Angelo King Institute
for Economic and Business Studies

Monitoring the Philippine Economy
First Quarter Report for 2019

Project of Angelo King Institute

Mitzie Irene P. Conchada[1]
Associate Professor
School of Economics

Won Hee Cho
BS-AEL Economics
School of Economics

First quarter 2019 growth performance slowed to 5.6 percent from 6.5 percent the previous year.

The Philippine economy falls short in meeting growth expectations. First quarter growth was recorded at 5.6 percent, which was below the government's growth expectations of 6.0 to 7.0 percent. Weak domestic investment, government underspending, worsening trade deficit, slowing industry sector growth, and sluggish agriculture sector contributed to the Q1 2019 growth slowdown in spite of higher household expenditure growth and uptick in service sector growth. Although inflation eased this quarter, the drastic underspending by the government due to delays in the national budget remarkably contributed to the economic downgrade. Moreover, adverse weather conditions, specifically the El Niño episode, and policy uncertainties arising from internal and external economic factors remain as challenges the government has to face. Nonetheless, with improved consumer confidence, improved business outlook, and pro-active government initiatives, growth in the year ahead is expected to meet government targets.

- **Major components of aggregate demand**

  - **Private consumption was the key driver of growth in the demand-side.** Household Final Consumption Expenditure (HFCE) in the first quarter exhibited a growth of 6.3 percent year-on-year (y-o-y), which was significantly faster than 5.6 percent and 5.3 percent the previous year and quarter, respectively. According to the Philippine Statistics Authority (PSA)[2], all HFCE components posted positive growth rates except Alcoholic beverages and Tobacco, which posted -3.7 percent growth rate probably due to the TRAIN Law. Food and Non-Alcoholic beverages, which comprise the biggest share in HFCE with 38.7 percent, registered higher growth of 5.8 percent from 5.0 percent, y-o-y. Education (12.0 percent from 6.7 percent, y-o-y), Clothing and Footwear (3.7 percent from 0.5 percent, y-o-y), Transport (5.7 percent from 2.5 percent, y-o-y), and Communication (8.5 percent from 7.0 percent, y-o-y) also posted accelerated growth rates. In contrast, Housing, water, electricity, gas and other fuels (6.6 percent from 8.9 percent, y-o-y), Furnishings, household equipment and routine household maintenance (3.2 percent from 4.9 percent, y-o-y), Health (4.8 percent from 5.7 percent, y-o-y), Recreation and culture (7.0 percent from 4.0 percent, y-o-y), Restaurants and hotels (8.5 percent from 9.0 percent, y-o-y), and Miscellaneous goods and services (7.0 percent from 7.2 percent, y-o-y) posted decelerated growth rates. Given the easing of price levels and improvement in consumer confidence, private spending

[1] Report is based on latest available data as of June 10, 2019. For comments and questions, please email mitzie.conchada@dlsu.edu.ph
[2] http://psa.gov.ph/nap-press-release/sector/Household%20Final%20Consumption

started to pick up. Consequently, household consumption was the sole component in the demand-side this quarter that favorably contributed to the Philippines' GDP growth.

- **Gross domestic capital formation slowed.** Domestic investment slowed down to 6.8 percent from 10.3 percent the previous year. Investments in fixed capital expanded by only 5.7 percent, slowest growth since Q2 2014. According to PSA[3], the slowdown was caused by the deceleration in Fixed Capital Investments in Construction (5.0 percent from 10.8 percent, y-o-y), Durable Equipment (5.7 percent from 7.2 percent, y-o-y), and Breeding Stocks and Orchard Development (3.8 percent from 4.1 percent, y-o-y). Only Intellectual Property Products (13.8 percent from 11.1 percent, y-o-y) posted an accelerated growth.

- **Government underspent due to budget delays.** Government final consumption expenditure significantly weakened with a growth of 7.4 percent from 13.6 percent the previous year. According to National Economic Development Authority (NEDA) [4], budget delays resulted in drastic underspending of approximately P1 billion per day during Q1 2019, equivalent to P80 billion to P90 billion in disbursements. *The Senate-House deadlock over the 2019 General Appropriations Bill forced the government to operate on a reenacted 2018 budget for the entire quarter*. This immensely constrained various economic activities such as infrastructure modernization and human capital development projects.

