



Monitoring the Philippine Economy First Quarter Report for 2018

Project of Angelo King Institute

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First quarter 2018 growth performance of 6.8 percent edged above the annual 2017 growth of 6.7 percent due to substantial expansion in fiscal expenditures, capital investments, and industry output despite a rise in the inflation rate and critical external factors that are weakening the peso.

Philippine's domestic economy rebounds in the first quarter of 2018. First quarter growth was 6.8 percent, up from 6.7 percent the previous year. Higher investments and government expenditures contributed to the economic expansion. Industry sector served as the main driver for growth. Improved economic performance supports optimism for the year ahead.

- **Major components of aggregate demand**
 - **Household spending growth slowed due to higher prices.** Private consumption in the first quarter slightly decreased to 5.6 percent year-on-year (y-o-y) from 5.9 percent the previous year. According to the Philippine Statistics Authority (PSA)², Food and Non-alcoholic Beverages, the component with the largest 38.7 percent share in consumption, displayed substantial decrease in growth (4.6 percent from 5.9 percent, y-o-y). Furthermore, Alcoholic beverages and Tobacco consumption significantly contracted (-10.5 percent from -1.3 percent, y-o-y). Meanwhile, remarkable growth in Communication (7.5 percent from 1.6 percent, y-o-y), Furnishings, Household Equipment and Routine Household Maintenance, and Housing (7.6 percent from 2.5 percent, y-o-y), Water, Electricity, Gas and Other Fuels (7.8 percent from 5.6 percent, y-o-y) contributed to the growth of the expenditure component. The overall slowdown in household spending in Q1 2018 may be attributable to higher oil prices and the recently implemented TRAIN Law. While this law may have increased disposable income of households, higher commodity prices offset this effect.
 - **Gross domestic capital formation accelerated.** Domestic investment growth improved to 12.5 percent from 11.4 the previous year. PSA³ reported that additions to inventories totaled ₱26.9 billion, which is over seven times more than ₱3.7 billion last Q1 2017. Investments grew in Construction by 10.1 percent, in Durable Equipment by 8.4 percent, and in Breeding Stocks and Orchard Development by 4.2 percent. On the other hand, growth in Intellectual Property Products (IPP) slowed down to 12.7 percent from 30.1 percent the same quarter the previous

¹ Report is based on latest available data as of May 23, 2018. For comments and questions, please email mitzie.conchada@dlsu.edu.ph

² <http://psa.gov.ph/nap-press-release/sector/Household%20Final%20Consumption>

³ <http://psa.gov.ph/nap-press-release/sector/Capital%20Formation>

year. This was influenced by the sluggish pace of investments in computer software and databases.

- **Fiscal expansion is expected to bolster growth prospects.** The surge in government spending by 13.6 percent in the first quarter is remarkably higher than the 0.1 percent rise, y-o-y. As reported by PSA⁴, the significant growth was contributed by the creation and filling up of government positions and the increase in the base pay of civilian and military and uniformed personnel. Moreover, expenses of various government agencies in fulfillment of their respective programs contributed to the increase.
- **Curtailed exports and imports of goods further widened trade deficit.** At the end of March, exports and imports were recorded at 5.5 billion USD (2.9 percent growth y-o-y) and 8.1 billion USD (9.3 percent growth y-o-y), respectively. First quarter left a trade balance of -2.6 billion USD. Growth in export of goods slowed considerably to 2.9 percent from 21.3 percent the previous year due to weakened external demand. However, growth in import of goods also slowed to 9.3 percent from 21.4 percent the previous year. The recorded growth in imports was lowest since Q4 2014. The National Economic and Development Authority (NEDA)⁵ indicated that the government should take into account the downside risks of the rising tensions between the United States and China as it may disrupt global trade and further worsen the Philippine trade deficit.
- **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 remained as the major contributor of the supply-side.** Services sector’s share in GDP remained at a robust rate of 56.8 percent, unchanged from the previous year. It posted the highest contribution to growth,

