Budget Notes

SENATE ECONOMIC PLANNING OFFICE

Macroeconomic and Fiscal Assumptions of the Proposed 2018 Budget

Mirroring the "change is coming" promise of the Duterte administration, the proposed national expenditure program of the Executive for the 2018 is dubbed as "a budget that reforms and transforms".

The implementation of the budget plan, however, is hinged on a set of macroeconomic assumptions approved by the Development Budget Coordination Committee (DBCC). These are indicators by which government determine the viability of the budget -- whether the proposed expenditure program is reasonable and sustainable and whether there are sufficient fiscal resources to fund it. Each macroeconomic indicator is measured by a range of values – with low-end projections reflecting a more pragmatic stance and allows for some flexibility in planning and designing the fiscal program. The macroeconomic assumptions of the proposed budget for 2018 are as follows:

TABLE 1. MACROECONOMIC ASSUMPTIONS

	2016	Adjusted 2017	Projection 2018	Emerging 2017 for periods indicated	
Real GDP Growth	6.9	6.5-7.5	7.0-8.0	6.4	Jan-Mar
Inflation rate	1.8	2-4	2-4	3.1	Jan-Jun
364-day T-bill rate	1.8	2.5-4.0	2.5-4.0	2.9	Jan-Jul
Foreign exchange rate (PhP/US$)	47.5	48-50	48-51	49.9	Jan-Jun
LIBOR, 6 mo.	1.1	1-2	1.5-2.5	1.4	Jan-Jun
Dubai Crude Oil Price (US$/barrel)	41.3	40-55	45-60	51.2	Jan-Jun
Unemployment rate	5.5	5.1-5.4	4.7-5.3	6.2	Jan, Apr
Exports of Goods (growth rate)	0.6	5.0	7.0	13.6	Jan-Jun
Imports of Goods (growth rate)	16.6	10.0	10.0	9.6	Jan-Jun
Current account bal. (in USD billion)	0.6	-0.6	-1.6	-0.3	Jan-Mar
percent of GDP	*0.2*	*-0.2*	*-0.5*	-0.4	Jan-Mar
GIR (year-end)(in USD billion)	80.7	80.5	79.7	80.8	Jul
import cover	*8.9*	*8.3*	*7.6*	*8.6*	Jul

Sources: 2016-2018 data are from the 2018 Budget of Expenditure and Sources of Financing (BESF)
Emerging 2017 data are from the PSA, BSP, and Index Mundi for Dubai Crude Oil price

GDP Growth. In the first quarter of 2017, the Philippine economy grew by 6.4 percent, slower than the 6.9 percent growth posted during the same period last year, and lower than the projected 6.5-7.5 percent GDP growth target for the year. The government partly attributed this to base effects, as growth last year was boosted by election-related spending.

On the production side, services remained the main growth driver, expanding, albeit at a slower rate than last year, by 6.8 percent. Industry likewise posted a moderate growth of 6.1 percent from 9.3 percent, tempered by the significant decline in the outputs of mining and quarrying and the slowdown in the utilities and construction sectors.

Benefiting mainly from favorable weather conditions, the agriculture sector posted a turnaround of 4.9 percent growth from its 4.3 percent contraction last year. This is particularly good news given the sector's sluggish performance, averaging 0.4 percent per annum in the last four years. The sector accounts for more than 25 percent of total employment but has a share of only 10 percent of the GDP. For the longest time, R&D spending that would help unlock this sector's productivity and potential has sorely been lacking.

On the demand side, a huge drop was seen in investment and public spending due to delays in the implementation and procurement of various government programs in the first quarter. The growth of household consumption, which accounts for almost 70 percent of GDP, decelerated to 5.7 percent, from 7.1 percent last year.

Exports. The export sector which posted a hefty growth of 20.3 percent in the first quarter made up for the slowdown in other spending items. While the 2nd quarter National Income Accounts are yet to be released, data from the Philippine Statistical Authority (PSA) show that the impressive performance of the export sector continued in the 2nd quarter. Merchandise exports grew robustly by 13.6 percent from January to June 2017, prompting the upward revision of the export growth projections from 3.0 to 5.0 percent this year.

Table 2. GDP Growth Rates (in%)

	1st Quarter	
	2016	2017
GDP	6.9	6.4
Production		
Agriculture	-4.3	4.9
Industry	9.3	6.1
Manufacturing	8.0	7.5
Construction	14.2	8.2
Mining and Quarrying	11.4	-20
Services	7.5	6.8
Expenditure		
Household consumption	7.1	5.7
Government consumption	11.8	0.2
Capital Formation	31.5	7.9
Exports	10.2	20.3
Imports	21.1	17.5

Source PSA

Table 3. Philippine Merchandise Trade Performance, Jan-Jun 2016 and 2017 *(in US$ Million)*

	Full Year 2016	Jan-June	
		2016	2017
Exports	43,444	27,334	31,043
annual %change	*0.6*	*(5.8)*	*13.6*
% share to GDP	*14.2*		
Imports	77,524	40,331	44,216
annual %change	*16.6*	*22.5*	*9.6*
% share to GDP	*25.4*		
Balance of Trade	-34,080	(12,998)	(13,173)

Source: BSP, Selected Economic and Financial Indicators 2017 and PSA, External Trade Statistics

During the said period, demand for Philippine exports from key trading partners picked up, with the exception of Japan, the country's top export destination. Japan-bound exports declined by 10 percent likely because of the anemic growth of its domestic economy. On the other hand, exports to the United States (US), the country's second largest trading partner, recorded a 4.7 percent growth in the first semester. The recent approval by the US of the Philippines' application to expand the Generalized System of Preference (GSP) coverage to include travel goods will likely give a further boost to Philippine exports to the US. Exports to the European Union (EU) were also significantly

higher by 35.8 percent. Exports to Germany and Netherlands, in particular, grew by 11.0 percent and 42.9 percent, respectively. Meanwhile, improved bilateral relations with China boosted Philippine exports to the said country by 20.2 percent, with shipments valued at USD 2.75 billion.

