Monitoring the Philippine Economy
Third Quarter Report for 2018

Project of Angelo King Institute

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Third quarter 2018 growth performance slowed to 6.1 percent from 7.2 percent the previous year.

The Philippine economy exhibits lethargic growth and pessimistic outlooks. Third quarter growth was recorded at 6.1 percent, which was slower than the government's growth target of 6.5 to 6.9 percent. Slowdown in private consumption and worsened trade deficit contributed to slowed economic growth. Service sector growth also slowed but this sector with the largest share of the economy still contributed the most to overall economic expansion. Robust growth in government spending and higher investments in capital formation also boosted overall growth. But the all-time high inflation rates and the continuous weakening of the peso are key challenges the government will have to tackle in the coming months.

- **Major components of aggregate demand**

    - **Private consumption hit lowest growth since Q3 2014 due to decline in key expenditure items.** Growth of Household Final Consumption Expenditure (HFCE) in the third quarter decelerated to 5.2 percent year-on-year (y-o-y) from 5.4 percent the previous year. This is also slower than the recorded growth of 5.9 the previous quarter. According to the Philippine Statistics Authority (PSA)[2], Food and Non-alcoholic Beverages, the component with the largest share of 40.1 percent in consumption, registered a decreased growth (2.8 percent from 4.3 percent, y-o-y). Moreover, Furnishings, household equipment and routine household maintenance (7.4 percent from 12.0 percent, y-o-y), Restaurants and hotels (5.5 percent from 9.9 percent, y-o-y), Health (3.7 percent from 7.6 percent, y-o-y), Transport (0.2 percent from 2.8 percent, y-o-y), and Communication (4.7 percent from 5.1 percent, y-o-y) contributed to the deceleration of HFCE growth. Alcoholic beverages and tobacco, and clothing and footwear experienced declining growth rates of 3.9 percent and 0.9 percent, respectively. For five consecutive quarters, the alcoholic beverages and tobacco group has been experiencing declining growth, which may be attributed to the TRAIN Law. On the other hand, some HCFE components exhibited faster growth such as Education (18.7 percent from 11.7 percent, y-o-y), Miscellaneous good and services (10.5 percent from 6.4 percent, y-o-y), Recreation and culture (3.7 percent from 0.7 percent, y-o-y), and Housing, water, electricity, gas and other fuels (8.5 percent from 6.4 percent, y-o-y). The overall slowdown in private consumption in Q3 2018 may be caused by continuous

[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://psa.gov.ph/nap-press-release/sector/Household%20Final%20Consumption

increase in commodity prices, higher interest rates, and pessimistic consumer confidence.

- **Gross domestic capital formation registered double-digit growth.** Domestic investment accelerated to 16.7 percent from 10.3 percent the previous year. According to PSA[3], all fixed capital investments registered relatively high growth rates: Intellectual Property Products, Durable Equipment, Construction, and Breeding Stocks and Orchard Development posted growth rates of 22.9, 17.5, 14.8, and 6.2 percent, respectively.

- **Government spending maintained its buoyant growth trend.** Government final consumption expenditure continued to rise with a double-digit growth of 14.3 percent, significantly higher than the recorded growth rate of 8.33 percent the previous year and 11.9 percent the previous quarter. According to BSP[4], the surge in government expenditure for Q3 2018 was ascribable to the implementation of the third tranche of salary increase for civilian and military uniformed personnel, and increased spending for social services such as the conditional cash transfers and unconditional transfer programs of the Department of Social Welfare and Development (DSWD). Also, it was due to the servicing of the operating requirements for the K-12 Program of the Department of Education (DepEd).

- **Trade deficit further widened with high level of imports.** At the end of September, exports and imports were recorded at 6.03 billion USD (0.8 percent growth y-o-y) and 9.75 billion USD (26.1 percent growth y-o-y), respectively. Third quarter left a trade deficit of 3.72 billion USD, wider than the 1.75 billion USD deficit in September 2017. Export of goods minimally improved to 13.5 billion USD from 13.4 billion USD the previous year due to better external demand from the Philippines' trading partners. A notable 35 percent increase in export of fruits and vegetables, particularly banana, led the growth in export of goods. Likewise, import of goods expanded by 18.1 percent than the previous year. The acceleration was due to heightened inbound purchases of raw materials and intermediate goods. China and South Korea were the major suppliers with 20.6 percent and 10.4 percent shares, respectively. With worsened trade balance, the National Economic and Development Authority (NEDA)[5] expressed the need for stronger support from the government through implementing strategies in the Philippine Export Development Plan 2018-2022, especially for the electronics, processed food and beverage, and vegetables sectors.

