environment and Climate Change Adaption and Mitigation	30,637	36,209	1.9	2.0	18.2
Total	741,731	877,905	45.1	48.3	18.4

* As submitted to Congress

Source: Department of Budget and Management

Daylight in Governance

Anti-Corruption and transparent, accountable, and participatory governance



Reforms in governance will make it more effective, transparent, and accountable to the public

- **Zero-Based Budgeting (ZBB):** ZBB has proven to be effective in weeding out waste and allocating resources; the ROP will continue to review and evaluate projects using the ZBB approach for 2012
- **Lump-Sum Reform:** To the extent possible, oft-abused lump-sum funds will be eliminated, reducing waste and corruption. Allocations will instead be released to the smallest implementing units of departments and agencies to facilitate implementation and enforce accountability
- **Increased Disclosure:** The 2012 Budget mandates the publication of agency budgets and statuses of major projects on the agency website in an effort to increase transparency over public finances and expenditures
- **Savings Reform:** Use of savings will be tightened with greater DBM oversight to ensure that funds will be used for their intended purposes; for example, special provisions allowing the use of savings for certain purposes by the Department of National Defense and Armed Forces of the Philippines have been deleted, eliminating potential areas for corruption
- **Information and Communications Technology (ICT) Revolution:** Enhanced ICT will allow the ROP to digitize government operations, promote arms-length transactions, reduce human intervention, and integrate the financial processes of the DBM, DOF, BTR, and COA through the introduction of the Government Integrated Financial Management Information Systems (GIFMIS)
- **Piloted Public Consultations:** Six departments (including Education, Health, Public Works) and three GOCCs consulted with civil society organizations in helping to craft the 2012 Budget for the first time in history. Citizens will forthwith be more engaged through all phases of the budget cycle

Combating Poverty

Poverty reduction and empowerment of the poor and vulnerable are central for better governance

Measures aimed at poverty alleviation are emphasized in the 2012 National Budget

- **Large Budgeting for the Social Services:** The Social Services sector will continue to receive the largest percentage of the National Budget in 2012 at 31.7% (P575.8 billion), an increase of 10.4% over the budgetary allocation for 2011
- **Pantawid Pamilyang Pilipino Program (4Ps):** The 4Ps, a program aimed to reduce poverty by providing qualified families with conditional cash grants, remains the cornerstone of the ROP's poverty alleviation program. It will be expanded to benefit 3 million households by January of next year from the current 2.3 million households
- **National Household Targeting System (NHTS):** Use of NHTS will be expanded so the government will be able to more accurately identify the poor and where they are located, increasing the precision of targeting the poor
- **PPP Approach:** Public-Private Partnerships will be utilized not only to tap private capital for key growth driving infrastructure projects but also to implement social services that may be delivered better and faster with the collaboration of the private sector and civil society. Projects will include the construction, operation, and maintenance of school buildings, health centers, and other government infrastructure
- **Basic Education Facilities Fund:** Under the proposed 2012 Budget, funding of P17.4 billion will be available for the construction of over 41,000 new classrooms, 25,667 water and sanitation facilities, and the procurement of 2.5 million new seats

Promoting Rapid and Sustainable Growth

Rapid, inclusive and sustainable economic growth to guarantee opportunities for all



Long-term and equitable economic growth is dependent on prudent policies and planning

- **Increased Investment Funding:** Rapid long-term growth is dependent on continued improvement in the infrastructure of the Philippines. The 2012 Budget provides for a larger infrastructure investment program of P182.2 billion, an amount 25.7% higher than this year. This figure will include P22.1 billion to elicit the entry of private capital in critical infrastructure and other projects in support of the PPP program
 - P33.5 billion will be used to construct 6,229 km of roads and 15,292 lineal meters of bridges in 2012
 - Development of tourism infrastructure will be prioritized
- **Supporting Key Economic Drivers:** The government will continue to expand and support established revenue generators such as remittances of OFWs, electronics and semiconductor manufacturing, and business process outsourcing. In addition, emphasis will be placed on infrastructure development and other sectors where the Philippines has an inherent advantage, such as tourism, agricultural production, and mining
- **Fiscal Consolidation:** The 2012 Budget is designed to narrow the fiscal deficit to 2.6% of GDP, keeping the ROP on track to achieving a deficit of 2.0% of GDP by 2013. Additionally, the outstanding debt of the National Government is expected to fall to 50.8% of GDP in 2012 from the emerging program of 51.7% for 2011; interest payments as a share of the budget is expected to decline to 18.3% in 2012 from more than 30% in the 2000s, thus creating additional space for priority programs. President Aquino has asked Congress to enact a Fiscal Responsibility Bill and has proposed restructuring of the excise tax on sin products to ensure the sustainability of consolidation efforts
- **Towards Food Self-Sufficiency:** Agriculture sector reforms will be sustained this year to achieve food self-sufficiency; food and rice self-sufficiency remains the cornerstone of the ROP's blueprint for food security for 2011 – 2016. In pursuit of this, irrigation development will be allocated P24.8 billion in 2012, a 93.6% increase from the 2011 allocation

