Economic Report

SENATE ECONOMIC PLANNING OFFICE

February 2018 ER-2018-01

2017 Full-year Economic Report

Building on Resilience

Highlights of the Economic Performance*.* *The Philippine economy was able to sustain its growth momentum in 2017. Though slightly slower than the pace seen in the previous year, the services sector continued to be the main growth driver. Economic growth was also supported by the robust expansion of manufacturing and the strong performance of trade in goods. The agriculture sector, likewise, posted its highest growth rate in recent years. Macroeconomic fundamentals remained intact and helped anchor consumer and business confidence. Despite the depreciation of the peso, inflation was within the pronounced target and consequently, interest rates remained steady. The economy also benefited from the continuous inflow of remittances, foreign direct investments, export earnings and sound fiscal and external accounts position.*

However, the growth of the domestic economy seems to have failed to yield substantial gains in employment and if perception surveys were to be considered, likely even led to worsening poverty.

For 2018, the economic outlook remains broadly upbeat but downside risks persist. External headwinds include uncertainties that may further constrict global financial conditions and heighten volatility in financial and capital markets. While a sustained upturn in the United States economy is generally expected, a steeper than expected slowdown due to geopolitical tensions in the Middle East and Korea, rebalancing in China, and the economic slowdown in Japan and the Euro zone could drag down growth. Production cuts and rising global demand are also expected to exert upward pressure on world oil prices, while protectionist policies in some advanced economies may adversely impact trade and cross-border investment flows.

On the domestic front, factors that delay the delivery of infrastructure projects will likely constrain productivity and thus, dampen economic prospects. A higher than anticipated inflation due to the newly enacted tax reform package, higher oil prices and weak currency also poses a risk if not addressed accordingly by the monetary authorities. Non-economic factors such as political noise and pressures to pass popular but unsustainable policies, as well as adverse natural and weather conditions also threaten the growth outlook.

Real Sector

Growth Rates of Selected Asian Economies (%), 2017

China	6.9
Vietnam	6.8
Philippines	6.7
Malaysia	5.8
Indonesia *	5.1
Thailand *	3.5
Singapore	3.5

Source: ADB Outlook 2017 Update
** Forecast*

The Philippine economy grew by 6.7 percent in 2017. This is within the official target growth range of 6.5-7.5 percent, but slower than the 6.9 percent growth recorded in 2016. Philippine economic growth is poised to be the fastest amongst the ASEAN-5 countries,[1] although it lagged behind that of China and Vietnam.

Production was largely driven by the output growth of the industry sector. The industry sector expanded by 7.2 percent in 2017. In particular, the manufacturing subsector posted a robust 8.6 percent growth. The construction subsector also recorded positive growth with public construction expanding by 13.5 percent. The closure of several mining firms during the year has led to a decline in this subsector's output, which in turn, stifled overall production growth.

The service sector continued to be the main growth driver, accounting for almost 60 percent of total domestic production. However, it grew at a slower rate of 6.7 percent during 2017 from 7.4 percent in 2016. The slow growth of transportation, storage, and communication services as well as recreational and sports served as a drag to the service sector's output. In contrast, the agriculture sector expanded by 3.9 percent, buoyed by favorable weather conditions. This is a turnaround from the sector's 1.3 percent contraction in 2016. This is also higher than the sector's medium-term growth target of 2.5-3.5 percent. The sector currently employs around 25 percent of total employment but accounts for only 10 percent of the GDP.

On the expenditure side, growth was propelled by the double-digit expansion of exports and imports. Household spending, which accounts for almost 70 percent of GDP, decelerated to 5.8 percent from 7.0 percent in 2016. Again, this may be due to base effects, as household expenditure growth in 2016 was boosted by election-related spending. Growth of public spending also slowed to 7.3 percent, in spite of the 25.1 percent boost in public construction during the fourth quarter of 2017. Capital formation or investment grew at a respectable, albeit slower rate of 9.0 percent.

The export sector on the other hand, posted a strong growth rate of 19.2 percent. Propelled by the depreciation of the peso and better-than-expected recovery in major trading partners, Philippine exports of goods recorded a double-digit growth of 20.7 percent. There was a particularly strong demand for electronics, which make up 55 percent of the country's merchandise exports. The growth of trade in goods was tempered by the slower growth in export of services, specifically, miscellaneous services from 19.8 percent in 2016 to 9.2 percent in 2017. The slower growth of miscellaneous services is largely attributed to the slower expansion of the information technology-business process outsourcing (IT-BPO)

[1] ASEAN pioneering members -- Indonesia, Malaysia, Thailand, Philippines, and Singapore.

sector. Strong protectionist rhetoric from United States' (US) President Trump, the seemingly anti-US tirades of President Duterte in the earlier part of the year, as well as the proposed change in the tax regime may have caused uncertainty in the IT-BPO sector (around 70 percent of which cater to the US market) and made stakeholders adopt a wait-and-see attitude. The IT and Business Process Association of the Philippines (IBPAP) also chalk up the slowdown to lingering infrastructure issues and the Marawi Crisis, as it impeded its expansion plans in Mindanao.

