Economic Report

SENATE ECONOMIC PLANNING OFFICE

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The Aquino government has set an aspirational gross domestic product (GDP) growth target of 7 percent to 8 percent for 2011 up to 2016. In considering the national budget though, it assumed a more conservative growth of 5 percent to 6 percent for 2011 and 5.5 percent to 6.5 percent for 2012. Even these lower targets, however, are in danger of not being met with the 2011 first half GDP growth averaging only 4.0 percent[1]. For the government to achieve its 2011 year-end target, the economy should thus grow by at least 6 percent in the next two quarters.

- Reduced government spending and lackluster external trade due to the prolonged weakness of the global economy, the political unrest in the Middle East and North African (MENA) region, and the disasters in Japan weighed in on the country's economic activity in the first semester. However, the government remains optimistic that the 5 to 6 percent GDP for the year is still doable as various agencies are said to have already been operationalizing their catch-up plans and are now fast tracking their spending.

- The government is also banking on the continued strength of farm and services output to prop up the second half growth.[2] Agriculture is expected to be boosted by strong prospects for palay production while construction and real estate, renting and business activities will be led by the private sector. A more robust private consumption growth is also expected, supported by receipts from business process outsourcing (BPO) and the strong inflows of remittances from overseas Filipino workers (OFWs) especially as the holidays near. Services will likewise be bolstered by the expected surge in tourism[3] while mining is expected to benefit further from high metal prices in the world market.

- To further support growth in the second half of 2011, the government has also lined up five Public-Private Partnership (PPP) projects worth PhP46.4 billion for auction before the year ends. Whether this plan will be realized though still remains to be seen. Last year, it was announced that ten big ticket PPP projects will be rolled out for 2011 but to date, only one project, the construction of the Daang Hari-South Luzon Expressway Link, has been bidded out. The most likely to be rolled out next is the Phase II of the Vaccine Self-Sufficiency Project which was not part of the original ten priority PPP projects identified last year.

Table 1. PPP projects for 2011 roll-out (2010 Prices in PhP Million)

Project	Amount
NAIA Expressway (Phase 2)	12,946.00
NLEX-SLEX Connector (DPWH)[1]	20,181.00
Daang Hari SLEX Link Road Project (DPWH)	1,956.00
PPP for Classrooms Project (Department of Education)	10,400.00
Vaccine Self-Sufficiency Project (VSSP) Phase II	960.00
Total	**46,447.00**

Source: PPP Center

[1] First quarter real GDP growth was 4.6 percent while for the second quarter, the GDP growth rate was only 3.4 percent.
[2] Agriculture grew by 5.6 percent in the first half. For 2011, it is set to increase on the average by 6.3 percent.
[3] Tourism is targeted to grow, on the average, by 6.3 percent in 2011.

- As in the PPP, the government's projection of strong agricultural growth in the next semester also faces uncertainty given the recent adverse climatic conditions. According to the Department of Agriculture (DA), the agricultural losses inflicted by typhoons Pedring and Quiel now amount to PhP12 billion. About 760,207 metric tons (MT) of palay, mostly in Central Luzon and which accounts for 11.7 percent of the total 6.5 million MT expected harvest for the last quarter, were damaged. Likewise, noting that mining is identified as one of the possible growth drivers in the second half, the impact of the recent attacks of insurgents on the three giant mining companies in Surigao del Norte would have to be accounted for. The destruction of equipment is estimated to have caused only half a billion pesos but its effect on prospective mining investors could be more damaging.

- The most important downside risk to growth is the persisting debt problem of the United States and the Eurozone countries which could mainly affect the country's trade and remittance inflows. The United States (US) is the country's second largest export destination next to Japan. It is also the Philippines' number one source of remittances. Meanwhile, the European Union (EU) is the second largest source of remittances to the Philippines and is the country's fourth largest trading partner.

