CPBRD

BUDGET BRIEF

NO. 4 | 2022

Public Debt Sustainability and the Proposed FY 2023 National Budget

cpbrd.congress.gov.ph

HIGHLIGHTS

- ❑ **The current administration has laid out the FY 2022-2028 Medium-Term Fiscal Framework (MTFF) in pursuit of a fiscal consolidation program to reduce the fiscal deficit to pre-pandemic level and ensure debt sustainability.** Fiscal deficit is expected to decline to P1.5 trillion or 6.1% of GDP in 2023, from this year's program of P1.7 trillion or 7.6% of GDP. Over the medium term, the fiscal deficit will gradually decrease by at least 1.0 percentage point every year until it reaches 3.0% of GDP in 2028. Meanwhile, the debt-to-GDP will settle at 51.1% by 2028.

- ❑ **The NG's fiscal deficit ballooned to P1.7 trillion in 2021**. The fiscal deficit as a share of GDP more than doubled in 2020 from 3.4% in 2019 to 7.6% in 2020. This continued to widen in 2021 at a record-high of 8.6% (or P1.7 trillion) which by far is the highest recorded since 1986.

- ❑ **The government's main source to finance the sizeable fiscal deficit is the domestic market.** The government raised about P2.6 trillion of gross borrowings to cover the widening fiscal deficit and provisioning cash requirements in 2021. Excluding amortization payments, net financing stood at P2.3 trillion in 2021 from P2.5 trillion in 2020. Of the P2.3 trillion net financing, P1.9 trillion came from domestic sources while the remaining P331.5 billion came from external sources.

- ❑ **In 2021, NG debt-to-GDP ratio reached 60.4% breaching the internationally-accepted debt threshold for the first time since 2004, the highest in 17 years.** With the approved MTFF, the debt-to-GDP ratio is expected to decline and will be reduced from 61.8% in 2022 to 51.1% in 2028.

- ❑ **The debt path under MTFF and ratios obtained by applying the IMF Debt Sustainability Analysis (DSA) follow a declining path.** The downward trajectory stems mainly from the declining primary balance and increase in GDP growth. Based on the generated DSA, a debt stabilizing primary balance (DSPB) of -3.3% of GDP or less will be needed to stabilize the debt-to-GDP ratio toward a sustainable path over the medium term. The MTFF debt path requires an average primary deficit of -3.0%. Since the calculated DSPB is negative, the government can still afford to borrow and run primary deficits.

- ❑ **For 2023, with primary deficit projected at 3.7% and possible upward adjustments in policy rates, the debt-to-GDP is seen to stay above the IMF debt threshold**. More importantly, this exceeds the average primary balance of the MTFF debt path of 3.0% of GDP over the medium-term. Nonetheless, as indicated in the MTFF, primary deficit levels will significantly decline in the next coming years until it settles at 2.2% in 2027.

- **The overall NG debt profile and corresponding ratios are broadly sound and vulnerabilities are at low risk.** With large holdings of domestic debt, the economy may be shielded from external debt market impulses and less exposure to risk emanating from exchange rate adjustments The share of external debt to total NG debt is between lower and upper thresholds, indicating a moderate vulnerability to rollover and interest rate risks. With the government debt in foreign currency found to be well within the IMF threshold, this indicates that NG reduces vulnerabilities associated with foreign exchange and interest rate shocks. However, it is still important that government expenditures must be targeted and productive to help the economy recover faster without adding too much debt.

PUBLIC DEBT SUSTAINABILITY AND THE PROPOSED FY 2023 NATIONAL BUDGET[1]

Jhoanne E. Aquino
Novel V. Bangsal

I. INTRODUCTION

- The National Government (NG) debt stance could be influenced by uncertainty in various macroeconomic variables (e.g., real gross domestic product (GDP), effective real interest rate, primary balance, and real exchange rate). For instance, higher growth improves sovereign debt-carrying capacity or the ability to meet current and future payment obligations without going into default. In contrast, weak GDP growth coupled with elevated debt level could result in debt distress—where a country is unable to fulfill its financial obligations and debt restructuring is required.

  With the reopening of the economy, the Philippines grew by 8.3% in the first quarter of 2022 (year-on-year), surpassing pre-pandemic output level and making the economy one of the fastest growing in the East Asia Region (PSA, 2022). The stronger-than-expected growth in the first quarter was mainly driven by a robust household consumption. However, the second quarter of 2022 was a different story. While the economy grew by 7.4%, it was below market expectations.[2] Rapidly rising prices weighed down on growth momentum. As for the rest of year, the economy is expected to grow slowly due to global headwinds, e.g., Russia-Ukraine conflict, China's slowdown and a faster tightening of the U.S. monetary policy (IMF, 2022).

- Monetary policy also impacts public debt through the interest rate channel. When monetary authorities raised interest rates to ease high inflation rates, the cost of debt offering increased. Recently, the *Bangko Sentral ng Pilipinas* (BSP) raised policy rates by a total of 175 basis points in response to the rising inflationary pressures. With better economic conditions in the first semester of 2022, the BSP still has flexibility to accommodate further tightening of monetary policy as inflation continues to accelerate over the coming months.

  Expectations about interest rates may affect the market valuation of existing public debts (Hernandez, 2011). An interest rate shock could increase the debt service burden of the government. Note that the average T-bill rate (90-days) was already higher at 1.6% in June 2022 compared to the 1.1% rate in June 2021. Higher interest rates could mean higher costs in servicing NG debts. Essentially, interest rates and economic growth are key factors that have important implications on the country's ability to take in more debt, while maintaining fiscal sustainability.

---

[1] *This paper benefitted from the overall guidance of Deputy Secretary General Romulo E.M. Miral, Jr. Ph.D. The author acknowledges the contributions of Rutcher M. Lacaza (technical inputs) and assistance of the Publication Team. The views, opinions, and interpretations in this paper do not reflect the perspectives of the House of Representatives as an institution or its individual Members.*

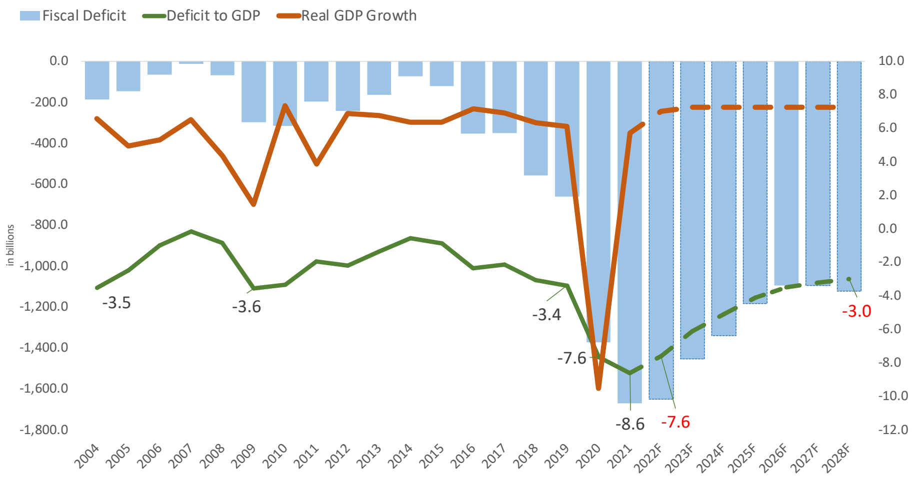
[2] *Market participants were expecting growth to settle at 8.4% from 8.3% in Q1 (ING, 2022).*

II. FISCAL CONSOLIDATION UNDER THE MEDIUM-TERM FISCAL FRAMEWORK

- In the FY 2022-2028 Medium-Term Fiscal Framework (MTFF), the government will pursue a fiscal consolidation program to: 1) reduce the fiscal deficit to pre-pandemic level, and; 2) ensure debt sustainability over the medium term, while achieving the growth targets. As such, NG revenues in 2023, as reflected in the Budget Expenditures and Sources of Financing (BESF) FY 2023, are expected to grow by 10.0% (y-o-y) to P3.6 trillion, or 15.3% of GDP, and disbursements to increase by 2.6% to P5.1 trillion.

