

# **The Philippines: A Fortified Economic Story**

## **Philippine Economic Briefing**

September 30, 2011  
Manila, Philippines

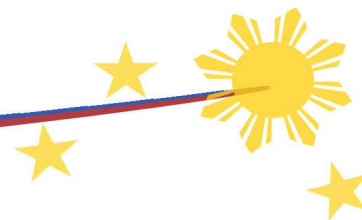
# Agenda



- 1 Executive Summary: A Fortified Economic Story**
- 2 Healthy, Sustained and Inclusive Growth**
- 3 Government Financial Strength: An Improving Profile**
- 4 Credible Monetary Policy and a Resilient Banking System**
- 5 Governance Reforms: Strengthening the Social Contract**
- 6 The Philippines: Reaching for Investment Grade**

# Executive Summary

A Fortified Economic Story



## Healthy, Sustained and Inclusive Economic Growth

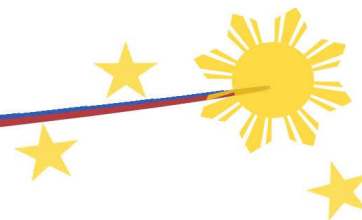
- The economy continues to expand at a healthy pace despite a challenging external environment. With a second quarter Gross Domestic Product (GDP) growth of 3.4 percent and a revised first quarter GDP growth of 4.6 percent, the first semester GDP growth for this year is 4.0 percent
- Growth in Q2 was 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 5.0% and 6.0% for 2011 and between 5.5% and 6.5% for 2012
- Economic growth in the Philippines is becoming more inclusive with unemployment rate at a low 7.2% as of April 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 4.3% as of end-August 2011, within the target band of 3.0-5.0%. Average inflation for the first eight 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\$76.0 billion at end-August 2011 – these reserve holdings are equivalent to 11.2x the country's short-term external debt based on original maturity
- Remittances remain strong – expanding by 8.2% in 2010 and by 6.3% in the first seven 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

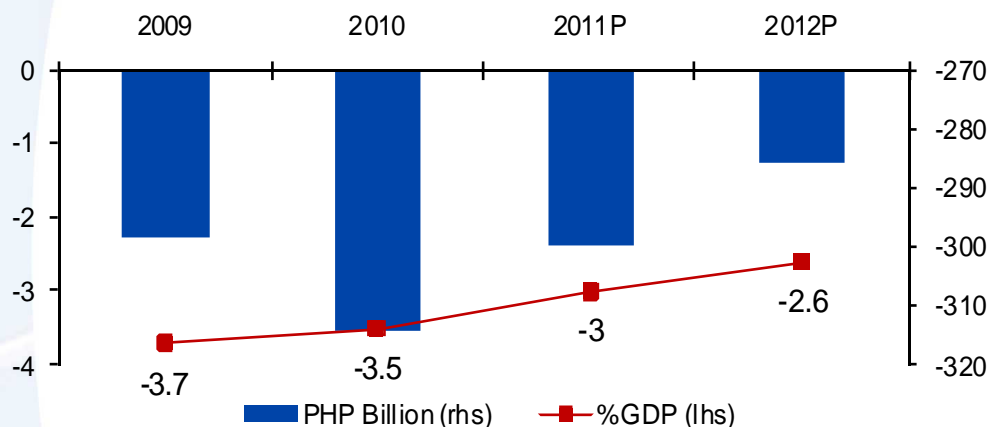
- The Aquino administration's governance reforms in the first 15 months in office have led to a ten-notch upgrade in the Philippines' ranking in the 2011-2012 WEF Global Competitiveness Report
- The Aquino administration has defined five areas of priority to strengthen the President's Social Contract
- 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

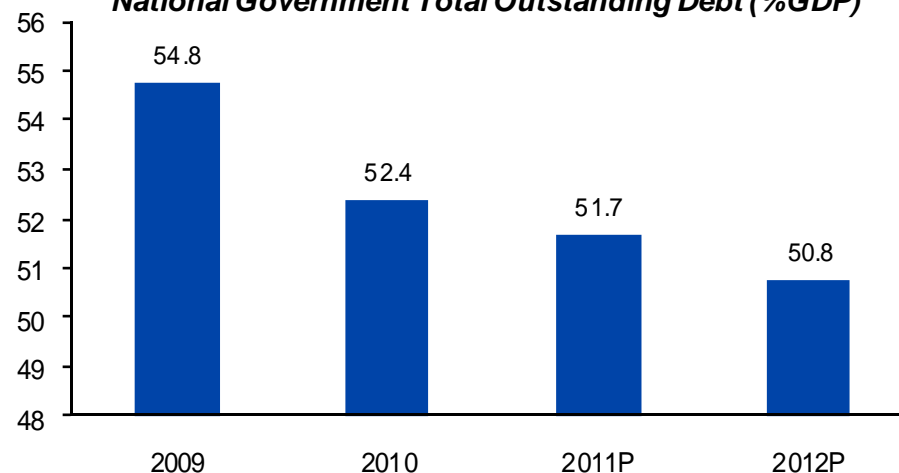
## Deficits are manageable and shrinking

**National Government Financial Position (%GDP and PHP bn)**



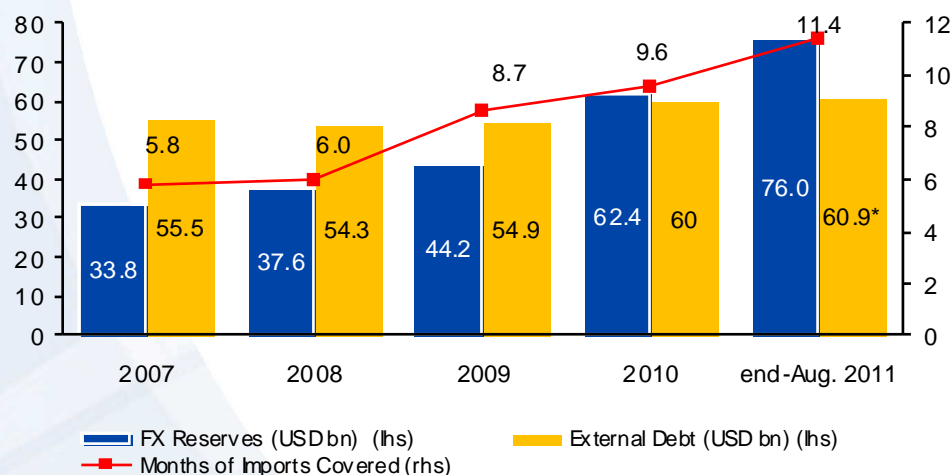
## Government debt ratios are declining rapidly

**National Government Total Outstanding Debt (%GDP)**



## The Philippines is a net external creditor

**FX Reserves, External Debt and Import Coverage**

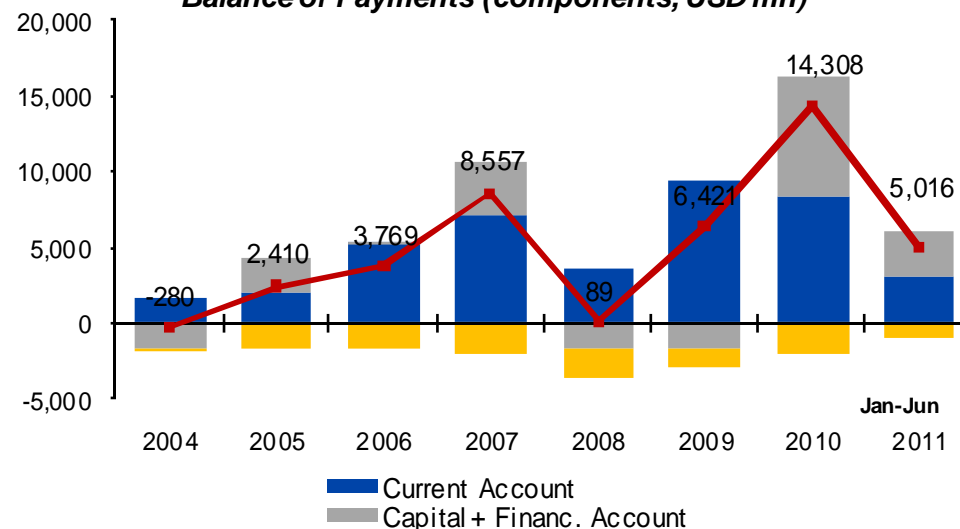


\*As of Q1 2011

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

## The Philippines enjoys a structurally positive BOP

**Balance of Payments (components, USD mn)**



\* Latest BOP position stood at US\$9.0 billion as of end-August 2011

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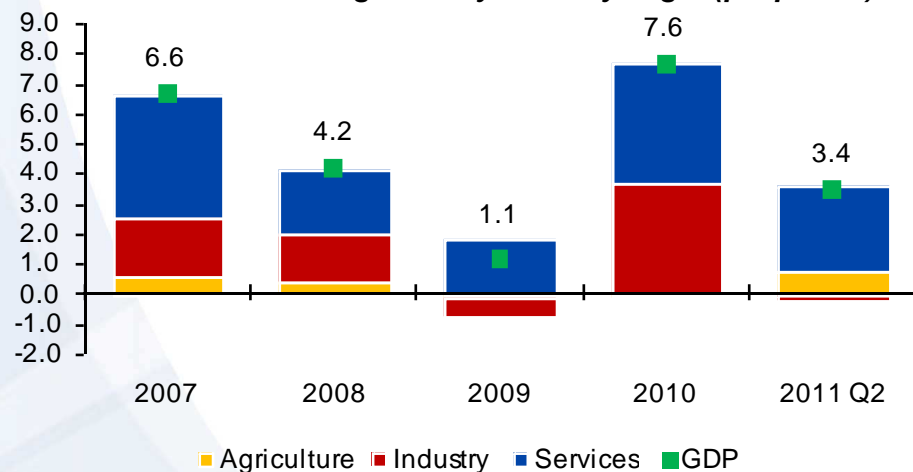
# Healthy, Sustained and Inclusive Economic Growth

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

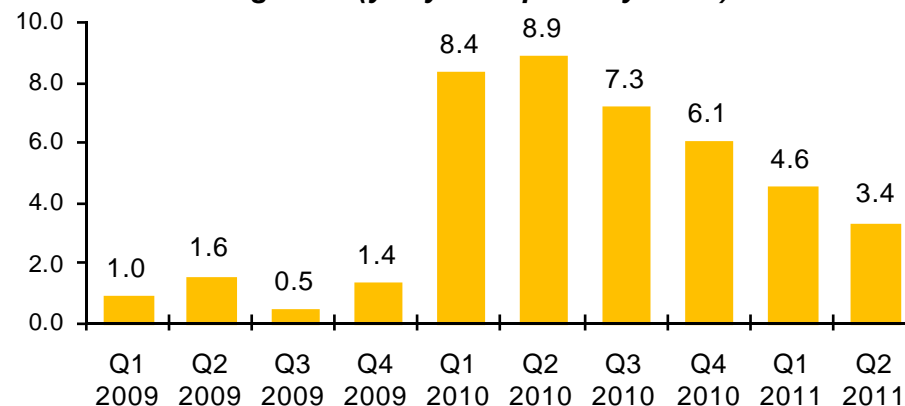
## Economic growth is becoming more balanced

Contribution to GDP growth by industry origin (pct points)



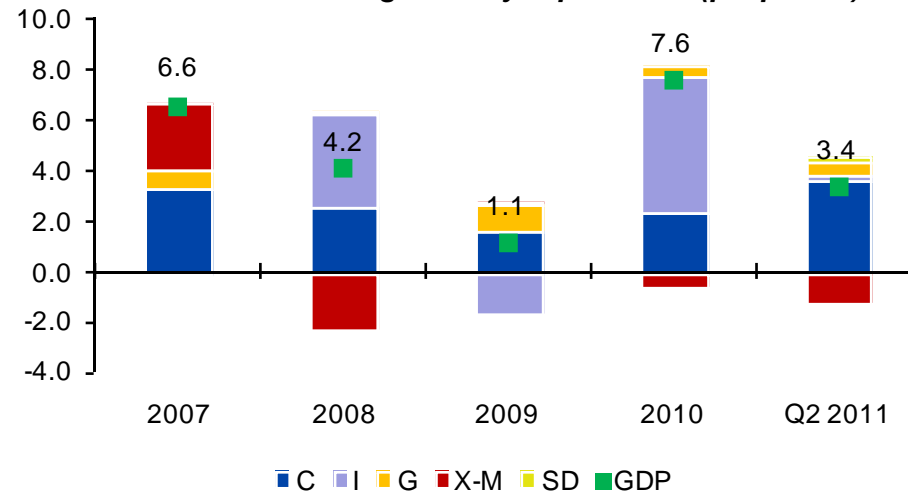
## Economic growth remains healthy

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



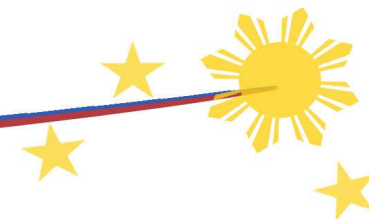
## Healthy growth is being driven by consumer spending

Contribution to GDP growth by expenditure (pct points)



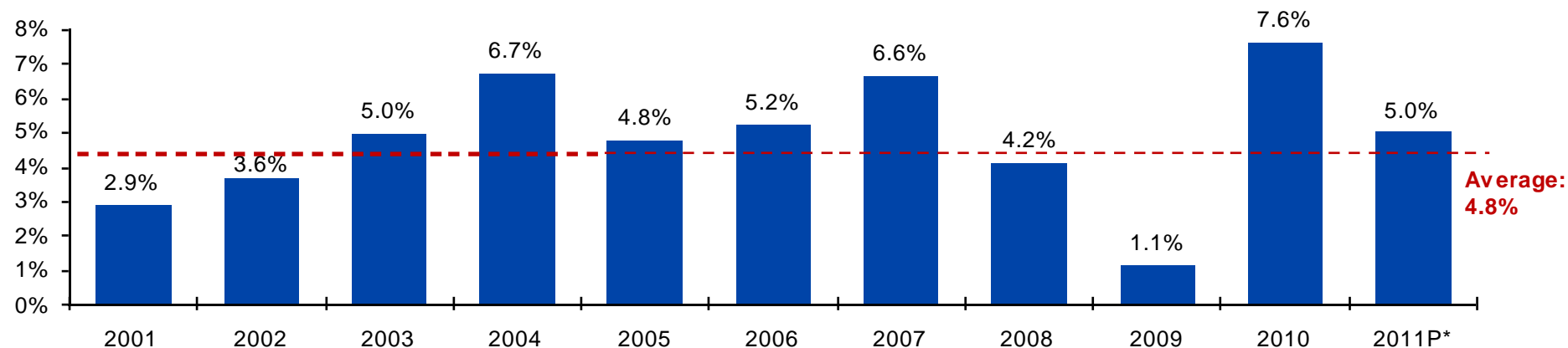
# Healthy, Sustained and Inclusive Economic Growth

