HOW WE WERE IN 2021:

Global and Domestic Macroeconomic Landscape

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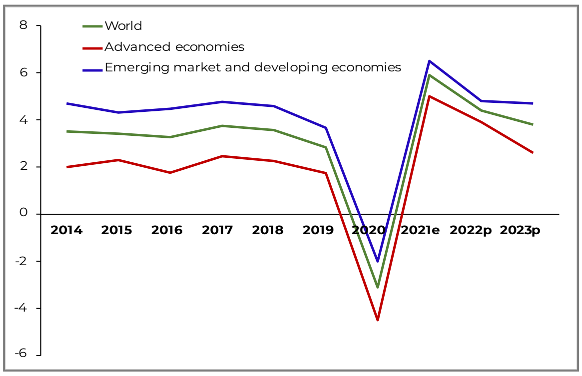
Global Economic Developments

Global economic activity expands in 2021

The global economy expanded in 2021 as accommodative monetary policy settings, sizable fiscal support, and continued vaccine rollouts underpinned the progressive recovery of demand in advanced economies (AEs) as well as in emerging markets and developing economies (EMDEs). The extraordinary interventions implemented by fiscal and monetary policymakers helped tide over households and businesses that were financially strained as recurrent lockdown measures were implemented due to multiple waves of COVID-19 infections.

Chart 1.1 World GDP Growth
At constant prices, year-on-year percent change



Source: IMF World Economic Outlook Updated, January 2022
e - estimated; p - projections

Disparate vaccine distribution and divergent policy measures aggravated the global economy's asynchronous recovery

The gradual rollout of COVID-19 vaccines at the start of the year enabled governments to sequentially ease pandemic-related restrictions and allow economic recovery to proceed. However, the issues in the distribution of vaccines caused COVID-19 to further spread and mutate in regions with limited access to health care services and effective medical interventions. In low-income developing countries and EMDEs, limited vaccine access caused widespread economic dislocation as repeated quarantine restrictions were imposed amid the emergence of more virulent COVID-19 variants.

Factories and export-oriented manufacturing firms located in these country groups had limited operational capacity as COVID-19 outbreaks led to staff shortages and mandatory shutdowns. Accordingly, retailers and businesses in AEs that are highly dependent on international production networks faced acute supply shortages and were unable to meet the pent-up demand as outbreaks in locations that are considered critical links of global supply chains prevented the seamless functioning of cross-border merchandise trade. The resulting supply constraints and elevated input prices reverberated throughout the global economy as supply chain integration created strong links in the transmission of price and output shocks.

In AEs, growth estimates were repeatedly revised downward by the International Monetary Fund (IMF) during the year as protracted supply chain disruptions, tight labor markets, and rapid demand recovery pushed inflation rates higher. Price pressures continued to broaden throughout the latter half of 2021 as persistent shortages, along with improving incomes and pent-up demand, contributed significantly to elevated inflation in the US and the Euro Area. Consequently, economic confidence in these regions moderated as soaring prices stymied consumption growth although strong fiscal support, continuous expansive monetary settings, and increased precautionary savings sustained overall economic recovery during the period.

In addition, the early rollout of vaccines and effective pandemic management strategies allowed AEs to normalize economic activity ahead of other country groups. The latest estimates from multilateral institutions suggest that most AEs are expected to revert to, if not exceed, pre-pandemic levels of economic output by end-2021.

Meanwhile, growth prospects for EMDEs were likewise lowered during the year due to the considerable slowdown in China's debt-ridden property sector as well as delayed output recovery in India and the ASEAN amid multiple waves of COVID-19 infections. At the same time, recurring quarantine restrictions amid rising COVID-19 cases, limited fiscal policy support, and lower public investments weighed on the EMDEs' recovery momentum. The slower overall recovery of the country group was partially offset by better growth prospects in commodity-exporting economies amid the continued rise in raw material prices.

Nevertheless, uncertainties emanating from the emergence of new COVID-19 variants, abrupt tightening of global financial conditions, limited policy space to support activity if needed, and elevated debt levels pose downside risks to the recovery and growth outlook of EMDEs for 2022 and 2023.

Risks to 2022 global growth are tilted to the downside amid protracted supply chain disruptions, elevated inflation, and abrupt tightening of monetary conditions

Looking ahead, global economic growth in 2022 is projected to slow down more than initially expected as recovery prospects have weakened.

Risks to the global growth outlook are tilted downward in view of tight labor markets in AEs, protracted global supply chain disruptions, uncertainty on inflation and monetary policy, and possible emergence of vaccine-resistant COVID-19 variants. Downside risks may also emanate from geopolitical tensions, social unrest, worsening climate disasters, rising energy commodity prices, continued tariff increases, and cross-border technology frictions.

Conversely, upside risk factors include higher vaccination rates, earlier-than-expected easing of supply chain pressures, and lower inflation. Nonetheless, recovery prospects and growth trajectories of AEs and EMDEs are still expected to remain asynchronous due to varying vaccination rates, surging prices, and divergent size of monetary and fiscal support.

Philippine Economic Developments

The Philippine economy rebounds strongly in 2021

The Philippine economy recovered strongly in the second year of the pandemic. Real gross domestic product (GDP) grew by 5.6 percent in 2021, a rebound from the 9.6 percent contraction recorded in 2020. It even exceeded the national government's (NG) revised growth target for 2021 of 5.0-5.5 percent.[1] This may be attributed to the successful management of the pandemic through targeting the areas with the highest risk of COVID-19 infections while allowing the rest of the economy to open.

On the supply side, growth was driven by the notable contributions of both the services (5.3 percent) and industry (8.2 percent) sectors, particularly human health and social work activities (15.0 percent), construction (9.8 percent), information and communication (9.1 percent), and manufacturing (8.6 percent). Unlike the stringent restrictions on business operations and mobility in the previous year, industries and services could operate and public transportation remained available at certain capacities for most of 2021. Meanwhile, agriculture, forestry, and fishing (AFF) contracted by 0.3 percent due to the lingering effects of the African Swine Fever (ASF) on hog production as well as damages caused by typhoons.

On the demand side, growth in 2021 was underpinned by the double-digit rise in gross capital formation (19.0 percent), supported by the expansion in durable equipment (11.9 percent) and construction (10.6 percent). Household consumption also grew by 4.2 percent, which indicates the return of consumer confidence as a result of more relaxed quarantine restrictions and the accelerated vaccination program. Government consumption likewise continued to expand by 7.0 percent in 2021.

Aggregate Output and Demand

Supply side. The services sector grew by 5.3 percent in 2021, a turnaround from the 9.2 percent decline in 2020, on account of eased quarantine restrictions that supported improved mobility during the year. Accounting for 60.5 percent of the domestic economy, the sector propped up the GDP growth outturn for the year by 3.2 percentage points (ppts). The rebound in services was buoyed by the marked improvements in its major subsectors, particularly the wholesale and retail trade, repair of motor vehicles and motorcycles subsector. The latter contributed by itself 0.8 ppts to GDP growth as it grew by 4.3 percent (from minus 6.0 percent in 2020). Public transportation and essential industries were also allowed to operate despite restrictions during extended periods of the COVID-19 surge, thus, supporting the 6.3 percent growth (from minus 30.9 percent) in the transport and storage subsector. There were two of these infection surges: in April 2021 due to the Alpha and Beta variants of the coronavirus, and in August to September 2021 due to the Delta strain. Furthermore, accommodation and food services activities posted a strong recovery during the year, expanding by 7.8 percent from

[1] Approved during the 180th Development Budget Coordination Committee meeting on 14 December 2021.

double-digit contraction of 45.4 percent in the previous year. The containment efforts of the government resulted in lower COVID-19 cases toward the end of the year; hence, restrictions were gradually eased, and establishments could increase their operational capacities. Under the government's pandemic Alert Level 2, restaurants could increase their indoor dine-in services to 50.0 percent capacity for fully vaccinated individuals and outdoor dine-in services to 70.0 percent capacity. Meanwhile, hotels and other accommodations could operate subject to guidelines issued by the Department of Tourism and the Inter-Agency Task Force for the Management of Emerging Infectious Diseases.

Meanwhile, among the major production sectors, industry recorded the fastest growth in 2021 at 8.2 percent (from a 13.2-percent decline in 2020). This was driven primarily by the strong rebound in construction and manufacturing activities during the year. Construction in 2021 recovered, posting a growth of 9.8 percent from the 25.7 percent drop in 2020 due mainly to higher public construction activities (37.4 percent from minus 10.4 percent) in line with the government's strategy to accelerate the completion and implementation of major infrastructure projects to revive the economy. Likewise, the manufacturing subsector, which comprised 64.1 percent of the total industry sector, rose by 8.6 percent in 2021 from a 9.8-percent decrease in 2020. Less stringent restrictions helped manufacturers resume operations and increase production amid supply chain challenges such as freight delays, port congestion and global shortages. The country's manufacturing Purchasing Managers' Index treaded above the 50.0 neutral threshold from September 2021 and hit a nine-month high in December 2021 at 51.8. This shift to expansion signals a solid uptick in business conditions and a move toward recovery in manufacturing activities as larger demand brought in new orders and higher output, combined with strong growth in exports.

On the other hand, the AFF sector further contracted by 0.3 percent in 2021 from 0.2 percent the year before. The negative performance of the sector was due largely to the double-digit decline in livestock production of 17.3 percent. This is the third consecutive year that livestock production contracted due to the continued presence of ASF. Nonetheless, the Department of Agriculture's (DA) partnership with hog farmers, local government units and the private sector has already resulted in significant drop in localities reporting ASF cases. From a high of 3,500 during the outbreak two years ago, the number of ASF-affected barangays has fallen to only 43 as of end-2021.[2] Palay production, on the other hand, continued to expand by 3.3 percent (from 3.1 percent in 2020) with support from the Rice Enhancement Competitiveness Fund.[3] In line with its goal of attaining national food security, the DA will continue to implement various programs on sustainable food production and provide policy and financial support to farmers and fisherfolk.[4]

[2] Statement by DA Assistant Secretary Noel Reyes in a virtual briefing.