Imports, likewise, posted a robust growth rate of 17.6 percent, marked by strong demand for capital goods (e.g., semiconductors, electronic data processing, communication/radar, control instrumentation, industrial instrumentation, automotive electronics, transport equipment, and electrical machinery). Higher imports of capital goods portend further rise in economic activity.

Growth Rates of Gross National Product and Gross National Income (%), 2012-2017

	2012	2013	2014	2015	2016	2017
Gross Domestic Product	6.7	7.1	6.1	6.1	6.9	6.7
Gross National Income	7.1	7.8	6.0	5.8	6.7	6.5
Production						
Agriculture	**2.8**	**1.1**	**1.7**	**0.1**	**-1.3**	**3.9**
Industry	**7.3**	**9.2**	**7.8**	**6.4**	**8.4**	**7.2**
Construction	18.2	9.6	7.2	11.6	13.7	5.4
Electricity, Gas, Water	5.3	4.7	3.7	5.7	9.8	3.2
Manufacturing	5.4	10.3	8.3	5.7	7.0	8.6
Mining and Quarrying	2.2	1.2	12.1	-1.5	3.2	1.9
Service	**7.1**	**7.0**	**6.0**	**6.9**	**7.4**	**6.7**
Financial Intermediation	8.2	12.6	7.2	6.1	7.6	7.7
Real Estate	6.4	8.9	8.0	7.1	8.9	7.5
Trade	7.6	6.2	5.8	7.1	7.2	7.1
Trans., Storage, Comm.	6.9	6.0	6.5	8.0	5.9	4.2
Other services	7.3	5.2	4.0	8.3	7.3	6.4
Expenditure						
Household Consumption	**6.6**	**5.6**	**5.6**	**6.3**	**7.0**	**5.8**
Government Consumption	**15.5**	**5.0**	**3.3**	**7.6**	**8.4**	**7.3**
Capital Formation	**-4.3**	**27.9**	**4.2**	**18.4**	**23.7**	**9.0**
Exports	**8.6**	**-1.0**	**12.6**	**8.5**	**10.7**	**19.2**
Goods	10.3	-0.4	13.9	6.6	9.2	20.7
Services	2.3	-3.3	7.4	16.5	16.2	13.6
Imports	**5.6**	**4.4**	**9.9**	**14.6**	**18.5**	**17.6**
Goods	3.0	3.6	9.7	14.0	20.8	19.8
Services	17.0	7.8	10.7	16.9	10.0	8.9

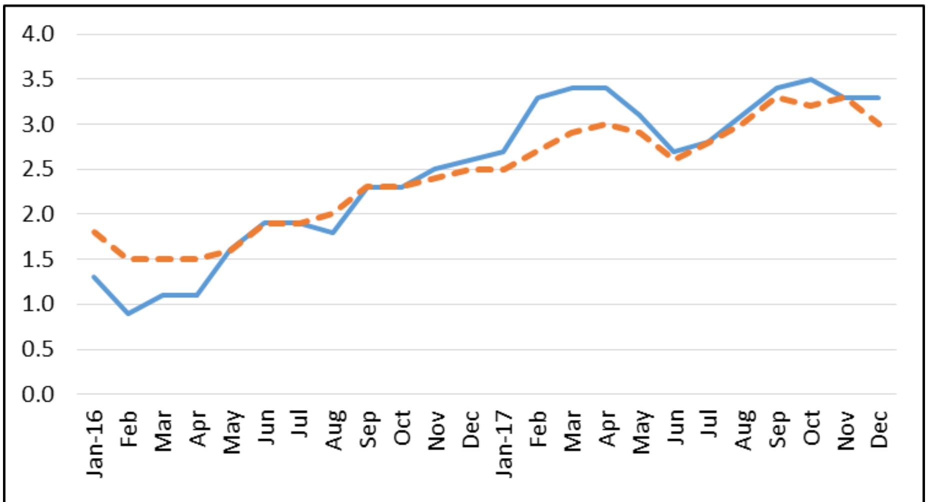
Source: Philippine Statistical Authority

Monetary and Financial

Inflation averaged at 3.2 percent in 2017. This is much higher than the 1.8 percent average in 2016, although well within the Bangko Sentral ng Pilipinas' (BSP) announced target range of 2-4 percent. The rise in inflation is attributed to strong demand and upward adjustments in electricity and transport prices, as well as to the uptick in commodity prices during the third quarter. The weaker exchange rate was also a factor since it made imported goods, including crude oil more expensive.

