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Angelo King Institute
for Economic and Business Studies

Monitoring the Philippine Economy First Quarter Report for 2017

Project of Angelo King Institute

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Economic performance: First quarter growth of 6.4 percent slower than 6.9 percent the previous year due to lower household expenditures and curtailed government consumption. Nevertheless, imports and exports continue to prosper as reported by the National Economic and Development Authority (NEDA).²

- **Major components of aggregate demand**
 - **Private consumption loses momentum.** Household consumption in the first quarter significantly decreased to 5.7 percent year-on-year (y-o-y) from 7.1 percent the previous year. Private consumption hit its lowest since the fourth quarter of 2014. According to the Philippine Statistics Authority (PSA)³, the contraction was caused by the substantial decrease in contributors of private consumption. Top contributors in the decline are recreation and culture (-2.0 percent y-o-y) and alcoholic beverages and tobacco (-1.4 percent y-o-y).
 - **Domestic investment decelerates.** From a rapid growth of 31.5 percent the previous year, the first quarter recorded a much slower growth rate of 7.9 percent. According to PSA⁴, investments in Durable Equipment increased only 12.5 percent, which was almost one-third the recorded increase of 37.4 percent during the previous year. Furthermore, the reduction in growth in Intellectual Property Product by almost one-half (50.4 percent to 27.2 percent y-o-y) contributed to the decrease in growth of domestic investment.
 - **Lower maintenance spending results in fiscal contraction.** Growth in government spending in the first quarter slipped from 11.8 percent the previous year to 0.2 percent. As reported by PSA⁵, slower growth was caused by the decline in maintenance expenditures of different government agencies. Postponement in the implementation and procurement of government-initiated programs contributed to the fiscal contraction in the first quarter. Moreover, government consumption was more moderate compared to the higher expenses recorded during the national election season in 2016.

¹ Report is based on latest available data as of June 26, 2017. For comments and questions, please email mitzie.conchada@dlsu.edu.ph

² <http://www.neda.gov.ph/2017/07/11/ph-trade-competitiveness-needed-to-sustain-growth-in-2017/>

³ <http://psa.gov.ph/nap-press-release/sector/Household%20Final%20Consumption>

⁴ <http://psa.gov.ph/nap-press-release/sector/Capital%20Formation>

⁵ <http://psa.gov.ph/nap-press-release/sector/Government%20Final%20Consumption>

- Both exports and imports of goods maintain robust growth.** At the end of March, exports and imports were recorded at 5.6 billion USD (21.1 percent growth y-o-y) and 7.9 billion USD (24.0 percent growth y-o-y), respectively. This resulted in a first quarter trade balance of -2.3 billion USD, with imports exceeding exports. Growth in export of goods was recorded at 21.1 percent from -15.1 percent the previous year. This was the highest growth in exportation of goods since the third quarter of 2010. Meanwhile, growth in import of goods was recorded at 26.9 percent from 16.8 percent the previous year, mainly driven by the growth in base metals, semiconductors, and electronic data processing. NEDA⁶ reported that the country's trade growth is consistent with the global pick-up, keeping its trade competitive to sustain growth in 2017.
- 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).⁷

- Services sector continues to be the major contributor of the supply-side.** Services sector had the highest contribution to growth, with 5.17 percentage points from positive quantity and real price growth (see Table 3). The sector grew 6.8 percent, which was slightly lower compared to the previous year's 7.5 percent growth. Its share of GDP still remains at a robust rate of 56.8 percent from last year's 56.5 percent. Top contributors for service sector were as follows: trade and repair of vehicles, personal, and household goods (TR), real estate renting and business activity (RERBA), and other services (OS) with 27.3 percent, 19.6 percent, and 19.5 percent, respectively.
- Manufacturing continues to lead the industry sector.** The industry sector grew by 6.1 percent, lower than the 7.5 percent growth the previous year. However, the sector performed consistently, maintaining the 34 percent share in GDP.