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



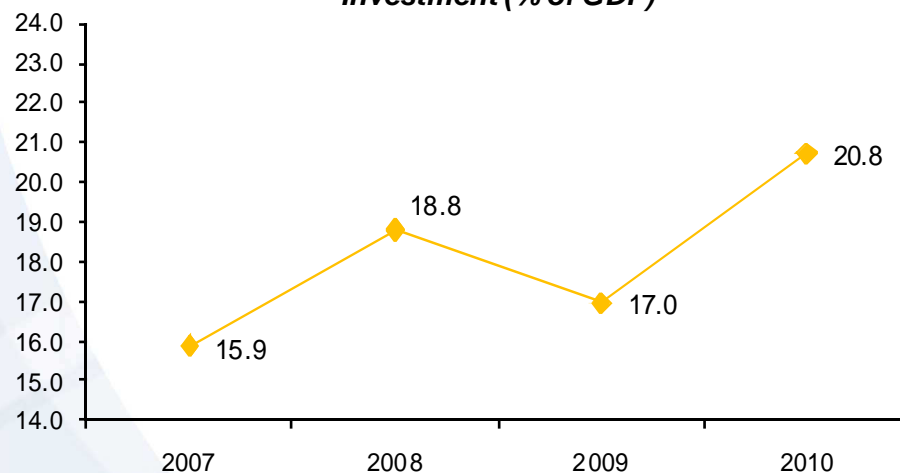
A decade of rapid and sustained economic growth is set to continue

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








Accelerating levels of investment should sustain healthy growth

*Investment (% of GDP)*



*Economic Growth Projections*

	2011	2012
Official Assumptions 	5.0 - 6.0	5.5 - 6.5
 International Monetary Fund	4.7	4.9
 The World Bank	5.0	5.4
 ADB Asian Development Bank	4.7	5.1
Poll of Forecasters 	4.7	5.0

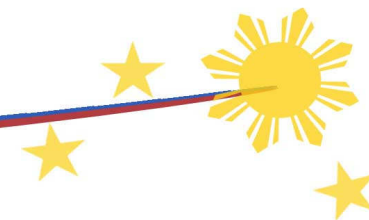
\*Average of 5.0%-6.0% official growth assumptions;

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



# 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

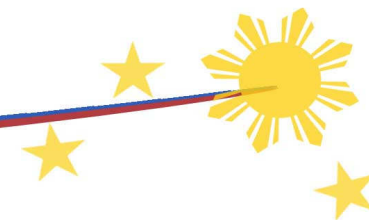
- **Household consumption will get a** boost from the employment creation program, the continuing implementation of the conditional cash transfer program for the lower income deciles, the modest inflow of remittances, and the still well-anchored inflation expectations.
- **Investments** will continue 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.

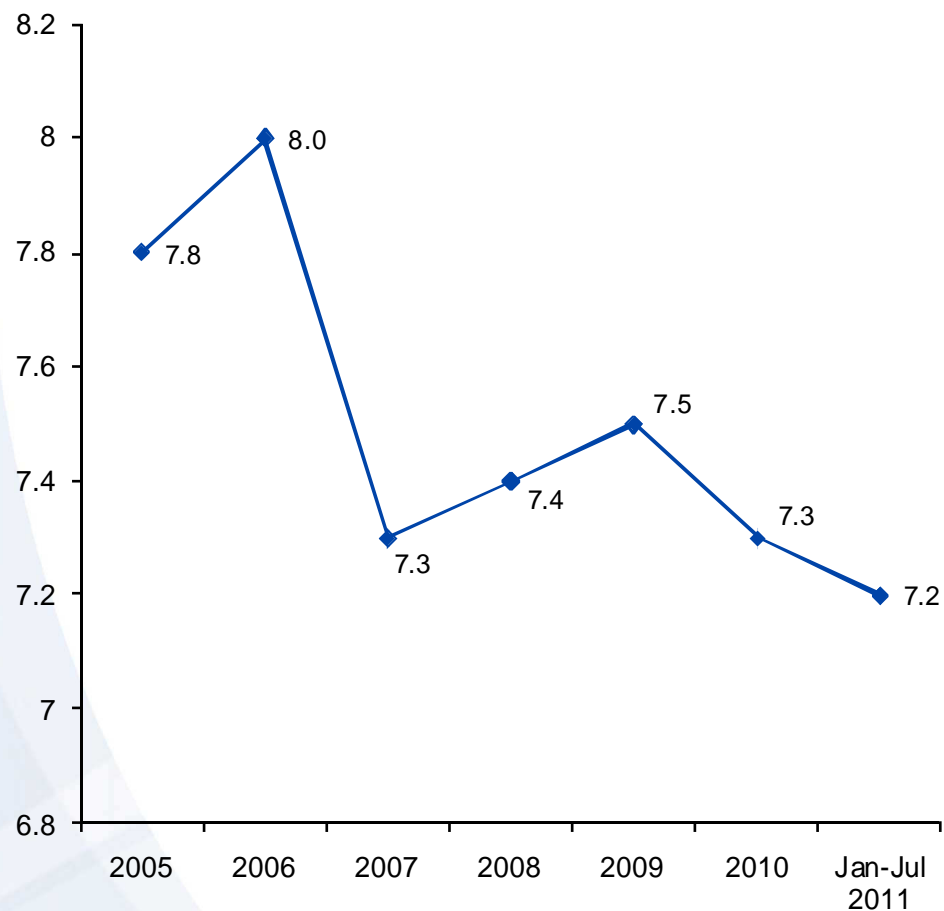
# Healthy, Sustained and Inclusive Economic Growth

Inclusive: Economic growth is generating opportunities for all



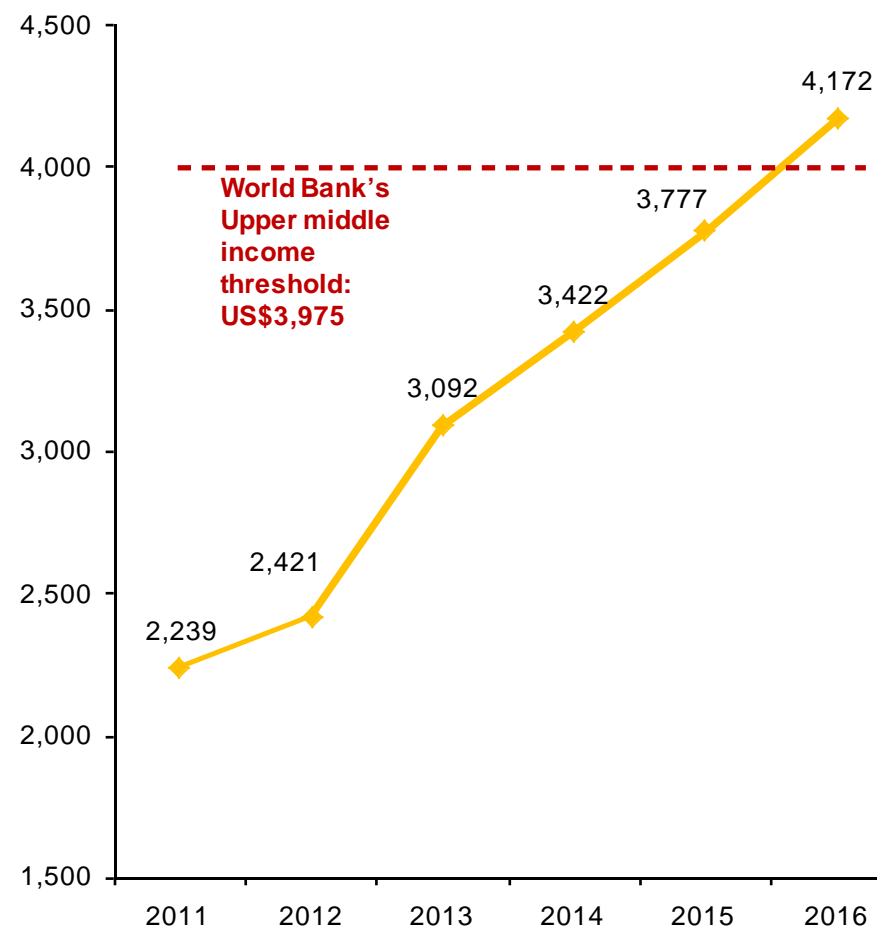
Unemployment has been consistently low and is declining

Unemployment rate (%)



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

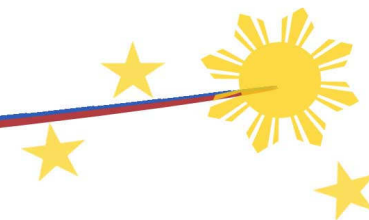
GDP Per Capita projections (Based on Government Assumptions)\*



\* 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)

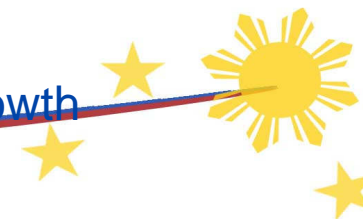
### ■ Develop Small and Medium Enterprises

- Capacitate small and medium enterprises (SME) by rewarding performers; make available training courses
- Formulate the National SME Development Plan 2011-2016
- Implement the Rural Micro-Enterprise Promotion Program
- 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



**Executive Order No. 8:** “Reorganizing and Renaming the Build-Operate and Transfer (BOT) Center to the Public-Private Partnership (PPP) Center of the Philippines and transferring its attachment from the Department of Trade and Industry to the National Economic and Development Authority and for other Purposes” (9 September 2010)

PPP projects for 2011 roll-out (2010 Prices in PhP Million)	
<b>NAIA Expressway (Phase 2)(Department of Public Works and Highways- DPWH)</b> <i>The 5km elevated toll road project will link Skyway and Manila-Cavite Coastal Expressway. It will provide vital access to Ninoy Aquino International Airport (NAIA) Terminals 1, 2, &amp; 3. Economic zones in Cavite Province will benefit through easier and faster transportation of products to NAIA as well as to Manila Port through this link and the North Luzon Expressway-South Luzon Expressway (NLEX-SLEX) Link Expressway</i>	12,946.00
<b>NLEX-SLEX Connector (DPWH)<sup>1/</sup></b> <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>	20,181.00
<b>Daang Hari-SLEX Link Road Project (DPWH)</b> <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>	1,956.00
<b>PPP for Classrooms Project (Department of Education)</b> <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>	10,400.00
<b>Vaccine Self-Sufficiency Project (VSSP) Phase II</b> <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 Hemophilus Influenza B), Tetanus Toxoid (TT), Single HepB</i>	960.00
<b>Total</b>	<b>46,447</b>

<sup>1/</sup> Unsolicited Project  
Source: Public-Private Partnerships (PPP) Center

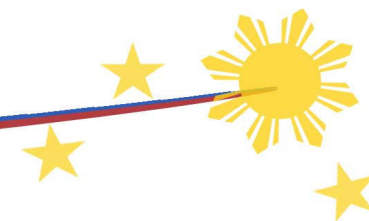
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# Government Financial Strength: An Improving Profile

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
- **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 57.4% as of June 2011, thanks to proactive liability management
- **Debt maturities as of June 2011** have been extended dramatically; 61.6% of domestic government debt is now long term. Short term debt amounts to only 13.8%. 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

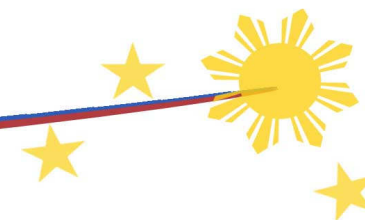
### Extremely Robust Balance of Payments

- **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\$76.0bn as of end-August 2011. This level is more than adequate covering 11.4 months worth of imports of goods and payments of services and income. It is also equivalent to 11.2 times the country's short-term external debt on original maturity
- **Dramatic decline in external debt.** Total external debt is now 29.5% of GDP as of end-March 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



# 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

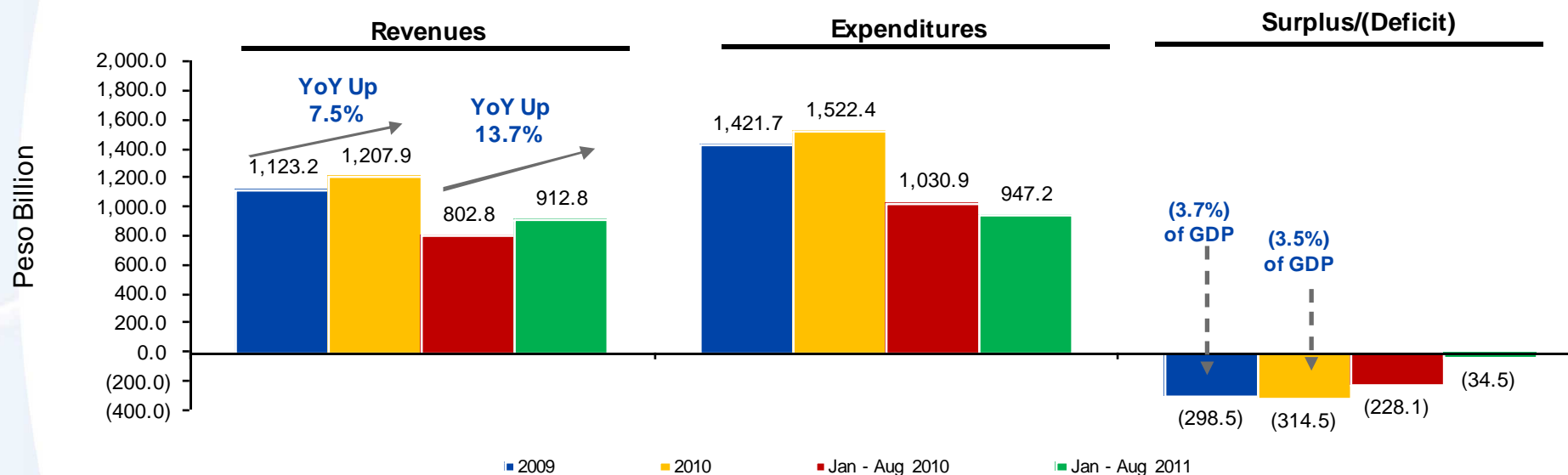
- Reduce the debt stock and debt service payments and lengthen the maturity profile where feasible through debt swaps and exchanges
- Continue with various initiatives to diversify the capital structure: examples already implemented include the Retail Treasury bond, Japanese Yen issue, Global Peso bond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

