2017 BUDGET BRIEFER

CONGRESSIONAL POLICY AND BUDGET RESEARCH DEPARTMENT

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ENSURING ECONOMIC STABILITY TO PROMOTE EQUITABLE PROGRESS[1]

The President's Budget Message for Fiscal Year 2017 specifically states that the budget as a tool for equitable progress will focus resources on the programs and projects that achieve the 10-point socioeconomic development agenda. This statement acknowledges the important role of the budget in pursuing inclusive and equitable development. *(Please see next page for the list of the 10-Point Agenda.)*

Recognizing the importance of not only sustaining economic growth but also of reducing the number of poor Filipinos, President Rodrigo Roa Duterte stated in his 10-point agenda that his administration will continue and maintain the current macroeconomic policies. During his State of the Nation Address (SONA), he reiterated this position and even stated his resolve to do better "through prudent fiscal and monetary policies that can help translate high growth into more and better job creation and poverty reduction".

A well-crafted and properly utilized national government budget plays an important role in economic development. The efficient and effective allocation and implementation of the budget ensures that sufficient resources are available to support national development objectives.

The President submitted to Congress an obligation budget amounting to P3.35 trillion for 2017, 11.6 percent higher than the P3.0 trillion budget in 2016. The proposed budget is equivalent to 21 percent of gross domestic product (GDP), slightly higher than the 20.7 percent in 2016.

TABLE 1
2015-2017 NATIONAL BUDGET

Particulars	2015	2016	2017
Obligation Budget (P trillion)	2.41	3.00	3.35
Growth Rate (%)	19.6	24.3	11.6
Ratio to GDP (%)	18.1	20.7	21.0

Source: 2016 and 2017 Budget of Expenditures and Sources of Financing (BESF)

[1] *Prepared by Rosemarie R. Sawali with technical assistance from Diomedes D. Goboleo. This paper benefitted from the discussions with Directors Elsie C. Gutierrez and Dina de Jesus-Pasagui, Executive Director Manuel P. Aquino, and Deputy Secretary General Romulo E. M. Miral, Jr., PhD.*

One of the major planned expenditures of the new administration is higher infrastructure spending to 6 - 7 percent of GDP within the next six years for the construction of roads, railways, classrooms, farm facilities, among others. The public sector infrastructure budget will grow by 13.8 percent to P860.65 billion from P756.4 billion in 2016. As a percentage of GDP, it will marginally increase to 5.4 percent from 5.1 percent this year. The 13.8 percent growth in infrastructure allocation for 2017, however, is a deceleration from the 31.4 percent growth for this year and 66.3 percent growth in 2015.

TEN-POINT SOCIO-ECONOMIC AGENDA

1. Continue and maintain current macroeconomic policies, including fiscal, monetary, and trade policies.
2. Institute progressive tax reform and more effective tax collection, indexing taxes to inflation. A tax reform package will be submitted to Congress by September 2016.
3. Increase competitiveness and the ease of doing business. This effort will draw upon successful models used to attract business to local cities (e.g., Davao) and pursue the relaxation of the Constitutional restrictions on foreign ownership, except as regards land ownership, in order to attract foreign direct investment.
4. Accelerate annual infrastructure spending to account for 5% of GDP, with Public-Private Partnerships playing a key role.
5. Promote rural and value chain development toward increasing agricultural and rural enterprise productivity and rural tourism.
6. Ensure security of land tenure to encourage investments, and address bottlenecks in land management and titling agencies.
7. Invest in human capital development, including health and education systems, and match skills and training to meet the demand of businesses and the private sector.
8. Promote science, technology, and the creative arts to enhance innovation and creative capacity towards self-sustaining, inclusive development.
9. Improve social protection programs, including the government's Conditional Cash Transfer program, to protect the poor against instability and economic shocks.
10. Strengthen implementation of the Responsible Parenthood and Reproductive Health Law to enable especially poor couples to make informed choices on financial and family planning.

More than 40 percent of the proposed 2017 national budget or P1.34 trillion will go to social services with education, culture, and manpower development getting a little over half of the allocation for the sector. Except for housing and community development, all subsectors of economic services will get a higher budget in 2017. Economic services will get the second highest allocation amounting to P924.0 million or 27.6 percent of the proposed 2017 budget with communications, roads and other transport, subsidy to LGUs, and agriculture and agrarian reform getting the highest share. The multiplier effects from higher government spending can further increase aggregate demand and spur economic activities.

TABLE 2
EXPENDITURE PROGRAM BY SECTOR

Particulars	Levels			Share to GDP (%)			Growth Rate (%)	
	2015	2016	2017	2015	2016	2017	15-16	16-17
Economic Services	708.0	834.0	924.0	5.3	5.7	5.8	17.8	10.8
Social Services	886.6	1119.8	1344.8	6.7	7.7	8.4	26.3	20.1
Defense	97.2	130.7	147.8	0.7	0.9	0.9	34.4	13.1
General Public Services	403.7	498.0	581.8	3.0	3.4	3.7	23.4	16.8
Net Lending	9.7	26.5	16.8	0.1	0.2	0.1	173.3	-36.7
Debt-Service-Interest Payments	309.4	392.8	334.9	2.3	2.7	2.1	27.0	-14.7
TOTAL	**2414.6**	**3001.8**	**3350.0**	**18.1**	**20.7**	**21.0**	**24.3**	**11.6**

Source: 2017 BESF

Notable in the sectoral allocation of the expenditure program is the sharp decline in net lending by 36.7 percent to P16.8 billion from P26.5 billion, and in debt-service-interest payments by 14.7 percent to P334.9 billion from P392.8 billion. The budget decline for these two items effectively free up or increase allocation for programs and activities to improve social welfare and enhance productivity.