Creating an Environment Conducive to Growth

Just and lasting peace and rule of law and commitment to climate change adaptation and mitigation are also central



National development requires lasting peace and the institutionalization of an efficient and impartial judicial system

- **PAMANA Program:** Aimed at ending long-standing conflicts throughout the Philippines, PAMANA is the national government's peace and development framework to strengthen peace building reconstruction and development in conflict-affected areas. This is a centerpiece of the government's overall strategy to pursue just, negotiated political settlements to end conflicts and create a comprehensive peace process
- **Peace Negotiations:** P100 million is allocated in the Budget to the Government Peace Negotiating Panel to enable them to pursue a final negotiated settlement to all armed conflicts with various MILF/CPP/NPA/NDF elements
- **Strengthening Rule of Law:** Additional resources will be provided to strengthen the Witness Protection Program and support law enforcement authorities in keeping the Republic safe from internal threats and prosecuting criminals

Environmental protection and proactive preparation for climate change are key in positioning the ROP for the future

- **Climate Change Adaptation and Mitigation:** The 2012 National Budget provides for P36.2 billion for funding climate change adaptation and mitigation activities, an 18.2% increase over 2011. Preparation includes identifying key risk areas, practicing disaster risk management planning, and improving weather forecasting
- **National Greening Program (NGP):** The NGP, a national priority reforestation program, will aim to plant 1.5 billion trees over 1.5 million hectares nationwide from 2011 to 2016. This is important to ensure that national resources will be utilized equitably for both present and future generations

Reform Achievements

Implemented reforms have already yielded concrete, positive results for the Philippines

Vast Improvement in the WEF Competitiveness Ranking

- The Philippines competitiveness ranking improved to 75 from 85, **the largest improvement in this year's rankings among 142 countries** and a record improvement since the country entered into this World Economic Forum in 1994
- The vast majority of individual indicators composing the Global Competitiveness Index improved, sometimes markedly
- The macroeconomic environment indicator jumped to 54 this year from 68 in the 2010-2011 report. The indicator noted the country's improving national savings, managed inflation, low interest rate environment and declining debt-to-GDP ratio
- Confidence in the new administration and better governance was also reflected in several sub-indicators: public trust to politicians (to 128 from 134 last year); transparency in policy making (to 120 from 123); intellectual property protection (to 102 from 103); and judicial independence (to 102 from 111)

Accountability and Efficiency in Public Fund Management

- Use of the ZBB approach and prudent management of public funds has allowed the government to provide P12 billion in funding in 2011 for other key social and economic services that were not included in the budget
- Transition to more transparent and competitive bidding for public works projects has allowed the DPWH to generate savings of P2.51 billion from 3,692 projects from July 2010 to June 2011 – DPWH expects total savings to be between P6 and P7 billion by the end of 2011
- Investigation of the AFP Retired and Veterans Pensions List has resulted in fund recoveries amounting to P4.7 billion
- Increased oversight by the DOF has resulted in increased GOCC remittances of P34.5 billion as of May 2011. By comparison, GOCC remittances in 2010 was P27 billion

Stringent Anti-Corruption Efforts

- The AFP filed cases before the Sandiganbayan (anti-graft court) against 31 AFP officers for corruption-related charges from July 2010 to June 2011
- As of 15 September 2011, the BIR filed 67 tax-evasion cases, involving a total notional amount of P29.4 billion. In addition, 44 criminal cases as of September 22, 2011 have been filed with the DOF involving 198 suspected smugglers with a total dutiable value of P59.2 billion
- As of 20 September 2011, the DOF has filed 87 cases involving 128 allegedly corrupt government employees before the Office of the Ombudsman

Improved Fiscal Consolidation and Responsibility

- For the first nine months of 2011, the government posted a deficit of P53.0 billion, 79.6% lower than the P259.8 billion deficit during the same period last year. Netting out the interest payments in the expenditures, the National Government recorded a primary surplus for January to September amounting to P169.4 billion.
- Disbursements were lower by 7.3% year-on-year in the first nine months due to more prudent spending of agencies
- National Debt-to-GDP ratio decreased more than expected in 2010 to 52.4%; well within the 2010 target of 56.5%.
- Revenue collection has continued to increase, to grow by 13.7% year-on-year in the first nine months of 2011



The Philippines: A Fortified Economic Story

Philippine Economic Briefing

October 2011