# Government Financial Strength: An Improving Profile

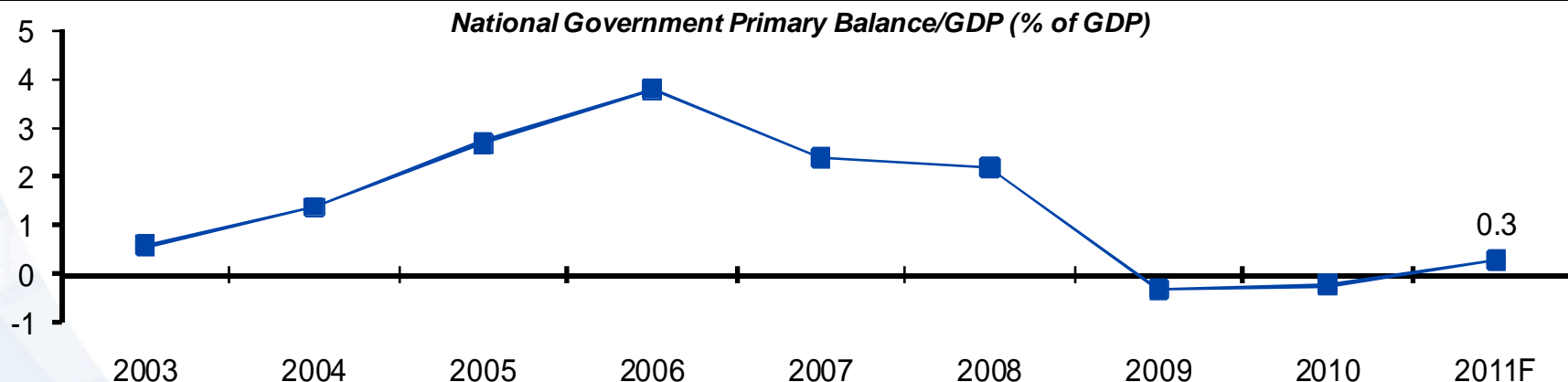
Fiscal performance remained strong through the financial crisis and further strengthens under the Aquino Administration

**National Government deficit from Jan – Aug 2011 much better than program at P34.5 billion;**

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



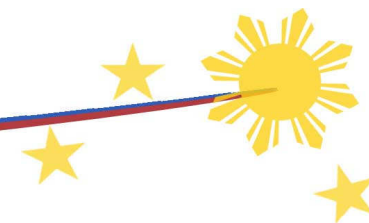
**The Philippines' primary balance provides flexibility to deal with global economic and financial uncertainties**



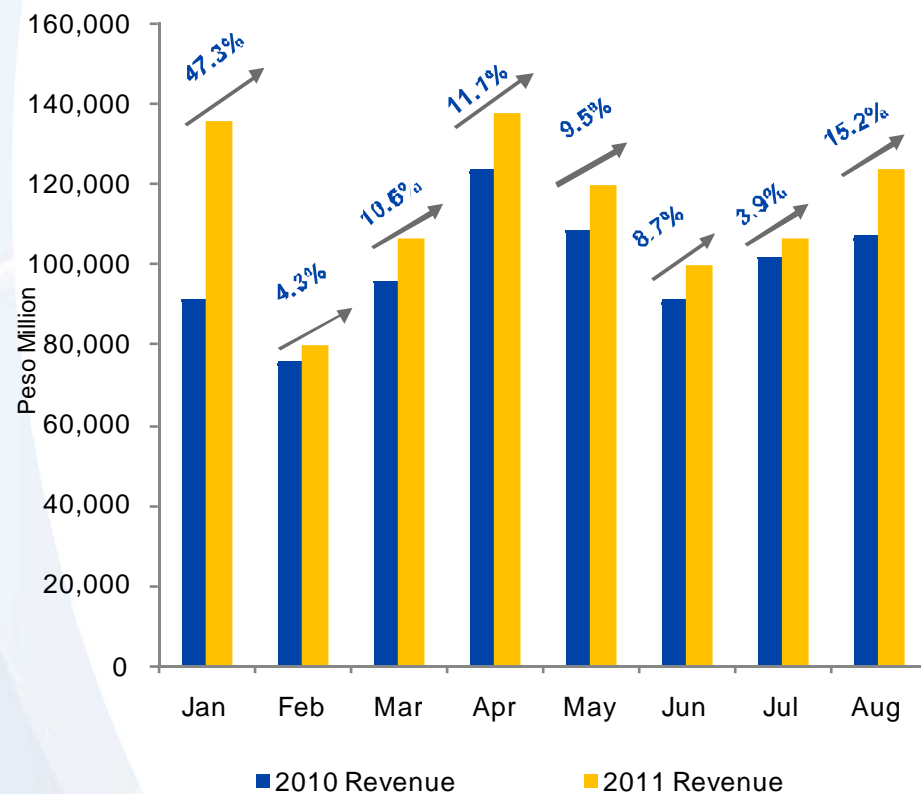


# Government Financial Strength: An Improving Profile

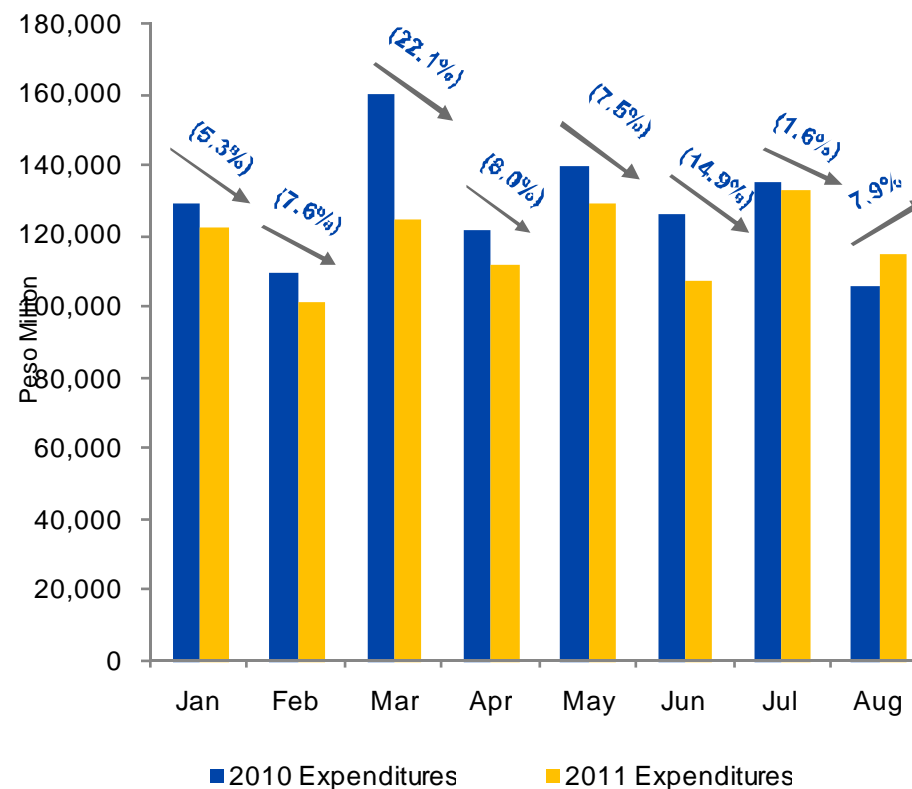
Fiscal consolidation on track in 2011 underpinned by strong revenue collection and tight expenditure discipline



## Firm tax administration measures push revenues higher in 2011



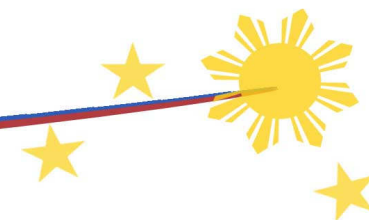
## Careful review of programs ensures productive expenditures



Source: DOF

# Government Financial Strength: An Improving Profile

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



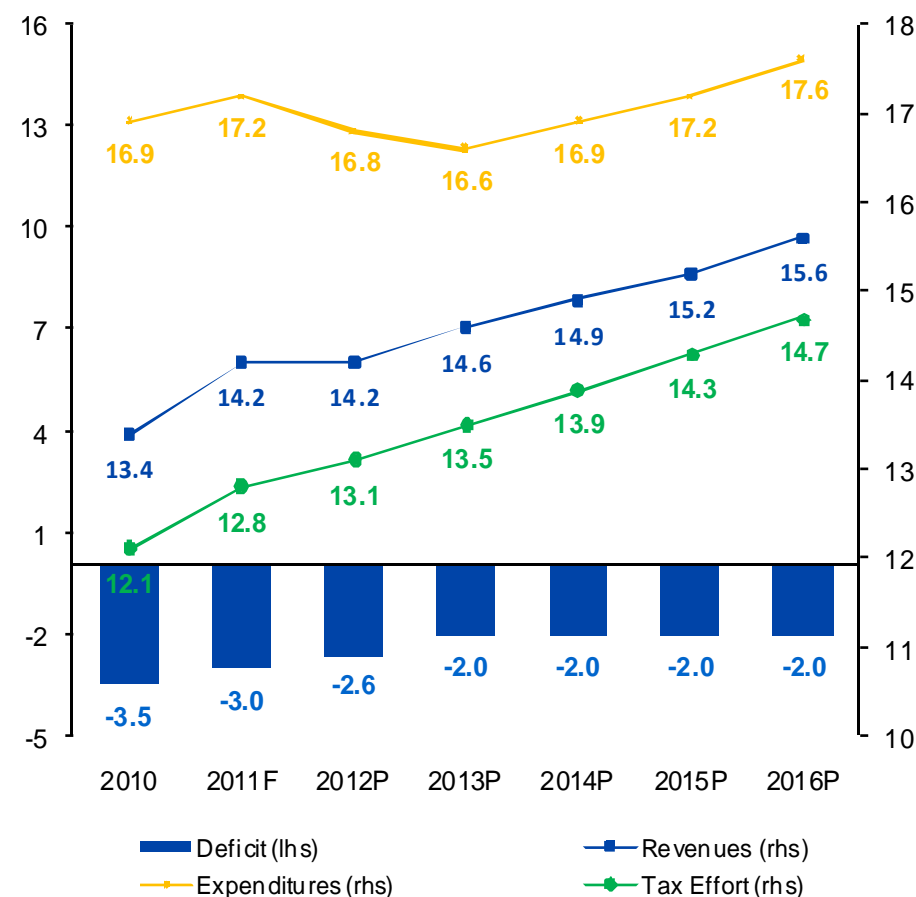
The proposed budget for 2012 cuts the deficit to 2.6%

**2012 National Government Fiscal Program (PHP bn)**

	2010 Actual	2011 Program	2012 Program	Growth Rate (2012/2011)
<b>Total Revenues</b>	<b>1,207.9</b>	<b>1,411.3</b>	<b>1,568.5</b>	
<b>% of GDP</b>	<b>13.4%</b>	<b>14.2%</b>	<b>14.2%</b>	<b>11.1%</b>
<b>Tax Revenues</b>	<b>1,093.6</b>	<b>1,273.2</b>	<b>1,445.5</b>	
<b>% of GDP</b>	<b>12.1%</b>	<b>12.8%</b>	<b>13.1%</b>	<b>13.5%</b>
BIR	822.6	940.0	1,066.1	13.4%
BOC	259.2	320.0	365.1	14.1%
Other Offices	11.8	13.2	14.2	7.6%
Non-Tax Revenues	114.3	138.1	123.0	-10.9%
<b>% of GDP</b>	<b>1.3%</b>	<b>1.4%</b>	<b>1.1%</b>	
BTr Income	54.3	69.0	51.6	-25.2%
Fees and Charges	58.6	63.1	69.4	10.1%
Privatization	0.9	6.0	2.0	-66.7%
Grants	0.4	0.0	0.0	
<b>Expenditure</b>	<b>1,522.4</b>	<b>1,711.3</b>	<b>1,854.5</b>	<b>8.4%</b>
<b>Surplus / (Deficit)</b>	<b>-314.4</b>	<b>-300.0</b>	<b>-286.0</b>	<b>-4.7%</b>
<b>% of GDP</b>	<b>-3.5%</b>	<b>-3.0%</b>	<b>-2.6%</b>	

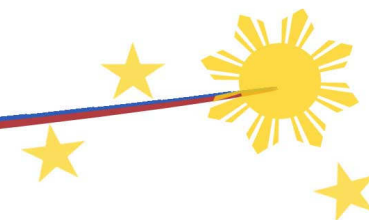
ROP remains on track with its fiscal consolidation program

**Proposed Medium-Term Fiscal Program to 2016 (% of GDP)**



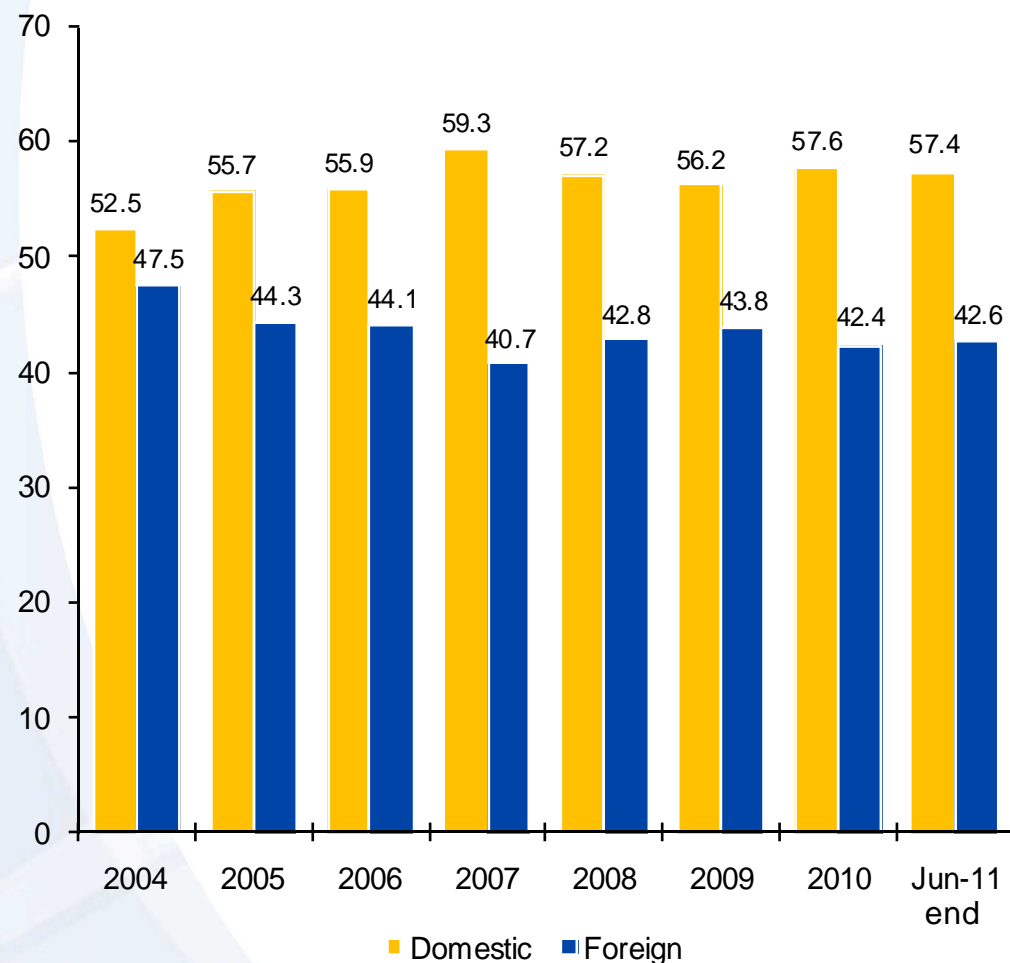
# Government Financial Strength: An Improving Profile