Table 4. Top 10 Philippines Export Markets, 1st Sem. 2016 and 2017

(FOB Value in US$ Million)

Trading Partners	Jan-Jun 2016		Jan-Jun 2017		Growth (%)
	Amount	% Share	Amount	% Share	
Total	27,335.5	100.00	31,043.1	100.00	13.6
Top 10 Countries Total	22,770.3	83.3	25,164.2	81.1	10.5
Japan	5,772.3	21.1	5,194.1	16.7	(10.0)
USA	4,344.7	15.9	4,549.0	14.7	4.7
Hong	3,020.2	11.0	4,033.1	13.0	33.5
China	2,751.2	10.1	3,304.3	10.6	20.1
Singapore	1,886.8	6.9	1,928.9	6.2	2.2
Thailand	1,044.8	3.8	1,277.0	4.1	22.2
South	1,004.4	3.7	1,294.0	4.2	28.8
Germany	1,143.2	4.2	1,269.2	4.1	11.0
Taiwan	963.8	3.5	1,115.2	3.6	15.7
Netherlands	838.9	3.1	1,199.2	3.9	42.9

Source PSA, External Trade Statistics

For 2018, the growth of exports is pegged at 7 percent.

Imports. Similarly, demand for imports is anticipated to remain strong. With the 9.6 percent growth of merchandise imports recorded in the first half of this year, it is likely that the 10 percent imports growth projection of the DBCC for 2017 will be achieved.

Increased imports of key production inputs such as capital goods and raw materials, indicates expected uptick in industrial activity while higher imports of consumer goods indicate robust demand, and thus bode well for the economy. On the downside, higher imports contribute to the widening of the trade deficit which could bring increased pressure on the exchange rate.

Growth outlook. Despite the slower growth in the first quarter of 2017, the Philippines remains the second fastest growing major Asian economy next to China, which grew by 6.9 percent. With the ongoing rebalancing of the Chinese economy, the Philippines would likely outpace China's GDP growth next year.

For 2018, the Philippine economy is set to grow by 7.0-8.0 percent. This government target is slightly higher than the projections of three multilateral institutions, as shown in Table 5.

Table 5. GDP Growth Forecasts

	2017	2018
DBCC	6.5-7.5	7.0-8.0
ADB	6.5	6.7
IMF	6.8	6.9
WB	6.9	6.9

Sources: ADB Asian Development Outlook, IMF World Economic Outlook , World Bank Philippine Economic Update

The government's optimistic growth prospect is underpinned by the country's strong macroeconomic fundamentals. Household consumption is anticipated to remain robust with the continuous inflow of remittances. For the first five months of 2017, personal and cash remittances from Overseas Filipinos (OFs) grew by 5.2 and 4.5 percent respectively. Likewise, government spending is expected to accelerate as the administration commences its ambitious infrastructure program. Infrastructure outlay in the proposed 2018 national budget is 27.9 percent or PhP239.4 billion bigger than this year's infrastructure budget. This is equivalent to about 6.3 percent of the low-end GDP projection. Additional revenues to be collected from the passage of the proposed tax reform measure will help fund the government's infrastructure program.

Risks to growth. Risks to the largely positive growth prospect include the rising foreign interest rates brought by the US Federal Reserve monetary policy normalization. Foreign rate differentials trigger capital outflows as investors search for higher yields. The resulting capital outflow usually leads to a depreciation of the domestic currency, which may put upward pressure on inflation and on domestic interest rates.

Likewise, trade restrictions as a result of rising protectionism in developed countries could dampen global trade. Aside from being an important trade partner of the Philippines, the US features prominently in the global value chain and is one of the top export markets for high value goods. While trade with our Asian neighbors has picked up in recent years, it is mainly because the Philippines is benefiting from the regional up cycle in electronics as part of the regional value chain, which is also linked to the global production network. Thus, any trade restrictions from the US against China, for example, could have adverse effects on our major export and import commodities. Moreover, should the US pursue restrictive trade policies on offshoring services, it would negatively impact the country's BPO industry. Amid this threat though, the BPO industry remains bullish and is expecting to hit its revenue target of USD 25.5 billion and 1.4 million employed Filipinos by the year end.

Other downside risks to growth include the policy uncertainty in the United Kingdom with regard to the "Brexit", the rebalancing or transition of China from an investment- driven to a consumption-oriented economy, as well as the ongoing geopolitical tensions in the Middle East and in North Korea.

On the domestic front, the usual bottlenecks that have hounded implementing agencies, including the low absorptive capacity, may derail the implementation of key infrastructure projects. Extreme weather disturbances may likewise drag growth down, and as such the government should be prepared to take measures to minimize their negative impact.

Moreover, an unpredictable policy environment may imperil the investment gains that have been reaped in previous years. In addition, peace and order issues, particularly in Mindanao, might further result in investors hanging back or having qualms about investing in the country. The ongoing conflict in Marawi, for instance, should be resolved at the soonest possible time to bring back normalcy and restore the confidence of both domestic and foreign tourists and investors. This is important especially if the government is keen to disperse more industries in the regions outside of Manila to bring about more inclusive growth.

Latest foreign direct investments (FDI) data from the BSP show a significant deceleration in the influx of new investments. Foreign equity placements other than reinvestments of earnings decreased by 85.3 percent during the first five months of 2017 vis-à-vis the same period in 2016. A substantial drop can be seen in the equity placements from the US, Europe, Japan and the ASEAN (Table 7). Reinvestment of earnings and debt holdings grew

by only 7.5 percent and 12.7 percent, respectively. Enhancing the over-all investment climate would help prevent further outflow of FDIs in the future.