- **Trade deficit worsened due to decreasing exports and sustained increase in imports.** At the end of March[5], exports and imports were recorded at 5.88 billion USD (-2.5 percent growth y-o-y) and 9.01 billion USD (7.8 percent growth y-o-y), respectively. First quarter displayed a trade deficit of 3.14 billion USD, wider than the 2.34 billion USD deficit in March 2018. The decreases in export sales of the four of the top ten major export commodities, namely machinery and transport equipment (-10.2 percent), other manufactured goods (-8.1 percent), electronic products (-3.7 percent), and metal components (-1.2 percent) significantly contributed to the dampening of exports. Meanwhile, the increases in total imported goods of the seven of the top ten major import commodities, namely cereals and cereal preparations (97.9 percent), miscellaneous manufactured articles (43.5 percent), telecommunication equipment and electrical machinery (37.2 percent), other food and live animals (33.5 percent), plastics in primary and non-primary forms (14.2 percent), industrial machinery and equipment (11.1 percent), and electronic products (6.5 percent) notably contributed to the expansion in imports. The further widening of the trade gap in Q1 2019 may be partly explained by the surge in Chinese imports, with 21.4 percent share. In March 2019, import bills from China reached 1.92 billion USD from 1.28 billion USD in March 2018.

[3] http://psa.gov.ph/nap-press-release/sector/Capital%20Formation
[4] http://www.neda.gov.ph/economic-teams-joint-statement-on-q1-2019-gdp-growth/
[5] https://psa.gov.ph/statistics/foreign-trade/fts-release-id/138615

- **Major components of aggregate supply**

  In this report, we present results from an alternative to the "traditional" (TRAD) method of decomposing growth of GDP in constant prices into sector contributions. This alternative method is a "generalized" (GEN) growth decomposition that applies to GDP in constant prices (e.g., in the Philippines) and to GDP in chained prices (e.g., in Canada and the US). While TRAD recognizes only "quantity" growth as the source of a sector's contribution to GDP growth, GEN posits that a sector's contribution comes from "quantity" growth and from "real price" growth where this price is, by definition, the ratio of a sector's deflator to the overall GDP deflator. The GDP deflator as the common denominator of the above ratio makes real GDP the numeraire and, thus, this ratio is the relative price or exchange value of the GDP of a sector in "GDP units," i.e., the "real price" of a sector's GDP. Therefore, a sector's positive "quantity" growth contribution will be diminished if accompanied by a negative "real price" growth of the same sector that may even result in a negative net contribution by the sector to GDP growth. On the other hand, a sector's positive "quantity" growth contribution will be enhanced if accompanied by a positive "real price" growth (see Table 3).[6]

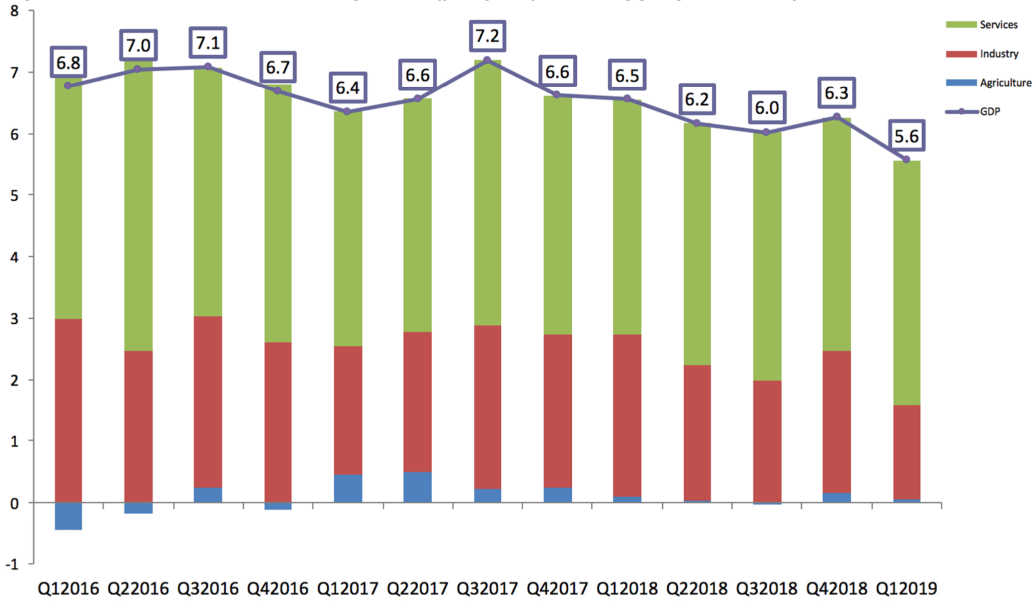
  - **Services sector led supply-side growth performance.** Services sector posted the highest contribution to growth, with 3.99 percentage points from positive quantity and real price growth (see Table 3). The sector maintained its major share of 57.7 percent in GDP. Also, growth accelerated to 7.0 percent, relative to the previous quarter's 6.8 percent and previous year's 6.7 percent growth. Transportation, Storage and Communication (8.1 percent from 6.6 percent, y-o-y), Trade and Repair (7.4 percent from 6.1 percent, y-o-y), and Financial Intermediation (9.8 percent from 7.8 percent, y-o-y) experienced faster growth in the sector. On the other hand, Real Estate, Renting and Business Activities (4.1 percent from 4.6 percent, y-o-y), and Public Administration and Defense (9.7 percent from 13.2 percent, y-o-y) experienced slower growth in the sector.