- Fiscal deficit is expected to decline to P1.5 trillion or 6.1% of GDP in 2023, from this year's program of P1.7 trillion or 7.6% of GDP (Figure 1). Over the medium-term (2022–2028), the fiscal deficit will gradually decrease by at least 1.0 percentage point every year until it reaches 3.0% of GDP in 2028.

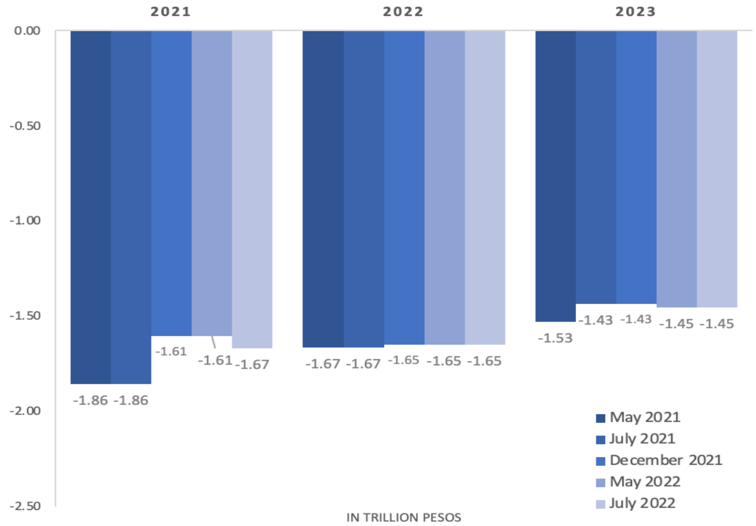
FIGURE I
DBCC FISCAL DEFICIT PROJECTIONS, 2022-2028



Sources of Basic Data: Bureau of the Treasury-Cash Operations Report (BTr- COR); Philippine Statistics Authority (PSA); Development Budget Coordination Committee (DBCC) Medium-term Fiscal Program (MTFP) July 2022

- Figure 2 shows the fiscal deficit projections of the Development Budget Coordination Committee (DBCC) from 2021 to 2023, and how the margins have changed from the May 2021 up to the July 2022 DBCC meetings. The 2021 projection was lowered by P249.4 billion to P1.61 trillion in December 2021 from the initial projection of P1.86 trillion in May 2021. The DBCC attributed the revisions to the reopening of the economy and the accelerated vaccination drive which prompted to have higher-than-target revenues. The actual fiscal deficit in 2021, recorded at P1.67 trillion, was well within the 2021 projected target of the DBCC. Although lowered by P14.6 billion, the fiscal deficit program for 2022 was kept at P1.65 trillion in the December 2021 and July 2022 DBCC meetings. Fiscal deficit projections for 2023 were also kept within the range of P1.43-1.45 trillion in July 2021 to July 2022 DBCC meetings.

FIGURE 2
DBCC FISCAL DEFICIT FORECAST HORIZON, 2021-2023



Sources of basic data: DBCC various meetings
Note: For 2021, the July 2021 value represents the actual fiscal deficit for 2021.

III. FISCAL DEFICIT, NET FINANCING, AND NG DEBT

- The fiscal deficit ballooned as tax revenue bases weakened amid both supply and demand shocks due to the COVID-19 pandemic. As a share of GDP, NG's fiscal deficit more than doubled from 3.4% n 2019 to 7.6% in 2020 (Table 1). This further widened in 2021, reaching record-high of 8.6% (or P1.7 trillion) which was the highest recorded since 1986.

- The primary deficit, which excludes government spending on interest payments on public debt, also jumped three-fold from 1.5% of GDP in 2019 to 5.5% in 2020 (Table 1). This further expanded in 2021 to 6.4%. Typically, the primary deficit is used as a measure of the country's capacity to service its debt. If primary deficit will remain elevated–and interest rates continue to rise—debt will possibly grow faster than the economy. However in the BESF FY2023, both fiscal and primary deficits are expected to improve at 4.1% and 1.6% of GDP by 2025, respectively.

- As public spending continues to accelerate in 2021 (from 23.5% of GDP in 2020 to 24.1% of GDP in 2021), the government raised about P2.6 trillion of gross borrowings to cover the widening fiscal deficit and provisioning cash requirements. Excluding amortization payments, net financing stood at P2.3 trillion in 2021 from P2.5 trillion in 2020.

TABLE I
FISCAL DEFICIT AND NET FINANCING SUMMARY

Particulars	Actual	Program	Projection		
	2021	2022	2023	2024	2025
Amounts (in billion pesos)					
Revenues	3,005.5	3,304.1	3,632.9	4,062.6	4,576.8
Expenditure	4,675.6	4,954.6	5,085.8	5,402.0	5,759.7
Fiscal Deficit	**1,670.1**	**1,650.5**	**1,452.9**	**1,339.4**	**1,182.9**
o.w. Primary Deficit	**1,240.7**	**1,137.9**	**870.6**	**688.6**	**468.7**
Gross Borrowings	2,579.2	2,211.8	2,207.0	2,418.0	2,075.0
Net Financing	2,252.1	2,075.2	2,082.5	2,190.2	1,913.2
Growth Rate (%)					
Revenues	5.2	9.9	10.0	11.8	12.7
Expenditure	10.6	6.0	2.6	6.2	6.6
Net Financing	(9.9)	(7.9)	0.4	5.2	(12.6)
As % of GDP					
Revenues	15.5	15.2	15.3	15.6	16.0
Expenditure	24.1	22.9	21.4	20.7	20.2
Fiscal Deficit	**8.6**	**7.6**	**6.1**	**5.1**	**4.1**
o. w. Primary Deficit	**6.4**	**5.3**	**3.7**	**2.6**	**1.6**
Net Financing	11.6	9.6	8.8	8.4	6.7

Note: Primary Balance is the difference between NG revenues and expenditure, excluding interest payments.
Sources of basic data: BTR-COR; DBM Budget of Expenditures and Sources of Financing (BESF) FY 2023; PSA

- The government finances its operations and investments from tax and non-tax sources, withdrawals from available cash balances, or through borrowings. In the latter, this could be through term loan facilities whereby a public institution borrows from financial institutions. The government, on the other hand, could also borrow directly from the private sector through its regular auctions of government securities or through the issuance of other sovereign debt papers (Hernandez, 2011). It can be observed that during black swan events such as COVID-19 pandemic, government borrowings have reached unprecedented levels. Note that the government relied mainly from the domestic market to finance the sizeable fiscal deficit.

- Gross domestic borrowings significantly increased from P693.8 billion in 2019 to P2.0 trillion in 2021 to finance the expanding deficit. Table 2 shows the bulk of domestic borrowings were from the sale of fixed-rate treasury bonds worth P701.7 billion and P1.2 trillion in 2020 and 2021, respectively. In 2021, the NG sold additional retail treasury bonds worth P823.3 billion. Meanwhile, the scheduled amortizations of P440.4 billion and P537.5 billion in 2020 and 2021, respectively, were reduced to P104.3 billion and P90.0 billion, respectively via redemption of Bond Sinking Fund (BSF).

