Economic Report

SENATE ECONOMIC PLANNING OFFICE

December 2013 ER-13-02

2013 MID-YEAR REPORT

Philippine Economy: Rising to New Heights, Better Opportunity for Reforms

All eyes are now on the Philippines. Having exceeded both government and market growth expectations for the last three quarters and now with Typhoon Yolanda's wrath still lingering, the world is eager to witness how the Philippines would rise above it.

Despite the drawback on productivity by the natural calamities, officials are still optimistic that the Philippines is still on track in achieving its 7.0 percent growth target for the year.

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.

I. Introduction

The Philippines continues to be one of the world's economic bright spots. It has managed to maintain high economic growth rates, a healthy fiscal position, a stable inflation outlook, and manageable external debt levels.

Overall, the Philippine economy appears strong enough to weather the downside risks it faces. First, reconstruction and rehabilitation efforts are expected to pick up the slack brought on by the recent natural calamities. Second, even with the impending power rate and fuel price hikes, inflation is expected to remain within the 3.0 to 5.0 percent levels.

Global economic growth will remain weak as downside risks persist. There is evidence that China and some of the other emerging economies are coming off their peaks (both for structural and cyclical reasons). All these imply that the Philippines' economic growth will likely depend very much on domestic growth drivers.

II. Highlights of the Economy

The Philippines' gross domestic product (GDP) rose 7.4 percent in the first three quarters of the year, exceeding the government's own target of 6.0 to 7.0 percent. The Philippine economy accelerated by 7.0 percent in the 3rd quarter from 7.6 percent in the previous quarter.

The Philippine growth, which came in next to China, surpassed the growth rates of other economies in the Asia Pacific region. This marks the 5th consecutive quarter that the country has recorded at least 7.0 GDP growth and the 7th uninterrupted quarter of above-6.0 percent gains.

On the demand side, the country's overall economic activity continued to be driven by personal consumption. Consumption growth picked up in tandem with remittance inflows, which posted a

Table 1. GDP Growth, 3rd Quarter 2013

China	7.7
Indonesia	6.2
Malaysia	5.2
Philippines	***7.0***
Singapore	0.3
Thailand	3.0
Viet Nam	4.7

Source: Asian Development Outlook 2013

6.2 percent increase in the 3rd quarter. Investment also grew 15.6 percent year-on-year. Both exports and imports improved, growing 10.6 percent and 14.2 percent, respectively.

On the supply side, growth was driven by the industry sector, which grew by 8.2 percent, with a 9.7 percent expansion in manufacturing. The chemical and chemical products subsector posted the highest growth in manufacturing, which increased 135.2 percent from 3.3 percent in the previous year. Investments in manufacturing were another key growth driver. The services sector likewise grew by 7.5 percent with a pick-up in real estate, renting, and other business activities. Moreover, agriculture slightly recovered from the last quarter's 0.2 percent decline, increasing 0.3 percent year-on-year due to a rebound in forestry production.

Table 2. GDP Growth Rates, 2012 and 2013 (At Constant 2000 Prices)