[3] DA News. "Rice industry rises amidst challenges", dated 7 February 2022.

[4] DA News. "DA, NEDA, DTI, other gov't agencies join forces towards national recovery", dated 25 January 2022.

Demand side. On the demand side, growth was propelled by the double-digit rise in gross capital formation and robust expansion in household and government expenditures. This reflects a boost in both consumer and business confidence as labor market conditions improved, attributable to the easing of restriction and reopening of more sectors of the economy.

Household final consumption expenditure expanded by 4.2 percent in 2021 from the 7.9 percent decrease in 2020. Having a share of about 72.7 percent to GDP, the upturn in the sector boosted overall output by 3.1 ppts. Almost all subcomponents of household spending increased, particularly food and non-alcoholic beverages (up by 3.4 percent), miscellaneous goods and services (4.5 percent), health (14.4 percent), and education (8.6 percent). The positive performance of household spending was supported by eased mobility restrictions, allowing more people to go back to work, and higher consumer confidence following the increasing vaccination rate in the country.

Government expenditures grew by 7.0 percent, albeit a moderation from 10.5 percent increase in 2020. The sustained growth in government spending was in line with its implementation of various COVID-19 response and recovery measures.

Gross capital formation rose by 19.0 percent, coming strongly from a steep contraction of 34.4 percent in the previous year. Lending support to this were the double-digit growth in durable equipment and construction. Durable equipment rose by 11.9 percent, a turnaround from a 29.7-percent contraction in 2020, due mainly to improved business sentiment following the safe reopening of the economy and continued operations of the manufacturing and transport sectors. Meanwhile, construction grew by 10.6 percent (from minus 30.3 percent in 2020) as all essential public and private construction projects were allowed at full operational capacity regardless of the area's quarantine status, subject to strict compliance with safety guidelines. While corporations' building activities posted a 22.7 percent decline, this was fully offset by the increase in construction activities of households (38.4 percent) and of the general government (37.4 percent). Infrastructure development remains at the core of the government's strategy to revive the economy.

Both exports and imports posted positive performances in 2021. Exports during the year increased by 7.8 percent, a rebound from the 16.3 percent contraction in 2020, indicating global economic recovery and eased restrictions on travel and export-oriented industries. Meanwhile, the expansion in the domestic economy, particularly in investments and household spending, was reflected in the broad-based recovery in goods imports. Total imports of goods and services increased by 12.9 percent in 2021, reversing the decline in 2020 of 21.6 percent. The resulting net exports led to a 6.6 ppts deduction from the 2021 GDP outturn.

Overall, the calibrated reopening of the economy, along with improving global economic landscape, government policy support and structural reforms, helped the Philippine economy to recover strongly in 2021. The government's accelerated vaccination drive has enabled the safe and targeted resumption of many economic activities. This led to additional employment, above-target revenue collections, and a strong and early recovery. Moving forward, the ₱5.0 trillion national budget in 2022 will enable the government to continue to implement its COVID-19 response and economic recovery efforts. The "Build, Build, Build" program of the government is also expected to generate more jobs and further revive businesses.

Furthermore, proposed legislation further liberalizing key economic activities (e.g., retail trade, foreign investments and public services), which are expected to be completed prior to the national election in May 2022, will lend support to greater competitiveness and increased investment appetite as well as boost the country's long-term growth potential.

Labor and Employment Conditions

Labor market Indicators improve from pre-pandemic levels

Gainful employment among Filipinos increased by 3.8 million as of the end of 2021 compared with the level before the onset of the COVID-19 pandemic. Based on the results of the December 2021 Labor Force Survey of the Philippine Statistics Authority, the number of Filipinos employed rose to 46.3 million from 42.5 million in January 2020.[5] Most of the employed as of December 2021 were in the services sector (26.2 million or 56.6 percent) while the others worked in the agriculture (11.8 million or 25.6 percent) and industry (8.2 million or 17.8 percent) sectors. However, the employment rate slightly declined to 93.4 percent in December 2021 from 94.7 percent in January 2020.

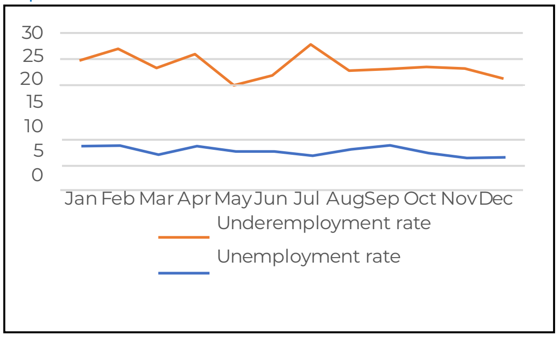
The unemployment rate also continued to ease as it fell to 6.6 percent in December 2021, which was closer to the 5.3-percent pre-pandemic level in January 2020. This was due to the continued relaxation in mobility and economic activity restrictions as the country moved to granular lockdowns in order to open up localities showing declines in COVID-19 cases. From 8.7 percent in January 2021, the unemployment rate declined to 6.5 percent in November 2021, the lowest since the pandemic started, as authorities lowered the alert level in many parts of the country.

Other labor market indicators likewise showed improvement. The Labor Force Participation Rate, or the percentage of the population 15 years and older that is in the labor force, increased to 65.1 percent in December 2021 from 61.7 percent in January 2020. Moreover, the underemployment rate of 14.7 percent in December 2021 was even slightly lower than the 14.8 percent registered in January 2020.

As the country further relaxes its restrictions amid continued vaccine rollout, labor market indicators are expected to further improve moving forward.

[5] In December 2020, the PSA Board approved the release of monthly LFS starting in 2021, with the monthly LFS conducted in between the regular (quarterly) LFS, in order to provide high frequency data on the labor market during the pandemic. All monthly estimates for 2021 are preliminary and the annual data will be released in June 2022.

Chart 1.2 Unemployment/Underemployment Rate
In percent



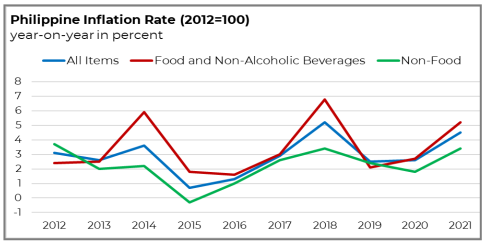
Prices

Using the 2012-based consumer price index (CPI) series, average headline inflation nationwide rose to 4.5 percent in 2021 from 2.6 percent the previous year[6] (Chart 1.4) because of rising energy prices and supply constraints of key food items. This is also above the government's annual inflation target range of 2–4 percent for 2021.

It should be noted that the PSA released the rebased CPI series using the 2018 base year on 4 February 2022. The new series updates the market basket, which better reflects the spending patterns of consumers. Using the 2018-based series, the annual headline inflation settled at 3.9 percent in 2021.

Food inflation remained elevated for most of the year, driven by just a couple of commodities, namely, meat and fish. Meat inflation climbed to double-digit rates in 2021 as the ASF outbreak reduced local hog production. At the same time, adverse weather conditions also hampered fishing, which pushed fish inflation higher during the year. Meanwhile, vegetable inflation eased slightly but remained elevated in 2021 due to supply disruptions from damage caused by weather disturbances in parts of the country.

Chart 1.3 Philippine Inflation Rate (2012=100)
In percent



Source: PSA

Similarly, non-food inflation increased, driven by rising energy prices. Transport inflation went up to 9.7 percent in 2021 from 3.2 percent in the previous year as domestic fuel prices rose reflecting the uptrend in global crude oil prices. At the same time, inflation for housing, water, electricity, gas, and other fuels also went up as electricity rates were adjusted upwards due to higher generation costs.

Inflationary pressures were tempered slightly by negative base effects from the significant increase in prices of meat and vegetable commodities in the latter part of 2020. Negative base effects can also be traced to the substantial uptick in transport fares in 2020 with the enforcement of health protocols.

Inflation in other areas outside NCR (AONCR) also showed an uptrend in 2021 due to faster increases in prices of food and non-food items, albeit price gains in AONCR were notably higher compared with those in the NCR. While NCR inflation accelerated to 3.5 percent in 2021 (from 2.2 percent in 2020), headline inflation in the rest of the country rose to 4.7 percent during the year from 2.7 percent the year before.

[6] The PSA released the rebased CPI series using the 2018 base year on 4 February 2022. Under the new series, annual inflation settled at 3.9 percent.

Demand-side pressures appear to be limited as depicted by core inflation, which excludes selected volatile food and energy items. Average core inflation remained firmly within the target band at 3.3 percent in 2021, broadly unchanged from 3.2 percent in 2020. Meanwhile, most of the alternative measures of core inflation estimated by the BSP increased in 2021. The only exception was the weighted median measure that fell to 1.7 percent in 2021 from 2.3 percent in the previous year.

Chart 1.4 Measures of Core Inflation (2012=100)
In percent

Table A. Alternative Measures of Core Inflation (2012-based CPI)

Year	Core Inflation	Trimmed Mean[1]	Weighted Median[2]	Net of Volatile Items[3]
2019	3.2	2.6	2.9	3.3
2020	3.2	2.1	2.3	3.4
2021	3.3	2.7	1.7	4.1

[1] The trimmed mean represents the average inflation rate of the (weighted) middle 70 percent in a lowest-to-highest ranking of year-on-year inflation rates for all CPI components.
[2] The weighted median represents the middle inflation rate (corresponding to a cumulative CPI weight of 50 percent) in a lowest-to-highest ranking of year-on-year inflation rates.
[3] The net of volatile items method excludes the following items: bread and cereals, vegetables, sugar, jam, honey, chocolate and confectionery, electricity, gas, fuel and lubricants for personal transport equipment, and passenger transport by road. These represent 29.5 percent of all items.
Sources: PSA and BSP estimates

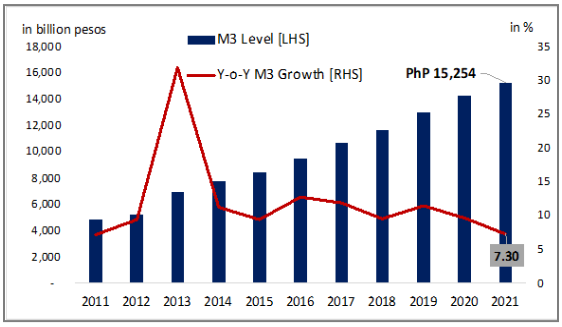
Monetary Aggregates

Domestic liquidity remains ample

Domestic liquidity or M3 increased by 7.3 percent year-on-year (y-o-y) as of end-December 2021 following a 9.6-percent expansion recorded at end-2020. The slower growth in domestic liquidity may be attributed to slower credit activity, particularly among resident households amid the resurgence of COVID-19 infections in the early part of the year. Nevertheless, the BSP's prior liquidity-enhancing measures and accommodative monetary policy stance have ensured ample liquidity in the financial system to support economic activity and strengthen market confidence. With adequate liquidity in the domestic financial system, and as the country's COVID-19 caseload improved, credit activity picked up during the latter part of the year.