  - **Industry sector growth slowed in Q1 2019.** The industry sector registered a growth of 4.4 percent, significantly slower than the 6.6 percent and 7.7 percent the previous quarter and year, respectively. The sector contributed 1.51 percentage points to GDP growth (see Table 3) while maintaining a 34.1 percent share in GDP. The industry sector's slowdown was due to slower growths in all sub-components of the sector: Mining and Quarrying (5.3 percent from 7.4 percent, y-o-y), Manufacturing (4.6 percent from 7.3 percent, y-o-y), Construction (3.9 percent from 10.2 percent, y-o-y), and Electricity, Gas and Water Supply (3.1 percent from 6.4 percent, y-o-y). The decline could be partly attributed to the existing US-China trade tensions, which caused global uncertainties and oil price increases.

[6] See the footnote to Table 3 for the source of the GDP growth contributions.

- **Agriculture sector continued to be heavily vulnerable to unfavorable weather conditions.** The agriculture sector posted a very slow growth of 0.8 percent, slower than the 1.8 percent and 1.1 percent the previous quarter and year, respectively. Agriculture and Forestry (0.7 percent from 2.0 percent, y-o-y) posted a slower growth while Fishing (1.5 percent from -3.6 percent, y-o-y) posted a faster growth. The sector was able to contribute only 0.07 percentage points (see Table 3) to GDP growth. The quarter reflected loss and damages from the current El Niño episode. The carryover is expected to last until August.

Figure 1. Contributions to GDP growth (y-o-y, %) from Aggregate Supply



Source: Author's calculations based on data in Table 3 below.

Challenges facing the economy

- **Peso-dollar exchange rate appreciates[7].** The peso strengthened by 1.71 percent to average ₱52.37/US$1, on a quarter-on-quarter basis, from the previous average of ₱53.26/US$1. The appreciation of the peso was mainly caused by the country's easing inflation and the recent dovish stance of the US Federal Reserve. Meanwhile, on a year-on-year basis, the peso depreciated by 1.78 percent from the previous average of ₱51.43/US$1 in Q1 2018. Nevertheless, the sustained inflows of foreign exchange from remittances, foreign direct investments, BPO receipts, ample level of the country's GIR, and the country's robust economic growth are foreseen to provide support to the peso.

- **Unfavorable economic factors may serve as adversities to the Philippine economy.** Factors such as (a) prolonged El Niño, (b) constraints in implementation of the national budget 2019, (c) delay in infrastructure projects given the 45-day ban on government expenditures before the May 2019 midterm elections, (d) security risks, (e) higher-than-expected increases in global oil and food prices, (e) persistent trade tensions, and (f) spillover effects emerging from geopolitical tensions serve as hindrances to the Philippine economy.