INDICATORS	2012				2013		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
GROSS NATIONAL INCOME	**5.7**	**6.5**	**7.3**	**6.4**	**7.8**	**6.4**	**7.8**
GROSS DOMESTIC PRODUCT	**6.5**	**6.3**	**7.3**	**7.1**	**7.7**	**7.6**	**7.0**
AGRICULTURE, HUNTING, FORESTRY AND FISHING	**1.1**	**0.6**	**4.4**	**4.9**	**3.1**	**-0.2**	**0.3**
Agriculture and Forestry	2.2	1.3	5.5	5.2	2.5	-0.9	0.1
Fishing	-3.8	-2.5	0.0	3.4	5.8	3.3	1.1
INDUSTRY	**5.3**	**5.8**	**7.1**	**8.9**	**10.9**	**10.3**	**8.2**
Mining and Quarrying	-1.7	6.5	-1.2	2.8	-1.9	-2.7	-0.8
Manufacturing	6.0	4.3	5.8	5.4	9.5	10.3	9.7
Construction	1.5	11.6	17.8	29.9	29.3	17.3	4.7
Electricity, Gas and Water Supply	8.5	6.1	2.7	3.4	0.3	6.0	6.7
SERVICES	**8.4**	**7.7**	**8.0**	**6.5**	**6.8**	**7.5**	**7.5**
Transport, Storage and Communication	9.7	9.3	9.4	4.4	2.8	6.6	6.6
Trade and Repair of Motor Vehicles, Motorcycles, Personal and Household Goods	7.8	7.8	8.2	6.6	5.5	6.8	5.8
Financial Intermediation	8.7	7.0	8.6	8.8	18.0	10.3	12.1
Real Estate, Renting and Business Activities	7.8	8.1	7.8	6.5	5.8	9.6	12.2
Public Administration and Defense; Compulsory Social Security	4.5	3.8	8.3	8.2	8.3	4.8	2.6
Other Services	10.4	8.4	6.5	5.8	5.3	6.4	5.4
HOUSEHOLD FINAL CONSUMPTION EXPENDITURE	**6.9**	**6.6**	**6.7**	**6.2**	**5.5**	**5.1**	**6.2**
GOVERNMENT FINAL CONSUMPTION EXPENDITURE	**21.3**	**7.2**	**12.3**	**9.5**	**13.2**	**18.0**	**4.6**
CAPITAL FORMATION*	**-31.3**	**3.6**	**6.2**	**9.5**	**44.5**	**18.0**	**15.6**
Fixed Capital	2.8	8.7	10.5	19.7	15.6	13.2	13.4
Construction	-1.2	10.2	19.2	30.4	30.1	16.0	4.2
Durable Equipment	4.5	8.4	5.8	14.1	9.6	13.0	22.3
Breeding Stock and Orchard Development	1.3	2.5	0.9	1.0	0.6	-1.5	-0.9
Intellectual Property Products	31.7	10.3	1.6	31.4	10.4	16.2	13.9
EXPORTS	**9.8**	**1.8**	**6.2**	**8.6**	**-7.6**	**-6.8**	**10.6**
Exports of Goods	9.9	12.7	7.0	11.9	-8.9	-8.8	11.5
Exports of Services	9.1	2.7	2.8	-0.6	-3.2	2.3	6.7
LESS: IMPORTS	**-1.9**	**8.3**	**7.0**	**8.0**	**2.0**	**-2.9**	**14.2**
Imports of Goods	-5.9	5.9	5.5	6.8	0.8	-4.3	14.9
Imports of Services	16.7	22.6	13.9	12.0	6.5	3.7	10.8

***** Capital Formation includes fixed capital & changes in inventories***

Source: National Statistical Coordination Board (NSCB)

Fiscal deficit hit PhP101.2 billion for the first three quarters of 2013, PhP43.3 billion below the January-September target. The budget deficit for end-September was recorded at PhP18.6 billion, bringing the first three quarters' total deficit to PhP101.2 billion, 2.7 percent lower than that recorded a year ago. The cumulative deficit is 42.5 percent of the full-year government target of PhP238.0 billion and leaves much leeway for more aggressive spending for the last quarter which bodes well for economic growth and tax revenues.