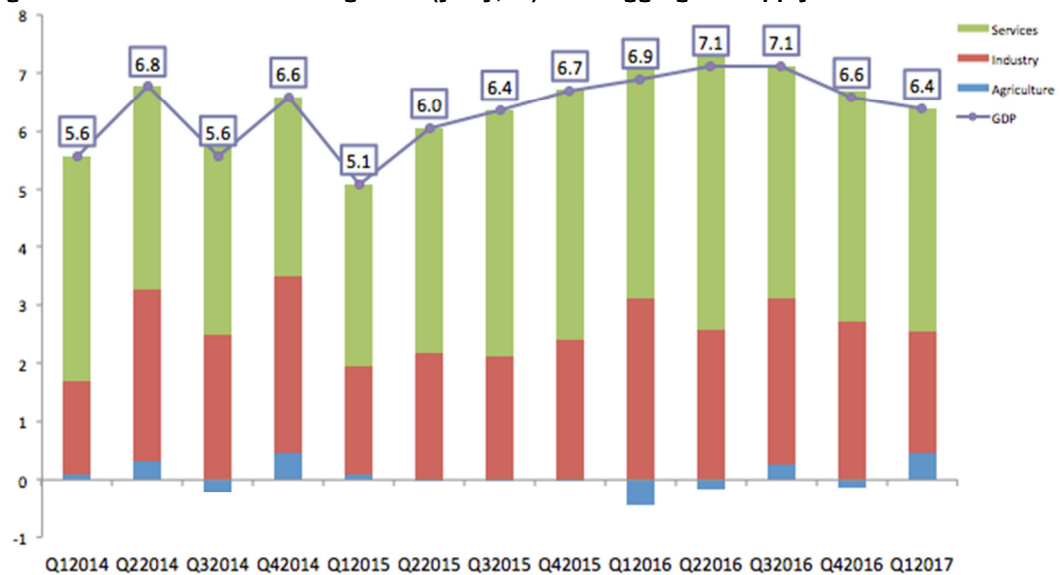
⁶ <http://www.neda.gov.ph/2017/07/11/ph-trade-competitiveness-needed-to-sustain-growth-in-2017/>

⁷ The results in Table 3 are AKI-DLSU *Philippine Economic Monitor* calculations by applying the data in Table 1 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, Jesus C. (2016), "Effects of Relative Prices on Contributions to the Level and Growth of Real GDP," Working Paper Series No. 2016-036, Angelo King Institute for Economic and Business Studies, De La Salle University, Manila. This alternative framework follows from the decomposition of "aggregate labor productivity" (ALP) growth in Dumagan, Jesus C. (2013), "A Generalized Exactly Additive Decomposition of Aggregate Labor Productivity Growth," *Review of Income and Wealth*, 59 (Issue 1): 157-168, 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 2.

Manufacturing (MAN) is the top contributor to the industry, with 71.9 percent share in the sector. Other contributors, especially mining and quarrying (MQ), made the lowest contribution as usual. In the first quarter, mining and quarrying only contributed 2.7 percent to the industry sector, lower than the previous year's 3.6 percent.

- Agriculture sector shows improvement.** With minimal natural disasters, the agriculture sector had a positive growth in the first quarter. From a negative growth of 4.3 percent the previous year, the sector improved by exhibiting positive growth of 4.9 percent (see Figure 1). Nevertheless, the share of the sector remained low at 9.1 percent from last year's 9.2 percent. Agriculture sector made a low contribution to growth, with 0.63 percentage points from positive quantity and real price growth (see Table 3).

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 continues to depreciate relative to the US dollar⁸.** The peso weakened by 1.8 percent to average ₱50.00/US\$1, on a quarter-on-quarter basis, from the previous average of ₱49.11/US\$1. Correspondingly, on a year-on-year basis, peso depreciated by 5.45 percent, from the previous year's ₱47.28/US\$1 average. Further weakening of peso was probably induced by aggressive remarks from several Fed officials prior to the March 15, 2017 Federal Open Market Committee (FOMC) meeting, which supported expectation of a policy rate hike in the US. Moreover, safe-haven buying on the back of continuous political commotion in Europe threatened the value of peso. Nonetheless, the volatility of the peso's