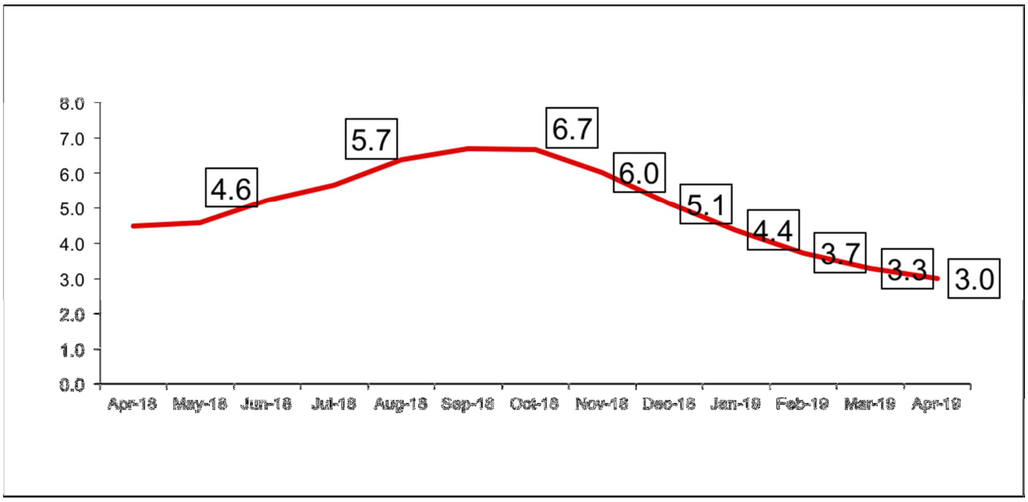
Other economic news

- **Stock market increases in PSEi[8].** At the close of the first quarter, PSEi reported a quarter-on-quarter surge of 9.0 percent with an average index points of 7,896.44. The index peaked on February 1 at 8,144.16 index points, as a result of dovish policy stance of the US Federal Reserve and optimism over easing trade tensions between US and China. The increases in PSEi were due to significant improvement in domestic inflation outlook, expectations of the positive impact on domestic inflation of the rice tariffication law, the enactment of the amended BSP carter, and the Financial Times Stock Exchange index rebalancing tempered the decline in PSEi. However, the delay in ratification of the 2019 national budget, concerns over global economic slowdown, uncertainty over the outcome of the US-China trade negotiations, and fears of a no-deal Brexit probably contributed to the decline in PSEi during the first quarter.

- **Inflation continues to slow down[9].** First quarter headline inflation eased to of 3.8 percent, which is within the National Government's inflation target of 3.0 percent ± 1.0 percentage point. This is notably slower than the 4.9 percent inflation in the previous quarter due to significant deceleration in food inflation during the first quarter. Forecasts of 2019 and 2020 inflation are expected to fall within the target range with the help of the implementation of the rice tariffication law, which is expected to improve domestic rice supply and stabilize prices. However, key risks to inflation include adverse weather conditions such as El Niño, volatile global oil prices, foreign exchange market, possible policy rate cut by the BSP, higher domestic demand due to midterm elections and school enrollment, and higher electricity rates.

Figure 2. Consumer price index (y-o-y, %)

[7] http://www.bsp.gov.ph/downloads/Publications/2019/IR_1qtr2019.pdf
[8] http://www.bsp.gov.ph/downloads/Publications/2019/IR1qtr_2019.pdf
[9] http://www.bsp.gov.ph/downloads/Publications/2019/IR1qtr_2019.pdf



Source: Graph prepared by author based on Philippine Statistics Authority data.

- **Consumer outlook recovered for the quarter[10].** Overall confidence index (CI) significantly improved to -0.5 percent, recovering from -22.5 percent the previous quarter, which was the all-time largest q-o-q increase since the start of the nationwide survey in Q1 2007. Despite the negative CI, the surge indicated that the number of households with optimistic views remarkably increased. According to the nationwide survey, the relatively more optimistic sentiment was due to (a) additional/high income, (b) improvement in peace and order, (c) availability of more jobs, and (d) good governance. The upbeat is expected to carryover in Q2 2019.

- **Business outlook improved for the quarter[11].** Overall confidence index (CI) increased to 35.2 percent from 27.2 percent the previous quarter, after declining for four consecutive quarters. The more optimistic sentiment was due to (a) more business activities during the start of the campaign period for the upcoming midterm elections, (b) increased orders and consumer purchases with the easing of inflation, (c) higher government infrastructure spending with the *Build, Build, Build* initiative of the current administration, (d) introduction of new and improved business strategies and processes, and (e) expansion of businesses and new product lines. The upbeat outlook is expected to continue in the forthcoming quarter.

