Angelo King Institute
for Economic and Business Studies

Monitoring the Philippine Economy
Second Quarter Report for 2018

Project of Angelo King Institute

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

Won Hee Cho
BS-AEL Economics
School of Economics

Second quarter 2018 growth performance declined to 6.0 percent from 6.6 percent the previous year.

Philippine's domestic economy falls short in meeting market expectations. Second quarter growth was recorded at 6.0 percent, which was significantly lower than the market expectations of a 6.6 percent to 7.0 percent growth range. Manufacturing and Construction served as the main driver for growth. Higher investments and government expenditures contributed to the economic expansion. Decline in household consumption contributed to the economic contraction. Weather disturbances and high inflation rates are key challenges the government will have to combat in the coming months.

Inflation soars to a new level in August[2]. Amidst expectations, prices of basic commodities rose to an all-time high in August. Headline inflation rate registered at 6.4 percent, much higher than last year's 3.0 percent. This brings annual average inflation to 4.8 percent, close to the revised 4.9 percent ceiling.

Food and non-alcoholic beverages registered the highest increase in August prices particularly rice, fish, meat and vegetables with month-on-month inflation of 1.6 percent compared to 0.9 percent in July. Rice registered 0.2 percentage points month-on-month contribution to inflation rate while fish, meat and vegetables contributed 0.1 percentage points. Food prices became unstable due to supply issues affected by both domestic and external factors.

With inflation target range of only 2 to 4 percent by end of the year, the government is initiating immediate reforms for addressing high food prices such as: (1) increase supply of fish by allowing more imports distributed across the various wet markets in the country; (2) address the supply of rice by mobilizing the supply of National Food Authority rice to be distributed immediately and; (3) increase imports of rice by simplifying licensing procedures[3].

- **Major components of aggregate demand**

    - **Private consumption continued to slow down due to the rise in commodity prices.** Household expenditure in the second quarter slightly declined to 5.6 percent year-on-year (y-o-y) from 6.0 percent the previous year. According to the Philippine Statistics Authority (PSA)[4], Food and Non-alcoholic Beverages, the component with the largest 41.5 percent share in consumption, reflected a slight

[1] Report is based on latest available data as of August 14, 2018. For comments and questions, please email mitzie.conchada@dlsu.edu.ph
[2] http://www.bsp.gov.ph/downloads/Publications/2018/IR2qtr_2018.pdf
[3] Notes from Department of Finance, 2018.
[4] http://psa.gov.ph/nap-press-release/sector/Household%20Final%20Consumption

increase in growth (6.3 percent from 6.2 percent, y-o-y). Furthermore, Miscellaneous goods and services, the component with the second largest share of 13.1 percent, significantly increased (10.0 percent from 7.0 percent, y-o-y). Communication (6.6 percent from 1.1 percent, y-o-y), Recreation and culture (2.3 percent from -1.4 percent, y-o-y), and Furnishings, household equipment and routine household maintenance (5.4 percent from 3.3 percent, y-o-y) contributed to the growth of the expenditure component. However, the growth in the aforementioned components were offset by the decreases in other components. The decline was mainly contributed by the contraction in Health (0.8 percent from 8.5 percent, y-o-y), and Restaurants and hotels (4.3 percent from 11.4 percent). The overall slowdown in household spending in Q2 2018 may be attributable to the rise in commodity prices caused by high inflation rate.

- **Domestic investment growth surged.** Gross domestic capital formation boosted to 20.7 percent from 7.6 percent the previous year. According to PSA[5], Investments in Construction and Investments in Durable Equipment accelerated with a growth of 12.9 percent and 28.6 percent, respectively. Meanwhile, Investments in Breeding Stocks and Orchard Development and Investments for Intellectual Property Products posted decelerated growths of 3.9 percent and 28.5 percent, respectively.

- **Government's infrastructure investment programs remarkably contributed in fiscal expansion.** Government spending continued to surge with a growth of 11.9 percent, significantly higher than the recorded growth rate of 7.6 percent the previous year. The government was no longer underspending. Instead, it started actively investing in its projects that are expected to bolster growth prospects. Improved performance was mainly attributed by the investments in infrastructure programs such as the *Build Build Build* project under the Duterte Administration.