[3] http://psa.gov.ph/nap-press-release/sector/Capital%20Formation
[4] http://www.bsp.gov.ph/downloads/Publications/2018/LTP_3qtr2018.pdf
[5] http://www.neda.gov.ph/2018/12/11/neda-ph-exports-need-steady-support/

- **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 contributed more than half of total growth.** Services sector posted the highest contribution to growth, with 4.06 percentage points from positive quantity and real price growth (see Table 3). Its share in GDP reported a high rate of 58.6 percent, but slightly lower than 58.8 percent the previous year. The sector growth slowed down to 6.9 percent, compared to the previous year's 7.3 percent growth. For the third quarter, Trade and Repair of Motor Vehicles Motorcycles Personal was the main driver of growth in the sector with a percentage point contribution of 1.03.

  - **Industry sector registered a slower y-o-y and q-o-q growth.** The industry sector exhibited a growth of 6.2 percent, slower than the 8.1 percent the previous year and 6.5 percent the previous quarter. The sector contributed 2.08 percentage points to GDP growth (see Table 3) while maintaining a 34.0 percent share in GDP. The overall slowdown of the industry sector was due to the continuous decline in manufacturing sub-sector growth. For Q3 2018, the manufacturing sub-sector registered a growth of 4.0 percent, which was lower than its average growth for the past eleven consecutive quarters of above 7.0 percent[7]. Regardless, Manufacturing (MAN) served as the second largest contributor to the industry's growth. Meanwhile, Construction (CNS) grew the fastest in the sector with a growth of 16.1 percent, driven by double-digit growth of 25.4 percent and 12.1 percent, respectively, in public and private construction. CNS contributed 1.00 percentage points to the GDP growth.

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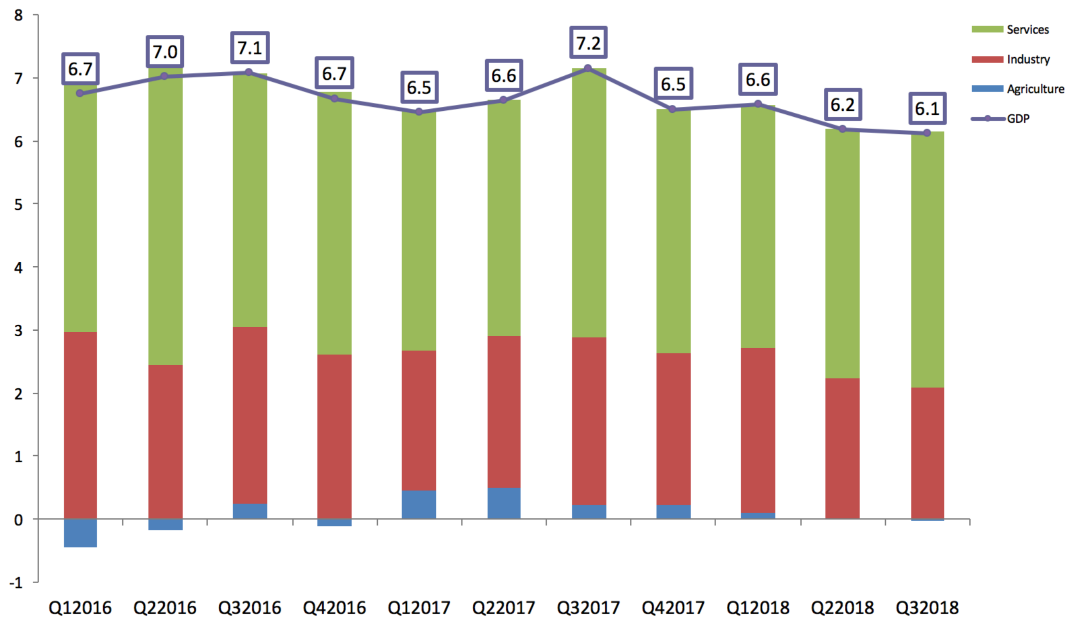
[6] The results in Table 3 are AKI-DLSU *Philippine Economic Monitor* calculations by applying the data in Table 1 to a "generalized" (GEN) exactly additive decomposition of GDP growth into *pure growth effect* (PGE) and *price change effect* (PCE) as an alternative to the "traditional" (TRAD) GDP growth 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.

