Economic Report

SENATE ECONOMIC PLANNING OFFICE

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As with most economies around the world, the year 2009 proved to be a tough year for the Philippines, which registered its lowest GDP in 11 years. While there are signs of small improvements, the growth figures also suggest some fragility. Mindful that recovery is in sight, policymakers must give careful consideration to exit strategies and greater vigilance must be observed for some of the downside risks.

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.

Lessons learned in 2009, imperatives for 2010

HIGHLIGHTS OF 2009 PHILIPPINE ECONOMIC PERFORMANCE

Production and Expenditure

The Philippine economy grew by 0.9 percent in 2009. It continued to post low, albeit positive, growth rates just as the global economy reached the bottom of the pool in 2009. However, in contrast to the fate of most of its neighbors, it slimly avoided a recession regardless of the painful effect of the global slowdown on exports. Substantial disbursements for infrastructure and robust consumer spending provided the much-needed boost to the economy.

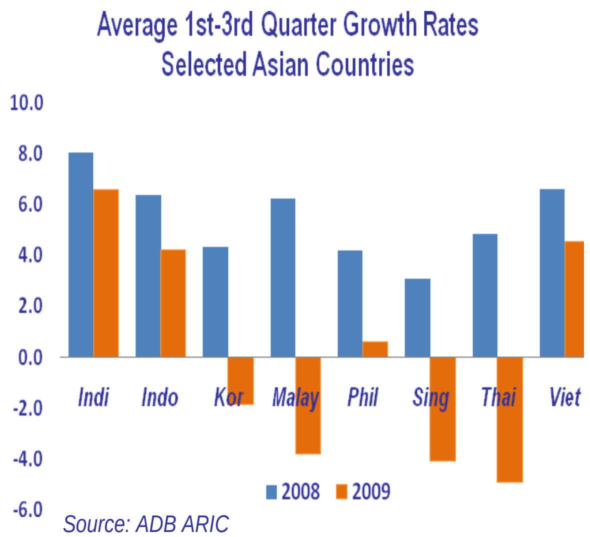
The services sector continued to be the largest contributor to economic growth and accounted for 43.9 percent of the domestic economy. Services grew by an average of 3.2 percent, which is largely attributable to the strong performance of the financial and government services. Meanwhile, the agricultural sector took a heavy brunt from the typhoons that wrought havoc on farmlands during the fourth quarter, and grew by only 0.3 percent. Palay, in particular, posted a negative 13.9 percent growth during the last quarter. The lackluster performance of the agricultural and fisheries subsector pulled down total GDP growth by 2.7 percentage points.

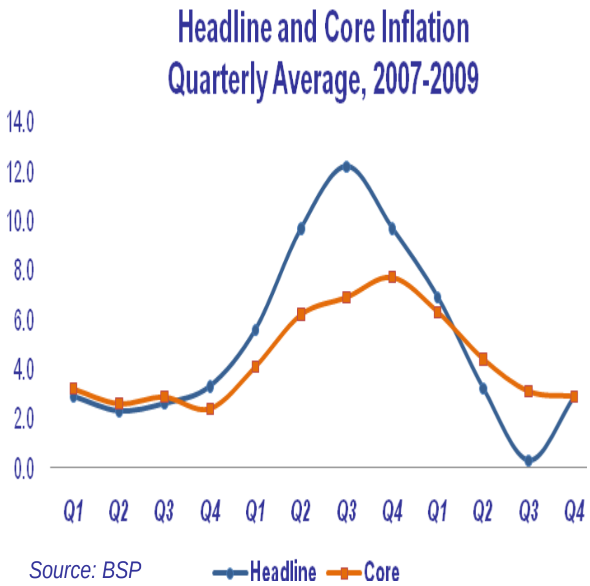
The industry sector suffered greatly during the onslaught of the crisis. The global slowdown that resulted in the contraction of exports was transmitted to the manufacturing subsector, which posted negative growth figures for most of 2009. Manufacturing industries have reported considerable decline in gross value added. These industries include manufacturing for products of petroleum and coal, footwear and wearing apparel, food manufacturing, and leather.