Dubai crude oil prices were well within the forecast for global oil prices in 2017, as analysts anticipated the increase following the Organization of Petroleum Exporting Countries' (OPEC) decision for production cuts until the first quarter of 2018. Dubai crude oil price averaged USD53.1/barrel for the year, significantly higher than the average annual price of USD41.2/barrel recorded in 2016. In December 2017, prices averaged USD61.4/barrel, the highest monthly average since 2014. Local pump prices reflected the price movements in the world market. In January 2017, pump prices of gasoline and diesel averaged PhP43-46/liter and PhP33/liter, respectively. By December, average pump prices of gasoline ranged between PhP43-55/liter, while diesel averaged at PhP32-41/liter.

Core and Headline Inflation Rates (%), 2016-2017



Source:BSP

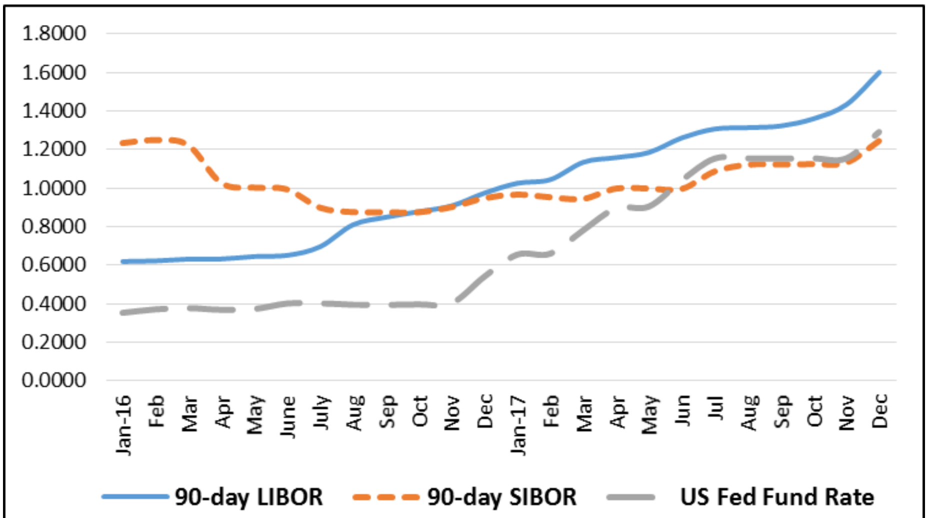
The key policy rate for the overnight reverse repurchase facility (RRP) was kept steady at 3.0 percent throughout 2017. The BSP's decision to keep the rate steady was based on the manageable level of inflation during the year. The corresponding interest rates on the overnight lending and deposit facilities were likewise kept steady, as well as the reserve requirement ratios.[2] This accommodative policy stance contributed to the expansion of

[2] These policy rates are tools used by the BSP (the monetary authority) to regulate liquidity in financial markets, which exert pressures on prices. Regulating liquidity is thus, in line with the BSP's mandate to stabilize prices. Relatively low policy rates in 2017, allowed for more funds to flow into the financial system, towards

domestic credit, with bank lending to the private sector (household consumption and production) increasing by 17.4 percent as of end-December 2017, faster than its 16.2 percent growth for the comparable period in 2016.

Foreign interest rates, on the other hand, have risen. The US Federal Reserve raised its policy rate thrice in 2017. While both 90-day London Interbank Offered Rate (LIBOR) and 90-day Singapore Interbank Offered Rate (SIBOR) increased in the fourth quarter to 1.4656 percent and 1.1681 percent from 1.315 percent and 1.1101 percent, respectively, in the previous quarter. Foreign rate differentials triggered capital outflows as investors search for higher yields.

Selected Foreign Interest Rates (%), 2016-2017



Source:BSP

External Accounts

Foreign investments were influenced by interest rate differentials as well as underlying macroeconomic resilience. As differences in interest rates widened, foreign portfolio investments which include equity or debt securities (termed as *hot money*) posted a net outflow amounting to US$1.9 billion in September 2017. On the other hand, foreign direct investments (FDI), the more desirable kind of capital, posted a net inflow of US$8.7 billion from January to November 2017 and exceeded the US$8 billion projection for the year.

productive activities (i.e., consumption and investments). This is what is known as accommodative or expansionary monetary policy stance.

Net Foreign Investments (US$ million), 2016-2017

Particulars	2016	2016	2017	Growth Rate (%)
		Jan-Nov		
Net Foreign Direct	7,980	7,264	8,725	20.1
		Jan-Sep		
Net Foreign Portfolio	-264	-155	-1,946	-1,155.5

Source BSP

Much of these investments are placed in the manufacturing sector, particularly in electronics and motor parts, as well as in construction and real estate. The steady inflow of FDI signifies continued investor confidence in the country's long-term growth prospects.