Table 3. NG Fiscal Performance, January-September 2012-2013 (in billion PhP)

PARTICULARS	2012 Jan.-Sept. Actual	2013 Jan.-Sept. Program	2013 Jan.-Sept. Actual	Variance	% Growth
REVENUES	1,118.9	1,295.3	1,266.6	(28.7)	11.6%
Tax Revenues	996.8	1,191.9	1,134.0	(57.9)	12.1%
Bureau of Internal Revenue	772.5	931.0	897.9	(33.1)	14.0%
Bureau of Customs	213.6	250.4	224.6	(25.8)	4.9%
Other Offices	10.7	10.5	11.5	1.0	6.9%
Non-Tax Revenues	122.1	103.4	132.4	29.0	7.8%
o/w Bureau of the Treasury Income	65.0	45.3	68.1	22.8	4.5%
EXPENDITURES	1,096.0	1,439.7	1,367.8	(71.9)	19.9%
Surplus/(Deficit)	**(103.9)**	**(144.5)**	**(101.2)**	**(43.3)**	**(2.7%)**

Source: BTr

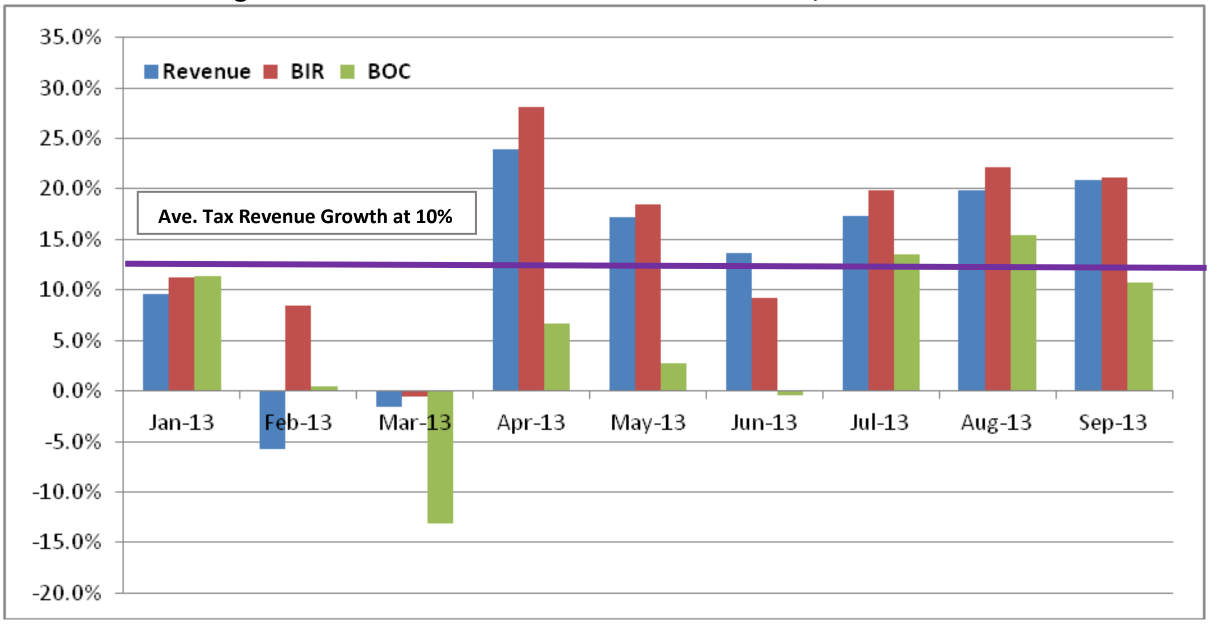
National government (NG) revenues and spending both posted considerable growth, but fell short of the full-year target. Revenues grew by 11.6 percent year-on-year due to a 63.9 percent increase in excise tax collection on sin products in the first nine months of 2013 and higher revenues from Bureau of the Treasury (BTr) income and fees and charges in the 1st quarter. While higher excise taxes and stricter tax administration enabled the Bureau of Internal Revenue (BIR) to post a robust PhP897.9 billion tax collection, persistent value-added tax (VAT) leakages and lower income tax collection in the 3rd quarter hampered it from hitting its target of PhP931.0 billion.

Also, the Bureau of Customs (BOC) continues to fall short of its collection target, citing rampant smuggling as the main reason. Nonetheless, its tax take improved by 4.9 percent, resulting in a shortfall of PhP25.8 billion, which is 10.3 percent lower from its revenue goal.