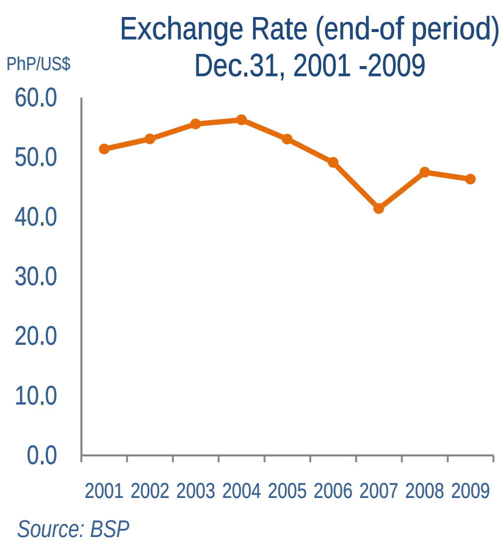
Real GDP Growth Rates, 2008-2009
in 1985 prices

by Production / by Expenditure	2008				2009				2008	2009[a]
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		
Gross domestic product	**3.9**	**4.2**	**4.6**	**2.9**	**0.6**	**0.8**	**0.4**	**1.8**	**3.9**	**0.9**
Agri., Fishery, Forestry	2.8	4.9	2.5	2.9	2.1	0.2	1.5	(2.8)	3.3	0.3
Agriculture & Fishery	2.8	5.0	2.5	2.9	2.2	0.2	1.4	(2.8)	3.3	0.3
Forestry	2.4	(3.8)	3.8	7.4	(11.8)	(6.1)	10.3	0.7	2.5	(1.7)
Industry	2.7	4.0	7.6	5.3	(2.5)	(1.7)	(5.0)	1.1	4.9	(2.0)
Mining & quarrying	12.3	(13.7)	0.7	18.2	19.5	22.1	26.9	17.0	4.4	21.4
Manufacturing	2.4	6.1	5.4	3.4	(7.6)	(7.4)	(7.8)	1.3	4.3	(5.4)
Construction	(4.3)	2.3	20.5	14.5	14.0	14.0	0.9	(5.8)	8.3	5.8
Electricity, gas & water	9.5	6.6	9.2	3.8	0.6	(4.9)	(6.3)	0.5	7.3	(2.5)
Service	5.2	4.0	3.3	1.3	2.0	2.7	3.8	4.2	3.5	3.2
Trans, comm & storage	5.6	3.9	2.9	4.5	5.6	1.0	(1.5)	1.9	4.2	1.8
Trade	1.1	2.8	1.3	0.0	0.4	2.7	4.4	3.5	1.3	2.8
Finance	12.2	1.0	1.8	(4.6)	1.2	5.8	11.5	11.0	2.6	7.4
Ownership dwelling & real	7.2	7.5	6.7	1.7	0.7	(2.5)	(2.3)	0.3	5.8	(1.0)
Private services	5.7	6.0	5.5	2.4	2.5	2.1	4.4	6.1	4.9	3.8
Government services	5.2	5.3	5.5	6.2	1.1	8.7	6.6	3.4	5.6	5.0
Personal consumption	5.1	4.1	4.4	5.0	1.3	5.4	3.2	5.1	4.7	3.8
Government consumption	(0.3)	0.0	11.8	2.6	4.5	9.7	8.1	12.1	3.5	8.6
Capital formation	(1.7)	13.6	9.4	(13.1)	(15.1)	(10.3)	(12.1)	(0.8)	2.1	(9.6)
Fixed capital	3.0	1.7	7.1	0.1	(7.2)	(3.9)	(0.9)	(1.6)	3.0	(3.4)
Construction	(4.1)	1.0	14.3	8.2	6.7	8.9	1.7	(2.9)	4.9	3.6
Public	(10.9)	(5.6)	23.4	(1.2)	11.5	27.7	21.8	(7.2)	1.4	13.5
Private	(0.2)	8.6	9.8	15.4	4.3	(10.1)	(9.4)	(0.1)	8.4	(3.8)
Durable equipment	9.6	3.7	1.0	(7.9)	(18.5)	(19.7)	(4.2)	(0.1)	1.6	(10.6)
Breeding stock & orchard dev't	(2.3)	(5.1)	(0.4)	1.2	1.0	(5.6)	1.5	(2.0)	(1.7)	(1.3)
Exports	(7.7)	6.1	3.3	(11.5)	(14.7)	(18.1)	(13.0)	(10.0)	(2.5)	(14.0)
Merchandise exports	(10.9)	5.9	4.8	(9.4)	(24.6)	(22.4)	(14.6)	(9.1)	(2.4)	(17.7)
Non-factor services	5.9	7.3	(4.3)	(19.4)	21.1	3.0	(4.1)	(13.9)	(2.6)	1.5
Imports	(2.6)	0.0	6.7	5.0	(20.6)	(2.2)	0.1	(2.5)	2.3	(6.3)
Merchandise exports	(3.4)	(1.3)	5.3	5.8	(22.6)	(2.1)	1.4	(1.8)	1.6	(6.3)
Non-factor services	7.7	19.2	28.2	(3.6)	1.8	(3.2)	(16.1)	(10.3)	12.9	(7.0)