Table 6. Foreign Direct Investments, Jan-May 2016 and 2017
(in USD Mn)

	Jan-May 2016	Jan-May 2017	Growth rate (%)
Net Incurrence of Liabilities:			
Non-resident investments in the Phil.	3945.5	3005.9	-23.8
Equity investments and fund shares	1774.1	557.6	-68.6
Equity other than reinvestment of earnings	1453.6	212.9	-85.3
Reinvestment of earnings	320.5	344.7	7.5
Debt instruments	2171.4	2448.3	12.7

Source BSP

**Table 7. Foreign Direct Investments by Source,
Jan-May 2016 and 2017**
(in USD Mn)

	2016	2017	Growth (%)
United States	62.3	0.5	-99.3
Europe	140.8	4.0	-97.2
of which: Germany	33.1	15.8	-52.2
Netherlands	25.2	-10.4	-141.5
United Kingdom	6.9	-14.0	-304.1
Japan	850.4	93.7	-88.9
China	1.7	2.6	54.9
South Korea	3.6	2.7	-23.5
Hong Kong	47.7	47.2	-1.0
Taiwan (ROC)	79.3	6.5	-91.8
ASEAN of which:	182.1	42.2	-76.8
of which: Indonesia	0.8	1.7	126.6
Malaysia	1.0	6.8	571.6
Singapore	156.8	32.4	-79.3
Thailand	22.5	0.3	-98.8
Viet Nam	0.5	0.3	-40.7
Australia	2.9	2.1	-26.6
Central & South America	74.6	5.8	-92.2
Others	5.2	3.1	-39.0

Source BSP

Inflation. Inflation averaged at 3.1 percent in the first half of 2017, much higher than the 1.3 percent average in the same period last year. The rise in inflation is attributed to some tightness in domestic food supply and upward adjustments in electricity and oil prices. The weaker exchange rate is also a factor since it makes imported goods and foreign financing more expensive. The latest baseline forecasts of the BSP indicate that inflation could settle slightly close to the midpoint of the 2-4 percent target range by the end of 2017.

For 2018, the BSP projects inflation to be within the same range. However, higher infrastructure spending as well as the passage of the government's fiscal reform program which would likely bring upward adjustments in electricity rates and transportation costs, tilt the risk to inflation on the upside. According to the Dept. of Finance, the proposed increase in petroleum excise tax could increase inflation by 0.9 percentage point. Potential upside pressure could also come from adverse weather conditions while downside risks include the lingering uncertainty over the prospects of the global economy.

Figure 1. Inflation Rate (%), 2016-2017
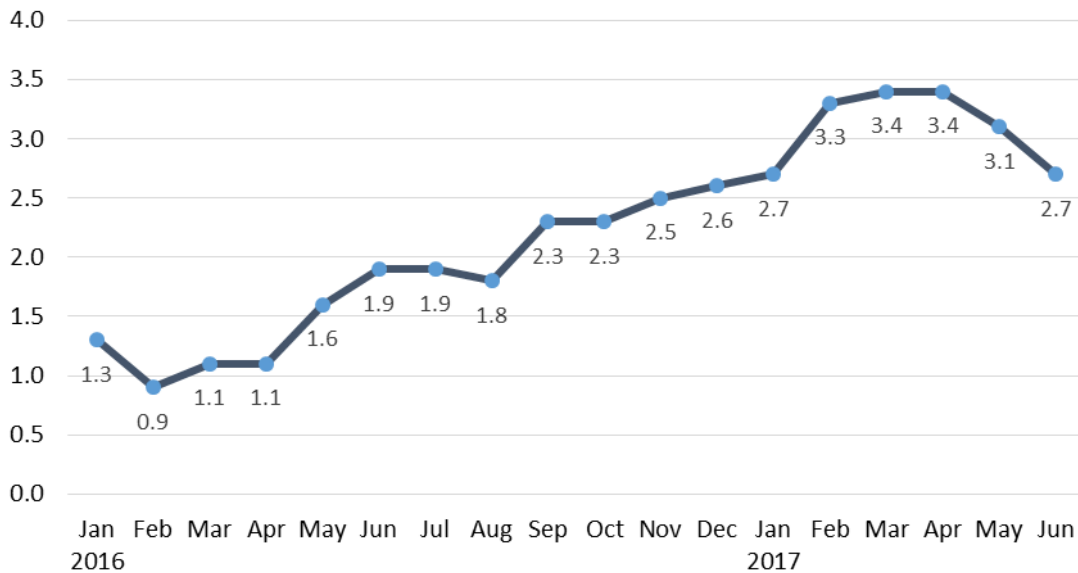
Dubai Crude Oil Price. Dubai crude oil prices were well within the assumed global oil prices for 2017. In the first six months of the year, crude oil prices averaged at USD51.20/bbl although monthly averages showed some slackening from a peak of USD54.33/bbl in February to USD46.70/bbl in June. Price movement for the rest of the year will very much depend on how the following factors will play out: (1) steady growth of demand; (2) pronouncement last May from the OPEC that production cuts will be extended until the first quarter of 2018; and (3) United States' steady production of shale. The government expects crude oil prices to hit between USD45 to USD60 per bbl in 2018.

Interest Rates. Because inflation remained manageable, the BSP has decided to keep steady its key monetary policy settings. It maintained at 3.0 percent and 3.5 percent its overnight borrowing or reverse repurchase rates (RRP) and overnight lending or repurchase (RP) rates, respectively. The special deposit account (SDA) facility rate is also maintained at 2.5 percent. However, primary market rates for the 364-day T-bill inched upward and averaged 2.8 percent for the first half compared to 1.8 percent in the same period last year. The increase in the T-bill rates would have a negative impact on the cost of government borrowings. Nonetheless, the current rates are still within the assumed rates for 2017 and 2018 which is 2.5 to 4 percent.

The movement in T-bill rates reflects the upward trend in the global market. The London Interbank Offered Rate (LIBOR), the international benchmark for short-term interest rates, has been moving up, hitting 1.4321 percent as of June 2017 from 0.936 percent in June 2016. The jump is mainly brought by the ongoing normalization policy of the United States Federal Reserve which has already implemented two rate hikes this year. The US Fed is

expected to raise rates once more on the third quarter of 2017. The assumed LIBOR for 2018 in the BESF is 1.5-2.5 percent.

