SENATE ECONOMIC PLANNING OFFICE
Economic Report

March 2012 ER-12-01

Philippine Economy:
Sluggish in 2011, bullish in 2012?

The Philippine domestic economy shrunk to 3.7 percent in 2011, after a stellar growth of 7.6 percent in 2010. Growth was mainly undermined by the severe state underspending as well as the frail external environment. Outlook for 2012 is relatively sanguine with the government hinging its optimism on robust consumer demand and a more vigorous public spending. However, downside risks to growth persist with the global recovery poised to remain slow and uncertain.

2011 domestic economy tepid at 3.7%. The Philippine domestic economy grew by 3.7 percent in 2011, almost half of its 7.6 percent growth in 2010. The growth is within the latest forecasts of the National Economic and Development Authority (3.6-4.0 %) and the International Monetary Fund (3.7%). However, the growth figure is well below that assumed by the Development Budget Coordination Committee (4.5-5.5%), Asian Development Bank (4.7%), and the World Bank (4.2%); and is significantly off the growth target of the Philippine Development Plan (7.0%). Notable is the country's poor economic performance relative to its neighbors. Except for Thailand, most Asian economies registered higher gross domestic product (GDP) growth rates than the Philippines in 2011.

Table 1. GDP Performance, Selected Asian Countries (in %)

Country	2011	2010
Indonesia	6.5	6.1
Malaysia	5.1	7.2
Philippines	3.7	7.6
Singapore	4.9	14.8
Thailand	3.1	7.8
Vietnam	5.9	6.8

Sources: Bank Indonesia; BIMP Securities Research, Malaysia; National Statistical Coordination Board (NSCB), Philippines; Ministry of Trade and Industry, Singapore; Businessweek, Thailand; General Statistics Office, Vietnam

Gross national income (GNI)[1] likewise slumped to 2.6 percent from 8.2 percent in 2010. This resulted from the significant contraction of net primary income (NPI),[2] which slowed to a negative 0.9 percent, a turnaround from the 10.0 percent growth in 2010 (Table 2).

Services lead growth. Only the service sector consistently contributed to the economy during all four quarters of 2011. Services contributed 2.8 percentage points to total GDP. The sector's growth was led by real estate (7.7%), other services (6.7%) and financial intermediation (6.7%). Brisk demand for residential and office spaces in 2011 sustained the expansion of real estate while other services was supported by sewage and refuse disposal (8.7%), and hotels and restaurants (8.1%), among others. Financial

[1] Used to be called gross national product (GNP) but was changed to GNI upon adoption of the 1993/2008 Philippine System of National Accounts (SNA) Changes in Terminology.
[2] Used to be called net factor income from abroad (NFIA) but was changed to NPI upon adoption of the 1993/2008 Philippine SNA Changes in Terminology.

The SEPO Economic Report, a semi-annual publication of the Senate Economic Planning Office, provides 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.

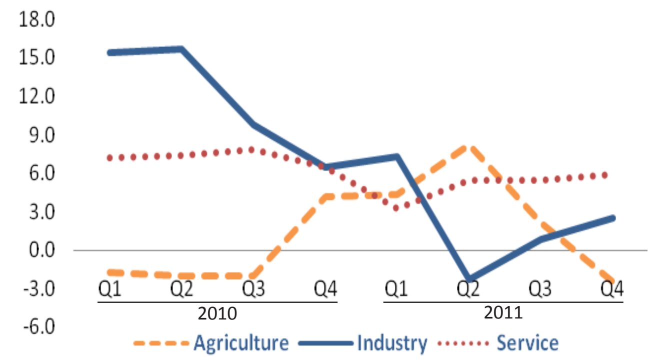
Table 2. GDP and GNI Growth Rates, 2010-2011 (at constant 2000 prices, in %)		
Indicator	2010	2011
Gross national income	8.2	2.6
Net primary income	10.0	-0.9
Gross domestic product	7.6	3.7
Agriculture, hunting, forestry & fishing	-0.2	2.6
Agriculture & forestry	-0.1	4.3
Fishing	-0.5	-4.0
Industry	11.6	1.9
Mining & quarrying	11.4	4.1
Manufacturing	11.2	4.7
Construction	14.3	-6.4
Electricity, gas & water supply	9.9	-2.8
Service	7.2	5.0
Transport, comm. & storage	1.0	3.9
Trade & repair of motor vehicles	8.4	2.6
Finance intermediation	10.1	6.6
Real estate, renting & bus. activities	7.5	7.7
Public administration & defense; compulsory social security	5.8	3.2
Other services	8.4	6.7
Household final consumption	3.4	6.1
Gov't final consumption	4.0	-0.7
Capital formation	31.6	11.1
Fixed capital	19.1	2.7
Construction	17.5	-4.1
Durable equipment	25.5	8.7
Breeding stocks & orchard dev't	0.3	-0.3
Intellectual property products	2.9	10.9
Exports	21.0	-3.8
Merchandise exports	24.7	-5.3
Non-factor services	6.5	3.4
Less: Imports	22.5	1.9
Merchandise imports	23.4	1.4
Non-factor services	18.9	4.2