- **Amid lower-than-expected GDP growth, Philippines remains among one of the region's fastest-growing economies[12].** For Q1 2019, the Philippines registered a growth of 5.6 percent, which was the slowest growth registered in 16 quarters since the 5.1 percent growth in Q1 2015. This was heavily attributed to the delay in national budget for 2019. While the recorded growth for Q1 2019 fell short in achieving the government's target of 6.0 percent to 7.0 percent growth, authorities expect economic growth to finish stronger for the remaining 2019 with *Build, Build, Build,* improved outlook in domestic consumption amid cooling

[10] http://www.bsp.gov.ph/downloads/Publications/2019/CES_1qtr2019.pdf
[11] http://www.bsp.gov.ph/downloads/Publications/2019/BES_1qtr2019.pdf
[12] http://www.neda.gov.ph/economic-teams-joint-statement-on-q1-2019-gdp-growth/

inflation, and initiatives to minimize the effects of possible adverse weather conditions among others. A *catch-up plan* on government investments is expected to take place in order to offset the low spending in the first quarter.

Table 1. Philippine Economic Indicators

Monthly Leading Indicators	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19
Industrial Production (y-o-y, %)	10.1	10.3	3.5	1.6	3.2	2.3	-8.2	-2.5	-8.1	-9.2	...
Consumer Price Index (y-o-y, %)	5.2	5.7	6.4	6.7	6.7	6.0	5.1	4.4	3.7	3.3	3.0
Exports (y-o-y, %)	3.7	2.3	4.0	1.1	6.7	1.0	-12.2	-6.7	-0.1	-2.5	...
Imports (y-o-y, %)	29.9	39.8	12.6	30.2	26.2	9.6	-4.9	3.6	2.6	7.8	...
Trade Balance, US$ million	-3,552.96	-4,016.22	-3,598.56	-4,023.64	-4,415.45	-4,074.18	-4,170.24	-3,920.10	-2,743.84	-3,137.51	...
Total Reserves (less gold), US$ billion	69.61	68.93	70.31	67.36	66.86	67.91	71.04	74.08	74.42	75.40	75.76
Policy Rate	3.5	3.5	4	4.5	4.5	4.75	4.75	4.75	4.75	4.75	4.75
Fiscal Balance (million pesos)	-54,288.00	-86,383.00	-2,587.00	-96,247.00	-59,865.00	-39,118.00	-81,042.00	-44,537.00	76,373.00	58,409.00	...
Quarterly/Annual Economic Indicators	**2015**	**2016**	**1Q2017**	**2Q2017**	**3Q2017**	**4Q2017**	**1Q2018**	**2Q2018**	**3Q2018**	**4Q2018**	**1Q2019**
Real GDP (y-o-y, %)	6.1	6.9	6.4	6.6	7.2	6.6	6.5	6.2	6.0	6.3	5.6
- Private Consumption	6.3	7.0	5.9	6.0	5.4	6.2	5.6	6.0	5.3	5.3	6.3
- Government Consumption	7.6	8.4	-0.6	6.8	7.6	11.4	13.6	11.9	14.3	12.6	7.4
- Gross Capital Fixed Formation	18.4	23.7	12.2	7.1	9.0	9.1	10.3	20.0	19.6	4.9	6.8
Current Account (% of GDP)	2.9	-0.4	-1.2	-0.1	0.7	-3.8	-0.4	-4.2	-2.1	-2.6	...
Financial Account (US$ million)	2,523.00	175.00	328.00	-945.00	442.00	-2,033.00	-816.00	-1,627.00	-1,621.00	-3,768.00	...
- Net Direct Investments, US$ million	-122.00	-5,883.00	-1,480.00	-1,868.00	-2,117.00	-2,646.00	-1,025.00	-2,672.00	-1,360.00	-797.00	...
- Net Portfolio Investments, US$ million	4,757.00	1,480.00	3,258.00	-129.00	875.00	-114.00	1,612.00	1,021.00	-500.00	-1,275.00	...
Overall BOP position (US$, million)	2,616.00	-1,038.00	-994.00	289.00	-662.00	505.00	-1,227.00	-2,030.00	-1,879.00	2,830.00	...
Unemployment rate	6	5.1	6.6	5.6	5.7	5	5.3	5.4	5.1	5.1	5.2
Others	**May-18**	**Jun-18**	**Jul-18**	**Aug-18**	**Sep-18**	**Oct-18**	**Nov-18**	**Dec-18**	**Jan-19**	**Feb-19**	**Mar-19**
Overseas Filipinos' Remittances (US$, million)	2,469.00	2,357.00	2,401.00	2,476.00	2,237.00	2,474.00	2,326.00	2,849.00	2,484.00	2,301.00	2,514.00
... = not available											
Source: Bangko Sentral ng Pilipinas, Philippine Statistics Authority, Asian Development Bank.											

