

POLICY BRIEF

MONITORING THE PHILIPPINE ECONOMY

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AKI

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MONITORING THE PHILIPPINE ECONOMY YEAR-END REPORT FOR 2015

The Philippine economy expanded by 5.9% for the year 2015, fortifying its status as one of the best economic performers in the region despite the difficult external environment and onset of El Niño.

Economic performance: Consumption, capital formation, and fiscal spending exceeded growth targets despite weak net exports. Household consumption led demand while services led supply.

Consistent growth bolsters Philippines to be among the fastest growing in Asia in 2015. Next to India and China, the growth acceleration has been respectable, giving the country a six-year average real GDP growth of 6.2%—the highest in 40 years. The growth for 2015 was driven by stronger domestic demand wherein

government spending and investments paved avenues for growth through public construction to increase employment, incomes, and well-being. With record-low inflation, household consumption grew by 6.2%. Exports had been lackluster, but service exports remain strong on the demand side. On the supply side, growth was driven by the services sector. Despite under performance for the 7.0% to 8.0% target, 2015 growth of 5.9% was in line with market expectations and sets the nation for brighter prospects for 2016.

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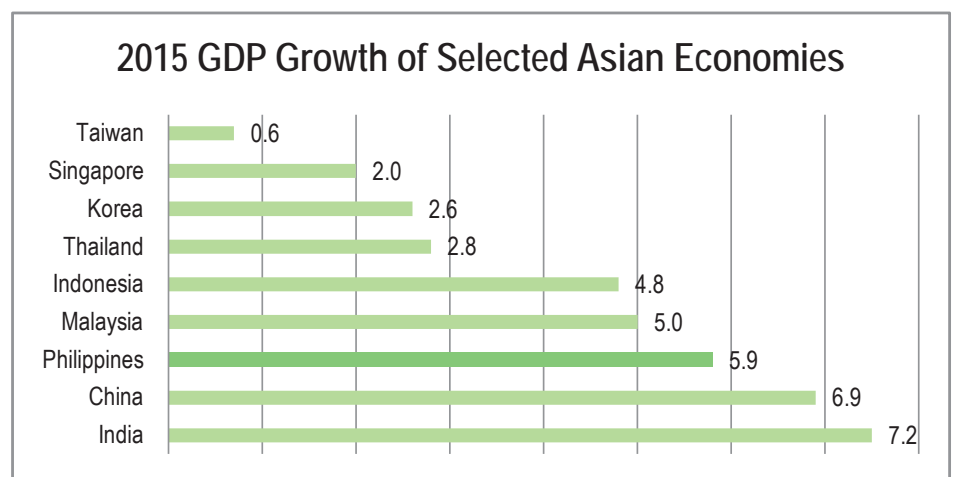


Figure 1. Growth of selected Asian economies.
Source: Bangko Sentral ng Pilipinas (2016a)

¹ Report is based on latest available data as of July 8, 2016. For comments and questions, please email mitzie.conchada@dlsu.edu.ph

MAJOR COMPONENTS OF AGGREGATE DEMAND

- **Household spending rises.** Compared to 5.4% in 2014, household consumption increased to 6.2% in 2015 and emerged as the leading growth driver. Top contributors to growth of household consumption were transport (10.9%), restaurants and hotels (10%), recreation and culture (8.9%), and health (8.3%).
- **Private investments improve on durable equipment purchases.** The year 2015 proved to be a good year for private investments as the sector's growth improved to 14% compared to 5% the previous year. The subsectors that exhibited the highest growth were durable equipment (20.3%) and intellectual property rights (14%). It was during the fourth quarter when investments for durable equipment (40.2%) experienced a boost.
- **Fiscal spending increases, yield greater deficit.** Expenditures reached Php179.7 billion in the fourth quarter, a 17.4% increase from 2014. At year-end, the total 9.4% increase of public expenditure contributed to a higher budget deficit of Php121.7 billion compared to Php73.1 billion in 2014, according to Bangko Sentral ng Pilipinas (2016b).
- **Net exports fall on weak external demand and worsening El Niño**

conditions. Exports have crawled to 5.5% in 2015 compared to 11.3% in 2014 with imports rising to 11.9% from 8.7%. Exports of goods and services grew only by 2.4% and 18.7%, respectively. In export of goods, cathodes (43.5%) outpaced electric components (18.6%), medical / industrial instrumentation grew 89.2% and office equipment rose 41.5%. On the other hand, miscellaneous services increased 20.7% and travel rose 15%, contributing the most to export of services. Imports of goods and services increased by 11.9% and 11.8%, respectively. In import of goods, medical and pharmaceutical products (40%) outpaced machinery and mechanical appliances (35.8%) and electronics (34.7%).