Figure 2. Selected Foreign and Domestic Interest Rates
Jan 2016-Jun 2017 (in %)
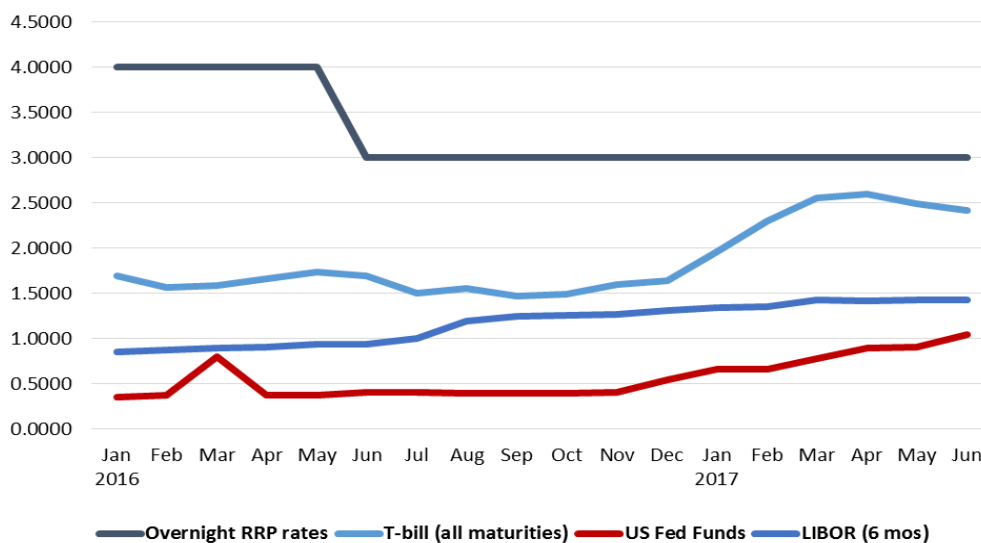
Source: BSP

Exchange Rate. The exchange rate is pegged to be between PhP48-50/USD1 this year, yet it has already averaged PhP50.64/USD as of July 2017 and has actually breached the PhP51 mark last August 11. The BSP mainly attributes the weakening of the peso to the monetary policy normalization of the US Fed on the back of the improving US economy. It must be noted that while the currencies of other Asian economies have strengthened, the Philippine peso has fallen by 1.47 percent as of July 31, 2017.

Figure 3. Year-to-date Appreciation
(+)/Depreciation (-)
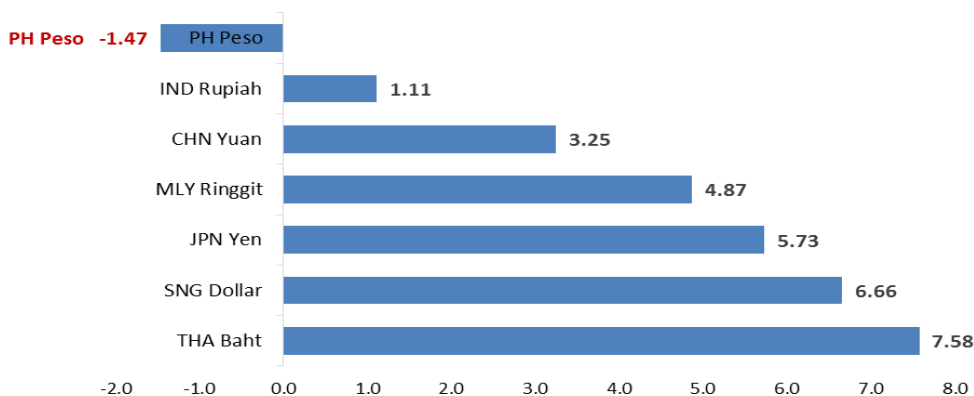
Source: BSP

The peso's depreciation can also be attributed to the weakening of the country's external position. The country's balance of payment (BOP) deteriorated from a USD634 million surplus in the first semester of 2016 to a USD706 million deficit in the same period this year.

Current Account. After posting a current account surplus in the last 15 years, a shortfall of USD318 million was recorded in the first quarter of this year. This was a complete reversal from the USD730 million surplus in the same period in 2016, and from the government's earlier projection of USD800-million surplus.

The BSP attributes the reversal mainly to the widening trade deficit as the country purchases more resources from abroad to meet its domestic consumption and investment requirements. By the end of the year, the current account is expected to hit a deficit of USD 600 million and this will even increase to a deficit of USD 1.6 billion in 2018.

Gross International Reserves. The Philippines recorded a negative 5.5 percent growth or USD 80.8 billion in its gross international reserve as of end of July compared to a positive 6.4 percent growth or USD 85.5 billion over the same period a year ago. This is mainly attributed to the sharp decline in foreign investments this year. Foreign investments account for 83 percent of the total GIR. Lower gold prices in the international market as well as higher payments to settle maturing foreign currency debt were cited as the other contributing factors to the decline in GIR.

The GIR is a measure of a country's ability to settle its import payments and service its foreign debt. As of July this year, the country can pay 8.6 months' worth of its import requirements, down from 9.9 months over the same period last year. The projected GIR level for 2018 is USD 79.8 billion or about 7.6 months of import.

Unemployment rate. The unemployment rate is expected to settle between 5.1 to 5.4 percent this year, slightly lower than the 5.5 percent posted in 2016. For 2018, the target is even lower at 4.7 to 5.3 percent.

Table 8. Household Population 15 Years Old and Over and Employment Status
(in '000 except rates)

Indicator	2016			2017		
	Jan	Apr	Ave.	Jan p	Apr	Ave.
Household Population 15 Years Old and Over	67,160	68,167	67,664	69,414	69,605	69,510
Labor Force	42,520	43,289	42,905	42,109	42,714	42,412
Employed	40,052	40,664	40,358	39,347	40,271	39,809
- Underemployed	7,881	7,431	7,656	6,398	6,468	6,433
Unemployed	2,468	2,625	2,547	2,761	2,443	2,602
Labor Force Participation Rate (%)	63.3	63.5	63.4	60.7	61.4	61.1
Employment Rate (%)	94.2	93.9	94.1	93.4	94.3	93.9
Underemployment Rate (%)	19.7	18.3	19.0	16.3	16.1	16.2
Visible Underemployment Rate (%)	10.3	10.5	10.4	9.8	10.0	9.9
Unemployment Rate (%)	5.8	6.1	6.0	6.6	5.7	6.2

Source: Philippine Statistical Authority

However, keeping the unemployment rate within the target for this year will likely be a challenge given the preliminary results of the January and April 2017 rounds of the Labor Force Survey (LFS). The average unemployment rate for the two rounds is already 6.2 percent, up from 6.0 percent in the same period last year. To meet the target, the jobless rate should not be lower than 4.7 percent in the next two LFS rounds in July and October.

