Economic Report

SENATE ECONOMIC PLANNING OFFICE

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MIDYEAR ECONOMIC REPORT

Is there room for optimism in 2009?

While the Philippines is said to be weathering the crisis better than its more export-dependent neighbors, and signs of recovery is emerging in global markets, the country's economic managers cannot be complacent. Unless the foreseeable upturn in global demand is realized, conditions are expected to remain tough. The biggest challenge would be preserving the growth momentum achieved in recent years, putting the fiscal house in order and protecting the country's most vulnerable.

The SEPO Economic Report is a semestral publication of the Senate Economic Planning Office. Its purpose is to provide useful information on the current state of the economy to the Senators and Senate Officials. The SEPO Economic Report is also available at www.senate.gov.ph.

HIGHLIGHTS OF THE ECONOMY IN THE FIRST SEMESTER

Production and Expenditure

The Philippine economy slimly dodged a recession. After posting an insipid 0.6% growth rate in the first quarter, the Philippine economy grew by a decent 1.5% in the second quarter of 2009, bringing the average first semester growth to 1.0% (Table 1). During the said period, the country fared worse than Indonesia and Vietnam but better than the rest of its Southeast Asian neighbors (Figure 1). For the second semester, the full disbursement of infrastructure budget, election-related expenditures, and the consumers' penchant for holiday spending are expected to provide the economy the boost that it needs to hit the year-end growth target of 0.8-1.8 percent.

The services and agricultural sectors managed to post positive growth rates but industry contracted considerably. Although the nature of the global economic crisis and its resulting effects on consumption has weighed down some of its sub-sectors, particularly, trade, finance, and ownership of dwelling and real estate, the services sector has continually posted positive, albeit slower growth rates over the last two quarters. Services, long touted as the economy's growth driver registered a 2.5 % growth rate in the first semester of 2009. The agricultural sector has likewise managed to grow, with significant contributions from the fishery, poultry, and livestock sub-sectors but its growth dropped from 3.8% in the first half of 2008 to 1.3% this year. On the supply side, the industry sector appeared to have been the most affected by the global crisis. It posted a negative growth rate for the second consecutive quarter this year, mirroring the weak performance of its manufacturing sub-sector. While the growth rates of the construction, mining, and quarrying sub-sectors are impressive, they account for only 4.8 %and 2.12 %of GDP, respectively.

Table 1. GDP and GNP Growth Rates, 2008 and 2009 (at constant 1985 prices)

