The Philippines' Financial Landscape

Emerging banking sector opportunities for unmet and rising financial needs



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Introduction

The Philippines has maintained an impressive record of economic growth thanks to the strength of domestic demand, favorable demographics, and the important role played in the economy by the service sector. These factors will tend to sustain ongoing demand for financial services.

The Philippines is one of the countries with significant economic dynamism, due to its high growth rates being among the top in ASEAN and serving as a key driver of the region's economy. Indeed, even while the outlook for the global economy remains sluggish, the International Monetary Fund (IMF) sees the country maintaining average growth rates of 6.0-6.4% over 2024 to 2028. **The key drivers of this economic growth include strong domestic demand**, with private sector consumption accounting for up to 75% of the Gross Domestic Product (GDP), alongside remittances from overseas Filipino workers (OFWs) represent a full 10% of GDP. **In addition, the service sector accounts for more than 60% of GDP**, in particular business process outsourcing services such as call centers and IT services.

The positive influence played on the economy by strong domestic spending and the vibrant service sector stems at least in part from the country's demography. In particular, the Philippines has a population of 110 million that has an average age of just 25 (this compares to the ASEAN average of 31.5 and Thailand's average age of 40). Moreover, over 90% of the population speaks English, albeit as a second language, and so the labor force is well positioned to support future expansion in the economy. Given this, it is very likely that ongoing economic growth and rising personal income and wealth will support broadening demand for financial services, both domestically and internationally.

Regarding the financial landscape of the Philippines, the banking sector plays a significant role and continues to grow. Although retail customers and small businesses often face difficulties accessing capital and other financial services, especially when dealing with commercial banks themselves, the scenario is improving. The rapid growth of digital technology in finance and the support to the sector provided by the government will expand business opportunities for the banking sector, which will then be well placed to connect to new consumer groups and to meet broadening future demand for financial services.

This paper therefore seeks to answer the following set of related questions: How is the Philippine financial landscape developing? How is the financial sector linked to the real economy? And what are the business opportunities and challenges in the Philippine banking sector that should be monitored?



Krittabhorn Sirichaichingkun

Economist
krittabhorn.sirichaichingkun@krungsri.com
+662 296 2968

Wanicha Direkudomsak

Senior Economist
wanicha.direkudomsak@krungsri.com
+662 296 4734



The development of financial landscape in the Philippines, and the linkages between the financial sector and the real economy

Compared to its regional peers, the Philippine banking sector is somewhat large, and this reflects the fact that corporations typically remain relatively disengaged from bond and stock markets and instead rely on large banks as sources of capital. Although the microfinance initiatives, the development of the fintech industry, and government efforts have helped to broaden access to financial services for retail customers and small businesses, collaboration from the banking sector is crucial to enhance the efficiency of capital allocation and to boost economic potential.

1. The overall financial landscape

Banks are the major players within the Philippine financial system and serve as a primary source of capital for large non-financial corporates. In the context of retail customers, it is noteworthy that non-bank providers of financial services continue to hold significance.

Understanding the overall financial institution system lays the foundation for an understanding of the development of the financial system and its linkage to the economy. The financial institution system of the Philippines consists of banks and non-bank financial intermediaries (NBFIs). According to the Bangko Sentral ng Pilipinas, the Central Bank of the Philippines or BSP, show that as of June 2023, the value of assets within the financial system totaled PHP 23.44 trillion (USD 419.5 billion) or around 106% of GDP, and banks accounted for more than 94% of the total assets of the financial institution system. Thus, the banking sector in the Philippines reflects almost the entire picture of the financial institution system.

1.1 Banks

Banks in the Philippines can take a variety of forms depending on the types of financial services on offer and the targeted core customer group, which can be classified into three major groups.

1) **Universal and commercial banks (UKBs):** UKBs are divided into Universal Banks and Commercial Banks. These two types of banks offer a full range of standard banking services including deposit facilities, loans, and investment products. However, the two differ in that Philippine commercial banks do not provide either investment banking services or insurance. The market is dominated by a few large UKBs, and the 10 largest of these account for more than 80% of all financial assets held by the banking industry[1/]. It should be noted that 2 of these 10 banks are state-owned financial institutions[2/].
2) **Thrift banks (TBs):** These provide home loans, other types of short- to medium-term credit, and other financial services to retail customers.
3) **Rural and cooperative banks (RCBs):** These are focused on meeting the needs of customers in rural areas, increasing access to financial services, and promoting local economic development.

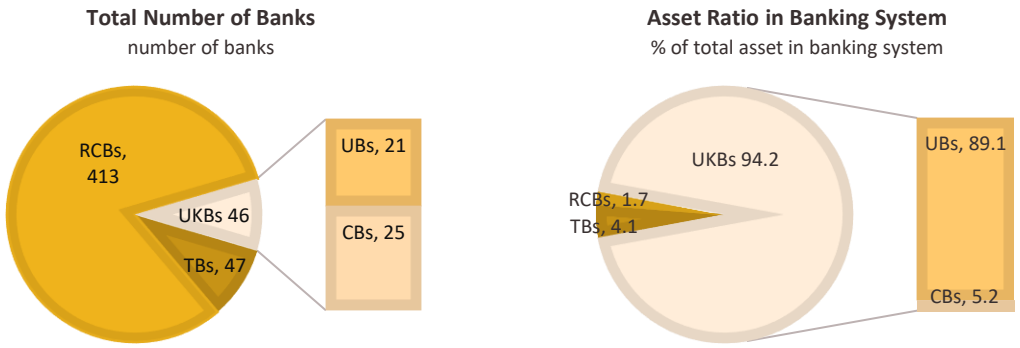
Although there are more than 450 institutions, TBs and RCBs are relatively insignificant as they hold respectively just 4.1% and 1.7% of total banking industry assets (Figure 1).

