Senate Economic Planning Office

Economic Report

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The Second Quarter Economic Performance: Explaining the 'Surprise' Growth

Many analysts considered the second quarter economic growth a 'surprise'[1] given the challenges faced by the economy like the rising oil prices and increasing U.S. interest rates, among others.

The industry and services sector mainly accounted for the growth in the second quarter. Our previous analysis showed that the growth trajectory of industry and services are well supported by investments. Business confidence surveys also indicated that the business climate remained good in the second quarter. Moreover, higher consumer confidence and increasing OFW remittances, together with the positive outlook for exports given the growth of our trading partners supported the second quarter growth.

The full impact of the fiscal problem, the paced hike in U.S. Federal rates, and the increased price of oil was not felt in the second quarter as their full effects started to creep in during the third quarter. The impact of these factors will reduce the growth of the economy in the second half of the year.

Revisions to 1st quarter estimates

First Quarter 2004 Initial and Revised NIA Estimates (in 1985 Prices)

National Income Accounts Indicators	Initial Estimates	Updated Estimates
Gross National Product (GNP)	6.2	6.5
Gross Domestic Product (GDP)	6.4	6.5
Net Factor Income from Abroad (NFIA)	3.3	6.7
Production		
Agriculture	7.7	8.1
Industry	5.5	5.6
Services	6.4	6.4
Expenditure		
Personal Consumption	5.9	5.7
Government Consumption	2.2	0.9
Capital Formation	16.2	10.1
Exports	10.0	11.1
Imports	4.9	4.3

***Source:* NSCB**

***as of August 2004**

Revisions on the NIA are based on more updated data that is made available by concerned government agencies. Given a more updated Balance of Payments (BOP) and Overseas Filipino Worker (OFW) deployment data, NFIA was adjusted to a 6.7-percent annualized growth for the first quarter from the original estimate of 3.3 percent, thus boosting GNP growth to 6.5 percent growth from the original estimate of 6.2 percent. This puts GDP and GNP growth at an equal pace of 6.5 percent for the first quarter. Underpinning the minimal upgrade of 0.1 percentage point in GDP were an upgrade in agriculture at the production side and downgrades for capital formation and imports countered by a an upgrade in exports at the expenditure side.

Nonetheless, the 2004 GNP and GDP growth targets of 6.0 percent and 5.8 percent respectively, will likely be attained despite the challenges faced by the economy. In fact, the Asian Development Bank, Bears, Stearns & Co.,

[1] The term was borrowed from the Philippine Daily Inquirer article, "Surprise Growth:6.2", August 31, 2004, p.1.

and Morgan Stanley already upgraded their growth expectations for the full year.

Sources of Growth

The domestic economy (GDP) grew by 6.2 percent in the second quarter of 2004. Over-all economic growth or the Gross National Product (GNP) grew by 5.7 percent for the same period. The GNP growth was tempered by a modest rise in Net Factor Income from Abroad (NFIA) of 0.3 percent.

The full first semester growth of GDP was 6.3 percent and GNP was 6.1 percent. The first quarter GNP growth was adjusted to 6.5 percent on account of updated data on balance of payments and OFW deployment, which raised the NFIA growth rate in the first quarter to 6.7 percent.

Table 1: Economic Growth Rates (in constant prices)

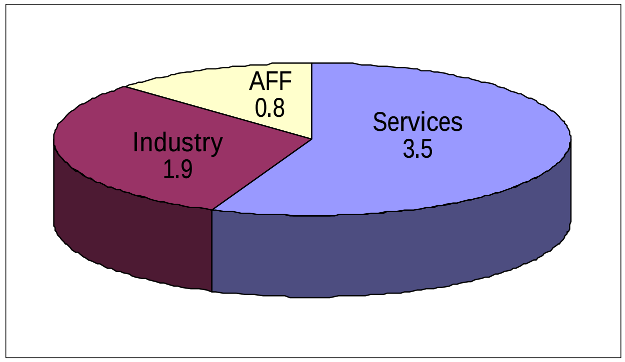
National Income Accounts Indicators	2003,Q2	2004,Q1	2004,Q2	2004, 1st Sem
Gross National Product (GNP)	6.5	6.5	5.7	6.1
Gross Domestic Product (GDP)	4.2	6.5	6.2	6.3
Net Factor Income from Abroad (NFIA)	6.5	6.7	0.3	3.5
Production				
Agriculture, Fisheries and Forestry (AFF)	1.6	8.1	4.3	6.3
Industry	3.6	5.6	5.6	5.6
Services	5.7	6.4	7.3	6.9
Expenditure				
Personal Consumption	5.3	5.7	6.0	5.9
Government Consumption	-5.4	0.9	0.1	0.5
Capital Formation	-0.8	10.1	8.5	9.4
Exports	1.2	11.1	14.9	13.0
Imports	7.0	4.3	7.0	5.7