Domestic claims[7] or credits to the domestic economy grew by 7.7 percent y-o-y due to the expansion in claims on the private sector (2.8 percent), reflecting the gradual improvement in bank lending in the last few months of the year. Meanwhile, net claims on the central government rose by 22.1 percent due in part to the sustained borrowings by the NG to help support the recovery of the domestic economy from the pandemic.

Chart 1.5 Domestic Liquidity (M3)
Levels in billion pesos; y-o-y growth in percent



Net foreign assets (NFA) in peso terms rose by 6.5 percent y-o-y in December 2021. The slower expansion in the BSP's NFA position reflected the decline in the country's gross international reserves relative to the previous year. Meanwhile, the NFA of banks expanded at a slower clip due to the increase in banks' foreign liabilities.

[7] Domestic claims consist of net claims on central government and claims on other sectors.

Operations of the National Government

The NG recorded a budget deficit of ₱1.7 trillion in 2021, 21.8 percent higher than the fiscal gap of ₱1.4 trillion recorded in 2020. This latest level of fiscal deficit was equivalent to minus 8.6 percent of GDP and was below the revised programmed deficit for 2021 by 10.0 percent.[8] The broader budget shortfall was a result of the sizable expansion in government spending in view of the immediate response to the socio-economic impacts of the prolonged COVID-19 pandemic. The NG's revenues increased by 5.2 percent y-on-y to ₱3.0 trillion from ₱2.9 trillion in 2020, mainly attributed to higher collections by the Bureau of Customs and Bureau of Internal Revenue by 19.7 percent and 6.5 percent, respectively. Relative to the size of the economy, total NG revenue in 2021 accounted for 15.5 percent of GDP, a slight decrease from the 2020 ratio of 15.9 percent.

Meanwhile, NG disbursements amounted to ₱4.7 trillion in 2021, equivalent to 24.1 percent of GDP, and higher by 10.6 percent from the ₱4.2 trillion level in 2020. The increase in spending for the year was brought about by the implementation of various COVID-19 mitigation and recovery measures. However, the disbursement level was lower than the revised programmed spending for 2021 by ₱61.5 billion or minus 1.3 percent.

The 2021 fiscal deficit was financed mainly through domestic sources, which covered about 85.3 percent of the gross financing requirement of the NG. The country's favorable fiscal position and sustained economic growth was disrupted by the pandemic, raising the debt-to-GDP ratio from 54.6 percent in 2020 to 60.5 percent in 2021. However, fiscal discipline has generated sufficient fiscal space which can be allocated mainly into funding health and social protection programs as well as economic stimulus measures against the widespread and profound impact of the COVID-19 pandemic.

[8] Bureau of the Treasury Press Release "Full-Year National Government Budget Deficit Rises to ₱1.7 trillion in 2021" 1 March 2022".

Financial Market Conditions

Exchange Rate

The peso shows resiliency despite concerns over the emergence of new COVID-19 variants and prospects of a faster pace of US Fed tightening

The peso averaged ₱49.3/US$1 for the period 4 January to 31 December 2021, appreciating by 0.8 percent from the ₱49.6/US$1 average in 2020.[9] The peso and the foreign exchange market remained resilient in 2021 despite worries over the emergence of new and aggressive COVID-19 variants, as well as prospects of a faster pace of tightening by the US Federal Reserve. This reflects, in general, investors' continued focus on the country's macroeconomic fundamentals, which include a manageable inflation environment, a strong and resilient banking system, a prudent fiscal position, and an ample level of international reserves buffer.

[9] Dollar rates or the reciprocal of the peso-dollar rates (based on reference rates data) were used to compute for the percentage change.

At the same time, positive market sentiment over the NG's efforts to accelerate the vaccination program, the consequent decline in local COVID-19 cases, and the easing of lockdown restrictions[10] translated to a relatively stable foreign exchange rate. Meanwhile, the continued buildup in the country's international reserves, as well as the reaffirmation of the country's credit ratings also helped sustain market confidence in the local currency.[11,12]

Chart 1.6. Quarterly Peso-Dollar Rate
PHP/US$ average per quarter

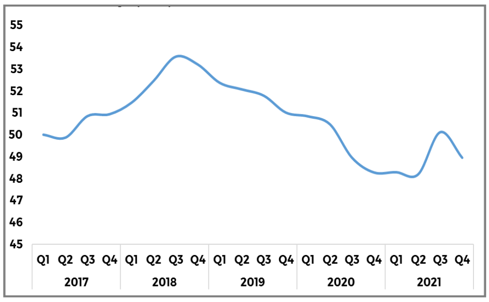
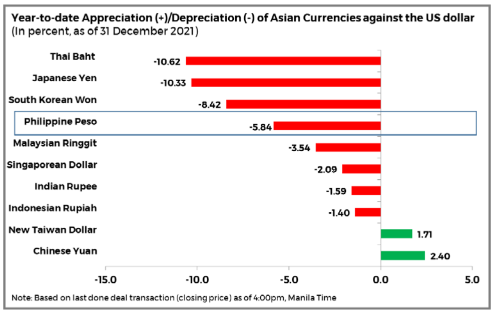


Chart 1.7 Year-to-date Appreciation (+) / Depreciation (-) of Asian Currencies against US$ In percent as of 31 December 2021



Source: Bloomberg, Reuters, and PDEX
Note: Based on last done deal Transaction (closing price) as of 4:00 p.m., Manila time Closing rates used for THB, NTD and KRW are as of 29 December 2021

As of end-December 2021, the peso closed at ₱51.0/US$1, depreciating by 5.8 percent from its closing rate of ₱48.0/US$1 on end-December 2020.[13] The peso depreciated along with most regional currencies except the Chinese yuan, which appreciated against the US dollar.[14] The depreciating trend of the peso and other currencies in the region toward the end of the year was due to market concerns over the prospects of a faster pace of tightening by the US Fed.

Meanwhile, the volatility of the peso (as measured by the coefficient of variation) stood at 2.2 percent (year-to-date) as of 31 December 2021, which was in line with the volatility of most currencies in the region.[15]

Chart 1.8 Volatility of Selected Currencies in 2021
Coefficient of Variation (CoVar)
In percent

Currency	CoVar
HKD	0.19
CNY	0.77
SGD	1.02
IDR	1.13
MYR	1.44
CHF	1.50
GBP	1.69
NZD	2.04
PHP	**2.20**
EUR	2.39
KRW	2.69
JPY	2.75
AUD	2.97
THB	4.02

[10] The new quarantine framework focuses on the imposition of granular lockdown measures over a city or municipality (under Alert Levels 1 to 5) and allows more economic activity and has relatively fewer restrictions.
[11] As of end-December 2021, the country's gross international reserves stood at US$110.1 billion (revised). This can cover 11.8 months' worth of imports of goods and payments of services and primary income. It is also equivalent to 9.5 times the country's short-term external debt based on original maturity and 5.4 times based on residual maturity.
[12] In Q3 2021, Fitch kept its "BBB" rating with a negative outlook while China Lianhe Credit Rating Co. Ltd. and JCRA affirmed its "AAA" and "A "ratings, respectively, both with a stable outlook.
[13] Last trading day for the Philippines for 2021 and 2020 is 31 and 29 December, respectively.
[14] The Chinese yuan appreciated against the US Dollar on the back of strong trade surpluses and robust portfolio inflows amid market enthusiasm for Chinese government bonds.
[15] The coefficient of variation is computed as the standard deviation of the daily exchange rates divided by the average exchange rate for the period.

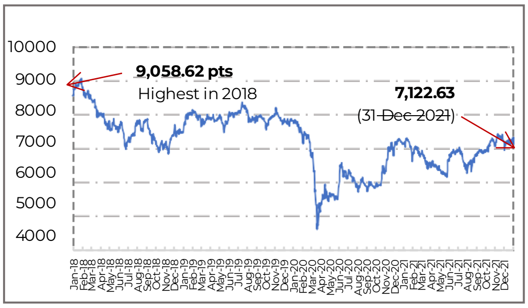
On a real trade-weighted basis, the peso lost external price competitiveness against the basket of currencies of all trading partners (TPI) and trading partners in advanced (TPI-A) countries in 2021. This was indicated by the y-o-y increase in the real effective exchange rate (REER) index of the peso against the TPI and TPI-A by 0.7 percent and 2.3 percent, respectively. Meanwhile, against the basket of currencies of trading partners in developing (TPI-D) countries, the REER index of the peso decreased by 0.2 percent.[16]

Stock Market

In 2021, the Philippine Stock Exchange index (PSEi) averaged 6,852.0 index points, higher by 7.8 percent than the preceding year's average of 6,355.3 index points. By year-end, the Philippine stock market managed to close at 7,122.6 index points near its end-2020 level of 7,139.7 index points. Over the year, investor sentiment improved amid market optimism on positive developments related to COVID-19, continued accommodative monetary policy of the BSP, and the passage of key structural reforms.

Reckoned on a monthly basis, however, trends were mixed. The equity index suffered temporary losses in the first half of the year due largely to investor concerns over the periodic spikes in daily coronavirus cases nationwide as well as the detection of new COVID-19 variants. Also dampening market sentiment were the slow pace of vaccine rollouts, and the subsequent implementation of stricter quarantine restrictions that resulted in weak economic figures and a negative growth outlook on the part of multilateral agencies.