TABLE 2
DOMESTIC BORROWINGS

Particulars	2019	2020	2021
Amounts (in billion pesos)			
Gross Domestic Borrowings	**693.8**	**1,998.7**	**2,010.6**
Fixed Rate T-Bonds	461.2	701.7	1,259.7
Retail T-Bonds	240.8	833.6	823.3
On-shore $ Bonds	0.0	0.0	80.8
T-Bills (Net)	(8.1)	463.3	(153.3)
Less: Net Amortization	**2.4**	**104.3**	**90.0**
Amortization	344.5	440.4	537.5
of which: redemption from BSF	342.1	340.1	447.5
Net Domestic Borrowings	**691.4**	**1,894.4**	**1,920.6**

Source: BTr- COR: CPBRD Facts in Figures in NG Financing 2021

- External borrowings increased from P321.9 billion in 2019 to P742.4 billion in 2020 but eventually decreased to P568.7 billion in 2021. Table 3 provides the summary of the net external borrowings wherein program loans remained the biggest source of external borrowings which stood at P375.2 billion in 2020 and P166.1 billion in 2021.

TABLE 3
EXTERNAL BORROWINGS

Particulars	2019	2020	2021
Amounts (in billion pesos)			
Gross External Borrowings	**321.9**	**742.4**	**568.7**
Program Loans	78.2	375.2	166.1
o.w. Asian Development Bank	47.3	205.8	61.4
World Bank	30.9	85.8	67.3
Global Bonds	78	250.8	146.2
Euro Bonds	43.5	67.3	121.9
Project Loan	58.1	49.1	110.2
Samurai Bonds	45.3	0.0	24.2
Panda Bonds	18.9	0.0	0.0
Less: Payments	**137.1**	**141.7**	**237.2**
Net External Borrowings	**184.8**	**600.7**	**331.5**

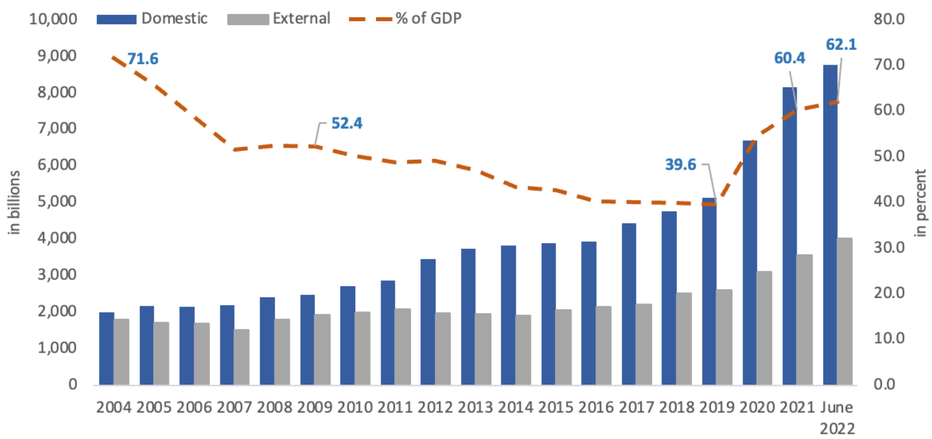
Sources: BTr-COR: CPBRD Facts in Figures in NG Government Financing 2021

In 2019, P47.3 billion worth of program loans came from the Asian Development Bank (ADB) while P30.9 billion was sourced from the World Bank (WB), both of which were mostly to finance development programs. In 2020, the majority of the borrowings were for COVID-19 programs with ADB as the biggest creditor with P205.8 billion. Aside from the WB, other creditors also offered pandemic relief loans. Meanwhile, the biggest program loans in 2021 were for natural disaster resiliency programs with P29 billion from the WB and P24.1 billion from the ADB.

- In 2021, the NG debt reached P11.7 trillion or equivalent to 60.4% relative to the size of the economy, already breaching the internationally-accepted debt threshold[3] for the first time since 2004, the highest in 17 years (Figure 3). During the pre-crisis year of 2019, the debt-to-GDP ratio was only about 39.6%. The debt ratio then increased further at the onset of the pandemic in 2020, with an uptick of more than 20 percentage points.

  Looking at the trend from 2004 to 2019, it shows that the government managed to lower its debt-to-GDP ratio, while domestic and external debts were increasing. This shows that the rate of economic growth was higher than the growth rate of debt incurred[4]. However, the reversal in previous gains is mainly attributable to higher financing requirements as a large fiscal stimulus is needed to effectively respond to the COVID-19 pandemic. As of June 2022, debt-to-GDP ratio stands at 62.1%.

FIGURE 3
ACTUAL NG DEBT-TO-GDP



Sources of basic data: BTr-COR

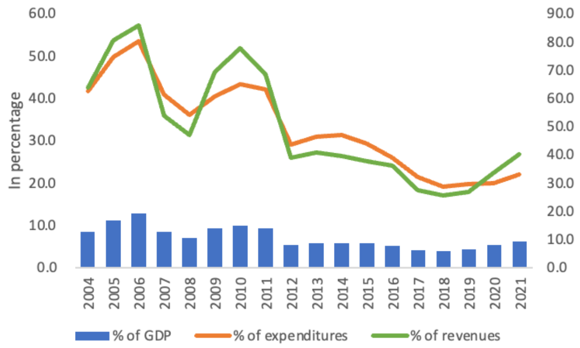
- Figure 4 shows that after subsequent declines, the debt services burden which consists of principal payments or amortization plus interest payments escalated in post-pandemic years. In 2006, the total debt service reached a record-high of 85.7% of NG revenues, 53.4% of NG expenditures plus principal payments, and 12.8% of GDP. After a decade, the debt services metrics improved to 36.0% of NG revenues, 26.0% of NG expenditures, and 5.2% of GDP. However, a reversal in the trend was seen in 2020 as debt services expanded during the pandemic. The debt services which are spread throughout the life of the debt could account for a significant chunk of the annual government budget.

  With debt build-up, interest payments climbed to 2.2% of GDP in 2021 from 1.8% of GDP in 2019. It is equivalent to 14.3% of revenues in 2021 from the pre-pandemic level of 11.5%

[3] *Per IMF Guidelines (2013), the debt-to-GDP ratio should not exceed to 60% of GDP.*
[4] *When the cost of raising debt is lower than the GDP growth rate, public debt comes with low fiscal costs. In such a situation, the debt-to-GDP ratio of the economy declines as debts are rolled over.*

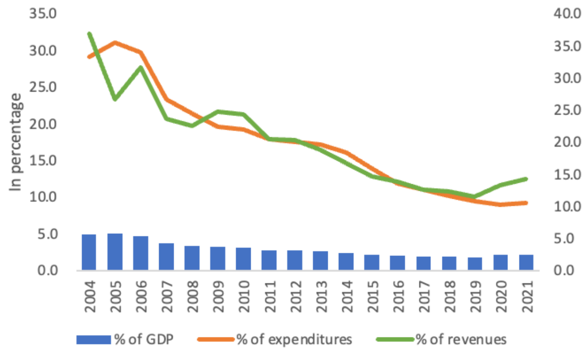
of GDP in 2019 (Figure 5). An increase in interest payments relative to revenues would indicate lesser public capacity to service debt, while an increase in interest payment relative to expenditures means higher debt service payments and constrains the government's fiscal space for more productive spending.