[7] http://www.bsp.gov.ph/downloads/Publications/2018/LTP_3qtr2018.pdf

- **Adverse weather disturbances further aggravated agriculture sector.** The agriculture sector posted a decelerated growth of 0.4 percent, y-o-y. With only 7.4 percent share, the sector remains as the lowest contributor to GDP. The sector contracted GDP growth by -0.03 percentage points (see Table 3). The slowdown was caused by significant decrease in major agriculture products such as rice, corn, and fish. Damages from numerous typhoons negatively affected agricultural activities during the quarter.

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[8].** The peso weakened by 2.07 percent to average ₱53.54/US$1, on a quarter-on-quarter basis, from the previous average of ₱52.43/US$1. Likewise, on a year-on-year basis, peso depreciated by 5.05 percent, from the previous year's ₱50.84/US$1 average. The depreciation was mainly because of concerns over prolonged trade tensions between US and its major trading partners. Other regional currencies, except the Thai Baht, weakened together with the Philippine peso. However, despite the continued depreciation, the sustained inflows of foreign exchange from overseas Filipino remittances, FDIs, BPO receipts, and the sufficient level of the country's gross international reserves are foreseen to give support to the peso.

- **Unfavorable economic factors may threaten the economy[9].** External factors such as (a) forecasts of slower global growth, (b) increase in trade tensions, (c) normalization of monetary policy in advanced economies, (d) contagion risks from selected developing countries, (e) volatilities in global oil market, (f) build-up of financial sector risks, and (g) excessive credit growth serve as impending risks the Philippine economy. Moreover, internal factors such as the (a) sluggish output in agriculture, (b) heightened intensity and frequency of natural disasters, (c) potential second-round effects from inflation shocks, (d) delays in the implementation of inflation-related mitigating plans, infrastructure and reconstruction projects, and postponement in the legislation of priority bills, (e) policy uncertainty in mining, and (f) security risks challenge the resiliency of the domestic financial system.

- **Unexpected weather disturbances serve as a challenge to the Philippine economy.** Inclement weather conditions, natural disasters, excessive rainfall, and the like are likely to disrupt agricultural activities in the country. These harsh conditions may aggravate poverty level and further threaten food security, especially the poor Filipinos. Also, it may interrupt local supply. Infrastructural improvements are deemed necessary to augment agriculture sector's resiliency.

Other economic news

- **Stock market reports declining PSEi[10,].** At the close of the third quarter, PSEi reported a quarter-on-quarter decline of 1.3 percent with an average index points of 7,534.96. The slowdown was caused by ongoing trade tensions between US and China, surge in domestic inflation, and slower-than-expected growth of the Philippine economy.

- **Inflation level continues to exceed government's targets[11].** Third quarter inflation reported a further increased headline value of 6.2 percent, which was higher than the quarter- and year-ago rates of 4.8 percent and 2.7 percent, respectively. During the quarter, food and non-food inflations were recorded at 8.2 percent and 4.1 percent, respectively. In addition, inflation in October 2018 hit the highest inflation of 6.7 percent after 9 years. The reported inflation level was remarkably higher than the National Government's target range of 2.0 percent to 4.0 percent. Moreover, forecasts of inflation are even higher. Survey on private sector economists for September reflected