1/ IMF, 2022

2/ The 2 state-owned UKB specialized financial institutions are: (i) the Land Bank of the Philippines (LBP), which provides financial services to farmers and fishermen; and (ii) the Development Bank of the Philippines (DBP), which provides services to players in the agriculture and industrial sectors and MSMEs, and promotes infrastructure and logistics development.

Figure 1:

Philippine Banking System and Total Assets Under Management, by Type

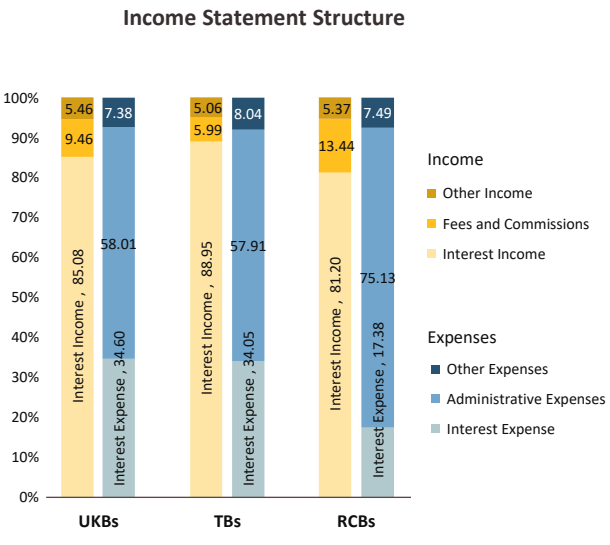


Source: BSP, Krungsri Research

Philippine commercial banks operate according to a traditional banking model that is built principally around deposits and loans. For all types of banks, income from interest represents over 80% of total income (Figure 2). Regarding assets, each type of bank holds credit assets as a proportion of total assets in the range of 52% to 65%. It is notable that a relatively high proportion of these assets are liquid assets (Figure 3).

Figure 2:

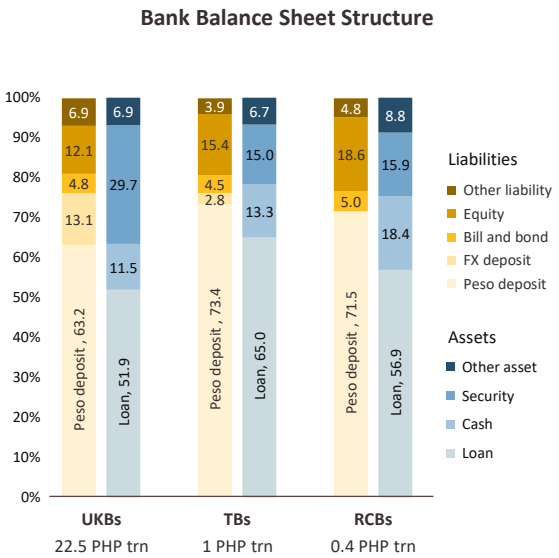
Income and Expenses as per Income Statements, by Bank Type



Source: BSP, Krungsri Research

Figure 3:

Assets, Liabilities, and Shareholder Equity Structure, as per Balance Sheets, by Bank Type



Source: BSP, Krungsri Research

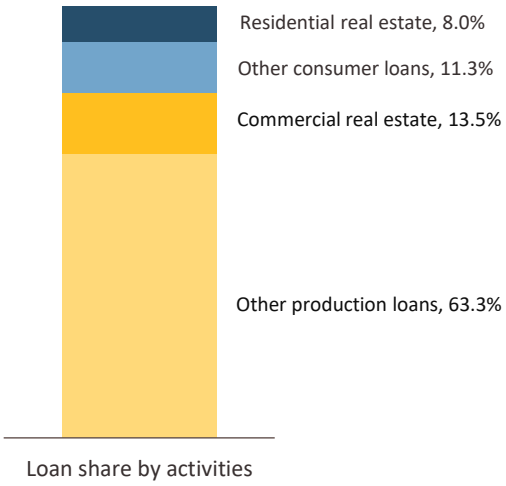
Data from the BSP show that as of the end of September 2023, the value of outstanding loans across the banking industry totaled PHP 12.55 trillion (USD 221.07 billion), or approximately 57% of GDP. 92.6% of this was held by UKBs, with TBs and RCBs accounting for respectively 5.4% and 1.9%. **Given their disproportionately large market share, the lending practices of UKBs define the overall credit profile of the banking sector.**

For the types of loans, the majority of lending by the banking sector is issued as credit to businesses in the manufacturing and service sectors. Lending by UKBs is focused principally on non-financial corporates (NFCs) that are part of mixed conglomerates operating principally on the domestic market in industries as varied as real estate, agro- and food-processing, retail and wholesale, construction, and telecommunications. Of these, the most important is commercial real estate (CRE), which generates 13.5% of all loans (Figure 4). By contrast, lending by TBs and RCBs is generally directed at retail and small-business borrowers. In the case of TBs, these are typically auto and motorcycle loans, home loans, and funding for household businesses, while for RCBs, loans are generally made in support of small-scale or household enterprises engaged in activities in the manufacturing or agricultural sectors.

However, loans issued to households and retail borrowers account for a small share of overall credit creation by the banking sector (Figure 4), and so personal and housing loans represent just 11% and 8% of the total respectively. By contrast, credit issued to NFCs in the manufacturing and service sectors represents almost 80% of all loans issued by the banking industry. Research by the IMF shows that this is in fact a highly unusual situation, particularly when compared to banking sectors in other emerging markets, where the share of credit issued to NFCs is typically closer to 50% of the total banking sector's lending[3/].

Figure 4:

Loans Issued by the Banking Sector



Source: BSP, Krungsri Research

3/ IMF, 2021

The high proportion of debt issued to NFCs is explained by the fact that **the 7 largest Philippine UKBs, which combined hold around 60% of the entire banking sector's assets, are all parts of a few large conglomerate business networks owned and operated by just a few families** (Figure 5). **These banks thus tend to concentrate their attention on other companies within their conglomerates, rather than try to fight for new customers in the market.** This reflects large businesses' financing gaps in capital raising in local corporate bond and stock markets. In addition, Philippine corporate bond market is relatively small compared to those of the regional peers (Figure 6). The total value of outstanding corporate bonds comes to just 15% of total credit issued by the banking sector, while the total market capitalization of companies traded on the Philippine stock market is also limited compared to the situation in other countries in the region (Figure 7). Adding to this, domestic retail investors are not heavily involved in the Philippine stock exchange. This is in line with the fact that large corporations have become dependent primarily on raising capital via bank credit.