MAJOR COMPONENTS OF AGGREGATE SUPPLY

In this report, we present results from an alternative to the “traditional” (TRAD) method of decomposing GDP growth 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 also 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,” that is, 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 2).²

- **Service sector leads supply-side growth.** Services remained the driver of growth and expanded from 6.2% to 6.8% by the end of 2015. The sector contributed 5.07 percentage points to GDP growth (Table 2) from 3.91 percentage

² The results in Table 3 are AKI-DLSU Philippine Economic Monitor calculations by applying the data in Table 2 to a “generalized” (GEN) exactly additive decomposition of GDP growth into pure growth effect (PGE) and price change effect (PCE) as an alternative to the “traditional” (TRAD) GDP growth decomposition. Analytically, PGE is the result of real GDP or “quantity” growth holding real price constant and PCE is the result of relative price or “real price” growth holding quantity constant. The GEN formulas for PGE and PCE and the TRAD formula are given, respectively, by equations (12), (13), and (17) in Dumagan and Balk (2016). This alternative framework follows from the decomposition of “aggregate labor productivity” (ALP) growth in Dumagan (2013), where ALP is the ratio of GDP to total labor employment. Thus, by removing the labor variable, the decomposition of ALP growth in the latter paper yields the decomposition of GDP growth into PGE and PCE in the former paper which is implemented in Table 3.

points of quantity growth (PGE) and 1.16 percentage points of relative price change effects (PCE). The leading subsectors include trade and repair of motor vehicles (1.44%), real estate (1.35%), and other services (0.90%). The lowest contributor was public administration and defense at 0.12%.

- Industry sector slows down due to sluggish global demand.** Industry growth slowed from 7.8% to 6.0% and contributed 1.28 percentage points to total GDP growth (Table 2). Construction, which grew 9.4%, emerged as the top contributor (0.71 percentage points) to GDP growth in the industry sector. This was attributed to higher spending on public construction. Manufacturing, which usually topped the industry sector, contributed only 0.65 percentage points due to lower global demand.
- El Niño phenomenon continues to affect the agriculture sector.** The performance of the agricultural sector was significantly affected in 2015, registering a meager 0.13% growth. The agriculture and forestry subsector slowed to 0.6% growth that together with falling real prices resulted in a negative 0.45 percentage points contribution to growth, with rubber and sugarcane suffering the most. On the other hand, fishing subsector showed no contribution to GDP growth.

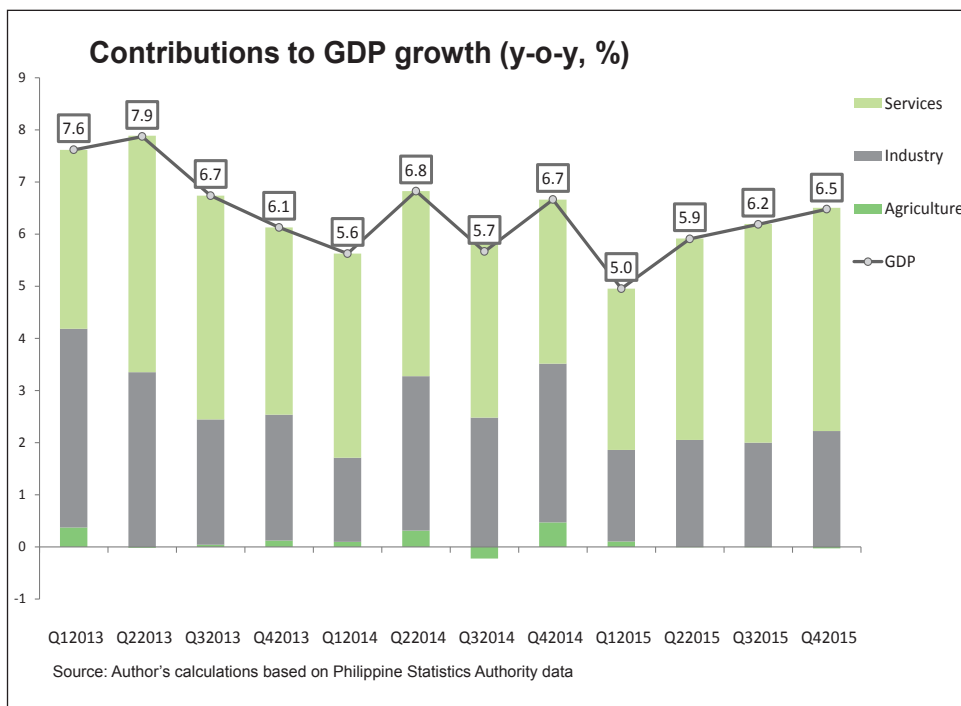


Figure 2. Contributions to GDP growth.
 Source: Philippine Statistics Authority, 2016.