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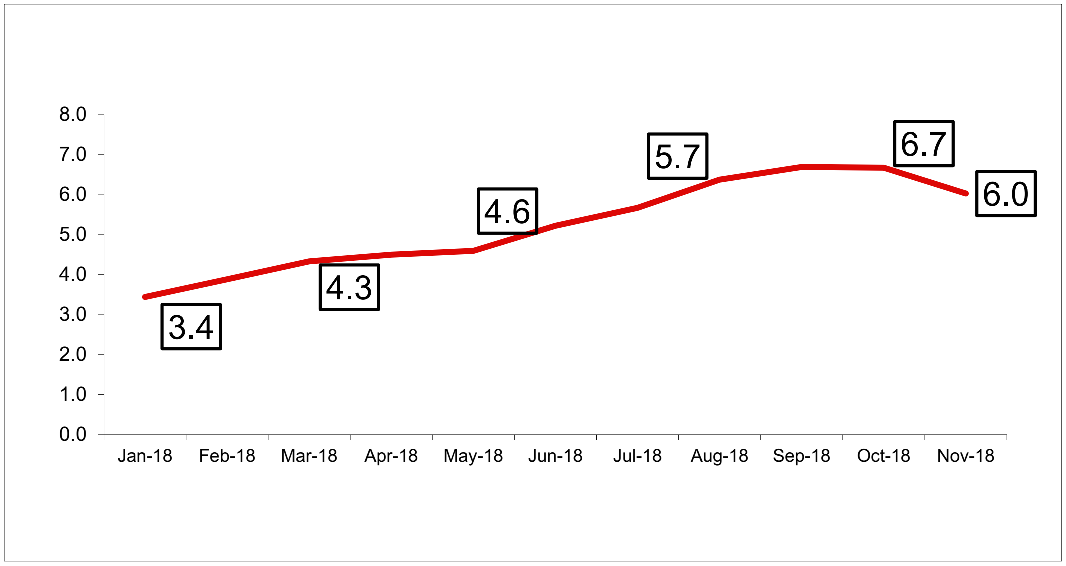
[8] http://www.bsp.gov.ph/downloads/Publications/2018/IR3qtr_2018.pdf
[9] http://www.bsp.gov.ph/downloads/Publications/2018/LTP_3qtr2018.pdf
[10] http://www.bsp.gov.ph/downloads/Publications/2018/LTP_3qtr2018.pdf
[11] http://www.bsp.gov.ph/downloads/Publications/2018/IR3qtr_2018.pdf

that the mean inflation forecast for 2018 rose to 5.3 percent from 4.5 percent in the June survey. Consequently, mean inflation forecasts for 2019 and 2020, from 3.8 percent for both years, increased to 4.3 percent and 3.9 percent, respectively.

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



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

- **Consumer outlook plunged across all income groups[12].** Overall confidence index (CI) changed to a pessimistic territory at -7.1 percent from a positive 3.8 percent the previous quarter. The negative sentiment was due to expectations of (a) increase in commodity prices, (b) low salary/income, (c) higher household expenses, (d) high unemployment rate, and (e) no increase in income. Furthermore, consumers expressed concerns on higher educational expenses and higher transportation costs. With gloomy prospects, it is expected that CI would be less optimistic for the next quarter and year ahead.

- **Business outlook declined across different types of businesses[13].** Overall confidence index (CI) decreased to 30.1 percent, the lowest level since Q1 2010. The pessimistic sentiment was due to (a) increasing prices of basic commodities in the global market, augmented by the effects of the implementation of the TRAIN Law on prices of local goods, (b) increasing overhead costs and lack of supply of raw materials, (c) seasonal factors, (d) weakening peso, and (e) domestic competition. However, CI is expected to rise in the next quarter and in 2019.

- **BSP tightened monetary policy to combat risks that may arise from any uncertainties in the market[14].** With prolonged price pressures, BSP raised the key policy rate twice during the third quarter. First on August 9 by 50 bps to 4.0 percent for the overnight reverse repurchase facility, then second on September 27

[12] http://www.bsp.gov.ph/downloads/Publications/2018/CES_3qtr2018.pdf
[13] http://www.bsp.gov.ph/downloads/Publications/2018/BES_3qtr2018.pdf
[14] http://www.bsp.gov.ph/downloads/Publications/2018/IR3qtr_2018.pdf

by another 50 bps to 4.5 percent. Consequently, the interest rates on the overnight lending and deposit facilities were increased accordingly.

