Philippines: Managing Fiscal Risks under COVID-19

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Treasurer of the Philippines

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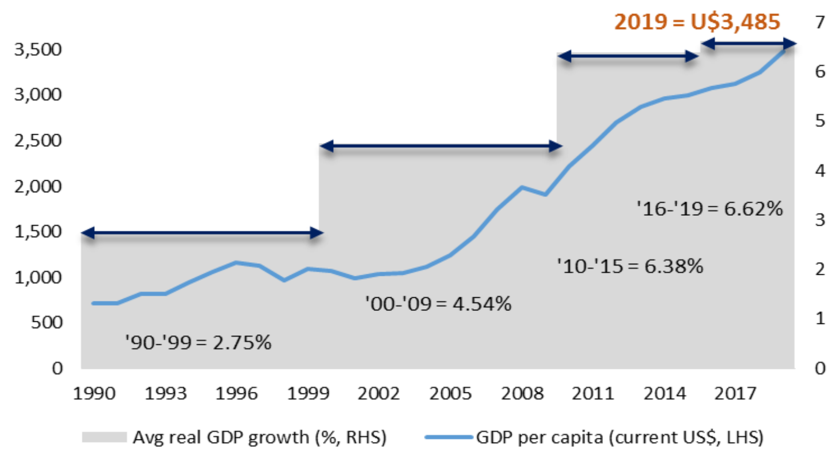
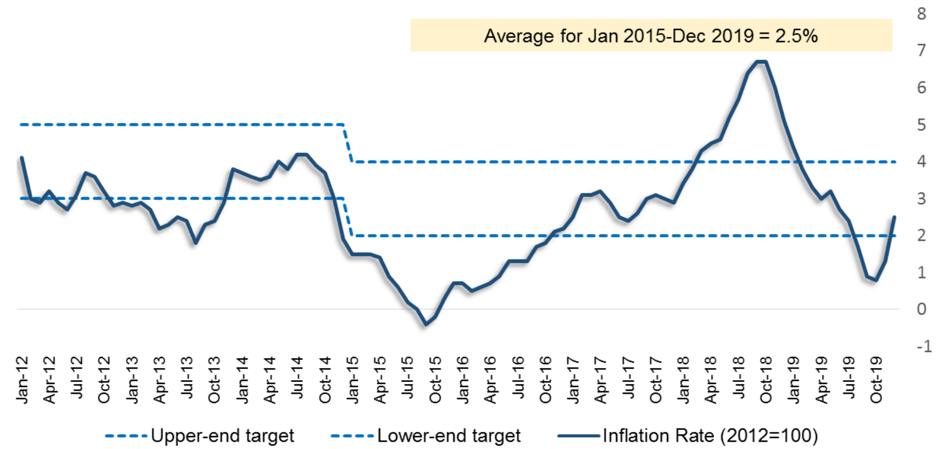
Background : Macro Fiscal Performance prior to Covid-19

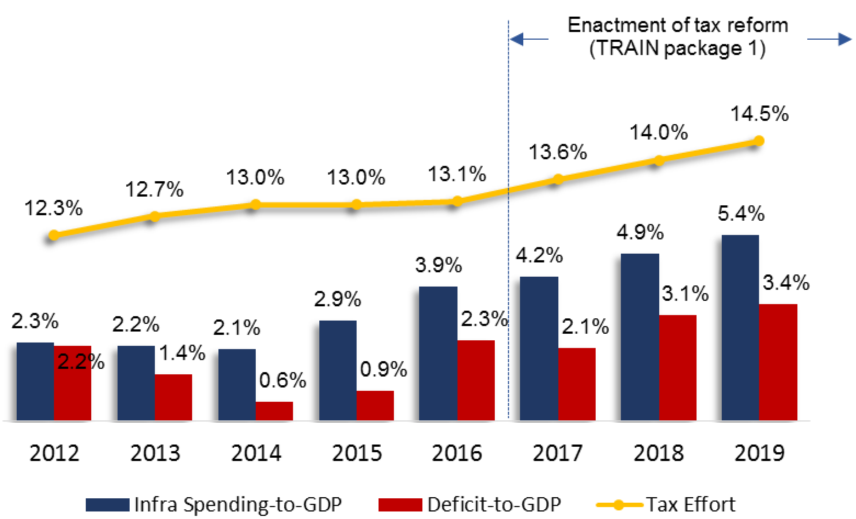
Likely to become upper middle income, high growth momentum



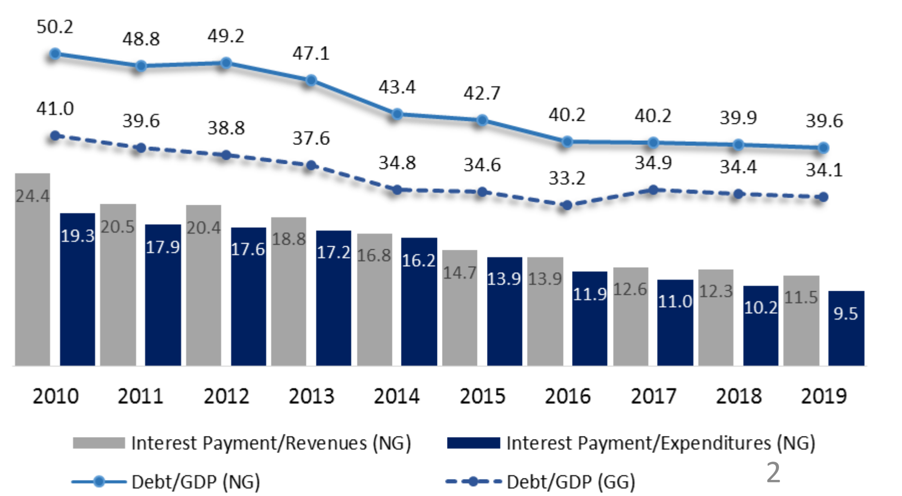
Low and stable inflation aided by Rice Tariffication Law