FIGURE 4
DEBT SERVICES BURDEN



Note: BTr GFS Classification
Sources of basic data: BTR-COR

FIGURE 5
INTEREST PAYMENTS



Note: BTr Government Finance Statistics (GFS)
Sources of basic data: BTR-COR

IV. DEBT SUSTAINABILITY ANALYSIS

- **NG debt path under MTFF.** With the approved Medium-Term Fiscal Program, the fiscal deficit is expected to decrease by at least 1.0 percentage point annually to ensure debt sustainability. Moreover, the debt-to-GDP ratio is expected to stabilize in 2022 and 2023 and start to decline in 2024 (Figure 6).

It is important to note, however, that the baseline debt-to-GDP (in 2022) is pegged at 61.8% of GDP which is much higher than the previous levels in 2021 (60.5%) and 2020 (54.6%). Also, higher primary deficits during the pandemic years at 5.5% and 6.4% in 2020 and 2021, respectively, largely contributed to the increase in the debt levels. Considering that the primary deficit for 2022 remains elevated, this will add pressure to the government to borrow more to stabilize the growth of public debt.

For 2023, with primary deficit projected at 3.7% and possible upward adjustments in policy rates, the debt-to-GDP is seen to stay above the IMF debt threshold. More importantly, this exceeds the average primary balance of the MTFF debt path of 3.0% of GDP over the medium-term. Nonetheless, as indicated in the MTFF, primary deficit levels will significantly decline in the next coming years until it settles at 2.2% in 2027.

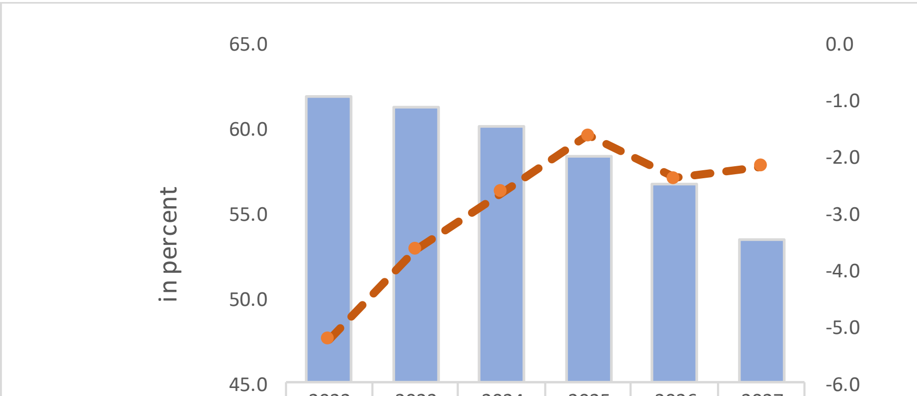
The International Monetary Fund's (IMF) condition for debt sustainability is that debt cannot grow faster than income/output and the capacity to repay it. Debt is sustainable if projected debt-to-GDP ratios are stable, decline, and are sufficiently low, and if a country can service its debt without the need for implausibly large policy adjustments, renegotiation, or default (IMF 2017).

- **Debt dynamics**. One approach to assess debt sustainability is understanding the debt dynamics—meaning the interplay of various factors, i.e., growth, real interest rates, and primary balance—that impact on public debt changes. There are two important things to consider: 1) the difference between real interest rate and growth rate (r – g); and 2) the debt-stabilizing primary balance.

  First, when the primary deficit is small and interest rates are lower than the growth rate of nominal GDP, the debt-to-GDP ratio will fall. However, if the primary deficit is substantial and the interest rates are rising faster than nominal GDP—debt will continue to grow faster than the economy. And second, the debt-stabilizing primary balance is the level of the primary deficit (i.e., non-interest) at which debt would stay constant as a share of GDP.

  To illustrate, for a debt-GDP ratio of 60%, each 1 percentage point gap between r and g implies a required primary surplus of 0.6% of GDP. The higher the existing debt ratio, the larger the primary surplus required per 1 percentage point (r – g) gap to outweigh the impact of this differential. On the contrary, when growth rate exceeds interest rate, the government can run primary deficit to stabilize debt-to-GDP, hence the government has room to borrow and incur more debts.

FIGURE 6
MTFF/DBCC NG DEBT-TO-GDP TRAJECTORY



	2022	2023	2024	2025	2026	2027
Debt-to-GDP Ratio	61.8	61.2	60.0	58.3	56.6	53.4
Primary Balance	-5.3	-3.7	-2.6	-1.6	-2.4	-2.2

Sources of basic data: DBCC/MTFF

- **Debt decomposition.** The debt-to-GDP ratio is the most common measure to assess debt sustainability. With current debt-to-GDP level surpassing the 60% threshold of the IMF, careful assessment of other debt indicators will be needed to have a full picture of the country's ability to service debt. To gauge this, this paper adopted the IMF Debt Sustainability Analysis (DSA) methodology (see Annex A for detailed information and data sources) to generate: 1) debt-to-GDP projections over the medium-term; 2) debt composition to identify key drivers of debt expansion; and 3) and the debt-stabilizing primary balance.

Applying the IMF DSA template and adopting the macroeconomic assumptions in the BESF FY 2023, the estimated debt-to-GDP trajectory is projected to peak at 63.6% in 2023 and settle slightly above the threshold level at 61.4% in 2026 (Table 4). It is important to note that the trajectory follows a downward slope similar to that of the MTFF debt path. The forecast also points to the gross financing needs[5] as decreasing from 8.4% in 2022 to 5.9% in 2026. This represents a positive note in terms of measure of sustainability. Based on the IMF threshold of 15%, the level of gross financing needs is found to be within the sustainable path.

Table 4 shows debt dynamics are favorable as GDP growth rates are higher than the interest rates. For 2022, GDP growth rate is expected to grow by 6.8% while interest rate at 4.6%. This suggests the rate of economic growth is faster and larger than the cost of borrowing.

Decomposing the debt indicators shows that the key drivers or contributors to the changes in the debt-to-GDP level are the primary deficit and real GDP growth. Notably in 2020 and 2021, the primary deficits peaked at 5.6% to 6.4%. This was mainly due to aggressive public spending which exceedingly outpaced revenue growth. Based on the generated DSA, the change in debt-to-GDP ratio is projected to be driven by decreases in primary deficit, from 5.3% in 2022 to 3.7% in 2023 and declining further to 2.4 in 2026. Based on the trajectory of the changes in debt-to-GDP, the downward path stems mainly from the declining primary balance and increase in GDP growth.

- **Economy's ability to service debt.** Another key indicator of debt sustainability is to look into an economy's ability to service debt. To gauge this, it is useful to consider the debt-stabilizing primary balance (DSPB). In terms of threshold, the IMF regards DSPB path as sustainable so long as the debt-to-GDP ratio is declining. Depending on the economic condition, if DSPB is negative or < 0 (less than 0), the government can afford to run primary deficits and still stabilize growth of debt. It has more fiscal space and can afford to provide fiscal stimulus. If it is >0, or positive DSPB, government has to run primary surpluses to stop debt from growing, and the government is more fiscally constrained. It needed to raise more revenues over and above expenditure.

  DSA results reveal that an estimated DSPB[6] of -3.3% of GDP or less is needed to stabilize the debt-to-GDP ratio toward a sustainable path from 2022 to 2027. The MTFF debt path requires an average primary deficit of 3.0%. Since the calculated DSPB is negative, the government can still afford to borrow and run primary deficits.