Nonetheless, the 20.1 percent increase in FDI is still lower relative to the 30.1 percent FDI growth rate recorded in the same period in 2016. The country's level of FDI also pales in comparison to neighboring countries such as Vietnam, which recorded an estimated US$ 17 billion of actual FDIs in 2017. These all point to the need for government to work harder to make the Philippines a more attractive investment destination.

Personal remittances from overseas Filipinos grew by 5.1 percent in 2017 and was given a boost by the depreciation of the peso. From January to November, total remittances amounted to US$28.2 billion of which, US$25.3 billion were coursed through banks. The top ten sources of these inflows make up 80 percent of the total. It might be worthy to note that although the level of remittances continues to increase, its growth has been decelerating. Remittances will also soon be eclipsed by the BPO industry as one of the country's top sources of foreign exchange. Earnings of the BPO industry is expected to grow by 9 percent and hit US$22 billion in 2017.[3]

Top 10 Sources of Remittances
(% share to total remittances), 2017

United States	33.6
United Arab Emirates	9.0
Saudi Arabia	9.0
Singapore	6.2
Japan	5.2
United Kingdom	4.8
Qatar	4.0
Kuwait	2.9
Germany	2.7
Hong Kong	2.6

Source: BSP

Overseas Remittances (US$ Million), 2016-2017

Particulars	2010	2011	2012	2013	2014	2015	2016	2016	2017
								Jan-Nov	
Cash Remittances (thru banks)	18.8	20.1	21.4	23.0	24.6	25.6	26.9	24.3	25.3
Growth rate (%)	*8.2*	*7.2*	*6.3*	*7.4*	*7.2*	*4.0*	*5.0*	*4.0*	
Personal remittances	20.6	22.0	23.4	25.4	27.3	28.3	29.7	26.9	28.2
Growth rate (%)	*7.8*	*6.6*	*6.5*	*8.6*	*7.5*	*3.8*	*4.9*	5.1	

Source: BSP

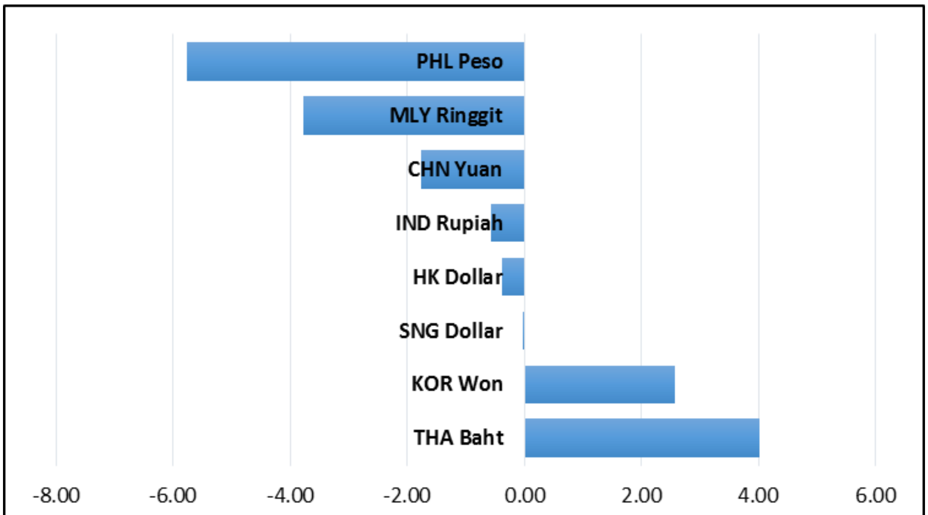
[3] http://www.pna.gov.ph/articles/1023356

The country's international financial position remains sound and primed against external shocks. The balance of payments (BOP) position recorded a deficit amounting to US$863 million during the period January-November 2017, up from US$420 million in comparable period in 2016, on account of the widening deficit in trade in goods. As the country imported more than what it exported, the cumulative trade deficit broadened from US$24.2 billion in 2016 to US$25.7 billion in 2017. In addition to this, the outflow in foreign portfolio investments and higher prepayments to foreign creditors contributed to the higher BOP deficit. The deficit however is lower than the BSP projection of US$1.4 billion for the year.

Nevertheless, the Gross international reserves (GIR) or the sum of all foreign exchange flowing into the country increased to US$81.6 billion at the end of 2017 due to higher growth in export earnings and the steady inflow of FDIs and remittances. This amount is equivalent to 8.3 months' worth of imports and primary income and 4.2 times the country's short-term external liabilities based on residual maturity. Conventionally, the GIR is considered adequate if it can cover at least 3 months' worth of imports or if it can cover 100 percent of the country's short-term external liabilities (i.e., falling due within the immediate 12-month period).