Chart 1.9 Philippine Stock Exchange Index (PSEi)
In index points



Nevertheless, the risk-off sentiments in the early part of the year were subdued by positive developments such as (1) favorable economic data releases; (2) decreasing number of daily COVID-19 infections that further boosted consumer spending; (3) the government's shift to a granular quarantine scheme that partly eased restrictions in Metro Manila and improved business confidence; and (4) the BSP's pronouncements on maintaining the current monetary policy stance and extraordinary liquidity measures that are supportive of Philippine economic recovery. Toward the end of the year, the passing of key legislative measures such as the Retail Trade Liberalization Act and the amendments to the Public Service Act and to the Foreign Investments Act, which will open up key economic sectors and attract foreign technical expertise

[16] The TPI measures the nominal and real effective exchange rates of the peso across the currencies of 14 major trading partners of the Philippines, which includes the US, Euro Area, Japan, Australia, China, Singapore, South Korea, Hong Kong, Malaysia, Taiwan, Indonesia, Saudi Arabia, United Arab Emirates, and Thailand. The TPI-A measures the effective exchange rates of the peso across currencies of trading partners in advanced countries comprising the US, Japan, Euro Area and Australia. The TPI-D measures the effective exchange rates of the peso across 10 currencies of partner developing countries, which includes China, Singapore, South Korea, Hong Kong, Malaysia, Taiwan, Indonesia, Saudi Arabia, United Arab Emirates, and Thailand.

into the country, also contributed to the recovery of the local bourse.

Other stock market indicators mirrored the general uptrend in the average PSEi in 2021. In particular, foreign transactions net selling substantially declined from ₱128.6 billion in 2020 to ₱2.8 billion in 2021 and total market capitalization rose by 13.8 percent to ₱18.1 trillion. Meanwhile, the P/E ratio of listed firms ended the year lower from 28.5 times in end-2020 to settle at 21.3 times in end-2021 amid dampened investor sentiment due largely to the negative impact of typhoon Odette and the sudden surge in local COVID-19 cases toward the end of the year.

For the coming year, the PSEi is expected to continue its growth momentum against the backdrop of the improving local COVID-19 situation and gradual reopening of the economy, positive macroeconomic prospects backed by sustained government infrastructure spending and complemented by the BSP's monetary policy support, and the implementation of the key structural reforms that were recently passed. However, stock market volatility is expected to continue in 2022 due to a number of risk factors, including: (1) rising global interest rates, particularly the faster-than-expected US Fed rate normalization; (2) potential surges in COVID-19 infections brought about by the emergence of new variants; (3) domestic election-related uncertainty; and (4) heightened geopolitical tensions.

Bond Market

The Philippine bond market continued to grow in 2021 amid the challenges brought about by the pandemic. Liquidity remained ample with sustained demand as evidenced by the high oversubscription consistently seen in the weekly Bureau of the Treasury (BTr) auctions in the primary market as the BSP continued to ensure the proper functioning of financial markets.[17] While there were episodes of short-term volatility, risk premiums remained generally steady.

In 2021, government issuances of local currency bonds increased by 13.3 percent from its level in 2020. The increase in government issuances reflected the NG's continued funding needs for pandemic and recovery response while ensuring prudent fiscal management. In contrast, private issuances decreased by 50.5 percent y-o-y, indicating that local firms may have limited need for additional funding amid the subdued business environment.

In terms of market share, issuances from the public sector comprised 91.0 percent of the total bond issuances while the private sector accounted for the remaining 9.0 percent. Bonds issued by the BTr accounted for the entire public sector issuances while issuers from the private sector consisted of holding companies, banks, oil industry players, telecommunication services providers, and real estate firms.

[17] The BSP's GS purchases in the secondary market helped encourage participation in the primary GS auctions, which in turn ensured that the National Government (NG) meets its domestic borrowing requirements.

Chart 1.10 Local Currency Bond Issuances
In billion pesos

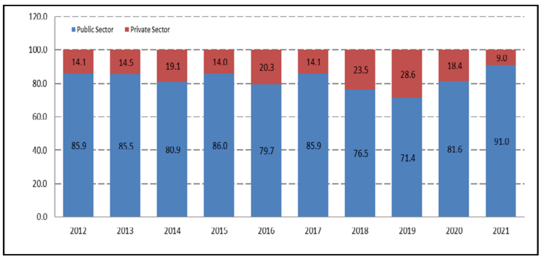
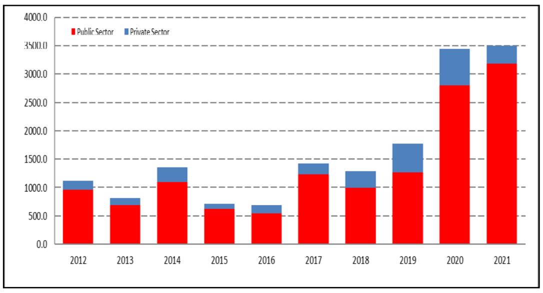


Chart 1.11 Local Currency Bond Issuances
As percent of market share

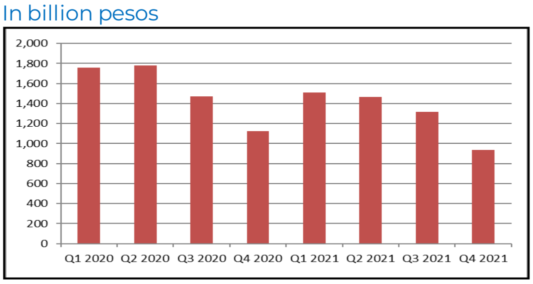


Source: BTr, Bloomberg

Investor preference for shorter-dated debt securities was greater than the preference for the longer end of the curve, indicating investors' risk-averse attitude amid the uncertain and challenging market environment.

In the secondary market, trading activity has slowed down despite the increased supply of relatively high-yielding retail treasury bonds in both peso and dollar denominations. The overall decreasing trend may be partly due to the wait and hold stance by market participants amid the uncertainty, brought about by the reimposition of strict lockdowns due to the emergence of new COVID-19 variants.

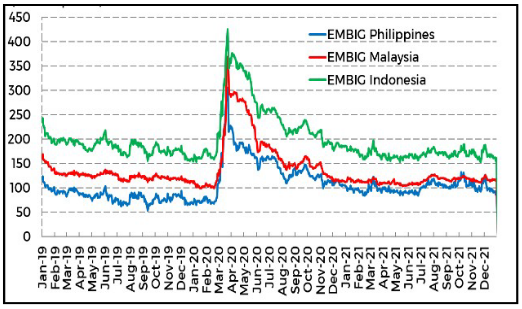
Chart 1.12 Secondary Market Volume
In billion pesos



Source: Philippine Dealing System

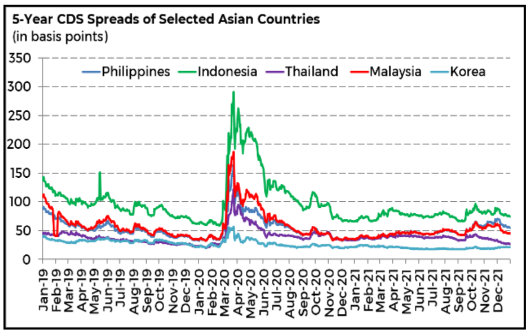
While the challenging and volatile operating environment affected investors' risk sentiment, risk premiums on the country's debt instruments have remained low, with occasional spikes observed during periods of uncertainties over COVID-19-related developments. Over the year, debt spreads continued to exhibit a narrowing trend, reflecting the recovery of some business activities and improved investor sentiment amid reports on the decline in the country's average daily new cases of COVID-19, which dropped to below one thousand by year-end 2021.

Chart 1.13 EMBIG Spreads of Selected ASEAN Countries
In basis points



Source: Bloomberg

Chart 1.14 5-Year CDS Spreads of Selected Asian Countries
In basis points



Source: Bloomberg

The extra yield investors demanded to own Philippine sovereign debt over US Treasuries or the Emerging Market Bond Index Global (EMBIG) Philippines spread stood at 93 basis points (bps) as of end-December 2021 compared with 106 bps recorded in the previous year. Meanwhile, the country's five-year sovereign credit default swap (CDS) year-end level was stable at 55 bps. Against other neighboring economies, the Philippine CDS was narrower than Indonesia's 75 bps but wider than Malaysia's 45 bps, Thailand's 27 bps, and Korea's 21 bps spreads.

Credit Rating Assessment

In 2021, the Philippines was able to keep its investment grade ratings amid the waves of negative credit rating actions and outlook revisions across the globe as the pandemic weighed down the performance and credit profiles of many economies.

In January, Fitch Rating kept the Philippines' investment-grade credit rating of "BBB" with a "stable" outlook.[18] The ratings agency cited the country's manageable fiscal situation and favorable growth prospects despite the COVID-19 crisis. Fitch noted the country's "modest government debt levels relative to peers, robust external buffers, and strong medium-term growth prospects."

In April, Japanese debt watcher Rating and Investment Information Inc. (R&I) affirmed the Philippines's "BBB+" rating with a "stable" outlook. The R&I noted the following factors that supported the favorable outlook for the Philippines: (1) role of fiscal and monetary measures in supporting growth; (2) aggressive public investments as a key driver of the recovery; and (3) strength of the country's external accounts which serve as buffers against external shocks.

Similarly, in May, S&P Global Rating maintained its "BBB+" rating on the Philippines and assigned a "stable" outlook. The S&P recognized that prospects for the Philippine economy remain favorable once the COVID-19 pandemic is contained, and expected that fiscal performance will strengthen accordingly.

In July, Fitch affirmed the Philippines' "BBB" investment grade rating, reflecting the country's robust external buffers and projected that government debt levels—while rising—should remain just below 'BBB' peer medians. However, it also revised the outlook on the rating from "stable" to "negative", noting the downside risks to the Philippines' medium-term growth prospects and possible challenges associated with unwinding the policy responses to mitigate the impact of the health crisis and to restore sound public finances in a post-pandemic period.