⁸ <http://www.bsp.gov.ph/downloads/Publications/FAQs/exchange.pdf>

daily closing rates, measured by the coefficient of variation, in the first quarter was recorded at 0.54 percent, which was less than the previous quarter's record at 1.43 percent.⁹

- **Near-term global economic recuperation remains vulnerable**¹⁰. The heightened uncertainty in policies, including Brexit and some developed economies' egocentric agenda, leaves the global economic recovery delicate. A potential shift towards protectionist policies may disrupt trade and financial flows, and migration. Consequently, this may affect Philippine remittances, offshoring/outsourcing industry, and trade.
- **Negative spillovers may arise from adverse developments in China**¹¹. Prolonged slowdown of the Chinese economy remains to be a challenge not only to the Philippine economy but also to the global economy. Despite the efforts to rebalance growth sources in China, its financial systems are still at risk given the rapid credit expansion. Increasing bilateral relations between the Philippines and China in the recent years places the Philippines in a vulnerable position as adverse developments in China may bring negative spillovers.
- **Weather disturbances remain a threat to the Philippine economy**. Unexpected inclement weather conditions, natural disasters, and the like may interrupt agricultural activities in the country. These harsh conditions may affect the vulnerable agricultural sector and aggravate poverty and further threaten food security, especially of the poor Filipinos. Infrastructural improvements are crucial for the agriculture sector's resiliency.

Other economic news

- **Bangko Sentral ng Pilipinas (BSP) continues to strive for monetary policy enhancements**¹². BSP integrated operational reforms by introducing the interest rate corridor (IRC) system last June 2016. This paved the way for market participants to adjust relatively fast to the new framework for monetary operations of the BSP. In addition, it will continue to uphold a market-determined exchange rate and adequate international reserves level as a defense against external shocks. On the other hand, the BSP maintained its key policy rates (3.0 interest rate) by the end of the first quarter on stable economic indicators.
- **Stock market reports increased PSEi**¹³. At the close of the first quarter, PSEi rose higher quarter-on-quarter and year-on-year by 6.9 percent and 0.7 percent, respectively. Expectations of continued robust growth of the Philippine economy, along with optimism over proposed fiscal policies, boosted investors' confidence.
- **Inflation level remains within target range**. Latest forecast released by BSP stated that inflation in 2017-2018 would likely fall within the range of 3.0 percent \pm 1.0 percentage point. Consumer price index in the first quarter was recorded at an average of 3.1 percent (see Figure 2). March inflation rate was recorded at the high-end level of 3.4 percent on higher oil prices and utility costs.

⁹ http://www.bsp.gov.ph/downloads/Publications/2017/LTP_1qtr2017.pdf

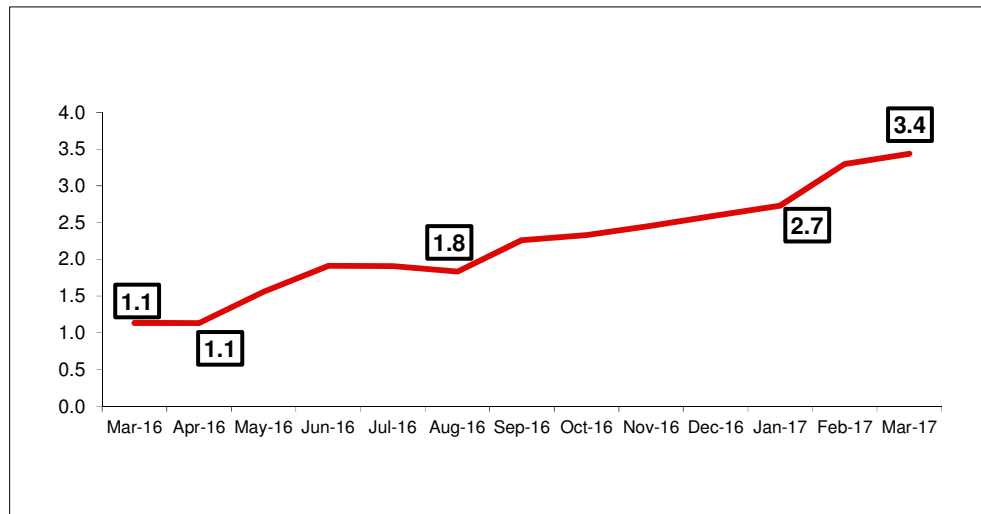
¹⁰ http://www.bsp.gov.ph/downloads/Publications/2017/LTP_1qtr2017.pdf