- As it is, Philippine export growth has already been sluggish. Exports grew by only 0.66 percent from January to August 2011 compared to the same period last year. Revenues from export of electronics fell by 15.3 percent and are expected to remain weak in the succeeding months following the 28.6 percent drop in import growth in July. As such, the annual export growth target of 8 to 10 percent will not be achieved.

- Most multilateral institutions and some investment banks have already revised downwards their growth forecasts for the Philippines both for 2011 and 2012. The downgrades were mainly attributed to the less-than-expected performance of the Philippine economy in the first half due to fiscal underspending as well as to the gloomier global outlook.

Table 2. Growth Projections of Selected Institutions for 2011 and 2012

Institutions	Original target		Revised Target		Reason for Revision
	2011	2012	2011	2012	
ADB	5.0	5.3	4.7	5.1	subdued government spending and slower exports
IMF	5.0	5.0	4.7	4.5	low actual performance in the first half of 2011; less benign global growth outlook
World Bank	5.0	5.4	4.5	5.0	weaker economic outlook for advanced economies
Credit Suisse	4.6	5.0	4.3	4.2	state under-spending; failure of PPP projects to get off the ground immediately; lower remittances from OFW; lower export earnings
Citicorp	3.9	4.6	3.7	3.9	fiscal underspending; weak exports; supply chain disruption; global fiscal storm because of the debt crisis in the US and Europe
HSBC	5.2	5.0	4.3	4.8	exports and investments would further decelerate due to "stiffer global headwinds."
Global Source	4.8	5.5	4.3	4.8	perceived recession in the US; sovereign debt crisis in Europe; weak public infra pending likely to remain

Table 3. Monthly Inflation Rate (in%)

Month	2010	2011
January	3.9	4.1
February	3.9	4.7
March	4.0	4.8
April	4.0	4.7
May	3.7	5.1
June	3.7	5.2
July	3.7	5.1
August	4.0	4.7
September	3.9	4.8
October	3.3	-
November	3.7	-
December	3.6	-
Average (Jan-Sept)	3.9	4.8

Source: BSP

Fig.1. Philippine Stock Market index

Source: Bloomberg

Inflation and interest rates

- Global food and oil prices have been on sustained and synchronized upward trend. Early this year, there were fears that inflation will breach the higher end of Bangko Sentral ng Pilipinas' (BSP) target range of 3 to 5 percent for 2011. Hence, the Monetary Board (MB) preemptively hiked policy rates twice and raised the banks' reserve requirements. So far, inflation has remained manageable, averaging 4.8 percent from January to September 2011.

- With the view that inflationary pressures may be receding given the moderating commodity prices and contained inflation expectations, the MB, in its last meeting last September 8, decided to keep its policy rates at 4.5 percent for the overnight borrowing rate and 6.5 percent on overnight lending rates.

- However, upside risks to inflation remain, particularly with the fast pace of credit growth and liquidity expansion. The volatility in capital inflows and oil prices also warrant close attention. The effect of the recent typhoons on the supply of rice as well as other agricultural commodities should also be monitored.

The stock market

- Despite the bearish global trend, total trades executed at the Philippine Stock Exchange (PSE) hit PhP1.05 trillion from January to September this year, up by 24.1 percent from PhP842.95 billion in the same period in 2010. Net foreign buying was higher by 37 percent while the combined market capitalization of listed companies climbed 11 percent during the said period.

- Last August 8, after the Standard and Poor's downgraded the US credit rating from AAA to AA+[1], the PSEi dropped by 2.4-percent. Since then, the general sentiment of the market has been on the cautious track. The local bourse suffered its biggest loss last September 23 when the PSEi closed at 3,885.96 following the US Federal Reserve's comments that despite the US government economic stimulus program, the US economy faces "significant downside risks." The Fed's forecast worsened the anxiety of investors who were already edgy about the sovereign debt crisis in Europe.

- Nonetheless, the PSE, together with Thailand Stock Exchange, were still among the best performing markets in the Asia-Pacific region for the July-September quarter. By October 7, the stock market has already bounced back to the 4000-level.