The current administration is pursuing an expansionary stance with the deficit targeted to increase to 3.0 percent of GDP from the projected 2.7 percent this year and 0.9 percent in 2015. The higher deficit in 2017 is intended to facilitate the attainment of a more equitable growth. For 2017, the spending program (on cash basis)[2] is P2.96 trillion (18.6% of GDP), 11.9 percent higher than the estimated disbursements of P2.65 trillion (18.2% of GDP) for 2016.

To finance the proposed 2017 budget, the government targets total revenue collection to grow by 10 percent to P2.48 trillion from P2.26 trillion. The revenue effort or total revenues as a percentage of GDP will marginally improve to 15.6% from 15.5% in 2016. Both these figures are lower than the actual 2015 revenue effort of 15.8 percent which can be attributed to proceeds from the sin tax reforms and gains from administrative reform measures. Compared with the ASEAN-5 member countries, the 15.9 percent revenue effort of the Philippines in 2015 remains low, just surpassing Indonesia's 13.0 percent while Vietnam recorded the highest at 22.1 percent.

[2] *The P3.35 trillion proposed budget is reckoned on obligation basis – that is, the targeted level of total appropriations that will be used or obligated during the year.*

TABLE 3
FISCAL OPERATIONS OF THE NATIONAL GOVERNMENT
IN BILLION PESOS

Particulars	Actual						Outlook	Target
	2010	2011	2012	2013	2014	2015	2016	2017
Levels (In Billion Pesos								
Revenues	1,208	1,360	1,535	1,716	1,909	2,109	2,257	2,482
Disbursements	1,552	1,558	1,778	1,880	1,982	2,231	2,646	2,960
Fiscal Balance	-314.5	-197.8	-242.8	-164	-73.1	-121.7	-388.9	-478.1
Percent of GDP								
Revenues	13.4	14	14.5	14.9	15.1	15.8	15.5	15.6
Disbursements	16.9	16	16.8	16.3	15.7	16.8	18.2	18.6
Fiscal Balance	-3.5	-2.0	-2.3	-1.4	-0.6	-0.9	-2.7	-3.0

Source: BESF, various years

Based on the fiscal program, the higher deficit target for 2016 is a result of higher spending and slower growth in revenues. For 2016, growth in total revenues is expected to slow down to only 7.0 percent from 10.5 percent in 2015 while disbursements is seen to accelerate by 18.6 percent. For 2017, growth in total revenues is expected to improve to 10.0 percent while disbursements will moderate to 11.9 percent.

The deficit will be financed by borrowing with a mix of 80:20 in favor of domestic sources to minimize foreign exchange risks and, at the same time, to support capital market development. The higher debt is not seen to compromise the stable financial position of the country as projected higher economic growth in the medium-term will enable the country to outgrow the debt burden. To support the higher proposed disbursements, it has become even more critical to further improve collection efficiency and to pursue tax reforms so as not to exacerbate the fiscal deficit. (*Tax reform measures will be discussed in greater detail in another budget brief focusing on financing the budget.*)

MACROECONOMIC ASSUMPTIONS

The preparation of the budget and its components is based on a set of macroeconomic parameters, which affect the viability of the budget proposal and the availability of resources that would finance the expenditure program. The major macroeconomic parameters include the following: (i) real GDP growth rate, (ii) inflation rate, (iii) interest rate (364-day Treasury Bill rate), (iv) foreign exchange rate, (v) Dubai oil price, and (vi) unemployment rate.[3]

[3] *Other parameters include the London Interbank Offered Rate (LIBOR), population, exports and imports of goods, current account balance, and gross international reserves.*

The macroeconomic variables and the budget exhibit a dynamic relationship wherein the latter affects and, at the same time, is affected by the former. Miral (2007) explained that the budget underpins government consumption and public investment which constitute part of the economic performance, which, in turn, affects revenue performance and government expenditure.

TABLE 4
SELECTED MACROECONOMIC PARAMETERS

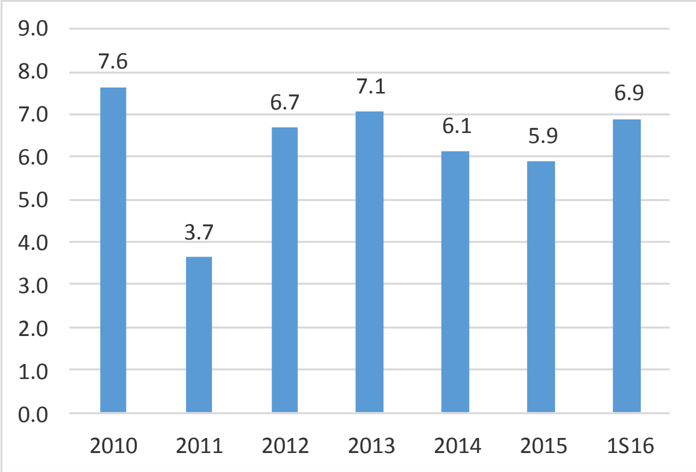
Particulars	Actual	Latest Available[1]	Adjusted	Projections[2]
	2015	2016	2016	2017
Real GDP Growth (%)	5.9		6.0-7.0	6.5-7.5
Inflation Rate, CPI (2006=100)	1.4	1.4	2.0-4.0	2.0-4.0
364-Day T-bill Rate (%)	2.1	1.8	2.0-4.0	2.5-4.0
Foreign Exchange Rate (P:$)	45.5	46.9	45-48	45-48
Dubai Oil Price (US$/Barrel)	50.92	37.8	35-50	40-55
Unemployment Rate (%)	6.3[3]	6.1	6.5-6.7	n.a

