DEBT SUSTAINABILITY ANALYSIS[1]

1. **Economic growth in the Philippines has deteriorated sharply since the onset of the coronavirus disease (COVID-19) pandemic**. The contraction of real gross domestic product (GDP) in 2020 is estimated at 8.5%, and growth is expected to resume at an annual pace of about 6.5% this year and through to 2024, roughly along the country's 6.6% average economic performance during 2015–2019, prior to the pandemic (Table 1). The recent rise in annual inflation is expected to continue at an average pace of 2.8% in 2020–2024, nearly twice its past trend of 1.5% but well within the government's target range of 2-4%.

2. **Countercyclical policy mitigates the recession but deepens fiscal imbalances.** A boost in government expenditure to counter the pandemic's health and socio-economic impacts is expected to widen average fiscal deficits to 7.7% of GDP in 2020–2021, up from 0.7% in the past five years. Primary deficits are then expected to come down gradually, but heightened interest payments will keep the overall deficit from falling below 6% of GDP through to 2024.

3. **Ballooning fiscal deficits are pushing the public debt ratio from 37% in 2019 to nearly 49% in 2020, and above 58% by 2024.** This reverses a downward trend during recent years, as frugal deficits and robust growth nudged the debt ratio lower (Graph 1). Fiscal pressures are such that they will prevail and more than offset the alleviating effect on the debt-to-GDP ratio from a resumption of growth once the Philippines' economy will have thrown off the shackles of this pandemic. Potential scenarios of slower growth or larger primary fiscal deficits compared to baseline assumptions would see the debt ratio climb even higher, well above 60% of GDP by 2024 (Graph 2).

4. **Higher public debt and interest payments add to fiscal vulnerabilities, but low borrowing costs and concessional external debt help keeping risks manageable.** Although borrowing costs for the Government remain acceptably low, recent borrowing is expected to drive up interest payments to 2.7% of GDP by 2022, well above the 1.7% average in the years prior to the pandemic. However, the overall risk profile of the public debt stock remains favorable, as 73% of it is denominated in local currency and its external share is mostly concessional thus carrying relatively low currency and rollover risks.

5. **The Philippines' foreign reserves position is strong and exposure is relatively limited**. International reserves amount to 7 months of imports and 5 years of debt service (Table 3). Total external debt is low, at about 23% of GDP. The country's ratings by the main agencies span from BBB (Fitch) to Baa2 (Moody's) with an outlook that is mostly stable but with a chance of a downgrade this year.

6. **Financial assistance from ADB will not deteriorate the Philippines' debt sustainability in the medium term**. The proposed ADB loan of $400 million amounts to just 0.3% percent of the Philippines' outstanding public debt stock of $139.3 billion in 2019.[2] While providing critical countercyclical support to the economy, it would affect neither the debt ratio nor the annual debt service obligations facing the Government to any significant degree.

[1] The macroeconomic, fiscal, and debt forecasts for 2020–2021 are based on the Asian Development Bank (ADB)'s Asian Debt Monitor database (ASDM). Among other data sources, the ASDM reflects the latest ADB Asian Development Outlook (ADO) macroeconomic forecasts (currently: ADO Supplement, December 2020) and International Monetary Fund World Economic Outlook (WEO) macroeconomic and fiscal forecasts (currently: WEO October 2020).

[2] The proposed ADB loan has a maturity of 10 years including a grace period of up to 3-years, an interest rate at a spread of 50 basis points (bps) over LIBOR, a rebate or surcharge reflecting the cost of funds, and a commitment charge of 15 bps per year on the undisbursed loan balance.

Additional lending, as proposed by the Asian Infrastructure Investment Bank (AIIB) for a loan to the amount of $300 million would add another 0.2% to the public debt stock.[3] These two loans jointly would lift the public debt ratio but marginally above the baseline scenario, to 49.1% of GDP in 2020 and to 58.4% by 2024 (Graph 3).

Philippines: Public Debt Sustainability Assessment

(Variables are expressed as a percentage of GDP, unless indicated otherwise)