Investments

- Both foreign portfolio investments and foreign direct investments registered higher net inflows this year as compared to last year. Aside from the Philippine stock market, foreign investors also placed capital in peso-denominated government securities, peso time deposit, unit investment trust fund(UITF) and other money markets, bringing the total inflow of net foreign portfolio investments from January to August 2011 to US$3.06 billion from only US$926 million in the same period last year. This is a hefty increase of 230.2 percent.

Table 4. Net Foreign Portfolio Investments and Net Foreign Direct Investments (in million US$)

Period	Portfolio		FDI		Growth Rate (in%)	
	2010	2011	2010	2011	Portfolio	FDI
Jan	170.1	193.1	170.0	209.0	13.5	22.9
Feb	138.6	534.1	326.0	97.0	285.4	-70.2
Mar	76.0	245.4	69.0	180.0	222.9	160.9
Apr	210.1	673.8	85.0	68.0	220.7	-20.0
May	177.5	364.2	-31.0	161.0	105.2	-619.4
Jun	-85.8	353.8	50.0	64.0	-512.4	28.0
Jul	14.3	299.6	-	-	1995.1	-
Aug	225.1	394.1	-	-	75.1	-
Year-to-date	925.9	3058.0	669.0	779.0	230.3	16.4

Source: BSP

- Similarly, net FDI inflows for the first half of 2011 are higher by 16.4 percent and totaled US$779 million, from US$669 million net inflows recorded in the first half of 2010. Bulk of the FDIs came from the US, Japan, Hong Kong, Singapore, and the Netherlands while Singapore, the United Kingdom, US, Luxemburg, and Hong Kong were the sources of most portfolio inflows to the Philippines.

- The government expects more investments to come in following the country's improved ranking in the 2011-2012 Global Competitiveness Report of the World Economic Forum where it placed 10 notches higher (from 85th out of 139 countries to 75th place out of 142 countries) compared to the previous report. The sovereign rating upgrades which the Philippines received from Standard and Poor's, Moody's Investor Service, and Fitch Ratings are also likely to provide tailwinds for investment.

- The BSP attributes the robust growth in portfolio investments and FDI to favorable investor sentiment with the country's macroeconomic fundamentals remaining strong amid a backdrop of a moderating and uneven global economic outlook. It would be interesting to know though how the Philippines fared compared to its neighboring countries in cornering FDI inflows for the said period to see whether the increase is indeed because of the country's improved macroeconomic situation or if the country is simply benefiting from the shifting investor interest towards emerging markets.

Table 5. Number of Deployed Landbased Overseas Filipino Workers by Top 10, 2010

	Level	Share
All Destinations Total	**1,123,676**	**100.0**
1. Saudi Arabia	293,049	26.1
2. United Arab Emirates	201,214	17.9
3. Hongkong	101,340	9.0
4. Qatar	87,813	7.8
5. Singapore	70,251	6.3
6. Kuwait	53,010	4.7
7. Taiwan	36,866	3.3
8. Italy	25,595	2.3
9. Bahrain	15,434	1.4
10. Canada	13,885	1.2

Source: POEA

Table 6. OFW Remittances (In million US$)

	January-July		rowth
	2010	2011 p	Rate(%)
Total	**10,679**	**11,351**	**6.29**
Asia	1,346	1,482	10.13
Americas	5,730	5,969	4.18
Oceania	119	143	20.39
Europe	1,822	1,996	9.55
Middle East	1,645	1,741	5.88
Africa	18	19	8.77

Source: BSP

Table 7. Peso-Dollar Exchange Rate

Month	2010	2011
January	46.0276	44.1722
February	46.3116	43.7031
March	45.7425	43.5160
April	44.6266	43.2402
May	45.5971	43.1307
June	46.3027	43.3657
July	46.3203	42.8088
August	45.1825	42.4209
September	44.3137	43.0256
Average	**45.6027**	**43.2648**

Source: BSP

Remittances

- Despite the difficult situation in the MENA region and the anticipation of subdued growth of the usual OFW destination countries, remittances still expanded by 6.3 percent to US$11.4 billion in the first seven months of 2011. Bulk of the remittances came from the US, Canada, Saudi Arabia, the United Kingdom, Japan, Singapore, United Arab Emirates, Italy and Germany.