Note: 1/ 1st quarter for GDP growth rate; January-July average for inflation rate, exchange rate and Dubai oil price; January-June average for T-bill rate; April 2016 for unemployment rate,
2/ Adopted by the Development Budget Coordination Committee (DBCC) on 5 July 2016
3/ Excludes data from Leyte of Eastern Visayas or Region VIII
Sources: 2017 BESF, PSA, BSP, New Zealand Ministry of Economic Development

For instance, the 2017 Budget message states that enough revenues will be collected because the economy is seen to continue to grow by 6.5 – 7.5 percent next year, anchored on sustained expansion of the services and industry sectors and the rebound in agriculture. Pump-priming the economy by way of higher infrastructure spending is also seen to boost growth in the next six years. A revitalized Public-Private Partnership (PPP) program is expected to accelerate the roll out of infrastructure projects.

On Economic Growth. The economy grew by 6.9 percent in the first semester of 2016 from 5.5 percent in the same period last year. The government is on track of achieving its revised 6.0 – 7.0 percent growth target for the year. On the supply side, growth was mainly driven by sustained growth in the industry (7.9%) and the services sectors (8.0%) which compensated for the 3.3 percent contraction in agriculture. On the demand side, growth was buoyed by robust private consumption (7.2%), a pick up in government consumption (12.7) and strong growth in investments (27.1%).

CHART 1
GDP GROWTH RATE (%)



Source of basic data: Philippine Statistics Authority (PSA) website

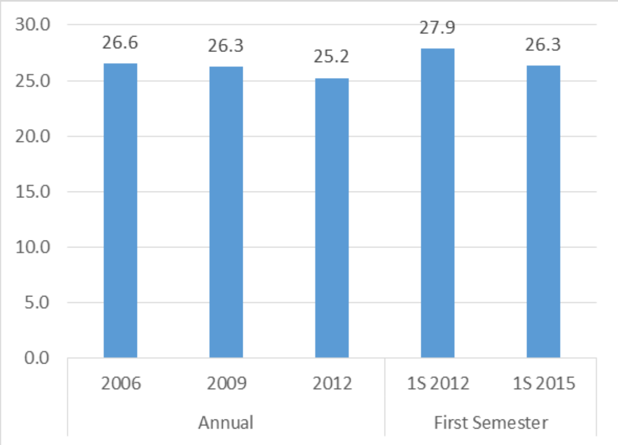
The key challenges for the Duterte administration in the economic front are sustaining the higher growth path the country achieved in the last six years and further reducing poverty. The country posted an average growth of 6.2 percent for the period 2010-2015. On the other hand, the improvement in annual poverty incidence was only minimal from 26.3 percent in 2009 to 25.2 percent in 2012. The first semester poverty incidence in 2015 is 26.3 percent, an improvement from the 27.9 percent in the same period in 2012 *(Chart 2)*. In the presentation of Socio-Economic Planning Secretary Ernesto Pernia during the 2017 DBCC Briefing to the Committee on Appropriation, he noted that the inequality indicator, Gini coefficient[4] at 0.46, has been "persistently high". He also noted that the economic growth of CAR, MIMAROPA, Eastern Visayas and ARMM in 2010-2015 were slower compared to 2004-2009 data.

Compared to other ASEAN member states, the Philippines has one of the highest share of population below the national poverty line based on the latest available data from the Asian Development Bank *(Chart 3)*.

Based on the studies by the World Bank, economic growth needs to be sustained for a number of years to make a significant improvement in poverty reduction. The World Bank noted that while the country achieved a few growth spurts, it has rarely been able to sustain growth at above 5% for an extended period of time.

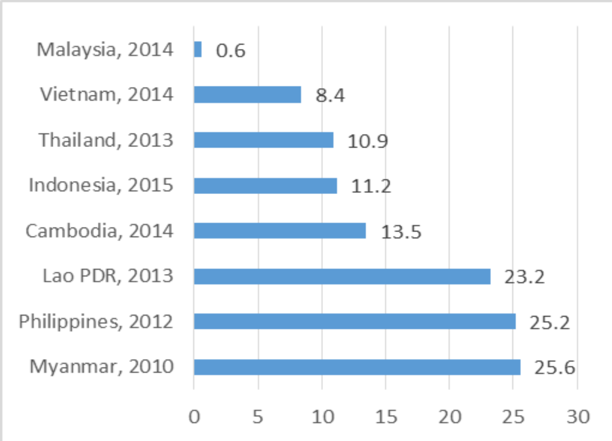
[4] *Gini coefficient measures the extent to which the distribution of income or consumption expenditure among individuals or households within an economy deviates from a perfectly equal distribution.*

CHART 2
POVERTY INCIDENCE AMONG POPULATION



Source of basic data: Philippine Statistics Authority (PSA) website

CHART 3
SHARE OF POPULATION
BELOW THE NATIONAL POVERTY LINE



Sources of basic data: PSA and Basic Statistics 2016, ADB

Based on a study by the IMF (2015), decomposition of the economic growth for the period 2010-2014 showed that growth was mainly driven by a faster acceleration in total factor productivity and physical capital while the contribution of labor and capital remained generally stable. The study also showed that the potential growth of the country has increased from around 5 percent during the period 2000 - 2009 to 6.5 percent in 2015 - 2016. The output gap for 2015 - 2016 is estimated at close to zero. It also noted that the robust economic performance since 2010 was not accompanied by higher inflation nor a decline in unemployment rate, implying that the increase in growth is associated with higher potential growth. This observation exposes the underlying structural problem of the economy -- high economic growth with high unemployment and underemployment.