Figure 5:

Philippine Conglomerates and subsidiary banks



Source: Krungsri Research

Figure 6:

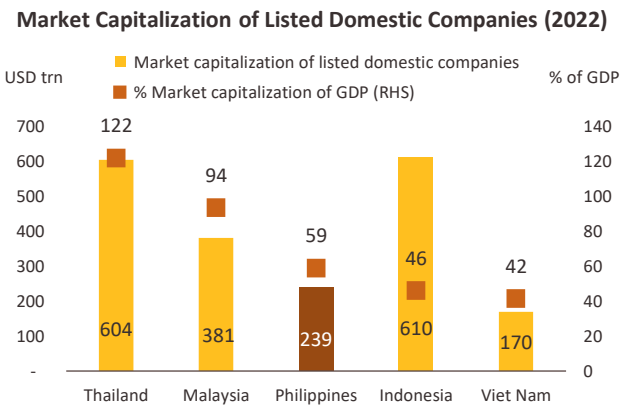
Outstanding Corporate Bonds as a Share of GDP



Source: ADB Asia Bond Monitor November 2023, Krungsri Research

Figure 7:

Total Market Capitalization of Listed Domestic Companies



Source: World Bank, Krungsri Research

1.2 Non-Bank Financial Intermediaries (NBFIs)

The Philippines is home to a wide range of non-bank financial intermediaries or NBFIs, including mutual funds, securities traders and brokers, savings associations, credit unions, insurance companies, and retirement funds. Other NBFIs target retail customers and small businesses, including different types of microfinance institutions, such as microfinance non-governmental organizations (MF NGOs), pawn shops, and cooperatives. These are an important source of finance for low-income earners and micro-, small-, and medium-sized enterprises (MSMEs).

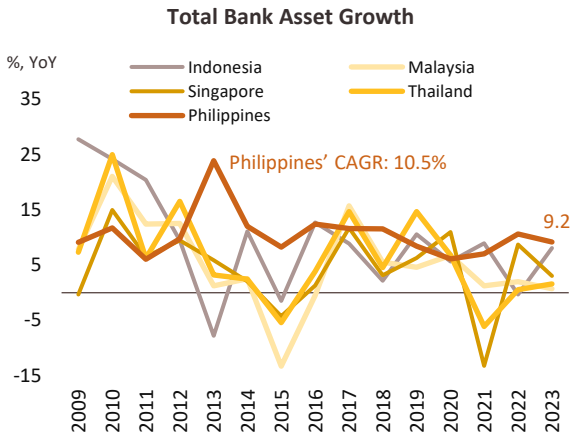
2. Important developments in the financial sector

Growth in the Philippine banking sector has been made possible by its close relationship with NFCs, but rising demand for financial services and the rapid development of financial technology has encouraged banks to begin expanding their offerings and to attempt to more deeply penetrate markets for retail clients.

Over the past decade, the total value of assets controlled by Philippine banks grew by an average of slightly more than 10% annually, ahead of growth rates recorded elsewhere in the region (Figure 8). This rapid increase reflects expansion in the financial sector overall, which has been lifted by rising incomes and broader growth in the economy, and this in turn has boosted demand for financial services such as for savings, loans, and financial planning (Figure 9).

Figure 8:

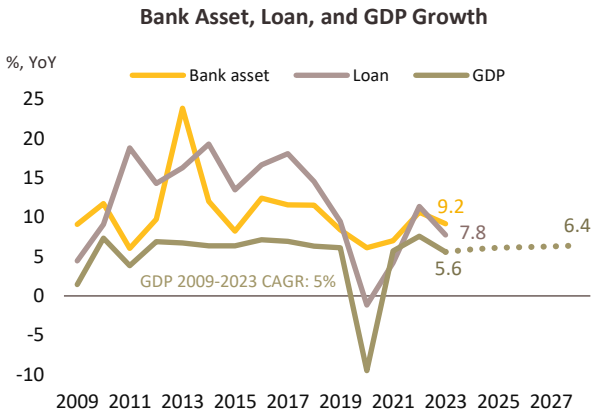
Growth in Total Bank Assets in the ASEAN-5 Nations



Source: CEIC, Krungsri Research

Figure 9:

Growth in Bank Assets, Loans and National GDP

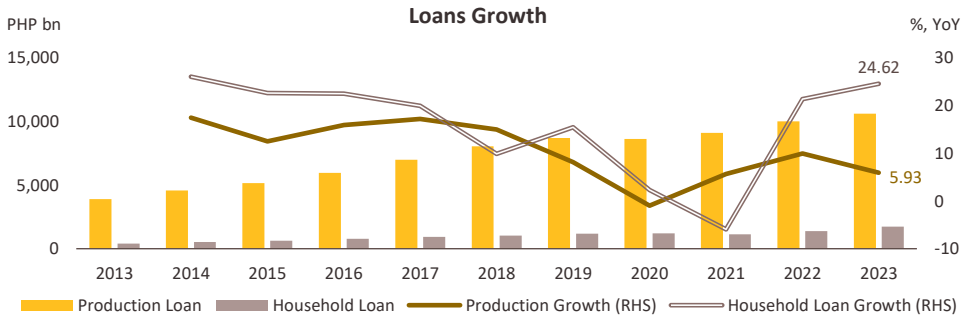


Source: IMF WEO Database (Jan 2023), CEIC, Krungsri Research

As stated above, most large Philippine banks are part of major conglomerates, **growth in total assets within the banking sector has been dependent on its close relationship with NFCs rather than retail customers' lending portfolio.** Nevertheless, over the past decade, many banks have begun to recognize the potential implicit in the market for personal loans and so banks have started to target retail customers more aggressively. In addition, the development of financial technology has helped banks extend their reach more deeply into Philippine households, and this is reflected in expansion in the market for consumer lending. **Nevertheless, compared to corporate lending, consumer or retail lending remains limited (Figure 10) and this imbalance has enabled NBFIs to consistently secure an important place in serving retail customers.**