Source: NSCB

On the production side, services and industry performed particularly well with growth rates of 5.6 percent and 7.3 percent, respectively, largely accounting for the growth in the second quarter. Services contributed 3.5 percentage points to GDP growth, while industry supplied 1.9 percentage points. Both registered substantially high seasonally adjusted growth rates of 1.1 and 2.3 percent, respectively.

The unprecedented first quarter growth of agriculture of 8.1 percent was not sustained in the second quarter as the pace of its growth slowed down to 4.3 percent. It contributed 0.8 percentage points to the growth of the domestic economy.

Figure 1: Sectoral Contributions to Second Quarter Growth



Source: NSCB

On the Production Side:

A dynamic services sector. The service sector's dynamism was led by transportation, communication and storage sub-sector which grew at 13.5 percent, followed by finance at 8.8 percent and private services at 6.8 percent.

The growth in transportation, communication and storage sub-sector was supported by the 16.0 percent growth of communication, boosted mainly by mobile phone service provider expansions, election-related activities and an increased subscriber base. Cellular communication has become a necessity for many Filipinos as evidenced by an increase in utilization. This has shown up in the expanding subscriber base and revenues of the industry.

Table 2: Selected Telecom Industry Indicators 2001-2003

	2000	2001	2002	2003
Subscriber Base (in millions)	6.4	12.2	15.4	22.5
Revenues (in billion pesos)	n.d.	46.1	68.2	92.5

Sources: Globe Telecoms and PLDT 2003 Annual Reports, NTC presentations.

The financial services sub-sector was bolstered by banks' increased interest and non-interest income and the insurance service providers' growth of 8.5 percent. The increased interest income of the banking sector was supported by a larger outstanding loans base, which grew by 3.8 percent in June compared to March levels. The growth of the private services sub-sector was supported by increased business services and recreational services, which included broadcasting media. The high demand for airtime during the campaign period contributed to this sub-sector's growth (NSCB).

Industry continuing on its higher growth trajectory. Since 2003, industry seems to be on a higher growth path and continued trudging this trajectory in the second quarter. It rose by 5.6 percent, a continued pace from the first quarter. Since the first quarter of 2003, it has grown by a substantially higher average of 4.4 percent, compared to the annual average of 1.8 percent for the period from 1998 to 2002.

Internal and external demand for manufactured goods has been strong and this is the driver of the industrial sector's growth. Personal consumption of food grew by 11.3 percent, beverage by 7.6 percent, and clothing by 9.2 percent. Moreover, the sector continued to benefit from the expansion of merchandise exports to trading partners as exports grew by a healthy 14.9 percent in the second quarter.

Modest but still substantial gains in agriculture. Slowing from a historic growth of 8.1 percent in Q1, the agriculture, fisheries and forestry (AFF) sector grew at a slower rate of 4.3 percent in Q2. The lower output growth in agriculture was accounted for by the decline in the output of palay, coconut, livestock, poultry, other crops and agricultural activities and services.

Nonetheless, corn and sugarcane posted a healthy growth of 15.5 percent and 34.7 percent, respectively. Fisheries also grew by 6.0 percent, supported by a huge jump in aquaculture production of 28.74 percent and a modest increase in prices of 0.47 percent. Expansion in the seaweeds industry particularly in Mindanao contributed to the growth, together with the rise of fish culture farming. The forestry sector which accounts for 0.14 percent of GNP grew at 110.4 percent. The growth of the agriculture and fisheries sub-sector was well supported at the production side and the demand side as prices and volume of production were generally higher compared to the same period of the previous year.

