Economic Report

SENATE ECONOMIC PLANNING OFFICE

March 2015 ER -15-01

2014 Economic Performance

Still Strong But Missing the Target

Despite setbacks in public spending and agricultural production, macroeconomic conditions have been broadly favorable and have helped sustain growth in 2014. Efforts to introduce structural reforms, difficult as they may be, must be continued. Increasing the tax base, ensuring fair competition and protecting property rights are imperatives if the country were to realize its full growth potential.

I. Introduction

The Philippine economy grew 6.1 percent in real terms in 2014. While this figure is above market expectation (5.8 percent), it is lower than the 7.2 percent gross domestic product (GDP) growth registered in 2013 and below the official target of 6.5 to 7.5 percent for 2014.

After three quarters of relatively slow expansion, the economy caught up in the last quarter of 2014 with a strong 6.9 percent growth. The Philippines performed fairly well compared to other Asian countries.

Real GDP Growth Rate, Selected Asian Countries

Country	2013	2014
Myanmar	8.3	7.7
Laos	7.9	7.4
China	7.7	7.4
India	6.4	7.1
Cambodia	7.4	7.0
Philippines	**7.1**	**6.1**
Malaysia	4.7	6.0
Vietnam	5.4	6.0
Indonesia	5.6	5.0
Taiwan	2.2	3.7
Korea	3.0	3.3
Singapore	4.4	2.9
Thailand	2.8	0.9
Brunei	-2.1	-1.2

Source: ADB, BSP

Growth in demand was fuelled by the continued strong performance of exports, which registered a 12.1 percent growth. This mirrors the recovery of the global manufacturing sector as well as the continued rise of the business process outsourcing (BPO) sector. Household

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consumption, which grew by 5.4 percent, remains a big contributor to growth. This was supported by the steady inflow of overseas Filipino workers' (OFW) remittances and the improvement in the employment situation, as evidenced by the latest employment figures.

Capital formation, on the other hand, contracted by 4.9 percent in the fourth quarter, bringing its full-year growth to a mere 1.1 percent. This is in stark contrast to the 29.9 percent growth it registered in 2013. Investments in durable equipment and intellectual property products contracted by 0.6 percent and 14.3 percent, respectively in the fourth quarter, while investment in construction continued to post a strong growth of 21.9 percent during the same period. Meanwhile, the slack in government consumption is largely viewed as a drag to 2014 growth after it registered zero growth in the second quarter and a 2.6 percent contraction in the third quarter. It did catch up with a 9.8 percent growth in the last quarter.

GDP Growth Rates, 2013 and 2014 (At Constant 2000 Prices)