Figure 10:

Growth in Business and Retail Lending



Source: BSP, Krungsri Research

Another important development within the Philippine financial landscape has been the rapid growth in financial technology. In response to changing consumer preferences, players across the financial sector have moved to a much greater reliance on digital channels for the delivery of financial services. This process has been significantly accelerated by the Covid-19 pandemic and government support for financial digitalization. Thus, in 2020, the Overseas Filipino Bank[4/] became the first institution to be licensed as a digital-only bank by the BSP, though following this, the Philippine central bank then went on to license another 5 digital banks[5/]. The BSP has said that it expects that it will take 5-7 years for digital banks to fully align their products with the market and to become profitable, and data from the central bank show that as of March 2024, only 2 of the Philippines' 6 digital banks had moved into profit, though this is in line with digital bank operations in other countries. The BSP will continue to report on the performance of the country's digital banks periodically.

Besides digital banks, a recent report by the BSP shows that uptake of digital payment services by retail customers has accelerated sharply, with the share of total payments made by retail customers attributable to digital channels rising from just 10% in 2018 to 42.1% in 2022. This matches the increase in the share of Philippine citizens with a bank or online bank account, which jumped from 22.6% in 2017 to 65% in 2022, and this is expected to have reached more than 70% in 2023. In particular, the number of Filipinos with an e-money account has risen sharply, and use of online banks or mobile applications has thus risen in step with this change in consumer behavior in digital payment. Especially notable apps include GCash and PayMaya, which allow users to make payments, transfers, and deposits without visiting a bank branch in person. However, digital delivery of financial services related to loans, insurance, and investments remains patchy and there is significant room for future development in these areas.

3. Linkages between the financial sector and the real economy

Access to financial services remains a problem for retail customers. However, growth in the microfinance institutions, digital financial services, and government efforts to broaden financial inclusion are bridging financial gaps.

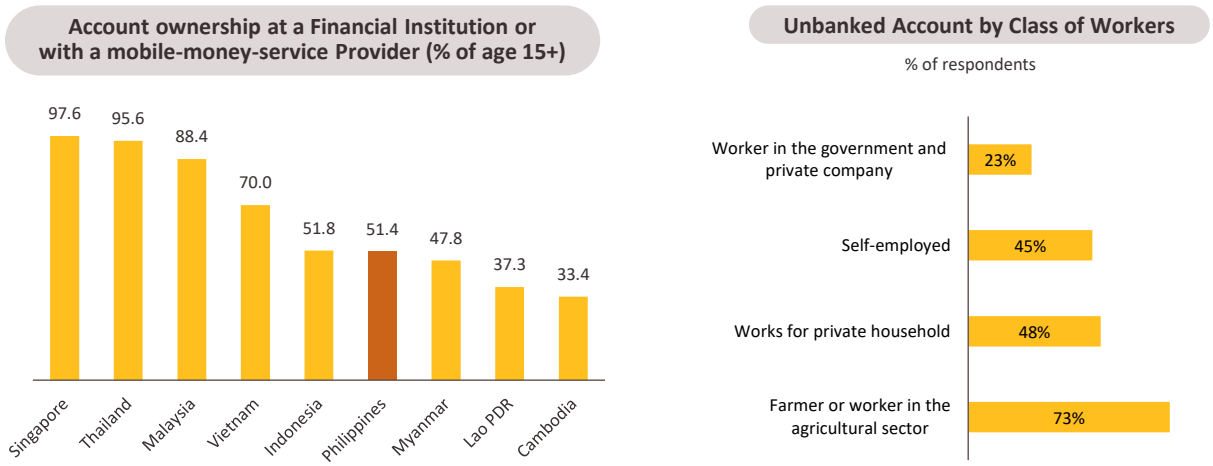
Although the Philippines has enjoyed rapid economic growth in recent years, both households and MSMEs continue to experience difficulty accessing financial services, leading to low financial inclusion, which is a major factor constraining the potential for future economic growth. A report by the World Bank shows that in 2021, 49% of Filipinos aged over 15 did not have a bank account at financial institutions or with mobile money service providers (Figure 11). A problem that was underlined by a 2021 survey by the BSP indicating that 73% of farmers belong to the group of occupations without bank accounts, which is the highest proportion compared to other occupations. Among those without an account, the most commonly cited reason was insufficient income, followed by problems securing the relevant documentation.

4/ A subsidiary of the Land Bank of the Philippines, one of the Philippines' two state-owned specialized financial institutions.

5/ In September 2022, the BSP announced that it would introduce a 3-year moratorium on issuing new digital-only bank operating licenses. With the digital banking sector at an early stage of development, the BSP wishes to use this time to examine digital banking operations, assess the impact of digital financial services on the banking industry, and evaluate the potential of digital channels to increase access to financial services (Philstar, 2021).