⁴ <http://psa.gov.ph/nap-press-release/sector/Government%20Final%20Consumption>

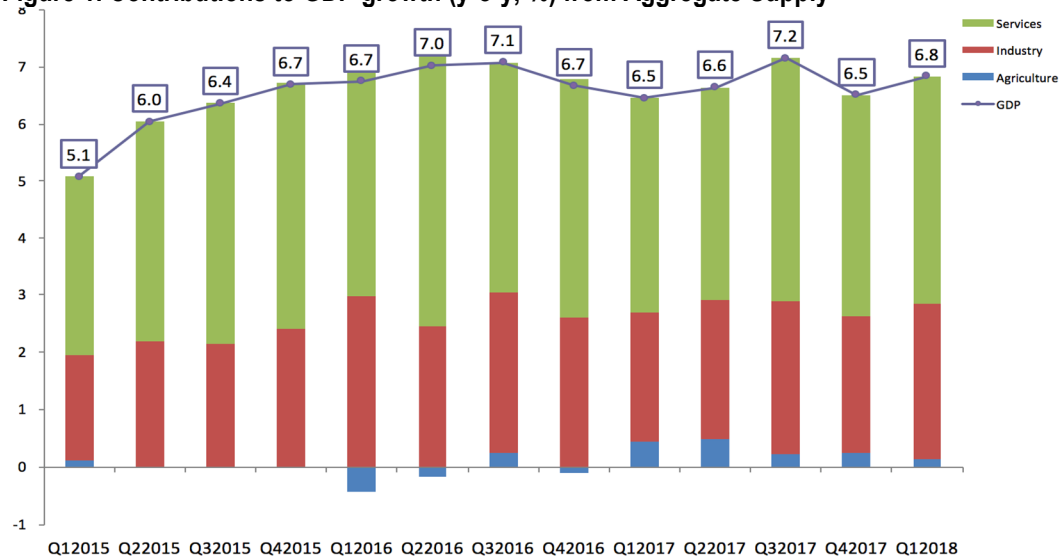
⁵ <http://www.neda.gov.ph/2018/04/11/globally-competitive-environment-to-sustain-ph-trade-growth-neda/>

⁶ 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.

with 3.86 percentage points from positive quantity and real price growth (see Table 3). The sector expanded by 7.0 percent, which was higher compared to the previous year's 6.7 percent growth. Other services were the main driver of growth in the sector with 8.8 percent growth performance.

- Industry sector grew the fastest, with manufacturing as the main driver of growth.** The industry sector grew the fastest among the three sectors with an expanded growth of 7.9 percent, higher than the 6.5 percent the previous year. The sector contributed 2.34 percentage points to GDP growth (see Table 3) while maintaining a 34.5 percent share in GDP. Manufacturing (MAN) remained as the top contributor to the industry, with a high 72.0 percent share in the sector. MAN rose by 8.0 percent from 7.7 percent the previous year. Other contributors, more specifically mining and quarrying (MQ) needs a revival, as it is always the industry component with the lowest contribution. In the first quarter, MQ remained stagnant at a 2.7 percent contribution to the industry sector, registering the same share as the previous year.
- Lower agriculture sector production experienced.** From improved performance the previous year and quarters, the agriculture sector posted a slow growth of 1.5 percent, y-o-y. This was lower than the reported 4.9 percent growth rate the previous year. The sector was able to contribute only 0.63 percentage points to GDP growth (see Table 3). The slowdown was partly due to the decline in fisheries as the period December to March is closed fishing season in the country. Nonetheless, sector performance is expected to improve with pending initiatives of the government.

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 continued to depreciate⁷.** The peso weakened by 0.97 percent to average ₱51.43/US\$1, on a quarter-on-quarter basis, from the previous average of ₱50.93/US\$1. Correspondingly, on a year-on-year basis, peso depreciated by 2.78 percent, from the previous year's ₱50.00/US\$1 average. Further weakening of peso was mainly attributed by market's concerns over the Philippines' widening trade gap and growing expectations of further US Federal Reserve rate hikes during the year. Additionally, the peso in the first quarter, recorded at 1.50 percent, has been more volatile compared to previous quarter's closing rate of 1.02 percent.
- **Weather disturbances serve as a threat to the Philippine economy.** Unforeseen inclement weather conditions, natural disasters, and the like may interrupt agricultural activities in the country. These harsh conditions may aggravate poverty level and further threaten food security, especially the poor Filipinos. Infrastructural improvements are deemed necessary to augment agriculture sector's resiliency.

Other economic news

- **BSP is optimistic about Philippine economic growth this 2018.⁸** The World Bank found the Philippines as the fastest-growing economy in ASEAN for 2018-2020. Third-party assessors give cheerful growth projections, consistent with the national government's target of 7.0 percent to 8.0 percent growth in the next three years. Buoyant industry output and capital investments, alongside with sustained investments in job-creating industries, give a favorable economic environment for greater economic activities. BSP will continuously watch out domestic and international markets for a more stabilized and resilient economic environment.
- **Stock market reports increased PSEi⁹.** At the close of the first quarter, PSEi reported a quarter-on-quarter rise of 2.6 percent with an average index points of 8,571.05. Expectations of higher inflation and interest rates suppress favorable sentiments in Q1 2018.
- **Inflation level hits highest quarterly average in 4 years¹⁰.** This 2018, the BSP expects inflation level to be in the higher ends of its target range of 2.0 percent to 4.0 percent. The rise in the consumer price index in the first quarter was recorded at an average of 4.3 percent (see Figure 2), going over the target range. High inflation levels in the coming months are highly expected mostly due to the recently implemented TRAIN Law, which would drive commodity prices higher. Also, weaker peso against the US dollar and tightening of US monetary policy contributed to the high CPI. Inflation rate is forecasted to ease by the start of 2019.