- The BSP attributes the higher remittance inflows to sustained demand for Filipino manpower. Filipinos are said to be preferred by employers abroad, thus they tend to be the last to go during job cuts. Philippine labor officials also partially lifted the ban on deployment of overseas Filipino workers to war-torn countries Iraq and Afghanistan. However, the growth could also be explained by the bigger amounts being remitted by OFWs to compensate for the stronger peso.

- Aside from the expected weakening of the global economy, another potential threat to remittance growth is the Saudization or "Nitaqat" program, a domestic policy being implemented by the Kingdom of Saudi Arabia to reduce the number of foreign workers and encourage employment of Saudi Arabian nationals in the private sector. Saudi Arabia is the number one destination of newly hired or rehired OFWs. In 2010, 293,049 OFWs were deployed to Saudi Arabia while remittances coming from the said country amounted to US$1.54 billion.

Exchange rate

- With the robust inflow of foreign exchange from OFW remittances, portfolio investments and FDIs, the peso appreciated to an average of PhP43.2648:US1 in January to September this year from PhP45.6027 last year. The peso strengthened both in nominal and in real terms not only against the dollar but also compared to the currencies of its competitor countries. This means that the peso lost its external price competitiveness.

- The peso was at its strongest in August at an average exchange rate of PhP42.4209:US$1. However, in September, with growing anxiety over the sputtering US economy and the Eurozone debt situation, risk aversion forced investors to pull out their capital from emerging markets to seek the safety of the US dollar.

External position

- Strong dollar inflows pushed the balance of payments (BOP)[4] surplus from January to August 2011 to US$9 billion or a jump of 166 percent, from US$6.7 billion last year. The said amount exceeded BSP's full-year BOP surplus forecast of US$6.7 billion for this year.

- Meanwhile, preliminary data show that the country's gross international reserves (GIR) as of end-September 2011 reached US$75.6 billion. The said GIR is slightly lower than the record US$75.9 billion GIR posted in August mainly because of the prepayments made by the government for its maturing foreign exchange obligations. Nonetheless, the said GIR was 40 percent higher than in the same period last year and is already above the BSP's US$75-billion revised full-year projection. Moreover, the said GIR could already cover 11.1 months worth of imports of goods and payments of services and income and 10.6 times the country's short-term external debt even as the benchmarks are only 3 months and one time, respectively[5]. These will figure in favorably in the future and provide the country adequate cushion from external shocks especially in light of the increasing uncertainty in the global environment.

Fiscal

- The Aquino administration has avowed that fiscal sustainability is at the core of its economic agenda. For 2011, it has targeted to bring down the national government deficit to P300 billion or 3 percent of the GDP from 3.5 percent last year. Latest fiscal data show that the government appears to be on track with its fiscal consolidation program but it is mainly due to slower-than-expected spending.

Table 8. National Government Fiscal Position (in billion PhP)

Particulars	Jan-Aug. 2011	Program for 2011	% of Total Program
Revenues	**912.75**	**1,411.3**	**64.7**
Tax Revenues	800.712	1273.2	62.9
BIR	619.713	940	65.9
BOC	171.992	320	53.8
Other offices	0	13	0.0
Non-tax	111.995	138	81.1
Expenditures	**947.24**	**1,711.3**	**55.4**
Surplus/(Deficit)	**-34.49**	**(300.0)**	**11.5**

Source of basic data: Bureau of Treasury

- Based on the Cash Operations Report from the Bureau of Treasury, from January to August 2011, government spending stood at PhP947.2 billion or merely 55.4 percent of the PhP1.711 trillion targeted expenditures for the year. It is also PhP83.7 billion lower than the spending level in the same period last year.