Figure 11:

Rates of Financial Inclusion



Source: World Bank, BSP's Financial Inclusion Survey (2021), Krungsri Research

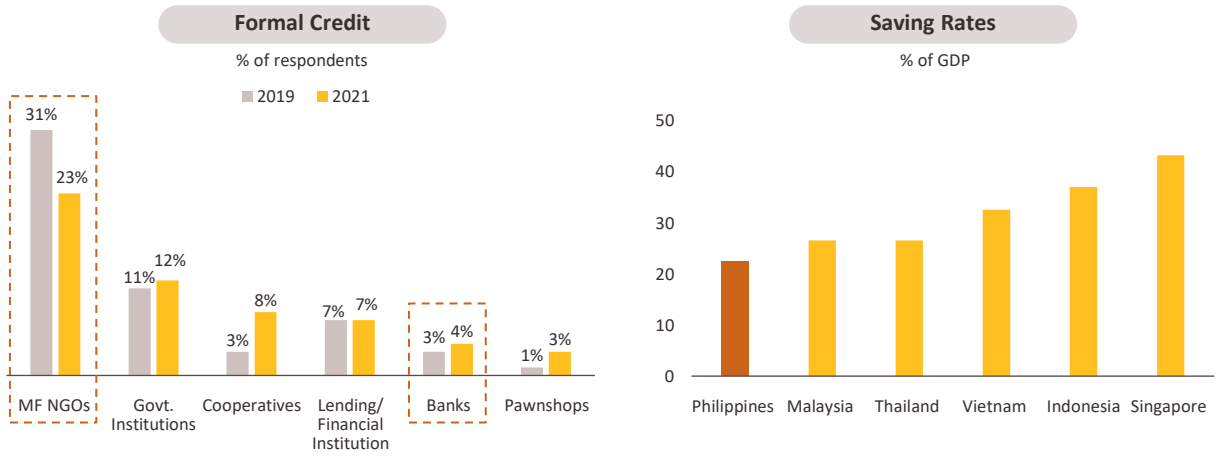
For potential borrowers, access to credit is complicated by the geography of the country, which makes it difficult for banks to extend their branch networks to more distant regions, as well as by the fact that the large banks are more focused on providing services to other companies within conglomerates than they are on broadening their customer base to include a greater proportion of retail savers and borrowers. Given this, **data from the BSP show that credit is accessed from formal and informal sources in almost equal proportions** (respectively 57% and 56% of survey respondents). The most common source of finance in the formal sector is microfinance NGOs (23% of survey respondents), but it is interesting to note that only 4% accessed credit from banks themselves, a figure that is almost unchanged from 2019 (Figure 12). Respondents most likely to have access to bank credit include those who live in urban areas (i.e., the VisMin region of Visaya and Mindanao Island groups), high-income earners (socio-economic classes ABC), business owners, and those aged 50 and over.

The fact that such a high proportion of retail and MSME borrowers have difficulty accessing bank services and so remain reliant on informal lending reflects the underlying problem of accessing loan in the Philippines' financial system. From the point of view of borrowers, over half of individual and MSME businesses believe that borrowing from formal financial institutions such as banks is excessively difficult due to the need for copious supporting documentation, the time-consuming application process, and borrowers' low income and lack of collateral. Many small businesses thus turn instead to informal lenders. Meanwhile, from the point of view of lenders, banks may feel that extending credit to individuals and small businesses in rural areas carries with it too high a risk of default. Other factors that restrain the supply of credit from banks include the lack of infrastructure in remoter parts of the country, which then makes it prohibitively expensive to open traditional brick-and-mortar branches, while the Philippines also has one of the lowest savings rates in the world (Figure 12). Given this and likely insufficient short-term returns, banks are not strongly incentivized to invest in operations in rural regions.

These problems have significant economic costs, particularly to the extent that MSMEs face obstacles securing loans. This is because MSMEs account for 99.6% of all businesses in the Philippines and provide 65% of all jobs, and **so if MSMEs are forced to seek out financing from informal lenders, this will add to their costs, reduce the efficiency of capital allocation, and drag on their and the economy's growth potential.**

Figure 12:

Sources of Credit and National Savings Rates



Source: World Bank, BSP's Financial Inclusion Survey (2021) and Krungsri Research

At present, microfinance lenders play an important role overcoming some of these problems. By explicitly targeting both small businesses and farmers and fishermen in rural regions, who are generally unable to access bank loans, microfinance institutions have been able to provide finance to MSMEs and low-income earners. **Much research in this area has shown that microfinance initiatives have significant potential to increase businesses' operating efficiencies and growth potential, and so official bodies have been active in promoting greater uptake of microfinance services**[6/].

Another significant development that has made financial services more accessible to people, even in rural areas of the Philippines, is the increasing importance of digital financial services. In fact, research has demonstrated digital financial services' potential to achieve just these ends. This is reflected in data showing that access to financial services jumped from 34% of the population in 2017 to 51% in 2021 following the rapid development of digital financial services, as described above.

Although uptake of digitally delivered financial services has grown rapidly, at 74% of the population, mobile phone ownership rates remain significantly ahead of the share of the population with a bank account (51%). Therefore, **the BSP plans to fully exploit financial technology's potential to improve access to financial services. In particular, the central bank plans to broaden access for both the financially 'unserved' (i.e., those with no access to the banking sector) and the 'underserved' (i.e., those with insufficient access to this).** To this end, the government has relaxed the rules on foreign participation in the financial sector, in particular by: (i) raising the limit on foreign ownership of Philippine financial institutions from 40% to 60%; (ii) maintaining restrictions on foreign participation in areas reserved for Filipino nationals; (iii) making the process of applying for a banking license easier and quicker; and (iv) imposing very low capital requirements for businesses registering as digital banks and allowing full foreign ownership of these. It is hoped that these moves will help to stimulate increased foreign investment in the Philippine financial system and through this, expand financial inclusion for households and small businesses.

While the government emphasizes promoting access to credit and financial services for MSMEs and marginalized populations, collaboration with the private sector to address these gaps is equally crucial. **In particular, financial institutions such as banks will have a major role to play in this process, though their centrality to these plans will open up exciting new business opportunities for companies in the finance sector to expand their service offerings and to extend their customer base**.

6/ The Social Reform and Poverty Alleviation Act promoted microfinance as a poverty-reduction tool. This allows microfinance lenders to provide loans of up to PHP 150,000 (around USD 2,650) for individual or small business borrowers, and up to PHP 300,000 (USD 5,300) for home loans.