- **Rise in imports of goods further aggravated trade deficit.** At the end of June, exports and imports were recorded at 5.70 billion USD (-0.1 percent growth y-o-y) and 9.05 billion USD (24.2 percent growth y-o-y), respectively. Second quarter left a trade balance of -3.35 billion USD, much worse than the 1.59 billion USD deficit in June 2017. Growth in export of goods minimally decreased by 0.1 percent than the previous year due to weakened external demand. Conversely, growth in import of goods increased by 24.2 percent than the previous year due to heightened inbound purchases. Although the trade balance widened, the National Economic and Development Authority (NEDA)[6] expressed hope for a potential rise in exports with the recent passage of Ease of Doing Business Act of 2018, opportunities from FTAs, and ratification of the Philippines-European FTA.

- **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 exactly additive decomposition" (GEAD) of growth 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,

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[5] http://psa.gov.ph/nap-press-release/sector/Capital%20Formation
[6] http://www.neda.gov.ph/2018/07/23/imports-back-trade-growth-in-may-2018-exports-contraction-softens/

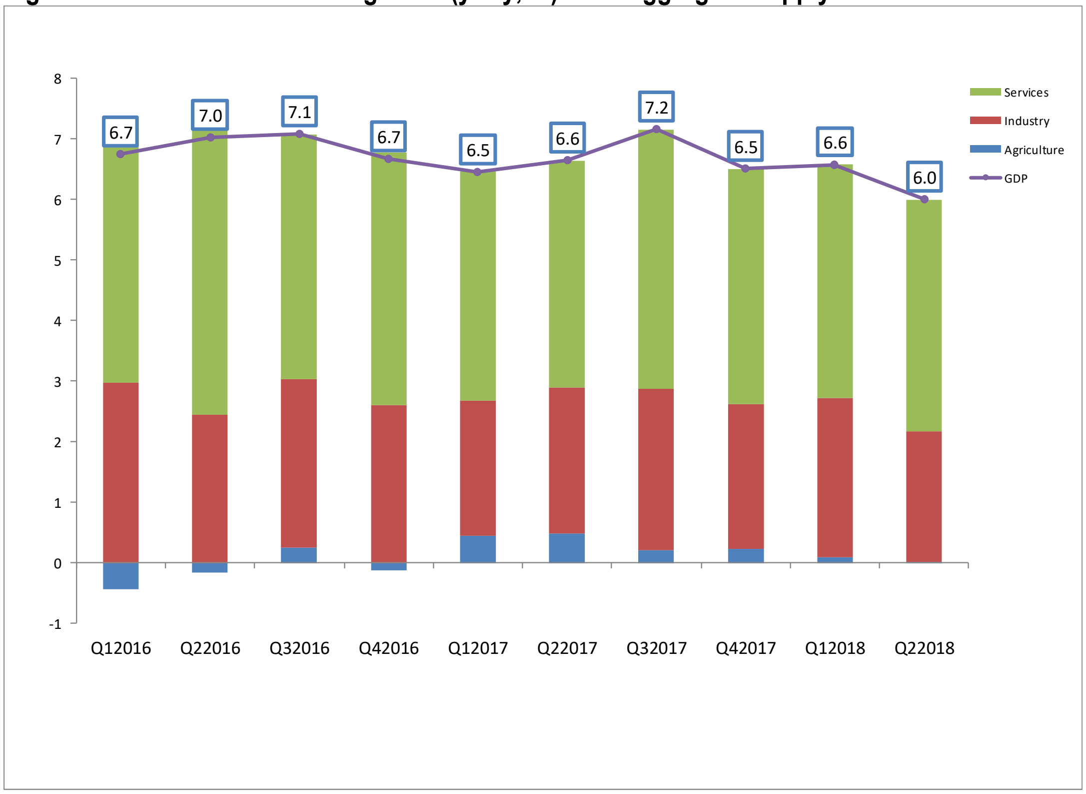
GEAD posits that a sector's contribution comes from "quantity" growth and from "real price" growth where this price is, by definition, the ratio of a sector's deflator to the overall GDP deflator. The GDP deflator as the common denominator of the above ratio makes real GDP the numeraire and, thus, this 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. The difference is that TRAD ignores this price effect. However, TRAD and GEAD yield the same quantity effect on GDP growth denoted by PGE (see Table 3).*

- **Growth and contribution in the services sector remained robust.** Services sector's share in GDP reported a robust rate of 58.6 percent, slightly improved from 58.3 percent the previous year. It posted the highest contribution to growth, with 3.83 percentage points from quantity growth alone (see Table 3). The sector expanded by 6.6 percent, which was higher compared to the previous year's 6.4 percent growth. For the second quarter, Trade and Repair of Motor Vehicles Motorcycles Personal was the main driver of growth in the sector with almost 1.0 percentage point contribution from quantity growth.