[5] *Includes fiscal deficit, amortization, and non-debt financing needs.*

[6] *The debt forecast error could originate from errors in projecting automatic debt dynamics (including the nominal interest rate, GDP deflator inflation, real GDP growth, and exchange rate), the primary balance (including revenue and non-interest expenditure), other flows, and the debt-to-GDP ratio in the same year (AMRO, 2022).*

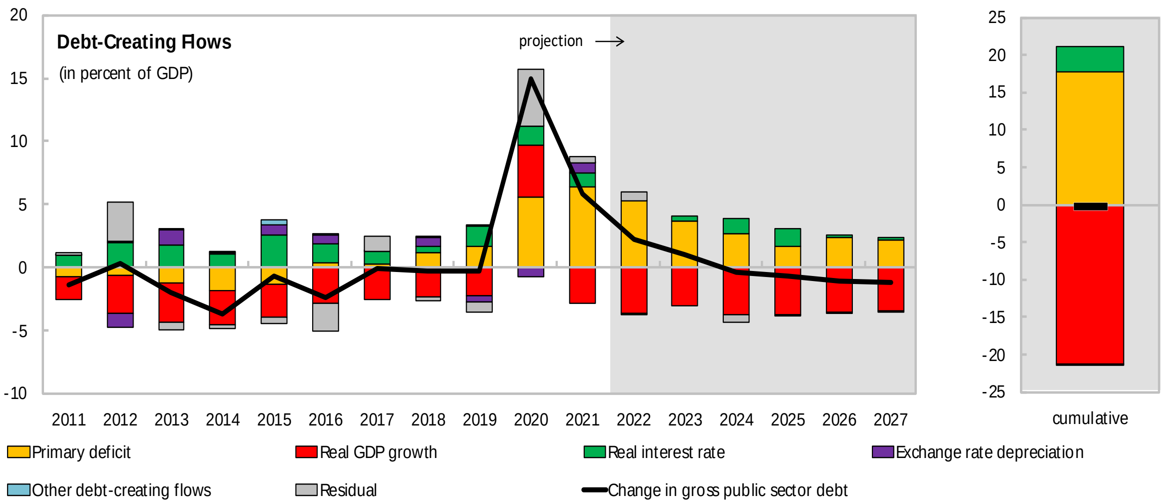
TABLE 4
ECONOMIC INDICATORS AND CONTRIBUTION TO CHANGES IN PUBLIC DEBT (IN PERCENT OF GDP)

Debt, Economic and Market Indicators

	Actual			Projections				
	2011-2019	2020	2021	2022	2023	2024	2025	2026
Nominal gross public debt	43.5	54.6	60.4	62.6	63.6	63.2	62.5	61.4
Public gross financing needs	5.2	10.9	12.6	8.4	7.9	7.4	6.2	5.9
Public debt (in percent of potential GDP)								
Real GDP growth (in percent)	6.3	-9.5	5.7	6.8	5.4	6.5	6.4	6.2
Inflation (GDP deflator, in percent)	2.0	1.7	2.3	4.5	4.0	3.0	3.0	3.0
Nominal GDP growth (in percent)	8.5	-8.0	8.1	11.7	9.6	9.7	9.6	9.4
Effective interest rate (in percent)	5.5	4.9	4.4	4.6	5.0	5.3	5.6	3.4

Contribution to Changes in Public Debt

	Actual			Projections							
	2011-2019	2020	2021	2022	2023	2024	2025	2026	2027	cumulative	debt-stabilizing primary balance
Change in gross public sector debt	-1.2	15.0	5.9	2.2	1.0	-0.4	-0.7	-1.1	-1.2	-0.3	
Identified debt-creating flows	-1.1	10.5	5.4	1.5	1.0	0.1	-0.7	-1.0	-1.2	-0.3	
Primary deficit	-0.3	5.6	6.4	5.3	3.7	2.6	1.6	2.4	2.2	17.8	-3.3
Primary (noninterest) revenue and grants	14.7	15.8	15.5	15.2	15.3	15.6	16.0	16.5	17.0	95.6	
Primary (noninterest) expenditure	14.4	21.4	21.9	20.5	19.0	18.2	17.7	18.9	19.2	113.4	
Automatic debt dynamics	-0.9	4.9	-1.0	-3.8	-2.6	-2.5	-2.3	-3.4	-3.3	-18.0	
Interest rate/growth differential	-1.1	5.6	-1.8	-3.8	-2.6	-2.5	-2.3	-3.4	-3.3	-18.0	
Of which: real interest rate	1.4	1.5	1.0	-0.1	0.4	1.2	1.4	0.1	0.1	3.3	
Of which: real GDP growth	-2.6	4.1	-2.9	-3.7	-3.1	-3.8	-3.7	-3.6	-3.5	-21.3	
Exchange rate depreciation	0.2	-0.7	0.9	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (1) (e.g., privatization receipts)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., other debt flows) (+ ir	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes	0.0	4.5	0.4	0.7	0.0	-0.5	0.0	-0.1	-0.1	0.0	



Note: For the assumptions used in calculating the primary balance, the projected revenues and expenditures for 2022-2027 were culled from the DBCC/MTFF; 2022-2025 interest payments were from the BESF FY2023; 2026-2027 interest payments from the assumptions of the Philippine Institute for Development Studies.

For FY 2023, the government's primary deficit stands at 3.7% of GDP. While this represents an improvement from the previous two years, it should be taken into account how it compares with the estimated DSPBs. Note that next year's primary deficit is below the estimated DSPB, which coincides with very minimal change in the debt-to-GDP level. Possible deviation from the required primary deficit should be able to provide some guidepost what interventions are needed to produce a more favorable debt dynamics. As shown in the debt decomposition analysis, the key drivers or contributors to the changes in the debt-to-GDP level are the primary deficit and real GDP growth.

V. NG DEBT PROFILE VULNERABILITIES

- The NG debt profile such as shares of domestic and external debt to total, shares of local and foreign currency-denominated debt, and relative maturities (e.g., short-, medium-, and long-term) provide additional insights into the fiscal vulnerabilities[7] of a country, especially those with relatively higher debt ratios.

By Domestic Source. The largest share of public debt for the period 2019-2021 is domestic[8], representing about 68.1% on average. The share of domestic debt to total debt has been increasing from 66.3% in 2019 to 69.7% in 2021 (Table 5).

TABLE 5
NG DEBT BY SOURCE, CURRENCY, AND MATURITY

Particulars	Actual			Share to total (%)		
	2019	2020	2021	2019	2020	2021
Amounts (in billion pesos)						
NG Actual Debt*	**7,731.3**	**9,795.0**	**11,729**	**100.0**	**100.0**	**100.0**
Source						
Domestic	5,127.6	6,694.7	8,170.4	*66.3*	*68.3*	*69.7*
External	2,603.7	3,100.3	3,558.1	*33.7*	*31.7*	*30.3*
Currency						
Peso	5,231.9	6,800.4	8,149.3	*67.7*	*69.4*	*69.5*
Foreign Currency	2,499.4	2,994.7	3,579.3	*32.3*	*30.6*	*30.5*
Maturity						
Short-term	491.1	956.0	796.1	*6.4*	*9.8*	*6.8*
Medium-term	1,374.3	2,251.8	3,123.6	*17.8*	*23.0*	*26.6*
Long-term	5,865.8	6,587.2	7,808.8	*75.9*	*67.3*	*66.6*

*Note: *Actual debt does not include guaranteed debt*
Source: Bureau of the Treasury

