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Angelo King Institute
for Economic and Business Studies

Monitoring the Philippine Economy Fourth Quarter Report for 2016

Project of Angelo King Institute

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Fourth quarter growth rose steadily to 6.6 percent from 6.5 percent the previous year to fulfill robust full-year growth forecasts.

Economic performance: capital formation and industry fueled fourth quarter growth.

Philippine economic growth met high-end target for 2016. Fourth quarter growth rose to 6.6 percent (year-on-year) from 6.5 percent in the previous year. Per the National Economic and Development Authority², the moving average of real GDP growth rates in the last seven years reached 6.3 percent – the highest since 1978. While fourth quarter growth came in third behind growth in China (6.8 percent) and in Vietnam (6.7 percent), Philippine full-year growth at 6.8 percent topped regional performance.

- **Major components of aggregate demand**
 - **Private consumption, though slower, continued to grow.** Household consumption grew by 6.3 percent due to better labor market conditions, improved consumer confidence, and modest inflation and interest rates. Personal and cash remittances stabilized at 5 percent and 4.9 percent by December 2016, respectively.
 - **Durable equipment, private and public investments remained robust.** Continued strong expansion in investments sustained economic growth at 15 percent, particularly in durable equipment which grew to 26.2 percent. Public investment in infrastructure expanded by 23 percent for public construction compared to last quarter's 20.1 percent expansion.
 - **Government expenditure slowed down due to reduced maintenance spending.** The fourth quarter performance of government spending slowed to only 4 percent from 15.8 percent during the same period in 2015. Causing the slowdown, as reported by the Philippine Statistics Authority³, was a decline in the maintenance and other operating expenditures of various government agencies. Programs were completed during the first semester in 2016. The slowdown came

¹ Report is based on latest available data as of March 15, 2017. For comments and questions, please email mitzie.conchada@dlsu.edu.ph

² <http://www.neda.gov.ph/2017/01/26/statement-of-secretary-ernesto-m-pernias-on-the-performance-of-the-philippine-economy-for-the-fourth-quarter-and-full-year-2016/>

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

after the momentary higher spending during the APEC 2015 Summit in November 2015 and the preparation of COMELEC for the 2016 National Elections.

- **Imports exceeded exports while both grew steadily.** Exports of goods steadily rose to 9.6 percent, higher than last quarter's 7.8 percent, while imports surged to 18.6 percent, up from the 14.2 percent growth in the third quarter. Imports growth was fueled by a continuing increase in capital and durable goods purchases from greater consumer confidence. In December 2016, total exports were valued at US\$ 4.8 billion, a 4.5 percent year-on-year increase, while total imports were worth US\$ 7.4 billion, a 19.1 percent year-on-year growth. The uptick in exports indicated resilience of our economy despite sluggish recovery in Europe and uncertainties in the UK and US.

- **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).⁴

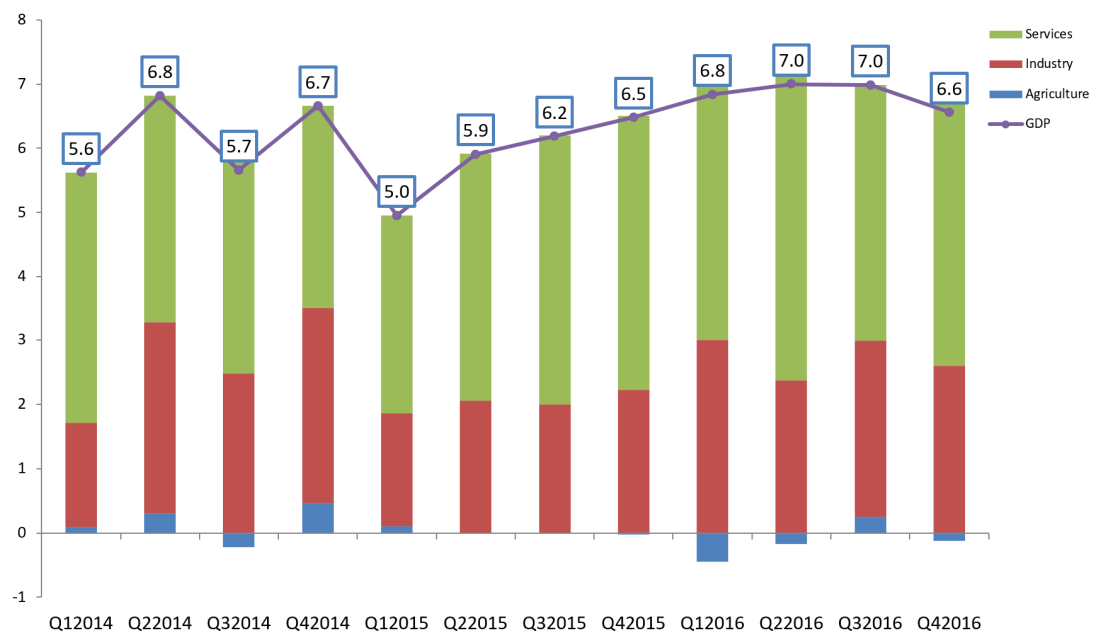
- **Services sector growth slowed in the fourth quarter.** Services sector grew 7.4 percent, slightly lower than the previous year's 7.8 percent growth. However, the National Economic and Development Authority⁵ projects the services sector to continue to grow aided by modest inflation, sustained growth of remittances and retail trade, a strong financial system, an influx of inbound tourists, and the flourishing of the IT-BPM sector.
- **Industry sector exhibited impressive growth.** The industry sector grew by 7.6 percent, higher than 6.5 percent in the previous year. With government commitments for critical infrastructure projects, the sector holds bright prospects for faster growth. While one of the strongest supply-side contributors to fourth quarter growth, the industry sector still relies on external demand, thus needing innovation and diversification.