- **Construction was on balance the main driver of industry sector growth.** The industry sector exhibited slower growth of 6.0 percent, down from 6.6 percent the previous year. The sector maintained a 34.0 percent share in GDP and contributed 2.15 percentage points to GDP growth (see Table 3) from quantity growth which was more than offset by its negative contribution from real price change. Construction (CNS) grew the fastest in the sector with a growth of 13.5 percent from 4.3 percent the previous year. CNS contributed almost 1.0 percentage points to GDP growth from quantity growth in addition to about 1.6 percentage points from real price growth. On the other hand, while Manufacturing (MAN) remained as the top contributor to the industry, with a high 65.8 percent share in the sector, it experienced a declined growth of 5.6 percent from 8.0 percent the previous year. Other contributors, more specifically mining and quarrying (MQ) needs significant improvements, as its growth further declined to 10.9 percent from 19.2 percent the previous year. MQ currently has negative GDP growth contributions both from quantity and real price changes by about one-half of a percentage point.

- **Agriculture sector performance disappointing.** From improved performance the previous year and quarters, the agriculture sector posted a very slow growth of 0.2 percent, y-o-y. This was remarkably much lower than the reported 6.3 percent growth rate the previous year. The sector was able to contribute over 1.0 percentage point to GDP growth (see Table 3) but almost wholly from real price growth. The slowdown was partly due to unfavorable weather conditions that affected several parts of the country.

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 depreciate[7].** The peso weakened by 1.91 percent to average ₱52.43/US$1, on a quarter-on-quarter basis, from the previous average of ₱51.43/US$1. Correspondingly, on a year-on-year basis, peso depreciated by 4.91 percent, from the previous year's ₱49.86/US$1 average. Second quarter peso-dollar exchange rate recorded low in 12 years since July 19, 2006, when the market closed at ₱52.74. Further weakening of peso was attributed to the second interest rate hike of the US Fed for 2018 and market expectations of two more rate hikes until the year ends. Furthermore, the weaker peso may have been due to the worsening trade deficit.

- **Unfavorable economic factors may threaten the economy[8].** External factors such as the continuing policy normalization in the US and trade tensions between key economies increase uncertainties to the Philippine economy. In addition, internal factors such as the current account deficit, higher inflation, and depreciating peso challenge the resiliency of the domestic financial system.

- **Weather interruptions serve as an adversity to the Philippine economy.** Unfavorable and unforeseen inclement weather conditions, natural disasters, and the like may disrupt 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.

- **Fed expects to hike interest rate once more to counter trade tensions.** Fed officials are considering to increase rates again before the year ends to counter risks arising from trade tensions and unfavorable international events. The uncertainty around US trade policy may negatively affect investments, raising possibilities of companies becoming hesitant to commit funds. Uncertainties include extreme price fluctuations and disruptions in supply chains. While the intensified tension between US and China would not directly affect the Philippine economy, Development Budget Coordination Committee (DBCC) suggests that it may affect the global economic growth, thus, adversely impacting Philippine exports. In fact, the government lowered previous growth targets of 10 percent and 11 percent to 9 percent and 10 percent, respectively, for exports and imports.

Other economic news

- **Stock market reports increased PSEi[9].** At the close of the second quarter, PSEi reported a quarter-on-quarter decline of 11.1 percent with an average index points of 7,618.99. The plunge was caused by concerns over development overseas and the country's unforeseen surge in domestic inflation.

- **Consumer sentiment turned optimistic despite price increases[10].** Overall confidence index (CI) changed to 3.8 percent from a low 1.7 percent the previous quarter. The more optimistic sentiment was due to expectations of (a) improvement in peace and order, (b) additional income, (c) availability of more jobs, (d) effective government policies, and (e) increase in family savings.