	2013				2014				ANNUAL	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	12-13	13-14
Gross Domestic Product	**7.7**	**7.9**	**7.0**	**6.3**	**5.6**	**6.4**	**5.3**	**6.9**	**7.2**	**6.1**
Gross National Income	**7.3**	**6.4**	**9.0**	**7.2**	**7.2**	**7.5**	**4.2**	**6.3**	**7.5**	**6.3**
by Type of Expenditure										
Household Final Consumption Expenditure	**5.5**	**5.1**	**6.2**	**5.9**	**5.9**	**5.7**	**5.0**	**5.1**	**5.7**	**5.4**
Government Final Consumption Expenditure	**10.0**	**12.1**	**7.0**	**-0.4**	**1.9**	**0.0**	**-2.6**	**9.8**	**7.7**	**1.8**
Capital Formation (FC+CI)	**49.8**	**33.6**	**21.6**	**22.4**	**9.5**	**-1.0**	**2.8**	**-4.9**	**29.9**	**1.1**
Fixed Capital (FC)	17.3	13.6	9.5	8.0	11.0	4.5	10.5	8.1	11.9	8.6
Construction	33.9	16.5	3.9	-4.3	-1.3	5.1	13.2	21.9	10.4	10.0
Durable Equipment	10.4	13.2	15.4	23.2	22.7	3.5	8.1	-0.6	15.5	8.7
Breeding Stock & Orchard Development	0.6	-1.0	-0.9	-12.1	-4.4	-2.1	-1.1	2.3	-4.0	-1.3
Intellectual Property Products	7.4	13.8	13.1	28.3	-5.1	38.6	34.7	-14.3	16.4	10.1
Exports	**-10.6**	**-7.7**	**12.4**	**3.2**	**13.5**	**10.5**	**9.9**	**15.5**	**-1.1**	**12.1**
Exports of Goods	-8.9	-8.8	13.7	6.2	14.2	10.0	9.7	15.9	0.1	12.1
Exports of Services	-16.4	-3.2	6.4	-6.7	11.1	13.0	10.8	14.1	-5.7	12.2
Less : Imports	**2.8**	**-4.6**	**17.3**	**6.4**	**10.1**	**3.1**	**5.1**	**5.3**	**5.4**	**5.8**
Imports of Goods	2.1	-6.1	16.7	4.4	7.5	-2.5	4.4	3.6	4.2	3.2
Imports of Services	5.3	3.1	19.9	12.8	19.2	28.9	8.0	10.8	10.3	15.9
by Industrial Origin										
Agriculture, Hunting, Forestry, and Fishing	**3.2**	**-0.2**	**0.3**	**0.9**	**0.9**	**3.4**	**-2.2**	**4.8**	**1.1**	**1.9**
Agriculture and forestry	2.6	-0.9	0.3	2.3	1.7	4.5	-2.6	4.7	1.2	2.3
Fishing	5.8	3.3	0.5	-4.4	-3.1	-1.6	-0.4	4.8	0.7	0.3
Industry	**11.3**	**10.5**	**7.7**	**7.6**	**5.3**	**7.9**	**7.6**	**9.2**	**9.3**	**7.5**
Mining & Quarrying	2.1	0.3	5.0	-2.5	9.0	2.1	5.2	-3.2	1.2	3.5
Manufacturing	9.5	10.3	8.9	12.0	6.9	10.9	7.3	7.3	10.3	8.1
Construction	31.1	16.6	3.4	-5.2	0.2	1.2	11.9	20.5	9.6	8.5
Electricity, Gas and Water Supply	0.6	7.0	8.4	3.0	1.0	2.8	2.9	6.3	4.9	3.2
Service	**6.5**	**7.8**	**7.7**	**6.7**	**6.8**	**6.1**	**5.3**	**6.0**	**7.2**	**6.0**
Transport, Storage & Communication	1.4	6.6	6.3	8.1	7.7	7.0	5.3	6.3	5.6	6.6
Trade and Repair of Motor Vehicles, Motorcycles, Personal and Household Goods	4.2	6.3	5.6	6.4	6.0	6.3	6.4	5.3	5.7	6.0
Financial Intermediation	18.0	10.3	12.1	10.7	5.7	6.1	8.4	6.6	12.6	6.7
R. Estate, Renting & Business Activities	5.8	9.5	11.6	7.6	9.5	8.6	6.2	8.3	8.7	8.1
Public Administration & Defense; Compulsory Social Security	5.3	5.9	6.0	-2.3	6.3	1.2	-2.9	10.9	3.8	3.5
Other Services	7.6	8.3	6.3	6.4	5.5	5.0	3.7	2.5	7.1	4.2

Source: Philippine Statistics Authority

Growth in production was mainly driven by the manufacturing sub-sector, which grew by 8.1 percent. Food manufacturing, beverage industries, petroleum and other fuel products, fabricated metal products, as well as transport equipment, contributed to growth in manufacturing. Demand for these manufactures came from both domestic and external markets. Construction likewise regained its footing in the last two quarters to expand by 8.5 percent. The services sector grew by 6.0 percent, still strong albeit slower compared to the 7.2 percent growth it registered the previous year. The agriculture, fishery, and forestry sector registered a 2.2 percent fall in output in the third quarter on account of the disruption brought by typhoons on palay and poultry production. The sector, however, bounced back with a 4.8 percent growth in the last quarter as crop production, which account for 50 percent of agricultural output, increased.

Fiscal position posted a deficit amounting to PhP73.1 billion for 2014, just 27.5 percent or PhP193.1 billion lower than the full-year program. The low deficit is largely the result of low state spending, which is PhP302.7 billion lower than programmed. Low state spending comes as a result of the government's efforts to "take out the fat" and plug the leakages in public spending. In July, the Supreme Court declared unconstitutional the Disbursement Acceleration Program (DAP), dubbed as a form of pork barrel, and this served to halt spending on several government projects.