In April of this year, 557,000 jobs were lost in the services sector, mostly in the area of wholesale and retail trade. NEDA attributes this to the tapering off of the effect of the 2016 election spending as well as potentially on recent changes in labor policies on contractual workers that may have had adverse effect on the firms' hiring decisions.

An encouraging development though is the decline in the underemployment rate from an average of 19 percent in January to April 2016 to 16.2 percent this year.

SENSITIVITY INDICATORS

According to the estimates of the Department of Finance (DoF) and the Bureau of Trasury (BTr), real GDP growth has the highest positive impact on the budget balance as increased economic activity brings in more revenues. That is, a one percentage point increase in real GDP growth rate reduces the deficit by PhP21.4 billion.

Table 9. Budget Sensitivity to Macroeconomic Parameters, 2018
In PhP Billion

Indicator	Change	Revenues	Disbursements	Budget Balance
Exchange rate	P1 depreciation	9.5	2.1	7.5
Treasury bill rate (All maturities)	1 percentage point increase	1.0	2.0	-1.0
Treasury bond rate (All maturities)	1 percentage point increase	0.6	3.2	-2.6
LIBOR (180-day)	1 percentage point increase		5.3	-5.3
Inflation rate	1 percentage point increase	20.7		20.7
Real GDP growth	1 percentage point increase	21.4		21.4
Growth rate of Imports	1 percentage point increase	4.2		4.2

Source BESF 2018

The inflation rate has the second highest impact on the budget balance, next to GDP growth. According to the Department of Finance (DoF) and the Bureau of Treasury (BTr), a one percentage point increase in the inflation rate is expected to bring an additional PhP20.7 billion in revenues.

Fiscal Assumptions of the Proposed 2018 Budget

To ensure that the delivery of infrastructure and social services keeps pace with the needs of the people, the Executive is proposing for a bolder fiscal program in 2018 with higher revenue and expenditure targets.
Cash disbursements are projected to increase to PhP3.36 trillion, 15.6 percent higher compared to this year. Revenue collection, on the other hand, is expected to grow by 17.0 percent or PhP2.84 trillion, bringing the target deficit to PhP523.6 billion. This is equivalent to a deficit-to-GDP ratio of 3.0 percent, higher than the 2.4 percent ratio posted in 2016 and the same ratio for this year.

Table 10. National Government (NG) Account Balance, 2015-2018

Particulars	Level (In Billion Pesos)	Growth (%)

	Actual 2015	Actual 2016	Program 2017	Proposed 2018	2015-2016	2016-2017	2017-2018
Revenues	2,109.0	2,195.9	2,426.9	2,840.5	4.1	10.5	17.0
% of GDP	*15.8*	*15.2*	*15.3*	*16.3*			
Expenditures	2,230.6	2,549.3	2,909.0	3,364.1	14.3	14.1	15.6
% of GDP	*16.7*	*17.6*	*18.3*	*19.3*			
Surplus/(Deficit)	(121.7)	(353.4)	(482.1)	(523.6)	190.4	36.4	8.6
% of GDP	*-0.9*	*-2.4*	*-3.0*	*-3.0*			

Source: Bureau of Treasury (BTr) and BESF 2018

Table 11. NG Fiscal Performance, Program vs Actual
1ˢᵗ Sem 2016-2017 *(in PhP Bn)*

Particulars	Jan – Jun 2016			Jan – Jun 2017			Growth (%)
	Program	Actual	Variance	Program	Actual	Variance	
REVENUES	1,292.8	1,100.9	(191.9)	1,193.0	1,176.6	(16.4)	6.9
Tax Revenues	1216.6	982.9	(233.7)	1,107.8	1069.0	(38.7)	8.8
BIR	968.5	783.4	(185.1)	881.7	848.0	(33.7)	8.2
BOC	238.3	190.6	(47.8)	217.7	210.3	(7.4)	10.4
Other Offices	9.8	9.0	(0.8)	8.4	10.8	2.3	19.9
Non-Tax Revenues	76.2	117.5	41.3	85.2	107.3	22.1	-8.7
Privatization	-	0.4	0.4	0.0	0.3	0.3	-43.6
Grants	0.0	0.0	0.0	0.0	0.0	0.0	10.7
EXPENDITURES	1,328.0	1,221.2	(106.8)	1,336.8	1,330.8	(5.9)	9.0
SURPLUS/(DEFICIT)	(92.9)	(120.3)	(27.5)	(143.8)	(154.3)	(10.4)	28.2

Source: BTr and Department of Budget and Management (DBM)

First Semester 2017 Fiscal Performance

Latest data show that the revenue collection and expenditure from January to June 2017 seem to be lower than what was planned for the period. Fiscal deficit amounted to PhP154.3 billion exceeding the programmed amount of PhP143.8 billion. This was mainly due to the missed targets of the major revenue collecting agencies.

Revenues. Tax revenue collection for the first half of 2017 amounted to PhP1.069 trillion, PhP38.7 billion short of the target amount. While revenue collection by the Bureau of Internal Revenue (BIR) grew by 8.2 percent, it was slower than the 11.0 percent growth it posted last year.

Collections from the Bureau of Customs (BOC) grew by 10.4 percent, and this can be partly attributed to the partial implementation of the Customs Modernization and Tariff Act (CMTA) and the anti-smuggling drive of the Bureau. However, while this is an improvement over the 6.7 percent growth last year, collection is still PhP7.4 billion short of the programmed amount for January to June 2017.
Non-tax revenues on the other hand, surpassed its target by PhP22.1 billion despite the lower remittance of dividends and reduced income generated from national government deposits and Bond Sinking Funds (BSF)/Security stabilization Fund (SSF) investments.