⁴ 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.

⁵ <http://www.neda.gov.ph/2017/01/26/statement-of-secretary-ernesto-m-pernias-on-the-performance-of-the-philippine-economy-for-the-fourth-quarter-and-full-year-2016/>

- Agriculture sector slipped further.** With the impact of typhoons “Karen” and “Lawin”, agricultural growth turned further negative to 1.2 percent compared to 0.2 percent in the same period of the previous year. Other subsectors experienced negative growth rates such as forestry (20.7 percent) and fishing (3 percent). Insulating the sector from shocks calls for strong measures to develop its resilience, especially for the fishery subsector that has consistently contracted for almost 7 years. This call can begin by reducing the cost of food and rice to alleviate poverty and by transitioning to high-value crops and adopting new technology to raise farm income and productivity.

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 continues to depreciate⁶.** The peso weakened by 4.2 percent to average ₱49.11/US\$1, on a quarter-on-quarter basis, from the previous average of ₱47.05/US\$1. The depreciation was likely caused by the US Fed rate hike in December 2016 and may continue in view of possible rate hikes in 2017. Additionally, investor sentiments about unfolding political dynamics and economic policies appear to play a role, e.g. local elections, Brexit, and Donald Trump’s election victory.
- Weather-related risk remains an obstacle to development plans.** Over the current administration, the economy is expected to expand by 50 percent in real terms. This results in per capita income to rise by over 40 percent and poverty to drop to 14 percent, lifting 6 million Filipinos above poverty. However, extreme weather changes like El Niño and sudden typhoons debilitate the agricultural sector, which is key to improving food security and

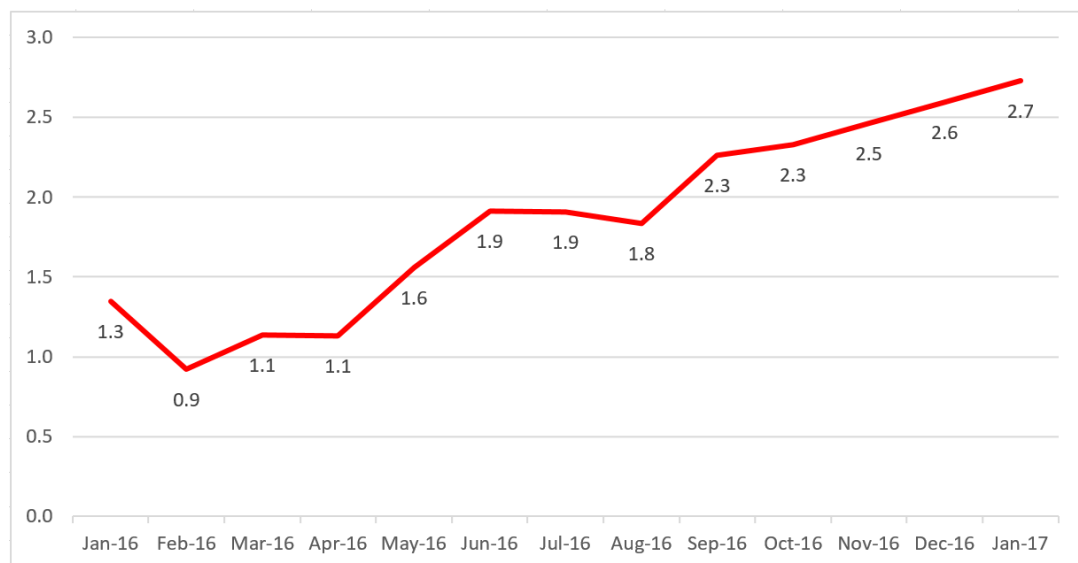
⁶ <http://www.bsp.gov.ph/downloads/Publications/FAQs/exchange.pdf>

lowering food costs especially for the poorest of the population. More investments to enhance the agriculture sector's resiliency to severe weather conditions are imperative.