Similarly, a study by the World Bank in 2014 noted that the close to zero output gap of the country indicates a limited capacity to sustain growth higher than 6 percent in the medium term. Thus, it is imperative to increase investments and to implement structural reforms that will boost the country's potential growth. The plan of the current administration to address underspending issues in the past few years bodes well to increasing the productive capacity of the economy to support long-term growth.

While the inflow of investments has been increasing, further revitalizing investments in the country remains an important task for the government. The investment rate (gross domestic investments as a percentage of GDP) of the country has remained relatively unchanged in the last six years, recording an average of 20.1 percent which is the lowest among ASEAN-5 economies. Indonesia, which showed an upward trend in investment rate, also recorded the highest average during the period at 34.0 percent.

TABLE 5
GROSS CAPITAL FORMATION
(PERCENT OF GDP)

	2010	2011	2012	2013	2014	2015	Ave
Indonesia	32.9	33.0	35.1	33.8	34.6	34.6	34.0
Malaysia	23.4	23.2	25.7	25.9	25.0	25.1	24.7
Philippines	20.5	20.5	18.2	20.0	20.5	20.6	20.1
Singapore	27.9	27.0	29.8	30.3	28.9	26.3	28.4
Thailand	25.4	26.8	28.2	27.5	24.1	-	26.4
Vietnam	35.7	29.8	27.2	26.7	26.8	27.7	29.0

Source: World Bank Development Indicators

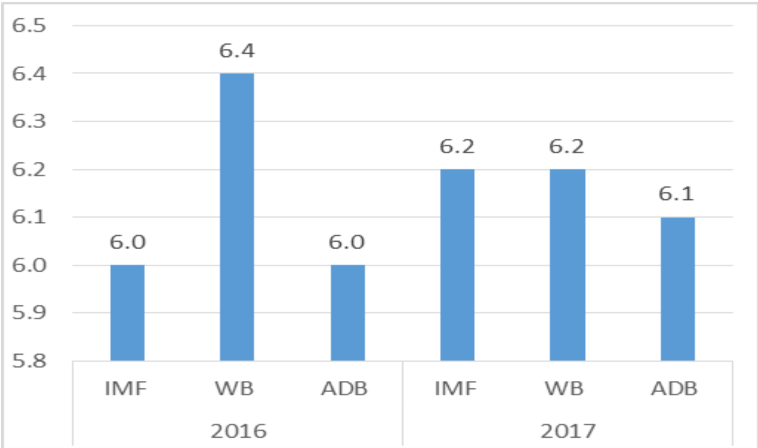
Addressing government underspending which has been a problem in the past needs to be prioritized as this has deprived the Filipino people of better infrastructure and social services. Further improving the budget execution process could lead to higher government spending on critical public infrastructure investments as well as in other projects that could support the robust growth in recent years. Reforms should be fast-tracked in solving institutional weaknesses in budget planning and execution. The World Bank (2016) recommends addressing bottleneck in disbursements, namely: (i) poor planning; (ii) weak program and project design; and (iii) repeated procurement and implementation difficulties such as frequent bid failures, weak capacity to procure, right-of-way issues, complications in securing permits and coordination problems.

For 2016, the government has adjusted its GDP growth target to 6.0 - 7.0 percent from the previous administration's target of 7.0 - 8.0 percent set in the 2016 BESF. DBM Secretary Benjamin Diokno attributed the revision of the target to a more conservative stance due to the "tapering effect of election spending, slow agricultural output due to El Niño, weak infrastructure due to seasonality and weak external trade." *(Philippine Daily Inquirer, 5 July 2016)* On the other hand, strong private consumption supported by modest inflation resulting from low oil prices and sustained inflow of remittances will prop up growth. The sustained expansion in industry and services on the supply side will prop up economic performance.

The Philippines is seen to sustain the robust growth momentum this year and in 2017. Multilateral institutions such as the World Bank, the International Monetary Fund (IMF) and the Asian Development Bank expect GDP to grow by at least 6 percent in 2016 and 2017 *(Chart 4)*. The IMF noted upside risks relating to better-than-anticipated execution of the 2016 budget. On the other hand, lingering uncertainties in the global economy and uneven growth prospects in emerging economies pose downside risks to growth prospects. While the IMF identified tighter global financial conditions and a surge in global financial volatility which could result to capital outflows and tightening of domestic financial conditions as other downside risks, it also noted that the strong macroeconomic fundamentals and ample policy space of the country will help cushion the impact of these issues should they materialize.

The forecast of other seven financial, credit rating and research institutions also shows an average GDP growth rate of 6.1 percent in 2017.[5]

CHART 4
GDP GROWTH PROJECTIONS



Sources: ADB Asian Development Outlook Supplement (July, 2016); IMF World Economic Outlook Update (July 2016); World Bank Philippine Economic Update (April 2016)

Taking into consideration actual first semester national income accounts, the CPBRD revised its 2016 growth forecast to between 6.6 and 7.0 percent. With the absence of the impact of election spending in the second semester and the global risks and uncertainties including the possible impact of weather disturbances, growth in the second semester is expected to be more subdued compared to the first semester. On the other hand, sustained private consumption spending is expected to drive the economy in the second semester, buoyed by remittance inflows, better employment prospects along with low inflation and interest rates.