Accelerated public infra modernization enabled by tax reform



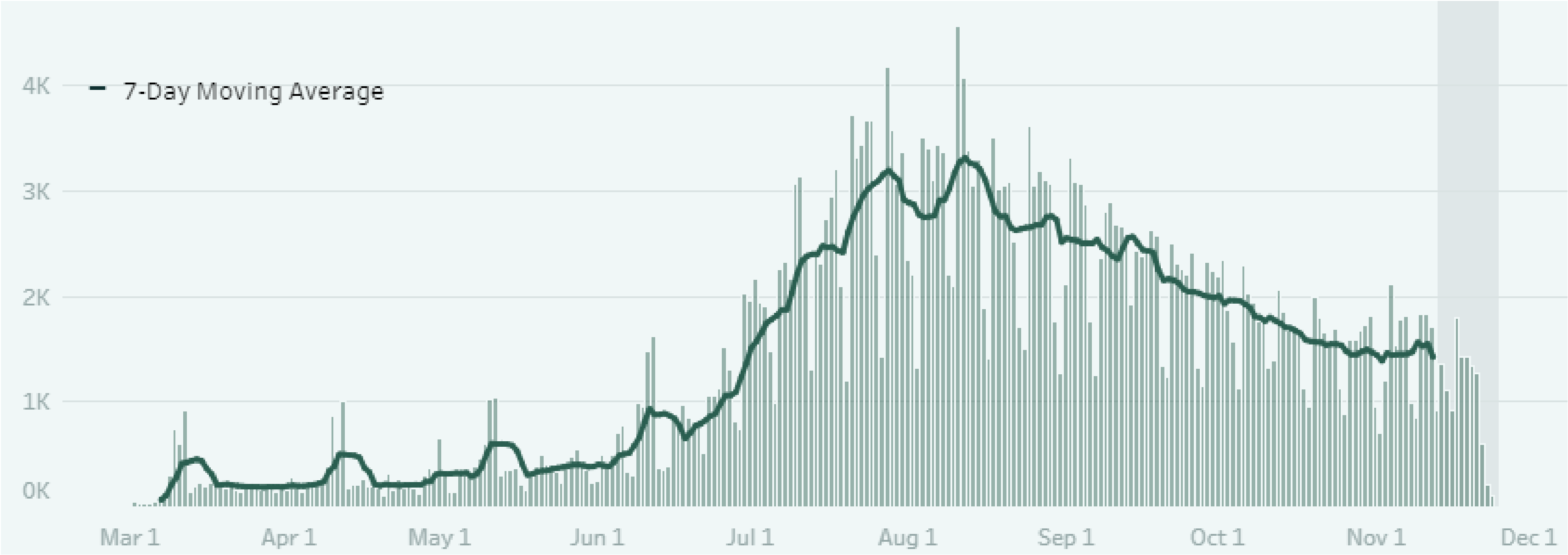
Declining debt and debt servicing ratios



Background : Onset of Covid-19 and Gov't Response

First event of community quarantine in early March 2020

Philippines: COVID-19 Daily Cases by Date of Onset of Illness



- Prompted the imposition of Enhanced Community Quarantine in mid-March (originally for 2 months but was extended)
- Restrictions on people movement and business operations; freeze on transportation (air, land, sea)
- Only essential industries are permitted to operate at limited capacity

Impact on Macroeconomic and Budget Outlook

High uncertainty regarding the duration and severity of the crisis complicated fiscal planning

Evolution of Macroeconomic and Fiscal Assumptions for 2020

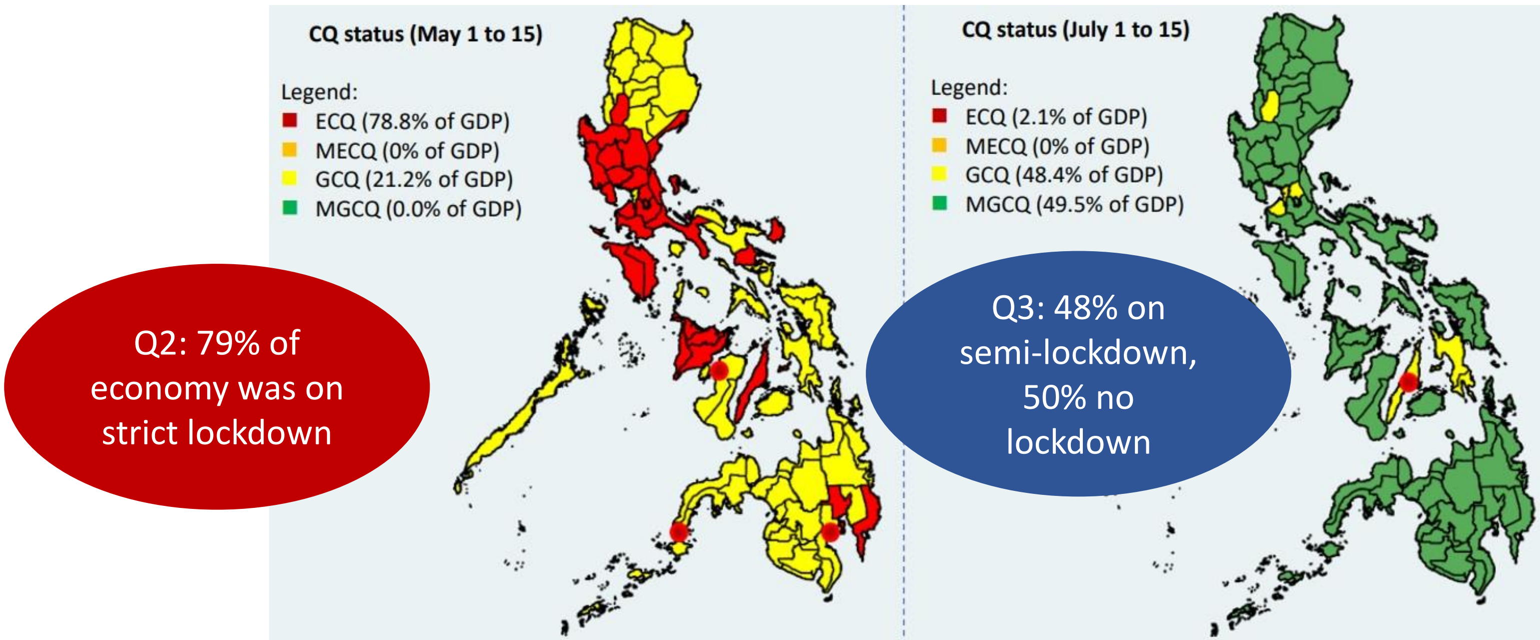
	Dec-19	Mar-20	May-20	Jul-20
Real GDP Growth (%)	**6.5 - 7.5**	**(1.0) - 0.0**	**(3.4) - (2.0)**	**(6.6) - (4.5)**
OF Remittances Growth (%)	3.0	3.0	2.0	(5.0)
Inflation Forecast (%)	2.0 - 4.0	2.0 - 4.0	1.75 - 3.75	1.75 - 2.75
Dubai Crude Oil (U$/b)	55 -70	35 - 50	23 - 38	35 - 45
Goods Import Growth (BPM6, %)	8.0	3.0	(5.5)	(18.0)
FX Rate (PHP/USD)	51.0 - 54.0	50.0 - 54.0	50.0 - 54.0	50.0 - 52.0
Deficit-to-GDP (%)	**3.2%**	**5.1%**	**8.4%**	**9.6%**
Revenues-to-GDP (%)	16.7%	16.2%	13.6%	13.4%
Tax Revenues-to-GDP (%)	**15.7%**	**15.3%**	**11.8%**	**11.7%**
Expenditure-to-GDP (%)	19.9%	21.3%	21.9%	23.0%