Meanwhile, government spending slowed significantly to 4.6 percent in the third quarter from 18.0 percent in the 2nd quarter. According to the Department of Budget and Management (DBM), this slowdown is to be expected during an election year as the government has already front-loaded its expenditure in the first half of the year. For the period January to September 2013, expenditures were recorded at PhP1,367.8 billion, 19.9 percent higher than the same period in 2012. This level is already 68.9 percent of the full year target of PhP1,983.9 billion.

The current administration is looking at further accelerating state spending in line with its goal to raise the budget earmarked for infrastructure to 5.0 percent of the expected GDP by 2016 to be at par with other Southeast Asian countries.

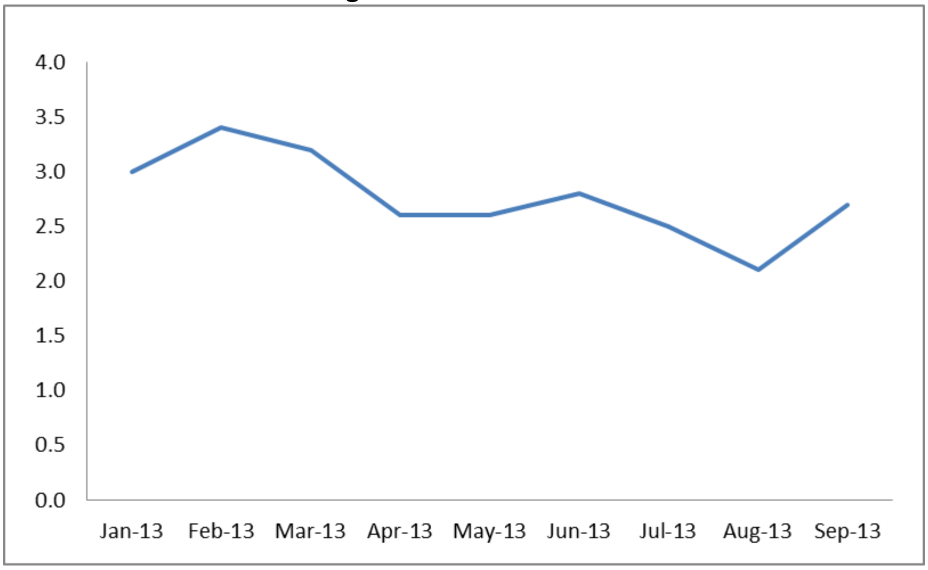
Figure 1. NG Revenue Performance Growth Rates, Year-on-Year



Source: BTr

Inflation continued to experience a slowdown in the 3rd quarter. Headline inflation came in lower-than-expected at 2.4 percent in the 3rd quarter from 2.7 percent in the previous quarter due to lower prices of non-food items such as electricity rates and domestic petroleum. Inflation is seen to reach the lower tail of 3.0 to 5.0 percent target for the year despite the devastating weather conditions and volatile capital flows that might cause upside risks to the inflation outlook.

Figure 2. Inflation Rate



Source: BSP

Key policy rates were maintained. The Bangko Sentral ng Pilipinas (BSP) maintained its key policy rates during the 1st nine months based on the assessment that the inflation environment continued to be manageable, with risks to the inflation outlook seen to be evenly balanced. However, interest rates on the special deposit account (SDA) facility were reduced twice during the 1st semester, with the current rate of 2.0 percent regardless of tenor effective end-April 2013. The Monetary Board decided to rationalize the BSP's SDA facility consistent with international central banking practice. Amid robust domestic growth prospects and a benign inflation environment, the refinement in the SDA facility is expected to help in the absorption of excess liquidity in the economy.