Table 1: Baseline Scenario

	Actual						Forecast					Avg.	Avg.
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	15-19	20-24
Public Debt 1/	**40.2**	**39.6**	**37.3**	**38.1**	**37.1**	**37.0**	**48.9**	**52.7**	**55.0**	**56.9**	**58.2**		
Macroeconomic Indicators													
Real GDP Growth (%)	6.3	6.3	7.1	6.9	6.3	6.0	-8.5	6.5	6.4	6.5	6.5	6.6	3.5
Inflation (%, based on GDP Deflator)	3.1	-0.7	1.3	2.3	3.7	0.8	2.2	3.0	3.0	3.0	3.0	1.5	2.8
Depreciation of Local Currency against US dollar (%)	0.5	5.7	5.6	0.2	5.6	-3.8	-2.1	1.1	0.8	0.4	0.4	2.7	0.1
Interest Rate on Public Debt (%, average effective) /5	5.4	5.2	4.8	4.8	4.8	4.6	5.2	5.5	5.5	5.3	5.3	4.8	5.4
Fiscal Indicators (General Government)													
Revenue	18.1	18.5	18.3	18.7	19.3	19.9	17.3	17.7	17.9	17.9	18.1	18.9	17.8
Primary Expenditure	15.2	16.0	16.9	17.4	19.2	20.1	23.2	22.5	21.4	21.4	21.4	17.9	22.0
Interest Payments	2.2	2.0	1.8	1.6	1.7	1.6	2.1	2.4	2.7	2.7	2.7	1.7	2.5
Primary Balance	3.0	2.5	1.4	1.3	0.1	-0.2	-6.0	-4.8	-3.5	-3.4	-3.3	1.0	-4.2
Overall Balance	0.8	0.6	-0.4	-0.4	-1.6	-1.8	-8.0	-7.2	-6.2	-6.1	-6.1	-0.7	-6.7

Table 2: Baseline Scenario - Change in Public Debt

	Actual						Forecast					Cum.	Cum.
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	15-19	20-24
Change in Public Debt	**-3.6**	**-0.6**	**-2.3**	**0.8**	**-1.0**	**-0.2**	**11.9**	**3.8**	**2.3**	**1.9**	**1.3**	**-3.3**	**21.3**
Identified debt-creating flows	-3.6	-0.6	-2.3	0.8	-1.0	-0.2	11.9	3.8	2.3	1.9	1.3	-3.3	21.3
Primary deficit	-3.0	-2.5	-1.4	-1.3	-0.1	0.2	6.0	4.8	3.5	3.4	3.3	-5.1	21.0
Revenue	18.1	18.5	18.3	18.7	19.3	19.9	17.3	17.7	17.9	17.9	18.1	94.7	88.9
Primary Expenditure	15.2	16.0	16.9	17.4	19.2	20.1	23.2	22.5	21.4	21.4	21.4	89.6	109.9
Automatic debt dynamics 2/	-1.6	0.6	-0.6	-1.6	-1.2	-1.3	4.3	-1.7	-1.8	-2.1	-2.2	-4.0	-3.5
Contribution from interest rate-growth differential 3	-1.7	-0.2	-1.4	-1.6	-1.9	-0.8	4.6	-1.9	-2.0	-2.2	-2.3	-5.8	-3.7
Of which contribution from the real interest rate	0.9	2.3	1.3	0.8	0.3	1.3	1.3	1.0	1.1	1.1	1.1	5.9	5.6
Of which contribution from real GDP growth	-2.5	-2.4	-2.6	-2.4	-2.2	-2.1	3.4	-2.9	-3.1	-3.2	-3.4	-11.7	-9.2
Contribution from exchange rate depreciation 4/	0.1	0.8	0.8	0.0	0.7	-0.5	-0.3	0.2	0.1	0.1	0.1	1.8	0.2
Other Funding Needs (Net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Factors Creating Debt (not identified elsewhere)	1.0	1.3	-0.3	3.6	0.4	0.9	1.6	0.7	0.7	0.6	0.2	5.9	3.7
Residual	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt-Stabilizing Primary Balance (' - ' means deficit)							6.0	-1.0	-1.2	-1.6	-2.0		

Table 3: Baseline Scenario - External Indicators

	Actual						Forecast				
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Debt Service (% of Reserves) 6/ 7/	29.4	33.7	32.3	31.8	28.3	20.3					
Imports of Goods and Services (% of Reserves) 7/	105.9	113.2	127.0	146.5	159.4	165.3	133.1	160.4	194.7	239.8	291.0
Interest Payments of Gov. External Debt (% of Reserves)	2.6	2.6	2.5	2.3	2.3	2.4	2.1	2.5	3.3	4.3	5.6