The Philippine peso depreciated against the US dollar by 5.78 percent in 2017. Other Asian currencies also depreciated against the US dollar, although compared to others, the Philippine peso weakened the most. The country's widening trade deficit and therefore rising demand for foreign currency, weighed in on the performance of the peso. Capital outflows, resulting mainly from the US Federal Reserve's rate hikes as well as the US' push for fiscal expansion, has also led to the depreciation of Asian currencies, including the peso, against the greenback. The sustained inflows of foreign exchange from overseas Filipino remittances, FDIs, exports, the ample level of gross international reserves, and the country's economic growth, helped provide support to the peso.

Year-on-year App. / Dep. of Selected Asian Currencies vs. US Dollar (%), 2017



Source: BSP

National Government Fiscal Position and Debt

The national government (NG) posted a deficit amounting to PhP243.5 billion from January-November 2017. This is 49.0 percent short of the full-year program of PhP484.1 billion, or 3.0 percent of the GDP. While the December 2017 fiscal performance is yet to be included, it is highly likely that the actual deficit will be much lower than the full year target.

Total revenue collection added up to PhP2.25 trillion during the 11-month period. This is 10.8 percent higher than that posted for the same period in 2016. Total collection of the Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC) for the period is 9.3 percent off their combined annual target. In contrast, the Bureau of Treasury and other revenue offices exceeded their programmed collection by PhP28.0 billion and PhP4 billion, respectively.

Total expenditure during the same period amounted to PhP2.49 trillion. This is PhP415.5 billion short vis-à-vis the full year expenditure target. The shortfall is mainly attributed to the underspending of government agencies, amounting to PhP315.5 billion. In addition to this, there are unreleased internal revenue allotments and interest payment savings, amounting to PhP34.6 billion and PhP44.9 billion, respectively. As per the Department of Budget and Management's (DBM) preliminary report, allotment releases for the month of December comprising of personnel services and subsidies, will still bolster the full year public spending figure.

National Government's Fiscal Performance, 2016-2017

Particulars (In Billion PhP)	2016 Revised Program (Full year)	2016 Actual (Jan-Nov)	2017 Program (Full year)	2017 Actual (Jan-Nov)	Variance	Growth (%)
REVENUES	**2,256.7**	**2,030.5**	**2,426.9**	**2,250.0**	**174.9**	**10.8**
Tax Revenues	2,044.0	1,827.8	2,258.4	2,054.0	204.3	12.4
Bureau of Internal Revenue	1,620.0	1,450.0	1,782.8	1,621.1	161.8	11.8
Bureau of Customs	409.0	361.5	459.6	413.1	46.5	14.3
Other Offices	15.0	16.3	15.9	19.8	-4.0	21.9
Non-Tax Revenues	212.7	202.7	168.5	196.0	-27.5	-3.3
Bureau of Treasury	90.0	95.3	58.6	86.5	-28.0	-9.2
EXPENDITURES	**2,645.6**	**2,265.8**	**2,909.0**	**2,493.5**	**415.4**	**10.1**
Allotment to LGUs	342.9	314.3	392.3	357.7	34.6	13.8
Interest Payments	327.7	285.4	334.9	290.0	44.9	1.6
Tax Expenditures	11.8	13.3	16.0	7.4	8.6	-44.4
Subsidy	70.7	98.1	95.5	99.9	-4.4	1.8
Equity	8.6	8.5	4.1	4.7	-0.6	-44.7
Net Lending	16.8	4.7	16.8	-0.1	16.9	-102.1
Others	1,867.0	1,541.5	2,049.5	1,734.0	315.5	12.5
SURPLUS/(DEFICIT)	**-388.9**	**-235.3**	**-484.1**	**-243.5**	**-240.5**	**3.5**

Source: Bureau of Treasury and Department of Budget and Management

As of end-December 2017, NG debt stock stood at PhP6.7 trillion, accounting for 42.1 percent of GDP. It grew by 9.2 percent, faster than its growth rate of 2.3 percent in 2016. External debt accounted for 33.2 percent (PhP2.2 trillion) of the total amount, a dip from its 35.4 percent share in 2016. The debt profile remained heavily biased towards long-term maturities, which made up 83.3 percent of total debt stock.

Employment, Poverty, and Hunger

Employment rate dipped slightly to 94.3 percent in 2017 from 94.6 percent in 2016. This reflected the slower pace of economic expansion during the year. Employed individuals totalled 40.3 million out of the 42.7 million belonging to the labor force.

The agricultural sector lost 803,000 jobs. This would have been of little concern had they been absorbed by industry or services. However, only 212,000 jobs were generated by the industry sector while the service sector also lost 72,000. Consequently, the unemployment rate rose from 5.4 percent in 2016 to 5.7 percent in 2017, equivalent to 2.4 million people without jobs. This is way off the target unemployment rate of 5.1 to 5.4 percent for the year. Among the regions, Ilocos Region (8.9 percent), NCR (7.4 percent) and CALABARZON (7.0 percent) had the highest unemployment rates.