Source: NSCB

intermediation was beefed up by insurance and non-banks. Insurance grew by 12.7 percent whereas non-banks was boosted by the stock market, with the Philippine Stock Exchange Index (PSEi) ending at 4,371.96 points, 4.0 percent higher than in 2010.

Agriculture trips in the 4th quarter. Agriculture grew at a significantly faster pace of 6.2 percent in the first half of the year but adverse weather conditions in the second semester got in the way of its continued growth. NEDA estimated that the damages caused by typhoons Pedring, Quiel and Sendong represent about 1.5 percent of the fourth quarter's GDP. Palay, in particular, suffered

Figure 1. Growth of the Economy's Main Sectors, Q1-Q4, 2010-2011



Source: NSCB

a negative 8.7 percent growth in the last quarter after posting double-digit growth in the first three quarters of 2011. Corn likewise suffered contractions in the last two quarters of 2011. Also affected by the prejudicial weather condition is fishing. Aggravating the already low fish stock was the massive fish kill in Pangasinan and Batangas.

Industry weakens. Industry started off robustly, recording a 7.3 percent growth in the first quarter. This was short-lived however, as it eventually contracted by 2.3 percent in the second quarter and only slightly recovered during the third and fourth quarters at 0.8 percent and 2.5 percent, respectively (Figure 1). The sector's unimpressive full-year growth of 1.9 percent was mainly due to the poor performances of construction, manufacturing, and mining and quarrying.

Severe government underspending resulted in the contraction of public construction by 27.0 percent and consequently turned around the construction sector's growth from 14.3 percent in 2010 to negative 6.4 percent in 2011. Manufacturing's growth, on the other hand, was mainly fettered by the weak demand for exports while mining and quarrying was weighed down by lower production of gold and crude oil, including natural gas.

Household spending bolsters demand. On the demand side, household spending again proved to be the main growth driver, expanding by 6.1 percent, even higher than in 2010. This expansion was supported by remittance inflows, the slow appreciation of the peso, and the benign inflation. NEDA also attributed the increase in household consumption to the continued implementation of the government's conditional cash transfer (CCT) program.

In contrast to the robust growth of consumption spending, government expenditures contracted by 0.7 percent from a positive growth of 4.0 percent in 2010.

Even as public construction rebounded with a considerable 50 percent growth in the fourth quarter of 2011, it was insufficient to manifest an increase in government spending and capital formation for the whole year. From a programmed expenditure of PhP1.7 trillion, actual state spending for 2011 was 9.0 percent lower at PhP1.6 trillion. The process of introducing reforms in budget management and execution processes hindered actual spending in 2011.

On the other hand, exports continued its downtrend, posting a negative 3.8 percent, with merchandise exports contracting by 5.3 percent, and non-factor services slowing to 3.4 percent. Export growth was dragged down largely by the low global demand and the supply chain disruptions caused by the floods in Thailand, among others. As a result of the lukewarm export growth, import growth deteriorated to 1.9 percent from 2010's 22.5 percent.

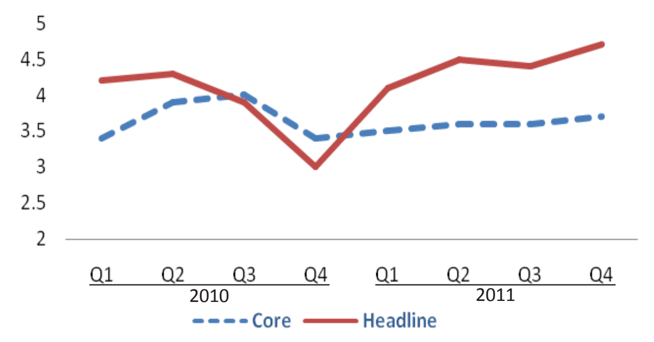
Table 3. Top and Bottom 5 Exports and Imports, 2011 (at 2000 constant prices, growth rate and contribution to export growth, in %)