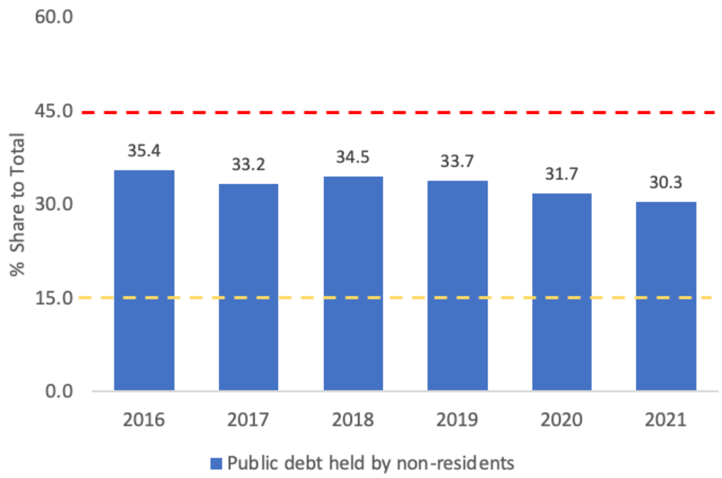
With large holdings of domestic debt, the economy may be shielded from external debt market impulses, less exposure to risk emanating from exchange rate adjustments, and provide some degrees of policy freedom. However, this situation may pose a downside risk to the banking system. The banking system may likely become a mere funnel for resources to meet public sector borrowing requirements at the expense of funding private investment (Nicholls, 2014). This may result in a crowding-out effect wherein an increase in public sector spending may drive down or even eliminate private sector spending, thereby reducing private investments.

---

[7] *Fiscal vulnerability describes a situation where a government is exposed to the possibility of failure to meet its aggregate fiscal policy objectives (Hemming and Petrie, 2000).*
[8] *Debt owed to residents of the Philippines.*

By External Source. The share of external debt or the share of debt held by nonresidents to total NG debt shows a declining trend from 33.7% in 2019 to 30.3% in 2021. Based on the IMF threshold, the lower bound is 15%, while the upper bound is 45%. Since the NG external debt is seen between the lower and upper thresholds, this indicates a moderate vulnerability to rollover and interest rate risks (Figure 7).

FIGURE 7
EXTERNAL DEBT, % SHARE TO TOTAL



Note: The yellow line indicates lower threshold, while red line indicates the upper threshold.
Sources of basic data: BTr (2022)

Of the total external debt[9] as of December 31, 2021 (P3.6 trillion or equivalent to USD 69.8 billion), the total Official Development Assistance[10] (ODA) loans accounted for 43.9% or P1.7 billion. The bulk of ODA loans is from NG-direct[11] and relent[12] loans which amount to P1.6 billion while guaranteed[13] loan amounts to only P96.0 million (COA, 2022).

Based on the 2021 Commission on Audit (COA) Consolidated Audit Report on Official Development Assistance-Funded Programs and Projects Report, the BTr and various Government-Owned and Control Corporations/Government Financial Institutions (GOCCs/GFIs) reported debt service expenditures (DSEs) for ODA loans totaling P77.9 billion. This comprises P67.1 billion for 339 NG direct loans, P2.2 billion for 12 loans relent to GOCCs/GFIs, and P8.5 billion for 39 guaranteed loans (Table 6). The DSEs consist of principal payments, interests, commitment fees (CFs), and other financial charges.

---

[9] *As reported in the Bureau of the Treasury-COR.*
[10] *As defined under RA No 8182, as amended by RA No. 8555, ODA is a loan or a grant administered with the objective of promoting sustainable social and economic development and welfare of the Philippines. Pursuant to RA 8182, the law mandates the NEDA to conduct an annual review of the status of all projects financed by ODA, while COA is mandated to conduct an audit on each and ongoing project and report to Congress not later than June 30 each year.*
[11] *NG-Direct refers to debt directly incurred by the NG for programs and projects implemented by national government agencies, GOCCs and GFIs.*
[12] *NG-Relent are those directly incurred by the NG for relending to GOCCs/GFIs and LGUs.*
[13] *NG-Guaranteed are loans contracted by the GOCCs/GFIs and are guaranteed by the NG.*

Of total DSEs, 57.8% are paid to multilateral development partners (DPs), of which were mostly paid to ADB and the International Bank for Reconstruction and Development (IBRD). On the other hand, 42.2%, or an amount equivalent to P32.8 billion is paid to bilateral DPs, of which the Japan International Cooperation Agency (JICA) gets the largest share. Based on the COA Report, the ADB, IBRD, and JICA loans remained the top contributors to the debt service payments.

TABLE 6
DEBT SERVICE EXPENDITURE BY DEVELOPMENT PARTNERS, 2021

Development Partners	No. of Loans	Principal	Interest	Commitment Fees	Other Charges	Total	% to Total DSE
Amounts (in million pesos)							
Multilateral	**70**	**34,525.92**	**9,552.33**	**396.15**	**552.04**	**45,026.44**	**57.82**
ADB	88	23,575.23	3,783.77	201.52	0.77	27,561.29	35.39
IBRD	61	10,310.14	5,385.87	160.23	499.98	16,356.22	21.01
IFAD	12	472.09	52.43	-	0.0	524.52	0.67
Others	9	168.46	330.26	34.40	51.29	584.41	0.75
Bilateral	**220**	**28,208.87**	**4,457.86**	**69.45**	**106.38**	**32,842.56**	**42.18**
JICA	149	19,813.85	3,355.24	19.15	4.21	23,192.45	29.78
BNP PARIBAS	4	2,392.43	129.60	-	1.16	2,523.19	3.25
JEXIM	1	1,271.02	20.52	-	0.0	1,291.54	1.66
Others	66	4,731.57	952.50	50.30	101.01	5,835.38	7.49
Total	**390**	**62,734.79**	**14,010.19**	**465.60**	**658.42**	**77,869.00**	**100.00**

Sources: COA Report (2022); Detailed DSEs of Foreign Loans-Direct, Relent to GOCCs/GFIs, and NG Advances for Guaranteed Loans for CY 2021, BTr-NGDAD; and DSEs for ODA Loans reported by GOCCs/GFIs as verified by COA auditors.

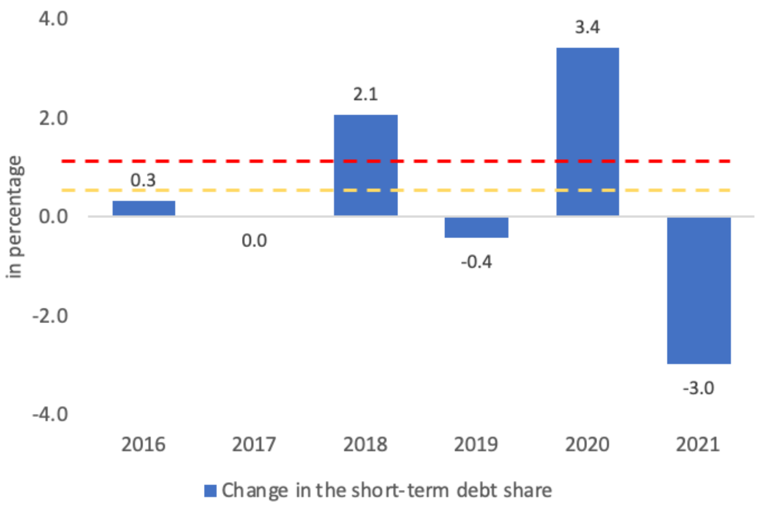
Program loans such as ODAs are designed for fiscal support, which are disbursed as needed following a financing program that is designed to bridge the fiscal deficit while keeping the debt-to-GDP level sustainable (NEDA, 2020). To ensure the sustainability of NG's debt service, the government prioritizes domestic borrowings to finance the NG's budget deficit, followed by ODA, and international capital markets (DOF, 2020).