¹¹ http://www.bsp.gov.ph/downloads/Publications/2017/LTP_1qtr2017.pdf

¹² http://www.bsp.gov.ph/downloads/Publications/2017/LTP_1qtr2017.pdf

¹³ http://www.bsp.gov.ph/downloads/Publications/2017/LTP_1qtr2017.pdf

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



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

- **Despite weaker peso, remittances remain on track**¹⁴. In March 2017, personal remittances grew by 11.8 percent, year-on-year, with the Overseas Filipinos (OFs) remitting a record-breaking 2.9 billion USD, increasing total remittances by 8.1 percent than in the previous year. Land-based workers, registered 10.5 percent growth in transfers, drove the increase. In the first quarter, nearly 80 percent of the cash remittances came from US, UK, UAE, Canada, Saudi Arabia, Qatar, Singapore, Japan, Kuwait, and Hong Kong.
- **The Philippines is situated on a robust growth path in 2017-2018**¹⁵. Economic growth in the first quarter was in line with the World Bank's growth projection. Although government spending was relaxed and investment growth was moderated, export and private consumption remained strong. Household expenditures and job opportunities are anticipated to grow. Furthermore, with the fact that global economic activity and trade are significantly improving, steady growth is expected to surge demand for Philippine exports.

¹⁴ <http://www.bsp.gov.ph/publications/media.asp?id=4363>

¹⁵ <http://www.worldbank.org/en/news/press-release/2017/07/01/philippines-remains-on-strong-growth-path-in-2017-2018>



Table 1. Philippine Economic Indicators

Monthly Leading Indicators	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17	May-17	Jun-17
Industrial Production (y-o-y, %)	13.3	11.2	9.9	15.1	21.8	17.3	10.4	12.8	5.9	...	...
Consumer Price Index (y-o-y, %)	1.8	2.3	2.3	2.5	2.6	2.7	3.3	3.4	3.4	3.1	...
Retail Sales (y-o-y, %)	12.5	12.1	11.5	15.6	21.8	14.2	21.6	19.6	...	...	...
Exports (y-o-y, %)	-3.0	5.1	7.6	-7.5	6.3	24.0	10.0	21.1	20.0	...	...
Imports (y-o-y, %)	12.2	13.5	5.9	19.7	13.8	12.2	20.3	24.0	4.6	...	...
Trade Balance, US\$ million	-1,952	-1,890	-1,983	-2,566	-2,158	-2,469	-1,768	-2,297	-1,754	...	...
Total Reserves (less gold), US\$ billion	77.5	77.8	77.0	74.0	73.4	73.7	73.6	73.0	74.1	74.2	...
Policy Rate	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Fiscal Balance (million pesos)	32,607	-75,327	-2,345	-19,145	-118,229	2,222	-23,724	-61,471	52,797	...	...
Quarterly/Annual Economic Indicators	2013	2014	1Q2015	2Q2015	3Q2015	4Q2015	1Q2016	2Q2016	3Q2016	4Q2016	1Q2017
Real GDP (y-o-y, %)	6.9	6.1	5.1	6.0	6.4	6.7	6.9	7.1	7.1	6.6	6.4
- Private Consumption	5.6	5.4	6.0	6.4	6.2	6.6	7.1	7.5	7.2	6.2	5.7
- Government Consumption	8.1	1.7	0.0	2.2	15.5	15.5	11.8	13.5	3.1	4.5	0.2
- Gross Capital Fixed Formation	27.3	5.4	15.7	28.6	15.3	16.2	31.5	30.3	21.7	14.7	7.9
Current Account (% of GDP)	4.2	4.4	3.2	3.1	0.1	4.8	0.9	0.1	1.3	1.2	-0.4
Financial Account (US\$ million)	2,230	10,084	152	1,258	-291	1,404	995	-1,039	308	54	579
- Net Direct Investments, US\$ million	-90	789	358	-476	-11	7	-1,119	-1,030	-498	-1,829	-1,142
- Net Portfolio Investments, US\$ million	-1,001	2,460	-459	3,375	2,202	-361	1,573	787	-843	-309	3,205
Overall BOP position (US\$, million)	5,085	-2,858	877	807	124	809	-210	843	1,014	-2,068	-994
Unemployment rate	7.1	6.8	6.4	6.5	5.6	5.8	5.8	5.4	4.7	4.7	6.6
Others	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16	Jan-17	Feb-17	Mar-17	Apr-17
Overseas Filipinos' Remittances (US\$, million)	2334	2131	2319	2383	2099	2,217	2,559	2,169	2,169	2,615	2,083
... = not available											