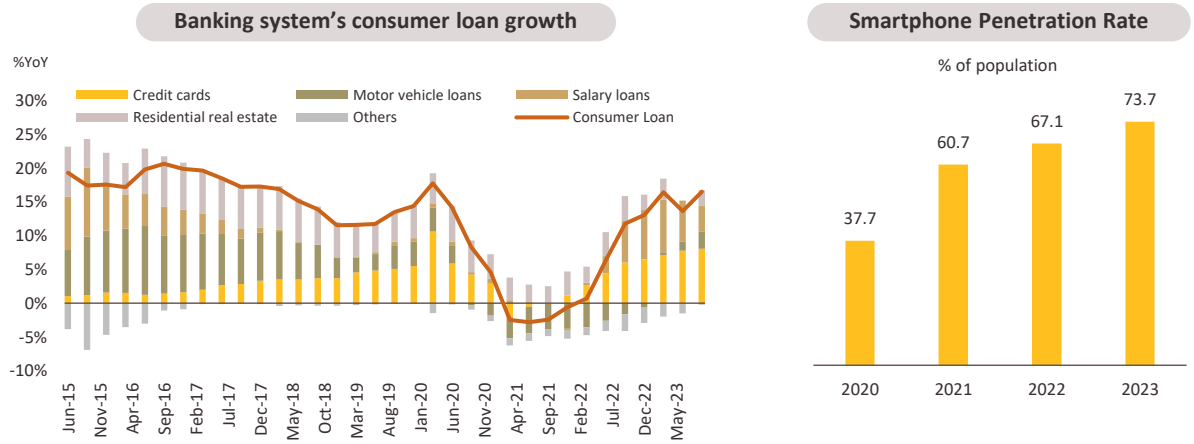
Business opportunities in the financial sector

The gaps in accessing financial services represent a business opportunity in the banking sector, especially for those issuing loans. Most notably, opportunities will be presented to those able to use digital financial products to develop new service delivery models and to target individual consumer groups more tightly.

Business opportunities in the Philippine financial sector will in particular be related to lending, especially by banks, due to several driving factors. Firstly, the high growth potential of this market will be supported by the current low rates of access to the formal credit system, thus indicating that there is significant unmet demand among retail and MSMEs borrowers for reasonable-cost financial services. **Secondly, the Philippine middle class is also expanding** (as of 2020, 43.5% of the country was classified as middle class[7/]) **and the population is young**, and these groups typically have increasing incomes and exhibit stronger demand for financial services. This will then allow banks to open up new markets, especially various types of credit products (Figure 13). In addition, a rapidly growing economy that is being driven by strong domestic consumption will add to demand for this. **Finally,** although remoter and more rural parts of the country may lack the infrastructure to maintain reliable connections, **mobile phone and internet penetration rates continue to rise** (Figure 13), and this will then support increased access to digitally delivered financial services among the general public.

Figure 13:

Growth in Consumer Loans, and Smartphone Penetration Rate



Source: BSP, Statista, and Krungsri Research

Another important factor influencing the business landscape is the ongoing efforts by the Philippine government to expand access to financing and financial services. In 2017, the government unveiled its National Strategy for Financial Inclusion (NSFI), which in its 2022-2028 iteration is currently focused on addressing unequal access to finance for MSMEs, low-income earners, and farmers (these representing 24.5% of all workers). This is being achieved through the continuing promotion of microfinance, the development of digital finance infrastructure, and training in financial literacy. The Financial Inclusion Steering Committee (FISC) has primary responsibility for this and for coordinating the work of other state bodies, and officials hope that the long-term outcome of this strategy will be to create a more inclusive financial system and to raise the country's growth potential.

7/ Philippines Statistics Office

In addition, the government is itself developing and extending the nation's digital infrastructure and this will facilitate the transition to a digital financial system. This includes the development of the Philippines Identification System, or PhilSys[8/], a digital national ID system that aims to address widespread problems with a lack of personal identification, a common factor preventing individuals from opening personal bank accounts. The PhilSys project should also help to accelerate the development of new digital financial products.

Considering the supportive factors above and the continuing unequal access to financial services (especially to sources of fund) faced by those in different professions or with different levels of income, it is clear that **business strategies will need to focus on the design of financial products and services that meet the particular needs of the population.** This will include developing loans for low-income personal borrowers, loans for small businesses, and home loans that address households' financial needs.

The rapid spread of digital technologies within the Philippines will also help to catalyze the development of additional business opportunities in the banking industry. A 2021 survey carried out by the BSP[9/] shows that most low-income borrowers who turn to informal sources of credit do so because these are easier to access, and repayments are simpler to make than is the case when dealing with the formal banking system. Thus, **if banks are able to leverage digital financial technology that make the process of applying for loans simpler, quicker and less dependent on assembling a complicated set of supporting documents, this should help people to find it easier to access to sources of fund from banks.** Wider use of digital technologies will also make it possible to better exploit customer databases and data analytics systems, therefore allowing banks to connect with a broader customer base, carry out better risk assessments of individual borrowers, and better target their promotions and marketing efforts.

On a wider scale, the Philippine central bank has joined with the Regional Payment Connectivity (RPC) system. This supports a number of payment methods, including QR codes and the fast payment system, to facilitate transfers between member states (Thailand, Indonesia, Malaysia, Singapore, and Vietnam) as well as other countries in Asia including Japan and South Korea. **The RPC system aims to help build a seamless and cost-effective cross-border payment system for individuals and businesses in the ASEAN,** and this will help to open new business possibilities for Philippine businesses transacting with partners across the ASEAN region.

In conclusion, **business opportunities in the Philippine banking industry will be concentrated in financial services for those who currently have difficulties gaining access to the formal lending system.** Of particular importance will be loans targeting MSMEs and personal and home loans for retail borrowers, for which demand is increasing. In addition, intelligent applications of digital financial technology will improve banks' risk management and make accessing bank facilities much easier for unserved or underserved borrowers than is currently the case, thereby helping banks compete better with informal sources of credit. This will then reduce financial constraints and unlock greater growth potential. Furthermore, improved regional cooperation over payment systems will also help businesses widen their horizons and encourage them to explore new business opportunities in markets across the ASEAN region.