Pursuant to Section 3 of the Republic Act (RA) No 8182 or the ODA Act of 1996, as amended by RA No. 8555, ODA is excluded from the total amount of loans, credits, and indebtedness, excluding interests, which the President is authorized to incur and shall not exceed USD 10 billion with terms of payment not less than 10 years except those contracted in the interest of national security and rehabilitation resulting from natural calamities.

By Currency. An increasing trajectory is also seen in the share of peso-denominated debt which edged up from 67.7% in 2019 to 69.5% in 2021, with foreign-denominated debt maintained at 30.5%. Based on the IMF threshold, the lower bound is around 20% while the upper bound is 60%. Since the government debt in foreign currency is well within the threshold, this indicates that NG reduces vulnerabilities associated with foreign exchange and interest rate shocks (Table 6).

By Maturity. In terms of maturity, the medium-[14] and long-term[15] (MLT) debt accounts for the bulk of the country's debt. In 2020, the combined share of MLT debt to total debt increased slightly from 90.2% in 2020 to 93.2% in 2021. In contrast, short-term[16] maturities declined from 9.8% in 2020 to 6.8% and 0.4 percentage points from the 2019 level (Table 6). The bulk of MLT maturity profiles or those with original maturities longer than one (1) year indicates that foreign exchange requirements for debt payments are still spread out and manageable. The government typically conducts its short-term borrowings through the issuance of Treasury bills (T-bills) while long-term borrowings are financed by issuing longer-dated Treasury bonds, and foreign-currency sovereign debt issuances (Hernandez, 2011).

FIGURE 8
CHANGE IN THE SHORT-TERM DEBT SHARE



Note: The yellow line indicates lower threshold, while red line indicates the upper threshold
Sources of basic data: BTr (2022)

Figure 8 presents that the share of short-term debt turned negative in 2021 at a negative 3.0% from 3.4% in 2020. Based on the IMF threshold for the change in the short-term debt, the maturity profile is below the upper threshold of 1.0% but below the lower bound of 0.5%. Considering the current maturity of the debt profile, roll-over risk is not an emerging potential problem in the country since the current maturity profile covers MLT maturities. This also maintains that foreign exchange requirements for debt payments are still spread out and manageable. The maturity profile also suggests that rollover risk is still low since the share of amortization within 12 months accounted for 6.8% of total NG outstanding debt.

- ❑ Another important indicator is the debt service ratio (DSR)[17] which measures the adequacy of the country's foreign exchange earnings to meet maturing obligations. Data from the BSP shows that the debt service ratio in 2021 climbed to 7.2% from 6.7% in 2020 or an increase

[14] *Maturity is more than a year to less than 10 years.*
[15] *Maturity is longer than 10 years.*
[16] *This refers to debt repaid within a year.*
[17] *This is calculated as the percentage of both principal and interest payments or debt service burden to exports of goods and receipts from services and primary income.*

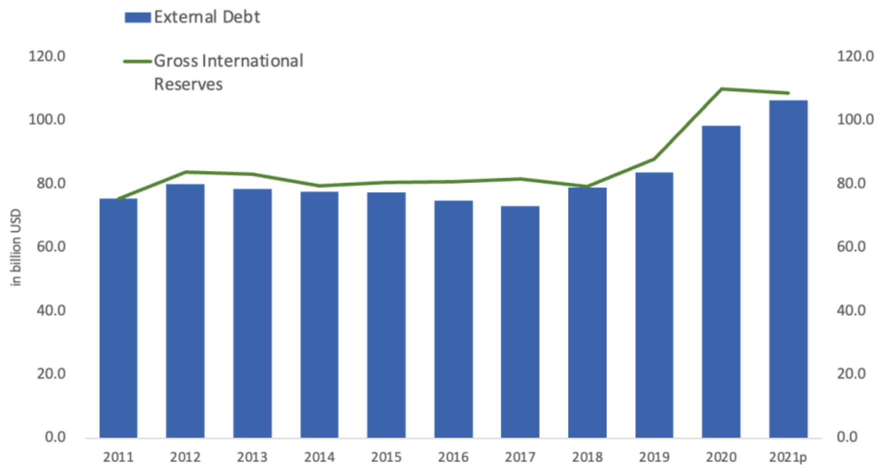
of 7.6 percentage points. For the period January to April 2022, the DSR dropped to 3.9% from 12.1% recorded for the same period last year due to lower scheduled repayments accompanied by higher receipts (BSP, 2022). Note however that despite the higher debt service ratio, it is still below the ADB threshold of 21% (Figure 9).

FIGURE 9
DEBT SERVICE BURDEN TO EXPORTS OF GOODS, AND RECEIPTS FROM SERVICES AND PRIMARY INCOME

Source: BSP (2022)

Despite the increase in external debt, the Gross International Reserves (GIR) remained at prudent levels from 2011 to 2021 (Figure 10). As of end-March 2022, the GIR stands at USD 107.31 billion which is lower than the USD 108.79 billion in end-December 2021. The end-March GIR level remains adequate as it can cover 9 months' worth of imports of goods and payments of services and primary income. This is also equivalent to 7.7 times the country's short-term external debt based on original maturity and 4.7 times based on residual maturity (BSP, 2022).

FIGURE 10
EXTERNAL DEBT AND GROSS INTERNATIONAL RESERVES, 2011-2021



Sources of basic data: BSP (2022)

VI. CONCLUSION

- **The debt paths in the MTFF and the applied IMF DSA follow a downward trend over the medium term.** Under the MTFF, the NG debt-to-GDP ratio is projected to peak to 61.8% in 2022 and settle below the IMF threshold level by 2025. Compared with the results generated through the IMF DSA, the debt-to-GDP trajectory is seen to settle slightly above the threshold level and reach 61.4% by 2026.

- **Government's primary deficit for 2023 stands at 3.7% of GDP**. While this represents an improvement from the previous two years, it should be taken into account how it compares with the estimated DSPBs. Possible deviation from the required primary deficit should be able to provide some guidepost what interventions are needed to produce a more favorable debt dynamics.

- **In decomposing debt-creating flows, the key drivers in the movements of the debt-to-GDP ratio are primary deficit and real GDP growth.** The downward trajectory of the changes in debt-to-GDP ratios over the medium-term is found to be attributable to the declining primary deficit and increase in GDP growth. The forecast also points to the gross financing needs as decreasing from 8.4% in 2022 to 5.9% in 2026. This represents a positive note in terms of measure of sustainability. Based on the IMF threshold of 15%, the level of gross financing needs is found to be within the sustainable path.

- **The government debt is still sustainable and the overall risk of debt sustainability is low.** The debt dynamics generated in the IMF DSA are favorable as the projected growth rates are seen as greater than the interest rates. With the resulting growth rates exceeding the interest rates combined with the estimated DSPB (-3.3% of GDP), it can be assessed that the government has some elbow room to borrow and still stabilize the debt-to-GDP ratio over the medium term.

- **The overall debt profile and corresponding ratios are at prudent levels.** With large holdings of domestic debt, the economy may be shielded from external debt market impulses and less exposure to risk emanating from exchange rate adjustments. The share of external debt to total NG debt is between lower and upper thresholds, indicating a moderate vulnerability to rollover and interest rate risks. With the government debt in foreign currency found to be well within the IMF threshold, this indicates that NG reduces vulnerabilities associated with foreign exchange and interest rate shocks. In terms of the current maturity of the debt profile, roll-over risk is not an emerging potential problem in the country since the current maturity profile covers MLT maturities.