Debt ratios have come down substantially and should drop further



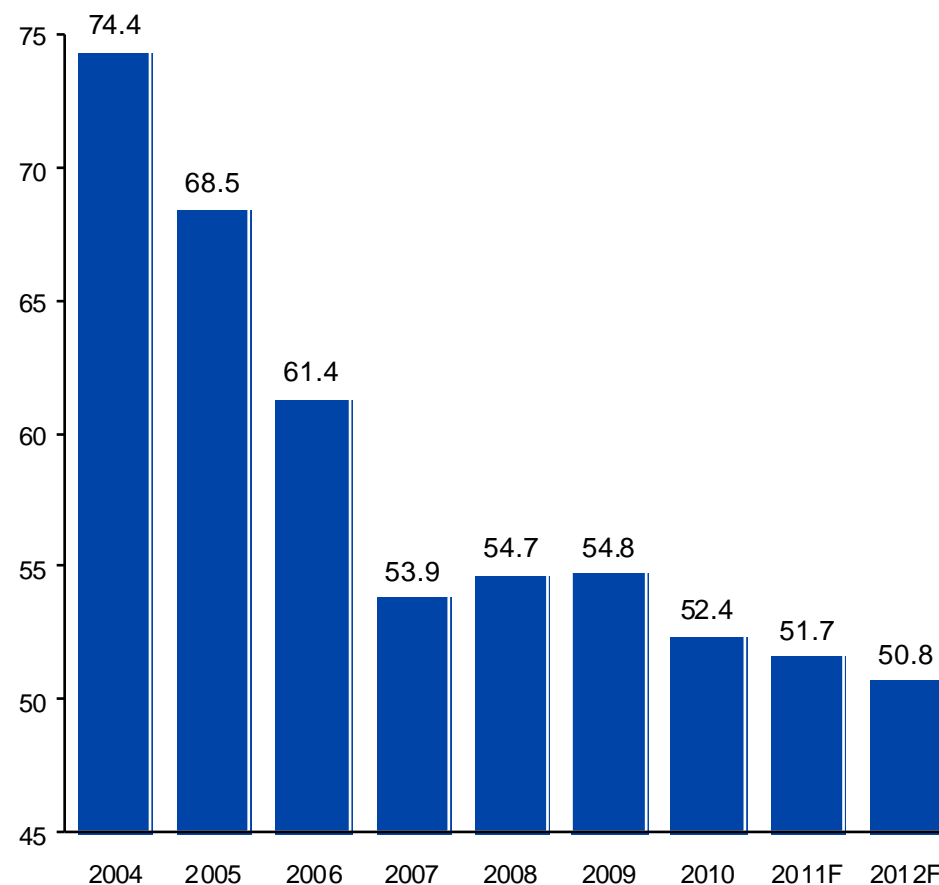
Debt composition continues to be rebalanced towards domestic sources

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)



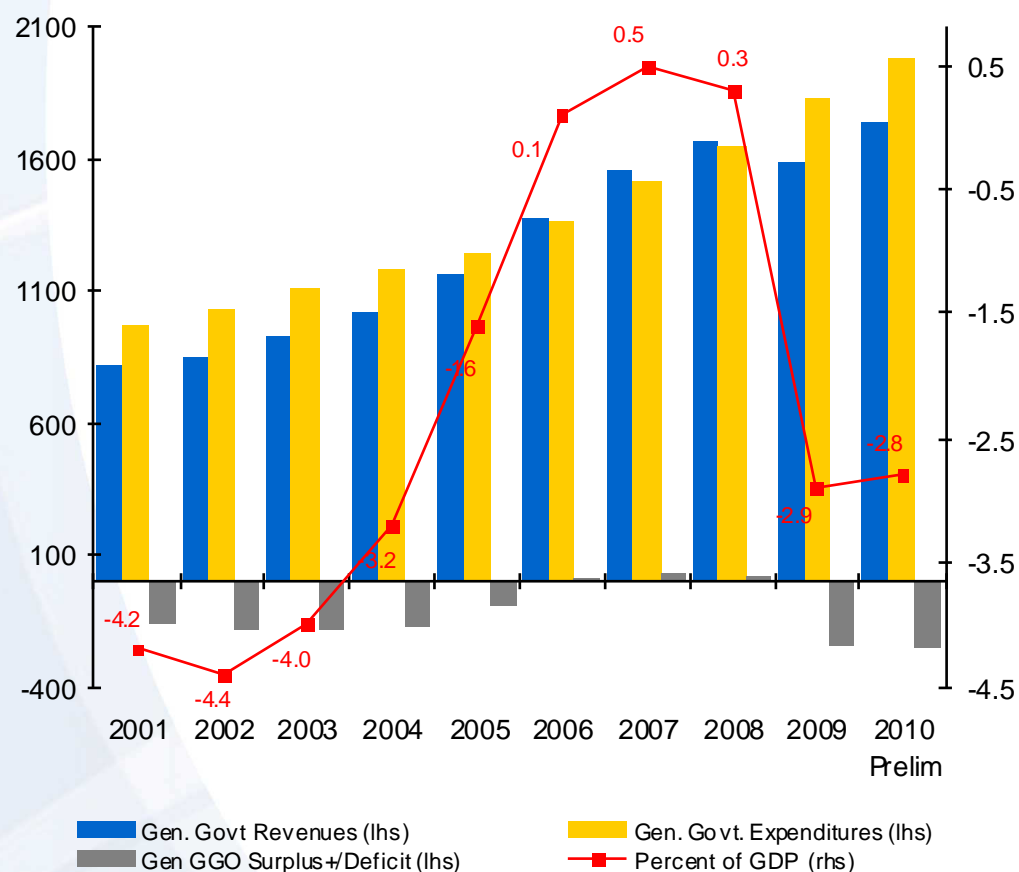
Source: Department of Finance

# Government Financial Strength: An Improving Profile

Government deficit and debt continue to improve on general government basis

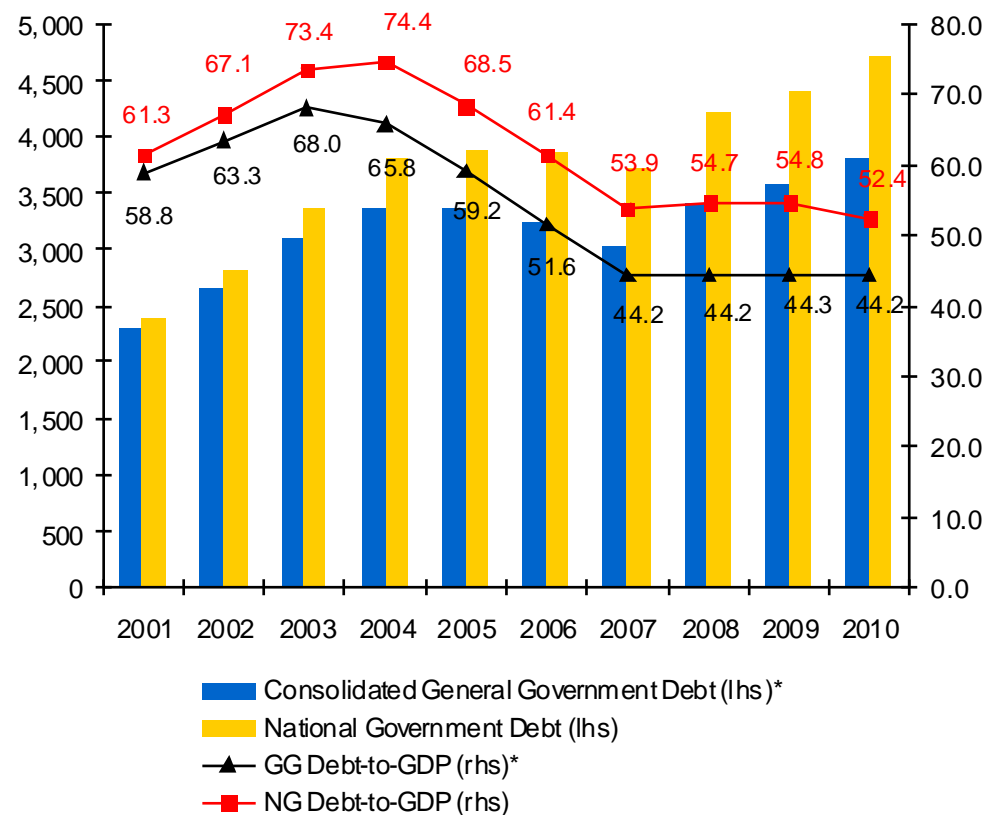
Healthy general government operations supported by LGU and SSI surpluses

in PHP bn; as % of GDP



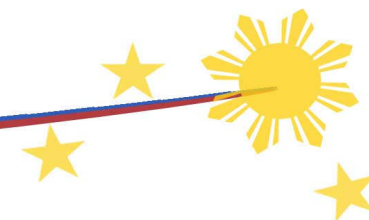
General government debt/GDP in 2010 is 10 percentage points lower than National Government debt

in PHP bn; as % of GDP



# Government Financial Strength: An Improving Profile

Proactive liability management has reduced the exposure to external financing sources

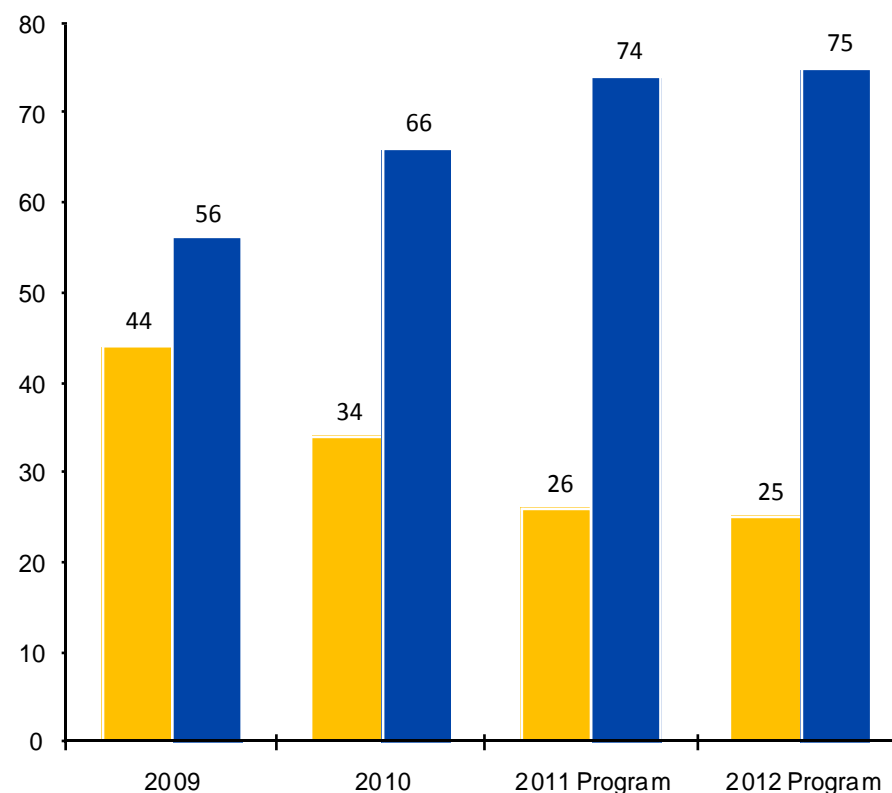


## ROP faces decreasing financing needs in 2011 and 2012

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

## Prudent financing strategies minimize FX risk and increase self-sufficiency

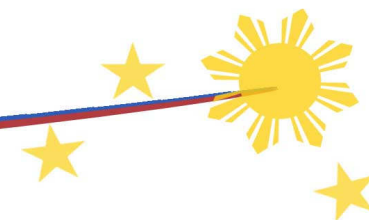
### Domestic and Foreign Financing Prog. (% of total financing)



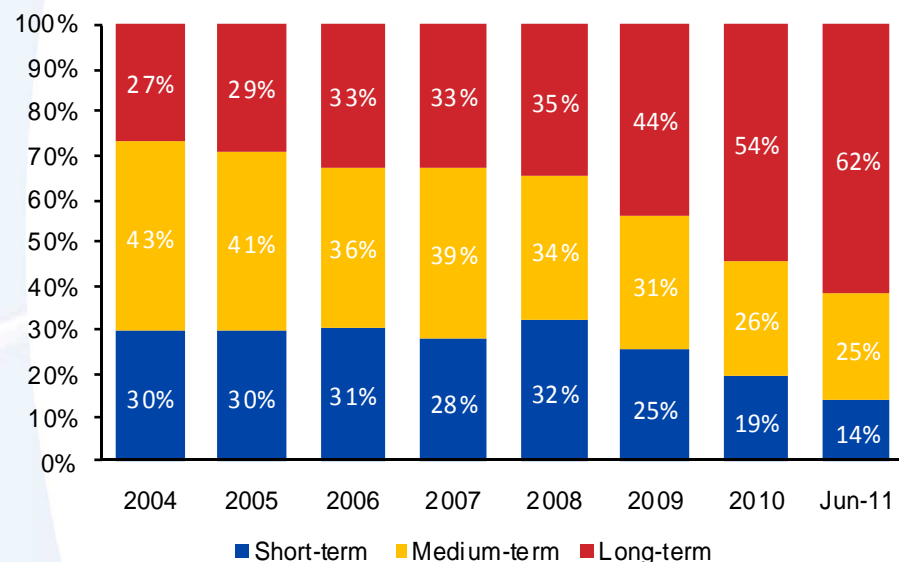
Foreign Domestic

# Government Financial Strength: An Improving Profile

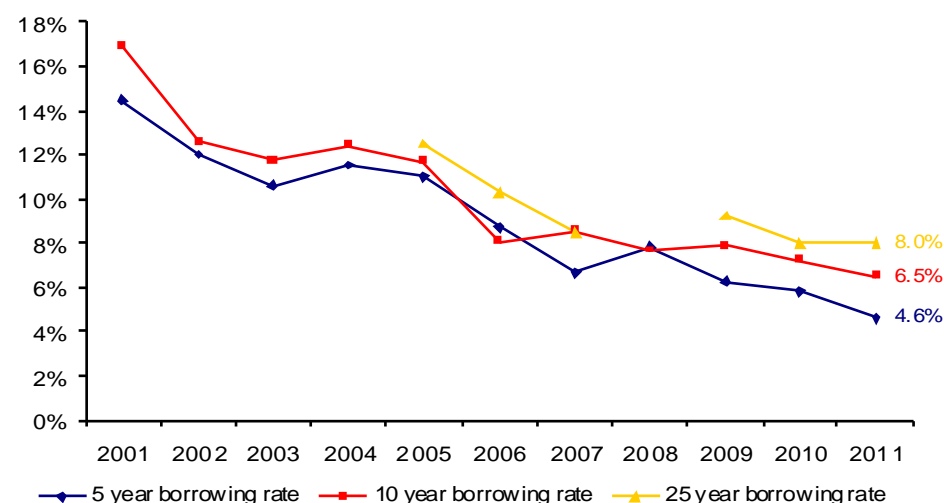
Proactive liability management has extended maturities and has lowered costs