Sources: dbm.gov.ph; pna.gov.ph

- Forecast uncertainty surrounding lockdown duration: initially assumed to last for two (2) months but imposition was prolonged
- Contemporaneous lockdowns in Overseas Filipinos (OF) destination countries severely affected inward remittances; hence, domestic consumption
- Low import demand and fall in global commodity prices exacerbated revenue weakness

The great lockdown

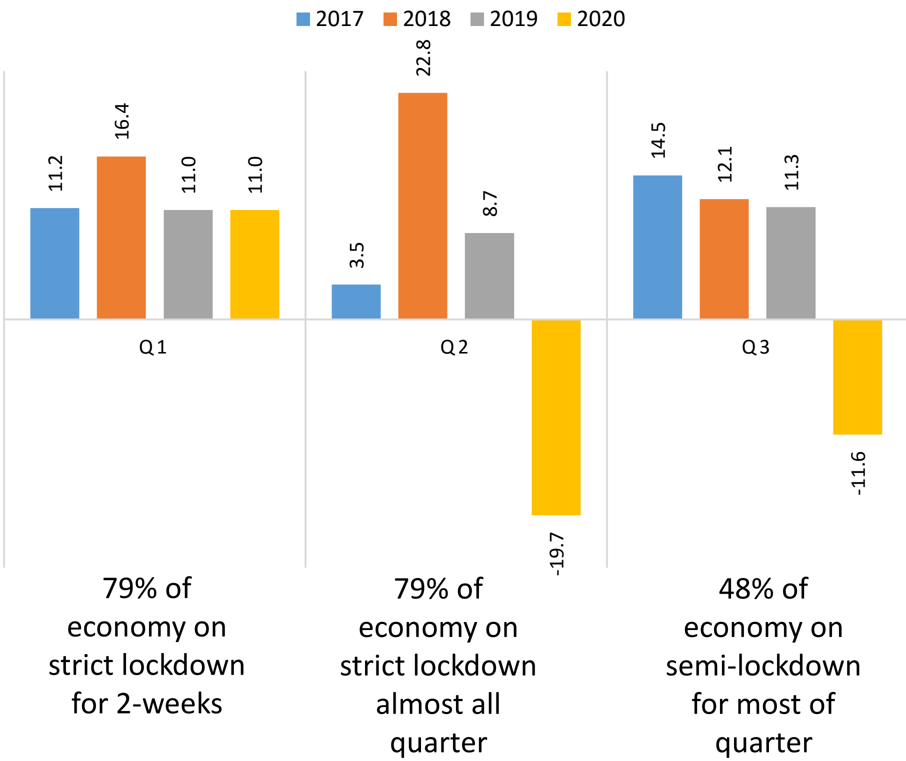
Various versions of Community Quarantine (CQ) relegated the economy to operate below potential



CQ Status	Enhanced Comm Qrtn (ECQ)	Modified Enh'd Comm Qrtn (MECQ	General Comm Qrtn (GCQ)
• Zone movement	Restricted regardless of age & health status	Limited w/n ECQ zone	Allowed between GCQ zones
• Economic Activity	Essentials only	Select, up to 50% of workforce	Most industries except leisure, up to 75% of workforce
• Public Transportation	None	Limited	Allowed but limited capacity

Severe impact on revenue generation

YoY Growth of Revenues per Quarter (%)



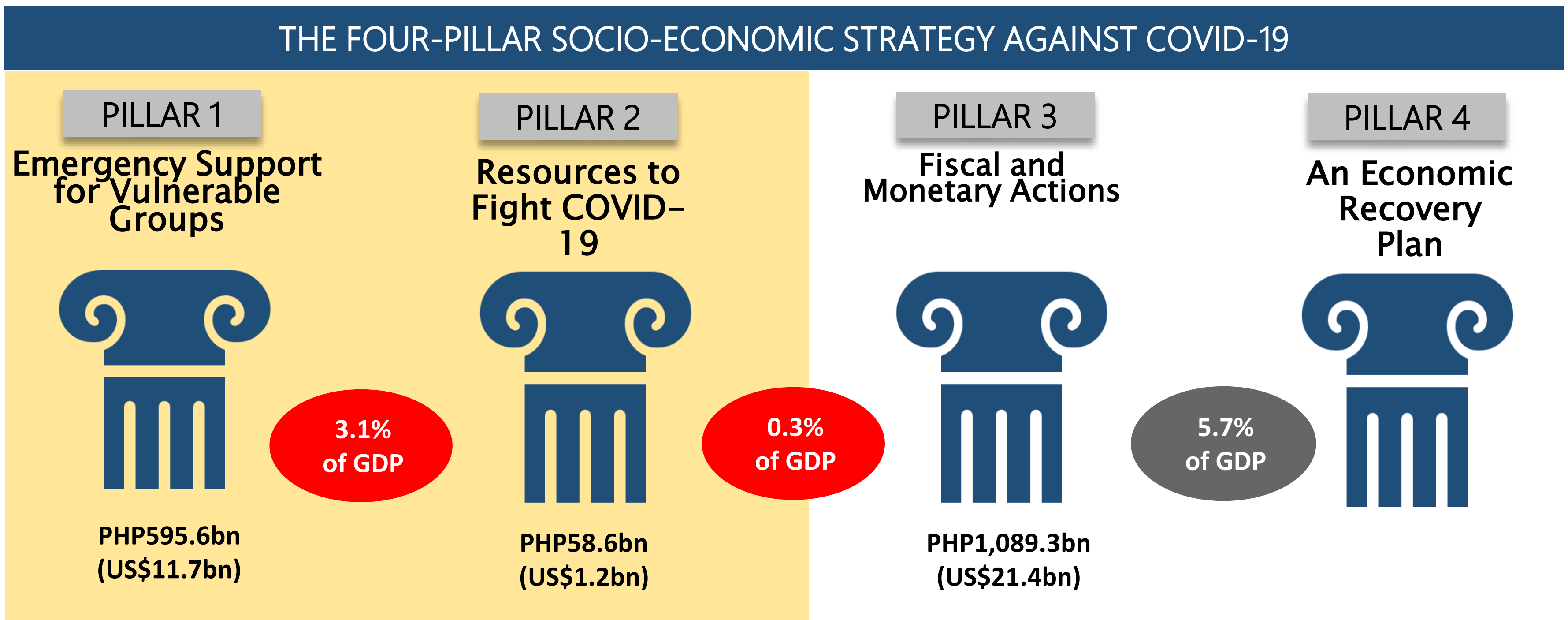
Revenue Sensitivity per 1 percentage point increase of Indicator (Php billion)