[7] http://www.bsp.gov.ph/downloads/Publications/2018/IR2qtr_2018.pdf
[8] http://www.bsp.gov.ph/downloads/Publications/2018/IR2qtr_2018.pdf
[9] http://www.bsp.gov.ph/downloads/Publications/2018/IR2qtr_2018.pdf
[10] http://www.bsp.gov.ph/downloads/Publications/2018/CES_2qtr2018.pdf

- **BSP remains vigilant against financial developments to achieve stability[11].** Given the continuous elevation of the inflation rates, BSP vigilantly took measures to ensure price stability and financial stability. BSP raised the key policy rate twice during the second quarter of 2018. First on May 10 by 25 bps to 3.25 percent for the overnight reverse repurchase facility, then second on June 20 by another 25 bps to 3.50 percent. Consequently, the interest rates on the overnight lending and deposit facilities were increased accordingly. Furthermore, BSP expressed its intention to coordinate with other government agencies in implementing non-monetary strategies to mitigate the impact of inflation.

- **The National Government reported a fiscal deficit twice higher than the previous year[12].** For January to May 2018, the government announced a ₱138.7 billion fiscal deficit. Revenues rose by 19 percent (₱1,186.3 billion) from ₱996.5 billion the previous year. Collections from the Bureau of Revenue (BIR) and the Bureau of Customs (BOC) grew by 15 percent and 31 percent, respectively. The noteworthy increase in the revenue from BOC could be caused by the effects of peso depreciation, higher oil prices, and higher imports. On the other hand, expenditures recorded a 25 percent increase (₱1,325.1 billion).

[11] http://www.bsp.gov.ph/downloads/Publications/2018/IR2qtr_2018.pdf
[12] http://www.bsp.gov.ph/downloads/Publications/2018/IR2qtr_2018.pdf

Table 1. Philippine Economic Indicators

Philippines Economic Data													
Monthly Leading Indicators	**Aug-17**	**Sep-17**	**Oct-17**	**Nov-17**	**Dec-17**	**Jan-18**	**Feb-18**	**Mar-18**	**Apr-18**	**May-18**	**Jun-18**	**Jul-18**	**Aug-18**
Industrial Production (y-o-y, %)	0.34063821	-5.6852557	-6.5651631	-10.122607	-6.061475	16.77821	22.07018	16.84501	29.12864	20.95302	17.968981	...	...
Consumer Price Index (y-o-y, %)	2.58064516	3.0358786	3.1221304	3.0136986	2.9117379	3.44515	3.884372	4.336043	4.50045	4.594595	5.2252252	5.670567	...
Retail Sales (y-o-y, %)	...	...	-2.184	-4.292	-9.359	-12.066	-9.9	10.017	7.384	7.65	18.37	11.055	9.651
Exports (y-o-y, %)	10.9531196	7.9705675	9.1897683	6.0275519	2.5907238	3.512908	2.687766	0.226922	4.050893	6.756378	10.595342	...	...
Imports (y-o-y, %)	14.227874	8.4883986	18.648214	21.438686	25.443271	11.43117	19.19332	3.141077	28.18163	16.07739	26.643104	...	...
Trade Balance, US$ million	-2,392.62	-2,077.39	-2,819.46	-3,844.94	-3,838.66	-3,162.78	-2,890.46	-2,532.15	-3,479.66	-3,690.10	-3,349.82	...	...
Total Reserves (less gold), US$ billion	73.29	72.90	72.35	72.26	73.23	72.72	72.12	72.14	71.36	71.01	69.61	69.10	
Policy Rate	3	3	3	3	3	3	3	3	3	3.25	3.5	3.5	4
Fiscal Balance (million pesos)	28,808	-36,892	-21,800	-8,623	-107,148	10,191	-61,734	-110,693	46,315	-32,873	...	...	...
Quarterly/Annual Economic Indicators	**2013**	**2014**	**2015**	**1Q2016**	**2Q2016**	**3Q2016**	**4Q2016**	**1Q2017**	**2Q2017**	**3Q2017**	**4Q2017**	**1Q2018**	**2Q2018**
Real GDP (y-o-y, %)	6.9	6.2	6.1	6.7451444	7.0214275	7.078761	6.670722	6.454745	6.642513	7.153637	6.5048284	6.57507	5.995075
- Private Consumption	5.6	5.6	6.3	7.157485	7.5410035	7.260268	6.662355	5.871274	5.962604	5.368521	6.2209217	5.703728	5.64872
- Government Consumption	8.1	3.3	7.6	12.409356	14.041492	3.643961	5.032895	0.149493	7.595969	8.33278	12.19364	13.55401	11.91423
- Gross Capital Fixed Formation	27.3	4.4	18.4	31.36955	30.587917	22.42154	16.62288	11.36765	7.593356	10.33531	8.3262374	12.36936	20.73078
Current Account (% of GDP)	4.2	3.8	2.9	0.9	0.1	1.3	1.2	-1.2	-0.1	0.7	-3.8	-0.3	...
Financial Account (US$ million)	2,230	9,631	2,523	995	-1039	308	54	328	-945	442	-2033	1457	...
- Net Direct Investments, US$ million	-90	1,014	-122	-1119	-1030	-498	-1829	-1480	-1868	-2117	-2646	-1349	...
- Net Portfolio Investments, US$ million	-1,001	2,708	4,757	1573	787	-843	-309	3258	-129	875	-114	2069	...
Overall BOP position (US$, million)	5,085	-2,858	2,616	-210	843	1014	-2068	-994	289	-662	505	-1227	...
Unemployment rate	7.1	6	5.8	5.8	5.4	4.7	4.7	6.6	5.6	5.7	5	5.3	...
Others	**May-17**	**Jun-17**	**Jul-17**	**Aug-17**	**Sep-17**	**Oct-17**	**Nov-17**	**Dec-17**	**Jan-18**	**Feb-18**	**Mar-18**	**Apr-18**	**May-18**
Overseas Filipinos' Remittances (US$, million)	2,310	2,467	2,283	2,499	2,186	2275	2,262	2,741	2,379	2,267	2,360	2,347	2,469