## Lengthening domestic debt maturities



## Declining local borrowing rates



Note: Weighted average annual yields of Philippine government securities

Source: Bureau of the Treasury

## Landmark liability management transactions

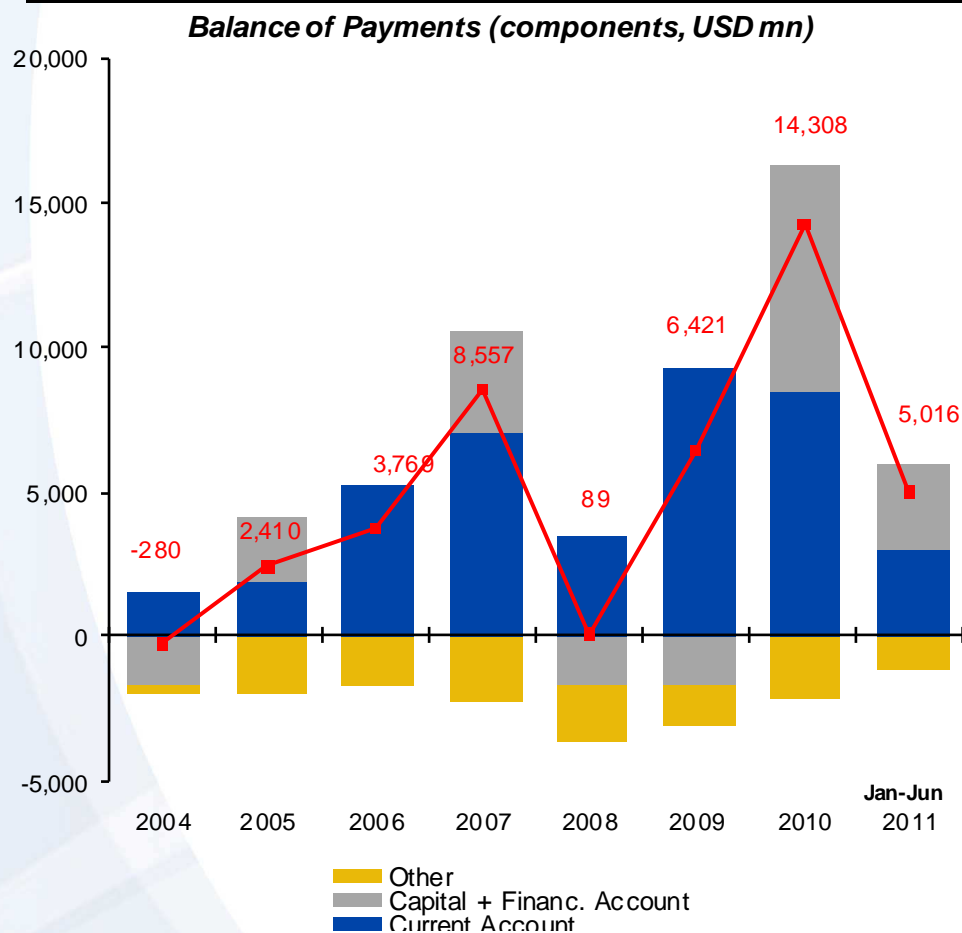
<b>Issuance of 25-year Global Peso Notes</b>	<ul style="list-style-type: none"> <li>Improved currency composition of NG debt and reduced foreign exchange risk</li> <li>Priced at a 23% discount to the local benchmark thereby reduces borrowing cost</li> <li>Further build up the GPN yield curve in support of other borrowers particularly for infrastructure projects</li> </ul>
<b>Bond Exchange</b>	<ul style="list-style-type: none"> <li>Achieved a maturity and duration extension of 9.1 years and 5.3 years, respectively</li> <li>Generated NPV savings of about US\$5.6M and cash interest savings of US\$69.6M per annum</li> <li>Approx. US\$1.7M of bonds maturing from 2011-2017 were retired in the exchange</li> </ul>
<b>Issuance of 15-year \$1.5 billion bond in March</b>	<ul style="list-style-type: none"> <li>Priced at 99.495 with a coupon of 5.5% to yield 5.55%</li> <li>Demonstrated strong global appetite for exposure to the Philippines' credit</li> </ul>

Source: Bureau of the Treasury

# Government Financial Strength: An Improving Profile

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

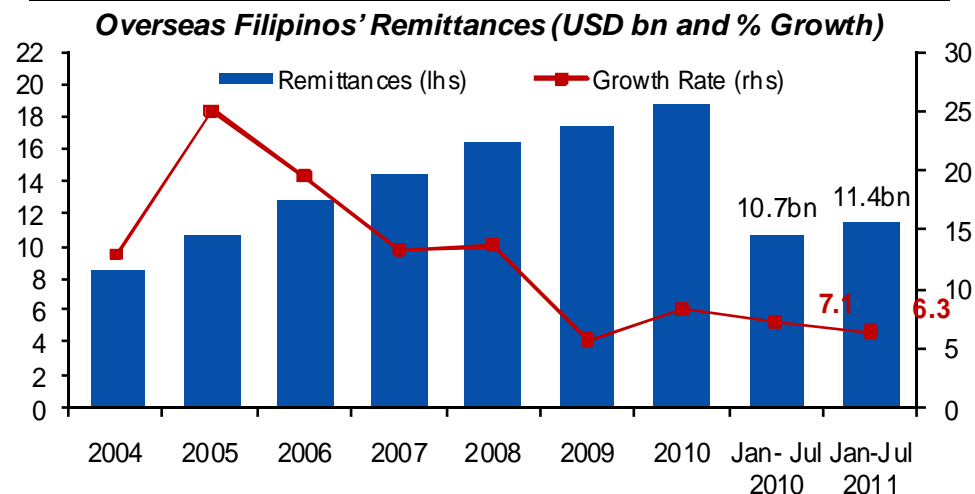
## The Philippines enjoys a structurally positive BOP



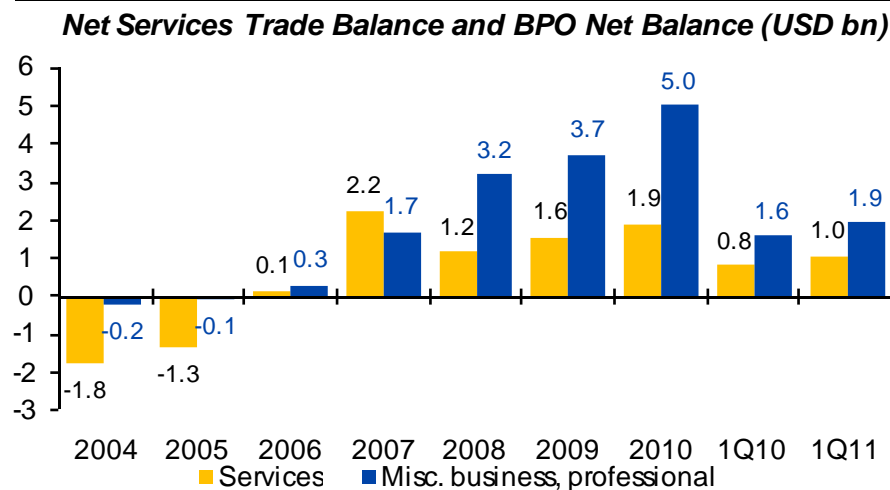
\* Latest BOP position stood at US\$9.0 billion as of end-August 2011

Source: Bangko Sentral ng Pilipinas, National Statistical Coordination Board

## Remittances continue to soar achieving a new monthly record of USD\$1.7bn in July 2011

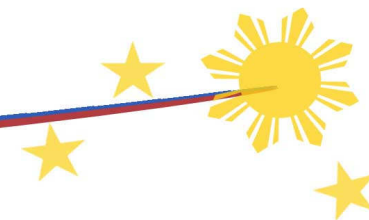


## BPO continues to grow quicker than the net services balance



# Government Financial Strength: An Improving Profile

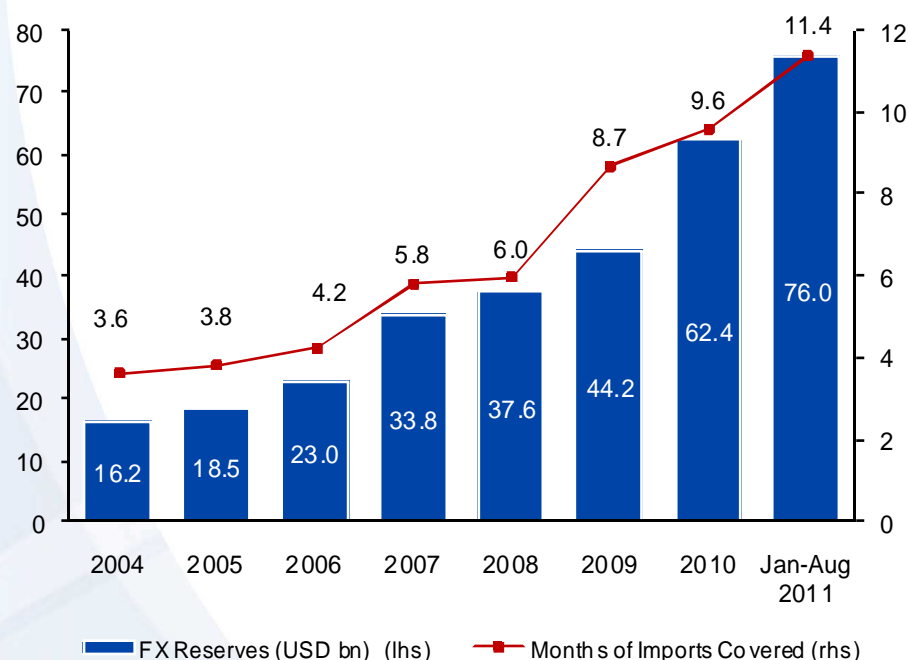
International reserves levels continue to soar providing an ample buffer against external shocks



- Gross international reserves expanded to a record US\$76.0 bn as of end-August 2011, much higher than the ROP's external debt of US\$60.9 billion.
- Large stockpile of international reserves provide a healthy buffer against external shocks – reserve holdings can cover 11.2x the country's short-term external debt on original maturity and 11.4 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

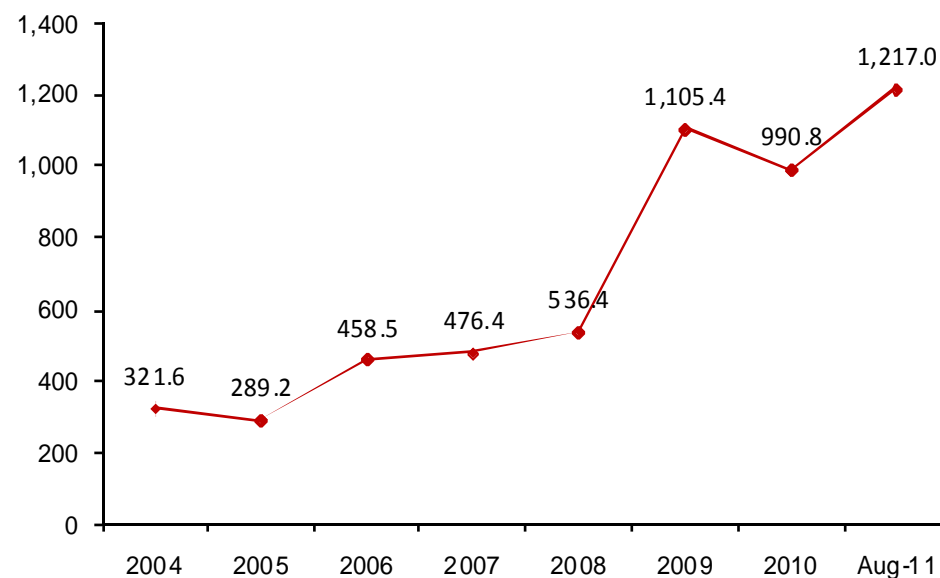
## Soaring FX reserves have fortified the economy's buffers

**Gross International Reserves (USD bn and Import Coverage)**



## Reserve coverage ratios are at all time high

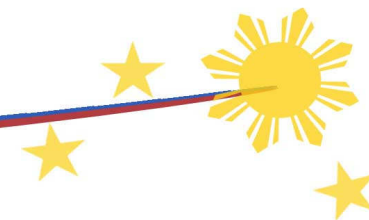
**Short-Term External Debt Cover (Original Maturity)**





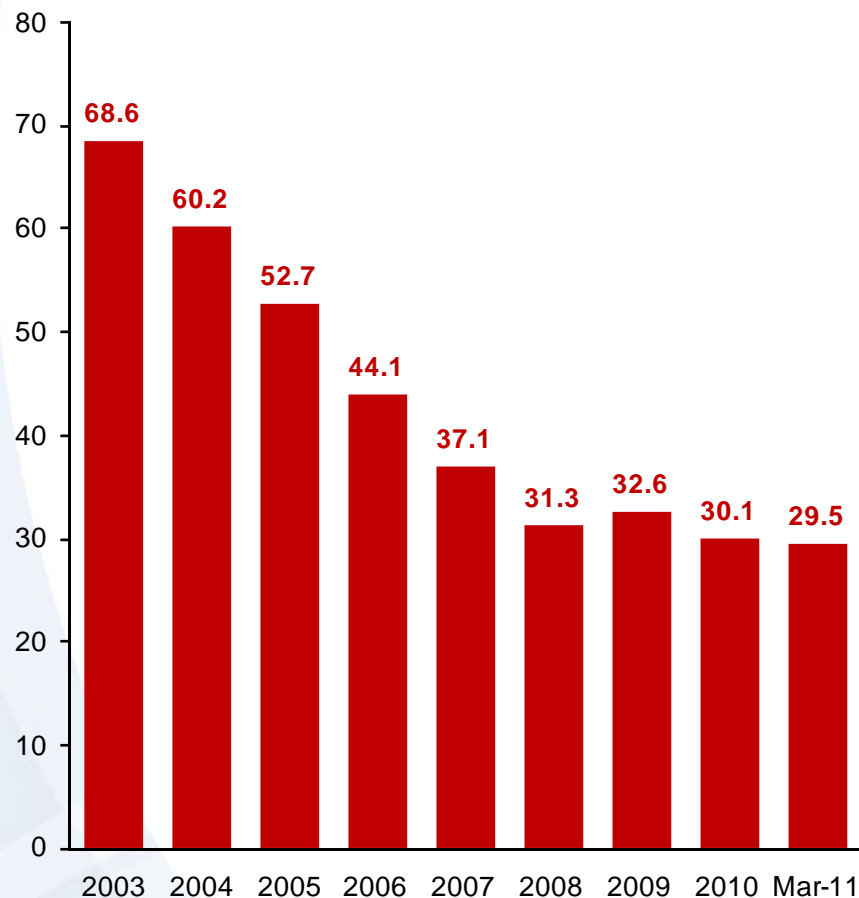
# Government Financial Strength: An Improving Profile