POLICY RESPONSE

- Banko Sentral ng Pilipinas (BSP) maintains monetary policy and prepares for implementation of Interest Rate Corridor System.** The BSP Monetary Board decided to continue the key policy interest rate at 4% and 6% for overnight borrowing and overnight lending, respectively. Reserve requirement ratios remained the same. Policy decisions were based on the dynamics and risks in the inflation environment over the policy horizon, making clear that domestic price movements in 2015 were driven largely by supply-side factors. The BSP would continue to monitor emerging price and output conditions to ensure price and financial stability conducive to sustainable economic growth. The adoption of an interest rate corridor (IRC) system in 2016 will introduce key changes in the framework for monetary operations that will facilitate the transmission of policy rate adjustments to key macroeconomic variables. The IRC is a system for guiding short-term market rates towards the BSP policy interest rate which is the overnight reverse repurchase rate and consists of the following instruments: overnight lending facility, overnight deposit facility, overnight reverse repurchase rate facility, and term deposit action facility (BSP, 2016c).

OTHER ECONOMIC NEWS

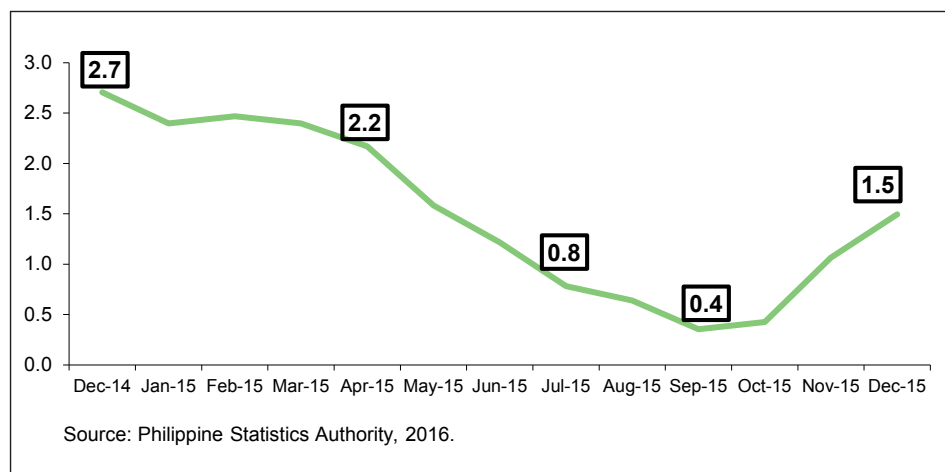


Figure 3. Consumer price index (y-o-y, %).

- Inflation gains stability on lower oil and food prices.** Based on the BSP (2016d) report, inflation settled below the target range by the end of 2015. Full-year average inflation was recorded at 1.4%, which is below the target of 3.0% +/- 1.0 percentage points. This was due to the significant drop of global oil prices, lower food prices due to ample supply, and a decrease in domestic utility rates. The inflation for 2015 was significantly lower than the previous year's 4.2%. Analysts are expecting inflation rate to stay within the range set by BSP this 2016, though higher on adverse climate conditions, election-related expenditures, and possible adjustments in utility rates (BSP, 2016d).

- Labor conditions improve in 2015.** The BSP (2016b) reported that the number of unemployed people declined to 2.6 million by the end of 2015. This brought the unemployment rate to 6.3%, lower than the previous year's

6.8%. Unemployment was highest among males (63.7%) ages 15 to 24 years old (49%), and high school graduates (29%). The expansion in the services sector, particularly in the wholesale and retail trade/repair of motor vehicles and motorcycles, transportation and storage, and public administration contributed to more employment opportunities.