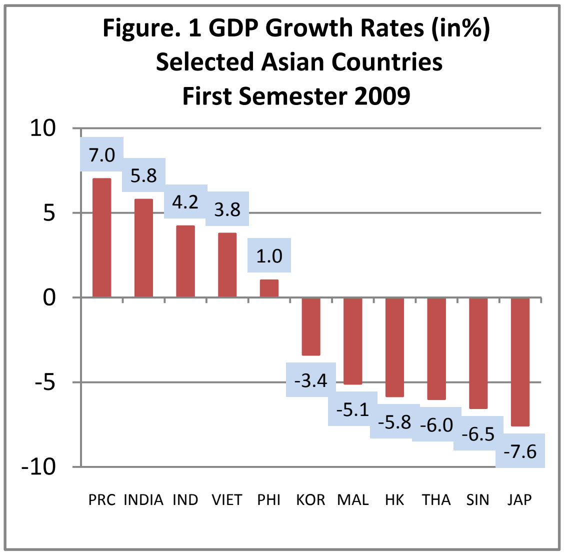
Indicators	2008				2009		2008	2009
	Q1	Q2	Q3	Q4	Q1	Q2	H1	H1
GNP	6.4	5.3	6.2	6.7	3.1	4.4	5.8	3.8
Net Factor Income from Abroad	36.2	15.8			40.8		26.0	
GDP	3.9	4.2	4.6	2.9	0.6	1.5	4.0	1.0
AGRICULTURE, FISHERY AND FORESTRY	2.8	4.9	2.5	2.9	2.1	0.3	3.8	1.3
Agriculture and Fisheries	2.8	5.0	2.5	2.9	2.2	0.4	3.8	1.3
Forestry	2.4	-3.8	3.8	7.4	-11.8	-8.7	-1.4	-10.0
INDUSTRY	2.7	4.0	7.6	5.3	-2.5	-0.3	3.4	-1.3
Mining & Quarrying	12.3	-13.7	0.7	18.2	19.5	21.4	-3.2	20.5
Manufacturing	2.4	6.1	5.4	3.4	-7.6	-7.2	4.3	-7.4
Construction	-4.3	2.3	20.5	14.5	14.0	16.9	-0.4	15.8
Electricity, Gas and Water	9.5	6.6	9.2	3.8	0.6	2.9	7.9	1.8
SERVICES	5.2	4.0	3.3	1.3	2.0	3.1	4.6	2.5
Transport., Communication, and Storage	5.6	3.9	2.9	4.5	5.6	1.7	4.7	3.6
Trade	1.1	2.8	1.3	0.0	0.4	3.0	2.0	1.8
Finance	12.2	1.0	1.8	-4.6	1.2	1.8	6.5	1.5
Ownership of Dwellings & Real Estate	7.2	7.5	6.7	1.7	0.7	3.4	7.3	2.1
Private Services	5.7	6.0	5.5	2.4	2.5	2.8	5.9	2.7
Government Services	5.2	5.3	5.5	6.2	1.1	7.7	5.2	4.5
PERSONAL CONSUMPTION EXPENDITURE	5.1	4.1	4.4	5.0	1.3	2.2	4.6	1.8
GOVERNMENT CONSUMPTION	-0.3	0.0	11.8	2.6	4.5	9.1	-0.1	7.0
CAPITAL FORMATION	-1.7	13.6	9.4	-13.1	-15.1	-9.8	5.7	-12.4
Fixed Capital	3.0	1.7	7.1	0.1	-7.2	-1.9	2.3	-4.4
Construction	-4.1	1.0	14.3	8.2	6.7	11.7	-1.1	9.7
Durable Equipment	9.6	3.7	1.0	-7.9	-18.5	-18.9	6.8	18.6
Breeding Stock & Orchard Dev't	-2.3	-5.1	-0.4	1.2	1.0	-4.9	-3.7	-1.7
EXPORTS	-7.7	6.1	3.3	-11.5	-14.7	-16.0	-0.4	-15.4
Merchandise Exports	-10.9	5.9	4.8	-9.4	-24.6	-22.4	-2.0	-23.3
Non-Factor Services	5.9	7.3	-4.3	-19.4	21.1	15.2	6.6	18.1
LESS : IMPORTS	-2.6	0.0	6.7	5.0	-20.6	-2.7	-1.3	-11.3
Merchandise Imports	-3.4	-1.3	5.3	5.8	-22.6	-2.1	-2.3	-12.0
Non-Factor Services	7.7	19.2	28.2	-3.6	1.8	-9.3	13.1	-3.7