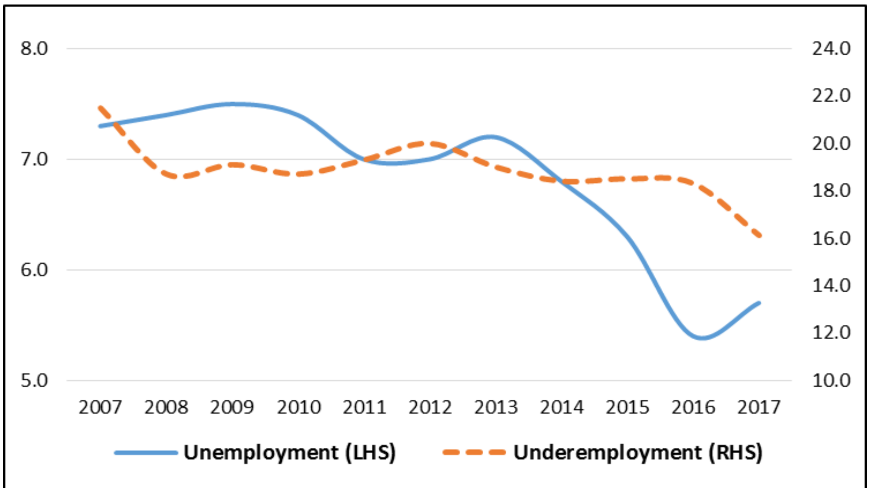
Employment Statistics, 2016-2017

Rates (%)	2016					2017				
	Jan	Apr	Jul	Oct	**Ave.**	Jan	Apr	Jul	Oct	**Ave.**
Labor Force Participation	63.6	63.5	63.2	63.6	**63.5**	60.7	61.4	60.6	62.1	**61.2**
Employment	94.3	93.9	94.6	95.3	**94.6**	93.4	94.3	94.4	95.0	**94.3**
Unemployment	5.7	6.1	5.4	4.7	**5.4**	6.6	5.7	5.6	5.0	**5.7**
Underemployment	18.5	17.2	16.5	17.2	**18.3**	15.2	15.1	15.4	15.1	**16.1**
Employment Growth						-3.30	-0.97	-1.91	-0.32	-1.62
Employment Generation ('000)						-1,342	-393	-784	-134	-663

Source: Labor Force Survey, Philippine Statistics Authority

Underemployment shows a decreasing trend, which is a favorable development. The underemployment rate continues to decline from 18.5 percent in 2015, 18.3 in 2016 and 16.1 in 2017. The improvement in the quality of work can also be seen in the class of workers wherein the number of self-employed and employers in own family-operated farm or business

PHL Unemployment and Underemployment Rate, 2007-



Source: Labor Force Survey, Philippine Statistics grew by 209,000 and 130,000, respectively while those who worked without pay declined by 845,000.

Self-rated poverty rose in 2017. The drop in the employment rate coincided with the rise in self-rated poverty from 44 percent in 2016 to 46 percent in 2017. While the full year average of self-rated hunger is lower in 2017, an increasing trend can be observed from 9.5 percent in the second quarter (June) to 15.9 percent in the last quarter of the year (December).[4]

Self-rated Poverty and Hunger (%), 1st-4th quarters 2016-2017

Rates (%)	2016					2017				
	1st	2nd	3rd	4th	Ave.	1st	2nd	3rd	4th	Ave.
Self-rated Poverty	46	45	42	44	44	50	44	47	44	46
Hunger	13.7	15.2	10.6	13.9	13.3	11.9	9.5	11.8	15.9	12.3

Source: Social Weather Station

Governance and Institutions

Governance reforms have been known to help boost competitiveness by creating an enabling environment for economic growth. Quality of institutions is considered a *necessary condition* that influences investment decisions, organization of production, and distribution of economic benefits to society.

Based on the results of the 2017 Open Budget Survey, the Philippines ranked first in Asia and 19th globally in terms of budget transparency. Conducted every two years, the survey showed that the Philippines' score improved to 67 out of 100, 3 points higher than in 2015. In the last survey, the Philippines ranked second in Asia, lagging behind South Korea. The 2017 survey showed the strong performance of the country in terms of public participation. The Philippines' score of 41 for Public Participation is more than thrice the global average and the country is one of only four to achieve a moderate score in the said category, along with New Zealand, Australia, and the United Kingdom. The Philippines also held a score of 65 out of 100 for Budget Oversight, with the legislature and the Commission on Audit providing adequate oversight over the budget.

[4] Data used for self-rated poverty and hunger were survey results of the Social Weather Station (SWS). Official poverty data are generated by the Philippine Statistics Authority from the Family Income and Expenditure Survey (FIES) which is conducted every three years. The latest FIES was conducted in 2015.