- Resiliency and innovation noted as crucial to growth.** The National Economic and Development Authority stated that each sector has to be diversified in terms of products and markets to reduce vulnerability or to achieve resiliency from shocks. The agriculture sector is vulnerable to weather shocks; the industry sector exposed to external demand shifts that could be adverse; and the services sector requires a policy environment that enables easier entry for firms and encourages innovation. To achieve higher economic growth, the country requires wider infrastructure development, more

efficient transport and logistics system, and highly competent yet adaptable human capital.

- Daang Matuwid (Official Gazette, 2016) paves path for prosperity.**

- Economy.** The Philippines climbed from 85th to 47th out of 140 countries in terms of competitiveness, and 109th to 70th out of 179 countries for economic freedom. Unemployment and debt-to-GDP decreased from 7.3% to 5.8% and 54.8% to 44.8%, respectively. Net foreign direct investments nearly doubled from US\$ 11.77 billion to US\$ 20.42 billion. The average inflation rate decreased from 4.1% to 1.4%. Philippine Stock Exchange index climbs from 3,372.71 to 8,127.48.

- Social Welfare.** The basic education budget tripled from P161.4 to P410.4 billion. Conditional Cash Transfer beneficiaries and classrooms increased 5-fold from 786,523 to 4,377,762 households and from 17,305 to an additional 89,720 classrooms with 95,429 more programmed for construction. Hunger in households and number of out-of-school children halved from 23.4% to 11.7% and PhP11.7 to PhP5.2 million, respectively. PhilHealth coverage doubled from PhP47.07 to PhP93.45 million; however, poverty incidence rate only slightly budged from 28.6% to 26.3%. Social services budget more than doubled from PhP415.8 billion to PhP1.1059 trillion.

o *Good Governance; Infrastructure.* In aspan of three years, from 2013 to 2016, Bottom-up Budgeting projects reached a total of 54,361. Cases filed against tax evaders, smugglers, and erring government officials reached 784. Infrastructure budget increased from PhP165 to PhP759.58 billion. Laguindingan Airport was completed along with the starting development of nine new airports and rehabilitation of 63 airports and 18 tourism ports. A total of 12 public-private partnership projects were awarded from 2010 to 2015 compared to six projects from 1992 to 2009. The North-South Railway project was developed to connect Malolos, Tutuban, and Legazpi. Moreover, 18,547 kilometers of the National Road Network and 107,579 lineal meters of national bridges were constructed, upgraded, improved, and rehabilitated.

o *Peace and Security; Tourism.* The Armed Forces of the Philippines modernization budget doubled from PhP26.22 to PhP59.24 billion with two new FA-50 fighter jets turned over to the Philippines from the Republic of Korea, and 68 completed projects compared to a collective 45 projects from the previous two administrations. ARMM budget allocation tripled from PhP10.4 to PhP29.41 billion. Direct employment from tourism increased from 4.1 to 4.99 million. Tourism road infrastructure investments rose from PhP13.79 during 2006-2010 to PhP60.48 billion during

2011-2015. Domestic tourist arrivals increased from 29.1 to 54.6 million, resulting in higher revenue from PhP713.8 billion to PhP1.5 trillion, respectively.

On the other hand, international tourist arrivals increased from 3.02 to 5.36 million, resulting in higher revenue from PhP112.55 to PhP227.62 billion.