External debt service and interest payments are very manageable



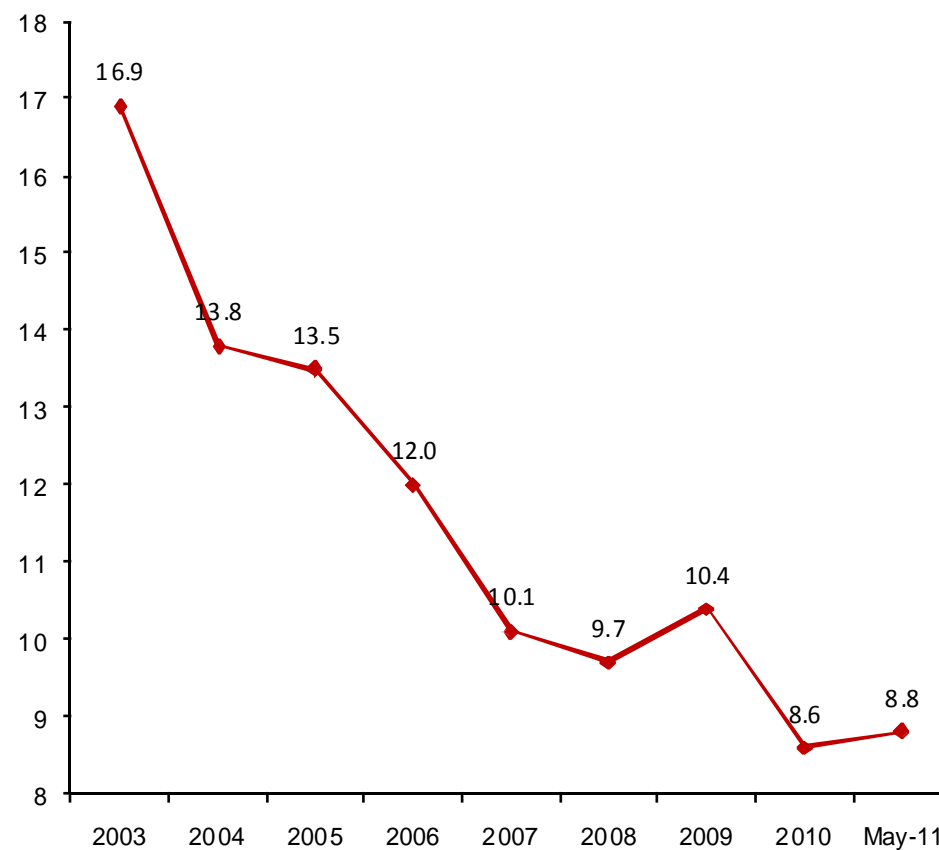
External debt-to-GDP has been cut by half in six years

*External Debt-to-GDP ratio (%)*



External debt service ratio keeps strengthening

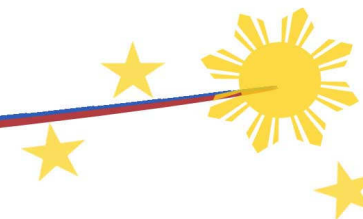
*Debt Serv. /Exports of Goods and Rcpts. from Serv. and Income (%)*



Source: Bangko Sentral ng Pilipinas

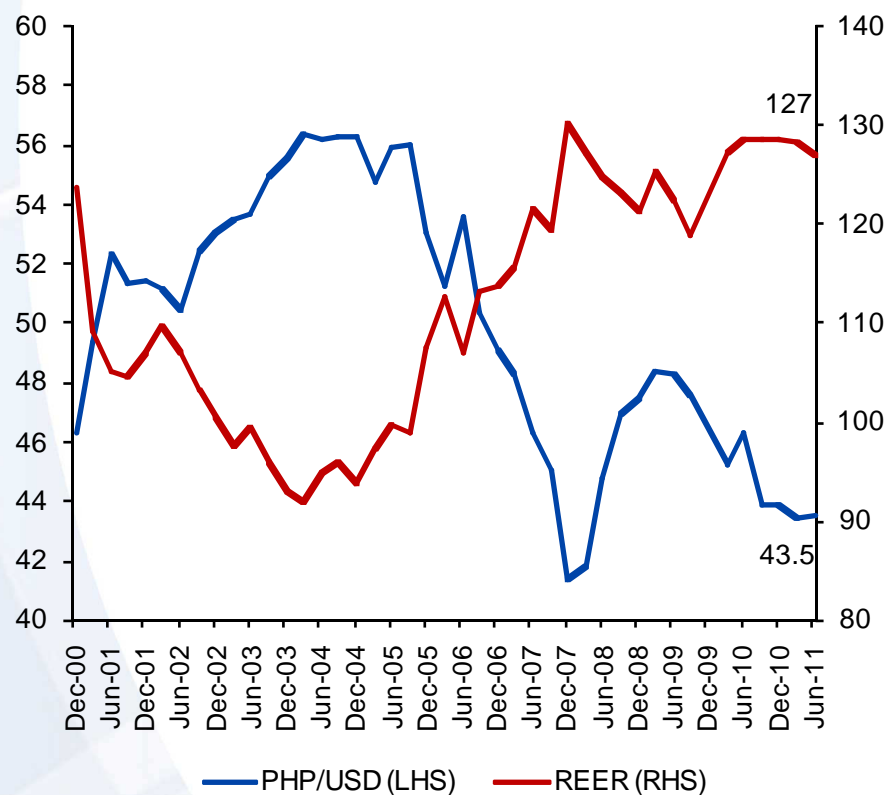
# Government Financial Strength: An Improving Profile

Reduced likelihood of destabilizing depreciation bolsters the Philippines' creditworthiness



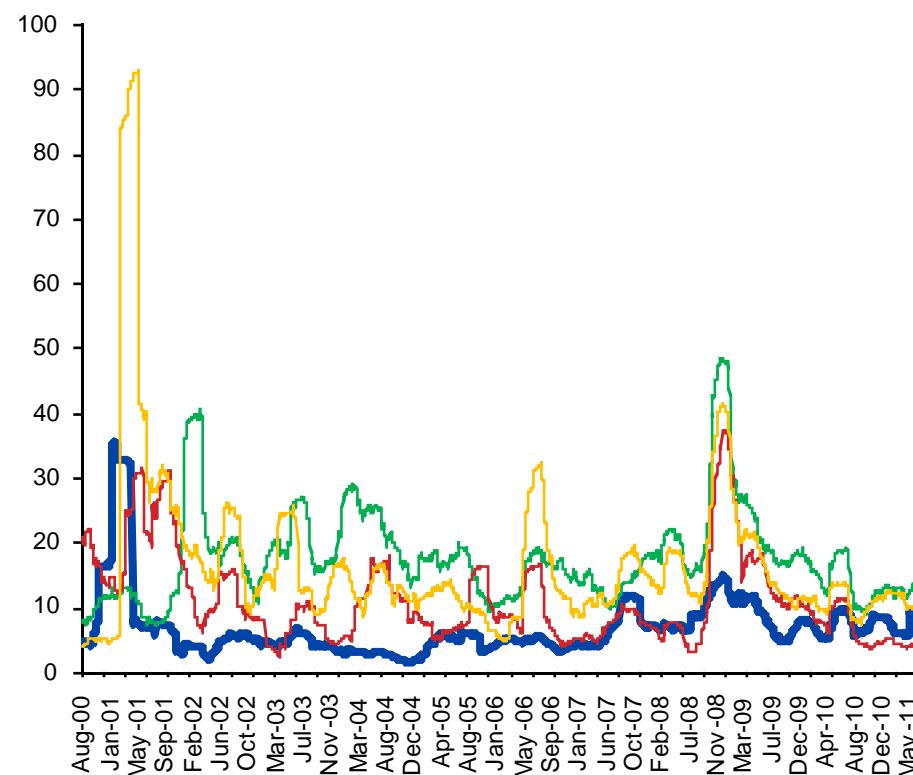
The Peso has strengthened both vis-à-vis the USD and on a real effective exchange rate basis

*PhP per USD and REER\**



Peso substantially more stable compared to peer currencies

*Three Months Realized Volatility*

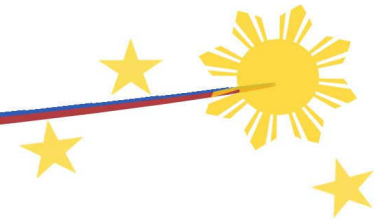


— Philippine Peso — South African Rand  
— Indonesian Rupiah — Turkish Lira

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

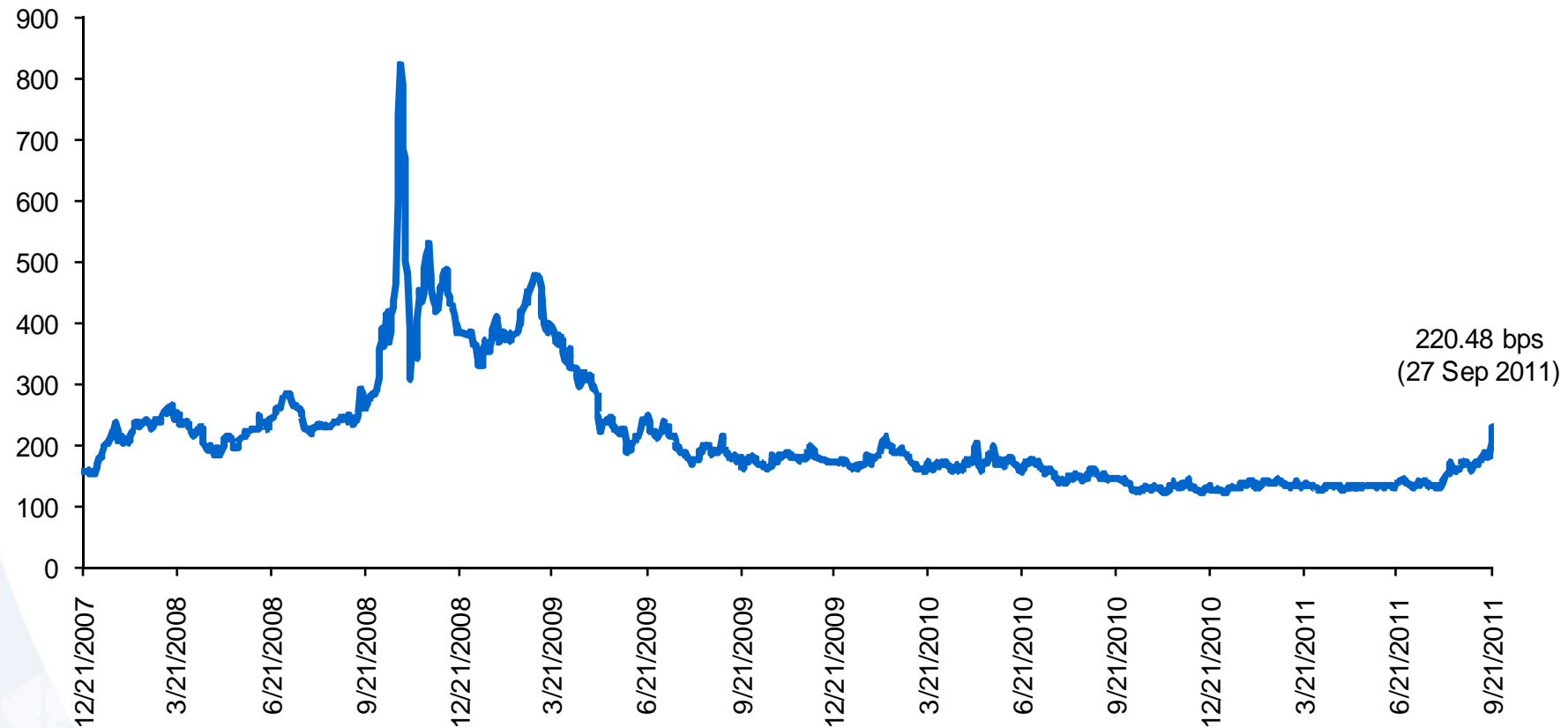
# Government Financial Strength: An Improving Profile

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



Source: Datastream

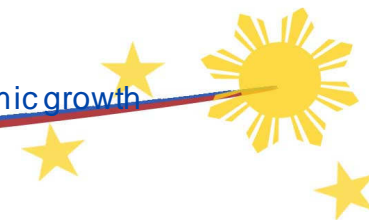
# Agenda



- 1 Executive Summary: A Fortified Economic Story
- 2 Healthy, Sustained and Inclusive Growth
- 3 Government Financial Strength: An Improving Profile
- 4 Credible Monetary Policy and a Resilient Banking System**
- 5 Governance Reforms: Strengthening the Social Contract
- 6 The Philippines: Reaching for Investment Grade

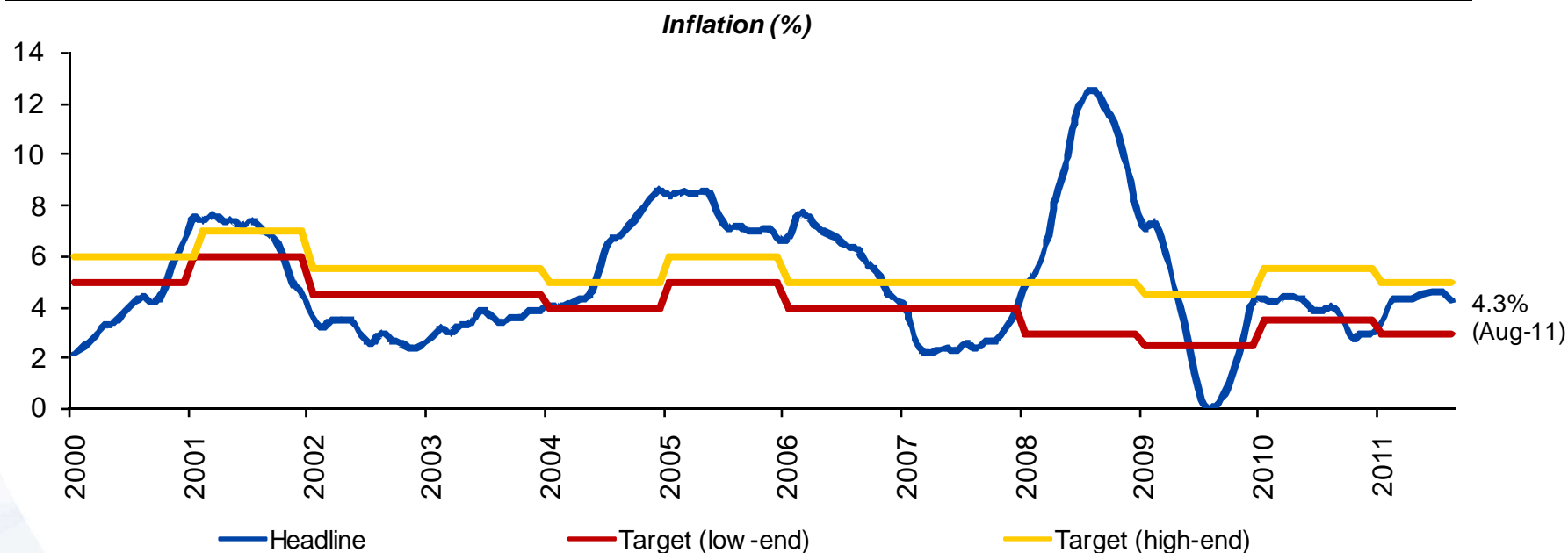
## Effective Monetary Policy – Supportive and Stable