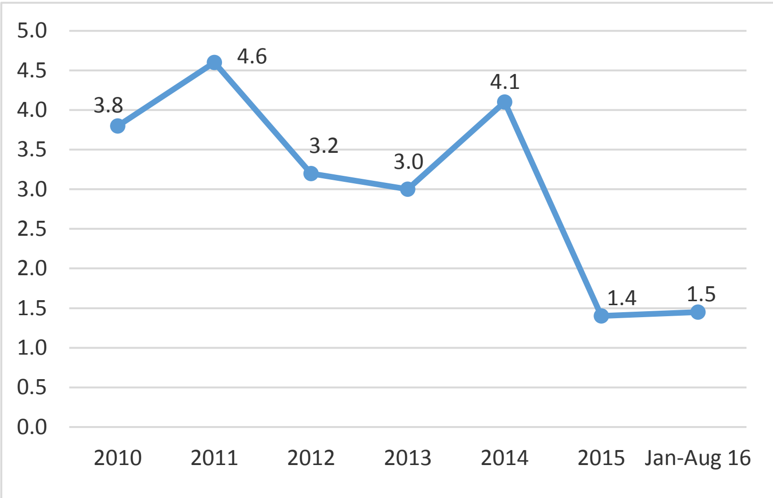
For 2017, the CPBRD expects GDP growth to moderate to between 6.2 and 6.7 percent. Sustained growth of the services and industry sectors particularly the resurgence in manufacturing will support growth next year. The expansionary stance of the government to increase government spending through expansion of human development and social protection programs, and to fast track public infrastructure investments will have significant impact on economic performance. The projection of a modest growth is related to the base effect of the huge election spending this year. While the performance of the global economy is generally expected to marginally improve in 2017, risks and uncertainties abound which could impinge on the expected acceleration. With the exception of the United States which has shown signs of

[5] *Includes Credit Suisse, JP Morgan and Chase Bank, Fitch, S&P, Moody's, Focus Economics and Nomura Global Market Research.*

steadier economic growth, the prospects of other advanced economies such as Japan and those in the European Union (uncertainties of the impact of Brexit) are still fragile. Moreover, the expected slowdown of China and other emerging economies also poses risks to growth prospects.

On Inflation. The inflation rate in the country has been relatively stable in the last six years, falling within the target of the government. The favorable inflation environment can be mainly attributed to low petroleum prices and ample food supply despite the El Niño phenomenon in 2015. For the period January to August 2016, inflation rate recorded an average of 1.5 percent which is below the low-end of the government's target of 2.0–4.0 percent.

CHART 5
PHILIPPINE INFLATION RATES, 2010 TO JULY 2016
(2006=100)



Source of basic data: PSA website

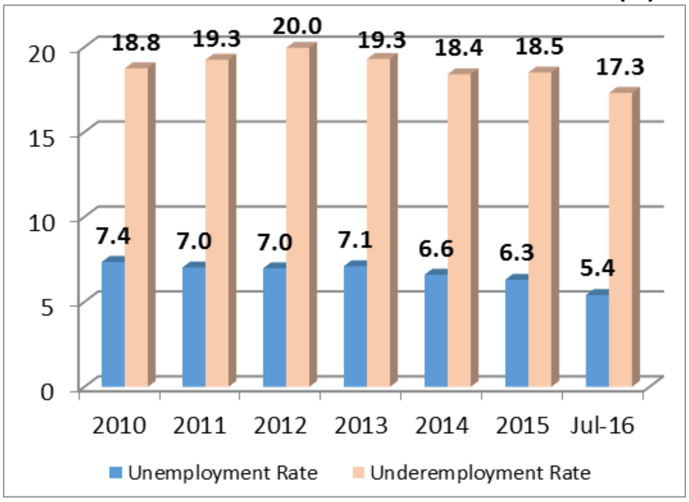
The government expects inflation rate to remain subdued for the rest of the year till 2017, and will be within the 2.0–4.0 percent target of the government. As per the 23 June 2016 monetary policy meeting, assessment of risks to inflation were broadly balanced, with the weakening of global economic activity as the downside risk and the pending petitions for electricity rate adjustment as the upside risk.

In the short-term, the possible impact of La Nina phenomenon and tropical cyclones on food supply pose risks to the inflation outlook. Based on the August 24, 2016 Press Statement of the Department of Science and Technology – Philippine Atmospheric, Geophysical and Astronomical Services Administration (DOST-PAG-ASA), a weak and short-lived La Niña phenomenon is projected to develop in either late September or October 2016, which may last through the remainder of the year. In addition, the country could still experience the normal number of tropical cyclones for the rest of the year.

In the medium-term, the proposed higher sin tax on oil to compensate for the lowering of personal and income tax is seen to stoke inflation. Based on the estimates of the BSP, a P6 per liter increase in the pump prices of fuel products arising from higher excise tax could raise inflation by 0.25 percentage point. However, the overall impact could be higher as the second round effects of the oil price increase on transport fare, food, and other commodities were not yet considered in the estimate.

On unemployment. Both the unemployment and underemployment rates have gone down in recent years, but were not enough to make a significant dent on poverty. From 7.4 percent in 2010, the unemployment rate went down to 6.3 percent in 2015 and further down to 5.4 percent in July 2016. Underemployment rate has remained significant, hovering around 19.0 percent during the period. In July 2016, underemployment rate was 17.3 percent or about 7.094 million persons who were employed but wanted additional hours of work or additional job as their incomes were presumably not enough to support their needs. Combining the numbers of unemployed and underemployed persons and dividing it by the number of adult workers per family, assumed at two, would roughly approximate the number of poor families at about 4.21 million in 2012.