Table 1. 2015 Philippines Economic Data

Philippines Economic Data	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15
Monthly Leading Indicators												
Industrial Production (y-o-y, %)	2.7	-2.1	14.9	1.8	-1.1	-1.9	-0.2	2.2	3.1	1.6	4.2	4.7
Consumer Price Index (y-o-y, %)	2.4	2.5	2.4	2.2	1.6	1.2	0.8	0.6	0.4	0.4	1.1	1.5
Exports (y-o-y, %)	0.0	-3.0	2.1	-4.1	-17.4	-1.8	-1.8	-6.3	-15.5	-10.8	-1.1	-3.0
Imports (y-o-y, %)	-13.1	10.2	-6.5	-12.2	-13.4	22.6	23.0	5.7	8.2	16.9	11.4	-16.7
Trade Balance, US\$ million	-862	-838	246	-337	507	-554	-1,519	-1,048	-1,316	-1,944	-977	604
Total Reserves (less gold), US\$ billion	73	73	73	73	73	73	73	73	74	74	73	74
Policy Rate	4	4	4	4	4	4	4	4	4	4	4	4
Fiscal Balance (million pesos)	-6,472	-9,673	-17,372	52,599	67,337	-72,673	-32,198	15,040	-22,140	-27,022	6,029	30,400
Quarterly/Annual Economic Indicators												
Real GDP (y-o-y, %)	3.6	6.8	6.9	6.1	5.6	6.8	5.7	6.7	5.0	5.9	6.2	6.5
- Private Consumption	5.7	6.6	5.6	5.4	6.3	5.7	4.9	5.3	6.1	6.4	6.1	6.5
- Government Consumption	2.1	12.2	8.1	1.7	3.4	1.5	-1.1	11.0	0.2	2.4	15.7	15.8
- Gross Capital Fixed Formation	2.0	-3.2	27.3	5.4	8.6	7.7	-0.2	5.7	12.5	21.4	14.5	13.3
Current Account (% of GDP)	2.3	2.8	4.2	4.4	2.3	4.4	4.8	5.9	3.2	3.1	0.1	4.8
Financial Account (US\$ million)	-5,610	-6,748	2,230	10,084	4,098	696	810	4,480	152	1,258	-291	1,404
- Net Direct Investments, US\$ million	-1,277	958	-90	789	-487	-543	842	977	358	-476	-11	7
- Net Portfolio Investments, US\$ million	-4,330	-3,205	-1,001	2,460	2,811	-649	-903	1,202	-459	3,375	2,202	-361
Overall BOP position (US\$, million)	11,400	9,236	5,085	-2,858	-4,475	330	712	574	877	807	124	809
Unemployment rate	7.4	7.0	7.1	6.8	7.5	7.0	6.7	6.0	6.4	6.5	5.6	5.8
Others												
Overseas Filipinos' Remittances (US\$, million)	1,956	1,935	2,390	2,126	2,147	2,227	2,253	1,994	2,234	2,164	1,871	2,470
... = not available												

Source: Bangko Sentral ng Pilipinas, 2016a; Philippine Statistics Authority, 2016; Asian Development Bank, 2016.

Table 2. Level of Philippine GDP, 2014-2015

	Nominal GDP		Real GDP	
	(million current pesos)		(million constant 2000 pesos)	
	2014	2015	2014	2015
Agriculture and Forestry	1,235,785	1,172,285	587,985	591,275
Fishing	195,504	193,778	130,794	128,473
Mining and Quarrying	130,192	108,109	81,695	80,500
Manufacturing	2,603,644	2,669,222	1,666,514	1,760,989
Construction	802,880	886,506	409,277	447,759
Electricity Gas and Water Supply	422,055	431,033	233,702	246,548
Transport Communication and Storage	784,881	856,051	538,044	581,289
Trade and Repair of Motor Vehicles Motorcycles Personal	2,244,736	2,412,096	1,185,810	1,270,526
Financial Intermediation	988,894	1,063,668	515,484	546,714
Real Estate Renting & Bus. Actvt	1,553,493	1,713,445	803,305	861,492
Public Administration & Defense: Compulsory Social Security	500,368	512,360	293,661	297,082
Other Services	1,182,840	1,288,713	724,144	781,122
Sum = GDP	12,645,271	13,307,265	7,170,414	7,593,769

Source: Philippine Statistics Authority, 2016

Table 3. Industry Contributions to Philippine GDP Growth, 2015

	TRAD	PGE	PCE	GEN
	GDP Growth (percent)	(percent)	(percent)	GDP Growth (percent)
		(1)	(2)	(1)+(2)
GDP Growth	5.90	5.87	0.03	5.90
Industry Growth Contribution				
Agriculture	0.01	0.03	-0.47	-0.45
Agriculture and Forestry	0.05	0.05	-0.50	-0.44
Fishing	-0.03	-0.03	0.02	0.00
Industry	2.02	1.93	-0.65	1.28
Mining and Quarrying	-0.02	-0.02	-0.15	-0.17
Manufacturing	1.32	1.17	-0.51	0.65
Construction	0.54	0.60	0.11	0.71
Electricity Gas and Water Supply	0.18	0.18	-0.09	0.09
Services	3.87	3.91	1.16	5.07
Transport Communication and Storage	0.60	0.50	0.11	0.61
Trade & Repair of Motor Veh., Cycles, Personal, & House. Goods	1.18	1.27	0.18	1.44
Financial Intermediation	0.44	0.47	0.17	0.64
Real Estate Renting & Bus. Actvt	0.81	0.89	0.46	1.35
Public Administration & Defense: Compulsory Social Security	0.05	0.05	0.07	0.12
Other Services	0.79	0.74	0.17	0.90

Source: Dumagan and Balk, 2016 and Dumagan, 2013.

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