Philippine Ranking in Global Competitiveness, 2014-2018

Years	Rank / Number of Countries	Score for 1st Pillar: Institutions
2014-2015	52/144	3.86
2015-2016	47/140	3.78
2016-2017	57/138	3.62
2017-2018	56/137	3.51

Source: Global Competitiveness Index Report, various years
Score of 1 to 7, with 1 being the lowest and 7 highest

However, in the 2017-2018 Global Competitiveness Report by the World Economic Forum (WEF), the Philippines seems to have declined in terms of the quality of institutions. The country's score for institutional quality slipped from 3.86 in 2014 to 3.51 in 2017.[5] The report likewise presented the results of the Executive Opinion Survey, also conducted by the WEF, which showed that the top five problematic factors of doing business in the country are inefficient government bureaucracy, inadequate infrastructure, corruption, tax rates and regulation, and policy instability.

This is consistent with the findings contained in the Heritage Foundation's 2018 Index of Economic Freedom, which saw the country's overall economic freedom score slightly slipping from 65.6 to 65.0. While this is still above the world and regional averages of 61.1 and 61.0, respectively, the Philippines' lower scores in government integrity, monetary freedom, and property rights offset the gains in fiscal policy, government spending, and trade freedom. The Index also pointed to the pervasive corruption and cronyism, weak enforcement of property rights, inefficient courts system, and the country being a regional money-laundering hub as impediments to the its economic development. The Philippines was ranked 61st worldwide and 13th in the region, behind Hong Kong, Singapore, Malaysia and Thailand.

2018 Prospects, Risks, and Policy Implications

The Philippine economic growth outlook is expected to remain buoyant in 2018. Domestic demand is likely to continue its expansion on the back of higher public spending on infrastructure and social services and the robust remittance flows which values would likely be higher following the depreciation of the peso and the creation of the Overseas Filipino Bank. Multilateral agencies remain upbeat about the country's economic prospects. The ADB slightly raised its 2018 growth forecast for the Philippines from 6.7 to 6.8 percent. Both the World Bank (WB) and the International Monetary Fund (IMF) project the Philippine economy to grow by 6.7 percent in 2018, with the former asserting that the Philippines will continue to be the fastest growing economy amongst the ASEAN-5 countries.

[5] Individual countries are given a score of 1 to 7 for each of the indicators, 1 for worst and 7 for best.

Macroeconomic parameters indicate sound fundamentals that enhance economic resilience. The external debt-to-GDP ratio currently stands at 23.4 percent down from 25.4 percent in the previous year. The ratio of current account deficit to GDP is expected to widen in 2018, albeit at a still manageable level of 0.2 percent of GDP and covered adequately by high foreign exchange reserve levels. Incidentally, despite the slower pace of investment growth, the share of fixed capital formation to GDP has risen to 28.7 percent in 2017, its highest level in over a decade and now comparable to other Asian peers. Likewise, the fiscal deficit is expected to stay close to 3.0 percent of GDP with fiscal revenues propped up by the newly enacted TRAIN. These help anchor business confidence, which remain positive to date.

The pickup in global economic activity also augurs well for our trading sectors, especially those that have integrated themselves to regional production networks. The Senate recently ratified the Framework Agreement on Partnership and Cooperation between the Philippines and the European Union (PH-EU PCA). This will provide the basis for concluding a free trade agreement (FTA) between the two economies. The Regional Comprehensive Partnership (RCEP) is also set to be concluded and agreed upon by the 16 partner economies[6] in 2018. Similar efforts provide our trading sectors with the opportunity to deepen market access.

Nonetheless, risks that are tilted on the downside persists. On the external front, disparities in individual countries' economic recovery raise uncertainties over the future course of monetary and fiscal policies. These uncertainties tighten global financing conditions and increase volatility that could, in turn, bring to head financial vulnerabilities. Nominal interest rates are set to climb further and this would serve as a pull factor for capital to flow out. It could also have an effect on foreign denominated debt. Moreover, while a stronger economic recovery is expected in the United States, a steeper than expected slowdown due to geopolitical tensions in the Middle East and Korea, the rebalancing in China, and weakness in the Japanese and the Euro zone economies could hurt the growth prospects.

Second, inward-looking policies, especially in advanced economies, could impact trade, cross-border investment flows, and climate change issues. For instance, the US' withdrawal from the Trans Pacific Partnership (TPP), its trade dispute with North American Free Trade Agreement (NAFTA) partners, and its refusal to join a United Nations (UN)-sponsored climate change agreement seemingly opposes the precepts of globalization. Brexit has likewise resulted in a disruption on expectations of an orderly system of global trade, with countries now looking for new ways of forging economic ties with the European Union (EU) and the United Kingdom, separately.

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[6] Philippines, Australia, Brunei, Cambodia, China, India, Indonesia, Japan, Laos, Malaysia, Myanmar, New Zealand, Singapore, South Korea, Thailand, and Vietnam.