Source: National Statistical Coordination Board
a: average of quarterly figures.







Consumption expenditure was buoyed by decelerating inflation and continued positive growth of remittances. Food consumption, which makes up at least half of personal consumption expenditure, continued to grow at an average of 10.9 percent during the year. Spending on durables, however, declined by 10.6 percent.

Government expenditure crowded out private investment. The higher-than-average growth of government expenditure reflected the fast-tracking of infrastructure projects, with public construction averaging at 20.5 percent during the first three quarters. However, this was not enough to offset the deceleration of private construction and investment in durable equipment, which contributed to the deterioration of capital formation to an average of negative 9.6 percent.

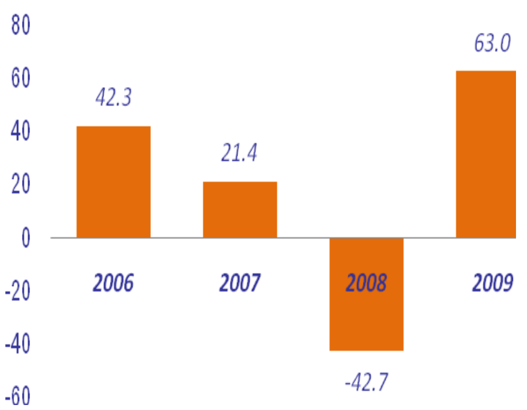
Monetary and Financial

Headline inflation was benign for most of 2009 largely due to base effect and stabilizing commodity prices. Full-year average inflation stood at 3.2 percent, well within the target range of 2.5 to 4.5 percent. This allowed the Bangko Sentral ng Pilipinas (BSP) to increase system liquidity by slashing its key policy rate by a total of 200 basis points (bps) from December 2008 to July 2009. BSP also cut the reserve requirements, and tripled its rediscounting budget. As headline inflation started to rise during the second semester from 0.1 percent in August to 0.7 percent in September, and to 4.4 percent in December, BSP halted its monetary easing to avoid stirring up further inflationary pressures.

The domestic banking system has been spared from the turmoils of the global financial crisis. Capital adequacy ratio remained healthy at 15.7 percent (on consolidated basis) as of June 2009, maintaining a wide margin above the Basel international standard of 8 percent and the BSP's required minimum of 10 percent. Ample liquidity has been infused into the economy last year with the average M3[1] expanding by 13.2 percent. Likewise, credit demand has started to recover. Bank lending increased by 10 percent net of reverse repurchase (RRP) placements. The productivity of these loans has also improved. As of end-December 2009, the non-performing loans (NPL) ratio of

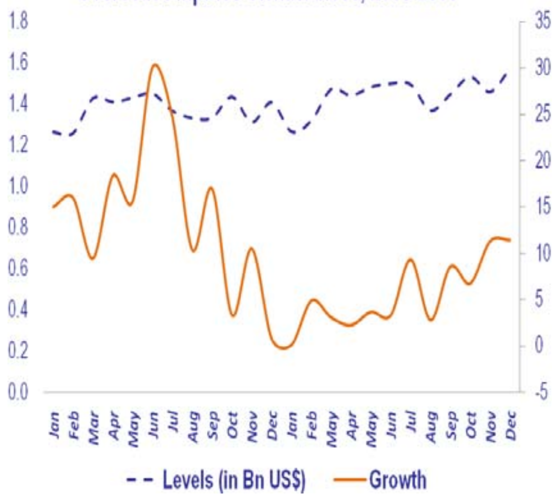
[1] M3 or total domestic liquidity consists of M2 or broad money plus peso deposit substitutes, such as promissory notes and commercial papers (i.e., securities other than shares included in broad money).