In September, Japan Credit Rating Agency affirmed the Philippines' credit rating of "A-" with a stable outlook, citing the soundness of the country's external payments position, fiscal situation, and banking sector, as well as efforts toward strong economic recovery from the COVID-19 crisis.

[18] "BBB" is one step above the minimum investment grade, while a "stable" outlook indicates absence of factors that could trigger an adjustment in the rating in the near term.

Box Article 1

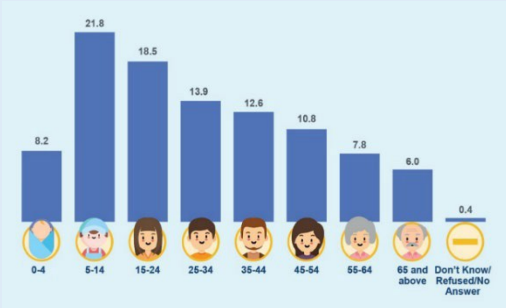
A Snapshot of Philippine Household Finances: Results of the 2018 Consumer Finance Survey

The Consumer Finance Survey (CFS) is a nationwide triennial survey of the BSP on the financial condition of Filipino households, considering their assets, liabilities, incomes, and expenditures.[19] Data from the 2018 CFS were gathered from 14,860 respondent households (82.6 percent of the targeted 18,000 sample households) nationwide from 11 October 2018 to 2 June 2019.

Household Profile

The results of the survey showed that the Philippines has a young population. Majority (63.6 percent) of the household members belonged to the working-age group, of which the largest sub-group was the young adults (aged 25-44 years old) at 26.5 percent. This was followed by the middle-aged (aged 45-64 years old) at 18.6 percent and the youth (aged 15-24 years old) at 18.5 percent. The age dependency ratio[20] was estimated at around 57 dependents for every 100 working-age persons. (See Chart 1.)

Chart 1. Distribution of Household Members, by Age
In Percent



Asset Accumulation of Households

From an asset perspective, the portfolio of households comprised mostly of non-financial assets (NFAs). The three most common NFAs held by households were home appliances, which are owned by 91.7 percent of total households, followed by their own residence at 71.6 percent, and motor vehicles at 30.5 percent. (See Chart 2.)

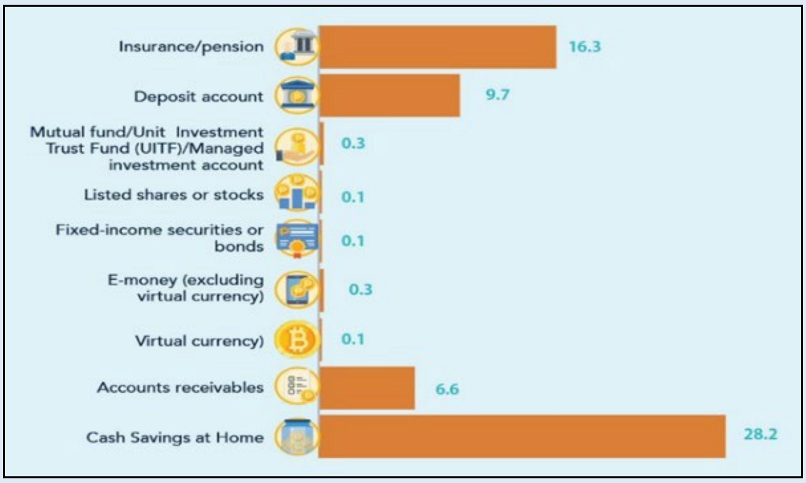
Chart 2. Distribution of Households with Non-Financial Assets, by Type of Asset In Percent

[19] Following the 2009 and 2014 CFS round and pursuant to Monetary Board Resolution No. 1802 dated 26 October 2017, the succeeding rounds shall be conducted triennially, starting with the 2018 CFS.

[20] Age dependency ratio is defined as the number of all age-dependent household members (0–14 years old and 65 years old and above) divided by the number of all working-age household members (aged 15–64 years old) in the country.

In terms of financial assets, 22.6 percent of Filipino households had access to financial products and services. The top financial assets owned by households were insurance or pension policies (held by 16.3 percent of households) and deposit accounts (9.7 percent). Less than 1 percent of households had financial investment and electronic money (e-money) accounts. Notably, more households kept their cash at home for emergencies (28.2 percent) than in deposit accounts (9.7 percent). (See Chart 3.)

Chart 3. Distribution of Household Members, by Age
In Percent



Outstanding Liabilities of Households

Nearly two in every five households (40.4 percent) owed some form of debt, most of which were outstanding loans (28.2 percent). This was followed by household bills (17.1 percent) and unpaid credit card bills (1.6 percent).[21]

The top sources of households' loans were the Home Development Mutual Fund (or Pag-IBIG) and National Housing Authority for housing loans, in-house financing for vehicle loans, and financing companies and institutions for business and other consumer loans.

Households were able to manage their loans well as most were paid on time (86.3 percent of business loans, 77 percent of other loans, 69.6 percent of credit card debts, 64.6 percent of vehicle loans, and 43.3 percent of housing loans).

Households' Sources of Income

Majority of Filipino households (73.7 percent) earned their income from employment in either the public or private sector. Only a few Filipino households (5.1 percent) were engaged in business.

[21] Outstanding loans refer to the remainder of the principal that has not yet been paid in full.

Nearly half of the households (47.6 percent) derived their income from other sources, commonly in the form of cash assistance from abroad; domestic support from family and relatives in the form of cash, goods or both; and government assistance through the Pantawid Pamilyang Pilipino Program and the Social Pension Program of the Department of Social Welfare and Development.

Households' Spending Patterns

Food accounted for the largest share (at least 72.1 percent) of total household expenditure. Spending on housing and utilities (23.9 percent), transportation (10.5 percent), and health (4.8 percent) comprised the biggest share among the non-food items.

Key Takeaways

In summary, households in 2018 prioritized the accumulation of non-financial assets over savings and investment, and they preferred to keep cash savings at home rather than maintain at least a basic deposit account. Nonetheless, the debt situation remained favorable as the bulk of households' debts were paid on time. Meanwhile, households derived most of their income from employment and other sources such as remittances from abroad. Filipinos allocated most of their budget to food.

The Philippine Banking System

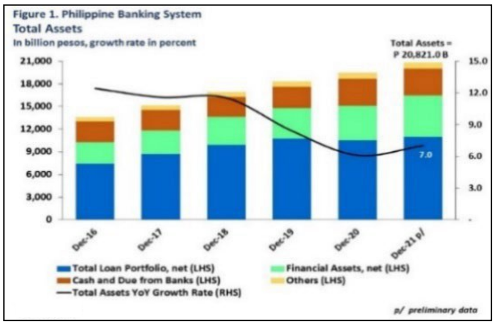
The Philippine banking system (PBS) sustained its solid footing as shown by the continued growth in assets, deposits, as well as healthy profits, stable capital and liquidity buffers, and ample loan loss reserves

The banking system's total resources and loans further expanded and remained supportive of the country's financing needs. This asset growth continued to be mainly funded by deposit generation and capital infusion.

Assets sustain positive growth

The 7.0 percent y-o-y growth in the PBS' total assets to ₱20.8 trillion as of end-December 2021 was primarily due to expansion of funds channeled to lending and investment activities and sourced mainly from deposits. Total loan portfolio[22] (TLP), net of allowance for credit losses, comprised the largest share of the banking system's total assets at 52.8 percent (₱11.0 trillion), followed by net financial assets other than loans,[23] and cash and due from banks with 26.3 percent share (₱5.5 trillion) and 17.1 percent share (₱3.6 trillion), respectively (Chart 1.15). Meanwhile, other assets[24] had a 3.8 percent share (₱788.0 billion).

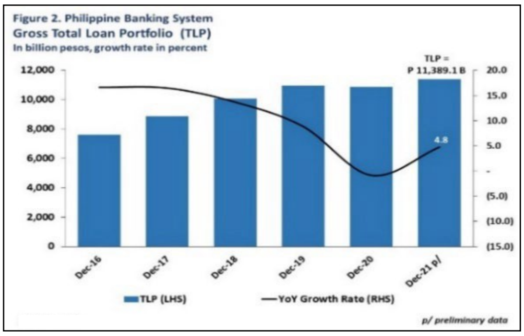
Chart 1.15 Philippine Banking System Total Assets
In billion pesos, growth rate in percent



The banking system's loan portfolio further expands

Gross TLP went up by 4.8 percent y-o-y to ₱11.4 trillion as of end-December 2021. This rate was a turnaround from the 0.9 percent contraction in December 2020 (Chart 1.16). This was also the fifth consecutive month of positive annual growth rate in TLP.

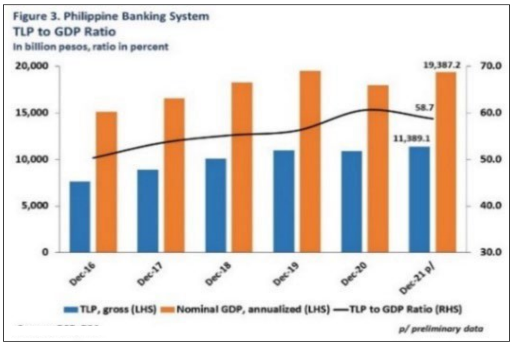
Chart 1.16 Philippine Banking System Gross Total Loan Portfolio (TLP)
In billion pesos, growth rate in percent



[22] Includes Interbank Loans Receivable and Reverse Repurchase.
[23] Composed of investments in debt and equity securities, as well as equity investments in subsidiaries, associates and joint ventures, net of allowance for credit losses.
[24] Includes real and other properties acquired.

Meanwhile, the ratio of gross TLP to annualized nominal gross domestic product (GDP) stood at 58.8 percent as of end-December 2021 (Chart 1.17).