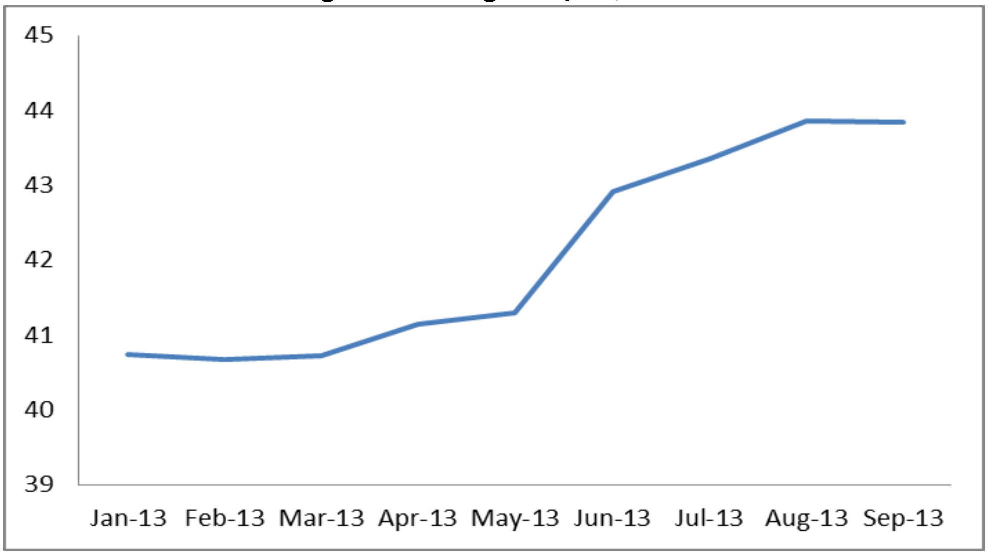
Remittance inflows were strong but decelerating. The Philippines has about 10.5 million[1] workers abroad who make an invaluable contribution to this consumption-driven economy. Despite the increasingly challenging economic conditions in the host countries, especially in the Eurozone, remittances continued to be resilient, growing by 5.8 percent in the 3rd quarter year-on-year. The sustained supply of and demand for Filipino workers abroad, the development in bank and non-bank channels, and the depreciation bias of the peso in the medium term, support this growth.

Exports recovered in the 3rd quarter but still not sufficient to beat the yearend target. Total exports increased 10.6 percent in the 3rd quarter than a year earlier, following a contraction of 6.8 percent in the 2nd quarter and 7.6 percent in the 1st quarter.

With growth momentum in China decelerating and the Eurozone demand still indolent, exports are unlikely to stage a recovery in 2013; any improvement will likely be modest; this means that growth will be primarily domestic-led. In the first half of 2013, China accounted for 12.4 percent of the country's exports with export receipts valued at US$6.8 billion. The Eurozone, on the other hand, held only 9.7 percent of the country's total trade, valued at US$5.4 billion. The export growth target for the year was initially set at 10 percent, however, it is likely to be revised downward to 3.0 to 4.0 percent due to the significant decline in electronic exports during the first half.

The peso failed to regain its strength against the greenback. The peso averaged PhP42.06 in the 3rd quarter of 2013, depreciating 1.23 percent from the same period last year. The peso's weakening was due mainly to the uncertainty about the exit from monetary policy stimulus in the United States. Nonetheless, the continued strong foreign exchange inflows from OFW remittances tempered the further depreciation of the peso.