Table 3: Growth Rates of Agricultural Production and Farmgate Prices, 1st Semester 2004 vs. 2003

SUB-SECTOR	VOLUME OF PRODUCTION	FARMGATE PRICES
AGRICULTURAL CROPS		
Palay	12.2	7.4
Corn	14.1	36.4
Coconut	-1.3	30.9
Sugarcane	18.3	-15.0
Banana	2.4	8.4
LIVESTOCK		
Carabao	8.0	-9.8
Cattle	-0.2	0.8
Hog	2.1	32.2
Goat	0.4	12.8
Dairy	2.6	4.7
POULTRY		
Chicken	1.0	13.8
Duck	-1.5	-18.4
Chicken Eggs	7.4	4.4
Duck Eggs	5.0	21.6
FISHERY		
Commercial	2.1	12.2
Municipal	2.5	6.3
Aquaculture	28.7	-5.4

Source: BAS

On the Expenditure Side:

Continued expansion of exports**.** The country enjoyed an upsurge in exports by 14.9 percent. This could be attributed to the economic growth of the country's trading partners. However, as shown below, the second quarter growth rates slowed compared to the first quarter for the country's top three trading partners. If this will continue for the rest of the year, slower growth may dampen demand for Philippine exports. NSO reported a decelerated growth rate of exports in July of 4.7 percent,which pales in comparison to the 14.9 percent growth in the second quarter.

Table 4: Selected Export Markets
'Q1 and Q2 Growth Rates and Export Shares
(in percent)

Country	Q1	Q2	Export Share
1. US	4.5	2.8	20.8
2. Japan	6.6	1.7	16.5
3. Netherlands	0.6	-0.2	8.4
4. Hong Kong	6.8	12.1	8.8
5. Singapore	7.4	11.7	6.9

Source: ***CNN, Eurostat, Bloomberg, MTI Singapore, and NSO***

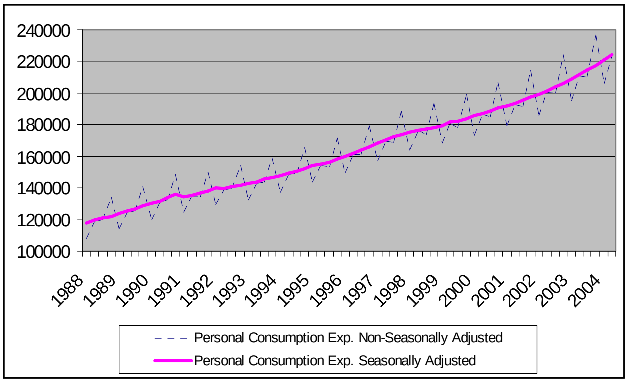
For the second quarter, total merchandise exports grew by 13.1 percent from a 9.2 percent growth in the first quarter. This was supported by a 20.6 percent growth of monetization of gold, which grew from a lower base during the same period of last year, while merchandise exports grew at 12.9 percent. Under merchandise exports, principal merchandise exports contracted by 7.3 percent, while merchandise exports classified under ***others*** rose 31.4 percent. This reinforces the growing consensus on the need to reclassify categories under principal merchandise exports because they are no longer the main exports of the economy. Exports under the category ***others*** currently account for 58.9 percent of total merchandise exports. The growth of export goods classified under the category ***others*** is explained by electronic products like electronic data processing, and components and devices.

The growing export of non-factor services, which includes provision of business services for companies located overseas grew at a robust pace of 28.1 percent in the second qaurter. Among its sub-sectors that grew at high rates were travel/ tourism at 59.3 percent and miscellaneous services (i.e. call centers, customer relations, accounting, etc.) at 17.1 percent. These sectors are expected to lead the growth of the economy in the second semester of 2004.

Further, outsourced business processes have caused increased occupancy rates and prices of real estate in the general Manila area. Particularly, this has reduced Makati Central Business District vacancy rates from 12.2 percent in 2003 to 11.6 percent as of March 2004. The projection is that by March 2005, vacancy rates will go down to 9.0 percent and that the annual escalation rate of 5 to10 percent per annum will prevail. This augurs well for the real estate sector of the country as business process outsourcing begins to have backward linkages in the domestic economy (Tan, CLSA, July 2004).