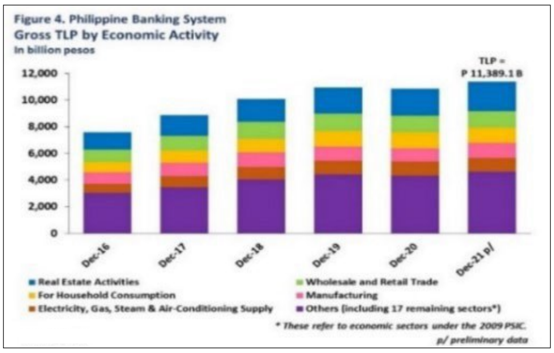
Chart 1.17 Philippine Banking System TLP to GDP Ratio
In billion pesos, ratio in percent



Loans remains broad-based across various industries

By economic activity, real estate had the largest share of TLP at 19.4 percent as of end-December 2021 (Chart 1.18). This was followed by wholesale and retail trade; manufacturing; and electricity, gas, steam, and air-conditioning supply with TLP shares of 10.9 percent, 9.8 percent, and 9.3 percent, respectively. Meanwhile, loans for household consumption had a TLP share of 10.0 percent. Real estate activities posted a growth rate of 8.3 percent y-o-y, indicating sustained lending to the real estate industry amid the crisis. However, loans for household consumption declined by 5.9 percent. By contrast, loans to the manufacturing; wholesale and retail trade; and electricity, gas, steam, and air-conditioning supply sectors went up by 9.5 percent, 1.3 percent, and 0.2 percent, respectively.

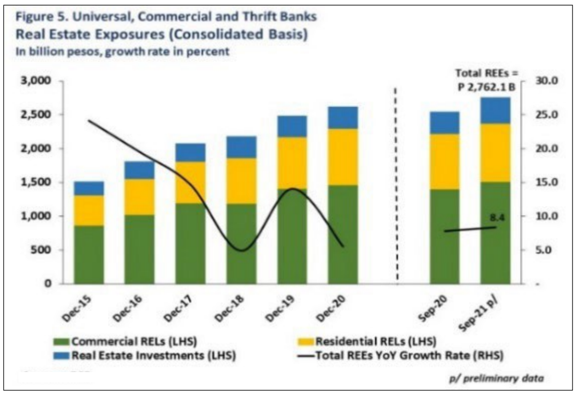
Chart 1.18 Philippine Banking System Gross TLP by Economic Activity
In billion pesos



Real estate exposures expand but consumer loans went down

The real estate exposures (REEs) of universal and commercial banks (U/KBs) and thrift banks (TBs) expanded from the previous year by 8.4 percent to ₱2.8 trillion on consolidated basis as of end-September 2021, higher than the 7.8 percent growth recorded a year before (Chart 1.19).

Chart 1.19 Universal, Commercial and Thrift Banks Real Estate Exposures (Consolidated Basis)
In billion pesos, growth rate in percent



These REEs were made up mainly of real estate loans (RELs) which had an 85.7 percent share while the rest were real estate investments. Total RELs continued to expand at an annual pace of 6.9 percent to ₱2.4 trillion as of end-September 2021. Commercial RELs, which accounted for almost two-thirds of total RELs, increased by 7.8 percent to ₱1.5 trillion. (Chart 1.20). Residential RELs went up by 5.3 percent to ₱859.9 billion. (Chart 1.21).

Chart 1.20 Universal, Commercial and Thrift Banks Commercial Real Estate Loans (Consolidated Basis) In billion pesos, growth rate in percent

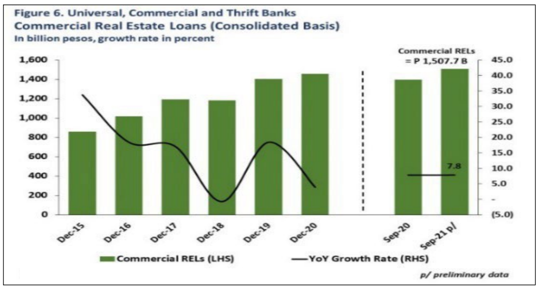
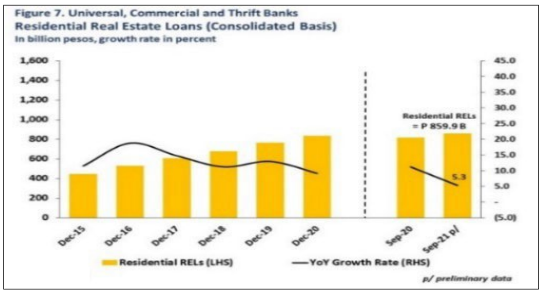


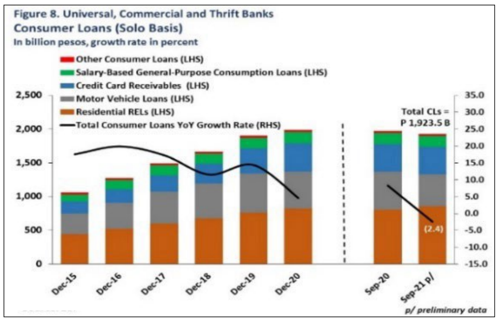
Chart 1.21 Universal, Commercial and Thrift Banks Residential Real Estate Loans (Consolidated Basis)
In billion pesos, growth rate in percent



Meanwhile, residential real estate prices of various types of new housing units in the Philippines recovered in Q3 2021 based on the y-o-y growth of the Residential Real Estate Price Index. Nationwide house prices increased by 6.3 percent partly due to the stronger consumer demand for residential property, particularly townhouses and condominium units. By area, residential property prices in the National Capital Region (NCR) and Areas Outside NCR expanded. By type of housing units, growth is mainly attributed to the rise in prices of townhouses and condominium units.

The level of consumer loans (CLs) of U/KBs and TBs went down by 2.4 percent to ₱1.9 trillion on solo basis as of end-September 2021 from the previous year. (Chart 1.22). Residential RELs made up the largest share of total CLs at 44.4 percent (₱853.7 billion), followed by motor vehicle loans[25] at 24.8 percent (₱476.2 billion), credit card receivables at 21.0 percent (₱404.5 billion), salary-based general-purpose consumption loans at 8.6 percent (₱164.7 billion), and other consumer loans at 1.3 percent (₱24.4 billion).

Chart 1.22 Universal, Commercial and Thrift Banks Consumer Loans (Solo Basis)
In billion pesos, growth rate in percent



Loan quality remains manageable and within the BSP expectations

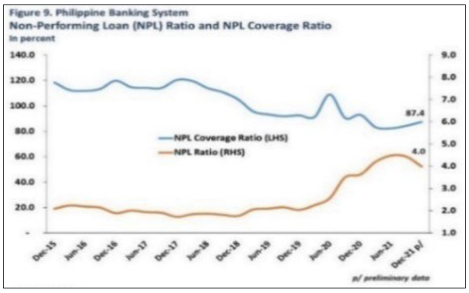
The quality of the PBS' loan portfolio was manageable. The non-performing loan (NPL) ratio[26] stood at 4.0 percent as of end-December 2021, higher than 3.6 percent as of end-December 2020 but

[25] Comprised mainly auto loans which stood at ₱444.3 billion (93.3 percent share) while the rest are motorcycle loans at ₱32.0 billion (6.7 percent share).

[26] Ratio of gross NPLs to gross TLP.

lower than 4.3 percent as of end-November 2021. Early recognition of provision for credit losses in 2020 resulted in the high NPL coverage ratio[27] of the PBS, which stood at 87.7 percent as of end-December 2021 (Chart 1.22). Meanwhile, the non-performing REL ratio stood at 5.2 percent as of end-September 2021 compared with 4.2 percent as of end-September 2020. The non-performing CL ratio was 9.9 percent as of end-September 2021, up from 8.5 percent as of end-September 2020.

Chart 1.22 Philippine Banking System Non-Performing Loan (NPL) Ratio and NPL Coverage Ratio
In percent



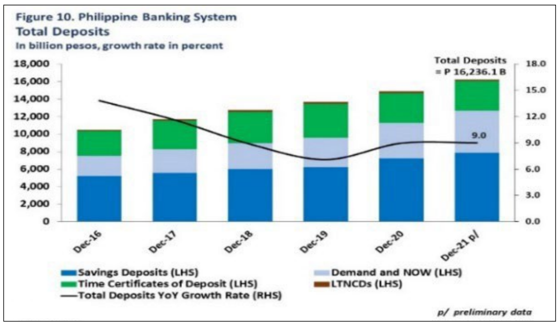
Banks' investment portfolio increases

Gross financial assets[28] increased by 21.2 percent y-o-y to ₱5.2 trillion as of end-December 2021. Gross financial assets were composed mostly of debt securities measured at amortized cost[29] at ₱2.6 trillion (50.3 percent share) and financial assets measured at fair value through other comprehensive income[30] at ₱2.3 trillion (44.8 percent share). Financial assets measured at fair value through profit or loss[31] had a minimal share at ₱255.3 billion (4.9 percent share).

Deposits fuel banks' lending and investment activities

The PBS' lending and investment activities were mostly funded by the 9.0 percent yearly growth in deposits to ₱16.2 trillion as of end-December 2021 (Chart 1.23). These deposits were mostly peso-denominated and sourced from resident individuals and private corporations. Savings deposits had the biggest share of total deposits at 48.5 percent, followed by demand and negotiable order of withdrawal accounts at 29.6 percent share and time certificates of deposit at 20.7 percent share. Long-term negotiable certificates of deposit had a minimal share at 1.2 percent. Other sources of funding such as bonds payable (₱613.8 billion) and bills payable (₱496.9 billion) remained relatively small compared with total bank's funding as of end-December 2021. Meanwhile, banks posted a stronger capital position as total capital expanded by 5.9 percent to ₱2.6 trillion in the same reference period.