Source: National Statistical Coordination Board

Table 2. Selected Macroeconomic Indicators

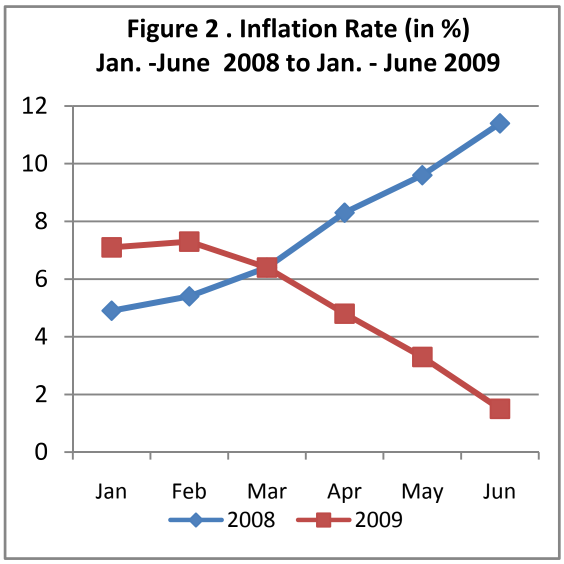
Indicators	2008		2009	
	Q1	Q2	Q1	Q2
FISCAL				
Fiscal balance (% of GDP)	(3.1)	1.8	(6.9)	(1.8)
Government debt (% of GDP)	57.1	56.6	56.4	.....
MONEY AND BANKING				
Domestic credit (%change)	12.5	16.2	21.6	16.9
Capital adequacy (in %of assets)	11.9	10.7	11.0	.....
Non-performing loans (%of total)	5.0	4.5	4.3	.....
EXTERNAL				
Current account balance (% of GDP)	3.2	2.2	5.9	.....
Foreign exchange reserves (in US$ million)	370.6	369.9	937.7	693.9
In months of imports	6.0	5.8	6.7	6.8
External debt (% of GDP)	35.6	33.8	32.3	.....
Of which: Short-term external debt	12.2	16.0	12.4	.....

Source: BSP and Bureau of Treasury



Source: ADB Asia Regional Integration Center

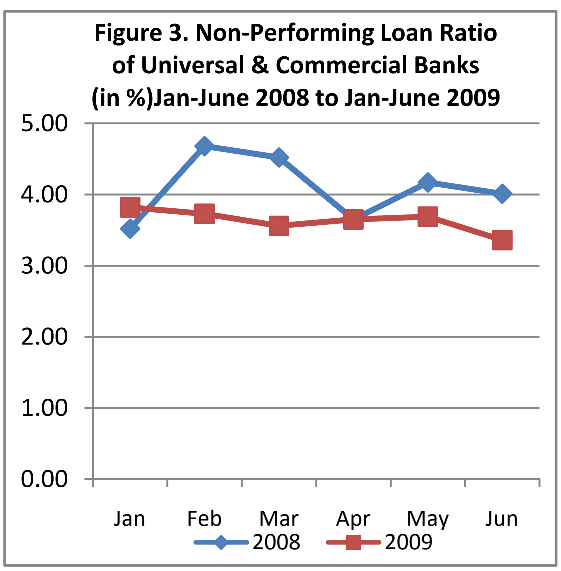
Decelerating inflation supported personal consumption expenditure. Despite the low inflation beginning late last year, consumer confidence remained low. Household spending grew by only 1.8 % compared to the 4.6 % growth it posted for the same period last year. Exports and imports likewise plunged to negative 15.4 % and negative 11.3% respectively, far worse than the negative 0.4 %and negative 1.3% they recorded in the first half of 2008. Traditional exports such as semiconductors and electronic products fell by as much as 36.7%, offsetting the robust growth of export of non-factor services, which went up to 49.0% from 17.5% in 2008. Meanwhile, the stimulus measures imposed by the government saw public spending grew by a stunning 7.0 %. The continued decline of capital formation expenditures, particularly on investments in durable equipment, however, does not bode well for the country's productive capacity in the medium- run.



Source: BSP

Monetary and Financial

Muted demand coupled with stabilizing food commodity supply has resulted in low inflation rates. Headline inflation rate averaged 5.1%, in the first semester, down from 7.7% in the same period last year. In July, inflation further dropped to 0.2%, the lowest in more than two decades. The low inflation environment gave more room for the Bangko Sentral ng Pilipinas (BSP) to ease its monetary stance, slashing key policy rates by a total of 200 basis points (bps) since December 2008. To increase liquidity further, the BSP also cut reserve requirements and tripled its rediscounting budget. As the real sector is expected to show further signs of recovery during the second half of the year, the BSP is anticipated to halt its monetary easing to avoid stoking inflation.