8/ The system is similar to the Thai digital national ID card (ThaiID). Both of these are national ID systems that rely on biometric data and that can be used for different purposes in place of older-style ID cards, and both aim to improve delivery of government services.

9/ Financial Inclusion Survey, BSP, 2021



Challenges facing players in the Philippine financial system

Undertaking business activities in the Philippine financial system entails confronting a certain number of challenges, particularly in terms of systemic risk. But, overall, the system is strong and stable, and regulatory oversight should help mitigate these risks.

Challenges facing players in the Philippine financial system include the following.

1. **The country's geography and the current state of infrastructure:** In remoter parts of the Philippines, population density may not be sufficient to justify banks extending their branch networks into these areas, while overall, national infrastructure requires further improvements and upgrades to meet the requirements of commercial banks before these are able to expand deeper into areas outside urban centers. In addition, internet access is limited in some areas, and this is thus another obstacle in the way of the digitalization of the financial system.
2. **Risk management and data security:** Risk management within the domestic financial system has a number of limitations, and banks are only able to assess this based on general data relating to work and income. This may then encourage lenders to view some groups as being excessively risky, which may then impact lending rates or encourage lenders to impose excessively tight loan conditions[10/]. Many members of the public also worry about the security of personal data when using digital financial services[11/].
3. **Financial stability:** Assessment of overall systemic risk within the Philippine financial system is required to identify systemic risks that may impact banking operations and credit activities. However, at present, the system is strong and stable with a Capital Adequacy Ratio (CAR) at 16.01%, exceeding the threshold (as per BSP reports in March 2022). NPLs have also declined to around 3%, though these remain above the pre-Covid average of 2%. Nevertheless, other issues that may pose a problem and that need to be tracked include risk arising from specific loan types, particularly real estate and consumer loans, and systemic risk connected to linkages between the financial sector and non-financial parts of the economy.

    - **Risk from real estate loans and consumer loans**

      Real estate loans are a significant part of overall bank lending (21.13% in March 2022) and at present, NPLs within this segment remain above their pre-Covid level. This is particularly the case for residential real estate loans, the performance of which has been hit by the slowdown in the economy and the run-up in interest rates. NPLs for commercial real estate loans have also risen on the post-pandemic preference for working from home and the drop off in demand from overseas games platforms, which has then pushed up the vacancy rate[12/]. Thus, in the second quarter of 2023, the vacancy rate for offices and condominiums in the Metro Manila region stood at respectively 18.4% and 17.2%, a sharp rise from pre-pandemic rates of respectively 5% and 10%[13/]. This could then put downward pressure on real estate prices, potentially undercutting the financial stability of those who have lent heavily in this area. Although real estate lending is limited to a maximum of 25% of a bank's total lending, a drawn-out slowdown in commercial property markets would impact profits.

10/ The government can reduce risk related to credit defaults and so cut costs by creating robust systems for tracking credit data and bills of landing and receipts, and setting up credit and agricultural insurance.

11/ NSFI Annual Report, 2022

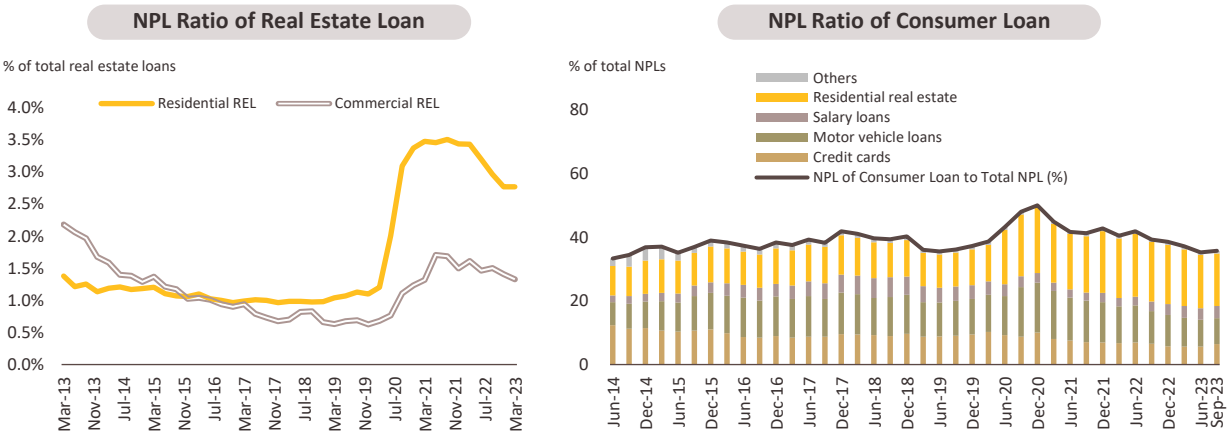
12/ This is partly due to efforts by the Philippine authorities to suppress illegal activities connected to overseas gaming platforms.

13/ AMRO, 2023

Furthermore, **consumer loans still maintain a higher NPL rate compared to other loan types.** Although consumer loans represent only 20% of the value of all outstanding loans within the banking system, non-performing consumer loans accounted for 35% of all NPLs as of the third quarter of 2023 (Figure 14).