Stock Market Returns



Source: PSE

Overseas Filipinos' Remittances, 2008-2009



Source: BSP

Foreign Direct Investment

in million US dollars

	Jan-Nov.		Growth Rate	
	2008	2009	2008	2009
Total FDI	1,336.0	1,410.0	-52.7	5.5
Equity capital	1,213.0	1,368.0	-36.5	12.8
Placements	1,396.0	1,540.0	-33.2	10.3
Withdrawals	183.0	172.0	2.8	-6.0
Reinvested earnings, net	-126.0	133.0	-123.1	205.6
Other capital, net	249.0	-91.0	-32.2	-136.5

Source: BSP

universal and commercial banks (U/KBs) eased to 1.97 percent, down by 0.55 percentage point from last year's ratio.

Even though the beginning of 2009 was wrought with uncertainty, stock market performance has been better than expected. The Philippine Stock Exchange Index (PSEi) rose by 63.0 percent, from a value of 1,872.75 on the last trading day of 2008 to 3,052.68 on the last trading day of 2009. This is a far cry from the negative 42.7 percent recorded in 2008. The best performing sector was mining and oil with an index that rose by 234 percent followed by the industrial sector, whose index rose by 116 percent. Also, foreign investors have renewed their interest as they bought PhP14.9 billion worth of local stocks.

External

The initial fear of decreasing remittance inflow was quelled by its constantly positive growth. OFW remittances coursed through banks amounted to US$17.4 billion in 2009, or a 5.6 percent growth from the previous year, higher than BSP's own forecast of only 4 percent. There is optimism that the demand for skilled and professional Filipino workers abroad will be sustained given the positive outlook for global economic recovery.

The exchange rate remained stable. The Philippine peso ended at P46.356: US$1 in the last day of 2009, or 2.5 percent higher from the closing exchange rate in 2008. Out of 13 currencies, it was ranked second least volatile.[2] The relative stability of the peso against the greenback helps business and consumers who depend on the exchange rate to plan more effectively.

Foreign investments stayed on. Cumulative net foreign direct investment (FDI) from January to November was US$1.4 billion, representing a 5.5 percent increase from that posted in 2008. The rise in FDI came on the back of the 12.8 percent rise in equity capital inflow in addition to the 205.6 percent growth of re-invested earnings. Gross equity capital placements during the said period reached US$1.5 billion. Recipient industries included manufacturing, real estate, construction, services, financial intermediation, mining, trade/commerce, and transportation/ storage/communications.

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[2] The least volatile currency in 2009 was the Chinese yuan, 0.08 percent followed by the Philippines, 1.51 percent; Japanese yen, 3.8 percent; Thailand baht, 2.49 percent; euro, 5.16 percent; Indonesian rupiah, 8.17 percent; Korean won, 7.81 percent; Singapore dollar, 3.23 percent; Taiwan dollar, 2.19 percent; British pound, 5.96 percent; Australian dollar, 11.89 percent; Malaysian ringgit, 2.59 percent and; New Zealand dollar, 12.18 percent.

Source:NSCB

NG Cash Budget 2009 (in Bn PhP)

	Actual	Program
REVENUE	1,123.20	1,239.20
Tax revenue	981.6	1,082.60
BIR	750.3	798.5
BOC	220.3	273.3
Others	11	10.9
Non-tax revenue	141.4	156.5
EXPENDITURE	1,421.70	1,489.20
Other NG Expenditure Accounts	1067.1	1084.7
Interest Payments	278.9	311.2
Tax Expenditures	51.9	55.3
Net Lending	5.1	15.0
Equity	1.4	11.6
Subsidy	17.4	11.3
SURPLUS/(DEFICIT)	-298.5	-250

Source: Bureau of Treasury

As expected, exporters bore the brunt of the recent global economic recession with total exports posting a negative growth of 14.2 percent vis-a-vis the negative 1.9 percent in 2008. A nascent recovery of most major economies, however, helped stem the decline in exports during the last quarter of 2009.[3] The weak performance of merchandise exports continues to drag total exports, while export of non-factor services (i.e, BPO/IT services) rebounded from negative 3.0 percent a year earlier to positive 3.2 percent in 2009.