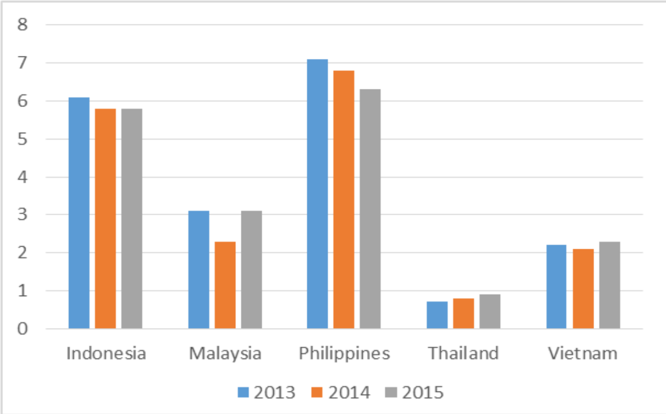
CHART 6
UNEMPLOYMENT RATE AND UNDEREMPLOYMENT RATE (%)



Source of basic data: PSA website

The unemployment rate in the Philippines, although improving, is the highest among the ASEAN-5 economies. For the period 2013-2015, the Philippines recorded an average unemployment rate of 6.7 percent followed by Indonesia's 5.9 percent. Thailand has the lowest unemployment rate at below 1 percent.

CHART 7
UNEMPLOYMENT RATE (%)



Source: BSP website

The 6.5 – 6.7 unemployment rate target for 2016 as stated in the 2016 BESF was maintained in the 2017 BESF. In light of the more positive unemployment figures in the January and April Labor Force Surveys recorded at 5.8 percent and 6.1 percent, respectively, there is a need to review the 2016 target. This will set the tone in targeting unemployment figures in the medium-term.

However, there is no unemployment projection made for 2017 in the BESF. This absence may be misconstrued as not giving due importance to the avowed goal of inclusive growth. The unemployment rate target is critical in ensuring that policies, programs, and projects are geared not only towards achieving the growth targets, but also in generating employment opportunities. However, focus should not be limited to reducing the unemployment figures but also in ensuring that the quality of employment is satisfactory.

It was, however, reported in the news that Secretary Pernia has mentioned that the government is looking at reducing unemployment rate to as low as 4 percent by 2022 with a focus on bringing down cases of job mismatch by ensuring better quality jobs. He added that reducing underemployment rates which have remained at double digits would be addressed through the creation of more regular quality jobs. *(Business World, 29 August 2016)*

The robust economic growth in recent years have not been accompanied by a commensurate improvement in both unemployment and underemployment rates. Reducing these two is necessary for inclusive economic growth and poverty reduction. Addressing structural impediments to employment creation and improving labor productivity need to be prioritized. In addition to higher spending in infrastructure, investments in research and development should also be strengthened. It is the responsibility of the government to achieve full or close to full employment (Felipe, 2010). The government is responsible for providing a favorable investment environment where businesses thrive to be able to generate wealth and provide employment. Cooperation and close coordination between the government and the private sector need to be strengthened to maximize employment creation.

On the Dubai Oil Price. After reaching a price of below $30 per barrel in January and February 2016, the price of Dubai oil has started to inch up to reach $46.36 in June and $43.92 in July. The average monthly price of $37.85 for the first seven months of 2016 is 33.4 percent lower compared to the $56.87 in the same period in 2015. This is within the range of the DBCC assumption of $35-$50 per barrel for the year. For 2017, the DBCC is adopting a higher range forecast of $40-$55.

Expectations of a modest growth of the global economy could put upward pressure on oil price. Uncertainties related to geopolitical tensions could also push oil prices higher. An increase in the price of oil will translate to higher local pump prices coupled with a possible weakening of the peso could weigh on inflation prospects.

CHART 8
Dubai Crude Oil Price
In US$/Barrel

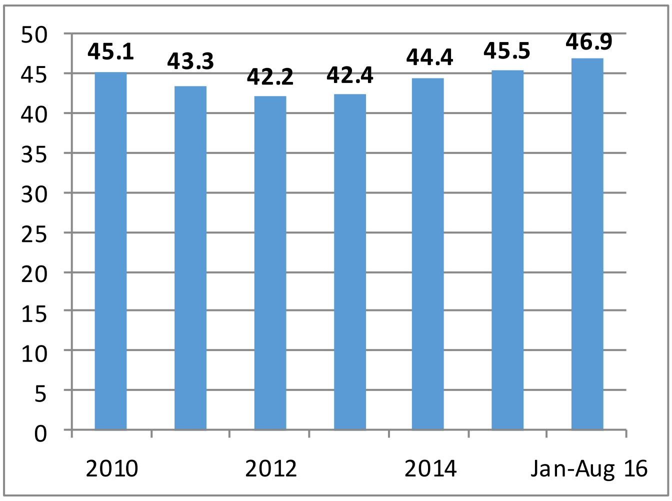
Source of basic data: New Zealand Ministry of Economic Development

On the Foreign Exchange Rate. The peso-US dollar rate has been generally exhibiting a depreciating trend over the last four years. From an annual average of P42.2:$ in 2012, it weakened to P45.5:$ in 2015. The P46.9:$ average exchange rate for the first seven months of the year is weaker compared to the P44.8:$ average in the same period last year. The weakness of the peso can be traced to the pullout of portfolio investments due to the expected Fed rate hike amidst improving economic prospects in the US. On the other hand, sustained foreign exchange inflows from OFW remittances, foreign direct and portfolio investments and BPO revenues kept the peso afloat.

The average peso-US dollar rate is not foreseen to change significantly in the near term. The DBCC expects the average peso-US dollar rate to range from P45 to P48 in 2016 and 2017. Continued recovery of the US economy as well as the realization of the Fed rate hike could further weaken the peso as these could result in investors withdrawing their funds in the country and transferring them to the US.

A weaker peso increases revenues from taxes on imports but also increases the cost of all US dollar denominated expenditures such as principal and interest payments of foreign debt. A weaker currency increases the competitiveness of the country and could help boost exports performance. However, this could put pressure on the inflation rate as the price of imported goods that are directly consumed or used as inputs to production would be higher.