- **The National Government reported a sixty percent higher fiscal deficit than the previous year[15].** For January to August 2018, the government announced a ₱282.0 billion fiscal deficit. Revenues rose by 19 percent (₱1,909.2 billion) from ₱1,601.4 billion the previous year. Collections from the Bureau of Revenue (BIR) and the Bureau of Customs (BOC) grew by 13 percent and 35 percent, respectively. The striking increase in the revenue from BOC could be attributed to the effects of peso depreciation, higher oil prices, proper valuation, strong enforcement, and revenue-enhancing measures. On the other hand, expenditures recorded a 23 percent increase (₱2,191.1 billion).

- **Although the Philippine economy falls short in meeting market expectations, it remains as one of the fastest-growing economies in Asia.** For the year 2018, the national government aimed for a growth target of 6.5 percent to 6.9 percent. With a growth rate of 6.1 for Q3 2018 and unfavorable economic conditions, the local economy fell short to achieve its target. However, it remained as one of the fastest-growing economies in Asia, next to Vietnam and China[16].

[15] http://www.bsp.gov.ph/downloads/Publications/2018/IR3qtr_2018.pdf
[16] http://www.bsp.gov.ph/downloads/Publications/2018/LTP_3qtr2018.pdf

Table 1. Philippine Economic Indicators

Philippines Economic Data													
Monthly Leading Indicators	**Nov-17**	**Dec-17**	**Jan-18**	**Feb-18**	**Mar-18**	**Apr-18**	**May-18**	**Jun-18**	**Jul-18**	**Aug-18**	**Sep-18**	**Oct-18**	**Nov-18**
Industrial Production (y-o-y, %)	-10.1	-6.1	10.8	15.3	11.1	21.1	13.1	10.8	11.8	8.7	4.2	3.9	…
Consumer Price Index (y-o-y, %)	3.0	2.9	3.4	3.9	4.3	4.5	4.6	5.2	5.7	6.4	6.7	6.7	6.0
Exports (y-o-y, %)	6.0	2.6	-4.0	-5.5	-6.8	-4.9	-1.8	2.8	0.3	3.4	0.8	3.3	…
Imports (y-o-y, %)	21.4	25.4	7.7	13.7	0.3	23.1	12.6	24.2	31.6	11.0	26.1	21.4	…
Trade Balance, US$ million	-3,845	-3,839	-3,163	-2,890	-2,532	-3,480	-3,690	-3,188	-3,546	-3,494	-3,723	-4,212	…
Total Reserves (less gold), US$ billion	72.3	73.2	72.7	72.1	72.1	71.4	71.0	69.6	68.9	70.3	67.4	66.9	67.9
Policy Rate	3	3	3	3	3	3	3.25	3.5	3.5	4.0	4.5	4.5	4.75
Fiscal Balance (million pesos)	-8623	-107148	10,191	-61,734	-110,693	46,315	-32,873	-54,288	-86,383	-2,587	-96,247	-59,865	…
Quarterly/Annual Economic Indicators	**2014**	**2015**	**1Q2016**	**2Q2016**	**3Q2016**	**4Q2016**	**1Q2017**	**2Q2017**	**3Q2017**	**4Q2017**	**1Q2018**	**2Q2018**	**3Q2018**
Real GDP (y-o-y, %)	6.2	6.1	6.7	7.0	7.1	6.7	6.5	6.6	7.2	6.5	6.6	6.2	6.1
- Private Consumption	5.6	6.3	7.2	7.5	7.3	6.7	5.9	6.0	5.4	6.2	5.7	5.9	5.2
- Government Consumption	3.3	7.6	12.4	14.0	3.6	5.0	0.1	7.6	8.3	12.2	13.6	11.9	14.3
- Gross Capital Fixed Formation	4.4	18.4	31.4	30.6	22.4	16.6	11.4	7.6	10.3	8.3	12.4	21.5	16.7
Current Account (% of GDP)	3.8	2.9	0.9	0.1	1.3	1.2	-1.2	-0.1	0.7	-3.8	-0.4	-3.9	-3.7
Financial Account (US$ million)	9,631	2,523	995	-1,039	308	54	328	-945	442	-2,033	-539	-1,512	-1,975
- Net Direct Investments, US$ million	1,014	-122	-1,119	-1,030	-498	-1,829	-1,480	-1,868	-2,117	-2,646	-1,034	-2,704	-1,300
- Net Portfolio Investments, US$ million	2,708	4,757	1,573	787	-843	-309	3,258	-129	875	-114	1,982	1,288	-447
Overall BOP position (US$, million)	-2,858	2,616	-210	843	1,014	-2,068	-994	289	-662	505	-1,227	-2,030	-1,879
Unemployment rate	6	5.8	5.8	5.4	4.7	4.7	6.6	5.6	5.7	5	5.3	5.4	5.1
Others	**Oct-17**	**Nov-17**	**Dec-17**	**Jan-18**	**Feb-18**	**Mar-18**	**Apr-18**	**May-18**	**Jun-18**	**Jul-18**	**Aug-18**	**Sep-18**	**Oct-18**
Overseas Filipinos' Remittances (US$, million)	2,275	2,262	2,741	2,379	2,267	2,360	2,347	2,469	2,357	2,401	2,476	2,237	2,474
… = not available													
Source: Bangko Sentral ng Pilipinas, Philippine Statistics Authority, Asian Development Bank.													