Consumption-driven growth. Our growth has been largely fuelled by personal consumption expenditure. It has accounted for an average of 74 percent of GDP for the past decade and has been steadily growing amidst seasonal fluctuations. Adjusting for seasonality of economic cycles like enrolment periods, holidays, agriculture production, and other yearly cycles, one can see that Seasonally Adjusted Personal Consumption Expenditure (SAPCE) has been growing steadily in constant 1985 terms.

Figure 2: Quarterly Personal Consumption Expenditure, Seasonally and Non-Seasonally Adjusted



Source: NSCB

For the second quarter, Personal Consumption Expenditure increased by 10.8 percent. Amidst all sub-sectors posting positive growth rates, consumption of transportation and communication services led the pack with a 22.3 percent growth, followed by food at 11.3 percent, clothing and footwear at 9.2 percent, and beverages at 7.6 percent. In the second semester, personal consumption may be pulled down by high oil prices, and increases in electricity rates and transport rates.

Continued modest rise in investments**.** Capital formation slowed from its 10.1-percent growth in the first quarter to 8.5 percent in the second quarter. However, this growth is still substantial. Construction led the growth with a 10.9 percent increase, while durable investments rose 3.1 percent. Private construction, which comprises 63 percent of the total, grew at 8.5 percent while public construction, which covers the remaining 37 percent, grew at 14.9 percent. Public construction was spurred by election-related spending, and will not to be sustained for the rest of the year especially with the government's fiscal woes. The growth of private construction is threatened by the hike in interest rates.

Outlook for 2004

The first semester economic performance augurs well for the government to achieve its high-end growth targets of 5.8 percent GDP growth and 6.0 percent GNP growth. Given the higher than expected first semester growth, the economy will need a GDP growth of 5.3 percent and GNP growth of 5.9 percent for the second semester. Hence, even if the impact of increasing oil prices drags down economic growth, the country will substantially outdo its 2003 GDPgrowth of 4.5 percent.

Table 5: Full-Year GDP Forecasts by Various Agencies

Agency	Full Year GDP Growth Forecast
NEDA	5.9 - 6.1
ADB	5.5
Morgan Stanley	5.6
Bear Stearns & Co.	5.8

Sources: NEDA, Ng, Lema, and Lian

This optimism has led to the upgrading of the growth targets for the country by the government, investment analysts and the Asian Development Bank. The table below shows that the full year growth targets are expected to be around half a percentage point higher than original estimates. This is due primarily to the strong growth in the domestic economy. The National Economic and Development Authority (NEDA) forecasts the growth to be supported by a 4.6 to 5.0 percent growth of the AFF sector, a 5.0 to 5.4 percent growth of the industry sector and a 6.2 percent to 6.9 percent growth of the services sector in the second semester (Star, September 15, 2004).

However, despite the good forecasts, the country is still expected to grow at a slower rate compared to the average economic growth rates of countries in Asia and the Pacific of 7 percent and 6.2 percent for the full-year of 2004 and 2005, respectively.

Table 6: Economic Growth Forecast for Asian Countries

Countries / Region	2004		2005	
	New	Previous	New	Previous
East Asia	7.3	6.9	6.4	6.8
China	8.8	8.3	8	8.2
Hong Kong	7.5	6	6	5.2
Southeast Asia	6.2	5.7	5.7	5.4
Indonesia	4.8	4.5	5.2	4.5
Malaysia	6.8	5.8	6	5.6
Philippines	5.5	5	5.5	5
Singapore	8.1	5.6	4.2	4.8
Thailand	6.4	7.2	6.6	6.2
Vietnam	7.5	7.5	7.6	7.6
South Asia	6.4	7.0	5.9	7.2
Central Asia	7.9	8.1	8	8.4
Pacific	2.9	2.9	2.4	2.4
AVERAGE	7.0	6.8	6.2	6.7

Source: Ng, Businessworld

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National Telecommunication Commission (NTC)
Philippine Stock Exchange (PSE)

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