... = not available

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

Table 2. Level of Philippine GDP, 2017Q2 – 2018Q2

	Nominal GDP (million current pesos)		Real GDP (million constant 2000 pesos)	
	2017Q2	**2018Q2**	**2017Q2**	**2018Q2**
Agriculture	**349,489**	**368,517**	**173,877**	**174,210**
Agriculture and Forestry	304,497	320,511	147,241	147,496
Fishing	44,992	48,006	26,636	26,713
Industry	**1,177,995**	**1,302,833**	**752,211**	**799,911**
Mining and Quarrying	35,765	36,811	31,709	28,252
Manufacturing	675,577	730,374	497,879	525,944
Construction	318,415	379,733	150,931	171,285
Electricity Gas and Water Supply	148,238	155,915	71,692	74,430
Services	**2,418,641**	**2,652,160**	**1,293,364**	**1,378,389**
Transport Communication and Storage	261,280	280,231	169,897	180,382
Trade and Repair of Motor Vehicles Motorcycles Personal	709,659	786,446	354,476	376,178
Financial Intermediation	344,412	392,252	169,079	183,767
Real Estate Renting & Bus. Actvt	518,567	544,613	261,373	271,080
Public Administration & Defense: Compulsory Social Security	173,281	205,757	95,342	109,633
Other Services	411,441	442,861	243,197	257,349
Sum = GDP	**3,946,125**	**4,323,509**	**2,219,452**	**2,352,509**

Source: Philippine Statistics Authority.

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Table 3. Industry Contributions to Philippine GDP Growth, 2017Q2 – 2018Q2

	TRAD	GEAD		GEAD
	GDP Growth			GDP Growth
	PGE*	PGE*	PCE*	PGE* + PCE*
	(percent)	(percent)	(percent)	(percent)
		(1)	(2)	(1)+(2)
GDP Growth	**6.00**	**6.00**	**0.00**	**6.00**
Industry Growth Contribution				
Agriculture	**0.01**	**0.01**	**1.19**	**1.20**
Agriculture and Forestry	0.01	0.01	1.21	1.22
Fishing	0.00	0.00	-0.03	-0.02
Industry	**2.15**	**2.15**	**-4.10**	**-1.95**
Mining and Quarrying	-0.16	-0.16	-0.37	-0.53
Manufacturing	1.26	1.26	-5.79	-4.53
Construction	0.92	0.92	1.59	2.51
Electricity Gas and Water Supply	0.12	0.12	0.47	0.59
Services	**3.83**	**3.83**	**2.92**	**6.75**
Transport Communication and Storage	0.47	0.47	-1.26	-0.78
Trade and Repair of Motor Vehicles Motorcycles Personal	0.98	0.98	2.33	3.31
Financial Intermediation	0.66	0.66	1.34	2.00
Real Estate Renting & Bus. Actvt	0.44	0.44	1.14	1.58
Public Administration & Defense: Compulsory Social Security	0.64	0.64	0.10	0.75
Other Services	0.64	0.64	-0.74	-0.10

Source: DLSU-AKI Philippine Economic Monitor calculations by applying the data in Table 2 to a "generalized exactly additive 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.