Source: BSP
Note: This includes inter-bank loans

The domestic banking system remained steadfast. The BSP has noted that banks' tolerance for risks seemed to have increased as lending continued to rise with universal and commercial bank loans posting a year-on-year growth rate of 11.1 % in June. The bulk of total loans outstanding went towards production activities (80.0 percent) indicating sustained economic activity, while loans for household consumption made up around 8.0 percent. The share of non-performing loans (NPLs) to total loan portfolio improved slightly to 3.36 % in June of 2009 compared to 4.01% last year while the latest capital adequacy ratio is 15.49 % on consolidated basis. London-based credit ratings agency Fitch Ratings recently did a stress test on local banks and reported that there is a low probability of capital impairment.

Figure 4. The Philippine Stock Exchange Composite Index, January to June 2009

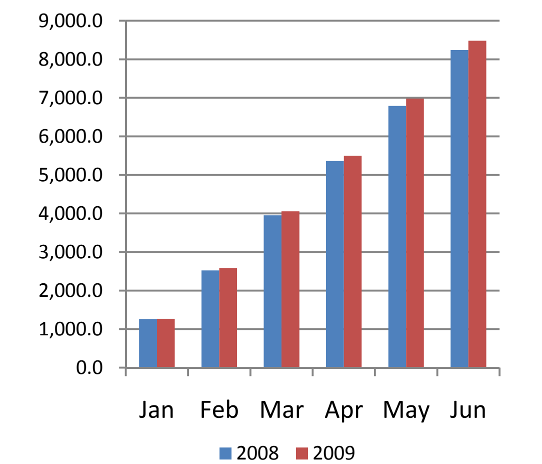
Source: Philippine Stock Exchange

Stock market performance has improved. Buoyed by the perception that the global economic downturn is starting to bottom out, the Philippine Stock Exchange Composite Index (PSEi) rose by as much as 30.0% during the first six (6) months of 2009. The mining & oil and industrial sectors contributed to this improvement, posting an increase in value of 76.5% and 57.2%, respectively. Average monthly turnover went up by PhP65.1 billion from the PhP64.3 billion in the first half of 2008 while total value raised amounted to PhP390.6 billion.

External

The initial fear of decreasing remittance inflow was quelled by its still positive growth. Cumulative OFW remittances coursed through banks amounted to US$8.5 billion from January to June, a 2.6% growth from the same period last year. The impact of this growth however, is subdued by the peso's depreciation against the US dollar. The peso weakened by 1.4% from PhP47.65 to a dollar at the start of the year to PhP48.31:US$1 by end of June 2009 on account of sluggish domestic growth prospects as well as the widening fiscal deficit. Nonetheless, analysts are cautiously optimistic that the sustained demand for skilled and professional Filipino labor in addition to emerging signs of global economic recovery would push up the remittance growth outlook for the year.

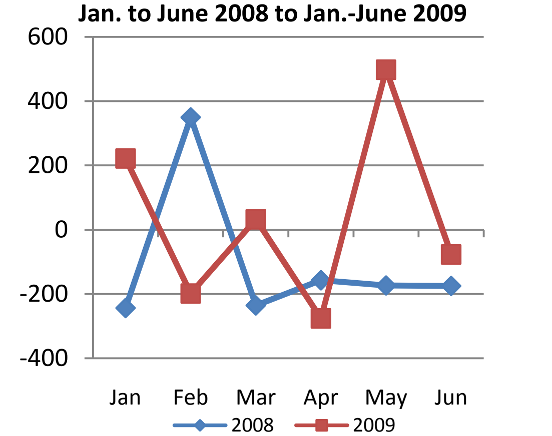
Figure 5. OFW Remittances (in million US$) Jan-June 2008 to Jan-June 2009



Source: BSP

Risk aversion of foreign investors has somewhat abated with investors seeking new opportunities in emerging economies. For the first half of 2009, foreign portfolio investments totaled a net inflow of US$199.2 million, a sharp reversal from the net outflow of US$636.3 million posted last year. Foreign direct investments likewise grew to US$946 million during the first five months of 2009 from US$320 million in 2008.