Third, OPEC's decision to extend production cuts throughout 2018 coupled with the pickup in global demand could keep world oil prices, and consequently, domestic pump prices elevated. In October 2017, the WB forecasted average crude oil price[7] to settle at US$56/barrel in 2018. As of January 2018, it already hit US$66.2/barrel. **Fourth, technological innovation presents some challenge to the IT-BPO sector.** The introduction of artificial intelligence (AI) and computer-generated voice technology may chip at the Philippine IT-BPO sector that is comprised mostly of call centers and other process-driven jobs.

On the domestic front, inadequate infrastructure has long been established as a growth constraint as it eats up factor productivity and limits potential output. The bullish sentiment on the Philippine economy is also, in part, premised on an infrastructure boom. Thus, factors that impinge on the implementation of the ambitious infrastructure plan, including capacity issues at the agency level, poses a risk to the economic outlook.

Upward pressure on prices raises some concern as it might temper demand and therefore, industry growth. The inflation outturn of 4 percent in January 2018 is already at the high end of the BSP's target range of 2 to 4 percent for the year. Moreover, the recent drop of the Purchasing Managers' Index (PMI),[8] from a score of 54.2 in December 2017 to 51.7 in January 2018, also seems to indicate a slowdown in output and new orders. The slowdown was attributed to higher prices on account of excise tax hike on various goods. The PMI score nevertheless remained above 50, which marks an increased, albeit more moderate, activity growth. The BSP also asserts that the first round price effect of the tax hike is as expected and is transitory.

Heightened political noise could shift attention away from the already demanding task of implementing the necessary structural reforms. Likewise, political pressure to pass popular but expensive measures may put a strain on limited fiscal resources and could eventually undermine fiscal sustainability. **Peace and order and security issues, not only in Mindanao but in the rest of the country, if left unattended, could continue to discourage investments and undermine business confidence. Finally, adverse weather conditions and natural calamities also pose a threat to economic output.**

With due consideration of these risks, government must continue and strengthen its resolve to carry out key measures guaranteed to raise productivity and put the economy on a higher growth path. First, stay on the course of delivering and improving infrastructure development. To this end, the passage of the budget reform bill is envisioned to help hasten budget execution and enhance transparency and accountability.

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[7] For average crude oil price, the WB averages the price of the Brent, Dubai and West Texas Intermediate (WTI)

[8] The PMI is developed through an independent monthly survey of carefully selected companies. It tracks variables such as output, new orders, stock levels, employment, and prices across the manufacturing, construction, retail, and service sectors. Data are collected using the same method across countries for comparability.

The budget reform bill must be passed taking into consideration concerns regarding the shift towards a cash-based appropriation system with a validity of one year.[9] Also, government initiatives can only do so much. Establishing better mechanisms that properly incentivize private sector involvement must be put in place.

Second, fast track the implementation of mitigating measures aimed at cushioning the impact of the recently passed TRAIN particularly on the poor. An amount of PhP24.5 billion in the 2018 budget is earmarked for unconditional cash transfers to the poorest 50 percent of households. Under this program, over ten million households will receive PhP200 per month to help them cope with the inflationary impact of TRAIN. The government has also allotted PhP2.3 billion for the loan facility to be extended to PUV drivers to replace their old public utility jeepneys with safer, more comfortable and more economic PUVs while another PhP2.0 billion will be used for the implementation of the National ID System to limit leakages and ensure delivery of social services programs to the intended beneficiaries.

With regard to the plans of the government to pursue the next tax reform packages, it must be ensured that they do not merely result in higher revenue in the immediate period, but also increase the capacity to raise revenue and safeguard against inequities over the long term.

Third, put forward reforms in education and skills training to enhance and upgrade the human resource pool. This is especially relevant for infrastructure development that requires a different set of human resource complement. It might be worthwhile to note that other Asian countries are embarking on their own infrastructure upgrades and competition for skilled labor may intensify. This is also critical for the IT-BPO sector, to enable them to compete in high-skilled, higher value production services such as data analytics, animation, software development, medical, and legal services. Associated with this, heavily investing in research and development (R&D), especially in the agriculture and manufacturing sectors, is important for product innovation and diversification.

Fourth, make markets even more contestable, especially in the services sector, not only to raise productivity but also to improve consumer welfare. To this end, passage of the amendments to the Public Service Act is being sought to ramp up competition and improve the regulatory framework for electricity and water services. **Fifth, pass the Bangsamoro Basic Law.** The enactment of the said measure is a crucial step in fostering a just and lasting peace in Mindanao and would help spur inclusive economic growth in the said area. **Finally, in so far as the political environment affect economic outcomes, more enlightened discourse must be made to engender broad and deeper understanding of the proposed shift towards a federal system of government.** This would help the public and the policymakers come up with an informed decision about the said proposal.

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[9] Manasan, Rosario G. (2017). Reforming the Legal Framework for the Budget Process. Philippine Institute for Development Studies.