Total dividends collected from GOCCs amounted to P18.8 billion as of June 2017, 33 percent or PhP9.2 billion lower than the 2016 level for the same period. According to the

Bureau of the Treasury (BTr), the decrease can be attributed to the non-remittance by the Land Bank of the Philippines (LBP) which has been exempted this year so that it can comply with the capital adequacy requirements of the Basel 3 regime. Last year, LBP remitted P6.6 billion to the national government. Another reason is the lower remittance by the Mactan Cebu International Airport Authority (MCIAA) which contributed P5.0 billion last year compared to P170.4 million this year. This was partially offset by new collections from the Civil Aviation Authority of the Philippines (CAAP) which remitted almost P2.0 billion in the first half of 2017.

It should be noted that despite lower GOCC dividend collections compared to the same period in 2016, the amount collected for the first six months have already surpassed the full-year 2017 target of P10.0 billion. It should be clarified with the Governance Commission for GOCCs (GCG) whether the target set for this year may have been too low as actual dividend collections in 2016 was already at PhP 28.6 billion.

Expenditures. Total cash disbursements amounted to PhP1,330.8 billion in the first semester of 2017. At first glance, underspending appears to have been reduced significantly from PhP 106.8 billion in the first half of 2016 to only PhP5.9 billion this year. However, this can be attributed mainly to the frontloading of allotments to LGUs. The amount is also bigger by more than PhP100 billion compared to last year's. Notable also is the increase in subsidies which exceeded the planned amount for the period by P31.6 billion. The incremental amount in subsidies largely went towards the National Housing Authority (PhP12 bn), the National Irrigation Administration (PhP 20.1 bn) and Philhealth (PhP9.3 bn).

On the other hand, the spending performance of national government agencies (NGAs) even worsened as the shortfall from the programmed expenditure increased to PhP82.5 billion compared to PhP51.8 billion last year (See Table 1).

Table 12. Expenditure Performance, Program vs Actual
1st Sem 2016-2017 *(in PhP Bn)*

Expenditure Items	Jan-Jun 2016			Jan-Jun 2017			Growth (%)
	Program	Actual	Variance	Program	Actual	Variance	
Interest Payments	194.3	153.7	(40.6)	163.5	151.6	(11.9)	-1.4
Allotment to LGUs	171.3	171.3	0.0	196.4	273.7	77.3	59.8
Tax Expenditures	11.5	5.3	(6.2)	9.0	1.5	(7.5)	-71.2
Net Lending	8.6	4.1	(4.5)	12.5	(1.3)	(13.9)	-132.4
Equity	10.1	8.4	(1.7)	2.3	3.2	0.9	-61.4
Subsidy	38.6	36.6	(2.0)	26.7	58.2	31.6	59.1
Other NG Exp. Accts.[1]	893.6	841.8	(51.8)	926.4	843.9	(82.5)	0.3
Total	**1,328.0**	**1,221.2**	**(106.8)**	**1,336.8**	**1,330.8**	**(5.9)**	**9.0**

[1] Includes check floats and treasury bills and bonds.

Source: BTr and Department of Budget and Management (DBM)

Proposed Revenue Program. For 2018, revenue collection is anticipated to grow by 17.0 percent. Of the PhP2.8 trillion projected revenue, 94.1 percent would come from tax collections, while the remaining 5.9 percent would come from non-tax sources.

Table 13. Revenue Program by Source, 2016-2018

| Particulars	Amount (In Billion)			Percent Distribution (%)			Growth (%)	
	2016 Actual	2017 Program	2018 BESF	2016 Actual	2017 Program	2018 BESF	2016-2017	2017-2018
Revenue	2,195.9	2,426.9	2,840.5	100.0	100.0	100.0	10.5	17.0
Tax Revenues	1,980.4	2,258.3	2,671.7	90.2	93.1	94.1	14.0	18.3
% of GDP	*13.7%*	*14.2%*	*15.3%*					
BIR	1,567.2	1,782.8	2,005.0	71.4	73.5	70.6	13.8	12.5
BOC	396.4	459.6	637.1	18.1	18.9	22.4	15.9	38.6
Non-tax Revenue	214.9	166.5	166.8	9.8	6.9	5.9	-22.5	0.2
Privatization	0.7	2.0	2.0	0.0	0.1	0.1	185.7	0.0
Memo Item:	*14,480.7*	*15,876.9*	*17,456.1*					

Source: 2018 BESF

The revenue forecast already assumes the passage of the Tax Reform for Inclusion and Acceleration (TRAIN), the first package of the Comprehensive Tax Reform Program (CTRP) of the Duterte administration which is currently being deliberated in Congress. The TRAIN is expected to bring in an additional PhP133.8 billion in net revenue for the government on its first year of implementation, or about 4.8 percent of the 2018 proposed revenue program. The estimate is based on the version of the measure passed by the House of Representatives in May 2017.

The Bureau of Internal Revenue (BIR) is projected to increase its revenue collection by 12.5 percent and will account for 70.6 percent of the total revenue. The expected growth for BOC is much higher at 38.6 percent. Non-tax revenue is estimated to grow by only 0.2 percent.

With these projections, the *tax effort* (tax-to-GDP ratio) is seen to rise from 13.6 percent in 2016 to 14.2 percent in 2017, and further improving to 15.3 percent in 2018 .