Figure 6. Monthly Transactions on BSP-Registered Foreign Portfolio Investments, (in million US$) Jan. to June 2008 to Jan.-June 2009



Source: BSP

First quarter balance of payment position (BOP) improved slightly by 1.1% and accounted for 4.8% of GDP. Despite the steady depreciation of domestic currency and the still weak external demand for merchandise exports, current account balance still managed to post a surplus of US$2.17 billion. Trade deficit stood at US$1.37 billion, tempered by a US$763 million surplus in export of services. Gross International reserves (GIR), meanwhile, has hit a new record high of US$39.6 billion in June, boosting the country's buffer against external shocks. At this level, the reserves are enough to cover 6.3 months of imports of goods and payments of services and income.

Table 3. Comparative Table on NG Cash Budget Performance (in billion PhP) January to June 2009

	CY 2008	Jan 1- June 30 2009		Difference
	Actual	Program	Actual	Program vs. Actual
REVENUES	**1,202.9**	**581.4**	**545.7**	**(35.7)**
BIR	778.6	388.4	375.6	(12.8)
BoC	260.2	124.9	104.8	(20.1)
BTr	63.7	29.1	30.1	1.0
Others	100.4	38.9	35.2	(3.8)
EXPENDITURES	**1,271.0**	**736.5**	**699.1**	**(37.4)**
Other NG Expenditure Accounts	911.9	538.1	511.5	(26.6)
Interest Payments	272.2	158.8	144.7	(14.1)
Tax Expenditures	49.7	21.5	29.0	7.6
Net Lending	14.4	7.3	6.5	(0.8)
Equity	1.7	3.0	0.4	(2.6)
Subsidy	21.1	7.9	7.0	(0.9)
SURPLUS/ (DEFICIT)	**(68.1)**	**(155.1)**	**(153.4)**	**1.7**

Source: BSP

Table 4. Selected Employment Indicators Jan. and April 2008 to Jan. and April 2009

Philippines	January		April	
Indicator (in %)	2008	2009	2008	2009
Labor Force Participation Rate	63.4	63.3	63.2	64.0
Employment Rate	92.6	92.3	92	92.5
Unemployment Rate	7.4	7.7	8	7.5
Underemployment Rate	18.9	18.2	19.8	18.9
Employment by Industry (in '000)				
Total	34,258	33,693	33,535	34,993
Agriculture	11,793	11,853	11,905	12,318
Industry	4,987	4,865	4,997	5,074
Services	16,914	17,540	16,633	17,601
Employment by Class of Workers (in '000)				
Wage and Salary Workers	17,917	17,419	17,740	18,161
Own Account	12,127	12,163	11,603	12,213
Unpaid Family Workers	42,14	41,11	4,192	4,584

Source: National Statistics Office

Fiscal

The state continues to face the challenge of pump-priming a weakened economy. Many have criticized the government for not spending enough on the right programmed items. During the first half of 2009, actual disbursement of the national government amounted to PhP699.1 billion, PhP37.4 billion less than the programmed spending for the said period. Recent data shows that although the share of capital outlay has increased from 14.4% in 2008 to 18.8% in 2009, the bulk of the budget or 23.1 % is still being eaten up by interest payments.

The ability of the government to spend its way out of the crisis will ultimately depend on putting its fiscal house in order. For the first half of the year, the Bureau of Customs and the Bureau of Internal Revenue both reported shortfalls from their collection targets by PhP20.1 billion and PhP12.8 billion, respectively. The fiscal deficit for the first semester stands at PhP153.4 billion, a little less than two-thirds of the targeted PhP250 billion deficit cap for the year. Debt-to-GDP ratio remains high and currently stands at 56.4%.