Indicator	2020 Revenues
PHP/USD Exchange Rate	10.7
Inflation Rate	22.3
Real GDP Growth Rate	26.9
Growth Rate of Imports	5.5

- Internal Revenue declined sharply amid fall in economic transactions
  - Deadline of filing tax returns was also postponed from April to June
- Custom collections declined with import demand
  - Low importation of capital goods reflect low investment appetite
  - Valuation affected by peso appreciation and fall in oil prices

Re-appropriation of the 2020 budget to accommodate COVID-19 response

- *Bayanihan* to Heal as One Act (*Bayanihan 1*) was passed to reconfigure the budget but spending ceiling remained because of statutory limits
- Early efforts were focused on providing social amelioration and shoring up of healthcare capacity which required acceleration of fiscal spending

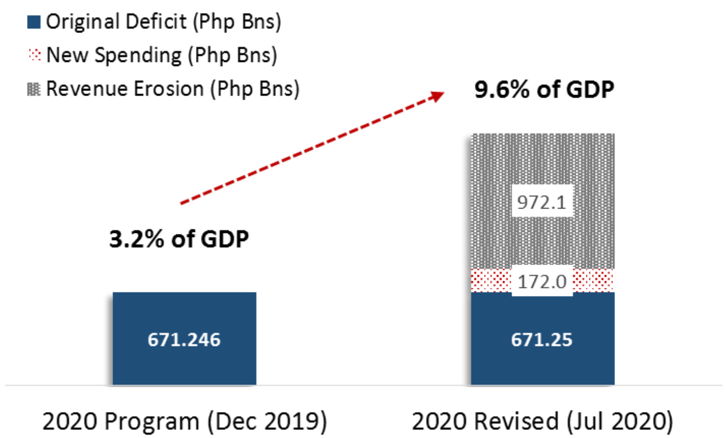


- *Bayanihan* to Recover as One Act (*Bayanihan 2*) added P140 billion in new spending from identified new sources of revenues (plus P25.5 in stand-by, contingent on revenue performance)

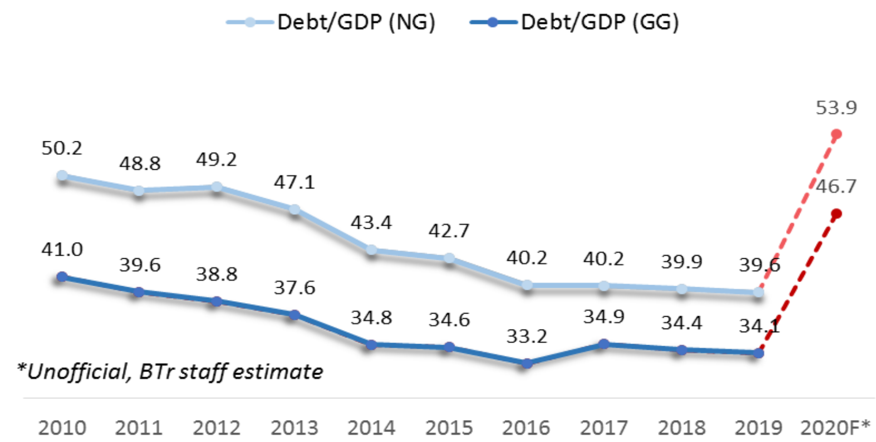
Sufficient space to absorb fiscal shock but rise in gross financing needs presents huge challenge

Deficit tripled resulting to largest gross financing requirement in history

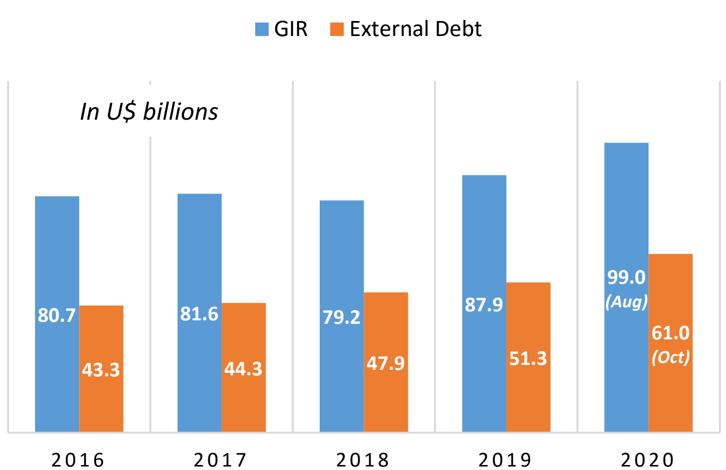
Decomposition of Revised Deficit Program (Php Bns)



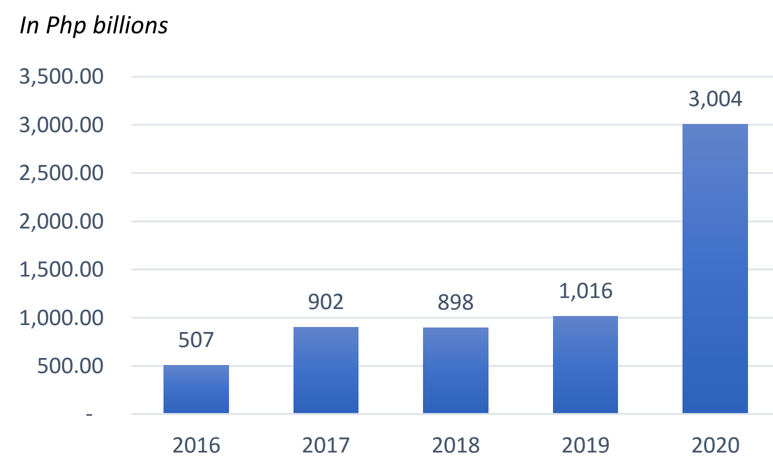
Sharp but manageable increase in debt level