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



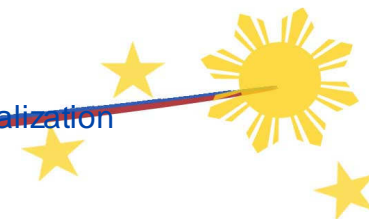
- Prudent monetary policy has kept inflation low and stable at 4.3% as of end-August 2011, within the target band of 3.0-5.0%. Average inflation for the first eight months of 2011 averaged 4.3%
- BSP preemptively hiked policy rates to rein in inflation expectations and raised reserve requirements to 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



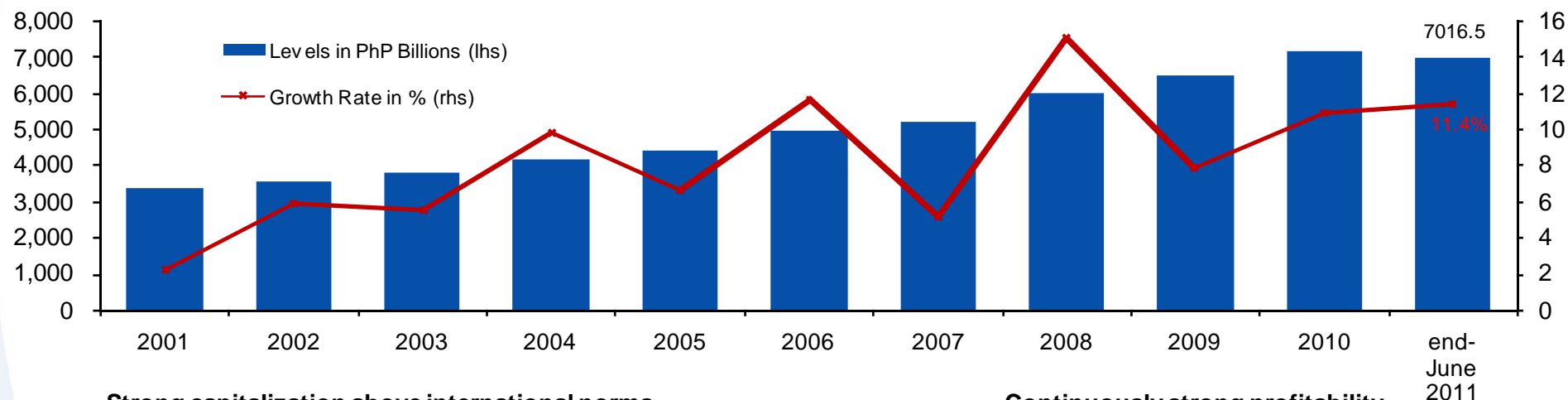
# Maturing Banking Sector Continues to Perform Well

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



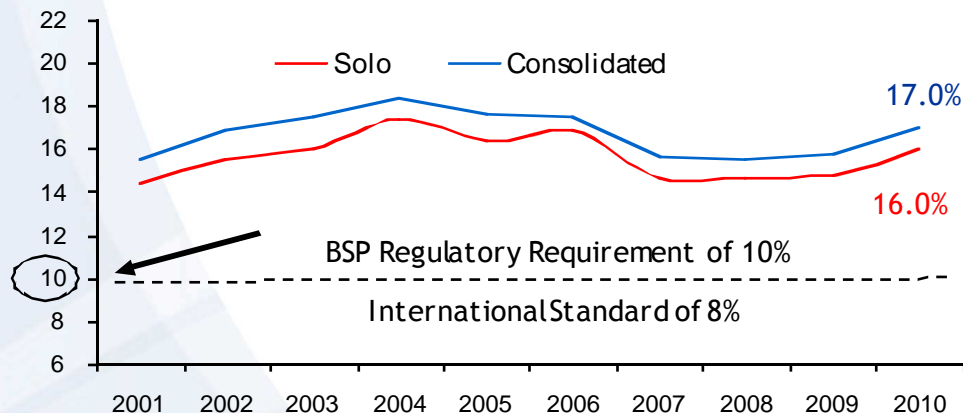
## Solid asset growth in line with economic expansion

**Philippine Banking System Asset Size and Asset Growth**



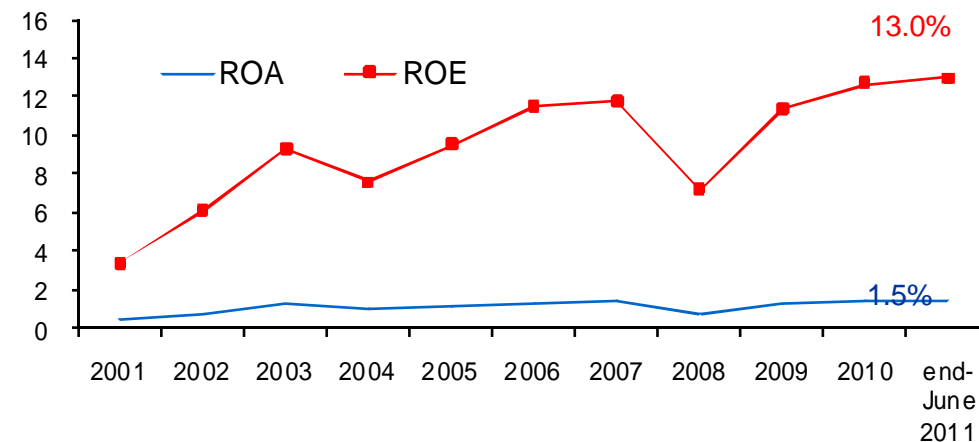
## Strong capitalization above international norms

**Capital Adequacy Ratio (%)**



## Continuously strong profitability

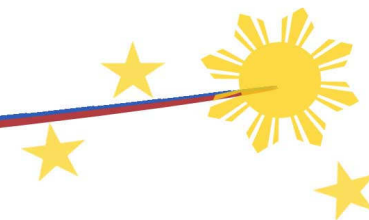
**Return on Equity (%) and Return on Assets (%)**



Source: Bangko Sentral ng Pilipinas

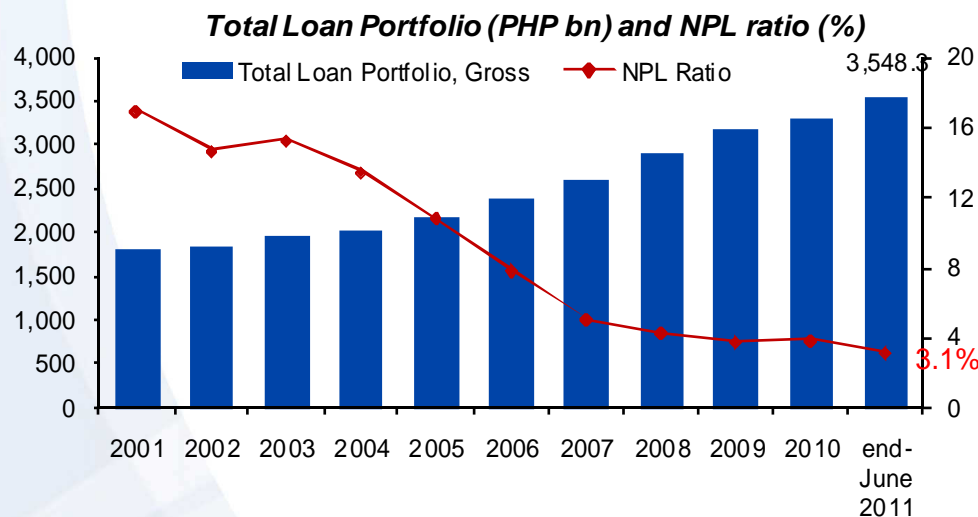
# Improving Asset Quality

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

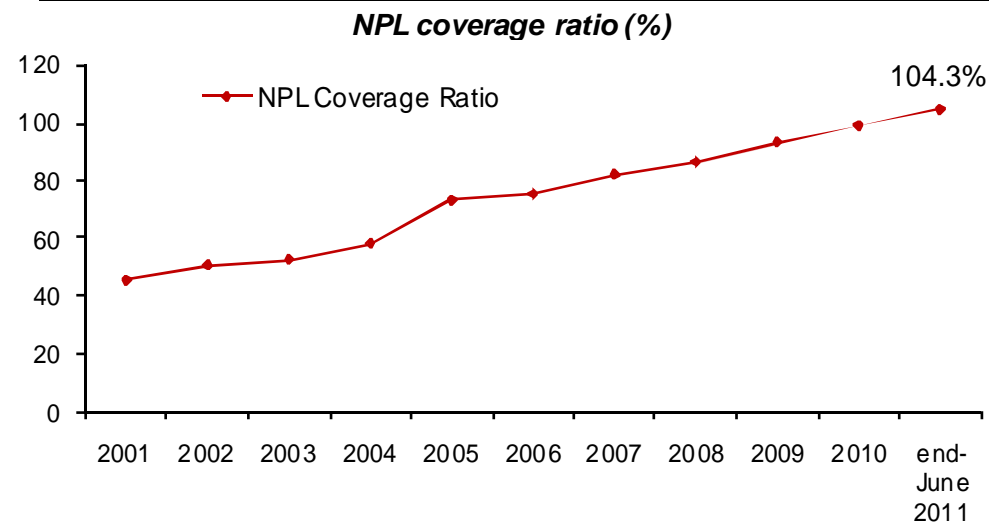


- The resilience demonstrated by the Philippine banking system is highlighted by the decrease in system-wide nonperforming loans (NPL) even at the heart of the global financial crisis
- Total loan portfolio continues to grow while NPL ratio continue to improve
- Improving asset quality helps minimize 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**



Source: Bangko Sentral ng Pilipinas

\*Note: All graphs refer to Universal and Commercial Banks

# Agenda

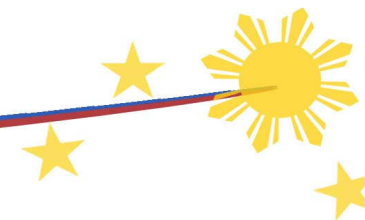


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- 6** The Philippines: Reaching for Investment Grade



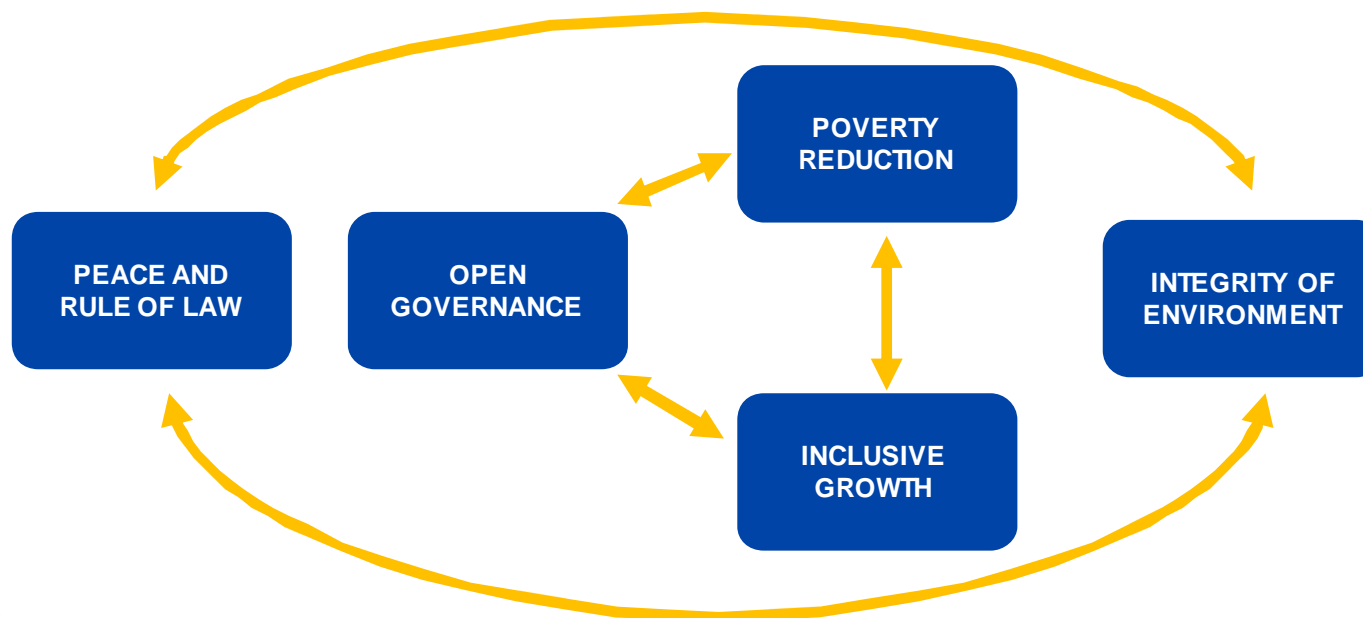
# Governance Reforms: Strengthening the Social Contract

Daylight in governance remains the overarching principle of the Aquino Administration



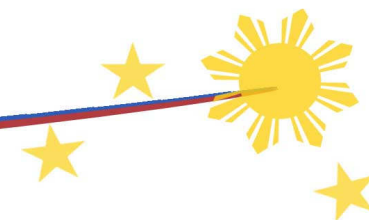
**President Aquino issued on May 13, 2011 Executive Order No. 43, defining five areas of priority of the Social Contract. These five areas drive the 2012 Budget and embody the ROP's commitment to lifting the poor from poverty through honest and effective governance:**

- 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



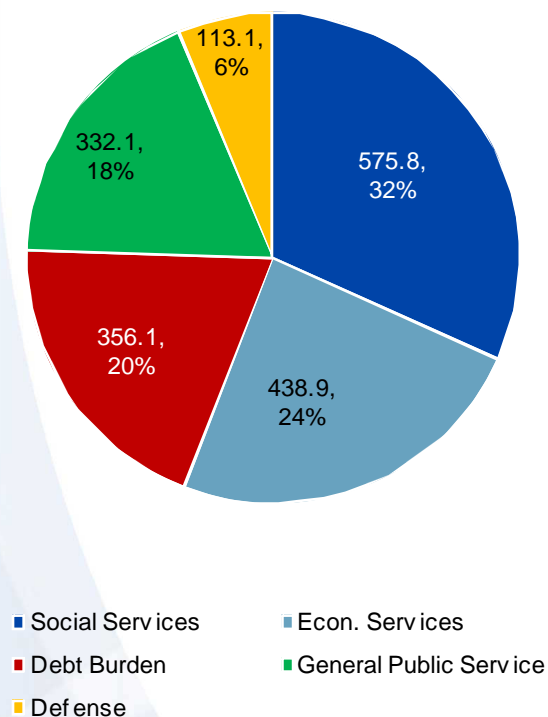
# Governance Reforms: Funding

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, %)

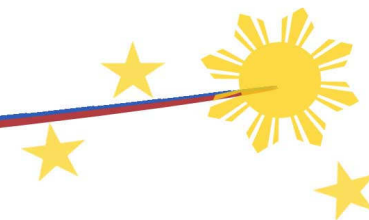


**Budget Allocations by the Five Priority Areas, FY 2011 and 2012**

	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
<b>Total</b>	<b>741,731</b>	<b>877,905</b>	<b>45.1</b>	<b>48.3</b>	<b>18.4</b>