Other economic news

- **The BSP continues to maintain its monetary policy settings⁷.** Although inflation rates started to edge upward, the BSP maintained its key policy interest rate in November and December. The interest rates for other monetary policy instruments and the reserve requirement ratios were similarly left unchanged. BSP's decisions are based on its assessment that the inflation environment remained manageable.
- **Stock market declines^{8,9}.** At the close of 2016, the stock market declined for a consecutive year wherein the PSEi lost 5.8 points or 0.09 percent. In 2015, the PSEi closed lower by 3.85 percent. As the PSEi once more ends lower, investors still wait for fourth quarter profit reports. The jitters felt from global anxiety and its effects on the Philippine economy may be causes for the decline. Services and property counters fell by more than 1 percent, which dragged the PSEi down.
- **Headline inflation rises but remains below target⁷.** Fourth quarter inflation increased to 2.5 percent from last year's 1.0 percent as costs of both food and non-food commodities rose. These were attributed to a depreciated peso, robust domestic demand, increased global oil prices, the anticipated impact of proposed tax reforms, higher probability of further Fed rate hikes, and higher government spending. These outweigh the risks from China's yuan devaluation, and the recession in Japan and the Eurozone.

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



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

⁷ http://www.bsp.gov.ph/downloads/Publications/2016/IR4qtr_2016.pdf

⁸ <http://business.inquirer.net/222217/market-last-trading-day-2016>

⁹ <http://business.inquirer.net/224247/psei-ends-lower-investors-await-4th-quarter-profit-reports>

- **Remittances surge in November¹⁰ and December¹¹ 2016.** Cash remittances in November surged to its fastest pace in over 8 years while December posted a new high. This brought the 2016 tally above the BSP's targets. In November, remittances reached US\$2.2 billion, rising 18.5 percent from US\$1.9 billion in 2015. In December, remittances reached US\$2.8 billion, growing 3.6 percent from US\$2.7 billion last year. The December remittances originated from land-based OFWs, particularly from Asia, the Americas, and the Middle East. These sources are expected to offset the declines recorded in Europe.
- **DENR shuts down mining projects due to environmental non-compliance¹².** The Department of Environment and Natural Resources (DENR) announced the cancellation of several certifications for mining projects due to negligence, non-compliance, and sub-standard performance. This comes at a time that the DENR adopts a focus on social and environmental justice to preserve biodiversity and promote economic transformation. However, this focus poses a challenge to come up with viable economic alternatives for those displaced by mine closures especially in impoverished areas of Davao Oriental, Palawan, Camarines Norte, Pampanga, and more.
- **Philippine Development Plan 2017-2022 close to completion¹³.** The National Economic and Development Authority provides medium-term priorities of the Duterte administration based on the results of the nationwide survey *AmBisyon Natin 2040* as follows: infrastructure development, human capital investment, regional development, social protection and humanistic governance, a high-trust society, resilient communities, and a globally competitive knowledge economy.

¹⁰ <http://www.bworldonline.com/content.php?section=TopStory&title=nov.-remittance-growth-fastest-in-over-8-years&id=139207>

¹¹ <http://www.manilatimes.net/dec-remittances-hit-record-2016-tally-breaches-target/312498/>

¹² <http://newsinfo.inquirer.net/854028/denr-cancels-ec-c-of-davao-or-mine-benguet-mining-probed-on-spill>

¹³ <http://www.neda.gov.ph/2017/01/26/statement-of-secretary-ernesto-m-bernas-on-the-performance-of-the-philippine-economy-for-the-fourth-quarter-and-full-year-2016/>



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Table 1. Philippine Economic Indicators