Revenue, on the other hand, grew by 11.2 percent during the same period mainly owing to the 12.0 percent growth in tax revenue. The Bureau of Customs (BOC) seems to have gained headway in improving its collection effort, posting a 21.1 percent growth in revenues. Also, the Bureau of Treasury's (BTr) interest income exceeded the programmed amount by PhP37.2 billion. Despite these gains however, actual total revenues still fell short of the target by PhP109.6 billion in 2014.

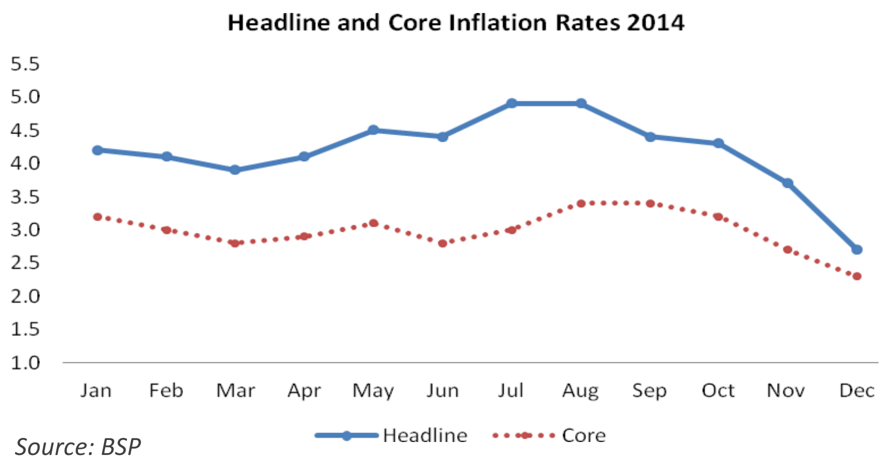
National Government's Fiscal Performance, 2013-2014 (in billion PhP)

Particulars	2013 Actual	2014 Program	2014 Actual	Variance	Growth (%)
REVENUES	1,716.1	2,018.1	1,908.5	(109.6)	11.2
Tax Revenues	1,535.7	1,879.9	1,720.1	(159.8)	12.0
Bureau of Internal Revenue	1,216.7	1,456.3	1,334.8	(121.5)	9.7
Bureau of Customs	304.9	408.1	369.3	(38.8)	21.1
Other Offices	14.1	15.5	16.1	0.6	14.0
Non-Tax Revenues	180.1	136.1	188.2	52.1	4.5
o/w Treasury Income	81.0	56.2	93.4	37.2	15.4
EXPENDITURES	1,880.2	2,284.3	1,981.6	(302.7)	5.4
Interest Payments	323.4	352.7	321.2	(31.5)	(0.7)
Allotment to LGUs	317.3	273.2	344.2	71.0	8.5
Equity	11.5	3.3	1.7	(1.6)	(84.8)
Net Lending	16.6	25.0	13.4	(11.6)	(19.3)
Subsidy	66.3	109.0	80.4	(28.6)	21.3
Tax Expenditures	19.0	29.9	25.9	(4.0)	36.2
Others	1,145.0	1,521.1	1,194.7	(326.4)	4.3
SURPLUS/(DEFICIT)	(164.1)	(266.2)	(73.1)	193.1	(55.5)

Source: BTr and Development Budget Coordination Committee (DBCC)

Inflation was broadly stable, averaging 4.1 percent in 2014, remaining within the target range of 3.0 to 5.0 percent. Some upward pressure on prices was observed mid-year on account of tight food supply conditions and petitions for upward adjustment of utility rates. Nonetheless, by September, inflation pressures eased as crop production improved during the last quarter. Favorable US oil supply inventories likewise helped stabilize world oil prices and in turn, tempered pressures on domestic petroleum products and utility prices.

Key policy rates were raised by the Monetary Board (MB) in July by 25 basis points and then again in September by another 25 basis points. These policy actions were aimed at reining in inflation expectations and preempting potential second-round inflation effects. In the MB's meetings last October and December, the Board decided to maintain policy rates at 4.0 percent for the overnight borrowing (RRP) facility and 6.0 percent for the overnight lending (RP) facility.