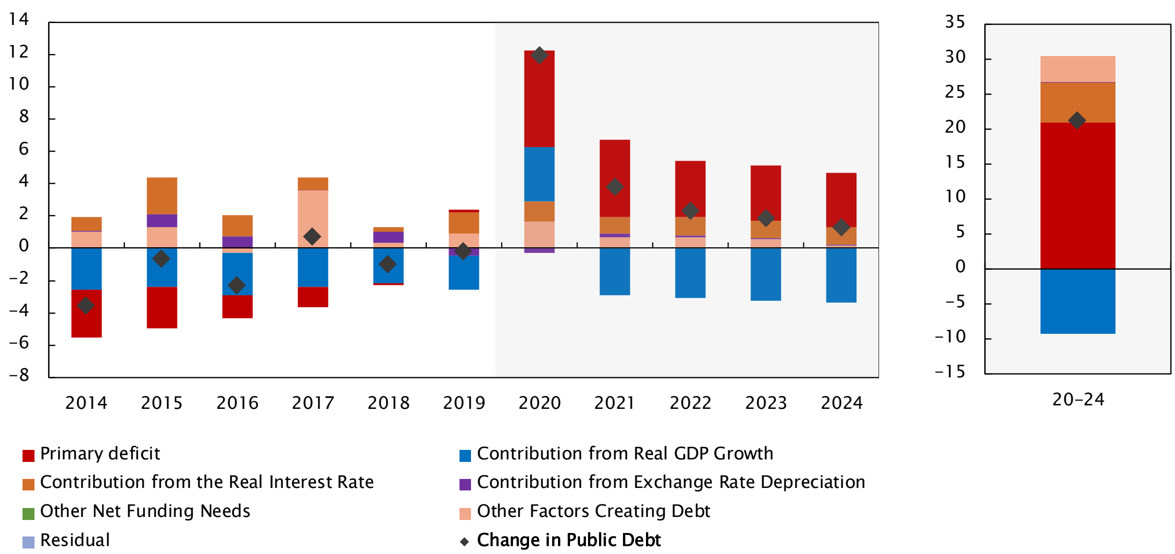
1/ Public debt refers to gross debt of the general government.
2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times the debt ratio in year t-1, with r = interest rate; p = growth rate of the GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by the increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
5/ Derived as nominal interest expenditure divided by the debt stock in year t-1.
6/ Debt Service in year t is the sum of interest payments in yeat t, short-term debt outstanding at the end of year t-1, and amortization payments of medium- and long-term debt in year t.
7/ Reseves are stocks measured at the end of year t-1.

[3] The proposed AIIB loan will be partially administered by ADB. It has a maturity of 10 years including a grace period of up to 3-years, an interest rate at a spread of 50 bps over LIBOR, a borrowing cost margin of 0.03%, and a maturity premium of 0.1%.

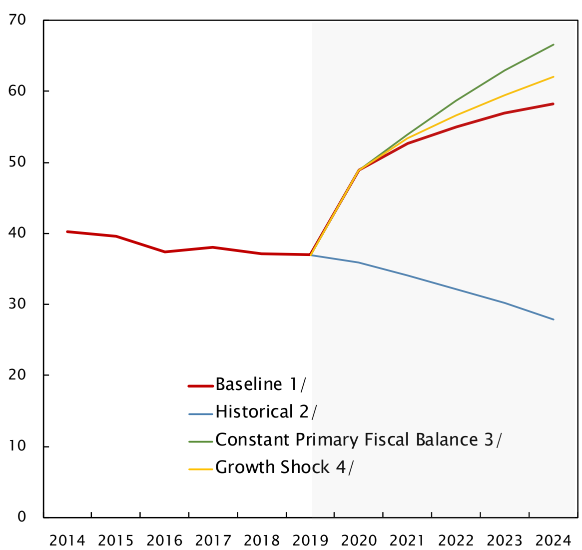
Philippines: Public Debt Sustainability Assessment

(Variables are expressed as a percentage of GDP, unless indicated otherwise)

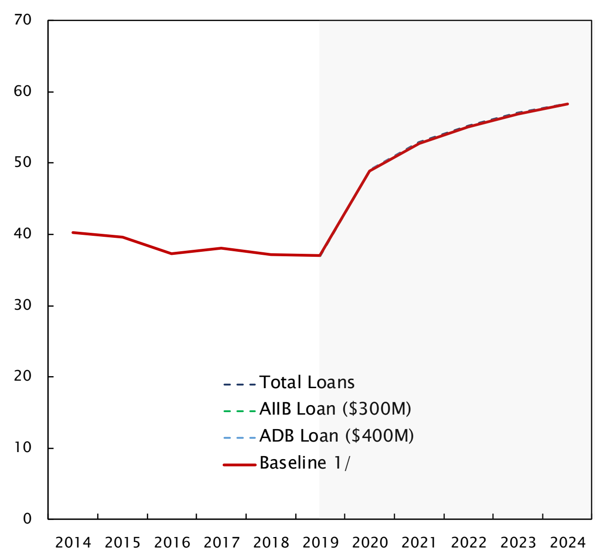
Graph 1: Drivers of Public Debt



Graph 2: Public Debt – *Baseline and Alternative Scenarios*



Graph 3: Public Debt – *Loan Scenarios*



1/ The baseline scenario is based on ERCD's Asian Debt Monitor (ASDM) database and projections.
2/ The historical scenario sets future macroeconomic and fiscal variables to their 10-year past average.
3/ The constant primary fiscal balance assumes that the primary fiscal balance remains unchanged throughout the projection period, equal to 2020.
4/ The growth shock scenario assumes growth that is 1 percentage point lower than in the baseline scenario.