Nevertheless, overall balance of payment position (BOP) remained firm. External balance position improved considerably well by 112.8 percent and accounted for 2.9 percent of GDP.[4] The US$5.6 billion trade deficit is offset by a whooping US$11.8 billion of (current) transfers (i.e, foreign aid), resulting in a current account surplus of US$6.2 billion. On the other hand, the capital and financial account posted a deficit amounting to US$1.7 billion. Moreover, given the resilience of the financial system and the strong balance of payment position, credit rating agencies have upgraded the Philippines' rating of sovereign credit, albeit still below investment grade.

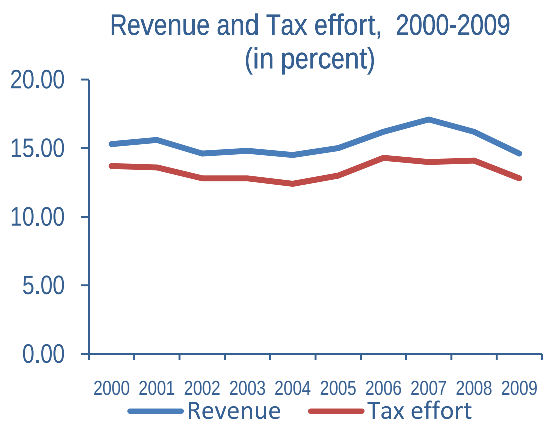
Fiscal

To guarantee any level of growth, the government pump-primed the economy. Expansionary fiscal policies were enacted at the start of the second semester of 2008 when tax exemptions were increased and conditional cash transfers were provided. In 2009, the government expedited the implementation of large infrastructure projects.

Despite taking an expansionary fiscal stance, actual public expenditure was still less than programmed. The national government spent PhP67.5 billion less than what it has planned for 2009. Interest payments made up more than a quarter (26.1%) of total government expenditure. Subsidies for the same period totalled PHp17.4.8 billion of which, 45 percent went to the National Food Authority (22.9%) and the National Housing Authority(22.1 %).

Mediocre revenue performance becoming more worrisome. Revenue collecting agencies Bureau of Internal Revenue(BIR) and Bureau of Customs(BoC) failed to meet their collection targets by PhP48.2 and PhP53.0 billion, respectively. Consequently, tax effort dipped to 12.8 percent from 14.1 percent in 2008, well below the targeted 14.4 percent tax effort

[3] Total exports decelerated by 10 percent during the fourth quarter, slower than the 13.0 percent recorded in the third quarter.
[4] Year-on-year, from January to September.



Source: Department of Finance

Labor and Employment Selected Indicators

	2008	2009
EMPLOYED PERSONS *(in thousands)*	34,089	35,060
by INDUSTRY SECTOR *(in percent)*		
Agriculture	35.3	34.4
Industry	14.9	14.5
Services	49.8	51.1
by CLASS OF WORKER *(in percent)*		
Wage and Salary	52.3	53.3
Own Account	35.5	34.7
Unpaid Family	12.2	12.0
by HOURS WORKED *(in percent)*		
Less than 40 hours	35.0	36.9
40 hours and over	63.5	61.5
Did not work	1.5	1.6

Source: NSO

2010 Philippine Growth Forecast

Asian Development Bank (ADB)	3.3
Development Bank of Singapore (DBS)	4.8
Fitch Ratings	3.2
Global Source (New York)	4.0
Goldman Sachs	4.2
Hong Kong and Shanghai Banking Corporation (HSBC)	5.1
International Monetary Fund (IMF)	3.1
Standard and Poor's (S&P's)	3.7
UN-Economic and Social Commission for Asia and the Pacific (UN-ESCAP)	3.5
World Bank (WB)	3.5

for 2009. The shortfall is blamed on the economic slowdown, measures that eroded the tax base, and failure to raise the targeted privatization proceeds. The weak revenue collection resulted in a wider deficit of PhP298.5 billion, PhP48.5 billion more than what was programmed. To plug the deficit, the national government resorted to floating bonds in the international market thrice during the year[5] which further increased its debt stock to PhP4.4 trillion in 2009 from PhP4.2 trillion in 2008.