Ample reserves to cover additional external borrowing if needed



Revised gross financing needs in 2020 > sum of last three fiscal years

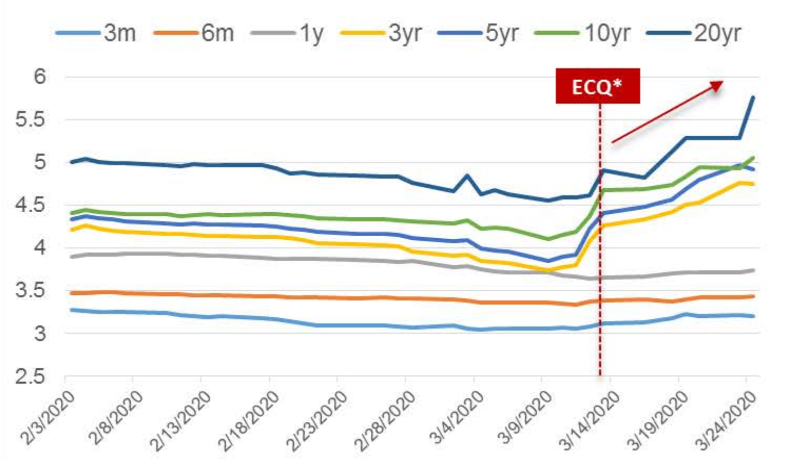


Immediate Financing Challenge : Extraordinary times require extraordinary measures

Early stages of the pandemic

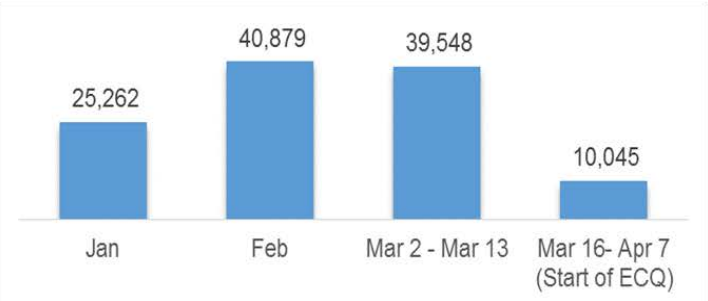
- Domestic and international bond markets were temporarily inaccessible
  - o Investors grappling with impact of pandemic and community quarantine on businesses, financial system

Yields on Selected Tenors of Gov't Securities (%)



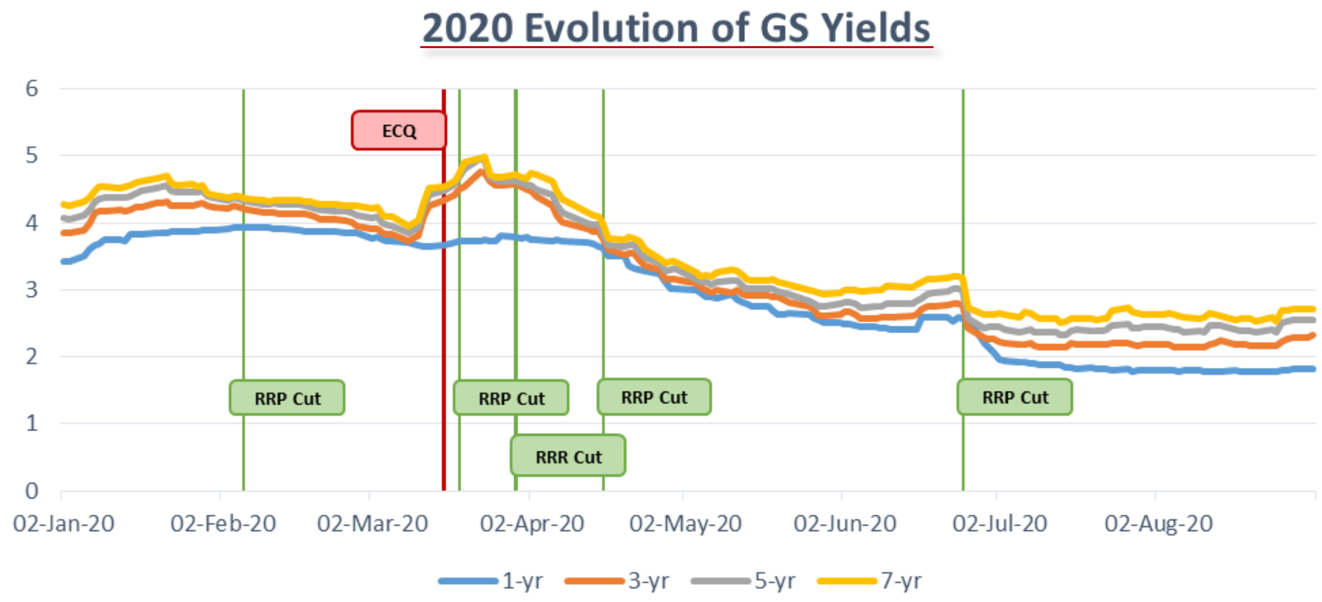
**announcement date*

Avg. Daily Trading Vol. of Gov't Securities (PHP Billions)



- Philippine Government resorted to unconventional financing modalities
  - ➢ Sweep of excess cash balances of government agencies
  - ➢ Advanced collection of dividends from SOEs
  - ➢ Activation of central bank credit line allowed during "extraordinary times"
    - o Sec 89. of the New Central Bank Act – allows lending to the National Government to finance expenditure for up to 20% of average annual income of the preceding 3 fiscal years at zero interest for 3-months (extendable by another 3-months)

Coordination between Monetary and Fiscal authorities to ensure government financeability