CHART 9
AVERAGE PESO PER US DOLLAR RATE

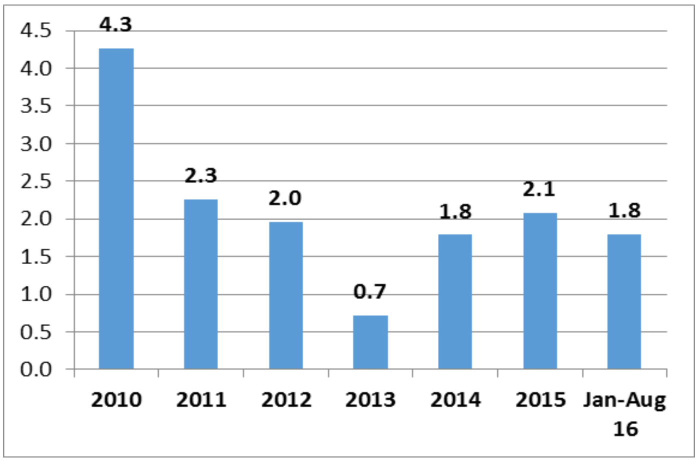


Source: BSP website

On the Interest Rate. For the first seven months of 2016, the 364-day T-Bill bill rate recorded an average of 1.8 percent, lower than the 2.1 percent in the same period last year. The DBCC expects the 364-day T-Bill rate to range between 2.5 percent and 4 percent in 2017, slightly higher than the 2 - 4 percent this year.

Both revenues and expenditures of the government are affected by the movement of the interest rate. An interest rate hike increases the cost of servicing domestic public debt. On the other hand, it beefs up revenues through higher taxes withheld from the interest income on the sale of government securities.

CHART 10
AVERAGE 364-DAY TREASURY BILL RATES



Source of basic data: BSP

ECONOMIC GROWTH AND FISCAL SCENARIOS

The current administration is diverging from the conservative fiscal position adopted by the previous administration. From a 2 percent fiscal consolidation target, the government is now pursuing an expansionary fiscal stance with a budget deficit target of 3 percent of GDP in 2017 from the estimated 2.6 percent this year. The deficit target for both 2016 and 2017 will be the highest since the 3.5 percent deficit in 2010.

2016 SCENARIOS

With a robust first semester growth at 6.9 percent, the government is on track of achieving its 6.0 - 7.0 percent target for the rest of the year. However, with the sharp increase in expenditures and the more modest increase in revenues in 2016, the budget deficit as a percentage of GDP will increase to 2.7 percent from 0.9 percent in 2015.

Using the same revenue effort of 15.5 percent, achievement of the high-end GDP target of 7.0 growth implies an increase in revenue collection amounting to P31.0 billion. The level of disbursements will also be higher by 36.4 billion assuming the same disbursement ratio of 18.2 percent. While modest, this amount could go a long way in further extending the social services of the government such as the 4Ps program or in modernizing health facilities in the rural areas. The bigger government spending could also further contribute to the growth in GDP, thus increasing the chances of meeting the higher-end budget assumption. It should be noted, however, that the effectiveness and efficiency of the budget is subject to the absorptive capacity of implementing agencies concerned.

TABLE 6
2016 GROWTH AND FISCAL SCENARIOS

Particulars	BESF Assumptions			CPBRD Growth Projections
	Low	High	Difference (High-Low)	
Real GDP Growth Rate	6.0	7.0	1.0	6.8
Nominal GDP (PBn)	14,528.9	14,728.8	199.9	14,670.0
Revenues (PBn)	2,252.0	2,283.0	31.0	2,273.8
% of GDP	15.5	15.5	-	15.5
Disbursements (PBn)	2,644.3	2,680.6	36.4	2,669.9
% of GDP	18.2	18.2	-	18.2
Deficit (PBn)	(392.3)	(397.7)	(5.4)	(396.1)
% of GDP	(2.7)	(2.7)	-	(2.7)

Source: BESF 2017 and CPBRD Assumptions as of 15 September 2012

For the first semester of 2016, total revenues grew by 1.0 percent to reach P1,101.0 billion while expenditures grew by 14.0 percent to reach P1,221.3, resulting in a fiscal deficit of P120.3 billion, reversing the P13.7 billion surplus in the same period in 2015.

The midpoint of the CPBRD updated forecast of a 6.8% GDP growth for the whole year of 2016 is closer to the 7.0% high-end of the government target. Compared to the low-end of the government target, the GDP growth projections of the CPBRD would result in higher revenues and disbursement by P22.0 and P26.0 billion, respectively, assuming the same revenue effort.

2017 SCENARIOS

The government is adopting a more optimistic outlook for 2017 with GDP expected to grow by 6.5 to 7.5 percent from the 6.0 to 7.0 percent this year. The CPBRD, on the other hand, forecasts a more subdued forecast at 6.5 percent. The aforementioned figures are more upbeat compared to the emerging consensus forecast of multilateral and private institutions of 6.1 percent.

Overoptimistic assumptions could compromise the achievement of revenue targets and the corollary deficit program. Tax revenues, the main source of budget financing, is affected by the GDP growth rate. In cases where actual GDP growth rate falls below the low-end of the target, the government could either increase local borrowing which could crowd out investments, or put upward pressure on interest rate, or increase foreign borrowing which increases exposure to exchange rate volatility.