Labor, Employment and Hunger

Latest employment figures showed a 2.8-percent increase year-on-year. Employment rate stood at 92.5 percent or an additional 971,000 workers hired in 2009. However, underemployment remains to be a concern with those working for less than 40 hours a week, numbering to 12.9 million or an increase of 1 million since 2008. Meanwhile, latest SWS survey showed that in the fourth quarter of 2009, 24 percent (estimated 4.4 million households) of total households experienced involuntary hunger at least once during the last three months.

Outlook and Challenges

The year 2009 proved to be a tough year for the Philippine economy for it was a year of close calls. Growth figures showed signs of small improvements, but also suggest some fragility.

For 2010, the government estimates the GDP to be between 2.6 to 3.6 percent and is counting on the expected recovery of the industry and services sectors to drive growth. Most private banks and thinktanks agree with the government forecast, some are even more optimistic. Greater vigilance, however, must be observed for some of the downside risks.

For instance, private investments are likely to be subdued against a backdrop of uncertainty prior to the elections. Notwithstanding the recovery of the global market, the outlook for 2010 is based on the assumption that a smooth political transition will take place in May and that the new government will be capable to track a credible economic program. On a lighter note, elections typically bring an expansion in consumer spending as well as support the retail trade, transportation, and communication sectors.

[5] Raising US$3.75 billion

The recent global economic crisis should have taught the Philippines one thing --- strengthening the domestic market and fine tuning the export sector to make it less dependent on major developed countries will likely offer more resiliency and set the economy to a consistent growth path.

Second, the inflation outlook is closely tied to the strength of the global economic recovery, specifically the rebound of the US dollar, and its associate effect on world prices of commodities and oil. The impact of the El Niño weather condition on domestic food supply together with utility (i.e, power and water) rate adjustments are also expected to induce upward pressure on prices in the near term. Thus, it is likely that the BSP will once again be performing the difficult task of keeping such pressures in check and evaluating the timing of exit from its accommodative stance. The BSP sees 2010 inflation to be between 3.5-5.5 percent.

Third, while it is true that fiscal policies must be supportive of growth, the government must no less continue to work on the fiscal consolidation process that it has already started. The ballooning fiscal gap must be addressed soon for it can severely compromise fiscal flexibility at a time when public investments in social buffers are needed. Likewise, a weak fiscal position is likely to result in (1) an increased risk factor in the pricing of the country's debt papers; and (2) an increased threshold rate of return required by investors, which ultimately, could slow even further foreign investment inflow. There are plans to contain the deficit to 2.8 percent of GDP and increase the tax effort to 14.3 percent in 2010. Revenue-enhancing measures such as restructuring excise taxes and rationalizing fiscal incentives granted to investors could help achieve these targets and curb the deterioration of the fiscal position.

Lastly, too much reliance on the external market may not be sustainable. This is not to say that an autarkic (i.e. non-reliance on imports and foreign aid) scheme must be reconsidered, but that it may be high time to come up with a more effective trade policy regime. The current proliferation of trade deals is administratively costly[6] and there is some suggestion of a low utilization rate for these preferential agreements. In addition, the narrow base of Philippine exports[7] is very much susceptible to being eaten up by other competing Asian neighbors. Remittances, on the other hand, expose the Philippines to the sudden changes in the fortune of other countries[8] and do not provide for a solid foundation needed for long term, sustainable development. Considering all these factors, the recent global economic crisis should have taught the Philippines one thing --- strengthening the domestic market and fine tuning the export sector to make it

[6] This is in addition to the favorable fiscal incentives being given to export industries.
[7] Around 50 percent of Philippine exports are electronic goods.
[8] In this light, the prudent use of capital and exchange rate controls will all the more be relevant.

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This Report was principally prepared by SEPO's **Macroeconomic Section** under the supervision of its Directors and the overall guidance of its Director General.

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