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[4] The BOP refers to the difference of foreign exchange inflows and outflows on a particular period and represents the country's transactions with the rest of the world.

[5] This is based on original maturity. The GIR is 6.3 times the short-term debt based on residual maturity.

- Despite the frontloading of the 2011 budget,[6] capital outlays from January to July 2011 decreased by 44.0 percent to PhP106.9 billion (year-on-year, equivalent to 33.2 percent of the 2011 budget) as the pace of project implementation and payment schedules decelerated.

- The underspending severely affected the growth of public construction. In the first semester of 2011, expenditures for public construction declined by 44.6 percent which consequently pulled down the GDP growth in the same period to just 4 percent. It has also undermined the otherwise positive investor sentiment of the private sector who brought the growth of private construction in the first semester to 20.5 percent. It must be noted that since the start of the Aquino administration, public construction spending has been going down by an average of 31.6 percent every quarter.

Table 9. Public construction growth, at constant prices ,2010-2011 (in %)

INDUSTRY/INDUSTRY GROUP	2010				2011		2010	2011
	Q1	Q2	Q3	Q4	Q1	Q2	1st sem	1st sem
1. Public	9.7	27.0	-23.4	-13.7	-37.9	-51.2	18.4	-44.6
2. Private	11.9	23.7	35.7	24.6	22.0	19.0	17.8	20.5
Gross Value In Construction	11.4	25.2	17.1	14.0	7.4	-13.5	18.3	-3.1
Gross Value Added In Construction	9.7	24.7	15.6	4.6	3.5	-16.1	17.2	-6.3

Source: NSCB

- Needless to say, the underspending is unwarranted especially amidst the dim global economic environment when stimulating the domestic economy is very critical.

- To accelerate spending, the government plans (i) to streamline the implementation process through clustering infrastructure projects of the Department of Public Works and Highways (DPWH) and Department of Education (DepEd) and (ii) to frontload PPP-related projects this year that are due for implementation next year. However, with just four months to go and still PhP764 billion to spend, the fiscal deficit will likely be lower than what was programmed for the year. January to August fiscal deficit stood at PhP34.5 billion or merely 11.5 percent of the PhP300 billion target deficit for the year.

- Resource mobilization has slightly improved with revenue collection from January to August 2011 higher by 13.7 percent from the collection over the same period last year. Even so, the government should further intensify its revenue collection efforts if intends to reach its targeted collection level for 2011.

- Revenue collection from January to August this year stood at PhP912.75 billion or just 64.7 percent of the PhP1.411 trillion target for 2011. While non-tax revenues have already reached 81.1 percent of the programmed collection, tax revenues are only 62.9 percent of the target.

- Bureau of Internal Revenue(BIR) collection for the first half of 2011 fell short of target by PhP2.3 billion while the Bureau of Customs (BOC) fell short by PhP13.8 billion. From

[6] Three-fourths of the programmed PhP1.645 trillion National Government budget for 2011 has been released by the Department of Budget and Management (DBM).

January to August 2011, revenues from the BIR stood at PhP619.71 billion or 65.9 percent of its PhP940 billion target for the year. BOC collection over the same period stood at PhP172 billion or 53.8 percent of its PhP320 billion target for the year.

- The World Bank estimates that in the absence of a new tax policy for 2011, the tax effort will likely fall to 12.3 percent of GDP, 0.2 percentage points higher than last year, but 0.5 percentage points lower than the government's target. Key compliance programs such as the Run After Tax Evaders (RATE) and Run After Smugglers (RATS) programs are expected to generate PhP29.5 and PhP11 billion for the BIR and the Bureau of Customs, respectively—a combined PhP40.5 billion which is almost 3 percent of the targeted collection in 2012. Though promising, revenue intake is projected to fall short of the government's additional spending needs to achieve its Philippine Development Plan (PDP) 2011-2016 targets. Hence, higher revenues need to be mobilized through improved tax administration and continued tax reforms.