Type of goods	2011	Contribution to growth
Top 5 exports of goods		
Automotive electronics	122.6	0.76
Sugar	736.8	0.33
Articles of apparel & clothing accessories	9.3	0.28
Bananas, incl. plantains, fresh or dry	60.4	0.22
Petroleum products	58.0	0.13
Bottom 5 exports of goods		
Components/devices (semiconductors)	-20.5	-11.81
Electronic data processing	-14.4	-1.39
Communication/radar	-48.6	-0.74
Other products manufactured from materials on consignment basis	-18.3	-0.23
Coconut oil	-26.5	-0.23
Top 5 imports of goods		
Machinery & mechanical appliances	16.3	0.83
Artificial resins	25.2	0.46
Communication radar	139.5	0.41
Electrical machinery	17.9	0.40
Telecommunication	36.2	0.34
Bottom 5 imports of goods		
Components/devices (semiconductors)	-14.8	-4.25
Cereals	-45.3	-1.54
Electronic data processing	-7.5	-0.49
Transport equipment	-5.5	-0.33
Mineral fuels	-3.6	-0.23

Source: NSCB

Headline inflation is within target. Headline inflation averaged 4.8 percent in 2011, well within the 3.0-5.0 percent inflation target for 2011 but higher than the 3.8 average recorded in 2010. A rise in the prices of food items had been recorded mainly due to the adverse effect of typhoons on agricultural food supplies. Core inflation,[3] on the other hand, averaged 3.6 percent.

Figure 2. Inflation Rate, 2010 vs. 2011 (CPI=2006)



Source: National Statistics Office (NSO)

Investment inflows still recorded but at lower levels. Latest data showed that in 2011, net foreign direct investments totalled US$782 million, lower by 38.5 percent from that recorded for the same period in 2010. Much of the equity investments were channelled towards financial and insurance activities, real estate, and manufacturing.[4] However, there was a considerable capital flight from the mining and quarrying sector totalling US$242.6 million.

In terms of foreign portfolio investments, the Bangko Sentral ng Pilipinas reported a net inflow amounting to US$4.1 billion. This represents an 11.5 percent decline from the US$4.6 recorded in 2010.

Higher 2011 GIR. Gross international reserves (GIR) level as of end-December 2011 stood at US$75.1 billion, higher by US$12.7 billion compared to the end-December 2010 GIR. The rise in GIR levels resulted from the strong inflow of overseas Filipino workers' (OFW) remittances, business process outsourcing (BPO) services receipts, and direct and portfolio investments, among others. The preliminary end-December 2011 GIR could cover 11.1 months' worth of imports and is equivalent to 10.5 times the country's short-term external debt based on original maturity (6.8 times based on residual maturity).

[3] Core inflation is a measure of inflation that excludes items which face volatile price movements, notably food and energy. In the Philippines, the following items are excluded from the computation of core inflation: a) rice; b) corn; c) fruits and vegetables; d) liquefied petroleum gas (LPG); e) kerosene; and f) oil, gasoline and diesel.

[4] Manufacturing particularly of semiconductors, wiring harness, garments/wearing apparel, iron and steel.

Table 4. NG Cash Operations Report, 2010-2011 (in billion PhP)					
	2010 Actual	2011 Actual	Growth (%)	2011 Program	Program vs. Actual
Deficit	314.5	197.8	37.1	300.0	102.2
Revenues	1207.9	1359.9	12.6	1411.3	51.4
BIR	822.6	924.1	12.3	940.0	15.9
BoC	259.2	265.1	2.3	320.0	54.9
BTr	54.3	75.2	38.5	69.9	5.2
Other offices	71.7	95.5	33.0	81.3	14.1
Expenditures	1522.4	1557.7	2.3	1711.3	153.6
Interest payments	294.2	278.9	5.2	321.6	42.6