Table 2. Level of Philippine GDP, 2017Q3 – 2018Q3

	Nominal GDP (million current pesos)		Real GDP (million constant pesos)	
	2017Q3	**2018Q3**	**2017Q3**	**2018Q3**
Agriculture	**347,192**	**364,713**	**164,437**	**163,797**
Agriculture and Forestry	293,790	304,784	134,880	134,556
Fishing	53,402	59,929	29,557	29,241
Industry	**1,088,633**	**1,216,241**	**697,689**	**741,279**
Mining and Quarrying	36,144	36,188	17,403	17,207
Manufacturing	677,138	729,483	471,272	490,229
Construction	267,380	330,243	130,204	151,112
Electricity Gas and Water Supply	107,971	120,327	78,810	82,731
Services	**2,382,682**	**2,641,221**	**1,231,217**	**1,316,267**
Transport Communication and Storage	221,582	236,122	139,344	146,883
Trade and Repair of Motor Vehicles Motorcycles Personal	778,645	864,564	385,948	407,428
Financial Intermediation	315,867	358,701	154,398	166,174
Real Estate Renting & Bus. Actvt	546,244	584,731	258,849	272,676
Public Administration & Defense: Compulsory Social Security	151,879	189,533	81,886	96,479
Other Services	368,465	407,570	210,791	226,626
Sum = GDP	**3,818,508**	**4,222,175**	**2,093,343**	**2,221,343**

Source: Philippine Statistics Authority

Table 3. Industry Contributions to Philippine GDP Growth, 2017Q3 – 2018Q3

	TRAD	GEAD		GEAD
	GDP Growth			GDP Growth
	PGE*	PGE*	PCE*	PGE* + PCE*
	(percent)	(percent)	(percent)	(percent)
		(1)	(2)	(1)+(2)
GDP Growth	**6.11**	**6.11**	**0.00**	**6.11**
Industry Growth Contribution				
Agriculture	**-0.03**	**-0.03**	**1.82**	**1.79**
Agriculture and Forestry	-0.02	-0.02	1.74	1.72
Fishing	-0.02	-0.02	0.09	0.07
Industry	**2.08**	**2.08**	**-5.16**	**-3.08**
Mining and Quarrying	-0.01	-0.01	0.18	0.17
Manufacturing	0.91	0.91	-4.60	-3.70
Construction	1.00	1.00	0.21	1.21
Electricity Gas and Water Supply	0.19	0.19	-0.95	-0.76
Services	**4.06**	**4.06**	**3.33**	**7.40**
Transport Communication and Storage	0.36	0.36	-0.86	-0.50
Trade and Repair of Motor Vehicles Motorcycles Personal	1.03	1.03	2.18	3.20
Financial Intermediation	0.56	0.56	0.84	1.40
Real Estate Renting & Bus. Actvt	0.66	0.66	2.15	2.81
Public Administration & Defense: Compulsory Social Security	0.70	0.70	-0.39	0.31
Other Services	0.76	0.76	-0.59	0.17

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