TABLE 7
2017 GROWTH AND FISCAL SCENARIOS

Particulars	BESF Assumptions			CPBRD Growth Projections
	Low	High	Difference (High-Low)	
Real GDP Growth Rate	6.5	7.5	1.0	6.5
Nominal GDP (PBn)	15,937.4	16,375.9	438.5	16,118.3
Total Revenues (PBn)	2,486.2	2,554.6	68.4	2,514.4
% of GDP	15.6	15.6	0.0	15.6
Disbursements (PBn)	2,964.4	3,045.9	81.6	2,998.0
% of GDP	18.6	18.6	0.0	18.6
Deficit (PBn)	(478.1)	(491.3)	(13.2)	(483.5)
% of GDP	(3.0)	(3.0)	0.0	(3.0)

Source: BESF 2017 and CPBRD Assumptions as of 15 September 2012

SUMMARY AND CONCLUSION

In the last six years, the economy grew by an average of 6.2 percent with an average inflation of 3.4 percent. However, both unemployment and underemployment rates were high at an average of 6.9 percent and 19.0 percent, respectively during the same period. Growth is likewise not broadly shared across socio-economic classes and regions. The marginal decline in annual poverty incidence from 26.9 percent in 2009 to 25.2 percent in 2012 was accompanied by an increase in the magnitude of poor population by almost 500,000. In the first semester of 2015, the PSE reported that poverty incidence declined to 26.3 percent from 27.9 percent in the same period in 2012.

During the same period, the budget deficit as a percentage of GDP was declining. The previous administration was criticized for its underspending particularly in 2013-2015 when the budget deficit fell below the 2.0 percent consolidation target, even reaching below one percent in 2014 and 2015. These point to an elbow room for an expansionary policy.

The Duterte administration is batting for expanding social services and increasing infrastructure investments to as high as 7 percent of GDP in the next six years. The proposed budget for 2017 shows an increase in revenues and disbursements by 10.0 percent and 11.9 percent, respectively. The 2017 disbursements as a percentage of GDP at 18.6 percent will be the highest since the 19.6 percent recorded in 2011. On the other hand, the 2017 revenues as a percentage of GDP will marginally increase to 15.6 percent from the estimated 15.5 percent this year. The deficit is seen to reach 3 percent of GDP in 2017. To sustain higher government expenditures without putting undue pressure on the deficit, the government must work doubly hard in improving the revenue effort which has remained low compared with other ASEAN countries. Prior to the Asian financial crisis, the country was able to post as high as 19.9 percent in revenue effort.

While the global economy is expected to post modest growth in 2017, uncertainties remain. It is therefore critical to tap internal sources of growth and the role of the government is crucial in stimulating the domestic economy. Policies that are geared towards addressing investment constraints and improving competitiveness need to be prioritized so that both local and foreign investments will continue to grow.

In relation to the goal of reducing poverty in the country, including unemployment and underemployment indicators in the macroeconomic assumptions of the proposed budget would somehow signal stronger commitment from the government to not just pursue job-creating programs and projects but also to address constraints in attracting more investments into the country. Also, there is a need to ensure the progressivity of public expenditure such that the benefits accrue more to those who are in need.

If used efficiently and effectively, it cannot be overemphasized that the budget plays an important role in achieving the development objectives of the country. Apart from ensuring the availability of resources to support the programs and projects, proper and timely implementation should be ensured. There is clearly a need to accelerate spending but it should still remain judicious to ensure that benefits are maximized.

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ANNEX 1
SENSITIVITY ANALYSIS

The movement of the macroeconomic parameters affects government revenues and disbursements and, consequently, the budget balance. Among the parameters, real GDP growth rate and inflation rate have the highest impact on the budget balance. Based on estimates by the Department of Finance (DOF) and the Bureau of the Treasury (BTr), a one percentage point increase in real GDP growth rate has the highest positive impact on the budget balance by reducing the deficit by P19.3 billion as a result of higher revenues from the increase in economic activities. A one percentage point increase in the inflation rate compared to the assumption is expected to push revenues by P18.4 billion. This can be attributed to the increase in the prices of taxable products. The increase in both real GDP growth rate and inflation rate do not have impact on disbursements resulting to a lower budget balance.

Likewise, a one percentage point increase in the growth rate of imports is expected to increase revenues by P3.7 billion as a result of higher collections from international trade and income/sales taxes. This reduces the deficit by the same amount as there is no accompanying impact on government expenditures.

BUDGET SENSITIVITY TO MACROECONOMIC PARAMETERS, 2017
IN BILLION PESOS

Indicator	Change	Revenues	Disbursements	Budget Balance[1/]
Peso-to-US$ exchange rate	P 1 depreciation	9.2	2.0	7.2
Treasury Bill Rate (All Maturities)	1 percentage point increase	0.5	3.2	(2.7)
LIBOR (180-Day)	1 percentage point increase		4.6	(4.6)
Inflation Rate	1 percentage point increase	18.4		18.4
Real GDP Growth Rate	1 percentage point increase	19.3		19.3
Growth Rate of Imports	1 percentage point increase	3.7		3.7

Notes: 1/A negative figure in the budget balance means an increase in the deficit.
Source: Department of Finance, Bureau of the Treasury

Both government revenues and disbursements are affected by the movements in the exchange rate and interest rate. A one peso depreciation in the foreign exchange rate is estimated to increase revenues and disbursement by P9.2 billion and P2.0 billion, respectively, resulting in a positive net effect of P7.2 billion on the budget balance. On the other hand, a one percentage point increase in the Treasury bill rate is estimated to increase revenues by P0.5 billion and disbursements by P3.2 billion, increasing the budget deficit by P2.7 billion. Meanwhile, a one percentage point increase in the 180-day LIBOR would increase government disbursements by P4.6 billion due to higher debt servicing and, consequently increases the deficit by the same amount.