- **But the level of debt may be influenced by uncertainty in macroeconomic variables.** The current debt profile may be broadly sound and vulnerabilities are at low risk, but the level of debt (while still near the threshold level) may still be influenced by uncertainty in macroeconomic variables (e.g., real GDP growth, effective real interest rate, primary balance, and the change in the real exchange rate). As noted by the DOF, the government needs to expand the economy by more than 6% annually in the next five (5) years to ensure that the Philippines grows out of debt.

ANNEX A.
IMF DEBT SUSTAINABILITY ANALYSIS

- **Methodology**. The post-pandemic debt trajectory will continue to remain high, as fiscal policy will continue to be expansionary in the near term to support recovery. In this case, it is important to assess if the government has the capacity to sustain and manage debt. This Briefing Note uses standard debt sustainability analysis (DSA), which is publicly available online, as described in IMF (2016) to assess public debt dynamics in the Philippines over the medium term.

  Note that the notion of sustainability hinged on whether the primary balance can stabilize public debt (or the debt-stabilizing primary balance) in baseline and realistic scenarios based on amounts that are both economically and politically feasible. The debt-stabilizing primary balance is the value of the primary balance at which debt would stay constant as a share of GDP or the level that stabilizes the debt-to-GDP ratio (Gottschalk, 2014). A caveat on this approach is that estimates depend crucially, however, on having reliable data and on coming up with accurate projections and assumptions for fundamental variables such as GDP growth, inflation, domestic and foreign interest rates, exchange rates, primary fiscal balances (based on interest and non-interest government income and spending), and other flows that may influence debt levels (PIDS, 2022).

  In decomposing debt dynamics[18], the change in debt is described as follows:

from $$d_t = \frac{1+r}{1+g}\, d_{t-1} - pb_t \qquad (1)$$

to $$d_t - d_{t-1} = \underbrace{\frac{r-g}{1+g}\, d_{t-1}}_{\text{interest rate or growth rate}} \underbrace{- pb_t}_{\text{primary balance}} \qquad (2)$$

Where:
d = denotes the public debt-to-GDP ratio
r = denotes the real interest rate
g = denotes the real growth rate
t = represents the time period
pb = denotes primary balance

[18] *Also referred as Debt Law of Motion which can be favorable if interest rate is less than growth rate (r<g) or unfavorable if interest rate is greater than growth rate (r>g).*

One can attribute the change in debt to interest rate, growth, and fiscal policy. Meanwhile, debt stabilizing primary balance is expressed by deriving equation 1 to equation 3:

$$pb_t = \frac{r - g}{1 + g} d_{t-1} \quad (3)$$

- **Data Sources.** For generating the debt dynamics and debt decomposition, secondary data were culled primarily from national government sources: (i) public sector data (macroeconomic variables) such as GDP, exchange rates, and national government revenues and expenditures were sourced from the PSA, BSP, and the DBM; (ii) historical debt data and banking sector data such as short-term and long-term debt and banking system assets were gathered from the BTr and BSP; and (iii) 2022-2025 macro and debt service forecast were gathered based on the DBCC July 8, 2022 macro-economic assumption and fiscal program as reflected in the BESF FY2023; PIDS and DBM-BESF for the assumptions on interest expenditures and principal payments for 2026; and BTr for the maturity and interest rates on the issuance of new debt to fill fiscal needs. Meanwhile, for the NG debt profile vulnerabilities, data sources were collected solely from the BSP and BTr.

REFERENCES:

ADB. (2021). *Debt Sustainability Analysis.* Manila: Asian Development Bank.

AMRO. (2022). *AMRO Annual Consultation Report The Philippines - 2021*. Available at https://www.amro-asia.org//wp-content/uploads/2022/07/AMRO-Annual-Consultation-Report-on-the-Philippines-2021.pdf (Accessed 15 August 2022)

Bureau of Treasury (BTr). *Cash Operation Report.* (various years)

BTr. *Debt Indicators*. (various years)

BTr. *Financing*. (various years)

BSP. (2022). *The Philippines' External Debt Ratios Remain at Prudent Levels in the First Quarter of 2022*. Available at https://www.bsp.gov.ph/SitePages/MediaAndResearch/MediaDisp.aspx?ItemId=6330 (Accessed 17 August 2022).

Commission on Audit. (2022). *Consolidated Audit Report on Official Development Assistance-Funded Programs and Projects 2021. Available at https://www.coa.gov.ph/reports/official-development-assistance-oda-projects/* (Accessed 17 August 2022).

Congressional Policy and Budget Research Department. *Budget Briefer.* Various years.

Department of Budget and Management (DBM). (2022). *Budget of Expenditures and Sources of Financing FY.* (various years)

DBM. (2022). *Briefer on the 2023 Budget Priorities Framework.* Available at https://www.dbm.gov.ph/index.php/budget-documents/2023/2023-budget-priorities-framework-expenditure-priorities (Accessed on 11 August 2022).

Gottschalk, J. (2014). *Fiscal and Debt Sustainability*. IMF [online]. Available at https://www.imf.org/external/region/tlm/rr/pdf/aug7.pdf (Accessed 10 August 2022).

Heijmans, P. et. al. (undated). *Credit Default Swaps* [Lecture Presentation]. Available at https://www.princeton.edu/~markus/teaching/Eco467/10Lecture/CDS%20Presentation%20with%20References.pdf (Accessed 18 August 2022).

Hemming, R and Petrie, M. (2000). *A Framework for Assessing Fiscal Vulnerability*. https://www.imf.org/en/Publications/WP/Issues/2016/12/30/A-Framework-for-Assessing-Fiscal-Vulnerability-3489 (Accessed 22 August 2022)

Hernandez, R. (2011). *Public Debt and Fiscal Consolidation*. Available at https://www.bsp.gov.ph/Media_And_Research/Publications/EN11-04.pdf (Accessed 10 August 2021).

International Monetary Fund (IMF). (2017). *Debt Sustainability Analysis*. Available at https://www.imf.org/external/pubs/ft/dsa/. (Accessed 15 August 2022)

IMF. (2013). *Staff Guidance Note for Public Debt Sustainability Analysis in Market-Access Countries*. International Monetary Fund, Washington, DC.

Kyriakopoulou, D. & Papadopoullos, C. (2020). *Demystifying Debt Dynamics.* Available at https://www.omfif.org/2020/04/demystifying-debt-dynamics/ (Accessed 22 August 2022).

Nicholls, G. (2014). '*Public Debt Profile and Public Debt Management in the Caribbean',* Available at https://www.elibrary.imf.org/view/books/071/20625-9781484369142-en/ch03.xml (Accessed 10 August 2022).

Office for Budget Responsibility (OBR). (2020). '*Trends in the debt stabilizing primary deficit',* Available at https://obr.uk/box/trends-in-the-debt-stabilising-primary-deficit/ (Accessed 30 March 2022)

OBR. (2022). *Economic and fiscal outlook – March 2022.* Available at https://obr.uk/efo/economic-and-fiscal-outlook-march-2022/ (Accessed 4 April 2022).

Simeon, L. (2022). Borrowings to remain above P2 trillion level. *Philstar Global.* Available at https://www.philstar.com/business/2022/08/17/2203105/borrowings-remain-above-p2-trillion-level- (Accessed 18 August 2022)

World Bank. (2021). *Regaining Lost Ground, Revitalizing the Filipino Workforce*. PEU December 2021 Edition.