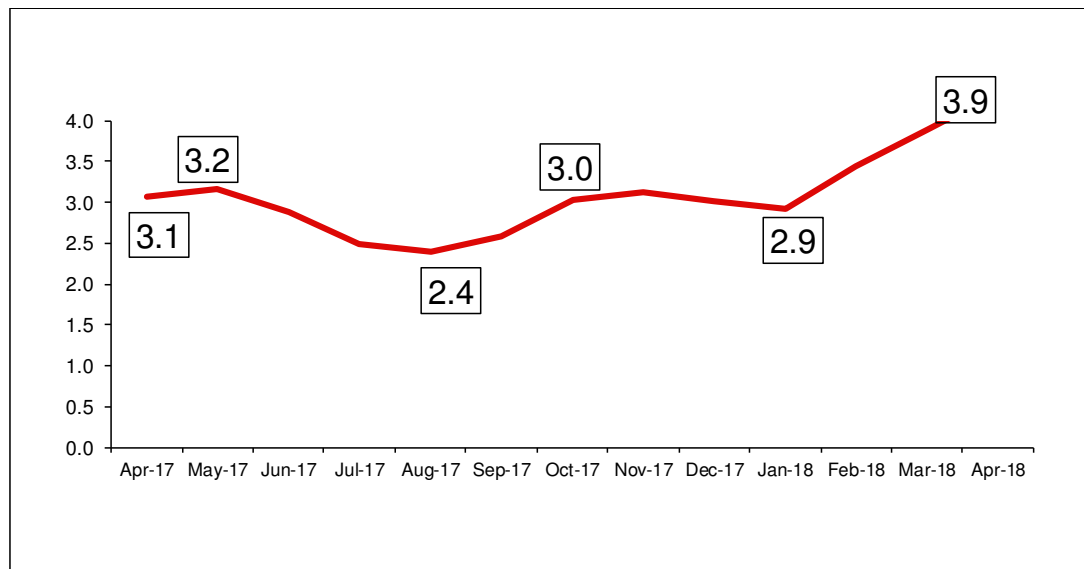
⁷ <http://www.bsp.gov.ph/downloads/Publications/FAQs/exchange.pdf>

⁸ <http://www.bsp.gov.ph/publications/speeches.asp?id=602>

⁹ http://www.bsp.gov.ph/downloads/Publications/2018/IR1qtr_2018.pdf

¹⁰ <https://www.rappler.com/business/199017-philippines-bsp-consumer-expectations-survey-q1-2018>

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



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

- **Consumer sentiment plunged¹¹.** Overall confidence index (CI) dropped to 1.7 percent from 9.5 percent the previous quarter. The pessimistic sentiment was due to expectations of (a) higher prices of goods, (b) low income, and (c) rise in household expenses. The trend of weakened consumer confidence was observable across income groups.