Chart 1.23 Philippine Banking System Total Deposits
In billion pesos, growth rate in percent

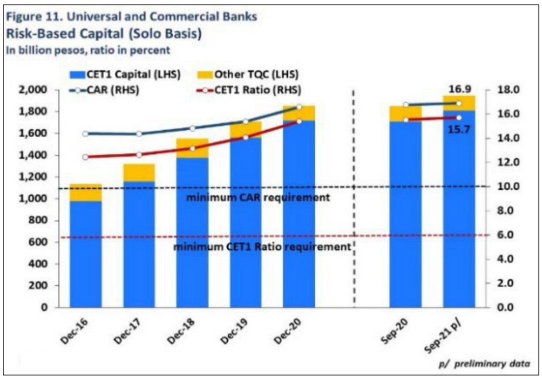


[27] Ratio of allowance for credit losses – TLP to gross NPLs.
[28] Other than loans and equity investments in subsidiaries, associates and joint ventures.
[29] Debt securities measured at amortized cost are classified as held-to-maturity (HTM) financial assets in the existing Financial Reporting Package (FRP) submitted by banks to the BSP.
[30] Classified as available-for-sale (AFS) financial assets in the FRP.
[31] Classified as financial assets held-for-trading (HFT) and designated at fair value through profit or loss (DFVPL) in the FRP.

Banks remain well capitalized; capital adequacy ratios (CARs) compliant with Basel requirements

The CARs of the U/KB industry on solo and consolidated bases were well above the minimum thresholds of 10 percent set by the BSP and 8.0 percent set by the Bank for International Settlements (BIS). As of end-September 2021, the CARs of the U/KB industry improved to 16.9 percent and 17.4 percent on solo and consolidated bases, respectively, from the previous year's 16.8 percent and 17.2 percent (Chart 1.24). Banks' risk-taking activities were supported by adequate capital, which was composed mainly of common equity and retained earnings. As of end-September 2021, the common equity tier 1 ratio of the U/KB industry improved to 15.7 percent and 16.3 percent on solo and consolidated bases, respectively, from the previous year's 15.5 percent and 16.0 percent.

Chart 1.24 Universal and Commercial Banks Risk-Based Capital (Solo Basis)
In billion pesos, ratio in percent



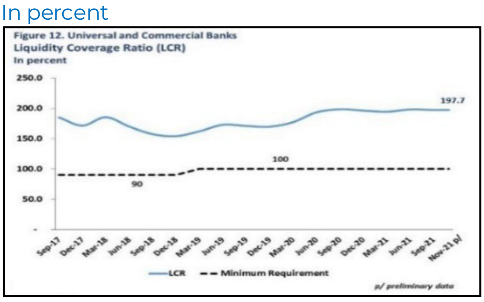
The U/KB industry's Basel III Leverage Ratio as of end-September 2021 stood at 9.6 percent and 10.1 percent on solo and consolidated bases, respectively. These ratios were well above the BSP and international thresholds of 5.0 percent and 3.0 percent, respectively. The ratio relates the level of a bank's tier 1 capital against its total on-book and off-book exposure.

The CAR of the TB industry as of end-September 2021 improved to 19.3 percent from the previous year's 17.5 percent, while the CAR of rural and cooperative banks slightly declined to 19.1 percent from the previous year's 19.2 percent[32]. These capital ratios were well above the minimum thresholds set by the BSP and the BIS.

The banking system maintains sufficient buffers to meet liquidity and funding requirements

Liquidity of banks was ample. The U/KB industry's solo and consolidated liquidity coverage ratios (LCR) of 197.6 percent and 194.9 percent, respectively, as of end-September 2021 remained well above the 100 percent minimum threshold. Preliminary data as of end-December 2021 showed that the U/KB industry's solo LCR stood at 200.9 percent (Chart 1.25). The high LCR of U/KBs indicated banks' ability to fund requirements during short-term liquidity shocks.

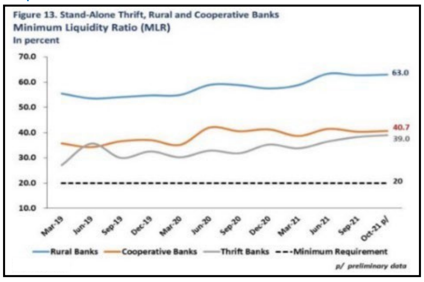
Chart 1.25 Universal and Commercial Banks Liquidity Coverage Ratio (LCR)
In percent



[32] Based on solo basis capital computation. Ratios are combination of Basel III and Basel 1.5 frameworks

Meanwhile, the liquidity ratios of stand-alone TBs, rural banks (RBs), and cooperative banks (CBs) surpassed the 20 percent minimum liquidity ratio[33]. Based on preliminary data as of end-December 2021, the liquidity ratios of standalone TBs, RBs, and CBs stood at 37.0 percent, 62.1 percent, and 41.5 percent, respectively (Chart 1.26).

Chart 1.26 Stand-Alone Thrift, Rural and Cooperative Banks
Minimum Liquidity Ratio (MLR)
In percent



As of end-December 2021, the U/KB industry's net stable funding ratio stood at 143.4 percent on solo basis and 145.1 percent on consolidated basis, well above the BSP regulatory threshold of 100.0 percent. These ratios indicated availability of more stable funding to serve bank customers in the medium term.

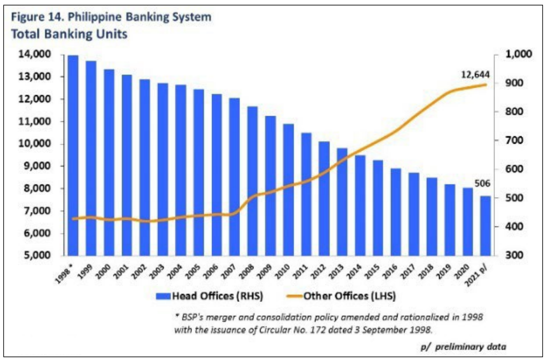
The banking system's net profit grows

The net profit of the banking system went up by 44.8 percent y-o-y to ₱224.8 billion for the year ending December 2021. Meanwhile, the return on assets[34] for the same period was 1.1 percent, higher than 0.8 percent posted a year before. Return on equity[35] inched up to 9.0 percent from the previous year's 6.5 percent. Meanwhile, net interest margin[36] went down to 3.5 percent for the said period from the previous year's 3.8 percent. The cost-to-income ratio[37] stood at 58.7 percent, remaining below 65.0 percent as in the past seven years.

Leaner and stronger banking landscape backs industry performance

The increase in bank assets was accompanied by an expansion in the banks' physical network. As of end-December 2021, the number of bank offices grew to 13,150[38] on account of new other offices added to the overall network (Chart 1.27).

Chart 1.27 Philippine Banking System
Total Banking Units



[33] As a relief measure, the BSP reduced the ratio from 20 percent to 16 percent until end December 2022.
[34] Ratio of annualized net profit or loss to average assets
[35] Ratio of annualized net profit or loss to average capital
[36] Ratio of annualized net interest income to average earning assets
[37] Ratio of annualized non-interest expenses to annualized total operating income
[38] Composed of 506 head offices and 12,644 other offices

The Non-Bank Sector

Non-Bank Financial Institutions with Quasi-Banking Functions (NBQBs)

The NBQB industry remains stable amid noted streamlining in its operations to improve overall performance

As of end-December 2021, the total number of sector participants stood at six, composed of one investment house, four financing companies, and one other NBQB. In terms of network, the four financing companies had a total of 121 branches.

Based on preliminary data as of end-December 2021, NBQBs' total assets contracted by 12.8 percent YoY to ₱168.3 billion. The industry, however, remained profitable as it recorded a net income of ₱1.3 billion for the period-ended December 2021.

Non-Stock Savings and Loans Associations (NSSLAs)

Overall performance of the NSSLA industry remains stable with sustained expansion in total resources

As of end-December 2021, there were 60 players with 138 branches. The industry posted a 6.1 percent annual increase in total assets to ₱283.3 billion as of end-December 2021, mainly due to the 5.1 percent rise in gross loans.

Capital accounts, which remained the main source of funds for NSSLAs, rose 3.2 percent to ₱180.2 billion as of end-December 2021. Deposit liabilities expanded by 14.0 percent to ₱80.6 billion in the same period. Meanwhile, the industry's net profit after tax went up by 25.8 percent y-o-y to ₱22.1 billion for the period-ended December 2021.

Pawnshops and Money Service Businesses (MSBs)

Pawnshops and MSBs remain as major financial service access points in the country particularly in providing immediate liquidity to borrowers, remittance services, and other financial services in the countryside

As of end-December 2021, there were a total of 15,388 pawnshop offices (1,152 head offices and 14,236 branches). Meanwhile, there were 7,449 MSB offices as of the same period. (748 head offices and 6,701 branches).

Most pawnshops offered corollary remittance activities while most MSBs were large-scale operators. By end-December 2021, there were 11,815 pawnshop offices under the type "C" license, which meant they had corollary remittance activities requiring BSP registration. Meanwhile, MSBs were dominated by large-scale operators with average monthly network volume of transactions of at least ₱75.0 million. These type "A" operators had a total of 5,078 offices as of the same period.

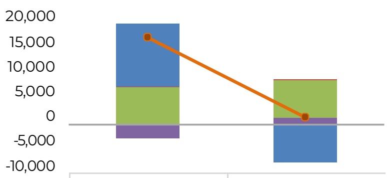
External Sector

Balance of Payments

Overall BOP position yields lower surplus

The BOP position yielded a lower surplus of US$1.3 billion in 2021 from the US$16 billion surplus recorded in the previous year. This outcome was primarily attributed to the recorded reversal of the current account surplus to a deficit, which, in turn, resulted from the continued widening of the trade in goods deficit.

Chart 1.28 Main Balance of Payments Accounts
In million US$
January-December 2021



	Jan-Dec 2020	Jan-Dec 2021
Current Account	11,578	-6,922
Capital Account	63	80
Financial Account*	-6,906	-6,942
Net Unclassified Items	-2,526	1,245
Overall BOP**	16,022	1,345

* In the Financial Account, a positive (negative) balance indicates an outflow (inflow). For graphical presentation purposes, inflows (outflows) are reflected as positive (negative) bars.
** The overall BOP position is equal to the current account balance plus the capital account balance minus the financial account balance plus net unclassified items.
Details may not add up to total due to rounding.

Meanwhile, the financial account recorded higher net inflows on the back of the upturn in net inflows of direct investments, other investments, and trading in financial derivatives. These inflows were partly muted by the turnaround in the portfolio investment account to net outflows.