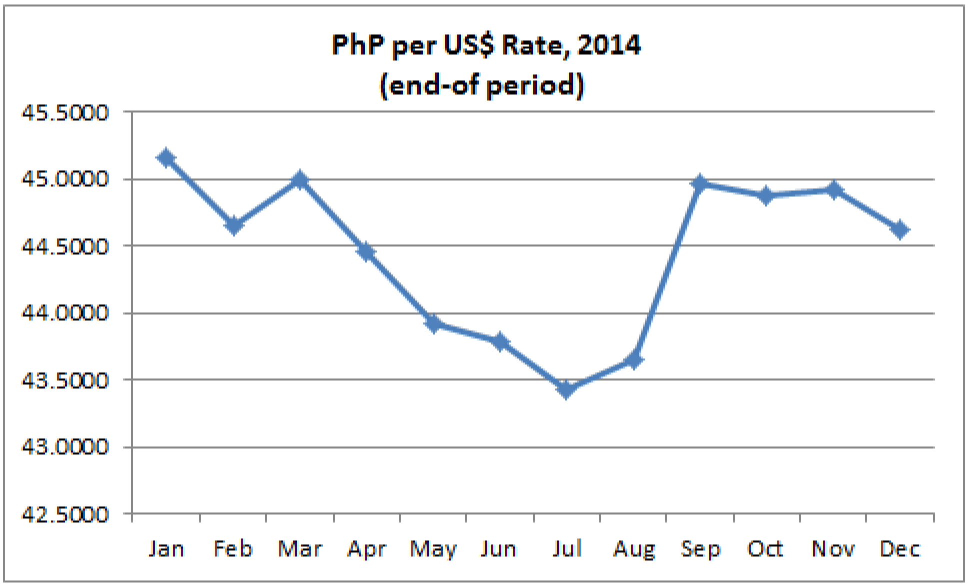


Source: BSP

Balance of payment (BOP) position in 2014 posted a deficit of US$2.8 billion, a reversal of the US$5.1 billion surplus it posted 2013. The Bangko Sentral ng Pilipinas (BSP) was expecting a BOP surplus of US$1 billion in 2014. The BOP deficit is largely the result of large outflows in the financial account, which posted a net outflow of US$10.1 billion. This is more than four times the outflow of US$2.2 billion in 2013. In particular, direct investments posted a reversal, from US$90 million inflow in 2013 to US$789 million in 2014. This came as a result of increased uncertainty in global financial markets.

Gross international reserves (GIR) by the end of December 2014 stood at US$79.5 billion, US$3.6 billion lower than that recorded the previous year. The decrease came with revaluation adjustments on the BSP's gold holdings, other foreign-denominated reserves, and payments for maturing foreign exchange obligations. Nevertheless, GIR level is deemed sufficient as it covers 10.4 months' worth of imports and is 4.9 times the country's short-term external debt (based on original maturity).

Philippine Peso-US Dollar exchange rate weakened due to increased capital outflows in light of strengthening US recovery and concerns over possible spillovers of Japan's recession. The Philippine peso depreciated by 4.4 percent, averaging at PhP44.4/US$1. This is consistent with the movement of other regional currencies against the US dollar following the US Federal Reserve's higher rate projections for 2015. The target range for the peso-dollar exchange rate for 2014-2016 was adjusted from PhP41.00-PhP44.00 to PhP42.00-PhP45.00.



Philippine Stock Exchange Index (PSEi) closed at 7,230.57 points at the end of 2014. This is 22.8 percent higher than its closing level of 5,889.83 points in 2013. The index was second next to China in terms of gains in the region. Overall, 26 out of the 30 companies that make up the index posted gains in 2014.

Source: http://www.tradingeconomics.com/

Employment levels improved according to latest official data. The October round of the Labor Force Survey (LFS) showed a 94.0 percent employment rate, showing a slight increase from the 93.6 percent employment rate in October 2013. This translates to a 1.046 million increase in the labor force, which now totals 41.3 million workers. Workers in the services sector account for 53.7 percent of the employed population while the agriculture sector account for 30.8 percent. Underemployment likewise increased from 18.0 percent in 2013 to 18.7 percent in 2014.