Figure 3. Average PhP/US$ Rate

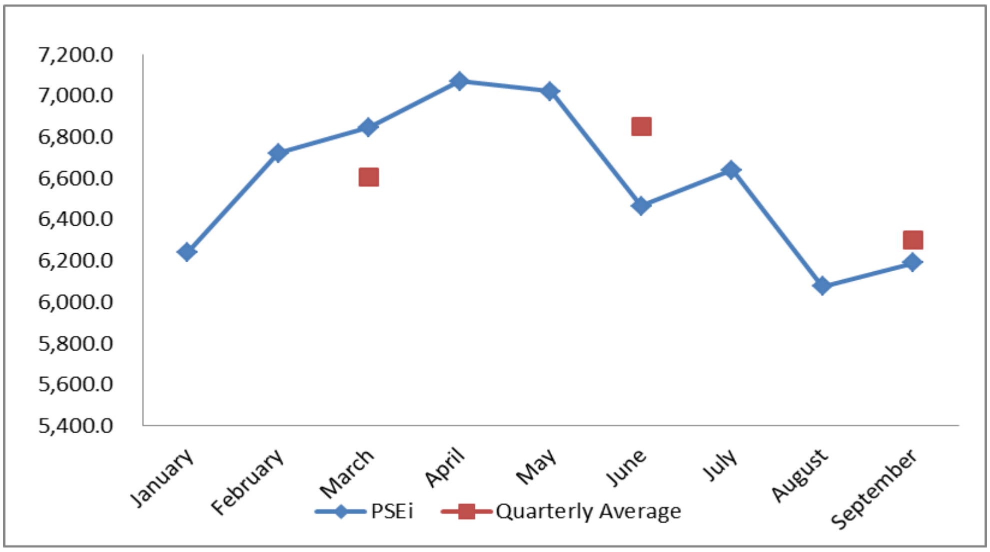


Source: BSP

Philippine stock market dove to the bear territory. The Philippine stock market made history with its index climbing the 7,000 range in May this year. However, this was not sustained as it plunged 500 points the following month. The market declined as investors took profits upon the Fed's announcement of a Quantitative Easing tapering and valuation concerns on the stock market. The decline in exports and concerns about high equity price valuations dampened sentiments in the latter half of the 2nd quarter, dwarfing investors' positive outlook on the Philippine economy.

[1] Stock estimate of overseas Filipino workers (OFWs) as of December 2012 from the Commission on Filipinos Overseas (CFO).

Figure 4. Philippine Stock Exchange Index



Source: NSCB

International reserves continued to rise. The country's gross international reserves (GIR) have increased by only 1.3 percent from year-ago levels to reach US$83.0 billion as of end-September 2013. Nonetheless, this healthy GIR level remains ample to cover 11.9 months' worth of imports of goods and services. It is also equivalent to 8.7 times the country's short-term external debt, cushioning the economy from external volatilities.

III. Outlook and Risks

The Philippines is expected to sustain its high growth momentum in the near to medium term. Private consumption, which makes up 70 percent of the economy, will continue to be strong given the still-robust growth in remittances and an upbeat Business Process Outsourcing (BPO) industry. Both public and private investments are also seen to be boosted by the doubling of public infrastructure spending (up to 5.0 percent of GDP) by 2016. Likewise, continuous reforms to improve the investment climate are observed.

On the downside, global recovery is expected to come slowly given the uncertainties in the advanced economies. These uncertainties are likely to cause volatility in financial markets, result in capital outflows, and weak external demand. Also, political drags (e.g. raising revenues) could compromise public infrastructure and social spending.

Moreover, the natural calamities that beset the country this year will likewise impact on productivity. Policymakers believe that the damages from Typhoon Yolanda will likely cut GDP growth in the last quarter by 0.3 to 0.8 percentage points, pushing economic growth to a range of 4.1 to 5.9 percent in the 4th quarter.[2] Nevertheless, reconstruction and rehabilitation efforts are expected to speed up recovery next year.

The challenge for the country remains to be inclusive growth. Making a dent in poverty through job creation is a daunting task. This highlights the need to boost productive capacity especially in the manufacturing sector.

To maintain a stronger grip on this growth momentum, the government must continue to invest heavily on both human and physical capital. This entails improving efficiency in government spending while

[2] http://business.inquirer.net/154289/philippines-says-typhoon-yolanda-to-cap-economic-growth-at-7-0.

simultaneously introducing reforms to make the tax system more responsive to economic growth. Furthermore, policies that engenders competition and those that make domestic industries more contestable need to be pushed. To this end, protection of property rights must be ensured and strengthened.

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