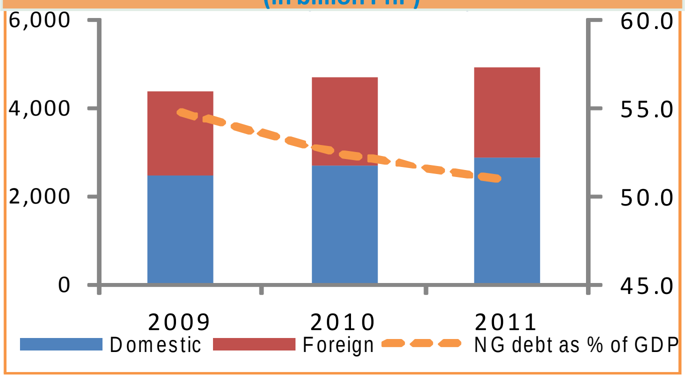
Source: Bureau of the Treasury

Fiscal position narrows. The 2011 fiscal deficit of the national government hit PhP197.8 billion, 37.1 percent smaller than that posted in 2010. The figure accounted for only 65.9 percent of the programmed PhP300 billion (3% of GDP) deficit for the year.

Cumulative revenue collection increased by 12.6 percent and amounted to PhP1.36 trillion in 2011. Although collection increased year-on-year, total revenue was still PhP51.4 billion short of the PhP1.41 trillion target, with both the Bureau of Internal Revenue and the Bureau of Customs missing their revenue collection goals for the year. Tax revenues collected by the BIR, which accounted for nearly 70 percent of total revenue collection, totalled PhP924.15 billion. BoC collection, on the other hand, amounted to PhP265.1 billion, or just 83 percent of its collection target.

The deficit was also reined in by the lower government expenditures, which only amounted to PhP1.56 trillion in 2011 as opposed to the PhP1.71 trillion programmed for the year. There was also a substantial savings on interest payments amounting to PhP42.6 billion.

Figure 3. National Government Debt 2009-2011 (in billion PhP)



Source: Department of Finance

NG debt to GDP ratio improves. National government (NG) debt stood at PhP4.9 trillion as of December 2011. Of this amount, PhP2.08 trillion (42%) is owed to foreign creditors. Domestic debt increased by PhP155 billion from 2010 to 2011, as the government issued more Treasury bills and bonds that it redeemed during the period. Similarly, foreign debt increased by PhP77 billion or 3.89 percent at the end of 2011 from PhP1.999 trillion at the end of 2010. In 2011, government debt was equivalent to 50.9 percent of GDP, the lowest ratio since 1998 when the ratio fell to 48.1 percent.

Unemployment down to 7%. The country's labor force numbered at 61.9 million in 2011. Of this number, 2.8 million were unemployed registering an unemployment rate of 7.0 percent. Moreover, the service sector's share of total employment increased from 51.8 percent in 2010 to 52.1 percent. Agriculture accounted for 33.0 percent of the employed while industry's share was 14.9 percent. Although the economy managed to generate more than one million jobs in 2011, the quality of employment is still a concern given the substantial increase in the underemployment rate as well as in the number of unpaid family workers. Latest data showed that the underemployed numbered at 7.2 million.

Table 5. Selected Labor and Employment Indicators (in '000, unless otherwise stated)		
Indicator	2010	2011
Household population 15 years old & over	60,717	61,882
Labor Force	38,893	40,005
Employed	36,035	37,191
Underemployed	6,762	7,163
Unemployed	2,859	2,814
Labor Force Participation Rate (in %)	64.1	64.6
Employment Rate (in %)	92.7	93
Underemployment Rate (in %)	18.8	19.3
Unemployment Rate (in %)	7.4	7.0
Employment by Industry		
Agriculture	11,956	12,266
Industry	5,399	5,530
Services	18,682	19,395
Employment by Class of Worker		
Wage and salary workers	19,626	20,537
Self-employed without any paid employee	10,858	10,992
Employer in own family-operated farm or business	1,394	1,356
Unpaid family workers	4,157	4,307
Jobs generated*	974	1,156

Source: Labor Force Survey, NSO
**derived by SEPO from the employment data*

All in all, the Philippine economy has been weighed down by several factors in 2011. On the external front, the diminished demand from the still shaky Euro economies and the United States has dampened export growth. The disasters in Japan and Thailand aggravated the situation as they brought disruptions in the global supply chain. On the domestic front, the drop in public infrastructure spending and the damages wrought by the adverse climatic conditions, which also led to higher food prices, have contributed to the poor growth performance in 2011.

It must be emphasized though that while it was a combination of different factors, it was the government's severe underspending which ultimately depressed economic growth.