To shore up market confidence and ensure adequate liquidity and credit

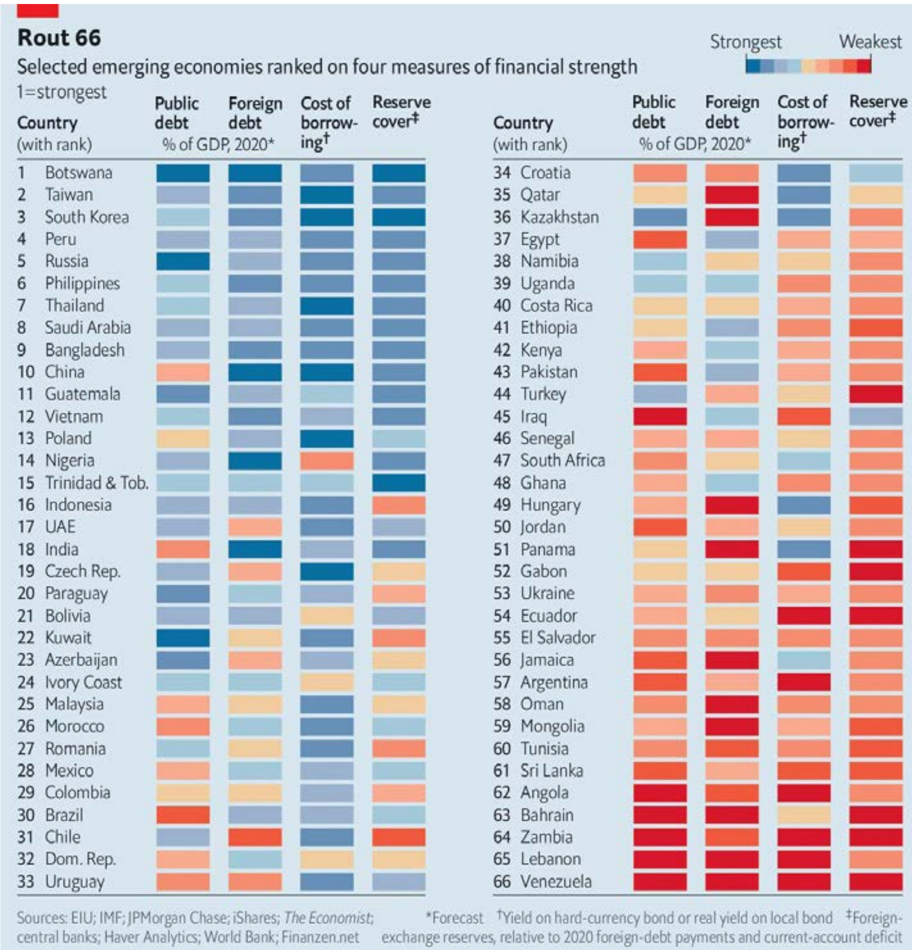
- Cut the policy rate by a cumulative 200 bps to 2.00% since February 2020
- Reduced the reserve requirement ratios (RRR) by 200 bps to 12%

To complement government programs through extraordinary liquidity measures

- Entered into a Php300 billion repurchase agreement with the National Government
- Opened a window for purchases of government securities in the secondary market

Starting point matters : Reaping the rewards of past actions

Ranked 6th by The Economist in Financial Strength Among EMs



From The Economist

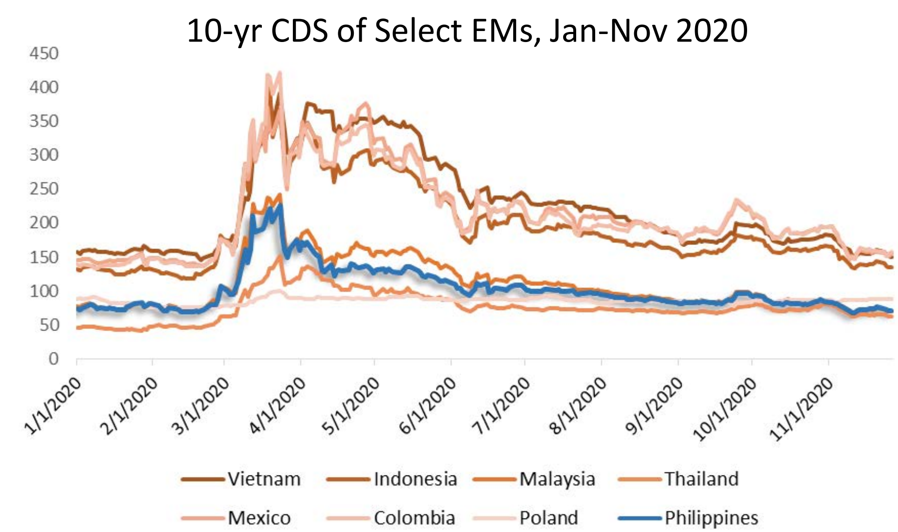
Successful return to global dollar bond market at the height of pandemic

Global Bond Issuance last April 2020

- **10-Year USD Bonds – USD 1.00 billion 2.457% (+180 bps over 10Y UST)**
- **(25-Year USD Bonds – USD 1.35 billion 2.945 (+169 bps over 25Y UST)**

➢ Lowest coupon in history for both tenors

Preserved relative favorable ranking among EMs despite heightened risk aversion



Financing performance as of October 2020

Gross financing target likely to be achieved behind strong demand for government securities

	2019	2020		
	Actual	Original Prog	Jan-Oct (Actual)	Revised Prog
Fiscal Deficit	660,236	671,246	940,579	1,815,402
% of GDP (rebased series)	*3.38%*	*3.20%*	*4.80%**	*9.63%*
Gross Financing	1,015,790	1,400,123	2,835,194	3,003,843
by source:				
Foreign Borrowing	321,947	353,155	574,435	785,613
Domestic Borrowing	693,843	1,046,968	2,260,759	2,218,230
Foreign (in U$ Bns Equivalent)	5,991	6,792	11,705	15,404
Financing Mix (Domestic : Foreign)	68:32	75:25	80:20	74:26
NG Debt/GDP	39.61%	41.06%	51.15%*	53.88%
IP/Revenue	11.50%	12.91%	14.13%	16.71%
IP/Expenditure	9.50%	10.83%	10.12%	9.71%
Interest Payments	*360,874*	*450,964*	*335,044*	*420,964*
Debt Stock	*7,731,290*	*8,610,725*	*9,368,876**	*10,160,660*
Real GDP Growth	*5.9%*	*6.5%*	*-10.0%**	*-5.5%*
Nominal GDP (old series)	*18,613,044*	*19,516,418*		
Nominal GDP (new series)	*19,516,418*	*20,971,350*	*18,316,305**	*18,856,315*
Assumed USDPHP (end of period)	*50.80*	*52.00*	*48.40*	*51.00*