Current account reverses to a deficit

The current account recorded a deficit of US$6.9 billion (equivalent to -1.8 percent of GDP) in 2021, a reversal of the US$11.6 billion surplus (equivalent to 3.2 percent of GDP) recorded in 2020. The reversal of the current account surplus to a deficit emanated from the widening of the merchandise trade gap, coupled with the reduction in net receipts in the primary income account. This was partly mitigated by the expansion in net receipts of the secondary income and trade in services accounts.

- The trade gap widened by 59.2 percent from US$33.8 billion in 2020 to US$53.8 billion in 2021 as the recovery in imports of goods continued to outpace that of exports due to increased trade and commerce as COVID-19 restrictions continued to ease globally.
    - Total exports reached US$54.2 billion in 2021, up by 12.4 percent from US$48.2 in 2020. Electronic products continued to drive the growth, posting an increase of 8.9 percent from US$24.1 billion the previous year to US$26.3 billion in 2021. Furthermore, exports of mineral products and coconut products increased by 15.8 percent and 58.7 percent, respectively. On a by-country basis, exports growth was mainly driven by demand from the top export markets, particularly the US and China.
    - Meanwhile, total imports continued to accelerate, registering a 31.7-percent growth in 2021 to US$108.0 billion from US $82.0 billion the previous year as imports of almost all major commodity groups recovered. This uptrend was mainly driven by the 30.4-percent rise in importation of raw materials and intermediate goods in 2021 to

US$43.0 billion. Specifically, higher local demand for chemicals and manufactured goods increased by 43.0 percent (to US$14.0 billion) and 31.9 percent (to US$14.8 billion), respectively. In addition, imports of mineral fuels and lubricants, and capital goods also registered notable increases at 91.3 percent (to US$14.6 billion) and 24.3 percent (to US$29.1 billion), respectively. On a by- country basis, the continued acceleration of imports growth was mostly on account of larger imports from China, Indonesia, Japan, and South Korea.

- Net receipts of trade in services increased by 2.2 percent y-o-y to reach US$14.2 billion in 2021 from US $13.9 billion in 2020. The major contributor to this growth was the 9.9-percent uptick in net receipts from technical, trade-related, and other business services to US$14.3 billion during the year. Furthermore, net receipts from exports of manufacturing services on physical inputs owned by others also grew by 21.1 percent to US$5.0 billion in 2021.[39]

- Primary income net receipts dropped by 21.4 percent to US$3.2 billion in 2021 from US$4.1 billion in 2020, mainly due to the 31.7 percent increase to US$5.1 billion in income payments on foreign affiliates' equity and investment fund shares in local companies.

- Secondary income net receipts registered a 7.6-percent expansion from US$27.4 billion in 2020 to US$29.5 billion in 2021 on the back of sustained remittance inflows from non-resident overseas Filipino workers, which grew by 5.6 percent to US$27.0 billion during the year. Moreover, net receipts from other current transfers (mostly in the form of gifts and donations received by institutions and individuals) also improved by 104.5 percent to US$1.0 billion.

Capital account registers higher net receipts

The capital account posted a 26.3-percent growth in net receipts to reach US$80.0 million in 2021 from US$63.0 million in 2020. This resulted from the lower gross acquisition of non-produced non-financial assets, which fell by 77.2 percent to US$4.0 million.

Financial account posts moderate gains

The net inflows in the financial account rose moderately by 0.5 percent in 2021, with the level broadly unchanged at US$6.9 billion. An increase in net inflows was noted in the direct and other investment accounts as well as in the financial derivatives account. However, these inflows were offset in part by the reversal of the portfolio investment account to net outflows.

- Net inflows of direct investments grew by 149.0 percent from US$3.3 billion in 2021 to US$8.1 billion. This was due mainly to the 54.2-percent expansion of foreign direct investments to a record high of US$10.5 billion, underpinned by the 80.4-percent rise in intercompany

[39] Manufacturing services on physical inputs owned by others cover processing, assembly, labeling, packing, and so forth undertaken by enterprises that do not own the goods concerned.

borrowings to reach US$7.5 billion during the year. Net equity capital placements also climbed by 0.7 percent, buoyed by investments from Singapore, Japan and the US. These placements were channeled primarily into: (1) manufacturing; (2) electricity, gas, steam and air conditioning supply; (3) financial and insurance; and (4) real estate activities. Moreover, residents' direct investments abroad declined by 32.6 percent to US$2.4 billion due to lower intercompany lending by residents to their non-resident affiliates.

- Portfolio investment net outflows reached US$8.0 billion in 2021, a turnaround from the US$1.7 billion net inflows posted a year ago. This developed on the back of the reversal of foreign portfolio investments to US $1.4 billion net outflows in 2021 from US$8.2 billion net inflows in 2020, as foreign investors sold their holdings of Philippine debt securities to residents in the secondary market. Moreover, items classified as "other sectors" posted net repayments amounting to US$1.4 billion on debt securities held by non-residents, a reversal of the US$4.3 billion net availments recorded in the past year.

- Net inflows from other investments expanded by more than three times to US$6.3 billion in 2021 from US$1.8 billion in the previous year. This developed as net outflows from net acquisition of assets declined by 90.5 percent from US$4.0 billion in 2020 to US$376.0 million in 2021, while net inflows from net incurrence of liabilities registered a 16.2 percent uptick from US$5.7 billion to US$6.6 billion over the same period.

- Trading in financial derivatives yielded an increase of net gains amounting to US$603.0 million in 2021, more than three times from the US$199.0 million net gains recorded in 2020.

Gross International Reserves

The country's gross international reserves (GIR) amounted to US$108.8 billion as of end-December 2021, lower compared with the recorded level of US$110.1 billion the previous year. At this level, the GIR can cover 9.6 months' worth of imports of goods and payments of services and primary income. It is also equivalent to 7.2 times the country's short-term external debt based on original maturity and 5.1 times based on residual maturity.

The y-o-y decrease in reserves reflects lower inflows arising from the BSP's income from its investments abroad, the downward revaluation adjustments on the BSP's gold holdings due to the decrease in the price of gold in the international market as well as the lower reserve position in the IMF. These were partially offset, however, by the NG's net foreign currency deposits as well as the additional allocation of Special Drawing Rights (SDR) to the Philippines on 23 August 2021 given the IMF's efforts to increase global liquidity amid the pandemic.

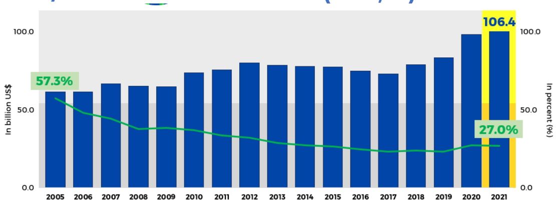
Bulk of the country's reserves, or 84.2 percent of the total, were held in foreign investments. Meanwhile, 8.8 percent were in gold and the remaining 7.2 percent were in holdings of SDRs, the BSP's reserve position in the IMF, as well as in foreign exchange.

Net international reserves, which refer to the difference between the BSP's GIR and total short-term liabilities, amounted to US$108.8 billion as of end-2021, an increase of US$1.3 billion from its level the year before.

External Debt

As of end-2021, outstanding Philippine external debt stood at US$106.4 billion, up by US$7.9 billion (or 8.1 percent) from the US$98.5 billion level as of end-2020. This was brought about by net availments of US$9.8 billion, mainly by the NG, and prior periods' adjustments of US$3.8 billion. These were partially offset by the US$3.7 billion increase in residents' investments in debt papers issued offshore and the US$2.0 billion negative FX revaluation as the US Dollar strengthened against other currencies such as the Japanese Yen and the Euro.

Chart 1.28 External Debt (US$ billion) and External Debt/Gross Domestic Product (GDP, %)



The maturity profile of the country's external debt remained predominantly medium-and long-term (MLT), accounting for 85.8 percent of the total. On the other hand, short-term accounts comprised the 14.2 percent balance of the debt stock, consisting mainly of bank liabilities, trade credits and others.[40] FX requirements for debt payments remain spread out and, thus, manageable.

Public sector external debt grew by US$5.8 billion to US$63.9 billion during the year as the NG required financing to support its COVID-19 response and recovery projects and programs, among others. About US$55.4 billion of public sector obligations were NG borrowings while the remaining US$8.5 billion consisted of loans of government-owned or controlled corporations, government financial institutions and the BSP. Similarly, private sector borrowings rose by US$2.1 billion to US$42.5 billion in 2021 due to prior periods' adjustments of US$3.7 billion, whose impact was partially offset by the increase in residents' investments in debt papers issued offshore of US$2.1 billion and net availments of US$749.0 million (largely by private non-banks).

The creditor mix continues to be well-diversified. Loans from official sources (multilateral and bilateral creditors such as Japan, with loans of US$8.7 billion; China, US$1.5 billion; and France, US $677.0 million) accounted for the largest share of total outstanding debt at 37.2 percent. On the other hand, borrowings in the form of bonds and notes made up 34.7 percent of the total, while obligations to foreign banks and other financial institutions accounted for 22.3 percent. The remainder of 5.8 percent were owed to suppliers, exporters and others.

The bulk of MLT borrowings continued to carry fixed interest rates, accounting for 58.6 percent (US$53.4 billion) of the total as of end-2021 compared with the 60.0 percent (US$50.6 billion) the year before. Risks from possible increase in interest rates are minimized.

[40] Others refer to short-term loans and revolving credit, among others.

Despite the increase in external debt, its impact on key external debt indicators is within prudent levels. The GIR covers 7.2 times the value of short-term debt based on original maturity. The debt service ratio, which relates principal and interest payments to exports of goods and receipts from services and primary income, increased to 7.2 percent in 2021 from 6.7 percent the year before due to higher payments. An important solvency indicator, namely, the external debt ratio or total outstanding external debt (EDT) expressed as a percentage of GDP, decreased to 27.0 percent in 2021 from 27.2 percent in 2020. Meanwhile, EDT to Gross National Income ratio was recorded at 26.1 percent last year, higher than the 25.3 percent the year before. The generally low ratios indicate the country's strong position to service foreign obligations in the medium to long term.