Fig.4 Tax effort, 2004-2018
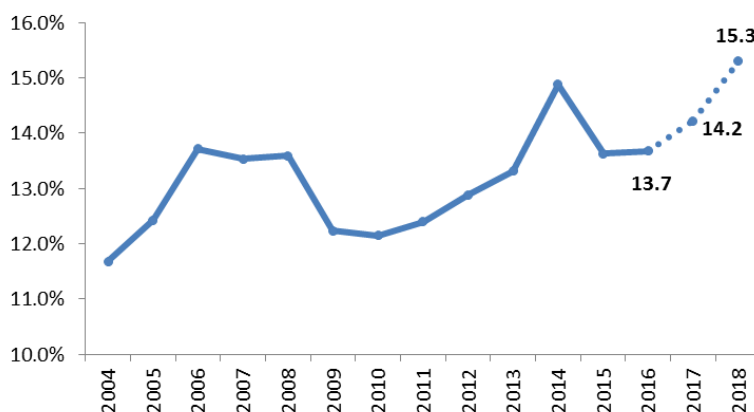
Revenues from TRAIN. The proposed TRAIN is expected to raise PhP133.8 billion additional revenues in its first year of implementation to help fund the major infrastructure and anti-poverty programs of the government. Higher revenue gains are expected in the succeeding years, amounting to PhP233.6 billion in 2019 and PhP272.9 billion in 2020 (Table 14):

Table 14. Comprehensive Tax Reform Program Revenue Projection

(In billion PhP)

Particulars	2018	2019	2020
Bureau of Internal Revenue	-8.8	48.7	64.0
Personal Income Tax (PIT)	-141.4	-155.5	-172.1
Estate and Donor's Tax	-3.1	-3.2	-3.4
Value Added Tax (VAT)	37.0	74.7	82.1
Excise Tax on Petroleum	35.6	60.3	73.3
Excise Tax on Automobiles	1.7	2.9	3.0
Sugar-Sweetened Beverages	42.3	44.4	46.6
Tax Administration	13.1	25.0	34.4
Tax Amnesty	6.0	-	-
Bureau of Customs	129.8	170.5	193.1
Excise Tax on Petroleum	38.1	64.1	77.8
Value Added Tax (VAT)	44.0	48.3	53.1
Excise Tax on Automobiles	12.4	20.5	21.8
Sugar-Sweetened Beverages	4.7	4.9	5.2
Tax Administration	30.7	32.6	35.3
Motor Vehicle User's Charge	12.9	14.4	15.9
TOTAL REVENUES	133.8	233.6	272.9

Based on House Bill 5636 with Complementary Measures

Source: BESF 2018

The proposed tax reform would have a revenue eroding impact on BIR collections in 2018 because of the significant revenue loss from the planned lowering of the personal income tax (PIT) and the imposition of a flat 6 percent estate and donor's taxes. This would be offset by the projected collection from the VAT expansion, excise tax on petroleum and automobiles, the imposition of tax on sugar sweetened beverages (SSBs). These will be complemented by the implementation of the tax amnesty and administration reforms, leading to a net revenue loss of only PhP8.8 billion. The BOC, on the other hand, is expected to gain PhP129.78 billion more from the said compensatory measures.

To mitigate the anticipated inflationary impact of these tax proposals on the poor and vulnerable, forty (40) percent of the incremental revenue from petroleum excise tax, amounting to PhP29.5 billion is proposed to be earmarked for the following: a) targeted cash transfer program; b) social assistance for commuters and public transport; c) Pantawid Kuryente program; d) public utility vehicle (PUV) modernization; and e) national ID/social welfare card program. All these are already subsumed in the proposed 2018 budget.

As the Senate deliberates on its own version of the TRAIN, it should bear in mind the impact of the measure on the revenue and expenditure targets of the national government. Moreover, it is critical for the Senate to review and validate the sufficiency of the proposed mitigating programs to ensure that the TRAIN will not compromise the welfare of the poor and the vulnerable.

Proposed Expenditure Program. For 2018, total expenditure is expected to grow by 12.4 percent. The proposed budget still puts a premium on the social services sector which would account for 37.8 percent of total expenditures. However, the increase in the budget for social services is only 5.4 percent, much less compared to the 39.0 percent budget increase this year. The budget for Housing and Community Development, in particular, would be reduced by PhP10 billion or almost 70 percent. This is mainly due to the decrease in the resettlement budget. This year, a budget of PhP1.3 billion was allocated for community facilities in Typhoon Yolanda projects and in addition, an PhP8.75 billion budget was allotted for the resettlement program for informal settler families in the Manila Bay Area. This will go down to PhP27.59 million in 2018.

Table 15. 2018 Expenditure Program by Sector

(in PhP Bn)

Sector	Actual 2016	Program 2017	Proposed 2018	Growth (%) 2016-2017	Growth (%) 2017-2018	Distribution (%) 2018
Economic Services	820.3	922.9	1,153.4	12.5	25.0	30.6
Social Services	972.6	1,351.5	1,424.9	39.0	5.4	37.8
Defense	113.8	148.7	155.7	30.6	4.7	4.1
General Public Services	456.3	575.4	662.1	26.1	15.1	17.6
Net Lending	15.3	16.8	16.8	9.6	0.2	0.4
Debt Service Interest Payments	304.3	334.9	354.0	10.0	5.7	9.4
Total	2,682.7	3,350.00	3,767.0	24.9	12.4	100.0

Source: BESF 2018

While all other sectors are expected to receive higher allocations, the budgetary increment for economic services is the largest. The sector is set to receive PhP 235 billion more, 25 percent higher than this year's budget, owing to the expected increase in infrastructure spending as part of the government's Build Build Build program.

The General Public Services Sector which includes Peace and Order will see a substantial increase of 15.1 percent while the Defense sector is set to receive a budget that is higher by 4.7 percent to address the ongoing territorial disputes and terrorism threats.

It is worth noting that the share of debt payments to total expenditure will further go down to 9.4 percent in 2018 from 10.0 percent this year. This will free up more resources for other productive programs and projects of the government.

Top Departments. The proposed budget of the top 10 departments comprises more than half (57.1%) of the total proposed budget and amounts to PhP2.150 trillion, which corresponds to a 16 percent increase from the 2017 level. The education sector- the DepEd including SUCs, CHED and TESDA, will get the biggest allocation followed by Department of Public Works and Highways (DPWH) which budget will grow by a hefty 37.5 percent, the highest growth among agencies. The composition of of the top 10 departments in terms of allocation is the same as last year's with the exception of the Department of Health which will rank 4th in 2018 and the DILG which will rank 3rd among the top 10 departments.