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Table 2. Level of Philippine GDP, 2018Q1 – 2019Q1

	Nominal GDP (million current pesos)		Real GDP (million constant 2000 pesos)	
	2018Q1	**2019Q1**	**2018Q1**	**2019Q1**
Agriculture and Forestry	347,878	331,323	157,622	158,663
Fishing	48,826	52,815	26,578	26,985
Mining and Quarrying	36,731	37,748	21,381	22,504
Manufacturing	785,486	827,773	530,522	554,839
Construction	271,370	295,488	120,429	125,177
Electricity Gas and Water Supply	132,545	143,276	65,103	67,147
Transport Communication and Storage	247,357	269,475	164,782	178,178
Trade and Repair of Motor Vehicles Motorcycles Personal	658,669	721,304	331,007	355,429
Financial Intermediation	347,444	396,167	165,628	181,924
Real Estate Renting & Bus. Actvt	505,937	539,792	234,375	243,970
Public Administration & Defense: Compulsory Social Security	140,955	162,082	83,825	91,987
Other Services	392,155	429,673	236,758	250,203
Sum = GDP	**3,915,354**	**4,206,915**	**2,138,010**	**2,257,007**

Source: Philippine Statistics Authority

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Table 3. Industry Contributions to Philippine GDP Growth, 2018Q1 – 2019Q1

	TRAD	GEAD		GEAD
	GDP Growth			GDP Growth
	PGE*	PGE*	PCE*	PGE* + PCE*
	(percent)	(percent)	(percent)	(percent)
		(1)	(2)	(1)+(2)
GDP Growth	**5.57**	**5.57**	**0.00**	**5.57**
Industry Growth Contribution				
Agriculture	**0.07**	**0.07**	**2.01**	**2.08**
Agriculture and Forestry	0.05	0.05	1.96	2.01
Fishing	0.02	0.02	0.05	0.07
Industry	**1.51**	**1.51**	**-2.94**	**-1.43**
Mining and Quarrying	0.05	0.05	-0.06	-0.01
Manufacturing	1.14	1.14	-4.77	-3.64
Construction	0.22	0.22	1.46	1.68
Electricity Gas and Water Supply	0.10	0.10	0.43	0.53
Services	**3.99**	**3.99**	**0.93**	**4.92**
Transport Communication and Storage	0.63	0.63	-1.66	-1.04
Trade and Repair of Motor Vehicles Motorcycles Personal	1.14	1.14	1.13	2.28
Financial Intermediation	0.76	0.76	0.86	1.62
Real Estate Renting & Bus. Actvt	0.45	0.45	2.23	2.68
Public Administration & Defense: Compulsory Social Security	0.38	0.38	-0.50	-0.12
Other Services	0.63	0.63	-1.13	-0.50

Source: DLSU-AKI Philippine Economic Monitor calculations by applying the data in Table 2 to a "generalized exactly addtive decomposition" (GEAD) of GDP growth into pure growth effect (PGE*) and price change effect (PCE*) as an alternative to the "traditional" (TRAD) GDP growth decomposition that recognizes PGE* but not PCE*. PGE* is the result of real GDP or "quantity" growth holding relative price (real price) constant and PCE* is the result of "real price" growth holding quantity constant. PCE* measures the change in value of an industry's output when outputs of all industries are converted to the same unit of measure, in terms of the economy's "GDP basket." The GEAD formulas for PGE* and PCE* and the TRAD formula (which equals PGE*) are given, respectively, by equations (39), (40), and (46) in Dumagan, Jesus C. (2018), "Modifying the 'Generalized Exactly Additive Decomposition' of Growth of GDP and Aggregate Labor Productivity in Practice for Consistency with Theory," Working Paper Series No. 2018-07-053, Angelo King Institute for Economic and Business Studies, De La Salle University, Manila. The paper by Dumagan, Jesus C. (2013), "A Generalized Exactly Additive Decomposition of Aggregate Labor Productivity Growth," Review of Income and Wealth, 59 (Issue 1): 157-168 decomposed growth of aggregate labor productivity (ALP), which is the ratio of GDP to total labor employment. Thus, by removing the labor variable, the decomposition of ALP growth becomes a decomposition of GDP growth into the modified PGE* and PCE* formulas which were implemented in this Table 3.