¹¹ <http://www.bsp.gov.ph/publications/media.asp?id=4642&yr=2018>



Table 1. Philippine Economic Indicators

Philippines Economic Data											
Monthly Leading Indicators	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18
Industrial Production (y-o-y, %)	-5.1	0.3	-5.7	-6.5	-9.3	-4.8	18.6	23.7	13.6	...	...
Consumer Price Index (y-o-y, %)	2.4	2.6	3.0	3.1	3.0	2.9	3.4	3.9	4.3	4.5	...
Exports (y-o-y, %)	10.4	11.0	8.0	9.2	6.0	2.6	3.5	2.7	-1.3	...	...
Imports (y-o-y, %)	-3.2	14.2	8.5	18.6	21.4	25.4	11.4	19.2	3.0	...	...
Trade Balance, US\$ million	-1,646	-2,393	-2,077	-2,819	-3,845	-3,839	-3,163	-2,890	-2,608	...	...
Total Reserves (less gold), US\$ billion	73	73	73	72	72	73	73	72	72	71	...
Policy Rate	3	3	3	3	3	3	3	3	3	3	3.25
Fiscal Balance (million pesos)	-50,512	28,808	-36,892	-21,800	-8,623	-107,148	10,191	-61,734	-110,693	...	...
Quarterly/Annual Economic Indicators	2014	2015	1Q2016	2Q2016	3Q2016	4Q2016	1Q2017	2Q2017	3Q2017	4Q2017	1Q2018
Real GDP (y-o-y, %)	-385.3	-49.0	6.7	7.0	7.1	6.7	6.5	6.6	7.2	6.5	6.8
- Private Consumption	0.0	0.0	7.2	7.5	7.3	6.7	5.9	6.0	5.4	6.2	5.6
- Government Consumption	5.6	5.6	12.4	14.0	3.6	5.0	0.1	7.6	8.3	12.2	13.6
- Gross Capital Fixed Formation	8.1	3.3	31.4	30.6	22.4	16.6	11.4	7.6	10.3	8.3	12.5
Current Account (% of GDP)	3.8	2.9	0.9	0.1	1.3	1.2	-0.7	-0.1	0.7	-3.8	...
Financial Account (US\$ million)	9,631	2,523	995	-1,039	308	54	328	-945	442	-2,033	...
- Net Direct Investments, US\$ million	1,014	-122	-1,119	-1,030	-498	-1,829	-1,480	-1,868	-2,117	-2,646	...
- Net Portfolio Investments, US\$ million	2,708	4,757	1,573	787	-843	-309	3,258	-129	875	-114	...
Overall BOP position (US\$, million)	-2,858	2,616	-210	843	1,014	-2,068	-994	289	-662	505	...
Unemployment rate	6	5.8	5.8	5.4	4.7	4.7	6.6	5.6	5.7	5	5.3
Others	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18
Overseas Filipinos' Remittances (US\$, million)	2,310	2,467	2,283	2,499	2,186	2,275	2,262	2,741	2,379	2,267	2,360
... = not available											
Source: Bangko Sentral ng Pilipinas, Philippine Statistics Authority, Asian Development Bank.											



Table 2. Level of Philippine GDP, 2017Q1 – 2018Q1

	Nominal GDP		Real GDP	
	(million current pesos)		million constant 2000 pesos	
	2017Q1	2018Q1	2017Q1	2018Q1
Agriculture and Forestry	291,259	317,494	146,369	154,527
Fishing	42,804	46,601	27,251	27,569
Mining and Quarrying	29,734	30,704	23,513	19,319
Manufacturing	663,990	719,078	459,043	494,415
Construction	213,727	241,094	102,107	112,042
Electricity Gas and Water Supply	112,220	117,447	60,157	61,197
Transport Communication and Storage	216,812	230,225	148,380	154,641
Trade and Repair of Motor Vehicles Motorcycles Personal	544,464	601,268	290,658	311,915
Financial Intermediation	281,446	310,512	143,651	153,670
Real Estate Renting & Bus. Actvt	433,065	474,373	209,402	224,104
Public Administration & Defense: Compulsory Social Security	109,263	120,994	69,578	73,418
Other Services	329,141	360,937	206,492	221,561
Sum = GDP	3,267,925	3,570,728	1,886,602	2,008,377

Source: Philippine Statistics Authority.



Table 3. Industry Contributions to Philippine GDP Growth, 2017Q1 – 2018Q1

	TRAD	PGE	GPIE	RPE	GEN
	GDP Growth				GDP Growth
	(percent)	(percent)	(percent)	(percent)	(percent)
		(1)	(2)	(3)	(1)+(2)+(3)
GDP Growth	6.83	6.69	-0.02	0.16	6.83
Industry Growth Contribution					
Agriculture	0.14	0.17	0.01	0.46	0.63
Agriculture and Forestry	0.19	0.22	0.01	0.38	0.61
Fishing	-0.05	-0.05	0.00	0.08	0.02
Industry	2.71	2.47	-0.01	-0.11	2.34
Mining and Quarrying	0.04	0.04	0.00	0.05	0.09
Manufacturing	1.96	1.60	-0.02	-0.26	1.32
Construction	0.52	0.63	0.00	-0.03	0.60
Electricity Gas and Water Supply	0.18	0.20	0.01	0.13	0.34
Services	3.99	4.06	-0.01	-0.18	3.86
Transport Communication and Storage	0.49	0.41	-0.01	-0.13	0.27
Trade and Repair of Motor Vehicles Motorcycles Personal	0.95	1.03	0.01	0.10	1.14
Financial Intermediation	0.58	0.66	0.01	0.09	0.76
Real Estate Renting & Bus. Actvt	0.52	0.62	0.00	-0.07	0.55
Public Administration & Defense: Compulsory Social Secur	0.48	0.45	0.00	-0.02	0.42
Other Services	0.97	0.89	-0.01	-0.16	0.71

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.