# Daylight in Governance

Anti-Corruption and transparent, accountable, and participatory governance



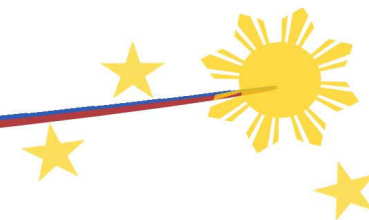
## Reforms in governance will make it more effective, transparent, and accountable to the public

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- **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



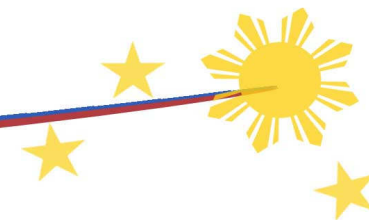
## Measures aimed at poverty alleviation are emphasized in the 2012 National Budget

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- **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, 25,000 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

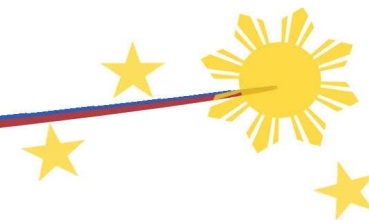


## Long-term and equitable economic growth is dependent on prudent policies and planning

- **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
  - P38.5 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 other sectors where the Philippines has an inherent advantage, such as tourism, agricultural production, and infrastructure development
- **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

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- **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

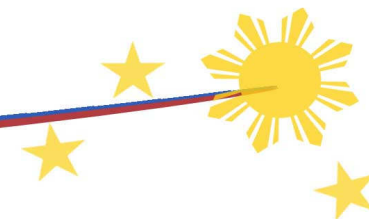
## Environmental protection and proactive preparation for climate change are key in positioning the ROP for the future

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- **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

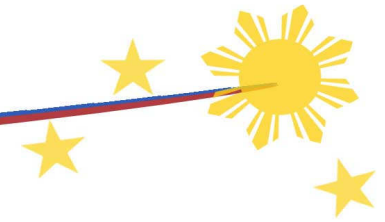
- The AFP filed cases before the Sandiganbayan (anti-graft court) against 31 AFP officers for corruption-related charges from July 2010 to June 2011
- As of 15 September 2011, the BIR filed 67 tax-evasion cases, involving a total notional amount of P29.4 billion. In addition, 44 criminal cases as of 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 eight months of 2011, the government posted a deficit of P34.5 billion, **84.9% lower than the P228.1 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 August amounting to P162.1 billion.
- Disbursements were lower by 8.1% year-on-year in the first eight 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, increasing 13.7% year-on-year in the first eight months of 2011



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- 3** Government Financial Strength: An Improving Profile
- 4** Credible Monetary Policy and a Resilient Banking System
- 5** Governance Reforms: Strengthening the Social Contract
- 6** The Philippines: Reaching for Investment Grade

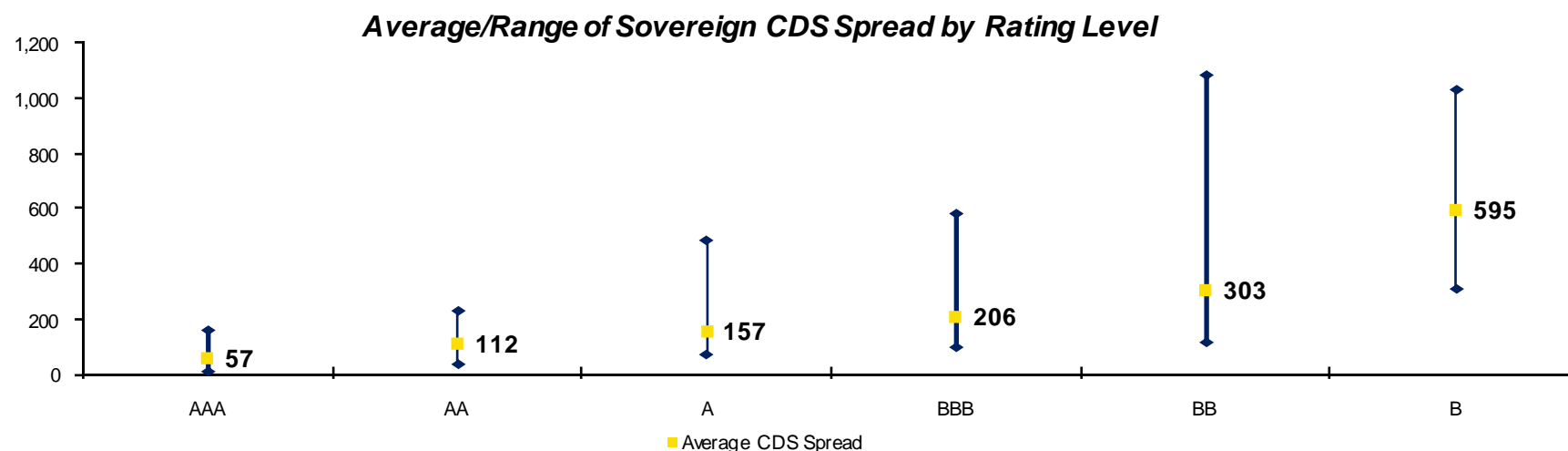


# ROP: How Far From Investment Grade?

Does IG Matter?

Investment Grade status has a well documented effect on the cost of borrowing

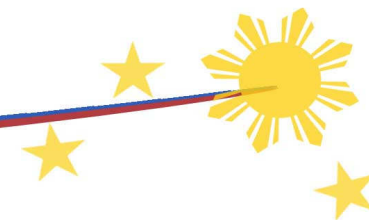
Sovereign CDS spreads decline as a sovereign's credit rating improves



- According to a recent study published by the IMF, reaching investment grade status reduces sovereign financing spreads by 36% above and beyond what is implied by macroeconomic fundamentals, suggesting significant tangible benefits of reaching IG
  - This compares to a 5-10% reduction in spreads following an upgrade within IG-class and no impact for moves within the speculative grade-class
- Investment grade status also triggers inflows from institutional investors whose covenants prevent them from investing in speculative grade assets, resulting in a broader and more diverse investor base
  - Investment grade credits may also benefit from a “flight to safety” phenomenon in times of international financial distress
- A sovereign's loss of investment grade status triggers a “statistically significant widening of CDS spreads,” according to a recent IMF Global Financial Stability Report (Oct 2010)
- There is a broader benefit to the sovereign achieving an investment grade rating, as rating agencies assign higher country ceilings relative to the sovereign, lifting potential ratings for corporates/financial institutions in the country

# The Philippines: Reaching for Investment Grade

Mapping the rating scale



- Ratings broadly divided into two categories

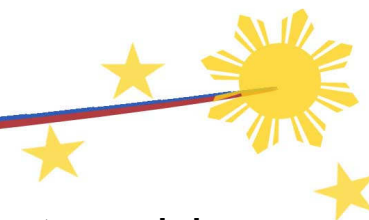
- Investment grade
- Non-investment (or speculative) grade

	STANDARD & POOR'S	Moody's Investors Service	Fitch Ratings	Perceived Strength
Investment Grade Ratings (IG)	AAA	Aaa	AAA	Extremely strong
	AA+	Aa1	AA+	Very strong
	AA	Aa2	AA	
	AA-	Aa3	AA-	
	A+	A1	A+	Strong
	A	A2	A	
	A-	A3	A-	
	BBB+	Baa1	BBB+	Adequate
	BBB	Baa2	BBB	
	BBB-	Baa3	BBB-	
Non-investment Grade Ratings (HY / Junk Status)	BB+	Ba1	<b>BB+</b>	Less vulnerable
	<b>BB</b>	<b>Ba2</b>	BB	
	BB-	Ba3	BB-	
	B+	B1	B+	More vulnerable
	B	B2	B	
	B-	B3	B-	
	CCC+	Caa1	CCC+	Currently vulnerable
	CCC	Caa2	CCC	
	CCC-	Caa3	CCC-	
Default	CC	Ca	CC	Currently highly vulnerable
	C	C	C	
	SD	D	RD	
	D		D	Default

**BB** Foreign currency rating currently assigned to the Philippines

# The Philippines: Reaching for Investment Grade

The challenges ahead



The credit ratings of the country have gathered significant positive momentum culminating with the recent upgrade by Fitch to BB+

The country has earned 3 credit rating upgrades since President Aquino took office in June 2010

## ROP's Sovereign Rating strengths and concerns

STANDARD  
& POOR'S

BB/Stable

### Concerns:

- High public sector debt, stemming from a narrow tax base and high incidence of tax evasion
- Excessive exposure to foreign-currency-denominated public debt and consequent vulnerability to adverse exchange-rate changes

### Strengths:

- Continued improvements in the country's external liquidity position
- Demonstrated resilience of Philippines' external accounts against the backdrop of challenging global economic and financial environments
- Track record of resilient economic growth

FitchRatings  
KNOW YOUR RISK

BB+/Stable

### Concerns:

- Weak public finances characterized by a low revenue base and high debt ratios
- Domestic investment in the Philippines is extremely low, and has been trending lower for the past decade
- Long standing structural weaknesses including low average income, poor human development indicators and a weak business environment

### Strengths:

- A manageable external financing requirement
- Strong growth potential supported by remittance inflows



Moody's Investors Service

Ba2/Stable

### Concerns:

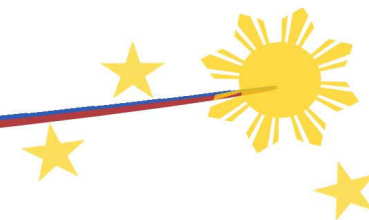
- High, but declining, public sector debt
- Structural fiscal revenue weaknesses
- Political and social tensions with low per capita income

### Strengths:

- Strong build-up in official foreign exchange reserves
- Large overseas Filipino remittance inflows
- Stable and resilient banking system
- Flexible exchange-rate policy

# The Philippines: Reaching for Investment Grade

ROP's path to investment grade



**On balance, ROP compares moderately well in some key macroeconomic and financial ratios**

**However, there are some concerns that need to be addressed before IG is attained**

Strengths	Areas for Improvement	Equal-weight
<ul style="list-style-type: none"><li>• Real GDP Growth</li><li>• Current Account Balance Surplus</li><li>• Current Account Balance / GDP</li><li>• ST External Debt / Total External Debt</li><li>• Net External Debt / CA Receipts</li><li>• Employment generation</li><li>• Reserves / CA Payments</li><li>• Contingent liabilities / GDP</li></ul>	<ul style="list-style-type: none"><li>• GDP per Capita</li><li>• Gen Govt Debt / Gen Gov Revenue</li><li>• Gen Govt Debt / GDP</li><li>• Gen Govt Int Payment / GG Rev</li><li>• Gross Investment / GDP</li><li>• Governance Indicators</li></ul>	<ul style="list-style-type: none"><li>• Current Account Receipts / GDP</li><li>• Savings / GDP</li><li>• Inflation (CPI)</li><li>• Gen Govt Balance / GDP</li></ul>

# The Philippines: Reaching for Investment Grade

Investment grade is within reach

- The Aquino administration and its economic team are committed to enhance the Philippines' credit profile and take creditworthiness seriously as a key factor in policy making
- Investment Grade is well within reach for the ROP:
  - Resilient economic growth
  - Accelerating levels of investment
  - Declining government debt ratios
  - Robust external payments position
  - Enhanced policy environment
  - More stable political environment

The Philippines already outperforms IG medians in several key areas...

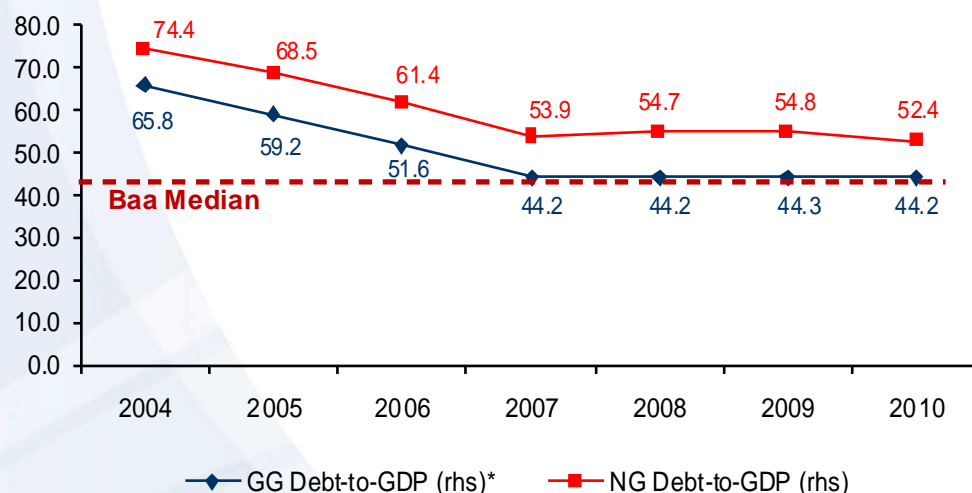
*ROP's credit metrics vs Baa range median*

	ROP 2010	Baa Range Median*	
Real GDP (% change)	7.6	3.9	✓
Inflation (CPI, % change Dec/Dec)	3.8	4.7	✓
National Gov. Deficit/GDP	-3.5	-3.6	✓
Current Account Balance/GDP	4.2	-1.5	✓
External Debt/GDP	30.1	46.4	✓
External Debt/CA Receipts	91.5	113.2	✓
External Vulnerability Indicator	33.6	67.7	✓

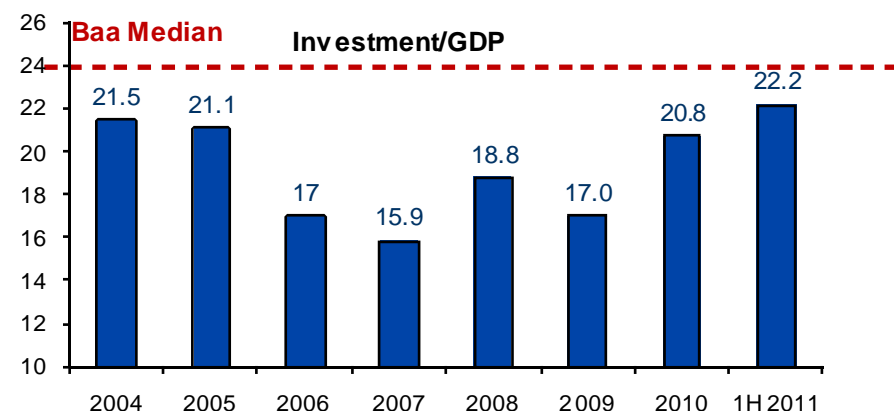
\* Moody's data

...While it is catching up rapidly in others

*National Government and General Government Debt 2004-2010 (% of GDP) and Investment-to-GDP (% of GDP)*



Source: NEDA-NPPS, Department of Finance





# **The Philippines: A Fortified Economic Story**

## **Philippine Economic Briefing**

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