Poverty incidence increased based on the latest Annual Poverty Indicator Survey (APIS). Poverty incidence among Filipinos was recorded at 25.8 percent in the first semester of 2014, higher than the 24.6 percent recorded in the first semester of 2013. Among Filipino families, poverty incidence also worsened to 20 percent from 18.8 percent in the same period in 2013. The increase is attributed to the rise in food prices and the lingering effects of Typhoon Yolanda.

First Semester Per Capita Thresholds and Incidences: 2013 and 2014

Statistic	1st Sem. 2013	1st Sem. 2014	Variance (%)
Per Capita Food Threshold (PhP)	6,712	7,350	9.5
Subsistence Incidence (%)			
Families	7.5	7.6	
Population	10.5	10.5	
Per Capita Poverty Threshold (PhP)	9,630	10,534	9.4
Poverty Incidence (%)			
Families	18.8	20.0	
Population	24.6	25.8	

Source: Philippine Statistics Authority

II. Outlook, Risks and Policy Implications

The Philippine economy grew by 6.1 percent in 2014, down from 7.2 percent in 2013. Still, the Philippines remains the second fastest growing economy in Asia next to China. Setbacks in agricultural production and public spending slowed growth but were eventually corrected. The steady influx of remittances from OFWs and the continuing expansion of the services sector (i.e., BPO services) are continually creating a new middle class with purchasing power that foreign investors are taking note of.

Prospects and Risks

The 2015 growth target is set at 7.0-8.0 percent. Good prospects will come as a result of a stable macroeconomic framework, strong remittances from OFWs, falling world oil prices, resurgence in the manufacturing sector, robust services sector, and upbeat consumer and business sentiment. Effective execution of the General Appropriations Act of 2015 and the approved Yolanda masterplan is expected to bolster growth further.

Delays in public-private partnership (PPP) projects will likely temper any potential. In addition, risk also comes with the weak or uncertain prospects of the country's trading partners—Japan has yet to reignite growth, China is slowing down, the US is recovering (although at a slow pace), and the Eurozone continues to falter.

Multilateral agencies' growth forecasts for the Philippines in 2015 are less sanguine—the Asian Development Bank (ADB) with 6.4 percent, the World Bank (WB) with 6.5 percent, and the International Monetary Fund (IMF) with 6.6 percent.

Policy Implications

Lower public spending reflects government's efforts to improve governance and transparency in public works. While this is necessary and commendable, public spending will have to increase, particularly for infrastructure. There is general consensus that the country's infrastructure is lagging behind and is therefore unable to meet the demands of a growing population and economy. Studies show that the economy loses up to PhP140 billion each year due to traffic congestion alone. Add to that, losses due to outdated airports and congested seaports. The Philippines also pays one of the most expensive electricity rates in Asia. The Aquino administration is cognizant of these constraints to growth and has committed to increase public spending on infrastructure to 5.0 percent of GDP by 2016. This level of infrastructure spending has to be sustained beyond that.

Public spending on education and health is also critical to ensure that workers gain and keep high-skill/high-value jobs. Close ties between educational institutions and key industries must be encouraged and promoted. Increasing both public and private investments in research and development (R&D) cannot be overemphasized as well.

Higher spending on infrastructure and social services makes increasing revenue collection an imperative. Improving the efficiency of tax administration and widening the tax base still remain part of an already well-known policy agenda of structural reforms. The Philippine's tax-to-GDP ratio is one of the lowest in Asia. If the Philippines were to lower poverty levels by sharing prosperity amongst its citizens, then policymakers must recognize the significant redistributive impact of a progressive (income) tax system.

Other key structural reforms include enhancing competition in key industries, strengthening protection of property rights, and simplifying business regulations, particularly for micro and small enterprises. A few proposed measures pertaining to these reforms are currently pending in the Legislature. These include the amendments to the Build-Operate-Transfer (BOT) Law, Cabotage Law and the National Internal Revenue Code (net taxable income and nominal tax rates) as well as the proposed Customs and Tariff Modernization Act, Competition Law and the Rationalization of Fiscal Incentives.

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This Economic Report was prepared by Macroeconomics Sector Head Maria Kathreena D. Tan and Myrna E. Diana under the supervision of the SEPO Directors and the overall guidance of its Director General.