- A welcome development in the fiscal position of the government is the substantial interest payment savings brought by the improved creditworthiness of the country, the appreciation of the peso and the stable interest environment. For the first half of 2011, spending for debt servicing was lower than programmed by PhP20.1 billion.

- Setting realistic macroeconomic targets such as the GDP growth is critical as they impact on government revenues, disbursements and the budget balance. For instance, the Department of Finance estimates that for 2012, a one percentage point change from the assumed real GDP, would result in a PhP13 billion difference in revenues while a percentage point change in inflation would result in PhP12.5 billion revenues.

Table 10. Sensitivity Matrix for 2012
(in billion PhP)

Indicator	Changes	Revenues (in bn PhP)	Disbursements (in bn PhP)	Budget Balance (in bn PhP)
Exchange Rate	P1 depreciation	7.5	2.5	5.0
Treasury bill rates	1 ppt increase	7.4	5.3	2.1
Inflation rate	1 ppt increase	12.5		12.5
Real GDP growth rate	1 ppt increase	13.0		13.0
Growth of imports	1 ppt increase	4.3		4.3

Source: Department of Finance

Labor and Employment

- Like its predecessor, the Aquino government has also targeted to generate 1 million jobs a year from 2011 to 2016. For the period January to July 2011, it has managed to generate an average of 857,000 new jobs, just slightly higher to absorb the 839,000 new entrants to the labor force. Unemployment rate was slightly lower at 7.2 percent from 7.4 in the same period in 2010. However, underemployment inched up to 19.3 percent from 18.5 percent.

- Studies have pointed out that poverty in the Philippines is associated more with the problem of underemployment than unemployment. The poor cannot afford to be jobless so they will grab whatever opportunity is available, regardless of how low the salary is and how insecure the working conditions are.

Table 11. Selected Employment Indicators, January to July 2011
(in thousands)

Employment Indicator	Jan-July 2010	Jan-July 2011
Household Population, 15 yrs old and over	60,566	61,788
Labor Force	38,762	39,601
Employed	35,884	36,740
Underemployed	6,635	7,089
Unemployed	2,878	2,874
Labor Force Participation Rate	64.0	64.1
Employment Rate	92.6	92.8
Underemployment Rate	18.5	19.3
Unemployment Rate	7.4	7.2
Employment generated	839	857
New entrants to the labor market	-131	839

Source: National Statistics Office
Notes: Jan-July figures are the average of the January, April and July rounds of the Labor Force Survey
The number of employment generated and new entrants to the labor market are SEPO's computation

- Another interesting employment indicator to look at is the class of workers. Again, based on the January, April and July rounds of the Labor Force Survey this year, while the number of employed has increased, there are now more unpaid family workers, indicating a deterioration in the quality of jobs being generated by the economy.

Table 12. Employment by class of worker, January to July 2011
(in thousands)

Class of worker	Jan-July 2010	Jan-July 2011
Wage	19,577	19,971
Worked for Private Household/Establishment	16,526	17,258
Worked for Government/Gov't. Corporation	3,051	3,034
Employer	1,391	1,304
Self-Employed	10,799	10,963
Unpaid Family worker	4,116	4,143

Source: National Statistics Office

Conclusion

The anticipated global economic slowdown is arguably the biggest threat to the achievement of the country's economic goals in the short-term. As the Philippines cannot anymore rely on the external market, particularly that of the advance economies, to influence its growth, strengthening the domestic economy is of utmost importance. For this, the role of the State is very crucial. A tight rein in expenditure, as what had happened in the first half of 2011 is not only unwarranted, it is also costly. Responsive government spending must be ensured to narrow the development gaps, especially in the areas of infrastructure and human development. Government should also focus on the creation of domestic employment opportunities as its effect goes beyond boosting consumption; more importantly it will have a significant impact on alleviating poverty in the country.

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This Report was principally prepared by Ms. Maria Cristina R. Pardalis under the supervision of its Directors and the overall guidance of its Director General.