Source: Bangko Sentral ng Pilipinas, National Statistics Office, Asian Development Bank.



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Table 2. Level of Philippine GDP, 2016Q1 – 2017Q1

	Nominal GDP		Real GDP	
	(million current pesos)		(million constant 2000 pesos)	
	2016Q1	2017Q1	2016Q1	2017Q1
Agriculture and Forestry	291,259	318,005	146,369	154,666
Fishing	42,804	46,189	27,251	27,451
Mining and Quarrying	29,760	30,129	23,544	18,843
Manufacturing	663,990	719,736	459,043	493,646
Construction	219,391	243,539	104,813	113,419
Electricity Gas and Water Supply	111,945	116,701	59,975	60,818
Transport Communication and Storage	216,812	231,149	148,380	155,643
Trade and Repair of Motor Vehicles Motorcycles Personal	544,464	600,273	290,658	311,355
Financial Intermediation	281,446	311,823	143,651	154,315
Real Estate Renting & Bus. Actvt	433,065	474,376	209,402	223,806
Public Administration & Defense: Compulsory Social Security	109,386	121,131	69,656	73,501
Other Services	329,342	362,787	206,666	222,452
Sum = GDP	3,273,665	3,575,838	1,889,409	2,009,914

Source: Philippine Statistics Authority.



Table 3. Industry Contributions to Philippine GDP Growth, 2016Q1 – 2017Q1

	TRAD	PGE	PCE	GEN
	GDP Growth			GDP Growth
	(percent)	(percent)	(percent)	(percent)
		(1)	(2)	(1)+(2)
GDP Growth	6.38	6.47	-0.09	6.38
Industry Growth Contribution				
Agriculture	0.45	0.51	0.12	0.63
Agriculture and Forestry	0.44	0.50	0.06	0.56
Fishing	0.01	0.01	0.06	0.07
Industry	2.08	1.95	0.08	2.02
Mining and Quarrying	-0.25	-0.18	0.20	0.02
Manufacturing	1.83	1.53	-0.63	0.90
Construction	0.46	0.55	0.42	0.97
Electricity Gas and Water Supply	0.04	0.05	0.08	0.13
Services	3.85	4.01	1.16	5.17
Transport Communication and Storage	0.38	0.32	0.01	0.34
Trade and Repair of Motor Vehicles Motorcycles Personal	1.10	1.18	0.12	1.30
Financial Intermediation	0.56	0.64	0.20	0.84
Real Estate Renting & Bus. Actvt	0.76	0.91	0.54	1.45
Public Administration & Defense: Compulsory Social Security	0.20	0.18	0.17	0.35
Other Services	0.84	0.77	0.12	0.88

Source: DLSU-AKI 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. The GEN formulas for PGE and PCE and the TRAD formula are given, respectively, by equations (12), (13), and (17) in Dumagan, Jesus C. (2016), "Effects of Relative Prices on Contributions to the Level and Growth of Real GDP," Working Paper Series No. 2016-036, Angelo King Institute for Economic and Business Studies, De La Salle University, Manila. 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. This alternative framework follows from the decomposition of "aggregate labor productivity" (ALP) growth in Dumagan, Jesus C. (2013), "A Generalized Exactly Additive Decomposition of Aggregate Labor Productivity Growth," Review of Income and Wealth, 59 (Issue 1): 157-168, 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 which is implemented in this Table 3.