**As of Sep 2020*

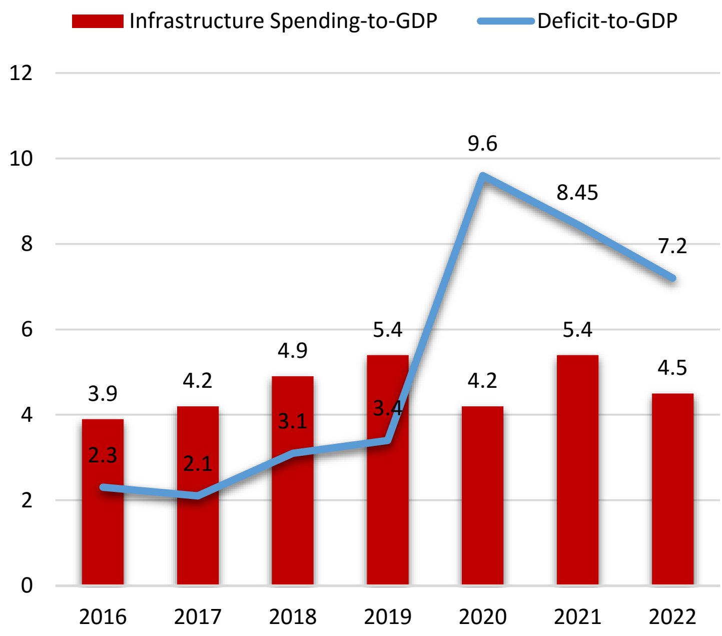
Year	Bid-to-Cover	Rejection
2020	2.9	11.4%
2019	2.5	12.5%
2018	1.7	32.7%
2017	2.0	22.1%
2016	2.0	11.3%
2015	1.8	31.7%
2014	2.2	16.7%
2013	2.4	9.5%
2012	2.4	19.6%
2011	2.6	23.4%
2010	2.5	14.5%
2009	2.1	24.4%

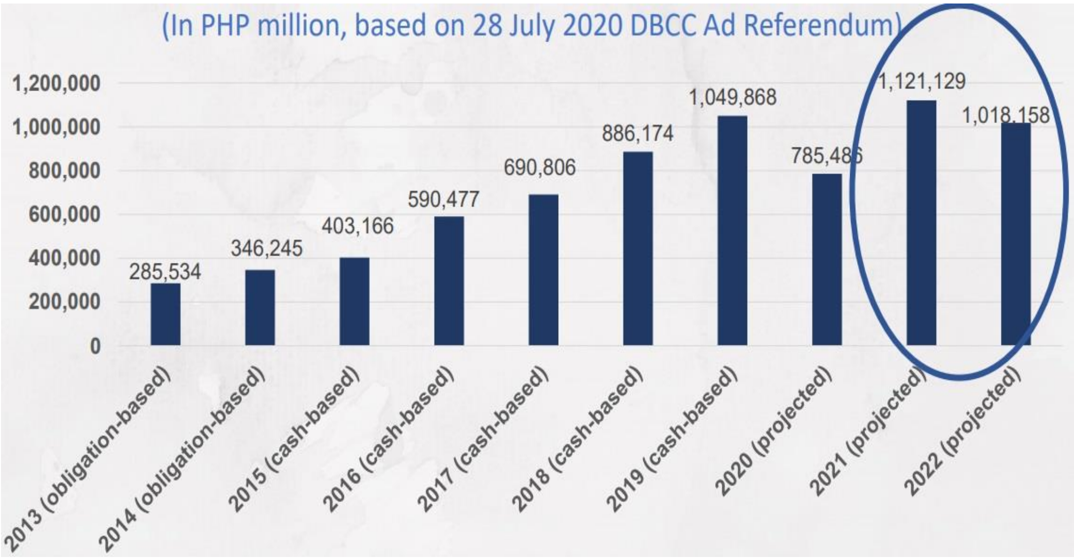
Slippage in debt indicators is minimal; average interest rate is declining

Indicator	Dec-16	Dec-17	Dec-18	Dec-19	Oct-20
Share of floating interest debt	8.64%	8.31%	8.90%	8.94%	9.60%
Share of external debt	35.40%	33.24%	34.50%	33.68%	29.42%
Average maturity (residual, years)	10.05	9.8	10.38	8.59	7.61
Weighted average interest rate	4.99%	4.89%	5.05%	5.00%	4.27%

Medium-term Strategy: Crisis likely to be deeper and last longer (1/2)

- Economic performance in Q1-Q3 2020 reached -10.0% vs worst case forecast of -6.6%
- Fiscal Response: allow elevated but declining deficits for 2020-2022
  - Focus on the revitalization of the economy via public investments





Medium-term Strategy: Crisis likely to be deeper and last longer (2/2)

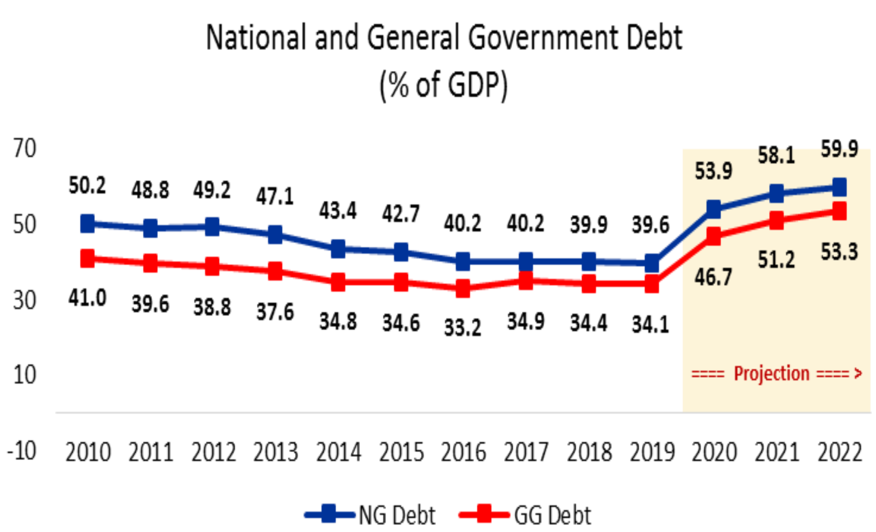
Size of fiscal intervention takes into account long-term debt sustainability