Philippines Economic Data										
Monthly Leading Indicators	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16
Industrial Production (y-o-y, %)	8.24	10.79	8.25	10.82	13.39	15.32	11.81	10.51	15.13	23.01
Consumer Price Index (y-o-y, %)	1.13	1.13	1.56	1.91	1.91	1.83	2.26	2.33	2.46	2.59
Exports (y-o-y, %)	-15.14	-4.06	-3.77	-11.36	-12.98	-2.99	5.06	7.58	-7.53	6.27
Imports (y-o-y, %)	11.71	29.82	39.34	15.35	-1.67	12.15	13.52	5.92	19.74	13.84
Trade Balance, US\$ million	-1,747	-2,306	-2,021	-2,098	-2,058	-1,952	-1,890	-1,983	-2,566	-2,158
Total Reserves (less gold), US\$ billion	75	76	75	77	77	78	78	77	74	73
Policy Rate	4	4	4	3	3	3	3	3	3	3
Fiscal Balance (million pesos)	-74,388	55,022	-17,656	-45,194	-50,667	32,607	-75,327	-2,345	-19,145	...
Quarterly/Annual Economic Indicators	2013	2014	1Q2015	2Q2015	3Q2015	4Q2015	1Q2016	2Q2016	3Q2016	4Q2016
Real GDP (y-o-y, %)	6.95	6.23	4.96	5.91	6.19	6.48	6.84	7.00	6.98	6.90
- Private Consumption	5.63	5.54	6.09	6.44	6.06	6.54	7.02	7.41	7.10	6.26
- Government Consumption	8.08	3.25	0.22	2.38	15.68	15.76	11.83	13.45	3.11	3.98
- Gross Capital Fixed Formation	27.35	5.41	12.46	21.43	14.53	13.26	26.65	25.03	18.63	15.00
Current Account (% of GDP)	4.20	2.30	3.20	3.10	0.10	4.80	0.90	0.10	1.30	...
Financial Account (US\$ million)	2,230	4,098	152	1,258	-291	1,404	995	-1,039	308	...
- Net Direct Investments, US\$ million	-90	-487	358	-476	-11	7	-1,119	-1,030	-498	...
- Net Portfolio Investments, US\$ million	-1,001	2,811	-459	3,375	2,202	-361	1,573	787	-843	...
Overall BOP position (US\$, million)	5,085	-4,475	877	807	124	809	-210	843	1,014	...
Unemployment rate	7.1	6.8	6.4	6.5	5.6	5.8	5.8	5.4	4.7	4.7
Others	Mar-16	Apr-16	May-16	Jun-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16
Overseas Filipinos' Remittances (US\$, million)	2,362	2,213	2,188	2,334	2,131	2,319	2,383	2,099	2,217	2,559

... = not available

Source: Bangko Sentral ng Pilipinas, National Statistics Office, *International Finance Statistics*, IMF, Asian Development Bank

Table 2. Level of Philippine GDP, 2015Q4 – 2016Q4

	Nominal GDP		Real GDP	
	(million current pesos)		(million constant 2000 pesos)	
	2015Q4	2016Q4	2015Q4	2016Q4
Agriculture and Forestry	367,127	375,337	176,146	174,847
Fishing	49,261	48,430	39,640	38,470
Mining and Quarrying	25,009	25,143	15,209	15,133
Manufacturing	869,348	936,956	501,178	535,769
Construction	235,271	268,010	123,851	137,434
Electricity Gas and Water Supply	95,706	100,080	60,133	65,484
Transport Communication and Storage	223,307	238,926	158,088	167,994
Trade and Repair of Motor Vehicles Motorcycles Personal	677,929	741,383	354,316	378,606
Financial Intermediation	274,419	298,161	140,448	148,935
Real Estate Renting & Bus. Actvt	451,376	506,027	221,070	240,890
Public Administration & Defense: Compulsory Social Security	152,034	177,614	75,297	84,381
Other Services	347,447	377,657	195,769	208,414
Sum = GDP	3,768,233	4,093,725	2,061,146	2,196,358

Source: Philippine Statistical Authority, 2016

Table 3. Industry Contributions to Philippine GDP Growth, 2015Q4 – 2016Q4

	TRAD	PGE	PCE	GEN
	GDP Growth			GDP Growth
	(percent)	(percent)	(percent)	(percent)
		(1)	(2)	(1)+(2)
GDP Growth	6.56	6.59	-0.03	6.56
Industry Growth Contribution				
Agriculture	-0.12	-0.11	0.09	-0.02
Agriculture and Forestry	-0.06	-0.07	0.10	0.03
Fishing	-0.06	-0.04	-0.01	-0.05
Industry	2.59	2.50	-0.39	2.11
Mining and Quarrying	0.00	0.00	-0.01	-0.01
Manufacturing	1.68	1.59	-0.27	1.32
Construction	0.66	0.68	0.05	0.73
Electricity Gas and Water Supply	0.26	0.23	-0.16	0.07
Services	4.09	4.20	0.27	4.47
Transport Communication and Storage	0.48	0.37	-0.08	0.29
Trade and Repair of Motor Vehicles Motorcycles Personal	1.18	1.23	0.07	1.31
Financial Intermediation	0.41	0.44	0.04	0.48
Real Estate Renting & Bus. Actvt	0.96	1.07	0.12	1.19
Public Administration & Defense: Compulsory Social Security	0.44	0.49	0.10	0.59
Other Services	0.61	0.60	0.01	0.61

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.