The Philippine Institute for Development Studies notes that the global economic slowdown, particularly the decline in exports, was more or less anticipated and therefore incorporated in the forecast Philippine growth of 5.5-6.0 percent for 2011. Moreover, since the country's exports have relatively small value added, the fall in export demand has little impact on GDP. The PIDS estimates that the lower-than-anticipated global output growth leading to lower demand for Philippine exports may have only reduced the GDP by 0.2 percent. The higher-than-anticipated food and fuel prices also contributed negative 0.6 percent to the GDP while government underspending caused the domestic economy 1.5 percentage points. This means that had the planned government expenditures been actualized, GDP growth could have been 5.2 percent instead of 3.7 percent.

Growth Prospects and Risks for 2012

For 2012, NEDA is expecting the Philippine GDP growth to fall between 5.0 and 6.0 percent. The government think tank, PIDS, sees it at 5.6 percent while ADB reckons it will be 5.1 percent. Both the World Bank and the IMF, on the other hand, have lower forecast figure at 4.2 percent.

Table 6. Philippine GDP Growth Forecast 2011-2012 (in %)

Institution	2011	2012
NEDA	3.6-4.0	5.0-6.0
PIDS	5.9	5.6
ADB	4.7	5.1
WB	4.2	4.2
IMF	3.7	4.2

Sources: NEDA, PIDS, ADB, WB and IMF

The government hinges its optimism on a more vigorous public spending and the continuing resilience of consumer spending.

Because the "housekeeping"[5] task of reforming government processes and plugging expenditure leaks have kicked off in 2011, public spending is seen to be fast-tracked in 2012. In fact, to signify the fast-tracking of budget execution, the Department of Budget and Management already released 72 percent or PhP786.6 billion of the PhP1.092 trillion new appropriations under the national budget. In terms of capital outlay, the agency has released 72 percent or PhP150.2 billion of the PhP208.3 billion allocation for capital outlay.[6] Aside from the faster process of budget execution, PhP72 billion worth of projects under the Disbursement Acceleration Program is carried over from 2011.[7]

Furthermore, after much delay, it is expected that the implementation of the Public-Private Partnership (PPP) program will be fast-tracked this year. The government bagged its first PPP project, the Daang Hari-South Luzon Expressway (SLEX) Connector, only in December 2011.[8] For 2012, sixteen projects under the PPP program are in the pipeline with an estimated cost of PhP140.8 billion. The government has allotted PhP19.6 billion in counterpart funds for the PPP program this year, an increase from 2011's PhP12.5 billion.[9]

The government is particularly bullish on having higher investments in 2012 as investment pledges registered with the Philippine Economic Zone Authority surged by 47 percent in the first two months of the year. The PSEi's breaching of the 5,000 mark for the first time in March 2012 is also said to bode well for the equities market.

Likewise, private construction, particularly in the property subsector, is anticipated to remain robust given the upward momentum in office demand and investments in low-cost housing. Demand for commercial spaces will continue to be buoyed by the BPO sector, the revenues of which are slated to grow even further this year by 20 percent. The residential sector is also expected to receive continued support by the robust demand from families of overseas Filipinos. Consumer spending will similarly be sustained by the favorable inflation outlook and the continuous inflow

[5] This includes setting up the system for PPP funding and other various infrastructure projects. It also involves streamlining the budget and expenditure processes.
[6] Of this amount, the Department of Public Works and Highways received PhP91.06 billion, Department of Agriculture received PhP24.97 billion, and the Department of Education received PhP11.06 billion.
[7] Although part of the PhP72 billion went to increasing the capitalization of the BSP, an expenditure which does not directly contribute to the economy.
[8] With Ayala Corporation as the private proponent, the project is classified under a Build-Transfer-Operate (BTO) scheme totalling PhP1.956 billion (US$43.5 million).
[9] Of this amount, PhP8.6 billion goes to the Department of Transportation and Communications, PhP4 billion to DepEd, PhP3 billion to DPWH, PhP3 billion to the Department of Health, and PhP1 billion to the DA.

of remittances which have been countercyclical in the past. Tourism is also seen to be an important source of growth this year.

Spending for the election in 2013 and the continued implementation of social protection programs (i.e., CCT) will also likely support consumer demand.

One must note though that even if the government meets its 5-6 percent forecast for 2012, it will still miss, for the second year in a row, the 7-8 percent annual growth it has envisioned in its Philippine Development Plan, 2011-2016.