- Preservation of middle-of-the-pack standing among similarly rated peers

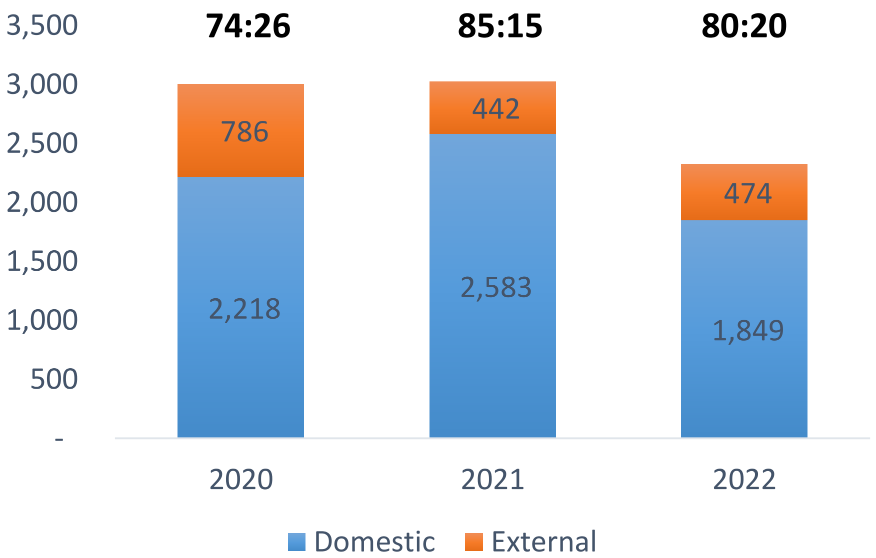
Bias for domestic financing to be maintained; mitigate build-up of external imbalance

- Take advantage of flight to safety investor behavior to deepen local bond market
- Sustained limited tapping of global bond market to update sovereign credit pricing, enable local corporations gain access to foreign credit at reasonable rate

Projected evolution of debt ratios under baseline deficit scenario

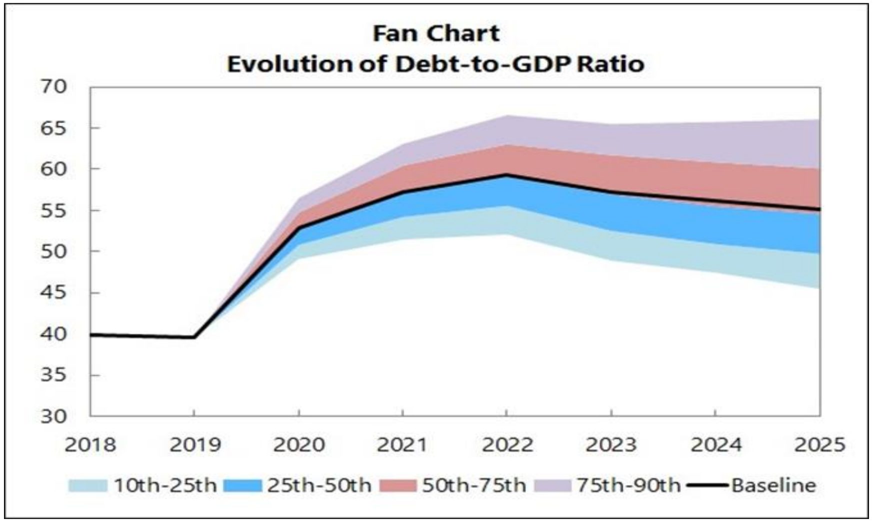


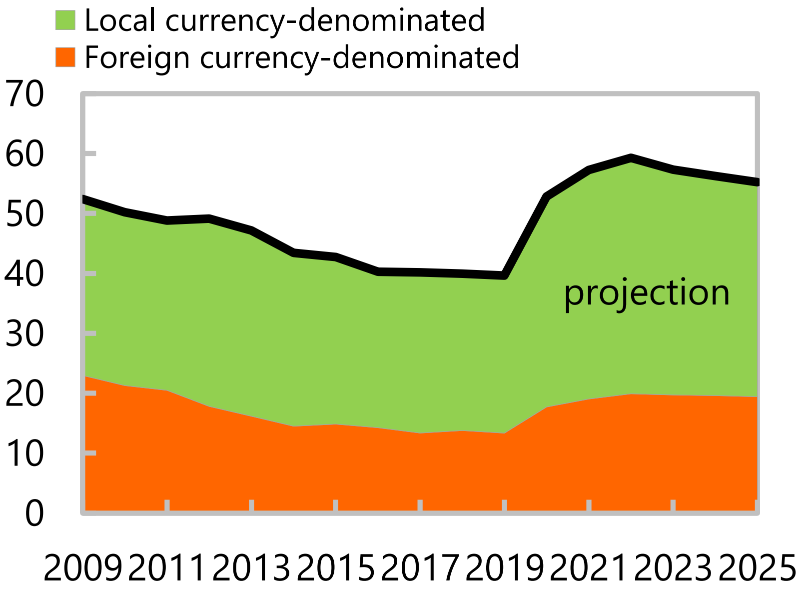
Appropriation of Gross Funding Needs per source (Php Bns)



Debt Sustainability Analysis

- Resumption of fiscal consolidation is largely hinged on economic recovery
- Return to pre-Covid-19 real GDP growth and deficit level by 2023 will restore downward trend in medium-term debt path





Credible Recovery Plan – Budget and Non-budget

Bayanihan to Recover as One Act (Bayanihan II)

Php165 billion fiscal stimulus package to stimulate consumer demand and support businesses and individuals critically impacted by COVID-19

Financial Institutions Strategic Transfer (FIST)

Allow banks to dispose of bad loans and assets to free up capital for expansion of investment and lending activities

Build, Build, Build

Accelerate the implementation of infrastructure modernization program to generate jobs and businesses

Corporate Recovery and Tax Incentives for Enterprises (CREATE)

Reduce corporate income tax rate from 30% to 25% and reform fiscal incentive system

Government Financial Institutions Unified Initiatives to Distressed Enterprises for Economic Recovery (GUIDE)

Strengthen the role of government financial institutions to provide needed assistance to distressed enterprises

Php4.5 trillion 2021 National Budget

Reprioritize on most urgent sectors like healthcare, agriculture, infrastructure and food supply chain to prime-pump the economy to a resilient growth

Summary

How did the Philippines cope with fiscal risks amid Covid-19?

- Unconventional but effective cash management
  - Sweep of excess cash, accelerated dividends collection from SOEs to fund social amelioration
- Coordination with monetary authority and legislative branch
  - Swift passage of laws enabling budget realignment
  - Activation of short-term emergency lending facility
  - Supporting demand for Government Securities and keeping borrowing costs low
- Adherence to long-term fiscal sustainability
  - Ensuring return to fiscal consolidation
  - Focus on quality of spending; use of GFIs to maximize return on spending
- Credible recovery plan
  - Continuation of infrastructure modernization
  - Use of legislation for recovery (CREATE, GUIDE, FIST)
- Effective communication strategy

“Arigatou Gozaimasu!”