Figure 14:

Real Estate and Consumer NPLs



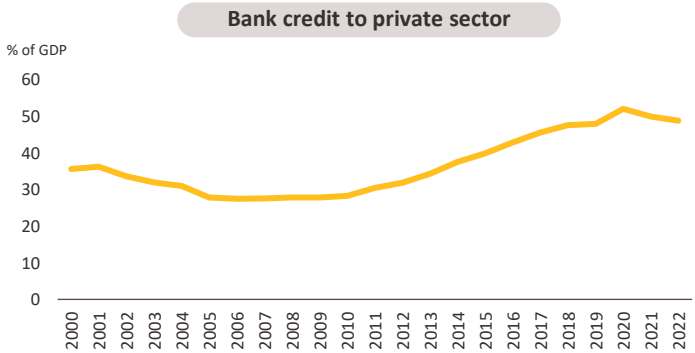
Source: BSP and Krungsri Research

- **Systemic risk arising from linkages within the financial system and NFCs**

  In addition to focusing on lending to NFCs that belong to the same business conglomerate, the large number of financial conglomerates[14/] reflect the linkages that exist within the financial system itself and between the financial system and the real economy, which has the potential to generate systemic risk. Moreover, NFCs in the Philippines have increased their borrowing as these companies have sought capital from banks to fund operating costs and investments in financial assets (Figure 15). The increasing level of indebtedness has also raised exposure to risk arising from changes to interest and exchange rates[15/]. Thus, if an event negatively impacts the income of NFCs, connections within the financial system and between this and different parts of the economy could cause these problems to multiply, affecting the stability of the banking sector.

Figure 15:

Share of Loans Issued by the Banking Industry to NFCs



Source: World Bank and Krungsri Research

14/ BSP has defined a 'financial conglomerates' as "any group of companies under common control whose exclusive or predominant activities consist of providing significant services in at least two different financial sectors such as in banking, securities, and insurance".

15/ BIS, 2020

In response, the Philippine authorities have instituted a regulatory regime to monitor and reduce systemic risk connected to the activities of major players within the financial system, and so in 2004, the BSP established the Financial Sector Forum (FSF). This was tasked with improving cooperation between regulatory agencies including the Securities and Exchange Commission (SEC), the Insurance Commission (IC) and the Philippine Deposit Insurance Corporation (PDIC), which are responsible for oversight of 12 financial conglomerates. In 2022, the FSF tightened regulation of the market by extending this to include risk reviews, scenario planning, and the monitoring of business structures, the latter with the aim of reducing the risk of negative impacts affecting other businesses in the same group in the event that one business in the group encounters financial difficulties. Over 2023 to 2024, the FSF carried out risk assessment for 3 conglomerates, and it expects to complete this process for all 12 groups within the next 5 years.





Krungsri Research view

The Philippine financial landscape is centered principally on the banking sector. Although the sector has enjoyed ongoing growth through the recent past, the banks have been largely focused on securing sources of credit for other businesses within same conglomerate. Banks have thus failed to establish themselves as secure sources of financing for small businesses or retail customers, for whom access to financial services remains patchy and inadequate. This issue is considered a structural problem in accessing capital and financial services that have long troubled the country. However, the development of the Bangladeshi Grameen Bank[16/] has shown how financial inclusion can be extended to embrace low-income earners, in particular through the development of new credit models, for example microloans that do not require collateral. In 1997, the Philippines therefore created a rural bank of Grameen-style banking, and this has been successful in extending access to capital for those in rural areas. This has then provided the motivation for promoting MF NGO-backed group lending through to the present day.

Given ongoing domestic economic growth and government initiatives to expand access, demand for financial services will strengthen in the coming period, and clearly the banking sector will have a major role to play in meeting this. This will be especially the case for providing loans and credit to small businesses and retail customers, which will likely open up significant business opportunities for banks to expand the customer base going forward. Against this background, designing new products and services that are a better match for particular occupational or income groups, leveraging financial technology to enhance accessibility to financial services, and improving risk management will all help to raise banks' competitiveness and sharpen their ability to compete with informal lenders for market share. However, challenges in banking operations and transitioning to digital finance persist. Overcoming these problems will depend on the ongoing collaboration and cooperation of all stakeholders to create favorable business environment in the financial sector. This includes infrastructure development, cost reduction, stronger motivation for both borrowers and lenders to participate in the market, and greater transparency and stability across the financial system.

16/ Grameen Bank, or 'The Village Bank', is a non-profit organization that was established to improve access to financial services for the poorest parts of society. Loans issued by Grameen Bank are based on what is called 'social collateral' and the mutual trust of members of group lending schemes. In the past, Grameen Bank was focused on issuing microcredit to support business activities but it has now broadened its offerings to cover a full range of services to those in financial hardship.

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KRUNGSRI RESEARCH

Pimnara Hirankasi, Ph.D.
Head of Research Division and Chief Economist

Macroeconomic Team

Sujit Chaivichayachat
Head of Macroeconomic Research

Wanicha Direkudomsak
Senior Economist

Churailuk Pholsri
Senior Economist (Forecasting)

Thansin Klinthanom
Economist

Krittabhorn Sirichaichingkun
Economist

Supasyn Itthiphatwong
Economist

Analytics & Intelligence Team

Pimnara Hirankasi, Ph.D.
Acting Head of Analytics and Intelligence Research Department

Nathanon Ratanathamwat
Senior Analyst

Narichaya Satafang
Analyst

Parinya Mingsakul
Analyst

Chanatta Thararos
Analyst

MIS and Reporting Team

Thamon Sernsuksakul
Administrator

Chirdsak Srichaiton
MIS Officer

Wongsagon Keawuttung
MIS Officer

Industry Team

Pimnara Hirankasi, Ph.D.
Acting Head of Industry Research

Taned Mahattanalai
Senior Analyst (Digital)

Poonsuk Ninkitsaranont
Senior Analyst (Healthcare, Mobile Operators)

Piyanuch Sathapongpakdee
Senior Analyst (Transport & Logistics)

Narin Tunpaiboon
Senior Analyst (Power Generation, Modern Trade, Chemicals, Medical Devices)

Thian Thiumsak
Senior Analyst (Energy, Petrochemicals)

Puttachard Lunkam
Senior Analyst (Construction Contractors, Construction Materials, Hotels, Industrial Estate)

Patchara Klinchuanchun
Senior Analyst (Real Estate)

Chaiwat Sowcharoensuk
Senior Analyst (Agriculture)

Prapan Leenoi
Analyst (ESG)

Supawat Choksawatpaisan
Analyst (Automobile, Electronics & Electrical Appliances)

Suppakorn Kornboontritos
Analyst (Agriculture, Food & Beverages)