Table 16. Top 10 Departments in the 2018 Proposed Budget *(in PhP Bn)*

Agencies	2017 GAA		2018 Proposed		Growth (%)
	Amount	Rank	Amount	Rank	
Department of Education including SUCs, CHED and TESDA	656.3	1	698.1	1	6.4
Department of Public Works and Highways	467.7	2	643.3	2	37.5
Department of Interior and Local Government	149.4	4	172.3	3	15.4
Department of Health including Philhealth	151.6	3	164.3	4	8.4
Department of National Defense	137.4	5	145.0	5	5.5
Department of Social Welfare and Development	128.4	6	138.0	6	7.5
Department of Transportation	55.7	7	73.8	7	32.6
Department of Agriculture	45.9	8	54.2	8	18.1
Autonomous Region for Muslim Mindanao	33.5	9	33.5	9	0.0
Department of Environment and Natural	27.3	10	27.9	10	2.1
Total	1,853.2		2,150.4		16.0

Source: DBM

Consolidated Public Sector Deficit. The consolidated public sector deficit (CPSD) for 2018 will amount to PhP161.2 billion, a little lower than the PhP169.7 billion projected this year. Bulk of the deficit is accounted for by the PhP523.6 billion deficit of the national government and the continuing restructuring cost of the defunct Central Bank which is expected to reach PhP6.1 billion in 2018 (Table 17).

These deficits will be offset by the robust financial performance of the Social Security Institutions (SSIs), the Government Service Insurance System (GSIS), the Government Financial institutions (GFIs) and Local Government Units. Monitored GOCCs are likewise expected to perform well and continue to post a surplus in 2017 as well as in 2018.

National Government Financing. Because projected revenues will not suffice to finance the planned expenditures, the government intends to borrow PhP888.2 billion, of which, PhP176.3 billion will be sourced from external sources and PhP711.9 billion from the domestic market. This corresponds to a foreign-domestic borrowing mix of 20:80 which will minimize the risk from exchange rate fluctuations. The said borrowings will finance not only the PhP523.6 billion budget deficit of the national government, but also the debt amortization and sinking fund contribution for the retirement of domestic debt (Table 18).

The national government plans to borrow from external sources through concessional loans from development partners and issuance of dollar bonds in global capital markets. On the other hand, domestic financing will be done through the issuance of treasury bills and bonds to local investors.

Table 17. Consolidated Public Sector Financial Position, 2015-2018
(in PhP Bn)

Particulars	2015	2016	2017 Program	2018 BESF

TOTAL SURPLUS/(DEFICIT)	136.2	(21.1)	(169.7)	(161.2)
Ratio to GDP (%)	1.0%	(0.1%)	(1.1%)	(0.9%)
TOTAL Public Sector Borrowing Requirement	(113.8)	(316.4)	(464.9)	(510.3)
Ratio to GDP (%)	(0.9%)	(2.2%)	(2.9%)	(2.9%)
National Government	(121.7)	(353.4)	(482.1)	(523.6)
CB restructuring	(3.7)	(3.2)	(2.7)	(6.1)
Monitored GOCCs	2.8	24.9	3.9	2.7
Adjustments in net lending and equity to GOCCs	8.9	15.3	16.0	16.8
SSS/GSIS/PHIC	60.6	72.4	75.5	84.7
BSP	(3.7)	17.7	1.0	1.0
GFIs	13.8	15.5	12.2	14.2
LGUs	179.2	189.6	206.5	249.2

Source: BESF 2018

Table 18. Government Financing Program 2016-2018

(in PhP Bn)

Particulars	2016 Actual	2017 Program	2018 Proposed
Net Financing	330,939	584,780	821,274
External (Net)	-24,113	43,170	114,346
External (Gross)	149,523	182,770	176,269
Less: Amortization	173,636	139,600	61,923
Domestic (Net)	178,069	535,023	706,928
Domestic (Gross)	357,497	544,969	711,958
Less: Amortization	2,445	3,359	5,030
Change in Cash	-257,654	-129,215	42,536
Budgetary	-22,483	102,695	297,686
Non-Budgetary	-235,171	-231,910	-255,150
NG Transactions	-231,954	-231,910	-255,150
CB Restructuring	-3,217	-	-
Gross Financing Mix	100	100	100
Foreign	29	25	20
Domestic	71	75	80
Total Net Financing Requirement	353,422	482,085	523,588

Source: BESF

Despite earlier announcements that the government is keen on tapping China as a main ODA source, no program loan in the 2018 BESF has been identified to be coming from the said country. With terms and conditions still being negotiated, China loans will probably be contracted starting 2019 onwards. ODA for next year will total USD1.65 billion, the bulk of which will be sourced from the Asian Development Bank.

Table 19. Program Loans, 2016-2018

(in USD Mn)

ODA Source	Loan Amount	Actual 2016	Program 2017	Proposed 2018

Asian Development Bank (ADB)	2,900.00	668.25	350.00	1,109.65
World Bank (WB)	2,505.00	21.55	349.40	341.60
Japan International Cooperation Agency (JICA)	200.00	-	-	200.00
Agence Francaise de Developpement (AFD)	205.60	55.29	150.00	-
Total Program Loans		745.09	849.40	1,651.25

Source: BESF 2018

NG Debt. As of 2016, the country's debt stock reached PhP6.09 trillion of which PhP3.93 trillion (64.6 percent) are domestic liabilities and PhP2.16 trillion (35.4 percent) are foreign obligations. For 2017, total outstanding debt of the national government is expected to reach PhP6.47 trillion and by the end of 2018, PhP6.99 trillion. The debt-to-GDP ratio is projected to decline to 40.1 percent, the lowest since 2005. For developing countries, the IMF recommends a sustainable debt-to-GDP ratio of 40 percent.

The country's debt profile remained heavily biased towards medium- to long-term (MLT) accounts. Over the years, the tenor of the debt portfolio has gone much longer. In 2016, 88.2% are long-term debt while short-term and medium-term debt are 4.9% and 6.8%, respectively. The preference for longer maturity debt enables the government to better manage the country's debt payments.

**Figure 5. NG Debt Level and NG Debt to GDP
2005-2018**