Labor, Employment

Latest employment figures showed a 2.9 % increase in the first half of 2009 compared to the same period last year. Labor force surveys conducted in January and April show that an average of 1.05 million jobs were generated year-on-year. However, the number of wage and salary workers increased by only 2.5% while unpaid family workers increased by 5.4%. Moreover, the survey results showed that 35,800 jobs were lost in the manufacturing sector during the period, reflecting the weak performance of export manufactures. Underemployment remains to be a serious concern accounting for 18.5% of the total labor force, with almost 12 million working less than 40 hours a week. The slack in the domestic labor market gave rise to moves towards flexible working arrangements, which result in slowing wage growth.

Hunger and Poverty

Results of the Second Quarter 2009 hunger survey of the Social Weather Survey reveal that one in five Filipino families (20.3%) or about 3.7 million families have experienced hunger in the preceding three months, up from 15.5% (estimated 2.9 million families) in the previous quarter. Self-rated poverty also increased in June, with 50.0% of families (9.3 million) considering themselves poor, an increase from the 47.0 % recorded in February 2009.

Outlook and Challenges

While there is some room for optimism for the rest of the year as the global markets show emerging signs of recovery, the Philippine economy is still far from being out of the woods. Many analysts predict an L-shaped (i.e prolonged), rather than a V-shaped (i.e quick), recovery period. That is, during the next three to four years, economic growth will not be any near what the Philippines had in the recent past. Unless the foreseeable upturn in global demand is sustained, conditions are expected to remain tough. The biggest challenge would be preserving the growth momentum achieved in recent years, strengthening the fiscal position and protecting the country's most vulnerable.

Fiscal authorities must ensure that its fiscal stimulus package is placed within the framework of fiscal sustainability.

With the expected rise in demand (i.e. consumption) during the second half of the year, inflation will likely be on an uptrend from hereon with monetary authorities taking a wait-and-see attitude with regards to easing its key policy rates. The monetary authority has so far demonstrated laudable efforts to accommodate the macroeconomic shocks while the crisis serves as a good reminder to push for legislation geared towards strengthening its regulatory powers.

Furthermore, with memories of last year's financial fiasco still fresh, investors are pouring more money into steadier, fixed-income earnings rather than in equities. This might have augured well in terms of improving our investment climate but as it is, our corporate bond market is practically nil compared to that of other countries in the region. Institutional reforms must be introduced to lay the groundwork for developing our corporate bond market to allow firms to raise capital when credit sources are tight elsewhere.

While there are expectations of recovery in the coming years, efficient public spending to support economic growth must be continued. Of the PhP330 billion stimulus package, around 50% is allotted to welfare programs, around 30 %for large, labor-intensive infrastructure projects, and the remainder comes in the form of tax breaks intended to fuel spending. The fiscal deficit will likely hit the PHp250 billion deficit cap that the government has set for the year.

That being said, the consistently weak generation of revenues has forced the government to float more debt papers, making investors seek higher yields from what they perceive as risky holdings. The large share of debt-to-GDP and interest payments to the budget makes the economy vulnerable to financial market swings. The fiscal deficit must continually be kept in check. Rates significantly higher than programmed might unsettle financial markets and rating agencies, and may raise borrowing costs.

Implementation of foreign-assisted projects should be expedited to reduce the risk of rising costs of foreign borrowings and to avoid project delays and its attendant commitment fees. Given the still tight global credit markets, ODA financing might be much more reasonable than commercial borrowings.

Moreover, there is now more pressure to increase the efficiency of tax administration as this is crucial in reversing the decline in the tax effort. The government must step up efforts to pursue the indexation of sin taxes and the rationalization of fiscal incentives.

Measures must be taken to ensure job preservation. The effect of the stimulus package on consumption spending (which account for around 70% of GDP) could have been limited as people could have opted to save more when good jobs are scarce and wage growth is slow. Job generation requires investments, which comes as a result of an improved investment climate. This, in turn, implies reforms addressing the problems of an inefficient bureaucracy, policy instability, and corruption – significant constraints in investment growth.

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