Moreover, the government should continue to be mindful of the fragile external environment. While everyone is hopeful for a more solid global recovery in 2012, it is likely that it will remain slow and uncertain. Multilateral agencies such as the World Bank and the IMF have downgraded their global growth forecasts for 2012 and 2013.[10] Likewise, ADB sliced its growth projection for emerging East Asia from 7.5 percent to 7.2 percent, citing the presence of significant downside risks.

First, the economic turmoil in Europe can cause difficulties in restoring market confidence, and puts into question the sustainability of the region's finances. Also, high debt levels and deficits in the US and Japan have not been resolved, and together with slow growth in other high-income economies, they could possibly trigger sudden adverse shocks. To further aggravate the situation, political tensions in the Middle East and North Africa will most likely disrupt oil supply.

Second, given the intricacies of restoring stability and keeping the sustainability of developed countries' finances, it is likely that markets would be unwilling to finance the deficits and maturing debt of these countries. This implies that the likelihood of a global credit crunch is very much present. Although the situation is kept in check for the moment, an actuality may bring a much broader and longer recession than that of 2008-2009.

Third, should another major crisis occur, both developed and developing countries would not have the resources to launch countercyclical measures the same way as they had back in 2008-2009 crisis. Thus, if conditions in world financial markets deteriorate, limited ability to respond accordingly could exacerbate and prolong the debacle. Things could be worse particularly for developing countries for they would have much less fiscal (policy) space to respond to an economic downturn.[11] For instance, a vicious crisis in high-income economies could put a strain on current account balances and incomes of developing countries that are heavily reliant on export commodities and remittance inflow.[12]

Fourth, volatility in world oil prices (due to tensions in the Middle East) present an upside risk to inflation. In the Philippines, the increase in electricity rates and domestic oil prices during the fourth quarter of 2011 caused an upward adjustment in the 2012 inflation path.

Internal risks are also present, the most important of which is the continuing vulnerability of the agricultural sector to natural calamities. Adverse weather conditions may potentially trigger agricultural supply shocks, resulting in higher food prices. Rising food prices is a significant factor in inflationary conditions as food accounts for around 50 percent of the consumption basket of the Philippines. Evidence also suggests that the pass-through of prices from food items to non-food items is more significant in developing countries. For example, rising food costs is likely to trigger petitions for higher wages in the Philippines.

Notwithstanding the challenges mentioned, the Philippines may still be able to avert a slowdown in 2012. Given the highly uncertain environment, the Philippines must make an honest appraisal of its vulnerabilities and plan contingencies to manage the immediate and long-term impact of a downturn. In this regard, social safety nets and infrastructure programs must be prioritized to ensure long-term growth. In this light, gaining ample fiscal space is critical.

To the extent that government spending needs to increase, a higher revenue level is necessary to finance priority spending and to contain the deficit. Prudent strategies to finance annual funding requirements must be introduced not only to improve on self-sufficiency with regard to funding, but also to minimize foreign exchange risks. Also, and more importantly, there must be renewed urgency to pass the proposed measures on excise tax and rationalization of fiscal incentives. It is also best to ensure that tax expenditure and fiscal risk reporting be an integral part of the budget process.

[10] The World Bank cut its 2012 global growth projection, from 3.1 percent (June 2011) to just 2.5 percent (February 2012), with most of the growth expected from emerging economies. The IMF likewise trimmed its global growth forecast to 3.3 percent from its earlier projection of 4 percent.

[11] The World Bank estimates that 38 percent of developing countries have a government deficit of 4 percent (or more) of GDP in 2011. For the Philippines, government deficit was 2 percent of GDP in 2011.

[12] According to the BSP, cash transfers from overseas Filipinos are estimated to be around 9 percent of GDP in 2011.

Export products should also be diversified as dependence on a particular product segment (i.e., electronics and semiconductors) will intensify the adverse effect of falling foreign demand. This is a matter of *not* putting all the country's eggs in one basket. NEDA said that in December 2011 alone, electronic exports declined to US$1.5 billion from the US$2.3 billion in 2010.

In relation to this, the US Semiconductor Industry Association reported that the worldwide chip sales contracted by 5.3 percent in December due to weak demand in the US, Europe and Japan, and the massive flooding in Thailand. Being trade-dependent, the Philippines should diversify its global product market. Intra-regional trade, particularly with China, is in the forefront.[13]

[13] China is moving to rebalance its economy to become more consumption-oriented and import-based.

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